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Supreme Court Case No. 90891-5
Court of Appeals No. 31491-0-III

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**SUPREME COURT
OF THE STATE OF WASHINGTON**

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,**

Petitioners,

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.

SUPPLEMENTAL BRIEF OF RESPONDENTS

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I. INTRODUCTION AND STATEMENT OF ISSUES

This appeal raises two issues.¹

The *first issue* is whether Congress intended with Sections 541(c)(1) and 365(c) and (e) of the United States Bankruptcy Code (11 U.S.C. § 101, *et seq.*) to preempt an important aspect of state-level regulation of business organizations like the limited liability company involved in this matter, Pac Organic Fruit, LLC (“Pac Organic”). More precisely, the Washington Legislature – like that of virtually every state in the nation – has determined that members of a Washington limited liability company may not be compelled to admit, as new members, parties with whom they have not chosen to do business. To this end, when one member of a Washington limited liability company elects to transfer her membership interest to a third party, whether by non-bankruptcy assignment or by transfer to an estate in bankruptcy, the transferor is “dissociated” and loses her status as a member, while the transferee never becomes a member and holds only the economic rights of an assignee. Neither the transferor nor the transferee has any right

¹ This Supplemental Brief will rely upon the party definitions used in the Answer to Petition for Review. Respondents Greg Holzman, Greg Holzman, Inc. (now known as Purity Organic Holdings, Inc.) and Total Organic, LLC will be referred to collectively as the “Holzman Parties,” while Harold and Shirley Ostenson will be referred to as the “Ostensons.”

thereafter to participate in the management of the affairs of the entity.

RCW 25.15.130(1)(b) & (d)(iii); RCW 25.15.250.

The Ostensons contend that Congress purposefully eliminated this principle in the bankruptcy context. They suggest that Congress' intention to preempt Washington's (and by implication, every other state's) legislative enactment on the point is expressed in Section 541(c)(1) of the Bankruptcy Code.² The Court of Appeals gracefully dispatched this argument below. It recognized that, far from preempting this important principle of state law, the Bankruptcy Code actually *defers* to it. This Court should do the same.

The *second issue* is whether this Court's decision in *Hector v. Martin*, 51 Wn.2d 707, 321 P.2d 555 (1958), prevented the trial court from granting a motion to dismiss under CR 41(b)(3) merely because it took the matter under advisement at the close of the Ostensons' case, then granted it after hearing a portion of the Holzman Parties' case. The Court of Appeals sensibly held that it does not. This Court should affirm the Court of Appeals on this point as well.

² Nearly every state in the country has enacted a limited liability company statute containing provisions that are either identical to RCW 25.150.130(d)(iii) and (iv) or are to the same substantive effect. A survey and summary of these laws is attached to this Supplemental Brief as Appendix A.

II. ARGUMENT

A. Section 541(c)(1) of the Bankruptcy Code Does Not Preempt RCW 25.15.130 or 25.15.250.

It is worth emphasizing at the outset several principles that control any preemption analysis. For instance, this Court applies a “rigorous analysis” in preemption matters in light of its “continuing desire to uphold state sovereignty to the maximum extent.” *Hue v. Farmboy Spray Co., Inc.*, 127 Wn.2d 67, 77, 896 P.2d 682 (1995). This rigorous analysis is founded upon a “strong presumption” against preemption, which presupposes that Congress does not “relish[] abrogating state authority.” *Id.* at 78. This Court has “‘repeatedly emphasized’ that . . . State laws are not superseded by federal law unless that is the clear and manifest purpose of Congress.” *Id.* (citations omitted). This presumption requires that the purportedly preempting provision of federal law be given a “fair but narrow reading.” *Id.* at 79 (quoting *Cippollone v. Liggett Grp., Inc.*, 505 U.S. 504, 524, 112 S. Ct. 2608, 120 L. Ed. 2d 407 (1992)). The federal courts take a similarly hesitant approach to preemption, one that defers to state sovereignty and the right of a state to legislate matters within its sphere. *See, e.g., Medtronic, Inc. v. Lohr*, 518 U.S. 470, 485, 116 S. Ct. 2240, 135 L. Ed. 2d 700 (1996) (“we ‘start with the assumption that the historic police powers of the States were not to be superseded by the Federal Act unless that was the clear and manifest

purpose of Congress”) (citations omitted); *Air Conditioning & Refrigeration Inst. v. Energy Res. Cons. & Dev. Comm’n*, 410 F.3d 492, 496 (9th Cir. 2005) (emphasizing presumption against preemption in reversing lower court’s finding of preemption).

The Ostensons’ burden requires them to demonstrate that Congress clearly and purposefully intended with Section 541(c)(1) to abrogate the well-established principle of state law set forth in RCW 25.15.130 and 25.15.250.

1. RCW 25.150.130 and 25.15.250.

It is beyond argument that the State of Washington possesses the power to regulate the formation, management and operation of all manner of business entities, including limited liability companies like Pac Organic. With RCW 25.15.130 and 25.15.250, the Washington Legislature has used this regulatory authority to build into the law a critical principle: a member of a limited liability company may not transfer her membership interest to a third party in a way that forces the original members to do business with the transferee or to accept the transferee as a “new” member. Washington’s legislature strongly values the associational rights of members of a limited liability company and purposefully has crafted the protection of those rights into our law.

This is why RCW 25.15.130 and 25.15.250 read as they do.

Section 25.15.250(1), for instance, authorizes a member to assign her interest to a non-member, but provides that the assignee “shall have no right to participate in the management of the business and affairs of a limited liability company except . . . [u]pon the approval of all of the [other] members of the limited liability company . . .” Subsection (2)(a) goes on to provide that the assignment “entitles the assignee to share in such profits and losses [and to hold the other economic entitlements] to which the assignor was entitled, to the extent assigned[].”

Section 25.15.130 complements and extends this principle with its description of the events that result in a member’s “dissociation.” It first says that a member “ceases to be a member . . . following an assignment of all the member’s limited liability company interest.”

