

No. 66752-1

COURT OF APPEALS, DIVISION I
OF THE STATE OF WASHINGTON

NAME INTELLIGENCE, INC., a Washington corporation; and JAY
WESTERDAL, an individual

Appellants/Cross Respondents,

vs.

GUSTAVO NELSON ARZOLA, an individual, MICHAEL KLATT, an
individual, and SUSAN PROSSER, an individual,

Respondents/Cross-Appellants.

APPEAL FROM THE SUPERIOR COURT
FOR KING COUNTY
THE HONORABLE CAROL A. SCHAPIRA

REPLY BRIEF OF APPELLANTS/
CROSS-RESPONDENTS' BRIEF

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I. REPLY TO RESTATEMENT OF THE CASE

Respondents' statement of the case is misleading in several respects. For instance, respondents assert that the Stock Right Cancellation ("SRC") Agreement payments were "not based on any type of valuation," but rather "were simply defined sums on defined dates." (Resp. Br. at 14, 16) But the amount each respondent received was directly based on the number of shares they were entitled to and the value of those shares. (CP 349, 383-87 (reflecting that each respondent received 66 cents per share)) The SRC agreements also stated the payments under those agreements were "in exchange for all the shares of Common Stock due" to the respondents. (CP 296, 311, 321) The stock right payments were also subject "to the same terms, conditions and adjustments of the Post-Closing Payments in the Exchange Agreement" further reflecting that the payment amounts were based on the value of Name Intelligence, and would be adjusted based on the amount paid by Thought Convergence for its stock. (CP 296, 311, 321)

Respondents also omit important facts underlying their receipt of the third stock right payment. Respondents do not

mention that the deadline for Thought Convergence to pay Name Intelligence the third payment under the Exchange Agreement was changed from May 2, 2010, to May 5, 2010. (1/31 RP 231-32) Respondents also neglect to mention that they did not reject Name Intelligence's May 7 check and letter tendering payment until May 13. (1/31 RP 235)

II. REPLY ARGUMENT

A. **Neither The Stock Rights Themselves Nor The Payments That Respondents Received In Consideration Of Cancelling Their Stock Rights Upon The Sale Of The Corporation Are Wages Under RCW 49.52.050.**

Respondents ignore the origin and nature of the stock right cancellation payments upon which they based their claim to double damages. The stock rights respondents received as bonuses while employees of Name Intelligence are not "wages," because the amount of stock to which each respondent was entitled to was based upon individual performance and subject to Name Intelligence's discretion. Such discretionary awards are gratuities, not wages. Respondents further ignore that the SRC payments were not in exchange for their services as employees, but rather were the consideration paid for the surrender of their ownership interests in Name Intelligence. Thus, even if their stock rights were

initially “wages,” the payments at issue here were no different than any other equity payment due an investor in consideration of their stock rights. The trial court erred in finding that the SRC payments were subject to Washington’s wage withholding law.

1. Stock Rights Received As A Discretionary Bonus Are Not “Wages.”

Respondents argue that because they would not have received their stock rights “but for” their employment, those stock rights must be “wages” under RCW 49.52.050. (Resp. Br. at 12) But discretionary bonuses are not “wages.” (See App. Br. at 15-17) This is true regardless of the form a bonus ultimately takes. Respondents’ rights to shares of Name Intelligence stock were not initially “wages,” but discretionary bonuses.

“[A] discretionary bonus, unless given consistently and repeatedly, is a mere gratuity, not compensation.” ***Byrne v. Courtesy Ford, Inc.***, 108 Wn. App. 683, 690-91, 32 P.3d 307 (2001) (holding that a television awarded as a discretionary bonus was not a “wage” under RCW 49.52.050), *rev. denied.*, 146 Wn.2d 1019 (2002); *see also Coulombe v. Total Renal Care Holdings, Inc.*, 2007 WL 1367601 at *6-7 (W.D. Wash. 2007), *aff’d*, 298 F. App’x 617 (9th Cir. 2008) (holding that stock options were not

wages under RCW 49.52.050 because they were not awarded “consistently or repeatedly” and “the award of such options fell within [the employer]’s discretion”). As one court stated when interpreting a similar wage statute, “The fact that [the employer] could always decide to simply not grant [the employee] stock options . . . counsels against defining the stock option grants in this case as ‘wages.’” ***Varghese v. Honeywell Int’l, Inc.***, 424 F.3d 411, 420 (4th Cir. 2005) (stock options granted as a discretionary bonus were not “wages” under Maryland Wage Payment and Collection law).

