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IN THE SUPREME COURT OF IOWA

Supreme Court No. 19-1790

TRACY BARKALOW, TSB HOLDINGS, L.L.C. and BIG TEN PROPERTY MANAGEMENT, LLC,
Plaintiffs/Appellees/Cross-Appellants,
v.
BRYAN CLARK, JEFFREY CLARK,
Defendants-Appellants/Cross-Appellees,
And JOSEPH CLARK,
Defendant/Cross-Appellee.

BRYAN CLARK AND JEFFREY CLARK,
Counterclaim Plaintiffs/Appellants/Cross-Appellees,
v.
TRACY BARKALOW,
Counterclaim Defendant/Appellees/Cross-Appellant.

APPEAL FROM THE IOWA DISTRICT COURT
FOR JOHNSON COUNTY NO. LACV 079040
HONORABLE PAUL D. MILLER

APPELLANT'S FINAL BRIEF

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ROUTING STATEMENT

This case should be retained by the Iowa Supreme Court because it involves substantial issues of first impression concerning application of the judicial dissolution provision of the Revised Uniform Limited Liability Company Act, Iowa Code Chapter 489, in particular Iowa Code section 489.701(1)(d)(2) governing judicial dissolution when it is "not reasonably practicable to carry on the company's activities," and the equitable authority to fashion additional remedies. The court's resolution of this issue will have a significant impact on similarly situated limited liability companies dealing with disgruntled minority members, and this court should therefore retain this case. *See* Iowa Rule Appellate Procedure 6.1101(2)(c).

STATEMENT OF THE CASE

Nature of the Case

This case involves the district court's equitable authority to dissolve a viable and ongoing limited liability company because a minority member created an acrimonious and tense relationship amongst the company's members. It also involves the district court's authority to re-write company operating agreements regarding the allocation of equity interests to members by reclassifying capital contributions as loans and the limits of its equitable authority to order equitable remedies.

Like so many cases involving disputes within closely held business entities, this is a family dispute. Three members of Outside Properties, LLC ("Outside Properties") are brothers: Jeff Clark, Joe Clark, and Bryan Clark. (Vol.I-48:1-12).[1] The fourth member of Outside Properties is Tracy Barkalow. Mr. Barkalow, Jeff Clark, and Bryan Clark are brothers-in-law; they are married to three sisters. (Vol.I-48:1-12). Outside Properties was formed by four individuals to invest in rental property in Iowa City. Most of Outside Properties' real estate holdings are lucrative student rentals near Kinnick Stadium.

Mr. Barkalow initiated this lawsuit in an attempt to wrest control of Outside Properties from the Clarks and keep it for himself, or alternatively to dissolve Outside Properties. Just a few of his claims were: judicial expulsion (or dissociation) of the Clark brothers; judicial dissolution; breach of fiduciary duty; breach of contract; economic duress; and civil extortion. The disputes revolved around company governance issues, including voting rights, management rights, and contribution rights. After a five-day bench trial, the district court settled these disputes, clarifying the members' relationships going forward. The district court rejected and dismissed nearly

[1] Joe Clark is separately represented and has not appealed the district court ruling.
Each reference to "Vol.[I, II, III, IV or V]" refers to the Trial Transcript Volume.

all of Mr. Barkalow's claims, making detailed fact-findings in the Clark brothers' favor.

The district court overwhelmingly found against Mr. Barkalow factually and legally, recognizing that Mr. Barkalow was a "difficult partner." The court rejected Mr. Barkalow's request to dissolve Outside Properties on the ground of majority member oppression, but nonetheless entered an order dissolving the company on the basis that it was "not reasonably practicable to carry on the company's activities in conformity with the certificate of organization and the operating agreement" under Iowa Code § 489.702(d)(2) due to the acrimony between Mr. Barkalow and the Clarks. It then recategorized as loans capital contributions made by the Clark brothers years prior that Mr. Barkalow claimed unfairly diluted his interest in Outside Properties.

Though the district court's fact findings were sound, with one exception, its dissolution of Outside Properties—a viable enterprise— and its recategorization of validly made capital contributions as loans was improper and exceeded its equitable authority. Dissolution was improper where the court resolved the governance disputes between the parties, such that Outside Properties can viably carry on. The recategorization of properly made capital contributions into loans contravened the members' intent that they be able to make voluntary capital contributions, as expressed in the company's governing documents and correctly recognized by the district court. The recategorization remedy also produced a patently inequitable result by giving Mr. Barkalow, a recognized bad actor, a windfall of approximately $423,000.

Faithfulness to the provisions of the Revised Uniform Limited Liability Company Act requires this court to reverse the district court's order of dissolution. Alternatively, even if this court does not reverse the order of dissolution, it should still reverse the recategorization remedy.

Course of Proceedings

Plaintiffs are Tracy Barkalow ("Mr. Barkalow") and TSB Holdings, LLC and Big Ten Property Management, LLC, two entities owned solely by Mr. Barkalow. Mr. Barkalow's claims included: Count I: judicial expulsion of the Clarks from Outside Properties under Iowa Code § 489.602; Count II: judicial dissolution of Outside Properties under Iowa Code § 489.701; Count III: Breach of Fiduciary Duty against the Clarks; Count IV: Breach of Contract / Breach of Implied Covenant of Good Faith and Fair Dealing related to the Outside Properties Operating Agreement against the Clarks; Count V: Appointment of Receiver under Iowa Code § 680.1; Count VI: Breach of Contract/ Breach of Implied Covenant of Good Faith and Fair

Dealing related to Security Agreements; Count VII: Economic Duress; Count VIII: Civil Extortion; Count IX: Civil Conspiracy; Count X: Injunctive Relief (App. 015, 6/25/2018 Amended Petition). Mr. Barkalow dismissed Counts V and VII prior to trial.

Jeff and Bryan filed counterclaims against Mr. Barkalow, asserting claims for: Counts I and II: Declaratory Judgment and request for Injunctive Relief; Count III: Breach of Fiduciary Duty and Accounting; Count IV: Conversion (derivative claim on behalf of Outside Properties); Count V: Breach of Fiduciary Duty (derivative claim on behalf of Outside Properties); Count VI: Expulsion of Tracy as a member of Outside Properties (derivative claim on behalf of Outside Properties). (V.I.App. 071-077, Answer and Counterclaim to Amended Petition). Jeff and Bryan dismissed Counts I and III prior to trial.

The case proceeded to a five-day bench trial before the Honorable Judge Paul Miller on December 11, 2018. The district court entered its Ruling on August 8, 2019.

Following the district court's disposition of post-trial motions, Jeff and Bryan filed a timely Notice of Appeal on October 24, 2019, and Plaintiffs filed a Notice of Cross-Appeal on November 4, 2019.

Disposition of the Case in District Court

In its detailed August 8, 2019 Ruling, the district court made numerous legal and fact-findings in the Clarks' favor related to the interpretation of the operating agreement, determination of voting rights, and dispute over capital contributions.

The district court expressly found Outside Properties' governing documents unambiguously allowed additional voluntary capital contributions by the members under certain circumstances. (V.I.App. 271, Ruling). Such contributions were allowed if: (1) the voluntary contributions were approved by a majority of voting members, and (2) all members were provided an opportunity to participate. (*Id*.) Critically, the district court found both conditions were met for the two capital contributions Mr. Barkalow disputed. (*Id.* at 10, 12-15).

With respect to voting rights of the members, the district court found the governing documents unambiguously provided voting rights were based on one vote per member unless a demand was made with respect to a specific vote, in which case voting was proportionate to each member's total capital contributions. (V.I.App. 272-273, Ruling).

Ultimately, the district court concluded the Clarks did not act oppressively toward Mr. Barkalow when they made voluntary capital contributions, which diluted Mr. Barkalow's proportionate equity interest because (1) "Tracy was offered the opportunity to participate in both capital calls and declined, and (2) "both of the capital calls were supported by a legitimate business purpose." (V.I.App. 279, 280, Ruling). This finding was determinative of most of Plaintiffs' claims.

The district court dismissed Mr. Barkalow's claim for judicial dissolution of Outside Properties based on majority member oppression (Count II), because Mr. Barkalow failed to prove the Clarks defeated his reasonable expectations as a minority member and failed to show the Clarks' actions lacked a business purpose. (V.IApp. 278-281, Ruling). Counts III, IV, and X (breach of fiduciary duty; breach of contract/implied covenant of good faith and fair dealing; and for an injunction to prohibit dilution of Mr. Barkalow's membership interest) likewise failed based on the district court's findings that the Clarks acted pursuant to the governing documents and with a proper business purpose. (V.I.App. 281-283, Ruling).

With respect to Mr. Barkalow's separate claim that he and the Clarks entered an oral agreement to allow him to buy out the Clarks' interests in Outside Properties at some future date (Count IV), the district court found the terms Mr. Barkalow claimed were too indefinite to form a binding contract. (V.I.App. 283-285; Ruling).

