

Appellate Court Case No. A05-1293

STATE OF MINNESOTA
IN COURT OF APPEALS

Hoyt Properties, Inc., and Hoyt/Winnetka, LLC,

Appellants,

v.

Production Resource Group, LLC,
Haas Multiples Environmental Marketing and Design, Inc.,
d/b/a Entolo—Minneapolis and Entolo, Inc.,

Respondents.

APPELLANTS' BRIEF

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STATEMENT OF LEGAL ISSUES

1. Did the district court err in dismissing Hoyt's breach of contract claims against Respondents Haas Multiples, Inc. and Entolo Inc. based upon the settlement agreement, when the settlement agreement specifically reserved Hoyt's right to raise such claims.

The district court concluded that Hoyt's breach of contract claim was barred by the settlement agreement, even though the settlement agreement specifically allowed Hoyt to raise these claims.

Apposite Authority:

Minneapolis Baseball Co. v. City Bank, 76 N.W.2d 1024 (Minn. 1898);

Cloverdale Foods of Minnesota, Inc. v. Pioneer Snacks, 580 N.W.2d 46 (Minn.App. 1998)

2. Did the district court err in dismissing Hoyt's claim to rescind a settlement agreement and to pierce the corporate veil against Respondents, where an agent for Respondents induced Hoyt to enter into this agreement through false representations on which Hoyt justifiably relied.

The district court concluded that the fraudulent statements made by Respondents were non-actionable and that Hoyt did not reasonably rely upon those statements.

Apposite Authority:

Miller v. Osterlund, 191 N.W. 919, 919 (Minn. 1923);

Ganley Bros. v. Butler Bros. Bldg. Co., 212 N.W. 602 (Minn. 1927);

L & H Airco, Inc. v. Rapistan Corp., 446 N.W.2d 372, 380 (Minn. 1989)

3. Did the district court err in dismissing certain of Hoyt's claims with prejudice, where Hoyt voluntarily sought dismissal of those claim without prejudice as allowed and permitted by Minn. R. Civ. P. 41(a).

The district court dismissed these claims with prejudice without any reasoned decision.

Apposite Authority:

Minn. R. Civ. P. 41(a)

STATEMENT OF THE CASE

This action was commenced in May 2003, when Appellants filed a complaint in Hennepin County District Court. Respondents subsequently removed the case to United States District Court and filed a motion to dismiss. This motion was denied, and the case was remanded to state court. Respondents filed a motion for summary judgment, which the Honorable Isabel Gomez granted. Following this dismissal, Appellants noted their intent to dismiss certain remaining claims without prejudice pursuant to Minn. R. Civ. P. 41(a). The district court dismissed these claims, but did so with prejudice. Appellants then filed this timely appeal.

STATEMENT OF THE FACTS

I. The Parties And The Lease Agreement.

Appellant Hoyt Properties, Inc. and Hoyt/Winnetka, L.L.C. (collectively “Hoyt”) are Minnesota corporations, both of which are owned and operated by Steven Hoyt. (Complaint at ¶ 1). Mr. Hoyt is a businessman active in the real estate business, as well as a non-practicing attorney.¹

¹ See Affidavit of Tom Boyd in Support of Defendants Motion for Summary Judgment (“Boyd Affidavit”) at Ex. E, 6:25-7:4.

Respondent Haas Multiples, Inc. (“Haas”) is a Minnesota corporation that was active in the trade show business.² In 2002, appellee Entolo, Inc. (“Entolo”) was formed, and it became the successor corporation to Haas.³ In 2003, Haas’ and Entolo’s parent, appellee Production Resource Group (“PRG”), liquidated both corporations and took the proceeds of Entolo’s remaining assets. (App. 105-06). Although neither Haas nor Entolo currently engage in business, PRG has not dissolved either corporation.

In late 2001, after months of negotiations, Hoyt entered into a lease agreement (the “Lease”) with Haas.⁴ This Lease was later transferred to Entolo upon its creation, although Haas remained jointly liable under the Lease. (App. at 34). (Because Entolo is Haas’ successor, and because they are jointly liable under the Lease, they will be collectively referred to as “Entolo.”)

This Lease was a long term lease, with a term extending over ten years. Steve Hoyt spent approximately \$1.3 million of his money for the benefit of Entolo to make tailor-made tenant improvements to rebuild as requested by Entolo. (App. at 49). In return, Entolo was expected to make lease payments of approximately \$10 million over these ten years. (App. at 34; Complaint at Ex. A). Entolo,

² See Complaint at ¶1; Answer at ¶1.

³ Id.

⁴ See Complaint at ¶¶3-4, Ex. A, App. at 34-35.

however, would breach this Lease after having made only two monthly payments on the ten year Lease.⁵

II. Following Entolo's Liquidation By PRG, Bruce Knight Files A Lawsuit Against PRG And Entolo.

Unbeknownst to Steve Hoyt, in mid 2002, PRG made the decision to liquidate Entolo in part because PRG did not want to make Entolo's Lease payments. (App. at 105, 113-114). PRG controlled all of Entolo's cash and receivables. PRG decided to stop paying most of Entolo's creditors, other than those directly involved in the liquidation process. (Id. at 105-106, 113-114).

One of these unpaid creditors was Bruce Knight. Entolo owed Mr. Knight approximately \$750,000 due to be paid in October 2002. (App. at 183-189). As a former employee of Entolo/PRG, Knight knew that Entolo did not have any money, and that Entolo was certainly not run as a separate entity apart from PRG.

As a result, in early December 2002, Mr. Knight filed and served a complaint in Minnesota state court raising a breach of contract claim against Entolo, as well as a piercing the corporate veil claim against PRG seeking to hold it liable for Entolo's debts. (App. at 183-89). It alleged that PRG took all of Entolo's cash, forcing Entolo to send all of its receivables and revenue to PRG. (App. at 183-89). The Complaint further alleged that PRG interfered with and

⁵ See Complaint at ¶ 4, App. at 195.

controlled the details of Entolo's daily business and financial affairs— hiring and firing key Entolo employees, controlling Entolo's budget and its strategic decisions, taking all of Entolo's money and receivables, not following proper corporate formalities, using Entolo employees and resources for PRG business, and otherwise treating Entolo as a mere division and instrumentality of PRG. (Id. at 187-89). When in 2002 Entolo's debts became too significant because of PRG's actions, the Complaint alleged PRG forced Entolo to shut down its business so Entolo's remaining creditors need not be paid. (Id. at 187-88). PRG then liquidated Entolo's remaining assets and took its money. (Id. at 187-88).

This Complaint was served upon PRG's general counsel, Robert Manners, who retained Karl Robinson of Winthrop & Weinstine to represent both PRG and Entolo, all before the crucial settlement conference with Steve Hoyt on December 26, 2002 (see below). (App. at 73-74). Because of this Complaint, PRG had a serious problem – a \$10 million problem – if Hoyt discovered the facts alleged in the *Knight* complaint regarding how PRG operated Entolo.

II. Hoyt, Entolo, And PRG Enter Into A Limited Settlement Agreement Based Upon A False Representation By PRG's Attorney.

Steve Hoyt knew none of these facts when Entolo defaulted by failing to make its third monthly rental payment on December 1, 2002. (App. at 36, 195). After this default, Hoyt filed an unlawful detainer complaint seeking to evict

Entolo from the leased premises. (App. at 36, 195). This claim was set for a hearing on December 26, 2002. (App. at 36, Boyd Affidavit at Ex. E, 82:10-17).

Testimony from Karl Robinson established that he had reviewed the *Knight* Complaint along with Robert Manners prior to this hearing. (App. at 74, 77).

There is no question that the substance of the *Knight* Complaint was true. Thus, it is apparent that Karl Robinson went to the Courthouse on December 26, 2002 with a plan to resolve PRG's potential \$10 million problem by securing a release for PRG, even though PRG was not a party to the Lease with Hoyt.

At this eviction hearing, Steve Hoyt was present with his attorney Michael Meyer. (App. at 64). Entolo was represented by Robinson and another attorney from Winthrop, Hart Kuller. (Id.) Robinson and Kuller admit having discussed the piercing allegations in the *Knight* complaint prior to this hearing. (Id. at 76).

When the hearing convened, the judge instructed the parties to go into the hallway and attempt to resolve the dispute.⁶ The parties did so and came to an agreement that would allow Entolo to remain in the leased premises for a short time in return for a small payment. (App. at 64-65). Hoyt would retain the right to sue Entolo for the remaining sums due under the Lease. (Id. at 66-67).

Once the agreement was complete, however, PRG's lawyers approached Meyer with a "wrinkle in the deal." (App. at 67). They informed Meyer that PRG

⁶ See Boyd Aff., Ex. E at 88:13-22.

also wanted a release as a part of the agreement. (Id.) Meyer brought this request to Steve Hoyt's attention. (Id.) Steve Hoyt then walked over to ask why PRG wanted this release. Mr. Kuller replied, "I suppose they don't want to get sued after the fact." (App. at 69). Mr. Hoyt responded skeptically, saying "that would be piercing the veil. I don't know of any reason why [PRG] could be liable. Do you?" (App. at 69). Hart Kuller just stared straight ahead. (Id.) He did not say a word. (Id.) Karl Robinson, however, replied, representing to Mr. Hoyt that "There isn't anything. PRG and Entolo are totally separate." (Id. at 69). To which Hoyt replied, "Well, you would know." (Id.) Mr. Hoyt walked over to Michael Meyer (who, as Steve Hoyt carefully recollected, had walked away prior to this conversation) and told him it was agreeable to insert a "global" release into the settlement agreement.⁷ (Id.) Hoyt testified that he agreed to the release based upon Robinson's representations. (App. at 69-71).

Over the next several days, Meyer worked with Robinson to draft the settlement agreement. (App. at 69). Hoyt cautioned Meyer that he did not know anything about PRG or Entolo "except what I've heard here this morning." (Id.)

⁷ Respondents, of course, contest the accuracy of this conversation. But they agreed that for the purposes of the summary judgment motion, they had to accept these facts as those most favorable to the Plaintiffs. See Defendants Memorandum of Law in Support of Their Motion For Summary Judgment at 10.

The final release for PRG included two “carve outs:” it allowed Hoyt to raise claims against PRG for fraudulent transfers and for any fraud PRG committed in describing Entolo’s financials. (App. at 195-99).

Mr. Hoyt did not include a “carve out” for a piercing claim because of Robinson’s representation that there was no viable piercing claim against PRG for Entolo’s lease default as Entolo and PRG were “totally separate.” (Id. at 70-71). Hoyt saw no need to put Robinson’s representation in the contract because Hoyt did not believe that an attorney would openly lie:

I mean . . . this is a small community. We tend to believe what, especially what other lawyers say, because we find ourselves not always on the same side.