Respondents argue that the payments here were “no different than a deferred compensation or commission agreement which provides for payments in the future.” (Resp. Br. at 13) But commissions or deferred compensation awarded as part of an employee’s *base* salary are “wages” because an employer has no discretion to withhold such compensation. Here, Name Intelligence was under no obligation to award the stock rights to respondents, but issued them shares of stock as part of a discretionary “performance based reward system.” (e.g., CP 126) “[T]he mere fact that the stock options were granted does not convert them from

a form of a gratuity or reward to 'wages' that must be paid. Under that logic, any and all forms of compensation, once granted, would constitute 'wages.'" **Varghese**, 424 F.3d at 420.

Respondents argue that regardless of whether their underlying stock rights were wages the SRC agreements transformed those rights into "wages."¹ (Resp. Br. at 13-14, 16-18) But respondents cite no cases to support this proposition. Under respondents' definition of wages, if the employer in **Byrne** paid the employee money in exchange for the TV, that payment would be "wages" even though the TV itself was not because it would be "cash compensation identified and owing." (Resp. Br. at 13) As the trial court correctly recognized, a right to own or purchase stock

¹ Respondents also cite several cases for the proposition that stock options constitute "wages." (See Resp. Br. at 13 n.8 (*citing New Jersey Ass'n of School Adm'rs v. Schundler*, 414 N.J.Super. 530, 999 A.2d 535, 546 (2010), *cert. granted*, 205 N.J. 519, 16 A.3d 384 (2011); **Schachter v. Citigroup, Inc.**, 47 Cal.4th 610, 218 P.3d 262, 268 (2009); **Kim v. Citigroup, Inc.**, 368 Ill.App.3d 298, 856 N.E.2d 639, 646 (2006), *rev. denied*, 862 N.E.2d 235 (2007)). These cases are distinguishable from the present case. **Schundler** interpreted the meaning of "compensation" under a New Jersey statute governing the contracts of school administrators and had nothing to do with a wage payment statute. In both **Schachter** and **Kim** the court held that the employer's practice of requiring employees to forfeit restricted stock received in lieu of cash compensation if they resigned within two years did not violate their respective wage payment statutes. Neither **Schachter** or **Kim** involved stock rights received as discretionary bonuses, but rather dealt with stock rights awarded as part of an employee's base salary.

itself is not “wages.” (FF 2.15, CP 481)² The trial court then erred in holding that payments in exchange for those rights are “wages” under RCW 49.52.050.

2. Name Intelligence’s Payment To Surrender Respondents’ Ownership Interest In The Company Is Not A “Wage” Because It Is Not In Consideration For The Employees’ Services Or Labor.

Name Intelligence paid respondents for their stock rights – for the surrender of their ownership interest in Name Intelligence and not in consideration of services they performed as employees. According to respondents, because they received their ownership interests as a “byproduct” of employment those interests were necessarily “wages.” (Resp. Br. at 10-14) But respondents’ contractual SRC payments were the same as any other shareholder – the right to receive money in exchange for their ownership interest. Such a right is not “wages.”

² Respondents argue that the trial court distinguished between stock options and the rights at issue here in finding that “stock options are not wages.” (FF 2.15, CP 481) (Resp. Br. at 13 n.8) However, the trial court repeatedly referred to the stock rights that were being cancelled under the SRC Agreements as “options.” (1/26 RP 29-30 (“They were being paid for stock options. Those aren’t wages.”), 1/31 RP 327) Respondents fail to offer a principled distinction between the right to purchase stock under an option and the right to acquire stock at issue here.

