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No. 60923-8-I

DIVISION I, COURT OF APPEALS  
OF THE STATE OF WASHINGTON

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HUMPHREY INDUSTRIES, LTD.,

Plaintiffs-Appellant

v.

CLAY STREET ASSOCIATES LLC, et al.,

Defendant-Respondents

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ON APPEAL FROM KING COUNTY SUPERIOR COURT  
(Hon. Harry McCarthy)

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APPELLANT'S REVISED REPLY BRIEF

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## I. INTRODUCTION

This appeal concerns the dissenters' rights provisions in the LLC Act.<sup>1</sup> The company intentionally violated the statute and fundamental principles of corporate governance, when it paid the dissenter late and less than the majority. The amount paid was not "fair value" -- it was less than written purchase offers that non-parties had made. As with the parallel provisions in the Washington business corporate act and the 1984 Model Business Corporation Act, "the purpose of dissenters' rights statutes" is "the protection of minority [owners] against oppressive action by the majority."<sup>2</sup> The reason

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<sup>1</sup> Clay Street includes a "procedural discussion" which suggests that the Court "should disregard Humphrey's statement of facts" because it does not cite to the record. Br. of Resp., at 3. Because this case involves an unusually complex factual background, Humphrey chose to integrate its citations to the record into the body of the argument in its brief to avoid repetition. E.g. App.'s Revised Opening Br. nn2, 15, 18, 19, 20, 21, 23, 24, 27, 30, 31, 32, 37, 38, 44, 53, 56, 57, 58, 59, 60, 61, 62, 63, 68, 70, 71, 73, 75, 78, 79, 84, and appendices A-D (provided for the Court's convenience). Humphrey's very brief "statement of the case" (Revised Opening Br., 6-7) contains the undisputed factual and procedural background. Clay Street may be referring to the "Summary Introduction," Opening Br. 3-6, allowed by RAP 10.3(a)(3). But as that RAP notes, such an optional section "need not contain citations to the record. . . ." In any event, Humphrey's main argument is that the trial court's ruling was predicated on unequivocal errors of law, which this Court reviews de novo.

Clay Street also erroneously contends there were no challenges to the findings in connection with the fee award. Br. of Resp. at 4. In fact, App.'s Revised Opening Br., App. E "Assignments of Errors Re Order Regarding Fees and Expenses" reproduces the court's actual findings and conclusions and identifies in italics the challenged ones. *Id.* at 1:19:20 ("ASSIGNMENTS ARE IN ITALICS"). Moreover, the challenges to the fee award were "clearly disclosed in the associated issue pertaining" to assignments of error 1 and 2. RAP 10.3(g); *see* Revised Opening Br. at 2, issues A1, A2, A3, A4, A5, A6. *Pierce County v. State*, \_\_\_ Wn. App. \_\_\_, ¶ 108, n.23, 185 P.3d 594 (2008)(holding assignments of error to findings were adequate "where the brief makes the nature of the challenge clear and includes the findings in the text."); *id.* (holding assignments of error to findings were adequate where the nature of the challenge was clear and the party "included the trial court's findings of fact and conclusions of law and final order and judgment in appendices to its brief." [emphasis added]). If the Court construes the use of the appendix to violate the page limitations, then Humphrey requests relief to file an over-length brief.

<sup>2</sup> *China Prods. N. Am., Inc. v. Manewal*, 69 Wn. App. 767, 772, n.3, 850 P.2d (continued . . .)

for the protection is simple. At common law, all company actions were subject to unanimous approval. To remove the rigidities inherent in the unanimous approval approach, the legislature allowed actions to be taken on a majority basis rather than unanimously.<sup>3</sup> But to protect the interests of the minority owners who did not agree with the majority action, the legislature explicitly gave dissenters the right to "demand that the corporation pay 'fair value' for the dissenters' ownership interests if the proposed action is effectuated."<sup>4</sup> Thus, for a company to condemn a dissenter's property rights in the company against his wishes, the company must meet a series of requirements under the statute.

Here, the company and later the trial court took this carefully calibrated statutory regime for protecting dissenters' rights and turned it both upside down and inside out. The trial court turned the protections upside down, when it refused to award Humphrey attorney fees even though Clay Street as a matter of undisputed fact violated a series of the statutory requirements designed to protect Humphrey's interests as a dissenter. This error of law was predicated on the trial court's misinterpretation of Washington law governing "substantial compliance"<sup>5</sup> and on its

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(. . . continued)

565 (1993).

<sup>3</sup> Matthew G. Norton Co. v. Smyth, 112 Wn. App. 865, 873, 51 P.3d 159 (2002).

<sup>4</sup> Id. at 867; see CP 2359 (FOF 10, noting that defendants structured the merger to "allow a sale of Clay Street's property to occur without the consent of George Humphrey").

<sup>5</sup> RCW 25.15.480(2)(a)(allowing fees against the LLC "if the court finds the limited liability company did not substantially comply with the requirements of" the dissenters' rights provisions); CP 2366 (FOF 43, noting that although defendants facially

(continued . . .)

misconstruction of the statute. Further, the trial court turned the Act's protections inside out, when it actually **rewarded** Clay Street for its violations of the statute by awarding Clay Street fees. The trial court based this award on its finding that Humphrey engaged in arbitrary, bad faith, or vexatious acts by refusing an offer of judgment under CR 68, even though such offers are inadmissible as a matter of law to prove liability or fees.<sup>6</sup> Effectively, Clay Street drove Humphrey's car off the lot and used it for four months or more without Humphrey's permission. Regardless of whether one calls the conduct "theft" or the failure to "substantially comply with the requirements" of the statute, the trial court erred as a matter of law in ruling the company's noncompliance amounted to substantial compliance with the statutory requirements. The trial court committed numerous additional errors resulting from Clay Street's strategic noncompliance with the statutory requirements and attempt to rewrite the law. Those multiple errors of law substantially prejudiced Humphrey and infected the judgment as a whole.

## **II. STANDARDS OF REVIEW**

The meaning of a statute is a question of law reviewed de novo.<sup>7</sup> Similarly, a "trial court decision awarding or refusing to award attorney

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violated statutory requirements by delaying payment for five months, "the LLC substantially complied with the LLC Act.")

<sup>6</sup> CR 68; RCW 24.15.480(2)(b); App.'s Revised Opening Br. at 30-32; *infra* at 15.

<sup>7</sup> *Smith v. Moran, Windes & Wong, PLLC*, 2008 WL 2574150, No. 60712-0-1 (June 30, 2008) (¶ 11); *Sound Infiniti, Inc. v. Snyder*, Nos. 59477-0-01, 59571-7-1, \_ Wn. App. \_ ¶ 17, 186 P.3d 1107 (Div. 1 June 23, 2008) (stating "a trial court's interpretation of the Washington Business Corporation Act . . . is a question of statutory construction and is so reviewed de novo on appeal").

fees is an issue of law, which we review de novo."<sup>8</sup> In addition, "an attorney fee award, if any, must be based on proper grounds."<sup>9</sup> "The process of applying the law to the facts ... is a question of law and is subject to de novo review."<sup>10</sup> Conclusions of law are reviewed de novo, whether denominated as that or not. "Because [a] conclusion of law is a conclusion of law wherever it appears, any conclusion of law erroneously denominated a finding of fact will be subject to de novo review."<sup>11</sup> Error is reversible if it is prejudicial and prejudicial if "it affects, or presumptively affects, the outcome of the trial."<sup>12</sup> This appeal involves two main issues of law under RCW 25.15.480(2): (1) whether the company failed to "substantially comply with the requirements" of the statute, id., and (2) whether the company or the dissenter acted "arbitrarily, vexatiously, or not in good faith with the respect to the [statutory] rights." (emphasis added).

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<sup>8</sup> Boules v. Gull Indus., Inc., 133 Wn. App. 85, 134 P.3d 1195 (2006); Ethridge v. Hwang, 105 Wn. App. 447, 460, 20 P.3d 958 (2001) ("Whether a party is entitled to attorney fees is an issue of law which is reviewed de novo." [citations omitted]).

<sup>9</sup> Just Dirt, Inc. v. Knight Excavating, Inc., 138 Wn. App. 409, 416, 157 P.3d 431 (2007). Two out-of-state decisions construe the statute and are very instructive. Sec. State Bank v. Ziegeldorf, 554 N.W.2d 884, 892 (Iowa 1996) (reversing denial of fees to dissenters and remanding for a determination of reasonable fees and expenses for dissenter, and using a two-tier standard of review); Roemmich v. Eagle Eye Dev., LLC, 526 F.3d 343, 355-54 (8th Cir. 2008) (requiring de novo review of "the legal issues related to the award of fees and costs").

