STATE OF MINNESOTA
IN COURT OF APPEALS
A09-2256

Lois Becher,
Respondent,

vs.

Cami Freeman-Waag a/k/a Cami Waag, et al.,
Appellants.

Filed September 14, 2010
Affirmed
Stauber, Judge

Hennepin County District Court
File No. 27CV077367

Matthew J. Pfohl, Thomas B. Olson, Olson & Lucas, P.A., Edina, Minnesota (for respondent)

Richard M. Carlson, Morris Law Group, P.A., Edina, Minnesota (for appellants)

Considered and decided by Stauber, Presiding Judge; Lansing, Judge; and Muehlberg, Judge.*

* Retired judge of the district court, serving as judge of the Minnesota Court of Appeals by appointment pursuant to Minn. Const. art. VI, § 10.

U N P U B L I S H E D O P I N I O N

STAUBER, Judge

Appellants challenge a limited liability company Member Control Agreement provision restricting the use of a member's ownership units as security for a loan. Respondent cross-appealed, arguing that the district court abused its discretion in denying her motion for attorney fees. We affirm.

FACTS

In June 2001, appellant Cami Freeman-Waag (Waag), and respondent Lois Becher formed 101 Farms, LLC. Waag, an attorney, drafted a Member Control Agreement (MCA) for the company which established the two partners as the sole members of the company's board of governors. Thereafter, 101 Farms purchased 26 acres of undeveloped land in Corcoran on a contract for deed.

In 2003, without informing Becher, Waag assigned her interest in 101 Farms as collateral for a bank loan to finance a motorcycle shop she owned separately. Waag subsequently defaulted on the loan, and the bank attempted to foreclose on its security interest in 101 Farms. Becher then helped Waag obtain a forbearance agreement to prevent foreclosure. On November 15, 2004, Waag and Becher entered into a second MCA which superseded the original and required the "unanimous approval of the Board of Governors" prior to the assignment of an interest in the company.[1] It is the second MCA at issue in this appeal.

[1] Section 7.4 of the original Member Control Agreement only required the "approval of the Board of Governors"

In 2006, notwithstanding the MCA, Waag again entered into an agreement to assign her interest in 101 Farms to another lender, Associated Bank, N.A, to help finance her other businesses. Subsequently, the bank brought a lawsuit against Waag and others for defaulting on the loan. The bank sought protection as a judgment creditor by seeking an order prohibiting Waag from transferring or further encumbering her interest in 101 Farms. In that lawsuit, Waag claimed the bank did not have possession of her interest, as it was never pledged or acquired by the bank. The court ordered a money judgment in favor of the bank, granted the bank's motion for protection as a judgment creditor, and allowed the bank to proceed with a sale of Waag's interest in 101 Farms in order to satisfy its judgment against the defendants.

In December 2006, Associated Bank sold its assignment of notes and related loan documents and judgments, including Waag's membership interest in 101 Farms to appellant Excel Capital, LLC, "AS-IS, WHERE-IS, WITH ALL FAULTS." Waag then surrendered her interest in 101 Farms to Excel Capital in partial satisfaction of a judgment against one of her other businesses, Lucky's Garage, LLC. The chief manager of Excel Capital, Richard Morris, is also the primary partner of the law firm where Waag was employed as an attorney. One month later, Becher received a memo from Excel Capital informing her of the change in ownership and requesting her to set up a members meeting. Excel Capital informed Becher that it was "prepared to vigorously enforce its rights with respect to financial and governance rights" in 101 Farms.

In April 2007, Becher brought a declaratory judgment action against Waag and Excel Capital, to determine who the partners were in 101 Farms. During discovery,

Becher learned that Excel Capital had assigned its rights in 101 Farms to appellant CMF Holdings (CMF), another company owned by Morris; CMF was subsequently added as a defendant.[2] Following trial, the jury found that Waag breached her fiduciary duty to Becher, breached the MCA, and breached an implied covenant of good faith and fair dealing. The jury also found that Excel Capital intentionally caused the breach of the MCA, and that the MCA restriction was not manifestly unreasonable, and was noted conspicuously, and that all parties had knowledge of the restriction. The district court then found that the MCA restricted Waag from transferring her interest in 101 Farms, that all transfers of Waag's interest to other parties were void, and that Waag retained all of her interest in 101 Farms. The court also denied Becher's request for attorney fees and denied appellants' motion for a charging order against Waag's interest in 101 Farms.

Appellants subsequently filed a motion for judgment as a matter of law and a motion for a new trial. The district court denied the motions and these appeals followed.

