

*This opinion is nonprecedential except as provided by
Minn. R. Civ. App. P. 136.01, subd. 1(c).*

**STATE OF MINNESOTA
IN COURT OF APPEALS
A22-1305**

Susan Schneider,
Appellant,

vs.

Max Schmidt, et al.,
Respondents,
KMAX Paradise Pork, LLC, a Minnesota limited liability company,
Respondent.

**Filed July 31, 2023
Affirmed in part, reversed in part, and remanded
Reyes, Judge**

Mower County District Court
File No. 50-CV-15-1757

Matthew C. Berger, Gislason & Hunter, L.L.P., New Ulm, Minnesota (for appellant)

Terrence J. Fleming, Sandra Smalley-Fleming, Christopher D. Pham, Devin T. Driscoll,
Sarah J. Theisen, Fredrikson & Byron, P.A., Minneapolis, Minnesota (for respondents Max
Schmidt, et al.)

Adam J. Houck, Adams, Rizzi & Sween, P.A., Austin, Minnesota (for respondent and
cross-appellant KMAX Paradise Pork, LLC)

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

NONPRECEDENTIAL OPINION

REYES, Judge

In this shareholder dispute, appellant Susan Schneider asserts that the district court erred by dismissing as derivative her claims that respondents KMAX Farms LLC and Max Schmidt engaged in (1) unfairly prejudicial conduct; (2) breach of fiduciary duty; and (3) breach of a member-control agreement. By notice of related appeal, respondent and cross-appellant KMAX Paradise Pork LLC (Paradise Pork) challenges the district court's damages award on Schneider's claim that Paradise Pork failed to provide statutorily required notice of the sale of its assets and of Schneider's dissenter's rights. We reverse and remand on Schneider's claims against KMAX Farms and Schmidt and affirm on Schneider's claim against Paradise Pork.

FACTS

Undisputed facts and background

Paradise Pork became duly incorporated and formed in June 2013 by KMAX Farms, Schmidt, Schneider, and Jennifer Harris. The members of Paradise Pork certified Schmidt, Schneider, Harris, and Duane Boderman as governors of Paradise Pork. The members also elected Schneider as president and chief manager and Schmidt as secretary, treasurer, and chief financial manager.

The following month, Schneider and Schmidt entered into a promissory note and loan agreement (the note) with Farm Credit Services of America for \$800,000 to fund

Schneider's capital contribution and buy into Paradise Pork.¹ The next year, Schneider acquired Harris's ownership interest in Paradise Pork, which resulted in the following ownership interests: KMAX Farms owning 48.15%, Schneider owning 33.33%, and Schmidt owning 18.52%. Schmidt, however, owned more than 90% of the shares in KMAX Farms. As a result, it is undisputed that Schmidt personally controlled a 66.7% membership interest in Paradise Pork.

Paradise Pork served as a sow unit facility which mainly operated as a cost center, making little to no profit. On October 20, 2013, Paradise Pork's sow unit became contaminated with porcine reproductive and respiratory syndrome. Then, in 2014, Paradise Pork had its first outbreak of porcine epidemic diarrhea virus in its unit, and no pigs were weaned during that time. Schneider and Schmidt differed on the cause of the outbreak and on how to manage operations at Paradise Pork to prevent a future outbreak. Paradise Pork's problematic farming operations continued throughout 2014 and into 2015, resulting in financial losses.

In June 2015, Schmidt and KMAX Farms decided that Paradise Pork needed to be dissolved and its property and assets sold. The members and governors of Paradise Pork met on June 22, 2015, to discuss the dissolution of Paradise Pork. Before the meeting, Schmidt sent the following notice to members and governors:

¹ Schneider and Schmidt are both identified as "Borrowers" on the note, and Schneider is identified as "the primary borrower/payer of the record on this loan." While the record is not clear on Schmidt's characterization as a party to the note, there is no dispute that Schmidt had to pay the outstanding balance of the note as either a borrower or guarantor. There is also no dispute that Paradise Pork was not a party to the note.

