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STATE OF MINNESOTA
IN COURT OF APPEALS
A17-0172

Carmen A. Dulhanty,
on her own behalf and on behalf of those similarly situated,
Appellant,
Fintegra Holdings, LLC, an Indiana limited liability company,
Plaintiff,

vs.

Daniel Conner, et al.,
Respondents,
Doreen Lea Weber, et al.,
Respondents,
Frank Charles "Chet" Taylor, III,
Respondent,
Fintegra Holdings, LLC, an Indiana limited liability company,
Defendant.

Filed August 28, 2017
Affirmed
Reyes, Judge

Hennepin County District Court
File No. 27-CV-15-14487

Edward P. Sheu, Best & Flanagan, L.L.P., Minneapolis, Minnesota (for appellant)

Matthew D. Forsgren, Sybil L. Dunlop, Anna M. Tobin, Greene Espel, P.L.L.P., Minneapolis, Minnesota (for respondents Daniel Conner, et al.)

Vincent D. Louwagie, Cory D. Olson, Christopher J. Haugen, Anthony Ostlund Baer & Louwagie, P.A., Minneapolis, Minnesota (for respondents Doreen Lea Weber, et al.)

F. Chet Taylor, Taylor Law Office, P.L.C., Minneapolis, Minnesota (for respondent Frank Charles "Chet" Taylor III)

Considered and decided by Reyes, Presiding Judge; Bjorkman, Judge; and Hooten, Judge.

UNPUBLISHED OPINION

REYES, Judge

Appellant challenges the summary-judgment dismissal of her claims against respondents arising out of the alleged sale of all assets belonging to Fintegra LLC, asserting that the district court erred by applying the business-judgment rule to conclude that appellant's claims failed as a matter of law. We affirm.

FACTS

Minnesota-based limited-liability company Fintegra, LLC (Fintegra) operated as a Financial Industry Regulatory Authority (FINRA) registered broker-dealer. Fintegra is a wholly owned subsidiary of Fintegra Holdings, LLC (Holdings), an Indiana limited-liability company with approximately 44 members (Holdings' members).[1] Appellant Carmen Dulhanty is a Holdings member. Respondents Daniel Conner, Douglas Schmitz, Kenneth Walter, and Stephen Caurro (collectively, the directors) served on both Fintegra's and Holdings' identically constituted boards of directors. Respondents Doreen Lea Weber, Jeffrey Allen Schuh, and Frank Charles "Chet" Taylor III (collectively, the Fintegra managers) are former managers responsible for the day-to-day management of Fintegra. The Fintegra managers did not have any role in Holdings.

[1] Holdings' members invested $4.89 million in Holdings.

The majority of Fintegra's business involved purchasing and selling securities on its own account before selling the securities to customers through registered representatives employed by Fintegra. These registered representatives acted as agents for customers, assisting them in executing the securities transactions. Holdings' only asset was Fintegra, which derived its value from its relationships with approximately 23 financial institutions and approximately 127 registered representatives and revenues, known as gross-dealer concessions (GDC), associated with their work with customers.

In 2013, a group of Fintegra customers filed claims against Fintegra regarding a failed investment and sought rescission of the investment. Fintegra manager Taylor expressed concern about the potential "devastating" and "catastrophic" consequences of an adverse outcome to the other Fintegra managers and then to the directors. On June 12, 2015, Fintegra received an adverse arbitration award of $1,560,626.24 in damages, fees, and costs from FINRA and suspended its securities business because it incurred a "net-capital violation." The directors then hired a law firm to advise them on the best course of action for Fintegra's creditors and investors. In late June and early July 2015, following the law firm's advice, the directors negotiated selling Fintegra's assets to another brokerage firm, Securities America (SA), in a private sale outside of bankruptcy. The directors instructed the Fintegra managers to assist in the sale.

The proposed sale between Fintegra and SA included an asset-purchase agreement (APA), a referral agreement (RA), and a transition assistance agreement (TAA). The APA included the sale of Fintegra's assets, including property, rights in customer accounts, and goodwill associated with customer accounts, but did not transfer registered representatives.

