IN THE SUPREME COURT OF IOWA

SUPREME COURT NO. 18-0950

HOMELAND ENERGY SOLUTIONS, LLC,

Plaintiff/Appellee,

v.

STEVE J. RETTERATH,

Defendant/Appellant.

JASON and ANNIE RETTERATH,

Intervenors/Appellants.

APPEAL FROM THE IOWA
DISTRICT COURT FOR POLK COUNTY
THE HONORABLE PAUL D. SCOTT AND ROBERT J. BLINK

INTERVENORS'/APPELLANTS' PROOF REPLY BRIEF

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TABLE OF CONTENTS

TABLE OF AUTHORITES

Case Law **Page(s)**

Statutes & Rules **Page(s)**

Other Authorities **Page(s)**

Legislative Materials

STATEMENT OF THE ISSUES PRESENTED FOR REVIEW

I. DID THE DISTRICT COURT ERR IN RULING THE MEMBERSHIP APPROVAL REQUIREMENTS OF THE HES OPERATING AGREEMENT DO NOT APPLY TO THE MURA?

A. Intervenors Seek to Preclude the HES Board from Compelling Performance of an Admitted Insider Deal

IOWA CODE § 489.110(5)

B. HES Admits Section 5.6(b)(v) is Intended to Protect Against Insider Deals.

IOWA CODE § 489.110(5)

C. Basic Principals of Contract Interpretation Require the Inverse of the Conclusion Reached by the District Court and Advocated by HES.

C & J Vantage Leasing Co. v. Wolfe, 795 N.W.2d 65, 77 (Iowa 2011)

D. Only the Members can Ratify the MURA

Life Inv'rs Ins. Co. of Am. v. Estate of Corrado, 838 N.W.2d 640, 646 (Iowa 2013)

RESTATEMENT (THIRD) OF AGENCY § 4.01(2)–(3), § 4.04, § 3.04

IOWA CODE § 489.110(5)

Cf. Theunen v. Iowa Mut. Ben. Ass'n, 70 N.W. 712 (Iowa 1897)

II. DID THE DISTRICT COURT ERR IN CONCLUDING THE MURA DID NOT VIOLATE THE PUBLIC POLICY OF IOWA?

Mincks Agri Center, Inc. v. Bell Farms, Inc., 611 N.W.2d 279 (Iowa 2000)

Des Moines Bank & Trust v. George M. Bechtel & Co., 51 N.W.2d 174 (Iowa 1952)

Atlas Coal Co. v. Jones, 61 N.W.2d 663, 667–68 (Iowa 1953)

Iowa Code § 489.407(3)(d)(3)

Iowa Code § 489.111(1)

Rogers v. Webb, 558 N.W.2d 155, 156 (Iowa 1997)

III. DID THE DISTRICT COURT ERR IN IN NOT ENJOINING HES FROM SEEKING SPECIFIC PERFORMANCE OF THE MURA?

Mincks Agri Center, Inc. v. Bell Farms, Inc., 611 N.W.2d 279 (Iowa 2000)

Carmody v. Toll Bros., 723 A.2d 1180 (Del. Ch. 1998)

Paramount Commc'ns Inc. v. QVC Network Inc., 637 A.2d 34 (Del. 1994)

IV. DID THE DISTRICT COURT ERR IN SEVERING THE SPECIFIC PERFORMANCE TRIAL?

IOWA R. CIV. P. 1.914

In re Marriage of Thatcher, 864 N.W.2d 533 (Iowa 2015)

ARGUMENT

I. THE DISTRICT COURT ERRED IN RULING THE MEMBERSHIP APPROVAL PROTECTIONS FOR INSIDER DEALS DID NOT APPLY TO THE MURA.

A. Intervenors Seek to Preclude the HES Board from Compelling Performance of an Admitted Insider Deal

Throughout its briefing in the underlying proceedings, and now on appeal, Homeland Energy Services, LLC (hereinafter "HES") attempts to minimize the arguments of Jason and Annie Retterath (hereinafter "Intervenors") by referencing the fact they are Steve Retterath's son and daughter-in-law. (HES Brief, p. 27 n.3). HES implies Intervenors are only involved in the legal action to support Steve Retterath. This implication cleverly camouflages the real reason Intervenors are involved in this proceeding: Intervenors are uniquely[1] aware of all actions the HES Board has taken in pursuing and attempting to enforce the Membership Unit Repurchase

[1] Iowa Code § 489.110(5) provides a limited liability company's operating agreement may dictate who may ratify an act that may otherwise violate the duty of loyalty "after full disclosure of all material facts." IOWA CODE § 489.110(5) (2013). This is exactly what Section 5.6(b)(v) of the HES Operating Agreement does. As detailed below, Intervenors are currently the only members who have received at least a nearly full disclosure of the material facts surrounding the HES Board's actions.

