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IN THE SUPREME COURT OF IOWA

SUPREME COURT NO. 18-0950

HOMELAND ENERGY SOLUTIONS, LLC,

Plaintiff/Appellee,

v.

STEVE J. RETTERATH,

Defendant/Appellant.

JASON and ANNIE RETTERATH,

Intervenors/Appellants.

APPEAL FROM THE IOWA
DISTRICT COURT FOR POLK COUNTY
THE HONORABLE PAUL D. SCOTT AND ROBERT J. BLINK

INTERVENORS'/APPELLANTS' FINAL BRIEF

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TABLE OF CONTENTS

Table of Authorities 4

Statement of the Issues 8

Routing Statement.. 14

Statement of the Case 14

Statement of the Facts.. 17

Argument 22

I. The District Court Erred in Ruling the Membership Approval Protections of the HES Operating Agreement do not Apply to the MURA Such that no Membership Vote was Required to Ratify the MURA……………………………………………………22

Scope and Standard of Review…………………………….............22
Preservation of Error………..……………………………..........23
Argument………………………………………………………… 24

A. The District Court Summary Judgment Ruling is Contrary to the Acknowledged Intent of the HES Operating Agreement's Insider Deal Protections as Clearly Expressed in Section 5.6(b)(v)…………………………………………………25

1. Membership Units are "Equity Securities" Under Section 5.6(b)(v)……………………………………29

2. The Committee Powers of Section 5.16 of the Operating Agreement do not Trump the Members' Voting Protections for Insider Deals…………………..34

B. The HES Operating Agreement and Iowa Code Chapter 489 Require the MURA be Ratified by a Member Vote……..39

1. Only the Members can Ratify an Insider Deal……..…39

2. HES cannot Substitute Its Judgment for Members..…..44

3. HES cannot Render the Voting Protections a Nullity By Making a Director's Resignation a Term of the Insider Deal……………………………………………46

C. Summary……………………………………………………..50

II. The District Court Erred in Concluding the MURA Did Not Violate the Public Policy of Iowa…………………………………...51

Scope and Standard of Review………………………….............51
Preservation of Error……..……………………………..................51
Argument……………………………………………………………51

III. The District Court Erred in Not Enjoining HES from Seeking Specific Performance of the MURA...………………………………55

Scope and Standard of Review……..…………………….............55
Preservation of Error………………………………………...........55
Argument……………………………………………………………56

IV. The District Court Erred in Severing the Specific Performance Trial…………………………………………………………………62

Scope and Standard of Review……..…………………….............62
Preservation of Error………………………………………...........62
Argument……………………………………………………………64

Conclusion 68

Request for Oral Submission 69

Certificate of Filing and Service... 70

Certificate of Compliance with Typeface Requirements and Type-Volume Limitation.. 70

TABLE OF AUTHORITES

Case Law **Page(s)**

Allen v. Highway Equip. Co., 239 N.W.2d 135 (Iowa 1976)………...…….22

Am. Anglian Envtl. Technologies, L.P. v. Envtl. Mgmt. Corp., 412 F.3d 956 (8th Cir. 2005)……………………………………………..26

Am. Soil Processing, Inc. v. Iowa Comprehensive Petroleum Underground Storage Tank Fund Bd., 586 N.W.2d 325 (Iowa 1998)……………...38, 49

Atlas Coal Co. v. Jones, 61 N.W.2d 663 (Iowa 1953)……………………………...……28, 32, 48, 53, 55, 59, 68

B&F Jacondson Lumber & Hardware, L.L.P. v. Acuity, a Mut. Ins. Co., No. 16-1134, 2017 WL 6513961 (Iowa Ct. App. Dec. 2017)………..…68

Beeman v. Manville Corp. Asbestos Disease Comp. Fund, 496 N.W.2d 247 (Iowa 1993)……………………………………………62

Brown v. McLanahan, 148 F.2d 703 (4th Cir. 1945)...……………………59

C & J Vantage Leasing Co. v. Wolfe, 795 N.W.2d 65 (Iowa 2011)……….49

Christmas v. Kennedy, 129 Pa. Super. 80, 85, 194 A. 773 (1937)…………58

Cookies Food Prod., Inc., by Rowedder v. Lakes Warehouse Distrib., Inc., 430 N.W.2d 447 (Iowa 1988)……………………………………………41

Dennison v. MediaComm, Inc., No. 15-0308, 2006 WL 1627998 at *2 (Iowa Ct. App., June 14, 2006)……………………………………41

Des Moines Bank & Trust Co. v. George M. Bechtel & Co., 51 N.W.2d 174 (Iowa 1952)………….………………28, 32, 41, 53, 55, 68

Dickerson v. Mertz, 547 N.W.2d 208 (Iowa 1996)………………………...22

DuVall v. Moore, 276 F. Supp. 674 (N.D. Iowa 1967)………………...44, 58

Fein v. Lanston Monotype Mach. Co., 85 S.E.2d 353
(Virginia 1955)……………………………………………………45, 59

Goggin v. Vermillion, Inc., No. CIV.A. 6465-VCN,
2011 WL 2347704, at *6 (Del. Ch. June 3, 2011)………………………62

Gord v. Iowana Farms Milk Co., 60 N.W.2d 820 (Iowa 1953)……...…….28

Graber v. City of Ankeny, 616 N.W. 2d 633 (Iowa 2000)…………………65

Hartig Drug Co. v. Hartig, 602 N.W.2d 794 (Iowa 1999)………………...23

Harvey v. Leonard, 268 N.W.2d 504 (Iowa 1978)…………………………42

Holcomb v. Forsyth, 216 Ala. 486, 113 So. 516 (1927)…………………...45

Int'l Banknote Co. v. Muller, 713 F. Supp. 612 (S.D.N.Y. 1989)…………61

In re Langholz, 887 N.W.2d 770 (Iowa 2016)……………………………..55

In re Marriage of Thatcher, 864 N.W.2d 533 (Iowa 2015)………………..64

In re NextMedia Investors, *LLC*, CIV.A. 4067-VCS,
2009 WL 1228665 (Del. Ch. May 6, 2009)…………………………25, 56

Jones. v. Univ. of Iowa, 836 N.W.2d 127 (Iowa 2013)……………………65

King v. Gustafson, 459 N.W.2d 651 (Iowa Ct. App. 1990)………………..40

Lange v. Lange, 520 N.W.2d 113 (Iowa 1994)……………………25, 26, 32

Lewis Invs., Inc. v. City of Iowa City, 703 N.W.2d 180 (Iowa 2005)……...55

Life Investors Ins. Co. of Am. v. Estate of Corrado,
838 N.W.2d 640 (Iowa 2013)……………………………………………40

Lyon v. Willie, 288 N.W.2d 884 (Iowa 1980)……………………………...67

McCarter v. Uban, 166 N.W.2d 910 (Iowa 1969)…………………………43

McGinnis v. Iowa Clinic, *P.C.*, 776 N.W.2d 110 (Iowa Ct. App. 2009)…..41

McLain v. Lanova Corp., 28 Del. Ch. 176, 39 A.2d 209 (1944)…………..44

Meier v. Senecaut, 641 N.W.2d 532 (Iowa 2002)……………………24, 51, 56

Miller v. Register and Tribune Syndicate, 336 N.W.2d 709 (Iowa 1983)…36

Mills v. Elec. Auto-Lite Co., 396 U.S. 375, 90 S. Ct. 616,
24 L. Ed. 2d 593 (1970)…………………………………………...32, 48

Mincks Agri Center, Inc. v. Bell Farms, Inc., 611 N.W.2d 279
(Iowa 2000)…………………………………………………………52

Morrison v. Mahaska Bottling Co., 39 F.3d 839 (8th Cir. 1994)………25, 57

Nelson v. All Am. Life & Fin. Corp., 889 F.2d 141 (8th Cir. 1989)………...46

Rector v. Falbo, 786 N.W.2d 519 (Iowa Ct. App. 2010)…………………..43

Reifsnyder v. Pittsburgh Outdoor Advert. Co., 405 Pa. 142,
173 A.2d 319 (1961)……………………………………………..58

Rogers v. Webb, 558 N.W.2d 155 (Iowa 1997)……………………………55

Peak v. Adams, 799 N.W.2d 535 (Iowa 2011)……………………………..33

Pillsbury Co. v. Ward, 250 N.W.2d 35 (Iowa 1977)………………………43

Pillsbury Co. v. Wells Dairy, Inc., 752 N.W.2d 430 (Iowa 2008)…………48

Seinfeld v. Hosp. Corp. of Am., 685 F. Supp. 1057 (N.D. Ill. 1988)……….31

Shidler v. All Am. Life & Fin. Corp., 775 F.2d 917
(8th Cir. 1985)………...……………………………………...33, 45, 49, 60

State ex rel. Dobbs v. Burche, 729 N.W.2d 431 (Iowa 2007)……………...55

Tenney v. Atlantic Assocs., 594 N.W.2d 11 (Iowa 1999)...……………..22, 51

Westlake Investments, *LLC v. MLP Mgmt., LLC*, No. 4:09-cv95, 2010 WL 7361159, at *5 (S.D. Iowa Mar. 3, 2010)……………………..36

Statutes & Rules **Page(s)**

Iowa Code Chapter 489…………………………...14, 25, 39, 41, 51, 56, 57

Iowa Code § 489.104…………………………………………………….57

Iowa Code § 489.110……………………………………………….........57

Iowa Code § 489.110(1)…………………………………………………56

Iowa Code § 489.110(5)……………………………………...41, 42, 53, 56

Iowa Code § 489.901…………………………………………………….57

Iowa Code § 502.102(28)(e)…………………………………………….32

Iowa R. App. P. 6.1102(2)………………………………………………14

Iowa Rule Civ. P. 1.914…………………………………………………64

Other Authorities **Page(s)**

17 C.F.R. § 240.3a11-1…………………………………………………32

H.R.Rep.No.1383, 73d Cong., 2d Sess., 13………………………………..33

Webster's NewWorld Dictionary 62 (2nd College Ed. 1984)………………33

STATEMENT OF THE ISSUES PRESENTED FOR REVIEW

I. DID THE DISTRICT COURT ERR IN RULING THE MEMBERSHIP APPROVAL REQUIREMENTS OF THE HES OPERATING AGREEMENT DO NOT APPLY TO THE MURA SUCH THAT NO MEMBERSHIP VOTE WAS REQUIRED TO RATIFY THE MURA?

Standard and Scope of Review

Tenney v. Atlantic Assocs., 594 N.W.2d 11 (1999)

Dickerson v. Mertz, 547 N.W.2d 208 (Iowa 1996)

Allen v. Highway Equip. Co., 239 N.W.2d 135 (Iowa 1976)

Hartig Drug Co. v. Hartig, 602 N.W.2d 794 (Iowa 1999)

Preservation of Error

Meier v. Senecaut, 641 N.W.2d 532 (Iowa 2002)

Argument

A. The District Court Summary Judgment Ruling is Contrary to the Acknowledged Intent of the HES Operating Agreement's Insider Deal Protections as Clearly Expressed in Section 5.6(b)(v).