The APA would become effective only upon approval of Holdings' members.[2] Furthermore, the APA contained a "no-shop" clause, prohibiting Fintegra, Holdings, or their representatives from negotiating with other entities until August 31, 2015. The RA required SA to pay Fintegra a referral fee for each Fintegra registered representative who joined SA. The TAA required SA to pay Fintegra employees to stay and help transition the business to SA in the event the APA was fully executed. On June 30, 2015, the directors voted unanimously to execute the APA. The record contains no evidence that the directors or the Fintegra managers ever received any payment from SA under the APA or TAA.

On July 3, 2015, director Conner signed the APA. On July 7, 2015, the directors forwarded the APA to Holdings' members for approval. By the end of July 2015, it became clear to the parties that Holdings' members were not going to approve the APA. The directors proposed that SA terminate the APA but SA refused, citing the "no-shop" clause.

During this time, the Fintegra managers communicated with SA and Fintegra's registered representatives to encourage the registered representatives to move their accounts from Fintegra to SA. Furthermore, Fintegra consented to the transfer of its institutional banks' customer accounts to SA. By the end of August 2015, SA had acquired 53 Fintegra registered representatives, representing over $11 million in GDC, and 23 banks, constituting over $6 million in GDC. Fintegra filed for bankruptcy on September 16, 2015.

[2] Article III, section 3.1(d) of the APA states, "[Fintegra's] sole member shall have approved the Agreement as required by its governing documents and the Minnesota Limited Liability Company Act."

On August 15, 2015, Dulhanty commenced this double-derivative action[3] on Holdings' behalf. In an amended complaint, Dulhanty alleged six claims against the directors: (1) breach of fiduciary duties (two counts); (2) breach of fiduciary duty against director Conner; (3) gross negligence; (4) tortious interference with economic advantage; and (5) corporate waste. Dulhanty also maintained claims against the Fintegra managers: (1) breach of fiduciary duties; (2) breach of fiduciary duty against manager Weber; (3) aiding and abetting breach of fiduciary duties; (4) tortious interference with prospective advantage; and (5) corporate waste.

On June 15, 2016, the directors and the Fintegra managers moved for summary judgment on all claims under Minnesota Rules of Civil Procedure 23.09 and 56.[4] On December 2, 2016, the district court granted the directors' and the Fintegra managers' motions for summary judgment, determining that Dulhanty's claims were barred under the business-judgment rule. This appeal follows.

D E C I S I O N

On appeal from summary judgment, we review de novo whether there are any genuine issues of material fact and whether the district court's application of law was erroneous. *Ruiz v. 1st Fid. Loan Servicing, LLC*, 829 N.W.2d 53, 56 (Minn. 2013). We view the evidence in the light most favorable to the nonmoving party. *STAR Ctrs., Inc. v.*

[3] A double-derivative suit is a lawsuit by a parent corporation, usually initiated by a shareholder of the parent corporation, to enforce a cause of action of a related subsidiary corporation. *See Blasband v. Rales*, 971 F.2d 1034, 1044 (3d Cir.1992).

[4] The case was fully briefed and argued before the district court. The district court, however, did not record oral arguments, so no transcript of the oral arguments is available.

Faegre & Benson, L.L.P., 644 N.W.2d 72, 76-77 (Minn. 2002). Summary judgment is inappropriate when the nonmoving party has presented sufficient evidence to permit reasonable persons to draw different conclusions. *Schroeder v. St. Louis County*, 708 N.W.2d 497, 507 (Minn. 2006).

I. The district court did not err in applying the business-judgment rule to the directors in their capacity as Holdings' directors.

Dulhanty argues that the business-judgment rule does not apply to the directors acting under their authority as Holdings' directors because they made a nonbusiness decision by violating Holdings' operating agreement and Indiana law. We disagree.

Holdings is an Indiana limited liability company governed by the Indiana business flexibility act. *See* Ind. Code Ann. § 23-18-1-1 (LexisNexis 2010); *see also Potter v. Pohlad*, 560 N.W.2d 389, 391 (Minn. App. 1997) (companies and their management are governed by their state of incorporation). Holdings' operating agreement is "binding upon all the members." *See* Ind. Code Ann. § 23-18-1-16 (LexisNexis 2010) ("Operating agreement means any written or oral agreement of the members as to the affairs of a limited liability company and the conduct of its business that is binding upon all the members."); *see also* Ind. Code Ann. § 23-18-4-4(a)(1) (LexisNexis 2010).

