

APR 03 2015

Ronald R. Carpenter
Clerk

SUPREME COURT NO. 90891-5
(COURT OF APPEALS, DIVISION III, NO. 31491-0)

SUPREME COURT OF THE STATE OF WASHINGTON

NORTHWEST WHOLESALE, INC., a Washington corporation,

Plaintiff,

vs.

PAC-O 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, as members of
PAC-O FRUIT, LLC a Washington limited liability company,

Petitioner,

vs.

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

Respondents.

PETITIONERS' SUPPLEMENTAL BRIEF

MARIS BALTINS
LAW OFFICES OF MARIS BALTINS, P.S.
Attorneys for Appellants
7 S. Howard St., Suite 220
Spokane, WA 99201
Telephone: (509) 444-3336

TABLE OF CONTENTS

	Page
I. INTRODUCTION	1
II. PERTINENT FACTS	1
III. ARGUMENT	3
A. When the Ostensons Filed Their Chapter 11 Bankruptcy Petition, 11 U.S.C. § 541(c) Preempted the Dissociation Provisions of RCW 25.15.130(1)(d)(ii)	3
B. The <i>Ipsa Facto</i> Provisions of the Pac-O Operating Agreement are Preempted Under 11 U.S.C. 365(e)(1).....	14
IV. CONCLUSION	20

TABLE OF AUTHORITIES

CASES	Page(s)
<u>Biltmore Assocs., LLC v. Twin City Fire Ins. Co.</u> , 572 F.3d 663 (9 th Cir. 2009)	18
<u>Finkelstein v. Securities Properties, Inc.</u> , 76 Wn.App. 733, 888 P.2d 161 (1995)	3, 15, 16, 17
<u>In re Daugherty Construction, Inc.</u> , 188 B.R. 607 (Bankr. D. Neb. 1995)	8, 9
<u>In re Dixie Mgmt. & Inv. Ltd. Partners</u> , 474 B.R. 698 (Bankr. W.D. Ark. 2011)	8, 9
<u>In re Ehmann</u> , 319 BR 200 (D.Ariz. 2005)	8, 15
<u>In re Garrison-Ashburn, L.C.</u> , 253 B.R. 700 (Bankr. E.D. Va. 2000)	3, 4, 5, 6, 8
<u>In re JZ L.L.C.</u> , 371 B.R. 412 (BAP 9th Cir. 2007)	15
<u>In re Klingerman</u> , 388 B.R. 677 (E.D.N.C. 2008)	6, 8
<u>In re LaHood</u> , 437 B.R. 330 (Bankr. C.D. Ill. 2010)	7
<u>In re Warner</u> , 480 B.R. 641 (Bankr. N.D. W.Va. 2012)	9, 10, 11

<u>In re Yonikus,</u> 996 F.2d 866 (7 th Cir. 1993)	10
<u>NLRB v. Bildisco & Bildisco,</u> 465 U.S. 513, 104 S. Ct. 1188, 79 L. Ed. 2d 482 (1984)	17, 18
<u>Nw. Wholesale, Inc. v. Pac Organic Fruit, LLC,</u> 183 Wn. App. 459, 334 P.3d 63 (2014)	2, 4, 14, 15, 16, 17
<u>In re Va. Broadband, LLC,</u> 498 B.R. 90, (Bankr. W.D. Va. 2013)	11, 12, 13

CONSTITUTION, STATUTES AND RULES	Page(s)
Title 11 U.S.C.	3
11 U.S.C. § 365	15, 16
11 U.S.C. § 365(a)	14
11 U.S.C. § 365(c)	14, 18, 20
11 U.S.C. § 365(e)	14, 18, 20
11 U.S.C § 541	5, 6,
11 U.S.C § 541(a)	3, 7, 14
11 U.S.C § 541(c)	3, 6, 7, 8, 9, 10, 14
11 U.S.C § 1101	17
RCW 25.15.130	1, 2, 3
RCW 25.15.375	2
RAP 13.7(d)	1

I. INTRODUCTION.

Pursuant to RAP 13.7(d), Appellants Harold Ostenson and Shirley Ostenson (hereinafter collectively referred to as “Ostensons”), submit this Supplemental Brief to provide additional points and authorities on whether Appellants became dissociated as members of Pac Organic Fruit, LLC (“Pac-O”) as a result of their bankruptcy filing under RCW 25.15.130 or the Pac-O Operating Agreement.¹