And you know, at least in this city – maybe not in New York City, but at least in this city I think lawyers are pretty forthright and honest.

I certainly didn’t expect that Winthrop & Weinstine or Karl Robinson or Hart Kuller were going to be a party to this agreement, but I also recognized that they knew more about PRG than anybody.⁸

(App. at 70).

Thus, Hoyt relied on Robinson’s integrity and did not believe that Robinson would lie. Hoyt did not see any need to include Robinson’s representation in the

⁸ This deposition testimony has been edited to remove speaking errors. No substantive changes have been made.

written settlement agreement. (Id.) Given the ethical duty for attorneys' to tell the truth, there was no reason to mistrust Robinson's truthfulness. (Id.)

But in hindsight, Hoyt would learn that Robinson "clearly knew something that he didn't want to say." (App. at 71).

III. Steve Hoyt Learns Of Robinson's Fraud And Of PRG's Complete Dominance Over Entolo.

PRG would almost get away with its scheme to mislead Steve Hoyt. But Hoyt would learn that Robinson did know something that he did not want to say. A few months after this release was signed, Bruce Knight contacted Steve Hoyt and informed him of the facts alleged in the *Knight* complaint. Steve Hoyt learned that Robinson and PRG had deliberately schemed to get him to sign a release in favor of PRG, and had knowingly misrepresented the extent to which PRG controlled and dominated Entolo's affairs, siphoned its funds, and caused Entolo's liquidation.

Although not directly relevant to this appeal, discovery in the *Knight* and the Hoyt cases has revealed just how strong Hoyt's piercing claim is.⁹ When PRG

⁹ The district court's decision in PRG's summary judgment motion was based on the legal effect of Robinson's statements (i.e., did Hoyt raise a valid rescission claim based upon Robinson's statements), rather than on the strength of Hoyt's piercing claim. PRG therefore filed its motion for summary judgment before most of the discovery was taken in this matter. Nevertheless, evidence before the district court at the time of PRG's motion demonstrates the strength of Hoyt's piercing claim if this case is remanded. Moreover, United States

purchased Entolo (then Haas) in 1998, it was an independent, thriving Minnesota company, essentially debt free with significant cash reserves and revenue.¹⁰ To refinance a debt offering on which it had defaulted, PRG entered into two loan agreements with GMAC. (App. at 8, 35. See also *Knight* Decision at 3-5). The first was a \$50 million term loan, to be repaid over time like a traditional loan. (App. at 8, 35, n. 4; See also *Knight* Decision at 3-5).¹¹ The second was a \$75 million revolving loan, which allowed PRG to request proceeds and make payments on a revolving basis. (*Id.* at 8, 35. See also *Knight* Decision at 3-5). PRG forced Entolo to sign on as a guarantor to these loans and to pledge all of its assets to secure the loans. (App. at 8. See also *Knight* Decision at 3-5). Entolo's management had no choice in the matter: PRG's counsel signed on Entolo's behalf.¹²

Under these agreements Entolo lost all control over its own assets. It was forced to send *all* receivables and *all* cash directly to PRG; PRG would then

District Court Judge Davis recently rejected PRG's Motion for Summary Judgment in the *Knight* case, based (in part) on further evidence gathered in discovery (the "Knight Decision"). That decision is contained in an addendum to this brief.

¹⁰ See *Knight* Decision at 7.

¹¹ See also Affidavit of Joseph Skaferowski in Support of Defendants' Motion For Summary Judgment (Skaferowski Affidavit) at 4.

¹² See Affidavit of Thomas Boyd In Support of Production Resource Group's Motion for Summary Judgment at Ex. A, 00792, 00910

provide this money to GMAC to pay down the revolving credit loan. (App. 8-9, 100, 110-111, 104; *Knight* Decision at 3-5).¹³ In return, only PRG had the ability to request money from GMAC under the revolving credit loan. (*Id.* 8-9, 159-160; See also *Knight* Decision at 3-5). Without any funds of its own, and without even a bank account, Entolo had to request every penny it needed to pay creditors and employees and to expand and fund business operations from PRG. (*Id.* at 8-9, 57, 100, 110-111, 159-160; See also *Knight* Decision at 3-5). These requests occurred at weekly conference calls convened by PRG with Entolo and PRG's other corporate divisions at which PRG would dole out funds for the week.¹⁴ Entolo rarely received an amount sufficient to fund its operations or pay its creditors.¹⁵ (*Id.* at 110-111, *Knight* Decision at 3-5). PRG thus decided what money to provide for Entolo's operation, which Entolo creditors to pay or not to pay, and generally whether to fund Entolo's business operations. (*Id.* at 100, 110-111; See also *Knight* Decision at 3-5). PRG treated its supposedly separate subsidiary Entolo as just another division, all to the admitted detriment of Entolo.

¹³ See also Affidavit of Francis McCloskey in Support of Defendants' Motion For Summary Judgment (McCloskey Affidavit) at ¶ 6.

¹⁴ See *Knight* Decision at 4-5.

¹⁵ See *Knight* Decision at 5.

Around the time the GMAC agreements were finalized, PRG decided that Entolo no longer fit into its long-term plans. As a result, PRG took Entolo's cash and receivables (as required by the GMAC financing) and refused to provide an equivalent amount of cash in return. (*Knight Decision* at 5). By doing this PRG took \$6 million more from Entolo than Entolo received from PRG during the first few months of the GMAC agreement. (*Knight Decision* at 5). Entolo employees testified that PRG's siphoning of funds had a devastating effect. Entolo's inability to pay its vendors or invest in its business jeopardized and severed customer relations. (*Id.*) Customers fled. It got to the point where executives at Entolo used their personal credit cards to pay company debt in order to maintain relationships with customers and vendors.

The GMAC agreement was only one facet of PRG's complete dominance over Entolo. As PRG executives have admitted under oath, PRG operated Entolo as a mere division of PRG. (App. at 94; See also *Knight Decision* at 5-6). PRG considered Entolo as merely part of one overall PRG economic unit, including various other PRG subsidiaries. (*Knight Decision* at 5-6). Entolo employees routinely worked for other divisions of PRG, and executives with Entolo were interchangeable and had PRG duties. (App. at 166; *Knight Decision* at 5-6). PRG and Entolo tax returns and financial documents were consolidated, and PRG represented to the world that Entolo was a part of PRG. (*Id.*) PRG controlled all

aspects of Entolo's business, including but not limited to hiring, firing, salaries, layoffs, commissions, budgets, projections, etc. (App. at 93-95, 97, 101, 104, 110-111, 146-47, 161-68). PRG's general counsel signed documents for Entolo. Entolo's board of directors did not even function: Entolo's former CEO was surprised to find out that he was a member of its board of directors; he was never invited to or attended a meeting. (App. at 161-62). Most importantly, PRG controlled all aspects of Entolo's money and capital to the detriment of Entolo and to the benefit of PRG. (App. at 105).

By 2002, PRG's siphoning of Entolo's funds had taken its toll. Entolo's reputation with its service providers and clients was impaired as a result of PRG's refusal to pay Entolo's debts. (App. at 169). (As described above, Entolo did not have any money of its own or even any control over its own incoming revenue). In part because of the significant payments due under the Lease, PRG decided in 2002 to liquidate Entolo. (App. at 105-06; 112-113). It terminated most of Entolo's remaining executives. (App. at 105). PRG began an aggressive campaign to collect Entolo's remaining receivables and sell its remaining inventory for PRG's benefit. (App. at 105, 112-114; See also *Knight* Decision 7-8). The only sums PRG provided to Entolo (or its creditors) in return were those directly necessary to pay parties involved in the liquidation. (App. at 105, 112-114; See also *Knight* Decision 7-8). This campaign netted PRG over \$1 million over the last

months of 2002. (App. at 105, 112-114; *Knight* Decision 7-8). At the same time, Entolo's remaining business was ruined and most of its creditors were not paid. (App. at 105-06). Then, in December 2002, Entolo would fail to make its lease payment to Hoyt.

This evidence demonstrates that PRG treated Entolo as a mere instrumentality and did not respect Entolo's existence as a separate legal entity. This evidence is so significant that United States District Court Judge Michael Davis recently rejected PRG's motion for summary judgment in the *Knight* case, holding there are genuine issues of material fact on Mr. Knight's piercing claim. (See Addendum) That case is currently awaiting trial.

IV. The District Court Dismisses Hoyt's Claim To Pierce PRG Corporate Veil.

When Steve Hoyt learned of the facts alleged in the *Knight* complaint, he recognized that Robinson's representations were false, and that PRG and Robinson had planned an elaborate scheme to get him to agree to the release of PRG. This scheme, if successful, would save PRG from a \$10 million liability.

Hoyt subsequently commenced an action against PRG and Entolo, raising two relevant claims:

Count I of the Complaint alleged two separate claims. It first alleged a breach of contract claim against Entolo for breach of the Lease Agreement. It

second alleged a claim against PRG, seeking to hold it liable for Entolo's debts and obligations under a piercing the corporate veil theory. (Complaint at Count I).

Count II of the Complaint sought to rescind the settlement agreement. This count alleged that the agreement was induced by Robinson's fraud. (Id. at Count II).

PRG removed this action to the United States District Court and filed a motion to dismiss, arguing that the statements Hoyt alleged Robinson made were non-actionable legal opinions. United States Magistrate Judge Lebedoff rejected this argument, holding that Robinson's representations "likely amounted to an implied assertion that facts existed justifying PRG's conclusion of law regarding the viability of a veil piercing claim." (App. at 90-92). Relying on such Minnesota cases as Miller v. Osterlund, 191 N.W 919, 919 (Minn. 1929), the Court held that Robinson's assertions contained a sufficient factual thrust to be actionable. (Id.).

The case was eventually remanded to state court. After discovery, PRG moved for summary judgment against Hoyt's rescission claim (Count II) on behalf of all Defendants, and on Count I against PRG only. (App.. at 30, n. 2). PRG argued that the rescission claim failed because Robinson's representations were pure conclusions of law that could not form the basis of a misrepresentation claim, and that Mr. Hoyt did not reasonably rely upon these representations. (App. 41-

51). PRG then argued that because the settlement agreement was valid and enforceable, Count I must be dismissed against PRG due to the release. (App. at 41).

The district court granted PRG's motion. In dismissing the rescission claim, the district court interpreted Mr. Robinson's statements as a representation that "PRG and Entolo are separate corporations that have maintained separate boundaries and formalities, and, therefore, are not vulnerable to piercing claims." (Id. at 17). The district court concluded, however, that this statement was merely a statement of legal opinion:

Mr. Hoyt's question was a legal question . . . In responding, adverse counsel gave a legal opinion. . . .

