No. 90891-5

No. 314910-III

COURT OF APPEALS, DIVISION III
OF THE STATE OF WASHINGTON

FILED

SEP 10 2013

COURT OF APPEALS
DIVISION III
STATE OF WASHINGTON
By_____

NORTHWEST WHOLESALE, INC., a Washington corporation,

Plaintiff,

v.

PAC ORGANIC FRUIT, LLC, a Washington limited liability company; GREG HOLZMAN, INC., a foreign corporation authorized to do business in the State of Washington; and HAROLD OSTENSON and SHIRLEY OSTENSON,

Defendants.

HAROLD OSTENSON and SHIRLEY OSTENSON, on behalf of PAC ORGANIC FRUIT, LLC, a Washington limited liability company,

Appellants,

v.

GREG HOLZMAN, an individual, TOTAL ORGANIC, LLC, a Washington limited liability company; and GREG HOLZMAN, INC., a foreign corporation authorized to do business in the State of Washington,

Respondents.

BRIEF OF RESPONDENTS

Daniel J. Appel
LAW OFFICES OF DALE M. FOREMAN, P.S.
124 N. Wenatchee Ave., Suite A
Wenatchee, WA 98801
(509) 662-9602
Attorneys for Respondents

TABLE OF CONTENTS

I. **Introduction** 1

II. **Issues Presented for Review** 4

III. **Statement of the Case** 6

IV. **Argument** 11

A. The Superior Court Properly Considered and Ruled on the Holzman Parties' CR 41(b)(3) Motion 12

B. Under Washington Law, the Ostensons Were Disassociated from Pac Organic upon Filing for Bankruptcy and No Longer Had the Authority to Prosecute Derivative Claims on Its Behalf, and the Court Should Not Consider the Ostensons' Preemption Argument, Which Fails on the Merits Anyway 14

1. The Court Should Not Consider the Ostensons' Preemption Argument 16

2. The Ostensons' Preemption Argument Fails on the Merits 19

a. *11 U.S.C. § 365(e)(1) Does Not Apply Because Pac Organic's Operating Agreement Is Not Executory* 20

b. *11 U.S.C. § 541(c)(1) Does Not Apply Because All of the Ostensons' Property Interests in Pac Organic Became Part of Their Estate* 23

3. The Stipulation Does Not Evidence the Holzman Parties' Consent to the Ostensons' Continued Status as Members of Pac Organic 29

C. The Ostensons' Trio of Estoppel Arguments Is Meritless 33

1. The Holzman Parties Are Not Judicially Estopped.....34

2. The Holzman Parties Are Not Collaterally Estopped...36

3. The Holzman Parties Are Not Barred by Res Judicata 37

D. The Court May Also Affirm Because the Ostensons' Derivative Claim Is Really a Direct Claim Against the Holzman Parties, All of Which the Ostensons Released in the Stipulation.....38

E. The Court Should Deny the Ostensons' Request for Attorney Fees.....40

V. **Conclusion** 41

TABLE OF AUTHORITIES

Cases

Austin v. U.S. Bank of Wash.,
73 Wn. App. 293, 869 P.2d 404 (1994).....40

Blueberry Place Homeowners Ass'n v. Northward Homes, Inc.,
126 Wn. App. 352, 110 P.3d 1145 (2005).....40

Butner v. United States,
440 U.S. 48, 99 S. Ct. 914, 59 L. Ed. 2d 136 (1979) 23, 24

Clark v. Baines,
150 Wn.2d 905, 84 P.3d 245 (2004) 36, 37

Commonwealth Real Estate Servs. v. Padilla,
149 Wn. App. 757, 205 P.3d 937 (2009).....12, 13

Fotouhi v. Mansdorf,
427 B.R. 798 (N.D. Cal. 2010).....25, 26

Hadley v. Maxwell,
144 Wn.2d 306, 27 P.3d 600 (2001) 36

Hector v. Martin,
51 Wn.2d 707, 321 P.2d 555 (1958) 13, 14

Hendrickson v. King Cnty.,
101 Wn. App. 258, 2 P.3d 1006 (2000).....38

Hilltop Terrace Homeowner's Ass'n v. Island Cnty.,
126 Wn.2d 22, 891 P.2d 29 (1995) 37

Hook v. Lincoln Cnty. Noxious Weed Control Bd.,
166 Wn. App. 145, 269 P.3d 1056 (2012).....17

In re Albright,
291 B.R. 538 (Bankr. D. Colo. 2003).....25

In re A-Z Electronics, LLC,
350 B.R. 886 (Bankr. D. Idaho 2006) 25

In re Capital Acquisitions & Mgmt. Corp.,
341 B.R. 632 (Bankr. N.D. Ill. 2006) 21

In re Daugherty Const., Inc.,
188 B.R. 607 (Bankr. D. Neb. 1995) 26, 27

In re DeLuca,
194 B.R. 65 (Bankr. E.D. Va. 1996) 23

In re Estate of Black,
116 Wn. App. 476, 66 P.3d 670 (2003) 38

In re Farmers Markets, Inc.,
792 F.2d 1400 (9th Cir. 1986) 24

In re Garrison-Ashburn, L.C.,
253 B.R. 700 (Bankr. E.D. Va. 2000) 24, 25, 28

In re Tsiaoushis,
383 B.R. 616 (Bankr. E.D. Va. 2007) 21, 22

In re W. Asbestos Co.,
313 B.R. 832 (Bankr. N.D. Cal. 2003) 25

In re Warner,
480 B.R. 641 (Bankr. N.D.W. Va. 2012) 22, 27

In re Wegner,
839 F.2d 533 (9th Cir. 1988) 21

Integrated Solutions, Inc. v. Serv. Support Specialties, Inc.,
124 F.3d 487 (3d Cir. 1997) 20

Int'l Shoe Co. v. Pinkus,
278 U.S. 261, 49 S. Ct. 108, 73 L. Ed. 318 (1929) 20

Johnson v. Si-Cor Inc.,
107 Wn. App. 902, 28 P.3d 832 (2001) 34

Korst v. McMahon,
136 Wn. App. 202, 148 P.3d 1081 (2006).....12

Markley v. Markley,
31 Wn.2d 605, 198 P.2d 486 (1948) 34

Milford Power Co., LLC v. PDC Milford Power, LLC,
866 A.2d 738 (Del. Ch. 2004) 26

River House Dev. Inc. v. Integrus Architecture, P.S.,
167 Wn. App. 221, 272 P.3d 289 (2012).....17

Sabey v. Howard Johnson & Co.,
101 Wn. App. 575, 5 P.3d 730 (2000).....39

Skinner v. Holgate,
141 Wn. App. 840, 173 P.3d 300 (2007).....35

Sumlin Const. Co., L.L.C. v. Taylor,
850 So.2d 303 (Ala. 2002) 23

Teratron Gen. v. Institutional Investors Trust,
18 Wn. App. 481, 569 P.2d 1198 (1977).....17

Thweatt v. Hommel,
67 Wn. App. 135, 834 P.2d 1058 (1992).....40

Tooley v. Donaldson, Lufkin & Jenrette, Inc.,
845 A.2d 1031 (Del. 2004).....39

Wilcox v. Lexington Eye Inst.,
130 Wn. App. 234, 122 P.3d 729 (2005).....17

Wilson Court Ltd. P'ship v. Tony Maroni's, Inc.,
134 Wn.2d 692, 952 P.2d 590 (1998) 40

Other Authorities

U.S. Const. art. VI, cl. 2 .....19, 20

11 U.S.C. § 365 ..... *passim*

11 U.S.C. § 541 ..... *passim*

CR 41(b)(3) ..... *passim*

CR 59 17

RAP 18.1 ..... 40, 41

Fed. R. Bankr. P. 9019 36

RCW 25.15.130 ..... *passim*

RCW 25.15.250 ..... 15, 23

RCW 25.15.370 15

RCW 25.15.375 15

RCW ch. 7.60 32

I. INTRODUCTION

The present litigation between Appellants Harold and Shirley Ostenson (the "Ostensons") and Respondents Greg Holzman, Greg Holzman, Inc. ("GHI", now known as Purity Organic Holdings, Inc.), and Total Organic, LLC (collectively "Holzman Parties") has been dragging on now for over five years. The Holzman Parties have battled the Ostensons' meritless claims at great cost, finally dispatching them by means of a Civil Rule 41(b)(3) motion during trial, which Chelan County Superior Court Judge Lesley Allan granted after considering the parties' extensive briefing and arguments concerning Washington law. The trial court's order, backed by appropriate findings of fact and conclusions of law, entered final judgment in favor of the Holzman Parties. Facing complete defeat, the Ostensons moved for reconsideration, brandishing a brand new argument grounded in federal bankruptcy law. Unmoved by this tardy—and substantively deficient—attempt to resurrect a dead lawsuit, the trial court denied the motion, insisting on the application of Washington law. Because the relevant facts are undisputed and because the trial court correctly applied the law, this Court should affirm the final judgment dismissing the Ostensons' claims against the Holzman Parties.

