IN THE COURT OF APPEALS OF IOWA

No. 3-898 / 12-2213
Filed October 23, 2013

TERRY NEVILLE and ERIN NEVILLE,
Plaintiffs-Appellees/Cross-Appellants,

vs.

MICHAEL MILLIRON and AG AIR LTD,
Defendants/Cross-Appellees,

AG AIR LTD,
Counterclaimant-Appellant,

vs.

MIDWEST AERIAL APPLICATIONS, LLC, and TERRY NEVILLE,
Defendants to Counterclaim-Appellees.

Appeal from the Iowa District Court for Sac County, Kurt L. Wilke, Judge.

Ag Air LTD appeals, and Terry and Erin Neville cross-appeal, from the district court's order in this equity action. **AFFIRMED ON BOTH APPEALS.**

Jerry L. Schnurr III, Fort Dodge, for appellant.

James R. Van Dyke of Eich, Van Dyke & Werden, P.C., Carroll, for appellees.

Heard by Vaitheswaran, P.J., and Potterfield and Danilson, JJ.

POTTERFIELD, J.

Ag Air LTD appeals, and Terry and Erin Neville cross-appeal, from the district court's ruling in this equity action. Finding no reason to disturb the court's findings and judgment, we affirm on both appeals.

I. Background Facts and Proceedings.

Terry and Erin Neville filed a petition in equity challenging "the formation and execution of" a document entitled "Declaration and Contract of Trust . . . Ag Air LTD (A Private Contract Irrevocable Trust)," which contains a declaration that it was "made" on September 9, 2009. In count I of the petition, the Nevilles asserted the trust was invalid and void pursuant to Iowa Code section 633A.2102 (2009)[1] and the common law of Iowa; in count II, the trust was created due to

[1] Iowa Code section 633A.2102 (2009) provides the "requirements for validity" of a trust. However, "[a] business trust is to be distinguished from an ordinary trust." 16A William Meade Fletcher et al., Fletcher Cyclopedia of the Law of Corporations § 8228 (Westlaw 2013) (Fletcher). "Its purpose is not to hold and conserve particular property, but to conduct a business." *Id.*; *see Daries v. Hart*, 243 N.W. 527, 529 (Iowa 1932) (stating an entity known as the Franklin Trust "appears to be a voluntary association of individuals, each of whom was party to the written trust agreement heretofore described"); *Mallory v. Russell*, 32 N.W. 102, 104 (Iowa 1887) (treating business trust property as partnership property to which a widow was not entitled a dower share).

> A business trust . . . is a business organization created by a deed of trust or declaration of trust under which business enterprise assets are transferred to trustees to manage for the benefit of individuals holding certificates evidencing beneficial interests in the trust estate. The trustees have legal title to the property in trust and act as principles for the certificate holders, or "shareholders."

16A Fletcher § 8228.

Business trusts are referenced many times throughout various Iowa Code sections. For example, several sections define "person" for purposes of that statute to include a business trust. *See* Iowa Code §§ 4.1, 68A.102, 68B.2, 88.3, 124.101. However, while other states have specific statutes dealing with the formation and governance of business trusts, *see, e.g.*, Mass. Gen. Laws ch. 182 (2013); Minn. Stat. ch. 318 (2013), and the Iowa legislature has enacted numerous statutory chapters dealing with the formation, filing, and governance of other business entities, *see* Iowa Code chs. 486A-487 (Partnerships); 488 (Limited Partnerships); 490 (Business Corporations); 490A (Limited Liability Companies); 491 (Corporations for Pecuniary Profit); 496C (Professional Corporations); 497-499 (Cooperative Associations); and 504-

fraud or misrepresentation by Michael Milliron; and in count III, that Milliron had slandered and libeled them.[2] The Nevilles sought a judgment declaring the Ag Air LTD declaration of trust void and of no effect. They also asked the court for other equitable relief.

Milliron and Ag Air LTD filed an answer generally denying the allegations. Ag Air LTD filed a counterclaim, seeking damages against Terry Neville for breach of contract and breach of fiduciary duty as a result of his taking $45,000 in assets. Ag Air LTD also sought damages and temporary and permanent injunctive relief for breach of the covenant not to compete.