RCW 25.15.130(1)(b). The statute then provides that any of a series of events which involve a transfer of control over a member’s interest – including as a result of a member’s “voluntary petition in bankruptcy” or the entry of “an order for relief in bankruptcy proceedings” against the member³ – will also result in the member’s dissociation. If any of these

³ Section 541(a) of the Bankruptcy Code contemplates the creation of an “estate” into which a debtor’s state-law defined assets are effectively transferred at the commencement of a bankruptcy proceeding. *See, e.g., In re Gilroy*, 235 B.R. 512, 515 (Bankr. D. Mass. 1999) (“Section 541(a)(1) does not use the word ‘transfer,’ but, in essence, it states that the filing of a bankruptcy petition effectuates a transfer from the

things occur, the original member will cease to be a “member” and will relinquish her management rights,⁴ but will retain all of the economic value and entitlements associated with her interest.

Under Washington law, all of this means that when a membership interest in a limited liability company has been transferred, including by way of bankruptcy, the other members are not obligated to treat the transferor or the transferee as a “member” or to accept from either of them the exercise of management rights over the entity or its assets. While protecting the associational rights of non-transferring members in this way, Washington law isolates and preserves the *economic* value of the transferred interest for the transferee.

The question for this Court, then, is whether Congress intended Section 541(c)(1) of the Bankruptcy Code to preempt our legislature’s (and nearly every other state legislature’s) protection of members’ associational rights in this setting.

There is no shortage of prior cases, most decided by federal bankruptcy courts.⁵ The Court will find that these cases address the issue

Debtor to the bankruptcy estate”). Once this transfer has occurred, the debtor is divested of any interest in the property held by the estate. *See, e.g.*, 5 COLLIER ON BANKRUPTCY, ¶ 541.03 at 541-17 (16th ed.) (“[u]nder section 541, once the estate is created, no interests in property of the estate remain in the debtor”).

⁴ Importantly for this matter, it also means that the former member may not thereafter initiate a derivative action on behalf of the limited liability company. *See* RCW 25.15.370.

from a variety of angles and with widely-varying degrees of analytical depth. Several summarily assert the primacy of Section 541(c)(1), while others acknowledge the vitality of state law. Several incorporate Section 365 of the Bankruptcy Code into the analysis in different ways, while others do not. Several distinguish single-member entities from multi-member entities, while others do not. There is no clean analytical line running through these cases that will plainly lead this Court to the right result. The case law is disparate and inconsistent.

What the Court will *not* find among these cases, though, is a well-developed and “rigorous” preemption analysis of the type required by this Court’s precedent. When this analysis is invoked – and when the presumptions *against* preemption are properly applied – it becomes possible to harmonize Section 541(c)(1) with RCW 25.15.130 and to recognize that the Bankruptcy Code actually defers to the state-level policy objectives embodied in that provision and in RCW 25.15.250.

2. Section 541(c)(1) and Section 365(c) and (e) of the Bankruptcy Code.

To appreciate this, it is important to understand how Sections 541(c)(1) and 365(c) and (e) of the Bankruptcy Code function and interrelate. Both contain what are known in bankruptcy parlance as

⁵ No state court in the country seems to have concluded that Section 541(c)(1) preempts a dissociation provision like RCW 25.15.130(1)(d)(iii) and (iv), though, as discussed below, at least one state court in a very similar situation has concluded that it does not.

ipso facto provisions, or provisions that purport to invalidate contractual or legal provisions that flow from and penalize debtors upon the commencement of a bankruptcy proceeding.

Structurally, Section 541(c)(1)'s job is to facilitate the smooth transfer of a debtor's property into the estate when a bankruptcy is filed. While federal law, as embodied in Section 541, describes *what* property flows into an estate, it is a foundational principle of bankruptcy law that *state* law defines what the scope and extent of that property actually *is*. See *Butner v. United States*, 440 U.S. 48, 55, 99 S. Ct. 914, 59 L. Ed. 2d 136 (1979). By invalidating contractual or non-bankruptcy law restrictions upon transfer into an estate, Section 541(c)(1) protects the easy movement of that property into bankruptcy once state law has defined what it is.

Section 365(e)(1), in turn, invalidates contractual provisions or non-bankruptcy law that would prevent a bankruptcy estate from assuming the benefits of any "executory contract" to which the debtor was a party before bankruptcy.⁶ Critically, though, both Section 365(e)(2)

⁶ The Court of Appeals accurately noted that the Bankruptcy Code does not specifically define the term "executory contract," but that the United States Court of Appeals for the Ninth Circuit has adopted the generally-prevailing "Countryman Test," under which a contract is executory, and is thereby susceptible to assumption and assignment, if "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." *Nw. Wholesale, Inc. v. Pac Organic Fruit, LLC*,

and a related provision, Section 365(c), operate together to carve out from the *ipso facto* prohibition of Section 365(e)(1) the associational rights of *non*-debtors under applicable law – which is to say, the very rights that RCW 25.150.130 and 25.15.250 are intended to protect and preserve.

Section 365(e)(2) does this by establishing an explicit exception to Section 365(e)(1) for executory contracts for which “applicable law” excuses a non-debtor party to the contract (like the non-bankrupt member of a limited liability) from “accepting performance from or rendering performance to the trustee or to an assignee of such contract . . .” In other words, when a state legislature chooses to protect the associational rights of parties to executory contracts, Section 365(e)(2) *defers* to that choice and permits what otherwise would be an “*ipso facto*” provision to operate unimpeded. Section 365(c)(1) does the same when it bars a trustee in bankruptcy from assuming or assigning an executory contract if, again, “applicable law” excuses a non-debtor party to the contract from accepting performance from or to an assignee of the contract.⁷

183 Wn. App. 459, 486-87, 334 P.3d 63 (Wash. Ct. App. 2014). *See also In re Wegner*, 839 F.2d 533, 536 (9th Cir. 1986).

⁷ In the Ninth Circuit, Section 365(c)(1) has been read to provide that a bankruptcy debtor *itself* may not even assume an executory contract (whether an assignment to a third party is intended or not) if a non-debtor party to the contract would be excused from accepting or rendering performance from an assignee. *See In re Catapult Ent., Inc.*, 165 F.3d 747 (1999). In the Ninth Circuit, then – so strong is the reading of Section 365(c)(1)’s deference to state law – a contract of this type is essentially a dead letter unless a non-debtor party consents to the debtor’s assumption of it in bankruptcy.