II. PERTINENT FACTS.

Since May 29, 1998, Mr. and Mrs. Ostenson have been members of Pac-O, a Washington limited liability company, in which they owned a 49% interest. The remaining 51% is owned by GHI, a corporation owned by Mr. Holzman. Plaintiffs’ Exhibit (“Ex P-”) 25, P-26. On January 9, 2007, Mr. and Mrs. Ostenson filed a Chapter 11 Bankruptcy Petition in the United States Bankruptcy Court for the Eastern District of Washington. Defendants’ Exhibit (“Ex D-”) 5² (Voluntary Petition). While in

¹ The Respondents, Greg Holzman, Greg Holzman, Inc. (“GHI”) and Total Organic LLC (“Total Organic”) are collectively referred to herein as “Holzman.”

² Ex D-5 consists of four separate documents: (1) Order Approving Compromise Settlement and Shortening Time to Object (“Order”); (2) Amendment to Debtor’s First Amended Plan of Reorganization (“Amendment”); (3) Chapter 11 Voluntary Petition (“Voluntary Petition”); and (4) First Amended Plan of Reorganization (“Amended Plan”). The Stipulation is attached to items 1 and 2.

bankruptcy, Mr. and Mrs. Ostenson, Holzman and Pa-O entered into a Stipulation which preserved, *inter alia*, causes of action held by Pac-O against Holzman. The Stipulation was approved by the Bankruptcy Court and incorporated into the Ostensons' Amended Plan of Reorganization on August 18, 2008. Ex D-5 (Order and Amendment). Pursuant to the Stipulation, on July 25, 2009, Ms. and Mrs. Ostenson filed their Crossclaims and Third Party Complaint ("Complaint") against Holzman in Chelan County Superior Court. CP 35-53. The Complaint included a derivative claim by Pac-O against Holzman.

On October 3, 2012, the trial court dismissed the derivative claim on the grounds that, as a result of their bankruptcy filing, Mr. and Mrs. Ostenson were dissociated as members of Pac-O pursuant to RCW 25.15.130(1)(d)(ii), and therefore lacked standing to pursue the derivative action under RCW 25.15.370 and RCW 25.15.375(1). CP 2043-2051.

Mr. and Mrs. Ostenson sought review of the dismissal by the Court of Appeals, Division III. CP 2405-2422. On September 4, 2014, the Court of Appeals issued its Opinion affirming the dismissal.³

³ Nw. Wholesale, Inc. v. Pac Organic Fruit, LLC, 183 Wn. App. 459, 334 P.3d 63 (2014).

III. ARGUMENT.

A. When the Ostensons Filed Their Chapter 11 Bankruptcy Petition, 11 U.S.C. § 541(c) Preempted the Dissociation Provisions of RCW 25.15.130(1)(d)(ii).

Under the Bankruptcy Code (Title 11, U.S.C.), the commencement of a bankruptcy case creates an estate comprised of “all legal or equitable interests of the debtor in property as of the commencement of the case.” 11 U.S.C. § 541(a)(1). The extent of the debtor’s property cannot be restricted or limited by any “agreement transfer instrument, or applicable nonbankruptcy law ... that is conditioned on the insolvency or financial condition of the debtor, on the commencement of a case under [the Bankruptcy Code], ... and that effects or gives an option to effect a forfeiture, modification, or termination of the debtor's interest in property.” 11 U.S.C. § 541(c)(1).

In its Opinion, the Court of Appeals primarily relied on the cases In re Garrison-Ashburn, L.C., 253 B.R. 700 (Bankr. E.D. Va. 2000) and Finkelstein v. Securities Properties, Inc., 76 Wn.App. 733, 888 P.2d 161 (1995) to support the proposition that the dissociation provisions of RCW 25.15.270 essentially trumps the mandate of 11 U.S.C. § 541 because dissociation of a member does not result in a dissolution of the limited liability company. Accordingly, the court of appeals reasoned that, while Mr. and Mrs. Ostenson lost their non-economic rights as members, their

economic rights to profits and losses and to receive distributions were unimpaired. However, because of the loss of these non-economic rights, Mr. and Mrs. Ostenson lacked standing to bring the derivative claim. Nw. Wholesale, Inc., id., at 484-485.