<sup>10</sup> Tapper v. State Employment Sec. Dep't., 122 Wn.2d 397, 403, 858 P.2d 494 (1993).

<sup>11</sup> Robel v. Roundup Corp., 148 Wn.2d 35, 43, 59 P.3d 611 (2002)(internal quotation marks omitted).

<sup>12</sup> Thomas v. French, 99 Wn.2d 95, 104, 659 P.2d 1097 (1983); Keller v. City of Spokane, 104 Wn. App. 545, 551, 17 P.3d 661 (2001) ("An erroneous statement of the applicable law is reversible error if it prejudices a party.")

Here, the court misconstrued the statutory requirements and rights as a matter of law. Reviewing those errors of law de novo, this Court should (1) reverse the trial court's error in denying Humphrey fees based on its erroneous interpretation of the doctrines of substantial compliance and fair value; (2) remand for a determination of the amount of costs, fees, and expenses awardable to Humphrey in light of a proper construction of the statute; and (3) reverse the award of fees to Clay Street as not supported by the record and as predicated on the legal error of admitting an offer of proof under CR 68 to show liability for fees. (4) This Court should also either vacate the \$3.15 million "fair value" determination, increase the value to \$3.19, \$3.3 or \$3.6 million (based on the "pre-merger" purchase agreements of \$3.19 to \$3.3 million, the \$100,000 in additional office space, the actual expenses for leasing versus the \$100,000 higher hypothetical ones, or the \$3.6 million in the report of court-appointed appraiser), or remand to the trial court for a range of "fair value" consistent with a correct construction of the statute and legal standards governing "fair value." Finally, the Court should reverse as an abuse of discretion the deduction of \$85,849 in sales/transactions costs from the fair value determination.

### III. ARGUMENT

**A. The trial court erred as a matter of law when it denied Humphrey fees based on misconstruing the fee provisions of RCW 25.15.480(2).**

Humphrey argued four violations of the statute's requirements at trial.<sup>13</sup> Three out of the four violations were not even mentioned by the trial court's findings. CP 2356-84. The one violation the trial court did address, it did so by misconstruing the legal standard for "substantial compliance."

**1. The trial erred as a matter of law by construing non-compliance with a statutory time limit, designed to enforce dissenters' rights, as "substantial compliance."**

"Substantial compliance has been defined as actual compliance in respect to the substance essential to every reasonable objective of [a] statute. In the cases where substantial compliance has been found, there has been actual compliance with the statute, albeit procedurally faulty."<sup>14</sup> "Noncompliance with a statutory mandate is not substantial compliance."<sup>15</sup> Moreover, "[i]t is impossible to substantially comply with a statutory time limit ... It is either complied with or it is not ... failure to comply with a statutorily set time limitation cannot be considered substantial compliance."<sup>16</sup>

Clay Street indisputably violated the RCW 25.15.460's time limitations by delaying payment to Humphrey for four months. Ex. 73. In

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<sup>13</sup> See, e.g., CP 1881:5-10, 1889:1-1893:9; see also App.'s Revised Opening Br. at 12-21 (detailing four violations)

<sup>14</sup> City of Seattle v. PERC, 116 Wn.2d 923, 928, 809 P.2d 1377 (1991)(citations and internal quotation marks omitted).

<sup>15</sup> Petta v. Dep't of Labor and Indus., 68 Wn. App. 406, 409, 842 P.2d 1006 (1992).

<sup>16</sup> PERC, 116 Wn.2d at 928-29.

fact, the court correctly entered an explicit finding that "the delay in payment to Humphrey until the property was sold constituted a violation of the statute." FOF 43, CP 2366 (emphasis added). Unfortunately the court then committed an error of law by finding that in spite of the facial violation of the Act, "the LLC substantially complied with the LLC Act." Id. Here, there was nothing "procedurally faulty" about Clay Street's delayed payment. Rather, it simply facially violated the Act and, with it, Humphrey's right as a dissenter to immediate payment. Under black letter law, non-compliance is never substantial compliance. "It is impossible to substantially comply with a statutory time limit."<sup>17</sup>

The trial court excused Clay Street's non-compliance on the theory "that Clay Street lacked any funds to make the payment to Humphrey" and that "it could not obtain the requisite funds without a sale of the property." FOF 43, CP 2366. But nothing in the governing law suggests that there is some kind of "funding" defense to compliance with the Act. Moreover, nothing in its own findings or in the record supports the trial court's assertion. To the contrary, the record directly contradicts that assertion.<sup>18</sup>

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<sup>17</sup> PERC, 116 Wn.2d at 928-29.

<sup>18</sup> Ex. 70 (showing over \$1.5 million in equity); RP 438:1-10 (the company's managers admitted the company had over \$1 million in equity); id. (they admitted they had personal funds to make the payment). In fact, the company's managers were withholding from Humphrey over \$300,000 in funds from the sale of the 901 Tacoma (\$249,000) and Clay Street II properties (\$98,822), which were finally paid years later. RP 432:21-445 (Ostroff trial Test. [declining an interim distribution of funds from 901 Tacoma to permit the payment of taxes from sale]); Ex. 66 (Mar. 28, 2005 letter [declining to make distribution]); CP 24:11-25:2 (complaint alleging sale of Clay Street II and how Humphrey had not received any funds since construction was completed in 2002); CP 41:1-6 (\$700,000 from sale of Clay Street II); CP 2346-47 (Nov. 6, 2006 order approving final accounting of proceeds from sale of Clay Street II); CP 3220 (\$249,000 paid to Humphrey and Malen from 901 Tacoma); CP 2350  
(continued . . .)

The assertion that Clay Street "could not obtain the requisite funds without a sale of the property" is directly contradicted by the equity in the property and the non-responsive evasive answer to the question of if they ever asked the bank to refinance. RP 432:11-2. In fact, the managers went so far as to conceal the effectuation of the merger from the bank.<sup>19</sup> In addition to funding options, the company had the statutory option (RCW 25.15.465) to restart the merger and "repeat the payment demand procedure" which would have extended the valuation date and avoided the suit.

Clay Street argues that the "substantial compliance" rule relating to deadlines is in the context of jurisdiction. Br. of Resp. at 25. First, that is not true.<sup>20</sup> Second, nothing in the appellate decisions limits the meaning of "substantial compliance" regarding deadlines to jurisdiction; to the contrary, the language is quite general and plain as a pikestaff. Third, even if that doctrine were initially limited only to jurisdictional issues, it has been expressly incorporated into the dissenter's rights statute and so, by legislative fiat, it now applies beyond the jurisdictional context.

Clay Street argues that the trial court found Humphrey suffered no prejudice from the delay. Br. of Resp. at 26 (citing FOF 43). But that

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(\$98,822 paid to Humphrey from Clay II); CP 1220:19-1221:2 (Ostroff Test. about having no recollection about ability to pay).

<sup>19</sup> RP 430 (Ostroff Trial Test.); CP 1847:8-22 (Ostroff Dep. Test.).

<sup>20</sup> Accord, United States v. Boyle, 469 U.S. 241, 251-52, 105 S. Ct. 687, 83 L. Ed. 2d 622 (1985) ("the failure to make a timely filing of a tax return is not excused by a taxpayer's reliance on agent [attorney]" and is not "reasonable cause").

finding merely states that the question "before the Court is simply the extent to which George Humphrey was financially prejudiced" without in any way suggesting he was not prejudiced. CP 2366-67. The prejudice was the tardy interest payment which did not remedy the "alter[ing] of [his] investment"<sup>21</sup> and the taxable gain and the loss of use of over \$183,000 for four months and the loss of opportunities in a rising market, while he was asking for funds to pay the taxes from the other sales.<sup>22</sup> Finally, "[s]ubstantial compliance has been defined as actual compliance in respect to the substance essential to every reasonable objective of [a] statute."<sup>23</sup> Here, the trial court's construction violated the statute's expressed purpose: "since the person's rights as a shareholder are terminated . . . , the shareholder should have immediate use of the money."<sup>24</sup>

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<sup>21</sup> China Prods. N. Am., 69 Wn. App. at 773. In a company whose term was over 30 years, Humphrey's express contractual rights to prevent the sale of the property, to arbitrate disputes, and an appraisal performed by a mutually selected appraiser were altered and replaced with non-voting units. Ex. 31 (letters attaching merger approval, notice of dissenters' rights, and company agreements).