Indiana law permits a limited liability company's operating agreement to contain a standard of liability, so long as the language does so clearly. *See* Ind. Code Ann. § 23-18-4-2(a) (LexisNexis 2010). Holdings' operating agreement contains a standard of liability that mirrors the Indiana code, stating that "[a] Director is not liable for any action taken as a Director, or any failure to take any action, unless the Director has breached or failed to

perform the Director's duties and the breach or failure to perform constitutes willful misconduct or recklessness." *See* Ind. Code Ann. § 23-1-35-1(e) (LexisNexis 2010). Because Holdings' operating agreement sets the same standard as Indiana law governing corporations, the district court did not err in applying the standard under section 23-1-35-1(e) and caselaw interpreting that standard in this matter.

"Indiana has statutorily implemented a strongly promanagement version of the business judgment rule . . . includ[ing] a presumption that in making a business decision, the directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company." *G&N Aircraft, Inc. v. Boehm*, 743 N.E.2d 227, 238 (Ind. 2001) (quotation omitted). In order for the directors to be liable, they (1) must have breached or failed to perform a duty and (2) the breach or failure must have constituted willful misconduct or recklessness. *See G&N Aircraft*, 743 N.E.2d at 238 (quotation omitted). Here, the district court determined that Dulhanty failed to present any evidence that would satisfy these two elements and, as such, her claim is barred by the business-judgment rule.

Article V, section 5.1(b)(1), of Holdings' operating agreement grants Holdings' members, like Dulhanty, the right to approve by a supermajority a disposition of all or substantially all of Holdings' assets. Additionally, article VI, section 6.1(d) of Holdings' operating agreement provides that the directors could "[n]egotiate or empower others to negotiate: (i) merger of [Holdings] with another entity or (ii) a sale of [Holdings] or substantially all of the assets of [Holdings]." The operating agreement also provided that, in performing their duties, the directors could rely on the information and opinions of

"[a]ny attorney . . . as to matters which [the directors] reasonably believe[d] to be within such person's professional or expert competence."

We first note that, even assuming assets were transferred to SA, the assets belonged to Fintegra, not Holdings. Fintegra is a subsidiary of Holdings, the parent company. In the parent-subsidiary context, "[a] corporate parent which owns the shares of a subsidiary does not, for that reason alone, own or have legal title to the assets of the subsidiary." *Dole Food Co. v. Patrickson*, 538 U.S. 468, 475, 123 S. Ct. 1655, 1660 (2003). The same principles apply to limited-liability companies. *See Pazmino v. Bose McKinney & Evans LLP*, 989 N.E.2d 784, 786 (Ind. Ct. App. 2013) (recognizing limited-liability companies as distinct legal entities). Here, Holdings has a membership interest in Fintegra but does not own or have legal title to Fintegra's assets. As a matter of law, any putative transfer of assets would have been of Fintegra's assets, not Holdings'. Therefore, Dulhanty has not demonstrated that the directors transferred any of Holdings' assets in violation of Holdings' operating agreement.

The directors negotiated an asset sale of Fintegra with SA, conduct in which they were authorized to engage. Notably, the APA could not be fully executed until Holdings received member approval under its operating agreement, which required a supermajority vote. Additionally, neither the RA nor the TAA contained any provisions to transfer Holdings' assets. And, throughout this process, the record shows that the directors acted on the advice of counsel. Even viewing these facts in favor of Dulhanty, she cannot demonstrate a breach of a duty owed to Holdings or any reckless or willful misconduct by the directors. Accordingly, the business-judgment rule shields the directors' actions in

their capacity as Holdings' directors, and the district court did not err in granting summary judgment in favor of the directors. *See TP Orthodontics*, *Inc. v. Kesling,* 15 N.E.3d 985, 990 (Ind. 2014) (noting that under Indiana law, director liability is limited to reckless or willful misconduct).

II. The district court did not err in applying Minnesota's business-judgment rule to the directors and the Fintegra managers with regard to their respective roles within Fintegra.

Dulhanty argues that the business-judgment rule does not apply to the directors or the Fintegra managers because they made nonbusiness decisions in their respective capacities as directors and mangers of Fintegra in violation of Minnesota law. We disagree.