Agreement (hereinafter "MURA") — and they are uniquely aware that these Board actions violate the HES Operating Agreement. [2]

For instance, in its annual report for the fiscal year ending December 31, 2013, filed with the Securities and Exchange Commission (hereinafter "SEC"), HES provided the following recitation of its dispute with Steve Retterath:

> On June 13, 2013, the Company entered into an agreement with Steve Retterath, the Company's largest equity holder, to repurchase and retire all of the units owned by Mr. Retterath. The Company agreed to repurchase and retire 25,860 membership units owned by Mr. Retterath in exchange for $30 million. The Company believes that it has a binding agreement with Mr. Retterath. Mr. Retterath contends he is not bound by the agreement. The Company's position is as of the closing date, Mr. Retterath is no longer the equitable owner of any membership units in the Company. . . .

(Appendix v. VII p. 323-324).

Information missing from this Form 10-K annual report and unknown to most HES members, but known to Intervenors, includes the following facts: (1) That on June 13, 2013, when the HES Board Buyback Committee purportedly "entered into an agreement" with Steve Retterath, Steve Retterath

[2] Intervenors are also not parties to the MURA and are the owners of approximately four percent of the outstanding units in HES. (Appendix v. II p. 64, ¶ 4).

was indisputably a Director[3], thereby making the "agreement" an insider deal; (2) The $30 million price "agreed to" by the HES Board represents a per unit price less favorable to HES than what an independent third party could obtain, thus making the insider deal the very type of insider deal the members have a contractual right to know about; and (3) The HES Board's "self-help" went beyond inexplicably declaring Steve Retterath is "no longer the equitable owner" of any membership units in the Company, but also included wrongfully[4] assessing the income from this same equity to Steve for taxation purposes — thereby exposing the membership to adverse tax consequences. Significantly, in its Appellate Brief, HES admits the first two facts laid out above.

For instance, on page 14 of its brief, HES details how it formed a "Buyback Committee" to negotiate and repurchase a fellow Director's Units. In addition, on pages 18 and 19 of its brief, HES details the Buyout Committee's continued negotiations with a fellow Director, including the

[3] Notably, the Form 10-K describes Steve Retterath as "the largest equity holder", but it omits that he is and was a Director of HES.

[4] The undisputed expert testimony offered at trial was that HES's continued allocation of taxable income to Steve Retterath proportionate to his approximate 28 percent ownership interest, while not paying any distributions to him to offset this tax liability, violates the tax code. (Appendix v. VI p. 291:15–19; Appendix v. VI p. 133:20–Appendix v. VI p. 134:2, Appendix v. VI p. 135:23– Appendix v. VI p. 136:4)

signing of the MURA by Buyout Committee member Boyle on June 13, 2013. (HES Brief, pp. 14, 18–19). Steve Retterath was indisputably[5] a Director on June 13, 2013.[6] Therefore, HES clearly admitted that the "agreement" entered into as reported in its Form 10-K "on June 13, 2013" was a deal between the Board of Directors and one of its own, i.e., an insider deal.

Significantly, HES further admits the HES Units were selling at $1,000 per Unit price when negotiations began between the Board and one of its own. (HES Brief, p. 14). HES explains, "The Board must approve all sales of membership units, so the Board was aware of the prices at which HES units were selling." (*Id.* at p. 14 n.1). Yet, HES acknowledges in its brief that the purported "agreed upon price" of $30 million was "approximately $1,160 per Unit." (HES Brief, p. 19). This price is 16 percent less favorable to HES than had the sale been to an independent third party, which is in contravention of Section 1.9 of the HES Operating Agreement. (Appendix v. II p. 30, § 1.9). Obviously, the HES Board's overpayment in excess of $4 million to a fellow Director is the very type of deal the members should know about and vote on.

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[5] HES asserts Steve Retterath resigned his Directorship on June 17, 2013. (HES Brief, p. 19). Steve Retterath and Intervenors assert any resignation by the terms of the MURA was not effective until Closing of the MURA (Ex. 17), an event that never occurred.

[6] Consistent with this conclusion, HES does not contest in its Brief that Steve Retterath was a director or an affiliate of a director.

Worse, the HES Board attempts to justify its acknowledged overpayment by asserting Steve Retterath was "toxic." (HES Brief, p. 29). Again, the members should know and consider whether a dispute amongst Directors justifies an overpayment to one Director, including the reasons for the dispute.

B. HES Admits Section 5.6(b)(v) is Intended to Protect Against Insider Deals.

As detailed in Intervenors' initial appellate brief, HES's counsel acknowledged in the U.S. District Court for the Southern District of Iowa that the purpose of Section 5.6(b)(v) of the HES Operating Agreement (hereinafter "Section 5.6(b)(v)") is to protect the members from insider deals, i.e., deals where "the directors as a whole, as a governing body, are transacting with one of their own, one of the directors on that same board." (Appendix v. III p. 40-43). HES has not argued otherwise on appeal. In fact, HES has detailed specific types of insider deals it agrees Section 5.6(b)(v) is intended to protect against. (HES Brief, pp. 46–47).