<sup>22</sup> Ex. 113, first document (Apr. 13, 2004 letter at 2: \$300,000 increase in five months); RP 98:13-22 (Barnes' Test.: 15% increase in 2005); CP 1923:15-1924:5 (28.5%/yr). In addition, Humphrey took actions to protect his right by making an arbitration demand in October 2004 shortly after making his demand for payment (Exs. 44, 47), made another demand in November (CP 1668-90), asked for an interim distribution from the sales proceeds of another company in March 2005 (Ex. 66 [letter declining to make distribution]), and later demanded global mediation. CP 1850 (Ostroff Test. at 64:16-65:5).

<sup>23</sup> City of Seattle v. Pub. Employment Relations Com'n, 116 Wn.2d at 923.

<sup>24</sup> CP 1973 (Wash. Bus. Corp. Act, Appendix A: Bus. Corp. Act Comments, Model Bus. Corp. Act § 13.25, comment).

**2. The trial erred as a matter of law when it ruled the company substantially complied with the statute, when the company committed three other material statutory violations, which the findings ignored.**

First, the trial court ignored the violations of RCW 25.15.430(2) and RCW 25.15.460(1)'s requirement to pay "fair value," which is defined in RCW 25.15.425(3). Purchase offers were probative evidence of fair value. See infra at nn.50, 51. As a matter of law, Clay Street violated the statute and principles of corporate governance, when it made a tardy payment that used a \$2.5 million "fair value" which was lower than the rejected \$2.9 million letter of intent and the \$3.19 million purchase agreement (Exs. 49, 51, 52) and a signed a letter of intent for \$3.3 million (Ex. 56) and which was the value in a seven year old appraisal.<sup>25</sup> In less egregious circumstances, the Iowa supreme court reversed the denial of fees and remanded for a determination of the reasonable amount of fees due be awarded the dissenter, where the company, like Clay Street, arbitrarily paid "book value" which was less than "an expression of interest" by a non-party.<sup>26</sup> Clay Street's actions are more egregiously "arbitrary," because the fair value was less than three purchase offers that were rejected as too low; Clay Street did

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<sup>25</sup> CP 741-59 (1998 appraisal by Watts for \$2.5 million).

<sup>26</sup> Sec. State Bank v. Ziegeldorf, 554 N.W.2d 884, 892 (Iowa 1996) (reversing trial court's denial of fees to dissenters and remanding for a determination of reasonable fees and expenses, on ruling on appeal that the bank's "book value" offer to dissenters was "arbitrary" [defined as arising from unrestrained exercise of will, caprice or personal preference], where its expert testified the book value had no relationship to fair value and was a liquidation method instead of a going concern method, there was an express of interest by an outsider for a price higher than the book value, the bank's principal shareholder had a purchase option for a higher value in his divorce which he later exercised, and bank presidents offered no justification for the book value offer). Clay Street's manager offered no justification for the book value offer – except that their attorney came up with it. CP 1202:13-1204:18, 1205:10-1206:21, 1219:11-1220:13.

not retain an independent financial advisor to determine the amount of the payment (RP 576:1-12); its own expert said the \$2.5 million value was not "consistent with my conclusion" (\$3.15 million); and Clay Street reaffirmed the \$2.5 million value in a pleading after it received the report of its own expert. CP 265:7-22.

Second, the trial court ignored the violation of RCW 25.15.460(2)'s requirement that the payment be accompanied by "[c]opies of the financial statements . . . for its most recent fiscal year." In response, Clay Street argues the claim "borders on frivolous," is rebutted by evidence, there was no trial evidence on the claim, and Humphrey was not prejudiced based on the assertion that Humphrey did not modify his June 2005 position. Br. of Res. at 29-30, 38. But in fact, Humphrey did modify his position, when he formally stipulated to the court-appointed appraiser's value,<sup>27</sup> while Clay Street contested the value resulting in additional appraisal expenses and the trial.<sup>28</sup> Moreover, Judge Hayden had ordered the production of the statements. CP 230 (order). Humphrey's claim was well supported in pretrial pleadings<sup>29</sup> and in trial testimony.<sup>30</sup> The single

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<sup>27</sup> CP 567:17-21, 569:18-22, 694-95, 1358; RP at 9:3-7 (Opening Statement).

<sup>28</sup> CP 265:7-22 (Ostroff Decl. reaffirming \$2.5 million value).

<sup>29</sup> CP 2071:1-10, CP 2071:19-2072 (refusal to produce Clay Street records, one year before suit); CP 257:1-7 [refusal to comply with order to produce records and disclose funds being held]; CP 48 ¶ 37 ("Clay Street [] violated the statute by providing only an income statement and not the other financial statements required by the statute, . . . ignored HI's request for the finalized merger and other documents relating to the company since September 2004, including e-mails, notices and other communications"); CP 1819-21 (Oct. 14, 2005 letter to Judge Hayden at 2-4 confirming oral ruling); CP 1949:3-1951:2 (refusal to produce records); CP 1959:1-10 (identifying missing information on income statements); CP 1822-24 (Oct. 31, 2005 letter to Judge Hayden about failure to comply).

income statement that was delivered failed to identify the new lease deposits and the actual leasing costs (which were a \$100,000 less than the hypothetical costs used by Clay Street and its appraiser).<sup>31</sup> Clay Street failed to supply the other financial records to Humphrey and later to its own appraiser who had requested them.<sup>32</sup> In short, Clay Street's failure to provide the financial statements was a material violation of the statute.

Third, the trial court ignored Clay Street's violation of RCW 25.15.475(1)'s requirement that it "shall commence a proceeding within sixty days after receiving the payment demand . . ." Clay Street received the payment demand in October but failed to file suit until July. In response, Clay Street argues that its delay in making the statutorily required payment had a ripple effect and in turn delayed the deadline to file suit, because there was no "unsettled demand for payment." Br. of Resp. at 30-31. The statutory terms and structure fail to support this contorted construction. RCW 25.15.445(d) requires the company to set a date when it "must receive a demand for payment." In turn, RCW 25.15.475(1) uses the date of the "payment demand" to trigger the deadline to file suit. RCW 25.15.475(1) does not define "unsettled demand for payment," but it does

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<sup>30</sup> See App. B.

<sup>31</sup> CP 2275:21-2276:14 (identifying how the complete financial statements show the payment of lease commissions for spaces that were classified as vacant under the value calculation); see *infra* n.56 (\$132,000 in hypothetical costs).

<sup>32</sup> RP 574:8-574:16 (information not provided); Ex. 132 letter (requesting information); RP 576:12-:21 (Barnes was told marketing started in December after the merger -- but Clay Street started it earlier in September but told the market it could not sell until December); RP 545:2-:16 (after producing his report, he learned about the additional office space). With these omissions, his report does not comply with GAAP and issued FAS.

clearly require "a proceeding within sixty days after receiving the payment demand." The failure to meet this statutorily-imposed deadline cannot constitute "substantial compliance." See supra at 6. The plain language does not support Clay Street's construction. Moreover, it is based on the false assumption that a company can indefinitely postpone the deadline for filing suit, if it fails to comply with RCW 25.15.460's deadline for making the fair value payment -- an assumption which makes a mockery of the statute. Furthermore, if Clay Street had filed a timely declaratory suit or acceded to arbitration or mediation demands, the parties might have avoided the litigation costs which have resulted from its failure to do so.<sup>33</sup>

In summary, the court committed errors of law, when it either ruled on (or ignored) these four independent violations of the statute and assumed the violations constitute "substantial compliance" with the statutory requirements. "[A] failure to comply (through inaction, inadvertence, or in a manner which does not fulfill the objective of the statute), or belated compliance, cannot constitute substantial compliance . . ."<sup>34</sup> As a matter of law, Clay Street's "belated compliance" and "inadvertence" do not constitute substantial compliance, especially when it ignored the statutory deadlines and altered the statutory framework and the canon of construction that the special remedial statute "should be liberally construed in favor of the"

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<sup>33</sup> Br. of Resp. at 13 falsely claims the company was "unaware Humphrey had filed suit," when in fact the counsel who signed the brief had declined to accept service (Ex. 79) and sent an email about the suit which was immediately forwarded to Clay Street's corporate counsel, Cowan (Ex. 81).