It is submitted that whether either dissociation or dissolution occurs is irrelevant. In either event, the effect would amount to nothing less than a “forfeiture, modification, or termination of the debtor's interest in property.” 11 U.S.C. § 541(c)(1). The Court of Appeals, in following the reasoning in In re Garrison-Ashburn, reached a result squarely prohibited by 11 U.S.C. § 541(c)(1).

In re Garrison-Ashburn involved the sale of two parcels of real property; one owned by the debtor, Garrison-Ashburn, LLC and the other by its sister company, Garrison-Woods, LLC. Craig Z. Comer and Stephen H. Chapman were the two principals of both companies. Sale of both properties were integral to the transaction. The bankruptcy court approved the sale of the properties but Chapman opposed the sale and contended that his approval was necessary to allow Garrison-Woods to enter into the sale. Id., at 702. In rejecting this contention, the Garrison-Ashburn court noted that Garrison-Woods, LLC was manager managed and that the operating agreement vested the officers (i.e., the manager and assistant manager), not the members, with authority to approve the sale of

the real property. *Id.*, at 703. Accordingly, because Comer was the only officer, authority to sell the property rested with him. *Id.*

Even if member approval was required, the bankruptcy court reasoned that because Chapman himself was in a Chapter 11 bankruptcy, under Virginia law, he had become dissociated as a member of Garrison-Woods, LLC and became an assignee, without the right to participate in the management and affairs of the company. *Id.*, at 704.

In applying the Virginia dissociation statute to the scope of the bankruptcy estate created under 11 U.S.C. §541, the bankruptcy court noted that:

Section 541(a) clearly encompasses all of Chapman's interest in Garrison-Woods, whatever that interest may be, whether economic or non-economic. ***Section 541(c)* makes plain that no restriction on the transfer of any interest of a debtor -- whether it arises from the operative documents themselves or from applicable nonbankruptcy law -- prevents an interest from becoming property of the estate. Chapman's interest in Garrison-Woods, both his membership interest and his non-economic rights and privileges as a member, became property of the bankruptcy estate.** All the rights and privileges Chapman had immediately prior to filing became property of his bankruptcy estate. Unless otherwise provided in the Bankruptcy Code, the rights and benefits were burdened with all of the duties and obligations that came with them.

Id., at 708. (italics in original; emphasis added).

It is submitted that this is a correct statement of law. However, notwithstanding the scope of 11 U.S.C. § 541(a), the bankruptcy court

ruled that Chapman was nevertheless dissociated as a member under Virginia law because of his bankruptcy. As a result, Chapman's bankruptcy estate only had the rights of an assignee. To the extent this conclusion resulted in a loss of Chapman's non-economic rights in Garrison-Woods, LLC as a result of his bankruptcy, it is clearly inapposite to the provisions of 11 U.S.C. § 541.

This aspect of In re Garrison-Ashburn has been subsequently criticized, distinguished and limited in subsequent bankruptcy cases. In In re Klingerman, 388 B.R. 677 (E.D.N.C. 2008), Steven D. Klingerman, in a Chapter 11 bankruptcy, sought judicial dissolution of a limited liability company in which he was a member. In opposition, the other member of the company, Bradley E. Parker, asserted that Klingerman, by declaring bankruptcy, had ceased to be a member and therefore had no standing under North Carolina law. Id., at 678. In analyzing this issue, the bankruptcy court considered the holding In re Garrison Ashburn regarding the effect of the state law dissociation provisions on the scope of 11 U.S.C. § 541. While agreeing with In re Garrison-Ashburn regarding the statement regarding 11 U.S.C. § 541(a), the bankruptcy court stated:

However, the court disagrees with the conclusion that debtor/member's bankruptcy estate only had the rights of an assignee. *Section 541(c)* provides that all of the debtor's interest passes to the estate notwithstanding applicable nonbankruptcy law that effects a modification or termination of the debtor's interest

upon the commencement of a bankruptcy case. *11 U.S.C. § 541(c)*. **Converting a debtor's membership interest to that of an assignee by operation of statute is a modification or termination of the interest that is rendered ineffective by § 541(c).**

Id., at 679 (italics in original; emphasis added).