This dispute centers on the parties' soured business relationship that began fifteen years ago, in 1998. At that time, the Ostensons and Mr.

Holzman, through GHI, formed Pac Organic Fruit, LLC ("Pac Organic") to operate a fruit packing operation in Quincy, Washington. The decline and fall of Pac Organic sets the stage for this appeal. Upon that stage, the Ostensons laboriously narrate a long and colorful story of alleged wrongs supposedly suffered at the hands of the Holzman Parties, an account the latter entirely dispute. But to decide this appeal, the Court need not bog down in the minutiae of the trial testimony as the few relevant facts are undisputed.

For purposes of this appeal, only the following facts are pertinent:

1. Effective June 1, 1998 GHI and the Ostensons formed Pac Organic, the former owning 51% of the equity interest and the latter 49%.

2. On January 9, 2007, the Ostensons filed a voluntary petition for bankruptcy in the Eastern District of Washington under Chapter 11 of the United States Bankruptcy Code.

3. In the course of their bankruptcy case, the Ostensons entered into a Stipulation with the Holzman Parties that fully and mutually released all claims unless specifically excluded. The Stipulation allowed Pac Organic to assert claims against the Holzman Parties, but is entirely silent on the issue of whether the Ostensons' bankruptcy alters the normal application of Washington law regarding the disassociation of members upon filing for bankruptcy. Nor does the Stipulation indicate any consent

on the part of the Holzman Parties allowing the Ostensons to remain members of Pac Organic, a status required to assert derivative claims on behalf of the LLC.

4. The bankruptcy court approved the Stipulation at the Ostensons' request, and it was incorporated into their plan of reorganization.

5. On July 25, 2008, the Ostensons filed direct claims in this lawsuit against Pac Organic and a hodgepodge of unnamed allegations packaged as a shareholder derivative claim on behalf of Pac Organic against the Holzman Parties.

Following the presentation of the Ostensons' case in chief at trial, which commenced on July 11, 2011, the Holzman Parties moved for dismissal of the Ostensons' derivative claim under CR 41(b)(3). The trial court took the motion under advisement and the trial proceeded, only to later be continued. During the hiatus from trial, the parties extensively briefed the CR 41(b)(3) motion and argued it to the court on September 7, 2012. The trial court granted the motion.

To the undisputed facts stated above, the trial court applied straightforward Washington law (RCW 25.15.130(1)) to conclude that the Ostensons were dissociated from Pac Organic (i.e., no longer members) upon the filing of their petition for bankruptcy, that the Stipulation did not

alter the application of this law, and that only parties who were members at the time of filing suit can bring derivative claims (RCW 25.15.375). Accordingly, the Ostensons lacked authority to assert a derivative claim against the Holzman Parties on behalf of Pac Organic. Thus, on October 3, 2012, the trial court dismissed the sole claim against the Holzman Parties.

The Ostensons moved for reconsideration, advancing a new argument: federal bankruptcy law preempts Washington law and preserves the Ostensons' status as members, allowing them to bring a derivative claim against the Holzman Parties. The Holzman Parties objected to this eleventh-hour insertion of a complicated preemption issue into what had hitherto been a state-law discussion and argued that the court should not even consider this new argument. The trial court denied the motion, making no mention whatsoever of the federal preemption argument and reaffirming her decision under Washington law. Likewise, this Court need not consider the Ostensons' last minute preemption argument.

The trial court correctly granted the Holzman Parties' CR 41(b)(3) motion to dismiss and denied the Ostensons' motion for reconsideration, the two orders at issue on appeal. This Court should affirm.

II. ISSUES PRESENTED FOR REVIEW

The Ostensons present eight issues on appeal, which the Holzman Parties restate as follows:

1. Did the trial court correctly consider and rule on the Holzman Parties' CR 41(b)(3) motion to dismiss when the facts are undisputed and the issues of law are properly briefed and presented? (Responsive to the Ostensons' first issue)

2. Did the trial court correctly rule that the Ostensons lacked authority to prosecute a derivative claim against the Holzman Parties on behalf of Pac Organic because they were disassociated as members of that entity when they filed for bankruptcy? (Responsive to the Ostensons' second and third issues)

3. Did the trial court correctly exercise its discretion and refuse to consider a federal preemption argument raised for the first time on reconsideration, and, even considering the merits of that argument, correctly determine that federal law does not preempt the application of Washington law? (Responsive to the Ostensons' fourth issue)

4. Did the trial court correctly determine that the Stipulation is silent on the issue of the Ostensons' post-bankruptcy membership in Pac Organic, meaning the Holzman Parties did not consent to such continued membership? (Responsive to the Ostensons' fifth issue)

5. Did the trial court correctly reject the Ostensons' various estoppel arguments? (Responsive to the Ostensons' sixth, seventh, and eighth issues)

6. Should the Court affirm on the alternate ground that the Ostensons released all direct claims against the Holzman Parties and seek to indirectly by means of a derivative claim?

III. STATEMENT OF THE CASE[1]

Northwest Wholesale, Inc. ("NWI") commenced this lawsuit on May 23, 2007, asserting claims against Pac Organic, GHI, and the Ostensons relating to a debt Pac Organic owed to NWI. CP 4-9. In 2011, Pac Organic and GHI later settled with NWI, GHI paying the settlement on behalf of Pac Organic. CP 589; RP 813.

Previously, on January 9, 2007, the Ostensons voluntarily filed for bankruptcy protection under Chapter 11 of United States Bankruptcy Code (*In re Ostensons*, No. 07-00058-FLK11 (E.D. Wash.)). CP 2045. In this proceeding, the Ostensons and the Holzman Parties negotiated a settlement of the various claims they had against each other, submitting some to arbitration and releasing the balance. Ex. D-5 (Stipulation). On August 18, 2008, the bankruptcy court, at the Ostensons' request, approved the Stipulation as required by court rules, giving the Ostensons

[1] Most of the facts included in the Ostensons' Statement of the Case, particularly the detailed descriptions of the trial testimony, are simply unnecessary to decide the narrow questions on appeal. Naturally, the Holzman Parties dispute the story the Ostensons tell and the evidence used and will provide a few, key rebuttal facts that tell a different story that describes what actually happened. Because these facts are extraneous to the issues on appeal, however, this rebuttal evidence will be brief.

the authority to sign the Stipulation and incorporate it into their reorganization plan. Ex. D-5 (Order, Amendment), CP 2045-47.

The Stipulation states: "The parties shall incorporate into the Ostenson's plan of reorganization a general and mutual release of all claims not expressly addressed or treated herein." Ex. D-5 (¶ 5). From this broad release, the Stipulation carved out two categories of claims:

> 7. This Stipulation does not affect nor release the following claims:
>
> a. Any purported claims of the Ostensons against Pac-O, including but not limited to, claims for unpaid lease installments, wages, expense reimbursement, dividends, fruit proceeds, and/or failure to pay Keybank's line of credit, provided that the Ostensons shall not be entitled to assert those purported claims, whether derivatively or directly (including by way of a veil-piercing or similar theory) against Holzman, GHI or POP, such purported claims to be released; and
>
> b. Any purported claims of Pac-O (and Pac-O only) against Holzman, GHI, POP and/or Total Organic for their alleged failure to pay packing fees, expenses, and revenues earned solely by Pac-O or fruit proceeds or rent due Pac-O or for conversion of assets of Pac-O.

Ex. D-5 (¶ 7).

