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**STATE OF MINNESOTA
IN COURT OF APPEALS
A17-1441**

Donald Sealock, derivatively on behalf of
St. Michael Mall, Inc.,
Appellant,

vs.

John A. Robeck, Michael F. Hosko, Ronald D. Reh,
Julie M. Reh in their capacities as
Officers, directors, and/or shareholders of
St. Michael Mall, Inc., et al.,
Respondents.

**Filed April 23, 2018
Affirmed in part, reversed in part, and remanded
Rodenberg, Judge**

Wright County District Court
File No. 86-CV-17-2121

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Considered and decided by Smith, Tracy M., Presiding Judge; Bjorkman, Judge;
and Rodenberg, Judge.

UNPUBLISHED OPINION

RODENBERG, Judge

Appellant Donald Sealock challenges the district court's application of res judicata to dismiss his derivative claims on behalf of St. Michael Mall, Inc. (St. Michael). Appellant argues that the district court erred in applying res judicata because his earlier action did not involve the same parties or privies, there was no final judgment on the merits in the earlier action, and appellant did not have an opportunity to fairly and fully litigate these derivative claims. Because the district court erroneously applied res judicata as a bar to appellant's derivative claims, we reverse and remand for further proceedings. In a related appeal, respondents challenge the district court's order denying their motion for sanctions and attorney fees, contending that the district court erred in failing to award them attorney fees. We affirm the district court's denial of sanctions and fees.

FACTS

Appellant is a shareholder, and former president of the board of directors, of St. Michael, a closely held S-corporation¹ formed for the purpose of purchasing and operating a mall property in Wright County. Respondents are all current or former shareholders in St. Michael, and current or former directors of St. Michael. Each shareholder of St. Michael holds common shares proportionate to the total square footage of the mall each leases as a mall tenant.

¹ An S-corporation is taxed differently than a regular corporation. 20 Minn. Prac. Business Law Deskbook § 1:7 (2018). S-corporations are subject to pass-through taxation, which means that any profits are distributed to shareholders, who then pay taxes on the profits as individuals. *Id.*

The First Action

Disputes arose between appellant and respondents regarding the management of St. Michael. St. Michael sued its property-management company, that company's owner, and appellant in a lawsuit previous to this one (first action).² In the first action, St. Michael alleged breach of fiduciary duty, conversion, past-due rent, and civil conspiracy, and it sought equitable remedies based on allegations that the property-management company's owner, individually and through his companies, improperly took money from St. Michael in the role of the mall's property manager. St. Michael also sued appellant, alleging that he "engaged in a pattern of misdealing, self-dealing, and waste in violation of his duty owed to the mall."

Appellant brought third-party claims against respondents and against St. Michael's newly contracted property-management company, alleging that respondents violated their statutory duties, breached their fiduciary duties, and that the board of directors committed corporate waste and civil conspiracy. Appellant also requested equitable relief. After some other pleadings amendments, appellant moved for leave to amend his third-party complaint for a second time to add derivative claims on behalf of St. Michael and for permissive intervention to add his wife as a third-party plaintiff. The district court denied both motions, determining that the newly discovered evidence on which the proposed amendments were based was not new, and that the amendments would not "meaningfully impact the litigation" and would substantially delay and unduly prejudice the other parties.

² The first action remains pending in district court at the time of this decision.

The parties brought cross-motions for summary judgment. The district court granted summary judgment for appellant on St. Michael's claims against him for conversion, past-due rent, civil conspiracy, and for equitable remedies. It granted summary judgment for respondents and St. Michael's new property-management company on appellant's third-party claim for corporate waste. Notably, appellant's claim for corporate waste was dismissed because the district court determined that the claim should have been brought as a derivative claim. The district court denied summary judgment on appellant's third-party claims for breach of statutory duties, equitable remedies, breach of fiduciary duties, and civil conspiracy.