In giving his legal opinion, (which adds up to "PRG and Entolo are separate corporations that have maintained separate boundaries and formalities and, therefore, are not vulnerable to piercing claims.") defendants' lawyer articulated the position that defendants have held to this day. Plaintiffs have not shown that the opinion was contrary to any trier's findings. . . . Certainly, defense counsel have no legal or ethical duty to concede that their clients' adversaries might have a winning claim.

(Id.) The district court did not even discuss cases such as Miller holding that statements of law are actionable; it instead (erroneously) concluded that statements of law are never actionable. (Id.)

The court went on to conclude alternatively that this rescission claim failed because Mr. Hoyt did not justifiably rely upon Robinson's representation. (Id. at 18.) It held that Mr. Hoyt was not justified "to rely upon opposing counsel in an adversarial negotiating process." (Id. at 18). Mr. Hoyt's reliance was also unjustified because the settlement agreement did not include Robinson's representation. (Id.) It was therefore "unreasonable for Mr. Hoyt to have relied on a statement not important enough to record." (Id.)

Having dismissed Count II, the Court then dismissed Count I's piercing claim as barred by the valid settlement agreement. But the Court went on to (apparently inadvertently) dismiss Court I's breach of contract claim against Entolo as well. It did so even though (as noted earlier) the settlement agreement did not bar claims against Entolo and even though Defendants did not request dismissal of Count I against Entolo.

SUMMARY OF ARGUMENT

The heart of this appeal is Hoyt's attempt to rescind the settlement agreement induced by Robinson's fraud. The evidence below revealed that PRG and its attorney Karl Robinson knew about Entolo's massive debt to Hoyt. They also knew of the allegations in the *Knight* complaint, and that if Steve Hoyt learned about these allegations, PRG faced \$10 million in liability to Hoyt. PRG and Robinson therefore schemed to induce Steve Hoyt into signing a release in PRG's

favor. And when Steve Hoyt expressed skepticism about a release and questioned whether there were any facts that supported a good faith piercing claim against PRG, Robinson abandoned responsible advocacy and represented to Hoyt that there were no issues and that PRG and Entolo were “totally separate.”

By granting PRG’s summary judgment motion the district court not only misunderstood the law and engaged in impermissible fact finding, it ratified and encouraged this fraud. It held that Robinson’s statements amounted to non-actionable “legal conclusions” even in the face of decades of Minnesota law (apparently ignored by the district court) holding that so-called “legal conclusions” can be actionable. Indeed, as United States Magistrate Judge Lebedoff concluded, Robinson’s statements were directly factual statements. The district court also erred in concluding that Hoyt was not justified in relying upon these representations. A long string of Minnesota cases – neither cited to or distinguished by the district court – recognizes that a party can rely upon oral statements inducing a written contract. The district court wrongly approved fraudulent behavior with a legal analysis that simply ignored decades of relevant Minnesota law. Its decision must therefore be reversed.

ARGUMENT

I. This Court Reviews The District Court's Summary Judgment Order *De Novo*.

This is an appeal of the district court's decision to grant summary judgment to Respondents under Minn. R. Civ. P. 56, which is subject to de novo review by this Court. E.g., Fairview Hosp. and Health Care Services v. St. Paul. Fire and Marine Ins. Co., 535 N.W.2d 337, 341 (Minn. 1995). Summary judgment is an extraordinary remedy – a blunt instrument to be used only where it is clearly applicable. Katzner v. Kelleher Construction, 535 N.W.2d 825, 828 (Minn. Ct. App. 1995), aff'd 545 N.W.2d 378 (Minn. 1996). It is not intended as a substitute for trial when there are factual issues to be determined. Naegele Outdoor Adver. Co. of Minneapolis v. City of Lakeville, 532 N.W.2d 249, 252 (Minn. Ct. App. 1995). As such, Hoyt is entitled to a reversal and remand on its claims if: (1) there is any genuine issue of material fact; or (2) the district court erroneously interpreted the law. Id. When determining whether there is a genuine issue of material fact, this Court reviews the evidence in the light most favorable to Hoyt. E.g., City of Willmar v. Short-Elliott-Hendrickson, Inc., 475 N.W.2d 73, 77 (Minn. 1991).

II. The District Court Erroneously Dismissed Count I Against Entolo Because The Settlement Agreement Did Not Bar Claims Against Entolo.

Initially, even Defendants will not seriously contest that the district court erroneously dismissed Hoyt's claims against Entolo. The district court dismissed Count I of the complaint in its entirety because it believed that this claim was barred by the settlement agreement. But the settlement agreement does not purport to bar Hoyt's breach of contract claim against Entolo – just the opposite, it specifically reserved these claims. (App. 195-199).

Indeed, Defendants themselves did not even move that the court dismiss this count against Entolo. Rather, their pleadings only moved that Count I be dismissed as against PRG, and only PRG. See supra at 15. Defendants themselves recognized that there was no basis for dismissing Hoyt's claims against Entolo. The district court's apparently inadvertent dismissal of Hoyt's breach of contract claims against Entolo must be reversed.

III. The District Court Erroneously Dismissed Hoyt's Rescission Claims Because Mr. Hoyt Reasonably Relied Upon A False Statement Of Fact.

The district court's dismissal of Hoyt's rescission claim failed to distinguish – indeed utterly ignored – a multitude of directly contrary decisions from the Supreme Court of Minnesota. As United States District Court Magistrate Judge Lebedoff recognized, the Supreme Court has long recognized that a party can raise a fraud claim based upon statements of law that imply a knowledge of facts

supporting the ultimate legal conclusion. By assuring Steve Hoyt that PRG and Entolo were not vulnerable to a piercing claim, Robinson directly implied he had knowledge of facts that supported his conclusion. And by assuring Mr. Hoyt that PRG and Entolo were “totally separate,” he made – as the district court itself recognized – a direct factual assertion about PRG’s and Entolo’s business operations. The district court did not distinguish, much less even address the long line of Minnesota cases holding essentially identical statements to be actionable.

Mr. Hoyt also justifiably relied upon these representations. As various Supreme Court opinions have held – neither distinguished or even discussed by the district court – a party can justifiably rely upon a oral representation even if it is not included in the final written contract. And as other Supreme Court cases have held (again, not distinguished, not discussed, not even cited by the district court) it is entirely justifiable for a party to rely upon an opposing attorney’s word – even in the context of settlement negotiations. Steve Hoyt therefore justifiably took Robinson at his word when he assured Mr. Hoyt that PRG and Entolo were not vulnerable to a piercing claim because they were “totally separate.”

A. A Reasonable Jury Could Conclude That Mr. Robinson’s Statements To Mr. Hoyt Were Actionable Statements of Fact.

As noted above, when Robinson asked Mr. Hoyt for a release for PRG, Mr. Hoyt said that he had not considered whether he may have a piercing claim against PRG. He then asked Robinson for an representation that there was no good faith

basis for such a claim. Robinson replied with two separate representations. First, he assured Mr. Hoyt that there “isn’t anything” to any piercing claim he might wish to bring. Second, he went beyond that statement to assert that Entolo and PRG were “totally separate” companies. See supra at 7-8. As the district court itself recognized, these representations added up to a representation that “PRG and Entolo are separate corporations that have maintained separate boundaries and formalities and, therefore, are not vulnerable to piercing claims.”

The district court erred in concluding that these representations were merely “legal opinions” and therefore not actionable. Although Robinson couched his first representation as a legal conclusion, a long line of Minnesota cases holds that such legal conclusions are actionable if they imply knowledge of facts that justify the conclusion. This is exactly what Mr. Robinson’s first representation does: it implies a knowledge that there were no facts to justify raising a good-faith piercing claim. And Robinson’s assertion that PRG and Entolo were “totally separate” reasonably communicates that PRG and Entolo were operated as separate and distinct entities.

1. Mr. Robinson’s Representation That There “Isn’t Anything” To A Veil Piercing Theory Is An Actionable Factual Statement.

Mr. Robinson’s representation to Mr. Hoyt that there “isn’t anything” to a piercing claim is an actionable statement under Minnesota law.

Although Minnesota courts did, at one time, hold that abstract statements of law are not actionable,¹⁶ they have just as firmly recognized that a statement of law that implies knowledge of facts that justify the legal statement are actionable. E.g., Miller v. Osterlund, 191 N.W. 919, 919 (Minn. 1923) (“A misrepresentation though involving a matter of law will be held actionable if it amounts to an implied assertion that facts exist that justify the conclusion of law which is expressed.”); Simonson v. BTH Properties, 410 N.W.2d 458, 461 (Minn. 1987); Nodak Oil Co. v. Mobil Oil Corp., 533 F.2d 401, 406-407 (8th Cir. 1976) (“Here the representation concerned the legal effects of facts not disclosed or otherwise known to the recipient; thus, [plaintiff] justifiably interpreted the statement as implying that there were facts which substantiated the statement.”); Restatement (Second) of Torts, § 545 (1977). Put another way, a statement that is a mixture of law and fact is actionable, even if an abstract statement of law is not. Nodak, 533

¹⁶ The origin of the rule that a statement of pure legal opinion is not actionable is based on the “old canard” that everyone is “conclusively presumed to know the law.” See 2 Harper, James & Grey, The Law of Torts, § 7.8, p. 431 n.27 (1988). Modern courts are moving away from this rule, id., and some courts have abandoned the rule entirely, at least where the statement was intentional. See Nelson v. Taff, 499 N.W.2d 685, 688 (Wis. 1993) (abandoning rule that misrepresentations of law are not actionable, at least where the speaker acts knowingly). To the extent there is any force left in this rule, Minnesota courts should hold that any knowing misrepresentation can support a fraud claim. The law should not protect any party that knowingly induces another through fraud and deceit. Miller, 191 N.W. at 919 (“[C]ourts should not be too indulgent of defendants who have made misrepresentations” of which they falsely assert knowledge); See also Restatement (Second) of Torts at § 545.

F.2d at 406-407 (noting the actionable statement in question “constituted a representation of fact, although it may technically have also stated a legal conclusion.”); Colby v. Life Indem. & Inv. Co., 59 N.W. 539, 542 (Minn. 1894).

Mr. Robinson’s statement that there “isn’t anything” to support a good-faith veil piercing claim clearly implied that he had knowledge of facts to support his legal conclusion. Mr. Robinson’s statement assured Steve Hoyt that there were no *facts* to support a veil piercing claim. After all, whether Hoyt could bring a piercing claim against PRG is not an abstract legal question, but one necessarily dependent on the *factual* question of the degree to which PRG participated in and interfered with Entolo’s affairs: did PRG siphon off Entolo’s funds (it did); was Entolo’s board an active, functioning entity (it was not); did Entolo have control over its own money, cash, and receivables (it did not), etc.¹⁷ Robinson’s representation implied that the facts regarding PRG’s and Entolo’s business operations justified his conclusion that there “isn’t anything” to a good-faith piercing claim.