On July 25, 2008, the Ostensons filed, in this case, crossclaims and third-party claims, asserting seven causes of action against Pac Organic and a single derivative cause of action on behalf of Pac Organic against the Holzman Parties. CP 38-53 (The Ostensons later filed an amended complaint, CP 476-93). The precise nature of this derivative claim was

disputed, CP 1750-51, the Ostensons later clarifying that it was essentially a conversion claim, CP 1880, RP (09/07/12) 34.

Trial began July 11, 2011. Following two days of testimony from Mr. Ostenson and Paul Fruci, their accounting expert, the Ostensons rested. RP 580. The Holzman Parties moved for dismissal of the Ostensons' derivative claim under CR 41(b)(3). RP 580-603. The trial court took the motion under advisement and testimony continued. RP 602-03. The Holzman Parties called three witnesses, Charles Kay (a consultant hired to help with Pac Organic), Edward Suchow (GHI's controller to June of 2005), and Kathryn Dubsky (Mr. Suchow's replacement), but did not finish their case. RP 830. Trial was to be completed at a later date. *E.g.*, CP 1746-48.

At few key facts from trial:[2]

1. Pac Organic lost money from is formation in 1998 to 2003, showing an ordinary income loss of over $490,000 in 2003 alone. Ex. D-41, RP 708-12, 715-16. After learning of this loss in the Spring of 2004, the principals of GHI, including Mr. Holzman, continued to work with Pac Organic, managed by Mr. and Mrs. Ostenson, to make things work. RP 714.

[2] Again, these facts are not relevant to this appeal but are included merely to show that the Ostensons' version of the underlying case is disputed. The Holzman Parties have always maintained that all actions taken with respect to Pac Organic were proper and that the Ostensons' claims to the contrary are meritless.

2. As trust broke down between GHI and the Ostenson during the fall of 2004 to early 2005, Mr. Ostenson began to threaten to shut Pac Organic down if his demands were not met. RP 721-26, Exs. D-27, D-17. Mr. Ostenson proved difficult to work with, making the fruit difficult to sell because prices were refused, fruit sat past its prime, resulting in credit being issued to the buyers and lost revenue to Pac Organic. RP 726-30.

3. The Holzman Parties never sought to steal the Pac Organic business from the Ostensons; rather, the business proved to be worthless. RP 735-37.

4. The promissory note Pac Organic executed in favor of GHI was legitimate and, if anything, understated the amount Pac Organic owed to GHI. RP 808-13, Ex. P-9.[3]

Before trial was resumed, the parties fully briefed the Holzman Parties' CR 41(b)(3) motion, CP 1749-2006, and the trial court heard argument on September 7, 2013, RP (09/07/12) 2-65. The court ruled in favor of the Holzman Parties, dismissing the Ostensons' derivative claim. RP (09/07/12) 60-64. Formal findings of fact, conclusions of law, and judgment dismissing the claims against the Holzman Parties were entered October 3, 2012. CP 2043-51.

The trial court's findings were as follows:

[3] Ms. Dubsky's testimony refers to Defendant's Exhibit No. 3, which is the same as Plaintiffs' Exhibit 9.

1. The Ostensons and GHI formed Pac Organic on June 1, 1998, GHI owning 51% and the Ostensons 49%. CP 2045; Ex. P-26.

2. The Ostensons voluntarily filed for bankruptcy on January 9, 2007. CP 2045; Ex. D-5.

3. In the context of the bankruptcy proceeding, the parties entered into the Stipulation, described above, mutually releasing all claims save those specifically exempted. CP 2045-46; Ex. D-5 (Stipulation).

4. The Stipulation does not contain any language by which the Holzman Parties agreed to relieve the Ostensons from the workings of Washington corporate law, by which they were disassociated from Pac Organic upon filing for bankruptcy protection. CP 2046.

5. The bankruptcy court approved, at the Ostensons' request, the Stipulation and allowed them to amend their plan of reorganization. CP 2046-47; Ex. D-5 (Order and Amendment).

6. The Ostensons filed crossclaims and third-party claims in this case, including a claim entitled "Derivative Action – Minority Members on behalf of Pac Organic Fruit, LLC against Greg Holzman, Total Organic, LLC, and Greg Holzman, Inc.", which Ostensons purported to assert derivatively on behalf of Pac Organic. CP 2047.

Based on these facts and applicable law, the trial court concluded that the Ostensons were disassociated from (that is, no longer members of)

Pac Organic upon filing for bankruptcy on January 7, 2007. CP 2048. Because state law requires a person to be a member of a limited liability company when filing a derivative action, the Ostensons had no authority to file derivative claims on behalf of Pac Organic, as they attempted to do in this case. CP 2048-49. Thus, the only claim against them having been dismissed, the trial court entered final judgment in favor of the Holzman Parties. CP 2050.

The Ostensons moved for reconsideration. CP 2052-55. Besides reiterating the same arguments made in opposition to the Holzman Parties' CR 41(b)(3) motion, the Ostensons for the first time advanced a new argument, that federal bankruptcy law preempted the workings of state law. CP 2059-62. The Holzman Parties objected to the bankruptcy argument, encouraging the trial court not even to consider it. CP 2199-2201. After a hearing on the motion, RP (11/08/12) 2-61, the trial court denied the motion, making no mention of the Ostensons' bankruptcy argument. CP 2400-04. The Ostensons appealed. CP 2423-40.

IV. ARGUMENT

The Ostensons advance numerous arguments, both procedural and substantive, in attack of the trial court's order of dismissal and order denying reconsideration. These arguments fall into four broad categories: (1) CR 41(b)(3) is an improper vehicle for dismissal of the Ostensons'

derivative claim; (2) federal bankruptcy law preempts Washington corporate law and preserves the Ostensons' status as members of Pac Organic; (3) the Stipulation evidences the Holzman Parties' consent to the Ostensons' continued status as members; and (4) various estoppel theories bar the Holzman Parties' position. None of these arguments has merit.

A. The Superior Court Properly Considered and Ruled on the Holzman Parties' CR 41(b)(3) Motion.

Civil Rule 41(b)(3) allows a defendant, after a plaintiff has presented its case in a bench trial, to move for dismissal of the plaintiff's case "on the ground that upon the facts and the law the plaintiff has shown no right to relief." *See Commonwealth Real Estate Servs. v. Padilla*, 149 Wn. App. 757, 762, 205 P.3d 937 (2009) ("CR 41(b)(3) provides that in a bench trial, the court may grant a motion to dismiss at the close of the plaintiff's case either as a matter of law or a matter of fact."). When a trial court grants a CR 41(b)(3) motion and enters judgment with findings and conclusions, the court of appeals reviews the findings and conclusions in a two-step process. *Korst v. McMahon*, 136 Wn. App. 202, 206, 148 P.3d 1081 (2006). First, the court determines if substantial evidence supports the findings of fact. *Id.* Second, the court decides if the findings support the conclusions of law, which are reviewed de novo. *Id.*; *see also Padilla*, 149 Wn. App. at 762 ("If the trial court dismisses the case as a matter of

law after the plaintiff rests, review is de novo . . . ."). Here, the Ostensons do not challenge the trial court's findings of fact. Thus, the Court's review is limited to the conclusions of law.

The Ostensons argue that the Holzman Parties waived their CR 41(b)(3) motion by presenting evidence at trial after the trial court took the motion under advisement, citing *Hector v. Martin*, 51 Wn.2d 707, 321 P.2d 555 (1958). The trial court considered and properly rejected this argument. In *Hector*, the defendant challenged the sufficiency of the evidence—not under CR 41(b)(3)—at the close of the plaintiff's case. *Id.* at 709. The trial court granted the motion in part and reserved its ruling in part. The defendant then put on its case and renewed its motion at the close of all evidence. The trial court denied the motion and ruled in favor of the plaintiff on the remaining claim. On appeal, the Supreme Court ruled that a defendant waives a challenge to the sufficiency of the plaintiff's evidence if he proceeds to present evidence on his own behalf, no matter if the trial court denies or reserves ruling on the motion. *Id.* at 709-10. As the Court reasoned: "A contrary rule would deny both parties the benefit of all the evidence in the case to which they are both entitled." *Id.* at 710.