In this case, it is impossible to pin down the Ostensons' position on whether Pac Organic's Operating Agreement is an executory contract. In their Petition for Review, they were quite explicit – while conceding that the Operating Agreement incorporates the events of dissociation outlined in RCW 25.15.130, they argued that “[the Operating Agreement] *is an executory contract* and its *ipso facto* dissociation provisions cannot be enforced against the Ostensons [under Section 365(e)(1)],” and took pains to explain why the contract is executory. Petition at 16-17 (emphasis added). In their Reply, though, the Ostensons took an abrupt U-turn (one undoubtedly motivated by the citations to Sections 365(e)(2) in the Holzman Parties' Answer) and argued rather incoherently that Section 365 does *not* really apply to the Operating Agreement. Reply at 1-4. To be charitable, the Ostensons' argument here is difficult to follow.⁸

⁸ There is no genuine issue over whether Pac Organic's Operating Agreement is an “executory contract” for purposes of Section 365, as the Ostensons themselves conceded when they made precisely that argument to both the Court of Appeals and to this Court in their Petition for Review. *Nw. Wholesale*, 183 Wn. App. at 487 (“The Ostensons characterize the Pac Organic LLC operating agreement as an executory contract because of several provisions.”); Petition at 16-17. The Operating Agreement has all the attributes identified in the “Countryman Test.” The Ostensons have never explained, though, why they failed to make any effort to assume the Operating Agreement in their now long-closed bankruptcy proceeding – though, had they made that effort, the principle expressed in *Catapult* (*see* footnote 7 *supra*) would have barred their doing so. Accordingly, there was simply no circumstance in which the Ostensons' bankruptcy estate ever could have been a “member” in Pac Organic, and the estate never even made the attempt to become one. This highlights the irony of their now arguing that their estate actually achieved “member” status – under an Operating Agreement they made no

Ultimately, what the Ostensons say on the point does not matter. What matters is that Congress has expressed its intention to honor states' protection of associational rights in the bankruptcy context in Sections 365(e)(2) and 365(c) of the Bankruptcy Code. The Court of Appeals recognized this, as have many other courts. *Nw. Wholesale*, 183 Wn. App. at 486 ("Section 365(c)(1) and (e)(2)(A) were designed to protect nondebtor third parties whose rights may be prejudiced by having a contract performed by an entity other than the one with which they originally contracted.").

In light of all of this, to read Section 541(c)(1) as expressly preempting RCW 25.15.130(1)(d)(ii) and (iii) would be to conclude that after laboring to preserve and protect state-created associational interests in Section 365(e)(2) and 365(c), Congress chose to invalidate those same interests in Section 541(c)(1). It would be to find that Congress, having specifically closed the door to the coerced alteration of associational rights in Section 365(e)(2) and 365(c), chose in Section 541(c)(1) to create an indirect, non-specific back door into that very type of forced association. The Ostensons may not put it in these terms, but this is precisely what they are urging this Court to find.

attempt to assume and never could have assumed – through a back door purportedly opened by Section 541(c)(1).

But it makes no sense. One need only consider what are perhaps the two primary principles of statutory construction: (i) the “Whole Act Rule,” which requires a court to read a statute as a whole, rather than as disconnected elements⁹; and (ii) the rule that a legislature’s specifically-expressed intention in a statute will control the interpretation of a more generally-expressed intention elsewhere.¹⁰ To read the general language of Section 541(c)(1) in the way the Ostensons suggest would run afoul of each of these precepts. It would preempt, nonsensically, both RCW 25.15.130 *and* the specific language of Sections 365(e)(2) and 365(c).¹¹ Moreover, it would ignore the preemption principles expressed in, for instance, this Court’s opinion in *Hue*, 127 Wn.2d at 78-79, and in similar federal preemption jurisprudence. This precedent *presumes* that

⁹ See, e.g. *Roe v. TeleTech Customer Care Mgmt. (Colo.) LLC*, 171 Wn.2d 736, 747, 257 P.3d 586 (2011) (“This court will not read a statutory phrase in isolation; its language takes meaning from the enactment as a whole.”) (citations omitted).

¹⁰ See, e.g. *Ass’n of Wash. Spirits & Wine Distribs. v. Wash. State Liquor Control Bd.*, ___ Wn.2d ___, 340 P.3d 849, 856 (2015) (“A general statutory provision must yield to a more specific statutory provision.”)

¹¹ It also would run afoul of an important concept that neither the Court of Appeals nor the Ostensons seem to have addressed. It is clear as a matter of bankruptcy law that when an executory contract is involved (as the Ostensons persistently have argued is true here), a debtor’s rights under the executory contract do not become property of the estate – so that Section 541(c)(1) never even comes into play – until such time as the contract is assumed or assigned. See, e.g., *In re Qintex Ent., Inc.*, 950 F.2d 1492, 1495 (9th Cir. 1991) (“An executory contract does not become an asset of the estate until it is assumed pursuant to § 365 of the Code.”); *In re Plitt Amusement Co. of Wash.*, 233 B.R. 837, 840 (Bankr. C.D. Cal. 1999). This principle necessarily establishes that Section 541(c)(1) cannot operate *at all* – much less preempt state law – when, as here, the Ostensons never even attempted to assume the executory contract, and it could not have been assumed under *Catapult* in any event.

Congress does not intend to invalidate state law. Far from invoking and rigorously applying this presumption, to read Section 541(c)(1) as the Ostensons suggest would be labor to ignore the intention expressed in more specific and directly-applicable provisions of a federal statute while searching for an unspecified preemptive intent.

None of this is necessary. It is entirely possible to read Sections 541(c)(1) in harmony with Section 365 and state law, and to avoid a preemption that the law presumes has not occurred. Several courts have done so.