The following facts can be gleaned from the trial record. Terry Neville is a resident of Sac County, Iowa. He is a farmer with many personal connections throughout the region. Erin Neville is his spouse.

Michael Milliron is a helicopter pilot specializing in crop dusting, most of which—prior to 2009—had been conducted in California. Shea Miech is his

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504A (Nonprofit Corporations), it has not enacted legislation dealing with the formation and governance of business trusts.

It is the same in Texas, which the Declaration and Contract of Trust claims as its "situs," and states the "rights of all parties and the construction and effect of every provision hereof shall . . . be subject to the Laws of the situs of this Trust . . . ."

> In Texas, where the business trust had a very rapid development, it was finally held in 1925, after considerable vacillation in the earlier cases, that this form of organization was ineffective in securing limited liability for the shareholders. [*See Thompson v. Schmitt*, 274 S.W. 554, 558 (1925) ("[W]e cannot allow the mere matter of an express delegation to certain members of a voluntary commercial association of exclusive control over the common property to convert into a trust what would otherwise be universally considered a joint-stock company, with the members subject to the liabilities of partners.")].

Myron Kove, George Gleason Bogert & George Taylor Bogert, *The Law of Trusts and Trustees* § 247 (Westlaw 2013).

In *Loomis Land & Cattle Co*. *v*. *Diversified Mortgage Investors*, 533 S.W.2d 420, 426 (Tex. Civ. App. 1976), a Texas appellate court wrote, "While Massachusetts Business Trusts are not recognized in this state it has been held that they are to be treated as a partnership or an unincorporated joint stock company."

[2] The Nevilles dismissed Count III, the defamation claim, before trial.

daughter. Milliron has no personal connection to Sac County, but came to Iowa in 2009 to fly for Speas Aviation. Milliron flew for Speas Aviation under the designation of "Ag Spray"[3] governed by a contract that included a two-year covenant not to compete. Milliron sprayed fields in Iowa using Speas Aviation's federal certification.

While flying for Speas Aviation in 2009, Milliron and Terry Neville became friends and discussed forming their own crop spraying business. Milliron offered aviation connections, equipment, and technical expertise. Terry offered clientele, a base of operations, and nontechnical labor.

Neither party consulted an attorney. Milliron prepared a document that purported to create an irrevocable trust called Ag Air LTD on September 9, 2009.[4] The document listed Erin Neville as the "sole settlor." Terry Neville and Shea Miech were the "trustees." The document states its "original situs" is Williamson County, Texas, and provides that it "shall be interpreted and governed by Common-Law in the State of Texas."[5] Milliron was named as successor trustee. The document included a provision that "each Trustee" agreed not to "engage in business or service now engaged by AG AIR LTD

[3] Milliron testified at deposition that Ag Spray was a business trust of which he was "the trustee." He claimed not to know where the company was based or where its principal place of business was. Milliron testified he printed his name on the contract with Speas Aviation, but "[t]hat's not a signature," and, consequently, he did not believe the covenant not to compete was binding.

[4] Milliron testified the document "came from a trust document that had been in the family for years, I mean, a long time, 25, 30 years." He stated further, "It was prepared from a document that we had in the possession in terms of from a Word document, Microsoft Word, and in relation to other trusts that I have had over the years, it's more or less a copy of that." He did not know when the Nevilles signed the document, but he knew it was not on September 9, 2009. (Depo Tr. at 13-14). The Nevilles testified they provided their signatures in May 2010.

[5] As noted in footnote 1, Texas treats business trusts as a partnership or an unincorporated joint stock company. *See Loomis Land & Cattle Co.*, 533 S.W.2d at 426.

within a radius of Sixty (60) miles of the place of business of the Trust." And further, that "if any Member withdraws from the Trust, he will not, within the above described territory and for a period of five (5) years, directly or indirectly carry on, engage in or be interested in the business or service now engaged by the Trust."

