DIVISION ONE
FILED: 01/10/2012
RUTH A. WILLINGHAM, CLERK
BY: DLL

IN THE COURT OF APPEALS
STATE OF ARIZONA
DIVISION ONE

PIERRE E. LEROY, a married man, Plaintiff/Appellee, v. SEATTLE FUNDING GROUP OF ARIZONA, LLC, dba SFG OF ARIZONA, an Arizona limited liability company; SFG INCOME FUND VI, LLC, a Washington limited liability company, Defendants/Appellants.	)	1 CA-CV 10-0714 DEPARTMENT C **MEMORANDUM DECISION** (Not for Publication - Rule 28, Arizona Rules of Civil Appellate Procedure)

Appeal from the Superior Court in Maricopa County

Cause No. CV 2006-009362

The Honorable Joseph C. Kreamer, Judge

AFFIRMED IN PART; VACATED IN PART

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B R O W N, Judge

¶1 SFG Income Fund VI, LLC, and Seattle Funding Group of Arizona, LLC, (collectively "SFG") appeal a declaratory judgment

(1) invalidating their lien against property owned by JGD, LLC, ("JGD") and (2) awarding $52,423.46 in interest as supplemental relief to Pierre Leroy, one of JGD's members. For the reasons that follow, we affirm the court's judgment invalidating SFG's lien, but vacate the court's award of interest.

BACKGROUND

¶2 According to JGD's Articles of Organization, Leroy and J. Gordon Development Company are members of JGD and hold equal ownership shares. They formed JGD for the purpose of building an investment home in Scottsdale (the "Property").

¶3 JGD's Operating Agreement identifies Jay G. Wolpe as the company's sole manager. JGD's operating agreement gives the manager the sole authority "[t]o borrow money for the Company" and "grant security interests in the assets of the Company to secure repayment of the borrowed sums provided the amount thereof does not exceed $10,000.00."

¶4 JGD obtained title to the Property in December 2004. Leroy funded the entire $626,072.46 purchase with a personal loan from Wells Fargo Bank (the "Bank") and asked the Bank to secure its loan with a deed of trust in order "to make sure that the place wouldn't be double financed."

¶5 Leroy testified that he and Wolpe agreed that (1) Wolpe would "provide the construction" without liening the Property, and (2) JGD would reimburse Leroy for interest paid on

the Bank loan. According to Leroy, the agreement to pay interest was an oral agreement entered before the parties signed the Operating Agreement.

¶6 In June 2005, Wolpe obtained a loan for $200,000 (the "2005 loan") from SFG to begin design work on the Property. In February 2006, Wolpe, purportedly acting on behalf of JGD, obtained a second loan from SFG for $2.3 million to fund construction of a house on the property (the "2006 loan").

¶7 SFG hired American Title Services Agency ("American Title") to document and close escrow on the 2006 loan. American Title accordingly prepared a limited liability company resolution (the "Resolution") to be signed by JGD's members, gave it to Wolpe, and made no effort to contact Leroy about the pending transaction. Wolpe returned the Resolution, purportedly signed by Leroy and Wolpe, via fax. Leroy denied signing the Resolution, and an expert forensic document examiner testified that he was "one hundred percent" confident that Leroy's signature on the Resolution was a mechanical or electronic duplicate of Leroy's original signature from the operating agreement.

¶8 In February or March of 2006, Leroy discovered that the Bank failed to record a deed of trust and SFG had placed a lien on the Property. By April 28, 2006, Leroy had served a written protest of SFG's lien, challenged the underlying loan's

legality, and demanded removal of the encumbrance pursuant to Arizona Revised Statutes ("A.R.S.") section 33-420 (2007).[1] By the time Leroy communicated his objection, SFG had already disbursed $535,481.87.