In *In re LaHood*, 437 B.R. 330 (Bankr. C.D. Ill. 2010), Michael LaHood, a non-debtor member of FLLZ, LLC, sought to dissolve the company and distribute its assets notwithstanding a Chapter 7 bankruptcy filed by the remaining member, Richard LaHood. The Trustee challenged the propriety of the distribution as violating the automatic stay. Michael contended that the Trustee had only the rights of the debtor, and that Richard, by filing bankruptcy, had voluntarily transferred his interest to the bankruptcy estate in derogation of the notice and consent provisions of the operating agreement, rendering his dissociation wrongful and thereby relinquishing any right to participate in the dissolution and winding up of the company. *Id.*, at 333-334. The bankruptcy court rejected this position and Michael appealed the decision to the United States District Court.

In affirming the decision of the bankruptcy court, the District Court found persuasive the reasoning that 11 U.S.C. § 541(a)(1) creates an estate which includes “all of the debtor’s interest notwithstanding applicable non-bankruptcy law or contractual provisions effecting modification or termination of the debtor’s interest upon filing,”

specifically citing In re Daugherty Construction, Inc., 188 B.R. 607 (Bankr. D. Neb. 1995), In re Ehmann, 319 BR 200 (D.Ariz. 2005), In re Klingerman, id., and In re Garrison-Ashburn, id., for this proposition. 335-336. Accordingly, the District Court held that the provisions of the operating agreement limiting or restricting Michael's interest in FLLZ, LLC as a result of his filing for bankruptcy were unenforceable under 11 U.S.C. § 541(c). Id., at 336. It is significant that the District Court rationalized that the limitation in In re Garrison-Ashburn was based on readily distinguishable facts which involved preserving, as opposed to depriving, the estate of valuable assets in derogation of the Congressional intent underlying 11 U.S.C. § 541(c).⁴ Id.

In In re Dixie Mgmt. & Inv. Ltd. Partners, 474 B.R. 698 (Bankr. W.D. Ark. 2011), the debtor, a member of Moberly Investment Group, LLC ("MIG"), filed Chapter 11 bankruptcy. Two other members of MIG, Ralph Duncan and Lisa Cantrell filed a declaratory judgment complaint seeking a declaration that as a result of its bankruptcy, Dixie became dissociated as a member of MIG pursuant to the operating agreement and

⁴ 11 U.S.C. § 541(c) was promulgated to "invalidate restrictions on the transfer of property of the debtor, in order that all the interests of the debtor in property will become property of the estate." H.R. Rep. No. 595, 95th Cong. 1st Sess. 368-69 (1977).

Arkansas Code. Id., at 699-700. The bankruptcy court rejected the argument, finding:

At the time [Dixie] filed its bankruptcy petition, it owned a 62% membership interest in MIG. That interest, and any rights the debtor held under the OA, becomes property of the estate under § 541. *Daugherty Constr.*, 188 B.R. at 611; see also *Klingerman v. ExecuCorp, LLC (In re Klingerman)*, 388 B.R. 677, 679 (Bankr. E.D.N.C. 2008); *In re Garrison-Ashburn, L.C.*, 253 B.R. 700, 707 (Bankr. E.D. Va. 2000) ("There is no question that the economic rights, that is the membership interest, becomes property of the estate.").

Id., at 700.

To the extent either the MIG operating agreement or the Arkansas Code purported to dissociate Dixie as a result of its bankruptcy filing, the bankruptcy court held such provisions to be in contravention of 11 U.S.C. § 541(c)(1) and further, with respect to the Arkansas Code, unenforceable under the Supremacy Clause of the United States Constitution, Id., at 701, *citing In re Daugherty Construction, id.*

In re Warner, 480 B.R. 641 (Bankr. N.D. W.Va. 2012) involved a Chapter 7 bankruptcy filed by one of 12 members of McCoy Farm, LLC and the effort of the Trustee to recover the debtor's membership interests in the company which had previously been transferred to another member as security for a loan. Id., at 644-645. Under the terms of the operating agreement, bankruptcy of a member constituted an event of dissolution unless the remaining members unanimously agreed to continue the

company within 60 days. The non-debtor members contended that such an agreement had been reached and that the members had also agreed to dissociate the debtor so that he would have no right to participate in the business of the company. Both these agreements were set forth in resolutions. *Id.*, at 647. The bankruptcy court held that the attempt to dissociate the debtor was a violation of the automatic stay. *Id.*, at 647. The bankruptcy court further held the agreement continuing McCoy Farms, LLC was not accomplished within 60 days of the event of dissolution and was therefore untimely. Accordingly, the dissolution provisions of the operating agreement potentially controlled. *Id.*, at 648.

