

**COURT OF APPEALS
DECISION
DATED AND FILED**

March 19, 2014

Diane M. Fremgen
Clerk of Court of Appeals

NOTICE

This opinion is subject to further editing. If published, the official version will appear in the bound volume of the Official Reports.

A party may file with the Supreme Court a petition to review an adverse decision by the Court of Appeals. See WIS. STAT. § 808.10 and RULE 809.62.

Appeal No. 2013AP930

Cir. Ct. No. 2012CV2420

STATE OF WISCONSIN

**IN COURT OF APPEALS
DISTRICT II**

AM COMMUNITY CREDIT UNION, AURORA CREDIT UNION, ENTERPRISE CREDIT UNION, FIRST CREDIT UNION, FOCUS CREDIT UNION, GLACIER HILLS CREDIT UNION, GUARDIAN CREDIT UNION, LADISH COMMUNITY CREDIT UNION, LANDMARK CREDIT UNION, MCU FINANCIAL CREDIT UNION, PRIME FINANCIAL CREDIT UNION, SHERWIN WILLIAMS CREDIT UNION, SOUTHSHORE CREDIT UNION, SUMMIT CREDIT UNION, SUNRISE CREDIT UNION AND W.C.U.L. SERVICES CORPORATION,

PLAINTIFFS-APPELLANTS,

v.

M&D INVESTMENT COMPANY, LLC, JEROME A. GEBHARD, PATRICK O'NEIL AND BARBARA O'NEIL REVOCABLE TRUST, BARBARA O'NEIL, WILLIAM O'NEIL, MICHAEL P. O'NEIL, O'NEIL FAMILY TRUST, ORVILLE AND MARGARETTE O'NEIL TRUST, RUBY O'NEIL, DAVID G. CHAPMAN, LLC, THE WOODS PROPERTIES, LLC, VANCE WERNER, KATHLEEN WERNER, MICHAEL McDONALD, NANCY McDONALD, REGAN SCHNEIDER AND SCOTT BERG,

DEFENDANTS-RESPONDENTS,

DAVID CHAPMAN, TIMOTHY CASEY, RICHARD JUNGEN, ELAINE E. JUNGEN N/K/A ELAINE E. JAEGER, JEROME J. POEHNELT, JOAN POEHNELT, RICHARD MATTHEWS AND MATTHEWS LIVING TRUST,

DEFENDANTS.

APPEAL from an order of the circuit court for Waukesha County:
JAMES R. KIEFFER, Judge. *Affirmed.*

Before Brown, C.J., Neubauer, P.J., and Gundrum, J.

¶1 GUNDRUM, J. Plaintiffs-Appellants appeal the circuit court’s order dismissing their “unjust enrichment/constructive trust” and fraudulent transfer claims against Defendants-Respondents. The circuit court granted Respondents’ motions to dismiss, concluding that the amended complaint failed to state a claim against Respondents because Appellants’ claims are derivative and they do not have standing to bring them. We agree and affirm.

BACKGROUND

¶2 The following relevant allegations are made by Appellants in the amended complaint. Appellants were investors¹ in one or more mortgage loan participation pools maintained by Central States Mortgage Company (CSMC), a credit union service organization. Upon information and belief, Respondents were

¹ Appellants Landmark Credit Union, Summit Credit Union, Sunrise Credit Union, and W.C.U.L. Services Corporation were also shareholders of Central States Mortgage Company. In their original complaint, all the plaintiffs therein (which did not include W.C.U.L.) were identified as shareholders. In the amended complaint, the shareholder designation was removed from all Appellants except Landmark, Summit, Sunrise, and W.C.U.L.

investors in an additional pool maintained by CSMC, “the P-55 Pool,” a pool Appellants did not participate in and were unaware existed.

¶3 The participation pools were all governed by written participation agreements between CSMC and the investors. The P-55 Pool participation agreement contained a provision which allowed P-55 Pool participants “to require CSMC to redeem their participation interest upon ninety (90) days written notice to CSMC.” The amended complaint alleges that certain “insider” defendants (insiders), none of whom are Respondents on this appeal, “conspired to and did improperly liquidate the P-55 Pool without providing adequate notice,” and did so “in violation of other provisions of the participation agreements for the P-55 Pool and without the proper authorization of CSMC.” It alleges “[t]he participants in the P-55 Pool were paid using CSMC corporate assets including credit and cash causing monetary losses” to Appellants. It alleges upon information and belief, that all defendants, including Respondents, received proceeds “directed from CSMC pools,” that the money paid to them by CSMC was the property of investors “in all of the participation pools” and that the payments wrongfully deprived Appellants of their investments in the pools.