This rule makes perfect sense in the context of a sufficiency challenge, but it has no bearing on the present case at all. As to the

disassociation issue, which served as the basis of the trial court's ruling and is central to this appeal, the facts are undisputed. The issue is purely legal, which the trial properly resolved in favor of the Holzman Parties, as was proper under CR 41(b)(3). The evidence put in by the Holzman Parties did not alter those undisputed facts, nor would additional evidence change the picture. Unlike the defendant in *Hector*, the Holzman Parties are not trying to rewind the clock and have the court only consider the Ostensons' evidence. The Holzman Parties have no objection to the court considering all of the additional evidence presented at trial, though it is not relevant to the legal issues upon which the trial court dismissed the Ostensons' claims. In short, *Hector* simply does not apply to this case. To reverse and remand for the completion of trial would simply waste the parties' and the courts' resources, as the Holzman Parties would simply make the same legal argument again with the same result.

B. Under Washington Law, the Ostensons Were Disassociated from Pac Organic upon Filing for Bankruptcy and No Longer Had the Authority to Prosecute Derivative Claims on Its Behalf, and the Court Should Not Consider the Ostensons' Preemption Argument, Which Fails on the Merits Anyway.

The mechanics of Washington corporate law are clear and undisputed. RCW 25.15.130(1) states that a "person ceases to be a member of a limited liability company" if, *inter alia*, the person "files a

voluntary petition in bankruptcy."[4] The disassociated person is then treated as an assignee, who maintains the right to "share in such profits and losses, to receive such distributions, and to receive such allocation of income, gain, loss, deduction, or credit or similar item to which the assignor was entitled, to the extent assigned." RCW 25.15.250(2)(a). In other words, the disassociated person cannot participate in management, RCW 25.15.250(1), but still receives the full economic benefit of his interest in the LLC.

Separate statutes define who may bring a derivative claim on behalf of the LLC. RCW 25.15.370 states that a "member may bring an action . . . in the right of a limited liability company to recover a judgment in its favor if managers or members with authority to do so have refused to bring the action or if an effort to cause those managers or members to bring the action is not likely to succeed." RCW 25.15.375 further requires the plaintiff to be "a member at the time of bringing the action" and at the time of the events in question.[5]

---

[4] The statute allows the members to agree otherwise in the LLC operating agreement, or to consent in writing to the filing of bankruptcy. RCW 25.15.130(1)(d). The Pac Organic operating agreement does not vary from the default rules under state law. Ex. P-26 at 13. The Ostensons argue, incorrectly, that the Stipulation provides the needed member consent. This argument is rebutted below.

[5] Full copies of these and all other statutes at issue in this appeal are attached to this brief as Appendix A.

Thus, if a member files for bankruptcy, he relinquishes the membership status needed to prosecute a derivative action. The Ostensons filed for bankruptcy on January 9, 2007, CP 2045, and by operation of Washington law were disassociated from Pac Organic. No longer members of Pac Organic, the Ostensons lacked authority to bring a derivative claim on its behalf, as they tried to do on July 25, 2008 when they filed such a claim against the Holzman Parties in this action. CP 2047. The trial court's conclusions of law simply recite these straightforward concepts. CP 2049 (¶¶ 5, 6).

The Ostensons do not dispute these conclusions regarding the operation of Washington law. Instead, they argue two points in response: (1) federal bankruptcy law preempts state law and preserves the Ostensons' status as members of Pac Organic; and (2) the Stipulation served as the Holzman Parties' consent to the continued membership of the Ostensons in Pac Organic. Neither argument is persuasive.

1. The Court Should Not Consider the Ostensons' Preemption Argument.

The Ostensons' raised the argument that federal bankruptcy law preempts Washington corporate law for the first time in its motion for reconsideration. Appellant's Br. at 25. "Generally, new theories of the case presented as part of a motion for reconsideration need not be

considered." *Hook v. Lincoln Cnty. Noxious Weed Control Bd.*, 166 Wn. App. 145, 158, 269 P.3d 1056 (2012); *see also Wilcox v. Lexington Eye Inst.*, 130 Wn. App. 234, 241, 122 P.3d 729 (2005) ("CR 59 does not permit a plaintiff to propose new theories of the case that could have been raised before entry of an adverse decision."); *Teratron Gen. v. Institutional Investors Trust*, 18 Wn. App. 481, 489, 569 P.2d 1198 (1977) ("A new claim of error brought forward for the purpose of reversing a judgment is too late if made for the first time on the motion for new trial . . . .").

While the trial court's legal conclusion in its order granting the CR 41(b)(3) motion is reviewed de novo, its order denying the Ostensons' motion for reconsideration is reviewed for abuse of discretion. *Wilcox*, 130 Wn. App. at 241. "A trial court abuses discretion when its decision is based on untenable grounds or reasons." *Id.* "The trial court's discretion extends to refusing to consider an argument raised for the first time on reconsideration absent a good excuse." *River House Dev. Inc. v. Integrus Architecture, P.S.*, 167 Wn. App. 221, 231, 272 P.3d 289 (2012).

The excuse the Ostensons offered for their failure to raise the preemption issue earlier is revealing: they thought they would win under state law. *See* RP (11/08/12) at 15-16 ("[The failure to argue preemption earlier] was done in a sincere belief that we were right, Your Honor, and

that I -- I thought the Court was going along, you know, thinking the same thing."). Sincere or not, the Ostensons deliberately chose *not* to include the preemption argument in earlier briefing, despite ample opportunity. The issue was well-known to the parties. The Holzman Parties had briefed the issue in a motion to the bankruptcy court that was never decided there. CP 02279-95. The Ostensons objected to the motion and argued the issue should be decided by the trial court in this litigation, to which course of action the Holzman Parties ultimately agreed. CP 2267-71, 2299-300 (¶¶ 3, 6), 2320-21. Then, the Ostensons filed 122 pages of briefing and responsive materials to the Holzman Parties' CR 41(b)(3) motion to dismiss, CP 1860-1981, without mentioning the federal preemption issue at all. In short, the Ostensons knew about the argument but strategically chose to rely on other arguments. When those arguments proved unavailing, the Ostensons resurrected the preemption argument at the eleventh hour. By then, it was too late.

In its ruling denying the motion for reconsideration, the trial court did not say a single word about the preemption argument. CP 2400-04. Instead, the court was "persuaded that Washington Law" governed and reaffirmed its earlier ruling. CP 2403-04. The most natural reading of the trial court's order is that the court refused to consider the Ostensons' late preemption argument. In its order granting the Holzman Parties CR

41(b)(3) motion, the court spent eight pages detailing the facts, law, and judgment on a straightforward issue under Washington law. CP 2043-50. In the subsequent order, the single substantive paragraph mostly reiterates that previous ruling. In a proper exercise of its discretion, the trial court simply did not consider the Ostensons' tardy preemption argument. This Court should follow suit and affirm.

2. The Ostensons' Preemption Argument Fails on the Merits.

The Ostensons argue that two provisions of the U.S. Bankruptcy Code, 11 U.S.C. §§ 365(e)(1) and 541(c)(1), preempt the undisputed results of Washington law and prevent their disassociation upon filing for bankruptcy protection. The proper answer to this question—as determined by the better-reasoned cases on the topic—is that the member is disassociated by operation of state law, and then all of these rights become part of the bankruptcy estate. Thus, the Ostensons were disassociated and their bankruptcy estate cannot maintain this derivative action, as the Ostensons were no longer members of Pac Organic when they filed the derivative claims against the Holzman Parties.

The Holzman Parties do not dispute that the Bankruptcy Code, Title 11 of the United States Code, preempts all state *bankruptcy* laws under the Supremacy Clause of the United States Constitution. U.S. Const.

art. VI, cl. 2; *Int'l Shoe Co. v. Pinkus*, 278 U.S. 261, 265, 49 S. Ct. 108, 73 L. Ed. 318 (1929). How that basic principle of law applies in this situation, however, requires careful analysis, particularly in light of the maxim that Congress will not be presumed to preempt state law:

> The usual rule is that congressional intent to pre-empt will not be inferred lightly. Pre-emption must be either explicit, or compelled due to an unavoidable conflict between the state law and the federal law. Because we are reluctant to assume federal preemption, we noted that any analysis should begin with the basic assumption that Congress did not intend to displace state law.

