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IN THE SUPREME COURT OF THE STATE OF IDAHO

DAVID JOHNSON, an individual, and TESSA COUSINS, an individual,

Plaintiffs-Appellants,

vs.

DAVID CROSSETT, an individual,

Defendant-Respondent.

Case No. 44791-2017

RESPONDENT'S BRIEF

Appeal from the District Court of the
Fourth Judicial District for Ada County

Honorable D. Duff McKee, District Judge, Presiding

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Dyet v. McKinley, 139 Idaho 526, 81 P.3d 1236 (2003)

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I.C. § 30-25-407(a)

I.C. § 30-25-409(c)

I.C. § 30-25-602

I.C. § 30-25-801(a)

I.C. § 30-25-802

A. Statement of the Case

This is an appeal from a decision issued following a Court trial that took place on October 16 and 17, 2016. R000064-000086 (Findings of Fact, Conclusions of Law and Directions for Entry of Judgment, hereinafter "Decision").

Appellant David Johnson ("Johnson") filed a Complaint in this case on August 10, 2015. In his Complaint, Johnson sought, in sum, (1) a declaration that he was a member of Drug Testing Compliance Group, LLC ("DTC"); (2) a declaration that he is an equal interest member in DTC; (3) a finding that Respondent David Crossett ("Crossett") breached a fiduciary duty to Johnson in his management, operation and eventual sale of DTC; (4) a finding that Crossett made improper distributions to himself through DTC; and (5) that Crossett improperly removed Johnson as a member of DTC. *See* R000010 – R000018.

The First Amended Complaint was filed on April 8, 2016, and added Appellant Tessa Cousins ("Cousins") as a plaintiff, added several defendants that were later dismissed and are not party to this appeal, and also added allegations related to those dismissed defendants. *See* R000025 – R000040.

The District Court found that Johnson and Cousins were never Members of DTC. The District Court went on to state that even if they had become Members of DTC, Crossett had the authority to manage, and appropriately managed and sold DTC, did not pay himself any improper distribution, and that as of December 2015, DTC was no longer a going concern. *See* R000080 – R000081.

B. Relevant Facts

Johnson learned of a business opportunity from information he obtained about DOT Compliance Service ("DOT"), a business owed and operated by Jeff Minert, Johnson's brother-in-law. R000065. DOT is in a niche market of providing drug and alcohol testing programs, and other compliance services, to employers and operators of qualifying transport companies, for drivers that have been identified as being required to comply with certain Department of Transportation licensing requirements and reporting regulations. *Id.*

Johnson got Crossett interested in opening a similar business, and the "two then investigated the specifics of getting the company up and operating during the early months of 2013." *Id.* By April of 2013, they had decided on their general plan that Crossett and Johnson would be the members of the Company, that Crossett would run the Company and receive a salary. R000066.

Johnson knew of Cousins, "who was an employee of the brother-in-law's company, and after discussion with Crossett, they decided that Crossett would approach Cousins with a proposal for her to join their new company." *Id.*

Cousins would receive a salary for her position and would become a 10% member of the Company at some point in time. *Id.*

DTC was formed by David Crossett in June of 2013 as a single member entity, with Crossett being the sole member upon filing papers with the Idaho Secretary of State. R000067.

A written operating agreement was prepared by Mr. Jacobson (counsel to Johnson) and approved by both Crossett and Johnson at the end of July, 2013. That agreement was never signed. *Id.*

A few days after DTC opened for business, it was sued by Johnson's brother-in-law's company, DOT. R000067. "This litigation was eventually settled in the summer of 2014, at a huge cost of legal fees." R000067.

At all relevant time periods, Johnson wanted to keep his involvement with DTC a secret, "he did not want to disclose to the family members involved that he was starting a company in direct competition with those family members." Defendant's Exhibit J, p. 8, LL 1-4.

Johnson went so far as to sign a statement for his brother-in-laws' attorneys that, although he had supplied information about the in-laws' business to Crossett, he did not have any interest in the entity that Crossett had formed." *Id.*, citing Defendant's Exhibit J.

Johnson told Crossett that he did not want to sign the operating agreement "until the dust settled." R000068.