¶4 The amended complaint further alleges upon information and belief that Appellants lost additional money because the insiders redistributed unsold, largely unperforming loans remaining in the P-55 Pool “to the remaining CSMC loan participation pools.” Finally, the amended complaint alleges that the payments were made with intent to hinder, delay, or defraud “CSMC creditors,” including Appellants; “without CSMC receiving a reasonably equivalent value in exchange for the transfers”; “at a time when the CSMC insiders responsible for the transfers knew or reasonably should have known that CSMC was or would become indebted beyond its ability to pay ... when the remaining assets of CSMC

were unreasonably small in relation to those transfers,” and when “CSMC was insolvent, or, in the alternative, CSMC became insolvent as a result of those transfers.”

¶5 Respondents filed a motion to dismiss for failure to state a claim upon which relief may be granted, asserting, among other arguments, that the claims were derivative and Appellants did not have standing to bring them. The court agreed and dismissed the claims. Appellants appeal.

DISCUSSION

¶6 We review de novo a circuit court’s grant of a motion to dismiss for failure to state a claim upon which relief may be granted, focusing on the facts pled in the complaint. *State ex rel. Lawton v. Town of Barton*, 2005 WI App 16, ¶9, 278 Wis. 2d 388, 692 N.W.2d 304 (2004); *see also Doe 67C v. Archdiocese of Milwaukee*, 2005 WI 123, ¶19, 284 Wis. 2d 307, 700 N.W.2d 180; *Preston v. Meriter Hosp., Inc.*, 2005 WI 122, ¶13, 284 Wis. 2d 264, 700 N.W.2d 158. Further, whether claims are derivative is a question of law we review independently of the circuit court. *See Park Bank v. Westburg*, 2013 WI 57, ¶37, 348 Wis. 2d 409, 832 N.W.2d 539.

¶7 The seminal Wisconsin case addressing whether an action is a derivative, as opposed to direct, action is *Rose v. Schantz*, 56 Wis. 2d 222, 201 N.W.2d 593 (1972). Considering the allegations of the complaint before it, the *Rose* court stated:

It is the corporation’s funds that allegedly are to be used to pay off debts before due and to redeem stock. It is the corporation that allegedly will have its working capital impaired. It is the corporation that allegedly will no longer be able to stay in business. At least, the primary injury set

forth is to the corporation, not the individual stockholder bringing the suit.

That such primary and direct injury to a corporation may have a subsequent impact on the value of the stockholders' shares is clear, but that is not enough to create a right to bring a direct, rather than derivative, action. Where the injury to the corporation is the primary injury, and any injury to stockholders secondary, it is the derivative action alone that can be brought and maintained.

Id. at 229.

¶8 The supreme court drew upon *Rose* in its recent *Park Bank* decision. In that case, Park Bank filed suit against the Westburgs seeking payment under guaranty contracts the Westburgs had executed to fund a business. *Park Bank*, 348 Wis. 2d 409, ¶¶6, 8. The Westburgs created Zaddo, Inc. (Zaddo) and Zaddo Holdings, LLC to house the operations and assets of the business. *Id.*, ¶7. The guaranties guaranteed that the Westburgs would pay the two entities' debt obligations with the Bank. *Id.*, ¶8. When Zaddo had problems meeting financial commitments, the Bank met with the Westburgs. *Id.*, ¶¶13-16. Around that time, the Bank prevented the Westburgs from accessing a personal account they had with the Bank.² *Id.*, ¶¶17-18, 20.

¶9 The Bank ultimately filed suit seeking payment under the guaranties. *Id.*, ¶¶21-23. The Westburgs counterclaimed alleging breach of fiduciary duty and/or the duty of good faith and fair dealing related to the Bank denying them access to their personal account; forcing Zaddo into an unnecessary receivership; and taking other improper actions toward Zaddo and Zaddo Holdings. *Id.*,

² As collateral for the business loans, the Bank had obtained a security interest in the Westburgs' account at the Bank. *Park Bank v. Westburg*, 2013 WI 57, ¶11, 348 Wis. 2d 409, 832 N.W.2d 539.

¶¶25-26. They further alleged counterclaims for declaratory judgment and injunctive relief, negligence, and breach of a duty to disclose. *Id.* As described by the *Park Bank* court, the Westburgs sought damages related to loss of “their personal investment and loans to Zaddo and Zaddo Holdings”; liability resulting from personal guaranties related to Zaddo’s debt to third-party vendors; liability stemming from personal guaranties of Zaddo’s corporate credit cards; unreimbursed expenses they incurred on behalf of Zaddo and Zaddo Holdings on their personal credit cards; liability stemming from their personal guaranty of sales commissions owed by Zaddo; lost wages and employment benefits from Zaddo; and liability on their guaranties of loan obligations under a Small Business Administration loan to Zaddo. *Id.*, ¶27.