The SRC agreements expressly state that the payments under the agreements are “in exchange” for respondents’ rights to shares of Name Intelligence. (CP 296, 311, 321) Respondents contend that the SRC payments “were simply defined sums on defined dates.” (Resp. Br. at 16) Respondents ignore that these payments bore no relation to the value of respondents’ services (App. Br. at 17-18), but rather were based on the sale price of Name Intelligence. (CP 349, 383-87) Such payments are not “wages” because they are not in consideration for the employees’ services, but rather are for the surrender of their proprietary interest in the corporation. (App. Br. at 18-21) That respondents originally received their stock rights while employees does not transform such payments into “wages.” Respondents’ rights as shareholders to compensation for their equity interest in this closely held corporation, reflected in the Stock Right Cancellation Agreements, are no different than those of any other shareholder.

“The purposes of avoiding secret kickbacks enabling an employer to avoid minimum wage laws or collective bargaining agreement obligations, and of protecting employees’ reliance interests in their expected wages, do not apply to stock options.”

International Business Machines Corp. v. Bajorek, 191 F.3d 1033, 1039 (9th Cir. 1999). Name Intelligence owed respondents for their ownership interests in the company and not for their services as employees. The trial court erred in holding that the SRC payments were wages.

3. The Tax Treatment Of The SRC Payments Is Immaterial To Their Status As Wages.

Respondents' reliance on the tax treatment of the SRC payments is misplaced. (Resp. Br. at 14-16) Respondents cite no cases supporting the proposition that an employer's subjective belief regarding the proper tax treatment of a payment is relevant to whether it is wages.³ The question whether the SRC payments are "wages" under RCW 49.52.050 is a question of law to be determined by this court. It is not controlled by the subjective belief of the parties. ***Morgan v. Kingen***, 141 Wn. App. 143, 160-61, 169 P.3d 487 (2007) (definition of "wages" under RCW 49.52.050 is a

³ Respondents argue that this court should disregard the trial testimony establishing that Name Intelligence mistakenly withheld amounts from the SRC payments under the Federal Insurance Contribution Act (FICA) (Resp. Br. at 6 n.3), but overlook the evidence before the trial court on summary judgment that the SRC payments should not be treated as "wages" under other tax law. (See, e.g., CP 397 (Washington State Employment Security Department handbook stating that stock options are not "wages" for purposes of state unemployment taxes))

question of law), *aff'd*, 166 Wn.2d 526, 210 P.3d 995 (2009). Nor should it be controlled by the diverse treatment given to stock ownership plans under state and federal tax law. The trial court erred in holding on summary judgment that the stock right cancellation payments due respondents were wages.

B. Respondents Are Not Entitled To Attorney's Fees Because The Payments At Issue Are Not "Wages."

This court should reverse the trial court's award of attorney's fees because the SRC payments are not "wages" and thus there is no statutory basis to award respondents their attorney's fees. Respondents argue that they are entitled to contractual attorney's fees under the Exchange Agreement, irrespective of RCW 49.48.030 and 49.52.070. (Resp. Br. at 19-20) This argument is without merit.

Respondents were not parties to the Exchange Agreement. Even were they considered third party beneficiaries of the Exchange Agreement, they would have standing to enforce the agreement only against Thought Convergence, not against Name Intelligence, which sued Thought Convergence to enforce the Exchange Agreement on behalf of all Name Intelligence's shareholders, including respondents. *Kinne v. Lampson*, 58

Wn.2d 563, 567, 364 P.2d 510 (1961) (a third-party beneficiary “can enforce the contract only to the extent that it is enforceable by the promisee”)

Because the SRC Agreement, to which the respondents *are* parties, does not contain a fee provision, ***Labriola v. Pollard Group, Inc.***, 152 Wn.2d 828, 100 P.3d 791 (2004) (Resp. Br. at 21) is inapposite. The ***Labriola*** Court held that a contractual attorney’s fees provision could support an award of attorney’s fees even when the contract is invalidated by the court. 152 Wn.2d 839. It did not hold, as respondents suggest, that a court can award attorney’s fees to a litigant who is not a party to the contract for prevailing on a claim that is not based on the contract. Respondents’ entitlement to fees must stand or fall on RCW 49.48.030 and RCW 49.52.070.

C. Respondents Are Not Entitled To Their Non-Statutory Costs.

The statute at issue here authorizes the recovery of “costs of suit,” not “litigation expenses.” RCW 49.52.070. See ***Hume v. American Disposal Co.***, 124 Wn.2d 656, 674-75, 880 P.2d 988 (1994) (“costs” limited to statutory costs), *cert. denied*, 513 U.S.