Crossett continued to ask Johnson to sign the operating agreement and he refused. *Id.*

Cousins was not party to any of the discussions between Johnson and Crossett about the formation of DTC. *Id.* Cousins also refused to sign the written operating agreement when requested, and eventually resigned as an employee of DTC. *Id.*

From the outset, DTC had severe financial and legal problems. R000069.

In the early Fall of 2014, Crossett again asked Johnson to sign the operating agreement and "Johnson indicated that he considered all of the legal problems and management issues to be Crossett's problems to solve, and he was not willing to sign the operating agreement until the problems were resolved." R000069.

During the late Fall of 2014 Crossett informed Johnson that he would continue with DTC as a single member company and do what he could to salvage the company. R000070. Johnson then asked for the money back that he had paid towards start up costs, approximately $10,000, and those monies were paid by DTC to Johnson by December of 2014. *Id.*

With an individual named Scott Lee, Crossett later formed a company called Vurv, LLC, which was a call center. The call center would assume all sale calls for DTC products and services. R000071. The trucking "compliance services offered by DTC was only one of the services to be sold by the Vurv call center operation." *Id.*

Through 2014 and 2015, DTC was still experiencing critical cash flow issues and was still servicing a huge amount of debt. *Id.* Crossett then sold DTC to Vurv, and in exchange, Vurv agreed to payoff all DTC debts. *Id.* [1] This transaction closed in December 2015 and thereafter DTC ceased to exist. *Id.* Vurv, LLC was later sold to Blak, Inc. (owned by the dismissed defendants, Bo W. and Kystal Schmelling). *See* R000005.

After Appellants learned of the sale of Vurv, LLC to Blak, Inc., Appellant's filed their First Amended Complaint, adding Tessa Cousins as a party plaintiff, and also added allegations related of the sale of Vurv, LLC to Blak, Inc. R000080 – 81.

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[1] These debts exceeded $230,000. R000072.

C. Additional Issues presented on Appeal

Respondent has no additional issues to present in this appeal.

D. Attorney Fees on Appeal

Crossett is entitled to an award of his attorney fees on appeal under I.C. § 12-120 (3) because the issue that is the crux of Appellants' appeal is whether the District Court's finding that Appellants' were not members of DTC was in error.

That is, whether the Appellants' allegation that they and Crossett *had an oral agreement* that they became members of Drug Testing Compliance Group, LLC upon its formation, was valid and enforceable. The District Court found Appellant's claim invalid, and specifically held that Appellants did not become members of DTC upon its formation, or at any time thereafter.

This purported oral agreement is not a transaction for personal or household purposes, but is commercial in nature, and falls within the purview of I.C. § 12-120 (3). That section provides that "[i]n any civil action to recover on ... any commercial transaction unless otherwise provided by law, the prevailing party shall be allowed a reasonable attorney's fee to be set by the court, to be taxed and collected as costs." I.C. § 12-120 (3) The statute defines "commercial transaction to mean "all transactions except transactions for personal or household purposes." *Id.* "This Court has interpreted .C. § 12-120 (3) to mandate the award of attorney fees on appeal as well as trial." *Farm Credit Bank of Spokane v. Stevensen*, 125 Idaho 270, 275, 869 P.2d P.2d 1365, 1370 (1994).

Appellants sued Crossett for money damages related to two main claims of breach; breach of the alleged agreement that they became members upon the formation of DTC,

and thereafter, Crossett's alleged breach of duty and loyalty to Appellants during his management, operation and eventual sale to DTC to Vurv, LLC.

Thus, in the event Crossett prevails on this appeal, he should be awarded his fees and costs incurred in having to defend it pursuant to I.C. § 12-120 (3).

E. Argument

Appellants make no argument in this appeal warranting overturning or otherwise remanding this case to the District Court for any further ruling. Crossett requests that a remittitur including the taxation of costs and attorney fees be entered following a motion for the same.

1. The District Court did not error in its treatment of statements contained in Respondent's Answer, nor did it abuse its discretion in denying Appellant's Motion for New Trial regarding the same.

Appellants argue that a certain "admission" contained in Respondent's Answer filed in the underlying case should have "negated the possibility of the trial court ruling that Defendant Crossett formed a single-member LLC." Appellant's Brief, p. 12.