On June 28, 2010, a bank account for Ag Air LTD was set up at a bank in Odebolt, Iowa. Terry Neville and Miech were designated signatories.

Milliron[6] thereafter formed a Wyoming corporation called Ag Air, Inc. As found by the trial court, "The corporation became an unexpected and necessary afterthought because of FAA rules" that did not recognize a business trust as a valid holder of the certifications necessary for spraying agricultural chemicals. The "By-laws of Ag Air, Inc." note a special meeting was held at a Buchanan Avenue, Kiron, Iowa address on May 22, 2010—that address is the Nevilles' residence. At that meeting, Milliron was named as temporary chairperson, and Shea Miech and Terry Neville were listed as shareholders.

In a separate oral agreement, Terry Neville and Milliron agreed that Terry would receive $1 per acre sprayed by Ag Air. In return, Terry introduced Milliron to his many contacts in and around Terry's home in Sac County.

Clients were billed $12 per acre for spraying. Revenue was deposited into Ag Air LTD's bank account. Ag Air LTD was to keep $2 per acre. The rest was to be used for Ag Air, Inc.'s expenses and bills, including pilots' wages, helicopter leases, airfield maintenance, insurance, fuel, general labor, and a $1-per-acre cut

[6] As with the Ag Air LTD, the corporation was formed without consulting an attorney. Milliron stated the corporate papers "came from corporate papers that I've had in the same thing, from that software."

to Terry Neville. Although the helicopter leases and pilot contracts identified Ag Air, Inc. (the corporation), "Ag Air" was used interchangeably to refer to the corporation, Ag Air LTD, or both.

The district court found that Milliron

> pulled all the strings for the corporation and the trust [Ag Air LTD]. He acted as president of the corporation. And although Ms. Miech performed ministerial tasks for the trust [Ag Air LTD], Mr. Milliron acted as de facto general manager without any objection from either trustee or any beneficiary.
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> Business took off. In 2010, pilots sprayed almost 54,000 acres. The parties projected over a million dollars in revenue over four short months. Mr. Milliron flew helicopters. Mr. Neville maintained an airfield on his land and worked directly with the pilots and ground crews. He also recruited new clients. Ms. Miech signed the checks.
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> But the homespun legal hodgepodge malfunctioned. Self-dealing and conflicts of interest were baked in from the start. Loyalties were designedly divided among the beneficiaries, corporation, and Mr. Milliron. Ms. Miech signed off on checks alone, without her co-trustee's knowledge. Business formalities were dishonored. Trust and corporate funds comingled in the trust's account. The corporation never opened a bank account until after August 2010. Pilots complained to Mr. Neville about missing paychecks. He covered a $5,000 insurance payment. Meanwhile, Mr. Milliron took lavish vacations, and the trust [Ag Air LTD] paid large cash payments to mysterious accounts in California. Mr. Neville finally received $25,000 in August.
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> Frustrated, Mr. Neville confronted Mr. Milliron on August 24, 2010. The two exchanged tense words. Mr. Milliron told Mr. Neville that he would not be paid any more money. Mr. Neville orally tendered his immediate resignation from the business and as co-trustee. After Mr. Milliron left, Mr. Neville drove to the bank and withdrew $45,000 from the trust bank account.
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> The next season, Mr. Neville launched his own spraying company [Midwest Aerial Applications, L.L.C.] using connections and techniques learned while working for Mr. Milliron. Most area farmers took their business to their friend Mr. Neville. Mr. Milliron's business struggled while Mr. Neville's thrived.

The trial court rejected the Nevilles' claim that Milliron fraudulently induced their signatures on the Ag Air LTD document, writing, "The Nevilles treated the

trust as a legitimate transaction through August 2010. Mr. Neville accepted $25,000 from the trust. Although the document itself is extremely suspicious, the Court is not convinced of a fraud."