Under Minnesota law, the business-judgment rule provides that "disinterested directors [making] an informed business decision, in good faith, without an abuse of discretion . . . will not be liable for corporate losses resulting" from that decision. *Janssen v. Best & Flanagan*, 662 N.W.2d 876, 882 (Minn. 2003). The decision to apply the business-judgment rule is a question of law, which this court reviews de novo. *See Blohm v. Kelly*, 765 N.W.2d 147, 153 (Minn. App. 2009).

The Minnesota Limited Liability Company Act requires a majority vote of interested members before a board of directors can dispose of all or substantially all of a company's assets. Minn. Stat. § 322B.77, subd. 2(a) (2016). This statutory requirement cannot be waived and applies unless an LLC has been dissolved. Minn. Stat. § 322B.813, subd. 4 (2016); *see also* Minn. Stat. § 322B.70, subd. 3(2016).

Here, the Fintegra directors were required to obtain "the affirmative vote of the owners of a majority of the voting power of the interests entitled to vote" before disposing

of all or substantially all of Fintegra's assets. Minn. Stat. § 322B.77, subd. 2(a). Holdings, as the sole owner of Fintegra, holds a majority of the voting power. Under Holdings' operating agreement, the directors could act on behalf of Holdings "by the affirmative vote of a majority of [Holdings'] Directors." That happened here. A supermajority vote of Holdings' members is not required unless the action would dispose of Holdings' assets, which, as already stated, is not the case here. The record establishes that a majority of Holdings' directors exercised Holdings' voting power to permit Fintegra to enter into the APA, RA, and TAA. Therefore, even assuming a transfer of assets occurred, the directors' actions were not in violation of Minn. Stat. § 322B.77, subd. 2(a).

Dulhanty relies on *Aiple v. Twin City Barge & Towing Co.*, 274 Minn. 38, 44-46, 143 N.W.2d 374, 378-79 (1966), to support her argument that the directors' actions did not constitute a business decision. But in *Aiple*, the supreme court concluded that the directors of a parent corporation were enjoined from using a subsidiary to avoid a statutory shareholder voting requirement because it was done to circumvent the voting requirements needed to amend the articles of incorporation. 274 Minn. At 41-43, 45-46, 143 N.W.2d at 376-77, 379. Unlike in *Aiple*, here, the directors' actions did not circumvent the procedures required under the applicable law and were not done for that purpose. To the contrary, the directors and the Fintegra managers made an informed business decision based on the advice of counsel to follow the procedures in both Fintegra's and Holdings' operating agreements as well as the applicable statute.

With respect to the Fintegra managers, Dulhanty does not point to any evidence demonstrating bad faith or actions that the Fintegra managers knew to be outside of their

authority as delegated to them by the directors. The record demonstrates that the Fintegra managers, at the direction of the directors, communicated to the registered representatives, such as by sending emails encouraging registered representatives to apply and transfer to SA. As such, the business-judgment rule protects the decisions made by the directors and the Fintegra managers, and the district court did not err in so determining.

III. The directors sufficiently pleaded the business-judgment rule in their motion for summary judgment.

Dulhanty argues that the district court erred in granting the directors summary judgment on the basis of the business-judgment rule because they did not adequately argue this issue to the district court. We are not persuaded.

Minnesota law specifies that summary judgment is appropraite when "the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that either party is entitled to a judgment as a matter of law." Minn. R. Civ. P. 56.03. Here, the directors filed their motion for summary judgment pursuant to Minn. R. Civ. P. 23.09 and 56.03. The directors incorporated the Fintegra managers' arguments with respect to the applicability of the business-judgment rule in a footnote in their motion. Accordingly, Dulhanty was on notice of all of the opposing parties' bases for summary judgment, knew that the district court would consider it as a basis for summary judgment, and made essentially the same arguments to the district as she does now with respect to why the business-judgment rule should not apply in this matter. Therefore, it was not error for the district court to consider the business-judgment rule in granting summary judgment for the directors. *Cf. Doe v.*

Brainerd Int'l. Raceway, Inc., 514 N.W.2d 811, 822 (Minn. App. 1994) (holding it was error for district court to grant summary judgment on grounds not raised by moving party when opposing party had no notice district court would consider summary judgment on that basis), *rev'd on other grounds*, 533 N.W.2d 617 (Minn. 1995).

Affirmed.