¹⁷ See, e.g., Victoria Elevator Co. of Minneapolis v. Meriden Grain Co., Inc., 283 N.W.2d 509, 512-513 (Minn. 1979) (noting the factual elements necessary to support a claim for piercing the corporate veil); Association of Mill and Elevator Mut. Ins. Co. v. Barzen Intl. Inc., 553 N.W.2d 446, 449-451 (Minn. Ct. App. 1996) (same).

Thus, this first statement fits squarely within the rule that a misrepresentation of law is actionable “if it amounts to an implied assertion that facts exist which justify the conclusion of law which is expressed.” Miller, 191 N.W. at 496; Nodak, 533 F.2d at 406-07 (noting that a statement that concerns “the legal effects of facts not disclosed or otherwise known to the recipient” is actionable). As Magistrate Judge Lebedoff determined when construing the exact same language in PRG’s motion to dismiss, Mr. Robinson’s statement “likely amounted to an implied assertion that facts existed justifying [his] conclusion of law regarding the viability of a veil piercing claim.”¹⁸ This statement therefore falls directly within the core holdings of a long line of Minnesota cases holding

¹⁸ For the same reason, Defendants cannot argue that this first statement is not actionable because it is a mere opinion. Obviously the statement was not couched as a mere statement of opinion. See Restatement (Second) of Torts at § 545, comment d (describing a statement of legal opinion as one where the speaker says, “I think that my title to this land is good, but do not take my word for it; consult your lawyer.”). Instead, it was a simple assertion that implies that the speaker knows facts that justifies the conclusion. Second, even if it was couched as an opinion, both clearly established Minnesota law and the Restatement indicate that a misrepresentation of law that implies facts is actionable, even if it couched as an ultimate legal opinion. See Miller, 191 N.W. at 919; Restatement (Second) of Torts at § 545(2) (“If the misrepresentation of law is only one of opinion as to the legal consequences of facts, the recipient is justified in relying upon it to the same extent as though it were a representation of any other opinion.”) and Restatement (Second) of Torts at § 539(a) (recognizing that a statement of opinion may be reasonably understood to imply statements of fact, and therefore be actionable, if it implies “that the facts known to the maker are not incompatible with his opinion” or that the speaker “knows facts sufficient to justify him in forming it.”).

that assertions of fact are actionable, even if couched in an ultimate legal conclusion.

For example, in Miller, the defendant stated that the insurance company in question had the right to issue insurance in Minnesota. Miller, 191 N.W. at 495. This turned out not to be true, and the plaintiff sued. Id. Defendant, like PRG here, claimed that the statement was a misrepresentation of law and therefore not actionable. The Supreme Court of Minnesota disagreed and reversed, however, and concluded that, although the statement at issue itself was a legal conclusion, it conveys the meaning “that the company has complied with the well-known requirements of our laws” and was therefore able to sell insurance in Minnesota. Id. at 497. Just as in Miller, Robinson represented that there was no valid piercing claim against PRG, which conveys the meaning that there were no facts that would allow a party to raise a good-faith piercing claim.¹⁹

Although they were cited by Hoyt, the district court did not distinguish or even discuss cases such as Miller, and Nodak. Instead, it simply characterized Mr. Robinson’s statements as “legal opinions” and therefore concluded – without any

¹⁹ See also, e.g., Simonson v. BTH Properties, 410 N.W.2d 458, 461 (Minn. Ct. App. 1987); Restatement (Second) of Torts at § 545, comment c (“Even though the language of a representation concerns only legal consequences and is in the form of an expression of opinion, it may, as in the case of any other statement of opinion, carry with it by implication the assertion that the facts known to the maker are not incompatible with his opinion or that he does not know facts that justify him in forming it.”).

support – that they were automatically not actionable. But as Miller, Nodak, Simonson, the Restatement, and cases across the country recognize, simply because a statement is a “legal conclusion” does not immunize the speaker from liability for false representations. Indeed, the district court’s own opinion even recognized that these statements amount to more than a mere “legal opinion.” The court concluded that Mr. Robinson’s statements “adds up to ‘PRG and Entolo are separate corporations that have maintained separate boundaries and formalities and, therefore, are not vulnerable to piercing claims.’” The representation that PRG and Entolo have “maintained separate boundaries and formalities” is not even a legal conclusion that implies facts – it is a direct factual assertion.

Likewise, the district court’s statement that Mr. Robinson had no “legal or ethical duty” to concede that their clients’ adversaries might have a winning claim completely misses the point. Of course Mr. Robinson had no duty to disclose affirmatively the possibility of a piercing claim against PRG, or even to disclose the newly-pending *Knight* litigation. But when Mr. Robinson chose to assure Mr. Hoyt that there was no possibility of bringing a piercing claim against PRG, he had an obligation to speak truthfully. E.g., Safeco Ins. Co. of America v. Dain

Bosworth, Inc., 531 N.W.2d 867 (Minn. App. 1995) (recognizing that a party who chooses to speak must speak truthfully, even in the absence of a duty to speak).²⁰

Finally, to justify its opinion, the district court created an impossible Catch-22 for Hoyt. The court concluded that Hoyt's claim failed because he "had not shown that the [statements were] contrary to any trier's findings." The district court's conclusion is absurd: it would require Hoyt to demonstrate that a jury found that the statements were untrue, but Mr. Hoyt was denied that very opportunity. It should be apparent that this conclusion makes no sense.

2. *Mr. Robinson's Representation That PRG And Entolo Were "Totally Separate" Is Actionable.*

Mr. Robinson's second representation – that Entolo and PRG were "totally separate" – is also an actionable statement. Indeed, unlike the first statement, this assertion does not even contain any representation of law. It is a pure statement of fact about the interrelationship between PRG and Entolo, and false statements of fact are clearly actionable. E.g., *Simonson v. BTH Properties*, 410 N.W.2d 458, 461 (Minn. Ct. App. 1987).

Any piercing claim necessarily depends on the extent to which the parent dominated the subsidiary's affairs, or allowed the subsidiary to operate as a separate and distinct corporate entity. *Victoria Elevator Co. of Minneapolis v.*

²⁰ See also *Klein v. First Edina Nat'l Bank*, 196 N.W.2d 619 (1972); *Newell v. Randall*, 19 N.W. 972 (1884).

Meriden Grain Co., Inc., 283 N.W.2d 509, 512-513 (Minn. 1979) (noting that the first element of any piercing claim is whether the subsidiary was the alter ego of the parent, or if it instead operated as a separate corporation). Here, there is significant evidence in the record that PRG and Entolo were, in fact, not separate: as discussed above, Entolo's board was totally dominated by PRG executives; PRG took all of Entolo's receivables and cash; PRG dominated Entolo's business and decisions; PRG made the decision to close down Entolo against the wishes of Entolo's management. By representing that PRG and Entolo were "totally separate," Robinson made a straightforward (and false) factual representation about the degree of control PRG exercised over Entolo's affairs.

The district court incorrectly concluded that the only factual information this assertion communicated was that Entolo and PRG were formally separate corporations (*i.e.*, both Entolo and PRG were as a matter of form separate entities). At best, this interpretation of Robinson's representation inappropriately resolved a factual issue through a summary judgment motion.

When interpreting the meaning of a statement, a court examines how a reasonable individual would interpret the statement at issue. E.g., Sawyer v. Tildahl, 148 N.W.2d 131, 133-134 (Minn. 1967). It must examine the context of the statement, including the entire conversation. Hexamedics v. Guidant Corp., 2002 WL 246678 (D. Minn. 2002) ("it is important to examine the entire

statement, the context in which that statement was made, and the effect the statement was likely to have in that context.”). If the statement is susceptible to more than one reasonable interpretation, then its meaning is a question for a jury. See id.

Robinson made this statement in response to Hoyt’s question about the viability of a piercing claim. A jury could therefore reasonably interpret his statement that Entolo and PRG were “totally separate” as referring to the factual manner in which PRG and Entolo conducted their business, rather than simply referring to their formal legal status. Indeed, this is really the only reasonable interpretation of these words – why would Mr. Robinson reply to Hoyt’s question by telling him that PRG and Entolo were in form distinct entities? This was a fact that was obvious to both individuals and was not even responsive to Hoyt’s question.

Indeed, the district court’s own opinion recognizes that Mr. Robinson’s statements add up to an assertion that “PRG and Entolo . . . have maintained separate boundaries and formalities and, therefore, are not vulnerable to piercing claims.” (emphasis added). This conclusion directly contradicts the district court’s earlier conclusion that Robinson’s statement only communicated information about Entolo’s and PRG’s formal legal status.

A reasonable jury could therefore interpret Robinson's statement as assuring Mr. Hoyt that, because of the fact that Entolo and PRG were run as separate corporations, they would not be vulnerable to a piercing claim. As a result, this assertion is a clear and actionable factual statement. The district court's decision should therefore be reversed.

B. The District Court Erred In Holding A Reasonable Jury Could Not Conclude That Mr. Hoyt Reasonably Relied Upon Mr. Robinson's Statements.

The district court concluded that Steven Hoyt did not justifiably rely upon Mr. Robinson's misrepresentations for two reasons. First, it concluded that Mr. Hoyt was unreasonable in relying upon the statements of an opposing attorney in a negotiation setting. Second, the district court concluded that Mr. Hoyt was unreasonable because he did not commit Mr. Robinson's representation to writing. Both conclusions are directly contradicted by clearly applicable governing precedent from the Supreme Court of Minnesota.

Initially, there is no serious dispute that a reasonable jury could conclude that Mr. Hoyt actually relied upon Mr. Robinson's representations. Mr. Hoyt testified that he agreed to the release in PRG's favor because Karl Robinson told him that there was no basis to raise a good faith piercing claim against PRG. He accepted this representation because, as an attorney himself, he understood that other attorneys had an ethical obligation to tell the truth – even to opposing parties.

He did not believe that an attorney would openly lie, particularly in the collegial Twin Cities legal community. Thus, Respondents will not dispute that Mr. Hoyt actually relied upon Mr. Robinson's statements in agreeing to PRG's release.²¹

The district court, instead, concluded that Mr. Hoyt's unjustifiably relied on an opposing attorney's integrity and truthfulness. Just as before, the district court did not distinguish or even discuss the various Supreme Court decisions directly contradicting this conclusion.

In order to state successfully a claim for fraudulent rescission, a party must demonstrate that he or she justifiably relied upon the alleged fraudulent statement. E.g., Davis v. Re-Trac Mfg. Corp., 149 N.W.2d 37, 38-39 (Minn. 1967); Taylor v. Sheehan, 415 N.W.2d 575 (Minn. 1989). See also Field v. Mans, 516 U.S. 59 (1995); Restatement (Second) of Torts at § 537.²²

Generally, the question of justifiable reliance is a question for a jury. E.g., Nicollet Restoration, Inc. v. City of St. Paul, 533 N.W.2d 845, 848 (Minn. 1995); Placke v. White-Price Co., 228 N.W. 554, 555 (Minn. 1930) (noting that whether

²¹ See, e.g., 9 Stuart M. Speiser, et. al., The American Law of Torts § 32. 49 (1992) (recognizing that "actual reliance" in a misrepresentation claim only requires a showing that the party acted or refrained from acting based upon the alleged misrepresentation.)