In re NextMedia Investors, *LLC*, CIV.A. 4067-VCS, 2009 WL 1228665 (Del. Ch. May 6, 2009)

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Lange v. Lange, 520 N.W.2d 113 (Iowa 1994)

Am. Anglian Envtl. Technologies, L.P. v. Envtl. Mgmt. Corp., 412 F.3d 956 (8th Cir. 2005)

Atlas Coal Co. v. Jones, 61 N.W.2d 663 (Iowa 1953)

Des Moines Bank & Trust Co. v. George M. Bechtel & Co., 51 N.W.2d 174 (Iowa 1952)

Gord v. Iowana Farms Milk Co., 60 N.W.2d 820 (Iowa 1953)

1. Membership Units are "Equity Securities" Under Section 5.6(b)(v)

Seinfeld v. Hosp. Corp. of Am., 685 F. Supp. 1057 (N.D. Ill. 1988)

17 C.F.R. § 240.3a11-1

Lange v. Lange, 520 N.W.2d 113 (Iowa 1994)

Des Moines Bank & Trust Co. v. George M. Bechtel & Co., 51 N.W.2d 174 (Iowa 1952)

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Mills v. Elec. Auto-Lite Co., 396 U.S. 375, 90 S. Ct. 616, 24 L. Ed. 2d 593 (1970)

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Webster's NewWorld Dictionary 62 (2nd College Ed. 1984)

2. The Committee Powers of Section 5.16 of the Operating Agreement do not Trump the Members' Voting Protections for Insider Deals

Miller v. Register and Tribune Syndicate, 336 N.W.2d 709 (Iowa 1983)

Westlake Investments, LLC v. MLP Mgmt., LLC, No. 4:09-cv95, 2010 WL 7361159, at *5 (S.D. Iowa Mar. 3, 2010)

Am. Soil Processing, Inc. v. Iowa Comprehensive Petroleum Underground Storage Tank Fund Bd., 586 N.W.2d 325 (Iowa 1998)

B. The HES Operating Agreement and Iowa Code Chapter 489 Require the MURA be Ratified by a Member Vote

1. Only the Members Can Ratify an Insider Deal

Life Investors Ins. Co. of Am. v. Estate of Corrado, 838 N.W.2d 640 (Iowa 2013)

King v. Gustafson, 459 N.W.2d 651 (Iowa Ct. App. 1990)

Iowa Code § 489.110(5)

Des Moines Bank & Trust Co. v. George M. Bechtel & Co., N.W.2d 174 (Iowa 1952)

Cookies Food Prod., Inc., by Rowedder v. Lakes Warehouse Distrib., Inc., 430 N.W.2d 447 (Iowa 1988)

Dennison v. MediaComm, Inc., No. 15-0308, 2006 WL 1627998 at *2 (Iowa Ct. App., June 14, 2006)

McGinnis v. Iowa Clinic, P.C., 776 N.W.2d 110 (Iowa Ct. App. 2009)

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Pillsbury Co. v. Ward, 250 N.W.2d 35 (Iowa 1977)

Rector v. Falbo, 786 N.W.2d 519 (Iowa Ct. App. 2010)

McCarter v. Uban, 166 N.W.2d 910 (Iowa 1969)

2. HES Cannot Substitute its Judgment for the Members

DuVall v. Moore, 276 F. Supp. 674 (N.D. Iowa 1967)

McLain v. Lanova Corp., 28 Del. Ch. 176, 39 A.2d 209 (1944)

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Shidler v. All Am. Life & Fin. Corp., 775 F.2d 917 (8th Cir. 1985)

Nelson v. All Am. Life & Fin. Corp., 889 F.2d 141, 148 (8th Cir. 1989)

3. HES Cannot Render the Voting Protections a Nullity by Making a Director's Resignation a Term of the Insider Deal

Pillsbury Co. v. Wells Dairy, Inc., 752 N.W.2d 430 (Iowa 2008)

Atlas Coal Co. v. Jones, 61 N.W.2d 663 (Iowa 1953)

Mills v. Elec. Auto-Lite Co., 396 U.S. 375, 90 S. Ct. 616, 24 L. Ed. 2d 593 (1970)

Am. Soil Processing, Inc. v. Iowa Comprehensive Petroleum Underground Storage Tank Fund Bd., 586 N.W.2d 325 (Iowa 1998)

C & J Vantage Leasing Co. v. Wolfe, 795 N.W.2d 65 (Iowa 2011)

II. DID THE DISTRICT COURT ERR IN CONCLUDING THE MURA DID NOT VIOLATE THE PUBLIC POLICY OF IOWA?

Tenney v. Atlantic Assocs., 594 N.W.2d 11 (Iowa 1999)

Dickerson v. Mertz, 547 N.W.2d 208 (Iowa 1996)

Meier v. Senecaut, 641 N.W.2d 532 (Iowa 2002)

Mincks Agri Center, Inc. v. Bell Farms, Inc., 611 N.W.2d 279 (Iowa 2000)

Des Moines Bank & Tr. Co. v. George M. Bechtel & Co., 51 N.W.2d 174 (Iowa 1952)

Atlas Coal Co. v. Jones, 61 N.W.2d 663 (Iowa 1953)

Rogers v. Webb, 558 N.W.2d 155 (Iowa 1997)

III. DID THE DISTRICT COURT ERR IN NOT ENJOINING HES FROM SEEKING SPECIFIC PERFORMANCE OF THE MURA?

State ex rel. Dobbs v. Burche, 729 N.W.2d 431 (Iowa 2007)

Lewis Invs., Inc. v. City of Iowa City, 703 N.W.2d 180 (Iowa 2005)

In Re Langholz, 887 N.W.2d 770 (Iowa 2016)

Meier v. Senecaut, 641 N.W.2d 532 (Iowa 2002)

Iowa Code section 489.110(1)

Iowa Code section 489.110(5)

In re NextMedia Investors, LLC, CIV.A. 4067-VCS, 2009 WL 1228665 (Del. Ch. May 6, 2009)

Morrison v. Mahaska Bottling Co., 39 F.3d 839, 843 (8th Cir. 1994)

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DuVall v. Moore, 276 F.Supp. 674 (N.D. Iowa 1967)

Brown v. McLanahan, 148 F.2d 703 (4th Cir. 1945)

Fein v. Lanston Monotype Mach. Co., 196 Va. 753, 85 S.E.2d 353 (1955)

Atlas Coal Co. v. Jones, 61 N.W.2d 663 (Iowa 1953)

Shidler v. All Am. Life & Fin. Corp., 775 F.2d 917 (8th Cir. 1985)

Int'l Banknote Co. v. Muller, 713 F. Supp. 612 (S.D.N.Y. 1989)

Goggin v. Vermillion, Inc., No. CIV.A. 6465-VCN, 2011 WL 2347704, at *6 (Del. Ch. June 3, 2011)

IV. DID THE DISTRICT COURT ERR IN SEVERING THE SPECIFIC PERFORMANCE TRIAL?

Beeman v. Manville Corp. Asbestos Disease Comp. Fund, 496 N.W.2d 247 (Iowa 1993)

In re Marriage of Thatcher, 864 N.W.2d 533 (Iowa 2015).

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Jones. v. Univ. of Iowa, 836 N.W.2d 127 (Iowa 2013)

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B&F Jacondson Lumber & Hardware, L.L.P. v. Acuity, a Mut. Ins. Co., No. 16-1134, 2017 WL 6513961 (Iowa Ct. App. December 20, 2017)

ROUTING STATEMENT

The Iowa Supreme Court should retain this case as it presents substantial issues of enunciating legal principles, as it requires this Court to determine whether Iowa's common law favoring corporate governance through member suffrage, and disfavoring insider deals, applies equally to insider deals within Iowa Code chapter 489 Limited Liability Companies. *See* Iowa R. App. P. 6.1102(2) (noting cases presenting substantial questions of enunciating legal principles are ordinarily retained). Further, this appeal presents substantial issues of enunciating legal principles pertaining to Iowa Code chapter 489 limited liability companies, including application of Iowa law governing specific performance to units in a limited liability company.

STATEMENT OF THE CASE

Nature of the Case. This is an appeal by Jason and Analia Retterath (hereinafter "Intervenors"), members of Homeland Energy Solutions, LLC ("HES") of the District Court's October 16, 2015, Ruling on Defendant's Motion for Summary Judgment (Appendix v. III p. 62-78), as modified by the December 8, 2015 Ruling on Rule 1.904(2) Motion (Appendix v. III p. 107-110) denying Intervenors, and the rest of HES's membership, the opportunity to vote on an insider deal between HES and its largest single member, Steve J. Retterath ("Retterath"). (Appendix v. III p. 62-78; Appendix v. III p. 107-

110). Intervenors further appeal from the November 6, 2016, order severing trial of Intervenors claims from HES's specific performance claim and limiting discovery.

Prior Proceedings. On August 14, 2014, HES filed a Petition seeking specific performance of a Membership Unit Repurchase Agreement ("MURA") purportedly entered into by HES on June 13, 2014. (Appendix v. I p. 20-62). On February 18, 2015, HES filed a Motion for Summary Judgment seeking a declaration that a member vote was not required to validate the MURA. (Appendix v. I p. 162-163). On March 4, 2015, Intervenors filed a Motion with the Polk County District Court seeking leave to intervene as a matter of right in order to protect their right to vote on the transaction contemplated in the MURA. (Appendix v. I p. 358-362). On April 16, 2015, the District Court entered its Ruling on the Motion to Intervene, and concluded therein that Intervenors had standing to bring a direct action against HES to enforce their voting rights under the HES Operating Agreement. (Ruling on Motion to Intervene).

On May 26, 2015, Intervenors filed their Second Amended Petition in Intervention asserting five (5) counts against HES. (Appendix v. I p. 493-548). On June 1, 2015, Intervenors filed their Motion for Summary Judgment asserting the MURA violated the HES Operating Agreement. (Appendix v. I

p. 549). On October 16, 2015, the District Court entered a ruling granting HES's Motion for Summary Judgment, and denying Intervenors' and Retterath's Motions for Summary Judgment. (Appendix v. III p. 62-78). On December 8, 2015, the District Court entered a ruling on Intervenors' and Retterath's Rule 1.904(2) Motion limiting its October 16, 2015, ruling to the conclusion that "the Member approval requirements of Section 5.6(b)(v) of the Operating Agreement do not apply to the MURA and therefore a membership vote was not required to ratify the MURA." *(*Appendix v. III p. 107-110).

On January 7, 2016, Retterath and Intervenors applied to the Iowa Supreme Court for Interlocutory Appeal of the District Court's Summary Judgment Ruling. (Appendix v. III p. 111-181; Appendix v. III p. 182-187). On February 25, 2016, the Iowa Supreme Court denied Intervenors' and Retterath's Applications for Interlocutory Appeal. (Appendix v. III p. 188).

On July 21, 2016, Intervenors moved to file an Amended Petition in Intervention. (Appendix v. IV p. 20-205). On August 4, 2016, the District Court granted Intervenors' Motion to Amend. (Appendix v. IV p. 292-293). HES moved for reconsideration of these orders on August 9, 2016. (Appendix v. IV p. 294-299). Following a September 9, 2016, hearing, the District Court, on November 6, 2016, entered an Order confirming its prior order allowing

Intervenors and Retterath to file amended pleadings asserting new claims, but bifurcating the proceedings so that trial would be held on January 17, 2017, on HES's Petition only. (Appendix v. V p. 221-223).

