

IN THE SUPREME COURT OF IOWA
No. 19-1790

TRACY BARKALOW, TSB HOLDINGS, L.L.C., and BIG TEN PROPERTY
MANAGEMENT, LLC,
Plaintiffs/Appellees/Cross-Appellants,
vs.
BRYAN CLARK, JEFFREY CLARK,
Defendants/Appellants/Cross-Appellees,
and JOSEPH CLARK,
Defendant/Cross-Appellee.

BRYAN CLARK AND JEFFREY CLARK,
Counterclaim Plaintiffs/Appellants/Cross-Appellees,
v.
TRACY BARKALOW
Counterclaim Defendant/Appellee/Cross-Appellant.

Appeal from the Iowa District Court in and for Johnson County
Case No. LACV079040
The Honorable Paul D. Miller

Plaintiff-Appellee / Cross-Appellant Tracy Barkalow's Final Reply Brief

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STATEMENT OF ISSUES PRESENTED FOR REVIEW

I. THE DISTRICT COURT ERRED BY NOT ORDERING DISSOLUTION BASED ON DEFENDANTS' OPPRESSION.

Baur v. Baur Farms, Inc., 832 N.W.2d 663 (Iowa 2013)
Iowa Code § 489.701

II. THE DISTRICT COURT ERRED BY NOT AWARDING BARKALOW DAMAGES ON HIS BREACH OF FIDUCIARY DUTY CLAIM.

Baur v. Baur Farms, Inc., 832 N.W.2d 663 (Iowa 2013)
Baur v. Baur Farms, Inc., 885 N.W.2d 829, 2016 WL 4036105 (Iowa Ct. App. 2016)

ARGUMENT

I. THE DISTRICT COURT ERRED BY NOT ORDERING DISSOLUTION BASED ON DEFENDANTS' OPPRESSION.

A. The District Court Erred by Holding that Barkalow's Reasonable Expectations Were Not Frustrated by Appellants.

The district court erred by not ordering the dissolution the Company pursuant to Iowa Code § 489.701(1)(d)-(e). Court-ordered dissolution of an LLC is appropriate if the members in control of the company have acted in a manner that is oppressive and directly harmful to the applicant (Barkalow). Iowa Code § 489.701(1)(e)(2). Majority members act oppressively when their actions frustrate the reasonable expectations of the minority members. *Baur v. Baur Farms, Inc.*, 832 N.W.2d 663, 674 (Iowa 2013).

Appellants frustrated the reasonable expectations of Barkalow to not be required to contribute additional capital and not have his ownership interest diluted. They did so by requiring Barkalow to contribute capital in 2015 and 2016 or face dilution of his ownership interest, and thereafter by contributing capital without a legitimate business basis for doing so and for the sole (or predominant) purpose of diluting Barkalow's interest.

The Certificate of Organization states that "no additional capital contributions will be required." (App. I 391-94). Barkalow testified that he took this provision to mean that after the members made their initial capital contributions, none of the members would have to put more money into the Company. (Trial Tr. Vol. 1 at 60:19-61:10). He had that understanding because, at the time the LLC was formed, only one property purchase was contemplated. (*Id.*). Barkalow's expectation to not have to put in additional capital did not change as the Company acquired additional properties, because the Company acquired these properties through debt financing and/or seller financing. (Barkalow Final Brief, Statement of Facts § I). Aside from the down payment on the Company's first property purchase, the entirety of the Company's operations was funded through debt and seller financing. (*Id.*). Given that, it was reasonable for Barkalow to expect that he would not be required to contribute additional capital.

In their reply brief, Appellants / Cross-Appellees Bryan Clark and Jeffery Clark argue that Barkalow's expectation to not be required to contribute capital in order to keep his ownership interest in the company was unreasonable because, while the Operating Agreement does state that no additional capital contributions will be required, it also states that voting rights could be adjusted from time to time to reflect any additional contributions or withdraws. (Jeffrey & Bryan Reply Brief at 29, citing App. I at 328, Ex. 1). They also point to the Company's Management Certificates, which provide that "proportionate equity interest is subject to change." (*Id.*). But neither of these provisions undercut Barkalow's reasonable expectation – based on no additional capital contributions being required and how the Company's operation was funded from the outset by loan financing – that he would not be required to contribute capital or face dilution of his ownership interest in the Company.

Bryan and Jeffery also claims that Barkalow must be arguing that contributions could never be allowed or only by unanimous consent of the members. (Jeffrey & Bryan Reply Brief at 28-29). Neither point is true. Barkalow testified at trial that there was nothing wrong with making additional capital contributions so long as such contributions were done "lawfully, legally, . . . and in the best interest of the company . . . and the members of the company." (Trial Tr. Vol. 2 at 110:9-:17). The Clarks compelled Barkalow to make these

contributions or face the repercussion of having his ownership interest diluted. There was nothing voluntary about these contributions. As these contributions were required, they were in violation of the Operating Agreement and Barkalow's reasonable expectations.