Two of Mr. Barkalow's claims (Count VI-breach of contract and Count VIII-civil extortion) related to security agreements he entered with Jeff and Bryan separate from their relationship as members of Outside Properties. The Clarks regarded Mr. Barkalow as family, and wanted to help him through a "snowballing" personal financial crisis that reduced Mr. Barkalow to tears and seeking his brother-in-laws' help because he was "really underwater." (Vol.IV-161:8-20). The security agreements were tied to money the Clarks loaned Mr. Barkalow to help him out of this crisis, but the financial assistance they provided strained their relationship. (Vol.IV-162:6-9). Mr. Barkalow alleged the Clarks threatened to default him under the security agreements if he did not use their rental property lease form for his own property management company. The district court dismissed Mr. Barkalow's breach of good faith and fair dealing claim related to the security agreements failed because the damages he sought—attorney's fees and a settlement Mr. Barkalow's company made in an unrelated case—were not foreseeable. (V.I.App. 286-288, Ruling). The district court also dismissed his civil extortion claim (Count VIII) related to the security agreements, finding the Clarks never made any threats to Mr. Barkalow, and noting Mr. Barkalow's testimony about the alleged threats was "uncorroborated" and "vague." (V.I.App. 288-289, Ruling).

With respect to Jeff and Bryan Clark's counterclaims, the district court found Outside Properties was a member-managed limited liability company and Mr. Barkalow lacked authority to act unilaterally or to the exclusion of the other members. The district court credited the Clarks' testimony that the members all agreed to provide certain services to the company without compensation, which Mr. Barkalow did not dispute. (V.I.App. 289-290, Ruling). Despite this agreement, Mr. Barkalow unilaterally paid one of his own wholly owned entities $153,203.25. Based on these findings, the district court found Jeff and Bryan proved their counterclaims for declaratory judgment (Count II), conversion (Count IV), and breach of fiduciary duty (Count V). (V.I.App. 290-296, Ruling).

Ultimately, the district court found in favor of the Clarks on all of their counterclaims and found against Mr. Barkalow on all of his claims—except his claim for judicial dissolution on the basis that it was not reasonably practical to carry on the company's activities. (V.I.App. 296-298, Ruling). The district court ordered Outside Properties dissolved based on its conclusion that the members had a "toxic relationship." (V.I.App. 298, Ruling).

Not only did the district court order dissolution of Outside Properties, it also invoked its "equitable powers to fashion a remedy" to order that the capital contributions which it explicitly found appropriate under the company's governing documents be reclassified as loans with an interest rate of 3.85%, restoring each member's ownership interest—including Mr. Barkalow—to 25%. (V.I.App. 298-299, Ruling).

Given the district court's order of dissolution, it denied as moot all parties' claims seeking dissociation of the others. (*Id.*)

SUMMARY OF THE FACTS

The district court made detailed findings of fact, many of which required the district court to choose among conflicting testimony of the parties.

I. The parties adopted organizational documents to govern their relationship and the operation of Outside Properties, LLC.

Outside Properties, LLC, formed in 2009 after Mr. Barkalow found a piece of residential rental property he was interested in buying. (Vol.I-45:20-46:11). Mr. Barkalow lacked the financial ability to buy it himself, so he asked Bryan Clark to help finance the property. (*Id.*). Bryan enlisted Jeff and Joe Clark, and the four individuals formed a new limited liability company, Outside Properties, LLC.

The four members—Jeff, Bryan, Joe, and Mr. Barkalow— were each required to contribute $41,000 for an equal 25% share of the company. The cash was needed for the $150,000 down payment to purchase the property and to cover the first annual principal payment. (V.I.App. 468, Ex. 322; Vol.I-57:14-58:21). Mr. Barkalow lacked the funds to make his initial contribution, and the three Clark brothers put in additional cash as a loan to him. (V.I.App. 263, Ruling).

The company was governed by a Certificate of Organization, filed with the Iowa Secretary of State on October 2, 2009, an Operating Agreement signed by all four members on August 31, 2009, and Management Certificates issued to each member. (V.I.App. 270, Ruling; V.I.App. 321, Ex. 1; V.I.App. 391, Ex. 36; V.I.App. 462-468, Exs. 319-322). It was organized as a member-managed company. (V.I.App. 327, Ex. 1, § 5.1). The stated "Purpose" of the company was "primarily, to invest in real estate holdings and, secondarily, to engage in all lawful types of business, as from time to time determined by the members." (V.I.App. 391, Ex. 36, ¶ 3).

While additional capital contributions could not be required of any member (*see* V.I.App. 391, Ex. 36, ¶ 7 ("Additional Liability of Members. That no additional capital contributions will be required.")), voluntary capital contributions were allowed, which would result in reducing the proportionate interest of any member who did not participate in a capital call. The Management Certificates each provided: "The stated capital contribution *and proportionate equity interest* is subject to change and is reflected in the books and records of the company that are prepared and kept in accordance with the Certificate of Organization and all Operating Agreements as may be in force from time to time." (V.I.App. 468, Ex. 322 (emphasis added)).

Mr. Barkalow admitted at trial that the organizational documents permitted voluntary capital contributions "as long as they were done lawfully and legally." (Vol.II-105:5-9, 110:5-12). Mr. Barkalow also admitted the organizational documents permitted dilution of a member's proportionate interest if that member chose not to participate in a capital call "as long as it was done in the best interests of the company." (Vol.II-110:9-12).

The Operating Agreement also determined voting rights of the members. Generally, each member had one vote and the vote of a majority of the members at a meeting with a quorum determined company action. (V.I.App. 325, Ex. 1, § 2.7.1). However, the Operating Agreement also contained a "demand" rule, providing: "Upon demand of any member, voting on a particular issue shall be in proportion to the capital contributions of each member to the company, as adjusted from time to time to reflect any additional contributions or withdraws." (*Id.*).

Each of the members brought something to the company. The members agreed not to receive compensation for certain services they provided until all loans had been repaid. (Vol.II-112:19-24 (Mr. Barkalow) ("Q. Okay. And you had an oral argument that you've already testified about at the beginning that there would be no distribution of profits until the debt was paid off; right? A. Correct, we said we would not take any money out of the company.")). Under this agreement, Mr. Barkalow was to provide property management services without charging Outside Properties, while Jeff Clark provided remodeling and construction services, Bryan Clark provided financial and maintenance services, and Joe Clark was available for consulting with Mr. Barkalow—all without compensation. (Vol.I-76:7-78:7 (Tracy); Vol.II-91:21-92:24 (Tracy); Vol.III-111:8-114:21 (Jeff); Vol.IV-181:20-182:9, 185:25-186:3, 188:19-23 (Bryan); Vol.IV-84:16-85:1 (Joe)). While Mr. Barkalow managed the day-to-day operations, Bryan was primarily involved in arranging financing to purchase additional properties and ensure adequate cash flow. (Vol.IV-157:23-158:9, 159:4-12). Jeff and Bryan each provided construction, remodeling, and maintenance for Outside Properties' properties worth over $100,000 without compensation from the company. (Vol.III-111:8-114:21 (Jeff); Vol.IV-183:5-184:20 184:22-185:24 (Bryan)).

II. Mr. Barkalow had financial problems.

While Mr. Barkalow was good at finding properties, he lacked the financial capacity to buy them. So he relied heavily on the Clarks to finance Outside Properties. Mr. Barkalow did not pay his initial $41,000 contribution into Outside Properties when it was formed in 2009 to purchase the first property. Indeed, he did not make his initial (or any other) monetary contribution into Outside Properties until years later on September 15, 2016—the same day he wrote unauthorized checks to his wholly owned entity, Big Ten Property Management. (V.I.App. 292, Ruling; V.II.App. 141, Ex. 96).

Outside Properties ultimately purchased seven properties between 2009 and 2012. Four were purchased through seller financing, requiring down payments for each; two were purchased using a mortgage from U.S. Bank, also requiring a down payment; and the last property was purchased with cash. (V.II.App. 219, Ex. 121). The Clark family (Jeff, Bryan, Joe, their parents, and their two sisters) had a number of entities that loaned money to Outside Properties, primarily to help finance the purchase of additional properties by providing cash for the required down payments, pay off U.S. Bank to save interest expenses for Outside Properties through lower interest loans, and provide the cash to purchase the last property. (V.II.App.

