73915-8

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Court of Appeals
Division I
State of Washington

73915-8

No. 73915-8-I

COURT OF APPEALS OF THE STATE OF WASHINGTON,
DIVISION I

MARK JORDAN,

Appellant,

v.

COLUMBIA STATE BANK,

Respondent,

and

INVICTA LAW GROUP, PLLC

Defendant.

BRIEF OF RESPONDENT

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I. INTRODUCTION

The doctrine of successor liability was designed to protect creditors against unscrupulous debtors who would otherwise seek to avoid their financial obligations through fraudulent transfers or by the mere changing of corporate hats. It was designed to protect good-faith lenders like Columbia State Bank – who, through its financing programs, provides capital and opportunity for small businesses to grow and succeed. And it was designed to protect those lenders from debtors like Mark Jordan, whose law practice benefited from a $165,000 loan from Columbia State Bank and whose attempt to avoid repayment of that loan by the mere changing of his corporate status rightly failed.

This case represents the poster child for successor liability in Washington State. Appellant Mark Jordan ("Jordan") acting as Invicta Law Group PLLC (the "PLLC") borrowed $165,000 from Respondent Columbia State Bank ("CSB") evidenced by a Promissory Note executed by Jordan on behalf of the PLLC (the "Note"). The Note was backed by Jordan's personal guaranty. However, just months before the balloon payment was set to come due, Jordan filed personal bankruptcy and converted the PLLC from a professional limited liability company to a sole proprietorship. Aside from his entity status, however, Jordan maintained the exact same law practice as before. As Invicta Law Group sole proprietorship, he served the same clients, maintained the same office, employed the same staff, used the same contact information, and held himself out as the PLLC in essentially every way – other than, of course, repayment of the PLLC's debt. What's more, Jordan took all of these actions in secret: without telling the PLLC's clients, its landlord, its insurer, or its subtenants.

The evidence at trial established that Jordan effectuated this scheme specifically to avoid his obligations to CSB. Accordingly, the trial court found Jordan liable as the successor to the PLLC. Despite mountains of uncontroverted evidence in support of the trial court's decision, Jordan nevertheless asks this Court to reverse because, according to Jordan, "CSB's right to foreclose on the collateral gave it everything to which it even arguably was entitled." But even Jordan admits that "the collateral" he refers to—and the only collateral made available—was "worthless." Such worthless collateral does not provide adequate or complete relief to CSB who is rightfully owed more than $150,000 on the Note. However, holding Jordan liable for the debts he chose to incur does provide that relief. The trial court's ruling was based on substantial evidence and should be upheld in every respect.

II. STATEMENT OF THE CASE[1]

In February of 2012, CSB loaned the PLLC $165,000. (Ex. 7). To obtain the loan, the PLLC's sole member, Mark Jordan, executed the Note (Ex. 7), Security Agreement (Ex. 8), and Loan Agreement on behalf of the PLLC (Ex. 9), in addition to executing a Personal Guaranty for the Note (the "Guaranty") (Ex. 81). The terms of Note required the PLLC to make twenty-three (23) consecutive monthly payments of $2,377.04 beginning March 20, 2012 at an interest rate of 5.5 percent per annum, with a final balloon payment of the balance on February 20, 2014. (Ex. 7). The Security Agreement granted CSB a first-priority security interest in all of the PLLC's personal property, including intangibles. (Ex. 8). The parties agreed that both the Note and the Security Agreement would be binding against all successors. (Ex. 7 & 8; *see also* CP 147). Mark Jordan personally signed each loan document. (Ex. 7, 8, 9, & 81).

On September 30, 2013, Jordan filed personal bankruptcy. (CP 148). That same day, he ceased operating as the PLLC and began operating as Invicta Law Group, sole proprietor. (CP 148). Jordan testified that the only steps he took to effectuate the conversion was to (1) apply for

[1] Jordan's Statement Of The Case contains uncited facts and impermissible argument. Such statements should be stricken and / or disregarded by the appellate court. RAP 10.3(a)(5).

a new tax ID number, (2) apply for a new UBI number, and (3) open new bank accounts. (RP 87).

Every other facet of Jordan's law practice remained the same including its trade name, location, services, clients, and contact information. (CP 149). Moreover, Jordan continued to hold himself out as the PLLC – including entering into new client agreements as the PLLC (Ex. 79), entering into new subleases as the PLLC (Ex. 35; RP 134-35), accepting sublease payments made out to the PLLC and depositing the sublease payments into his sole proprietor accounts (RP 98). Importantly, Jordan accomplished all of this without informing the PLLC's clients (RP 94), opposing counsel in ongoing PLLC cases (RP 96-97), or the PLLC's landlord (Hart Dep. 20:8-18, 21:10-21). Moreover, between September and November 2013, Jordan via a series of withdrawals and deposits transferred funds from the PLLC's accounts at CSB to the sole proprietorship's accounts at Umpqua Bank and American West Bank. (CP 148). All bank accounts were in the name of "Invicta." (*See, e.g.*, Ex. 29, 47, & 74).

On January 2, 2014, less than two months before the balloon payment was to come due on the Note, the bankruptcy court discharged Jordan's personal Guaranty. (CP 148). Jordan's personal Guaranty "was a significant reason for Jordan's bankruptcy." (Ap. Br. at 1). Notably, the

PLLC never filed bankruptcy. (CP 148). In fact, at trial Jordan made it clear that he "didn't leave Invicta because of its financial problems. He left Invicta because of his financial problems." (RP 487-88). Yet Jordan concedes "[t]he sole purpose in winding up the LLC was to get rid of creditors." (RP 485).

The last payment the PLLC made to CSB on the Note was in October of 2013. (CP 148). Thereafter, Jordan contacted CSB to acknowledge the default and make available certain collateral to CSB. Jordan agreed to provide additional information to CSB, including detailed financial and accounts receivable information as well as his bankruptcy schedules. (Ex. 82). Counsel for CSB also requested a detailed inventory of the collateral being made available. (RP 400-01). Jordan never provided the information. (RP 401). Nevertheless, Jordan continued to use the PLLC's assets. (*E.g.*, Ap. Br. at 1, 8, & 10). When CSB inspected the collateral made available to it, CSB discovered what Jordan now concedes: the collateral was worthless. (Ex. 80; *see also* Ap. Br. at 41).

On February 6, 2014, CSB filed suit in King County Superior Court against the PLLC for breach of contract and foreclosure and against Mark Jordan for successor liability. (CP 1-9). On December 17, 2014, CSB obtained the entry of an order for summary judgment against the PLLC for liability on the Note. (CP 78-80). After a bench trial, Judge Sean

O'Donnell awarded CSB $151,360.40 against the PLLC and Mark Jordan jointly and severally under the doctrine of successor liability, holding that Jordan's sole proprietorship was a "mere continuation" of the PLLC. (CP 153). Specifically, the trial court found: (1) the PLLC defaulted on the Note; (2) the PLLC transferred all its assets to Jordan; (3) there was no consideration given by Jordan; and (4) on account of the transfer Jordan is liable for the PLLC's obligations on the Note. (CP 152-53).

Jordan now appeals, alleging that foreclosure on "worthless collateral" is an adequate remedy for the PLLC's failure to pay over $150,000 on a debt it rightfully owed. (*E.g.*, Ap. Br. at 19). Because Jordan fails to identify any reversible or material error, the decisions of the trial court should be affirmed in every respect.

III. STANDARD OF REVIEW

"Where a court evaluates evidence in a bench trial, appellate review is limited to determining whether the findings are supported by substantial evidence and whether the findings support the conclusions of law." *State v. Kaiser*, 161 Wn. App. 705, 723, 254 P.3d 850, 860 (2011). Substantial evidence is "the quantum of evidence sufficient to persuade a rational fair-minded person." *Sunnyside Valley Irrig. Dist. v. Dickie*, 149 Wn.2d 873, 879, 73 P.3d 369 (2003). The court shall "view the evidence and all reasonable inferences in the light most favorable to the prevailing party." *Kaiser*, 161 Wn. App. at 723-24. To be considered by the appellate court, the appellant must indicate "[a] separate assignment of error for each finding of fact a party contends was improperly made" and must include "reference to the finding by number." RAP 10.3(g). "On review, unchallenged findings of fact are verities on appeal." *In re Estate of Jones*, 152 Wn.2d 1, 8, 93 P.3d 147, 151 (2004).

IV. ARGUMENT

A. Substantial Evidence Supports The Trial Court's Finding Of Successor Liability Against Jordan.

Because Jordan usurped all of the PLLC's valuable assets without consideration and with the specific intent to avoid creditors, he is appropriately liable for the PLLC's debts and obligations as its successor. The record demonstrates that the trial court's finding of successor liability was based on substantial evidence and should be affirmed.

1. Successor liability is meant to protect creditors like CSB.

In order to protect bona fide purchasers who lack notice of prior claims, a general rule of corporate succession is that a "purchasing corporation does not become liable for the debts of the selling corporation." *Eagle Pac. Ins. Co. v. Christensen Motor Yacht Corp.*, 135 Wn.2d 894, 901, 959 P.2d 1052, 1055 (1998). Washington courts, however, will impose successor liability when "(1) there is an express or implied agreement for the purchaser to assume liability; (2) the purchase is a *de facto* merger or consolidation; (3) the purchaser is a mere continuation of the seller; or (4) the transfer of assets is for the fraudulent purpose of escaping liability." *Cambridge Townhomes, LLC v. Pac. Star Roofing, Inc.*, 166 Wn.2d 475, 482, 209 P.3d 863, 868 (2009), *as corrected* (Sept. 22, 2009). These exceptions "were developed principally to protect creditors." *See, e.g.*, *George v. Parke-Davis*, 107 Wn.2d 584, 588, 733 P.2d 507, 510 (1987); *see also Martin v. Abbott Labs.*, 102 Wn.2d 581, 609, 689 P.2d 368, 384-85 (1984). "In any of these four circumstances, the court will find that the acquiring entity is a successor to the liabilities and obligations of the selling corporation." *Abbott Labs.*, 102 Wn.2d at 609.

2. Successor liability against Jordan is appropriate here because it provides the only path for CSB to achieve an adequate and complete remedy.

The trial court properly invoked its equitable jurisdiction in finding Jordan liable under the doctrine of successor liability. A court may impose successor liability when the plaintiff lacks "a clear, adequate, complete, and speedy remedy at law." *See, e.g.*, *Gall Landau Young Const. Co. v. Hedreen*, 63 Wn. App. 91, 99, 816 P.2d 762, 767 (1991). "Where the remedy by action for damages is inadequate or insufficient to do complete justice between the parties, equity will take jurisdiction and grant proper relief." 30A C.J.S. Equity § 25 (cited by *Gall*). "[T]he fact that a plaintiff may have a remedy at law by an action for damages does not prevent equity from assuming jurisdiction if the equitable remedy is better adapted to render more perfect and complete justice than the remedy at law." *Id.*

"Whether there is a plain, speedy, and adequate remedy in the ordinary course of the law is a question left to the discretion of the court." *River Park Square, L.L.C. v. Miggins*, 143 Wn.2d 68, 76, 17 P.3d 1178, 1182 (2001); *see also Ahmad v. Town of Springdale*, 178 Wn. App. 333, 342, 314 P.3d 729, 733 (2013). An appellate court "will not disturb a decision regarding a plain, speedy, and adequate remedy on review unless the superior court's discretion was manifestly unreasonable, or exercised on untenable grounds, or for untenable reasons." *Id.*

Here, the trial court determined that CSB was left without an adequate or complete remedy at law. (CP 152). The evidence unequivocally supports the trial court's finding. Jordan relies on *Seattle Mortgage Co.* in arguing that CSB had an adequate remedy at law in its contractual right to foreclose on *some* of the PLLC's physical collateral which he selectively made available. (Ap. Br. at 16-22). Jordan's reliance on *Seattle Mortgage* is misplaced. In that case, Tacoma PUD had made a $3,186.96 loan secured by a deed of trust to the borrower's residence. When the borrower defaulted, Tacoma PUD had the right to foreclose on the borrower's residence, which was worth substantially more than the loan balance. Because Tacoma PUD had an adequate legal remedy in the form of a lien on real property, the court refused to grant an equitable lien which would have allowed Tacoma PUD to terminate utility services to the residence until the loan was paid. The case did not involve successor liability and is entirely inapplicable here. *See Seattle Mortgage Co. v. Unknown Heirs of Gray*, 133 Wn. App. 479, 500, 136 P.3d 776, 788 (2006).

Unlike the borrower in *Seattle Mortgage*, Jordan admits that the "collateral" he made available was "worthless" (Ap. Br. at 41). Every other asset belonging to the PLLC—those with *any value*—were usurped by Jordan's sole proprietorship. Foreclosure on admittedly "worthless collateral" would be both inadequate and insufficient to do complete justice here. Moreover, the court in *Seattle Mortgage* acknowledged that "neither case law nor statute" provided the specific form of relief sought by Tacoma PUD, and therefore the court refused to fashion what it saw as an extraordinary remedy absent clear authority to do so. *Seattle Mortgage*, 133 Wn. App. at 497. Here, on the other hand, the well-established doctrine of successor liability specifically provides for the relief CSB seeks.

Jordan's reliance on *Sorenson* is likewise misplaced. (Ap. Br. at 18). In *Sorenson*, the Supreme Court refused to grant an equitable lien against real property because (a) the plaintiff had already obtained an $868,000 judgment against defendants and (b) the owner of the real property was an *innocent* third party.[2] *See Sorenson v. Pyeatt*, 158 Wn.2d 523, 544, 146 P.3d 1172, 1182 (2006). The Court concluded "that the Lenders have failed to show how the equities would be served by requiring, in essence, Sorenson [innocent third party] to bear the burden of satisfying the Lenders' judgment against the Pyeatts [defendants]." *Id.*

Here, unlike in *Sorenson*, the trial court expressly found that CSB's legal remedy (*i.e.*, foreclosure on worthless collateral) was inadequate in light of the debt owed. Moreover, Jordan is not an innocent third party: He is the successor to the PLLC and rightfully subject to successor liability under Washington law.

Jordan also argues that "[a] secured creditor can never satisfy the fundamental requirements of a successor liability claim" because a secured creditor always has the right to foreclose on collateral.[3] (Ap. Br. at

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[2] Like *Seattle Mortgage*, *Sorenson* does not address successor liability.

[3] Jordan contends that "CSB's right to foreclose…gave it everything to which it even arguably was entitled under its agreement with Invicta." (Ap. Br. at 19). This of course ignores CSB's right to pursue all available remedies at law or in equity – the most fundamental of which is the right to collect a money judgment against any and all liable parties, including successors, for the amount owed. (*See, e.g.*, CP 18; Ex. 8)

20). Under Jordan's theory, foreclosure on collateral is an adequate remedy regardless of the value of the collateral or the size of the debt. This argument turns equity on its head. Not surprisingly, Jordan fails to cite a single authority for this proposition. As a result, the Court should decline to consider this argument. *See In re Marriage of Fahey*, 164 Wn. App. 42, 59, 262 P.3d 128, 136-37 (2011) ("We do not address arguments that are not supported by cited authorities"); *Estate of Becker v. Forward Tech. Indus., Inc.*, 192 Wn. App. 65, 81, 365 P.3d 1273, 1281 (2015) ("We will not address issues raised without proper citation to legal authority"); *see also* RAP 10.3(a)(6). "Where no authorities are cited in support of a proposition, the court is not required to search out authorities, but may assume that counsel, after diligent search, has found none." *DeHeer v. Seattle Post-Intelligencer*, 60 Wn.2d 122, 126, 372 P.2d 193, 195 (1962); *see also In re T.W.J.*, 193 Wn. App. 1, 367 P.3d 607, 610 (2016).

To the contrary, where the debtor makes available only "worthless collateral" and transfers all other valuable assets, including intangibles, to a successor entity for insufficient consideration, a secured creditor most assuredly *can* satisfy the necessary elements for equitable relief because at that point the creditor's legal remedy (*i.e.*, foreclosure) is, by definition, inadequate and incomplete and "the equitable remedy is better adapted to render more perfect and complete justice than the remedy at law." *See* 30A C.J.S. Equity § 25.

These are precisely the circumstances the doctrine of successor liability was designed to combat. As Jordan admits, in each of the cases he cites, "legal remedies were uncertain *but adequate*." (Ap. Br. at 18) (emphasis added). Here, it was patently reasonable for the trial court to determine that foreclosure on "worthless collateral" was grossly inadequate in light of the $151,360.40 debt owed. Accordingly, the trial court's decision finding Jordan to have successor liability for the PLLC debt to CSB should be affirmed.

3. The evidence overwhelmingly supports the trial court's finding that Jordan's sole proprietorship is a mere continuation of the PLLC.

In determining whether an entity[4] is a mere continuation of its predecessor, Washington courts consider two factors: (1) "a common identity between the officers, directors, and stockholders of the selling and purchasing companies" and (2) "the sufficiency of the consideration running to the seller corporation in light of the assets being sold."[5]

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[4] The fact that Jordan converted the PLLC into a sole proprietorship does not change the analysis. Mere continuation applies regardless of the form of the entities. *Cambridge*, 166 Wn.2d at 482.

[5] Jordan cites *Gall* for the proposition that there is a third "implied" element. (Ap. Br. at 28). *Cambridge*, however, supersedes *Gall* and applies the traditional two-factor test. *Cambridge*, 166 Wn.2d at 482. Likewise, Jordan's reliance on *Hall v. Armstrong Cork,*

Cambridge, 166 Wn.2d at 482. "In considering these factors, the objective of the court is to discern whether the purchaser represents merely a new hat for the seller." *Id.* (internal quotations omitted); *see also Gall*, 63 Wn. App. at 96-97 ("The mere continuation theory is designed to prevent the corporation from escaping liability by merely changing hats") (internal quotations omitted).

Here, there is no dispute that the first factor is met as Jordan controlled at all relevant times both the PLLC and the sole proprietorship. And it is uncontested that Jordan failed to pay any consideration, much less sufficient consideration, for any of the assets he usurped from the PLLC. On its face, the test for mere continuation has been met.

Nevertheless Jordan argues that he cannot be liable as a successor under the mere-continuation theory without evidence of an *actual* transfer of assets from the PLLC to the sole proprietorship (*e.g.*, a formal assignment or sale). (Ap. Br. at 22-28). Jordan's proposition is again without citation or support and directly contradicts controlling authority.

Under Washington law, "[l]iability may be imposed regardless of the exact form of transfer of assets between the corporations." *Eagle Pac.*,

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Inc. is misplaced as that case specifically deals with the "product line rule" of liability. 103 Wn.2d 258, 262, 692 P.2d 787, 790 (1984). That test is not applicable here.

135 Wn.2d at 901, *citing Stoumbos v. Kilimnik*, 988 F.2d 949, 961 (9th Cir. 1993) (applying Washington law) ("We conclude that the Washington court would extend liability to transfers other than straightforward purchases. Otherwise, unscrupulous businesspersons would be able to avoid successor liability and cheat creditors merely by changing the form of the transfer"). In fact, in *Cambridge*, the Washington Supreme Court affirmed successor liability in the absence of *any* actual transfers at all. *See Cambridge*, 166 Wn.2d at 483.

The case at bar closely resembles the *Cambridge* case, in which the Washington Supreme Court held that a one-man corporation was liable for work performed by that person's prior entity because (1) the business performed by the two entities was the same, (2) the same individual was "at the helm" of both entities, and (3) the clients remained the same. *Cambridge*, 166 Wn.2d at 483. With regard to adequate consideration, the Court stated, "[t]here is no issue of sufficient consideration in this case because there was no sale of assets. Utley simply chose to incorporate his business. In sum, P.J. Inc. merely represented a new hat for the sole proprietorship. We therefore hold that P.J. Inc. assumed the sole proprietorship's liabilities under a theory of successor liability." *Id.* Thus, when an entity merely changes its entity status but continues in the same business with the same clients, that transition meets the requirement for asset transfers under the mere-continuation theory.

Here, it is undisputed that Jordan's transition from a PLLC to a sole proprietorship involved nothing more than a change in entity status.[6] Jordan continued to offer the same legal services to the same clients. (CP 149). Moreover, the record demonstrates that *all* of the PLLC's assets of value were retained by Jordan's sole proprietorship without *any* consideration whatsoever. Jordan maintained, among other things, (1) the same controlling principal (RP 111), (2) the same employees (RP 92, 103), (3) the same location under the same lease (RP 117, 120, 122-24)[7], (4) the same trade name (RP 101, 309), and (5) the same clients (RP 103). (*See also* CP 148-49, uncontested FOF 15-22). Like the defendant in *Cambridge*, Mark Jordan merely changed hats.

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[6] Jordan testified at trial that the only steps he took when he ceased operations as the PLLC and started as a sole proprietor were (1) apply for a new tax ID number, (2) apply for a new UBI number, and (3) open new bank accounts. (RP 87).

[7] Jordan contends that the PLLC could not have "transferred" its lease to Jordan because there was no evidence of a formal written assignment. (*See* Ap. Br. at 13). However, as Jordan recognizes, lease assignments may be effective without a written instrument if the parties partially perform. *Id.* Here, Jordan *fully performed* as if the lease had been assigned to him – remaining in the building and paying the rent, although usurping revenue from PLLC subtenants to cover a portion of it.

It is also important to note that Jordan's culpable conduct, in fact, goes far beyond the conduct of the defendant in *Cambridge*.[8] Here, Jordan operated as a sole proprietor *in secret*. In almost all his professional dealings, he continued to hold himself out as the PLLC. Among other things, Jordan continued to (1) accept sublease payments directed to the PLLC and deposit those payments into *his own* accounts (RP 95-96, 98-99, 198, 245), (2) enter into client agreements on behalf of the PLLC but collect the revenue for himself (RP 173-174, 185-186; Hart Dep. 25:18-27:20), (3) enter into new sublease agreements as the PLLC (RP 134-35)[9], (4) utilize the PLLC's insurance agreements for his sole proprietorship (RP 151), and (5) remain in the PLLC's office space under the PLLC's lease and benefit from the PLLC's $5,000 security deposit (RP 96, 252; Hart Dep. 14:6-15, 15:14-17).[10] Jordan did all of these things, and more,

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[8] The defendant in *Cambridge* changed entity status with full disclosure, a new name, and even entered into a separate contract as the new entity. He was nevertheless found liable under the mere-continuation theory. *See Cambridge*, 166 Wn.2d at 479.

[9] Jordan admits that the PLLC entered into the new sublease. (*See* Ap. Br. at 25). Yet he fails to explain why he—and not the PLLC—retained the revenue from the new sublease.

[10] While Jordan argues that the trial court's findings of fact with regard to the PLLC's asset transfers do not satisfy CR 52 (*see* Ap. Br. at 23), Jordan later concedes "[r]emand is not necessary here because this Court has the record and can determine for itself whether substantial evidence supports even the conclusory statements of the trial court." (Ap. Br. at 24). Further, "the trial court is not required to make findings in regard to every item of evidence introduced in a case," but instead must only make findings of ultimate fact concerning the material issues to enable an appellate court to review questions raised on appeal. *See Ford v. Bellingham-Whatcom County Dist. Bd. of Health*, 16 Wn. App. 709, 717, 558 P.2d 821 (1977) (*citing* CR 52; *Bowman v. Webster*, 42 Wn.2d 129, 133, 253 P.2d 934 (1953); *Wold v. Wold*, 7 Wn. App. 872, 875, 503 P.2d 118 (1972)) .

without disclosing the defunct status of the PLLC to its clients (RP 94), its landlord (RP 97; Hart Dep. 20:8-18, 21:10-21), its insurer (RP 144-45; CP 151), opposing counsel on the PLLC's cases (RP 96-97), or Jordan's new banks, where he deposited checks made out to the PLLC. (RP 95-96, 98, 198).[11] Like in *Cambridge*, there is no doubt that Jordan operating as "Invicta Law Group" sole proprietorship was a mere continuation of "Invicta Law Group PLLC" – that the "new" entity was exactly the same as the old entity, but with a new hat. The absence of any formal transfer, even if found to be true, would be irrelevant. *See Cambridge*, 166 Wn.2d at 483.

Moreover, in his opening brief, Jordan acknowledges that he has, in fact, acquired the assets from the PLLC. (*See, e.g.*, Ap. Br. at 3, 15, & 21). It is axiomatic that in order for Judge O'Donnell or CSB to take the PLLC's assets from Jordan, it is first necessary that Jordan have obtained the assets. Jordan cannot argue on the one hand that no transfer of assets occurred and then on the other hand argue that the trial court has unfairly taken those same assets from him. The truth is the transfers did occur, rendering Jordan liable as a successor. The decision of the trial court

[11] Jordan opened up new bank accounts under the name "Invicta law Group" where he deposited checks made out to "Invicta Law Group PLLC". (*See, e.g.*, Ex. 29, 47, & 74; RP 188-89). Notably, Jordan changed banks entirely and not just bank accounts – perhaps because CSB would recognize checks made out to the PLLC and continue to garnish the accounts. (*See* RP 333-34).

finding Jordan is a successor to the PLLC and liable to CSB on the Note should be affirmed.

