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No. 88132-4

SUPREME COURT
OF THE STATE OF WASHINGTON

LK OPERATING, LLC,
a Washington Limited Liability Company, LES and PATRICIA
POWERS and KEITH and MARSHA THERRIEN,

Petitioners,

v.

THE COLLECTION GROUP, LLC,
a Washington Limited Liability Company,
and BRIAN FAIR and SHIRLEY FAIR, husband and wife,
and the marital community composed thereof

Respondents.

SUPPLEMENTAL BRIEF OF RESPONDENTS

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A. Introduction.

Attorneys Les Powers and Keith Therrien went into the debt collection business with their client Brian Fair, without required written disclosures or informed consent. In exchange for an interest in the venture, petitioner attorneys¹ “redlined” the initial agreement to purchase a debt portfolio, drafted legal pleadings, instructed respondent The Collection Group, LLC (TCG), the company Fair had created to pursue the debt collection business, how to file lawsuits *pro se*, and ultimately executed pleadings on behalf of TCG themselves.

Although Fair asked them to do so, the attorneys failed to document the venture with a written agreement for over two years while respondents built the business. A dispute arose over the

¹ This supplemental brief refers to Powers and Therrien as “petitioner attorneys” or “the attorneys.” Respondents’ interactions were mostly with Powers. The trial court founds as a matter of fact that Powers – not, as petitioners repeatedly misrepresent, LKO – accepted Fair’s offer to participate in the debt collection business that became TCG. (CP 2396, 2401; *see generally* Reply Brief of Respondents/Cross-Appellants) Both Powers and Therrien were managers of LKO, through Powers & Therrien Enterprises, Inc., a corporation that the attorneys had created and owned 50/50. (CP 2371, 2395) Through a byzantine series of trusts and corporations, both attorneys’ children were the beneficiaries of the attorneys’ investment through LKO in TCG. (CP 1247 *reproduced in* Appendix A to Corrected Brief of Respondents/Cross-Appellants) RPC 1.10 expressly imputes violations of RPC 1.7 to lawyers associated in a firm. Both attorneys intervened in this appeal to address their RPC 1.8 violations. *See also* RPC 5.1 (responsibilities of law partners).

ownership of TCG, at least in part because the attorneys had failed to document the joint venture. The attorneys then caused another client, petitioner LK Operating, LLC (LKO), a company the attorneys had created and managed as an estate planning device to benefit their children, to sue respondents, on the grounds that the attorneys had “passed on” to their children the “business opportunity” in TCG that was premised on the attorneys’ contribution of legal services.

The trial court’s decision to rescind and return to petitioner LKO, with interest, all funds invested by the attorneys in TCG is now before this Court for review. An attorney cannot enter into a business transaction with a client without informing the client of their potentially adverse interests, and then claim that he has violated no ethical obligations because he secretly substituted as the contracting party a company that he created and controls for family members. This Court should therefore affirm.

B. An Attorney Violates RPC 1.8 By Entering Into A Business Venture With A Client Without Proper Safeguards That Were Indisputably Not Present Here.

RPC 1.8 prohibits a lawyer from entering into a business transaction with a client unless the transaction and its terms are

fully disclosed in writing in a manner that the client can reasonably understand; the client is given a reasonable opportunity to seek the advice of independent counsel; and the client thereafter consents to the essential terms of the transaction:

(a) A lawyer shall not enter into a business transaction with a client or knowingly acquire an ownership, possessory, security or other pecuniary interest adverse to a client unless:

(1) the transaction and terms on which the lawyer acquires the interest are fair and reasonable to the client and are fully disclosed and transmitted in writing in a manner that can be reasonably understood by the client;

(2) the client is advised in writing of the desirability of seeking and is given a reasonable opportunity to seek the advice of independent legal counsel on the transaction; and

(3) the client gives informed consent, in a writing signed by the client, to the essential terms of the transaction and the lawyer's role in the transaction, including whether the lawyer is representing the client in the transaction.