091, Ex. 78; V.II.App. 161, Ex. 99). Mr. Barkalow agreed Outside Properties could borrow money from the Clark entities to make down payments. (Vol.II-117:15-18). These were referred to by the parties as the Clark entity or Clark family loans. The Clark family loans were reflected on Outside Properties' financial statements, prepared semi-annually by their accountant, Jason Wagner. (Vol.IV-61:21- 63:19; V.II.App. 010-025, Exs. 54-61). Notably, some of these loans were made by Clark entities whose members were not members of Outside Properties. (*Id.*)

In 2010, when Mr. Barkalow and his wife faced significant financial troubles, Mr. Barkalow asked Bryan and Jeff for help. Jeff and Bryan each extended credit, or became co-signors on loans, to help Mr. Barkalow refinance his significant debt which otherwise would have gone into default. (Vol.IV-161:4-162:5). Initially, they loaned Mr. Barkalow $65,000 in October 2010, when no other lender would give him any money. (V.I.App. 331, Ex. 3). In addition, Bryan co-signed a loan in the amount of $2,591,000 with Mr. Barkalow, and Jeff co-signed a $500,000 loan for Mr. Barkalow to purchase Jeff's house as well as a $50,000 line of credit. (Vol.II-148:13-150:16 (Tracy)). When Mr. Barkalow was unable to meet the obligations, and Jeff and Bryan each had to continue lending their credit to refinance Mr. Barkalow's loans, the Clarks conditioned their continued help on Mr. Barkalow entering into a security agreement. Mr. Barkalow was represented by his personal counsel when he agreed to the security agreement. (V.I.App. 286, Ruling; Vol.I-193:8-20).

The initial security agreement was signed on October 29, 2010. (V.IApp. 263, Ruling). However, Mr. Barkalow's financial problems continued, requiring the security agreements to be rewritten two more times, because he still could not pay off or otherwise refinance his debt obligations without Jeff and Bryan's assistance. (Vol.II-150:17-157:17; V.I.App. 331, Ex. 3; V.I.App. 356, Ex. 20). Each time, Mr. Barkalow was represented by counsel. (V.I.App. 286, Ruling). The first supplement was signed on February 24, 2011, and the second supplement was signed on April 4, 2013. (V.I.App. 263, Ruling). Mr. Barkalow continued to struggle financially. The parties' relationships began to deteriorate in 2013 as Mr. Barkalow continually failed to meet his promises, and Jeff and Bryan grew weary of helping him. (Vol.IV-162:6-9).

In August 2014, Mr. Barkalow requested information about the Clark entity loans. (Vol.I-96:17-97:2; Vol.IV-165:8-168:6; V.I.App. 471, Ex. 401). Accountant Jason Wagner supplied Mr. Barkalow with information about the loans, detailing the receipt of the funds, the property purchased with the funds, and amortization schedules reflecting payments and remaining balances. (V.I.App. 472-473, Ex. 401). Despite the documentation of the receipt and use of proceeds from the Clark entity loans, Mr. Barkalow challenged the loans because there were no written and executed loan agreements, repeatedly telling the Clarks: "no note, no mortgage, no payment." (V.I.App. 471, Ex. 401; Vol.IV-167:10-15; V.I.App. 411, Ex. 45).

III. The disputed capital contributions followed the requirements of the governing documents and were for valid business purposes.

The disputes leading to litigation largely revolved around two sets of voluntary capital contributions, which were made against the backdrop of the parties' relationship described above.

A. The December 2015 decision to use capital contributions to pay off the Ellis Shultz balloon payment.

Three of the properties purchased by Outside Properties were purchased on September 3, 2010 from Ellis Shultz for a total purchase price of $1,200,000, with $1,080,000 financed by the seller. (Vol.I-65:17-24, 67:18-19; V.I.App. 397, Ex. 39.) The contract had a balloon payment due on December 1, 2015 for $1,005,298.26. (*Id.*, Vol.I-101:13-25; V.I.App. 397, Ex. 39). Even though Mr. Barkalow was in charge of general operations, he was unaware of the balloon payment until Mr. Shultz called him on or around December 1, 2015. (*Id.*, Vol.I-102:19-103:1). Mr. Shultz refused to extend the balloon payment beyond December 9, 2015. (Vol.I-142:5-15 (noting Mr. Shultz would agree to a 10-day or two week extension, "but nothing significant"); *see also* Vol.IV-87:19-24; Vol.III-138:8-10, 139:22-25).

The four members of Outside Properties had several discussions about what to do about the Shultz payoff between December 1 and 7, 2015. (V.I.App. 397, Ex. 39). Joe Clark was concerned about losing the property. He believed it was in the best interests of Outside Properties to fully pay off Mr. Shultz by the December 9, 2015 deadline and for him to put the money in to make that happen. (Vol.IV-87:25-89:1, 128:5-13). Jeff and Bryan Clark agreed it was important for Outside Properties to timely pay its debts and that they needed to find funds to meet the December 9, 2015 deadline. (Vol.III-141:7-142:2; Vol.IV-172:3-6). Mr. Barkalow, however, took the position that the Shultz loan was not in "default" even though he admitted it was past due. (Vol.II-86:6-87:16, 87:14-16; V.I.App. 432, Ex. 72).

Jeff, Bryan, and Joe orally agreed to make capital contributions to get the loan repaid by December 9, 2015. (Vol.III-138:3-21 (Jeff); Vol.IV-171:25-172:2) (Bryan); Vol.IV-123:3-20; *see also* V.I.App. 400, Ex. 40). Those actions were ratified by a majority vote at a duly called member meeting held on December 17, 2015, just a week after the capital contributions were made and the Shultz loan repaid. (V.I.App. 401, Ex. 41; Vol.IV-142:15-143:18). Mr. Barkalow was given the opportunity to make an equal contribution, but declined to do so. (Vol.II-199:23-200:12; V.I.App. 406, Ex. 43, (February 19, 2016 meeting minutes noting "Tracy had been given the opportunity to participate in that voluntary capital contribution but opted not to do so."), p. 3 (Tracy's attorney approving accuracy of minutes)). Jeff, Bryan, and Joe each contributed $333,956.62 on December 9, 2015 to pay off the Ellis Shultz balloon payment. (V.II.App. 114, Ex. 79). The contributions were booked as additional capital contributions pursuant to the members' vote. (V.II.App. 207, Ex. 112).

B. The 2016 decision to use capital contributions to repay the Clark entity loans.

Mr. Barkalow has never disputed that Outside Properties accepted funds from the Clark entities or that the company used those funds to cover the down payments needed to buy additional properties and refinance the U.S. Bank mortgage to reduce interest expenses. He nonetheless continued to question the validity of those loans, repeatedly stating: "no note, no mortgage, no payment." (V.I.App. 471, Ex. 401; Vol.IV-167:10-15). Mr. Barkalow's dispute about the Clark entity loans caused Outside Properties to stop making payments on those loans between September 2014 and January 2016. (Vol.IV-167:15-168:6). Joe attempted to refinance the Clark entity loans with U.S. Bank in the spring of 2015. But, U.S. Bank required approval by all four members of the company, and Mr. Barkalow refused to agree, stopping Joe's attempted refinance. (V.II.App. 209, Ex. 118; *see also* Vol.IV-91:2-94:4; Vol.IV-167:6-15; Vol.III-122:12-127:13, 194:20-25). It took two contested votes of the members to restart payments on the Clark entity loans, both of which Mr. Barkalow voted against. (Vol.IV-147:21-148:15; V.I.App. 401, Ex. 41 (12/17/15 meeting); V.I.App. 404, Ex. 42 (1/15/16 meeting)).

The Clark entities making the loans were owned not only by Jeff, Bryan, and Joe, but also by their parents and their two sisters. Given the stop in payments and Mr. Barkalow's actions of disputing the validity of the Clark entity loans, the members of those entities (the Clark parents and sisters) made demands to Outside Properties that the loans—which had no due date—be repaid. (V.I.App. 280, Ruling; Vol.IV-168:18-170:20).

Against this backdrop, the members held a meeting on January 15, 2016 and voted whether to pay off the Clark entity loans. The members voted three-to-one to refinance using a financial institution. (V.I.App. 404, Ex. 42, Vote 2). However, the minutes reflected that "[I]f this proposal [to refinance using a bank] is voted down by any member, then according to U.S. Bank, they will not loan to the entity." (*Id*.)

Since Mr. Barkalow's "no" vote prevented institutional financing, the members then voted on whether to use voluntary capital contributions to repay the Clark entity loans. (*Id.*, V.I.App. 405, Ex. 42, Vote 3). Bryan and Jeff voted yes to Vote 3, Tracy voted no, and Joe did not vote, asking to defer the vote. Despite Jeff and Bryan both voting yes, the members ultimately agreed to defer the decision at Joe's request. (*Id.*, V.I.App. 405, Ex. 42).