4. The evidence also supports a finding of successor liability based on fraud.

An appellate court may affirm on any basis supported by the record. *See, e.g.*, *Eagle Pac. Ins. Co. v. Christensen Motor Yacht Corp.*, 85 Wn. App. 695, 707, 934 P.2d 715, 721 (1997), *as amended on reconsideration* (Aug. 5, 1997). In *Eagle Pacific*, the Court of Appeals affirmed the trial court's finding of successor liability based on fraud, even though the trial court had relied on the mere-continuation theory. *Id.* Affirming the Court of Appeals, the Washington Supreme Court held that the fraud exception applied because "the facts demonstrated [the] transfer of assets…was designed to avoid the reach of creditors." *Eagle Pac.*, 135 Wn.2d at 902. "Transferring assets to another corporation to hinder or delay creditors is by definition a fraudulent transfer." *Id.* at 910. When an entity transfers assets "to avoid the reach of the creditors, the transaction is fraudulent and successor liability attaches." *Id.*

The facts in *Eagle Pacific* are eerily similar to the case at bar. As described by the Washington Supreme Court:

> CMYC's principal business purpose was the construction of yachts. In the course of the construction of the three yachts, CMYC incurred debts which it could not pay. With the transfer of the three yacht contracts to CSL, and CMYC's surrender of its employees and facilities to CSL, CMYC

> was stripped of its main potential source for future revenues. Christensen admits the yacht contracts were transferred to CSL to allow the continuation of construction on the yachts unhampered by creditors' efforts to collect unpaid bills.

Id. at 906.

Here, the PLLC's principal business purpose was legal services. In the course of those services, the PLLC incurred significant debts. By filing personal bankruptcy and then changing hats from the PLLC to a sole proprietorship, including the transfer of client accounts, employees, and facilities, Jordan stripped the PLLC of its main potential source for future revenues, which he admits was done to avoid liability on the Note. (*See* Ap. Br. at 1).

Specifically, in his opening brief, Jordan admits that his personal Guaranty of the Note was "a big reason for [his] bankruptcy." (Ap. Br. at 1). Jordan also testified at trial that his primary reason for filing bankruptcy was because the PLLC "wasn't making enough revenue to pay [him] a sufficient income...to maintain any type of modest lifestyle." (RP 275-76). As Jordan's counsel stated to the trial court, Jordan "didn't leave Invicta because of *its* financial problems. He left Invicta because of *his* financial problems."[12] (RP 487-88) (emphasis added). Jordan's counsel

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[12] Jordan's trial brief directly contradicts his representations at trial. For example, Jordan states in his brief that "[i]n 2013, Invicta experienced financial problems, ultimately causing Jordan to file a personal Chapter 7 petition." (Ap. Br. at 6).

further stated that "[t]he sole purpose in winding up the LLC was to get rid of creditors. That's true." (RP 485). Notably, the PLLC never filed bankruptcy (RP 115, 386). The evidence demonstrates that Jordan filed personal bankruptcy and converted the PLLC to a sole proprietorship for the explicit purpose of avoiding both his and the PLLC's obligations to CSB and other creditors – the exact conduct condemned as fraudulent by the Washington Supreme Court and meant to be addressed through successor liability. *See Eagle Pac.*, 135 Wn.2d at 910.

The facts support a finding that Jordan should be liable as successor to the PLLC under the fraud exception *in addition to* the mere-continuation theory. Like the defendant in *Eagle Pacific*, if successor liability does not apply, Jordan "ultimately yields the profits from [the PLLC's] operations while cutting off [CSB's] ability to recover its debts." *Id.* at 902-03. The decision of the trial court finding Jordan is a successor to the PLLC and liable to CSB on the Note should be affirmed.

5. The trial court's grant of both legal and equitable remedies was necessary to provide adequate relief.

Jordan contends that the trial court's award of both legal and equitable remedies was error. (Ap. Br. at 4). He contends that "equitable relief is awarded to an appropriate plaintiff instead of the legal remedy, not in addition to it." (Ap. Br. at 21). Because this argument was not raised at the trial court and is not supported by any authority, the Court should decline to address this new argument. RAP 2.5(a), 10.3(a)(6). Even if Jordan had raised the argument with the trial court, the trial court's decision to grant both a judgment for successor liability and a judgment to foreclose was proper. The two judgments are harmonious.

First, it is well established that "[a] court may grant relief in both law and equity." *GMB Enterprises, Inc. v. B-3 Enterprises, Inc.*, 39 Wn. App. 678, 687, 695 P.2d 145, 149 (1985); *see also Yount v. Indianola Beach Estates, Inc.*, 63 Wn.2d 519, 525, 387 P.2d 975, 979 (1964). In fact, successor liability (an equitable doctrine) necessarily depends upon the existence of an underlying *legal* claim and corresponding remedy. *See, e.g.*, *Brown Bark III, L.P. v. Haver*, 219 Cal. App. 4th 809, 823, 162 Cal. Rptr. 3d 9, 20 (2013) ("Successor liability requires an underlying cause of action and merely extends the liability on that cause of action to a corporation that would not otherwise be liable"). Here, the underlying cause of action supporting successor liability against Jordan was CSB's breach of contract claim against the PLLC. Without the legal claim and corresponding judgment against the PLLC, there can be no successor liability.

Second, successor liability merely attaches the debts and obligations of one entity to a successor individual or entity making the

PLLC's obligations, here, under the loan documents Jordan's obligations. Likewise, each of CSB's rights and remedies against the PLLC becomes rights and remedies against Jordan.

Third, because many of the PLLC's assets are intangible and therefore not readily marketable, a money judgment against Jordan provides a more adequate remedy than foreclosure alone. *See Eagle Pac.*, 135 Wn.2d at 902-03 (recognizing that "[i]n some situations…the selling corporation has intangible assets on which it is difficult to place a value"). However, a money judgment does not eliminate the possibility that CSB might still seize some assets in partial satisfaction of the money judgment. Hence, the judgment to foreclose goes hand in hand with the money judgment.

The finding of successor liability against Jordan, the money judgment against Jordan in the sum of $151,360.40, and the judgment for foreclosure of the PLLC assets transferred to Jordan should each be affirmed.

B. The Testimony Of Alana Rouff Was Properly Admitted.

At trial, CSB employee Alana Rouff testified on behalf of CSB regarding the amount due on the Note, of which Ms. Rouff had personal knowledge. (RP 319, 330). When Ms. Rouff could not remember the exact and most-recent amount due, counsel for CSB showed Ms. Rouff a copy of the most-recent payoff statement. (RP 316-17). After reviewing the payoff statement, which Ms. Rouff had generated from the bank's internal accounts system the previous day, Ms. Rouff testified that the amount due, as of that point in time, was $152,422.24. (RP 332). Counsel for Jordan objected that Ms. Rouff's testimony was hearsay because he claimed the document itself was hearsay. (RP 322). The trial court overruled the objection stating,

> "I'm going to overrule your objection, and the reason I'm overruling the objection is because she testified with respect to her position at the bank, her familiarity with the records associated with the note, Exhibit 7, and that she would have knowledge of this in the normal course of her profession. I'm also satisfied that the document that's been shown to her, Exhibit 85, has independently refreshed her memory. And what she's testifying to is not simply from the document, but from her memory now that it has been refreshed."

(RP 326-27).

Jordan contends the trial court improperly admitted the testimony and that this Court should engage in *de novo* review as to whether Ms. Rouff's testimony was hearsay. Jordan further contends that striking the testimony removes from the record all evidence of the amount due on the Note. Jordan's arguments are misplaced. Because the testimony meets the requirements for refreshed recollection, it is by definition not hearsay, and its admission was proper. Further, regardless of error, admission of the challenged testimony is harmless because all the information necessary for the trial court to estimate damages exists elsewhere in the record.

1. The challenged testimony was not hearsay.

Jordan argues that this Court should engage in *de novo* review of whether Ms. Rouff's testimony was hearsay. (Ap. Br. at 33). However, "allowing the use of notes to refresh the memory of a witness lies within the discretion of the trial court." *State v. Huelett*, 92 Wn.2d 967, 969, 603 P.2d 1258, 1259 (1979). "The extent to which the witness may use such a memorandum is for the trial judge in his discretion to determine, and his ruling will not be disturbed unless there has been an abuse of such discretion." *Id.* "Such abuse occurs only if no reasonable person would take the view adopted by the trial court." *Id.* The document "need not be admissible as evidence" and "need not satisfy the hearsay and best evidence rules." 5A Wash. Prac., Evidence Law and Practice §§ 612.2, 612.4 (5th ed.). Likewise, the document "need not have been prepared by the witness." *Id.* at § 612.4. That is because "[t]he testimony is the evidence, the writing is not." *State v. Little*, 57 Wn.2d 516, 520, 358 P.2d 120, 122 (1961).

The criteria for refreshing a witness' recollection are "(1) that the witness' memory needs refreshing, (2) that opposing counsel have the right to examine the writing, and (3) that the trial court be satisfied that the witness is not being coached—that the witness is using the notes to aid, and not to supplant, his own memory." *Little*, 57 Wn.2d at 521. Here, the factors are met. Ms. Rouff testified that she could not recall the exact loan balance during testimony, counsel for Jordan had the opportunity to review the document and cross examine Ms. Rouff on the document, and the trial court affirmatively held "that the document that's been shown to her, Exhibit 85, has independently refreshed her memory. And what she's testifying to is not simply from the document, but from her memory now that it has been refreshed." (RP 327).

In support of his argument, Jordan cites *Podbielancik v. LPP Mortgage*. (Ap. Br. at 34). *Podbielancik*, however, has no bearing on the issues here. In that case, a witness recited the contents of documents *in a declaration* without attaching the documents themselves. *See Podbielancik v. LPP Mortgage Ltd.*, 191 Wn. App. 662, 667, 362 P.3d 1287 (2015). The court held that a custodian may not testify to the contents of a business record when that document is not in the record. *Id.* The case *did not* address the refreshing of a live witness' recollection of her personal knowledge and is therefore inapplicable.[13] Here, Ms. Rouff did not testify

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[13] Notably, counsel for Jordan conceded at trial that the very exhibit he claims is hearsay was in fact a business record. (327-28). However, for purposes of refreshing recollection, the admissibility of the documents is irrelevant. The determination is whether the witnesses is basing her testimony on personal knowledge.

to the contents of documents; rather, the contents of the documents refreshed her recollection of facts of which she had prior personal knowledge on account of her position and duties at CSB.

Jordan further tries to muddy the water by arguing that Ms. Rouff's inability to recite the exact loan balance during cross examination somehow evidenced a lack of personal knowledge. (Ap. Br. at 31-32). However, the results of the limited cross-examination were ambiguous at best. When "cross-examination reveals a very brief line of questioning that at best is ambiguous, [the appellate court] cannot and should not substitute [its] judgment for the exercise of discretion by an experienced and highly able trial judge." *State v. Huelett*, 92 Wn.2d at 970. The trial court's discretion should be affirmed.

2. The admission of the challenged testimony was harmless.

As Jordan concedes, "an erroneous evidentiary ruling does not result in reversal unless the defendant was prejudiced," and an appellate court will reverse "only if, within reasonable probabilities, the outcome of the trial would have been materially affected had the error not occurred." (Ap. Br. at 33) (internal citation and quotation omitted). Here, Jordan incorrectly argues "Rouff's testimony...was prejudicial because it was the only evidence supporting the judgment amount." (Ap. Br. at 33).

First, the trial court determined that the amount due was $151,360.40, which differs slightly from the amount testified to by Ms. Rouff. Second, Jordan's argument ignores the fact that every piece of information necessary to compute the judgment amount is located elsewhere in the record. The Note and other loan documents themselves contain (1) the loan amount, (2) the date of first payment, (3) the date of maturity, (4) the payment amounts, (5) the interest rate, and (6) all penalty provisions. (CP 11-26; Ex. 7-9). Furthermore, the trial court's *uncontested* findings of fact further establish the amount due. (*See* CP 146-48, FOF 2 (loan amount), 8 (starting date, payment terms, date of maturity), 11 (date of final payment)). In fact, the trial court's ultimate finding of fact regarding the amount due remains uncontested—likely because Jordan does not actually contest the accuracy of the amount due on the Note but rather he is trying to derail the trial court's finding by using the "see if it will stick" method. (*See* CP 151, FOF 41). These uncontested findings of fact "are verities on appeal." *See, e.g., In re Estate of Jones,* 152 Wn.2d 1, 8, 93 P.3d 147 (2004); *see also* RAP 10.3(g). Therefore, even without Ms. Rouff's testimony, the trial court had sufficient evidence in the record in order to compute damages, and the judgment for damages against Jordan should be affirmed.

C. The Trial Court Properly Awarded Attorneys' Fees To CSB As The Prevailing Party In An Action To Enforce The Note.

Because Jordan's successor liability arose out of an action to enforce the Note, the trial court properly awarded attorneys' fees to CSB. The trial court's award should be affirmed.

1. CSB's judgment against Jordan arose directly from enforcement of the Note.

Jordan concedes that a party may recover attorneys' fees under a contractual provision such as the one at issue here when (1) the *underlying action* is brought on the contract and (2) the contract is central to the dispute. (Ap. Br. at 39); *see also Seattle First Nat. Bank v. Washington Ins. Guar. Ass'n*, 116 Wn.2d 398, 413, 804 P.2d 1263, 1270 (1991). It follows, "[t]he court may award attorney fees for claims other than breach of contract when the contract is central to the existence of the claims, *i.e.*, when the dispute actually arose from the agreements. *Deep Water Brewing, LLC v. Fairway Res. Ltd.*, 152 Wn. App. 229, 278-79, 215 P.3d 990, 1016 (2009) (awarding fees jointly and severally against one defendant for breach of contract and against another for tortious conduct arising from the agreements); *see also LaCoursiere v. CamWest Dev., Inc.*, 172 Wn. App. 142, 154, 289 P.3d 683, 690 (2012), *aff'd,* 181 Wn.2d 734, 339 P.3d 963 (2014).

Here, it is undisputed that the underlying action was against the PLLC for breach of the Note and that the Note is central to this dispute with Jordan. (*See* CP 1-9; *see also* Ap. Br. at 6-15; RP 426-27). In fact, without its judgment against the PLLC for breach of contract, CSB could not have pursued successor liability against Jordan at all. Jordan's liability arises from and directly depends upon the action to enforce the Note against the PLLC. *See, e.g.*, *Brown Bark III, L.P. v. Haver*, 219 Cal. App. 4th 809, 823, 162 Cal. Rptr. 3d 9, 20 (2013) ("Successor liability requires an underlying cause of action and merely extends the liability on that cause of action to a corporation that would not otherwise be liable"). Furthermore, as recognized by the trial court, the loan documents explicitly state that any and all successors will be liable on the Note. (*See* CP 147, FOF 4 & 5). Jordan, as the PLLC's controlling principal and sole representative, was intimately aware of and agreed to these successor-liability terms. (*See* CP 13, 20, & 26; Ex. 7-9).

2. Jordan is properly liable for attorneys' fees.

Jordan contends that its counsel "has searched the country for a case upholding an award of contractual attorney fees against a party liable under the successor liability rule and came up empty" and that CSB is "seeking a remedy that no court has ever adopted." (Ap. Br. at 40). To the contrary, after a brief search, counsel for CSB located cases in multiple jurisdictions supporting an award of contractual attorneys' fees under a theory of successor liability.

For example, in *Schwartz v. Virtucom, Inc.*, the Minnesota Court of Appeals held that a third-party was liable for contractual attorneys' fees under a theory of successor liability based on a fees provision in the contract between its predecessor and plaintiff. *Schwartz v. Virtucom, Inc.*, No. A08-1059, 2009 WL 1311816, at *5 (Minn. Ct. App. May 12, 2009) (unpublished).[14] This is the exact authority Jordan claims does not exist.

Likewise, in *Brown Bark III, L.P. v. Haver*, the California Court of Appeals cited numerous decisions in holding that a non-signing third party who successfully defends a suit for successor liability is entitled to an award of contractual attorneys' fees specifically because "[plaintiff] *would have recovered* its attorney fees if it had prevailed on its successor liability theory." *Brown Bark*, 219 Cal. App. 4th at 815 (emphasis added). In other words, had the plaintiff been successful, the court would have awarded contractual attorneys' fees against the successor entity.

In *Herzog Aluminum, Inc. v. Gen. Am. Window Corp.,* this Court cited with approval near-identical reasoning of the California Supreme Court, which stated, "[h]ad plaintiff prevailed on its cause of action

[14] Citation to an unpublished decision from another jurisdiction is proper so long as that jurisdiction permits citation. GR 14.1.

claiming defendants were in fact the alter egos of the corporation, defendants would have been liable on the notes. Since they would have been liable for attorney's fees pursuant to the fees provision had plaintiff prevailed, they may recover attorney's fees pursuant to section 1717 now that they have prevailed." *Herzog Aluminum, Inc. v. Gen. Am. Window Corp.*, 39 Wn. App. 188, 196, 692 P.2d 867, 872 (1984), *quoting Reynolds Metals Co. v. Alperson*, 25 Cal.3d 124, 599 P.2d 83, 86, 158 Cal.Rptr. 1 (1979).

The very doctrine of successor liability contemplates liability against non-signing third parties. The concept is that liability rests against an entity who is party to a contract but that plaintiff cannot recover because the liable entity has transferred assets to a separate entity. There is fundamentally no difference between successor liability for damages (*i.e.*, judgment on an unpaid note) and successor liability for attorneys' fees. Both are assessed initially against the liable party to the contract and then flow to the successor. The trial court's award of attorneys' fees and cost to CSB in the sum of $258,045.78 should be affirmed. (CP 335).

D. CSB Is Entitled To Fees On Appeal

Pursuant to RAP 18.1, CSB requests an additional award of fees and costs arising from this appeal.

V. CONCLUSION

Jordan concedes "[i]t would have been unethical...for Invicta to remain in business as a law firm knowing that at any moment, CSB might appear and seize all of its property." (Ap. Br. at 6). But that's *exactly* what Jordan did. Because Jordan merely changed hats from a professional limited liability company to a sole proprietorship for the purpose of avoiding the PLLC's debt with CSB, the trial court rightfully held Jordan accountable under the doctrine of successor liability. As such, CSB requests that the appellate court affirm the trial court in every respect and grant CSB an additional award of fees and costs arising from this appeal.

RESPECTFULLY SUBMITTED this 28th day of July, 2016.

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APPENDICES OF OUT OF STATE AND SUPPLEMENTAL AUTHORITIES

APPENDIX
I

219 Cal.App.4th 809
Court of Appeal,
Fourth District, Division 3, California.

BROWN BARK III, L.P., Plaintiff and Respondent,
v.
Jaimie HAVER, et al., Defendants and Appellants.

G047198
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Filed August 26, 2013

Synopsis

Background: Lender brought action against borrower's former employee and her new corporation for breach of contract, conversion, and fraud. The Superior Court, Orange County, No. 30–2009–00122631, Derek W. Hunt, J., entered judgment on jury verdict for former employee and her new corporation but denied attorney fees. Borrower's successors appealed.

Holdings: The Court of Appeal, Aronson, J., held that:

[1] former employee's corporation was entitled to attorney fees for successfully defending against breach of contract claim, but

[2] unilateral attorney fee provision was not made reciprocal by statute to extent that it applied to tort claims.

Affirmed in part, reversed in part, and remanded.

West Headnotes (29)

[1] **Costs**
Contracts

In the absence of a statute authorizing the recovery of attorney fees, the parties may agree on whether and how to allocate attorney fees, including an agreement that the prevailing party will be awarded all the attorney fees incurred in any litigation between them, an agreement to limit the recovery of fees only to claims arising from certain transactions or events, or an agreement to award them only on certain types of claims. Cal. Civ. Proc. Code § 1021.

4 Cases that cite this headnote

[2] **Costs**
Particular Actions or Proceedings
Costs
Contracts

Parties may agree to award prevailing party attorney fees on claims sounding in both contract and tort. Cal. Civ. Proc. Code § 1021.

3 Cases that cite this headnote

[3] **Costs**
Contracts

The reciprocal contractual attorney fee statute allows a party who defeats a contract claim by showing the contract did not apply or was unenforceable to nonetheless recover attorney fees under that contract if the opposing party would have been entitled to attorney fees had it prevailed. Cal. Civ. Code § 1717.

5 Cases that cite this headnote

[4] **Costs**
Contracts

The reciprocal contractual attorney fee statute covers only contract actions, where the theory of the case is breach of contract, and where the contract sued upon itself specifically provides for an award of attorney fees incurred to enforce that contract. Cal. Civ. Code § 1717.

2 Cases that cite this headnote

[5] **Costs**
Particular Actions or Proceedings

The reciprocal contractual attorney fee statute does not make a unilateral fee provision reciprocal on tort or other noncontract claims. Cal. Civ. Code § 1717.

2 Cases that cite this headnote

[6] **Costs**
Contracts

To invoke the reciprocal contractual attorney fee statute a party must show (1) he or she was sued on a contract containing an attorney fee provision; (2) he or she prevailed on the contract claims; and (3) the opponent would have been entitled to recover attorney fees had the opponent prevailed. Cal. Civ. Code § 1717

Cases that cite this headnote

[7] **Costs**
Contracts

The court must disregard any tort claims included in the action when determining whether the reciprocal contractual attorney fee statute applies. Cal. Civ. Code § 1717.

1 Cases that cite this headnote

[8] **Corporations and Business Organizations**
Costs and attorney fees

Costs
Contracts

Costs
Persons entitled or liable

Under reciprocal contractual attorney fee statute, borrower's former employee's new corporation was entitled to recover attorney fees for successfully defending against lender's claim, under a successor liability theory, for breach of contracts between borrower and lender which contained attorney fee provisions, even though the successor liability theory lacked merit, since lender would have been entitled to its attorney fees had it prevailed on the breach of contract claims under attorney fee provision stating that it was binding on "successors and assigns." Cal. Civ. Code § 1717.

Cases that cite this headnote

[9] **Costs**
Contracts

As long as an action involves a contract it is "on the contact" within the meaning of the reciprocal contractual attorney fee statute. Cal. Civ. Code § 1717.

Cases that cite this headnote

[10] **Costs**
Contracts

To determine whether an action is "on the contract" under the reciprocal contractual attorney fee statute, courts look to the complaint and focus on the basis of the cause of action. Cal. Civ. Code § 1717

1 Cases that cite this headnote

[11] **Costs**
Contracts

Any action that is based on a contract is an action "on" that contract under the reciprocal contractual attorney fee statute, regardless of the relief sought. Cal. Civ. Code § 1717.

3 Cases that cite this headnote

[12] **Corporations and Business Organizations**
Exceptions to Successor Non-Liability

Under exceptions to the general rule that one corporation is not liable for the debts and liabilities of another corporation simply because it purchased the corporation's assets, the purchasing corporation may be held liable for the selling corporation's debts and liabilities when it expressly or impliedly agrees to assume those debts and liabilities; the asset sale amounts to a consolidation or merger of the two corporations; or a consumer is injured by one of the selling corporation's products that the purchasing corporation continues to manufacture and sell.

3 Cases that cite this headnote

[13] **Corporations and Business Organizations**
Exceptions to Successor Non-Liability

Corporations and Business Organizations

Mere continuation

Successor liability is an equitable doctrine that applies when a purchasing corporation is merely a continuation of the selling corporation or the asset sale was fraudulently entered to escape debts and liabilities.

3 Cases that cite this headnote

[14] **Corporations and Business Organizations**
Exceptions to Successor Non-Liability

Successor liability requires an underlying cause of action and merely extends the liability on that cause of action to a corporation that would not otherwise be liable.

3 Cases that cite this headnote

[15] **Corporations and Business Organizations**
Contracts

Successor liability's nature as an equitable doctrine does not prevent it from forming the basis for a contractual claim under the reciprocal contractual attorney fee statute. Cal. Civ. Code § 1717.

Cases that cite this headnote

[16] **Costs**
Persons entitled or liable

A breach of contract claim based on an alter ego theory is still a claim on the contract and a nonsignatory who successfully defends against the claim may recover its attorney fees under the reciprocal contractual attorney fee statute. Cal. Civ. Code § 1717.

2 Cases that cite this headnote

[17] **Corporations and Business Organizations**
Justice and equity in general

Corporations and Business Organizations
Alter ego in general

In California, two conditions must be met before the alter ego doctrine will be invoked: first, there must be such a unity of interest and ownership between the corporation and its equitable owner that the separate personalities of the corporation and the shareholder do not in reality exist; and second, there must be an inequitable result if the acts in question are treated as those of the corporation alone.

Cases that cite this headnote

[18] **Corporations and Business Organizations**
Alter ego in general

Corporations and Business Organizations
Exceptions to Successor Non-Liability

Although the showings required to invoke the alter ego doctrine and the successor liability doctrine are different, their effect is the same.

Cases that cite this headnote

[19] **Costs**
Contracts

Under reciprocal contractual attorney fee statute, the prevailing party determination is made by comparing the relief awarded on the contract claim or claims with the parties' demands on those same claims and their litigation objectives as disclosed by the pleadings, trial briefs, opening statements, and similar sources. Cal. Civ. Code § 1717(b)(1).

Cases that cite this headnote

[20] **Costs**
Contracts

Borrower's former employee's corporation was the prevailing party on lender's contract claims against corporation, under the reciprocal contractual attorney fee statute, where former employee's corporation completely defeated all breach of contract claims alleged against it, even though the parties agreed not to submit the breach of contract causes of action to the jury in the bifurcated trial, and even though lender prevailed on its claims against borrower. Cal. Civ. Code § 1717(b)(1).

1 Cases that cite this headnote

[21] **Costs**
Contracts

When a defendant completely defeats all breach of contract claims alleged against it, the defendant is the prevailing party under the reciprocal contractual attorney fee statute as a matter of law. Cal. Civ. Code § 1717(b)(1).

1 Cases that cite this headnote

[22] **Costs**
Contracts

If neither party achieves a complete victory, a trial court has discretion to determine which party, if any, prevailed under the reciprocal contractual attorney fee statute, but a trial court lacks discretion to determine whether there was a prevailing party when one party obtains a simple, unqualified victory by completely prevailing on or defeating all contract claims. Cal. Civ. Code § 1717.