Intervenors agree that Section 5.6(b)(v) protects against the specific insider deals identified by HES in its brief. However, stopping with these examples is illogical, and neither the district court nor HES has argued a logical basis for such a narrow application of insider deal protections. Why would the members of HES need voting protections only for promissory notes

issued by a Director to HES, or HES's purchase of stock in Steve Retterath's construction company as referenced by HES, but not for the HES Board agreeing to buy a Director's HES Units at inflated prices? There is no logical basis for interpreting the voter protections to apply only to extraneous equity; HES's examples are the result of a result-based calculus. Put simply, applying the voter protections in an illogically and absurdly narrow fashion is the only way HES can justify its attempts to enforce the insider deal that is the MURA without a member vote.

C. Basic Principals of Contract Interpretation Require the Inverse of the Conclusion Reached by the District Court and Advocated by HES.

HES argues the district court properly relied on Section 5.16(vii) of the HES Operating Agreement (hereinafter "Section 5.16 (vii)") to conclude "the Board does possess the power to reacquire" member Units. (HES Brief, p. 46). Intervenors agree that Section 5.16(vii) states a Board Committee generally[7] has the power to authorize or approve the reacquisition of member

[7] As detailed below the Board's general power is subject to Section 5.6(b)(v) of the Operating Agreement. Further, as detailed by Steve Retterath Section 4.1 of the Operating Agreement mandates that distributions to members are subject to applicable loan agreements. Notably, the payment contemplated by the MURA violates the HES Master Loan Agreement ("MLA"), which prohibits any HES funds to be spent to acquire member interests in the Company and accordingly violates the Operating Agreement. (Appendix v. VII p. 260, § 502(b); Appendix v. II p. 38, § 4.1). HES never obtained a waiver of its loan covenants. Further, the transaction contemplated by the

Units. However, what HES and the district court overlook is the fact the Units at issue are not just "any member's" Units, but rather the Units of a Director. Section 5.6(b)(v) uniquely and specifically applies to acquisition of a Director's Units, and it specifically provides only the members can approve the acquisition of a Director's Units. Otherwise stated, the HES Board generally can approve the reacquisition of a member's Units under Section 5.16(vii); however, when the Units are those of a specific kind of member, a fellow Director, only the members can approve such an acquisition. This conclusion is logically consistent with Section 5.6(b)(v) being exactly what all parties have acknowledged it is – a protection against insider deals. Therefore, contrary to the district court's conclusion, and HES's arguments, Section 5.16(vii) deals with the HES Board's reacquisition of Units of members generally, and Section 5.6(b)(v) specifically mandates who must approve acquisition of the Units of a fellow Director.

HES also argues, "to interpret the phrase 'equity or debt security' to include Units would dilute (if not nullify) Section 5.16. . . ." (HES Brief, p. 46). This argument is simply wrong. To wit, if "equity or debt security" includes Units, then Section 5.16 would still allow the HES Board to acquire

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MURA is outside HES's ordinary course of business and thus requires unanimous approval of the members. *See* IOWA CODE § 489.407(3)(d)(3).

the Units of any members other than fellow Directors. Only when the Board attempts to enter into an insider deal with one of its own would Section 5.6(b)(v) "trump" Section 5.16 by requiring approval of the members. However, the inverse of HES's interpretation is true. HES's interpretation of Section 5.16 renders Section 5.6(b)(v) superfluous, as it allows Board Committee approval of insider deals, thereby nullifying the insider deal voting protections of Section 5.6(b)(v). *See C & J Vantage Leasing Co. v. Wolfe*, 795 N.W.2d 65, 77 (Iowa 2011) ("Because an agreement is to be interpreted as a whole, it is assumed in the first instance that no part of it is superfluous. . . ." (emphasis added)).

HES's additional argument that use of the verb "acquire" in the insider deal protections of Section 5.6(b)(v) instead of "reacquire" is intended to narrow the application of these member vote protections to only insider deals not involving Units is nonsensical. (*See* HES Brief, p. 45 n.9). The verb "acquire" means, "buy or obtain (an asset or object) for oneself." *Acquire*, OXFORD UNIVERSITY PRESS, https://en.oxforddictionairies.com/definition/acquire (last visited Jan. 11, 2019). The term "reacquire" means, "acquire (something) again." *Reacquire*, OXFORD UNIVERSITY PRESS, https://en.oxforddictionaries.com/definition/reaquire (last visited Jan. 11,

2019). Thus, a reacquisition, by definition, is an acquisition — such that prohibitions on acquisitions of a Director's Units would necessarily include prohibitions on reacquisitions.