After the district court's summary-judgment ruling, appellant asked the district court to reconsider the denial of his motion to amend the complaint. He argued that, because his direct claim alleging corporate waste was dismissed by the district court based on its reasoning that it should have been brought as a derivative claim, and the district court had earlier denied his motion to amend his pleadings to add a derivative claim for corporate waste, the district court should now allow the amendment denied earlier based on the reasoning that the amendment would not "meaningfully impact the litigation." Appellant specifically argued that allowing him to add the derivative corporate-waste claim would avoid his bringing the very same claim in a second action.

This Action

Appellant commenced this second, derivative suit before the district court acted on appellant's request for reconsideration in the earlier case. The district court later declined to reconsider.

Appellant's complaint in this action is styled as a derivative suit, and alleges that respondents violated their statutory and fiduciary duties to St. Michael, and that the board of directors committed corporate waste. It also requests equitable relief.³ These claims are based on the same facts as appellant's third-party complaint in the first action, namely that some shareholders were paying rent at less-than-the-market rates for their space in the mall, that rent owed by some of the shareholders was not paid to St. Michael, that St. Michael improperly terminated the contract of its initial property-management company, that two shareholders improperly sold their shares without honoring the other shareholders' right of first refusal and St. Michael effectively "subsidized" this sale to a new shareholder, and that corporate funds were improperly used to pay attorneys to accomplish these allegedly wrongful acts.

***Appellant's Motion to Consolidate Actions and Respondents' Motion
for Judgment on the Pleadings***

Appellant moved the district court to consolidate this action with the first action, under Minn. R. Gen Pract. 113.02. Respondents moved for judgment on the pleadings in this action, arguing that res judicata and collateral estoppel barred this action.

³ In response to appellant's filing of this action, respondents notified appellant's counsel that they would be seeking rule 11 sanctions and attorney fees if appellants did not withdraw the derivative suit because it was barred by res judicata and collateral estoppel, and was brought in bad faith. They later moved for sanctions and attorney fees. The district court denied respondents' motion. It found that respondents' motion was procedurally sufficient, but that sanctions were not appropriate because the claim was not brought in bad faith.

The district court granted respondents' motion for judgment on the pleadings in this action. It determined that res judicata barred appellant's derivative claims because the parties and the causes of action were the same in the two suits. It concluded that the earlier denial of appellant's motion to amend his third-party complaint in the first action amounted to a final judgment on the merits. It also determined that appellant had a full-and-fair opportunity to litigate his claims, including the derivative claims, and concluded that appellant had participated in discovery and was not procedurally limited in his ability to litigate his first action. It further concluded that appellant was fully incentivized to litigate in the first action the issues raised in this action.

This appeal followed.

D E C I S I O N

Appellant argues that the district court erred when it applied res judicata to grant respondents' motion for judgment on the pleadings in this action, a derivative suit. He argues that the district court erred when it determined that he was in privity with St. Michael, that there was a final judgment on the merits, and that he had a full and fair opportunity to litigate his derivative claims in the first action.

"On appeal from a grant of a motion for judgment on the pleadings under Minn. R. Civ. P. 12.03, we consider only the facts alleged in the complaint, accepting those facts as true and drawing all reasonable inferences in favor of the nonmoving party." *Burt v. Rackner, Inc.*, 902 N.W.2d 448, 451 (Minn. 2017) (quotation omitted). We review the district court's application of res judicata de novo. *Rucker v. Schmidt*, 794 N.W.2d 114, 117 (Minn. 2011). The doctrine of res judicata provides that "[a] judgment on the merits