RPC 1.8.²

Petitioner attorneys did not disclose, in writing or otherwise, the terms of the proposed agreement injecting LKO as the

² This is the language of the current rule. Before September 2006, notification of the right to independent counsel and the client's informed consent did not have to be in writing. *See* 157 Wn.2d 1190. The former and current language of the rule is reproduced in Appendix A.

contracting party to their client Fair. Petitioner attorneys did not advise their client Fair of the desirability of obtaining independent legal counsel. Respondents TCG and Fair never consented to LKO (and not the attorneys themselves, to whom Fair offered this business opportunity) being a partner in the venture. Petitioner attorneys violated RPC 1.8(a).

Fair, a current client,³ proposed going into the debt collection business with Powers and Therrien in October 2004. Fair proposed that, in addition to paying half the price of purchasing debt portfolios, the attorneys contribute legal services in exchange for their interest in the debt collection business:

Les [Powers], Keith [Therrien],

...

Regarding an agreement between myself and you two, this is how I would like to see it:

³ The trial court found that "Fair was a client of Powers & Therrien, P.S. at all times material hereto." (CP 2395) In January 2004, Powers and Therrien had formed a Nevada corporation, BF Trading, Inc., for Fair. (CP 195, 205) In February 2005, Fair asked the attorneys to "set up a new account for me" for TCG. (CP 749) Once an attorney-client relationship is established it continues until it is either terminated by some action of the parties or is abandoned. *Matter of McGlothlen*, 99 Wn.2d 515, 523-24, 663 P.2d 1330 (1983). The client relationship was never terminated or abandoned, the attorneys continued to maintain the Nevada corporation, and Powers & Therrien even sent Fair a bill after the attorneys had caused LKO to file this lawsuit in July 2007. (CP 206-17, 1520-21, 1592)

A. We split the purchase price and other out of pocket costs, including legal services that your firm cannot provide.

B. *You will contribute legal services you can provide (review the purchase agreement contract, legal doc for this JV (if needed), demand letter, ask smart questions, kick the tires, etc.)*

...

(CP 216) (emphasis added). The attorneys accepted Fair's proposal, sending a redlined redraft of the agreement to purchase debt that would be collected by the venture (CP 196-97, 218-27), providing legal pleadings and specific instructions regarding filing lawsuits *pro se* on behalf of TCG (CP 733-37, 741-45)⁴, and, beginning in February 2005, investing funds to purchase debt portfolios. (CP 90-91, 197, 231, 441)

The initial investment in TCG of \$3,984.61 was in the form of a "counter check" signed by Michelle Briggs (known to Fair as an employee of Powers & Therrien) with "LK Operating LLC" handwritten in the upper left-hand corner. (CP 90-91, 197, 231, 441) Fair assumed the check was from an account controlled by the attorneys Les Powers and Keith Therrien ("LK"). (See CP 88, 197)

⁴ Months later, after the courts and attorneys representing debtors threatened civil and criminal actions against Fair for unauthorized practice of law because he had followed the attorneys' advice on having TCG file pleadings *pro se*, Powers began signing the pleadings. (CP 91)

Fair was not given any other explanation for the source of these funds; the trial court concluded that Fair “did not care” and “left up to Powers” from whom the funds came. (CP 2398) But following this initial investment, Fair faxed an accounting to the attorneys that concluded “Les, this gives *you guys* 1/2 ownership in the company. You can formalize however you wish.” (CP 311) (emphasis added)

Between March 2005 and September 2006, the attorneys sent Fair three additional LKO “counter” checks, for a total \$52,000, to purchase debt portfolios. (CP 198, 281, 284, 286) But the attorneys never “formalized” the agreement as Fair requested. Indeed, there is no evidence that the attorneys even told their clients Fair and TCG that they had purportedly “passed on” the investment opportunity to their children by giving LKO, a company the attorneys had set up to benefit their children, the money to send the checks for purchase of the debt portfolios. (See CP 604-05)