²² As both the United States Supreme Court and the authors of the Restatement have indicated, demonstrating "justifiable" reliance is much simpler than demonstrating "reasonable" reliance. E.g., Field v. Mans, 516 U.S. 59 (1995); Restatement (Second) of Torts at § 537.

plaintiff, an experienced businessman, was justified in relying upon the defendant's representations was "nevertheless [a] question[] for the jury."). And Minnesota courts have long recognized that a party can justifiably rely upon a representation unless its falsity is known or is obvious to him or her. E.g., Speiss v. Brandt, 41 N.W.2d 561, 566 (Minn. 1950) ("[I]t is the well-established rule that in a business transaction the recipient of a fraudulent misrepresentation . . . is justified in relying on its truth, although he might have ascertained its falsity had he made an investigation."); Nave v. Dovolos, 395 N.W.2d 393, 398 (Minn. Ct. App. 1986); First Nat'l Bank v. Halo Invs., 394 N.W.2d 158, 160 (Minn. Ct. App. 1986); Erickson v. Midgarden, 31 N.W.2d 918, 191 (Minn. 1948); Restatement (Second) of Torts, § 540 (1977) ("The recipient of a fraudulent misrepresentation is justified in relying on its truth, although he might have ascertained the falsity of the representation had he made an investigation."). Thus, clearly established Minnesota law unambiguously holds that Mr. Hoyt was entitled to rely upon Mr. Robinson's statement.²³

²³ See also e.g., Speiser, The American Law of Torts at § 32:55 ("It is a fundamental and basic rule in the American law of fraud and deceit that the injured person—the recipient of the representation or representatee – has a right to rely, that there is justifiable reliance, upon the representation."); Dan Dobbs, The Law of Torts, § 475 at p. 1360-61 (noting that a party's reliance on a representation is reasonable unless "plaintiff is on notice that the statement is not to be trusted or knows the statement to be false.").

The district court first disregarded this long-standing precedent because Mr. Robinson was an attorney engaged in adversarial negotiations. But this conclusion ignores decades of Minnesota Supreme Court precedent, which hold that “an attorney who makes affirmative misrepresentations to an adversary . . . may be liable for fraud.” L & H Airco, Inc. v. Rapistan Corp., 446 N.W.2d 372, 380 (Minn. 1989) (citing Hoppe v. Klapperisch, 28 N.W.2d 780 (Minn. 1947)). See also McDonald v. Steward, 182 N.W.2d 437, 440 (Minn. 1970); Farmer v. Crosby, 45 N.W.866, 866 (Minn. 1890); Hugher v. Consol – Pennsylvania Coal Co., 945 F.2d 594 (3rd Cir. 1991); Matsuura v. E.I. du Pont de Nemours and Co., 73 P.3d 687 (Hawaii 2003). The district court did not address these various Minnesota decisions holding that a party can raise a fraud claim (and therefore justifiably rely) upon the statements of an opposing attorney in a negotiation setting.

The district court’s reasoning on this point is particularly obtuse, because parties rely upon representations by an opposing party constantly. In many, perhaps most, settlement negotiations, an opposing party will make various representations or warranties to the other party. Courts regularly enforce these warranties and representations even though they were received during an arms-length negotiation process.

The Restatement (Second) of Torts recognizes as much. It makes clear that a party justifiably relies upon a statement by an adverse party. See Restatement (Second) of Torts at § 541A.²⁴ Even in the case of representations made by an adverse party, “the recipient [of a representation] is entitled to assume that a representation of fact . . . is honestly made, unless its falsity is obvious to his senses.” Id. at Comment *a*. The same holds in the case of an opinion that, as here, may “reasonably be interpreted to include an implied assertion of the existence or non-existence of facts.” See Restatement (Second) of Torts at § 542, comment *b*.

In fact, Mr. Robinson’s status as an attorney makes Mr. Hoyt’s reliance more justifiable, not less. After all, lawyers have a professional obligation not to make false statements, even to adversaries. Minn. R. Prof. Conduct § 4.1 (“In the course of representing a client a lawyer shall not knowingly make a false statement of fact or law.”). See also Matsuura, 73 P.3d at 687-692 (recognizing that an attorney’s ethical duty justifies reliance on opposing counsel’s statements). And Mr. Hoyt relied upon this statement because Mr. Robinson was an attorney, not in spite of that fact. See supra at p. 7-8 (testimony of Steve Hoyt stating “this is a small community [of lawyers]. We – we tend to believe what . . . especially what other lawyers say.”). Surely this Court should not condone a rule holding that a

²⁴ “The recipient of a fraudulent misrepresentation of fact may be justified in relying upon it although he believes the maker to have an adverse interest in the transaction.” Restatement (Second) of Torts at § 541A.

party is unjustified when he or she relies upon an attorney's truthfulness, regardless of the context.

The district court's conclusion that Mr. Hoyt unreasonably relied upon Mr. Robinson's statements because no "competent lawyer would undercut his client by giving an assessment of the client's possible weakness, if any" utterly avoids the issue. Obviously, Mr. Robinson had no duty to disclose affirmatively Hoyt's potential piercing claim. But once he decided to answer the question, Mr. Robinson had a duty to speak truthfully. See supra at n. 19. See, also e.g., Minn. R. Prof. Cond. 4.1; L & H Airco, Inc., 446 N.W.2d at 380. Zealous advocacy, after all, does not contemplate intentional or even negligent lies. E.g., Minn. R. Prof. Cond. 4.1. Robinson could have remained silent and lawfully disclosed nothing. But by choosing to respond to Mr. Hoyt's question falsely, Mr. Robinson went beyond the bounds of responsible advocacy, and opened the matter to a fraudulent rescission claim.

The district court second decided to disregard the rule set out in Speiss, Nave, and the other authorities cited above because of Mr. Hoyt's business experience. But again, this conclusion is directly contrary to the Minnesota Supreme Court's well-established precedent. Minnesota courts regularly hold that an experienced businessman or woman is entitled to rely on statements by an opposing party to a transaction. E.g., Placke v. White-Price, Co., 228 N.W. 554,

555 (Minn. 1930).²⁵ The only exception to this rule is where an individual's business experience makes the truth or falsity of the representation apparent. E.g., Berg v. Xerxes-Southdale Office Bldg. Co., 290 N.W.2d 612, 616 (Minn. 1980).

This is simply an extension of the rule mentioned earlier that a party justifiably relies upon a representation "unless the plaintiff is on notice that the statement is not to be trusted or knows the statement to be false." E.g., Dan Dobbs, The Law of Torts, Vol. 2 p. 1359 (2001).

The district court third ignored the Supreme Court's decision in cases such as Speiss and Nave because Mr. Hoyt did not include Mr. Robinson's representation in the settlement agreement, even though it was his general practice to include all material terms of an agreement in the agreement. But – yet again – this conclusion is directly contradicted by controlling precedent from the Minnesota Supreme Court.

Minnesota courts – along with the vast majority of common law courts – recognize that a fraudulent inducement can void a contract, even though the misrepresentation was not included as a written contractual condition. E.g., Ganley Bros. v. Butler Bros. Bldg. Co., 212 N.W. 602 (Minn. 1927); Clements Auto Co. v. Service Bureau Corp., 444 F.2d 169, 177 (8th Cir. 1971) Martin v.

²⁵ Kempf v. Ranger, 132 Minn. 64, 155 N. W. 1059; Kraus v. National Bank of Commerce, 140 Minn. 108, 167 N. W. 353; Old Colony Life Ins. Co. v. Moeglein, 165 Minn. 117, 205 N. W. 885.

Guarantee Reserve Life Ins. Co., 155 N.W.2d 744, 749 (Minn. 1968) Financial Timing Publications, Inc. v. Compugraphic Corp., 893 F.2d 936, 944 (8th Cir.(Minn.) Jan 09, 1990); Gopher Oil Co. Inc. v. Union Oil Co. of California, 955 F.2d 519, 526 (8th Cir. 1992).²⁶

For example, in Ganley, the plaintiff alleged that a contract had been induced by fraud. The fraudulent representation was not mentioned in the contract, and the contract even included an integration clause stating that the plaintiff was “not relying upon any statement made by” the defendant. Nevertheless, the Supreme Court held that the plaintiff could proceed with a rescission claim. It was irrelevant that the contract did not include the representation at issue: “A contract resting on [oral] fraud, when under attack, cannot stand. The fact that the contract has been reduced to writing does not change the rule.” Ganley, 212 N.W. at 602-03. The representation that sought to absolve the defendant of fraud was likewise void as against public policy. A party, after all, cannot seek to absolve itself of fraud. Id. at 603.

²⁶ See also Peggy Rose Revocable Trust v. Eppich, 640 N.W.2d 601, 607 (Minn. Mar 21, 2002) (recognizing continuing authority of Ganley). Wisconsin Mystic Iceless Refrigerator, Inc. v. Minnesota Mystic Iceless Refrigerator, Inc., 180 Minn. 334, 230 N.W. 796 (1930); Roseberry v. Hart-Parr Co., 145 Minn. 142, 176 N.W. 175 (1920); Edward Thompson Co. v. Schroeder, 131 Minn. 125, 154 N.W. 792 (1915); 54 Minn. L. Rev. 846, 850 (1970); cf., Martin v. Guarantee Reserve Life Insurance Co., 279 Minn. 129, 155 N.W.2d 744 (1968).

The mere fact that Mr. Hoyt usually reduced most representations to writing does not change the result. First of all, as noted above, justifiable reliance is a jury question, not susceptible for resolution on summary judgment. And as cases such as Ganley indicate, it is entirely justifiable for a party to rely upon an oral representation by another party. The district court did not cite a single case for the proposition that a party is not justified in relying upon an oral representation simply because they usually reduce such representations to writing. And various Minnesota cases include directly opposite holdings. There is, therefore, at minimum a jury question on whether Steve Hoyt's reliance was justified.