A bench trial was held on January 17, 2017 through January 23, 2017 on HES's claims against Retterath only. On June 15, 2017, the District Court issued its ruling after trial, granting HES specific performance and ordering a closing on the MURA by August 1, 2017. (Appendix v. V p. 319-333). On June 30, 2017, Retterath and HES filed post-trial motions under Iowa Rules of Civil Procedure 1.1004 and 1.904(2). (Appendix v. V p. 334-348; Appendix v. V p. 349-364). On July 28, 2017, the District Court entered an Order staying the closing of the MURA. (Appendix v. V p. 375-77). On May 4, 2018, the District Court entered its rulings on the parties' post-trial Motions. (Appendix v. V p. 395-398). Intervenors timely filed their Notice of Appeal on May 30, 2018. (Appendix v. V p. 404-406).

STATEMENT OF FACTS

Plaintiff Homeland Energy Solutions, LLC ("HES") is an Iowa-based limited liability company in the business of processing feedstock into ethanol and related by-products at a plant it owns and operates in Chickasaw County, near Lawler, Iowa. (Appendix v. VII p. 24). Steve J. Retterath is a Florida resident and member of HES with an ownership interest of approximately

28.6 percent. (Appendix v. I p. 198, *¶ 5*). Intervenors, Jason and Annie Retterath, own approximately 4 percent of the outstanding units in HES and, at all relevant times, Intervenors were and are voting members of HES. (Appendix v. II p. 64, ¶ 4).

At all times material, the rights and obligations of HES and its members were set forth in the Amended and Restated Operating Agreement of Homeland Energy Solutions, LLC (the "Operating Agreement"). (Appendix v. VII p. 24). Under the Operating Agreement, HES has "one (1) class of Membership Interests, designated as Units, which Units are the only class of equity in the Company. The Units shall have no par value and shall be a single class with identical rights." (Appendix v. VII p. 42, § 6.1). HES Units are registered with the United States Securities Exchange Commission. (Appendix v. II p. 311-331).

HES is a manager-managed limited liability company, and refers to its managers as Directors, who are elected or appointed to its Board (the "Board"). (Appendix v. VII p. 26, § 1.10(n)). The Operating Agreement defines the authority of the Board of Directors in managing HES. (Appendix v. VII p. 34, Article V). Section 5.6(b)(v) of the Operating Agreement, contained under the "Restrictions on Authority of Directors" heading, states as follows:

> (b) The Directors shall not have the authority to, and they covenant and agree that they shall not cause the Company to, without the consent of the majority of the Membership Voting Interests:
>
> (v) Cause the Company to acquire any equity or debt securities of any Director or any of its Affiliates, or otherwise make loans to any Director or any of its Affiliates.

(Appendix v. VII p. 39, § 5.6(b)(v)). As acknowledged by HES, the clear purpose of this provision is to protect the members from insider deals between the Board of Directors and a fellow Director. (Appendix v. III p. 40-43).

On June 10, 2013, a Buyout Committee formed by the Board made an offer to acquire Steve Retterath's Units. (Appendix v. II p. 135). On June 13, 2013, Pat Boyle, acting at the direction and on the authority of the Buyout Committee formed by the Board, executed the MURA with HES Director Steve J. Retterath. (Appendix v. II p. 60-63). On June 19, 2013, the Board held a meeting to purportedly approve the MURA by an 8-3 vote. (Appendix v. I p. 188-189, ¶¶ 29, 30; Appendix v. II p. 65, ¶ 9).

The MURA purports to effectuate a complete acquisition of Defendant Steve Retterath units in HES. (Appendix v. II p. 60; Appendix v. II p. 65, ¶ 8). Steve J. Retterath was a Director when HES negotiated, made offers, and caused the MURA to be executed. (Appendix v. II p. 65, ¶ 10; Appendix v. II

p. 135). At no time, has HES obtained the consent of a majority of the Membership Voting Interests for the MURA or for any agreement or action causing HES to acquire the equity Units of Steve J. Retterath. (Appendix v. II p. 65, ¶ 11). In fact, after the MURA was signed, HES took the position that the MURA did not need a vote of the members to be valid. (Appendix v. II p. 74, ¶ 25).

Section 5(e) of the MURA provides Steve J. Retterath would submit his resignation as a Director as a condition of the MURA, and that this resignation would not be effective until "the Closing." (Appendix v. II p. 61, ¶ 5; Appendix v. II p. 65, ¶ 10). Pursuant to the MURA, the acquisition of Defendant Steve J. Retterath's equity units was to close on or before August 1, 2013. (Appendix v. II p. 61, ¶ 8). No closing ever occurred. (Appendix v. V p. 375-377).

On August 14, 2013, HES filed the above captioned lawsuit seeking specific performance of the MURA. (Appendix v. I p. 20-62). In its Petition filed in the above-captioned cause of action, HES alleges that the MURA is a "valid, written, enforceable contract that was properly executed by all parties thereto" and that HES is "ready, willing, and able to perform all of its duties under the agreement and has otherwise fully performed all of its duties under the agreement." (Id.). HES further asked the district court to order Defendant

Steve J. Retterath specifically perform his obligations under the MURA. (Id. at ¶ *16*).

As with the MURA itself, HES never obtained the consent of a majority of the Membership Voting Interests prior to pursuing and prosecuting its specific performance action. (Appendix v. II p. 66, ¶ 16). HES has also indicated that, despite never performing the MURA, it has acquired the "equitable interest" in Steve J. Retterath's Units. (Appendix v. II p. 66, ¶ 17; Appendix v. II p. 80; Appendix v. II p. 94; Appendix v. II p. 116). HES never obtained consent of a majority of the Membership Voting Interests prior to this acquisition of Steve J. Retterath's "equitable interest." (Appendix v. II p. 66, ¶ 18)

Section 11.11 of the Operating Agreement provides in pertinent part as follows:

> Each member acknowledges and agrees that the Company and the other Members would be irreparably damaged if any of the provision of this Agreement are not performed in accordance with their specific terms, and that monetary damages would not provide an adequate remedy in such event. Accordingly, it is agreed that, in addition to any other remedy to which the Company and the non-breaching Members may be entitled hereunder, at law or in equity, the Company and the non-breaching Members shall be entitled to injunction relief to prevent breaches of the provision of this Agreement . . . .

(Appendix v. II p. 58, § 11.11).

ARGUMENT

I. THE DISTRICT COURT ERRED IN RULING THE MEMBERSHIP APPROVAL PROTECTIONS OF THE HES OPERATING AGREEMENT DO NOT APPLY TO THE MURA SUCH THAT NO MEMBERSHIP VOTE WAS REQUIRED TO RATIFY THE MURA.

Scope and Standard of Review. This Court reviews a district court's summary judgment for errors at law. *Tenney v. Atlantic Assocs*., 594 N.W.2d 11, 14 (Iowa 1999). When reviewing the propriety of a grant of summary judgment, “the moving party is required to show that no genuine issue of material fact exists and that he or she is entitled to judgment as a matter of law.” *Dickerson v. Mertz,* 547 N.W.2d 208, 212 (Iowa 1996). In determining whether the movant has met this burden, the record is viewed “in a light most favorable to the party opposing summary judgment.” *Id.* Thus, “the nonmoving party [is] entitled to every legitimate inference that reasonably can be deduced from the evidence and summary judgment is inappropriate if reasonable minds can differ on how the issue should be resolved.” *Id.*

In this case, Intervenors challenge the district court’s conclusions as to the meaning and effect of the HES Operating Agreement. “Interpretation involves ascertaining the meaning of contractual words; construction refers to deciding their legal effect.” *Allen v. Highway Equipment Co*., 239 N.W.2d

135, 139 (Iowa 1976). Generally, the construction and interpretation of a contract are reviewed as a matter of law. *Hartig Drug Co. v. Hartig,* 602 N.W.2d 794, 797 (Iowa 1999). Thus, this Court is not bound by the construction or interpretation made by the district court. *Id*. However, if the interpretation was predicated upon extrinsic evidence, the findings of the trial court are binding on appeal if supported by substantial evidence. *Id*. However, "when no relevant extrinsic evidence exists, the resolution of any ambiguity in a written contract is a matter of law for the court." *Id*. The district court did not rely on any extrinsic evidence in interpreting and applying the HES Operating Agreement. (Appendix v. III p. 70-75). Therefore, the district court's interpretation and construction of the HES Operating Agreement are both reviewed for errors of law.

Preservation of Error. On May 26, 2015, Intervenors filed their Second Amended Petition. All five counts of this petition are premised on HES's failure to allow its members, including Intervenors to vote on the insider deal contemplated by the MURA as required by the HES Operating Agreement. (Appendix v. I pp. 498-504). Intervenors argued a membership vote was required by HES's Operating Agreement in their motion for summary judgment papers. (Appendix v. II p. 144-159). The district court ruled on this issue in its Ruling on Defendant's Motion for Summary

Judgment. (Appendix v. III p. 75). The district court later clarified its ruling was limited to the conclusion, "the Member approval requirements of Section 5.6(b)(v) of the Operating Agreement do not apply to the MURA and therefore a membership vote was not required to ratify the MURA." (Appendix v. III p. 109). In the same ruling, the district court confirmed it was adjudicating and dismissing all five Counts in the Intervenors' Second Amended Petition. (*Id).* Therefore, the voting issue was raised and ruled upon and is accordingly preserved for review. *See Meier v. Senecaut*, 641 N.W.2d 532, 537 (Iowa 2002) ("It is a fundamental doctrine of appellate review that issues must ordinarily be both raised and decided by the district court before we will decide them on appeal.")

Argument. The district court, in its December 8, 2015 Order clarifying, enlarging, and modifying it prior ruling on the parties motions for summary judgment framed the issue before it on the parties' motions for summary judgment as follows: "[t]he sole issue before the Court on the parties' Motions for Summary Judgment was 'whether or not a Member vote was required to approve the [MURA] that [Steve] Retterath and <u>HES executed</u> in June 2013." (Appendix v. III p. 108 (emphasis added)). The above emphasized portion of the district court's recitation of the issue demonstrates the district court never fully grasped the material issue before it: was Pat

Boyle's June 13, 2013, signature on the MURA ever properly ratified by HES such that HES "signed" the MURA? Resolution of this issue turns on whether HES's Board of Directors could ratify Boyles' signature on the MURA, as HES claims, or whether the members of HES needed to approve the insider deal contemplated by the MURA. The answer to this question is provided by the common law of Iowa, Iowa Code chapter 489 governing limited liability companies like HES, and HES's Operating Agreement.

A. The District Court Summary Judgment Ruling is Contrary to the Acknowledged Intent of the HES Operating Agreement's Insider Deal Protections as Clearly Expressed in Section 5.6(b)(v).

"[T]he purpose of an LLC agreement, like all agreements, is to define the rules of the game so that all parties know what to expect." *In re NextMedia Investors, LLC*, CIV.A. 4067-VCS, 2009 WL 1228665 (Del. Ch. May 6, 2009); *see also Morrison v. Mahaska Bottling Co.*, 39 F.3d 839, 843 (8th Cir. 1994) ("The voting rights for the stock in this case must be determined by the terms of the agreements."). Importantly, while discussing articles of incorporation for a corporation, rather than a limited liability company's operating agreement, the Iowa Supreme Court noted, "articles of incorporation form part of a contract between the corporation and its shareholders." *Lange v. Lange*, 520 N.W.2d 113, 118 (Iowa 1994).