This sort of informal, uninformed agreement between an attorney and client is void as a violation of public policy. Dealings between an attorney and client are “prima facie fraudulent.” *Valley/50th Ave., L.L.C. v. Stewart*, 159 Wn.2d 736, 745, ¶ 16, 153 P.3d 186 (2007), *rev. denied*, 172 Wn.2d 1020 (2011) (citing

disciplinary cases). As early as 1922, this Court likened the relationship of attorney and client to that of guardian and ward, and held that it was “fully committed” to the rule that equity will “relieve a client from hard bargains or from any undue advantage secured over him by his attorney.” *Conner v. Hodgdon*, 120 Wash. 426, 432, 207 P. 675 (1922). The Court’s extreme skepticism of business deals between attorneys and clients was carried forward into RPC 1.8, which requires that the attorney prove that he has provided the client written disclosure of the transaction and the terms on which the lawyer proposes to acquire an interest, and which compels rescission if the disclosure requirements of the rule are not met. *Stewart*, 159 Wn.2d at 745, ¶ 16.

In *Stewart*, a law firm had obtained a deed of trust from a client, in part to secure attorneys’ fees and costs already owed by another, related, client.⁵ This Court explained the heavy burden borne by an attorney to justify a business transaction under RPC 1.8:

⁵ Petitioners repeatedly miscite *Stewart* for the proposition that the “separate personhood of legal entities” somehow limits the attorneys’ ethical obligations. *See, e.g.*, LKO Supplemental Brief at 9. To the contrary, this Court in *Stewart* used the independent status of a limited liability company to *expand* an attorney’s disclosure requirements to an LLC controlled by another client. 159 Wn.2d at 747, ¶¶ 20-21.

Under this rule, the lawyer must establish, “(1) there was no undue influence; (2) he or she gave the client exactly the same information or advice as would have been given by a disinterested attorney; and (3) the client would have received no greater benefit had he or she dealt with a stranger.” The disclosure which accompanies an attorney-client transaction must be complete. Attorneys, to defend their actions, must prove they complied with the “stringent requirements imposed upon an attorney dealing with his or her client.”

Stewart, 159 Wn.2d at 745 ¶15 (citing disciplinary cases). This Court in *Stewart* confirmed that a lawyer must prove strict compliance with all of the safeguards of RPC 1.8(a): “full disclosure, opportunity to consult outside counsel, and consent must be proved by the communication between the attorney and the client” before a transaction with a client can be approved. 159 Wn.2d at 745, ¶16 (citing disciplinary cases). Because there was an issue of fact whether the attorneys had fulfilled those obligations under the rule, this Court reversed a summary judgment in favor of the attorneys. *Stewart*, 159 Wn.2d at 739, ¶1.

Here, however, there is no question that petitioner attorneys did not comply with their obligations under RPC 1.8. Petitioner attorneys did not disclose in writing the terms of an agreement injecting LKO as the contracting party to their client Fair. They did not advise their client Fair of the desirability of obtaining

independent legal counsel. And respondents TCG and Fair never consented to LKO (and not the attorneys themselves, to whom they had offered this business opportunity) being a partner in the venture.

Petitioner attorneys could not “pass on” to their children an opportunity to go into business with their client unless they complied with RPC 1.8. They indisputably did not. Finally, there is no support for petitioners’ argument that a venture between client and attorney must confer some benefit or potential benefit on the attorney in order to implicate RPC 1.8. Even were there such a requirement of “benefit” to the attorney, it was fulfilled in this case. As the courts below determined, petitioner attorneys “had a significant personal and financial interest in LKO as a parent, as an owner/officer of its manager, and as its attorney.” *LK Operating, LLC v. Collection Group, LLC*, 168 Wn. App. 862, 880, ¶ 40, 279 P.3d 448 (2012). Powers and Therrien violated RPC 1.8 by entering into a business venture with a client and in indisputably failing to provide the safeguards that the rule requires for business transactions with a client.

C. An Attorney Cannot Immunize His Violation Of RPC 1.8, And Violates RPC 1.7, By Transferring A Business Venture With A Client To An Entity Owned By The Attorney's Family That Is Also A Client.