The four members met again on February 19, 2016 at the office of Mr. Barkalow's personal attorney, Bob Downer. (V.I.App. 406, Ex. 43; Vol.IV-104:13-105:10 (Joe).) Jeff, Bryan, and Joe offered to purchase Mr. Barkalow's interest in Outside Properties "for the undiscounted fair market value of his units." (V.I.App. 406, Ex. 43, p. 1, second paragraph). Mr. Barkalow declined the offer, and the topic then moved to "how the company would finance paying off the debt obligations owed various Clark family entities" of approximately $930,000. (V.I.App. 406, Exh. 43 p. 1, third paragraph.) The parties discussed obtaining third-party loans to repay both the Clark entity loans and the capital contributions made by the Clark brothers in December 2015, which would "restore all of the owners to equal 25% ownership." (V.I.App. 406, Ex. 43 p. 1, fifth paragraph). Mr. Barkalow rejected this offer as well. He objected "most strenuously" to the requirement of a global release, as Mr. Barkalow was more interested in retaining his right to sue the Clarks than accepting their offer to restore everyone to 25% ownership (according to the minutes prepared by attorney Paul Morf, and reviewed by attorney Bob Downer). (V.I.App. 407, Ex. 43 p. 2, first full paragraph).

Given Mr. Barkalow's rejection of both offers, the Clarks requested voluntary capital contributions from all members to finance the payoff of the Clark entity loans. "Accordingly, the question was posed whether the company should seek voluntary contributions from existing members in an amount of $950,000 to pay off those loans. It was indicated that this opportunity would be made equally available to all owners." (V.I.App. 407, Ex. 43 p. 2, fourth full paragraph). The Clarks offered Mr. Barkalow additional time to decide whether to participate in the approved voluntary capital contributions, and their offer was rejected. (V.I.App. 407, Ex. 43 p. 2, fourth full paragraph; *see also* Vol.IV-116:4-24, confirming accuracy of Exhibit 43 as reflecting what happened at the February 19, 2016 meeting); Vol.III-159:11-17). Each of the three Clarks stated they would participate in the voluntary capital contribution. (V.I.App. 406, Ex. 43).

During this same timeframe, Mr. Barkalow purchased eight pieces of real estate for his separate, wholly owned company, TSB Holdings LLC, for over three million dollars. (Vol.II-201:23-202:15). While Mr. Barkalow was choosing to invest in his wholly owned company, he expected the Clarks to make loans to provide the capital needed to operate Outside Properties. When asked why he did not participate in the voluntary capital call, Mr. Barkalow testified he chose not "to deprive [him]self of gaining another company to benefit [Outside Properties]." (Vol.II-202:16-22).

While Joe preferred to go back to all members owning 25%, he also testified that he voted to allow voluntary capital contributions in February 2016 for the purpose of repaying the Clark entity loans. Although Joe had committed to making a voluntary capital contribution for the February 2016 capital call, he never did, and Bryan and Jeff put in additional capital to fully fund the Clark entity loan repayments. (Vol.IV-117:1-3, 132:1-15 (Joe)). Jeff and Bryan each contributed $316,666 on June 25, 2016 for their share of the cash needed to repay the Clark entity loans. They each then contributed another $158,333 on July 1, 2016 to cover the amount Joe had originally agreed to contribute but did not. (V.II.App. 113, Ex. 79). These were booked as additional capital contributions pursuant to the members' vote. (V.II.App. 207, Ex. 112).

Ultimately, Jeff, Bryan, and Joe made equal voluntary capital contributions following the December 2015 capital call to repay the Ellis

Shultz balloon payment, and Jeff and Bryan made equal voluntary capital contributions following the February 2016 capital call to repay the Clark entity loans. Joe made total additional contributions of $333,956.62 and Jeff and Bryan each contributed an additional $808,955.62. (V.II.App. 113, Ex. 79). At that point, Mr. Barkalow had still not repaid the loan for his original $41,000 capital contribution. (V.I.App. 292, Ruling (noting Tracy repaid the loan on September 15, 2016); V.II.App. 141, Ex. 96).

IV. Mr. Barkalow engaged in self-dealing and conversion.

Mr. Barkalow's primary contribution to Outside Properties was providing property management services. The members agreed Mr. Barkalow would be in charge of daily operations, but he agreed he lacked authority to direct the other members. (Vol.II-137:1-3, 138:3-14; V.I.App. 327, Ex. 1, Operating Agreement § 5.2 ("The general manager shall report and answer to the members.")). Mr. Barkalow performed the day-to-day property management services through his wholly owned entity, Big Ten Property Management, LLC ("Big Ten"). Outside Properties' eleven rental units account for less than 10% of the work performed by Big Ten, which manages a total of 150 to 160 rental units. (Vol.II-219:20-220:10).

In September 2016, Mr. Barkalow issued two checks from Outside Properties' checking account to Big Ten: check # 2150 for $117,617.50, and check # 2151 for $27,585.75. (V.I.App. 423, Ex. 49). Check # 2150 was based on a statement received from Big Ten for purported management fees totaling $125,617.70 (less an $8,000 credit for electronic funds previously withdrawn directly from Outside Properties' checking account) for each year 2009 through 2016, representing 6% of the company's gross income for each year. (V.I.App. 292, Ruling; V.I.App. 422, Ex. 49). Mr. Barkalow made the management fee payments even though the members had not approved them, and in fact had been in an ongoing dispute over whether he was entitled to receive property management fees. (V.I.App. 292-293, Ruling; Vol.II-208:16-209:7).

Check # 2151 related to a class action lawsuit against Big Ten. Big Ten attempted to pass through a proportionate share of the settlement and related attorney's fees it incurred in the lawsuit to various properties for which Big Ten provided management services, including Outside Properties. (V.I.App. 292, Ruling; V.I.App. 421, Ex. 49; V.III.App. 021, Ex. 205). As the district court found, Big Ten lacked any authority to pass its own attorney's fees to Outside Properties, which was not a party to the lawsuit. (V.I.App. 292-293, Ruling).

Both checks were dated September 15, 2016, which was the same date Mr. Barkalow finally paid Outside Properties for his initial $41,000 capital contribution that he had not paid when the entity was formed seven years before in 2009. (V.I.App. 292, Ruling; V.II.App. 141, Ex. 96; Vol.II-209:25-210:10).

Neither of these payments to Mr. Barkalow's wholly owned entity was approved by the members. When Jeff, Bryan, and Joe learned about the two checks, they called a member meeting on May 9, 2017 and passed a resolution requiring Mr. Barkalow to make an accounting of his activities and to repay the unauthorized withdrawals. (V.I.App. 418, Ex. 49).

Mr. Barkalow filed this lawsuit less than a month later, on June 7, 2017. The parties entered into an interim management agreement, under which Mr. Barkalow is paid for providing property management services. Mr. Barkalow testified that if he "continue[s] to manage [Outside Properties] under the management agreement that [they] have right now, Outside Properties will continue to make profit." (Vol.II-219:3-6).

V. Outside Properties continues to be a profitable, viable business.

Despite the disputes over governance of the company, the members continued to profitably operate Outside Properties, and continue to do so to this day. The company's net income grew every year. (V.II.App. 010-025, Exs. 54-61). Likewise, the fair market value of the properties Outside Properties owned increased significantly over the amounts paid to purchase them. The seven pieces of property appraised for a total of $3,420,000 as of July 31, 2018, whereas they were purchased for a total of $2,706,250, a 26% increase in value. (V.II.App. 219, Ex. 121; Vol.II-14:1-16:5). The properties are located directly across from Kinnick Stadium, roughly between the University of Iowa Children's Hospital and the soon-to-be completed Marriott hotel. (Vol.III-110:2-6).

The primary disputes among the members included voting rights and ownership interests. (Vol.IV-97:24-98:4). The district court settled those disputes, concluding: the governing documents allow the members to approve voluntary capital contributions that change the percentage ownership of the members; the company is a member-managed company; and each member has an equal vote unless any member makes a demand on a particular issue to vote based on proportionate capital contributions. Once those issues were decided, there were no major impediments to the successful and continued operation of Outside Properties. (Vol.III-98:4-15; Vol.IV-180:1-16).

Outside Properties owns a unique group of real estate in Iowa City, which is worth more collectively than divided up. (Vol.IV-95:19-21). Joe, who preferred to either restore all members to equal ownership or dissolve the company, testified that Outside Properties had operated successfully since its inception, had increased in value, and continued to operate profitably at the time of trial. (Vol.IV-144:23-146:11; Vol.IV-180:3-5). Even Mr. Barkalow admitted, "[b]y every objective measure, Outside Properties continues to be a financial success." (Vol.II-219:15-18).

As Jeff explained, "in the end maintenance has been worked out, property management's been worked out, it's functioning – Outside Properties is functioning fine." (Vol.IV-64:16-65:16). In fact, the company has "functioned fine all the way through," both before and after an interim management agreement was put in place following the filing of the lawsuit. (*Id.*) As with any company, while there have been questions, "those were resolved." (Vol.IV-43:24-44:10).