Cases that cite this headnote

[23] **Corporations and Business Organizations**
Costs and attorney fees
Costs
Contracts

Reciprocal contractual attorney fee statute did not entitle borrower's former employee's new corporation to recover attorney fees for successfully defending against lender's tort claims for conversion and fraud, even though lender contended that the new corporation was a "successor in interest" formed to fraudulently avoid borrower's debts and liabilities, and even if the unilateral contractual attorney fee provisions were broad enough to cover tort claims in requiring borrower's successors to pay attorney fees "incurred in any dispute relating to the interpretation, enforcement, or performance" of the contracts, where the contracts did not identify former employee's new corporation as a party entitled to the benefit of the attorney fee provisions. Cal. Civ. Code § 1717.

1 Cases that cite this headnote

[24] **Costs**
Particular Actions or Proceedings
Costs
Contracts

The reciprocal contractual attorney fee statute makes a unilateral attorney fee provision reciprocal only on contract claims; it does not make a unilateral provision reciprocal on tort claims. Cal. Civ. Code § 1717.

4 Cases that cite this headnote

[25] **Corporations and Business Organizations**
Costs and attorney fees

Reciprocal contractual attorney fee statute did not entitle borrower's former employee to recover attorney fees for successfully defending against lender's tort claims for conversion and fraud, even though lender contended that the new corporation was a "successor in interest" formed to fraudulently avoid borrower's debts and liabilities, and even if the unilateral contractual attorney fee provisions were broad enough to cover tort claims in requiring borrower's successors to pay attorney fees "incurred in any dispute relating to the interpretation, enforcement, or performance" of the contracts, where former employee was not sued on the contracts. Cal. Civ. Code § 1717.

Cases that cite this headnote

[26] **Costs**
Contracts
Costs
Form and requisites of application in general

Where a cause of action based on the contract providing for attorney fees is joined with other causes of action beyond the contract, the prevailing party may recover attorney fees under the reciprocal contractual attorney fee statute only as they relate to the contract action, and the prevailing party therefore must generally allocate the attorney fees it incurred between the causes of action on the contract and the noncontract causes of action. Cal. Civ. Code § 1717.

17 Cases that cite this headnote

[27] **Costs**

Form and requisites of application in general

Attorney fees need not be apportioned when incurred for representation on an issue common to both a cause of action in which fees are proper and one in which they are not allowed, since all expenses incurred with respect to issues common to all causes of action qualify for award if the issues are so interrelated that it would have been impossible to separate them into claims for which attorney fees are properly awarded and claims for which they are not. Cal. Civ. Code § 1717.

9 Cases that cite this headnote

[28] **Costs**

Form and requisites of application in general

Allocation of attorney fees is generally required when the same lawyer represents one party that is entitled to recover its attorney fees and another party who is not, but allocation among jointly represented parties is not required when the liability of the parties is so factually interrelated that it would have been impossible to separate the activities into compensable and noncompensable time units.

5 Cases that cite this headnote

[29] **Costs**

Duties and proceedings of taxing officer

The trial court is the best judge of the value of professional services rendered in its court, and allocation of attorney fees into compensable and noncompensable time units is a matter within the trial court's discretion.

See 7 Witkin, Cal. Procedure (5th ed. 2008) Judgment, § 165 et seq.

3 Cases that cite this headnote

****13** Appeal from an order of the Superior Court of Orange County, Derek W. Hunt, Judge. Affirmed in part, reversed in part, and remanded. (Super. Ct. No. 30–2009–00122631)

Attorneys and Law Firms

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Lanak & Hanna, Jennifer M. Schildbach and Mac W. Cabal for Plaintiff and Respondent.

OPINION

ARONSON, J.

***814** Plaintiff and respondent Brown Bark III, L.P. sued defendants and appellants Jaimie Haver and Westover Capital Corporation to recover funds Westover Financial, Inc., failed to repay on a revolving line of credit. [1] Although Westover Capital was not a party to the contracts that created the line of credit, Brown Bark sued Westover Capital for breach of those contracts on a successor liability theory. Brown Bark also sued Haver and Westover Capital for conversion and fraud, alleging they converted the Westover Financial assets pledged as security for the line of credit and made misrepresentations to prevent and delay Brown Bark's efforts to recover the outstanding balance from Westover Financial. Following a bifurcated jury and court trial, Haver and Westover Capital obtained a favorable judgment on all of Brown Bark's causes of action. They subsequently sought their attorney fees under the fee provisions in the line of credit contracts, but the trial court denied their fee motion. Haver and Westover Capital now appeal.

We conclude the trial court erred in failing to award Westover Capital its attorney fees on the breach of contract causes of action. Civil Code section 1717 makes an otherwise unilateral attorney fee provision reciprocal and entitles a noncontracting party to recover contractual attorney fees when it ***815** defeats a contract-based cause of action that would have made the noncontracting party liable for contractual attorney fees had it lost.[2] Brown Bark ****14** would have recovered its attorney fees if it had prevailed on its successor liability theory against Westover Capital because the line of credit contracts made their fee provisions binding on the contracting parties' successors. Section 1717 therefore allows Westover Capital to recover its attorney fees because it defeated claims for breach of the line of credit contracts that would have exposed Westover Capital to attorney fee liability had it lost. Section 1717 only applies to contract causes of action, however. We therefore affirm the trial court's order denying Westover Capital attorney fees on the tort causes of action.

We also affirm the trial court's order denying Haver's fee motion. She was not a party to the line of credit contracts and Brown Bark did not sue her for breaching those contracts. Because Haver never faced attorney fee liability under the line of credit contracts, she may not invoke section 1717 to recover her fees.

We remand the matter to the trial court to determine (1) whether and how to allocate Westover Capital's attorney fees between the breach of contract and successor liability issues and the tort issues; (2) whether and how to allocate the fees for the attorneys who jointly represented Westover Capital and Haver; and (3) the amount of attorney fees Westover Capital may recover for this appeal.

I

FACTS AND PROCEDURAL HISTORY

Westover Financial was a leasing and equipment finance company Joseph G. Woodley founded in the mid-1980's. Woodley, his wife, and Steven R. Jones were the only shareholders. Westover Financial later hired Haver as an employee and she eventually became corporate secretary, but she never held any shares or voting rights and lacked authority to bind the corporation.

In 2007, Westover Financial opened a $1 million revolving line of credit with First Heritage Bank, N.A. (First Heritage). To open the line of credit Westover Financial entered into several contracts with First Heritage, including the "Credit Agreement," the "Revolving Line of Credit Promissory Note" (Promissory Note), the "Security and Pledge Agreement" (Security Agreement), and the "Custodian Agreement" (collectively, Line of Credit Contracts). Woodley and Jones also personally guaranteed Westover Financial's ***816** performance. The Line of Credit Contracts each contained unilateral attorney fee provisions entitling the "Lender" or "Secured Party" to recover from the "Borrower" or "Debtor" all attorney fees incurred in any dispute relating to the interpretation, enforcement, or performance of any of the Line of Credit Contracts.

Westover Financial failed to repay more than $850,000 it borrowed from First Heritage under the line of credit. In January 2009, the Federal Deposit Insurance Corporation, as receiver for First Heritage, sold and assigned all interests in Westover Financial's line of credit to Brown Bark.

In May 2009, Brown Bark filed this action against Westover Financial, Woodley, and Jones, seeking the outstanding balance on the line of credit plus interest, penalties, costs, and attorney fees. Brown Bark quickly obtained an ex parte right to attach order against Westover Financial. Around the time Brown Bark filed this action, Westover Financial began the process of dissolving as a corporation. It completed the process and filed its certificate of dissolution in November 2009.

Westover Financial's decision to dissolve left Haver unemployed. She subsequently formed Westover Capital in June 2009 to ****15** capitalize on the leasing and equipment finance expertise she acquired while working for Westover Financial. Haver filed the articles of incorporation and all other documents necessary to incorporate Westover Capital just 10 days after Brown Bark obtained its right to attach order against Westover Financial. Haver is Westover Capital's sole shareholder, officer, and director.

Brown Bark amended its complaint to add Haver and Westover Capital as defendants when it learned Haver continued to operate a business in the leasing and equipment finance industry. Brown Bark took Westover

Financial's default when it failed to respond to any of Brown Bark's complaints and dismissed Woodley and Jones after they each filed for bankruptcy protection. The operative third amended complaint alleged the following causes of action against the remaining defendants: (1) breach of the Credit Agreement, Promissory Note, and Security Agreement against Westover Financial and Westover Capital; (2) breach of the Custodian Agreement against Westover Financial and Westover Capital; (3) conversion against Westover Capital and Haver; (4) fraud against Westover Capital and Haver; and (5) suppression of material facts against Westover Capital and Haver.

Brown Bark alleged Westover Capital was liable for Westover Financial's breach of the Line of Credit Contracts because Westover Capital was either Westover Financial's alter ego or a successor in interest formed to fraudulently avoid Westover Financial's debts and liabilities. According to Brown ***817** Bark, Haver was an officer and director of both Westover Financial and Westover Capital, she transferred Westover Financial's assets to Westover Capital without any consideration, and she used those assets to conduct the same business under the Westover Capital name. The conversion cause of action alleged Haver and Westover Capital converted all the assets Westover Financial pledged as collateral for the line of credit. Finally, the two fraud claims alleged Haver and Westover Capital misrepresented and concealed facts from Brown Bark to prevent or delay its efforts to collect on Westover Financial's line of credit. [3]

On the first day of trial, Brown Bark dismissed its alter ego allegations and proceeded against Westover Capital on the breach of contract claims based solely on a successor liability theory. Westover Capital asked the trial court to bifurcate the trial and hear the successor liability issues first. Brown Bark opposed that motion because it intended to offer the same evidence to prove the successor liability theory and the conversion and fraud claims. The trial court decided to bifurcate the trial, but not as Westover Capital had requested. Instead, the court bifurcated the trial into a liability phase and a damages phase. The court explained the successor liability theory and the conversion and fraud claims would both be tried during the liability phase, with the jury deciding the conversion and fraud claims and the court deciding the successor liability theory. The court also explained it would treat the liability phase as a default prove-up for the breach of contract claims against Westover Financial.

At the close of trial, the court instructed the jury on the conversion and fraud claims only. Although the record fails to explain why, the parties agreed not to submit the breach of contract claims to the jury. The court therefore did not instruct ****16** the jury on breach of contract and the jury did not return a verdict on the breach of contract claims. The court's instructions told the jury "not to be concerned about" Brown Bark's claim that Westover Capital was Westover Financial's successor in interest, but rather to simply assume that claim was true. The jury returned a verdict in Haver and Westover Capital's favor, finding they neither converted Brown Bark's property nor "defrauded [Brown Bark] by the creation of Westover Capital."

The trial court did not make any express findings or rulings regarding the successor liability theory, but entered judgment for Haver and Westover Capital on all causes of action. Specifically, the court's judgment stated (1) Brown Bark "sought adjudication of its First and Second Causes of Action for Breach of Contract against Westover Capital Corporation on a theory of successor liability"; (2) Brown Bark "shall recover nothing from Defendants ***818** Jaimie Haver and Westover Capital Corporation on the following causes of action: [¶] First and Second Causes of Action for Breach of Contract; [¶] Sixth Cause of Action for Conversion; and [¶] Eighth and Ninth Causes of Action for Fraud"; and (3) Brown Bark "shall take nothing from Defendants Jaimie Haver and Westover Capital Corporation on any cause of action in the Third Amended Complaint." The judgment awarded Brown Bark a default judgment against Westover Financial on the breach of contract claims in the principal amount of more than $750,000.

After entry of judgment, Haver and Westover Capital jointly sought more than $170,000 in attorney fees and costs based on the attorney fee provisions in the Line of Credit Contracts. The trial court denied the motion, finding Haver and Westover Capital were not entitled to the benefit of the Line of Credit Contracts' attorney fee provisions because Brown Bark did not sue Haver on those contracts and Haver and Westover Capital only prevailed on the two tort causes of action, not a contract cause of action.

Haver and Westover Capital timely appealed the trial court's decision denying their fee motion. Neither side appealed from the trial court's judgment.

II

DISCUSSION

A. *Governing Legal Principles on Contractual Attorney Fee Awards*

[1] **[2]** A party may not recover attorney fees unless expressly authorized by statute or contract. (Code Civ. Proc., § 1021; *Sessions Payroll Management, Inc. v. Noble Construction Co.* (2000) 84 Cal.App.4th 671, 677, 101 Cal.Rptr.2d 127 (*Sessions*).) In the absence of a statute authorizing the recovery of attorney fees, the parties may agree on whether and how to allocate attorney fees. (*Xuereb v. Marcus & Millichap, Inc.* (1992) 3 Cal.App.4th 1338, 1341, 5 Cal.Rptr.2d 154 (*Xuereb*).) They may agree the prevailing party will be awarded all the attorney fees incurred in any litigation between them, limit the recovery of fees only to claims arising from certain transactions or events, or award them only on certain types of claims. The parties may agree to award attorney fees on claims sounding in both contract and tort. (*Id.* at pp. 1341–1342, 5 Cal.Rptr.2d 154.)

To ensure mutuality of remedy, however, section 1717 makes an attorney fee provision reciprocal even if it would otherwise be unilateral either by its terms or in its effect. (*Santisas v. Goodin* (1998) 17 Cal.4th 599, 610, 71 Cal.Rptr.2d 830, 951 P.2d 399 (*Santisas*); ***819** *Reynolds Metals Co. v. Alperson* (1979) 25 Cal.3d 124, 128, 158 Cal.Rptr. 1, 599 P.2d 83 (*Reynolds*).) ****17** Specifically, section 1717 states, "In any action on a contract, where the contract specifically provides that attorney [ ] fees and costs, which are incurred to enforce that contract, shall be awarded either to one of the parties or to the prevailing party, then the party who is determined to be the party prevailing on the contract, whether he or she is the party specified in the contract or not, shall be entitled to reasonable attorney[ ] fees in addition to other costs." (§ 1717, subd. (a).)

Section 1717 makes an otherwise unilateral attorney fee provision reciprocal in at least two situations relevant to this appeal. The first "is 'when the contract provides the right to one party but not to the other.' [Citation.] In this situation, the effect of section 1717 is to allow recovery of attorney fees by whichever contracting party prevails, 'whether he or she is the party specified in the contract or not' [citation]." (*Santisas, supra,* 17 Cal.4th at pp. 610–611, 71 Cal.Rptr.2d 830, 951 P.2d 399.)

[3] "The second situation in which section 1717 makes an otherwise unilateral right reciprocal ... is when a person sued on a contract containing a provision for attorney fees to the prevailing party defends the litigation 'by successfully arguing the inapplicability, invalidity, unenforceability, or nonexistence of the same contract.' [Citation.] Because these arguments are inconsistent with a contractual claim for attorney fees under the same agreement, a party prevailing on any of these bases usually cannot claim attorney fees as a contractual right. If section 1717 did not apply in this situation, the right to attorney fees would be effectively unilateral ... because only the party seeking to affirm and enforce the agreement could invoke its attorney fee provision." (*Santisas, supra,* 17 Cal.4th at p. 611, 71 Cal.Rptr.2d 830, 951 P.2d 399.) Accordingly, section 1717 allows a party who defeats a contract claim by showing the contract did not apply or was unenforceable to nonetheless recover attorney fees under that contract if the opposing party would have been entitled to attorney fees had it prevailed. (Santisas, at p. 611.)

This second situation arises not only when a signatory to a contract defeats another signatory's claims, but also when a *non*signatory defeats a signatory's efforts to enforce the contract. As our Supreme Court explained in the seminal *Reynolds* case: "Its purposes require section 1717 be interpreted to further provide a reciprocal remedy for a nonsignatory defendant, sued on a contract as if he were a party to it, when a plaintiff would clearly be entitled to attorney[ ] fees should he prevail in enforcing the contractual obligation against the defendant." (*Reynolds, supra,* 25 Cal.3d at p. 128, 158 Cal.Rptr. 1, 599 P.2d 83; see *Real Property Services Corp. v. City of Pasadena* (1994) 25 Cal.App.4th 375, 382, 30 Cal.Rptr.2d 536 (*Real Property Services*) ["in cases involving nonsignatories to a contract with an attorney fee provision, the following rule may be ***820** distilled from the applicable cases: A party is entitled to recover its attorney fees pursuant to a contractual provision only when the party would have been liable for the fees of the opposing party if the opposing party had prevailed"].)

In *Reynolds*, the signatory plaintiff sued two nonsignatories to recover on a promissory note, alleging they were liable as the alter egos of the corporation that signed the note. (*Reynolds, supra*, 25 Cal.3d at p. 127, 158 Cal.Rptr. 1, 599 P.2d 83.) The nonsignatories prevailed by showing they were not the corporation's alter egos and therefore the plaintiff could not enforce the note against them. The Supreme Court allowed the nonsignatories to recover their attorney fees under a fee provision in the note because the plaintiff would **18 have been entitled to recover its fees under that provision if the plaintiff had succeeded in enforcing the note against the nonsignatories. (*Id.* at p. 129, 158 Cal.Rptr. 1, 599 P.2d 83; see also *Pueblo Radiology Medical Group, Inc. v. Gerlach* (2008) 163 Cal.App.4th 826, 828–829, 77 Cal.Rptr.3d 880 (*Pueblo*).)

[4] Section 1717 and its reciprocity principles, however, have "limited application. [They] cover[ ] *only* contract actions, where the theory of the case is breach of contract, and where the contract sued upon itself specifically provides for an award of attorney fees incurred to enforce *that* contract. [Section 1717 's] only effect is to make an otherwise unilateral right to attorney fees reciprocally binding upon all parties to actions to enforce the contract." (*Xuereb, supra*, 3 Cal.App.4th at p. 1342, 5 Cal.Rptr.2d 154, original italics.)

[5] Tort and other noncontract claims are not subject to section 1717 and its reciprocity principles. (*Santisas, supra*, 17 Cal.4th at p. 615, 71 Cal.Rptr.2d 830, 951 P.2d 399; *Gil v. Mansano* (2004) 121 Cal.App.4th 739, 742–743, 17 Cal.Rptr.3d 420 (*Gil*).) The parties to a contract are free to agree that one or more of them shall recover their attorney fees if they prevail on a tort or other noncontract claim, but the right to recover those fees depends solely on the contractual language. (*Gil*, at p. 743, 17 Cal.Rptr.3d 420; *Exxess Electronixx v. Heger Realty Corp.* (1998) 64 Cal.App.4th 698, 708, 75 Cal.Rptr.2d 376 (*Exxess*).) Section 1717 does not make a unilateral fee provision reciprocal on tort or other noncontract claims. (*Moallem v. Coldwell Banker Com. Group, Inc.* (1994) 25 Cal.App.4th 1827, 1831–1832, 31 Cal.Rptr.2d 253 (*Moallem*).)

[6] [7] Accordingly, to invoke section 1717 and its reciprocity principles a party must show (1) he or she was sued on a contract containing an attorney fee provision; (2) he or she prevailed on the contract claims; and (3) the opponent would have been entitled to recover attorney fees had the opponent prevailed. (*Santisas, supra*, 17 Cal.4th at pp. 610–611, 71 Cal.Rptr.2d 830, 951 P.2d 399; *Reynolds, supra*, 25 Cal.3d at pp. 128–129, 158 Cal.Rptr. 1, 599 P.2d 83; *Exxess, supra*, 64 Cal.App.4th at p. 706, 75 Cal.Rptr.2d 376.) The court must disregard any tort claims included in the action when determining whether section 1717 applies. (*Santisas*, at p. 615, 71 Cal.Rptr.2d 830, 951 P.2d 399; *Exxess*, at p. 708, 75 Cal.Rptr.2d 376.)

*821 "On appeal this court reviews a determination of the legal basis for an award of attorney fees de novo as a question of law." (*Sessions, supra*, 84 Cal.App.4th at p. 677, 101 Cal.Rptr.2d 127; see also *Dell Merk, Inc. v. Franzia* (2005) 132 Cal.App.4th 443, 450, 33 Cal.Rptr.3d 694 (*Dell Merk*).)

B. *Section 1717 Entitles Westover Capital to Recover Its Attorney Fees on the Breach of Contract Claims*

Westover Capital sought to recover its attorney fees based on the attorney fee provisions in the Line of Credit Contracts between First Heritage and Westover Financial. Each of these contracts included a unilateral attorney fee provision entitling the "Lender" or "Secured Party" to recover its attorney fees and costs from the "Borrower" or "Debtor." For example, the Credit Agreement provided, "in the event that any dispute arises (whether or not such dispute is with Borrower) relating to the interpretation, enforcement or performance of this Agreement or any of the other Loan Documents, Lender shall be entitled to collect from Borrower on demand all reasonable fees and expenses incurred in connection therewith, including but not limited to fees of attorneys... ."

[8] **19 As a nonsignatory seeking to recover its attorney fees for successfully defeating Brown Bark's efforts to hold it liable for Westover Financial's breach of the Line of Credit Contracts, Westover Capital must show (1) Brown Bark sued Westover Capital on the Line of Credit Contracts; (2) Westover Capital prevailed on Brown Bark's breach of contract claims; and (3) Brown Bark would have been entitled to its attorney fees had it prevailed on the breach of contract claims.

1. Brown Bark Sued Westover Capital on the Line of Credit Contracts

[9] [10] [11] "California courts construe the term 'on a contract' liberally. ' "As long as the action 'involve[s]' a contract it is ' "on [the] contact" ' within the meaning of section 1717. [Citations.]" [Citations.]' [Citation.]" (*Turner v. Schultz* (2009) 175 Cal.App.4th 974, 979–980, 96 Cal.Rptr.3d 659; see *Dell Merk, supra,* 132 Cal.App.4th at p. 455, 33 Cal.Rptr.3d 694.) To determine whether an action is on the contract, we look to the complaint and focus on the basis of the cause of action. (*Mepco Services, Inc. v. Saddleback Valley Unified School Dist.* (2010) 189 Cal.App.4th 1027, 1047, 117 Cal.Rptr.3d 494 (*Mepco*); *Kachlon v. Markowitz* (2008) 168 Cal.App.4th 316, 347, 85 Cal.Rptr.3d 532; *Kangarlou v. Progressive Title Co., Inc.* (2005) 128 Cal.App.4th 1174, 1178–1179, 27 Cal.Rptr.3d 754.) Any action that is based on a contract is an action on that contract regardless of the relief sought. (See ***822** *Kachlon,* at pp. 347–348, 85 Cal.Rptr.3d 532 [lawsuit to quiet title and for declaratory and injunctive relief is an action on a contract because the action was based on a promissory note and deed of trust].)

The third amended complaint named Westover Capital as a defendant on both the first and second causes of action for breach of contract. These claims alleged both Westover Financial and Westover Capital breached the Line of Credit Contracts, and sought to recover damages caused by Westover Financial's failure to repay the funds borrowed under those contracts. Brown Bark alleged Westover Capital was liable for those damages on a successor liability theory because Westover Capital was a mere continuation of Westover Financial that Haver fraudulently formed so Westover Financial could escape its debts and liabilities. Brown Bark pursued its successor liability theory against Westover Capital throughout this action. For example, it amended its complaint several times seeking to adequately allege the breach of contract claims based on successor liability, it opposed Westover Capital's summary adjudication motion challenging the breach of contract claims, it argued the successor liability theory in its trial brief, and it presented evidence at trial seeking to prove Westover Capital was merely a continuation of Westover Financial. Accordingly, Brown Bark sued Westover Capital on the Line of Credit Contracts.

Brown Bark nonetheless argues it did not sue Westover Capital on the Line of Credit Contracts or any other contract, but rather it sued Westover Capital on a successor liability claim only. To support this contention, Brown Bark relies on an unpublished federal district court case. *Sunnyside Development Co., LLC v. Opsys, Ltd.* (N.D.Cal., Aug. 29, 2007, C 05 0553 MHP) 2007 WL 2462141 (*Sunnyside*), which concluded attorney fees could not be recovered on a successor liability claim because "successor liability is an equitable doctrine [citation] and is therefore not a contract claim. [Citation]." (*Id.* at p. *4.) We disagree with Brown Bark's characterization of its claims against Westover Capital and decline to follow ****20** *Sunnyside* for three reasons. [4]

[12] [13] [14] First, successor liability is not a separate claim independent of Brown Bark's breach of contract claims. To the contrary, successor liability is an equitable doctrine that applies when a purchasing corporation is merely a continuation of the selling corporation or the asset sale was fraudulently entered to escape debts and liabilities. [5] (***823** *Franklin, supra,* 87 Cal.App.4th at p. 621, 105 Cal.Rptr.2d 11; *Rosales v. Thermex–Thermatron, Inc.* (1998) 67 Cal.App.4th 187, 195–196, 78 Cal.Rptr.2d 861.) Successor liability requires an underlying cause of action and merely extends the liability on that cause of action to a corporation that would not otherwise be liable. (Cf. *Design Associates, Inc. v. Welch* (1964) 224 Cal.App.2d 165, 171, 36 Cal.Rptr. 341 [as an equitable doctrine extending a corporation's liabilities to the individuals who control it, the alter ego doctrine requires an underlying cause of action]; *McMartin v. Children's Institute International* (1989) 212 Cal.App.3d 1393, 1406, 261 Cal.Rptr. 437 [civil conspiracy requires an underlying tort because it merely extends liability for the tort to individuals who shared in the tortfeasor's plan or design, but did not actually commit the tort].)

