

No. 37272-0-II

COURT OF APPEALS, DIV. II
OF THE STATE OF WASHINGTON

SAVE COLUMBIA CU COMMITTEE, CATHRYN CHUDY,
KATHRYN EDGECOMB, LLOYD MARBET, and ROBERT
TICE, Appellants,

vs.

COLUMBIA COMMUNITY CREDIT UNION and STATE OF
WASHINGTON DEPARTMENT OF FINANCIAL
INSTITUTIONS, Respondents.

APPELLANTS' REPLY BRIEF

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**I. REPLY TO ARGUMENTS OF THE WASHINGTON
DEPARTMENT OF FINANCIAL INSTITUTIONS**

In its Response Brief, the Department of Financial Institutions (DFI) defends the allegedly arbitrary inactions of its Division of Credit Unions (DCU) by asserting that (1) DCU has no “duty required by law” to regulate state credit unions and (2) if DCU has such a duty it did not act arbitrarily and capriciously in deciding not to act.

In that DFI makes essentially the same arguments here as it made to the trial court, Plaintiffs call this court’s attention to their response to those arguments in Plaintiffs’ Response to Motion for Summary Judgment (CP 520-528) and the Declaration of Schafer re: Exhibits (CP 481-519). In those pleadings, Plaintiffs illustrate the consistent practice of DCU exercising its regulatory authority concerning Columbia’s internal affairs. DFI argues (DFI Responsive Brief at 20-24) that DCU Director Jekel’s actions cited in those pleadings were not “enforcement actions” even though several illustrated express directives given by DCU’s Director Jekel to Columbia.

In a 1998 case, DFI made inconsistent arguments, asserting that “jawboning” by DCU — the informal practice of threatening formal action in order to ensure credit union compliance with regulatory requests — “is a permitted regulatory method in Washington.” *Aitken v. Reed*, 89 Wn. App. 474, 485, 949 P.2d 441 (1998), *rev. denied* 136 Wn.2d 1004

(1998). Jawboning was recognized as permissible enforcement practice for DFI's banking officials in *Liberty Bank v. Henderson*, 75 Wn. App. 546, 878 P.2d 1259 (1994), *review denied*, 126 Wn.2d 1002 (1995).

DFI asserts (DFI Response Brief at 5) based on DCU Director Jekel's Declaration signed in February 2007 (CP 406), that state and federal credit union regulatory authorities do not become involved in corporate governance issues except if there is a violation of law or a safety and soundness concern. But that is no longer the case with the federal regulatory authority, the National Credit Union Administration (NCUA). That very recent change should be recognized here as significant because of the ease by which Washington credit unions may merge with or convert to federal credit unions and vice versa. RCW 31.12.464 and .467.¹

It is true that NCUA, which insures the deposits of Columbia and all Washington credit unions (RCW 31.12.408(a)) and is the primary regulator for federal credit unions (FCUs), had before late 2007 a long history of abstention on credit union governance disputes leaving them for resolution by state courts applying the state's general corporate law. *E.g.*, *Ridenour v. Andrews Federal Credit Union*, 897 F.2d 715, n.4 (4th Cir. 1990); 70 Fed. Reg. 40924, 40930 (July 15, 2005) (“[G]enerally state

¹ In January 2006, according to Final Bill Report to HR 2364 (2005-06 session) about 79 state credit unions and 61 federal credit unions operated in Washington state. That report stated, “Since 1990, 19 credit unions converted from the federal to the state charter, and 27 mergers between state and federal credit unions under the state charter have taken place.” <http://apps.leg.wa.gov/documents/billdocs/2005-06/Pdf/Bill%20Reports/House%20Final/2364.FBR.pdf>

corporate law, to the extent it is consistent with the Federal Credit Union Act and NCUA regulations, determines disputes regarding the enforcement of bylaw provisions. Therefore, NCUA generally does not become involved in resolving internal governance disputes in federal credit unions involving bylaw disputes unless a matter presents a safety and soundness concern.”)

But in large part due to this Court’s shocking opinion in *Save Columbia CU Comm. v. Columbia Community Credit Union*, 134 Wn. App. 175, 139 P.3d 386 (2006), the NCUA determined not to rely on state courts to resolve all credit union governance disputes. In April 2007, it proposed a rule titled “Member Inspection of Credit Union Books, Records, and Minutes,” 72 Fed. Reg. 20061 (April 23, 2007), and among the reasons for the change the agency stated, at 20062:

“The NCUA Board believes regulating member inspection rights of FCU records is preferable to reliance on state corporation law. ... [S]ome courts may refuse to apply their corporation law to inspection requests by FCU members or may incorrectly analogize the financial interests of credit union members to those of depositors in a mutual savings bank and deny members inspection on those grounds. *See, e.g., Save Columbia Credit Union Committee v. Columbia Credit Union*, 139 P.3d 386, 393–95 (Wash. App. 2006) (refusing to apply state corporation law to records inspection request by members of a state-chartered credit union).”