The purpose of this meeting is to consider the dissolution of KMAX Paradise Pork, LLC as the operation is not cash-flowing and is creating additional debt. Further, the members would consider an orderly liquidation including the sale of assets to possible purchasers.

At the meeting, Schmidt, Boderman, Schneider, and Paradise Pork's counsel Paul Sween were present. Schmidt proposed that Paradise Pork proceed with the "orderly liquidation of its assets by trying to sell the assets to prospective purchasers" because of its financial condition. Despite Schneider's opposition, the board of governors adopted the resolution. There were no other votes taken during this meeting nor were there any other meetings held by the Paradise Pork board members. In July 2015, Schmidt sold Paradise Pork to Son-D Farms LLC for \$2,919,046. Schmidt used funds from that sale to pay off the note that he had co-signed for Schneider in the amount of \$633,727.33 without Schneider's consent.

Procedural history

On August 3, 2015, Schneider filed suit against Schmidt, KMAX Farms (collectively respondents), and Paradise Pork, asserting claims in her individual capacity. Related to this appeal, she alleged the following four counts: (1) unfairly prejudicial conduct under Minn. Stat. § 322B.833 (2014); (2) breach of fiduciary duties; (3) failure to comply with notice requirements under Minn. Stat. §§ 322B.77, subd. 2, 322B.386, subd. 2 (2014); and (4) breach of contract for both the Paradise Pork operating agreement and member-control agreement.² Respondents moved for summary judgment to dismiss count

² In 2014, the legislature replaced the Minnesota Limited Liability Company Act (MLLCA), Minn. Stat. §§ 322B.01-975 (2014), with the Minnesota Revised Uniform

I, count II, and count IV, arguing that these claims were derivative and should be dismissed for failure to make a presuit demand on Paradise Pork.

After the summary-judgment hearing, the district court determined that the following count I claims of unfairly prejudicial conduct were derivative:

- (b) Engaged in self-dealing to the detriment of [Schneider] and Paradise Pork;
- (c) Disregarded the governance structure of Paradise Pork;
- (d) Consistently ignored and disregarded the business opinions of [Schneider];
- (e) Acted in excess of their authority with regard to the property and assets of Paradise Pork;
- (h) Frustrated [Schneider's] reasonable expectation that [respondents] would permit [Schneider] to manage Paradise Pork in accordance with generally accepted industry standards;
- (l) Improperly attempted to dissolve Paradise Pork; and
- (m) Attempted to sell assets and property of Paradise Pork for a price far below fair value and without proper notice.

It also determined that the following count II claims of breach of fiduciary duties, which mirror the count I claims, were derivative:

- (a) Engaged in self-dealing to the detriment of [Schneider] and Paradise Pork;
- (b) Disregarded the governance structure of Paradise Pork;
- (c) Consistently ignored and disregarded the business opinions of [Schneider];
- (d) Acted in excess of their authority with regard to the property and assets of Paradise Pork;
- (g) Frustrated [Schneider's] reasonable expectation that [respondents] would permit Schneider to manage

Limited Liability Company Act, Minn. Stat §§ 322C.0101-.1205 (2022). *See* 2014 Minn. Laws ch. 157, art. 1. Because the events pertinent to this litigation all took place before January 1, 2018, when the revised act took effect for preexisting LLCs, we apply the MLLCA. *See* Minn. Stat. § 322C.1204 (2022).

- Paradise Pork in accordance with generally accepted industry standards;
- (k) Improperly attempted to dissolve Paradise Pork; and
- (l) Attempted to sell assets and property of Paradise Pork for a price far below fair value and without proper notice.

Finally, the district court determined that the count IV claims of breach of contract of both the Paradise Pork operating agreement and the member-control agreement were also derivative. Consequently, the above claims that the district court determined as derivative were dismissed without prejudice for failure to make a demand upon Paradise Pork pursuant to Minn. R. Civ. P. 23.09. The district court determined that Schneider's remaining claims of counts I and II were direct claims and denied respondents' motion for summary judgment on those claims. Following this, Schneider made a demand upon Paradise Pork to appoint a special litigation committee (SLC) to investigate the derivative claims.