VI. Whether the contributions by Bryan and Jeff are treated as loans to Outside Properties or as capital contributions has significant monetary consequences.

As discussed above, Outside Properties' value has grown significantly since its inception. Mr. Barkalow belatedly "contributed" $41,000 (with funds the district court found he "presumably . . . converted" from Outside Properties) and provided property management work. (V.I.App. 280, Ruling). Jeff and Bryan each contributed a total of $849,955 in addition to their significant contribution of construction, remodeling, and maintenance work. Despite the district court's conclusion that the voluntary capital contributions were properly authorized and made for valid business purposes, the court nonetheless ordered that Jeff and Bryan's capital contributions, as well as Joe's additional $333,956 contribution, be reclassified as loans, to earn interest at 3.85%. (V.I.App. 299, Ruling). As discussed above, these capital contributions were made for proper business purposes. The December 2015 capital contributions were needed to pay off the Ellis Shultz balloon payment, and the 2016 capital contributions were needed to pay off the Clark entity loans.

If this reclassification is upheld, it will have an immense impact on the financial benefit each party will receive from Outside Properties. If Jeff and Bryan's capital contributions are reclassified as loans, Mr. Barkalow's $41,000 "investment" is worth $422,937 as of December 31, 2018—more than *ten times* his original investment. (V.II.App. 677, Ex. 323; Vol.II-32:25-33:15). However, if the Clarks' capital contributions are recognized as such, Mr. Barkalow's initial $41,000 investment (which he did not even pay until September 15, 2016, assuming he paid at all) will have a fair market value of $79,037 as of December 31, 2018. (V.II.App. 676, Ex. 323; Vol.II-20:13-21:5).

At the same time, Jeff and Bryan each made $849,955 worth of capital contributions into Outside Properties ($41,000 initial investment + $333,956

2015 investment + $474,999 2016 investment). But under the reclassification scenario, their equity return is the same as Mr. Barkalow's, $422,937, and the company would owe them $984,105 each for repayment of the loans. Mr. Barkalow, therefore, derives a one-sided and immense benefit from the reclassification remedy, and the Clarks are punished. (Vol.II-37:19-39:16 ; V.II.App. 677, Ex. 323). In effect, reclassifying Jeff and Bryan's capital contributions as loans shifts the benefit of those funds from Jeff and Bryan to Mr. Barkalow.

This has the significant inequitable effect of depriving Jeff and Bryan of the equity associated with the capital they properly contributed to Outside Properties and redistributing it to Mr. Barkalow, who "had not contributed one dollar towards this growing business" until he "repaid" the Clarks for his $41,000 capital contribution with money the district court held he effectively stole from the company. (*Compare* V.II.App. 676, Ex. 323, (Engstrom Expert Report) (concluding Mr. Barkalow's $41,000 capital contribution was worth $79,037 as of December 31, 2018 if the additional Clark contributions remained classified as contributions) *with* Vol.II-69:1-18(Eubank)) (concluding Mr. Barkalow's membership interest was worth $477,163 as of December 31, 2018 if the Clark capital contributions were reclassified as loans at 3.85% interest)).

SUMMARY OF THE ARGUMENT

Bryan and Jeff won the battles—all of them—yet somehow still managed to lose the war. Though the district court made insightful, detailed fact findings, in the end, it exceeded its authority when it found all of the disputed issues in Bryan and Jeff's favor, but then gave Mr. Barkalow the exact relief he sought by ordering dissolution of Outside Properties, and reclassifying the Clarks' entirely proper capital contributions as low-interest loans as part of the dissolution and winding up process.

The district court's ruling brings to fruition this court's warning in *Baur v. Baur*, 832 N.W.2d 663 (Iowa 2013), Iowa's foundational case on the adjudication of minority shareholder claims of oppression. The outcome of the district court decision gave Mr. Barkalow, a minority member in Outside Properties, "a foothold that is oppressive to the majority." *See Baur*, 832 N.W.2d at 678. The court secured that foothold by financially rewarding Mr. Barkalow, fulfilling his unreasonable expectation that he alone could prevent Outside Properties' other members from making additional voluntary contributions, and defeating the Clarks' reasonable expectations that their properly made capital contributions would remain investments in Outside Properties—not loans.

Reversal of the order of dissolution will necessarily result in reversal of the district court’s remedial order reclassifying the voluntary capital contributions as loans, as there would be no equitable basis to even consider reclassifying the contributions.

Even if this court does not reverse the order of dissolution, it should nonetheless reverse the district court’s order reclassifying the capital contributions as loans. The district court based its dissolution order on the purported impracticability of carrying on company business. Importantly, however, the court first found that the voluntary capital contributions were properly authorized by the company’s governing documents and approved by the members. The district court’s authority to order dissolution based on an inability to carry on the company’s business into the future does not extend to rearranging the members’ properly authorized actions in the past. It intrudes upon the parties’ freely made contractual agreement that voluntary contributions were permitted, and is inequitable because it gives Mr. Barkalow, a recognized bad actor, a benefit and punishes the Clarks.

LEGAL ARGUMENT

I. The district court erred in ordering dissolution of Outside Properties, LLC, a viable and profitable enterprise, where the Court's ruling settled the members' disputes.

A. Preservation of error

Bryan and Jeff preserved error on this issue by presenting evidence at trial and by identifying the legal issue in their Post-Trial Brief and Post-Trial Reply Brief. (V.I.App. 177-178, 202-204, Jeff/Bryan's 2/4/2019 Post-Trial Brief; V.III.App. 017-19, Jeff/Bryan Post-Trial Reply Brief). The district court addressed the issue in its ruling by granting dissolution. (V.I.App. 298, Ruling). *See Meier v. Senecaut*, 641 N.W.2d 532, 537 (Iowa 2002).

B. Standard of review

Dissolution of a limited liability company under Iowa Code section 489.701(1)(d)(2) is an equitable matter, which this Court reviews *de novo*. *See Baur*, 832 N.W.2d at 668. Under a *de novo* review, this court reviews the entire record and decides anew the factual and legal issues presented on appeal. *Hensch v. Mysak*, 902 N.W.2d 822, 824 (Iowa Ct. App. 2017). However, "even in a *de novo* appellate review, 'great weight' is accorded the findings of the trial court where the testimony is conflicting. This is because the trial court is in a far better position to weigh the credibility of witnesses than the appellate court." *Albert v. Conger*, 886 N.W.2d 877, 880 (Iowa Ct. App. 2016) (internal citations omitted).

C. The standard for dissolving a limited liability company when it is impracticable to carry on its activities was not met here.

The district court properly found the Clarks, as the majority members, did not act oppressively toward Mr. Barkalow and rejected his claims for breach of fiduciary duty and dissolution based on oppression under Iowa Code section 489.701(1)(e)(2). The district court nonetheless ordered dissolution on the separate basis that it was "not reasonably practicable to carry on the company's activities in conformity with the certificate of organization and the operating agreement." (V.I.App. 298, Ruling). *See* Iowa Code § 489.701(1)(d)(2).

That Mr. Barkalow does not get along with the Clark brothers is not a valid basis for dissolving this viable company when it can continue to carry on its identified purposes despite these "relationship" problems.

1. Courts make clear that "impracticability to carry on" is a high standard.

Judicial dissolution of a properly formed limited liability company is considered a drastic remedy, and for good reason: "A limited liability company is as much a creature of contract as of statute." 5 Ia. Prac., Business Organizations section 13:16. Under Iowa law, "Since time immemorial, the law of contracts provides that parties are entitled to bargain freely and that their agreements will be enforced in a court of law. . . . Courts generally enforce contracts as written, plain and simple." *Kern v. Palmer Coll. of Chiropractic*, 757 N.W.2d 651, 667 (Iowa 2008) (Appel, J. concurring).

As to limited liability companies, the Supreme Court of Virginia has also noted the contractual underpinning that makes judicial dissolution an extreme remedy: "The statutory standard set by the General Assembly for dissolution of a limited liability company is a strict one, reflecting legislative deference to the parties' contractual agreement to form and operate a limited liability company." *Dunbar Grp., LLC v. Tignor*, 267 Va. 361, 367, 593 S.E.2d 216, 219 (2004). Likewise, one prominent commentator explained in the context of corporate dissolution,

> Since dissolution is viewed as an extreme remedy, courts are vested with broad discretion in determining whether there is sufficient evidence of unbreakable management or shareholder deadlock and whether dissolution is in the best interests of the corporation and its shareholders. Thus, for example, the profitable operation of a deadlocked corporation may warrant the dismissal of a dissolution proceeding. There must be a demonstrated inability to conduct the business of the corporation. Mere disagreement on how to conduct the business is not sufficient. Likewise, a shareholder's dislike of another shareholder does not create a corporate deadlock.

16A Fletcher Cyc. Corp. § 8066.10 (footnotes omitted).