To support their argument that the contributions were permissive, Bryan and Jeffery point to the court's finding that Barkalow was offered an opportunity to contribute capital, but declined, choosing to invest in other opportunities rather than the Company. (Bryan and Jeffery Reply Brief at 30, citing to App. 1 at 279). But Barkalow testified that he did not have the ability to make the capital contributions being required of him by the Defendants. (Trial Tr. Vol. 2 at 201:19-:22). Barkalow did testify that in 2016 his company TSB Holdings, L.L.C. acquired eight new real estate holdings. (*Id.* 202:2-:6). But these acquisitions were made through seller financing and debt financing from Hills Bank, which required security in the form of mortgages on the acquired properties. (Trial Tr. Vol. 2 at 203:14-:25; Trial Tr. Vol. 3 at 91:14-92:20). Given that Barkalow would not have had similar collateral to provide Hills for purposes of financing the required contributions, he would not have had the funds available to make the contributions in 2015 and 2016. (*Id.*).

The required contributions frustrated Barkalow's reasonable expectations. But, even if contributions that would dilute a non-contributing member's

ownership interest were allowed, the contributions in this case – made for the sole or predominant purpose of diluting Barkalow – were oppressive and frustrated Barkalow’s reasonable expectations.

B. The Capital Calls Were Not Supported by a Legitimate Business Purpose and Were Instead for the Purpose of Diluting Barkalow’s Interest in the Company.

In their Reply Brief, Bryan and Jeffery Clark do not dispute that the evidence shows that they had been contemplating ways to dilute Barkalow out of the Company since 2013. They also make no argument to refute the fact that, as of early 2016, the Clark family loans were not past due or in default, and had a schedule pursuant to which the Company would repay them with interest over a 10-year period.

They instead point to Barkalow’s supposed refusal and obstruction in attempting to refinance the Shultz loan and the Clark family loans through U.S. Bank. (Bryan and Jeffery Clark Reply Brief 31-32). But Jeffery Clark himself testified that while funding was available through U.S. Bank in December 2015 to finance the payoff of the Shultz debt, Jeffery was against utilizing a U.S. Bank secured loan to pay off the Shultz debt. He was against using U.S. Bank because the unsecured, undocumented Clark family loans would have been placed in a subordinate position to the U.S. Bank loan. (Trial Tr. Vol. 3 at 201:21-203:20). So, while third-party financing to pay off the Shultz loan was available, Jeffery

refused. In doing so, he placed his family's interests before that of the Company, and also took advantage of the situation to dilute Barkalow through his and his brothers' contributions.

As for the proposals made in 2016 that the Company borrow money from a bank to pay off the Clark family loans, the Clarks were requiring that Barkalow agree to certain terms – including a “mutual global releases by all members and their respective entities” – in order for the Clarks to agree to pay off the Clark family loans through third-party financing. (App. 1 at 406-07). The proposal was not, as Jeffery and Bryan would have the Court believe, a simple up and down vote to obtain commercial financing. The Clarks demanded that Barkalow and his entities release all claims against the Clarks – even those having nothing to do with the Company. Barkalow was not willing to agree to release his and his entities' claims. When Barkalow refused, the Clarks' action was to punish Barkalow by again contributing capital to pay off these Clark family loans (which, again, were being serviced and not in default or past due), and further dilute Barkalow.

C. Joseph Clark Oppressed Barkalow by Making the 2015 Contribution.

Joseph Clark argues that he made his 2015 contribution in good faith for the business purpose of paying the Shultz debt, and therefore his conduct was not oppressive. Joseph Clark relies on Barkalow's testimony that he believes that

Joseph Clark did not make the 2015 contribution intentionally with the bad faith purpose to dilute Barkalow's interest. (Joseph Clark Final Brief, citing to Trial Tr. Vol. 2 at 226:2-:9).

While Barkalow testified that Joseph, unlike the Bryan and Jeffrey, did not contribute the purported capital intentionally in bad faith for the purpose of diluting Barkalow's profit interest and voting rights, (Trial Tr. Vol. 2 at 226:2-:9), it is also undisputed that the purported contributions did exactly that – dilute Barkalow profit interest and voting rights. Joseph Clark's conduct, taken in concert with the other defendants, frustrated the reasonable expectations of Barkalow's interests as a member of the LLC, and constitutes member oppression and is a breach of the duty he owes to Barkalow, his fellow member. *Baur*, 832 N.W.2d at 673-74. While Joseph Clark's lack of bad faith intention shields him from punitive damages, it does not otherwise shield him from Barkalow's claims of oppression and breach of fiduciary duty.

