

IN THE IOWA DISTRICT COURT IN AND FOR CLAYTON COUNTY

MICHAEL WALZ, DEAN WALZ,)
JARED WALZ, and SUPREME BEEF,)
LLC, individually and as members of)
and on behalf of Walz Energy, LLC,)
WALZ INCORPORATED, and W 6)
FARMS, INCORPORATED,)

Plaintiffs,)

v.)

FEEDER CREEK ENERGY, LLC,)
FEEDER CREEK GROUP, INC., and)
HEATH KELLOGG and JON HAMAN,)
Individually and as managing members)
or shareholders of Walz Energy, LLC,)
Feeder Creek Energy, LLC, and Feeder)
Creek Group, Inc.,)

Defendants.)

Case No. EQCV010637

**RULING ON PLAINTIFFS’
MOTION FOR PARTIAL
SUMMARY JUDGMENT ON
COUNTS I and III**

On August 28, 2019, the Plaintiffs’ Motion for Partial Summary Judgment came before the Court for argument. The Plaintiffs were represented by Attorneys Teresa K. Baumann, Samuel E. Jones, and Dennis McMenimen. The Defendants were represented by Attorneys John C. Wagner and Matthew S. Roling. After having considered the evidence presented, the written and oral arguments of counsel, and the applicable law, the Court enters the following ruling on the pending motion.

FACTUAL & PROCEDURAL BACKGROUND

These legal proceedings revolve around Walz Energy, LLC (Walz Energy). The following facts about Walz Energy and the parties in the two succeeding paragraphs are

undisputed.¹ Walz Energy is an Iowa limited liability company (LLC) that was formed on February 28, 2017, and has its principal place of business in West Des Moines, Iowa. The purpose of Walz Energy is to create and subsequently operate a cattle feeding operation that uses anaerobic digesters to break down the manure from the cattle feeding operation into renewable energy that can then be sold to energy utilities. Walz Energy currently has two members, Supreme Beef, LLC (Supreme Beef) and Feeder Creek Group.

Supreme Beef, LLC (Supreme Beef) is an Iowa LLC with its principal place of business in Monona, Iowa. Mike Walz manages Supreme Beef, in addition to being a member, and Dean Walz and Jared Walz are also members of Supreme Beef. Walz, Incorporated (Walz, Inc.) and W6 Farms, Incorporated (W6 Farms) are each Iowa corporations with their principal places of business in Monona, Iowa. Dean Walz, Jared Walz, and Mike Walz operate a cattle and grain farming business through Walz, Inc. and W6 Farms.

Feeder Creek Energy, LLC (Feeder Creek Energy) is an Iowa LLC that was formed on August 15, 2018 and has its principal place of business in West Des Moines, Iowa. Feeder Creek Group, Inc. (Feeder Creek Group) is a Wyoming corporation that was formed on August 20, 2015 as Conservation Industries, Inc. and has its principal place of business in Cheyenne, Wyoming. Heath Kellogg manages Feeder Creek Energy and is the President and Director of Feeder Creek Group. Feeder Creek Energy was an original member of Walz Energy. However, on February 5, 2018, Feeder Creek Energy merged with Feeder Creek Group, and as a result of the merger, Feeder Creek Energy's assets, obligations, and membership units in Walz Energy were assigned to Feeder Creek Group.

¹ Plaintiffs' Statement of Material Facts (SMF) ¶¶ 1, 3–7; Defendants' Response to Plaintiffs' SMF ¶¶ 1, 3–7; Plaintiffs' Petition ¶¶ 4–8, 11–14; Defendants' Answer ¶¶ 4–8, 11–14.

I. Walz Energy Timeline of Events²

In late December 2016, Jon Haman and Kellogg became in contact with Mike Walz, Dean Walz, and Jared Walz. The parties began discussing the idea of a cattle feeding facility that would have anaerobic digesters. Haman had previously been employed with Amana Farms, a beef cattle farm that used anaerobic digesters, and Kellogg had previously been responsible for raising financing for a Sysco cattle-related investment in Iowa. During these initial discussions, the parties discussed the possible revenue and risks involved with the cattle feeding and anaerobic digester operation. After discussing proposals over the company, the parties entered into an operating agreement and formed Walz Energy.³

On February 1, 2017, Haman and Kellogg entered into construction management agreements with Feeder Creek for the project site. (Defendants' Exh. 1–2). Haman, as a representative of Feeder Creek, entered into a contract with Kellogg to be a manager of the project's construction site, and Kellogg, as a representative of Feeder Creek, entered into a contract with Haman to be a manager of the project site's construction. *Id.* Under the construction management agreements, the base salary for each of the managers was \$150,000. *Id.* The construction management agreements also state that Feeder Creek will provide the managers with housing, transportation, and meals during site construction. *Id.* Haman and Kellogg did not inform the Plaintiffs of the construction management agreements or obtain their approval for these agreements. (Plaintiffs' Affidavit of Mike Walz).

² The following background in the first four paragraphs of this section is primarily taken from the Plaintiffs' Petition and the Defendants' Answer to the Petition unless otherwise noted. Plaintiffs' Petition ¶¶ 17–30, 35–36, 46–47, 56; Defendants' Answer ¶¶ 17–30, 35–36, 46–47, 56. The parties are in dispute as to certain facts relating to the formation of Walz Energy. The Court makes no findings as to the facts from the Plaintiffs' Petition unless they were discussed in the parties' filings for this motion. However, the Court finds it useful to explain the background of how Walz Energy was formed in order to give context to the actions that gave rise to this litigation and how the parties assumed their roles in the company.