<sup>34</sup> Clymer v. Employment Sec. Dep't, 82 Wn. App. 25, 28-29, 917 P.2d 1091 (1996).

dissenter and to accomplish the statutory purpose of "protecting the property rights of [dissenters] which alter the character of their investment,"<sup>35</sup> not "leaving the dissenter in a twilight zone where the dissenter has lost former rights but has not gained new ones"<sup>36</sup> and providing "for recapturing their complete investment."<sup>37</sup> Moreover, Clay Street admitted that it had no intention of complying from the start, and so its conduct cannot amount to substantial compliance with the statute.<sup>38</sup> For these reasons, the trial court

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<sup>35</sup> China Prods. N. Am., 69 Wn. App. at 773.

<sup>36</sup> CP 1645:2-5 (quoting official comments to the 1984 Model Bus. Corp. Act § 13.01 [defining "fair value" as possibly including consideration of appreciation that results from corporate actions] in 2 Senate Journal, 51st Leg., App. A at 3086-87 (Wash. 1989)).

<sup>37</sup> Swope v. Siegel-Robert, Inc., 243 F.3d 486, 493-94 (8th Cir.), cert. denied, 534 U.S. 887 (2001).

<sup>38</sup> See, e.g., CP 1378:1-20 (Ostroff Test.). See Boyle, 469 U.S. at 251-52. Furthermore, the finding that Clay Street's lawyer advised "the LLC that it could satisfy the LLC Act by paying . . . interest, at the time the property was sold" (CP 2366:19-20) is not supported by his testimony, his written legal advice, or the law. Rather, in his opening statement, Clay Street's counsel asserted that its prior counsel's advice was "pay when you become liquid. Pay interest. You are in technical compliance." RP 29:12-14. Clay Street did not rely on Cowan's advice "100%"; because it deviated from the written advice concerning the time of the payment requirement and to hire an appraiser. Ex. 28 at 0194 (Cowan's memo to Ostroff stating these requirements). There was no testimony about any advice concerning "interest" in lieu of the cash payment. In his deposition, Cowan merely testified: Q: Why did the company fail to tender payment 30 days after the effective date of the merger? A: The company had no cash. Q: Did you advise them not to make the payment? A: No. We discussed the requirement and the company had no cash to make the payment. Jan. 18, 2007 Cowan Dep. at 56:12-19. (No CP cite yet.) The company's managers had material information about its financial resources. Hines v. Data Line Sys., Inc., 114 Wn.2d 127, 147, 787 P.2d 8 (1990) (affirming ruling that a director who had knowledge of facts deemed material cannot escape liability under state securities act by relying on advice of counsel that the facts are not material); Green v. McAllister, 103 Wn. App. 452, 467-688, 14 P.3d 795 (2000) (reversing denial of attorneys' fees based on erroneous conclusion of law that advice of counsel was an excuse; disposing of partnership assets was a breach of fiduciary duty and constructive trust and mere passivity and disavowal of knowledge should not excuse responsibility). Because the attorney who made the valuation was not an appraiser or financial advisor and did not have some of the purchase offers while Clay Street's managers had them, there is no advice of counsel defense. See, e.g., Montgomery Cellular Holding Co. v.

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erred in its ruling on the legal predicates for an award of fees to Humphrey under RCW 25.15.480(2)(a)'s "substantial compliance" standard. It also erred in construing RCW 25.15.480(2)(b)'s "arbitrarily, vexatiously or not in good faith" standard with respect to the statutory "requirements."<sup>39</sup> The court's rulings turned statutory protections upside down.

**B. The trial court erroneously awarded fees to Clay Street under RCW 25.15.480(2)(b).**

The trial court's conclusion of law that Clay Street was entitled to fees pursuant to the statute rests on Findings 3 and 4 that a "Rule 68 offer" would have given Humphrey more than other members and more than the amount of controversy, that Humphrey "had no reasonable or legitimate basis for his refusal to accept the Rule 68 offer," and that his insistence on litigation after the offer was "arbitrary and vexatious" is an error of law. CP 2379:17-25 (FOF 3, 4); CP 2380:19-25 (Conclusion (1)). The trial

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Dobler, 880 A.2d 206 (Del. Super. 2005) (cited by Resp. and on appeal awarding fees to the dissenter, when the company failed to hire an independent financial advisor to make the valuation and engaged in other bad faith conduct); Genesco, Inc. v. Slotznick, 871 S.W.2d 487, 491 (Tenn. Ct. App. 1993) (affirming fee award for bad faith when company failed to consult an established appraiser, destroyed some information necessary to test assumptions used by investment banker that made the calculation and was less than forthcoming in discovery); see also RP 29:16-30:4 (Clay Street's admission that Cowan's calculation but the calculation was not "particularly reasonable" and was troubling). Finally, the business judgment rule does not immunize the company. Br. of Resp. at 33.

<sup>39</sup> This Court should reject the suggestion that because the award of fees is discretionary, it doesn't matter that the court misapplied the doctrine of substantial compliance and ignored multiple and intentional violations of the statute. Br. of Resp. at 23-25. First, it was an error of law to misconstrue the legal standard of substantial compliance. Second, the trial court exercised its discretion on untenable grounds by misinterpreting the statute. Based on the record, this Court should rule as a matter of law that Humphrey is entitled to a fee award or at the least, remand for a proper determination of whether Humphrey is entitled to fees in light of a correct interpretation of the governing law.

court committed an error of law when it misconstrued the statute and CR 68, and abused its discretion based on a mistaken interpretation or application of relevant law, when it awarded fees and costs incurred after the CR 68 offer of judgment. The dissenters' rights statute clearly does not define fees to be costs; one provision governs costs (RCW 25.15.480(1)) and a separate provision governs fees (RCW 25.15.480(2)).<sup>40</sup> Furthermore, while RCW 25.15.460 requires the company to make a cash payment of fair value,<sup>41</sup> in contrast RCW

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<sup>40</sup> Cf. RCW 11.96A.150 (Trust and Estates Dispute Resolution Act defines costs to include fees and grants a court general equitable powers); accord, Kennedy v. Martin, 115 Wn. App. 866, 872, 63 P.3d 866 (2003) (cited in Br. of Resp. at 22, construing the private right of way condemnation statute that grants the discretion to award fees "in the light of the circumstances of each case.")

<sup>41</sup> Cf. 3 ABA Model Business Corporation Act Annotated at 13-82 (Fourth ed., 2008) (statutory comparison of § 13.24 stating Alabama, Florida, Georgia, Alaska and Illinois require merely an offer to pay, and Texas requires the company to either accept the shareholders' demand or make offer an alternative within 20 days). A West Virginia statute, repealed in 2002, was recently construed in Dodd v. Potomac Riverside Farm, Inc., 2008 W. Va. Lexis 45, No. 33501 (June 13, 2008) expressly permitted fee shifting "if the court shall find the action of such shareholders in failing to accept such [tender] offer was arbitrary or vexatious or not in good faith." The Dodd decision is instructive for an additional reason. Even with under the "tender offer" statutory framework, the appellate court affirmed the denial of fees and costs, because "the offers of judgment were not simply for the per share value . . . but also included all attorney's fees and costs" and the trial court had found the per share offer had decreased during the proceeding, while the supreme court ruled that was impermissible. Id. \*9, \*13. Clay Street's offer of judgment suffered from the same defects. From a practical standpoint, the amount of the offer had decreased. The first settlement offer was for \$144,184. [\$375,576 - \$181,193 = \$144,184.] {CP 292 ("\$325,376, constituting the fair value of the property as established in the enclosed appraisal as of December 7 . . . less the prior payment."). CP 278 (\$181,193 prior payment).} The offer of judgment was for the same \$144,184 but it also "included fees and costs," so the amount offered had decreased. CP 3310-11; but see CP 315:11-19 (Clay Street's brief using higher numbers). The decreasing amount was consistent with Clay Street's pleadings. CP 265:7-22 (recanting \$3.15 appraised value and reasserted \$2.55 million value). Furthermore, the offer of judgment did not use as a bench mark the real estate value that the parties had used during the prior eighteen months. See Ex. 73 (fair value calculation); CP 265:7-22 (Decl. filed a year before the offer of judgment); CP 567, 631-32 (court-appointed appraiser's report that Humphrey (continued . . .))