1112 (1995). Respondents cite the ***Olympic Steamship***⁴ doctrine to support their claim to non-statutory costs, but this is not an insurance coverage dispute. (Resp. Br. at 18-19 (citing ***Panorama Village Condo. Owners Ass'n Bd. of Directors v. Allstate Ins. Co.***, 144 Wn.2d 130, 144, 26 P.3d 910 (2001))

Olympic Steamship's limited exception to the narrow definition of costs applies only "[w]hen insureds are forced to file suit to obtain the benefit of their insurance contract," and has no application to recovery of costs under Washington's wage payment statutes. ***Panorama***, 144 Wn.2d at 143 (quotation omitted). Washington courts have rejected attempts to apply ***Panorama*** outside the context of an insured suing to establish coverage. See, e.g., ***Park Avenue Condo. Owners Ass'n v. Buchan Developments, L.L.C.***, 117 Wn. App. 369, 388, 71 P.3d 692 (2003) (refusing to award litigation expenses under ***Panorama*** to party who prevailed under the Washington Condominiums Act), *on reconsideration in part*, 75 P.3d 974; see also ***Polygon Northwest Co. v. American Nat. Fire Ins. Co.***, 143 Wn. App. 753, 795-96, 189 P.3d 777 (2008) ("The equitable basis established in ***Olympic***

⁴ ***Olympic S.S. Co., Inc. v. Centennial Ins. Co.***, 117 Wn.2d 37, 53, 811 P.2d 673 (1991).

Steamship for attorney fee awards is limited to efforts necessary to establish coverage for claims against the insured”) (holding that **Olympic Steamship** did not extend to equitable contribution claims between insurers), *rev. denied*, 164 Wn.2d 1033 (2008).

Statutory costs are narrowly defined. **Hume**, 124 Wn.2d at 674 (“Costs have historically been very narrowly defined, and RCW 4.84.010 limits cost recovery to a narrow range of expenses such as filing fees, witness fees, and service of process expenses.”). The Washington Supreme Court has previously held that the phrase “costs of suit” in a statute limits the prevailing party to statutory costs under RCW 4.84.010. See **Nordstrom, Inc. v. Tampourlos**, 107 Wn.2d 735, 743, 733 P.2d 208 (1987) (RCW 19.86.090, which authorizes the award of “costs of the suit,” did not authorize award of costs beyond those allowed under RCW 4.84.010). The trial court erred in refusing to limit respondents to statutory costs under RCW 4.84.010.

III. ARGUMENT IN RESPONSE TO CROSS-APPEAL

Like the other SRC payments, the third SRC payment is not a “wage” and thus respondents are not entitled to exemplary damages. But even if all the SRC payments were “wages,”

substantial evidence supports the trial court's finding that Name Intelligence only "willfully" withheld a small portion of the third payment. If this court affirms the trial court's findings that the SRC payments were wages, this court should also affirm the trial court's factual determination that Name Intelligence did not act willfully and with intent to deprive respondents of their wages in paying their third and final payment only several days after it received an adjusted payment following settlement with Thought Convergence.

A. Respondents' Cross-Appeal Should Be Rejected Because The Trial Court's Denial Of Summary Judgment May Not Be Reviewed After A Full Trial On The Merits, And Respondents Have Not Assigned Error To Specific Findings of Fact.

Ignoring the trial court's findings of fact, respondents argue that the trial court erred "by refusing to enter a summary judgment awarding double damages for the May 2010 payment." (Resp. Assignment of Error No. 1) But "a denial of summary judgment cannot be appealed following a trial if the denial was based upon a determination that material facts are in dispute and must be resolved by the trier of fact." *Johnson v. Rothstein*, 52 Wn. App. 303, 304, 759 P.2d 471 (1988). Here, the trial court reserved ruling on whether double damages were warranted until after trial

because whether Name Intelligence acted willfully and whether there was a bona fide dispute was a question of fact. (CP 455-56; 1/26 RP 32) Because the court's denial of summary judgment is not reviewable after trial, this court should refuse to consider respondent's cross-appeal for this reason alone.