And in June 2007, NCUA proposed reincorporating its standard FCU bylaws into its regulations (as had been the case before deregulation in

1982) and clarifying its authority to administratively enforce a FCU's bylaws. Its explanation for the proposed change included the following (72 Fed. Reg. 30984, 30985 (June 5, 2007)):

NCUA's post-deregulatory policy has sometimes had the effect of requiring FCU members to resort to state court action in order to force their credit union to abide by its bylaws. While this approach worked fairly well for the most part over the years, recently, NCUA has learned of cases where members have been unable to use the judicial system to enforce rights granted by the Bylaws.

In October of 2007, the NCUA adopted both proposed regulations, signaling its intention to administratively address corporate governance disputes within federal credit unions rather than to rely upon state courts to address them. 72 Fed. Reg. 56247 (Oct. 3, 2007)(Member Inspection Rights); 72 Fed. Reg. 61495 (Oct. 31, 2007)(Bylaws Enforcement).

DFI argues (DFI Response Brief at 14) that its regulatory power is always discretionary, that it has no duty by law to exercise its enforcement authority in any circumstance. DFI fails to recognize any duty arising from the legislative statement of purpose in RCW 31.12.015 that "The [DFI] director is the state's credit union regulatory authority whose purpose is to protect ... the integrity of credit unions as cooperative institutions ..." [Emphasis added.] But our state supreme court has recognized that a legislative statement of purpose is important to a determination of the scope of an enforcement agency's duties. *Tyner v. DSHS*, 141 Wn.2d 68, 78-79, 1 P.3d 1148 (2000) (When investigating

child abuse allegations, state agency has duty to parents because “the declaration of purpose section [RCW 26.44.010] makes it clear that a parent’s interests were contemplated by the Legislature.”)

If DFI’s lax interpretation of the Washington Credit Union Act and DCU’s duty is correct, then the agency and the courts are powerless to prevent a renegade majority of a credit union’s board of directors from expelling all dissenting directors, requiring incumbency for nomination and election to the board, expelling any members who attempt to call a special meeting as RCW 31.12.195 permits, or even expelling all members except themselves and their friends and dividing the credit unions’ net assets among those few through a voluntary liquidation as permitted by RCW 31.12.474. Such an interpretation must be rejected as inconsistent with the Legislature’s intentions as reflected in its statement of purpose that DFI shall protect “the integrity of credit unions as cooperative institutions.”

II. REPLY TO ARGUMENTS OF COLUMBIA COMMUNITY

CREDIT UNION

A. Columbia’s Dispositive Motion. It should be noted, initially, that Columbia’s Motion to Dismiss or, Alternatively, for Summary Judgment, filed July 20, 2007, that the trial court granted on December 20, 2007, sought dismissal under CR 12(b)(6) of all of Plaintiffs’ claims, and,

alternatively, dismissal under CR 56 of Chudy and Edgecomb's claims for failure to join necessary parties and of Marbet's claim as moot. CP 619. The alternative CR 56 motion as to the latter two claims were supported by a Declaration of J. Parker Cann. CP 615-617. No declarations or affidavits supported Columbia's CR 12(b)(6) motion.

B. Wrongful Expulsion Claims of SaveCCU and Tice. In

Columbia's Response Brief from 12 to 23 it argues that SaveCCU and Tice failed to state a claim of wrongful expulsion, though it admits that Washington law does "recognize a claim of wrongful expulsion from a state-chartered credit union." Columbia's Resp. Br. at 12. Plaintiffs argued the adequacy of SaveCCU and Tice's statement of their claim in the Opening Brief at pages 17-20 and in the Plaintiff's Response to Motion to Dismiss, or Alternatively, for Summary Judgment. CP 638-41. Columbia's present argument appears to be that, notwithstanding the detailed facts alleged in the complaint concerning the expulsion of these plaintiffs, they fail to state claims under CR 12(b)(6) because they did not in ¶ 51 of their First Amended Complaint actually use the word "irregular" or the phrase "bad faith." Plaintiffs submit the use of those particular words are not essential when the detailed facts alleged throughout the First Amended Complaint and its Appendices so clearly illustrate bad faith.

C. Wrongful Suspension and Removal Claims of Chudy, Edgecomb, and Marbet. Except as noted below, Plaintiff believe that

Columbia's arguments (Columbia's Response Br. 23-43) supporting the dismissal of the wrongful suspension and removal claims of Chudy, Edgecomb, and Marbet are adequately countered by Plaintiffs' arguments in its Opening Brief at 20-31 and 33-34.