Under Iowa law, "the cardinal rule of contract construction [is that] the parties' intent controls." *See Lange v. Lange*, 520 N.W.2d 113, 119 (Iowa 1994); *see also Am. Anglian Envtl. Technologies, L.P. v. Envtl. Mgmt. Corp.*, 412 F.3d 956, 958 (8th Cir. 2005) ("The fundamental principle of interpreting operating agreements is to ascertain the intent of the parties and give effect to it.") (citing analogous Missouri case law). Unless there is an ambiguity, "intent is determined by what the contract itself says." *See Lange*, 520 N.W.2d at 119 *see also Envtl. Technologies, L.P.*, 412 F.3d at 958 ("A clear and unambiguous operating agreement must be enforced according to its terms.") In interpreting a contract, our Iowa courts give effect to the language of the entire contract. *See Lange*, 520 N.W.3d at 119.

The central issue for this Court's consideration is whether Section 5.6(b)(v) of the Operating Agreement restricts the HES's Board's authority and actions pertaining to the MURA. Section 5.6(b)(v) provides as follows:

> (b) The Directors shall not have the authority to, and they covenant and agree that they shall not cause the Company to, <u>without the consent of the majority of the Membership Voting Interests</u>:
>
> > (v) <u>Cause the Company to acquire any equity or debt securities of any Director</u> or any of its Affiliates, or otherwise make loans to any Director or any of its Affiliates.

(Appendix v. II p. 44, § 5.6(b)(v) (emphasis added))

Significantly, HES has acknowledged the clear intent of this provision is to prevent insider deals between the Company and its Directors. (Appendix v. III p. 40-43). To wit, before a hearing in federal court, the presiding judge circulated questions to counsel, one of which was for the parties to indicate the purpose of Section 5.6 of the HES Operating Agreement. HES's counsel responded as follows:

> So to get started, to answer your first question, what is the purpose of this section, and from our perspective, if you took a very broad view, the purpose of this section is to protect the members. It protects them in a way that is specific by requiring the **Board to get their consent in the context of certain specified transactions where the directors as a whole, as a governing body, are transacting with one of their own, one of the directors on that same board.**

(Appendix v. III p. 40, (emphasis added)).

Even without this acknowledgement, the intent is obvious, as the section is titled, "Restrictions on Authority of Directors." Further, this intent is consistent with Iowa law, as our Iowa Supreme Court has mandated, insider deals,

> [M]ust be done in the strictest good faith and with full disclosure of the facts to, and the consent of, all concerned. And the burden is upon them to establish their good faith, honesty and fairness. Such transactions are scanned by the courts with skepticism and the closest scrutiny, and, may be nullified on slight grounds.

Atlas Coal Co. v. Jones, 61 N.W.2d 663, 667-68 (Iowa 1953); *Des Moines Bank & Trust Co. v. George M. Bechtel & Co.*, 51 N.W.2d 174, 216 (Iowa 1952); *accord Gord v. Iowana Farms Milk Co.*, 60 N.W.2d 820, 831 (Iowa 1953) ("Corporate Directors and officers may under proper circumstances transact business with the corporation including the purchase or sale of property, but it must be done in the strictest good faith and with full disclosure of the facts to, and the consent of, all concerned.").

Despite the clear intent of Section 5.6(b)(v) the district court concluded "the Member approval requirements of Section 5.6(b)(v) of the Operating Agreement do not apply to the MURA and therefore a membership vote was not required to ratify the MURA." (Appendix v. III p. 108) The rationale for this conclusion is contained in the district court's October 16, 2015, Ruling on Defendant's Motion for Summary Judgment wherein the district court inexplicably concludes the HES Units of a Director that are being sold back to the Company are not "equity securities" within the meaning of HES's insider trading protections. (Appendix v. III p. 75). The district court's rationale is equally confounding as it reasoned the insider trading protections were meant to protect the HES members only from limited types of insider deals involving extraneous equity, while leaving insider deals in the Company's own equity available. (Id.). To wit, as stated by the district court,

> The Court finds… that the language in 5.6(b)(v) refers to the acquisition of something different than a Director's Units…. The Court finds that 'Unit' is not encompassed in the language 'acquire any equity or debt securities', as used in Section 5.6(b)(v).

(Id.) (emphasis added). As established below, this conclusion is wholly unjustifiable in the light of the HES Operating Agreement, Prospectus as well as federal and Iowa statutes governing public securities.

1. Membership Units are "Equity Securities" Under Section 5.6(b)(v)

As detailed above, the district court concluded the term "any equity or debt securities" as used in Section 5.6(b)(v) of the HES Operating Agreement is narrow. In fact, the district court concluded the term is so narrow it actually excludes the only equity actually referred to in the Operating Agreement, that being, HES Units. Stated otherwise, the district court's interpretation of the HES Operating Agreement anti-insider dealing provision is that it allows some types of insider deals, and in fact, specifically allows insider deals in the Company's equity. Not surprisingly, review of the Operating Agreement, as well as Iowa statutes governing limited liability companies and public securities establishes a contrary intent.

To wit, the Operating Agreement provides as follows: "each Member who holds five thousand (5,000) or more Units, all of which were purchased by such Member from the Company during its initial public offering ("IPO")

of equity securities filed with the Securities Exchange Commission, shall be deemed an 'Appointing Member'…." (Appendix v. II p. 41, § 5.3(f) (emphasis added)). Significantly, the Prospectus makes clear what "equity securities" were offered at the IPO, as it provides as follows:

> The Securities being offered by [HES] are Limited Liability Company Membership Units….We are offering limited liability company membership units in Homeland Energy Solutions, LLC, a development stage Iowa limited liability company….The offering will end no later than November 30, 2007. If we sell the maximum number of units prior to November 30,3007, the offering will end on or about the date that we well the maximum number of units.

(Appendix v. II p. 312 (emphasis added)). As emphasized, the equity securities being offered by HES at the IPO were clearly HES Units. Therefore, when read together, Section 5.3(f) of the Operating Agreement and the Prospectus establish that the "equity securities" offered at the IPO were Units. This conclusion is substantiated by a review of Section 6.1 of the Operating Agreement, titled "Membership Units" which provides as follows: "The Company is initially organized with (1) class of Membership Interests, designated in Units, which Units are initially the only class of **equity** in the Company." (Appendix v. II p. 47, § 6.1 (emphasis added)).

This conclusion is further bolstered by the fact HES Units are registered with the United States Securities Exchange Commission ("SEC"). Importantly, the following definition of "equity security" provided by the

Securities and Exchange Act belies the district court's conclusion the term is narrow:

> The term "equity security" means any stock or similar security; or any security future on any such security; or any security convertible, with or without consideration, into such a security, or carrying any warrant or right to subscribe to or purchase such a security; or any such warrant or right; or any other security which the Commission shall deem to be of similar nature and consider necessary or appropriate, by such rules and regulations as it may prescribe in the public interest or for the protection of investors, to treat as an equity security.

15 U.S.C.A. § 78c. As emphasized above, and as noted by the U.S. District Court for the Northern District of Illinois, this definition gives the SEC authority to include within the definition of equity security "any other security which the Commission shall deem to be of a similar nature" and considers appropriate to treat as an equity security. *See Seinfeld v. Hosp. Corp. of Am.*, 685 F. Supp. 1057, 1064 (N.D. Ill. 1988). Additionally, the SEC has itself broadly defined "equity security" as follows:

> The term equity security is hereby defined to include any stock or similar security, certificate of interest or participation in any profit sharing agreement, preorganization certificate or subscription, transferable share, voting trust certificate or certificate of deposit for an equity security, limited partnership interest, interest in a joint venture, or certificate of interest in a business trust; any security future on any such security; or any security convertible, with or without consideration into such a security, or carrying any warrant or right to subscribe to or purchase such a security; or any such warrant or right; or any put, call, straddle, or other option or privilege of buying such a

> security from or selling such a security to another without being bound to do so.

17 C.F.R. § 240.3a11-1. Finally, the Iowa General Assembly has expressly included an interest in a manager-managed limited liability company, such has HES, within the definition of "security." *See* Iowa Code 502.102(28)(e). Therefore, the term "Unit" is encompassed within the term "equity security" rather than excluded by it.

The district court's contrary conclusion runs afoul of the cardinal principal of contract interpretation and construction, i.e., the intent of the parties. *See Lange*, 520 N.W.2d at 119. Specifically, as noted above, HES acknowledged at a hearing before the United States District Court for the Northern District of Iowa the purpose of the voting requirement is to protect the shareholders from the insider deals, such as the MURA. (Appendix v. III pp. 42-43).

As referenced above, this protection against such insider deals is consistent with the public policy of this state and throughout the United States. *See*, *George M. Bechtel & Co.,*51 N.W.2d at 216-17; *Atlas Coal Co. v. Jones*, 61 N.W.2d 663, 667-68 (Iowa 1953) (noting insider deals must be done with consent of all involved); *See also*, Mills *v. Elec. Auto-Lite Co.,* 396 U.S. 375, 381, 90 S. Ct. 616, 620, 24 L. Ed. 2d 593 (1970) ("Fair corporate suffrage is an important right that should attach to every equity security bought on a

public exchange." (quoting H.R.Rep.No.1383, 73d Cong., 2d Sess., 13); *Shidler*, 775 F.2d at 925 (8th Cir. 1985) (noting deprivation of voting procedure "deprived minority shareholders of their basic property right to a meaningful voice in the conduct of corporate affairs.")

Further, application of the term "equity securities" to include HES Units is clearly supported by the context in which the term is used. *See Peak v. Adams*, 799 N.W.2d 535, 547 (Iowa 2011) ("[The] canon of construction, *noscitur a sociis* . . . summarizes the rule of both language and law that the meanings of particular words may be indicated or controlled by associated words."). In full context, Section 5.6(b)(v) of the Operating Agreement states Directors shall not "cause the company to acquire **any** equity or debt securitie*s*." In this context, where the word "any" is used as a pronoun in conjunction with a plural noun, it means, "any one or ones; any amount or number." *See Webster's NewWorld Dictionary 62* (2nd College Ed. 1984). Consequently, in full context, consistent with the SEC definition, the term "equity securities" is used broadly to denote an entire category of equity, which includes HES Units.

Additionally, common sense also dictates that HES units are included in the phrase "any equity or debt securities" in Section 5.6(b)(v) rather than excluded from it. Under the district court's analysis, the HES membership

would need to vote to determine if HES could buy ten shares of IBM stock from a Director, but not vote on whether the HES Board of Directors could buyout a fellow Director's Units, including what the terms of this insider deal would be. The membership clearly has a greater interest in the transaction which directly affects their investments in HES.

In rejecting the above analysis and logic, the district court relied on its interpretation of Section 5.16 of the HES Operating Agreement, concluding it controlled the insider deal contemplated by the MURA rather than Section 5.6(b)(v). Otherwise stated, the district court concluded the committee powers referenced in Section 5.16[1] of the HES Operating Agreement trump the voting rights of the members mandated in section 5.6. (Appendix v. III p. 74-75). In so concluding, the district court again erred.

2. The Committee Powers of Section 5.16 of the Operating Agreement do not Trump the Members' Voting Protections for Insider Deals.

The district court reasoned as follows regarding the effect of Section 5.16 of the HES Operating Agreement:

> [T]he language in § 5.16 subparagraph (vii) indicates… that in fact the Board does possess the power to reacquire. Section 5.16 clearly contemplates a situation exactly like what happened in this case. A committee was formed and authorized by the Board.