Petitioners' defense to the attorneys' clear violation of RPC 1.8 is that respondents' agreement was with LKO, the entity the attorneys created and were managing to "pass on" to their children the business opportunity Fair had presented to the attorneys in exchange for their legal services. But RPC 1.7 prevents an attorney from representing a client whose interests are directly adverse, or whose representation may be materially limited by the lawyer's personal interest or by his responsibilities to another client. Such a concurrent conflict of interest exists if:

(1) the representation of one client will be directly adverse to another client; or

(2) there is a significant risk that the representation of one or more clients will be materially limited by the lawyer's responsibilities to another client, a former client, or a third person or by a personal interest of the lawyer.

RPC 1.7.⁶ RPC 1.7 requires written confirmation of a client's waiver of any conflict arising from concurrent representation. RPC

⁶ This is the language of the current rule. RPC 1.7 was also rewritten effective September 2006. 157 Wn.2d 1176. The former and current language of the rule is reproduced in Appendix B.

1.7(b)(4). Independent of, but exacerbated by, the violation of RPC 1.8, petitioner attorneys' conduct also violated RPC 1.7.

Petitioner attorneys indisputably had a personal interest in obtaining an interest (adverse to their client Fair) in their client TCG for their children through their client LKO, the company the attorneys had created and managed. Petitioner attorneys' efforts to saddle their clients TCG/Fair with a "partner" they had never even met, in a business venture that was premised on the attorneys' contribution of legal services, was directly adverse to the respondents' interest. The attorneys' conduct at a minimum created a significant risk that their representation of Fair and TCG would be materially limited by their representation or personal interest in LKO. It therefore violated RPC 1.7.

Fair was a current client of Powers & Therrien; the attorneys assisted him in tax planning by providing legal services to form and maintain the corporation BF Trading, and Powers & Therrien continued to bill Fair for services until after they caused LKO to file this lawsuit. (CP 195, 205, 206-217, 1591) The attorneys represented TCG as well, reviewing and rewriting purchase agreements, drafting and executing pleadings, and providing advice

on the development of the debt collection business. (CP 733, 740, 741-45)

Petitioners' claim that RPC 1.7 applies only when a lawyer's concurrent clients are both involved in the same transaction is clearly wrong; RPC 1.7 bars a lawyer from representing a client in a negotiation with someone who is a client in an unrelated matter:

Directly adverse conflicts can also arise in transactional matters. For example, if a lawyer is asked to represent the seller of a business in negotiations with a buyer represented by the lawyer, *not in the same transaction but in another*, unrelated matter, the lawyer could not undertake the representation without the informed consent of each client.

Comment 7, RPC 1.7 (emphasis added) *See also Disciplinary Proceeding Against Egger*, 152 Wn.2d 393, 412, 98 P.3d 477 (2004), in which this Court disciplined an attorney who represented a lender at the same time his firm represented the borrower in unrelated matters. 152 Wn.2d at 412, 420.

An attorney cannot immunize himself from his violation of RPC 1.8 by secretly transferring a business venture with a client to another client owned by family members and controlled by the attorney. Such dual representation is a conflict of interest under RPC 1.7.

D. Rescission Is The Proper Remedy For Violation Of RPC 1.8, And Under The Facts As Found In This Case The Trial Court Did Not Abuse Its Discretion In Ordering Rescission For Violation Of RPC 1.7.

Respondents proposed the TCG debt collection opportunity to the attorneys in exchange for contribution of “legal services you can provide (review the purchase agreement contract, legal doc for this JV (if needed), demand letter, ask smart questions, kick the tires, etc.” (CP 216) When LKO – which was created, managed, and represented by petitioner attorneys – sued, based on an agreement that violated both RPC 1.7 and RPC 1.8 (and that had not been properly documented only because of the petitioner attorneys’ violation of either rule), the trial court did not abuse its discretion in rescinding and returning to petitioner LKO the funds, with interest, that it had (at the direction of the petitioner attorneys) invested in TCG.