Respondents do not assign error or set out as required by RAP 10.3(g) the specific challenged findings of fact underlying the court's refusal to award double damages on the third SRC payment, including its findings that the circumstances surrounding the final May 2010 payment, received by respondents twenty-two days after the date set out in the SRC Agreement, did not establish "willful withholding" under RCW 49.52. (FF 4.6, CP 483) Instead, respondents assert that the trial court erred "by refusing to enter a judgment awarding double damages against the appellants for the May 2010 payment." (Resp. Assignment of Error No. 2) Because Respondents fail to challenge the factual determinations underlying the trial court's decision, those findings are verities on appeal. ***Merriman v. Cokeley***, 168 Wn.2d 627, 631, 230 P.3d 162 (2010) ("Unchallenged findings of fact are verities on appeal.").

B. Substantial Evidence Supports The Trial Court's Determination That The 22 Day Delay In Payment Of The Third SRC Payment Was Not "Willful."

"The question of whether the employer willfully withheld money owed . . . is a question of fact" and a court's "review is limited to whether there was substantial evidence to uphold the court's decision." *Lillig v. Becton-Dickinson*, 105 Wn.2d 653, 660, 717 P.2d 1371 (1986). A trial court's finding withstands appellate review if the evidence is "in sufficient quantum to persuade a fair-minded person of the truth of the declared premise." *Lillig*, 105 Wn.2d at 658 (quotations omitted). Contrary to respondents' assertion that review is de novo (Resp. Br. at 23), the trial court's finding that all but a small portion of the third SRC payment was not willfully withheld is a factual determination reviewed for substantial evidence.

Respondents' factual challenge to the trial court's finding that Name Intelligence did not act "willfully" ignores the circumstances surrounding this final payment. Thought Convergence did not pay Name Intelligence its (reduced) final payment until May 5, 2010. (FF 4.3, CP 482-83; 1/31 RP 231-32) Name Intelligence attempted to make the third payment to respondents, and settle the litigation

on May 7, 2010. (CP 288-290; FF 4.4, 4.5, CP 483; 1/27 RP 60) Respondents rejected this tender because it charged respondents a portion of the corporation's expenses in settling the Thought Convergence lawsuit, but did not do so until May 13, 2010. (1/31 RP 235) Moreover, plaintiff Carl Taylor accepted the payment, thus further reducing the lump sum due this group of shareholders. (FF 4.5 n.2, CP 483; 1/27 RP 216) Name Intelligence paid the remaining respondents unconditionally on May 24, 2010. (FF 4.5; CP 483)

RCW 49.52.070 "provides double damages only for the *willful* withholding of wages." **Lillig**, 105 Wn.2d at 659 (emphasis added). An employer's attempt to pay its employees, and the employees' subsequent rejection of that attempt, is probative evidence that an employer did not "willfully" withhold wages under RCW 49.52.070. See **Yates v. State Bd. for Community College Educ.**, 54 Wn. App. 170, 773 P.2d 89, *rev. denied*, 113 Wn.2d 1005 (1989). In **Yates**, a counselor at a community college sued for unpaid wages, arguing that the college's failure to pay him for "professional improvement credits" earned under a collective bargaining agreement violated RCW 49.52.070. During

negotiations with the union the college offered to pay for the credits, but these offers were rejected. The trial court dismissed the counselor's case. 54 Wn. App. at 174. The Court of Appeals affirmed citing the college's offer to pay the counselor for his credits as evidence that the college did not act "willfully" under RCW 49.52.070. 54 Wn. App. at 177.

Similarly, here, Name Intelligence should not be penalized for its good faith attempt to pay respondents amounts that were in dispute and not subject to immediate resolution. Name Intelligence did not know how much it would receive from Thought Convergence until the 2010 settlement, which reduced the purchase price by \$125,000. (CP 353; FF 4.3; CP 482-83) Contrary to respondents' "res judicata" argument, Judge Kallas' 2009 partial summary judgment (CP 235-36, 518-22) did not address whether a reduction in the sale price of Name Intelligence could be deducted from the final SRC payment. Nor could it have resolved this issue, because the amounts due under the stock right cancellation agreements were "subject to . . . adjustment" based on

the Exchange Agreement. (CP 269, 311, 321)⁵ The dispute involving the amounts due under the Exchange Agreement was not resolved until 2010. (CP 353; FF 4.3; CP 482-83) Substantial evidence supports the trial court's finding that there was a bona fide dispute over whether Name Intelligence had the right to reduce the final 2010 payment to reflect the reduction of Thought Convergence's purchase price.