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[1] The district court also referenced Article 9 of the HES Operating Agreement. This Article is inapplicable to the parties' dispute on its face, as it applies only to transfers of Units. (Appendix v. II pp. 51-52).

> The purpose was to negotiate the reacquisition of Retterath's units. The Court finds HES's argument in this respect persuasive and agrees that the language in 5.6(b)(v) refers to the acquisition of something different than a Director's Units.

(Appendix v. III pp. 74-75). Section 5.16 deals with authority of directors to create committees and states:

> 5.16 Committees; Authority. The Directors may create such committees, and appoint such persons to serve on them, as the Directors deem appropriate…. Board committees may exercise only those aspects of the Directors' authority which are expressly conferred by the Directors by express resolution. Notwithstanding the foregoing, however, a committee may not, under any circumstances: …. (vii) authorize or approve the reacquisition of Units, except according to a formula or method prescribed by the Directors….

(Appendix v. II p. 45, § 5.16(vii) (emphasis added)).

Importantly, as emphasized, Section 5.16, contains the following limitation on the power of committees: "Board committees may exercise only those aspects of the Director's authority as are expressly conferred by the Directors…." (Appendix v. II p. 45, § 5.16 (emphasis added)). Notably, section 5.6 is titled "Restrictions on Authority of Directors." (Appendix v. II p. 43, § 5.6 (emphasis added)). As detailed above, subpart (a) of section 5.6 mandates that Directors "shall not have authority to" take certain actions without the unanimous consent of the Members, and subpart (b) provides Directors "shall not have authority to" take certain other actions without approval of a majority of Members. (*Id*. (emphasis added)). Thus, the

committee formation provisions of section 5.16 of the Operating Agreement could never trump the voting restrictions on Director authority contained in section 5.6. Rather, the restrictions on Director authority contained in section 5.6 are expressly applicable to the committees formed under section 5.16. Logically, Section 5.6 of the Operating Agreement contains a list of activities that Directors have no authority to authorize without approval of the Members, and likewise, cannot be authorized by committees without Member approval. *See Miller*, 336 N.W.2d at 716 (concluding a corporate board did not have the power to delegate to a committee the authority to do that which it may not do itself).

In concluding otherwise, the district court relied on the "well-established rule of contract construction…that when a contract contains both general and specific provision on a particular issue, the specific provisions are controlling." (Appendix v. III p. 74). The district court correctly recited the general rule. *See Westlake Investments, LLC v. MLP Mgmt., LLC*, No. 4:09-cv95, 2010 WL 7361159, at *5 (S.D. Iowa Mar. 3, 2010) ("[I]f a conflict exists between contractual provisions, 'a contract's specific term controls over a general term.'"). However, the district court erred in its application.

Significantly, the district court does not explain or otherwise support how it concluded the provisions of Section 5.16 are more specific than those

of Section 5.6. A review of the HES Operating Agreement supports a contrary conclusion. To wit, Section 5.6 is the only provision of HES's Operating Agreement that specifically applies to the authority of Directors, and subsection 5.6(b)(v) is the only provision that specifically addresses how the Directors may cause the company to acquire **any** equity security **of a Director**. As established above, Section 5.6(b)(v)'s language "acquire **any** equity or debt securities of any Director" necessarily includes HES Units as **any** equity or debt securities is a category much broader than the defined term Units. Whereas Section 5.16(vii) discusses reacquisition of Units of any member generally. Under the rule of construction cited above, and referenced by the district court, Section 5.16(vii) discussing reacquisition of Units generally, must yield to the specific provisions of Section 5.6(b)(vii) restricting insider deals involving the acquisition of a director's equity securities.

The district court also appeared to place some importance on the use of the term "acquire" in Section 5.6(b)(v) and "reacquisition" in 5.16(vii). (Appendix v. III p. 74). As with the rules of construction discussed above, the import of the distinction is the reverse of the reasoning set forth by the district court, and highlights the district court's failure to apprehend the breadth and resultant effect of terms. Once again, the term used in the insider

deal protections of Section 5.6(b)(v) – "acquire", is broader, than that used in Section 5.16(vii) – "reacquire."

Simply stated, the term "acquire" necessarily includes all acquisitions, including "reacquisitions", whereas the term reacquisition does not necessarily include all acquisitions. This broad language is consistent with the acknowledged intent of Section 5.6(b)(v) of the Operating Agreement, i.e., to prevent insider deals, as it requires membership approval whenever HES obtains "any" equity from a director, whether it be a reacquisition or an initial acquisition.

For example, it requires membership approval whether HES is seeking to reacquire a Director's Units in HES or acquire a Director's Apple stock. The operative distinction is not what equity is being acquired, or whether it is an initial acquisition or reacquisition, but from whom it is being obtained. If that person is a Director, a member vote is necessary.

In addition to the above, the district court's conclusion Section 5.16(vii) supersedes Section 5.6(b)(v) is in error because it renders the acknowledged intent of Section 5.6(b)(v) superfluous. *See Am. Soil Processing, Inc. v. Iowa Comprehensive Petroleum Underground Storage Tank Fund Bd.*, 586 N.W.2d 325, 334 (Iowa 1998) ("Because an agreement is to be interpreted as a whole, it is assumed in the first instance that no part of it is superfluous; an

interpretation which gives a reasonable, lawful, and effective meaning to all terms is preferred to an interpretation which leaves a part unreasonable, unlawful, or of no effect".) Specifically, the acknowledged intent of Section 5.6(b)(v) is to restrict the authority of HES's Directors by establishing member vote procedures protecting the members from insider deals. If the district court's interpretation were correct, and the Committee powers of Section 5.16 trump the voting protection of Section 5.6, then the Directors could completely circumvent the voting protections of Section 5.6(b)(v) by simply appointing a Committee to "cause the company to acquire" the equity securities of a Director.

B. The HES Operating Agreement and Iowa Code Chapter 489 Require the MURA be Ratified by a Member Vote.

1. Only the Members can Ratify an Insider Deal.

HES has argued in prior briefing that no member vote was required on the insider deal contemplated by the MURA because the HES Board of Directors "approved" the MURA on June 19, 2013. HES acknowledges in the MURA itself that it had not made a valid offer or acceptance on June 13, 2013, when Mr. Boyle signed the MURA, as the MURA indicates the MURA must be accepted by the HES Board. (Appendix v. II p. 61, § 5(b)). HES avers its Board did so on June 19, 2013 when it "ratified" its June 10, 2013, offer and Pat Boyle's execution of the MURA by "approving" the MURA.

However, what HES fails to acknowledge is that its Board could never ratify its June 10, 2013, offer or Pat Boyle's June 13, 2013, execution of the MURA so that the HES Board's act of "approving" the offer or acceptance on June 19, 2013 is of no consequence.

Specifically, under Iowa law, only the principal may ratify the unauthorized act of an agent. *See Life Investors Ins. Co. of Am. v. Estate of Corrado*, 838 N.W.2d 640, 644 (Iowa 2013); *King v. Gustafson*, 459 N.W.2d 651, 653 (Iowa Ct. App. 1990) (noting the presence of a principal is the first element of a ratification). As established below, HES's argument that the Board vote of June 19, 2013, ratified the June 10, 2013, offer and/or Pat Boyle's acts of June 13, 2013 is fatally flawed as it is premised on the proposition that the HES Board was the "principal" that could authorize the offer/acceptance made on June 13, 2013.

Importantly, the HES Operating Agreement includes the following clause following its recitation of the "Restrictions on Authority of Directors":

> The actions specified herein as requiring the consent of the Members <u>shall be **in addition to** any actions by the Director that are specified in the Act as requiring the consent or approval of the Members.</u> Unless otherwise required by this Agreement or the Act, any such required consent or approval may be given by a vote of a majority of the Membership Voting Interests.

(Appendix v. II p. 43, § 5.6 (emphasis added)). The "Act" is defined as the Iowa Revised Uniform Limited Liability Company Act, which is codified in

Iowa Code chapter 489 (hereinafter the "LLC Act"). (Appendix v. II p. 30, § 1.10(a)).

Importantly, the LLC Act provides as follows:

> The operating agreement may specify the method by which a specific act or transaction that would otherwise violate the duty of loyalty may be **<u>authorized or ratified</u>** by one or more disinterested and independent persons after <u>full disclosure</u> of all material facts.

See Iowa Code § 489.110(5) (emphasis added). As detailed above and below, this statutory provision has its impetus in the common law and public policy of Iowa. *George M. Bechtel & Co.*, 51 N.W.2d 174 at 216. ("Corporate directors and officers may under proper circumstances transact business with the corporation including the purchase or sale of property, but it must be done in the strictest good faith and with full disclosure of the facts to, and the consent of, all concerned."). Of course, Iowa has recognized that self-dealing, or insider deals, typically violate the duty of loyalty. *Cookies Food Prod., Inc., by Rowedder v. Lakes Warehouse Distrib., Inc.*, 430 N.W.2d 447, 452 (Iowa 1988) (noting the duty of loyalty "derives from 'the prohibition against self-dealing that inheres in the fiduciary relationship.'"); *Dennison v. MediaComm, Inc.*, No. 15-0308, 2006 WL 1627998 at *2 (Iowa Ct. App., June 14, 2006) (same); *McGinnis v. Iowa Clinic, P.C.*, 776 N.W.2d 110 (Iowa Ct. App. 2009) ("The duty of loyalty generally requires officers and directors

to act in the best interests of the corporation and its shareholders, avoid conflicts of interests, and not engage in faithlessness and self-dealing."); *see also Harvey v. Leonard*, 268 N.W.2d 504 (Iowa 1978) (concluding trustees as income beneficiaries could agree to permit self-dealing on part of some trustees so long as all beneficiaries agreed and trust instrument permitted it, but since approval of all beneficiaries was not secured, such self-dealing was violative of trustees' duty of loyalty to trust and its beneficiaries). Thus, Iowa Code section 489.110(5) clearly provides that an operating agreement can "specify the method by which [insider deal]… may be authorized or ratified…."

HES's Operating Agreement does exactly this in providing the Directors cannot cause the company to acquire the equity of a Director or any of its Affiliates without "the consent of a majority of the Membership Voting Interests." (Appendix v. II p. 43, § 5.6). As detailed above, Section 5.6 further explains "any such required consent or approval may be given by a vote of a majority of the Membership Voting Interests." (Id.). Therefore, read in the light of Iowa Code section 489.110(5), Section 5.6(b)(v) of the Operating Agreement clearly and unambiguously establishes that the voting members of HES are the <u>only</u> "principal" that can ratify the insider deal contemplated by

the MURA.[2] Of course, HES's members were never provided full knowledge of the transaction, and the necessary vote never occurred. *Pillsbury Co. v. Ward*, 250 N.W.2d 35, 39 (Iowa 1977) (indicating that in order to ratify an unauthorized act of an agent the principal must have full knowledge of the facts and must intend to ratify.)