64.55.160 requires that an offer of judgment "specify the amount of damages, not including costs and fees" and demonstration of ability to pay damages, but Clay Street did not comply with those requirements. Here, the court erroneously construed the statute as a matter of law, when it considered settlement offers to shift fees and costs.<sup>42</sup> Finally, Humphrey did not waive the statutory rights and requirements.<sup>43</sup> The trial court

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had stipulated to). Thus, the offer did not provide a means to compare "likes with likes" as to the property's value, when Humphrey had already incurred over \$100,000 in fees and costs (CP 1903:7-9). The trial court's confusion continued in FOF (3) (CP 2379:14-15) that \$50,000 to \$85,000 was the real amount in controversy, but that was contradicted directly by the \$85,849 transaction costs in dispute (*infra* n.59) plus an additional \$125,000 above the present award if the court adopted the \$3.6 million appraisal, making the total in dispute amount roughly \$271,000. CP 1381:9-21 (Humphrey receives 25% of excess above \$2.5 million).

<sup>42</sup> In Br. of Resp. at 38, Clay Street argues a CR 68 offer is relevant "in deciding whether Humphrey acted arbitrarily and vexatiously for the purpose of RCW 25.15.480(2)(b)" because "it is relevant and admissible on the question of Humphrey's good faith. *See* ER 408." The argument fails for two reasons. First, CR 68 has its own express exclusionary terms. *See* App. A. Second, in the statutory fee provision, "good faith" is defined in terms of the "rights provided" under the statute. RCW 25.15.480(2)(b) ("party against whom the fees and expenses are assessed acted arbitrarily, vexatiously, or not in good faith with respect to the rights provided by this article.") But, unlike other statutes, the applicable statute does not grant a right to make an offer of judgment or settlement offer. Therefore, an "offer of judgment" or settlement offer cannot be used to decide if a party acted with good faith or "not in good faith with respect to the rights provided by this article" provision. The argument that the permissible "other purpose" exception to ER 408 (for proof of either the good faith in making the offer or bad faith in failing to accept the offer) fails for the same reason. It presupposes there is a statutory right to make the offer -- when there is none. The amount of the offer cannot be used both for a purpose for prohibited under ER 408's general rule (for the "liability for or invalidity of the claim or its amount") and simultaneously be admissible at the same time for "another" purpose. Finally, from a policy standpoint creating a judicial "good faith" exception to ER 408 to prove good faith opens the door to attorney testimony, leading to disqualification motions, and increased fees and costs. To permit the use of the offer of judgment and settlement offer impermissibly rewrites the statute and denies Humphrey due process.

<sup>43</sup> On appeal, Clay Street argues Humphrey "waived any objection" to the admission of the settlement offers and cites a single question during trial. Br. of Resp. at 40-41. But, the objection was well preserved pretrial motions (CP 832:11-12, 836:3-4, 845:25-26, 975:16-24), the trial brief (CP 1388:20-25), the objection and ruling about

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turned the statutory protections inside out when it awarded fees and costs to Clay Street and the Rogels.

**C. The trial court committed an error of law when it granted the Rogels fees pursuant to RCW 25.15.490(2)(b).**

The fee award rests on the finding (CP 2381:22-28, FOF 5) that Humphrey refused to dismiss the Rogels as parties to the lawsuit and the ruling that "Humphrey had no claim" against them. CP 2378:3-6.<sup>44</sup> The finding is contradicted by pleadings and discovery responses that the direct claims against the Rogels "for the funds in trust subject to creditor

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Clay Street's opening statement (RP 39:13-40 ADD) and other trial objections, a specific brief during trial (Dkt. #262, June 15, 2007 (No CP yet), and in post-trial pleadings. See App. C. Even if there were a waiver of the evidentiary rule, Humphrey did not waive the statutory terms. Next, Clay Street asserts the offer of judgment was not mentioned at trial and was filed with its fee application. Br. of Resp. at 41. In similar circumstances, RCW 4.84.280 requires an offer of judgment "shall not be filed or communicated to the trier of fact until after judgment" and this court has affirmed the forfeiture of fees for the violation of this requirement. Hansen v. Estell, 100 Wn. App. 281, 290-91, 997 P.3d 426 (2000). Furthermore, starting with the opening statement (RP 36:9-15, 39:14-40:5, 40:9-22), Clay Street interjected the settlement offer that it later argued was related to the offer of judgment. In responding to briefing concerning postponing the fee application until after the motion to alter the court's oral ruling on fair value, Clay Street also emphasized the settlement offer/offer of judgment: "Finally, as set forth in defendants' motions for fees, this case could have and should have been resolved long ago given defendants' offer to pay plaintiff far more than . . . plaintiff recovered at trial." Clay Street Defs.' Resp. to Plf's Motion to Continue Plf's Motion to Continue Defs. Motions for Fees and Costs at 1:20-23 (July 12, 2007) (Supp CP.) By impermissibly rewriting CR 68 to shift fees, Clay Street deprived Humphrey of having a separate cost hearing.

<sup>44</sup> The Rogels' "vexation" argument was Humphrey could not "chose persons as defendants (the Rogels) to satisfy a claim lacking facts (that Clay I cannot pay a judgment), where the underlying claim (dissenters' rights) is solely against another person, here Clay I." Br. of Resp. at 44 (without citing any authority); CP3431:14-3432:6 (same). The last assertion in the argument is irrelevant but correct. The appraisal claim was "solely against" the company and was tried to the court, twenty months after Judge Hayden granted the motion compelling arbitration of the "breaches of fiduciary duty claims against Clay I and the other members [the Rogels]." CP 1997:11-14; CP 342-45 (order); CP 3391:21-24 (admitting non-appraisal claims were reserved for arbitration).

claims" were stayed pending arbitration so the claims were not part of the "judicial appraisal." App.'s Revised Opening Br. at 38-39 & nn.62-63. Furthermore, the ruling that Humphrey "had no claim" against them is a clear error of law, because the stayed direct claims were well supported by the LLC statute and the common law concerning preferential distributions by a dissolved company.<sup>45</sup> There was also documentary evidence that additional funds were owed (the appraisal of Clay Street's own expert) and of insolvency.<sup>46</sup> In summary, the trial court committed an error of law

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<sup>45</sup> By operation of RCW 25.15.230, Humphrey was a "creditor" once he was entitled to a "distribution" in the form of the "fair value" payment, and creditor status vested when "the merger becomes effective" pursuant to RCW 25.15.450, and at which time he lost all rights in the company. Thirty days later the payment became due by operation of RCW 25.15.460, but the company failed to make the payment. During the winding up of the dissolved company, RCW 25.15.300(1)(a) required creditors, like Humphrey, to be paid first. Noble v. A&R Env'tl Serv. LLC, 140 Wn. App. 29, 36 (2007) (assets to be distributed first to creditors). In addition, the company violated RCW 25.15.235(1) (limiting distributions to the members) and a statutory/constructive trust that attached to the past due funds owed to Humphrey, when the other members were paid first and without making a "fair value" calculation. This action resulted in the individual members (owners) having liability under RCW 25.15.235(2)), and triggered RCW 25.15.235(3)'s deadline to sue the other members. RCW 25.15.235(2) imposes statutory liability on the members, while its "other applicable law" provision reserves common law claims against the members for constructive trust, breach of fiduciary duty, and piercing the corporate veil (RCW 25.15.060). See CP 70:16-26 (constructive trust claim against members receiving distributions); CP 255:1-12 & nn.8-9 (summarizing statutory and common law claims); CP 13-20 & nn.14-15 (responding to similar argument by Rogels); CP 329:1-11 & nn.6-8 (asserting insolvent company's assets are a trust fund and possible fraudulent transfers); CP336:20-337:1 & n.17 (link for company's expired license); CP 1996:21-1997 (opposing fee claim and arguing RCW 25.15.300 which refers to RCW 25.15.215 and .230), CP 1999:16-2001:20 (opposing Rogel's fee claim and expanding on the arguments). Humphrey can pursue direct claims against the other members "if his alleged entitlement to them arises from something other than his shareholder [member] status," -- here the status is a creditor. Sound Infiniti, Inc., Wn. App. ¶¶ 38-39, 186 P.3d 1107.

<sup>46</sup> CP 241:21-24 & n.1 (company admitting "nearly all proceeds were dissipated" and "[a] relatively small sum . . . is being held"); CP 261 (handwritten provision in order requiring notice prior to disbursement).

when it ruled Humphrey had no statutory or common law claim against the Rogels.