Appellants appear to argue that the District Court committed error by not properly considering the alleged admission in their case-in-chief, as well as in their motion for new trial. Respondent will address both arguments in a single response, as the District Court committed no error.

a. Applicable Law.

With regard to an error of law under Idaho Rule of Civil Procedure 59(a)(1)(H), a new trial may be granted for an error in law occurring at trial. When reviewing a trial court's ruling on a motion for new trial, this Court applies the abuse of discretion

standard. A trial court has wide discretion to grant or refuse a new trial, and on appeal, "this Court will not disturb that exercise of discretion absent a showing of manifest abuse." *Schmechel v. Dille*, 148 Idaho 176, 179, 219 P.3d 1192, 1195 (2009).

"The test for evaluating whether a trial court has abused its discretion is: (1) whether the lower court rightly perceived the issue as one of discretion; (2) whether the court acted within the outer boundaries of such discretion and consistently with any legal standards applicable to specific choices; and (3) whether the court reached its decision by an exercise of reason." *Id.*, quoting *Dyet v. McKinley*, 139 Idaho 526, 529-30, 81 P.3d 1236, 1239-40 (2003).

b. The District Court did not error in its treatment of the subject admission in Respondent's Answer.

Appellants in their Complaint and First Amended Complaint alleged "Defendant [Crossett] filed, on behalf of the business that Plaintiffs and Defendant Crossett had formed, articles of organization for an Idaho limited liability company, listing himself as a Member or Manager and as the registered agent. The limited liability company was named Drug Testing Compliance Group, LLC." *See* R000027.

Crossett has never denied this allegation. There is a difference in a group of people forming a company, and the individuals that formed the company actually becoming members of the limited liability company, or in this case, refusing to become members. That is, forming a company and becoming a member of a limited liability company are two separate things, and as Appellants have been made repeatedly aware, that has been how Crossett has consistently explained this so called "admission." Yes, Johnson got the idea of the company (which become DTC) from his brother-in-law,

discussed it and researched it with Crossett, they started (formed) the company, but Johnson nor Cousins ever became a member of DTC. The District Court did not abuse its discretion so finding.

In fact, evidence was presented throughout trial that Plaintiffs didn't want to become members of DTC Group or sign the written operating agreement[2] given the turmoil that had erupted since it opened its doors for business. The Court got it exactly right when it held that "the oral agreement with regard to Cousins and Johnson was that they would become members upon signing of the operating agreement." R000074. This finding was made obvious throughout the trial. "[T]he written agreement was finished by the lawyers, and was ready to be signed by mid-July 2013, but Johnson would not sign. Conditions had changed. The lawsuit by DOT Group had been filed, and Johnson no longer wanted his name associated with DTC." R000075. Put another way, signing of the written operating agreement was a condition precedent to Johnson and Cousins becoming members of DTC, and the both repeatedly refused to sign it.

Next, Appellants assert that Crossett "admitted" in the Answer that he listed himself *a* member and not *the* member, and that this admission should have negated a finding by the Court that DTC Group was a single member LLC. Appellants take the untenable position that if he really thought he was the only member then he could only *deny* the allegation. Appellant's argument is frivolous.

Johnson and Crossett formed DTC Group, and orally agreed that becoming a member in DTC was contingent upon signing a written operating agreement. Crossett proceeded to file necessary documents with the Idaho Secretary of State so that DTC

[2] The operating agreement, which was drafted by Mr. Jacobsen, had been completed and was ready to sign within a few weeks of DTC opening for business.

could commence operations. However, Johnson later took the position that he wanted to "wait until the dust settled" before he signed the operating agreement. This was not a mutual agreement, and clearly was not agreed to by Crossett. This left Crossett holding the bag as the sole member of the LLC, and left Crossett with all the risk of carrying the company's operations forward." R000075. "Johnson's actions were contrary to what the two had agreed upon – that there would be a signed operating agreement." *Id.* Johnson and Cousins simply backed out of the deal.

The District Court's findings in this regard are not an abuse of discretion, and were consistent with the evidence presented at trial. There was no error. Contrary to Appellant's argument, the District Court did not "ignore" Crossett's admissions, it appreciated the subject admission in the Answer for what it said and gave it the weight it deserved, which in the context of the facts of the case, was little weight at all.