[15] [16] [17] Second, successor liability's nature as an equitable doctrine does not prevent it from forming the basis for a contractual claim under section 1717. For example, alter ego is an equitable doctrine that also extends a corporation's liability on a cause of action to another corporation or individual when the doctrine's requirements are met. [6] (*Webber v. Inland Empire Investments, Inc.* (1999) 74 Cal.App.4th 884, 900–901, 88 Cal.Rptr.2d 594.) It is well settled a breach of contract claim based on an alter ego theory is still a claim on the contract and a nonsignatory that successfully defends against the claim may recover its attorney fees under section 1717. (*Reynolds, supra,* 25 Cal.3d at pp. 128–129, 158 Cal.Rptr. 1, 599 P.2d 83; *Pueblo, supra,* 163

Cal.App.4th at pp. 828–830, 77 Cal.Rptr.3d 880 ["The claim of 'alter ego' was a step directly implicated in the contract action"].) In the same manner, a breach of contract claim based on a successor liability theory is still a claim on the contract under section 1717.

[18] Brown Bark contends *Reynolds* and its progeny do not apply to breach of ****21** contract claims based on a successor liability theory because alter ego and successor liability are distinct concepts. This argument misses the mark. Although the showing required to invoke these two equitable doctrines is different, their effect is the same. Under both doctrines, the legal distinction between two corporations (or a corporation and an individual) is disregarded ***824** and they are treated as one entity, at least when the basis for the successor liability is that one corporation is a mere continuation of another corporation.

Here, Brown Bark based its successor liability theory on its claim Westover Capital was a mere continuation of Westover Financial and therefore they should be treated as the same entity. In applying section 1717 and *Reynolds,* it is irrelevant whether the plaintiff sought to disregard a corporation's separate legal existence because the individuals running the corporation failed to respect its separate existence (alter ego doctrine) or transferred all of the corporation's assets to another corporation to escape liability (successor liability doctrine). The critical point is that the corporation and its shareholders or another corporation are treated as one for determining the underlying liability.

Third, *Sunnyside* does not address a defendant's right to recover attorney fees for defeating a breach of contract claim brought on a successor liability theory. *Sunnyside* involved a plaintiff that prevailed on a breach of lease and other claims against one defendant, but lost on its claims against a second defendant. The district court granted the plaintiff's attorney fee motion, but limited the fees to those incurred on the successful breach of lease claim. The court denied fees on tort claims that were not covered by the attorney fee provision and on the plaintiff's unsuccessful successor liability claim against the second defendant. (*Sunnyside,supra,* 2007 WL 2462141, *4.) Because the party seeking attorney fees in *Sunnyside* was the plaintiff that lost on the successor liability theory, *Sunnyside* did not consider whether *Reynolds* and its progeny required an attorney fee award to a defendant who defeats a breach of contract claim brought on a successor liability theory. Sunnyside therefore does not support Brown Bark's position. (*Nevarrez v. San Marino Skilled Nursing & Wellness Centre, LLC* (2013) 216 Cal.App.4th 1349, 1363, 157 Cal.Rptr.3d 793 ["A case is not authority for a proposition the court did not consider."].)

2. Westover Capital Prevailed on Brown Bark's Breach of Contract Claims

[19] Section 1717 defines "the prevailing party on the contract" as "the party who recovered a greater relief in the action on the contract." (§ 1717, subd. (b)(1).) The prevailing party determination is made by " 'compar[ing] the relief awarded on the contract claim or claims with the parties' demands on those same claims and their litigation objectives as disclosed by the pleadings, trial briefs, opening statements, and similar sources.' [Citation.]" (*Scott Co. v. Blount, Inc.* (1999) 20 Cal.4th 1103, 1109, 86 Cal.Rptr.2d 614, 979 P.2d 974 (*Scott*).)

[20] **[21]** ***825** Here, the trial court did not make an express ruling on the successor liability theory, but the court's judgment declared Brown Bark "sought adjudication of its First and Second Causes of Action for Breach of Contract against Westover Capital Corporation on a theory of successor liability" and determined Brown Bark "shall take nothing from ... Westover Capital Corporation on *any* cause of action in the Third Amended Complaint." (Italics added.) Westover Capital therefore prevailed on the contract claims because it ****22** recovered the greater relief. (§ 1717, subd. (b)(1).) Specifically, Brown Bark sought to recover more than $850,000 in principal, interest, attorney fees, and costs from Westover Capital on the breach of contract claims, but it recovered nothing and the trial court entered judgment in Westover Capital's favor. When a defendant completely defeats all breach of contract claims alleged against it, the defendant is the prevailing party under section 1717 as a matter of law. (*Hsu v. Abbara* (1995) 9 Cal.4th 863, 866, 876, 39 Cal.Rptr.2d 824, 891 P.2d 804 (*Hsu*).)

The trial court nonetheless denied Westover Capital's fee motion because it found Westover Capital prevailed only on the two tort claims for conversion and fraud. The court acknowledged Brown Bark sued Westover Capital on the Line of Credit Contracts, but it concluded Westover Capital did not prevail on those contract claims because the parties agreed not to submit the breach of contract causes of action to the jury. The trial court erred in reaching this conclusion.

Whether the parties submitted the breach of contract claims to the jury is irrelevant to the question of who prevailed on those claims. (See *Mepco, supra,* 189 Cal.App.4th at p. 1047, 117 Cal.Rptr.3d 494.) Indeed, it does not matter how or why a party prevailed on the contract; it only matters that the party prevailed. (*Real Property Services, supra,* 25 Cal.App.4th at p. 384, fn. 7, 30 Cal.Rptr.2d 536.) Section 1717 required the trial court to determine the prevailing party by comparing the relief sought and the relief obtained on the Line of Credit Contracts. (§ 1717, subd. (b)(1); *Scott, supra,* 20 Cal.4th at p. 1109, 86 Cal.Rptr.2d 614, 979 P.2d 974.) That comparison shows Westover Capital prevailed on Brown Bark's two breach of contract claims because Brown Bark obtained nothing from Westover Capital on those claims.

Brown Bark contends it prevailed on the breach of contract claims because it obtained a default judgment against Westover Financial for the full amount due under the Line of Credit Contracts. This argument fails because it ignores that Westover Capital and Westover Financial are independent entities and the trial court's judgment did not hold Westover Capital responsible for any of Westover Financial's liabilities. When a plaintiff sues more than one independent party on the same contract, the trial court must separately determine who prevailed on the plaintiff's claim against each independent ***826** defendant. (Cf. *Arntz Contracting Co. v. St. Paul Fire & Marine Ins. Co.* (1996) 47 Cal.App.4th 464, 491, 54 Cal.Rptr.2d 888 ["When an action involves multiple, independent contracts, each of which provides for attorney fees, the prevailing party for purposes of ...section 1717 must be determined as to each contract regardless of who prevails in the overall action"]; 7 Witkin, Cal. Procedure (5th ed. 2008) Judgment, § 94, p. 633 ["One defendant who prevails may recover costs even though the plaintiff recovers against another defendant"].) Brown Bark's default judgment against Westover Financial on the breach of contract claims in no way changes the outcome on the breach of contract claims between Brown Bark and Westover Capital. Westover Capital remains the prevailing party because it obtained a judgment against Brown Bark on those claims.

[22] Brown Bark also argues Westover Capital failed to show the trial court abused the broad discretion it had under section 1717 to determine the prevailing party. Brown Bark overstates the extent of the trial court's discretion. If neither party achieves a complete victory, a trial court has discretion to determine which ****23** party, if any, prevailed. (*Scott, supra,* 20 Cal.4th at p. 1109, 86 Cal.Rptr.2d 614, 979 P.2d 974.) A trial court, however, *lacks* discretion to determine whether there was a prevailing party when one party obtains "a simple, unqualified victory by completely prevailing on or defeating all contract claims." (*Ibid.*) In that situation, the party obtaining the unqualified victory is entitled to attorney fees under section 1717 as a matter of law. (*Hsu, supra,* 9 Cal.4th at pp. 866, 876, 39 Cal.Rptr.2d 824, 891 P.2d 804.) Here, Westover Capital obtained an unqualified victory and therefore the trial court had no discretion to determine Westover Capital did not prevail.

3. Brown Bark Would Have Been Entitled to Its Attorney Fees Had It Prevailed on the Breach of Contract Claims

If Brown Bark had succeeded in showing Westover Capital was merely a continuation of Westover Financial that Haver formed to fraudulently avoid Westover Financial's debts and liabilities, then the successor liability doctrine would have allowed Brown Bark to recover from Westover Capital for Westover Financial's breach of the Line of Credit Contracts. (*Franklin, supra,* 87 Cal.App.4th at p. 621, 105 Cal.Rptr.2d 11; *Ray, supra,* 19 Cal.3d at p. 28, 136 Cal.Rptr. 574, 560 P.2d 3.) Moreover, Brown Bark would have been entitled to recover its attorney fees under the Line ****24** of Credit Contracts' attorney fee provisions because those agreements included the following provision making all their terms binding on the contracting parties' successors: "This Agreement ... shall be *binding upon* and inure to the benefit of Borrower and Lender and their respective *successors* and assigns... ." (Italics added.) Accordingly, because Westover Capital would have been subject to the burden of the Line of Credit Contracts' attorney fee provisions if Brown Bark had prevailed, section 1717 's reciprocity principles ***827** entitle Westover Capital to the benefit of those attorney fee provisions and authorize it to recover the fees it reasonably incurred in prevailing on Brown Bark's breach of contract claims. (*Reynolds, supra,* 25 Cal.3d at pp. 128–129, 158 Cal.Rptr. 1, 599 P.2d 83; *Pueblo, supra,* 163 Cal.App.4th at pp. 828–829, 77 Cal.Rptr.3d 880.)

The trial court, however, denied Westover Capital's fee motion because it found Westover Capital would not have been liable for Brown Bark's attorney fees had Brown Bark prevailed. According to the trial court, Brown Bark's successor liability claim "was nothing more than a theory" on which Brown Bark could never prevail because "it was quite clear" Westover Capital was not a continuation of Westover Financial. The trial court erred in reaching this conclusion.

Whether Brown Bark's successor liability theory lacked merit is irrelevant to whether Westover Capital could recover its attorney fees under section 1717. (*Dell Merk, supra,* 132 Cal.App.4th at p. 455, 33 Cal.Rptr.3d 694.) Regardless of the theory's merit, Brown Bark sued Westover Capital on that theory and forced Westover Capital to incur attorney fees to defend against it through trial. "[T]he pertinent inquiry for purposes of ...section 1717 is whether [Brown Bark] would have been entitled to attorney fees in a hypothetical situation in which [it] did prevail on its claim[s]." (*Mepco, supra,* 189 Cal.App.4th at p. 1047, 117 Cal.Rptr.3d 494.) Had Brown Bark succeeded in proving Westover Capital was Westover Financial's successor, the Line of Credit Contracts would have allowed Brown Bark to recover its attorney fees from Westover Capital. Accordingly, Westover Capital is entitled to recover its attorney fees on the breach of contract claims under the Line of Credit Contracts' attorney fee provisions.

C. *Westover Capital May Not Recover Attorney Fees on the Conversion and Fraud Causes of Action*

[23] In addition to the two breach of contract claims, Brown Bark also sued Westover Capital on tort claims for conversion and fraud. The jury rejected these claims and returned a verdict for Westover Capital. The trial court concluded Westover Capital had no right to recover attorney fees on these tort claims because the Line of Credit Contracts' attorney fee provisions did not identify Westover Capital as a party entitled to the benefit of those provisions. We agree.

"[S]ection 1717 does not apply to tort claims; it determines which party, if any, is entitled to attorney[ ] fees on a *contract claim only.* [Citations.] As to tort claims, the question of whether to award attorney[ ] fees turns on the language of the contractual attorney[ ] fee provision, i.e., whether the party seeking fees has 'prevailed' within the meaning of the provision and ***828** whether the type of claim is within the scope of the provision. [Citation.] This distinction between contract and tort claims flows from the fact that a tort claim is not 'on a contract' and is therefore outside the ambit of section 1717. [Citations.]" (*Exxess, supra,* 64 Cal.App.4th at p. 708, 75 Cal.Rptr.2d 376, original italics; see also *Santisas, supra,* 17 Cal.4th at p. 615, 71 Cal.Rptr.2d 830, 951 P.2d 399; *Gil, supra,* 121 Cal.App.4th at pp. 742–743, 17 Cal.Rptr.3d 420; *Xuereb, supra,* 3 Cal.App.4th at p. 1342, 5 Cal.Rptr.2d 154.)

[24] Section 1717 's reciprocity principles therefore make a unilateral attorney fee provision reciprocal only on contract claims; they do not make a unilateral provision reciprocal on tort claims. (*Gil, supra,* 121 Cal.App.4th at pp. 742–743, 17 Cal.Rptr.3d 420; ****25** *Exxess, supra,* 64 Cal.App.4th at p. 708, 75 Cal.Rptr.2d 376; *Xuereb, supra,* 3 Cal.App.4th at p. 1342, 5 Cal.Rptr.2d 154.) A party may recover attorney fees on a tort claim only if an attorney fee provision broad enough to cover tort claims expressly identifies that party as a party entitled to its benefits. (*Moallem, supra,* 25 Cal.App.4th at pp. 1830–1832, 31 Cal.Rptr.2d 253.)

In *Moallem,* the plaintiff successfully sued its real estate broker for negligence and breach of fiduciary duty and then sought attorney fees under a fee provision in the brokerage agreement. (*Moallem, supra,* 25 Cal.App.4th at pp. 1828–1829, 31 Cal.Rptr.2d 253.) Although the fee provision's language was otherwise broad enough to cover the plaintiff's tort claims, the *Moallem* court affirmed the trial court's decision denying the plaintiff's fee motion because the fee provision's language limited the right to recover attorney fees to the broker only; it did not authorize the plaintiff to recover attorney fees on any type of claim. Because the claims at issue were not on the contract, the plaintiff could not rely on section 1717 's reciprocity principles to make the unilateral fee provision reciprocal. (*Moallem,* at pp. 1831–1832, 31 Cal.Rptr.2d 253.)

As explained above, the attorney fee provisions in each of the Line of Credit Contracts authorized the "Lender" or "Secured Party" to recover its attorney fees from the "Borrower" or "Debtor." The provisions did not authorize the Borrower or Debtor to recover its attorney fees under any circumstance. Westover Capital may rely on section 1717 and its reciprocity principles to recover its attorney fees on the contract claims, but those principles do not apply to Brown Bark's tort claims. (*Gil, supra,* 121 Cal.App.4th at pp. 742–743, 17 Cal.Rptr.3d 420; *Exxess, supra,* 64 Cal.App.4th at p. 708, 75 Cal.Rptr.2d 376; *Xuereb, supra,* 3 Cal.App.4th at p. 1342, 5 Cal.Rptr.2d 154.)

Westover Capital argues it is entitled to recover its attorney fees on the tort claims because the fee provisions in the Line of Credit Contracts are broad enough to cover tort claims. But the type of claims the fee provisions cover is only half of the analysis. The fee provisions also must identify Westover Capital as a party entitled to the benefit of those provisions. (*Moallem, supra,* 25 Cal.App.4th at pp. 1830–1832, 31 Cal.Rptr.2d 253.) The fee provisions, however, are unilateral ***829** provisions that only authorize the Lender or Secured Party to recover attorney fees. Even the "sharp quillets of the law" will not permit Westover Capital to invoke section 1717 and make the unilateral fee provisions reciprocal as to the tort claims. (Shakespeare, Henry VI, pt. 1, act II, scene 4, line 17.) The trial court therefore properly denied Westover Capital's motion to recover the attorney fees it incurred on the tort claims.

D. *Haver Is Not Entitled to Recover Any of Her Attorney Fees Under the Line of Credit Contracts*

[25] Brown Bark did not name Haver as a defendant on either of the breach of contract causes of action, but rather sued her only on the conversion and fraud claims. The trial court denied the fee motion as to Haver because she was not sued on a contract and therefore had no right to recover attorney fees under any of the Line of Credit Contracts. We agree.

As explained above, section 1717 only applies when a party is sued on a contract. Because Brown Bark did not sue Haver on the Line of Credit Contracts, she may not invoke section 1717 to seek the benefit of the attorney fee provisions in those contracts. The trial court therefore properly denied the fee motion as to Haver.

E. *The Trial Court Must Determine Whether and How to Allocate Attorney Fees Between the Contract and Tort Claims and Between Westover Capital and Haver*

[26] "Where a cause of action based on the contract providing for attorney [ ] fees is joined with other causes of action beyond the contract, the prevailing party may recover attorney[ ] fees under section 1717 only as they relate to the contract action." (*Reynolds, supra,* 25 Cal.3d at p. 129, 158 Cal.Rptr. 1, 599 P.2d 83; see *Amtower v. Photon Dynamics, Inc.* (2008) 158 Cal.App.4th 1582, 1603–1604, 71 Cal.Rptr.3d 361 (*Amtower*).) The prevailing party therefore must generally allocate the attorney fees it incurred between the causes of action on the contract and the noncontract causes of action. (Reynolds, at p. 129; Amtower, at pp. 1603–1604.)

[27] Attorney fees, however, "need not be apportioned when incurred for representation on an issue common to both a cause of action in which fees are proper and one in which they are not allowed. All expenses incurred with respect to [issues common to all causes of action] qualify for award." (*Reynolds, supra,* 25 Cal.3d at pp. 129–130, 158 Cal.Rptr. 1, 599 P.2d 83; see *Amtower, supra,* 158 Cal.App.4th at pp. 1603–1604, 71 Cal.Rptr.3d 361.) The governing standard is whether the "issues are so interrelated that it would have been impossible to separate ***830** them into claims for which attorney fees are properly awarded and claims for which they are not ...." (*Akins v. Enterprise Rent–A–Car Co.* (2000) 79 Cal.App.4th 1127, 1133, 94 Cal.Rptr.2d 448 (*Akins*); see *Abdallah v. United Savings Bank* (1996) 43 Cal.App.4th 1101, 1111, 51 Cal.Rptr.2d 286 (*Abdallah*) [allocation not required when the claims are " ' "inextricably intertwined" ' [citation], making it 'impracticable, if not impossible, to separate the multitude of conjoined activities into ****26** compensable or noncompensable time units' "].)

[28] Allocation also generally is required when the same lawyer represents one party that is entitled to recover its attorney fees and another party that is not. As with allocation among causes of action, allocation among jointly represented parties "is not required when the liability of the parties is 'so factually interrelated that it would have been impossible to separate the activities ... into compensable and noncompensable time units. ... [Citation.]' " (*Cruz v. Ayromloo* (2007) 155 Cal.App.4th 1270, 1277, 66 Cal.Rptr.3d 725; see *Zintel Holdings, LLC v. McLean* (2012) 209 Cal.App.4th 431, 443, 147 Cal.Rptr.3d 157.)

[29] Here, the trial court did not address allocation because it found neither Westover Capital nor Haver was entitled to recover attorney fees on any cause of action. "The trial court[, however,] is the best judge of the value of professional services rendered in its court ..." (*Akins,* *supra,* 79 Cal.App.4th at p. 1134, 94 Cal.Rptr.2d 448) and allocation of attorney fees "is a matter within the trial court's discretion" (*Amtower, supra,* 158 Cal.App.4th at p. 1604, 71 Cal.Rptr.3d 361; see *Abdallah, supra,* 43 Cal.App.4th at p. 1111, 51 Cal.Rptr.2d 286). Accordingly, on remand the trial court must determine (1) whether and how to allocate Westover Capital's attorney fees between the breach of contract and successor liability issues and the tort issues; (2) whether and how to allocate the fees for the attorneys who jointly represented Westover Capital and Haver; and (3) the amount of attorney fees Westover Capital may recover for this appeal (*Akins,* at p. 1134, 94 Cal.Rptr.2d 448).

III

DISPOSITION

We affirm the trial court's order denying Haver her attorney fees and denying Westover Capital attorney fees on the conversion and fraud causes of action. We reverse the trial court's order denying Westover Capital attorney fees on the breach of contract claims and remand for further proceedings to ***831** determine the amount of fees Westover Capital may recover consistent with the views expressed in this opinion. Westover Capital and Haver shall recover their costs on appeal.

WE CONCUR:

BEDSWORTH, ACTING P.J.

FYBEL, J.

All Citations

219 Cal.App.4th 809, 162 Cal.Rptr.3d 9, 13 Cal. Daily Op. Serv. 10,334, 2013 Daily Journal D.A.R. 12,439

Footnotes

1 We will refer to Brown Bark III, L.P., as Brown Bark, Jaimie Haver as Haver, Westover Capital Corporation as Westover Capital, and Westover Financial, Inc., as Westover Financial. Westover Financial is not a party to this appeal.

2 All statutory references shall be to the Civil Code unless otherwise stated.

3 The third amended complaint also alleged causes of action for claim and delivery and injunctive relief and included Westover Financial on the conversion, fraud, and suppression of material fact claims, but Brown Bark later dismissed those claims.

4 We also note *Sunnyside* is an unpublished federal district court case that we are not required to follow. (*Gomes v. Countrywide Homes Loans, Inc.* (2011) 192 Cal.App.4th 1149, 1155 & fn. 6, 121 Cal.Rptr.3d 819.)

5 Although not relevant to this action, the purchasing corporation also may be held liable for the selling corporation's debts and liabilities when (1) it expressly or impliedly agrees to assume those debts and liabilities; (2) the asset sale amounts to a consolidation or merger of the two corporations; or (3) a consumer is injured by one of the selling corporation's products that the purchasing corporation continues to manufacture and sell. (*Franklin v. USX Corp.* (2001) 87 Cal.App.4th 615, 621, 105 Cal.Rptr.2d 11 (*Franklin*); see also *Ray v. Alad Corp.* (1977) 19 Cal.3d 22, 28, 30, 34, 136 Cal.Rptr. 574, 560 P.2d 3 (*Ray*).) These situations are all exceptions to the general rule that one corporation is *not* liable for the debts and liabilities of another corporation simply because it purchased the corporation's assets. (Franklin, at p. 621; Ray, at pp. 28, 30, 34.)

6 "In California, two conditions must be met before the alter ego doctrine will be invoked. First, there must be such a unity of interest and ownership between the corporation and its equitable owner that the separate personalities of the corporation and the shareholder do not in reality exist. Second, there must be an inequitable result if the acts in question are treated as those of the corporation alone." (*Sonora Diamond Corp. v. Superior Court* (2000) 83 Cal.App.4th 523, 538, 99 Cal.Rptr.2d 824.)

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APPENDIX
II

KeyCite Yellow Flag - Negative Treatment
Disagreement Recognized by Super 7 Motel Associates v. Wang, Cal.App. 4 Dist., June 10, 1993

25 Cal.3d 124, 599 P.2d 83, 158 Cal.Rptr. 1

REYNOLDS METALS COMPANY,
Plaintiff and Appellant,
v.
NORMAN O. ALPERSON et al.,
Defendants and Respondents

L.A. No. 31045.
Supreme Court of California
August 31, 1979.

SUMMARY

Plaintiff brought an action against two shareholders and directors of two bankrupt corporations, seeking to hold them liable for the debts owed plaintiff by the corporations, claiming defendants were "alter egos" of the companies. One count was based on two unpaid promissory notes executed by one corporation with the other as endorser, which provided for recovery of collection cost, including attorney fees limited to 15 percent of the principal amount. Defendants had not signed the promissory notes. Two other causes of action were on common counts. The trial court rejected the alter ego theory and absolved defendants from personal liability for the obligations of the corporations. In addition, the trial court granted defendants 100 percent of their legal fees incurred in attachment proceedings, 75 percent of their fees incurred from the commencement of the lawsuit until certain tort causes of action were dismissed, and 100 percent of their remaining fees. (Superior Court of Los Angeles County, No. C61852, August J. Goebel, Judge.)

The Supreme Court reversed for redetermination of attorney fees. The court held that Civ. Code, § 1717, enacted to establish mutuality of remedy where contractual provision makes recovery of attorney fees available for only one party, is to be interpreted to further provide a reciprocal remedy for a nonsignatory defendant, sued on a contract as if he were a party to it, when a plaintiff would clearly be entitled to attorney fees should he prevail in enforcing the contractual obligation against defendant. Accordingly, the court held that, since defendants would have been liable for attorney fees pursuant to the fees provision in the promissory note had plaintiff prevailed, they could recover attorney fees pursuant to Civ. Code, § 1717, now that they had prevailed. The court further held that, because the promissory notes contained a provision limiting attorney fees to 15 percent of the amount of the notes, recovery of fees under Civ. Code, § 1717, must be similarly limited, and the trial court erred in failing to observe that limitation. (Opinion by Clark, J., expressing the unanimous view of the court.)

HEADNOTES

Classified to California Digest of Official Reports

(1)
Costs § 7--Amount and Items Allowable--Attorney Fees.
Unless authorized by either statute or agreement, attorney fees ordinarily are not recoverable as costs.

(2)
Damages § 11--Compensatory Damages--Attorney Fees--Contractual Provision--Mutuality--Nonsignatory.
Civ. Code, § 1717, enacted to establish mutuality of remedy where contractual provision makes recovery of attorney fees available for only one party and to prevent oppressive use of one-sided attorney fee provisions, is to be interpreted to further provide a reciprocal remedy for a nonsignatory defendant, sued on a contract as if he were a party to it, when a plaintiff would clearly be entitled to attorney fees should he prevail in enforcing the contractual obligation against defendant. Accordingly, in an action against two defendants on promissory notes executed by bankrupt corporations in which defendants were shareholders and directors, with defendants' liability predicated on an alter ego theory, even though defendants had not signed the notes, they were entitled to attorney fees where the notes provided for recovery of collection costs, including attorney fees. Because defendants would have been liable for attorney fees pursuant to the fees provision had plaintiff prevailed, they could recover attorney fees pursuant to the statute when they prevailed. (Disapproving *Arnold* v. *Browne* (1972) 27 Cal.App.3d 386, 398-399 [103 Cal.Rptr. 775] and *Sain v. Silvestre* (1978) 78 Cal.App.3d 461, 476 [144 Cal.Rptr. 478], insofar as they are inconsistent.)

