STATE OF MINNESOTA
IN COURT OF APPEALS
A13-0144

Your Magazine Publisher, Inc., et al.,
Respondents,

vs.

BMO Harris Bank, N.A.,
Appellant.

Filed July 29, 2013
Affirmed in part and reversed in part
Worke, Judge

Ramsey County District Court
File No. 62-CV-12-7845

Daniel M. Gallatin, Miller & Stevens, P.A., Wyoming, Minnesota (for respondent)

Elizabeth A. Larsen, Keith S. Moheban, Leonard, Street & Deinard, P.A., Minneapolis, Minnesota (for appellant)

Considered and decided by Larkin, Presiding Judge; Halbrooks, Judge; and Worke, Judge.

U N P U B L I S H E D O P I N I O N

WORKE, Judge

Appellant bank seeks to overturn a default judgment, claiming that respondent-merchants' complaint failed to state a claim for breach of contract against appellant, the district court abused its discretion by awarding attorney fees, the motion for default judgment was procedurally deficient, and service of the summons was ineffective. We

affirm the district court's decision to enter default judgment but reverse its award of attorney fees to respondents.

FACTS

Respondents Your Magazine Publisher, Inc., Magazines of Florida, Inc., and Big Sky Publishers, Inc., are three publishing companies (the companies) that sell magazine subscriptions over the telephone. The companies entered into a contract with Cynergy Data to facilitate credit-card purchases of the companies' magazines. Appellant BMO Harris Bank (the bank) was the sponsor bank that provided a merchant account to offer a temporary repository for the companies' customer proceeds. Under the contract, Cynergy retained a percentage of customer proceeds to cover credit-card purchases that were fraudulent or rejected by customers. By amendment, the contract also permitted the companies to make a written demand to Cynergy for return of these reserve proceeds 270 days after termination of the contract.

The companies discovered that they began to have customer charge-backs after an employee entered false transactions using customer credit-card numbers; the employee was discharged. Upon discovery of this occurrence, Cynergy terminated the contract with the companies but the bank continued to retain approximately $140,000 in the companies' reserve funds held in its merchant account. The companies sued the bank for return of the reserve funds, alleging breach of contract and asking for costs and attorney fees.

The bank did not answer the complaint, and the companies moved for default judgment. Following a hearing, the district court entered default judgment in favor of the

companies on the ground that the bank breached its contract with the companies by refusing to release the companies' reserve funds. The district court also awarded the companies $5,000 in attorney fees, in addition to costs and disbursements, and directed the bank to remit the companies' funds within ten days.

The bank moved to vacate the default judgment, arguing that the companies had failed to show a factual basis for a breach-of-contract claim and that the default judgment was void because of ineffective service of process on the bank. Before the hearing on the motion to vacate, Danette Smith, an initial-stock-offering compliance manager for Cynergy Data, submitted an affidavit, which states that "Cynergy is a payment service provider" and that the bank "has been the sponsor bank for Cynergy since at least 2009." Smith's affidavit states that the companies entered into merchant application agreements "with Cynergy and [the bank]" and that "[the bank] control[led] physical possession of the reserve funds" because Cynergy was not permitted to do so. Smith's affidavit also states that the companies sought return of the reserve funds and that Cynergy had refunded a total amount of $121,384.21 as of November 2012.

The motion to vacate was heard on January 28, 2013, and at the end of the hearing the district court denied the motion, ruling from the bench that the bank did not meet the standard for vacating the default judgment because the bank did not demonstrate excusable neglect or a reasonable defense on the merits. On the next day, the district court issued a written order denying the motion to vacate.

The companies moved to supplement the appellate record with the January 28, 2013 hearing transcript on the motion to vacate. This court issued an order questioning

whether the appeal was filed prematurely. By order dated May 14, 2013, this court accepted the appeal and stated that "[a]lthough appellant elected to appeal only the default judgment . . . this court's scope of review includes the motion hearing . . . and the district court's written order . . . denying [the bank's] motion to vacate the default judgment." This court reasoned that "[b]ecause there was a district court disposition of the motion to vacate before the appeal was filed," the appeal was not premature. Noting that "[o]n appeal from a judgment" this court can "review any order involving the merits or affecting the judgment" under Minn. R. Civ. App. P. 103.04 and that on an appeal from a judgment this court has discretion "to review a subsequent order denying a motion to vacate, even if the order is not independently appealable," this court ruled that the companies were "entitled to raise the subsequent motion hearing and the district court's denial of [the bank's] motion to vacate the default as alternative grounds for affirmance."

This appeal followed.