Turning to the operating agreement, the bankruptcy court noted that “every conceivable [property] interest of the debtor, future, nonpossessory, contingent, speculative, and derivative is within the reach of [11 U.S.C. § 541(a)].” *Id.*, at 652, *citing In re Yonikus*, 996 F.2d 866, 869 (7th Cir. 1993). Because 11 U.S.C. § 541(c)(1) renders ineffectual any contractual or statutory provisions that purport to restrict or condition the transfer of the debtor’s property to the estate, the dissolution provision of the operating agreement was ruled unenforceable. *Id.*, at 655. As the bankruptcy court noted, to rule otherwise would lead to the untenable situation where, “[p]rior to his bankruptcy [the debtor] held the full array of economic and non-economic rights provided under the Operating

Agreement in a viable, operating company; while after his bankruptcy, he held an economic interest in a defunct LLC and constrained non-economic rights.” Id. To the extent In re Warner relies upon In re Garrison-Ashburn, it is merely for the proposition that the debtor retained both his economic and non-economic interest in the LLC when he filed his Chapter 11 petition. Id., at 647.

The last case, In re Va. Broadband, LLC, 498 B.R. 90, (Bankr. W.D. Va. 2013), brings this discussion full circle regarding the relationship between the Virginia dissociation statute and the scope of the bankruptcy estate under 11 U.S.C. §541. In In re Va. Broadband, LLC, the Board of Managers of debtor Virginia Broadband, LLC (“VABB”) ratified consents authorizing VABB to file a Chapter 11 petition. After filing, the official committee of unsecured creditors (“Committee”) sought dismissal of VABB’s bankruptcy case on the grounds that one of the Board of Managers, Hunter S. Chapman had, prior to the VABB bankruptcy, filed a Chapter 13 petition with the bankruptcy court. As a result, the Committee contended that Chapman was dissociated under Virginia law and lost any and all non-economic rights as a member and was not authorized to vote on VABB’s bankruptcy petition. Without Mr. Chapman’s vote, the Committee contended that the consents would not have had the required majority to pass. Id., at 92-94.

The issue as articulated by the bankruptcy court was “whether Chapman’s non-economic interest in VABB was property of the estate and, as such, revested upon dismissal of his bankruptcy.” *Id.* In answering this question in the affirmative, the bankruptcy court ruled:

The Bankruptcy Code provides that an interest of the debtor in property becomes property of the estate notwithstanding any applicable non-bankruptcy law that affects a forfeiture, modification, or termination of a debtor's interest merely because the debtor filed bankruptcy. *11 U.S.C. § 541(c)(1)*. Such provisions are termed "*ipso facto*" clauses and are not enforceable. ... **Regarding this case, *Virginia Code section 13.1-1040.1(6)(a)*⁵ is a provision of applicable non-bankruptcy law that affects a forfeiture, modification, or termination of a debtor-member's non-economic interest in a LLC by: 1) converting the debtor-member to an assignee; and 2) stripping him of everything but his economic rights merely because the debtor-member filed bankruptcy. The Bankruptcy Code addresses this consequence by invalidating enforcement of this particular provision. Pursuant to *section 541(c)(1)*, Mr. Chapman's economic and non-economic interests in VABB were not forfeited, modified, or terminated merely because he filed bankruptcy, but rather became property of his estate.**

Id., at 95 (italics in original, citations omitted, emphasis added).

The bankruptcy court in *In re Va. Broadband, LLC*, also distinguished the result in *In re Garrison-Ashburn* as follows:

In re Garrison-Ashburn involved the question of whether a debtor-member could invoke a provision of his Virginia LLC's operating agreement to prevent the LLC from selling property owned by the LLC. ... In particular, the debtor-member was a co-manager of the Virginia LLC. ... The LLC's operating agreement required the debtor's signature to approve the sale of LLC property. ... The

⁵ This is the same dissociation statute involved in *In re Garrison-Ashburn*.

court ultimately concluded that the debtor could not invoke the provision because the operating agreement was not an executory contract; therefore, the *ipso facto* prohibition under *Bankruptcy Code section 365* did not apply in this context and did not invalidate *VA. CODE ANN. § 13.1-1040.1(6)(a)*.