Similarly, HES further fails to comprehend the intended breadth of the insider deal protections when it argues that Section 5.6(b)(v)'s use of the "general phrase equity or debt securities" (HES Brief, p. 45) (emphasis added), instead of the narrow category of equity, "Units", somehow demonstrates an intent to limit the protection of Section 5.6(b)(v) to only acquisitions not involving Units. Specifically, as emphasized above, HES's acknowledgement that the term "equity or debt securities" is a "general phrase" is important, because this phrase generally includes specific types of "equity or debt securities", such as stocks, bonds, and HES Units. Moreover, HES ignores the fact the HES Prospectus specifically delineated the form of general "securities" offered at HES's initial public offering ("IPO") were Units. (Appendix v. II p. 312).

In a last-ditch effort to justify its clear violation of the insider deal protections of the HES Operating Agreement, HES resorts to an argument based on a section of the Operating Agreement clearly inapplicable to the dispute at hand — namely, Article 9, which deals with transfers of Units, rather than sales. (HES Brief, p. 47). Worse, in making its argument, HES

omits reference to the member protections of this section and the fact they too supersede the HES Board's power. To wit, HES references Section 9.2, which discusses "permitted transfers", and Section 9.4, which discusses "prohibited transfers," but it omits any reference to Section 9.3, which details "Conditions Precedent to Transfer". (Appendix v. II p. 52-53, §§ 9.2–9.4). Importantly, the omitted Section 9.3(e) provides certain types of transfers must be approved by the members. (*Id.* at Section 9.3(e)). Consistent with the arguments made by Intervenors, Section 9.3 expressly provides the following: "[T]he Directors shall have the authority to waive any legal opinion or other condition in this Section 9.3 other than the Member approval requirement set forth in Section 9.3(e)." (Appendix v. II p. 52-53, § 9.3) (emphasis added). Thus, a review of Section 9 further establishes a common theme throughout the Operating Agreement — the HES Board's power must yield where a member vote protection is provided for.

D. Only the Members can Ratify the MURA.

HES acknowledges in the MURA that it had not made a valid offer or acceptance on June 13, 2013, when Pat Boyle (hereinafter "Boyle") signed the MURA, as the MURA indicates the MURA must be accepted by the HES Board. (Appendix v. II p. 61, § 5(b)). Further, Section 5.20 of the Operating Agreement provides instruments pertaining to the business and affairs of the

Company shall be signed on behalf of the Company by the President or by such other Officers or Directors authorized by a specific resolution of the Directors. (Appendix v. II p. 47, § 5.20). Therefore, there is no dispute[8] that Boyle's signature on the MURA was unauthorized on June 13, 2013.

HES brashly[9] recites in its Statement of Facts that "on June 19, 2013, the Board approved the MURA by an 8-3 vote." (HES Brief, p. 20). This purported statement of fact ignores a key fact: the MURA is a time-of-the-essence contract, requiring that it be executed by both parties by 2 p.m. on June 13, 2013. Boyle's signature on June 13, 2013 was not authorized. Consequently, HES's subsequent act of "approving" Boyle's signature on the MURA was of no consequence.

Further, assuming *arguendo* that the MURA could be "approved" after 2 p.m. on June 13, 2013, HES's nonchalant treatment of how and by whom the MURA may be "approved" is mistaken. The issue of who may ratify Boyle's signature, and how it can be ratified, is governed by Iowa law. Importantly, Iowa law mandates that under no circumstance could the HES

[8] HES has not contested in its briefing that Boyle was not authorized to sign the MURA for HES on June 13, 2013.

[9] In their initial brief, Intervenors established that under the Operating Agreement as augmented by the Revised Uniform Limited Liability Company Act (hereinafter "LLC Act"), only the members can ratify this insider deal. (Intervenors' Brief, p. 40). HES has not responded to this argument.

Board "ratify" or "approve" Boyle's execution of the MURA without a vote of the members.

Specifically, in *Life Investors Insurance Co. of America v. Estate of Corrado*, the Iowa Supreme Court noted with approval that under the Restatement (Third) of Agency, ratification does not occur unless the person ratifying has capacity to ratify as stated in section 4.04 of the Restatement. *See Life Inv'rs Ins. Co. of Am. v. Estate of Corrado*, 838 N.W.2d 640, 646 (Iowa 2013) (addressing certified question from federal court as to whether a principal may ratify an unknown signature on a contract) (quoting RESTATEMENT (THIRD) OF AGENCY § 4.01(2)–(3) (AM. LAW INST. 2006) (noting that ratification cannot occur unless "the person ratifying has capacity as stated in § 4.04")). Comment (b) to section 4.04 provides as follows: "Capacity to ratify requires that the would-be ratifier have capacity to act as a principal in a relationship of agency." *Id.* at § 4.04 cmt. b. Important to the dispute before this Court, the Restatement further provides the following guidance for how an entity, such as a limited liability company, may ratify the act of an agent:

> A person that is not an individual, such as a sovereign state or a corporation, cannot act in the physical world except through actions of individual persons. This basic fact distinguishes such persons from individuals as principals. The legal capacity of a person that is not an individual is governed by the legal regime by virtue of which such person exists and functions.