In *Backman v. Northwest Pub. Ctr.*, 147 Wn. App. 791, 197 P.3d 1187 (2008) (Resp. Br. at 24-26), unlike here, the employer "willfully" withheld its employee's wages because the employer knew the amount owed to its employee when it delayed payment. 147 Wn. App. at 793 (employee's commissions were earned as soon as the advertisements sold by the employee appeared in their respective magazines). Here, the parties could not even agree on what payments were due respondents until Name Intelligence settled with, and then received final payment from Thought Convergence on May 5, 2010. Further, in *Backman*

⁵ Respondents do not challenge the trial court's determination that there was a bona fide dispute regarding \$3,625.18 of the third payment, which reflects respondents' pro rata share of the \$125,000 reduction in the sale price of Name Intelligence that was negotiated in the settlement between Name Intelligence and Thought Convergence. (Resp. Br. at 10 n.6; FF 4.7, CP 484)

there was no attempt by the employer to pay the employee his wages. In contrast, Name Intelligence was actively negotiating with the respondents and attempted to pay these equity owners just two days after receiving the final payment from Thought Convergence, reaching agreement with one of them. Even if these adjusted stock right payments were “wages,” the trial court did not err in finding that Name Intelligence did not act willfully and with the intent to deprive respondents of all or part of their wages in negotiating a resolution with this group of stock right holders.

C. Respondents Are Not Entitled To Their Attorney’s Fees On Appeal.

If, as Name Intelligence has argued, respondents did not prevail on their claim for “wages,” respondents were not entitled to attorney’s fees as prevailing parties below. (App. Br. at 21-22) Respondent’s request for fees on appeal is based on their entitlement to fees below. (Resp. Br. at 26) Because the trial court erred in awarding respondents their attorney’s fees below, the court should deny respondents their fees on appeal. Moreover, to the extent this court rejects any portion of their arguments on appeal, respondents should not be deemed prevailing parties for purposes of RCW 49.48.030 and RCW 49.52.070.

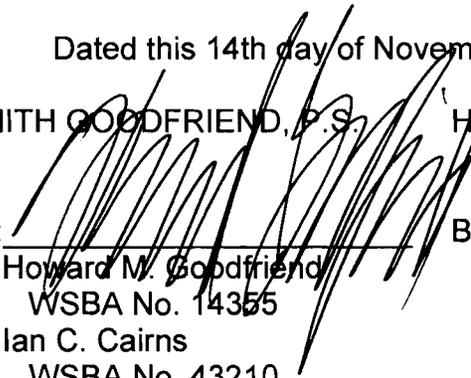
IV. CONCLUSION

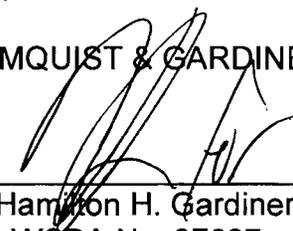
This court should reverse and vacate the judgment for exemplary damages under RCW 49.52.050 and for attorney fees and litigation expenses under RCW 49.52.070 and RCW 49.48.030. This court should also reject cross-appellants' appeal.

Dated this 14th day of November, 2011.

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DECLARATION OF SERVICE

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

That on November 14, 2011, I arranged for service of the foregoing letter to the clerk with attached Reply Brief of Appellants/ Cross-Respondents' Brief, to the court and to the parties to this action as follows:

Office of Clerk Court of Appeals - Division I One Union Square 600 University Street Seattle, WA 98101	<input type="checkbox"/> Facsimile <input type="checkbox"/> Messenger <input checked="" type="checkbox"/> U.S. Mail <input type="checkbox"/> Overnight Mail
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DATED at Seattle, Washington this 14th day of November, 2011.



Victoria K. Isaksen

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