The court, however, rejected Milliron and Ag Air LTD's demand that Terry Neville be ordered to return $45,000 to Ag Air LTD. The court found Terry "Neville's contract entitled him to $53,388 for his essential connections that he brought to the business. He deserves reimbursement of $5000 insurance payment as authorized by the trust instrument. His labor entitles him to $15,000, for a grand total of $73,388." The court observed that Terry Neville had received a $25,000 payment; the $45,000 he withdrew from the Ag Air LTD account on August 24; and the benefit of spraying his own acres, which the court calculated at $16,575. The court thus calculated Terry Neville had received $76,825 from Ag Air LTD. The court entered judgment against Terry Neville in favor of Ag Air, LTD in the amount of $13,187.

The court refused to enforce the covenant not to compete contained in the Ag Air LTD document for several reasons: the covenant "unreasonably restricts Mr. Neville's rights"; the $500 annual consideration stated therein was not paid; and, on August 24, 2010, Milliron "repudiated every agreement with Mr. Neville, including the one ancillary to the covenant," and his prior breach independently excused Terry Neville from the covenant not to compete.

The Nevilles filed a motion to amend or enlarge asserting the court erroneously calculated the benefit Terry Neville received from the spraying of his 700 acres, having erroneously included a calculation of 1600 acres belonging to others. The Nevilles asked the court to delete judgment against them. They

contended that "at the very least there should be a $33,000 offset against that $16,575 found by the court for spraying of Plaintiff's farm," the $33,000 being for "itemized damages for money owed" for the use of Terry Neville's truck, the use of farm gas and fuel, unpaid wages to Frank Neville and Todd Gunderson, and the use of the Nevilles' shop, yard, and water. In resistance to the motion to enlarge, Ag Air LTD argued the plaintiffs were not entitled to a setoff as they did not "seek damages in any pleadings filed herein." The district court amended its order and judgment finding "Terry Neville only received a benefit of $6825 from the Defendants' spraying of Terry Neville's farm," and ordered Terry Neville to return $3437 to the Ag Air LTD.

The parties filed an appeal and a cross-appeal.

II. Scope and Standard of Review.

Our review of this equity action is de novo. Iowa R. App. P. 6.907. We give weight to the trial court's factual findings, especially when considering the credibility of witnesses, but we are not bound by them. Iowa R. App. P. 6.904(3)(g).

III. Discussion.

On appeal, Ag Air LTD contends: (1) Terry Neville breached his duty of loyalty to the trust by self-dealing when he withdrew $45,000 from the trust account; (2) Terry Neville was not entitled to any offset against any judgment entered against him; and (3) the trial court erred in declaring the covenant not to compete unenforceable. On cross-appeal, the Nevilles assert the judgment entered against Terry Neville should be set aside and that the court should have awarded them $36,388.

III. Discussion.

A. *Setoff.* We first address the issue of setoff raised in the appeal and cross-appeal. Iowa Rule of Civil Procedure 1.957 provides,

> A claim and counterclaim shall not be set off against each other, except by agreement of both parties or unless required by statute. The court, on motion, may order that both parties make payment into court for distribution, if it finds that the obligation of either party is likely to be uncollectible. If there are multiple parties and separate set-off issues, each set-off issue should be determined independently of the others. The court shall distribute the funds received and declare obligations discharged as if the payment into court by either party had been a payment to the other party and any distribution of those funds back to the party making payment had been a payment to that party by the other party.

The rule has been addressed in *City of Sioux City v*. *Freese*, 611 N.W.2d 777, 778 (Iowa 2000), which involved a city's suit for damages and an engineering firm's counterclaim for damages and the court ruled setoff of judgments was mandatory under rule 225 (now rule 1.957) where the parties had stipulated to a setoff of judgments. More recently, in *Lewis Electric Co. v. Miller*, 791 N.W.2d 691, 696 n.8 (Iowa 2010), which involved a claim and counterclaim for damages, the court noted in a footnote, "Should the district court determine Miller is entitled to a judgment on his counterclaim, under Iowa Rule of Civil Procedure 1.957, the court may not set off damages awarded on Miller's counterclaim against Lewis Electric's recovery under the Sioux City contract, as the parties have neither agreed to such an arrangement nor have they brought the court's attention to a statute that requires a setoff."