D E C I S I O N

"When a party against whom a judgment for affirmative relief is sought" fails to answer or appear, a district court may grant judgment by default against that party. Minn. R. Civ. P. 55.01. "[O]n appeal from a default judgment, a party in default may not deny facts alleged in the complaint when such facts were not put into issue below." *Thorp Loan and Thrift Co. v. Morse*, 451 N.W.2d 361, 363 (Minn. App. 1990), *review denied* (Minn. Apr. 13, 1990). Further, "[t]here are only a limited number of issues that may be raised in a direct appeal from a default judgment. These include arguing that the plaintiff's complaint did not state a cause of action or that the relief granted was not

justified by the complaint." *Mesenbourg v. Mesenbourg*, 538 N.W.2d 489, 493 (Minn. App. 1995); *see Nazar v. Nazar*, 505 N.W.2d 628, 633 (Minn. App. 1993) (stating that on direct appeal from default judgment, the scope of review includes only whether the record evidence supports the district court's findings and whether the findings support the conclusions of law), *review denied* (Minn. Oct. 28, 1993), *superceded by statute on other grounds*, Minn. Stat. § 518.551, subd. 5b(d).[1]

This court reviews a decision to grant a default judgment for abuse of discretion. *Black v. Rimmer*, 700 N.W.2d 521, 525 (Minn. App. 2005), *review dismissed* (Minn. Sept. 28, 2005). This court also reviews a district court's denial of a motion to vacate a default judgment for an abuse of discretion. *Foerster v. Folland*, 498 N.W.2d 459, 460 (Minn. 1993); *see* Minn. R. Civ. App. P. 103.04 (permitting appellate court to "review any order involving the merits or affecting the judgment" or, "any other matter as the interest of justice may require"); *see also Bush Terrace Homeowners, Ass'n., Inc. v. Ridgeway*, 437 N.W.2d 765, 770 (Minn. App. 1989) (stating, "[b]ecause a motion to vacate by its nature asks the [district] court to reassess its final judgment, an order denying the motion will, thus, involve the merits or affect the judgment entered"), *review denied* (Minn. June 9, 1989). On the same day, the bank filed a direct appeal from the

[1] The companies argue that the bank fails to address the *Finden* factors in seeking relief. *See Finden v. Klaas*, 268 Minn. 268, 271, 128 N.W.2d 748, 750 (1964). The *Finden* factors apply to rule 60 motions to vacate a judgment or order. *See, e.g., Palladium Holdings, LLC v. Zuni Mortg. Loan Trust 2006-OA1*, 775 N.W.2d 168, 173 (Minn. App. 2009) (stating that *Finden* factors are "used to analyze rule 60.02 motions"), *review denied* Minn. Jan. 27, 2010). The bank has asserted a direct appeal and does not appeal from the district court's January 29, 2013 order denying the bank's motion to vacate the default judgment.

default judgment. The bank asserts that the district court (1) erroneously entered a default judgment because the companies' complaint failed to state a cause of action for breach of contract, (2) improperly awarded attorney fees, (3) erroneously entered default judgment because the companies' motion was deficient, and (4) erroneously entered default judgment because service of process of the summons was insufficient.

Failure to state a claim

"A claim of breach of contract requires proof of three elements: (1) the formation of a contract, (2) the performance of conditions precedent by the plaintiff, and (3) the breach of the contract by the defendant." *Thomas B. Olson & Assocs., P.A. v. Leffert, Jay & Polglaze, P.A.*, 756 N.W.2d 907, 918 (Minn. App. 2008), *review denied* (Minn. Jan. 20, 2009). The bank argues that the district court abused its discretion by granting default judgment to the companies because their complaint fails to state a claim.

The complaint states that the companies "entered into contracts with [the bank's] predecessor for merchant accounts" and that the bank, "upon information, belief, and representation, [is] now a party to the Contracts." At the default judgment hearing, the companies' attorney stated that the bank was "not the party to the contract itself. The accounts have been transferred since the . . . contracts were agreed to[.]" The bank claims that the complaint and the attorney's representation fell "short of asserting the existence of a contract between the parties." The record also included an unsigned contract between the companies and Bank of America, N.A.