II. THE DISTRICT COURT ERRED BY NOT AWARDING BARKALOW DAMAGES ON HIS BREACH OF FIDUCIARY DUTY CLAIM.

A. Argument.

In order to recover on a breach of fiduciary claim, a claimant must show (i) the existence of a fiduciary relationship; (ii) defendants breached that fiduciary relationship; (iii) the breach of duty caused damage to the claimant;

and (iv) the amount of damage. Iowa Civ. Jury Inst. 3200.1 (citing Restatement (Second) of Torts § 874). The members of an LLC owe each other and the company the duty of loyalty and the duty of care. Iowa Code §489.409. Majority members owe an obligation to minority members to conduct themselves in a manner that is not oppressive to the minority members. Majority members act oppressively when their actions frustrate the reasonable expectations of the minority members. *Baur*, 832 N.W.2d at 674.

For all of the reasons stated above and in Barkalow’s principal brief, Appellants and Joseph Clark have breached their fiduciary obligations to Barkalow by engaging in oppressive conduct which resulted in the frustration of Barkalow’s reasonable expectations.

The court, without elaboration or any analysis of the expert testimony and evidence submitted at trial clearly evidencing Barkalow’s damages based on dilution of his interest, held Barkalow “failed to provide evidence of his damages under the methodology required by the Iowa Supreme Court. (Ruling at 20, citing the Iowa Court of Appeals’ *Baur* decision, *Baur v. Baur*, 885 N.W.2d 829, 2016 WL 4036105 (Iowa Ct. App. 2016)). As explained in Barkalow’s principal brief, Barkalow submitted detailed evidence supported by expert testimony as to how the Clarks’ dilution of his interest has damaged him in the amount of \$398,126, which is the

difference in the net value of his ownership interest if contributions are treated as such instead of loans.

Bryan and Jeffery seize on the court's statement regarding damages, and argue that "[w]hen suppression is shown, and a minority member is allowed to withdraw, the Supreme Court has made clear his interest must be discounted for minority interest and tax implications. Barkalow's did not provide that valuation" (Bryan and Jeffery Clark Reply Brief at 33). This assertion is an utter misstatement of Iowa law, specifically the Supreme Court's decision in *Baur*. The Court's decision in *Baur*, far from supporting applications of discounts, holds that Iowa courts, in dissolution proceedings, should apply the "fair value" definition found at Iowa Code § 490.1301(4), *id.* at 673, which states a company's shares shall be valued "without discounting for lack of marketability or minority status." Iowa Code § 490.1301(4). The Court made no secret of its disdain for lack of marketability/minority interests discounts in dissolution proceedings – "we note, however, our recent disapproval of share valuations incorporating a discount for a minority interest in other corporations." *Id.* at 670 n. 5.

Not only is there no basis in Iowa law to apply a minority interest discount, there is also no basis to apply a tax discount. Jeffrey Clark's and Bryan Clark's position is premised on the Iowa Court of Appeals' *Baur* decision affirming the

lower court's decision on remand from the Supreme Court. *Baur*, 885 N.W.2d 829, 2016 WL 4036105, *4-5. In that decision, the Court of Appeals held that it was not oppressive of the majority shareholders to refuse to buy out the minority shareholder's interest at an amount that did not include tax implications and liquidation value. *Id.* The decision had nothing to do with how to assess damages on a breach of fiduciary claim. Furthermore, *Baur* was dealing with a different kind of entity, a C Corporation, with a different tax scheme. The decision has no application here, and Jeffrey Clark and Bryan Clark cannot explain why tax discounts should be applied to Barkalow's claim for damages.

Furthermore, even if the discounts do apply (they do not) the burden was on Jeffrey and Bryan to submit such evidence of such discounts, and the court could have taken Barkalow's calculated damages and reduced them accordingly. The burden was not on Barkalow to submit evidence of inapplicable discounts.

CONCLUSION

For the reasons stated above and in Barkalow's principal brief, this Court should affirm the district court's ruling dissolving Outside Properties, LLC and further ordering that the contributions be recategorized as loans, and that the members each be restored to their original 25% ownership interest. Alternatively, if the Court rules that the district court erred by ordering dissolution under the "reasonably practicable" standard, the Court should reverse the district court's ruling

denying dissolution and equitable relief based on member oppression. Alternatively, if the Court overturns the district court on dissolution under the “reasonably practicable” standard, and affirms the district court’s denial of relief based on member oppression, then the Court should reverse the district court’s ruling on Barkalow’s breach of fiduciary claim and remand directing the district court to enter judgment in Barkalow’s favor in the amount of \$398,126.

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/s/ Wesley T. Graham
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August 21, 2020
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I, Wesley T. Graham, hereby certify that I electronically filed the foregoing document with Clerk of the Supreme Court of Iowa using the Iowa Judicial System Electronic Document Management System, which will send notification of such filing to the counsel below on the 21st day of August, 2020.

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