**D. The fair value determination rests on untenable grounds<sup>47</sup> resulting from Clay Street's manipulation of the appraisal process.**

Clay Street's brief does not contest the material facts that are the basis for challenging the fair value determination.<sup>48</sup> What remains are either errors of law or untenable bases. The decision is based on an incorrect standard because it violates "management's fiduciary responsibilities" to pay "the highest price that a third party was actually

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<sup>47</sup> "A court abuses its discretion when its decision is based on untenable grounds or is manifestly unreasonable or arbitrary." Weyerhaeuser Co. v. Commercial Union Ins. Co., 142 Wn.2d 654, 683, 15 P.3d 115 (2000). "A court's decision is manifestly unreasonable if it is outside the range of acceptable choices, given the facts and the applicable legal standard." In re Marriage of Littlefield, 133 Wn.2d 39, 47, 940 P.2d 1362 (1997). A court's decision is based on untenable grounds "if it is based on an incorrect standard or the facts do not meet the requirements of the correct standard." Id.

<sup>48</sup> App.'s Revised Opening Br. at 41-42 & App. E Assignments of Error to Findings of Fact and Conclusions of Law at 9:19-10:15, 11:12-12:5, 12:23-2257, 13:9-10, 17, 14:6-17, 14:25-15:11, 16:6-20, 17:11-18; 19:16-20:16, 21:7-22:5, 22:15-23:3, 25:16-23. These facts include that Clay Street had provided its own appraiser misinformation about the marketing and square feet of office space in the warehouses. "It was sold subsequent to the appraisal date closing in May 2005 at price of \$3,300,000. ... The property was marketed for sale beginning in December 2004 with an asking price of \$3,350,000. It [was] placed under contract in March, 2005." Ex. 257 (Appraisal, Intro. at 1); RP at 576:13-21 (Barnes testifying information provided by Cowan and Scott Rogel). In fact, it was pre-marketed starting in October before it could be sold, and it was placed under a letter of intent in December, and the same buyer signed a contract for the same price in February. See also Ex. 257 at Summary of Salient Facts (appraisal showing 11% office space, 1998 year built); Ex. 257 at 55-61, 72-73 (failing to mention actual sale in sales comparison and reconciliation and final opinion value). Clay Street does not contest the fact that its appraiser never considered the additional office space or the comparables identified by the court-appointed appraisers or Humphrey, and that at trial its appraiser disclosed a new opinion that he had placed considerable weight on the "post-merger" sale to reduce his opinion from \$3.35 to \$3.15 million. Compare Ex. 257 (appraisal using \$3.15) with Ex. 133 (draft report showing \$3.35); RP at 557:6-15, 586:8-588:8 (Test. by appraiser explaining reduction was based on the sales price).

prepared to pay" or "had offered."<sup>49</sup> It also violates the rule that the rejected purchase offer "tends to prove the lowest possible value,"<sup>50</sup> as does the signed letters of intent and purchase and sale agreements.<sup>51</sup> The \$150,000 to \$40,000 error resulted from "trickery" when Clay Street supplied to its own appraiser false information that the property was not marketed until "December" (the valuation/merger date was December 7) causing him not to consider the "pre-merger" purchase offers,<sup>52</sup> and when

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<sup>49</sup> American Law Institute Principles of Corporate Governance, Standards for Determining Fair Value, § 7.22(b) cmt. d, at 323-24.

<sup>50</sup> Chrome Data Sys., Inc. v. Stringer, 109 Or. App. 513, 820 P.2d 831, 833 (1991) (in appraisal proceeding, a preliminary offer from a third party provided a floor and is "a good indicator of the value of the business as a whole"); accord, In re 75,629 Shares of Common Stock of Trapp Family Lodge, Inc., 169 Vt. 82, 725 A.2d 927, 931 (Vt. 1999) ("Thus, to find fair value, the trial court must determine the best price a single buyer could reasonably be expected to pay. . ."); In re Valuation of Common Stock of McLoon Oil Co., 565 A.2d 997, 1004 (Me. 1989) ("highest price a single buyer could reasonably pay"); Knight v. Pine Island Fruit Corp., 445 So.2d 684, 685 (Fla. Dist. Cit. App. 1984) (proportionate share of sales price, where the company sold its only asset).

<sup>51</sup> The Hernando Bank v. Huff, 609 F. Supp. 1124, 1126 (N.D. Miss. 1985) ("offers have particular relevance . . . offer is not diminished due to the consummation of the sale"), aff'd, 796 F.2d 803 (5th Cir. 1986); Principles § 7.22(c) ("highest realistic price that a willing, . . . fully informed buyer would pay"). The \$3.15 million fair value determination was less than the \$3.3 million transaction price that was ultimately paid to the other members (Exs. 56, 227) and was less than a \$3.19 million purchase agreement (Exs. 51, 52). The broker who made the rejected purchase agreement told the first court-appointed appraiser, he was "a little upset that he didn't see it soon enough to get the proper offer in that he would be in the range where the appraiser was" and should have paid "more attention to it." CP 2490; CP 2249:2-2250:17 (Allen test.); Ex. 113 (Allen appraisal is second document at \$3.5 million which he later increased). Consistent with the letter of intent (Ex. 56), a purchase and sale agreement was prepared twenty days later (Exs. 61, 62), described as almost at full price (Ex. 64), there was a \$20,000 variable (Ex. 65, Jan. 20, 2005 email) and the parties signed virtually the same agreement for the same price on February 5, 2004. Ex. 65A.

<sup>52</sup> There is a presumption that that "post-merger offers" are presumptively excluded from consideration in a fair value determination. See, e.g., Kahn v. Household Acquisition Corp., 591 A.2d 166, 175 (Del. 1991) (affirming exclusion of "post merger" offers). To mirror Ex. 257 (the report by Clay Street's appraiser who did not mention the "post-merger" sale in his valuation), joint instructions were given to the court-appointed assignment that "the fair value should not be based upon . . . any facts or transactions (continued . . .)

he did not walk the mysteriously omitted office space which the court-appointed appraisers valued at an additional \$100,000<sup>53</sup> (a material factor to a "fully informed buyer").<sup>54</sup> As part of the "as-is" valuation, Humphrey was penalized on the revenue side for the missing income for the "vacant" spaces<sup>55</sup> and on the expense side deducted hypothetical costs to lease the spaces (including \$100,000 in expenses Clay Street never incurred) and even double deducted the costs,<sup>56</sup> while the company had intentionally violated the statute. The trial court compounded this error and abused its discretion by excluding Humphrey's expert testimony concerning the mandatory application Financial Accounting Standard Statement 157 governing "fair value" and generally accepted accounting principles,<sup>57</sup>

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(. . . continued)

relating to the Property arising after December 7, 2004 [the valuation date]." CP 420:4-9 (Clay Street's pleading referring to the joint instructions); CP 425-26 (describing history of letter); CP 550 (redlined joint letter to appraiser); CP 552 (email about joint letter). After the court-appointed appraiser finished his report and one week before the discovery deadline, Clay Street unilaterally changed the instructions, which resulted in additional work and delay. CP 833:19-835:2, 838:8-839:23 (changes to include consideration of the sales price and contact witnesses including offerors); CP 939:23-940:6 (expert discovery).

<sup>53</sup> Compare RP 54:19-22 (Shedd Test.); CP 2254:12-21; CP 2255:14-22 (Shedd Test.) with RP at 570:11-21 (Barnes Test.).

<sup>54</sup> Principles § 7.2(c).

<sup>55</sup> It is counterintuitive to value space a vacant, when there is a signed lease, lease deposit, and lease commissions. App.'s Revised Opening Br. at 45 n.75; CP 2275:21-2276:14.

<sup>56</sup> Compare Ex. 70 (settlement statement showing \$21,927 in lease commissions which were deducted as transactions costs) with Ex. 257 at 72-73 (appraisal reducing value to "as is" basis using \$132,000 in hypothetical costs including \$29,913 for lease commissions, \$21,913 in tenant improvements, and \$22,000 in soft costs and developer profits to make the property fully leased). Not only was Humphrey double charged for the lease commissions, Clay Street never incurred any of the other \$110,000 in hypothetical costs according to its financial statements, and Humphrey was even charged as transaction costs legal fees (Ex. 70 [\$4,476], Ex. 73 [\$6,000]) which included fees to effectuate the merger and flawed dissenters' rights process (Ex. 139 [\$7,934 in fees for the period]).