Schmidt and Boderman appointed attorney Douglas Elsass as Paradise Pork's SLC over Schneider's objection. In his report, Elsass determined that "it [was] not in Paradise Pork's best interest to pursue any of the derivative claims. Rather, pursuit of these claims would be to [Paradise Pork's] detriment." Based on Elsass's recommendation, respondents moved to dismiss the derivative claims. Following a hearing to dismiss the derivative claims, the district court found that "the thoroughness of the SLC's investigation, including its procedures and methodologies, were adequate and appropriate, and also that the SLC pursued its investigation and made its determination[] in good faith." The district court ultimately dismissed Schneider's derivative claims with prejudice.

On January 19, 2021, the district court held a hearing on Schneider's motion for summary judgment on count III for Paradise Pork's failure to (1) provide notice of the sale to Son-D Farms under Minn. Stat. § 322B.77, subd. 2, and (2) give Schneider notice of her dissenters' rights under Minn. Stat § 322B.386, subd. 2. After the hearing, the district court determined that Paradise Pork "violated all notice requirements . . . with respect to [Schneider's] dissenters' rights and the sale to Son-D Farms." It therefore granted Schneider's motion for summary judgment regarding Paradise Pork's liability but denied Schneider's motion for summary judgment on damages because there were "genuine issues of material fact with respect to the valuation of [Paradise Pork] and the amount owed to [Schneider]." The district court then held a court trial on damages and awarded Schneider \$931,327.77 plus costs and disbursements.

Schneider appeals the summary judgment in favor of respondents, challenging the district court's determination that count I (unfairly prejudicial conduct), count II (breach of fiduciary duties), and count IV (breach of the member-control agreement) were derivative claims instead of direct claims. By notice of related appeal, Paradise Pork challenges the district court's order granting summary judgment in favor of Schneider on count III, arguing that the district court erred by failing to apply the business-judgment rule and in calculating damages.

DECISION

- I. The district court erred by determining that Schneider’s count I claims of unfairly prejudicial conduct, count II claims of breach of fiduciary duty, and count IV claims of breach of the member-control agreement were derivative claims rather than direct claims.**

Schneider argues that the district court erred by granting respondents’ motion for summary judgment because her claims of unfairly prejudicial conduct, breach of fiduciary duty, and breach of the member-control agreement were direct claims belonging to her rather than derivative claims belonging to Paradise Pork.³ Her argument is persuasive.

“We review the grant of summary judgment de novo to determine whether there are genuine issues of material fact and whether the district court erred in its application of the law.” *Montemayor v. Sebright Prod., Inc.*, 898 N.W.2d 623, 628 (Minn. 2017) (citation and quotation omitted). “The determination of whether shareholder claims are direct or derivative presents a question of law subject to de novo review.” *In re Medtronic, Inc. S’holder Litig.*, 900 N.W.2d 401, 405 (Minn. 2017).

While the Minnesota limited-liability-company statute does not expressly address derivative suits, we look to the law governing claims involving corporations for guidance. *See Haley v. Forcelle*, 669 N.W.2d 48, 56 (Minn. App. 2003) (“The relationship between shareholders of a closely held corporation is analogous to the relationship between partners in a partnership.”), *rev. denied* (Minn. Nov. 25, 2003). “As an entity distinct from its stockholders, a corporation holds the separate right to sue in its own name.” *In re*

³ Schneider’s counts I, II, and IV claims were against respondents only and not against Paradise Pork.

Medtronic, Inc. S'holder Litig., 900 N.W.2d at 406. For derivative claims, “Minnesota has long adhered to the general principle that an individual shareholder may not assert a cause of action that belongs to the corporation, but instead must sue in a representative capacity on behalf of the corporation if asserting a claim alleging an injury to the corporate entity.” *Id.* (quotation omitted). In contrast, a direct claim “alleges an injury to the shareholder rather than an injury to the corporation.” *Id.* In determining whether a claim is direct or derivative, courts consider two issues: (1) who suffered the injury alleged and (2) who would receive the benefit of any recovery. *Id.* at 408. For that reason, “we look not to the theory in which the claim is couched, but instead to the injury itself.” *Blohm v. Kelly*, 765 N.W.2d 147, 154 (Minn. App. 2009) (quotation omitted).