Id. at § 3.04 (emphasis added).

The "legal regime by virtue of which [HES] functions" is the LLC Act. *See id.* (*See* Appendix v. II p. 30, § 1.10(a) (defining "Act" as used in the operating agreement to mean the LLC Act)). Pursuant to the LLC Act, HES is "bound by . . . the operating agreement, whether or not the company has itself manifested assent to the operating agreement." *See* IOWA CODE § 489.111(1). Further, when it comes to ratification on insider deals, the LLC Act provides that the operating agreement may specify the method by which such transactions may be authorized. *See* IOWA CODE § 489.110(5).

As indicated above, Section 5.20[10] clearly provides that only the President of HES, or another Officer or Director specifically authorized by the Board, could execute the MURA on June 13, 2013. The HES Board, as members of officers in HES, are presumed to know the contents of the Operating Agreement. *Cf. Theunen v. Iowa Mut. Ben. Ass'n*, 70 N.W. 712, 713 (Iowa 1897) (noting members of a corporation are presumed to know of the contents of the articles of incorporation). Yet, on June 13, 2013, Pat

[10] Section 5.20 references contracts or other instruments pertaining to the "business or affairs of the company." As detailed below, the MURA was outside the ordinary business of HES. The foregoing assumes *arguendo* that the MURA involves the business of HES.

Boyle, who was neither the President nor specifically authorized, executed the MURA.

On June 19, 2013, the HES Board had a meeting, purportedly to authorize this signature. Notably, in so doing, the Board was attempting to authorize a signature that the Board knew was in violation of Section 5.20. Pursuant to Section 5.6(a)(ii) of the Operating Agreement, in order to approve a knowing violation of the Operating Agreement, the Board needed the unanimous approval of the members. (*See* Appendix v. II p. 43-44, § 5.6). Further, as established in Intervenors' initial brief, an insider deal such as the MURA needs the approval of a majority of the Membership Voting Interests. In short, for HES as an entity to have "capacity" to ratify Boyle's signature, it had to comply with the "legal regime" governing it, which required there be a vote of the members. *See* RESTATEMENT (THIRD) OF AGENCY § 3.04. (*See* Appendix v. II p. 43-44, § 5.6). There was no such vote; thus, HES never had capacity to ratify Boyle's execution of the MURA.

II. THE DISTRICT COURT ERRED IN CONCLUDING THE MURA DID NOT VIOLATE THE PUBLIC POLICY OF IOWA.

As noted by our Iowa Supreme Court,

> A promise or other term of an agreement is unenforceable on grounds of public policy if legislation provides that it is unenforceable or the interests in its enforcement is clearly outweighed in the circumstances by a public policy against the enforcement of such terms.

Mincks Agri Center, Inc. v. Bell Farms, Inc., 611 N.W.2d 279, 275 (Iowa 2000). Intervenors argued in their initial brief (*See* Intervenors' Brief, p. 33) that even if the HES Operating Agreement does not require a vote of the members prior to performance of the MURA, the public policy of Iowa,[11] as announced decades ago by the Iowa Supreme Court, requires that insider deals such as that contemplated by the MURA be nullified if not done "with full disclosure of the facts to, and the consent of, all concerned." *See Des Moines Bank & Trust v. George M. Bechtel & Co.*, 51 N.W.2d 174, 216 (Iowa 1952); *accord Atlas Coal Co. v. Jones*, 61 N.W.2d 663, 667–68 (Iowa 1953). HES has not addressed this argument on appeal.

Instead, HES argues that while Section 5.6(b)(v) is meant to provide member voting protections for insider deals, and the MURA contemplates an insider deal, the deal contemplated by the MURA is not the "type" of insider deal requiring member approval. Specifically, HES admits the following propositions:

1. Section 5.6(b)(v) of the Operating Agreement requires a member vote to approve insider deals. (Appendix v. III p. 40-43).

[11] This public policy is codified in Section 5.6(b)(v) of the Operating Agreement, as allowed under Iowa Code section 489.110(5), which provides a limited liability company can specify in its operating agreement how an action that otherwise violates the duty of loyalty owed by a Director to the company may be "ratified by one or more disinterested and independent persons after full disclosure of all material facts." *See* § 489.110(5).

2. The deal contemplated by the MURA is an insider deal. (Appendix v. VII p. 323-324; HES Brief, pp. 14, 18–19).

The natural and necessary conclusion is: "therefore, the members must vote to approve the MURA." However, HES argues the MURA is excepted from this logic because it is an insider deal in HES's own equity, rather than extraneous equity. (*See* HES Brief, pp. 46–47).

HES offers no explanation as to why this purported distinction modifies the necessary conclusion. In fact, logic dictates the members would be most concerned about an insider deal in the company's own equity as it directly effects the members' investment. Further, a review of Iowa's case law surrounding insider deals establishes that deals in the company's own equity or assets can be the primary subject of an impermissible insider deal. *See, e.g.*, *Atlas Coal Co.*, 61 N.W.2d at 667–68 (nullifying an insider deal where two members of the Board of Directors of a company purchased an asset of the company at a dramatically low price).