D E C I S I O N

Because this case presents both questions of law and fact, "we will correct erroneous applications of law, but accord the [district] court discretion in its ultimate conclusions and review such conclusions under an abuse of discretion standard." *Langford Tool & Drill Co. v. Phenix Biocomposites, LLC*, 668 N.W.2d 438, 442 (Minn. App. 2003) (quoting *Rehn v. Fischley*, 557 N.W.2d 328, 333 (Minn. 1997)). Pursuant to Minn. R. Civ. P. 52.01, "[f]indings of fact . . . shall not be set aside unless clearly erroneous." The supreme court has defined "clearly erroneous" as "manifestly contrary

[2] Waag, Excel Capital, and CMF are collectively referred to as "appellants."

to the weight of the evidence or not reasonably supported by the evidence as a whole." *Northern States Power Co. v. Lyon Food Prod., Inc.*, 304 Minn. 196, 201, 229 N.W.2d 521, 524 (1975). But a review of the application of statutes is a question of law that we review de novo. *In re Kleven*, 736 N.W.2d 707, 709 (Minn. App. 2007) (citing *Brookfield Trade Ctr. v. County of Ramsey*, 584 N.W.2d 390, 393 (Minn. 1988)).

I.

A. Member Control Agreement

Appellants argue that the MCA only prohibits an "outright sale or assignment of a member's units and not a granting of a security interest in a member's interest." They claim that nowhere in the MCA is there a "restriction on the granting of the member's units as security for a loan." However, the record is replete with evidence showing that it was Waag's intention and belief that the MCA, which she drafted, prohibited her from pledging any interest in 101 Farms, LLC for any purpose. E-mail correspondence from Waag, offered into evidence at trial, stated that "each section require[s] 100% agreement by the board of governors (that being you and me), so that any decision requires both of us to agree. . . . I hope the . . . language I am suggesting . . . will offer you the most security and equal control in the farm as possible . . . ." Also offered at trial was the deposition of Waag who stated:

> My understanding is I have no right nor does my partner in pledging in *any way, shape, or form* that by means of pledge, mortgage, *any other* means to offer the property in *any way* to anyone. . . . I don't want her to be able to mortgage or pledge the property in *any other way* nor would she want me to be able to do that.

(Emphasis added.) Thus, the district court's conclusion that "no reasonable jury could find that the 2004 [MCA] did not restrict . . . Waag from transferring a pledge of a security interest in her membership units in 101 Farms" was reasonably supported by the evidence and was not clearly erroneous.

Appellants also contend that the transfer was legitimate under Minnesota law. Although appellants acknowledge that Minnesota law on limited liability companies allows restrictions on the outright transfer of financial interests pursuant to Minn. Stat. § 322B.31, subd. 3 (2008), they contend that Waag only granted "security or *collateral* rights" in her membership in 101 Farms to Associated Bank—as such, that is different from the transfer or assignment of actual or financial rights. Appellants argue that Minn. Stat. §322B.313 (2008) allows a member to grant a security interest in a membership interest without consent or approval of the other members. Appellants further argue that because the law allows for the foreclosure of a security interest in a membership interest without consent of other members under Minn. Stat. § 322B.31, subd. 3(d), and Minn. Stat. § 322B.313, subd. 7, then it follows that the law would also allow the granting of the security interest without consent.

Minn. Stat. § 322B.31, subd. 3(b) provides:

> [A] written restriction on the assignment of financial rights that is not manifestly unreasonable under the circumstances and is noted conspicuously in the required records may be enforced against the owner of the restricted financial rights or a successor or transferee of the owner, including a *pledgee* or legal representative. Unless noted conspicuously in the required records, a restriction, even though permitted by this section, is ineffective against a person without knowledge of the restriction.

(Emphasis added.) The "Reporters Notes" to this statute state: "The term 'assignment' is intended in its broadest sense to encompass the assignment of *any interest*, including the granting of a security interest in the financial rights. The board of governors or the members may choose to impose restrictions on the assignment of financial rights. Minn. Stat. Ann. § 322B.31 reporter's notes, subd. 1 (West 1992) (referencing subdivision 3).

Here, Waag pledged her ownership interest in 101 Farms to Associated Bank, the pledgee, in violation of the restriction set out in the MCA. Ample evidence and testimony was offered at trial to support the jury's findings that the restrictions on the assignment of interest were not manifestly unreasonable under the circumstances (given that Waag had twice assigned her interest without Becher's knowledge), and were conspicuous (section 7.2 of the MCA was not hidden or difficult to read), and that all parties had knowledge of the restriction pursuant to section 322B.31 (the parties were experienced real estate investors with knowledge of limited liability companies).