constitutes an absolute bar to a second suit for the same cause of action, and is conclusive between parties and privies, not only as to every matter which was actually litigated, but also as to every matter which might have been litigated therein.” *Sundberg v. Abbott*, 423 N.W.2d 686, 689 (Minn. App. 1988) (quoting *Mattesen v. Packman*, 358 N.W.2d 48, 49 (Minn. 1984) (emphasis removed)), *review denied* (Minn. June 29, 1988). Res judicata, or claim preclusion, acts as a bar to a subsequent claim when “(1) the earlier claim involved the same set of factual circumstances; (2) the earlier claim involved the same parties or their privies; (3) there was a final judgment on the merits; [and] (4) the estopped party had a full and fair opportunity to litigate the matter.” *Hauschildt v. Beckingham*, 686 N.W.2d 829, 840 (Minn. 2004). For the doctrine to apply, an earlier claim must have been “decided between the same parties who were actually adversaries in the prior litigation.” *Nitz v. Nitz*, 456 N.W.2d 450, 452 (Minn. App. 1990) (quotation omitted). If all four elements are present, a district court may exercise its discretion in determining whether to apply res judicata to bar a claim. *Dixon v. Depositors Ins. Co.*, 619 N.W.2d 752, 757 (Minn. App. 2000).

I. Because the second element, that the actions involve the “same parties or their privies,” is not met on these facts, res judicata does not apply to bar appellant’s derivative action.

Appellant makes no argument on appeal regarding the first element of res judicata, but disputes the remaining three elements. Because the second res judicata element, that res judicata is available only if the two actions involve the same parties or their privies, is plainly not satisfied on these facts, we reverse the district court’s dismissal based on its

application of res judicata. We do not address appellant's arguments concerning the remaining elements, regardless of their merit.

A. The first action and the derivative claims in this action do not involve the same parties.

The derivative claims appellant asserts in this second and derivative action belong to the corporation and not to appellant. "When a shareholder asserts a cause of action belonging to the corporation, the shareholder must seek redress in a derivative action on behalf of the corporation rather than in a direct action by the individual shareholder." *Wessin v. Archives Corp.*, 592 N.W.2d 460, 464 (Minn. 1999). A shareholder bringing a derivative claim "step[s] into the corporation's shoes." *In re UnitedHealth Grp. Inc. S'holder Derivative Litig.*, 754 N.W.2d 544, 550 (Minn. 2008) (quotation omitted). Here, as a minority shareholder, appellant asserts derivative claims on behalf of St. Michael. Appellant's third-party claims brought against respondents in the first suit were direct claims. Those direct claims asserted only appellant's rights, not those of the corporation. Because the claims in the second action are derivative and belong to St. Michael, the second element of res judicata cannot be met. The actions do not involve the same parties.

B. Appellant is not "in privity" with St. Michael for res judicata purposes.

Appellant and St. Michael were likewise not "in privity" with one another in the first action. While there is no overarching definition of privity that can be applied universally, "[p]rivity is usually a question of fact requiring a case-by-case determination." *Miller v. Nw. Nat'l Ins. Co.*, 354 N.W.2d 58, 62 (Minn. App. 1984). "A privy to a party may be identified by the privy's controlling participation and active self-interest in the

original litigation. A privy is so identified with the party in interest as to be affected with the party by the litigation.” *Id.* (citation omitted).

Minnesota law establishes that a minority shareholder bringing a derivative action on behalf of a corporation after a direct action by the shareholder individually and involving the same issues is not necessarily in privity with the corporation for purposes of considering whether res judicata bars the later derivative action. In *Miller*, we reasoned that it was possible for a majority owner to be so “sufficiently identified” with the interests of a corporation as “to be said to represent the corporate concerns in his individual litigation.” *Id.* We relied on the Restatement (Second) of Judgments § 59 (1982) for the general rule that “[a]n individual who has full ownership of a corporation and is in complete control of its affairs is presumed to have a sufficient common interest to be in privity with the corporation.” *Id.*

In *Miller*, we also quoted comment (e) to the Restatement § 59, which guides courts to consider evidence of “conflict” between the interests of an owner of a closely held corporation and the interests of the corporation when considering whether the interests of both were aligned when determining whether the parties are in privity:

When [a] controlling owner is the party to the litigation, his opportunity and incentive to litigate issues commonly affecting him and the corporation is ordinarily sufficient to treat his participation as being on behalf of the corporation as well. . . . However, it can happen that a substantial proprietor in a corporation finds himself in conflict with the corporation’s management or with other stockholders . . . [.] The rule of . . . preclusion should not be applied in such circumstances, or where its application would unfairly affect another person associated with the corporation, or . . . where the interests of the corporation and its owners were in such potential conflict

. . . that it would be unfair to give preclusive effect to the prior determination.