For instance, in *Milford Power Company, LLC v. PDC Milford Power, LLC*, 866 A.2d 738 (Del. Ch. 2004), the Delaware Chancery Court undertook a nuanced analysis of all of these concepts. The Chancery Court began with a “restrained preemption analysis,” which, while observing that state courts must “apply with fidelity the preemption principles articulated by the federal courts,” also noted that “we are not duty-bound to go out of our way to look for reasons to preempt our own state’s law.” *Id.* at 756. The Chancery Court scrutinized at length the relationship between state regulation of limited liability companies, including the effect of provisions contained in an operating agreement that directed a member’s immediate “withdrawal” upon a bankruptcy filing (which corresponded to provisions of Delaware’s limited liability

statute and operate identically to RCW 25.15.130), and Sections 541(c)(1), 365(e) and 365(c) of the Bankruptcy Code.¹²

The Chancery Court balanced all of this in a way that produced a sensible, equitable and compelling result – one that simultaneously honors both federal and state law while giving due weight to the commercial associational interests of non-debtor members. The Chancery Court held that Sections 541(c)(1) and 365(e)(1) *do* preempt state law to the extent that state law would eliminate a member’s (or a transferee’s) *economic* interest upon a bankruptcy filing. But Sections 541(c)(1) and 365(e)(1) do not preempt provisions of state law that protect non-debtor members against being forced to admit a bankruptcy estate as a new member. *Id.* at 758-62. The “practical effect” of the Chancery Court’s ruling was that “a member who files for bankruptcy still ceases to be a member” – so that Delaware’s equivalent to RCW 25.15.130(d)(ii) and (iii) retained “vitality” and was not preempted – “but becomes an assignee with the economic rights specified” in Delaware’s equivalent to

¹² The Chancery Court specifically noted that Sections 365(e)(2) and 365(c)(1), “taken together . . . are an expression of Congress’s recognition that certain types of executory contracts to which debtors are parties . . . should not be assumable by a Bankruptcy Trustee in circumstances when state law would not require the non-debtor parties to accept substitute performance.” *Milford Power*, 866 A.2d at 752. The Chancery Court also observed that the provisions of Delaware’s limited liability statute which establish that “members of a Delaware LLC need not fear that they will have as fellow members bankruptcy trustees or assigns of bankruptcy trustees” constitute “applicable law that excuses a solvent member from accepting substitute performance as a member from a Bankruptcy Trustee or an assignee of a Bankruptcy Trustee.” *Id.* at 754.

RCW 25.15.250. *Id.* at 762. This is also the “practical effect” of the holdings of the trial court and of the Court of Appeals in this case.¹³ The Chancery Court’s ruling in *Milford Power* deftly harmonized the issues in a way that ought to guide this Court as it considers the same question.

The United States Bankruptcy Court for the Eastern District of Virginia came to a similar conclusion in *In re Garrison-Ashburn, L.C.*, 253 B.R. 700 (Bankr. E.D. Va. 2000). Notably, the Bankruptcy Court in *Garrison-Ashburn* found that the particular operating agreement at issue was *not* executory, so that Sections 365(c) and 365(e) did not directly govern. Focusing solely upon Section 541(c), the Bankruptcy Court implemented that provision with an eye toward its function, which is to preserve the transfer of *state law-defined* property into the estate. Because the Virginia law (like Washington’s) provided that a bankruptcy estate could not participate in the management of the entity, the “rights and benefits [associated with the interest] were burdened with all of the duties and obligations that came with them” under state law. *Id.* at 708.

¹³ Moreover, this result is consistent with the outcome in the case the Ostensons rely upon most heavily, *In re Daugherty Constr., Inc.*, 188 B.R. 607 (Bankr. D. Neb. 1995). As the Court of Appeals observed below, the driver for the outcome in *Daugherty* was the Nebraska statute’s elimination of the *entirety* of the member’s interest, including all economic rights, upon the filing of a bankruptcy proceeding. *Nw. Wholesale*, 183 Wn. App. at 483-84. The Court of Appeals even found *Daugherty* “persuasive” to that extent, but noted that *Daugherty* is not applicable because Washington law affirmatively preserves a member’s economic interest despite a bankruptcy filing. *Id.* It is worth noting that Nebraska law now seems to have been changed so that it operates similarly to Washington law. See Appendix A.

Garrison-Ashburn's analytical approach differs somewhat from *Milford Power's*, but it necessarily comes to the same conclusion – that Section 541(c) does not preempt state protection of the associational rights of non-debtor members so long as the economic value of a debtor's interest is preserved. *Garrison-Ashburn* demonstrates that it ultimately does not matter if an operating agreement is an “executory contract.” No matter how an agreement is viewed, Section 541(c)(1) is in harmony with state law. With good reason, the Court of Appeals found *Garrison-Ashburn's* approach to the issue persuasive and adopted its reasoning below. *Nw. Wholesale*, 183 Wn. App. at 485.

Milford Power, *Garrison-Ashburn* and other decisions like them¹⁴ exemplify a subtle and considered approach to the preemption issue. They do justice to legitimate federal interests as *actually* expressed in the Bankruptcy Code, while acknowledging the equally legitimate interests states have in protecting the associational rights of non-debtor members. They contrast with several of the federal bankruptcy court cases the Ostensons rely upon that seem to use the Bankruptcy Code as a cudgel to invalidate state law without accommodating, or really even

¹⁴ See, for instance, the cases cited at footnote 6 to the Holzman Parties' Answer to Petition for Review.

acknowledging, state interests of the type built into RCW 25.15.130 and 25.15.250.

This Court's precedent on federal preemption requires more than the superficial analysis offered by the Ostensons and by the cases upon which they rely. It calls for the rigorous analysis undertaken by the courts in *Milford Power*, *Garrison-Ashburn* and other cases in that vein, and it calls for the same result they reached: a holding that federal bankruptcy law does not preempt RCW 25.15.150(d)(1)(iii) and (iv).