A. The district court erred by granting summary judgment based on its determination that the claims in counts I and II were derivative claims.

Schneider argues that the district court erred by granting summary judgment to respondents by determining that the count I claims of unfairly prejudicial conduct and count II claims of breach of fiduciary duty were derivative claims, when she suffered a direct injury with regard to the liquidation and distribution of the sale proceeds of Paradise Pork. We agree.

The Minnesota Supreme Court case *Young v. Blandin* is particularly instructive for our case. 9 N.W.2d 313 (Minn. 1943). In *Young*, a majority shareholder made unauthorized investments with the funds of the corporation during liquidation. *Id.* at 315. A minority shareholder directly sued the majority shareholder for improperly liquidating and distributing the assets of the company. *Id.* The supreme court affirmed the district

court's award of damages in favor of the minority shareholder and held that the majority shareholder violated his fiduciary duty to the shareholders by failing to liquidate and distribute the assets of the corporation properly. *Id.* at 317.⁴ Applying the principles from *Young* and viewing the evidence in the light most favorable to Schneider, she has alleged sufficient facts that respondents engaged in unfairly prejudicial conduct and breached their fiduciary duties to Schneider at the time of the liquidation and distribution of Paradise Pork's assets. During liquidation and distribution, respondents unilaterally used a portion of the sale proceeds to pay off Schneider's note from Farm Credit in the amount of \$633,727.33. Schneider never approved the use of the sale of Paradise Pork's assets to pay off the note and no meeting of the members or governors of Paradise Pork was held. Moreover, Paradise Pork did not authorize the note payment, nor did it grant respondents any authority to make the payment. Further, at the time of liquidation and distribution of assets, Paradise Pork no longer had an independent interest in the assets and therefore could not be directly injured by the misuse of those assets because Paradise Pork's only

⁴ We also considered in *Ashbach v. Peterson* whether legal-malpractice claims brought by an appellant shareholder arising out of another shareholder's mismanagement of corporate property to himself were direct or derivative. No. A20-0771, 2021 WL 562347, at *1 (Minn. App. Feb. 12, 2021), *rev. denied* (Minn. Apr. 28, 2021). In that case, the appellant argued that he was directly harmed when a shareholder conveyed a 40-acre property to himself without authorization several years before the dissolution. *Id.* at *2. The appellant relied on *Young* to support his argument. *Id.* at *5. We rejected appellant's argument and clarified that "[i]n *Young*, the only injury that occurred took place during the liquidation and distribution process." At that point, it was only the shareholders who were injured by the majority shareholder's misconduct because the terminated corporation no longer had an interest in the assets." *Id.* at *5. We note that *Aschbach* is a nonprecedential opinion but is cited for its persuasive authority. See Minn. R. Civ. App. P. 136.01, subd. 1(c) (stating that nonprecedential opinions are not binding authority but may be cited as persuasive authority).

remaining task was to distribute the rest of the assets to the shareholders of Paradise Pork. Much like the majority shareholder who made the unauthorized investments with company funds in *Young*, respondents made unauthorized payments with the funds from Paradise Pork. And like the minority shareholder in *Young*, Schneider alleged direct harm when respondents improperly liquidated and distributed the assets of Paradise Pork by paying off a personal loan.

We conclude that the district court erred by granting summary judgment on Schneider's claims of count I (unfairly prejudicial conduct) and count II (breach of fiduciary duty) because they are direct claims not shared by Paradise Pork. As a result, we reverse and remand for a trial to address those claims only to the extent that they relate to the liquidation and distribution of the sale proceeds and assets.

B. The district court erred by granting summary judgment based on its determination that the claims in count IV (breach of the member-control agreement) were derivative claims.

Schneider also argues that the district court erred by granting summary judgment by determining that all the claims in count IV were derivative when respondents, not Paradise Pork, violated the member-control agreement with regard to the liquidation and distribution of the sale proceeds of Paradise Pork. We agree.