2. The District Court did not error in its treatment of Idaho Code as it related to limited liability companies, or its denial of the Motion for New Trial regarding the same.

Appellant's assert that the District Court committed a prejudicial error in its treatment of Idaho Code as it relates to limited liability companies. Then Appellants' argue they should have been given a new trial because the District Court allegedly ignored Idaho Code, which provides that an oral operating agreement can serve as a fully functioning operating agreement. Because the District Court found that Johnson and Cousins were not members of DTC, the issue of looking the Idaho Code was moot – it didn't pertain to them.

Crossett will again address Appellants' claim of "error", and the denial of motion for new trial together, as there was no error committed by the District Court in either context.

As a preliminary matter, simply because the District Court did not cite to the code provisions contained in Appellants' pre-trial memorandum in its decision, does not mean the District Court committed error. Again, there was no need for the District Judge to look to the Code after it determined Johnson and Cousins were not members of DTC.

The District Court acknowledged in its decision that an operating agreement can be an oral agreement. R000077. What Appellant's don't appreciate is that Idaho Code doesn't help the Appellants in this case, given the District Court's findings. For example, Appellants cite Idaho Code § 30-25-102(a)(9), which states in relevant part, "[a]s soon as a limited liability company *has any members*, the limited liability company perforce has an operating agreement ..." The District Court held that Crossett was the only member of DTC upon its formation. This finding rendered Appellant's remaining claims moot.

The District Court didn't have to look to other provisions in the Code once it determined that Johnson and Cousins were not members.

The District Court cited Idaho Code § 30-25-401(b), which states in relevant part that under Idaho law "[i]f a limited liability company is to have more that one (1) member *upon* formation, those persons become members as agreed by the persons before the formation of the company." The District Court held that "[h]ere I think the only conclusion that can be drawn from the evidence was that the agreement between Johnson and Crossett was that Johnson, and eventually Cousins, would become members upon signing the operating agreement." Conclusions, p. 19, R000082. That is, they were not

members upon the formation of DTC Group, and did not agree to satisfy the condition precedent to becoming members.

Appellants orally agreed they would *become* members upon signing the written operating agreement prepared by Jacobson. Appellants refused to sign it. Which begs the question – if they thought they were actually members of DTC Group – why would they refuse to sign the written operating agreement? To follow Appellants' line of argument, signing the written operating agreement would simply *confirm* their membership. Appellants weren't members of DTC. They didn't want to become members, ergo, they refused to sign it. Any argument otherwise is disingenuous.

To further support this point, the written operating agreement that had been drafted by Mr. Jacobsen provided that **no person will be admitted to the Company** as a member unless they sign the signature page of the operating agreement. Defendant's Exhibit A, Section 3.4, p. 9. Signing was a *condition precedent* to membership. Appellants simply choose to ignore this fact.

There was no formation of the LLC with Appellants in it. "...the only oral agreement was an agreement to sign a written agreement." Conclusions, p. 16. "When Johnson declined to sign the written agreement when it was ready, the formation of the LLC fell apart." *Id.* That is, the formation of the LLC with Appellants as members.

The District Court carefully articulated that it fully accepted that "Crossett was acting on behalf of both parties when he formed the LLC and became its sole member. But Johnson didn't become a member upon [its] formation. Crossett's agreement with Johnson was that he and Johnson would control the LLC ***when*** formed by means of a written operating agreement. The written agreement was prepared, and both Johnson and

Crossett approved of its terms. All was ready to go, but Johnson would not sign." Conclusions, p. 17, R000080.

DTC with Johnson and Cousins as members was never consummated. "Although the plan was for common ownership between Johnson and Crossett to be as alleged, with Cousins to be included at some stage, and although Crossett formed the company as a single member but with the intent that both Johnson and Cousins would be joining him as members as soon as the operating agreement was approved and signed, neither Cousins nor Johnson completed the essential step in the organization of the LLC necessary for them to become members of it, that being to sign the operating agreement…Johnson's decision not to sign the essential document necessary … was a conscious and deliberate decision on his part." R000082.