* * *

As stated previously, a membership interest in a Virginia LLC is personal property. As such, the membership interest is the property and any interest, whether economic or non-economic, in that property would become property of the estate under *section 541(c)(1)* despite Virginia law to the contrary. To say that *541(c)(1)* makes the economic interest, but not the non-economic interest, property of the estate confuses the issue of what becomes property of the estate with what rights and powers the debtor has in that property upon the commencement of his bankruptcy case. ... This Court holds that *VA. CODE ANN. § 13.1-1040.1(6)(a)* is an *ipso facto* provision under *section 541(c)(1)(B)*, and that Mr. Chapman's economic and non-economic interests in VABB became property of his bankruptcy estate.

Id., at 95-97 (italics in original, citations and footnotes omitted, emphasis added).

The line of cases since In re Garrison-Ashburn, evidences a clear judicial trend favoring pre-emption or unenforceability of statutory and contractual dissociation provisions resulting from bankruptcy filings in favor of including all of a debtor's interest, both economic and non-economic, in the bankruptcy estate. In other words, contrary to the Court of Appeals Opinion, the weight of authority on this issue follows the reasoning first expressed in In re Daugherty. To the extent the Opinion of the Court of Appeals in this matter ruled to the contrary, it is based upon an analysis which is largely discredited and should be reversed.

B. The *Ipsa Facto* Provisions of the Pac-O Operating Agreement are Preempted Under 11 U.S.C. 365(e)(1).

The Court of Appeals' conclusion that 11 U.S.C. 365(e) excuses GHI from continuing to accept further performance under the Pac-O Operating Agreement extends and compounds its flawed analysis of 11 U.S.C. §§ 541(a) and 541(c). Nw. Wholesale, Inc., id., at 486.

Under 11 U.S.C. § 365(a) the trustee, subject to the court's approval, may assume or reject any executory contract or unexpired lease of the debtor. 11 U.S.C. § 365(a). This authority, however, is subject to provisions of 11 U.S.C. § 365(c) and 11 U.S.C. § 365(e). Under 11 U.S.C. § 365(c)(1) the trustee is prohibited from assuming or assigning the rights of the debtor as long as the contract is an agreement where applicable law prohibits substitute performance. 11 U.S.C. § 365(c)(1). Furthermore, while 11 U.S.C. § 365(e)(1) invalidates *ipso facto* provisions in executory contracts conditioned on the commencement of a bankruptcy case, 11 U.S.C. § 365(e)(2) excludes its application 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 or lease ... and such party does not consent to such assumption or assignment.” 11 U.S.C. § 365(e).

These provisions come into play only where an executory contract is involved. Conversely, if there is no executory contract, 11 U.S.C. § 365 is inapplicable. A contract is executory if "the obligations of both parties are so 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 Ehmman, 319 BR 200, 203-204 (D.Ariz. 2005), In re JZ L.L.C., 371 B.R. 412, 425 (BAP 9th Cir. 2007).

The Court of Appeals, in its Opinion, never determined whether the Pac-O Operating Agreement was in fact an executory contract but rather, proceeded on the assumption that it was. Nw. Wholesale, Inc., id., at 487-488.⁶

In resolving this issue, the Court of Appeals relied exclusively on the case of Finkelstein, id. In Finkelstein, the appellant, Stephen Finkelstein, since 1972, had been a partner in two general partnerships which were general partners of several limited partnerships. In 1981, Finkelstein filed a Chapter 11 bankruptcy petition which was converted to a Chapter 7 the following year. In 1991, Finkelstein sued the general

⁶ In this case, the Pac-O Operating Agreement obligates the Ostensons to provide additional capital also lease the business premises to Pac-O and obtain and pay a loan against the premises for improvements which Holzman would guaranty. P-26, ¶ 3.4(a), 3.4(b); P-27. Respondents, in their Brief, contended that the Pac-O Operating Agreement was not executory. *See* Brief of Respondents, at 20-23.