¶9 Meanwhile, Leroy received his first and only interest reimbursement, a $48,000 check drawn on JGD's account, and cashed it on or about March 6, 2006. Wolpe claimed to have told Leroy that the SFG loan was the source of this $48,000 payment at the time of the loan's approval. Leroy testified, however, he did not know Wolpe was using SFG proceeds to fund the interest payment at the time he accepted it, and he did not learn of the existence of SFG until after he received the payment.

¶10 Leroy filed a complaint in June 2006 alleging several claims against Wolpe and Wolpe's company, J. Gordon Development Co., including breach of fiduciary duty and constructive fraud. Leroy's complaint also contained a derivative claim for declaratory relief that the notes and deeds of trust for both loans were void.

¶11 In May 2007, Leroy amended his complaint to include a claim for negligence against SFG (Count V), as well as claims for aiding and abetting a breach of fiduciary duty (Count VI),

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[1] Absent material revision, we cite the statute's current version.

aiding and abetting fraud (Count VII), intentional interference with a contract (Count VIII), and constructive trust (Count IX). Counts V, VII, and VIII all asserted direct damages claims against SFG.

¶12 Wolpe answered the complaint and asserted several counterclaims against Leroy. SFG answered and filed claims against JGD for unjust enrichment and against Wolpe, J. Gordon Development Co., and JGD for fraud. The trial court entered judgment against Wolpe and dismissed the counterclaims against Leroy. Wolpe subsequently filed personal bankruptcy, and the trial court ordered Wolpe removed as managing member of JGD.

¶13 In March 2008, Leroy attempted to tender the $48,000 interest payment to SFG, with his lawyer's notation of "accord and satisfaction" on the check's memo line. SFG refused to accept the check or to release its lien on the Property.

¶14 In their joint pretrial statement, filed in September 2009, Leroy and SFG narrowed the claims to Counts I through V of Leroy's complaint and SFG's cross-claims. Leroy reframed his negligence claim as one for vicarious liability for American Title's alleged negligence. Leroy articulated his claim in his proposed findings of fact and conclusions of law as follows: "As a direct and proximate result of SFG's negligence, JGD's property has been rendered unmarketable since June of 2005, and

Leroy has incurred interest on his acquisition loan with Wells Fargo bank."

¶15 The trial court conducted a three-day bench trial during which SFG defended on the grounds of judicial estoppel and ratification by Leroy of the 2006 Loan and asserted that it was not liable for American Title's actions. During trial, the court granted SFG's motion for judgment as a matter of law on the vicarious liability claim. In response to SFG's other defenses, Leroy testified that he did not learn that the 2006 Loan was the likely source of the interest payment until after he had filed suit.

¶16 Following trial, the court found that Leroy had not ratified the 2006 Loan transaction and thus SFG's note and deed of trust were invalid. Additionally, after deducting the earlier $48,000 interest payment, the court found Leroy was entitled to net interest of $52,423.46, but made no award for a diminution in the Property's value because "[t]here is simply no way to know what would have happened had a sale been attempted in 2006."

¶17 Leroy filed a Rule 15(b) motion to amend his complaint to conform to the trial evidence, which the court granted. Leroy's Second Amended Complaint included a clarification of the derivative claim for declaratory relief under Count IV; an addition of the alternative and direct claim for declaratory

relief; and a demand for monetary relief on the declaratory judgment counts.

¶18 The trial court awarded Leroy relief on Count IV of the Second Amended Complaint against SFG for "Derivative Action – Declaratory Relief" and held that the promissory notes and deeds of trust purportedly executed by JGD and delivered to SFG were invalid and of no legal effect. It also awarded $52,423.46 on Count V of the Second Amended Complaint (Direct Action Declaratory Relief), along with $200,000 in attorneys' fees and $446.20 in costs. The trial court also dismissed Leroy's Count VI (negligence) and SFG's cross-claims. The trial court entered a final judgment on August 27, 2010. This timely appeal followed.