1. RCW 31.12.285. Columbia wrongly claims (Columbia's Response Br. 23-25) that Chudy, Edgecomb, and Marbet failed in the trial court to argue that Columbia's majority directors did not have "cause" within the meaning of RCW 31.12.285 to suspend them. But the First Amended Complaint, at ¶ 38 quoted RCW 31.12.285 and at ¶ 52 alleged, "The suspensions on October 16, 2006, from their elective offices of Chudy, Edgecomb, and Marbet by Columbia's board was [sic] not based upon cause as defined in RCW 31.12.285 and was not lawful." CP 595 and 597. At page 6 of Plaintiff's Response to Columbia's Motion to Dismiss, or Alternatively, for Summary Judgment, Plaintiffs argued, "Plaintiffs' First Amended Complaint, at ¶ 52, alleges that the suspension of those elected officials by the other Columbia board members on October 16, 2006, was not based upon cause as defined in RCW 31.12.285 and was not lawful." CP 643. And on page 2 of Plaintiffs' Two-Page Statement of Allegations Supporting Wrongful Expulsion Claim, Plaintiffs argued, "After this Court enjoined the expulsions of Chudy, Edgecomb, and Marbet, the board majority, on October 16, 2006, suspended them for acts 'found' in their August notices of expulsion, though the acts were not

‘cause’ as defined in RCW 31.12.285 governing such suspensions.” And Plaintiffs made more lengthy arguments concerning this issue at pages 7-9 of their Motion for Injunctions and Memorandum in Support Thereof (CP 313-15) and pages 1-3 of Plaintiffs’ Reply to Columbia’s Motion to Strike (CP 360-62). It simply is not true that Chudy, Edgecomb, and Marbet raised this issue for the first time on appeal, for they repeatedly raised this issue in the trial court.

2. November 22, 2006, Meeting. Columbia argues that Plaintiffs failed to state a claim as to the wrongfulness of Columbia’s special meeting held November 22, 2006, because though they alleged “Columbia waged a costly publicity campaign to falsely denigrate and malign them” (First Amended Complaint ¶ 45, CP 596) they allegedly failed to specifically identify any false statement. Columbia Response Br. at 29. Though CR 12(b)(6) requires no such specificity, Plaintiffs’ Two-Page Statement of Allegations (CP 663) stated, beginning at line 22:

Columbia’s false and malicious campaign referred to them as “offenders” who had broken the law and been disloyal to Columbia by participating in the newspaper ad, by filing the declaratory judgment action, and by causing the supervisory committee to call the special meeting. The campaign implied that this Court recommended their banishment. (A headline read, “Judge says Volunteers must be suspended before expelled.”)

Columbia argues (Responsive Br. at 30-31) that its board could not have permitted members to vote by mail, as the members had in the two previous annual meetings and the 2004 special meeting, because of a provision the board had placed in its bylaws. That argument is well refuted by the Declaration of Cathryn Chudy (CP 363-80) that illustrates Columbia's board's pattern of amending the provisions of its bylaws whenever that served the board's strategic objectives. DCU Director Jekel stated at page 3 in her letter of June 30, 2006, to Robert Tice and Columbia's board that Columbia could mail out ballots to members in advance of a special meeting, but simply could not have post-meeting balloting by mail. CP 82.

3. Mootness Argument. Columbia argues that the wrongful suspension and removal claims by Chudy, Edgecomb, and Marbet are moot because the terms of the positions to which there were elected have now expired. Columbia Response Br. 34-38. In addition to the Plaintiff's arguments at Opening Br. 26-28, Plaintiffs here assert the arguments it made in its Response to Motion to Dismiss filed in this court September 5, 2008:

The Court of Appeals has the power to grant effective relief to the plaintiffs and because the claim fits within a recognized exception to the mootness doctrine as an issue that is likely to escape review because the facts of the controversy are short-

lived.

The Court of Appeals possess the equitable power to grant effective relief if it determines that Columbia's majority directors acted unlawfully or inequitably in their suspension and removal of Chudy and Edgecomb from their positions on the board of directors of Columbia. Washington courts have broad equitable powers to correct unlawful and inequitable corporate conduct. *E.g., King County Dep't of Cmty. & Human Servs. v. NW Defenders Ass'n*, 118 Wn. App. 117, 127, 75 P.3d 583 (2003) ("A court acting in equity must act with restraint, but in extreme cases must have wide latitude to respond to the particular circumstances presented.") In *King County*, the appellate court approved the appointment of a receiver to entirely replace the management and the board of directors of a corporation. In this case a more restrained judicial response would be, for example, to restore Chudy and Edgecomb to Columbia's board by increasing its number by two for the number of months remaining in their terms when they were wrongfully suspended and removed from their elective positions.