Stated otherwise, for the MURA to have been enforceable on June 19, 2013, as HES claims, there must have been a validly formed contract. *See Rector v. Falbo*, 786 N.W.2d 519 (Iowa Ct. App. 2010) (noting the distinction between formation of a valid contract and the enforceability of said contract). As detailed above, HES was without authority to make or accept an offer when these acts purportedly occurred on June 10 and June 13 of 2013. Thus, the Board's June 10, 2013, offer and Pat Boyle's June 13, 2013, execution of the MURA needed to be "ratified" by the parties to the agreement. *See McCarter v. Uban*, 166 N.W.2d 910, 913 (Iowa 1969) (noting that in order to become contractually bound the parties must manifest a mutual, unequivocal assent to the terms of the contract). Under the Operating Agreement, as authorized by the LLC Act, the "party" that must manifest assent to the insider deal

[2] Consistent with this conclusion, the LLC Act provides that the HES Board could not undertake any action outside the ordinary course of business without consent of the members. *See* Iowa Code 489.407(3)(d)(3). An insider deal, such as the MURA, is outside the ordinary course of business, and thus requires member approval. (Appendix v. II p. 29, § 1.3).

purportedly "struck" on June 13, 2013, is the voting members. Because this never occurred, there is no contract to enforce.

2. HES cannot Substitute Its Judgment for that of the Members.

In attempting to argue for enforcement despite the lack of a valid contract, HES has asserted in past briefing that "even if the Board had exceeded its powers in approving the MURA [without a vote], the MURA was not void because it was undeniably in the interests of the Company and its members." (HES Memorandum in Resistance to Steve Retterath MSJ, p. 8). This "no harm/no foul" argument completely ignores the importance of member voting as recognized by both Iowa courts and the rest of the country.

The U.S. District Court for the Northern District of Iowa has noted that under Iowa law, "[d]eprivation of a stockholder's right to vote takes away an essential attribute of his property." *DuVall v. Moore*, 276 F. Supp. 674, 679 (N.D. Iowa 1967); *McLain v. Lanova Corp.*, 39 A.2d 209, 211 (Delware 1944) ("The right to vote shares of stock, having voting powers, is ordinarily an incident of its legal ownership.") Further, the Supreme Court of Virginia, in summarizing the general law of the country concerning owner voting rights, emphasized that the right to vote cannot be taken away based on the belief others know better what is "best" for the corporation or company:

> Speaking generally, the right to vote is a right which is inherent in and incidental to the ownership of corporate stock, and as such is a property right, and it follows that the stockholder cannot be deprived of it, and that the right cannot be essentially impaired, either by the legislature or the corporation, without his consent, through amending the charter or by-laws. *This is equally true though he is given what others might regard as a better right by way of substitute.*

Fein v. Lanston Monotype Mach. Co., 85 S.E.2d 353, 360 (Virginia 1955) (emphasis in original); *See Holcomb v. Forsyth*, 113 So. 516, 520 (Alabama 1927) ("The authorities are agreed that a stockholder in a corporation, who appears by the books of the corporation to be such, cannot be deprived of the right to vote his stock on the mere allegation that he proposes to use his legal right for purposes which other stockholders may think not to the best interest, or even to the detriment, of the corporation." (Emphasis added)). Put simply, the HES Board exceeded its authority by attempting to authorize an insider deal without a member vote, and the Board cannot decree the deal valid by declaring the deal to be in the interest of the company.

A review of the 8th Circuit's decision in *Shidler v. All Am. Life & Fin. Corp.*, 775 F.2d 917 (8th Cir. 1985) is instructive. In *Shidler*, the court concluded that a private right of action existed for a corporation's failure to comply with a similar voting requirement found in Iowa's Business Corporation Act for corporate mergers. *See Shidler*, 775 F.2d at 924. Importantly, in *Shidler*, the shareholders, like Intervenors, claimed that the

denial of their right to vote effectuated a conversion. *See id*. at 925. Similar to HES, the corporation summarily dismissed the shareholders right to vote by claiming the failure to follow the statutory voting requirement was a mere "technical violation." *See id*. Significantly, the 8th Circuit held as follows:

> **We reject the defendant's characterization of its failure to follow the statutory prescriptions as a mere "technical flaw."** The single-class voting procedure deprived minority shareholders of their basic property right to a meaningful voice in the conduct of corporate affairs. Thus, plaintiffs may treat this deprivation as an injury sounding in the tort of conversion.

Id. at 925-26 (emphasis added, citations omitted). On appeal following remand, the 8th Circuit affirmed the district court's grant of summary judgment to the shareholders on their conversion claim. *Nelson v. All Am. Life & Fin. Corp.*, 889 F.2d 141, 148 (8th Cir. 1989) ("We think under Iowa law no reasonable jury could find but that a conversion has occurred."). Thus, the Intervenors' and other members right to vote on the MURA cannot be disposed of by arguing the result of the Board of Director's unauthorized action is somehow beneficial.

3. HES Cannot Render the Voting Protections a Nullity by Making a Director's Resignation a Term of the Insider Deal.

HES has also argued Retterath was not a Director when the MURA was "approved" by the Board so that no member vote was required. The district court concluded in its Motion for Summary Judgment Order that a dispute of

fact exists as to whether Steve Retterath was a Director at the time the Board approved the MURA. (Appendix v. III p. 70). As demonstrated below, this purported fact issue is immaterial.

In past briefing, HES asserted the Buyout Committee offer to Steve Retterath on June 10, 2013, when he was indisputably a Director, and the June 13, 2013 execution of the MURA by Pat Boyle, again while Steve Retterath was a Director, are of no consequence because the MURA was "not enforceable until the HES's Board's June 19, 2013, approval", which HES contends was after Steve Retterath resigned as a Director. (Appendix v. II p. 575). In so arguing, HES equates the enforceability of the MURA with actions that "cause the company to acquire" Units of a Director within the meaning of Section 5.6(b)(v). In other words, HES asserts it need not concern itself with the voting requirement of Section 5.6(b)(v) until after it enters into an enforceable contract with a Director. This argument is nonsensical.

Under HES's logic, the Members would not ever vote on an insider deal until after it was an enforceable contract. For instance, in the case *sub judice*, HES indisputably took the action that it believed rendered the MURA enforceable, i.e., its Board "approved" the MURA on June 19, 2013. When were the Members to vote on this insider deal? Under HES's illogical interpretation of "cause to acquire" it never needs to seek permission from its

owners to enter into an insider deal; instead, its Board of Directors need to seek forgiveness from the members in the event the members learn of and contest the insider deal entered into.

HES's interpretation is belied by the language used in the remainder of Section 5.6. For instance, Section 5.6(a)(ii) provides the Directors shall not "Knowingly engage in any act in contravention of this agreement." (Appendix v. II p. 43, § 5.6(a)(ii)). Likewise, Section 5.6(a)(iii) provides Directors shall not "Possess Company Property." (Appendix v. II p. 43, § 5.6(a)(iii)). Thus, when the Operating Agreement seeks to prohibit only a completed act, it has said exactly such.

Moreover, "[t]he cardinal rule of contract interpretation is to determine what the intent of the parties was at the time they entered into the contract." *Pillsbury Co. v. Wells Dairy, Inc.*, 752 N.W.2d 430, 436 (Iowa 2008). The restriction contained in Section 5.6(b)(v) governs insider deals between HES and its Directors. As detailed above, this type of deal, "must be done in the strictest good faith and with full disclosure of the facts to, and the consent of, all concerned." *Atlas Coal Co.*, 61 N.W.2d 663 at 667-68 (emphasis added). The Member vote restrictions in Section 5.6, are intended to provide the Members "full disclosure of the facts" so that the Members can provide (or withhold) their consent to the proposed insider deal through a vote. *See Mills*

v. Elec. Auto-Lite Co., 396 U.S. 375, 381, 90 S. Ct. 616, 620, 24 L. Ed. 2d 593 (1970); *Shidler*, 775 F.2d at 925.

Put simply, HES's attempt to replace the "cause to acquire" voting protection for members contained in Section 5.6(b)(v) with the term "enter into an enforceable contract" renders the voting protections of the Operating Agreement a nullity in contravention of Iowa law pertaining to construction of contracts. *See Am. Soil Processing, Inc.*, 586 N.W.2d at 334 ("This is in violation of another rule of contract construction: Because an agreement is to be interpreted as a whole, it is assumed in the first instance that no part of it is superfluous; an interpretation which gives a reasonable, lawful, and effective meaning to all terms is preferred to an interpretation which leaves a part unreasonable, unlawful, or of no effect.") *C & J Vantage Leasing Co. v. Wolfe*, 795 N.W.2d 65, 77 (Iowa 2011) (same). Specifically, under HES's construction, the HES Board can negotiate, execute, and agree on all material terms associated with its offer to acquire a Director's Units, and later approve and close on the insider deal with the Director, all without obtaining the approval of the majority of voting Members, so long as the selling Director resigns at or before closing. This absurd result is yet another reason why the Operating Agreement says "cause the Company to acquire" rather than simply "acquire." In sum, whether Steve Retterath was a Director on June 19, 2013,

is not material to the resolution of the parties' dispute, as under the clear terms of the Operating Agreement the HES Board indisputably caused HES to acquire is equity securities in the Company prior to June 19, 2013.

Additionally, Section 5.6(b)(v) provides a member vote is necessary when the Directors cause HES to acquire the equity security of an Affiliate of a Director. (Appendix v. II p. 44, § 5.6(b)(v)) Section 1.10(c) of the Operating Agreement defines the term "Affiliate" broadly to include "any Person directly or indirectly controlling, controlled by or under common control with such Person . . ." Mr. Eastman and Mr. Hatten continued to serve on HES's Board through not only August 1, 2013, but through trial. (Appendix v. VI p. 213:1-11). Mr. Eastman and Mr. Hatten continued to serve at the pleasure of Mr. Retterath. (*Id.* at Appendix v. VI p. 213:20-214:1). Thus, assuming *arguendo* that Mr. Steve Retterath was not a Director when the Board purportedly "approved" the MURA, he was indisputably an Affiliate of two Board members at such time such that the voting protections of Section 5.6(b)(v) still apply.

C. Summary

The district court's conclusion that "equity securities" as used in Section 5.6(b)(v) of the HES Operating Agreement "refers to the acquisition of something different than Director's Units" cannot be reconciled with the

acknowledged intent of Section 5.6(b)(v), the language used in the Operating Agreement, Iowa Code chapter 489, or common sense and logic. The district court summary judgment order is in error. Intervenors ask that this Court reverse the district court order and hold the MURA is unenforceable and invalid for lack of membership approval.

II. THE DISTRICT COURT ERRED IN CONCLUDING THE MURA DID NOT VIOLATE THE PUBLIC POLICY OF IOWA.

Scope and Standard of Review. This Court reviews a district court's summary judgment for errors at law. *Tenney v. Atlantic Assocs*., 594 N.W.2d 11, 14 (1999).

Preservation of Error. Intervenors argued the MURA violated the public policy of Iowa in their summary judgment papers, and at the hearing held on the motions for summary judgment. (Appendix v. III p. 33-34; MSJ Trans., pp 80-81). The district court ruled on this issue in denying Intervenors motion for summary judgment. (Appendix v. III p. 70, n. 4). Therefore, the public policy issue was raised and ruled upon and is accordingly preserved for review. *See Meier*, 641 N.W.2d at 537.

Argument. Even if the MURA was otherwise valid, it is nonetheless unenforceable. Specifically, our Iowa Supreme Court has determined,

> A promise or other term of an agreement is unenforceable on grounds of public policy if legislation provides that it is unenforceable <u>or</u> the interests in its enforcement is clearly

> outweighed in the circumstances by a public policy against the enforcement of such terms.