B. *Hector v. Martin* Did Not Prevent the Trial Court from Granting the Holzman Parties' CR 41(b)(3) Motion.

As the Court of Appeals observed, the Ostensons misunderstand both the holding and the purpose of this Court's ruling in *Hector v. Martin*, 51 Wn.2d 707 (1958). The Ostensons argue, in effect, that whenever a trial court takes under advisement a defendant's motion to dismiss made at the close of the plaintiff's case under CR 41(b)(3), both the defendant and the trial court become *bound* to complete the trial before the trial court can make a decision on the motion. This is not what *Hector* held, and to read it as the Ostensons suggest would produce a nonsensical outcome.

Here is what this Court said in *Hector*:

We have consistently adhered to the rule that a challenge to the *sufficiency of the evidence at the close of the*

plaintiff's case is waived by a defendant who does not stand on his motion and proceeds to present evidence on his own behalf, after his motion to dismiss has been denied. [Citations omitted.]

The same rule should be applied where the court *fails to rule* or *reserves* its ruling and the defendant thereafter submits his evidence. Therefore, the failure of the trial court to rule on such a motion before introduction of proof by a defendant, is tantamount to a denial of the motion. [Citations omitted.] Therefore, this case must be viewed in the light of all of the evidence.

Id. at 709-10 (emphasis added in first quoted paragraph).

It seems obvious, and perfectly sensible, that what is *waived* under *Hector* when a defendant proceeds with its proof is the right “to challenge . . . the sufficiency of the evidence *at the close of the plaintiff's case,*” but not the right to move *at all*. Put differently, it makes good sense that *Hector* would prevent a defendant from attempting to hermetically seal the evidentiary record at a moment in time (the close of the plaintiff's case) and then insisting that its motion be decided solely against that moment-in-time record, even if the defendant has offered additional evidence in its own case. By proceeding with its own case, the defendant waives the right to isolate the evidence in that way. That is the specific “challenge” waived under *Hector* – that right to challenge a particular configuration of the evidence – and when that challenge has been waived, *Hector* describes the remedy: a trial court deciding the motion, or a reviewing court on appeal, must consider it “in the light of

all of the evidence” actually introduced. *Id. Hector* simply does not say what the Ostensons would have it say, which is that the act of proceeding with a defendant’s proof means that the defendant has lost its right to ask a trial court to dismiss *at all*, even if the trial court considers the defense’s evidence along with the plaintiff’s.¹⁵

The Ostensons’ proposed rule is particularly nonsensical here, where the facts that dictated the trial court’s ruling are entirely beyond any dispute. As the Court of Appeals noted, the trial court founded its dismissal upon one central fact – that the Ostensons jointly filed a voluntary bankruptcy proceeding on January 9, 2007. The Ostensons have never denied this fact (which may even have been subject to judicial notice) and have never suggested that they would have elicited (or would have tried to elicit) any evidence during the defense case to contradict it. Consequently, if this case were remanded to the trial court under the Ostensons’ waiver theory, the trial court, after requiring the parties to complete their evidence, would simply issue the *same* ruling on the *same*

¹⁵ In addition to common sense, the Ostensons’ rule would run afoul of: (i) Washington’s general principle that “[i]t is always the duty of the trial court to take a case from the jury when the most favorable construction of the evidence, and the inferences to be drawn therefrom will not sustain a verdict,” and that a “motion [to dismiss] would lie at any time . . . but that, whenever made, it calls up the entire record for consideration,” *Peterson v. Dep’t of Labor & Indus.*, 40 Wn.2d 635, 640-41, 245 P.2d 1161 (1952); and (ii) the right of a trial court to revise an earlier ruling under CR 54(b), so that even if a CR 41(b)(3) motion is considered to have been denied if a defendant proceeds with its proof, the trial court may always elect thereafter to revise and grant that motion if it takes into account all of the evidence in the record when it does so. *Nw. Wholesale*, 183 Wn. App. at 476.

facts. The only difference between now and then is that the trial court would have been required to conclude an unnecessary trial and the parties would have been required to spend additional time and money for no good purpose. This Court observed long ago that this makes no sense.¹⁶

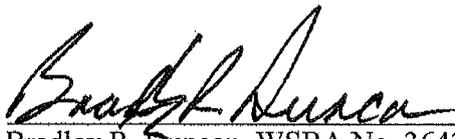
The Court of Appeals recognized all of this and read *Hector* in a sensible way. This Court should do the same.

III. CONCLUSION

For the reasons outlined above, the Holzman Parties respectfully ask the Court to affirm in all respects the ruling of the Court of Appeals in *Nw. Wholesale, Inc. v. Pac Organic Fruit, LLC*, 183 Wn. App. 459, 334 P.3d 63 (Wash. Ct. App. 2014).

RESPECTFULLY SUBMITTED this 2nd day of April, 2015.

HILLIS CLARK MARTIN & PETERSON P.S.

By 
Bradley R. Duncan, WSBA No. 36436
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¹⁶ See, e.g., *Peterson*, 40 Wn.2d at 641 (where appellant's contention that trial court erred in considering only a portion of the record in granting motion to dismiss, this Court declined to remand "for it would be an idle thing to return the cause to the superior court, when it must reach the same conclusion on the entire record").

CERTIFICATE OF SERVICE

The undersigned certifies that on this day she caused a copy of this document to be served via U.S. Mail, first class postage prepaid, to the following:

Maris Baltins
Law Office of Maris Baltins, P.S.
7 S. Howard Street, Suite 220
Spokane, WA 99201-3816

I certify under penalty of perjury under the laws of the state of Washington and the United States that the foregoing is true and correct.

DATED this 2nd day of April, 2015, at Seattle, Washington.