¶10 Affirming a grant of summary judgment to the Bank, *id.*, ¶¶34, 36, the *Park Bank* court was guided by *Rose* in holding that “where the injury to the corporation is the primary injury and any injury to a shareholder is secondary, the shareholder may not bring a direct action, and is instead limited to commencing a derivative action,” *Park Bank*, 348 Wis. 2d 409, ¶43. The court expounded, “where an individual’s injury results from the corporation’s injury, the resulting claim is derivative and the individual lacks standing to raise it in a direct action,” *id.*, and cited approvingly to a Seventh Circuit decision for its definition of a direct injury as an “injury independent of the firm’s fate,” *id.*, ¶48 (quoting *Mid-State Fertilizer Co. v. Exchange Nat’l Bank of Chicago*, 877 F.2d 1333, 1336-37 (7th Cir. 1989)).

¶11 Addressing the case before it, the *Park Bank* court concluded:

With the exception of their claim that Park Bank unlawfully denied them access to their personal account, each of the Westburgs’ counterclaims is derivative. The Westburgs’ alleged injuries are secondary to those of

Zaddo, arising as a result of Park Bank's conduct toward Zaddo Zaddo was primarily injured by allegedly being forced into receivership and any alleged resulting injury to the Westburgs occurred as a result of Zaddo's alleged injury. Under *Rose* and subsequent case law, those counterclaims are considered derivative.

Park Bank, 348 Wis. 2d 409, ¶52. The sole counterclaim found to be “arguably direct” was the Westburgs’ claim that the Bank unlawfully denied them access to their personal account.³ *Id.*, ¶54. The Westburgs’ injuries were derivative, the court further indicated, because they “arise as a result of Zaddo’s injuries, not independently of Zaddo’s injuries.” *Id.*, ¶53. The court also observed that the Westburgs’ claim for damages was “based upon their investment losses to Zaddo Each and every category of damages claimed by the Westburgs arises from their losses as guarantors, investors, and officers of Zaddo.” *Id.*, ¶54; *see also Read v. Read*, 205 Wis. 2d 558, 569-70, 556 N.W.2d 768 (Ct. App. 1996) (despite plaintiff’s allegations that “controlling directors and shareholders mismanaged the corporation and engaged in self-dealing in violation of their fiduciary duty to him and other minority shareholders” and plaintiff’s request for damages “to him individually,” we concluded that the complaint “allege[d] conduct that, if true, mean[t] [the] resulting primary injury is to the corporation, not the individual stockholder bringing the suit,” and thus plaintiff “could not bring a direct action against the defendants”).

¶12 As in *Park Bank*, here Appellants’ alleged injuries are secondary to those of CSMC, arising from their losses as investors through CSMC, which losses allegedly resulted from conduct directly toward CSMC. *See Park Bank*,

³ The *Park Bank* court also granted the Bank summary judgment on the Westburgs’ claim related to their personal account, but did so on other grounds. *Park Bank*, 348 Wis. 2d 409, ¶¶53, 54.

348 Wis. 2d 409, ¶52. According to the amended complaint, the primary wrongs were the conspiracy of the insiders to improperly liquidate CSMC's P-55 Pool in a manner which violated provisions of their participation agreements with CSMC, and these same insiders' redistribution of largely nonperforming loans from the P-55 Pool to the remaining CSMC pools. Respondents allegedly were paid by CSMC based on this conduct, and Appellants allege that their monetary losses stemmed from this conduct toward CSMC and all of the non-P-55 participation pools. The amended complaint further alleges that the improper money transfers were made at a time when the insiders responsible for the transfers knew or should have known "that CSMC was or would become indebted beyond its ability to pay." Appellants only lost funds because of the harm done directly to CSMC and all of its non-P-55 participation pools. Neither the harm-producing conduct nor the injuries which resulted from it were direct as to Appellants or independent of CSMC. While the amended complaint does allege that Appellants themselves were injured, it ultimately alleges that their injuries resulted from the damage done more directly and primarily to CSMC. There are no allegations that Appellants suffered injuries "independent of [CSMC's] fate."

¶13 Appellants' claims are based upon allegations of a primary injury to CSMC, with secondary injury to themselves. As a result, the lawsuit is a derivative action. It is undisputed that Appellants do not have standing to bring a derivative action, and thus, the circuit court correctly dismissed their claims.⁴

⁴ In one of their three reply briefs, Appellants request that if we conclude their claims as pled are derivative, we allow them to file another amended complaint. Because they make this request for the first time in this case in their reply brief on appeal, we do not address it. *See State v. Chu*, 2002 WI App 98, ¶42 n.5, 253 Wis. 2d 666, 643 N.W.2d 878.

By the Court.—Order affirmed.

Not recommended for publication in the official reports.