[See **Cal.Jur.3d,** Costs, § 64; **Am.Jur.2d,** Costs, § 79.]

(3)
Damages § 11--Compensatory Damages--Attorney Fees--Contractual Provision.
Where a cause of action based on a contract providing for attorney fees is joined with other causes of action beyond the contract, the prevailing party may recover attorney fees under Civ. Code, § 1717, only as they relate to the contract action. A litigant may not increase his recovery of attorney fees by joining a cause of action in which attorney fees are not recoverable to one in which an award is proper. Accordingly, attorney fees incurred solely by defendants for defending causes of action not related to an action on promissory notes providing for recovery of attorney fees were not recoverable.

(4)
Damages § 11--Compensatory Damages--Attorney Fees--Apportionment.
Attorney fees need not be apportioned when incurred for representation on an issue common to both a cause of action in which fees are proper and one in which they are not allowed. Accordingly, all expenses incurred by defendants with respect to an issue that was common to both an action on a promissory note providing for attorney fees and a cause of action not so providing, qualified for an award of attorney fees.

(5)
Damages § 11--Compensatory Damages--Attorney Fees--Contractual Provision--Mutuality--Amount.
Because promissory notes contained provisions limiting attorney fees to 15 percent of the amount of the notes, recovery of fees by defendants who prevailed in an action on the notes under Civ. Code, § 1717, establishing a reciprocal right to attorney fees, were limited to the same 15 percent of the face amount of the notes.

COUNSEL
Adams, Duque & Hazeltine, James L. Nolan and Margaret Levy for Plaintiff and Appellant.
Kranitz, Sarrow, Imerman & Sacks, Jerome H. Sarrow, Goodstein, Copes & Field, Donald A. Dewar and H. Walter Croskey for Defendants and Respondents.

CLARK, J.

Plaintiff appeals from judgment awarding defendants $80,500 attorney's fees. We reverse. ***127**

Defendants, shareholders and directors of Titanium Metallurgical, Inc. (TMI), owned and operated a subsidiary, Turner Metals Supply, Inc. (Turner). Plaintiff supplied aluminum goods and products to Turner pursuant to a general line consignment agreement executed in 1971. TMI signed the agreement as guarantor of Turner's payments. The agreement contained no provision for recovery of attorney's fees in the event of breach.

In January 1973, Turner, with TMI as indorser, executed and delivered two promissory notes in the aggregate principal amount of $60,794.12. The notes provided for recovery of collection costs, including attorney's fees limited to 15 percent of the principal amount of the notes, in the event of default.

In 1973, Turner and TMI became insolvent and bankruptcy proceedings commenced. Plaintiff, having extended credit of $823,231.48 to Turner, filed a creditor's claim in the proceedings. Plaintiff also brought this suit seeking to hold defendants personally liable for the debts owed plaintiff by Turner and TMI, claiming defendants were "alter egos" of the two bankrupt companies. Trial proceeded on three causes of action, two on common count and the third upon the two unpaid promissory notes.

After lengthy trial, the court rejected the "alter ego" theory advanced by plaintiff, absolving defendants from personal liability for the obligations of Turner and TMI. In addition, the trial court granted defendants $80,500 in attorney's fees. [1]

The court awarded defendants 100 percent of their legal fees incurred in attachment proceedings, 75 percent of their fees incurred from the commencement of the lawsuit until certain tort causes of action were dismissed, and 100 percent of their remaining fees.

I. Availability of Attorney's Fees

([1]) Unless authorized by either statute or agreement, attorney's fees ordinarily are not recoverable as costs. (Code Civ. Proc., § 1021; *D'Amico v. Board of Medical Examiners* (1974) 11 Cal.3d 1, 24-27 [112 Cal.Rptr. 786, 520 P.2d 10]; *Freeman v. Goldberg* (1961) 55 Cal.2d 622, 625 [***128** 12 Cal.Rptr. 668, 361 P.2d 244]; *Young v. Redman* (1976) 55 Cal.App.3d 827, 834-835 [128 Cal.Rptr. 86].)

Civil Code section 1717 provides in part: "*In any action on a contract*, where such contract specifically provides that attorney's fees and costs, which are incurred to enforce the provisions of such contract, shall be awarded to one of the *parties, the prevailing party, whether he is the party specified in the contract or not*, shall be entitled to reasonable attorney's fees in addition to costs and necessary disbursements." [2] (Italics added.)

The language of the statute is unclear as to whether it shall be applied to litigants who like defendants have not signed the contract. The section refers to "any action on a contract" thus including any action where it is alleged that a person is liable on a contract, whether or not the court concludes he is a party to that contract. Nevertheless the terms "parties" and "party" are ambiguous. It is unclear whether the Legislature used the terms to refer to signatories or to litigants.

([2]) Section 1717 was enacted to establish mutuality of remedy where contractual provision makes recovery of attorney's fees available for only one party (*International Industries v. Olen* (1978) 21 Cal.3d 218, 223 [145 Cal.Rptr. 691, 577 P.2d 1031]; *System Inv. Corp. v. Union Bank* (1971) 21 Cal.App.3d 137, 163 [98 Cal.Rptr. 735]; Review of Selected 1968 Code Legislation (Cont.Ed.Bar) pp. 35-36), and to prevent oppressive use of one-sided attorney's fees provisions. (*Coast Bank* v. *Holmes* (1971) 19 Cal.App.3d 581, 596-597 [97 Cal.Rptr. 30].)

Its purposes require section 1717 be interpreted to further provide a reciprocal remedy for a nonsignatory defendant, sued on a contract as if he were a party to it, when a plaintiff would clearly be entitled to attorney's fees should he prevail in enforcing the contractual obligation against the defendant.

Attorney's fees were awarded pursuant to section 1717 to a person found not to be a signatory to a contract in *Babcock v. Omansky* (1973) 31 Cal.App.3d 625, 633-634 [107 Cal.Rptr. 512]. The defendant prevailed following the plaintiff's allegation she was liable as a coventurer or partner with another defendant who had executed a promissory note ***129** providing for attorney's fees. Concluding that the nonsigning defendant was entitled to attorney's fees, the court reasoned the language of section 1717 was sufficiently broad to include persons who had not signed the contract but were sued on the note and found not to be parties to it. (See *Pas v. Hill* (1978) 87 Cal.App.3d 521, 533-536 [151 Cal.Rptr. 98]; *Canal-Randolph Anaheim, Inc. v. Wilkoski* (1978) 78 Cal.App.3d 477, 486, fn. 2 [144 Cal.Rptr. 474]; *Schlocker v. Schlocker* (1976) 62 Cal.App.3d 921, 923 [133 Cal.Rptr. 485]; *Boliver* v. *Surety Co.* (1977) 72 Cal.App.3d Supp. 22, 29 [140 Cal.Rptr. 259].)

Arnold v. Browne (1972) 27 Cal.App.3d 386, 398-399 [103 Cal.Rptr. 775] and *Sain v. Silvestre*, (1978) 78 Cal.App.3d 461, 476 [144 Cal.Rptr. 478] are disapproved insofar as they are inconsistent with our holding here.

Had plaintiff prevailed on its cause of action claiming defendants were in fact the alter egos of the corporation. (*Kohn v. Kohn* (1950) 95 Cal.App.2d 708, 718 [214 P.2d 71]),defendants would have been liable on the notes. Since they would have been liable for attorney's fees pursuant to the fees provision had plaintiff prevailed, they may recover attorney's fees pursuant to section 1717 now that they have prevailed.

II. The Amount

([3]) Where a cause of action based on the contract providing for attorney's fees is joined with other causes of action beyond the contract, the prevailing party may recover attorney's fees under section 1717 only as they relate to the contract action. (*McKenze* v. *Kaiser-Aetna* (1976) 55 Cal.App.3d 84, 88-90 [127 Cal.Rptr. 275]; see *Schlocker v. Schlocker, supra*, 62 Cal.App.3d 921, 923.) Describing the attorney's fees provision, section 1717 specifically refers to fees "incurred to enforce the provisions of [the] contract." A litigant may not increase his recovery of attorney's fees by joining a cause of action in which attorney's fees are not recoverable to one in which an award is proper. In this case, the two promissory notes contained contract provisions for attorney's fees, but no such provision existed in the general line consignment agreement. Accordingly, attorney's fees incurred solely for defending causes of action based on the latter agreement and defending against the tort causes of action are not recoverable.

Conversely, plaintiff's joinder of causes of action should not dilute its right to attorney's fees. ([4]) Attorney's fees need not be apportioned when incurred for representation on an issue common to both a cause of ***130** action in which fees are proper and one in which they are not allowed. All expenses incurred with respect to the alter ego issue - common to both the note and the general line consignment agreement - qualify for award.

([5]) Because the promissory notes contained provision limiting attorney's fees to 15 percent of the amount of the notes ($60,794.12) recovery of fees under section 1717 must be similarly limited. As we have seen, the section establishes a reciprocal right to attorney's fees, and the statutory right should be no greater than the contractual right. The statute refers to "reasonable attorney's fees," and reasonable falls within the fundamental principle of reciprocity.

The trial court erred in failing to observe the 15 percent limitation.

The judgment is reversed for redetermination of attorney's fees.

Bird, C. J., Tobriner, J., Mosk, J., Richardson, J., Manuel, J., and Newman, J., concurred. ***131**

Footnotes

1 Defendant Alperson sought to recover $39,445 in attorney's fees and was awarded $38,500. Defendant Blivas sought $51, 597.50 and was awarded $42,000.

2 Section 1717 also provides: "Attorney's fees provided for by this section shall not be subject to waiver by the parties to any contract which is entered into after the effective date of this section. Any provision in any such contract which provides for waiver of attorney's fees is void. [¶] As used in this section 'prevailing party' means the party in whose favor final judgment is rendered."

APPENDIX
III

2009 WL 1311816
Only the Westlaw citation is currently available.

NOTICE: THIS OPINION IS DESIGNATED AS UNPUBLISHED AND MAY NOT BE CITED EXCEPT AS PROVIDED BY MINN. ST. SEC. 480A.08(3).

Court of Appeals of Minnesota.

Perry SCHWARTZ, et al., Respondents,
v.
VIRTUCOM, INC., et al., Appellants.

No. A08-1059.
|
May 12, 2009.
|
Review Denied July 22, 2009.

West KeySummary

1 **Corporations and Business Organizations**
Particular Debts and Liabilities

A district court did not err by holding a successor company liable for a default judgment against a predecessor company under a successor-liability theory where there was a fraudulent transfer of assets from the predecessor to the successor. The underlying litigation against the predecessor was initiated prior to the corporate changes involving the predecessor. Around the time that the predecessor ceased doing business, the successor began to hold itself out as the predecessor and began to utilize assets previously held by the predecessor. Moreover, the predecessor did not receive any consideration for the transferred assets and the transfer was not disclosed. M.S.A. §§ 513.44(a)(1), 513.41(12), 513.44(b), 513.44(b)(3).

5 Cases that cite this headnote

Hennepin County District Court, File No. 27-CV-02-000265.

Attorneys and Law Firms

James H. Kaster, David E. Schlesinger, Jessica J. Clay, Nichols Kaster, PLLP, Minneapolis, MN, for respondents.

Jack E. Pierce, Tracy Halliday, Pierce Law Firm, P.A., Minneapolis, MN, for appellants.

Considered and decided by HUDSON, Presiding Judge; WORKE, Judge; and LARKIN, Judge.

UNPUBLISHED OPINION

LARKIN, Judge.

*1 Appellant St. Regis Ventures, Inc. d/b/a Virtucom Group claims that the district court erred by holding it liable for a default judgment against Virtucom, Inc., and Virtucom Group, Inc. under a successor-liability theory. Because the district court did not err by applying the fraudulent-transfer exception to the general rule against successor liability, we affirm.

FACTS

This appeal arises from a contractual dispute between respondent The Idea Farm, Inc. and Virtucom, Inc. The Idea Farm is a Minnesota corporation; respondent Perry Schwartz is its owner and president. Virtucom, Inc. was incorporated in Delaware in 1997 by founders Michael Jacobs and Tom Murphy. Jacobs and Murphy were the only shareholders, and Jacobs was the original CEO. Virtucom, Inc. did business as Virtucom Group, Inc. In 1998, Virtucom, Inc. moved to Minneapolis, as did Jacobs.

In February 2001, The Idea Farm and Virtucom, Inc. entered into a contract where Virtucom, Inc. would pay The Idea Farm commission for providing sales assistance to Virtucom, Inc. The Idea Farm received one payment on the contract in March 2001. Virtucom, Inc. made no additional payments. Schwartz and The Idea Farm filed a lawsuit against Virtucom, Inc. for breach of contract in April 2001.

In October 2001, Virtucom, Inc. incorporated in Minnesota. The following month, the Delaware Virtucom, Inc. and the Minnesota Virtucom, Inc. merged, with the Minnesota Virtucom, Inc. as the only surviving entity. In approximately July 2002, Virtucom, Inc. changed its name to Virtucom Content Solutions, Inc. (VCSI). This was a name change only; the legal entity did not change in any way. Virtucom, Inc. had used the domain name www.virtucomgroup.com. Following Virtucom, Inc.'s name change to VCSI, an individual entering www.virtucomgroup.com would be redirected to www.virtucomcsi.com. Jacobs owned roughly 60% of all VCSI stock as of November 2002. Shortly thereafter, Jacobs became the company's only major shareholder.

Shortly after Virtucom, Inc. changed its name to VCSI, Jacobs incorporated Versant Publishing Service, Inc. in New York in August 2002. Jacobs was the chairman, president, treasurer, secretary, and controlling shareholder. In April 2003, Versant Publishing Service, Inc. changed its name to St. Regis Ventures, Inc. St. Regis operates a division under the name of Virtucom Group. In the fall of 2006, 90% of St. Regis's work was within the Virtucom Group division. Jacobs owns 50% of the shares of St. Regis. The remaining shares are owned by an individual with whom Jacobs has a personal relationship. Although different parties have been members of the boards of VCSI and St. Regis, Jacobs has had substantial, if not complete, control over VCSI and St. Regis.

St. Regis acquired the following assets which were previously held by VCSI: the Virtucom Group domain name, the URL www.virtucomgroup.com, Virtucom Group's customer contacts, the Virtucom name, and the goodwill associated with Virtucom's name. Nearly all of St. Regis's customer contacts came from Jacobs's dealings with VCSI and its predecessor. In addition, the logos of Virtucom Group and St. Regis are nearly identical, sufficiently identical for one to believe they are the same entity.

*2 In mid-2003, VCSI stopped participating in The Idea Farm's lawsuit and its counsel withdrew. In August 2003, Jacobs informed the American Arbitration Association that VCSI was not a viable entity and had no money to pay for arbitration. Jacobs abandoned VCSI, and it ceased having board meetings and doing business. Around the same time, St. Regis began to service clients, and to hold itself out to customers and vendors, under the name Virtucom Group.

The Idea Farm obtained a default judgment against Virtucom, Inc. and Virtucom Group, Inc. in November 2003 in the amount of $232,921.84. The Idea Farm subsequently amended its complaint to add St. Regis as a defendant, seeking to hold St. Regis liable for the default judgment under a successor-liability theory. After a court trial on the amended complaint, the district court held that St. Regis is the successor of VCSI under the mere-continuation and fraudulent-transfer exceptions to the general rule against successor liability. St. Regis moved for amended findings of fact, conclusions of law, or in the alternative, a new trial. The district court denied this motion. The Idea Farm moved for attorney fees, costs, and interest. The district court awarded The Idea Farm $116,882.35 in attorney fees and costs, as well as interest calculated on the default judgment. This appeal follows.

DECISION

I. The district court did not err by holding St. Regis Ventures, Inc. liable for the default judgment against Virtucom, Inc. and Virtucom Group, Inc. under a successor-liability theory.

St. Regis argues that because it was not a mere continuation of VCSI, and because there was no fraudulent transfer of assets, the district court erred in finding St. Regis liable as a successor corporation. "An appellate court is not bound by, and need not give deference to, the district court's decision on a question of law." *Bondy v. Allen,* 635 N.W.2d 244, 249 (Minn.App.2001) (citing *Frost-Benco Elec. Ass'n v. Minn. Pub. Utils. Comm'n,* 358 N.W.2d 639, 642 (Minn.1984)). However, findings of fact will not be set aside unless clearly erroneous and "due regard shall be given to the opportunity of the trial court to judge the credibility of the witnesses." Minn. R. Civ. P. 52.01. St. Regis argues that the district court erred as a matter of law by imposing successor liability given the facts found by the district court. [1]

In Minnesota, a successor company is generally not liable for the debts of its predecessor. *See J.F. Anderson Lumber Co. v. Myers,* 296 Minn. 33, 37, 206 N.W.2d 365, 368 (1973) ("The general rule is that where one company sells or otherwise transfers all its assets to another company, the purchasing company is not liable for the debts and liabilities of the transferor."). The exceptions to this rule are:

> (1) where the purchaser expressly or impliedly agrees to assume such debts; (2) where the transaction amounts to a consolidation or merger of the corporation; (3) where the purchasing corporation is merely a continuation of the selling corporation; and (4) where the transaction is entered into fraudulently in order to escape liability for such debts. [2]

***3** *Id.* at 37-38, 206 N.W.2d at 368-69 (quotation omitted). The district court held that the mere-continuation and fraudulent-transfer exceptions apply in this case.

A company may be held liable for the debts and liabilities of a judgment debtor if the debtor's assets are fraudulently transferred to the company in order for the debtor to escape liability for such debts. *Id.* Relevant portions of the Minnesota Fraudulent Transfers Act (MFTA) provide that a transfer is fraudulent if it was made "with actual intent to hinder, delay, or defraud any creditor of the debtor." Minn.Stat. § 513.44(a)(1) (2008). " 'Transfer' means every mode, direct or indirect, absolute or conditional, voluntary or involuntary, of disposing of or parting with an asset or an interest in an asset, and includes payment of money, release, lease, and creation of a lien or other encumbrance." Minn.Stat. § 513.41(12) (2008).

In considering whether there was actual intent to hinder, delay, or defraud a creditor, courts may consider the factors set out in Minn.Stat. § 513.44(b) (2008). These factors include, but are not limited to whether:

> (2) the debtor retained possession or control of the property transferred after the transfer; (3) the transfer or obligation was disclosed or concealed; (4) before the transfer was made or obligation was incurred, the debtor had been sued or threatened with suit; ... (8) the value of the consideration received by the debtor was reasonably equivalent to the value of the asset transferred or the amount of the obligation incurred; (9) the debtor was insolvent or became insolvent shortly after the transfer was made or the obligation was incurred; (10) the transfer occurred shortly before or shortly after a substantial debt was incurred.

Minn.Stat. § 513.44(b). Application of these factors to the district court's findings of fact indicates that there was a fraudulent transfer of assets from VCSI to St. Regis and that the district court's application of the fraudulent-transfer exception to the rule against successor liability is appropriate.

First, the underlying litigation was initiated prior to the corporate changes involving Virtucom, Inc. and Versant Publishing Services, Inc. The Idea Farm filed suit against Virtucom, Inc. in April 2001. In October 2001, Virtucom, Inc. incorporated in Minnesota. The Delaware and Minnesota Virtucoms then merged. In July 2002, Virtucom Group changed its name to VCSI. Versant Publishing Service incorporated in August 2002 and changed its name to St. Regis Ventures in April 2003. In August 2003, Jacobs informed the American Arbitration Association that VCSI was insolvent and would no longer be participating in the lawsuit. Around the time that VCSI ceased doing business, St. Regis began to hold itself out as Virtucom Group and began to utilize assets previously held by VCSI. In November 2003, The Idea Farm obtained default judgment against Virtucom, Inc. and Virtucom Group, Inc. The timing of these events supports the conclusion that assets were transferred from VCSI to St. Regis in an effort to hinder, delay, or defraud The Idea Farm. *See id.* ("(4) before the transfer was made or obligation was incurred, the debtor had been sued or threatened with suit; ... (9) the debtor was insolvent or became insolvent shortly after the transfer was made or the obligation was incurred; (10) the transfer occurred shortly before or shortly after a substantial debt was incurred").

***4** Moreover, VCSI did not receive any consideration for the transferred assets. *See id.* ("(8) the value of the consideration received by the debtor was reasonably equivalent to the value of the asset transferred or the amount of the obligation incurred"). Inadequate consideration for the transfer of assets is indicative of fraud. *See J.F. Anderson Lumber Co.,* 296 Minn. at 41, 206 N.W.2d at 370 (stating the receiving corporation is responsible for the debts of the transferring corporation where the transfer is "entered into for inadequate consideration, or otherwise fraudulently, in order to escape liability for such debts").

And the transfer was not disclosed. *See* Minn.Stat. § 513.44(b)(3) ("the transfer or obligation was disclosed or concealed"). For example, the president of Redline Marketing, David Arundel, began a relationship with a company he knew as "Virtucom" in 2001. The relationship continues today. Arundel worked with "Virtucom" spanning the time that Virtucom, Inc. d/b/a Virtucom Group changed its name to VCSI and the time that St. Regis began using the name Virtucom Group. Arundel had never heard of St. Regis and was not aware that Virtucom Group or VCSI had stopped doing business. As stated by the district court: "St. Regis holds itself out as Virtucom Group and in so doing benefits from the goodwill and reputation associated with the Virtucom name."

Appellant argues that there was no fraudulent transfer because there is no evidence that an actual asset transfer occurred. Appellant stresses that the record is devoid of information regarding the identity of the transferor and transferee, the date of the transfer, and the actual value of the transferred assets. This argument is unconvincing. The Virtucom Group name, logo, domain name, established business, good will, and reputation are assets with measurable value. *See J.F. Anderson,* 296 Minn. at 39, 206 N.W.2d at 369 (stating that "in a proper case, if there is an asset of the corporation labeled 'good will,' which is transferred and which can be measured in money terms, perhaps there would be some basis for determining that the creditor of the transferring corporation has a claim against the receiving corporation").

The value attributable to the Virtucom Group name is evidenced by St. Regis's relationship with Best Buy. St. Regis does business under the name Virtucom Group and holds itself out to the public as the Virtucom Group. St. Regis uses the Virtucom name because it has "recognition." Best Buy decided to outsource some of its work in 2004 and hired a corporation it knew only as Virtucom Group. A former employee of Best Buy testified that he had never heard of St. Regis Ventures, despite working with the company for nearly a year. Best Buy even stated that "St. Regis Ventures has never been a vendor for Best Buy." St. Regis never identified itself as St. Regis Ventures to Best Buy.

The Virtucom Group name, logo, domain name, customer contacts, good will, and reputation originally belonged to VCSI, and they are now used by St. Regis. It is undisputed that St. Regis provided no consideration for these assets. While this case does present an interesting situation in part because the assets are intangible and the precise details of the transfer to St. Regis are unknown, it is clear that assets previously owned by VCSI are now held and utilized by St. Regis. It is also clear that Jacobs had control of the assets of VCSI and St. Regis Ventures before and after the unknown transfer date, which also indicates a fraudulent transfer. *See* Minn.Stat. § 513.44(b)(2) ("the debtor retained possession or control of the property transferred after the transfer"). We agree with the district court's conclusion that the factors discussed above, when taken together, indicate that assets were transferred from VCSI to St. Regis with intent to defraud. The district court appropriately summarized this situation by citing to *J.F. Anderson:*

> ***5** Transfers of all of the assets of a person or corporation in straitened circumstances, without fair consideration, to a corporation having substantially the same ownership, by which the just claims of creditors are defeated, are of such fraudulent nature that the new corporation may be held to the debt of the old.

296 Minn. at 38, 206 N.W.2d at 369 (quoting *Econ. Ref. & Serv. Co., v. Royal Nat'l Bank of N.Y.,* 20 Cal.App.3d 434, 97 Cal.Rptr. 706 (Cal.Ct.App.1971)).

We affirm the district court's judgment under the fraudulent-transfer exception to the general rule against successor liability. It is therefore unnecessary to consider the second ground for the district court's award of judgment, that being the mere-continuation exception.

II. The district court did not abuse its discretion by awarding The Idea Farm attorney fees, costs, and interest.

St. Regis argues that the district court abused its discretion in awarding attorney fees, costs, and interest to The Idea Farm. We disagree.

Attorney fees are recoverable when provided for by contract. *Barr/Nelson, Inc. v. Tonto's Inc.*, 336 N.W.2d 46, 53 (Minn.1983). "On review, this court will not reverse a [district] court's award or denial of attorney fees absent an abuse of discretion." *Becker v. Alloy Hardfacing & Eng'g Co.*, 401 N.W.2d 655, 661 (Minn.1987). The contract between The Idea Farm and Virtucom, Inc. provides:

> If either party shall bring any action for any relief against the other, declaratory or otherwise, arising out of this Agreement, the losing party shall pay the successful party a reasonable sum for the attorneys fee which shall be deemed to have accrued on the commencement of such action and shall be paid whether or not such action is prosecuted to judgment.

St. Regis, as successor to VCSI, is liable for attorney fees awarded against Virtucom, Inc. under the contract between Virtucom, Inc. and The Idea Farm. [3] The district court did not abuse its discretion by awarding attorney fees.