See Mincks Agri Center, Inc., 611 N.W.2d at 275 (emphasis added). Importantly, in the case *sub judice*, the MURA is unenforceable based on clear policies announced by the General Assembly and the Iowa Supreme Court.

Specifically, the Iowa General Assembly has provided that "[a] limited liability company is bound by and may enforce the operating agreement, whether or not the company has itself manifested assent to the operating agreement." *See* Iowa Code § 489.111 (emphasis added). The obvious intent of this provision is to ensure limited liability companies and their managers, such as the HES Board of Directors, abide by the restrictions on their power contained within the governing document. As detailed above, as it pertains to insider deals, the HES Operating Agreement requires consent of a majority of voting members as a protection against such deals.

Yet, in subsection 5 of the MURA, HES indicates that it can waive certain conditions to its obligation to close the transaction contemplated by the MURA, including the condition that "the Company's Board of Directors shall have approved this Agreement . . . in accordance with the Company's operating agreement." (Appendix v. II p. 61, § 5(b) (emphasis added)). Pursuant to section 489.111, HES cannot, as a matter of legislatively mandated policy, waive that its approval of the MURA be in accord with its

Operating Agreement, and the HES Board certainly cannot waive the voting protections of Section 5.6(b)(v) pertaining to insider deals.

Further, as detailed above, the Iowa Supreme Court has made the following pronouncement clearly stating a public policy disfavoring the deal contemplated by the MURA:

> Corporate directors and officers may under proper circumstances transact business with the corporation including the purchase or sale of property, but it must be done in the strictest good faith and with full disclosure of the facts to, and the consent of, all concerned. And the burden is upon them to establish their good faith, honesty and fairness. Such transactions are scanned by the courts with skepticism and the closest scrutiny, and, may be nullified on slight grounds. It is the policy of the courts to put such fiduciaries beyond the reach of temptation and the enticement of illicit profit. These principles are founded on the soundest morality and have received the clearest recognition in all courts.

George M. Bechtel & Co., 51 N.W.2d at 217 (citations omitted) (emphasis added); *accord Atlas Coal Co.*, 61 N.W.2d at 667-68 (emphasis added). As detailed above, this public policy is codified in the LLC Act wherein the General Assembly mandated that the Operating Agreement can "specify the method by which a [insider deal] may be authorized or ratified by one or more disinterested and independent persons after full disclosure of all material facts." *See* Iowa Code § 489.110(5) (emphasis added). While the district court noted that "the law allows nullification of an insider deal" it inexplicably

concludes, without analysis, that "the record does not support such a finding." (Appendix v. III p. 70, n. 4)

In sum, the legislature has announced a clear intent that limited liability companies be bound by their operating agreements. Yet, the MURA purports to allow HES to "waive" compliance with the Operating Agreement. Further, the Iowa Supreme Court disfavors insider deals, and indicated they should be nullified where all parties concerned have not been afforded knowledge of, and consented to, the deal. HES's specific performance action attempts to circumvent this public policy by enforcing an insider deal that was purportedly entered into, and is now being enforced, without affording the members full knowledge of the deal, and without obtaining their consent to either the deal, or the attempt to enforce it. Worse, HES has acknowledged the subject insider deal is the type of deal the members would want to know about, and vote on as one member of the HES Board admitted the MURA provided an "above-market" price. (Appendix v. VI p. 100:15-22). The district court failed to follow the Iowa Supreme Court's mandate and "scan [the transaction contemplated by the MURA] with skepticism and close scrutiny." Had it done so, the district court would have concluded the MURA was clearly an insider deal, and that it had been entered into by HES without the "knowledge and consent" of "all concerned" so that it should be

"nullified." *Atlas Coal Co.*, 61 N.W.2d at 667-68 (1953)*; see also George M. Bechtel & Co.*, 51 N.W.2d at 217 (concluding vote by board of directors would not give absolution to insider deal where board was dominated by interested board members); *see also Rogers v. Webb*, 558 N.W.2d 155, 156 (Iowa 1997) ("Contracts that contravene public policy will not be enforced.").

III. THE DISTRICT COURT ERRED IN IN NOT ENJOINING HES FROM SEEKING SPECIFIC PERFORMANCE OF THE MURA.

Scope and Standard of Review. "An injunction may be obtained as an independent remedy in an action in equity, or as an auxiliary remedy in any action." *State ex rel. Dobbs v. Burche*, 729 N.W.2d 431, 435 (Iowa 2007) (citing *Lewis Invs., Inc. v. City of Iowa City,* 703 N.W.2d 180, 184 (Iowa 2005) (quoting Iowa R. Civ. P. 1.1501)). If an injunction is obtained as an independent remedy in an equitable action, review is *de novo*; however, if an injunction is obtained as an auxiliary remedy in an action at law, review is for correction of errors of law. *See ex rel. Dobbs*, 729 N.W.2d at 435. This case was filed and tried as an equitable action in which Intervenors sought an injunction as an independent remedy such that review of this issue is *de novo*. *In re Langholz*, 887 N.W.2d 770, 775 (Iowa 2016) ("This case was filed and tried as an equitable action, and therefore our review is de novo.")

Preservation of Error. On May 26, 2015, Intervenors filed their Second Amended Petition asserting, in Count II, a claim for Permanent

Injunctive Relief. (Appendix v. I p. 500). Intervenors sought summary judgment on this claim. (Appendix v. II p. 159-160). The district court dismissed Intervenors' claim for injunctive relief as part of its Ruling on Defendant's Motion for Summary Judgment as clarified in its December 8, 2015, Ruling on Rule 1.904(2) Motion. (Appendix v. III p. 107-110). Therefore, this issue was raised and rule upon and is preserved for appellate review. *See Meier*, 641 N.W.2d at 537.

Argument. Jason and Annie intervened in the subject cause of action in order to protect their rights under the HES Operating Agreement, the Iowa Code, and the common law of Iowa. The Iowa General Assembly has recognized the importance of a limited liability company's operating agreement, and adherence thereto, in codifying Iowa Code chapter 489. Iowa Code section 489.110(1) provides that an LLC's operating agreement governs the relations between the company and its members, as well as the activities of the company and the conduct of those activities. As detailed above, Iowa Code section 489.110(5) provides that an operating agreement can specify how an unauthorized act by a director may be ratified. Further, as explained by other jurisdictions, a limited liability company's operating agreement "define[s] the rules of the game so that all parties know what to expect." *In re NextMedia Investors, LLC*, CIV.A. 4067-VCS, 2009 WL 1228665 (Del.

Ch. May 6, 2009); *see also Morrison v. Mahaska Bottling Co.*, 39 F.3d 839, 843 (8th Cir. 1994) ("The voting rights for the stock in this case must be determined by the terms of the agreements.").

Importantly, Iowa Code section 489.901 provides as follows: "a member may maintain a direct action against another member, a manager, or the limited liability company to enforce the member's rights and otherwise protect the member's interests, including rights and interests under the operating agreement or this chapter or arising independently of the membership relationship." Iowa Code § 489.901 (emphasis added). HES is an Iowa limited liability company and is thus governed by Iowa Code chapter 489 and its operating agreement. *See* Iowa Code §§ 489.104, 489.106 and 489.110. Intervenors are members of HES. Thus, Intervenors have a statutorily recognized interest in bringing an action to enforce their rights and interests under the HES Operating Agreement, Iowa Code chapter 489, and the common law of Iowa.

The importance of allowing member actions to prevent violations of the HES Operating Agreement is memorialized in the agreement itself. Specifically, Section 11.11 of the Operating Agreement provides in pertinent part as follows:

> Each member acknowledges and agrees that the Company and the other Members would be irreparably damaged if any of the

> provision of this Agreement are not performed in accordance with their specific terms, and that monetary damages would not provide an adequate remedy in such event. Accordingly, it is agreed that, in addition to any other remedy to which the Company and the non-breaching Members may be entitled hereunder, at law or in equity, the Company and the non-breaching Members shall be entitled to injunctive relief to prevent breaches of the provision of this Agreement and to specifically to [sic] enforce the terms and provisions of this Agreement.

(Appendix v. II p. 58, § 11.11 (emphasis added)).

Significantly, Intervenors do not seek to enjoin violation of just any provision in the HES Operating Agreement. Rather, Intervenors seek to enjoin violation of the voting protections contained in Section 5.6 of the agreement. HES's Prospectus clearly provides that "All membership units have equal voting rights." (Appendix v. II p. 312).

"The right to vote is basic and fundamental to most shares of stock and is independent of any right that the corporate entity possesses." *Reifsnyder v. Pittsburgh Outdoor Advert. Co.*, 173 A.2d 319, 322 (Penn. 1961). "The right of voting stock is inseparable from the right of ownership. The one follows as a sequence from the other, and the right to vote cannot be separated from the ownership without the consent of the legal owner."' *Christmas v. Kennedy*, 194 A. 773, 776 (Penn. 1937). "Deprivation of a stockholder's right to vote takes away an essential attribute of his property." *DuVall v. Moore*, 276 F.Supp. 674 (N.D. Iowa 1967); *see also Brown v. McLanahan*, 148 F.2d 703,

708 (4th Cir. 1945); *Fein v. Lanston Monotype Mach. Co.*, 85 S.E.2d 353, 360 (Virginia 1955).

Intervenors do not seek to enjoin performance of just any type of transaction; Intervenors seek to enjoin performance of an unauthorized insider deal. Insider deals between directors and officers "must be done in the strictest good faith and with full disclosure of the facts to, and the consent of, **<u>all concerned</u>**." *See Atlas Coal Co. v. Jones*, 61 N.W.2d at 667-68 (emphasis added). Further, "[s]uch transactions are scanned by the courts with skepticism and the closest scrutiny, and, may be nullified on slight grounds." *Id*. at 668. In point of fact, the insider deal at issue is exactly the type of deal the members should know about and vote on as the HES Board offered one of its own an "above market" price for the Company's equity securities. (Appendix v. VI p. 100:15-22).

As detailed above, HES has admitted that the very purpose of the voting provision in Section 5.6 of the HES Operating Agreement was to protect the members from the very transaction contemplated by the MURA. To wit, before a hearing in federal court, the presiding judge circulated questions to counsel, one of which was for the parties to indicate the purpose of Section 5.6 of the HES Operating Agreement. HES's counsel responded as follows:

> So to get started, to answer your first question, what is the purpose of this section, and from our perspective, if you took a

> very broad view, the purpose of this section is to protect the members. It protects them in a way that is specific by requiring the **Board to get their consent in the context of certain specified transactions where the directors as a whole, as a governing body, are transacting with one of their own, one of the directors on that same board.**

(Appendix v. III p. 40-43 (emphasis added)).

Intervenors are HES Members who are not parties to the MURA. The HES Operating Agreement requires that they and the rest of the membership vote on HES's acquisition of Director Steve Retterath's Units. Intervenors have a right under Iowa law and the HES Operating Agreement to bring a direct action to enjoin violations of the HES Operating Agreement, including the voting provisions of said agreement. HES has deprived, and continues to deprive, Intervenors of "their basic property right to a meaningful voice in the conduct of corporate affairs." *See Shidler*, 775 F.2d at 925.