Other courts that have addressed dissolution under the standard that it is no longer practicable to carry on the LLC's purpose make clear that it is a drastic remedy to be sparingly used. *See Matter of Arrow Inv. Advisors, LLC*, CIV.A. 4091-VCS, 2009 WL 1101682, *2 (Del. Ch. 2009) ("Given its extreme nature, judicial dissolution is a limited remedy that this court grants sparingly"). The focus is on the purpose of the entity as defined in its governing documents and whether it can continue to operate. The Mississippi Supreme Court found dissolution appropriate under this standard where an entity, whose purpose was the development and sale of commercial and residential property, had "existed for more than ten years and has yet to achieve, or even begin fulfilling, its stated purpose." *Venture Sales, LLC v. Perkins*, 86 So. 3d 910, 916-17 (Miss. 2012). The *Venture Sales* court distinguished *Arrow*, a Delaware case where the Chancery Court "refused to order the dissolution of a limited liability company based on the petition of a member who was dissatisfied with the direction of the company." *Id.* at 916-17 (citing *Arrow*, 2009 WL 1101682 at *2-3). In *Arrow*, the Delaware court granted a motion to dismiss a petition to dissolve a limited liability company as not practicable to carry on, explaining, "[t]he court will not dissolve an LLC merely because the LLC has not experienced a smooth glide to profitability or because events have not turned out exactly as the LLC's owners originally envisioned; such events are, of course, common in the risk-laden process of birthing new entities in the hope that they will become mature, profitable ventures." *Arrow*, 2009 WL 1101682 at *2-3.

In *Dunbar*, the Supreme Court of Virginia likewise held serious differences of opinion among the members and the managers and the commingling of funds were insufficient to support a finding that it was not reasonably practicable for the company to continue. *See Dunbar Group, LLC*, 593 S.E.2d at 218. After considering application of the standard by other courts, the New York appellate court requires that "the petitioning member must establish, in the context of the terms of the operating agreement or articles of incorporation, that (1) the management of the entity is unable or unwilling to reasonably permit or promote the stated purpose of the entity to be realized or achieved, or (2) continuing the entity is financially unfeasible." *In re 1545 Ocean Ave., LLC*, 893 N.Y.S.2d 590, 597-98 (N.Y. App. Div. 2d Dept. 2010).

The Iowa Business Court encountered a request for judicial dissolution under the "reasonably practicable" standard in *Busse v. Busse*, No. LACV083022, Findings of Fact, Conclusions of Law, and Judgment Entry, slip op. at 66 (Iowa Dist. Ct. for Linn County, May 22, 2017)

(Telleen, J.). In that case, the district court held that where the LLC "continued to operate as intended," continued to make distributions, and the managing partner was found to have not breached fiduciary duties, "the drastic remedy of dissolving BFA would be improper . . . ." *Id.*

Here, the purpose of Outside Properties is "to invest in real estate holdings." (App. 391, Ex. 36, § 3). There is no dispute that Outside Properties is fulfilling that purpose by profitably owning and leasing seven residential real estate properties in Iowa City. Disagreement over who should be identified as the tax matters partner or who is responsible for providing information to the company's accountant—the types of disputes the District Court relied on to support dissolution— do not thwart the company's ability to profitably carry on its stated purpose. (V.I.App. 297-298, Ruling).

Even deadlock is not generally sufficient, by itself, to support dissolution under a "not practicable to carry on" standard. *See, e.g., In re Hefel*, No. BR 10-02787, 2011 WL 4356215, at *3-5 (Bankr. N.D. Iowa Sept. 19, 2011) (canvassing caselaw and noting the unsettled nature of the law surrounding dissolution of an LLC under Iowa Code § 489.701(1)(d)(2)). Yet, under the district court's ruling prior to ordering dissolution, there is not even a chance of deadlock (let alone an actual decision that is in deadlock) given the court's interpretation of voting rights and allowance of Bryan and Jeff's capital contributions. Where any member can demand that voting be based on proportionate interests rather than one vote per member, the Operating Agreement—the one adopted by the members—provides a clear resolution to any dispute. That Mr. Barkalow (or even Mr. Barkalow and Joe Clark together) lack the votes necessary to defeat Jeff and Bryan if they choose to vote together is not a basis for dissolving the company.

The district court's order dissolving Outside Properties as not practicable to carry on its intended purpose is contrary to authority addressing the proper standard. The court's ruling effectively resolved the source of the parties' disputes, and the company continues to operate profitably and for the purpose for which it was organized. The district court erred in ordering dissolution merely because it viewed the parties' relationships as "toxic."

2. The district court's concerns do not make it impracticable to carry on Outside Properties' real estate investment business.

A review of the purported disputes the district court relied on to support its dissolution order reveals the vast majority of those disputes involved governance issues that were settled by the district court's ruling.

(V.I.App. 297-298, Ruling). Importantly, the resolution of these governance issues (specifically, ownership and voting rights) provides the necessary framework for this viable company to continue on. (V.I.App. 270, Ruling). To the extent the district court did not directly address every past conflict raised by Mr. Barkalow,[2] the district court's resolution of the voting structure—as approved by the members—provides a mechanism for the parties to resolve disputes that arise in the future. (V.I.App. 272-273, Ruling). The district court's ruling clarified the manner in which decisions are to be made and found that the two voluntary capital contributions were properly made, changing the percentage of voting power held by Bryan and Jeff given their additional capital contributions made in December 2015 and June/July 2016.

In the future, Outside Properties will be able to rely upon the voting structure that its members agreed upon, and the district court validated in its ruling. That Mr. Barkalow has a minority interest, and theoretically can be outvoted, does not make it impracticable to carry on the company's purpose of investing in real estate. Under that theory, a minority member would always have veto power over the majority members. In fact, Mr. Barkalow's

[2] Many of the specific disputes were created by Mr. Barkalow's attempted unilateral actions, such as attempting to fire RSM as the company's accountant without agreement of the other members. (*See, e.g.*, V.I.App. 410, Ex. 44.)

own testimony showed his understanding that having unequal voting power helps keep a company moving forward by preventing gridlock. (Vol.I-92:25-93:5). The district court has enabled to the company to carry on, despite the past acrimony between the members.

D. The district court's ruling upends corporate governance.

Policy considerations also support reversal of the district court's ruling dissolving the company. Quoting *Maschmeier v. Southside Press, Ltd.*, 435 N.W.2d 377, 383 (Iowa Ct. App. 1988), the Iowa Supreme Court explicitly cautioned in *Baur* that in majority-minority oppression claims, courts "must be careful when determining relief to avoid giving the minority a foothold that is oppressive to the majority." *Baur*, 832 N.W.2d at 674. The "foothold" may refer to the danger that a court's broad view of dissolution allows a disgruntled minority to hamstring a company's legitimate business and exert outsized control with threats of corporate death if the minority does not get its way. The court of appeals in *Maschmeier* looked to the Illinois appellate court's rationale in *Polikoff v. Dole & Clark Bldg. Corp.*, 37 Ill. App. 2d 29, 35-36, 184 N.E.2d 792, 795 (Ill. App. Ct. 1962), where that court explained:

> It is, however, fundamental in the law of corporations that the majority of its stockholders shall control the policy of the corporation, and regulate and govern the lawful exercise of its franchise and business. * * * Every one purchasing or

> subscribing for stock in a corporation impliedly agrees that he will be bound by the acts and proceedings done or sanctioned by a majority of the shareholders, or by the agents of the corporation duly chosen by such majority, within the scope of the powers conferred by the charter. And courts of equity will not undertake to control the policy or business methods of a corporation, although it may be seen that a wiser policy might be adopted, and the business more successful if other methods were pursued. The majority of shares of its stock, or the agents by the holders thereof lawfully chosen, must be permitted to control the business of the corporation in their discretion, when not in violation of its charter, or some public law, or corruptly and fraudulently subversive of the rights and interests of the corporation or of a shareholder.
>
> The Business Corporation Act has given to the courts the power to relieve minority shareholders from oppressive acts of the majority, but the remedy of liquidation is so drastic that it must be invoked with extreme caution. The ends of justice would not be served by too broad an application of the statute, for that would merely eliminate one evil by substituting a greater one-oppression of the majority by the minority.

Id.; *see also Alaska Plastics, Inc. v. Coppock*, 621 P.2d 270, 274 (Alaska 1980) ("Liquidation is an extreme remedy. In a sense, forced dissolution allows minority shareholders to exercise retaliatory oppression against the majority.").

This is exactly the outcome of the district court's dissolution order in this case. Mr. Barkalow is a minority member of Outside Properties. Yet he has managed, through his claims in litigation challenging lawful and legitimate business decisions that he disagrees with, to dissolve a viable company against the will of the controlling members, and without even showing that he has been oppressed. Instead of proving oppression by the majority, Mr. Barkalow has "become the oppressor." *Cf. Van Horn v. R.H. Van Horn Farms, Inc.*, 919 N.W.2d 768 (Iowa Ct. App. June 20, 2018) (rejecting minority shareholder oppression claim).