Petitioners’ pecuniary interest in respondent TCG was in the nature of a fee, which the courts routinely disgorge for violation of ethical rules. *See, e.g. Eriks v. Denver*, 118 Wn.2d 451, 462-63, 824 P.2d 1207 (1992). Indeed, no party disputes that rescission is the proper remedy for violation of RPC 1.8, and LKO’s supplemental brief as a consequence is devoted to arguing that there was not an

RPC 1.8 violation.⁷ The law is clear, however, that an attorney's family members are bound by the attorney's ethical obligations in claiming an interest in a business venture acquired by the attorney in violation of RPC 1.8. In *Corporate Dissolution of Ocean Shores Park, Inc. v. Rawson-Sweet*, 132 Wn. App. 903, 134 P.3d 1188 (2006), *rev. denied*, 159 Wn.2d 1009 (2007), for instance, the appellate court remanded to the trial court with direction that, if an attorney's widow could not make the required showing that the attorney had fulfilled his ethical obligations under RPC 1.8, the trial court was to enter an order divesting her of shares in a corporation that had been a client of the attorney. 132 Wn. App. at 915-16, ¶ 33, 913 ¶ 23 ("Though we have no evidence that Rawson-Sweet was guilty of any wrongdoing, she . . . now claims the benefit of that transaction and so it becomes her burden . . . to support a finding

⁷ LKO makes much of the trial court's failure to resolve the issue of whether petitioner attorneys violated RPC 1.8 after it determined a violation of RPC 1.7. But respondents are entitled to rely on alternative grounds for affirmance, and the issue whether the attorneys violated their professional responsibilities is a question of law. *Eriks*, 118 Wn.2d at 457-58. Respondents clearly raised this issue, both at trial and in response to LKO's appeal. Despite LKO's utter failure to respond to the RPC 1.8 issue on appeal, the issue was fully developed when petitioner attorneys were allowed to intervene and brief the issue in supplemental briefing in Division Three. No further development of the facts could evade a determination that the attorneys violated RPC 1.8 as well as RPC 1.7.

that this apparently void transaction was supported by adequate advice and consideration.”).

Under the facts of this case, rescission also was an appropriate remedy for violation of RPC 1.7. The Restatement (Third) of the Law Governing Lawyers §6 (2000) sets out a variety of judicial remedies available for a lawyer’s breach of ethical duties, including “cancellation or reformation of a contract, deed, or similar instrument.” A trial court has broad discretion to order appropriate relief, including rescission, where, as here, LKO sought the equitable relief of a declaration of its interest in TCG. This Court reviews “the authority of a trial court to fashion equitable remedies under the abuse of discretion standard.” *Sac Downtown Ltd. P’ship v. Kahn*, 123 Wn.2d 197, 204, 867 P.2d 605 (1994). Given the parties’ relationship and the attorneys’ indisputable control of their client LKO, the trial court did not abuse its discretion in determining that rescission and return to LKO of the funds that had been advanced to TCG, with interest, was the appropriate remedy for the attorneys’ violation of RPC 1.7.

Division Three concluded that rescission was not an appropriate remedy for violation of RPC 1.7 because it “could easily fall on an innocent client.” *LK Operating*, 168 Wn. App. at 876, ¶

32. That may be true, and it might be a reason for a trial court in its discretion to deny rescission in another case. But in *this* case, LKO was not “innocent,” and LKO lost nothing as a result of rescission. Powers and Therrien formed and financed LKO, for their own estate planning purposes, to benefit themselves and their children. (CP 965, 969) Powers and Therrien apparently funded the investment in TCG through their partnership LK Partners, which distributed funds to the entities that controlled LKO and was the source of funds sent to TCG. (See CP 604-05) The LKO Operating Agreement vested the broadest possible management control in Powers & Therrien Enterprises, Inc. – a corporation owned by Powers and Therrien 50-50. (CP 1281) The trial court, with ample evidence, found that LKO was controlled by Powers and Therrien. (CP 2371)

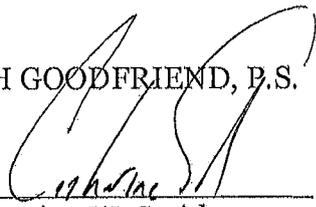
The petitioners cannot evade the consequences of the attorneys’ violation of RPC 1.8 on the grounds that their violation of RPC 1.7 as well does not compel rescission. Rescission is the only proper remedy for violation of RPC 1.8, and under the facts of this case the trial court did not abuse its discretion in ordering rescission for violation of RPC 1.7.