We acknowledge that Minn. Stat. § 322B.313, subd. 7, does allow the right to assign a security interest without unanimous consent. But it is subject to subdivision 6, which provides that the restrictions of assignments on governance must follow the same process set out in section 322B.31, subdivision 3, pertaining to the assignment of financial rights (*i.e.*, must be manifestly reasonable under the circumstances, conspicuously noted and with knowledge). Minn. Stat. § 322B.313, subd. 6.

Finally, appellants have misconstrued the plain meaning of section 322B.31, subdivision 3(d), and the final sentence of section 322B.313, subdivision 7. These provisions pertain to the secured party's rights to foreclose on its interest without the

approval of the member who pledged the security interest.[3] Accordingly, the bank would not need Waag's approval to foreclose. Besides, the issue on appeal is not Waag's consent, but whether Becher's consent was necessary prior to Waag assigning her security interest given the restriction in the MCA, and accordingly, whether that restriction was proper under Minnesota law on limited liability companies.

The district court properly concluded that pursuant to Minnesota law the members of 101 Farms, through its MCA, could restrict the transfer of financial and/or governance rights, and could enforce those restrictions against third parties, and that the restriction includes the right to restrict the granting of security interests.

B. Application of Equity

Next, appellants argue that based on equity this court must find that Waag's pledge of her security interest in 101 Farms is valid. "Equity" denotes "[f]airness; impartiality; evenhanded dealing." *Black's Law Dictionary* 560 (7th ed. 1999). In this case, the jury found that Waag: breached her fiduciary duty to Becher, her business partner; breached the 2004 MCA with Becher; and breached a duty of good faith and fair dealing; and that Excel Capital intentionally caused the breach of the 2004 MCA. Additionally, evidence submitted to the district court at trial showed that this was not the first time that Waag had assigned her security interest in 101 Farms without the knowledge or consent of Becher. "[H]e who seeks equity must do equity, and he who comes into equity must come with clean hands." *Hruska v. Chandler Assocs., Inc.*, 372

[3] Minn. Stat. § 322B.313, subd. 7, states: [A] security interest . . . may be foreclosed . . . without the consent or approval of the *member* whose full membership interest or governance rights are the subject of the security interest. (Emphasis added.)

N.W.2d 709, 715 (Minn. 1985). Based on the record, and the findings of the jury and the district court, we determine that there is no basis for equitable relief.

II.

Appellants contend that the October 16, 2006 order in the earlier case involving Associated Bank was a binding charging order pursuant to Minn. Stat. § 322B.32 (2008), and therefore, the district court here erred in voiding Excel Capital's and CMF's interests in 101 Farms. Appellants also argue that because Associated Bank was not a party to this action, the court erred in finding the bank's interest in 101 Farms void. Becher claims the effectiveness of a binding charging order is not properly before this court; but, if it is, it must fail on the merits.

Because the district court addressed the issue of whether the October 16, 2006 order was a charging order in its October 15, 2009 post trial order, it is properly appealable pursuant to this court's January 26, 2010 order. The district court found that the October 16, 2006 order was not a charging order under Minn. Stat. § 322B.32 because the earlier court did not order that Waag's financial rights could be charged. Rather, it ordered the protection of the bank's rights as a judgment creditor and further ordered that the bank "could proceed with a sale of . . . Waag's interest in 101 Farms, LLC, in order to satisfy its judgment against the defendants." The October 16, 2006 order enabled the bank to collect on its debt, nothing more. Appellants do not provide any evidence, nor does the record contain any information of the Associated Bank's request or motion for a charging order.

Because the record before us lacks evidence of a request for a charging order by the bank, appellants argue, in the alternative, that the October 16, 2006 order created a valid security interest in 101 Farms according to which "[a]s an assignee, Excel Capital effectively steps into the shoes of Associated Bank." Appellants argue that it was therefore "unjust" for the district court to take away all rights of Excel Capital in contradiction to the October 16, 2006 order, and that Excel/CMF's reliance on that order should not penalize Excel/CMF in a complete loss of its investment.

Excel Capital purchased the $600,000 in loan documents and judgments from Associated Bank for $450,000. In addition to Waag's security interest in 101 Farms, this package included several real-estate mortgages, a security interest in a bar, and Waag's motor home. Moreover, Excel Capital and CMF are not prohibited by the district court's order from seeking recovery from these other assets. The result is not unjust, nor has it taken away all rights nor is it a complete loss as alleged by Excel Capital and CMF.