Integrated Solutions, Inc. v. Serv. Support Specialties, Inc., 124 F.3d 487, 491 (3d Cir. 1997) (quotation marks and citation omitted). For the reasons that follow, neither of the statutes the Ostensons cite preempt Washington corporate law in this situation.

a. 11 U.S.C. § 365(e)(1) Does Not Apply Because Pac Organic's Operating Agreement Is Not Executory.

11 U.S.C. § 365(e)(1) provides that an executory contract "of the debtor may not be may not be terminated or modified, and any right or obligation under such contract or lease may not be terminated or modified, at any time after the commencement of the case solely because of a provision in such contract or lease that is conditioned on . . . the commencement of a case under this title . . . ." An executory contract is one "on which performance is due to some extent on both sides. Also, in

executory contracts the obligations of both parties are so far unperformed that the failure of either party to complete performance would constitute a material breach and thus excuse the performance of the other." *In re Wegner*, 839 F.2d 533, 536 (9th Cir. 1988) (citation omitted). Thus, if a contract is non-executory, a disassociation provision contained therein would be enforceable notwithstanding § 365(e)(1). *See In re Tsiaoushis*, 383 B.R. 616, 621 (Bankr. E.D. Va. 2007) *aff'd*, 1:07 CV 436, 2007 WL 2156162 (E.D. Va. July 19, 2007); *In re Capital Acquisitions & Mgmt. Corp.*, 341 B.R. 632, 637 (Bankr. N.D. Ill. 2006).

The Ostensons do not actually argue that Pac Organic's operating agreement, *see* Ex. P-26, is an executory contract, claiming that its disassociation provisions are unenforceable under § 365(e)(1) in any event. *See* Appellant's Br. at 29. As the cases cited above make clear, that position is simply wrong. Because Pac Organic's operating agreement is not an executory contract, § 365 does not apply.

First, this operating agreement does not place any definite, continuing obligations on the members. *See* Ex. P-26. While the member may be required to contribute additional capital "only if" the manager(s) approve the contribution, *id.* (¶ 3.4), such a speculative requirement is too remote to constitute the definite obligation of an executory contract, *e.g.*, *In re Tsiaoushis*, 383 B.R. at 619 (holding that such a contribution

requirement is too remote and speculative to constitute an executory contract). The Ostensons are not unconditionally required to contribute additional capital, nor have they argued that the condition was met in this instance. Absent any continuing obligation to perform under the operating agreement such that failure to do so is material breach of contract, the Pac Organic operating agreement is not executory, and § 365(e)(1) does not apply.

Second, the Ostensons did not list the operating agreement as an executory agreement in their reorganization plan. *See* Ex. D-5 (Article 16 of Reorganization Plan). The plan further states that the Ostensons do not have any executory contracts save for contracts with G&P Orchard Leasing. *Id.* The Ostensons' own plan of reorganization contradicts their position in this litigation, thoroughly discrediting this essentially unbriefed argument. Section 365(e)(1) does not alter the operations of Washington law (specifically RCW 25.15.130(1)) that disassociate a member upon that member's filing for bankruptcy protection.[6]

---

[6] Even if § 365(e)(1) did apply, § 365(e)(2) upholds the disassociation provisions of Washington law. This subsection states that § 365(e)(1) does not apply if "applicable law excuses a party, other than the debtor, to such contract or lease from accepting performance from or rendering performance to the trustee or to an assignee of such contract." § 365(e)(2); *see also In re Warner*, 480 B.R. 641, 650 (Bankr. N.D.W. Va. 2012) ("Section 365(e)(2) allows non-debtor parties to enforce transfer restrictions contained in an executory contract against a trustee and to excuse them from accepting or rendering performance to the trustee."); § 365(c)(1) (containing a similar limitation on the trustee's ability to assume executor contracts).

b. 11 U.S.C. § 541(c)(1) Does Not Apply Because All of the Ostensons' Property Interests in Pac Organic Became Part of Their Estate.

When a petition for bankruptcy is filed, a bankruptcy estate is created by operation of law. 11 U.S.C. § 541(a). With certain exceptions, the estate consists of all of the debtor's property, as defined by state law, at that time. § 541(a)(1). Further, the Code overrides state law or contractual provisions that restrict the transfer of assets to the estate or that work to forfeit, modify, or terminate the debtor's interest. § 541(c)(1). The Ostensons argue this last provision preempts Washington corporate law and preserved their status as members of Pac Organic with the authority to pursue a derivative action on its behalf. For the reasons that follow, this conclusion is erroneous.

A bedrock rule of bankruptcy is that state law defines a debtor's property interests:

> Property interests are created and defined by state law. Unless some federal interest requires a different result, there is no reason why such interests should be analyzed differently simply because an interested party is involved in

---

RCW 25.15.130(1) and 25.15.250(1) provide the non-debtor members of a LLC with authority to refuse consent to the membership status of an assignee of a member's interest. *Cf. In re DeLuca*, 194 B.R. 65, 78 (Bankr. E.D. Va. 1996) ("Consequently, the court concludes that the provisions of the operating agreement that provide for the dissolution of the company upon a member's bankruptcy filing, with the remaining members having the right to elect to continue the business and to elect a new manager, fall within the exception of § 365(e)(2) and accordingly are not invalid 'ipso facto' provisions under § 365(e)(1)."); *Sumlin Const. Co., L.L.C. v. Taylor*, 850 So.2d 303, 312 (Ala. 2002).

> a bankruptcy proceeding. Uniform treatment of property interests by both state and federal courts within a State serves to reduce uncertainty, to discourage forum shopping, and to prevent a party from receiving a windfall merely by reason of the happenstance of bankruptcy.

Butner v. United States, 440 U.S. 48, 55, 99 S. Ct. 914, 59 L. Ed. 2d 136 (1979) (quotation marks omitted). After state law defines the property interests, federal law determines whether that interest is included in the bankruptcy estate. *See* 11 U.S.C. § 541(a)(1). But federal law does not broaden or expand the debtor's interest in his property. *In re Farmers Markets, Inc.*, 792 F.2d 1400, 1402 (9th Cir. 1986).

Thus, under RCW 25.15.130(1), the Ostensons were disassociated from Pac Organic upon filing for bankruptcy and no longer had standing, as of that moment, to pursue a derivative claim. Various bankruptcy courts have upheld this position, most notably in *In re Garrison-Ashburn, L.C.*, 253 B.R. 700 (Bankr. E.D. Va. 2000). There, the member of an LLC filed for bankruptcy and then sought to execute a real estate contract on behalf of the LLC. 253 B.R. 704. The other member disputed the bankrupt member's right to bind the LLC, noting that under Virginia law a member is disassociated upon filing for bankruptcy. *Id.* at 707. Thus, the bankrupt member retained his economic interest in the LLC to share in the profits and losses, but could not longer participate in management. *Id.* The court held that § 541(c)(1) did not change the analysis:

> This result does not offend the Congressional intention behind Sections 541(c) and 365(c) and (e). These provisions were intended to expand the bankruptcy estate to the maximum feasible extent and to prevent the loss of valuable assets by the operation of *ipso facto* clauses that terminate valuable leases and other rights upon bankruptcy. Here the estate received the entire interest of the debtor in Garrison–Woods including its burdens and restrictions. The economic interest, that is the membership interest, remains in the estate and is available for the benefit of creditors. The enforcement of Chapman's statutory dissociation does not cause a forfeiture of those rights or impair the legal capacity of the company to continue in business.

Id. at 709; *see also In re W. Asbestos Co.*, 313 B.R. 832, 844 (Bankr. N.D. Cal. 2003) ("The Court views the meaning of 'property,' as used in 11 U.S.C. § 541(c)(1)(B), as something that may be sold or collected to generate funds to be distributed funds to creditors.").

Other cases are to the same effect. *See, e.g.*, *In re Albright*, 291 B.R. 538, 541 n.7 (Bankr. D. Colo. 2003) ("Where a single member files bankruptcy while the other members of a multi-member LLC do not, and where the non-debtor members do not consent to a substitute member status for a member interest transferee, the bankruptcy estate is only entitled to receive the share of profits or other compensation by way of income and the return of the contributions to which that member would otherwise be entitled."); *In re A-Z Electronics, LLC*, 350 B.R. 886, 890 n.12 (Bankr. D. Idaho 2006) (citing *In re Albright* with approval); *Fotouhi v. Mansdorf*, 427 B.R. 798, 802 (N.D. Cal. 2010) (partner disassociated

upon filing for bankruptcy); *Milford Power Co., LLC v. PDC Milford Power, LLC*, 866 A.2d 738, 759-61 (Del. Ch. 2004) (holding that neither §§ 365 nor 541 preempted state law provisions that deprive bankrupt members of governance rights).