partnerships and brought a derivative claim on behalf of the limited partnerships. *Id.*, at 734-735. The trial court dismissed Finkelstein's claims based upon lack of standing and statute of limitations. *Id.*, at 735

On appeal, Division I of the Court of Appeals held that under state partnership law, which is not superseded by federal bankruptcy law, a partnership dissolves upon one of the partners filing bankruptcy and accordingly, the partnerships were dissolved by Finkelstein's 1982 bankruptcy. *Id.*, at 734, 736. Further, the Court of Appeals held that the partnership agreements were executory contracts which the Trustee was not authorized to assume under 11 U.S.C. § 365, reasoning:

Finkelstein's bankruptcy trustee was not free to assume the contract under § 365 because the other partners were not obligated to accept such an assumption. Partnerships are voluntary associations, and partners are not obligated to accept a substitution for their choice of partner. The restraint on assumability also makes the deemed rejection provision of § 365 inapplicable to the partnership agreement. . . . Therefore, § 365(e)'s invalidation of ipso facto provisions does not apply, and state partnership law is not superseded.

Id., at 737 (italics in original, citations omitted).

This proposition rests at the heart of the Court of Appeals Opinion in this case. *Nw. Wholesale, Inc., id.*, at 489. However, applying these principles *carte blanche* to the Ostensons' litigation against Holzman is simply error for two independent reasons.

First, the Ostensons' bankruptcy was never brought under Chapter 7. It was initiated as and remained a Chapter 11 bankruptcy. Even the Court of Appeals in Finkelstein acknowledge that its decision dealt with the fact of a Chapter 7 bankruptcy. Finkelstein, Id., at 738-739, n.4. By comparison, the Court of Appeals here, simply concluded that the same reasoning should apply to the Ostensons' Chapter 11 bankruptcy. Nw. Wholesale, Inc., id., at 489. This is error. Because the Ostensons' bankruptcy was brought under Chapter 11, they were throughout the proceedings, the "debtor in possession." 11 U.S.C. § 1101(1) ('debtor in possession' means debtor). As such, there is no issue that assumption of the Pac-O Operating Agreement would force GHI to "accept a substitution for [its] choice of [member]." Finkelstein, id., at 737. The Supreme Court of the United States has rejected any distinction between debtor and Chapter 11 debtor in possession in the context of executory contracts. In NLRB v. Bildisco & Bildisco, 465 U.S. 513, 522, 528, 79 L. Ed. 2d 482, 104 S. Ct. 1188 (1984), the Supreme Court stated:

Obviously if the [debtor-in-possession] were a wholly "new entity," it would be unnecessary for the Bankruptcy Code to allow it to reject executory contracts, since it would not be bound by such contracts in the first place. For our purposes, it is sensible to view the debtor-in-possession as the same "entity" which existed before the filing of the bankruptcy petition, but empowered by virtue of the Bankruptcy Code to deal with its contracts and property in a manner it could not have done absent the bankruptcy filing.

Id., at 528.

The rejection of the “new entity” theory in Chapter 11 bankruptcy enunciated in Bildisco has been followed in the Ninth Circuit. Biltmore Assocs., LLC v. Twin City Fire Ins. Co., 572 F.3d 663 (9th Cir. 2009) (the debtor in possession is the same person for bankruptcy purposes as the pre-bankruptcy person that filed for bankruptcy).

It is submitted that under these facts, there has been no assumption of the Pac-O Operating Agreement by a different entity. The Ostensons, as debtor in possession, were the same parties to the Pac-O Operating Agreement. No applicable law exists rendering these obligations non-assumable where assumption is by the same person, rendering 11 U.S.C. § 365(c)(1)(A) and 11 U.S.C. § 365(e)(2)(A)(i) inapplicable.

Second, the Court of Appeals completely ignored the fact that there has been consent by the non-debtor parties to the assumption. Specifically, Holzman consented to assumption by virtue of the Stipulation entered into between all parties, approved by the Bankruptcy Court. Ex D-5 (Order and Amendment). That Stipulation preserved claims of Pac-O against Holzman for their failure to pay packing fees, expenses, and revenues earned by Pac-O or fruit proceeds or rent due Pac-O or for conversion of assets of Pac-O. Ex D-5 (Order and Amendment).