Brenda K. Partridge

4/02/15

APPENDIX A

State	Reference	Statutory Language
AL	Ala. Code § 10A-5A-6.02 (2012)	A person is dissociated as a member from a limited liability company when any of the following occurs: ... (g) the person becomes a debtor in bankruptcy, executes an assignment for the benefit of creditors, or seeks, consents, or acquiesces to the appointment of a trustee, receiver, or liquidator of the person or of all or substantially all of the person's property ...
AK	Alaska Stat. § 10.50.225 (2011)	(a) Unless otherwise provided in writing in an operating agreement of the company or authorized by the written consent of all of the members of the company at the time, a person's membership in a limited liability company terminates when the person (1) makes an assignment for the benefit of creditors; (2) files a voluntary petition in bankruptcy; ...
AZ	Ariz. Rev. Stat. Ann. § 29-733	Except as approved by the written consent of all members at the time, a person ceases to be a member of a limited liability company on the occurrence of any of the following events of withdrawal: ... 4. Unless otherwise provided in an operating agreement, the member does any of the following: (a) Makes an assignment for the benefit of creditors. (b) Files a voluntary petition in bankruptcy. (c) Is adjudicated as bankrupt or insolvent.
AR	Ark. Code Ann. § 4-32-802 (2010)	(a) A person ceases to be a member of a limited liability company upon the occurrence of one (1) or more of the following events: ... (4) Unless otherwise provided in writing in an operating agreement or by the written consent of all members at the time, the member: (A) Makes an assignment for the benefit of creditors; (B) Files a voluntary petition in bankruptcy; (C) Is adjudicated a bankrupt or insolvent; ...
CA	Cal. Corp. Code § 17706.02 (West 2012)	A person is dissociated as a member from a limited liability company when any of the following occur: ... (g) In a member-managed limited liability company, the person becomes a debtor in bankruptcy.
CO	Colo. Rev. Stat. § 7-80-702 (2014)	(1) The interest of each member in a limited liability company constitutes the personal property of the member and may be assigned or transferred. Unless the assignee or transferee is admitted as a member, the assignee or transferee shall only be entitled to receive the share of profits or other compensation by way of income and the return of contributions to which that member would otherwise be entitled and shall have no right to participate in the management of the business and activities of the limited liability company or to become a member.
CT	Conn. Gen. Stat § 34-180 (2012)	(a) Subject to subsection (b) of section 34-173, a person ceases to be a member of a limited liability company upon the occurrence of one or more of the following events: ... (4) unless otherwise provided in writing in the operating agreement or by written consent of all members at the time, the member (A) makes an assignment for the benefit of creditors, (B) files a voluntary petition in bankruptcy, (C) is adjudicated a bankrupt or insolvent ...
DE	Del. Code Ann. tit. 6, § 18-304 (West) (2014)	A person ceases to be a member of a limited liability company upon the happening of any of the following events: (1) Unless otherwise provided in a limited liability company agreement, or with the written consent of all members, a member: a. Makes an assignment for the benefit of creditors; b. Files a voluntary petition in bankruptcy; ...
FL	Fla. Stat. Ann. § 605.0602 (2014)	A person is dissociated as a member if any of the following occur: ... (8) In a member-managed limited liability company, the person: (a) Becomes a debtor in bankruptcy; (b) Executes an assignment for the benefit of creditors ...
GA	Ga. Code Ann. § 14-11-601.1 (2010)	(b) A person ceases to be a member of a limited liability company upon the occurrence of any of the following events: ... (4) Subject to contrary provision in the articles of organization or a written operating agreement, or written consent of all other members at the time, the member (A) makes an assignment for the benefit of creditors; (B) files a voluntary petition in bankruptcy; (C) is adjudicated a bankrupt or insolvent; ...

HI	Haw. Rev. Stat. § 428-601 (2014)	A member is dissociated from a limited liability company upon the occurrence of any of the following events: ... (6) If the member: (A) Becomes a debtor in bankruptcy; (B) Executes an assignment for the benefit of creditors ...
ID	Idaho Code Ann. § 30-6-602 (2014)	A person is dissociated as a member from a limited liability company when ... (7) In a member-managed limited liability company, the person: (a) Becomes a debtor in bankruptcy; (b) Executes an assignment for the benefit of creditors; ...
IL	805 Ill. Comp. Stat. 180/35-45 (2014)	Events causing member's dissociation. A member is dissociated from a limited liability company upon the occurrence of any of the following events: ... (7) The member's: (A) becoming a debtor in bankruptcy; (B) executing an assignment for the benefit of creditors; ...
IN	Ind. Code 23-18-6-3.1 (2013)	(b) Except as provided in a written operating agreement: (1) an interest is assignable in whole or in part; (2) an assignment entitles the assignee to receive, to the extent assigned, only the distributions to which the assignor would be entitled; (3) an assignment of an interest does not of itself dissolve the limited liability company or entitle the assignee to participate in the management and affairs of the limited liability company or to become or exercise any rights of a member
IA	Iowa Code Ann. § 489.602 (2014)	A person is dissociated as a member from a limited liability company when any of the following applies: ... 7. In a member-managed limited liability company, the person does any of the following: a. Becomes a debtor in bankruptcy. b. Executes an assignment for the benefit of creditors.
KS	Kan. Stat. Ann. § 17-7689 (2014)	A person ceases to be a member of a limited liability company upon the happening of any of the following events: (a) Unless otherwise provided in an operating agreement, or with the written consent of all members, a member: (1) Makes an assignment for the benefit of creditors; (2) files a voluntary petition in bankruptcy; ...
KY	Ky. Rev. Stat. Ann. § 275.280 (2014)	(1) A person shall disassociate from and cease to be a member of a limited liability company upon the occurrence of one (1) or more of the following events: ... (d) Unless otherwise provided in a written operating agreement or by written consent of majority-in-interest of the members, at the time the member: 1. Makes an assignment for the benefit of creditors; 2. Files a voluntary petition in bankruptcy; 3. Is adjudicated bankrupt or insolvent; ...
LA	La. Rev. Stat. Ann. 12:1332 (2014)	A. Except as otherwise provided in the articles of organization or a written operating agreement: (1) An assignee of an interest in a limited liability company shall not become a member or participate in the management of the limited liability company unless the other members unanimously consent in writing. (2) Until the assignee of an interest in a limited liability company becomes a member, the assignor shall continue to be a member ...
ME	Me. Rev. Stat. tit. 31, § 1582 (2014)	A person is dissociated as a member from a limited liability company when: ... 7. Bankruptcy; assignment; appointment of trustee, receiver or liquidator. The person becomes a debtor in bankruptcy, executes an assignment for the benefit of creditors or seeks, consents or acquiesces to the appointment of a trustee, receiver or liquidator of the person or of all or substantially all of the person's property.
MD	Md. Code Ann., Corps. & Ass'ns § 4A-606 (West 2013)	A person ceases to be a member of a limited liability company upon the occurrence of any of the following events: ... (3) Unless otherwise provided in the operating agreement or with the consent of all other members, the person: (i) Makes an assignment for the benefit of creditors; (ii) Files a voluntary petition in bankruptcy; (iii) Is adjudged bankrupt or insolvent or has entered against the person an order for relief in any bankruptcy or insolvency proceeding; ...