Id. (quoting Restatement (Second) of Judgments § 59 cmt. e).

Applying Restatement § 59 and our reasoning in *Miller* here, appellant was certainly not in privity with St. Michael in the first action. His interests were very different than St. Michael's in the first action. St. Michael was suing him. In this action, appellant asserts derivative claims of the corporation by a minority shareholder. As a minority shareholder, appellant does not exercise significant control over St. Michael. Having been directly adverse to St. Michael in the first action, wherein he asserted his direct claims, he did not assert derivative claims on behalf of St. Michael. The district court denied his motion to amend the pleadings in the first action to assert those claims. Appellant cannot be "said to [have sufficiently] represent[ed] the corporate concerns" in the first action such that we can conclude that he was in privity with St. Michael for res judicata to bar the derivative claims he now brings in the current suit. *Miller*, 354 N.W.2d at 62.

The second element of res judicata is not satisfied here. The district court focused its analysis of the second res judicata element on whether the cases involved "the same claims based on the same facts." The proper focus for the second element is whether the parties are "the same parties or their privies." *Hauschildt*, 686 N.W.2d at 840. Appellant's claims as stated in the second complaint are derivative and are therefore claims of the corporation and not of appellant individually. Appellant and St. Michael are not in privity for res judicata purposes.

In our view, it is noteworthy that the district court denied appellant's motion to add these derivative claims in the first action. The district court dismissed appellant's corporate-waste claim at summary judgment because it determined that appellant should have brought the claim as a derivative claim; it then applied res judicata and dismissed this action asserting those very derivative claims. *See Wessin*, 592 N.W.2d at 462 (recognizing that minority shareholders may bring a new suit with properly pleaded derivative claims following the dismissal of their direct claims as improperly plead derivative claims).

Although appellant's arguments concerning the other elements of res judicata may also have merit, we need not reach them because the second res judicata element is plainly not met. We also do not reach the merits of appellant's derivative action; this appeal concerns only the summary dismissal of the action on res judicata principles. We reverse the district court's judgment on the pleadings dismissing appellant's derivative claims based on its erroneous application of res judicata, and we remand for further proceedings.

II. The district court did not abuse its discretion in denying respondents' motion for attorney fees.

In the related appeal, respondents challenge the district court's denial of their motion for attorney fees pursuant to Minn. R. Civ. P. 11. Respondents' challenge is premised on the district court having properly dismissed appellant's claims in the second action as barred by res judicata. Respondents argue that appellant's "second suit was not founded upon the law, nor a good faith request to extend the law, because the second suit was barred by res judicata."

We review a district court's ruling on attorney fees for abuse of discretion. *Johnson ex rel. Johnson v. Johnson*, 726 N.W.2d 516, 518 (Minn. App. 2007). The district court concluded that respondents' motion was procedurally sufficient but that sanctions were not appropriate because appellant's claims were not brought in bad faith. The district court found that appellant brought the derivative claims on behalf of St. Michael as a shareholder after the previous summary-judgment ruling "held he could not bring [the corporate-waste] claim individually" and that there was "sufficient legal authority and facts to support bringing the [derivative] claim[s]." It further found that "there is no evidence [this action] was brought to delay the proceedings or for an improper purpose."

Because appellant's derivative claims are not barred by res judicata, there is no basis on this record to conclude that the district court abused its discretion when it denied respondents' motion for attorney fees. We therefore affirm the district court on this issue.

Affirmed in part, reversed in part, and remanded.