To wit, among the claims asserted by Intervenors is their claim that HES continues to violate the voting provisions of Section 5.6 of the HES Operating Agreement "by requesting the Court enforce the MURA." (Ruling on Motion to Disqualify, p. 2). As detailed above, the purpose of voting protections such as those found in Section 5.6 is to protect members and allow them to participate in governance of their company. HES's Board, by unilaterally pursuing performance of the MURA has hijacked this process from the members and is incurring substantial attorney fees and litigation

costs at their own whim, without permission or approval of the members. HES's Board has embarked on a path that if proven wrong, will require they ask forgiveness for the damages caused by their actions, rather than approval for the actions in the first place.

Significantly, as detailed above, Section 11.11 of the HES Operating Agreement provides a mechanism whereby members, such as Intervenors, can prevent the Board from causing damage in the first place as it authorizes an action for "injunctive relief to prevent breaches of the provision of this Agreement and to specifically . . . enforce the terms and provisions of this Agreement." (Appendix v. II p. 58, § 11.11) Intervenors availed themselves of this very relief in their Second Amended Petition wherein they sought to enjoin present and future violations of the HES Operating Agreement by way of HES's continuing efforts to enforce the insider deal contemplated by the MURA without allowing a vote of the members. It upheld, the district court order denying them an injunction, and allowing HES to continue to pursue performance of the MURA forever denies Intervenors this relief. This reality is why courts have "consistently found that corporate management subjects shareholders to irreparable harm by denying them the right to vote their shares." *Int'l Banknote Co. v. Muller*, 713 F. Supp. 612, 623 (S.D.N.Y. 1989);

accord Goggin v. Vermillion, Inc., No. CIV.A. 6465-VCN, 2011 WL 2347704, at *6 (Del. Ch. June 3, 2011).

In sum, as a result of the HES Board refusing to submit the MURA to a vote, the owners have been disenfranchised of the opportunity to decide whether HES should incur the significant expense and exposure to damages associated with the MURA and HES's specific performance action. The district court erred in not entering an injunction as allowed under Section 11.11 of the HES Operating Agreement preventing this ongoing violation of the voting protections of the Operating Agreement. Intervenors request this Court reverse the decision of the district court, and remand back to the district court with an Order to enter summary judgment in favor of Intervenors, including an Order enjoining the HES Board of Directors from continuing its unauthorized efforts to enforce the unauthorized MURA.

IV. THE DISTRICT COURT ERRED IN SEVERING THE SPECIFIC PERFORMANCE TRIAL.

Scope and Standard of Review. Bifurcation of trial is a matter of trial court discretion and will be disturbed only if the district court abused its discretion. *Beeman v. Manville Corp. Asbestos Disease Comp. Fund,* 496 N.W.2d 247, 251 (Iowa 1993).

Preservation of Error. On August 4, 2008, the district court entered an order granting Intervenors' Motion to Amend their Petition in Intervention

to assert additional claims and Steve Retterath's motion to amend his Answer to add counterclaims. (Appendix v. IV p. 292-293; Appendix v. IV p. 290-291). On August 9, 2016, HES filed a Motion to reconsider wherein they argued as an alternative form of relief that trial of HES's specific performance claim should be bifurcated from the claims brought through the respective amendments. (Appendix v. IV p. 294; ¶ 2). On August 19, 2016, Steve Retterath filed a Resistance to HES's Motion to Reconsider arguing bifurcation of the specific performance trial was not warranted. (Appendix v. V p. 215, ¶3(f)). On August 19, 2016, Intervenors likewise filed a Resistance to HES's Motion to Reconsider, joining in Steve Retterath's resistance and making additional argument. (Appendix v. V p. 218, ¶ 4). In addition, Intervenors argued the specific performance trial should not be bifurcated from their newly brought claims at the September 9, 2016, hearing held on HES's motion to reconsider (Appendix v. VI p. 37-43). On November 6, 2016, the district court entered an Order affirming its grant of leave to amend to Intervenors and Steve Retterath, but severing the trial of the specific performance action from the other claims and ordering "no discovery relating to the now amended pleadings of Defendant and Intervenor, or the issues raised therein, shall take place prior to the trial court's ruling relating to

Plaintiff's original petition." (11/6/16 Order on Motion to Reconsider, pp. 1-2)).

Argument. On November 6, 2016, the district court entered an Order severing HES's specific performance claim from Intervenors claims and Steve Retterath's counterclaims, and precluding any discovery on the respective claims and counterclaims. (Appendix v. V p. 221-222). While the district court did not cite any authority for its decision to bifurcate the specific performance trial and limit discovery, the authority therefore presumably derives from Iowa R. Civ. P. 1.914 which allows a court, "for convenience or to avoid prejudice, order a separate trial of any claim, counterclaim, cross-claim, cross-petition, or of any separate issue, or any number of any of them." *See* Iowa R. Civ. P. 1.914. As detailed below, the district court's order exceeded its authority under the Iowa Rules of Civil Procedure.

To wit, our Iowa Supreme Court has clarified Rule 1.914 is limited as follows:

> the district court purported to enter a final judgment on part of the case (i.e., whether the marriage was dissolved) without resolving the rest of it (i.e., the distribution of property). This is different from trying the case in segments while entering a final judgment only at the end, which is what rule 1.914 authorizes.

In re Marriage of Thatcher, 864 N.W.2d 533, 539–40 (Iowa 2015). As aptly summarized, "our rules of civil procedure do not allow the district court to

enter serial final judgments at different times in a single action between two parties, except for collateral matters such as cost or fee awards." *Id.* at 540.

In the case *sub judice,* the district court has entered a final judgment on HES's specific performance claim, without resolving the rest of the dispute between Steve Retterath and HES, and without resolving the dispute between Intervenors' and HES. Thus, the district court's order severing the specific performance trial will result in serial final judgments in contravention of Iowa's rules of procedure. Consequently, the order is an abuse of discretion. *Graber v. City of Ankeny,* 616 N.W .2d 633, 638 (Iowa 2000) (noting an abuse of discretion occurs when the court exercises its discretion on grounds or for reasons clearly untenable and a ground or reason is untenable when it is based on an erroneous application of the law).

This abuse of discretion has been prejudicial to Intervenors. *Jones. v. Univ. of Iowa*, 836 N.W.2d 127, 140 (Iowa 2013) (noting nonprejudicial error is not a ground for reversal on appeal). To wit, in their Third Amended Petition, Intervenors brought four counts all of which are substantially intertwined with HES's specific performance action and should have been decided at the time performance of the MURA was decided as they involve the same body of evidence. (Appendix v. V p. 38-44). For instance, in Count

VI[3], the Intervenors sought a declaration that the MURA had not closed at the time HES took Steve Retterath's "equitable interest" in his HES Units, and a declaration concerning HES's deprivation of distributions but continuing assessment of tax to Steve Retterath. (Id. p. 19). In Count VII, Intervenors sought an injunction under Section 11.11 of the HES Operating Agreement precluding HES from engaging in self-help by taking Steve Retterath's distributions without the MURA having been performed. Similarly, in Count IX the Intervenors asserted the HES Board of Directors violated their duties of good faith and fair dealing by their actions surrounding unauthorized MURA, unauthorized specific performance action, and the above referenced unauthorized "self-help" and taxation issues. As noted above, the Intervenors were precluded by the district court's order from conducting any discovery on these claims that were clearly related to the MURA and the HES's Board's unauthorized quest for performance of the MURA.

The prejudice to Intervenors is most clearly demonstrated by review of Count VIII of their Third Amended Petition. This Count isn't simply interrelated with the performance of the MURA, Count VIII avers the terms

[3] Intervenors began the numbering of their Counts in the Third Amended Petition in Intervention at Count VI because the district court had dismissed the Intervenors' Counts I-V in its rulings on the parties' motions for summary judgment.

of the MURA violate the HES Operating Agreement. Specifically, Count VIII asserts that even if a vote of the members were not required to perform the MURA, the MURA nonetheless violates Section 1.9 of the HES Operating Agreement because it is on terms less favorable to the Company than if the sale were with an "independent third party." (Id. at p. 22-23). Count VIII seeks an injunction under Section 11.11 of the Operating Agreement to prevent the HES Board from violating Section 1.9 of the Operating Agreement through performance of the MURA. (Id. at 23).

Significantly, Intervenors were not allowed to conduct any discovery on this issue prior to the trial on the specific performance action. Nonetheless, at the specific performance trial, HES Board Member Marchand admitted a violation of Section 1.9 of the Operating Agreement as she stated the MURA provided an "above-market" price. (Appendix v. VI p. 100:15-22). Yet, because of the district court's bifurcation order, Intervenors and their claim based on Section 1.9 of the Operating Agreement were not before the district court. Worse, if the district court's order granting specific performance is affirmed, and the MURA is performed, Intervenors will never get to present this claim in the current legal action. *See Lyon v. Willie*, 288 N.W.2d 884 (Iowa 1980) (noting allowing specific performance prior to adjudication of the rest of the parties' claims would result in an inability to unwind the

performance without a new lawsuit). Consequently, Intervenors have been prejudiced by the district court's order severing the specific performance trial from the Intervenors' claims and denying discovery on these claims. *See B&F Jacondson Lumber & Hardwar, L.L.P. v. Acuity, a Mut. Ins. Co.*, No. 16-1134, 2017 WL 6513961 (Iowa Ct. App. December 20, 2017) (holding district court abused its discretion to the prejudice of the appellant in failing to allow it to discover and present evidence on issues "at the heart of" its claims).

CONCLUSION

As the Iowa Supreme Court first acknowledge in 1952, insider deals, like the one contemplated by the MURA, should only be done "with full disclosure of the facts to, and the consent of, all concerned." *See George M. Bechtel & Co.,* 51 N.W.2d at 216; accord *Atlas Coal Co.*, 61 N.W.2d at 667-68. The district court's order denying Intervenors summary judgment and granting HES partial summary judgment allows HES to proceed towards performance of an insider deal without there ever having been "full disclosure of the facts to, and the consent of" the members of HES. The district court's conclusion upon which its order rests, i.e., that HES Units are not "equity securities" is in error. The district court summary judgment order should be reversed and remanded, with a directive that the district court enter judgment for Intervenors including a declaration that the MURA violates the voting

protections of Section 5.6(b)(v) of the HES Operating Agreement, Iowa's public policy regarding insider deals, and that HES be enjoined from continuing pursuit of performance of the MURA.

Alternatively, even if the district court's summary judgment were not reversed, the district court's order severing the specific performance trial from Intervenors' claims precluded Intervenors from establishing performance of the MURA violated the HES Operating Agreement prior to such performance being ordered, and was thus an abuse of discretion. This bifurcation order should be reversed, and a new trial ordered wherein all interrelated issues surrounding the MURA can be presented and decided.

REQUEST FOR ORAL ARGUMENT

Intervenors respectfully request oral argument concerning this appeal.

Respectfully submitted,

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CERTIFICATE OF FILING AND SERVICE

The undersigned hereby certifies he electronically filed the foregoing Intervenors/Appellants' Final Brief on February 1, 2019 via EDMS.

The undersigned hereby certifies on February 1, 2019, the foregoing Intervenors/Appellants' Final Brief was served by e-mail via EDMS on all parties of record.

/s/ Jason W. Miller February 1, 2019
Signature Date

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I hereby certify the cost of printing the foregoing Intervenors/Appellants' Final Brief was the sum of $ 0.00.

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