In Columbia's motion it cites only *Cotton v. City of Elma*, 100 Wn. App. 685, 693, 998 P.2d 339, *review denied*, 141 Wn.2d 1029 (2000), to support its position that the expiration of a term

of office renders moot a claim of wrongful suspension by the office holder. But *Cotton* involved a public official—a judge—who had been appointed to fulfill the remainder of a four-year judicial term. The appellate court ruled that because the term to which she had been appointed had then expired her claim for ouster of her successor—then serving a successive term—was moot. The court’s equitable power did not empower it to alter the terms of office of public officials. But that is distinguishable from corporate officials, for the courts do possess equitable power to correct inequitable corporate conduct by reinstating corporate officials, extending their terms, or expanding the size of a board of directors.

Columbia’s suggestion that the number of positions on its board of directors is fixed by its bylaws and therefore binding upon the Court must be rejected. RCW 31.12.225 permits a state credit union’s board to consist of between five and fifteen directors, each serving terms of from one to three years. Because Columbia’s board could amend its bylaws at any meeting without needing any approval from its members or from state officials, its bylaws became, to use a football analogy, its play book rather than its rule book. Bylaws Article XIII (CP 37); RCW 31.12.115. As noted at page 33 of the Opening Brief,

Columbia's board strategically amended its bylaws at least thirteen times in the twelve months before its October 15, 2006, meeting. Declaration of Chudy at 3 and Ex. B (CP 365, 369–379).

An noted above, RCW 31.12.225 sets the term of credit union directors at from one to three years. RCW 31.12.326 sets the term of the members of a credit union's supervisory committee at three years. There are presently about 75 state chartered credit unions in Washington, according to the website of the Division of Credit Unions, Department of Financial Institutions. <<http://www.dfi.wa.gov/cu/cucontacts.htm>> RCW 31.12.285 provides for the suspension and removal of members of a credit union board or supervisory committee only for cause as defined in that section. If claims of wrongful removal of credit union elected officials are rendered moot the moment that their term in office expires then its is likely that all such claims will be rendered moot simply due to the time required for trial court and appellate court review of such claims. Renegade boards will be free to oust their disagreeable members without regard to RCW 31.12.285, knowing that the time required for judicial review will extend beyond the ousted member's term, so any claims of wrongful removal will be rendered moot and dismissed.

But Washington cases recognize that an exception to the mootness doctrine is applicable to issues, such as compliance with RCW 31.12.285, that are likely to escape review because the facts of the controversy are short-lived. *E.g.*, *Marriage of Horner*, 151 Wn.2d 884, 892, 93 P.3d 124 (2004); *Westerman v. Cary*, 125 Wn.2d 277, 286-87, 892 P.2d 1067 (1994); *Welfare of B.D.F.*, 126 Wn. App. 562, 569, 109 P.3d 464 (2005). That exception is applicable to this case.

4. August 15, 2006, Expulsions. Though Columbia chose not to appeal the trial court's Order Granting Preliminary Injunction (CP 280-88) concluding that its majority directors unlawfully circumvented RCW 31.12.285 by expelling Chudy, Edgecomb, and Marbet from membership on August 15, 2006, it once again (Columbia Response Br. at 38-43) argues that the trial court's ruling was erroneous. Plaintiffs have responded repeatedly and extensively to Columbia's arguments on this point (made in at least three pleadings to the trial court). See Plaintiffs' Reply to Oppositions to Motion for Injunctions (CP 232-40), Plaintiffs' Response to Motion for Reconsideration (CP 295-300), and Plaintiffs' Response to Motion for Partial Summary Judgment (CP 383-89). Because Columbia chose not to appeal the trial court's ruling on this issue, the appellate court should not consider the issue

D. The Irregular July 22, 2006, Special Membership Meeting.

Columbia argues (Responsive Br. at 43-46) that Plaintiffs failed to state a claim under CR 12(b)(6) that Columbia's special membership meeting held July 22, 2006, was conducted unlawfully because, according to Columbia, Plaintiff's failed to allege that the flagrant procedural irregularities actually affected the meeting's outcome. By that rationale, an allegation that corrupt corporate officials notified only half of their shareholders or members of a special meeting would fail to state a claim; as would an allegation that such officials permitted nonmembers to vote, or permitted members to cast multiple ballots. That is not the law. Implicit in the requirement of RCW 31.12.195 that a credit union's corporate secretary give notice of a special membership meeting is the requirement that the same notice be given to all members eligible to vote at the meeting.

III. CONCLUSION

For the reasons argued in Plaintiff's Opening Brief and above, the trial court dismissal of Plaintiffs' claims should be reversed.

Respectfully submitted this 25rd day of September, 2008.

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