Just as importantly, evidence such as this of habit, common practice, and reasonable prudence (such as a practice of reducing representations to writing) may be relevant to a negligent misrepresentation claim, where contributory negligence is a defense. See Florenzano v. Olson, 387 N.W.2d 168, 175-76 (Minn. 1986) . But it is not relevant to a fraud claim – where contributory negligence is no defense. See id. at 176, n.7 (“We also consider it bad policy to permit an intentional tortfeasor the defense of comparative negligence merely because he or she chooses a gullible or foolish victim.”).²⁷ The reason for this difference is because in a negligent misrepresentation claim, a plaintiff should not recover if he

²⁷ “[I]f the representations were willfully false, it does not lie in the vendor's mouth to say that the vendee ought not to have relied upon them.” Wilder v. DeCou, 18 Minn. 470 (1871). Chamberlin v. Fuller, 59 Vt. 247, 256 (1887).

or she is more careless than the allegedly negligent defendants. See id. at 175-76. But in a fraud case where the defendant is alleged to have acted maliciously and with bad intent, then the plaintiff's mere negligence will not mitigate the defendant's malicious behavior. Id. Thus, even if 20-20 hindsight suggests that Steve Hoyt should have reduced Robinson's representations to writing, that is no defense to Robinson's fraud.

Gangley – and the multitude of cases across the country that recognize the same doctrine – directly apply here. Just as in those cases, Mr. Hoyt was misled by a representation that was not included in the final contract. Just as in Gangley, the district court dismissed the rescission claim because the misrepresentation was not included in the final written contract. And just as in Gangley, the district court erred and should be reversed.

IV. If Count II Is Reversed, Then The District Court's Dismissal Of Count I Against PRG Must Also Be Reversed.

Because Hoyt's attempt to rescind the settlement agreement failed in the district court's eyes, it concluded that Hoyt's piercing claim against PRG (contained in Count I) was barred by the same agreement. The district court dismissed Count I against PRG on this basis. It therefore follows automatically that if the district court's dismissal of Count II was erroneous, then its dismissal of Count I against PRG was also erroneous. If the Court decides to reverse the

district court's dismissal of Count II, then it should also reverse the district court's reversal of Count I against PRG as well.

V. The District Court's Dismissal Of Hoyt's Remaining Claims With Prejudice Should Be Reversed.

Finally, after the district court's issued its summary judgment order, Hoyt requested that the Court dismiss its remaining claims without prejudice pursuant to Minn. R. Civ. P. 41(a). The district court did dismiss these claims, but did so with prejudice. This determination was also erroneous.

Under Minn. R. Civ. P. 41(a), where a plaintiff seeks to dismiss voluntarily claims, that dismissal is without prejudice. See Minn. R. Civ. P. 41(a) (noting that the dismissal of claims by a plaintiff is "without prejudice.") There is no question that Hoyt's dismissal of these claims was done on its own volition. The district court erred by dismissing these claims with prejudice. Id. Hoyt therefore requests that the district court's order be reversed, and that it be instructed to dismiss these claims without prejudice.

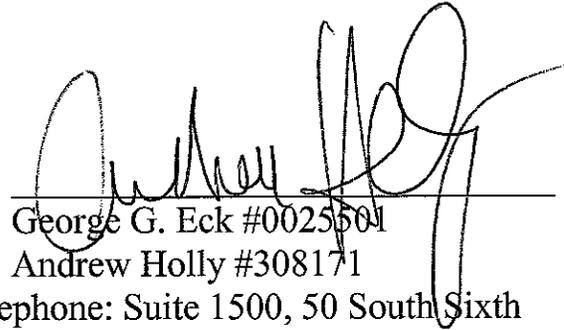
CONCLUSION

Hoyt therefore request that the district court's decision be reversed, and the case be remanded for further proceedings.

Dated: September 28, 2005

DORSEY & WHITNEY LLP

By

A handwritten signature in black ink, appearing to read "George G. Eck", is written over a horizontal line. The signature is stylized and cursive.

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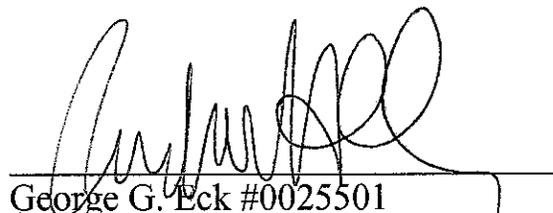
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CERTIFICATION OF BRIEF LENGTH

The Undersigned hereby certifies that this brief conforms to the requirements of Minn. R. Civ. App. P. 132.01, subs. 1 and 3, for a brief produced with Times New Roman 14 point font. The length of this brief is 42 pages, 9908 words, and 886 lines. The brief was prepared using Microsoft Word 20000 version of word processing software.

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ADDENDUM

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UNITED STATES DISTRICT COURT
DISTRICT OF MINNESOTA

BRUCE D. KNIGHT and
NORTHWAY EXHIBIT MARKETING, INC.,
d/b/a Lincoln Studios Midwest and
Vertex Exhibits,

Plaintiffs,

v.

MEMORANDUM OF LAW & ORDER
Civil File No. 03-6443 (MJD/JGL)

PRODUCTION RESOURCE GROUP, LLC,
HAAS MULTIPLES ENVIRONMENTAL
MARKETING & DESIGN, INC., d/b/a
Entolo-Minneapolis, and ENTOLO, INC.,

Defendants.

George G. Eck, Andrew J. Holly, and Kimberly A. Fuhrman, Dorsey & Whitney,
Counsel for Plaintiffs.

Thomas H. Boyd and Karl E. Robinson, Winthrop & Weinstine, and Randall L.
Sarosdy, Akin Gump Strauss Hauer & Feld, Counsel for Defendant Production
Resource Group, LLC.

I. INTRODUCTION

This matter is before the Court on Defendant Production Resource Group,
LLC's Motion for Summary Judgment. [Docket No. 44] The Court heard oral
argument on May 20, 2005.

II. FACTUAL BACKGROUND

A. Northway Purchase

In 1982, Plaintiff Bruce D. Knight incorporated Plaintiff Northway Exhibit Marketing, Inc. ("Northway"), which designed and created trade show displays. Knight Dep. at 10:20-22; 48:2-17. On August 2, 1999, after negotiations with Thomas Van Hercke, an employee of Production Resource Group LLC ("PRG"), Knight agreed to sell his business to Haas Multiples Environmental Marketing and Design, Inc. ("Haas"). Id. at 22:21-23:24, 88:8-17; Exhs. 2, 5 to Boyd Aff. Haas is a Minnesota corporation involved in the retail and trade show business. PRG, a limited liability company organized under Delaware law that provides goods and services to the entertainment industry, had acquired Haas on November 30, 1998. Exhs. 15 & 16 to Boyd Aff. Entolo, Inc., is a Delaware corporation, incorporated on December 21, 2001. Exh. 30 to Boyd Aff. Haas was Entolo's principal shareholder. Exh. 32 to Boyd Aff.

The Acquisition Agreement between Haas and Northway provided that in exchange for all of Northway's assets, Haas would provide Knight a cash payment of between \$500,000 and \$750,000 in 2002 (the "Earn-Out Payment"). ¶ 1.5 Exh. 2 to Boyd Aff. Additionally, Haas hired Knight under an Employment Agreement. Exh. 5 to Boyd Aff. Both agreements were fully integrated contracts. Exh. 2 ¶ 14.7 to Boyd Aff.; Exh. 5 ¶ 7.1 to Boyd Aff. PRG was not a party to either

contract, although it was explicitly named as a party to another contract executed on August 2, 1999, involving Haas's assumption of Northway's lease. Assignment, Assumption and Amendment of Net Lease, Exh. 6 to Boyd Aff.

On January 17, 2002, the Acquisition Agreement was amended so that the Earn-Out Payment was set at \$625,000. This change was reflected in the First Amendment to the Acquisition Agreement, to which Knight, Northway, Haas, and Haas's successor, Entolo, were parties. Exh. 10 to Boyd Aff. PRG was not listed as a party to the Amendment. According to Knight, before he signed the Amendment, the President and CEO of Entolo, Thomas Vogt, told him that PRG would place the debt to Knight on its books. Knight Dep. at 193:16-95:5. Vogt relied on instruction from PRG Chief Financial Officer, Kevin Baxley, to make that statement. Vogt Dep. at 92:2-93:3.

B. GMAC Financing Agreement

When PRG acquired Haas, Haas became a party to PRG's Bank of New York loan and all of Haas's assets were pledged as collateral under that agreement. Baxley Dep. at 63:13-64:6; Exh. 12 to Boyd Aff. Exh. 40 to Boyd Aff. In February 2001, PRG refinanced the Bank of New York loan by entering into two loan agreements with GMAC Business Credit, a \$50 million term loan and approximately \$70 million in revolving credit. Revolving Loan and Security Agreement, Exh. 36 to Boyd Aff.; Skaferowsky Aff. ¶ 4, Exh. 38 to Boyd Aff.; Exh.

3 to Skaferowsky Dep., Exh. D to Fuhrman Aff; Baxley Decl. ¶ 16, Exh. 40 to Boyd Aff.

Haas, and later Entolo, were both parties to the GMAC agreement and pledged their assets to secure the funding of the revolving loan. Baxley Dep. at 44:24-45:16, 50, Exh. E to Fuhrman Aff. Under the agreement, Haas and Entolo sent all of their receivables and creditor payments to a PRG “lockbox” bank account. Revolving Loan and Security Agreement ¶ 4.15(h). See also Schreyer-Pederson Dep. at 69:20-70:25, Exh. J to Fuhrman Aff.; Baxley Dep. at 97:3-98:22. GMAC swept the cash out of the PRG account at the end of every business day. Baxley Dep. at 97:5-9. Although Haas and Entolo were required to place all of their cash into the lockbox bank account, they did not have the ability to request loan proceeds from GMAC. Arrett Dep. at 23:14-26:25, Exh. C to Fuhrman Aff.; Grow Dep. at 22:10-24:24, Exh. F to Fuhrman Aff. Instead, they had to request a disbursement from PRG.

Each week, PRG would hold a weekly telephone conference that included representatives of various PRG divisions and subsidiaries. Hansen Dep. at 23:22-27:21, Exh. H to Fuhrman Aff.; Arrett Dep. at 38:25-44:25. Before the meeting, PRG had already determined the amount it would borrow under the GMAC revolving credit agreement, and at the meeting, the participants would decide how to allocate that amount among PRG’s divisions and subsidiaries. Id.; Hansen

Dep. at 32:8-23, 34:1-35:22.

Haas did not receive enough funds to run its business, and some suppliers refused to provide services to it. Arrett Dep. at 46:23-48:1; Van Hercke Dep. at 47:12-19, 61:7-24, 73:13-23. Overall, from January 2001 through April 2001, PRG collected approximately \$6 million more than it paid Haas in GMAC funds. Nicholson Aff. ¶ 13; Nicholson Report at 3. PRG then returned \$1.7 million of the money received from Haas by December 2003, but from October 2002 through February 2003, PRG received an additional \$1.7 million from Haas. Nicholson Aff. ¶ 16; Nicholson Report at 3.