<sup>57</sup> CP 987-93 (Humphrey Opinion).

which would have eliminated these distortions and support the higher report by the court-appointed appraiser. In short, the trial court's valuation was based on untenable grounds because "it is based on an incorrect standard or the facts do not meet the requirements of the correct standard."<sup>58</sup> In addition, it was an abuse of discretion to deduct \$85,849 in sales/transactions costs from the fair value.<sup>59</sup> The trial court failed "to show by appropriate substantial evidence and appropriate briefing"<sup>60</sup> that the costs were not "appreciation or depreciation in anticipation of the merger" (RCW 25.15.425(3)). There was no proof "by any techniques or methods that are generally acceptable in the financial community"<sup>61</sup> of the deductibility of these costs, because the appraisers,<sup>62</sup> Clay Street's prior counsel,<sup>63</sup> and FAS Statement 157 concur that transaction costs (realized after the merger) cannot be deducted from the "fair value" appraisal.

The finding (CP 2315:12-13) that "members could not realize their equity . . . without paying existing liabilities and incurring such

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<sup>58</sup> In re Marriage of Littlefield, 133 Wn.2d at 47.

<sup>59</sup> Ex. 70 (settlement statement showing \$84,727 in prepayment fees, \$5,000 legal fees, \$165,000 in sales commissions, \$58,740 excise tax, and \$8,000 in closing costs, \$21,927 lease commissions) = \$343,394. One fourth of these costs, Humphrey's share, was \$85,849. The court adopted Clay Street's readjustment of this allocation slightly by \$2,918, because the \$3.15 fair value was lower than the \$3.3 million sales price reducing the sales commission and excise tax, which are percentages of the value/price.

<sup>60</sup> Norton v. Smyth, 112 Wn. App. 865, 51 P.3d 159 (2002) (ruling tax implications for a built-in capital gains discount could be considered in fair value determination if there was substantial evidence and appropriate briefing that shareholders had not already been taxed for fair share of gain).

<sup>61</sup> Norton, 112 Wn. App. at 874 quoting official comments to RCW 23B.13.020.

<sup>62</sup> RP 573:7-574:1.

<sup>63</sup> CP 2274 ("dissenter gets paid on going concern basis, no deduct for closing costs").

transactions costs" is false; the expenses could have been avoided depending on the structure (merger, 1030 exchange, private sale, or buyout) and timing of a future transaction (the prepayment penalty was declining).<sup>64</sup> Within the context of the statute, where the dissenter's contractual right to veto the sale was replaced with a statutory remedy (which is construed in favor of the dissenter) and where the status quo ante bellum was no "pre-existing planning in the normal course of business" to sell the property,<sup>65</sup> it is manifestly unfair to construe the statute to cause "a wealth transfer" that grants the majority all the benefits (the appreciation/"future prospect" of the liquidation sale) and imposes the burdens (the sale expenses on the dissenter), while the company violated the statutory requirements and left the dissenter as an involuntary guarantor on the bank debt.

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<sup>64</sup> In addition, the court erroneously concluded (CP 2317:3-11) that it had discretion to deduct the sales costs on the basis that the company's dysfunctionality required the sale of the property. Although "dysfunctionality" might be relevant in a judicial "dissolution" (where there are other equitable remedies including a buyout), see Scott v. Trans-System, Inc., 148 Wn.2d 701, 717-18, 64 P.3d 1 (2003) or in a marital dissolution, it is not a relevant factor under the dissenters' rights statute. Furthermore, the finding was not supported by substantial evidence. App. Revised Opening Brief, App. E, Assignment of Errors at 4:3-20; CP 1646-47 at n.20 (summarizing testimony and exhibits concerning dysfunctionality, the business dispute concerned how to value the company in the Rogel divorce and the decision to sell the company as part of the divorce).

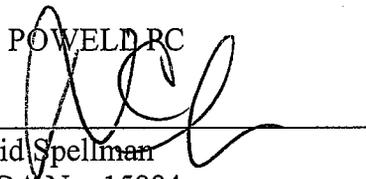
<sup>65</sup> One commentator observed: "Such tax consequences should be considered only when a sale of those assets is imminent and unrelated to the transaction which triggered the shareholders' right to dissent." Cecille C. Edward, Dissenters' Rights: The Effect of Tax Liabilities on the Fair Value of Stock, 6 DePaul Bus. L.J. 77, 98-99 (1993). The same rule should apply to other transaction costs like sales costs.

#### IV. CONCLUSION

Clay Street paid the dissenter less and after the majority members. It schemed to cover up its multiple material violations of the statute. It failed to substantially comply with the statutory requirements. It acted "arbitrarily" when it set a low "book value" fair value that it later disavowed. And it acted vexatiously<sup>66</sup> including but not limited to, when it avoided the statutory requirements and protections and created its own version of CR 68. When it ruled otherwise, the trial court turned the statutory protections upside down and inside out. It misconstrued the doctrine of substantial compliance. It failed to consider the application of FAS Statement 157 on fair value. It made clear, prejudicial errors of law, abused its discretion, and its decisions must be reversed on appeal.

Respectfully submitted this 11<sup>th</sup> day of August, 2008.

LANE POWELL PC

By 

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<sup>66</sup>CP 1391:22-24 (Trial Br: "Vexation" is defined as: "The injury or damage which is suffered in consequence of the tricks of another." Black's Law Dictionary at 1403 (5<sup>th</sup> Ed. 1979)).

## Appendix A

Clay Street's offer of judgment.

Evidence of this offer is not admissible except in a proceeding to determine costs and/or fees pursuant to CR 68 and other applicable law. . . . Notice is hereby given that in the event Humphrey Industries, Ltd. fails to recover a judgment in excess of the amount of this offer, plaintiff will be required pursuant to CR 68 to pay the costs and/or fees incurred in this action by Clay I and any individually named members of Clay I or any successor entity to the extent allowed by law. (Adding underline to sections outside the scope of CR 68.)

CP 3311.

### **CIVIL RULE 68, OFFER OF JUDGMENT**

At any time more than 10 days before the trial begins, a party defending against a claim may serve upon the adverse party an offer to allow judgment to be taken against him for the money or property or to the effect specified in his offer, with costs then accrued. If within 10 days after the service of the offer the adverse party serves written notice that the offer is accepted, either party may then file the offer and notice of acceptance together with proof of service thereof and thereupon the court shall enter judgment. An offer not accepted shall be deemed withdrawn and evidence thereof is not admissible except in a proceeding to determine costs. If the judgment finally obtained by the offeree is not more favorable than the offer, the offeree must pay the costs incurred after the making of the offer. The fact that an offer is made but not accepted does not preclude a subsequent offer. When the liability of one party to another has been determined by verdict or order or judgment, but the amount or extent of the liability remains to be determined by further proceedings, the party adjudged liable may make an offer of judgment, which shall have the same effect as an offer made before trial if it is served within a reasonable time not less than 10 days prior to the commencement of hearings to determine the amount or extent of liability.

Adding underline to sentence.

The sentence was altered in the Federal Rule "to make clear that the evidence of an unaccepted offer is admissible in a proceeding

to determine the costs of the action but is not otherwise admissible."<sup>1</sup>

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<sup>1</sup> Federal Rule of Civil Procedure 68, Advisory Committee Note, 1946 Amendment.

## Appendix B

"For Humphrey to assert that the trial court erred in failing to enter a finding on a subject [an single income statement instead of financial statements] about which he proffered no trial evidence . . . borders on frivolous." Br. of Resp. at 30.

### TRIAL TESTIMONY

RP 116:7-118:9 (lending agreement required "year-end balance sheets and profit and loss statements" and Scott Rogel testified as property manager he "prepared" "the December year-end statement for the property" and in 2004 his broker, where he was the designated agent, prepared them).

Ex. 2, RP 113:5-114:11 (1997 financial analysis for Clay Street).

RP 196:24- 199:23 (in Ex. 80, appraiser asked for operating statements and budgets but Scott Rogel referred him to the accountant who prepared income tax returns, the costs for three vacant spaces would be shown in the income statement and "monthly statements, or . . . paid bill file" [at 198:21-199:4], and accountant "had copies of those December statements and any other [statements]." [at 199:21-23])

RP 244:21-245:9 (Humphrey's attorney arguing: "We don't have a financial statement for this period. Part of my original lawsuit was saying 'we weren't getting the financial statements.' . . . We got an income statement. I didn't get things that people would normally call financial statements which would be the general ledgers and back up and so forth. So there is a hole in the accounting records. . .")