DISCUSSION

A. The Trial Court Properly Rejected SFG's Ratification Defense

¶19 "Ratification is the affirmance of a prior act done by another, whereby the act is given effect as if done by an agent acting with actual authority." Restatement (Third) of Agency § 4.01(1) (2006). "Ratification requires intent to ratify plus full knowledge of all the material facts." *United Bank v. Mesa N.O. Nelson Co.*, 121 Ariz. 438, 440, 590 P.2d 1384, 1386 (1979). Whether conduct is sufficient to indicate consent for ratification purposes is a question of fact. Restatement

(Third) of Agency § 4.01 cmt. d.[2] We review a trial court's findings of fact for abuse of discretion and reverse only when clearly erroneous. *Engel v. Landman*, 221 Ariz. 504, 510, ¶ 21, 212 P.3d 842, 848 (App. 2009).

¶20 SFG contends that Leroy ratified the loan when he took more than a year to proffer the check after learning the funds' source and even then made only a conditional offer to tender the proceeds he received. SFG also argues that a principal ratifies an agent's unauthorized act when he retains the benefits of the act, regardless of the principal's intent or whether the principal repudiates the unauthorized act. SFG relies heavily on *Miller v. Boeger*, 1 Ariz. App. 554, 405 P.2d 573 (App. 1965) for this contention. We disagree with SFG that *Miller* is the controlling authority in Arizona on this issue.

¶21 In *Miller*, this court considered whether a seller of property was liable for rescission when the seller's agent made fraudulent misrepresentations to the buyer purportedly without the seller's knowledge. *Id.* at 555, 405 P.2d at 574. The buyer argued that the seller had ratified the statements by retaining the proceeds of the sale, and the seller contended that the doctrine of ratification was not widely accepted. *Id.* at 557,

[2] We may look to the Restatement for guidance in the absence of case law to the contrary. *Burns v. Davis*, 196 Ariz. 155, 159, ¶ 5, 993 P.2d 1119, 1123 (App. 1999).

405 P.2d at 576. The court rebutted the seller's argument by quoting a treatise as follows:

> The general rule that a principal who accepts, or fails to restore, the benefits of an agent's unauthorized act shall be deemed to have ratified the same may be applicable so as to work a ratification regardless of the actual intent of the principal in the particular case, and is, accordingly, applicable notwithstanding his protestations or expressions of disapproval or repudiation of his agent's unauthorized act where the principal continues to retain the benefits which he obtained as a result of such act. . . .

Id. (quoting 2 C.J.S. *Agency* § 49). In our view, the court included the quote as "some indication" that the doctrine of ratification has gained "general acceptance," not as a complete statement of Arizona's rule on ratification. *See id.* Moreover, although the topics of a principal's intent and expressions of disapproval are mentioned in the quoted C.J.S. passage, the issue of intent to ratify was not before the court in *Miller*, and the court did not discuss the issue.

¶22 It is true that "a ratification *may* occur notwithstanding the principal's . . . repudiation of his or her agent's unauthorized act, where the principal continues to retain the benefits which he or she obtained as a result of such act." 2A C.J.S. *Agency* § 70 (West, Westlaw through Dec. 2011) (emphasis added). However, "[t]he general rule stated [in *Miller*] is not applicable so as to work a ratification . . .

where the circumstances surrounding the receipt of a benefit are not such as reasonably tend to show an intention to ratify." *Phoenix W. Holding Corp. v. Gleeson*, 18 Ariz. App. 60, 68, 500 P.2d 320, 328 (1972); *see also* 2A C.J.S. *Agency* § 70 (stating there is no ratification "where the circumstances surrounding the receipt of a benefit do not reasonably tend to show an intention to ratify"). Although delay can sometimes evidence intent to ratify, it must be considered in the context of all the facts and circumstances. *Phoenix W. Holding Corp.*, 18 Ariz. App. at 68, 500 P.2d at 328; *see also Cook v. Great W. Bank & Trust*, 141 Ariz. 80, 84, 685 P.2d 145, 149 (App. 1984) (holding that a ten-month delay in informing the bank of a forgery did not by itself constitute a ratification as a matter of law).