Furthermore, the district court did not abuse its discretion by awarding costs and interest to The Idea Farm. The district court has discretion to determine the amount of an award of costs and disbursements under Minn.Stat. §§ 549.02, .04 (2008). "[A] district court abuses its discretion when its decision is against logic and facts on the record." *Posey v. Fossen,* 707 N.W.2d 712, 714 (Minn.App.2006). The costs awarded were not against logic or the facts in the record. St. Regis argues that only those costs related to this action should be awarded, as St. Regis was not a party to the underlying contractual dispute between Virtucom, Inc. and The Idea Farm. This argument fails to recognize that St. Regis is liable as a successor corporation for the underlying judgment resulting from the contractual dispute between Virtucom, Inc. and The Idea Farm, as well as the costs associated with obtaining that judgment.

St. Regis also argues that the district court erroneously awarded the Idea Farm prejudgment interest under Minn.Stat. § 549.09, subd. 1(b) (2008). The district court ordered "[t]hat the Court Administrator shall also enter judgment ... against St. Regis Ventures for interest calculated on the judgment entered on November 21, 2003 in the amount of $232,921.84 as provided by Minn.Stat. 549 .09." *See* Minn.Stat. § 549.09, subd. 1(a) (2008) ("When a judgment or award is for the recovery of money ... interest from the time of the verdict, award, or report until judgment is finally entered shall be computed ... and added to the judgment or award ."). Again, St. Regis fails to recognize that it is liable for the default judgment against Virtucom, Inc., and its liability extends to post-judgment interest. The interest that the district court awarded was post-judgment interest on the November 2003 judgment against Virtucom, Inc. and Virtucom Group, Inc., not pre-judgment interest.

***6** Finally, St. Regis argues that it should have been allowed to defend against the successor-liability claim on the ground that there was no breach of the underlying contract between The Idea Farm and Virtucom, Inc. The district court denied St. Regis's motion for a new trial and for an opportunity to defend against the underlying contractual dispute on the merits because St. Regis failed to establish any ground for a new trial under Minn. R. Civ. P. 59.01. We review this decision under an abuse-of-discretion standard. *Halla Nursery, Inc. v. Baumann-Furrie & Co.*, 454 N.W.2d 905, 910 (Minn.1990).

The district court did not abuse its discretion by denying St. Regis's motion for a new trial and for an opportunity to defend against the underlying breach-of-contract claim on the merits. A default judgment was entered against Virtucom, Inc. and Virtucom Group, Inc. on November 21, 2003. St. Regis was not a party to the underlying lawsuit at that time, but became a party upon amendment of the complaint on June 30, 2004. Yet St. Regis never moved the district court to vacate the underlying judgment and grant a new trial pursuant to Minn. R. Civ. P. 60.02. St. Regis concedes that it had standing to bring a motion for relief from judgment once the complaint was amended to include it as a party. But St. Regis fails to cite legal authority for the proposition that it should be allowed to defend against the merits of the underlying breach-of-contract claim, after judgment had issued, absent a timely motion for relief from judgment. Because St. Regis failed to establish a basis for a new trial, the district court did not abuse its discretion by refusing to provide St. Regis an opportunity to defend against the underlying breach-of-contract claim on the merits.

Affirmed.

All Citations

Not Reported in N.W.2d, 2009 WL 1311816

Footnotes

1 St. Regis assigns specific error to only one of the district court's findings of fact and that finding relates solely to the court's application of the mere-continuation exception to the general rule against successor liability. St. Regis alleges that the district court erred by finding that the services provided by VCSI and St. Regis are in essence the same. Because we affirm the district court's judgment based on the fraudulent-transfer exception and do not consider the mere-continuation exception, we do not address the accuracy of this particular finding.

2 A 2006 amendment to Minn.Stat. § 302A.661, subd. 4 altered the applicability of these exceptions. Nonetheless, because the events giving rise to liability in this case occurred prior to the amendment, pre-amendment law will be applied in this case. Furthermore, the fraudulent-transfer exception survived the amendment.

3 Appellant does not challenge the amount of the attorney fees.

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APPENDIX IV

KeyCite Yellow Flag - Negative Treatment
Declined to Extend by In re Smith's Home Furnishings, Inc., 9th Cir.(Or.), September 13, 2001

988 F.2d 949
United States Court of Appeals,
Ninth Circuit.

Zachary STOUMBOS, Trustee, as successor to Dale V. Whitesides, Trustee, Plaintiff–Appellant–Cross–Appellee,
v.
Walter KILIMNIK, an individual, AAM Aerospace & Corrosion International, Inc., a Washington corporation, d/b/a Aerospace & Corrosion International, Inc., et al., Defendants–Appellees–Cross–Appellants.

Nos. 91–35524, 91–35525.
|
Argued and Submitted Sept. 16, 1992.
|
Decided March 9, 1993.

Chapter 7 trustee brought adversary proceeding seeking to recover from seller of assets to debtor the value of debtor's assets subsequently surrendered to seller, seeking to subject seller's claim to equitable subordination, and seeking to impose successor liability on seller's new corporation. The United States Bankruptcy Court for the Western District of Washington granted summary judgment in favor of seller with respect to his claim of security interest, found that one payment was preferential, and dismissed trustee's other claims. The District Court, Jack E. Tanner, J., affirmed. Trustee appealed and seller cross-appealed. The Court of Appeals, Fletcher, Circuit Judge, held that: (1) seller took a kind of "purchase money" interest in the equipment he sold to the debtor, but did not obtain an additional blanket interest in all equipment debtor acquired after sale; (2) seller failed to establish that bank account of debtors contained proceeds of collateral covered by security interest; (3) trustee established inequitable conduct, warranting subordination of seller's claim; (4) Bankruptcy Court erred in concluding that seller's new corporation could not have been subject of successor liability under Washington law because it did not purchase debtor's assets from debtor; and (5) payment made to secured creditor in redemption of $2,000 preferred stock issued to creditor for services to corporation was not a preferential transfer, as redemption was not payment for or on account of antecedent debt.

Reversed and remanded.

West Headnotes (25)

[1] **Federal Courts**
Contracts
Interpretation of contract is issue of law reviewed de novo.

1 Cases that cite this headnote

[2] **Evidence**
Grounds for admission of extrinsic evidence
Under Washington law extrinsic evidence is admissible as to entire circumstances under which contract was made as aid in ascertaining parties' intent.

Cases that cite this headnote

[3] **Secured Transactions**
After-acquired property
Purchase agreement gave seller of assets to debtor, through incorporation of terms of working capital financial agreement, security interest in after-acquired inventory to extent inventory secured working capital advanced by seller and outstanding at time of foreclosure, even though agreement alone did not establish that seller had security interest in after-acquired equipment and inventory.

4 Cases that cite this headnote

[4] **Secured Transactions**
After-acquired property
Issue of whether financing statement or security agreement providing for security interest in "all inventory" incorporates after-acquired inventory without any express

reference to after-acquired inventory has not been decided under Washington law.

4 Cases that cite this headnote

[5] **Secured Transactions**
After-acquired property

Financing statements or security agreement granting creditor security interest in all equipment does not automatically extend to after-acquired equipment, under Washington law.

2 Cases that cite this headnote

[6] **Secured Transactions**
After-acquired property

Seller of assets to debtor did not acquire security interest in debtor's after-acquired equipment, under Washington law, even though financing statement mentioned after-acquired equipment; rather, seller took only a kind of "purchase money" interest in equipment sold to debtor, and did not obtain additional security interest in all equipment company ever acquired after sale.

1 Cases that cite this headnote

[7] **Secured Transactions**
Notation on certificate of title

Seller of assets to debtor could perfect its claimed security interest in three motor vehicles he transferred into his own name after sale only by notation of his own name on vehicle's certification of ownership, not by filing a UCC–1, and thus, seller did not have perfected security interest in vehicles. West's RCWA 46.12.095.

Cases that cite this headnote

[8] **Bankruptcy**
Damages claims

Seller of assets, who after sale of assets to debtor seized three vehicles in which he claimed, but failed to perfect, security interests, could be required to turn over to Chapter 7 estate the market value of vehicles at time of transfer, plus interest, despite contention of seller that trustee failed to prove that "these old fuel-inefficient vehicles had a market value in excess of the cost of seizing and selling them"; seller did not realize value of vehicles by selling them and applying proceeds to reduce debt, but, rather, put them in use at his corporation. Bankr.Code, 11 U.S.C.A. § 542.

1 Cases that cite this headnote

[9] **Secured Transactions**
Secured party's rights in proceeds

Seller of assets, who merely testified that Chapter 7 debtor's liquid assets management account was "related to" his security interest, and who did not state that account contained only proceeds or that debtor had received proceeds in at least the amount he withdrew, failed to establish that funds in account were "proceeds" of collateral covered by security interest, and thus would be required to turn over to trustee amount taken from account, plus interest from date of taking. West's RCWA 62A.9–104(*l*), 62A.9–306, 62A.9–306(4); Bankr.Code, 11 U.S.C.A. § 542.

3 Cases that cite this headnote

[10] **Secured Transactions**
Actions

Creditor has burden of establishing that deposit account contains proceeds of collateral covered by security interest. West's RCWA 62A.9–104(*l*), 62A.9–306, 62A.9–306(4).

4 Cases that cite this headnote

[11] **Bankruptcy**
Discretion

Bankruptcy court's decision on issue of equitable subordination is reviewed for abuse of discretion.

Cases that cite this headnote

[12] **Bankruptcy**
Determination of priority

When trustee seeks to subordinate claim of creditor, trustee must present evidence of creditor's unfair conduct, and if trustee meets burden, claimant must then prove fairness of transactions with debtor, or his claim will be subordinated.

6 Cases that cite this headnote

[13] **Bankruptcy**
Determination of priority

Chapter 7 trustee established that seller of assets to debtor, who retained security interest in equipment sold to debtor, acted "inequitably," and that there was "harm" to creditors, thus requiring equitable subordination of seller's claims; seller participated in vote by debtor's board of directors to waive debtor's rights in seller's collateral, although debtor was thereby released of liability for deficiency claim, debtor made somewhat larger purchases from its suppliers while under seller's control, and seller made assurances to suppliers to persuade them to continue to do business with debtor.

1 Cases that cite this headnote

[14] **Bankruptcy**
Inequitable conduct

Whether creditor's claim is secured is irrelevant to inequitable conduct requirement for equitable subordination; rather, inquiry focuses on conduct of creditor at issue and nature of relationship to debtor.

4 Cases that cite this headnote

[15] **Bankruptcy**
Insiders, stockholders, fiduciaries, and dominant persons

Seller of assets to debtor was "insider" of debtor, for equitable subordination purposes; even after he sold assets to debtor, seller never relinquished operating control of debtor, and was president of debtor from time debtor acquired assets from seller. Bankr.Code, 11 U.S.C.A. § 101(31).

3 Cases that cite this headnote

[16] **Bankruptcy**
Insiders, stockholders, fiduciaries, and dominant persons

Where trustee seeks to subordinate claim arising from dealings between debtor and insider, court will give insider's actions rigorous scrutiny. Bankr.Code, 11 U.S.C.A. § 101(31).

4 Cases that cite this headnote

[17] **Bankruptcy**
Inequitable conduct

In deciding not to equitably subordinate claim of seller of assets to debtor, bankruptcy court erroneously focused on harm to creditors as a whole, rather than making proper inquiry as to whether seller's self-dealing resulted in injury to competing claimants or unfair advantage to seller himself; bankruptcy court should have looked at harm to each of relevant creditors to determine whether seller's claim should be subordinated to their claims and, if so, to what extent.

5 Cases that cite this headnote

[18] **Bankruptcy**
Inequitable conduct

Claim will be equitably subordinated only to claims of creditors whom the inequitable conduct has disadvantaged.

4 Cases that cite this headnote

[19] **Corporations and Business Organizations**
Conveyances When Insolvent or in Contemplation of Insolvency

Washington law does not limit successor liability to direct purchaser of assets of corporation, but, rather, extends liability to transfers other than straightforward purchases, as otherwise unscrupulous businesspersons would be able to avoid liability and cheat creditors merely by changing form of transfer.

7 Cases that cite this headnote

[20] **Corporations and Business Organizations**
Transfer to another corporation having same directors, officers, or shareholders

In determining whether corporation was liable for debts of Chapter 7 debtor as "successive corporation" under Washington law, bankruptcy court should have considered whether successor liability existed on either a continuation or a fraud theory; corporation's sole business interest was operation it assumed from debtor, corporation took over debtor's setup virtually without change and left debtor with substantial liabilities and no assets, and same principal was controlling force in both companies.

1 Cases that cite this headnote

[21] **Corporations and Business Organizations**
Transfer to another corporation having same directors, officers, or shareholders

Mere fact that transfer of assets involves foreclosure on security interest will not insulate successor corporation from liability where other facts point to continuation, under Washington law.

9 Cases that cite this headnote

[22] **Corporations and Business Organizations**
Mere continuation

In determining whether successor liability exists under mere continuation theory, court looks at two factors under Washington law: common identity of officers, directors, and stockholders in two companies; and sufficiency of consideration running to seller corporation in light of assets sold.

2 Cases that cite this headnote

[23] **Bankruptcy**
Property or rights transferred

Transfer of Chapter 7 debtor's goodwill to seller, who had sold assets to debtor and retained security interest in assets, was fraudulent transaction that could be avoided, despite contention of seller that any good will of debtor ceased to exist when seller foreclosed on debtor's tangible assets; evidence indicated that seller recognized that debtor had going concern value and took steps to misappropriate value, even before he foreclosed on assets, by incorporating similarly named corporation and setting up arrangement under which debtor became mere shell and causing its customers' inquiries to be forwarded to new corporation. Bankr.Code, 11 U.S.C.A. § 548.

1 Cases that cite this headnote

[24] **Attorney and Client**
Bankruptcy

Counsel for one of petitioning creditors in involuntary case did not have adverse interest to trustee with regard to prosecution of preference proceedings, and thus could be appointed special counsel to trustee to prosecute such proceedings; with regard to preference claims, interests of creditor and trustee coincided. Bankr.Code, 11 U.S.C.A. §§ 327, 372(c).

29 Cases that cite this headnote

[25] **Bankruptcy**
Antecedent debt or contemporaneous consideration

Bankruptcy
Fraudulent conveyances in general

Payment made to secured creditor in redemption of $2,000 preferred stock issued to creditor for services to corporation was not a preferential transfer, as redemption was not payment for or on account of antecedent debt; however, trustee might be able to recover on fraudulent transfer theory. Bankr.Code, 11 U.S.C.A. §§ 547(b)(2), 548.

3 Cases that cite this headnote

Attorneys and Law Firms

***952** Joseph E. Shickich, Jr., Riddell, Williams, Bullitt & Walkinshaw, Seattle, WA, for plaintiff-appellant-cross-appellee.

William S. Weinstein, Weinstein, Fischer & Riley, Seattle, WA, for defendants-appellees-cross-appellants.

Appeal from the United States District Court for the Western District of Washington.

Before WRIGHT, FLETCHER and CANBY, Circuit Judges.

Opinion

FLETCHER, Circuit Judge:

The trustee for debtor American Alloy Metals ("AAM") appeals the district court's affirmance of the bankruptcy court's decision in an adversary proceeding brought by the trustee against Walter Kilimnik, former president of AAM. The decision in most respects favored Kilimnik. Kilimnik cross appeals that portion of the judgment that disfavored him. We reverse in most respects and remand.

FACTS

Walter Kilimnik founded AAM in 1965. He moved the company from California to Vancouver, Washington in 1980.

In 1982, Kilimnik, AAM's president and sole shareholder, sold the assets of AAM to a corporation owned by Peter Suriano, AAM's general manager. The transaction was structured as a leveraged buy-out. Kilimnik changed the name of AAM to WNK Enterprises, Inc. ("WNK"), while Suriano set up a new corporation called AAM. The new AAM purchased the assets of WNK. Suriano and AAM arranged to pay the purchase price as follows: Suriano made a down payment of $50,000, (the new) AAM assumed $385,000 of WNK's trade payables, and Suriano and AAM executed a promissory note in favor of Kilimnik for $3.95 million. The nature of the collateral securing the balance of the purchase price is one of the key issues. On May 1, 1982, the parties executed an agreement for the sale of the assets of WNK ("Purchase Agreement") to AAM and Suriano. After the sale, however, Kilimnik was president of AAM, and Suriano was general manager, positions each had held in the first AAM.

Kilimnik was to receive periodic payments on the note, but payments ceased almost immediately. No payments were made between September 1982 and August 1985 (when a preferential payment was made to Kilimnik).

In the spring of 1985, Suriano and Kilimnik apparently had a falling out. After negotiation, Suriano agreed to leave the corporation. As part of the settlement, he gave Kilimnik an irrevocable proxy to vote all his stock in the corporation. AAM paid Suriano an amount roughly equivalent to his 1982 down payment, and Suriano was released from personal liability on the promissory note.

Kilimnik was in sole control of AAM as president and holder of an irrevocable proxy to vote the shares. Apparently, under his direction, AAM's business began to improve. However, it had some problems with slow pay to its trade creditors, and Kilimnik found it necessary to reassure some of them. In early July 1985, Kilimnik had a heart attack, and was hospitalized for about two weeks. At the end of July, Kilimnik leased a small office in a location a short distance from AAM.

In August 1985, AAM made a $75,000 payment on the note to Kilimnik, and also redeemed $2,000 of preferred stock he held. ***953** On August 29, 1985, Kilimnik gave AAM notice of his intention to declare default on the note on September 9, 1985. On September 13, 1985, Kilimnik filed suit in the Washington state court to enforce his security interest. During this period, AAM placed unusually large orders with several of its suppliers. The bankruptcy court found substantial payments were also made to creditors at this time, although creditors continued to press AAM for payment and even threatened legal action.

In September 1985, Kilimnik incorporated AAM Aerospace and Corrosion International, Inc. ("Aerospace").[1] Kilimnik began a transition of AAM's business to Aerospace. Aerospace took over AAM's facilities, and all AAM's employees became Aerospace employees. AAM's phone lines were moved to the small office that had been rented in July. A temporary employee was hired to answer the phone; she would take messages from AAM customers and deliver them to what was now Aerospace. Aerospace would then take the customer orders.

On September 30, 1985, Kilimnik informed AAM of his resignation as president and chairman of the board of directors, effective October 1, 1985. On October 1, a special meeting of AAM shareholders was held. A resolution was adopted directing AAM to waive its rights in its inventory, equipment and receivables and surrender them to Kilimnik, in exchange for Kilimnik's agreement to forego a deficiency judgment against AAM. AAM's assets were then turned over to Kilimnik. On October 2, 1985, Kilimnik withdrew $104,600 from an AAM deposit account.

On October 11, 1985, an involuntary chapter 7 petition was filed against AAM by certain of its creditors. In January 1986, the bankruptcy court approved the appointment of Joseph E. Shickich, Jr. as special counsel to the trustee for AAM; Shickich was employed for the purpose of bringing an adversary action against Kilimnik. In February 1986, the trustee instituted the proceeding against Kilimnik, seeking, among other things, to recover the value of AAM's assets surrendered to Kilimnik, to subject Kilimnik's claim to equitable subordination, and to impose successor liability on Aerospace.

The parties filed cross-motions for summary judgment on the issue of Kilimnik's security interest in AAM's assets. In May 1987, the bankruptcy court granted summary judgment in favor of Kilimnik.

In September 1988, the remaining issues were tried. The bankruptcy court found that the August 1985 payments to Kilimnik were preferential, but dismissed the trustee's remaining claims. The trustee appealed to the district court, which, without discussion, affirmed the bankruptcy court's decision in its entirety in September 1990. The trustee now appeals, and Kilimnik cross-appeals.

I

The trustee seeks recovery of the equipment, inventory and accounts receivable seized by Kilimnik in foreclosure of his claim. The trustee also seeks to recover the $104,631.79 that Kilimnik caused the debtor to withdraw from its Liquid Assets Management Account ("LAMA") and pay to himself on October 2, 1985, and the value of several motor vehicles Kilimnik transferred to himself.

On the parties' cross-motions for summary judgment, the bankruptcy court held that, at the time he foreclosed, Kilimnik had a valid, perfected security interest "in all inventories, deferred charges, machinery, equipment, automobiles, office furniture and equipment and accounts receivable" of AAM. Later, after trial, the court held that the LAMA was also subject to Kilimnik's security interest, because "the LAMA account was related to the Debtor's accounts receivable and such receivables were subject to the Kilimnik's [sic] security ***954** interest." The trustee appeals these rulings.

[1] **[2]** Interpretation of a contract is an issue of law reviewed de novo. *Taylor–Edwards Warehouse v. Burlington Northern,* 715 F.2d 1330, 1333 (9th Cir.1983) (applying Washington law). "Under Washington law, the role of the court in a contract action 'is to ascertain the parties' intentions and give effect to their intentions.' " *Id.* at 1334 (quoting *In re estate of Hollingsworth,* 88 Wash.2d 322, 560 P.2d 348, 350–51 (1977)). Extrinsic evidence is admissible as to the entire circumstances under which the contract was made as an aid in ascertaining the parties' intent. *Berg v. Hudesman,* 115 Wash.2d 657, 801 P.2d 222, 229 (1990).

[3] Three paragraphs of the purchase agreement are relevant. Paragraph 1 describes the property sold. Paragraph 8 is captioned "Security Agreement and Collateral" and provides, in relevant part:

> To the extent Buyer creates accounts receivable from sales made subsequent to closing date, Buyer agrees to allow the accounts receivable as collateral for the payments which are due or to become due under the terms of the promissory note delivered to Seller as part of the purchase price. Buyer also allows his stock certificate in American Alloy Metals, Inc. to be given as collateral for the note.

> Buyer and Seller agree to the terms of the Working Capital Financial Agreement attached hereto and made a part hereof, designated as Exhibit "H".

Paragraph 25, captioned "UCC–1 For Sale," provides for the buyer to "execute a Form UCC–1 and to initial such additional sheets as may be required to describe the items of personal property being purchased hereunder."

In reaching its decision that Kilimnik had a security interest in AAM's equipment and inventory, the bankruptcy court relied only on the plain language of the Purchase Agreement: "[T]he purchase and sale agreement, when read as a whole, contains a security agreement that described adequately the collateral that is the subject of this dispute." The bankruptcy court reasoned that paragraph 25 indicated that the seller was to retain a security interest in the property transferred, while paragraph 8 provided for additional collateral for the credit extended. On appeal, the trustee apparently does not contest that Kilimnik had a security interest in the equipment and inventory transferred at the time of the purchase agreement.

Nonetheless, a reading of the Purchase Agreement alone does not support a holding that Kilimnik had a secured interest in equipment and inventory acquired after May 1, 1982. Indeed, the bankruptcy court does not explicitly discuss this issue in its memorandum decision, although in its order it provides that Kilimnik had "a valid security interest in all" equipment, inventory and other personal property. The Purchase Agreement makes no reference to "after-acquired" equipment or inventory, although it does use "after-acquired" language with respect to accounts receivable.

However, Paragraph 8 states that the Purchase Agreement incorporates the terms of the Working Capital Financial Agreement. That Agreement provides for AAM to grant to Kilimnik a security interest, as set forth in a security agreement appended to it ("Working Capital Security Agreement"). The Working Capital Security Agreement gives Kilimnik a security interest "[i]n all of Debtor's inventory ... either now or hereafter acquired." Thus, through the incorporation set out in Paragraph 8, Kilimnik would have a security interest in inventory acquired by AAM after May 1, 1982 to the extent it secured working capital advanced by Kilimnik and outstanding at the time of foreclosure. The advance of any such amounts is not reflected in the bankruptcy court's findings.

[4] Kilimnik, however, argues that, where a creditor acquires a security interest in equipment and inventory, the court should find that this interest automatically extends to after-acquired inventory and equipment. There is substantial support for the proposition that, where a financing statement or security agreement provides ***955** for a security interest in "all inventory" (or uses similar broad language), the document incorporates after-acquired inventory. The rationale is that inventory is constantly turning over, and no creditor could reasonably agree to be secured by an asset that would vanish in a short time in the normal course of business. *See, e.g., American Employers Ins. Co. v. American Sec. Bank,* 747 F.2d 1493, 1501 (D.C.Cir.1984); *National Bank v. West Tex. Wholesale Supply Co. (In re McBee),* 714 F.2d 1316, 1331 (5th Cir.1983) (applying Texas law); *In re Nickerson & Nickerson, Inc.,* 329 F.Supp. 93, 96 (D.Neb.), *aff'd,* 452 F.2d 56 (8th Cir.1971); *In re Fibre Glass Boat Corp.,* 324 F.Supp. 1054, 1056 (S.D.Fla.), *aff'd,* 448 F.2d 781 (5th Cir.1971); *In re Kelton Motors, Inc.,* 117 B.R. 87, 90–91 (Bankr.D.Vt.1990) (financing statement; applying Vermont law) *rev'd on other grounds,* 135 B.R. 758 (D.Vt.1991); *In re American Family Marketing Corp.,* 92 B.R. 952, 954 (Bankr.M.D.Fla.1988) (financing statement; applying Florida law); *Sims Office Supply v. KA–D–KA, Inc. (In re Sims Office Supply),* 83 B.R. 69 (Bankr.M.D.Fla.1988) (security agreement) ("a provision for after-acquired property is to be automatically presumed unless there is some indication that the parties intended a different result"). The position that no express language is required is described as the "majority" view, *American Family Marketing,* 92 B.R. at 953, or the "modern trend." *Sims Office Supply,* 83 B.R. at 72. There is, however, contrary authority, which reasons that "the [UCC] contemplates that a security agreement should clearly spell out any claims to after acquired collateral." *Covey v. First Nat'l Bank (In re Balcain Equip. Co., Inc.),* 80 B.R. 461, 462 (Bankr.C.D.Ill.1987); *see also In re Middle Atl. Stud Welding Co.,* 503 F.2d 1133, 1135 (3d Cir.1974).