This is precisely what the derivative claim filed by Mr. and Mrs. Ostenson is attempting to do.

It was not until well after judicial approval of the Stipulation, investigation of their claims, and initiation of their lawsuit that Holzman began complaining that Mr. and Mrs. Ostenson lacked standing to assert the derivative claim, attempting to renege on the Stipulation. The effort even included Mr. Holzman placing Pac-O in bankruptcy on September 10, 2009, the eve of trial, thereby causing a year's delay. CP 97. On November 10, 2010, the Bankruptcy Court found that Mr. Holzman had acted in bad faith and awarded the Ostensons \$51,303.75 in attorney fees. RP 420:19-421:11. The paucity of Holzman's effort to obviate the Stipulation during trial was evidenced by the following exchange with the trial court discussing the Stipulation:

THE COURT: Under [paragraph] 7.b [of the Stipulation], ... that makes it look like claims could be asserted by Pac-O, against Mr. Holzman, POP, and Total Organic for certain things.

MR. DUNCAN: Right.

THE COURT: **Who would be bringing those claims, if not the Ostensons?**

MR. DUNCAN: Well, the answer to that question is -- and I will tell you what the -- what the expectation was, when this document was entered into.

First, you'll hear, from Mr. Holzman, that he agreed to this, as part of this resolution, in the bankruptcy court,

only because he didn't think there were any. He wouldn't have done this.

TR. at 38:21-39:8 (emphasis added).

The straight answer to the court's query should have been "nobody." Under the circumstances, it is unreasonable to expect Holzman to sue himself.

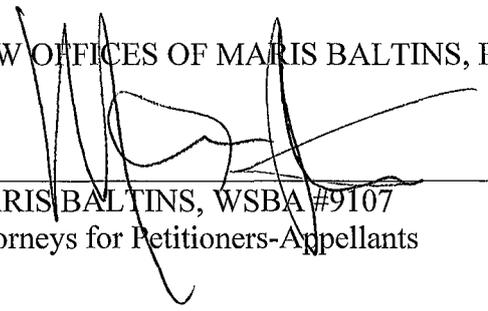
It is submitted that under the circumstances of this case, the Stipulation itself constitutes the consent of the parties within the meaning of 11 U.S.C. § 365(c)(1)(B) and 11 U.S.C. § 365(e)(2)(A)(ii). Accordingly, the *ipso facto* prohibition of 11 U.S.C. § 365(e)(1) applies with full force to the operating agreement.

IV. CONCLUSION.

Wherefore, it is respectfully requested that, based upon the foregoing arguments, the Supreme Court reverse the decision of the Court of Appeals and remand this case for trial.

DATED this 2nd day of April, 2015.

LAW OFFICES OF MARIS BALTINS, P.S.



MARIS BALTINS, WSBA #9107
Attorneys for Petitioners-Appellants

CERTIFICATE OF SERVICE

Seth Thompson hereby declares under penalties of perjury of the laws of the State of Washington that:

1. I am and at all times hereinafter mentioned was a citizen of the United States and a resident of the State of Washington, over the age of 18 years and not a party to this action.

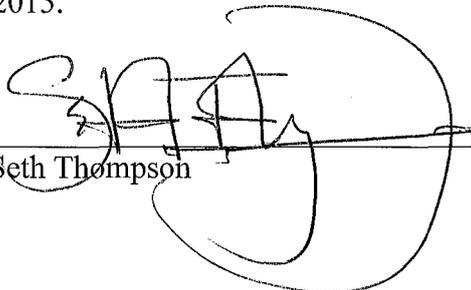
2. On the 2nd day of April, 2015, I delivered a true and correct copy of the foregoing document to Washington Legal Messengers, who will make personal service upon the following party:

Bradley R. Duncan
Josh R. Rataczyk
Hillis Clark Martin & Peterson P.S.
1221 Second Avenue, Suite 500
Seattle, WA 98101-2925

3. On the 2nd say of April, 2015, I served a copy of the foregoing document on said party by electronic mail, addressed to: brad.duncan@hemp.com.

4. On the 2nd say of April, 2015, I served a copy of the foregoing document on said party by depositing same in the United States Mail, postage prepaid.

DATED this 2nd day of April, 2015.


Seth Thompson