MA	Mass. Gen. Laws Ann. ch. 156C, § 39 (2014)	(a) A limited liability company interest is assignable in whole or in part except as provided in the operating 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: (1) upon the approval of all of the members of the limited liability company other than the member assigning the limited liability company interest; or (2) upon compliance with any procedure provided for in a written operating agreement.
MI	Mich. Comp. Laws Ann. § 450.4505 (2014)	(1) Except as provided in an operating agreement, a membership interest is assignable in whole or in part. (2) An assignment of a membership interest does not of itself entitle the assignee to participate in the management and affairs of a limited liability company or to become or exercise any rights of a member. An assignment entitles the assignee to receive, to the extent assigned, only the distributions to which the assignor would be entitled.
MN	Minn. Stat. § 322B.306 (2014)	Subdivision 1. Termination defined; member's power to terminate. The continued membership of a member in a limited liability company is terminated by: ... (viii) the member's bankruptcy; ...
MS	Miss. Code. Ann. § 79-29-313 (2013)	(3) Unless otherwise provided in the certificate of formation or written operating agreement or with the written consent of all members, a member ceases to be a member upon the happening of the following events: (a) A member: (i) makes an assignment for the benefit of creditors; (ii) files a voluntary petition in bankruptcy; (iii) is adjudicated a bankrupt or insolvent; ...
MO	Mo. Rev. Stat. § 347.123 (2014)	A person ceases to be a member of a limited liability company upon the happening of any of the following events of withdrawal: ... (4) Unless otherwise provided in the operating agreement or by the specific written consent of all members at the time, the member: (a) Makes an assignment for the benefit of creditors; (b) Is the subject of a bankruptcy; ...
MT	Mont. Code Ann. § 35-8-803 (2014)	(1) A member is dissociated from a limited liability company upon the occurrence of any of the following events: ... (g) the member's: (i) becoming a debtor in bankruptcy; (ii) executing an assignment for the benefit of creditors; ...
NE	Neb. Rev. Stat. § 21-145 (2014)	A person is dissociated as a member from a limited liability company when: ... (7) in a member-managed limited liability company, the person: (A) becomes a debtor in bankruptcy; (B) executes an assignment for the benefit of creditors; ...
NV	Nev. Rev. Stat. § 86.351 (2014)	1. The interest of each member of a limited-liability company is personal property. The articles of organization or operating agreement may prohibit or regulate the transfer of a member's interest. Unless otherwise provided in the articles or operating agreement, a transferee of a member's interest has no right to participate in the management of the business and affairs of the company or to become a member unless a majority in interest of the other members approve the transfer. If so approved, the transferee becomes a substituted member. The transferee is only entitled to receive the share of profits or other compensation by way of income, and the return of contributions, to which the transferor would otherwise be entitled.
NH	N.H. Rev. Stat. Ann. § 304-C:100 (2014)	Unless the operating agreement provides otherwise, an individual who is a member of a limited liability company shall be dissociated upon the occurrence of any of the following events: ... IV. Unless the other members at the time of occurrence of any of the following events vote unanimously not to treat the event as an event of dissociation, and except in the case of a single member limited liability company, the member: (a) Makes an assignment for the benefit of creditors; (b) Files a voluntary petition in bankruptcy; (c) Is adjudicated a bankrupt or insolvent; ...
NJ	N.J. Stat. Ann. § 42:2C-46 (West 2014)	A person is dissociated as a member from a limited liability company when: ... g. In a member-managed limited liability company, the person: (1) becomes a debtor in bankruptcy; (2) executes an assignment for the benefit of creditors; ...