¶23 We hold there is sufficient evidence in the record to support a finding that Leroy did not ratify the SFG loans. Soon after Leroy learned of the loan, he objected to it and demanded that the lien be removed. Although Leroy kept the $48,000 interest payment from JGD even after he discovered that the money likely came from the SFG loan proceeds and did not offer to unconditionally tender the money to SFG, these facts are not dispositive. *See Phoenix W. Holding Corp.*, 18 Ariz. App. at 68, 500 P.2d at 328; *Cook*, 141 Ariz. at 85, 685 P.2d at 150.

¶24 Leroy did not directly receive any proceeds of the SFG loan. Further, Leroy testified that he did not know that Wolpe

may have used SFG loan proceeds to fund the interest payment at the time he accepted it in March 2006 and that he did not learn of the existence of SFG until after litigation commenced in June 2006. We defer to the trial court's evaluation of the testimony presented at trial because it is in the best position to judge the credibility of witnesses. *See Goats v. A.J. Bayless Mkts., Inc.*, 14 Ariz. App. 166, 171, 481 P.2d 536, 541 (1971).

¶25 Other than retaining money he was owed from JGD, which may have been funded by SFG loan proceeds,[3] Leroy made no "externally observable manifestation of assent to be bound" by Wolpe's commitment to SFG. *See* Restatement (Third) of Agency § 4.01 cmt. b. To the contrary, Leroy consistently protested the lien once he learned of the details. Also, as the trial court acknowledged during an exchange with counsel, this case does not present a typical ratification scenario, in which a party who returns proceeds obtained by an unauthorized agent is entitled to void the contract. In this case, even unconditionally tendering the $48,000 to SFG would not free Leroy from the consequences of the SFG transactions.

¶26 Considering these circumstances, the trial court did not abuse its discretion in rejecting SFG's ratification defense. Our holding obviates the need to consider the

[3] At oral argument before this court, Leroy's counsel acknowledged it has not been definitively established that Wolpe used the SFG loan proceeds to fund the payment to Leroy.

alternative arguments as to whether it was possible to return the benefits received or whether the statute of frauds precludes ratification.

B. The Trial Court Erroneously Awarded Supplemental Relief Under Count V of Leroy's Complaint

¶27 SFG also contests the trial court's award of $52,423.46 in supplemental relief to Leroy on Count V of the Second Amended Complaint. Specifically, SFG argues that the trial court erroneously awarded damages under the Declaratory Judgment Act because SFG was not found at fault with respect to any of Leroy's direct claims. We need not resolve this issue or address the causation argument, however, because the direct claim under Count V is deficient as a matter of law.

¶28 Leroy's factual claim is that the lien SFG placed on the Property prevented JGD from selling it, and thereby prevented JGD from meeting its interest obligation to Leroy. Leroy has not, however, stated a cognizable legal claim that could establish that SFG is liable to Leroy directly. A claim is a predicate for relief; a direct action is merely a vehicle for asserting it.

¶29 Leroy cites *Albers v. Edelson Tech. Partners, L.P.*, 201 Ariz. 47, 31 P.3d 826 (App. 2001), for the proposition that a shareholder may maintain a direct claim when the individual shareholder sustains the injury. In *Albers*, we held that

shareholders, who had received stock options in their capacities as employees, could assert direct claims against the individual directors of the corporation related to the stock options because these claims were not based on their status as shareholders. *Id.* at 52, ¶ 18, 31 P.3d at 826. However, in *Albers* the plaintiffs had legally cognizable direct action claims. *See id.* at 52-53, ¶¶ 21, 23, 26, 31 P.3d at 826-27 (recognizing direct legal claims for diluted voting power, loss of stock option value due to fraud, and loss of employment and salary due to fraud).