Contrary to Appellants argument, the District Court **did not find** that an oral operating agreement becomes null and void upon the drafting of a written operating agreement, whether the draft is signed or not. Appellant's Brief, p. 18. The District Court found that the oral agreement between the parties was that they would become members of DTC upon signing the written operating agreement – that oral agreement established the *condition precedent to becoming a member of DTC.*

There was no oral operating agreement[3] as between Johnson and Crossett and Cousins – Johnson and Cousins weren't members of DTC.

When both Cousins and Johnson refused to sign the written operating agreement, it was clear they did not intend or want to be members of DTC.

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[3] Nor was the written operating agreement and "amendment" to the oral operating agreement as asserted by Appellants. *See* Appellant's Brief, p. 18.

Simply put, Idaho Code doesn't come into play because Appellants were not members of DTC. The District Court did not abuse its discretion in its treatment of Idaho Code as it is related to limited liability companies, or in denying Appellant's motion for new trial. The Code is simply not applicable given the District Court's ruling that Johnson and Cousins never become members of DTC.

3. The District Court did not abuse its discretion in not granting Appellant's Motion for New Trial related to liability and damages.

Idaho Rule of Civil Procedure 59(a)(1)(G) requires a trial court to apply a two prong test when determining whether to grant a new trial. *Blizzard v. Lundeby*, 156 Idaho, 204, 206 P.3d 286 (2104)(citations omitted). The trial judge must consider whether the verdict was against the weight of the evidence, and then whether a different result would follow on retrial. *Id.*

The District Court did not error in finding Appellants were never members of DTC. Appellants have pointed to no fact in the record which support a claim that they were members, other than their reliance on the "admission" in Crossett's Answer that they formed the business. A different result would not be reached if the case was retried.

Appellants have pointed to no fact in the record that they would have received an monies in excess of what DTC had paid to them, had they been members of DTC "since its inception." *See* Appellant's Brief, p. 21.

The District Court found that even if it accepted (which it did not) Appellants' theory that they were always members, or were members upon formation, that an oral operating agreement was in place, and Idaho Code governed the relation of the parties, the result of the case would be the same. ... "DTC Group was managed by Crossett. His

decision to outsource the sales to Vurv, and his decision to eventually transfer the assets to Vurv were his business decisions within the scope of his authority as manager of the LLC. Furthermore, by the time he made the decision to transfer the assets, the company was technically insolvent. Crossett's decisions served to satisfy all of the debt remaining in DTC and close it out debt free.." R000080. "Under their oral agreement, there is no dispute that Crossett was to work for the venture and have sole control over the management of it, Johnson was not. Crossett was to receive a guaranteed distribution of $60,000 or $65,000 per year for his direct services to the venture. The exact amount of his guaranteed distribution does not matter because the company did not earn enough to pay even a lesser amount. There is no obligation on Crossett's part to return or divide up any of the compensation he took, any more than there would be any obligation on the part of Cousins to return any part of her salary, since it did not at any time exceed the minimum guaranteed amount." R. 000081.

The District Court clarified: "[t]his means that even if the company is deemed to have survived with Johnson and Cousins as members, it is an empty shell, with no assets and no liabilities, and no claim upon Crossett to account or return anything. If I accept plaintiffs' argument, the result would be that there are no assets to distribute, and no money due or owing from Crossett." *Id.*

4. The District Court did not error in granting Respondent's Motion for Attorney Fees under Idaho Code § 12-120(3).

Appellants assert that the District Court should not have awarded Crossett attorney fees because the gravamen of this litigation is to "enforce a statutory penalty or

right" which is not a commercial transaction that falls within the purview of Idaho Code § 12-120(3). Appellants' Brief, p. 23.

In ruling on Appellants' objection to the motion for attorney fees in the underlying case, the District Court performed a thorough analysis of the applicable statutes and cases, and acknowledged an action to enforce a statutory penalty or right is not a commercial transaction for the purpose of applying Idaho Code § 12-120(3) recognized under controlling case law. R000144.