"In determining whether a contract was formed, [an appellate] court may look behind words to consider the surrounding facts and circumstances in the context of the

entire transaction, including the purpose, subject matter and nature of it." *Powell v. MVE Holdings, Inc.*, 626 N.W.2d 451, 460 (Minn. App. 2001) (quotation omitted), *review denied* (Minn. July 24, 2001). During the default judgment hearing, the companies' attorney and the district court referred to documents that established the companies' efforts to identify which bank was the proper party to sue for holding the companies' reserve funds. The companies' attorney stated that the bank named in the contract, Bank of America, was the "predecessor" institution to the bank and referred to documents that listed the bank "as the sponsoring bank for these merchant accounts." The companies' attorney also stated that "the correspondence included with the affidavit [of no answer] identifies and affirms [the bank] as the correct defendant in case that question were to arise," and he referred to other documents that established his difficulties in obtaining basic information about the bank. These documents are not included in the district court record because they were apparently not filed. *See* Minn. R. Civ. App. P. 110.01 (stating that the record on appeal consists of "[t]he papers filed in the trial court, the exhibits, and the transcript of the proceedings, if any").

However, by order of this court, the record also includes the transcript of the hearing on the motion to vacate. In its submissions on the motion to vacate, the bank provided signed contracts that buttress the companies' claims that the bank was a proper party to the action and that the bank breached the contract by retaining reserve funds. During the hearing on the motion, an attorney for the bank acknowledged that $120,000 of the reserve funds had been returned to the companies by the bank. The record also

included the affidavit by Danette Smith that states that Cynergy had refunded $121,384.21 to respondents as of November 2012.

Minn. R. Civ. P. 61 includes a harmless error provision that states, "[t]he court at every stage of the proceeding must disregard any error or defect in the proceeding which does not affect the substantial rights of the parties." Here, subsequent proceedings establish the existence and breach of the contract, and the primary issue remaining is what net funds are owed to the companies, if any, after proper offsets are taken for client charge-backs. As such, any deficiency in the default papers in relation to establishing the existence of the contract was harmless. *See Midway Ctr. Assocs. v. Midway Ctr., Inc.*, 306 Minn. 352, 356, 237 N.W.2d 76, 78 (1975) (stating that appellant must show both error and prejudice to prevail); *see also Brecht v. Schramm*, 266 N.W.2d 514, 520 (Minn. 1978) (stating that appellate court will affirm judgment of district court if it can be sustained on any ground).

Attorney fees

The bank next argues that the district court abused its discretion by awarding attorney fees in the default judgment because such fees were not allowed by law or supported by the facts. In Minnesota, attorney fees are generally permitted only if provided for by contract or statute. *Material Movers, Inc. v. Hill*, 316 N.W.2d 13, 18 (Minn. 1982). The Minnesota Rules of General Practice contain a particular rule that applies to attorney fees in default judgment proceedings: Rule 119.05 permits a party seeking default to obtain attorney fees administratively after establishing a basis for the award under applicable law, or to obtain fees after a formal hearing, if the "party provides

the court with evidence relevant to the amount of attorneys' fees requested as established by the factors a court considers when determining the reasonableness of the attorneys' fees." Minn. R. Gen. Pract. 119.05 (a), (b). The advisory committee comment to the rule notes that district courts "need to have information to support the reasonableness of the hours claimed to be expended as well as the reasonable hourly rate under the circumstances." *Id*. 1997 advisory comm. cmt.

The companies cited to no statute or caselaw when asking for attorney fees; the companies' attorneys requested $5,000 in attorney fees without providing the hours claimed or an hourly rate; and the district court did not consider the reasonableness of the requested amount. Further, some of the documents that would have demonstrated the companies' attorney's efforts to contact appellant and identify the bank as the proper party to sue were not filed in the district court, although the district court referred to them at the default-judgment hearing. On these facts, we conclude that the district court abused its discretion by awarding attorney fees.

Sufficiency of default-judgment motion and service of process

The bank also seeks to vacate the default judgment on the ground that the motion for default judgment was procedurally deficient. Claimed procedural irregularities are properly raised in the first instance to the district court in a motion to vacate the default judgment. *See Nazar*, 505 N.W.2d at 633 ("A party in default may not raise procedural irregularities on appeal which were not raised below"); *Thorp Loan and Thrift Co.*, 451 N.W.2d at 363 ("[A] party in default may not raise procedural irregularities on appeal which were not raised below, provided that adequate and expeditious relief is available

by motion in the [district] court."). On direct appeal from a default judgment, review is limited "to whether the evidence on record supports the findings of fact and whether the findings support the conclusions of law set forth by the [district] court." *Nazar*, 505 N.W.2d at 633.

Further, the bank did seek to reopen, but expressly chose not to appeal the order denying vacatur. As such, the district court's order became final except as to the issues properly challenged in this direct appeal. Because other issues raised by the bank are not properly before us, we decline to address them in this appeal.

Affirmed in part and reversed in part.