No Washington or Ninth Circuit cases appear to be directly on point. The trustee cites *DuBay v. Williams,* 417 F.2d 1277, 1285 (9th Cir.1969), as holding that express language is required to create an interest in after-acquired property. However, that case does not go quite so far. At issue in *DuBay* was the creditor's security interest in certain accounts receivable. The security agreement provided for the creditor to select, at given times, accounts to serve as security for his loan. The creditor argued that the designation of these accounts created a security interest "not only in respect of their then stated balances, but also of the future balances of those accounts" which were not later released from the security agreement. The court rejected this argument: "The contention fails because those instruments do not contain any words which import an intention to give a security interest in after-acquired property and the language used is not consistent with such an intent." 417 F.2d at 1285. The court added, "The parties intended any future accounts and balances to be added by later assignments; there was no intent presently to assign future balances in those accounts. It is obvious that the parties did not draft the agreement and the assignment with the provisions of the Commercial Code in mind." *Id.* In *DuBay,* then, the court found that the parties' agreement contemplated an arrangement very different from the usual Article 9 agreement. We do not read the case as establishing the requirements for an Article 9 security agreement or financing statement. [2]

We conclude that we need not decide whether to adopt the "majority" view in this case since the Purchase Agreement does not contain the usual language granting a security interest in "all inventory" or "inventory," but only in the items specifically ***956** described in paragraph 1 as "inventory ... on hand at May 1, 1982."

[5] In addition, the rationale of the "automatic" security interest cases does not apply to after-acquired equipment. Those cases discuss cyclically depleted and replenished assets such as inventory or accounts receivable. Unlike inventory, equipment is not normally subject to frequent turnover. [3]

We are aware that the financing statement mentions after-acquired equipment, suggesting that the parties intended Kilimnik's security interest would extend this far. Yet we must look to the entire circumstances under which the purchase agreement was made to ascertain its meaning. *See Berg,* 801 P.2d at 229. Under Washington law, a contract is interpreted by reference to many contextual factors, including the subject matter of the transaction, the subsequent conduct of the parties and the reasonableness of their interpretations. *See id.*

[6] The trustee here advances the more reasonable interpretation: Kilimnik took a kind of "purchase money" interest in the equipment he sold to AAM, but he did not get the additional security of a blanket interest in all equipment the company ever acquired after the sale. The subject matter of the transaction also supports this conclusion.

Kilimnik would not have had a clear reason to want after-acquired equipment covered by the purchase agreement. As we have seen, equipment, unlike inventory, is not normally subject to frequent turnover. Even if limited to the equipment on hand at the time of the sale, his interest would have been secure.

In summary, we conclude that Kilimnik's security interest was limited to equipment and inventory owned by AAM on May 1, 1982 except to the extent that after-acquired inventory secured outstanding working capital advances made under the working capital security agreement. This conclusion necessitates a remand to the bankruptcy court for determination of the value of the improperly seized collateral, and for further findings on whether Kilimnik received a preference. *See* 11 U.S.C. § 547 (trustee can "avoid" (recover for the bankruptcy estate) any "preferential" transfer of the debtor's property, made to satisfy an antecedent debt, while the debtor was insolvent, within 90 days before the filing of a bankruptcy petition, and which allows the creditor to receive more than it would otherwise receive under the debtor's liquidation or reorganization plan).

II

[7] On October 11, 1985, after AAM filed its bankruptcy petition, Kilimnik transferred three of AAM's motor vehicles into his own name, although he was not the registered or legal owner of any of them. The trustee contended the vehicles were property of the estate and should be returned, under 11 U.S.C. § 542 (turnover of property to the estate).

The bankruptcy court held that Kilimnik held a perfected security interest in the vehicles pursuant to the Purchase Agreement and the October 6, 1982 UCC–1.

The bankruptcy court erred. Under Washington law, a security interest in a motor vehicle is perfected by notation of the secured party's name on the vehicle's certificate of ownership, not by filing a UCC–1. Wash.Rev.Code § 46.12.095.

[8] Kilimnik does not seriously contest this point, but rather contends the trustee failed to prove that seizure of the vehicles was a preferential transfer and that "these old fuel-inefficient vehicles had a market value in excess of the costs of seizing and selling them." Kilimnik is correct that, in determining whether gaining title of the vehicles constituted a preferential transfer to him, the court must "focus on value in the hands of the creditor." *Smith v. Associates* ***957** *Commercial Corp. (In re Clark Pipe and Supply Co., Inc.),* 893 F.2d 693, 698 (5th Cir.1990). However, here Kilimnik did not realize value from the vehicles by selling them and applying the proceeds to reduce his debt, but rather by putting them into use at Aerospace. Thus, liquidation costs should not be deducted from the market value.

In any case, the trustee seeks recovery not on the theory that the transfer was preferential, but rather on the theory that Kilimnik's action was illegal because he had no legal right to the vehicles. *See Sherwood v. Bellevue Dodge, Inc.,* 35 Wash.App. 741, 669 P.2d 1258, 1262 (1983) (where creditor does not have a perfected security interest or contractual right to foreclose, nonjudicial repossession of vehicle constitutes "unlawful conversion"). Thus, on remand Kilimnik should be ordered to pay to the estate the market value of the vehicles at the time of transfer, plus interest.

III

[9] Generally, bank accounts are outside the scope of Article 9 of the UCC. Wash.Rev.Code § 62A.9–104(*l*) (Article 9 does not cover "any deposit account"). However, a creditor's security interest may extend to any or all funds in a deposit account where the funds are "proceeds" of collateral covered by a security interest. Wash.Rev.Code § 62A.9–306. Section 9–306(4) determines the extent of the security interest where the borrower has filed for bankruptcy; it provides, in relevant part:

> In the event of insolvency proceedings instituted by or against a debtor, a secured party with a perfected security interest in proceeds has a perfected security interest only in the following proceeds:
>
> (a) in identifiable non-cash proceeds and in separate deposit accounts containing only proceeds
>
> [...]
>
> (d) in all cash and deposit accounts of the debtor in which proceeds have been commingled with other funds, but the perfected security interest under this paragraph (d) is:
>
> [...]
>
> limited to an amount not greater than the amount of any cash proceeds received by the debtor within ten days before the institution of the insolvency proceedings less the sum of (I) the payments to the secured party on account of cash proceeds received by the debtor during such period and (II) the cash proceeds received by the debtor during such period to which the secured party is entitled under paragraphs (a) through (c) of this subsection (4).

Wash.Rev.Code § 62A.9–306(4).

Before the bankruptcy court, Kilimnik testified that the LAMA was "related to accounts receivable" and "related to the UCC filing as my security." However, apparently he submitted no documentary evidence, nor did he provide further testimony, as to the source of the funds in the LAMA. We conclude as a matter of law that this evidence was inadequate to establish Kilimnik's right to the funds in the account.

[10] This court has held that the creditor bears the burden of establishing that a deposit account contains proceeds of collateral covered by a security interest.

> The creditor's security interest in the whole account under Section 9–306(4) is *prima facie* valid, except as to the trustee, and, as to him, the creditor's security interest is presumptively preferential. The creditor can rebut the presumption by appropriately

> tracing his proceeds. We think that it is fair to place the burden on the creditor to identify his own proceeds and thus to defeat, in whole or in part, the trustee's claim of preference.

Arizona Wholesale Supply Co. v. Itule (In re Gibson Products), 543 F.2d 652 (9th Cir.1976), *cert. denied,* 430 U.S. 946, 97 S.Ct. 1583, 51 L.Ed.2d 794 (1977); *see also Maxl Sales Co. v. Critiques, Inc.,* 796 F.2d 1293, 1301 (10th Cir.1986) (creditor who failed to present evidence on amount of proceeds received by debtor could not establish right to funds in account); ***958** *United States v. Barsotti Bros. Bakery,* 80 B.R. 745, 749 (Bankr.W.D.Pa.1987) (dismissing claim of creditor who failed to meet burden of proving account contained only proceeds); *Charter First Mortgage v. Oregon Bank (In re Charter First Mortgage),* 56 B.R. 838, 850 (Bankr.D.Ore.1985) (creditor failed to show debtor received proceeds during 10–day period preceding filing).

Courts have generally required the creditor to submit detailed documentary evidence or testimony proving that an account contained only proceeds, or establishing the amount of proceeds the debtor received in the ten days preceding the bankruptcy filing. For example, in *In re Mark Twain Marine Indus., Inc.,* 115 B.R. 948, 953 (Bankr.N.D.Ill.1990), the court held that a creditor had failed to meet its burden. Although the debtor had submitted the bank statement of the account at issue, the creditor did not provide "any evidence of what any of the remittances [deposited into the account] were for." The court refused to "speculate" that the deposits were proceeds of the creditor's collateral.

Here, Kilimnik merely testified that the LAMA was "related to" his security interest. He did not even state that the LAMA contained only proceeds (to establish his rights under section 9–306(4)(a)), nor did he state that, in the ten days preceding its filing, AAM had received proceeds in at least the amount he withdrew (to establish his rights under section 9–306(4)(d)). Moreover, cases suggest that mere "self-serving" testimony such as Kilimnik's is inadequate. *Barsotti Bros. Bakery,* 80 B.R. at 748. Section 9–306 "require [s] the creditor to bird-dog his proceeds or pay the consequences." *Charter First Mortgage,* 56 B.R. at 851. Because he controlled AAM, Kilimnik could easily have instituted proper procedures to keep track of the proceeds of his collateral; moreover, he would be aware of the type of documentation available at AAM to substantiate his claim before the court.

Kilimnik argues that the trustee has submitted no evidence to controvert Kilimnik's "evidence." However, at issue here is whether Kilimnik has met his initial burden of rebutting the presumption against him. He has not done so. We reverse the bankruptcy court on this issue and direct that on remand Kilimnik be ordered to pay to the trustee the amount taken from the LAMA, plus interest from the date of taking.

IV

The trustee asked the court equitably to subordinate Kilimnik's claims to those of the other creditors. The bankruptcy court declined to do so.

[11] **[12]** The bankruptcy court's decision on the issue of equitable subordination is reviewed for abuse of discretion. *Spacek v. Thomen (In re Universal Farming Indus.),* 873 F.2d 1334, 1337 (9th Cir.1989). "Equitable subordination requires that: (1) the claimant who is to be subordinated has engaged in inequitable conduct; (2) the misconduct results in injury to competing claimants or an unfair advantage to the claimant to be subordinated; and (3) subordination is not inconsistent with bankruptcy law." *Id.; see also Christian Ctr. Life Litig. Defense Comm. v. Silva (In re Christian Life Center),* 821 F.2d 1370, 1376 (9th Cir.1987) ("The bankruptcy court may subordinate a claim if it finds the claimant engaged in fraud, unfairness or inequity and the claimant's conduct harmed the debtor or its other creditors.") When the trustee seeks to subordinate the claim of a creditor the trustee must present evidence of the creditor's unfair conduct. If the trustee meets this burden, "the claimant then must prove the fairness of his transactions with the debtor or his claim will be subordinated." *Estes v. N & D Properties, Inc. (In re N & D Properties),* 799 F.2d 726, 731 (11th Cir.1986); *see also Christian Life Ctr.,* 821 F.2d at 1377.

[13] In support of its decision not to subordinate Kilimnik's claims, the bankruptcy court stated:

> On this record, it would appear to me that where a secured creditor properly foreclosed a security agreement, that no duty to other creditors and/or to the

corporation to continue it in existence as ***959** a going business remained. Even if there was a technical breach by Mr. Kilimnik in that he controlled both American Alloy Metals and ACI [Aerospace], or that he intended to set up ACI after the foreclosure, there was no damage to the creditors as a whole.

Certainly there was benefit, on this record, to Mr. Kilimnik by his actions, in that he had the benefit of essentially putting in ACI as a going corporation; but I find no corresponding detriment or injury to the creditors as a whole.

ER at 285–86. The bankruptcy court issued this ruling orally; it did not revisit the issue in the conclusions of law it later propounded.

The bankruptcy court apparently concluded that neither the first nor the second factor necessary for equitable subordination was present: Kilimnik had not acted inequitably; nor was there any harm to creditors. On appeal, the trustee contends that both requirements were met.

A. Inequitable conduct

The bankruptcy court's ruling suggests it concluded that because he was merely a secured creditor, Kilimnik owed no fiduciary duty to the other creditors and thus cannot be found to have acted inequitably. It is difficult to square this analysis with precedent on the issue of equitable subordination.

[14] Case law suggests that whether or not Kilimnik's claim was secured is irrelevant to this issue. *See, e.g., Fabricators, Inc. v. Technical Fabricators, Inc. (In re Fabricators, Inc.)*, 926 F.2d 1458 (5th Cir.1991) (subordinating secured claim). Rather, the equitable subordination inquiry focuses on the conduct of the claimant at issue, and the nature of its relationship to the debtor.

[15] **[16]** Under the bankruptcy code, Kilimnik was an insider of the debtor. The bankruptcy court found, "In May of 1985, Mr. Kilimnik came back into control of [AAM]; and from that date until the involuntary bankruptcy petition, he did control the corporation, either as president, a member of the board of directors, or the controlling shareholder." The record suggests that the finding should have gone further: Mr. Kilimnik never relinquished operating control. He was president of AAM from the moment it acquired the assets from WNK. A "person in control of the debtor" is an "insider" of the debtor. 11 U.S.C. § 101(31). Where the trustee seeks to subordinate "a claim arising from the dealings between a debtor and an insider," the court will give the insider's actions rigorous scrutiny. *Fabricators,* 926 F.2d at 1465. Moreover, Kilimnik had a fiduciary duty to AAM. *See Pepper v. Litton,* 308 U.S. 295, 306, 60 S.Ct. 238, 245, 84 L.Ed. 281 (1939) ("dominant or controlling stockholder" is a fiduciary); *Washington v. Keypoint Oyster Co.*, 64 Wash.2d 375, 391 P.2d 979, 983 (1964) (corporate officers and directors have a fiduciary relation to the corporation). The "standard of fiduciary obligation is designed for the protection of the entire community of interests in the corporation—creditors as well as stockholders." *Pepper,* 308 U.S. at 307, 60 S.Ct. at 245 (footnote omitted).

Here, the bankruptcy court's own findings suggest Kilimnik's actions could not withstand this rigorous scrutiny. As a secured creditor whose loan was in default, Kilimnik was entitled to foreclose, but, as president, controlling shareholder and director, he participated in the vote by AAM's board to waive its rights in the collateral. Admittedly AAM was thereby released from liability for the amount by which Kilimnik's claim exceeded the value of the collateral, but that does not cure the problem. The court expressly found that "[i]n foreclosing on his note, opening AAM Aerospace & Corrosion International and having Debtor renounce its interest in collateral, Kilimnik intended, if possible, to place his own interest, which he believed to be secured, ahead of the interests of Debtor's creditors."

In addition, Kilimnik's other actions in the months preceding foreclosure demonstrate that he placed his own interests before those of AAM, and acted to the detriment of other creditors. The bankruptcy court found that, by September 1985, Kilimnik ***960** "had determined to start a new corporation which would compete directly with [AAM], if it continued to exist." The court also made findings that suggest that for some time Kilimnik operated AAM in such a way as to prepare for Aerospace to take over its business (he rented separate additional office space at the end of July 1985). The bankruptcy court found that there was evidence to suggest that Kilimnik had not purposely increased inventories or built up trade debt before he foreclosed on the AAM assets; however, the court also noted that AAM, while under Kilimnik's control, had made somewhat larger purchases from its suppliers, and that Kilimnik had made assurances to AAM's suppliers to persuade them to continue to do business with AAM. *Cf. Fabricators,* 926 F.2d at 1467 (insider creditor acted inequitably when it induced other creditors to extend credit to debtor, where insider knew debtor was in financial trouble).

B. Injury to competing claimants

The bankruptcy court found that Kilimnik's conduct had caused "no damage to the creditors as a whole." [4] It apparently reached the conclusion that there had been no damage because it had determined that Kilimnik, as a secured creditor, was entitled to foreclose. Because his claim had priority over the unsecured claims of the suppliers, his actions did not damage them. Moreover, the court found that AAM had made substantial payments to creditors in the months preceding Kilimnik's foreclosure and AAM's filing of a chapter 11 claim.

[17] **[18]** We conclude the bankruptcy court erroneously focused on the harm to "creditors as a whole." The proper inquiry was whether Kilimnik's self-dealing resulted in "injury to competing claimants or an unfair advantage" to Kilimnik himself. A claim will be subordinated only to the claims of creditors whom the inequitable conduct has disadvantaged. *Fabricators,* 926 F.2d at 1470; *N & D Properties,* 799 F.2d at 733. Thus, the bankruptcy court should have looked at the harm to each of the relevant creditors to determine whether Kilimnik's claim should be subordinated to their claims and, if so, to what extent. The bankruptcy court's findings here suggest that Kilimnik's conduct may have injured several trade creditors. After Kilimnik was in complete control of AAM, AAM made larger than normal purchases from certain suppliers; this suggests Kilimnik was building up inventory in preparation for foreclosure. In addition, the court's findings suggest that reassurances by Kilimnik induced Cabot Corporation to continue supplying AAM and to postpone efforts to collect on past due debt. [5]

C. Conclusion

We reverse the bankruptcy court's holding that Kilimnik's claim should not be equitably subordinated. We conclude that all three requirements for equitable subordination have been met, and that Kilimnik's claim should be subordinated to the claims of any named creditors. [6] On remand, the ***961** bankruptcy court must determine to which claims Kilimnik's claim should be subordinated, and to what extent.

V

The trustee also contends that Aerospace was liable for the debts of AAM as a "successor corporation." The bankruptcy court held that Aerospace was not subject to successor liability.

The Washington Supreme Court set out the principles of successor liability in *Martin v. Abbott Laboratories,* 102 Wash.2d 581, 689 P.2d 368 (1984):

> Traditionally, a corporation purchasing the assets of another corporation does not, by reason of the purchase of assets, become liable for the debts and liabilities of the selling corporation. The courts have recognized, however, that the traditional rule allows a transferring corporation, under certain circumstances, to effectively avoid its obligations to the detriment of *creditors* and minority *shareholders.* Thus, Washington has recognized four narrow exceptions to the traditional rule: (1) the purchaser expressly or impliedly agrees to assume liability; (2) the purchase is a *de facto* merger or consolidation; (3) the purchaser is a mere continuation of the seller; or (4) the transfer of assets is for the fraudulent purpose of escaping liability.

689 P.2d at 384.

The bankruptcy court found: "Since AAM Aerospace & Corrosion International did not purchase the Debtor's assets from the Debtor, AAM Aerospace & Corrosion International did not become a successor corporation to the Debtor and is not subject to successor liability."

[19] The bankruptcy court erred in this conclusion. While the Washington Supreme Court's formulation of the successor liability test refers to a "purchase" of assets, its discussion also suggests that other forms of "transfer" of assets may result in such liability. We conclude that the Washington court would extend liability to transfers other than straightforward purchases. Otherwise, unscrupulous businesspersons would be able to avoid successor liability and cheat creditors merely by changing the form of the transfer. Several states have explicitly included the phrase "or otherwise transfers" in their formulation of the law. *See, e.g., Florom v. Elliott Mfg.,* 867 F.2d 570, 575 (10th Cir.1989) (Colorado law) (discussing exception to general rule of nonliability of successor corporations where "predecessor sells or otherwise transfers all its assets to the successor ..."); *Wallace v. Dorsey Trailers Southeast, Inc.,* 849 F.2d 341, 343 (8th Cir.1988) (Missouri law) ("Where one corporation sells or otherwise transfers *all* of its assets to another corporation ...") (emphasis original; citation omitted). Fletcher's *Cyclopedia of Corporations* also suggests that successor liability is not limited to transactions in which the asset transfer is accomplished through purchase. *See* 15 William M. Fletcher, *Fletcher Cyclopedia of the Law of Private Corporations* § 7122 (perm. ed. rev. vol. 1990).

[20] The bankruptcy court should have considered whether successor liability existed on either a continuation or a fraud theory.

Kilimnik argues that Aerospace falls within the secured creditor exception to the mere continuation theory. In *Uni–Com Northwest, Ltd. v. Argus Publishing Co.,* 47 Wash.App. 787, 737 P.2d 304, *review denied,* 108 Wash.2d 1032 (1987), the court noted that where a secured creditor "tak[es] over an insolvent debtor to collect a bona fide debt pursuant to a valid, perfected security interest," there was no successor liability under the mere continuation theory. 737 P.2d at 313.

***962** **[21]** However, the *Uni–Com* discussion of successor liability also suggests that Aerospace may nonetheless be liable. In reaching its conclusion, the *Uni–Com* court distinguished certain cases because in them the creditor did not have a perfected security interest. It also noted that "none of [the distinguished cases] involve a creditor such as MPC who has substantial business interests in addition to those of the business assumed." The *Uni–Com* court cited, in contrast to the case before it, two cases in which successor liability had been found: *Bishop v. Dura–Lite Mfg. Co.,* 489 F.2d 710 (6th Cir.1973), in which a new corporation was formed specifically to take over the debtor corporation in order that the debtor corporation could escape liability, and *Brockmann v. O'Neill,* 565 S.W.2d 796 (Mo.Ct.App.1978), in which a new corporation was formed after the debtor corporation ceased doing business, and the new corporation completely took over all contracts of the seller, using the same work force, supervisors, trucks, tools and equipment. The facts in this case very closely resemble *Bishop* and *Brockmann:* Aerospace's sole business interest was the operation it assumed from AAM; Aerospace took over AAM's set up virtually without change; AAM was left with substantial liabilities and no assets. The mere fact that the transfer of assets involved foreclosure on a security interest will not insulate a successor corporation from liability where other facts point to continuation. In *Allied Indus. Int'l, Inc. v. Agfa–Gevaert, Inc.,* 688 F.Supp. 1516 (S.D.Fla.1988), *aff'd,* 900 F.2d 264 (11th Cir.1990), a case the trustee cites, the court found that a new corporation set up by the president of the old corporation to avoid payment of a judgment was subject to successor liability; all the equipment the new corporation used had belonged to the old one, until the president repossessed it in foreclosure of notes from the corporation to him. The similarity to the facts here is remarkable.

[22] In determining whether successor liability exists under the mere continuation theory, the court looks at two factors: common identity of the officers, directors and stockholders in the two companies, and sufficiency of consideration running to the seller corporation in light of the assets sold. *Cashar v. Redford,* 28 Wash.App. 394, 624 P.2d 194, 196 (1981). The first factor clearly is met here: Kilimnik was the controlling force in both companies. The second, however, is more complicated to analyze, as the "consideration" AAM received consisted of fulfillment of its obligation to Kilimnik through foreclosure and Kilimnik's renunciation of a deficiency judgment. Arguably, had Kilimnik had a good security interest in everything transferred there would have been adequate consideration. Any existing good will at the time Kilimnik seized AAM's assets also would affect the adequacy of the consideration. Kilimnik to some extent "paid" for the assets, but there was no payment for the employee base, customer relations and other intangible assets.

Because we conclude that successor liability may exist based on the fraud-to-creditors theory, at this juncture we need not decide the extent and adequacy of the consideration and the bankruptcy court may not need to do so on remand.

The circumstances of this case indicate that Kilimnik may be liable as a successor under a fraud-to-creditors theory. When Kilimnik took with him all AAM's assets and employees, he left AAM with substantial liabilities. The bankruptcy court found that substantial payments had been made to creditors during the 90 days before the bankruptcy filing; nonetheless, sufficient claims remained to give rise to an involuntary bankruptcy petition. In addition, the bankruptcy court found that in the months just prior to Kilimnik's foreclosure, AAM had made larger purchases than was customary from its suppliers, and had not paid for them.

We reverse the bankruptcy court's finding that Aerospace was not a successor to AAM. On remand the bankruptcy court should address the issue again, examining whether Kilimnik is liable first under a fraud-on-the-creditors theory and then, if necessary, under the mere continuation theory.

***963 VI**

[23] As a separate matter, the trustee contends that Kilimnik owes the estate for the value of AAM's good will which he improperly took in 1985. The bankruptcy court held that the good will, if any, of AAM ceased to exist when Kilimnik foreclosed on its tangible assets:

> On the record, it would appear to me that once the tangible assets of American Alloy Metals were taken, no good will existed or remained, even assuming that any existed at any time.
>
> The good will, under Mr. Wheeler's testimony and the theory advanced by the trustee, was dependent on the existence of operating assets; facilities; suppliers; customer base; and management, including Mr. Kilimnik or his equivalent replacement.
>
> When the security interest was foreclosed, the good will —again, I am assuming it existed, without so finding —ceased to exist, based solely on the taking or the imminent taking of the tangible assets.
>
> On this record, there was not a taking of intangibles improperly by the defendant; it just ceased to exist, under Mr. Wheeler's testimony, once the taking of those assets became imminent.

ER 283.

Washington courts have defined good will as the intangible "capital" a business builds up over time:

> The good will of a going business is an element which inheres in it and cannot be separated from the whole. There are many elements, defined in the decisions of this court and other jurisdictions, which comprise good will. Among these are continuity of name, location, reputation for honesty and fair dealing, individual talents and ability of the members of the going business organization, and many others. Good will is an intangible element that inheres in the value of a going business.

In re Estate of Glant, 57 Wash.2d 309, 356 P.2d 707, 709 (1960).

The bankruptcy court heard testimony that AAM had no going concern value in the fall of 1985. Ralph Arnold testified that the business had suffered such a steep decline that "the negatives were much greater than any positives which you might find." Rep.'s Tr. 1063. There was thus evidence to support the bankruptcy court's finding that no good will existed.