¶30 Generally, an action by a stockholder is "derivative rather than direct if the gravamen of the complaint is injury to the corporation." *Id.* at 52, ¶ 17, 31 P.3d at 826 (internal quotation and citation omitted). As Leroy's counsel conceded at oral argument, the damage done to Leroy's financial interest is derivative of harm done to JGD's "corporate property," and not to Leroy directly. *See Hampton Tree Farms, Inc. v. Jewett*, 865 P.2d 420, 429 (Or. Ct. App. 1993) (holding that an investor and a shareholder of a corporation were not entitled to pursue counterclaims independent of the corporation; their claimed damages stemmed from their financial interest in the corporation and were thus derivative of corporate claims). Accordingly, the trial court erred in holding that Leroy was entitled to relief

in a direct action (Count V of the Second Amended Complaint) under this theory. *See id.*

¶31 Leroy asserts nonetheless that his direct claim arises under A.R.S. § 33-420, which states in relevant part:

> A. A person purporting to claim . . . a lien or encumbrance against[] real property, who causes a document asserting such claim to be recorded in the office of the county recorder, knowing or having reason to know that the document is forged . . . *is liable to the owner or beneficial title holder of the real property* . . . .
>
> B. *The owner or beneficial title holder of the real property may bring an action* pursuant to this section . . . .

(Emphasis added.) We are not persuaded by Leroy's reliance on A.R.S. § 33-420.

¶32 First, we do not find any indication in the record that this claim was properly raised below. *See Richter v. Dairy Queen of S. Ariz., Inc.*, 131 Ariz. 595, 596, 643 P.2d 508, 509 (App. 1982) (stating that "an appellate court cannot consider issues and theories not presented to the court below"). Moreover, even assuming the § 33-420 claim was properly raised, Leroy does not have a legally cognizable claim under this section because he is not the "owner or beneficial title holder" of the Property—LGD is. Therefore, any claim arising under § 33-420 would belong to LGD and not to Leroy directly.

¶33 As SFG points out, direct relief is also available if an independent relationship exists between the individual plaintiff and the third-party defendant. *See Schroeder v. Hudgins*, 142 Ariz. 395, 398, 690 P.2d 114, 117 (App. 1984) (holding that the guarantors of a corporation had no personal right of action against a third-party corporate attorney for malpractice as they had no independent relationship), *abrogation on other grounds recognized by Franko v. Mitchell*, 158 Ariz. 391, 399-400 n.1, 762 P.2d 1345, 1353-54 n.1 (App. 1988); *Hershman's, Inc. v. Sachs-Dolmar Div.*, 623 N.E.2d 617, 619 (Ohio Ct. App. 1993) (holding that the plaintiffs' personal loan to the corporation did not support a personal right of action because they had no independent contractual relationship with the defendants). Because Leroy had no independent relationship with SFG, he cannot bring a direct claim for relief, and Count V fails as a matter of law. *See Schroeder*, 142 Ariz. at 398, 690 P.2d at 117; *Hershman's*, 623 N.E.2d at 619.

CONCLUSION

¶34 Based on the foregoing, we affirm the trial court's rulings rejecting the ratification defense and granting declaratory relief under Count IV of the Second Amended Complaint. We vacate, however, the court's award of $52,423.46 in interest damages under Count V. Finally, we deny both Leroy's and SFG's requests for attorneys' fees on appeal because

neither party cited any authority for its request. *See Roubos v. Miller*, 214 Ariz. 416, 420, ¶ 21, 153 P.3d 1045, 1049 (2007) ("When a party requests fees, it . . . must state the statutory or contractual basis for the award[.]"). SFG is entitled, however, to taxable costs on appeal upon compliance with Rule 21(a) of the Arizona Rules of Civil Appellate Procedure.

/s/

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MICHAEL J. BROWN, Presiding Judge

CONCURRING:

/s/

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PATRICIA K. NORRIS, Judge

/s/

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PHILIP HALL, Judge