For the contrary position, the Ostensons cite primarily to *In re Daugherty Const., Inc.*, 188 B.R. 607 (Bankr. D. Neb. 1995), a case that is distinguishable. In *Daugherty*, upon one member filing for bankruptcy, the LLC dissolved; that is, under Nebraska law, the bankruptcy filing terminated the LLC. 118 B.R. at 611. As a result, the member's interest itself terminated. *Id.* at 609-10. By contrast here, neither the Ostensons nor the Holzman Parties have ever suggested that Pac Organic was somehow dissolved when the Ostensons filed for bankruptcy. Nor does RCW 25.15.130(1)(d) suggest that the Ostensons' interests in Pac Organic were thereby terminated.

In the context of the rather harsh operations of Nebraska law—which are very different from Washington law—the *Daugherty* court concluded that § 541(c)(1) preempted the state law. 118 B.R. at 611. The court then went on to find that the operating agreement was an executory contract because the one member was obligated to provide additional capital an the other was obligated to provide services. *Id.* at 612. As argued above, Pac Organic's operating agreement places no such

obligations upon the Ostensons—who do not argue to the contrary—rendering *Daugherty* of dubious value in analogizing to this case. The two are completely different.

Another case the Ostensons cite is *In re Warner*, 480 B.R. 641 (Bankr. N.D.W. Va. 2012), which, like *Daughterty*, considered the provision of an operating agreement under which the company dissolved when a member filed for bankruptcy, unlike the agreement here. 480 B.R. at 655. The court determined that § 541(c)(1) invalidated that provision. *Id.* Significantly, in addressing the interplay between §§ 365 and 541, the court noted: "The court is presently reluctant to embrace the concept that if § 365 is inapplicable then § 541(c)(1) 'acts to render . . . [state and contract] restrictions and conditions unenforceable as against the Trustee." *Id.* at 649 n.5. The court continued: "Section 541(c)(1) does not define the bundle of rights that go with property or invalidate provisions that provide the parameters on which a trustee can sell a debtor's interest in property." *Id.* The section "is a provision of general application," merely invaliding "restrictions on the transfer of property of to the estate." *Id.*

The *Warner* court thus notes a tension between the two sections if interpreted as the Ostensons demand. As argued above, §§ 365(c)(1) and (e)(2), in tandem with Washington law, allow non-bankrupt members of an LLC to refuse to grant membership status to an assignee, including the

trustee in bankruptcy. If § 541(c)(1) nevertheless includes as property rights in the bankruptcy estate, it renders the other two provisions superfluous and, in fact, writes them out of the statute. The better interpretation, as recognized by *Garrison-Ashburn*, recognizes that state law defines what the debtor's interests are, including disassociation, then § 541 brings them into the estate, burdened by whatever state law requires. Once in the estate, § 365 applies to determine what may be done with executory contracts, should the particular operating agreement fall into that category.

One final note: none of these cases addresses the particular circumstance here. There is no dispute regarding the management rights of Pac Organic. There is no dispute that the Ostensons retain the full economic rights of their interest in Pac Organic. What is at issue is the Ostensons' right to bring a derivative action on behalf of Pac Organic, a right that necessarily benefits someone other than the Ostensons. Under § 541(b)(1), the debtor's bankruptcy estate specifically does not include "any power that the debtor may exercise solely for the benefit of an entity other than the debtor," which, by definition, includes a derivative claim, whose sole purpose is to benefit the entity. *See* Section D, *infra*. Because the Ostensons' bankruptcy estate, which is the plaintiff in this case, does

not possess this authority to bring a derivative claim, the trial court properly dismissed that cause of action.

All of these provisions add up to the conclusion that state law burdens, including disassociation, define the Ostensons' property interest, which was then included in their bankruptcy estate. The Ostensons' preemption arguments to the contrary are meritless. As the Ostensons were disassociated from Pac Organic under Washington law, they do not possess the right to maintain a derivative claim on behalf of Pac Organic. This Court should affirm the trial court's dismissal of that cause of action and refusal to reconsider its decision.

3. The Stipulation Does Not Evidence the Holzman Parties' Consent to the Ostensons' Continued Status as Members of Pac Organic.

The Ostensons' primary argument challenging the trial court's order granting the CR 41(b)(3) motion—as opposed to the order denying the motion for reconsideration—is that the Stipulation served as the Holzman Parties' consent to the continued membership of the Ostensons in Pac Organic, thus satisfying the requirements of RCW 25.15.130(d). But as the trial court ruled, the Stipulation is silent on the issue and cannot be construed as that consent.

The trial court's unchallenged findings of fact state:

> There is no language in the Stipulation which preserves the Ostensons' status as members of Pac O. The Stipulation contains no language whereby Pac O or the Holzman Defendants, as signatories to that document, consented to relieve the Ostensons from the effects of the dissociation from Pac O which resulted under RCW § 25.15.130(1)(d) when they filed for bankruptcy, or which authorized the Ostensons derivatively to assert any claims against the Holzman Defendants on Pac O's behalf.

CP 2046 (¶ 5). Nor is it surprising that the Ostensons chose not to challenge this finding. The plain language of the Stipulation confirms this finding, CP 1807-09, as it speaks only of claims of Pac Organic, not of the Ostensons: "This Stipulation does not affect or release the following claims: . . . Any purported claims of Pac-O (and Pac-O only) against Holzman, GHI, POP, and/or Total Organic for their alleged failure to pay packing fees, expenses, and revenues earned solely by Pac-O or fruit proceeds or rent due Pac-O or for conversion of assets of Pac-O." CP 1808.

If the parties had intended to negate the normal workings of Washington law, one would expect to see explicit mention of the substance of that consent. For example, the Stipulation should discuss the default disassociation under RCW 25.15.130 and the parties' intent to contrary. It doesn't. Next, the Stipulation should recite GHI's (as Pac Organic's only other member) explicit consent to the Ostenstons'

bankruptcy, as the statute's plain languages indicates.[7] It doesn't. Also, the Stipulation should state that the Ostensons retain the right to assert a derivative claim against the Holzman Parties on behalf of Pac Organic, notwithstanding the disassociation accomplished by state law. Again, it doesn't. The Stipulation says nothing whatsoever about any of these matters because it is not the written consent contemplated by the statute.

Rather, the Stipulation preserves the right of the Ostensons to pursue claims against Pac Organic, but specifically does not allow them to assert claim "derivatively or directly (including by way of veil-piercing or similar theory) against Holzman, GHI or POP, such purported claims to be released." CP 1808. It also preserves the right of Pac Organic (and only Pac Organic) to assert limited claims against the Holzman Parties. Finally and most importantly, the Stipulation operates as a full and final release between the Ostensons and the Holzman Parties of all claims not specifically exempted. CP 1808 (¶ 5). The trial court was correct to conclude that the Stipulation "simply does not address the question" of the Holzman Parties' consent to the Ostensons' bankruptcy sufficient to override the disassociation accomplished under state law. CP 2048.

---

[7] *See* RCW 25.15.130(1) ("A person ceases to be a member of a limited liability company . . . upon the occurrence of one or more of the following events: . . . unless . . . *with the written consent of all other members at the time*, the member . . . files a voluntary petition in bankruptcy . . . ." (emphasis added)). The statute requires the member to file bankruptcy "with" the other members' written consent. The Ostensons certainly did not file bankruptcy with the written consent of the Holzman Parties.

In response, the Ostensons simply assert the Stipulation serves as the Holzman Parties' consent to a derivative action. Beyond this unsupported assertion, their argument is hard to follow. Appellant's Br. at 34-35. It is true that the Holzman Parties did not believe Pac Organic had any valid claims against them. But the Ostensons do not show how this fact proves GHI consented to their continued membership in Pac Organic and their ability to assert derivative claims. Nor can they, as any such consent must, per the statute, be in writing, and no language in the Stipulation evidences that intent.