Further, consistent with Iowa precedent governing insider deals, the LLC Act contains substantial member approval protections for activities outside the normal course of company business. To wit, Iowa Code section 489.407, entitled "Management of limited liability company", provides that in a manager-managed LLC, such as HES, "[t]he consent of all members is

required to . . . [u]ndertake any other act outside the ordinary course of the company's activities." *See* IOWA CODE § 489.407(3)(d)(3). Steve Retterath asserted the MURA was an act outside the course of HES's normal business activity. (Steve Retterath Brief, pp. 47–48.) HES has not contested this assertion. Further, as detailed above, the transaction contemplated by the MURA violates the MLA. Put simply, the transaction contemplated by the MURA is an insider deal and is "outside the ordinary course of the company's activities", such that it needs approval of all members. *See* § 489.407(3)(d)(3).

Inexplicably, in addition to failing to recognize Iowa's clear public policy against insider deals that are not approved by all concerned after full disclosure of all material facts, HES continues to argue its Board can waive voter protections against insider deals. To wit, HES argues, "[t]he conditions precedent in Section 5 of the MURA are for HES's benefit", such that HES could waive them. (HES Brief, p. 33–34). One of the conditions contained in Section 5 of the MURA is as follows: "the Company's Board of Directors shall have approved this Agreement . . . in accordance with the Company's operating agreement." (Appendix v. II p. 61, § 5(b)) (emphasis added). This condition is not for the benefit of the Board of Directors, but for the benefit of all members, and it cannot be waived by the HES Board. In fact, the clear public policy of Iowa is that a limited liability company "is bound by . . . the

operating agreement. *See* IOWA CODE § 489.111(1). Thus, HES cannot, as a matter of legislatively mandated public policy,[12] waive the requirement that its approval of the MURA be in accord with its Operating Agreement. *See id.* Consequently, the HES Board cannot waive the voting protections of Section 5.6(b)(v) pertaining to insider deals.

In short, Iowa public policy requires an insider deal be approved by all concerned after full disclosure of the facts. The MURA is an insider deal, and it has not been approved by the members of HES following disclosure of all material facts. Consequently, the MURA should not be enforced. *See Rogers v. Webb*, 558 N.W.2d 155, 156 (Iowa 1997) ("Contracts that contravene public policy will not be enforced.").

III. THE DISTRICT COURT ERRED IN IN NOT ENJOINING HES FROM SEEKING SPECIFIC PERFORMANCE OF THE MURA.

As Intervenors noted in their initial brief, Section 11.11 of the Operating Agreement provides in pertinent part as follows:

> Each member acknowledges and agrees that the Company and the other Members would be irreparably damaged if any of the provision of this Agreement are not performed in accordance with their specific terms, and that monetary damages would not provide an adequate remedy in such event. Accordingly, it is

[12] The provision in the MURA purporting to allow HES to waive compliance with the Operating Agreement is unenforceable. *See Mincks Agri Center, Inc.*, 611 N.W.2d at 275 (stating a promise or term is unenforceable if legislation provides it is unenforceable or it is contrary to public policy).

> agreed that, in addition to any other remedy to which the Company and the non-breaching Members may be entitled hereunder, at law or in equity, the Company and the non-breaching Members shall be entitled to injunctive relief to prevent breaches of the provision of this Agreement and to specifically to [sic] enforce the terms and provisions of this Agreement.

(Appendix v. II p. 58, § 11.11) (emphasis added).

Intervenors further argue that performance of the MURA would violate Section 5.6(b)(v) of the Operating Agreement because the members were never allowed to vote on the MURA. (Intervenors' Brief, pp. 61–63). Intervenors conclude by asserting they are entitled to an injunction under Section 11.11 of the Operating Agreement, precluding HES from seeking performance of the MURA. (*Id.* at p. 63). HES has not addressed this argument on appeal.

HES's failure to address this argument is not surprising given the HES Board's calloused disregard of the Operating Agreement, including those provisions intended to allow members' participation in corporate governance through their votes. As noted by the courts of Delaware, "there is a fundamental value that the shareholder vote has primacy in our system of corporate governance because it is the ideological underpinning upon which the legitimacy of directorial power rests." *Carmody v. Toll Bros.*, 723 A.2d 1180, 1193 (Del. Ch. 1998) (emphasis added) (citations and quotation

omitted). In the case *sub judice*, the HES Board of Directors has denied the members the opportunity to participate in governance in all matters involving Steve Retterath.

For instance, HES has asserted on appeal that the MURA should be enforced because Steve Retterath was "toxic" and the MURA is the only way in which it can remove Steve Retterath "as Member and Director[13] of HES." (HES Brief, p. 29). This is simply wrong.