Under Minnesota Statutes section 322B.37, subdivisions 1 and 2 (2014), a limited-liability company may enter into a member-control agreement on the business and affairs of that company, including the declaration and payment of distributions and liquidation of the limited-liability company. The statute also provides that a valid member-control

agreement “is enforceable by persons who are parties to it.” Minn. Stat. § 322B.37, subd. 3 (2014).

Schneider argues that respondents violated section 10.2 of the member-control agreement which “imposed specific requirements for dissolution and liquidation of Paradise Pork, including application and distribution of the company’s assets.” Here, Paradise Pork was not a party to this agreement, but rather was “the Company” formed by the parties. The agreement imposed certain obligations and rights on the members themselves. Thus, the members themselves, and not Paradise Pork, were the parties to this agreement and only the members had a right to enforce the requirements under Minn. Stat. § 322B.37, subd. 3. As a result, the district court erred by granting summary judgment.

Schneider also alleged sufficient facts that respondents breached the agreement by failing to follow the required procedures of liquidation and distribution of Paradise Pork’s assets. As stated above, respondents used a portion of the sale of assets to pay off a personal loan without the consent of Schneider. We conclude that the district court erred by granting summary judgment on Schneider’s count IV claims. We reverse and remand on these claims for a trial to address the claims only to the extent that they relate to the liquidation and distribution of the sale and proceeds.

II. The district court did not err by declining to apply the business-judgment rule or in its calculation of damages.

A. The district court did not err by not applying the business-judgment rule.

Paradise Pork argues that the district court should have applied the business-judgment rule and deferred to the SLC's findings. Paradise Pork's argument is not persuasive.⁵

The sale of a limited liability company's assets under Minn. Stat. § 322B.77, subd. 2, requires that "[w]ritten notice of the meeting must be given to all members whether or not they are entitled to vote at the meeting." "In Minnesota, a board of directors may create [an SLC] consisting of one or more independent directors or other independent persons to consider legal rights or remedies of the corporation and whether those rights and remedies should be pursued." *In re UnitedHealth Grp. Inc. S'holder Derivative Litig.*, 754 N.W.2d 544, 550 (Minn. 2008) (quotation omitted). SLCs "enable a corporation to dismiss or settle a derivative suit despite a conflict of interest on the part of some or all directors." *Id.* at 550-51. A court only defers to an SLC's decision under the business-judgment rule on a *derivative* claim. *Id.* at 547.

"Under the business judgment rule, so long as a disinterested director makes an informed business decision, in good faith, without an abuse of discretion, he or she will not be liable for corporate losses resulting from his or her decision." *Id.* at 551 (quotation omitted). "Although courts defer to the business judgment of an independent SLC that

⁵ Because this was also a summary-judgment order, the same de novo standard of review applies.

conducts a good-faith investigation into a claim, no deference is due to the extent that the SLC does not investigate and analyze a claim.” *Blohm*, 765 N.W.2d at 157.

Here, the district court determined that Schneider’s count III claim on Paradise Pork’s failure to (1) provide notice of the sale to Son-D Farms and (2) give Schneider notice of her dissenters’ rights before the meeting constituted a direct claim. Paradise Pork does not challenge the district court’s determination of liability on count III. Instead, Paradise Pork appears to argue that the district court erred by “failing to defer to the findings of the SLC regarding Paradise Pork’s treatment of its own debts and obligations,” including the loan that respondents paid on behalf of Schneider. Paradise Pork’s argument fails for two reasons.

First, the business-judgment rule does not apply here because this is a direct claim. Courts only defer to an SLC’s decision, under the business-judgment rule, on a derivative claim. *See In re UnitedHealth Group Inc. S’holder Derivative Litig.*, 754 N.W.2d at 547. Second, the SLC report specifically noted in a footnote that the “statutory issues relating to the notice and approval of the asset sale itself [(count III)] are not before the SLC, but are being addressed by the [c]ourt in Schneider’s dissenters’ rights claim.” Because the SLC never analyzed this specific claim and made it clear that the district court would address count III, its findings referenced above do not pertain to count III, and we have stated that “no deference” is given to the SLC when it does not investigate and analyze a claim. *See Blohm*, 765 N.W.2d at 157. The district court therefore did not err by declining to apply the business-judgment rule and not deferring to the SLC’s findings.