According to PRG's comptroller, PRG managed its subsidiaries and its divisions in the same manner. Hansen Dep. at 57:9-13, Exh. H to Fuhrman Aff. Additionally, Haas and PRG were represented to the public as a single corporate entity. Hovis Dep. at 151:21-52:7, Exh. G to Fuhrman Aff. Employees from one subsidiary or division of PRG sometimes worked for other divisions of PRG. Arrett Dep. at 113:14-16:13, Exh. C to Fuhrman Aff. Haas's and Entolo's financial statements were consolidated with PRG's. PRG and Subsidiaries Consolidated Financial Statements, Exh. U to Fuhrman Aff. PRG management regularly directed the firing of Haas and Entolo employees, against the wishes of Haas's and Entolo's management. Schreyer-Pederson Dep. at 78:5-79:22; Van Hercke Dep. at 78:6-80:25; Grow Dep. at 38:14-39:3. PRG controlled Haas's and Entolo's

budgets, salaries, layoffs, significant expenditures, and revenue goals. Leistikow Dep. at 38:24-40:23, 84:18-85:19, Exh. I to Fuhrman Dep.; Van Hercke Dep. at 71:15-73:4, 95:14-96:15; Vogt Dep. at 160:4-62:15.; Arrett Dep. at 62:16-65:24; Knight Dep. at 157:11-22, Exh. A to Fuhrman Aff. Entolo had no shareholder meetings, had no board meetings, and provided no dividends. Arrett Dep. at 86:20-87:23. Haas never held any board meetings. Van Hercke Dep. at 48:19-51:1; Grow Dep. at 53:15-25. Van Hercke claimed to not even know that he was a member of the Haas board of directors because he was never invited to a board meeting. Van Hercke Dep. at 48:19-51:1.

C. Earn-Out Payment

Knight's Earn-Out Payment of \$625,000 was due on October 19, 2002. Exh. 10 to Boyd Aff. In September 2002, Judy Arrett, Haas's controller, informed Knight that PRG would deposit the money in Knight's account on that date. Knight Dep. at 202:7-03:14, Exh. 1 to Boyd Aff. However, on October 19, Knight did not receive his Earn-Out Payment. John Hovis, of PRG, told Knight that Jere Harris of PRG would be "reaching out" to present a payment plan. *Id.* at 207:22-25. However, Harris then told Knight that he would not pay him and that he might have to sue in order to recover his money. *Id.* at 208:6-16. PRG then refused to allow any disbursement to Haas to pay Knight, against the wishes of Haas's management. Arrett Dep. at 15:3-20; Leistikow Dep. at 121:9-21, Exh. I to

Fuhrman Aff.

D. Liquidation of Haas/Entolo

In 1998, when PRG acquired Haas, Haas had \$38 million in revenue, \$1 million in cash, and net earnings of twelve percent. Van Hercke Dep. at 16:10-19:7. In December 2001, PRG incorporated Entolo, Inc. Entolo was Haas's successor, and Haas owned a majority of Entolo's shares. According to PRG's expert, Haas and Entolo both experienced a decline in business due to September 11, 2001, and weakening business conditions in the trade show and retail business. McCloskey Report at 10-11, Exh. 44 to Boyd Aff.

During the summer of 2002, PRG directed Haas and Entolo to embark on an aggressive collection of their receivables. Schreyer-Pederson Aff. ¶¶ 8-9, Exh. 2 to Schreyer-Pederson Dep., Exh. J to Fuhrman Aff. The collected funds were sent to PRG's bank account. *Id.* PRG did not allow Haas or Entolo to pay their vendors, except for individuals necessary to the liquidation process. Schreyer-Pederson Aff. ¶¶ 9-10. While liquidating Haas and Entolo, from October 31, 2002, at which time Entolo was insolvent, to February 28, 2003, PRG collected \$1.7 million from Haas Nicholson Aff. ¶¶ 15-16, Exh. N to Fuhrman Aff.; Nicholson Report at 3, Exh. M to Fuhrman Aff.; Schreyer-Pederson Aff. ¶ 10; Arrett Dep. at 81-82. During that time, PRG provided severance packages to Haas and Entolo personnel Vogt and Arrett. Email Regarding Vogt 12/02 Severance, Exh. T to Fuhrman Aff; Arrett

Dep. at 10:2-8, 16:6-14. Haas and Entolo are now insolvent and are no longer operating.

E. Settlement Agreement and Current Action

In December 2002, Knight and Northway sued Haas, Entolo, and PRG in Hennepin County District Court. The district court ordered Knight, Northway, Haas, and Entolo into arbitration and stayed the litigation against PRG. In 2003, Knight, Haas, and Entolo entered into a stipulated arbitration award. Exh. 42 to Boyd Aff. Pursuant to that agreement, the court entered judgment against Haas and Entolo, jointly and severally, in the amount of \$750,000 for their breach of the Acquisition and Employment Agreements. *Id.* PRG subsequently removed the remaining case to this Court. In their First Amended Complaint [Docket No. 19], Plaintiffs allege Count I, Breach of Contract/Piercing PRG's Corporate Veil; and Count II, Fraudulent Transfer. PRG now moves for summary judgment on both claims against it.

III. DISCUSSION

A. Summary Judgment Standard

Summary judgment is appropriate if, viewing all facts in the light most favorable to the non-moving party, there is no genuine issue as to any material fact, and the moving party is entitled to judgment as a matter of law. Fed. R. Civ. P. 56(c); Celotex Corp. v. Catrett, 477 U.S. 317, 322-23 (1986). The party seeking

summary judgment bears the burden of showing that there is no disputed issue of material fact. Celotex, 477 U.S. at 323. Summary judgment is only appropriate when “there is no dispute of fact and where there exists only one conclusion.” Crawford v. Runyon, 37 F.3d 1338, 1341 (8th Cir. 1994) (citation omitted).

B. Minnesota Fraudulent Transfer Act

1. Requirements of the Minnesota Fraudulent Transfer Act

The Minnesota Fraudulent Transfer Act, Minn. Stat. §§ 513.41-51 (“MFTA”), prevents debtors from placing assets that are available to pay debts beyond their creditors’ reach. In re Butler, 552 N.W.2d 226, 232 (Minn. 1996). A “threshold question” under the MFTA is “whether a particular event qualifies as a ‘transfer’ within the purview of the Act. ‘Transfer’ means every mode, direct or indirect, absolute or conditional, voluntary or involuntary, 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.” Id. at 231-32 (quoting Minn. Stat. § 513.41(12)). In order to determine whether a “transfer” occurred, the Court must first determine whether the property at issue constituted “assets” under the definition provided in the MFTA. In re Wintz Cos., 230 B.R. 848, 860 (B.A.P. 8th Cir. 1999).

2. Whether the Property at Issue Constitutes Assets

Plaintiffs assert that PRG negotiated the GMAC financing agreement so that

Haas and Entolo took on PRG's debt and surrendered all of their receivables in order to service PRG's debt. Then PRG took assets from Entolo and Haas and did not allocate sufficient loan proceeds to them.

The property alleged to have be fraudulently transferred to PRG, Haas's and Entolo's assets, was encumbered by GMAC's valid lien and enforceable security interest; therefore, the property did not constitute "assets" under the statute. Under the MFTA, "[a]sset' means property of a debtor, but the term does not include: (i) property to the extent it is encumbered by a valid lien . . ." Minn. Stat. § 513.41(2). A lien is "a charge against or an interest in property to secure payment of a debt or performance of an obligation, and includes a security interest created by agreement." § 513.41(8).

Assets encumbered by a valid lien are not "assets" under the statute, and, thus, no "transfer" of those assets can occur under the MFTA. In re Wintz Cos., 230 B.R. 848, 860 (B.A.P. 8th Cir. 1999); Lorenz Bus Serv., Inc. v. Richfield Bus Co., No. C2-02-56, 2002 WL 2005468, at *4 (Minn. Ct. App. Sept. 3, 2002) (unpublished). At all relevant times, GMAC had a lawful security interest and held a valid lien on all property transferred by Haas and Entolo. Thus, that property cannot constitute an asset, and there can be no transfer to any party under the MFTA.

3. Whether the GMAC Agreement Itself Constituted a Fraudulent Transfer

Plaintiffs also allege that the GMAC Agreement itself was a fraudulent transfer. They note that the decision to guarantee a loan agreement can constitute a “transfer” of assets under the MFTA. Minn. Stat. § 513.41(12). Plaintiffs’ theory that the GMAC lien itself was fraudulent was not pled in their First Amended Complaint.

In order to challenge the validity of the lien, Plaintiffs must initiate an action against GMAC itself. United States v. Perry, 360 F.3d 519, 525 n.4 (6th Cir. 2004) (noting that a lienholder has a due process right to notice of a proceeding that would deprive it of its interest); In re Henline, 242 B.R. 459, 465 (Bkrtcy. D. Minn. 1999) (“[A] lien is an interest in property protected by the due process guarantees of . . . the United States Constitution. Threshold constitutional due process guaranties require the affected lienholder’s participation in a proceeding that results in the taking of the lienholder’s interest in property.”). Like the lender in Lorenz Bus Service, GMAC “is not a party to the lawsuit and has never been given an opportunity to defend the implication that it has acted improperly or fraudulently or to explain the commercial reasonableness of its actions,” and GMAC was not a debtor to PRG and did not transfer the collateral to an insider at PRG. Lorenz Bus Serv., 2002 WL 2005468, at *5-*6. The Court cannot set aside GMAC’s lien when GMAC is not a party to this lawsuit. Additionally, there is

insufficient evidence in the record to support a finding that the execution of the GMAC agreement was, itself, a fraudulent transfer.

4. Whether Haas and Entolo Transferred Assets Directly to GMAC

Plaintiffs also argue that Haas and Entolo did not transfer their receivables directly to GMAC. Rather, they transferred their receivables to PRG's account, and they were then transferred to GMAC. Plaintiffs assert that, because PRG did not have a valid lien on Haas's or Entolo's receivables, this first "transfer" did not occur pursuant to a valid lien, and thus it was a "transfer" of "assets" under the MFTA.

The record does not support the proposition that the funds deposited into the account actually went to PRG instead of to GMAC. Under the GMAC Agreement, Haas's and Entolo's receivables became GMAC's property once they entered the locked account. GMAC Revolving Loan and Security Agreement § 4.15(h). Even under Plaintiffs' version of the facts, PRG was a "mere conduit" in connection with the transfer of the funds. See In re Circuit Alliance, Inc., 228 B.R. 225, 232-33 (Bankr. D. Minn. 1998) (noting that, under bankruptcy law, there is no "transfer" when the debtor's funds enter the possession of a "mere conduit," who does not have a discretionary legal right to dispose of the funds but, instead, merely holds the funds in trust for the party that actually receives the legal interest). In this case, PRG fits the definition of a mere conduit: when it received

Haas's and Entolo's funds in the locked account, it "was acting solely as an intermediary, without a legal interest in the funds and certainly without authority to direct them to [its] own uses." Id. at 233 (footnote omitted). In any case, whether the funds went first to GMAC or to PRG, the funds were encumbered by GMAC's valid lien and, thus, were not assets under the MFTA, and transfers to any party are not covered by the MFTA. In re Wintz Cos., 230 B.R. 848, 860 (B.A.P. 8th Cir. 1999).