To wit, the Operating Agreement provides "the Members may remove a Director . . . ." (Appendix v. II p. 45, § 5.13). Significantly, the Operating Agreement further provides, "If a quorum is present, the affirmative vote of a majority of the Membership Voting Interests represented at the meeting and entitled to vote on the matter . . . shall constitute the act of the Members. . . ." (Appendix v. II p. 49, § 6.15). Thus, the Members may remove a Director through a vote of the Membership Voting Interests.

Perhaps fearing a vote would not accomplish the stated goal of removing Steve Retterath as a Director,[14] in the case *sub judice*, the HES

[13] In making this argument, HES admits the MURA contemplates a deal between the Directors and a fellow Director – an insider deal.

[14] Steve Retterath possessed 28 percent of the Membership Voting Interests and Intervenors possess an additional 4 percent. Further, the source of the purportedly "toxic" dispute between Steve Retterath and other members of the Board of Directors was the fact Steve was advocating for the payment of distributions, and other Directors did not want to pay distributions. (Hansen,

Board obviated the members' right to vote on the removal of a Director. The Board instead "took matters into their own hands" by attempting to accomplish this goal through an insider deal.[15] The Board then "doubled down" on its refusal to engage the membership in corporate governance by not allowing a member vote on this insider deal. As a result, the HES Board's directorial power has no legitimacy because the Directors have failed to provide a "full disclosure of the facts" to the members, and they have actively denied the members a vote on a matter clearly vested with the members.

The district court should have used the injunction remedy available under the Operating Agreement to protect the members' voting rights. *See Paramount Commc'ns Inc. v. QVC Network Inc.*, 637 A.2d 34, 42 (Del. 1994) ("Because of the overriding importance of voting rights, this Court and the Court of Chancery have consistently acted to protect stockholders from unwarranted interference with such rights."). Unfortunately, the district court's failure to enjoin the HES Board's unauthorized quest to remove a

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26:21-27:5). Distributions must be paid pro rata to all members under the Operating Agreement. (Appendix v. II p. 38, § 4.1). Thus, the Board's decision not to pay distributions was harmful to all members, so a vote occurring after full disclosure of all material facts to all members would likely not result in the Board's stated goal of removing Steve Retterath.

[15] Notably, Director Marchand admitted the MURA was the first time the Board attempted to buy out a fellow Director's Units. (Appendix v. VI p. 112:5– Appendix v. VI p. 115:21).

Director via an insider deal, as opposed to a vote, is to the substantial detriment to the members, including Intervenors. Specifically, the HES Board continues to keep the membership in the dark while spending the members' money to pursue the goal of removing Steve Retterath as a Director. Worse, the Board is exposing the members to potential liability by its use of wrongful tax treatment to pressure Steve Retterath into submission. (Appendix v. IV p. 477-478).

When this Court concludes HES could not enter into and perform the MURA without a vote of the members, as dictated by Section 5.6(b)(v) of the Operating Agreement, Intervenors further ask this Court to conclude the district court erred in not granting Intervenors an injunction under Section 11.11 of the Operating Agreement. Intervenors ask that this cause be remanded back to the district court with an Order to enter summary judgment in favor of Intervenors, including an Order enjoining the HES Board of Directors from continuing its unauthorized efforts to enforce the unauthorized MURA.

IV. THE DISTRICT COURT ERRED IN SEVERING THE SPECIFIC PERFORMANCE TRIAL.

HES argues Appellants' sole complaint regarding bifurcation is "that the district court incorrectly believed that disposition of HES's specific performance claim 'may well be dispositive of the entire dispute.'" (HES

Brief, p. 68). HES then asserts "the district court was correct in this regard." (*Id.*). HES is incorrect on both counts: (1) the district court's incorrect belief as to whether the specific performance claim could be dispositive was not Intervenors' complaint on appeal, and (2) the district court was not correct in its assessment of the dispositive nature of this claim.

First, Intervenors' complaint as it pertains to the bifurcation order is that the district court exceeded its authority under Iowa Rule of Civil Procedure 1.914 in severing the case, and that this was both an abuse of discretion and prejudicial to Intervenors. *See* IOWA R. CIV. P. 1.914 (2018) (providing for a court's authority to order separate trials on the various claims, counterclaims, cross-claims, cross-petitions, and issues in a case). Intervenors explained that impermissible serial final judgments would result from the district court's severing of the trial, followed by it purporting to enter a final judgment on part of the case, while leaving other claims unresolved. The district court's actions thus constituted a prejudicial abuse of its discretion. (Intervenors' Brief, pp. 65–66) (citing *In re Marriage of Thatcher*, 864 N.W.2d 533, 539–40 (Iowa 2015)).

HES does not address this argument or the Intervenors' cited authority on appeal. HES instead argues its belief as to why bifurcation arose. (HES Brief, p. 69). Respectfully, why bifurcation arose does not matter. The

question before this Court is whether bifurcation was an abuse of discretion that resulted in prejudice.