II. The district court exceeded its statutory and equitable authority by transforming capital into debt and by setting ownership shares in contravention to the LLC documents.

A. Preservation of Error.

Bryan and Jeff preserved error on this issue by presenting evidence at trial and by identifying the legal issue in their post-trial brief and post-trial reply brief. (V.I.App. 177-179, 202-204, Jeff/Bryan's 2/4/2019 Post-Trial Brief; V.III.App. 017-019, Jeff/Bryan Post-Trial Reply Brief at 9-11). The district court addressed the issue in its Ruling by ordering re-categorization of the voluntary contributions made by the Clark brothers to Outside Properties as loans. (App. 299 Ruling, ¶ 4). *See Meier v. Senecaut*, 641 N.W.2d 532, 537 (Iowa 2002).

B. Standard of review

This Court reviews the district court's exercise of its equitable authority *de novo*. *Baur*, 832 N.W.2d at 668; *Albert*, 886 N.W.2d at 880.

C. Absent fraud or oppression, the statute requires the court to defer to the operating agreements and the statute limits the available remedy.

After determining Outside Properties should be dissolved, the district court sought to use its "equitable powers to fashion a remedy that I believe is as fair as possible to all members." (V.I.App. 298, Ruling, ¶ 5). The district court then entered the following order to govern the distribution of company assets upon winding up:

> I am ordering that the 2015 capital contributions by Jeff, Joe, and Bryan and the 2016 capital contributions by Jeff and Bryan will be re-categorized as debt and will be treated as loans to Company and the members will be returned to their initial equity position of 25% each.[3]

(V.I.App. 298, Ruling, ¶ 5). If this court affirms dissolution of Outside Properties, the "re-categorization" and "return" remedy should be reversed because: (1) the statute requires the court to respect the intent of the parties to allow voluntary capital contributions, as expressed in Outside Properties' governing documents; and (2) the statute specifically limits the remedy absent fraud or oppression.

1. **Outside Properties' governing documents allowed voluntary capital contributions, and the district court's re-categorization remedy is not faithful to the parties' intent to allow them.**

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[3] The Court's award of 25% ownership interest matters: After the repayment of debt and unreturned contributions, the dissolution will require payment of the gains in value based on shares in the capital account in this case driven by the appreciation in real estate values. (V.I.App. 462, Ex. 319). The district court's order re-categorizing the Clarks' capital contributions as loans erases a significant portion the Clark brothers' ownership interest in Outside Properties, and increases Mr. Barkalow's ownership interest.

Under Iowa law, an operating agreement governs an LLC, with the statutory provisions of the Iowa LLC Act governing where the operating agreement does not otherwise provide. Iowa Code § 489.110(1)-(2); *Felt v. Felt*, 928 N.W.2d 882, 2019 WL 2372321 (Iowa Ct. App. June 5, 2019); 5 Ia. Prac. Series, Business Organizations § 13:16. The statute defines Operating Agreement broadly to be "the agreement whether or not referred to as an operating agreement and whether oral, in a record, implied, or in any combination thereof, of all the members of a limited liability company, including a sole member, concerning the matters described in section 489.110, subsection 1 (describing operating agreements)." Iowa Code § 489.102.

Here, the district court correctly recognized that the governing documents of Outside Properties (the certificate of organization, operating agreement, and management certificates) were contractual in nature. (V.I.App. 271, Ruling, ¶ 3). *See Felt*, 928 N.W.2d at *3 (interpreting an LLC operating agreement under ordinary contract principles); 5 Ia. Prac. Series, Business Organizations § 13:16 ("Based on the limited available precedent to date, it appears that Iowa courts apply ordinary contract construction principles when determining the meaning of a company's operating agreement"). The district court noted that the operating agreement and management certificates unambiguously allowed additional voluntary capital contributions. (V.I.App. 271, Ruling, ¶ 5). Even Mr. Barkalow admitted capital contributions and membership dilution were permitted if done "lawfully, legally, . . . and in the best interest of the company . . . ." (Vol.II-110:5-17). The district court found voluntary contributions were permissible when they were (1) approved by a majority of voting members, and (2) all members were "provided an opportunity to participate in the capital contributions." It held: "Both conditions were met here." (V.I.App. 271, Ruling, ¶ 7).

While the district court's fact-findings are sound, by relying on its equitable authority to fashion a remedy instead of enforcing the valid contractual provisions of the governing documents, the district court exceeded its authority. *See Felt*, 928 N.W.2d at (reversing district court's refusal to dissolve a company, and looking to "the intent of the parties forming the company" as expressed in the operating agreement to decide whether company should have been dissolved, stating "we are constrained to construe the contract according to its terms and the statutory law. We determine the intent of the parties forming the company from the language of the contract.").

The district court's re-categorization remedy contravenes the intent of the parties. Even though the district court was acting in equity jurisdiction in dissolving Outside Properties, it was nonetheless constrained by Outside Properties' operating agreement and governing documents. "[A] court of equity does not undertake to make a contract for the parties or to supply any essentials thereof." *Smith v. Stowell*, 256 Iowa 165, 171, 125 N.W.2d 795, 798 (1964). Considering the appropriateness of a request for the remedy of specific performance (an action in equity), the *Stowell* court stated as follows:

> It is not within the province, function, duty, or power of the court to alter, revise, modify, extend, rewrite, or remake a contract by construction, or to make a new, or different, contract for the parties, whether in the guise of construction or otherwise; its duty is confined to the construction or interpretation of the one which they have made for themselves.
>
> The court may not rewrite the contract for the purpose of accomplishing that which, in its opinion, may appear proper, or, on general principles of abstract justice, or under the rule of liberal construction, make for the parties a contract which they did not make for themselves, or make for them a better contract than they chose, or saw fit, to make for themselves, or remake a contract, under the guise of construction, because it later appears that a different agreement should have been consummated in the first instance, or in order to meet special circumstances or contingencies against which the parties have not protected themselves.
>
> Likewise, the court may not alter a contract for the benefit of one party and to the detriment of the other or others, or make a new contract at the instance of one of the parties, or, by a

> process of interpretation, relieve one of the parties from the terms to which he voluntarily consented, **or, because of equitable considerations, obviate objections which might have been foreseen and guarded against.**

Id., 256 Iowa at 172, 125 N.W.2d at 799 (quoting 17A C.J.S. Contracts § 296(3), pages 89–98 (1963)) (emphasis added).

In *Maschmeier*, the Iowa Court of Appeals applied these principles in its consideration of a minority-shareholder oppression action. 435 N.W.2d at 383. There, the court found that although its equitable authority allowed it to order majority stockholders to purchase the stock of the oppressed minority stockholders, nonetheless "the method of payment should be in a manner consistent with the bylaws." *Id.* The court of appeals stated it was compelled to modify the district court's ruling to the extent that it displaced the bylaws' method of payment:

> The method of payment is clear and unambiguous, and the intent of the parties under the bylaw in question is not disputed. For us to change the method of payment from the course agreed to in the bylaw would constitute a rewriting of the agreement of the parties. This, under these circumstances, courts should not do.
>
> Courts should not rewrite a shareholder agreement under the guise of relieving one of the parties from the apparent hardship of an improvident bargain.

Maschmeier, 435 N.W.2d at 383 (declined to follow by *Baur*, 832 N.W.2d at 674 (providing a different definition of majority oppression)).

Assuming without conceding that the district court was correct in dissolving Outside Properties, its remedy of re-categorizing the Clarks' prior, proper additional capital contributions as debt resulted in a re-writing of Outside Properties' governing documents. The district court found all three Clark brothers voted for the additional capital contributions, which were justified by a legitimate business purpose. (V.I.App. 274; 276, Ruling p. 13, ¶ 3; p. 15, ¶ 7). Mr. Barkalow declined the opportunity. These findings were determinative as to the validity of the capital contributions and prohibited their re-categorization as loans.

The district court's re-categorization remedy of the validly made capital contributions goes against the intent of the parties and Outside Properties' governing documents. It should be reversed, and the parties' capital contributions, and resulting proportionate equity interests, should be restored.

2. The statute does not provide the court with a remedy beyond dissolution unless the managing members acted in a manner that was illegal, fraudulent, oppressive or directly harmful.

The district court's authority to dissolve Outside Properties under Iowa Code section 489.701(1)(d)(2) is limited to those acts related to "the entry by a district court of an order dissolving the company." In contrast, the court may order a remedy other than dissolution only in proceedings where the court finds that the members in control have acted in a manner that is illegal, fraudulent, oppressive or directly harmful. Iowa Code section 489.701(1)(e) & (2). In this case the court determined there was no illegal, fraudulent, oppressive or directly harmful conduct. The plain reading of the statute limits the remedy to dissolution.