Beyond this non sequitur, the Ostensons suggest that apart from their prosecution of a derivative claim, the claims of Pac Organic against the Holzman Parties would never be asserted and the Stipulation must be construed to avoid this result. Of course, this simply is not true. Not only could the Ostensons put Pac Organic in bankruptcy, wherein the trustee could pursue whatever claims of Pac Organic that had merit, the Ostensons could seek the appointment of a receiver (under RCW ch. 7.60) to take control of Pac Organic for the same purpose. Either course would protect the rights of Pac Organic, but they would deprive the Ostensons of control. The Ostensons want this control, largely because it allows them to circumvent the Stipulations release of direct claims against the Holzman Parties and seek direct recovery for themselves. Clearly, the Holzman

Parties thought such claims were released and would never have agreed to the Ostensons' ability to recover indirectly what they had directly released.

As the trial court correctly determined, the Stipulation says nothing whatsoever about the Holzman Parties' consenting to the Ostensons' bankruptcy, continued membership in Pac Organic, or authority to assert derivative claims. This Court should affirm.

C. The Ostensons' Trio of Estoppel Arguments Is Meritless.

The Ostensons finish with a set of arguments premised on various estoppel theories, all of which are entirely meritless. Their basic argument—common to all three theories—is as follows: (1) the Stipulation permits the Ostensons to assert these derivative claims on behalf of Pac Organic; (2) the Holzman Parties so agreed; and (3) the bankruptcy court approved the Stipulation, so any position taken by the Holzman Parties in this litigation to the contrary is estopped. While the bankruptcy court did approve the Stipulation, that document does not permit the Ostensons to bring derivative claims, nor did the Holzman Parties so consent.

In essence, these estoppel arguments assume the Ostensons' interpretation of the Stipulation is correct. To the contrary, as argued above and as determined by the trial court, their position is wrong. If the Ostensons were correct regarding the Stipulation—but they are not—they

win on that basis, and the estoppel arguments are entirely superfluous. If the Ostensons are wrong—and they are—these arguments make no sense. Each specific argument is addressed in turn.

1. The Holzman Parties Are Not Judicially Estopped.

Judicial estoppel prevents a party from taking one position in court, then taking an inconsistent position in a subsequent case. *Johnson v. Si-Cor Inc.*, 107 Wn. App. 902, 906, 28 P.3d 832 (2001) ("The purposes of the doctrine are to preserve respect for judicial proceedings . . . and to avoid inconsistency, duplicity, and the waste of time."). To prevail on a judicial estoppel argument, the proponent must prove the following factors:

> (1) The inconsistent position first asserted must have been successfully maintained;
> (2) a judgment must have been rendered;
> (3) the positions must be clearly inconsistent;
> (4) the parties and questions must be the same;
> (5) the party claiming estoppel must have been misled and have changed his position;
> (6) it must appear unjust to one party to permit the other to change.

Id. (quoting *Markley v. Markley*, 31 Wn.2d 605, 614-15, 198 P.2d 486 (1948)). Under these factors, the Ostensons cannot prove they are entitled to relief.

First and foremost, the Holzman Parties have never taken the position that Ostensons were permitted to file derivative claims on behalf

of Pac Organic. Indeed, they have consistently taken the opposite position. As argued, the Stipulation itself is silent on the issue. Further, the Holzman Parties filed a motion in the bankruptcy court to define the extent of the bankruptcy estate, raising the disassociation issues under Washington law. CP 2267-71, 2279-95. The Ostensons, however opposed the motion and argued that issue should be decided by the trial court in this action. CP 2299-2300, 2320-21. The Holzman Parties acquiesced, and the issue was raised and decided in the trial court below.

Next, as noted, the bankruptcy court did not decide the issue, rendering it impossible that the Holzman Parties "successfully" maintained their position and that a "judgment" was entered. In fact, the Holzman Parties never sought any ruling in the bankruptcy court regarding the Stipulation; the Ostensons did, as the Stipulation was not binding without court approval. *See* Defendants' Ex. 5; *see also Skinner v. Holgate*, 141 Wn. App. 840, 848, 173 P.3d 300 (2007) (noting that one of the elements of judicial estoppel is the requirement that a "party successfully persuaded a court to accept the party's earlier position"). The bankruptcy court's approval of the Stipulation did not address the disassociation issue nor the authority of the Ostensons to assert derivative claims, Defendants' Ex. 5, serving simply as the approval required under the bankruptcy rules for the Ostensons to enter such an agreement. *See*

Fed. R. Bankr. P. 9019. This order hardly constitutes a decision on the merits.

Nor could the Ostensons have been misled, given the Holzman Parties' consistent position on the matter. And justice is hardly preserved by preventing the Holzman Parties from continuing in their constantly held position. Indeed, justice would be thwarted by a contrary ruling. The doctrine of judicial estoppel simply does not apply to these facts.

2. The Holzman Parties Are Not Collaterally Estopped.

Much of the same can be said in response to the Ostensons' collateral estoppel argument. This doctrine prevents parties from relitigating issues that were previously decided on the merits, requiring proof of four elements:

> (1) identical issues; (2) a final judgment on the merits; (3) the party against whom the plea is asserted must have been a party to or in privity with a party to the prior adjudication; and (4) application of the doctrine must not work an injustice on the party against whom the doctrine is to be applied.

Hadley v. Maxwell, 144 Wn.2d 306, 311, 27 P.3d 600 (2001); *see also Clark v. Baines*, 150 Wn.2d 905, 913, 84 P.3d 245 (2004) ("The determination of whether application of collateral estoppel will work an injustice on the party against whom the doctrine is asserted—the fourth element—depends primarily on whether the parties to the earlier

proceeding received a full and fair hearing on the issue in question." (quotation marks omitted)).

The fatal flaw in the Ostensons' position is that the disassociation issue was never decided in the bankruptcy court. For the reasons stated above, the Stipulation does not address the issue, and the bankruptcy court never addressed the issue. Indeed, the trial court in this litigation decided the issue only because the Holzman Parties acquiesced in the Ostensons' request to transfer the issue here. For the Ostensons to then argue a contrary position is simply incredible. Collateral estoppel does not bar the Holzman Parties in any way.

3. The Holzman Parties Are Not Barred by Res Judicata.

Like collateral estoppel, "res judicata applies to what has been decided." *Hilltop Terrace Homeowner's Ass'n v. Island Cnty.*, 126 Wn.2d 22, 32, 891 P.2d 29 (1995). For the same reasons given above, namely, that nothing was previously decided on this issue, res judicata has no application to this case.

To conclude, the Ostensons' estoppel arguments assume their interpretation of the Stipulation is correct and seek to bind the Holzman Parties to that interpretation when it was rejected by the trial court and not decided by the bankruptcy court. For such actions to have preclusive effect distorts these doctrines beyond recognition. The trial court decided

the disassociation issue *because the Ostensons wanted it to do so*, having taken that position in the bankruptcy court. For them to argue a different position once back in state court implicates the very doctrines the Ostensons seek to use against the Holzman Parties. The Court should reject the Ostensons' estoppel arguments as meritless.

D. The Court May Also Affirm Because the Ostensons' Derivative Claim Is Really a Direct Claim Against the Holzman Parties, All of Which the Ostensons Released in the Stipulation.

An appellate court can affirm the trial court for any reason supported by the record. *E.g.*, *In re Estate of Black*, 116 Wn. App. 476, 483, 66 P.3d 670 (2003) *aff'd on other grounds,* 153 Wn.2d 152, 102 P.3d 796 (2004); *Hendrickson v. King Cnty.*, 101 Wn. App. 258, 266, 2 P.3d 1006 (2000). In this case, the Ostensons are asserting a number of direct claims against Pac Organic, and a single derivative supposedly on behalf of Pac Organic against the Holzman Parties. Thus, the Ostensons seek to recover personally from the Holzman Parties even though they released these claims in the Stipulation. The Holzman Parties addressed this argument to the trial court, CP 1752-54, 1850-54, 1998-2000, and it provides a separate basis to affirm.