However, there is a strong argument to be made that the bankruptcy court erred, even under the "clearly erroneous" standard of review applicable to this factual finding. First, as the Washington Supreme Court's discussion of good will makes clear, elements of good will exist independent of a company's tangible assets. In addition, the bankruptcy court focused only on the time at which AAM's assets were seized; however, the code's fraudulent transfer provisions allow recovery of any interest transferred within one year of the filing of the petition. 11 U.S.C. § 548. Moreover, the circumstances surrounding the demise of AAM suggest that Kilimnik recognized that AAM had a going concern value and took steps to misappropriate that value, even before he foreclosed on its assets. He incorporated the similarly named "AAM Aerospace," set up an arrangement under which AAM became a mere shell and caused its customers' inquiries to be forwarded to the new company, and "took over" AAM's plant and employees. Thus, the bankruptcy court ignored substantial evidence that Kilimnik was attempting to take over AAM's intangible assets before he took possession of its equipment and inventory. [7]

***964** We conclude that the bankruptcy court erred in finding that AAM had no good will, and that Kilimnik did not benefit from a fraudulent transfer of that good will.

VII

[24] Kilimnik raises several issues on cross-appeal. First he challenges the appointment of Joseph Shickich as special counsel because of a conflict of interest. The bankruptcy court approved the employment of Shickich as special counsel to the trustee to prosecute the preference actions against Kilimnik. Kilimnik contends that the bankruptcy court should have disqualified Shickich from employment by the trustee because Shickich had represented Cabot Corporation, one of the creditors that had filed the involuntary petition against AAM and a competitor of Aerospace.

Section 327 governs the trustee's employment of professionals; it provides in relevant part:

> (a) Except as otherwise provided in this section, the trustee, with the court's approval, may employ one or more attorneys ... that do not hold or represent an interest adverse to the estate, and that are disinterested persons, to represent or assist the trustee in carrying out the trustee's duties under this title.
>
> (c) In a case under chapter 7, 12, or 11 of this title, a person is not disqualified for employment under this section solely because of such person's employment by or representation of a creditor, unless there is objection by another creditor or the United States trustee, in which case the court shall disapprove such employment if there is an actual conflict of interest.
>
> (e) The trustee, with the court's approval, may employ, for a specified special purpose, other than to represent the trustee in conducting the case, an attorney that has represented the debtor, if in the best interest of the estate, and if such attorney does not represent or hold any interest adverse to the debtor or to the estate with respect to the matter on which such attorney is to be employed.

11 U.S.C. § 327.

Kilimnik contends, first, that the district court failed to make the requisite findings under 327(c). The court adopted Shickich's proposed order of appointment; however, it changed the suggested language finding no "actual conflict of interest under Section 327(c)" to no "material conflict of interest under Section 327(c)." Thus, Kilimnik contends the court applied an incorrect legal standard, and the order of appointment should be reversed and remanded.

Section 327(c) allows the appointment of counsel to represent the trustee, even where counsel represents a creditor, where the court finds no "actual conflict of interest." Reasoning by analogy to section 327(e), several courts have held that, where the trustee seeks to appoint counsel only as "special counsel" for a specific matter, there need only be no conflict between the trustee and counsel's creditor client with respect to the specific matter itself. *Fondiller v. Robertson (In re Fondiller),* 15 B.R. 890, 892 (Bankr. 9th Cir.1981), *appeal dismissed,* 707 F.2d 441 (9th Cir.1983); *see also Altenberg v. Schiffer (In re Sally Shops, Inc.),* 50 B.R. 264, 266 (Bankr.E.D.Pa.1985) (following *Fondiller*). Here, with respect to the Kilimnik preference action, the interests of Cabot and the trustee coincide: if money is recovered for the estate, Cabot's pro rata recovery will ultimately be greater.

Kilimnik makes a complex argument that Cabot's interests are adverse to the trustee. He suggests that the trustee is the fiduciary representative of all the creditors, including Kilimnik. Thus, the trustee cannot let one creditor, Cabot, "seize assets foreclosed on by Kilimnik"; moreover, the trustee cannot further an action by Cabot against Aerospace, a competitor. This argument has no merit. It is the trustee who is seeking to recover a preference from Kilimnik. Under Kilimnik's reasoning, the trustee could never pursue an action against one of the estate's creditors, because he would have a fiduciary obligation ***965** to the creditor. In addition, the trustee has no obligation to protect Aerospace's interests as a competitor in its field. We conclude the appointment of Shickich was proper.

[25] Next, Kilimnik challenges the holding that the redemption of his $2000 preferred stock constituted a preferential transfer. On or about August 23, 1985, AAM paid Kilimnik $2000 for redemption of 2,000 shares of preferred stock issued to him in May 1985 for services to the corporation. The bankruptcy court found that this payment constituted a preferential transfer, and ordered Kilimnik to return the funds to the trustee. Kilimnik contends that the bankruptcy court erred, because the redemption of preferred stock was not a payment "for or on account of an antecedent debt." *See* 11 U.S.C. § 547(b)(2).

The trustee relies on *Consove v. Cohen (In re Roco Corp.),* 15 B.R. 813 (Bankr.D.R.I.1981), *aff'd in relevant part and vacated in part,* 21 B.R. 429 (Bankr. 1st Cir.1982), *aff'd,* 701 F.2d 978 (1st Cir.1983). The relevant issue in that case, however, was whether payments made in redemption of stock constituted a fraudulent transfer. *Id.* at 816–17. The opinion spoke to preferential payments but only in the context of loan repayments. *Id.* at 817–19.

Insofar as the bankruptcy court relied on the preferential transfer theory, it is reversed. The facts here suggest that the trustee should be able to recover on the fraudulent transfer theory, however, and on remand may be able to sustain the judgment on that basis.

CONCLUSION

The judgment of the district court affirming without comment the decision of the bankruptcy court is REVERSED in most respects and the case REMANDED to the district court for remand to the bankruptcy court for further proceedings consistent with this opinion.

All Citations

988 F.2d 949, Bankr. L. Rep. P 75,183, 20 UCC Rep.Serv.2d 333

Footnotes

1 In February 1986, the new corporation officially dropped the "AAM" from the beginning of its name.

2 The two other Ninth Circuit cases the parties cite are also not especially helpful. The trustee views *Northwest Acceptance Corp. v. Lynnwood Equip., Inc.,* 841 F.2d 918 (9th Cir.1988), as decisive in his favor. However, that case merely held that, where the financing statement and the security agreement differ as to the collateral covered, the security agreement defines "the extent of the security interest." 841 F.2d at 922. That is not the issue here. Kilimnik relies on *Biggins v. Southwest Bank,* 490 F.2d 1304 (9th Cir.1973). At issue there was whether the description in a financing statement adequately put creditors on notice of the security holder's interest. 490 F.2d at 1308–1309. The case also discusses the general validity of floating liens. *Id.* at 1309–1310.

3 Kilimnik also argues that he has a security agreement in after-acquired inventory and equipment because they must be proceeds of the accounts receivable in which he has a security interest. However, Wash.Rev.Code § 62A.9–306(2) provides that a creditor's security interest "continues in any identifiable proceeds." Kilimnik has not introduced evidence to identify the assets he claims as proceeds of his collateral.

4 The court later clarified this ruling, stating that it was referring to "any and all creditors of [AAM] between May–October 1985" rather than to "the creditors in this bankruptcy estate." ER 255.

5 Kilimnik contends that the trade creditors have suffered no injury because any harm to them "merely flowed from their status as junior unsecured creditors." This is incorrect: at issue is whether Kilimnik's inequitable conduct harmed the trade creditors by, for example, inducing them to ship goods to AAM when there was little likelihood they would be paid. Kilimnik cites *Spacek v. Thomen (In re Universal Farming Industries),* 873 F.2d 1334, 1337 (9th Cir.1989), but that case is distinguishable. There, this court held that a creditor did not act inequitably by acquiring an admittedly valid trust deed from a third party. Another creditor contended that this act created a risk that he would not be paid. This court concluded that such a risk arose from the latter creditor's status as a junior lienholder; the trust deed holder's misconduct, if any, did not create that risk. Here, the trustee is alleging that Kilimnik's misconduct while an insider of AAM directly harmed the trade creditors.

6 Kilimnik appears to suggest that equitable subordination would be inconsistent with the goals of bankruptcy law, because to do so would discourage corporate insiders from using their best efforts to turn around a struggling business. He cites *Benjamin v. Diamond (In re Mobile Steel),* 563 F.2d 692, 701 (5th Cir.1977), in which the court refused to require

fiduciaries to "prove the good faith and fairness of *every one* of their actions with respect to their corporation" because such a burden would "discourage those most interested in a corporation from attempting to salvage it through an infusion of capital." *See also 3 Collier on Bankruptcy* § 510.05, at 510–14 (Lawrence P. King ed., 15th ed. 1993) ("lawful claims of insiders are not automatically subordinated" because "such persons are the ones most interested in restoring and reviving" the debtor). However, Kilimnik's actions suggest that his goal was not to "revive" AAM, but rather to give Aerospace a good start.

7 This case closely resembles *Freehling v. Nielson (In re F & C Servs., Inc.),* 44 B.R. 863 (Bankr.S.D.Fla.1984). There, the president of an insurance agency set up a new agency, to which he shifted all the accounts of the old agency, while leaving the debts of the operation with the old agency. The old agency subsequently sought bankruptcy protection. The court held that the old agency's "book of business" had been fraudulently transferred to the new agency. 44 B.R. at 870–71. Kilimnik contends that this case is inapposite because it "involved a clearly fraudulent transfer where the debtor's Chairman of the Board secretly operated the company to strip its assets, sequester them in another corporation, and leave the ever-increasing debts in the former corporation's empty shell." Respondent's Br. 39. However, that seems to be just what Kilimnik did here.

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APPENDIX
V

5A Wash. Prac., Evidence Law and Practice § 612.2 (5th ed.)

Washington Practice Series TM
Evidence Law and Practice
Database updated June 2015
Karl B. Tegland [a0]
Chapter 6. Witnesses
Rule 612. Writing Used to Refresh Memory
Author's Commentary

§ 612.2 Overview of matters addressed by Rule 612, civil vs. criminal cases

West's Key Number Digest
West's Key Number Digest, Witnesses ⚷253
Legal Encyclopedias
C.J.S., Criminal Law §§ 965 to 971
C.J.S., Witnesses §§ 435, 437 to 444, 499, 571

Generally. As mentioned in the preceding section, Rule 612 concerns the use of a writing to refresh the memory of a witness in preparation for trial or a deposition. [1] The phrase *present recollection refreshed* is sometimes used to describe the instant subject.

Under Rule 612, the purpose of the writing is only to refresh the witness's memory to enable him or her to testify; the writing itself is not evidence. Because the writing itself is not evidence, it need not satisfy the hearsay and best evidence rules. [2]

Rule 612 should not be confused with the hearsay exception for recorded recollection. Under the hearsay exception, the writing itself *is* being offered as evidence, and the writing is admissible only if the more stringent requirements of Rule 803(a)(5) are met. [3]

Rule 612 does not address the general question of when, or under what circumstances, a writing may be used to refresh the memory of a witness. The foundation requirements continue to be governed by case law. [4] Rule 612 is concerned primarily with the opposing party's right to inspect a writing used for this purpose and to introduce it into evidence if desired. [5]

The practice of refreshing a witness's memory with something *other than* a writing continues to be governed by case law and is discussed in a later section. [6]

Civil vs. criminal cases. By its terms, Rule 612 applies to both civil and criminal cases. There is nothing in the text of Rule 612 limiting the rule to one kind of case or another. Thus, for example, it is perfectly proper for the prosecuting attorney to meet with a witness for the State prior to trial, to review the witness's pretrial statements and other evidence. [7]

In the federal courts, the operation of Rule 612 is restricted in some criminal cases by federal statutes and federal rules of court, but few if any of the federal restrictions apply at the state level. [8]

Footnotes

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1 **Trial or deposition**
Rule 612 applies to depositions. See § 612.7.

2
Is not evidence
See § 612.4.

3
Recorded recollection
See § 803.26.
The distinction is explained in State v. Gross, 31 Wash. 2d 202, 196 P.2d 297 (1948).

4
Foundation requirements
See § 612.13.

5
Right to inspect
See §§ 612.5, 612.6.

6
Other than a writing
See § 612.10.

7
Criminal cases
State v. Stevens, 127 Wash. App. 269, 110 P.3d 1179 (Div. 2 2005), aff'd, 158 Wash. 2d 304, 143 P.3d 817 (2006).

8
Federal restrictions
Mueller & Kirkpatrick, 3 Federal Evidence § 328 (2d ed.) (extended discussion with citations to most federal cases).

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APPENDIX
VI

5A Wash. Prac., Evidence Law and Practice § 612.4 (5th ed.)

Washington Practice Series TM
Evidence Law and Practice
Database updated June 2015
Karl B. Tegland [a0]
Chapter 6. Witnesses
Rule 612. Writing Used to Refresh Memory
Author's Commentary

§ 612.4 Nature of the writing used to refresh witness' memory

West's Key Number Digest
West's Key Number Digest, Witnesses ⚷255
Legal Encyclopedias
C.J.S., Witnesses §§ 438 to 444, 499

The writing need not be admissible as evidence when it is used solely to refresh the witness's memory,[1] and it is improper to introduce the writing as a part of the procedure for refreshing memory if the writing is inadmissible as hearsay or for some other reason.[2] Of course if the writing is independently admissible as a hearsay exception or under some other rule, it may be introduced after an appropriate foundation is laid.[3]

The writing need not have been made at or near the time of the occurrence or event recorded in the writing.[4] The writing need not have been prepared by the witness; writings prepared by others may be used so long as the other requirements of the rule are met.[5]

The more recent decisions cited in this section and in the preceding section abandon an earlier requirement that the writing had to be shown to be an accurate original.[6]

Footnotes

a0 Member Of The Washington Bar.

1
Need not be admissible
Broun, McCormick on Evidence § 9 (two-volume 6th ed.).

2
Improper to introduce
Mercer v. Department of Labor and Industries, 74 Wash. 2d 96, 442 P.2d 1000 (1968).
State v. Coffey, 8 Wash. 2d 504, 112 P.2d 989 (1941).
State v. McKeown, 172 Wash. 563, 20 P.2d 1114 (1933).
Dennis v. Trick, 165 Wash. 403, 5 P.2d 493 (1931).
State v. Tyree, 143 Wash. 313, 255 P. 382 (1927).
Kirkpatrick v. Collins, 95 Wash. 399, 163 P. 919 (1917).

3
If admissible
See § 612.6.

4
At or near time
State v. Little, 57 Wash. 2d 516, 358 P.2d 120 (1961). The court stated that Schmidt v. Van Woerden, 181 Wash. 39, 42 P.2d 3 (1935), and State v. Jensen, 194 Wash. 515, 78 P.2d 600 (1938), were not contrary to its ruling.

5
Prepared by others
Broun, McCormick on Evidence § 9 (two-volume 6th ed.) (referring to this as the majority view, and the "wiser" view).
U.S. v. Boyd, 606 F.2d 792 (8th Cir. 1979).
U.S. v. Landof, 591 F.2d 36 (9th Cir. 1978).

6
An accurate original
Broun, McCormick on Evidence § 9 (two-volume 6th ed.) (no showing of accuracy required, referring to the new rule as the majority view, and the "wiser" view).
The older rule was stated in Clausen v. Jones, 191 Wash. 334, 71 P.2d 362 (1937) (the memorandum must be an original if the original is procurable).
See also City of Seattle v. Erickson, 99 Wash. 543, 169 P. 985 (1918) (overruled in part by, Alaska Pac. S.S. Co. v. Sperry Flour Co., 107 Wash. 545, 182 P. 634 (1919)); American Bldg. & Loan Ass'n v. Hart, 2 Wash. 594, 27 P. 468 (1891).

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APPENDIX
VII

30A C.J.S. Equity § 25

Corpus Juris Secundum
June 2016 Update
Equity

Francis C. Amendola, J.D.; Paul M. Coltoff, J.D.; John Glenn, J.D.; and
John R. Kennel, J.D., of the staff of the National Legal Research Group, Inc.

II. Jurisdiction in Equity
B. Remedy at Law
3. Adequacy of Legal Remedies in Particular Circumstances
a. In General

Topic Summary References Correlation Table

§ 25. Where monetary damages available

West's Key Number Digest

West's Key Number Digest, Equity ⚷43, 46, 48
Equity will not ordinarily take jurisdiction where an award of monetary damages is adequate to afford complete relief and there are no other circumstances to support jurisdiction in equity.

Where compensation in money will afford complete and efficient relief, as where a money judgment is the ultimate, or the only, relief sought, the remedy at law is usually adequate for that purpose, and a party will be relegated thereto if the legal remedy is unimpeded and there are no other circumstances to support jurisdiction in equity. [1] Thus, equity will generally not interfere where it appears that there is an adequate remedy at law for damages, [2] and assumpsit or analogous actions must be resorted to where available. [3]

The refusal of equity to take jurisdiction is not due to any inability to render a decree for damages alone, however, [4] and there are situations and circumstances in which a court sitting in equity may make a decree for the payment of money. [5] On the other hand, a monetary remedy is not rendered equitable simply because it is not fixed or readily calculable from a fixed formula. [6]

Effect of inadequacy of damages.

Where the remedy by action for damages is inadequate or insufficient to do complete justice between the parties, equity will take jurisdiction and grant proper relief. [7] Even though the plaintiff's right at law is fully recognized and a money judgment would afford adequate relief, where the rules of procedure present obstacles to the attainment of such relief at law equity may be invoked to remove such obstacles. [8] However, the adequacy of the legal remedy for damages does not depend on the collectibility of the claim. [9]

According to some authority, the fact that a plaintiff may have a remedy at law by an action for damages does not prevent equity from assuming jurisdiction if the equitable remedy is better adapted to render more perfect and complete justice than the remedy at law. [10] Nevertheless, equity cannot enforce an action for damages merely because it has jurisdiction for an accounting, and by this means enforce demands which a court of law could not enforce. [11]

Where a party seeks a particular fund, such as the proceeds of an insurance policy, rather than a mere money judgment, he or she need not show that there is no adequate remedy at law in order to submit the cause to equity jurisdiction. [12]

Bonds.

A party who is adequately protected by a contractual or statutory bond may be required to resort to an action on the bond. [13]

CJS EQUITY § 25

Footnotes

1 U.S.—Floyd v. Ring Const. Corp., 165 F.2d 125 (C.C.A. 8th Cir. 1948).
Colo.—Mahoney Marketing Corp. v. Sentry Builders of Colorado, Inc., 697 P.2d 1139 (Colo. Ct. App. 1985).
N.Y.—Ansonia Associates v. Ansonia Residents' Ass'n, 78 A.D.2d 211, 434 N.Y.S.2d 370 (1st Dep't 1980).
Pa.—Meehan v. Cheltenham Tp., 410 Pa. 446, 189 A.2d 593 (1963).

Nonperformance of contract
U.S.—Huntington Beach Union High School Dist. v. Continental Information Systems Corp., 621 F.2d 353, 29 U.C.C. Rep. Serv. 112 (9th Cir. 1980).
Iowa—Mosebach v. Blythe, 282 N.W.2d 755 (Iowa Ct. App. 1979).

Money damages not adequate remedy for loss of unique business opportunity
Money damages are generally not regarded as an adequate remedy for the loss of a unique business opportunity, for purposes of determining whether damages are a viable alternative to the requested equitable relief.
U.S.—In re Ben Franklin Hotel Associates, 186 F.3d 301 (3d Cir. 1999) (applying Pennsylvania law).

2 Del.—Chateau Apartments Co. v. City of Wilmington, 391 A.2d 205 (Del. 1978).
Ill.—Chas. Todd Uniform Rental Service Co. of Ky. v. Klysce, 30 Ill. App. 2d 274, 174 N.E.2d 570 (4th Dist. 1961).
Kan.—Eastwood v. Eastwood, 167 Kan. 471, 207 P.2d 393 (1949).
Mo.—Boeving v. Vandover, 240 Mo. App. 117, 218 S.W.2d 175 (1949).

Money damages adequate
(1) The trial court lacked authority to grant equitable relief to a city attorney under the attorney's petition alleging wrongful removal against the city, where the attorney did not plead or present any evidence that there was not an adequate remedy at law for the cause of action raised in the wrongful removal petition, in that the attorney only sought money damages.
Mo.—Walton v. City of Berkeley, 118 S.W.3d 617 (Mo. Ct. App. E.D. 2003).
(2) The small claims court could not rely on principles of equity to make an award of damages to a shipper who had brought an action against an interstate carrier for damage to household furniture which occurred during transport, where the Carmack Amendment to the Interstate Commerce Act allowed the shipper to recover actual loss or injury to property, and, thus, provided an adequate remedy.
Ind.—Mayflower Transit, Inc. v. Davenport, 714 N.E.2d 794 (Ind. Ct. App. 1999) (citing 49 U.S.C.A. § 14706).

RICO claims against physician for diversion of patient fees
A health-care clinic which brought RICO claims against a former physician employee and officer for alleged diversion of patient fees from the clinic was not entitled to equitable remedies on pendent state-law claims, where it was apparent that the clinic had an adequate remedy at law in the form of money damages which could be calculated on the basis of a formula for

apportioning fees attributable to ongoing obstetric patients who followed the physician to the new organization contained in a settlement agreement schedule devised by the parties when the physician left the clinic.

U.S.—Hinsdale Women's Clinic, S.C. v. Women's Health Care of Hinsdale, 690 F. Supp. 658 (N.D. Ill. 1988).

3 Ill.—Edwin Pratt's Sons' Co. v. Schafer, 290 Ill. App. 80, 7 N.E.2d 901 (2d Dist. 1937).

N.J.—Borough of Kenilworth v. Graceland Memorial Park Ass'n, 124 N.J. Eq. 35, 199 A. 716 (Ch. 1938).

Pa.—Meehan v. Cheltenham Tp., 410 Pa. 446, 189 A.2d 593 (1963).

Where prior determination of breach of contract required

An insureds' claims against life insurers and agents for unjust enrichment and constructive trust should be heard in circuit court, not chancery court; even though the claims were based in equity, the insureds first needed to show that the contract was void and/or breached.

Miss.—Union National Life Ins. Co. v. Crosby, 870 So. 2d 1175 (Miss. 2004).

4 N.J.—Boyce v. Boyce, 19 N.J. Misc. 143, 18 A.2d 298 (Ch. 1940).

5 U.S.—Floyd v. Ring Const. Corp., 165 F.2d 125 (C.C.A. 8th Cir. 1948).

Fla.—Cook v. Central and Southern Fla. Flood Control Dist., 114 So. 2d 691 (Fla. Dist. Ct. App. 2d Dist. 1959).

Or.—Topolos v. Skotheim, 126 Or. 683, 270 P. 753 (1928).

6 U.S.—Feltner v. Columbia Pictures Television, Inc., 523 U.S. 340, 118 S. Ct. 1279, 140 L. Ed. 2d 438, 163 A.L.R. Fed. 721 (1998).

7 Miss.—Fortenberry v. Wilkerson, 222 Miss. 70, 75 So. 2d 274 (1954).

N.J.—Mantell v. International Plastic Harmonica Corp., 141 N.J. Eq. 379, 55 A.2d 250, 173 A.L.R. 1185 (Ct. Err. & App. 1947).

Ohio—State ex rel. Wright v. Weyandt, 50 Ohio St. 2d 194, 4 Ohio Op. 3d 383, 363 N.E.2d 1387 (1977).

Complicated accounts

Equity jurisdiction is available if the accounts between the parties are too complicated for a jury adequately to assess damages.

U.S.—Radial Lip Mach., Inc. v. International Carbide Corp., 76 F.R.D. 224, 24 Fed. R. Serv. 2d 712 (N.D. Ill. 1977).

Dollars not produced by money judgment

An exception is made to the rule that courts of equity will not deal in matters readily measurable in dollars where it appears that a money judgment would not produce the dollars, and hence courts sitting in equity often interfere in cases of insolvency and nonresidence.

Del.—Bayard v. Martin, 34 Del. Ch. 184, 101 A.2d 329 (1953).

8 Mich.—Multiplex Concrete Machinery Co. v. Saxer, 310 Mich. 243, 17 N.W.2d 169 (1945).

9 N.Y.—American Cities Power & Light Corp. v. Williams, 189 Misc. 829, 69 N.Y.S.2d 197 (Sup 1947).

10 N.D.—O'Connor v. Immele, 77 N.D. 346, 43 N.W.2d 649 (1950).

11 Ala.—Wynn v. Tallapoosa County Bank, 168 Ala. 469, 53 So. 228 (1910).

Ill.—Hornbeek v. Hornbeek, 5 Ill. App. 2d 253, 125 N.E.2d 535 (3d Dist. 1955).

12 Ill.—Brunnenmeyer v. Massachusetts Mut. Life Ins. Co., 66 Ill. App. 3d 315, 23 Ill. Dec. 652, 384 N.E.2d 446 (3d Dist. 1978).

13 Fla.—Union Indem. Co. of New Orleans v. Worthingstun, 98 Fla. 242, 123 So. 759 (1929).

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DECLARATION OF SERVICE

The undersigned certifies that I am a citizen of the United States of America and a resident of the State of Washington, I am over the age of twenty one years, I am not a party to this action, and I am competent to be a witness herein.

The undersigned declares that on July 28, 2016, I caused to be served this document as follows:

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DATED this 28th day of July, 2016, at Seattle, Washington.

s/ Michelle Stark
Michelle Stark