Here, the issue of set off was first raised in a post-trial motion when the Nevilles argued that if the court entered judgment for Ag Air LTD, "at the very least there should be a $33,000 offset against that $16,575." Ag Air LTD

responded by asserting the plaintiffs were not entitled to any set off because they had not sought damages in any pleadings. The district court agreed with Ag Air LTD: "In essence, the Plaintiffs seek judgment against the Defendants for an amount in excess of $36,000, yet no claim was filed on the Plaintiffs' behalf for a money judgment." We find no error.

B. $45,000 withdrawal. Ag Air LTD's counterclaim to the declaratory judgment action asserted Terry Neville made an unauthorized withdrawal of $45,000. Ag Air LTD contends the trial court erred in not requiring Terry Neville to return the full amount, asserting Terry Neville had resigned as trustee two hours before withdrawing the funds from the Ag Air LTD account and thus engaged in self-dealing.

Section 27.1 of the Declaration and Contract of Trust provides, "The Trustees and Trust Officers shall be entitled to reimbursements of all direct and indirect expenses of the Trust incurred and paid on behalf of the trust." Milliron testified he and Terry agreed that Terry would receive $1 per acre sprayed. Milliron agreed there were almost 59,000 acres sprayed. He agreed that Terry paid for the fuel to spray those acres. He acknowledged that Terry provided a home base for the spraying operation and provided other services.

The district court found, "[T]he parties wholeheartedly agree that Mr. Neville earned at least $1 per acre sprayed in 2010, or $53,688. Mr. Neville never breached during his time with the venture." The court concluded Neville was entitled to all but $3437 of the $45,000 he withdrew.

The district court impliedly found, and we agree, that Terry Neville did not engage in prohibited self-dealing. *Cf. Cookies Food Prods., Inc. v. Lakes*

Warehouse Distrib., 430 N.W.2d 447, 451-52 (Iowa 1988) (discussing principles of self-dealing and noting there is no breach of duty of loyalty where a corporate officer shows compensation was reasonable and actions were in good faith, honesty, and fairness to the company). We find Ag Air LTD's reliance on the timing of Terry Neville's resignation of no moment, particularly where "everyone wildly disregarded and trampled trust and corporate formalities, especially Mr. Milliron."

As for the cross-appeal claim that the court erred in requiring Terry Neville to reimburse any monies, we find no reason to modify the trial court's ruling.

C. *Covenant Not to Compete*. Milliron contends the court erred in declaring the covenant not to compete unenforceable. As a general rule, covenants not to compete are enforceable in Iowa. *Orkin Exterminating Co. v. Burnett*, 146 N.W.2d 320, 324 (Iowa 1966). "Where the basic contract is fair and equitable, such covenants do not violate public policy." *Id.* "[W]here the restrictive covenant is reasonably necessary for the protection of the employer from loss of business caused by the acts of the employee as a result of confidential knowledge acquired by training and service in the employer's business, it is usually enforceable in equity." *Id.*

> Essentially, [the] rules [concerning the enforcement of noncompetitive provisions in an employment contract] require us to apply a reasonableness standard in maintaining a proper balance between the interests of the employer and the employee. Although we must afford fair protection to the business interests of the employer, the restriction on the employee must be no greater than necessary to protect the employer. Moreover, the covenant must not be oppressive or create hardships on the employee out of proportion to the benefits the employer may be expected to gain.

Iowa Glass Depot, Inc. v. Jindrich, 338 N.W.2d 376, 381 (Iowa 1983).

As set forth, the covenant not to compete provides:

> As part of the consideration for this Agreement, each Trustee, General Manager and Officer agree as Members of this agreement:
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> That at no time during the term of this Agreement will, Members for his or herself, or in behalf of any person or entity engage in business or service now engaged by AG AIR LTD within a radius of Sixty (60) miles of the place of business of the Trust. Members will not, directly or indirectly, solicit or attempt to solicit business or patronage of any person or entity within such territory for the purpose of promoting business and service now engaged by AG AIR LTD, except on behalf of the trust;
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> That during the term of this agreement, Members will not service contracts and accounts from, or work in, the above-described territory for any person or entity other than the Trust selling products or services identical, similar or incidental to the business of the Trust; and
>
> That if any Member withdraws from the Trust, he will not, within the above-described territory, and for a period of five (5) years, directly or indirectly carry on, engage in or be interested in the business or service now engaged by the Trust.