Because there was no transfer of assets, Plaintiffs' MFTA claim cannot survive. Defendants' motion for summary judgment is granted as to Count II.

C. Piercing the Corporate Veil

1. Standard for Piercing the Corporate Veil

The decision of whether to pierce the corporate veil is determined under state law. Stoebner v. Lingenfelter, 115 F.3d 576, 579 (8th Cir. 1997). In this case, the parties agree that Minnesota law applies, and that Delaware law is substantially similar.

Generally, absent fraud or bad faith, a corporation will not be held liable for the acts of its subsidiaries. There is a presumption of separateness the plaintiff must overcome to establish liability by showing that the parent is employing the subsidiary to perpetrate a fraud and that this was the proximate cause of the plaintiff's injury.

Ass'n of Mill & Elevator Mut. Ins. Co. v. Barzen Int'l, Inc., 553 N.W.2d 446, 449 (Minn. Ct. App. 1996) (citation omitted). When deciding whether to pierce the

corporate veil, the Court must

1) analyze whether the corporation functioned as the mere instrumentality of the principals a party is attempting to reach by piercing the corporate veil, and 2) determine whether injustice or fundamental unfairness would occur if the corporate veil were left intact.

Stoebner, 115 F.3d at 579 (citing, e.g., Victoria Elevator Co. v. Meriden Grain Co.,

283 N.W.2d 509, 512 (Minn. 1979)). In determining the first prong, the Court

examines factors such as

insufficient capitalization for purposes of corporate undertaking, failure to observe corporate formalities, nonpayment of dividends, insolvency of debtor corporation at time of transaction in question, siphoning of funds by dominant shareholder, nonfunctioning of other officers and directors, absence of corporate records, and existence of corporation as merely facade for individual dealings.

Victoria Elevator Co. of Minneapolis, 283 N.W.2d at 512.

Minnesota law permits veil piercing in order to establish contract liability.

See, e.g., id. at 510, 513 (piercing the corporate veil on a breach of contract claim). Finally, the Court notes that “[p]iercing the corporate veil is an exception to be used only under limited circumstances.” Groves v. Dakota Printing Servs.,

Inc., 371 N.W.2d 59, 62 (Minn. Ct. App. 1985).

2. Application to Facts

a. Whether Haas and Entolo Were Instrumentalities of PRG

PRG asserts that it had a lawful right to operate and manage Haas, and

later, Entolo. Haas Bylaws Art. I § 1, Exh. 14 to Boyd Aff. It asserts that Haas and Entolo had valid boards of directors, Exhs. 27-29, 32-33 to Boyd Aff., who took action through written unanimous consent. See, e.g., Exhs. 26-28, 31-32 to Boyd Aff. Under Minnesota law, written consent has the same force and effect as an action taken in a board meeting. Minn. Stat. § 302A.239, subd. 1, 2; see also Haas Bylaws, Art. I, § 13.

In this case, Haas's and Entolo's boards of directors unanimously consented to be co-borrowers under the GMAC Agreement. Haas Consent to GMAC Loans, Exhs. 19-20 to Boyd Aff.; Haas Consent to Substitution of Entolo, Exh. 26; Entolo Consent to GMAC Loan, Exh. 35. PRG notes that, although Van Hercke now claims that he did not know that he was a member of Haas's board of directors, he signed unanimous board consents as a member of Haas's board. See, e.g., Exhs. 17-20, 27.

PRG also notes that an "increase in control by the parent constitutes a reasonable reaction of a parent to its failing subsidiary." Ass'n of Mill & Elevator Mut. Ins. Co., 553 N.W.2d at 450. It asserts that most of PRG's extensive control over Haas and Entolo occurred when they, too, were struggling financially.

The evidence before the Court raises a genuine issue of material fact regarding whether PRG insufficiently capitalized Haas and, later, Entolo. There is evidence that Entolo did not pay dividends. Viewing the evidence in the light

most favorable to Plaintiffs, there is sufficient evidence that PRG siphoned funds from Haas and Entolo by collecting their receivables as collateral and then granting them few loan proceeds. Van Hercke's testimony that he did not know that he was on Haas's board of directors raises questions about the functioning of Haas's board. Finally, PRG exercised almost complete control over the operations of Haas and Entolo and used their employees and assets to operate PRG and its other affiliated companies.

On the other hand, Haas was not insolvent at the time of the initial Acquisition and Employment Agreement, and Entolo was not insolvent at the time Plaintiffs' signed the Amendment. Although Haas and Entolo did not hold board meetings, they did follow some corporate formalities, have officers and directors, and maintain at least some corporate records, as shown by the evidence of actions taken by unanimous written consent.

Viewing the evidence in the light most favorable to Plaintiffs, the Court determines that, weighing the above factors, it could find that Haas and Entolo were mere instrumentalities of PRG. The Court concludes that Plaintiffs have raised genuine issues of material fact as to the first prong of the veil-piercing test. The Court now turns to the second prong of the test.

b. Whether the Failure to Pierce Would Cause Injustice

Plaintiffs note that they do not need to demonstrate that PRG engaged in fraud. Victoria Elevator Co. of Minneapolis v. Meriden Grain Co., Inc., 283 N.W.2d 509, 512 (Minn. 1979). Rather, they must simply show that, to allow the corporate veil to remain in place would create “an element of injustice or fundamental unfairness.” Id.

PRG argues that the GMAC agreement cannot constitute malfeasance because “joint credit agreements are an inevitable consequence of a parent-subsidary relationship.” Am. Commercial Lines, Inc. v. Ostertag, 582 S.W.2d 51, 53 (Ky. Ct. App. 1979). According to PRG’s expert witness, this lockbox arrangement, with multiple borrowers but only a single borrowing agent, the parent company, is a conventional and accepted method of borrowing. Adams Report ¶ 12, Exh. 43 to Boyd Aff. Additionally, Minnesota courts have held that there is no inherent unfairness in paying proceeds to a secured bank during liquidation and leaving nothing for unsecured creditors. Ass’n of Mill & Elevator Mut. Ins. Co., 553 N.W.2d at 450. However, in Association of Mill & Elevator, although the parent exercised some control over its subsidiary, it also infused cash into its subsidiary. Additionally, the plaintiffs did not assert “that the initial decision to obtain the line of credit was improper.” Id. at 448. Here, Haas and Entolo were guarantors on PRG’s loan and had no control over requesting loan proceeds. PRG, not Haas or Entolo, benefitted from the GMAC loan. Plaintiffs do

assert that GMAC loan was improper. Additionally, PRG specifically promised to pay Haas and Entolo's unsecured debt to Knight.

PRG also asserts that Knight was a sophisticated, represented party who signed a written contract that clearly indicated that the agreement was with a corporation: Haas and, later, Entolo. See Groves v. Dakota Printing Servs., Inc., 371 N.W.2d 59, 63 (Minn. Ct. App. 1985) (holding that there was no injustice where "[t]his was a commercial transaction, and [the plaintiffs] knew they were dealing with a corporation . . ."). While it is true that Knight is an experienced businessman who was represented by counsel in his contract dealings with Haas, Entolo, and PRG, unlike in Groves, he has produced evidence that, before he signed the Amendment, PRG explicitly represented to him that it would take responsibility for his Earn-Out Payment. Viewing the facts in the light most favorable to Plaintiffs, it would be fundamentally unfair for PRG to treat Haas and Entolo as mere instrumentalities, deliberately siphoning money from them, and, at the same time, induce Knight to become a creditor of Haas and Entolo by creating the belief that PRG would ensure payment, when it knew that its own actions would prevent them from fulfilling their debt to Knight.

The Court concludes that Plaintiffs have raised a genuine issue of material fact on their claim for piercing the corporate veil. Defendant's motion for summary judgment on Count I, Breach of Contract/Piercing PRG's Corporate Veil, is denied.

D. Damages

PRG requests that, if the Court denies summary judgment on the veil-piercing claim, the Court limit Plaintiffs' damages claim to the amount in the state court stipulated judgment against Haas and Entolo, \$750,000.

1. Attorney's Fees

Plaintiffs have conceded that their damages claim is capped at \$750,000 by their stipulated judgment against Haas and Entolo. However, Plaintiffs assert that they are entitled to recover attorney's fees incurred after the state court judgment from PRG beyond the stipulated judgment amount. They note that the Acquisition Agreement states that Haas and Entolo will indemnify Knight for all damages, including "reasonable attorneys' fees," that he incurred based on "any breach by Haas of any covenant or obligation of Haas in this Agreement." Exh. 2 to Boyd Aff. §§ 11.2, 11.4(b).

Plaintiffs did not reserve any claims for attorney's fees in the Acquisition Agreement in the stipulated judgment. Thus, the final judgment covers all aspects of Haas's and Entolo's alleged breach of the Acquisition Agreement, including any attorney's fees. Plaintiffs have asserted no right to attorney's fees apart from the contract. Any right to recover on the breach of contract claim from PRG through piercing the corporate veil is based solely on Haas's and Entolo's liability, and that liability has already been fixed. Thus, Plaintiffs cannot

recover damages beyond \$750,000 against PRG if the corporate veil is pierced.

2. Exemplary Damages

Plaintiffs request for “exemplary damages” must be stricken because they have brought no formal motion asserting punitive damages under Minnesota Statute sections 549.191-.20, and the deadline for motions to amend the pleadings has now past. See also Berczyk v. Emerson Tool Co., 291 F. Supp. 2d 1004, 1009 (D. Minn. 2003) (citation omitted). Plaintiffs appear to have abandoned their exemplary damages claim. In any case, their claim is barred by their failure to comply with the Minnesota statute.

Accordingly, based upon the files, records, and proceedings herein, **IT IS**

HEREBY ORDERED that:

Defendant Production Resource Group, LLC’s Motion for Summary Judgment [Docket No. 44] is **GRANTED IN PART** and **DENIED IN PART** as follows:

The motion is **DENIED** as to Count I of the First Amended Complaint, Breach of Contract/Piercing PRG’s Corporate Veil.

The motion is **GRANTED** as to Count II of the First Amended Complaint, Fraudulent Transfer, and Count II is **DISMISSED WITH PREJUDICE**.

Plaintiffs’ damages claim against Defendant Production Resource

Group is limited to seven hundred fifty thousand dollars (\$750,000).

Dated: July 8, 2005

s/ Michael J. Davis
Judge Michael J. Davis
United States District Court