RP 507:2-24 (pro forma income statement prepared by Rogel); RP 622:22-667:15- (Exs. 41 and 68 are pro forma income statements sent by

Scott Rogel to the attorney two weeks before fair value calculation were made); RP 691:18- 693:9 (they were sent because "I was trying to inform him of the fact that he would need to know to be able to understand as Jerry was talking about *calculations for Mr. Humphrey*" and disclosed the highest offer, \$3.19 million), RP at 192:18-194:25 (fax asserted the difference between \$3.3 and \$3.19 million was contributions).

RP 670:10-672:4 (Scott Rogel testifying about expenses to dress up property were in subpoenaed records as well as monthly statements).

RP at 436:15-437:19 (Ostroff testifying about providing year end financial statements to bank for company and for members but personal ones were not produced in discovery).

#### PRETRIAL

CP 230 (order requiring production of documents requested).

CP 687-688 (Oct. 14, 2005 letter at 2-3, in response to Judge Hayden's request for submissions concerning compliance with RCW 25.15.460's requirement of financial statements and quoting from FASB Statement and Black's Law Dictionary's different broader definition of financial statements)

CP 987-993 (Oct. 31, 2006 conclusions of George Humphrey about FASB Statement 157, failure to effectuate merger, fair value "as relates to financial statements, both public and private," [at CP 991]).

**REVISED  
APPENDIX C**

On appeal, Clay Street argues Humphrey “waived any objection” to the admission of the settlement offers and cites a single question during trial. Resp. Br. at 40-41.

Pretrial motions and pleadings and the trial brief.

Motion for Declaratory Relief at CP 832:11-12, 836:3-4, 845:25-26 (ordering excluding pursuant to ER 408 settlement offers, Clay Street has raised claims about “an unfunded settlement offer made by Clay Street after this suit was filed”); Reply in Supp. of Motion for Declaratory Relief at CP 975:16-24 (objecting to Clay Street’s claim that “the history of settlement offers” is relevant to prevailing party status and responding “the dissenters’ rights statute sets forth criteria for determining whether to shift costs, fees, and expenses, which do not refer to settlement offers”); Trial Brief at CP 1388:20-25, 1389:9-18: (“The offer made after this suit was filed was an inadmissible settlement offer that was merely a conditional offer of payment that was subject to a release of claims – thus, there was no tender or payment” and stating the model act and Washington act do not require negotiation but instead requirement payment)s .

Trial.

RP 36:9-18, 39:11-41:3 (Objection to Clay Street’s opening statement that Clay Street’s prior counsel “perhaps proceeded down the wrong path”

with this “negotiation process” but later cured the wrong by making a settlement offer based on Barnes’ appraisal.<sup>2</sup> Clay Street’s counsel argued “it is not a settlement offer” but “it was an effort to comply with the compartments [sic] of the LLC, an act to tender an offer . . .”<sup>3</sup> The court ruled: “I would like to say that at the outset that my inclination is to disallow any settlement discussions after the fact. If there are particular reasons that you believe that would be exceptions to that, you can argue those at the time as they come up.” RP 40:24-

RP 293:12-294:3:

Q: Sir, you agree that in July 2005, following the sale, Clay I offered to pay you for your dissenter’s interests, based on the appraisal of the property by Mr. Barnes at \$3.15 million dollars, is that correct?

A: That’s correct.

Q: In response to their offer to pay you at the appraisal, you demanded, again, that 4.109 million dollar number, a pay-out based on that amount?

A: I can’t remember the full response. I do know that we had said “don’t make an offer to pay,” as per the statute.

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<sup>2</sup> RP 36:9-15.

<sup>3</sup> RP 40:9-22.

I can't remember if I looked at 4.10, or continued, because we had made our submission as a response to the dissenter rights. I think that the primary gist of it was "don't be making offers. You are supposed to be paying me. If you believe that it is 3.15, pay the money."

RP 403:7-408:21 (ruling sustaining ER 408 to Ex. 273, settlement offer based on Barnes appraisal, and "testimony relating to the topic, may or may not be admitted. It depends upon the relevance and so forth." RP 408:16-409:4.)

RP at 412:22-413:11:

Q: [O]utside the exhibit, Mr. Ostroff, on behalf of [Clay Street] were you willing to proceed with a payment?

A: Yes.

Q: To Mr. Humphrey based on the Cushman and Wakefield appraisal?

Yes. Yes.

Mr. Spellman: Objection.

The Court: Overruled.

Q: Did you think that the offer, based on the Cushman Wakefield appraisal of approximately \$325,000 was fair?

A: It was more than fair.

Mr. Spellman: Objection.

The Court: Objection is overruled.

RP at 415:2-5:

Q: Mr. Ostroff, did you actually tender a check or money consistent with the Cushman and Wakefield appraisal?

A. I don't think so.

RP at 407:11-13 (settlement offer "is a tender in compromise of the statute. It does not rise in a vacuum. It is part and parcel of several of the statutory scheme. It should be admitted at least for the limited purpose of the parties substantial compliance at statutory act")

RP at 412: 3-6 (taking it under advisement.)

RP at 733:13-19 (referring to Humphrey's brief on the ER 408 issue and stating "before I have my decision, I will advise you whether or not I am going to consider the exhibit or not. But I will read your responsive brief.")

CP at 1654:15-1655:12 (Ex. 261, settlement letter with Barnes appraisal, was objected to as an offer to compromise liability in violation of ER 408. "I have considered the argument and I have originally excluded the exhibit. After having considered it further, I am going to maintain that

exclusion of the exhibit. It appears to the Court that the main purpose relates to offers of compromise in paragraph 3 and 4.”)

CP 2006:4-24, 2008:11-16 (Humphrey’s Opp. to Clay Street’s Motion for Attorney’s Fees and Expenses moving to strike Ostroff’s declaration and objecting to improper use of settlement offer and offer of judgment in opening statement and at trial).

No. 60923-8-I

DIVISION I, COURT OF APPEALS  
OF THE STATE OF WASHINGTON

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HUMPHREY INDUSTRIES, LTD.,

Plaintiffs-Appellant

v.

CLAY STREET ASSOCIATES LLC, et al.,

Defendant-Respondents

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ON APPEAL FROM KING COUNTY SUPERIOR COURT  
(Hon. Harry McCarthy)

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ERRATA TO APPELLANT'S REPLY BRIEF

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STATE OF WASHINGTON  
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ORIGINAL

Appellant is submitting a revised Reply Brief that corrects the errata listed below.

### **APPELLANT'S REPLY BRIEF**

<u>Page No.</u>	<u>Description</u>
iv	Delete " <u>Sec. State Bank v. McDowell</u> " and insert, " <u>Sec. State Bank v. Ziegeldorf</u> "
v	For <u>United States v. Boyle</u> , change the page cites from "4, 8" to "8, 14."
vi	for RCW 25.15.480(2) omit "17."
vi	Insert before "RAP 10.3(g)," "RAP 10.3.(a)(3) . . . 1. "
vi	CR 68, after "3" insert "5."
2	n. 5, delete "RCW 24.15.480(2)" and insert "RCW 25.15.480(2)."
4	n. 9, line three, delete "McDowell" and insert "Ziegeldorf."
10	n. 26, first line, delete "McDowell" and insert "Ziegeldorf."
14	n. 35, delete extra comma after "Am."
23	line 9, insert closed parenthesis, before period.

### **APPENDIX C**

<u>Page No.</u>	<u>Description</u>
5	Line 12, after "Trial Brief at," insert "CP." Line 13, insert a colon before the open parenthesis. Line 15, insert "a" before "release."
6	Line 5, make "discussion" plural, "discussions." Line 6, insert "that" after "believe."

Line 7, complete RP cite: "RP 40:24-41:3."  
Line 10, delete "Street" and insert "I."  
Line 12, insert "Mr." before Barnes.  
Line 12, insert "dollars" after "million."  
Line 16, hyphenate "payout": "pay-out."  
Line 18, insert comma after "pay."

7  
Line 1, delete "it" after "or."  
Line 2, insert "had" after "we."  
Line 2, insert "the" after "to."  
Line 9, delete "CP" and insert "RP."  
Line 12, insert brackets around "Clay Street": [Clay Street].  
Line 19, insert: "Objection is" before "overruled."

8  
Line 1, insert "that" after "think."  
Line 1, delete "and."  
Line 6, change line cite: "RP at 415:2-5."  
Line 18, delete "CP" and insert "RP."  
Line 18, modify ending page cite: "1654:15-1655:12."  
Line 21, delete "the" and insert "that."

RESPECTFULLY SUBMITTED this 11<sup>th</sup> day of August, 2008.

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