Intervenors further argued the order severing trials resulted in a prejudicial abuse of discretion because Intervenors were precluded from conducting discovery on and presenting evidence of their claims, which were substantially intertwined with HES's specific performance claim. (Intervenors' Brief, pp. 68–69). For instance, as detailed in their initial brief, Intervenors' remaining claims included claims that the HES Board of Directors breached their fiduciary duties and violated the HES Operating Agreement by purportedly unilaterally "closing" the MURA, thereby taking Steve Retterath's "equitable interest" and depriving him of distributions, all while assessing him tax liability for the same "equitable interest." (*Id.* at p. 67). Intervenors' remaining claims also included a claim that the MURA violated section 1.9 of the HES Operating Agreement because it was on terms less favorable to HES than were it with an independent third party. (*Id.* at p. 68). Of course, as detailed above, HES has admitted in its brief that a purchase from an independent third party would have been at $1,000 per Unit, and it paid Steve Retterath $1,160 per Unit. (HES Brief, pp. 14, 19). Again, HES has not addressed this argument on appeal.

HES instead focuses its argument on demonstrating a judgment deeming the MURA unenforceable would have made all of Appellants' claims moot. HES provides no authority to demonstrate how this showing would make the district court's bifurcation order a valid exercise of discretion. Moreover, HES is wrong. Had the district court determined the MURA was unenforceable, the Court would still need to adjudicate Intervenors claims that the HES Board violated its fiduciary duties by way of the following: (1) misrepresenting the parties' dispute in proxy statements, (2) seizing Steve Retterath's "equitable interest" and depriving him of distributions while assessing him taxable income for the same "equitable interest", and (3) pursuing specific performance action knowing the conditions precedent to performance of a member vote had not been satisfied.

CONCLUSION

As the Iowa Supreme Court first acknowledge in 1952, insider deals, like the one contemplated by the MURA, should only be done "with full disclosure of the facts to, and the consent of, all concerned." *See George M. Bechtel & Co.*, 51 N.W.2d at 216; *accord Atlas Coal Co.*, 61 N.W.2d at 667–68. HES has expressly stated Section 5.6(b)(v) is the mechanism whereby the members can learn of and vote on an insider deal. HES has further implicitly acknowledged the deal contemplated by the MURA is an insider deal. Yet,

HES has not disclosed the facts to all concerned, nor has it obtained their consent as required under Iowa law and the HES Operating Agreement. HES's position that an insider deal in its own Units is not the "type" of insider deal that needs to be disclosed and approved is incorrect under Iowa law and any fair reading of the Operating Agreement. *See, e.g.*, *Atlas Coal Co.*, 61 N.W.2d at 667–68 (nullifying an insider deal where two members of the Board of Directors of a company purchased an asset of the company at a dramatically low price); *see also Mills v. Elec. Auto-Lite Co.*, 90 S. Ct. 616, 620 (1970) ("[F]air corporate suffrage is an important right that should attach to every equity security bought on a public exchange." (quoting H.R. 73-1383, 73d Cong. (1934))); *Shidler v. All Am. Life & Fin. Corp.*, 775 F.2d 917, 925 (8th Cir. 1985) (noting deprivation of voting procedure "deprived minority shareholders of their basic property right to a meaningful voice in the conduct of corporate affairs.")

The district court's order denying Intervenors' summary judgment and granting HES partial summary judgment allows HES to proceed towards performance of an insider deal without there ever having been "full disclosure of the facts to, and the consent of" the members of HES. *See George M. Bechtel & Co.*, 51 N.W.2d at 216. The district court summary judgment order should be reversed and remanded, with a directive that the district court enter

judgment for Intervenors, including a declaration that the MURA violates the voting protections of Section 5.6(b)(v) of the HES Operating Agreement, Iowa's public policy regarding insider deals, and that HES must be enjoined from continuing pursuit of performance of the MURA.

Alternatively, even if the district court's summary judgment were not reversed, the district court's order severing the specific performance trial from Intervenors' claims precluded Intervenors from establishing performance of the MURA violated the HES Operating Agreement prior to such performance being ordered, and was thus an abuse of discretion. This bifurcation order should be reversed, and a new trial ordered, wherein all interrelated issues surrounding the MURA can be presented and decided.

REQUEST FOR ORAL ARGUMENT

Intervenors respectfully request oral argument concerning this appeal.

Respectfully submitted,

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CERTIFICATE OF FILING AND SERVICE

The undersigned hereby certifies he electronically filed the foregoing Intervenors/Appellants' Final Reply Brief on February 1, 2019 via EDMS.

The undersigned hereby certifies on February 1, 2019, the foregoing Intervenors/Appellants' Final Reply Brief was served by e-mail via EDMS on all parties of record.

/s/ *Jason W. Miller* February 1, 2019
Signature Date

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I hereby certify the cost of printing the foregoing Intervenors/Appellants' Final Reply Brief was the sum of $ 0.00.

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