NM	N.M. Stat. Ann. § 53-19-38 (2014)	B. Unless the articles of organization or an operating agreement provides otherwise, or the member shall obtain the written consent of all members to his continuing membership, a member ceases to be a member of a limited liability company upon the occurrence of one or more of the following events: (1) the member: (a) makes an assignment for the benefit of creditors; (b) files a voluntary petition in bankruptcy; (c) is adjudicated a bankrupt or insolvent; ...
NY	N.Y. Ltd. Liab. Co. § 603 (McKinney 2013)	(a) Except as provided in the operating agreement, (1) a membership interest is assignable in whole or in part; (2) an assignment of a membership interest does not dissolve a limited liability company or entitle the assignee to participate in the management and affairs of the limited liability company or to become or to exercise any rights or powers of a member; (3) the only effect of an assignment of a membership interest is to entitle the assignee to receive, to the extent assigned, the distributions and allocations of profits and losses to which the assignor would be entitled ...
NC	N.C. Gen. Stat. § 57D-3-02 (2014)	(a) A person ceases to be a member upon the occurrence of any of the following events: (1) The person does any of the following: a. Becomes a debtor in bankruptcy. b. Executes an assignment for the benefit of creditors ...
ND	N.D. Cent. Code § 10-32-30 (2014)	1. The continued membership of a member in a limited liability company is terminated by: ... h. The member's bankruptcy; ...
OH	Ohio Rev. Code Ann. § 1705.15 (West 2014)	Except as approved by the specific written consent of all members at the time, a person ceases to be a member of a limited liability company upon the occurrence of any of the following events of withdrawal: ... (C) Unless otherwise provided in writing in the operating agreement, the member does any of the following: (1) Makes an assignment for the benefit of creditors; (2) Files a voluntary petition in bankruptcy; (3) Is adjudicated a bankrupt or insolvent; ...
OK	Okla. Stat. Ann. tit. 18, § 2033 (2014)	A. Unless otherwise provided in an operating agreement: 1. A membership interest is not transferable; provided, however, that a member may assign the economic rights associated with a membership interest in whole or in part; 2. An assignment of the economic rights associated with a membership interest does not entitle the assignee to participate in the management and affairs of the limited liability company or to become or to exercise any rights or powers of a member; ...
OR	Or. Rev. Stat. § 63.265 (2013)	Except as otherwise provided in the articles of organization or any operating agreement: (1) A member shall cease to be a member in a limited liability company upon the member's death, incompetency, bankruptcy, dissolution, withdrawal, expulsion or assignment of the member's entire membership interest.
PA	15 Pa. Cons. Stat. Ann. § 8971 (2014)	(a) General rule.--A limited liability company is dissolved and its affairs shall be wound up upon the happening of the first to occur of the following events: ... (4) Except as otherwise provided in writing in the operating agreement, upon a member becoming a bankrupt [sic] or executing an assignment for the benefit of creditors or the death, retirement, insanity, resignation, ...
RI	R.I. Gen. Laws § 7-16-35 (2014)	(a) Unless otherwise provided in the articles of organization or a written operating agreement: (1) A membership interest is assignable in whole or in part; (2) An assignment of a membership interest does not of itself dissolve a limited liability company or entitle the assignee to participate in the management and affairs of the limited liability company or to become a member or to exercise any rights or powers of a member; (3) An assignment entitles the assignee to receive, to the extent assigned, only the distributions to which the assignor would be entitled; and (4) A member ceases to be a member and to have the power to exercise any rights or powers of a member on assignment of all of the member's membership interest.

SC	S.C. Code Ann. § 33-44-601 (2014)	A member is dissociated from a limited liability company upon the occurrence of any of the following events: ... (7) the member's: (i) becoming a debtor in bankruptcy; (ii) executing an assignment for the benefit of creditors; ...
SD	S.D. Codified Laws § 47-34A-601 (2014)	A member is dissociated from a limited liability company upon the occurrence of any of the following events: ... (7) The member's: (i) Becoming a debtor in bankruptcy; (ii) Executing an assignment for the benefit of creditors; ...
TN	Tenn. Code Ann. § 48-249-503 (2010)	(a) Events constituting termination. A member's membership interest in an LLC is terminated upon the occurrence of any of the following events: ... (7) The member: (A) Files a petition as a debtor in bankruptcy; (B) Executes an assignment for the benefit of creditors; ...
TX	Tex. Bus. Orgs. Code Ann. § 101.108 (West 2013)	(a) A membership interest in a limited liability company may be wholly or partly assigned. (b) An assignment of a membership interest in a limited liability company: (1) is not an event requiring the winding up of the company; and (2) does not entitle the assignee to: (A) participate in the management and affairs of the company; (B) become a member of the company; or (C) exercise any rights of a member of the company.
UT	Utah Code Ann. § 48-3a-602 (West 2014)	A person is dissociated as a member when: ... (8) in a member-managed limited liability company, the person: (a) becomes a debtor in bankruptcy; (b) executes an assignment for the benefit of creditors; ...
VT	Vt. Stat. Ann. tit. 11, § 3081 (2014)	A member is dissociated from a limited liability company upon the occurrence of any of the following events: ... (6) the member's: (A) becoming a debtor in bankruptcy; (B) executing an assignment for the benefit of creditors; ...
VA	Va. Code Ann. § 13.1-1040.1 (2014)	Except as otherwise provided in the articles of organization or an operating agreement, a member is dissociated from a limited liability company upon the occurrence of any of the following events: ... 6. The member's: a. Becoming a debtor in bankruptcy; b. Executing an assignment for the benefit of creditors; ...
WA	Wash. Rev. Code § 25.15.130 (2014)	(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; (iii) becomes the subject of an order for relief in bankruptcy proceedings; ...
WV	W. Va. Code § 31B-6-601 (2014)	A member is dissociated from a limited liability company upon the occurrence of any of the following events: ... (7) The member's: (i) Becoming a debtor in bankruptcy; (ii) Executing an assignment for the benefit of creditors; ...
WI	Wis. Stat. § 183.0802 (2013)	(1) A person ceases to be a member of a limited liability company upon the occurrence of, and at the time of, any of the following events: ... (d) Unless otherwise provided in an operating agreement or by the written consent of all members at the time of the event, the member does any of the following: 1. Makes an assignment for the benefit of creditors. 2. Files a voluntary petition in bankruptcy. 3. Becomes the subject of an order for relief under the federal bankruptcy laws.
WY	Wyo. Stat. Ann. § 17-29-602 (2014)	(a) A person is dissociated as a member from a limited liability company when: ... (vii) In a member-managed limited liability company, the person: (A) Becomes a debtor in bankruptcy; (B) Executes an assignment for the benefit of creditors; ...

Key

	Membership in LLC terminates upon bankruptcy of member.
	Membership in member-managed LLC terminates upon bankruptcy of member.
	Membership is assignable, but assignee only receives economic interest.
	Other.

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Cc: Bradley R. Duncan; Josh Rataczyk; Amit D. Ranade; Brenda Partridge
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NW Wholesale, Inc. v. Pac Organic Fruit, LLC, et al. - Harold Ostenson, et al. v. Greg Holzman, et al., Supreme Court Case No. 90891-5

Attached is a copy of the Supplemental Brief of Respondents, with Certificate of Service and Appendix A.

The person submitting this brief is Bradley R. Duncan, Telephone: (206) 623-1745, WSBA No. 36436, e-mail address: bradley.duncan@hcmp.com.

This brief is being served on all counsel of record by U.S. mail.

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