B. The district court did not err in calculating Schneider's damages.

Paradise Pork alternatively argues that the district court erred by shifting the burden to Paradise Pork and its calculation of Schneider's damages. We are not persuaded.

Appellate courts "review the district court's factual findings for clear error. *Rasmussen v. Two Harbors Fish Co.*, 832 N.W.2d 790, 797 (Minn. 2013). "That is, we examine the record to see if there is reasonable evidence in the record to support the court's findings." *Id.* "[W]hen determining whether a finding of fact is clearly erroneous, we view the evidence in the light most favorable to the verdict." *Id.* (quotation omitted). "To conclude that findings of fact are clearly erroneous we must be left with the definite and firm conviction that a mistake has been made." *Id.* (quotation omitted). But we review a district court's application of the law *de novo*. *Id.* "In an ordinary civil action, the plaintiff has the burden of proving damages caused by the defendant by a fair preponderance of the evidence." *Canada By & Through Landy v. McCarthy*, 567 N.W.2d 496, 507 (Minn. 1997). Under the dissenters' rights statute:

The court shall determine the costs and expenses of a proceeding under subdivision 7, including the reasonable expenses and compensation of any appraisers appointed by the court, and shall assess those costs and expenses against the limited liability company, except that the court may assess part or all of those costs and expenses against a dissenter whose action in demanding payment under subdivision 6 is found to be arbitrary, vexatious, or not in good faith.

Minn. Stat. § 322B.386, subd. 8 (2014).

Paradise Pork first argues that the district court erred as a matter of law when it shifted the burden of proof from Schneider to Paradise Pork. Paradise Pork's argument is

misguided. The party asserting dissenter's rights does not have the burden of proof. Instead, the court determines the cost and expenses. The district court did not err as a matter of law.

Next, Paradise Pork argues that the district court erred in its determination of damages. But the record shows differently. The district court first found the asset approach, used when a company is not operated to maximize profit but is primarily operated for some other purpose, to be the most appropriate in evaluating Paradise Pork because Paradise Pork "never operated as an independent business entity which sought to maximize its profits or even make a profit." Based on the asset approach, the district court found that "the fair market value of Paradise Pork's assets at the time of the sale to be \$2,793,983.32."

Paradise Pork argues that there were certain liabilities that should have been deducted from Paradise Pork's assets, including alleged feed obligations and other alleged debts. But the district court addressed Paradise Pork's alleged liabilities. First, for the feed obligations, the district court found that it received "no reliable evidence in the form of testimony or documentation showing that [Paradise Pork] agreed to pay such feed debts or owed such feed debts." Second, for Paradise Pork's owed legal fees, veterinary bills, and fees related to an audit for the sale to Son-D Farms, the district court again found that it had not received any "reliable evidence in the form of testimony or documentation establishing such debts." Paradise Pork cannot show error on the district court's findings of the alleged liabilities if it did not provide supporting evidence or documentation.

Finally, Paradise Pork argues that the district court's order is not fair and equitable because it does not account for Paradise Pork's unauthorized payment of Schneider. The district court addressed this issue by stating:

[Paradise Pork] was obligated to pay [Schneider], and let her decide whether to use that money to pay the Note with Farm Credit. Finally, Mr. Schmidt admitted in his deposition that he paid off the debt to maintain his "integrity," which obviously is a reference to his financial integrity because he was also personally obligated to pay the Note. Mr. Schmidt did not pay the Note to satisfy any debt [Paradise Pork] owed to [Schneider]; he did it solely for his personal benefit, and again without any approval of [Paradise Pork].

The district court carefully analyzed the assets and liabilities of Paradise Pork and came to a just and equitable determination. It therefore did not err in its calculation of damages.

Affirmed in part, reversed in part, and remanded.