The law forbids any attempt to disguise direct claims as derivative claims. Courts have used two basic paradigms for defining claims as either direct or derivative: the first method looks for a special duty owed

to the shareholder or a special injury suffered by the shareholder and confers standing on the shareholder to assert direct claims in either instance. *See e.g.*, *Sabey v. Howard Johnson & Co.*, 101 Wn. App. 575, 584, 5 P.3d 730 (2000). Another method looks at who suffered the alleged harm and who benefits from the recovery. *See Tooley v. Donaldson, Lufkin & Jenrette, Inc.*, 845 A.2d 1031, 1033 (Del. 2004). In this case, it is not important to parse the nuances of these approaches, as either leads to the same conclusion: the Ostensons' purported derivative claim against the Holzman Parties is really a direct claim.

In the Stipulation, the Ostensons released all claims they had against the Holzman Parties, including any veil-piercing claims. Ex. D-5 (Stipulation ¶¶ 5, 7(a)). But the Ostensons have attempted to subvert this release by pleading a two-step recovery, nominally asserting claims on behalf of Pac Organic against the Holzman Parties but seeking in reality to benefit themselves. The report of their expert, Paul Fruci, makes this point clear. In his report, Mr. Fruci opined that "the damages sustained by the *Ostensons* caused by [Greg] *Holzman* total $1,206,493.04." Ex. P-18 at 4 (emphases added). At trial, Mr. Fruci confirmed that the Ostensons were personally owed this money: "Q: So your – opinion here [in your report] is that from a damages perspective, the Ostensons are owed – personally – are owed $1.2 million. A: Yes." RP 467. In other words, the

Ostensons are seeking to recover for their own benefit, not for Pac Organic. These are direct claims, not derivative, as Pac Organic, an essentially defunct entity with no hard assets, will not benefit at all. But the Ostensons released their direct claims against the Holzman Parties, necessitating dismissal of their supposed derivative claim. The Court can affirm on this basis as well.

E. The Court Should Deny the Ostensons' Request for Attorney Fees.

The Ostensons close their brief with a one-sentence request for attorney fees, citing only RAP 18.1. They cite to no applicable law justifying an award of fees. A bald request for fees without argument and citation to authority is not sufficient. *Wilson Court Ltd. P'ship v. Tony Maroni's, Inc.*, 134 Wn.2d 692, 710 n.4, 952 P.2d 590 (1998); *Blueberry Place Homeowners Ass'n v. Northward Homes, Inc.*, 126 Wn. App. 352, 363 n.12, 110 P.3d 1145 (2005); *Austin v. U.S. Bank of Wash.*, 73 Wn. App. 293, 313, 869 P.2d 404 (1994); *Thweatt v. Hommel*, 67 Wn. App. 135, 148, 834 P.2d 1058 (1992) ("RAP 18.1(b) requires more than a bald request for attorney fees on appeal. Where there is any issue whatsoever as to a party's entitlement to attorney fees, the failure to argue the issue requires us to deny the request, at least insofar as the appeal is concerned."). The Court should deny the Ostensons' request.

V. CONCLUSION

For the reasons stated, the Holzman Parties respectfully ask the Court to affirm the trial court's judgment dismissing the Ostensons' derivative claim.

Dated this 9th day of September, 2013.

LAW OFFICES OF DALE M. FOREMAN, P.S.

Daniel J. Appel, WSBA #35544
Attorneys for Respondents

CERTIFICATE OF SERVICE

I hereby declare under penalty of perjury of the laws of the State of Washington that I am over the age of eighteen and not a party to this action, and that on September 9, 2013, I served a true and correct copy of the foregoing document as indicated below:

(By U.S. Mail and by Email)
Maris Baltins
Law Offices of Maris Baltins, P.S.
7 South Howard, Suite 220
Spokane, WA 99201
mbaltins@baltinslaw.com

Dated this 9th day of September, 2013.

Daniel Appel

APPENDIX A
Text of Relevant Statutes

11 U.S.C. § 365 (portions)

(c) The trustee may not assume or assign any executory contract or unexpired lease of the debtor, whether or not such contract or lease prohibits or restricts assignment of rights or delegation of duties, if—

(1)

(A) applicable law excuses a party, other than the debtor, to such contract or lease from accepting performance from or rendering performance to an entity other than the debtor or the debtor in possession, whether or not such contract or lease prohibits or restricts assignment of rights or delegation of duties; and

(B) such party does not consent to such assumption or assignment . . . .

(e)

(1) Notwithstanding a provision in an executory contract or unexpired lease, or in applicable law, an executory contract or unexpired lease of the debtor may not be terminated or modified, and any right or obligation under such contract or lease may not be terminated or modified, at any time after the commencement of the case solely because of a provision in such contract or lease that is conditioned on—

(A) the insolvency or financial condition of the debtor at any time before the closing of the case;

(B) the commencement of a case under this title; or

(C) the appointment of or taking possession by a trustee in a case under this title or a custodian before such commencement.

(2) Paragraph (1) of this subsection does not apply to an executory contract or unexpired lease of the debtor, whether or not such contract or lease prohibits or restricts assignment of rights or delegation of duties, if—

(A)

(i) applicable law excuses a party, other than the debtor, to such contract or lease from accepting performance from or rendering performance to the trustee or to an assignee of such contract or lease, whether or not such contract or lease prohibits or restricts assignment of rights or delegation of duties; and

(ii) such party does not consent to such assumption or assignment; or

(B) such contract is a contract to make a loan, or extend other debt financing or financial accommodations, to or for the benefit of the debtor, or to issue a security of the debtor.

11 U.S.C. § 541 (portions)

(a) The commencement of a case under section 301, 302, or 303 of this title creates an estate. Such estate is comprised of all the following property, wherever located and by whomever held:

(1) Except as provided in subsections (b) and (c)(2) of this section, all legal or equitable interests of the debtor in property as of the commencement of the case.

. . . .

(b) Property of the estate does not include—

(1) any power that the debtor may exercise solely for the benefit of an entity other than the debtor;

. . . .

(c)

(1) Except as provided in paragraph (2) of this subsection, an interest of the debtor in property becomes property of the estate under subsection (a)(1), (a)(2), or (a)(5) of this section notwithstanding any provision in an agreement, transfer instrument, or applicable nonbankruptcy law—

(A) that restricts or conditions transfer of such interest by the debtor; or

(B) that is conditioned on the insolvency or financial condition of the debtor, on the commencement of a case under this title, or on the appointment of or taking possession by a trustee in a case under this title or a custodian before such commencement, and that effects or gives an option to effect a forfeiture, modification, or termination of the debtor's interest in property.

RCW 25.15.130 (portions)

(1) A person ceases to be a member of a limited liability company, and the person or its successor in interest attains the status of an assignee as set forth in RCW 25.15.250(2), upon the occurrence of one or more of the following events: . . .

> (d) Unless otherwise provided in the limited liability company agreement, or with the written consent of all other members at the time, the member (i) makes a general assignment for the benefit of creditors; (ii) files a voluntary petition in bankruptcy . . . .

RCW 25.15.250 (portions)

(1) A limited liability company interest is assignable in whole or in part except as provided in a limited liability company agreement. The assignee of a member's limited liability company interest shall have no right to participate in the management of the business and affairs of a limited liability company except:

> (a) Upon the approval of all of the members of the limited liability company other than the member assigning his or her limited liability company interest; or
> (b) As provided in a limited liability company agreement.

(2) Unless otherwise provided in a limited liability company agreement:

> (a) An assignment entitles the assignee to share in such profits and losses, to receive such distributions, and to receive such allocation of income, gain, loss, deduction, or credit or similar item to which the assignor was entitled, to the extent assigned; and
> (b) A member ceases to be a member and to have the power to exercise any rights or powers of a member upon assignment of all of his or her limited liability company interest.

RCW 25.15.370

A member may bring an action in the superior courts in the right of a limited liability company to recover a judgment in its favor if managers or members with authority to do so have refused to bring the action or if an effort to cause those managers or members to bring the action is not likely to succeed.

RCW 25.15.375

In a derivative action, the plaintiff must be a member at the time of bringing the action and:

(1) At the time of the transaction of which the plaintiff complains; or

(2) The plaintiff's status as a member had devolved upon him or her by operation of law or pursuant to the terms of a limited liability company agreement from a person who was a member at the time of the transaction.