E. Conclusion.

This Court should not absolve petitioner attorneys of their ethical lapses because they purported to pass on a business opportunity with a client to their children, through a series of trusts, corporations, and limited liability companies that the attorneys themselves indisputably created and controlled. Petitioner attorneys violated of the Rules of Professional Conduct by going into business with a client (RPC 1.8). Their ethical transgressions were not immunized by the secret transfer of the venture opportunity to another client the attorneys created and controlled for their children (RPC 1.7). This Court should affirm rescission as a proper remedy that was within the trial court's discretion.

Dated this 31st day of July, 2013.

SMITH GOODFRIEND, P.S.

By: 
Catherine W. Smith
WSBA No. 9542

Attorneys for Respondents

DECLARATION OF SERVICE

The undersigned declares under penalty of perjury, under the laws of the State of Washington, that the following is true and correct:

That on July 31, 2013, I arranged for service of the foregoing Supplemental Brief of Respondents, to the court and to the parties to this action as follows:

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DATED at Seattle, Washington this 31st day of July, 2013.



 Victoria K. Isaksen

RULE 1.8:

~~CONFLICT OF INTEREST, PROHIBITED TRANSACTIONS;~~
CURRENT CLIENTS: SPECIFIC RULES

~~A lawyer who is representing a client in a matter:~~

(a) ~~A lawyer shall not enter into a business transaction with a client or knowingly acquire an ownership, possessory, security or other pecuniary interest adverse to a client unless:~~

~~(1) The transaction and terms on which the lawyer acquires the interest are fair and reasonable to the client and are fully disclosed and transmitted in writing to the client in a manner which that can be reasonably understood by the client;~~

~~(2) The client is advised in writing of the desirability of seeking and is given a reasonable opportunity to seek the advice of independent legal counsel in on the transaction; and~~

~~(3) The client consents thereto gives informed consent, in a writing signed by the client, to the essential terms of the transaction and the lawyer's role in the transaction, including whether the lawyer is representing the client in the transaction.~~

~~(b) A lawyer shall not use information relating to representation of a client to the disadvantage of the client unless the client consents in writing after consultation gives informed consent, except as permitted or required by these Rules.~~

RULE 1.7:

CONFLICT OF INTEREST; GENERAL RULE; CURRENT CLIENTS

(a) A Except as provided in paragraph (b), a lawyer shall not represent a client if the representation of that involves a concurrent conflict of interest. A concurrent conflict of interest exists if:

(1) the representation of one client will be directly adverse to another client, unless; or

(1) The lawyer reasonably believes the representation will not adversely affect the relationship with the other client, and (2) Each client consents in writing after consultation and a full disclosure of the material facts (following authorization from the other client to make such a disclosure).

(b) (2) A lawyer shall not represent a client if the representation of that client there is a significant risk that the representation of one or more clients may will be materially limited by the lawyer's responsibilities to another client, a former client or to a third person; or by a personal interest of the lawyer's own interests, unless:

(1) The lawyer reasonably believes the representation will not be adversely affected; and

(2) The client consents in writing after consultation and a full disclosure of the material facts (following authorization from the other client to make such a disclosure). When representation of multiple clients in a single matter is undertaken, the consultation shall include explanation of the implications of the common representation and the advantages and risks involved.

OFFICE RECEPTIONIST, CLERK

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Subject: LK Operating, LLC v. The Collection Group, LLC, Cause No. 88132-4

Attached for filing in pdf format is the Supplemental Brief of Respondents, in *LK Operating, LLC v. The Collection Group, LLC*, Cause No. 88132-4. The attorney filing this document is Catherine W. Smith, WSBA No. 9542, email address cate@washingtonappeals.com.

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