Although Appellants' contend that their cause of action against Crossett was founded on his breach of duty under one of the applicable statutes,[4] by the time of trial, DTC had been liquidated and dissolved. *Id.* The action was continued only as an individual action for damages by the plaintiffs against Crossett for damages. *Id.*

"This was not an attempted derivative action for the benefit of the company under I.C. § 30-25-802, but rather by individuals claiming to be members against another member for damages on account of the individual plaintiffs' own interests"; i.e. the failure of Crossett to divide profits as allegedly agreed. *Id.*

"The action was permitted by I.C. § 30-25-801(a) so long as no part of what is claimed inures to the benefit of the company generally, in which case it would be permitted only as a derivative claim under I.C. § 30-22-802." *Id.*, R000144 – 145. Notwithstanding this fact – Appellant's didn't even "get to" these statutory provisions because the District Court found they were never members of DTC. The commercial transaction – or the oral agreement that Appellants claim Crossett breached – was the alleged agreement that Crossett made Appellants members of DTC upon its formation,

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[4] For example, I.C. §§ 30-25-404(d), 30-25-407(a), 30-25-409(c), or 30-25-602.

this was integral to Appellant's claims and was the basis on which they sought recovery.[5] The District Court held through this alleged transaction, they did not become members of DTC, therefore the remainder of their claims became moot.

Appellants were found by the District Court to *not* be members of DTC. They had no "expectancy" in the operation of DTC because they refused to sign the written operating agreement. Put another way, the first "hurdle" Appellants had to get past in the litigation was whether or not they were members of DTC; did the events or "transactions" that transpired between the parties give Appellants membership status. This was not a statutory claim but required a factual determination by the Court, which determination was Appellants were not members and never became members of DTC. The remaining claims of Appellants' thereafter become moot.

The cases relied upon by Appellants don't help their case. As held by the District Court:

> The cases cited by the plaintiff are distinguishable from the facts found in this case. In *Kelly v. [Silver]wood Estates*, 127 Idaho 624 (1995), the suit was a claimed partner against the partnership as an entity for an accounting in connection with the winding up of partnership affairs. It was brought under the provisions of the Uniform Partnership Act and was not an action between individuals. In *Gumprect v. Doyle*, 128 Idaho 242 (1995), the gravamen of the action was by a professional who had withdrawn from the professional corporation in a dispute over the value of shares that were repurchased by the corporation; it was brought under the corporation code provisions pertaining to the rights of minority shareholders, it was not an action among individuals. *Shay v. Cesler*, 132 Idaho 585 (1999), was an action for treble damages on unpaid wages, which included a specific statute on attorney fees. *L[&]W Supply Corp v. Chartrand Family Trust*, 136 Idaho 738 (2002) was a statutory lien foreclosure with a specific statute covering attorney fees.

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[5] This commercial transaction was the basis of Appellants' claim for declaratory relief and relief via a claim for tortious interference with business expectancy in Counts I, II, and II of their First Amended Complaint.

R000147.

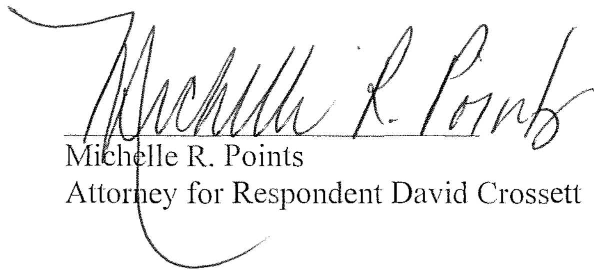
Given the outcome of the trial, the only conclusion can be that Crossett was the prevailing party and was entitled to an award of his attorney fees under I.C. § 12-120(3).

F. Conclusion

Based on the foregoing, it is requested that Appellants' appeal be denied in its entirety, and that Crossett be awarded his attorney fees and costs incurred in defending the appeal.

Respectfully submitted this 10th day of July, 2017

POINTS LAW, PLLC



Michelle R. Points
Attorney for Respondent David Crossett

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that on the 10th day of July, 2017, I caused to be served a true copy of the foregoing RESPONDENT'S BRIEF by the method indicated below and addressed to each of the following:

James F. Jacobson JACOBSON & JACOBSON, PLLC 7655 W. Riverside Drive Boise, Idaho 83714	__X__ U.S Mail, Postage Prepaid _____ Hand Delivered _____ Overnight Mail _____ Fax (208) 477-5210

Michelle R. Points