Milliron states there is "no dispute as to the place of business of the Trust as Odebolt, Sac County, Iowa." He asserts Terry Neville, through Midwest Aerial Applications, L.L.C., in 2011 sprayed 74,588 acres within sixty miles of Odebolt, violating the covenant not to compete.

"In deciding whether to enforce a restrictive covenant, the court will apply a three-pronged test: (1) Is the restriction reasonably necessary for the protection of the employer's business; (2) is it unreasonably restrictive of the employee's rights; and (3) is it prejudicial to the public interest?" *Lamp v. Am. Prosthetics, Inc.*, 379 N.W.2d 909, 910 (Iowa 1986). "When applied to owner-to-owner covenants not to compete, the court grants a greater scope of restraint." *Sutton v. Iowa Trenchless, L.C.*, 808 N.W.2d 744, 750 (Iowa Ct. App. 2011). But because this covenant did not arise in a sale of a business, we do not apply the owner-to-owner scope of restraint. *See id.* at 750-51, and cases cited therein.

The trial court ruled the "narrower scope of restraint applicable to employer-employee covenants applies." Under that narrower scope, the district court answered the first prong of the test in the affirmative, that is, the restriction was reasonably necessary for the protection of the spraying business. The trial court concluded, however, the restriction was unreasonably restrictive of Terry Neville's rights. The court found, "[Terry] could also spray farms more than sixty miles away under the covenant. However, the Court finds that the $500 annual consideration for the trust and covenant is so grossly disproportionate to the broad restraint on Mr. Neville and the benefit accruing to Mr. Milliron and the trust that it is unreasonable." In any event, the trial court found Milliron's repudiation and prior breach independently excused Terry Neville from the covenant not to compete.

Milliron argues the court erred in finding the covenant unduly restrictive, noting Terry is a grain farmer whose livelihood is not limited to chemical applications. We acknowledge that Terry Neville had other means of livelihood. But we note too that Terry Neville was the person who introduced Milliron to Iowa customers to the business. *Cf. Jindrich*, 338 N.W.2d at 382 (noting that restraints enforced against an employee often "relied upon the employee's close proximity to customers along with peculiar knowledge gained through employment that provides a means to pirate the customer"). In considering what is reasonable under the circumstances here, the trial court cited the grossly disproportionate restriction on Terry Neville in comparison to the consideration stated for that promise—a trustee was entitled to annual compensation not to exceed $500 per year. We need not rely on this ruling by the trial court.

We agree with the trial court Ag Air LTD, at Milliron's direction, failed to pay Terry Neville and that "on August 24, 2010 Mr. Milliron repudiated every contract with Mr. Neville." "Normally, repudiation consists of a statement that the repudiating party cannot or will not perform." *Conrad Bros. v. John Deere,* 640 N.W.2d 231, 241 (Iowa 2001) (citing II E. Allan Farnsworth, *Farnsworth on Contracts* § 8.21, at 535 (2d ed. 1998)). Such statement must be sufficiently positive to be reasonably understood that a breach will actually occur. *Id.* In other words, the repudiation must be definite and unequivocal, and it must give the other party a positive notice of an intended breach. *See id.*

Milliron repudiated all agreements with Terry Neville on August 24, 2010. Milliron's statements were definite and unequivocal and were sufficiently positive to be reasonably understood by Terry Neville that there would be no further performance under any of the contracts between the parties. Based on the particular facts of the case presented to us, we agree with the district court that this repudiation relieved Terry Neville of any restriction under the trust agreement. *See id.* ("Where one party to a contract repudiates the contract before the time for performance has arrived, the other party is relieved form its performance."). We therefore affirm.

AFFIRMED ON BOTH APPEALS.