As stated previously, the court declined to find fraud or oppression by the members in control against Mr. Barkalow. For that reason, the court's statutory remedy is limited dissolution (and only then if it meets the "not reasonably practicable" standard set out above).

The district court's equitable authority does not include reaching back three years to undo the 2015 and 2016 capital contributions that it expressly found to have complied with the governing documents. Assuming it was reasonably impracticable for the business to go on, and the district court correctly ordered dissolution, it nonetheless exceeded its authority in re-categorizing previous legitimate capital contributions as loans.

D. The court does not have equitable authority to fashion a remedy where there is no wrong.

A court's equitable power to fashion a remedy may be exercised when "a situation exists which is contrary to the principles of equity . . . ." *Moser v. Thorp Sales Corp.*, 256 N.W.2d 900, 907 (Iowa 1977); *Becker v. Cent.*

States Health & Life Co. of Omaha, 431 N.W.2d 354 (Iowa 1988). The following cautionary statement, although from a dissenting opinion, is an accurate description of the limitations on the court's equitable authority: "[E]ven our equitable powers should be exercised in a principled fashion, consistent with precedent; equity is not an opportunity to do whatever we think is right regardless of the law." *In re Marriage of Gallagher*, 539 N.W.2d 479, 489 (Iowa 1995) (dissent). Blackstone warns that:

> And law, without equity, tho' hard and disagreeable, is much more desirable for the public good, than equity without law; which would make every judge a legislator . . . .

Id. (quoting William Blackstone, 1 Commentaries on the Laws of England 62 (U. Chi. Press 1979)).

The Iowa Supreme Court has specifically cautioned against the use of equitable remedies in corporate disputes where the remedy is oppressive to the majority. *See* Baur, 832 N.W.2d at 678.

Absent from the district court's findings of facts is any finding of a "circumstance that is contrary to the principles of equity" for which the conversion of the Clark brothers' capital contributions into loans would serve as a remedy. The district court did not find Mr. Barkalow was harmed or prejudiced in any way by the Clark brothers' capital contributions.

Further, the district court did not explain its reasoning for the recategorization remedy. (V.I.App. 298, Ruling).

Contrarily, the district court found that: Mr. Barkalow "was also afforded an opportunity to contribute equally with both capital calls, and he simply chose not to contribute." (V.I.App. 279, Ruling). And that: Mr. Barkalow "seeks instead to force the Clarks to make loans to the Company while he is free to use his assets to make investments in his other enterprises." (V.I.App. 280, Ruling). And that: "Additionally, both of the capital calls were supported by a legitimate business purpose." (V.I.App. 280, Ruling). And that: "[T]he governing documents of Outside Properties allowed members to make voluntary contributions under the following conditions: (1) the voluntary contributions are approved by a majority of voting members and (2) all members are provided an opportunity to participate in the capital contributions. Both conditions were met here." (V.I.App. 271, Ruling). And that "Until [Mr. Barkalow] repaid the $41,000 loan obtained in 2009 from the Clark brothers, presumably with money that he had converted from the Company for his own use on September 15, 2016, he had not contributed one dollar towards this growing business and had for the majority of the time been treated as an equal partner." (V.I.App. 280, Ruling). Based on the district court's findings, the dilution of Mr.

Barkalow's interest is not a circumstance that is "contrary to the principles of equity."

Additionally, Iowa law recognizes that "he who seeks equity must do equity . . . ." *Myers v. Smith*, 208 N.W.2d 919 (Iowa 1973). Clearly here, where the district court found Mr. Barkalow liable for converting company funds for his own personal use, Mr. Barkalow cannot be fairly characterized as one who has "done" equity. *Cf. id.* (affirming district court's denial of equitable relief to plaintiff under the related equitable doctrine of unclean hands because the plaintiff had violated his duties to the corporation and "used its assets and facilities in an attempt to increase his personal gain"). The equitable remedy of recategorization of the Clark's investments in Outside Properties as loans was improper for this reason, as well.

So where is the inequitable circumstance for which the district fashioned the remedy? The only whiff of inequity is that Joe Clark did not contribute to the second capital call and Joe Clark's interest was thereby diluted. Joe Clark did participate in the 2015 capital contribution, and so his proportional interest remained equal to that of his brothers at that time. Despite authorizing the 2016 capital contribution, Joe Clark did not contribute to the 2016 capital contribution for reasons that he explained in his testimony.

The district court erroneously found that Joe testified he "was not aware or notified of Bryan and Jeff's 2016 capital contributions until months after they were made." (V.I.App. 298, Ruling). There was no such testimony.[4] The trial transcript, recited below, establishes that Joe Clark (1) voted for the second capital contribution, (2) was aware that he had an obligation to put money in, and (3) gave Bryan Clark very specific reasons for not making his contribution.

Joe Clark testified that he voted in favor of the second capital call in February 2016. (Vol.IV-135:3-9). Joe Clark testified in detail about his reasons for voting in support of the second capital call. (Vol.IV-104:22-105:10). The district court found: "Each of the three Clarks stated they would participate in the voluntary [2016] capital contribution." (V.I.App. 276, Ruling). Joe Clark testified he had an obligation to put money in following his vote for the capital contribution. (Vol.IV-132:20-15).

Bryan Clark testified he gave Joe Clark until the end of the month to make his share of that contribution, and that Joe could have made it any time before the end of the year. (Vol.IV-177:5-10). However, Joe made a decision to not make his part of the capital contribution. Joe testified he

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[4] Joe testified that he was unaware of the 2011 decision to repay a note to U.S. Bank, but that was a different transaction and not a capital contribution. (Vol.IV-109:18-110:5).

exchanged emails and text messages with Bryan to document his reasoning for not putting in his share of the 2016 capital contribution. (Vol.IV-103:17-22). Joe testified that a big part of his reason for not making the last capital contribution was the source of funds. (Vol.IV-117:4-7; Vol.IV-129:20-25). Joe testified he was concerned about the use of funds from other Clark family entities. (Vol.IV-119:23-121:18).

The trial transcript is inconsistent with the Court's finding that Joe was not aware of his brothers' 2016 contributions. Without the erroneous finding, there is no other fact that would support any inequity that would require a remedy.

Indeed, the district court did not make a finding that the 2016 capital contribution was inequitable in regard to Joe Clark. If that were the case, then the court would not have fashioned a remedy to convert both the 2015 and the 2016 capital contributions to loans. Further, if the inequity was limited to the 2016 capital contribution, presumably the court would have fashioned a remedy that did not include the 2015 capital contribution. If this was an inequity perceived by the district court, the recategorization remedy was still unjustified.

In the winding up an LLC, the parties must first repay debt and contributions. Iowa Code § 489.708. Following those repayments, the parties' operating agreement, including the membership certificate that was simultaneously executed with the operating agreement, governs the distribution of any "surplus." (V.I.App. 462-468, Exs. 319-322 (Management Certificates)). Under that regime, the parties' ownership interests in any surplus are determined by their capital account. The parties' course of conduct confirmed this distribution agreement when they filed tax returns from 2009-2014 that allocated profits and losses as percentages based upon capital contributions. (V.II.App. 232-546, Exs. 312-317). As required by the Operating Agreement and the course of conduct, when the company is dissolved, the profits from the sale of assets must be allocated to the capital accounts in accordance with the adjusted percentages.

However, the district court's 'remedy' has the effect of splitting the profits on the sale of the LLC assets based on the original $41,000 contributions. This creates a windfall for Mr. Barkalow, who, if he is returned to his original ownership position, stands to receive a return of approximately *ten times* his initial investment ($422,937) even though in the district court's words, "he had not contributed one dollar towards this growing business…." (Vol.II-33:9-15; 40:17-20). Conversely, the recategorization remedy punishes all three Clark brothers by reducing the return on their capital investment to a 3.85% loan interest. This is not an equitable result and should be reversed.

CONCLUSION

The district court's judgment should be reversed to the extent it ordered Outside Properties be dissolved and wound up. If this court reverses the order of dissolution, then the district court's order directing that capital contributions be reclassified as loans must necessarily be reversed as well.

Independent of whether this court affirms or reverses the district court's order of dissolution under Iowa Code § 489.701, the district court lacked the authority to order reclassification of voluntary capital contributions where it expressly found the voluntary capital contributions were properly authorized by the Outside Property's governing documents. Thus, the district court's order directing recategorization of the contributions as loans should be reversed, regardless of whether this Court affirms or reverses the order of dissolution.

STATEMENT ON ORAL ARGUMENT

Appellants Bryan Clark and Jeffrey Clark desire to be heard on all issues presented in this appeal.

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