Finally, appellants argue that because Associated Bank was not a party to this action, the district court lacked authority to invalidate the bank's security interest in 101 Farms, and thus it could not void Excel Capital's or CMF's interest. To support their claim, appellants rely on Minn. Stat. § 555.11 (2008) which states: "[w]hen declaratory relief is sought, all persons shall be made parties who have or claim any interest which would be affected by the declaration, and no declaration shall prejudice the rights of persons not parties to the proceeding."

The district court properly found that "the failure to join a party to a declaratory judgment action is not jurisdictional; it does not mean that this Court 'lacks authority' to

decide a declaratory judgment matter." *See State Auto and Cas. Underwriters v. Lee*, 257 N.W.2d 573, 575–76 (Minn. 1977) (failure to join an "indispensible" party does not render a declaratory judgment void, since it is not jurisdictional). Associated Bank sold its interest in 101 Farms to Excel Capital "AS-IS WHERE-IS, WITH ALL FAULTS." The bank clearly was aware of this action, as it responded to a subpoena by producing hundreds of pages of documents pertaining to its sale of the 101 Farms interest to Excel Capital. The bank had no reason to intervene in this case, and appellants did not bring a motion to join the bank in this action. We agree with the district court that the bank is not prejudiced by the court's judgment. Accordingly, the district court did not err in voiding Associated Bank's interest in 101 Farms.

III.

Respondent argues that the district court erred in denying attorney fees. Only if the district court abused its discretion, will an appellate court reverse a determination on an award or denial of attorney fees. *Giuliani v. Stuart Corp.*, 512 N.W.2d 589, 596 (Minn. App. 1994). According to the American rule, parties are responsible for their own attorney fees unless a specific contractual provision or statutory authorization provides otherwise. *Kallock v. Medtronic, Inc.*, 573 N.W.2d 356, 363 (Minn. 1998). An exception to this rule occurs when "[o]ne who through the tort of another has been required to act in the protection of his interests by bringing or defending an action against a third person is entitled to recover reasonable compensation for loss of time, attorney fees and other expenditures thereby suffered or incurred in the earlier action." *Padir v. Hughes*, 615 N.W.2d 276, 280 n.4 (Minn. 2000) (quotation omitted).

Respondent further argues that because the jury by special verdict form found that "Excel's and Waag's actions 'thrust' Becher into litigation," she is entitled to recover attorney fees. *See Dworsky v. Vermes Credit Jewelry, Inc.*, 244 Minn. 62, 70, 69 N.W.2d 118, 124 (1955) (stating that where the wrongful act of the defendant "thrusts" the plaintiff into litigation with a third party, the plaintiff may recover attorney fees from the defendant). In support of the jury's finding, respondent refers to Trial Exhibit 6, an email, in which Waag acknowledges that her actions caused Becher to become involved in her financial difficulties. However, appellants in this case are not "third parties." Waag, Excel Capital, and CMF are joint tortfeasors; their wrongful conduct grows out of the same wrong, which, in this case, was assigning a security interest without informing Becher. The Court of Appeals for the Eighth Circuit addressed the third-party exception in *OnePoint Solutions, LLC v. Borchert*, in which the court found that to be liable for attorney fees, a party must have (1) committed a tortious act; (2) which propelled the fee-seeking party into litigation; (3) with a third party. 486 F.3d 342, 352 (8th Cir. 2007). The court explained that where a fee-seeking party's complaint treats other parties as joint tortfeasors acting together during a single event that resulted in litigation, they cannot be third parties. *Id.* at 352. Otherwise, "courts could award attorney's fees under the third-party litigation exception whenever a plaintiff sued two or more defendants who acted jointly." *Id.*

Here, Becher's original complaint named Waag and Excel Capital collectively as defendants and, after discovery, Becher moved to join CMF as a defendant when she learned that Excel had assigned its interest in 101 Farms to CMF, another company under

the same ownership as Excel Capital. Becher argued to the district court in her motion to join CMF that neither Waag, nor Excel Capital, nor CMF provided her with any required notice of the transfer of membership units or interest in of 101 Farms in violation of their MCA. Following a motion hearing, the district court issued an order for joinder allowing CMF to be added as a defendant. Because Waag, Excel Capital, and CMF are joint tortfeasors and not third parties, the district court did not err in denying Becher attorney fees.

Affirmed.