³ See *infra* note 5 (discussing the Walz Energy Operating Agreement).

In May 2017, Supreme Beef had W6 Farms execute a warranty deed to convey real property in Monona, Clayton County, Iowa to Walz Energy for the site of the cattle feeding facility. In July 2017, Mike, Dean, and Jared Walz got a \$10,000,000 loan from People's State Bank supported by a mortgage on part of the land that W6 Farms conveyed to Walz Energy. Before the loan closed, W6 Farms advanced a total of \$3,450,000 to Feeder Creek for construction expenses which Walz Energy paid back after the loan closed. Once the loan closed, Peoples State Bank wired \$6,501,176.84 of the loan to Walz Energy for construction of the facilities.

Between March 2017 and summer 2018, Walz Energy built six cattle feeding buildings on the project site. However, beginning in February 2018, mechanic's liens were filed against Walz Energy property with the biggest mechanic lien being in the amount of \$2,372,109.56. In April 2018, the Plaintiffs borrowed \$3,100,000 from People's State Bank by mortgaging other property to pay off Walz Energy's contractors and remove the multiple mechanic's liens. The Plaintiffs assert that by October 2018, \$13,386,812.50 was owed to People's State Bank. As of July 2019, the cattle barns are 80% completed and the anaerobic digesters still need to be financed (Interim Receiver's Report through July 2019 at pp. 2-3).

On April 11, 2019, Michael Walz, Dean Walz, Jared Walz, and Supreme Beef, individually and as a member of and on behalf of Walz Energy, Walz Incorporated and W6 Farms (collectively referred to hereinafter as "Plaintiffs"), filed an action against Feeder Creek Energy, LLC, Feeder Creek Group, Inc., and Heath Kellogg, and Jon Haman, individually and as managing members or shareholders of Walz Energy, Feeder Creek Energy, and Feeder Creek Group (collectively referred to hereinafter as "Defendants").⁴

⁴ For purposes of this ruling, the parties named as Defendants will be collectively referred to as Defendants; however, the parties may be referred to individually as appropriate in portions of this Ruling.

The Plaintiffs allege the following claims against the Defendants collectively and individually: (1) Conversion against Feeder Creek, Feeder Creek Group, Kellogg, and Haman; (2) Misappropriation and Theft against Kellogg and Haman; (3) Breach of Fiduciary Duty against Kellogg and Haman; (4) Direct Action by Member Pursuant to section 489.901 of the Iowa Code; (5) Derivative Action by Supreme Beef against Kellogg and Haman pursuant to sections 489.902(2) and 489.906(2) of the Iowa Code; (6) Application for Dissociation of Feeder Creek Group pursuant to section 489.602 of the Iowa Code; (7) Breach of Contract against Feeder Creek and Feeder Creek Group; (8) Negligent Misrepresentation against Kellogg and Haman; (9) Piercing the Company Veil of Feeder Creek Group against Kellogg and Haman; (10) Promissory Estoppel against Defendants; (11) Unjust Enrichment against Defendants.

At the core of their petition, the Plaintiffs assert that the Defendants misled them into believing that the Defendants had already obtained \$15,000,000 in financing for the project, to construct an anaerobic digester, and that if they had known that the Defendants did not have the financing, they never would have taken out the \$10,000,000 loan or conveyed land to Walz Energy. (Plaintiffs' Petition ¶ 38). The Plaintiffs also assert that the Defendants' mismanagement of Walz Energy funds and failure to obtain financing for the project has resulted in Walz Energy being unable to finish construction, the project being non-operational, Walz Energy having no money, and the Plaintiffs having no way to fend off foreclosure proceedings from Peoples State Bank which has now foreclosed on the loan. (*Id.* ¶¶ 67–71; Plaintiffs' Motion to Appoint New Managers ¶¶ 7–9, 12, 16).

Also, on April 11, 2019, the Plaintiffs moved for an appointment of new managers for Walz Energy, or in the alternative, the appointment of a receiver. On May 28, 2019, the

Defendants stipulated to the appointment of a receiver, and on May 29, 2019, the Court appointed Jared Walz to be the receiver of Walz Energy.

The Plaintiffs now move for summary judgment on Count I and Count III. Under Count I, the Plaintiffs assert that Haman and Kellogg converted \$360,761.38 from the ISB account by intentionally writing checks and using debit cards and credit cards for unauthorized expenditures. The Plaintiffs further assert that Haman and Kellogg's conduct was a serious interference with Supreme Beef's possessory rights in the Walz Energy funds. Under Count III, the Plaintiffs assert that Haman and Kellogg, as managing members of Walz Energy, breached their fiduciary duties of loyalty and care to Walz Energy and Supreme Beef in the following ways: (1) by paying themselves a salary, wages, or compensation; (2) by using Walz Energy funds to pay for various personal expenses; (3) depositing Walz Energy funds into a bank account for another company instead of setting up a bank account for Walz Energy; (4) failing to account for the company's money.

For both counts, the Defendants assert the same arguments as to why they did not convert \$360,761.38 of Walz Energy funds or breach their fiduciary duties. First, they assert that there are genuine issues of material fact as to whether Haman and Kellogg intentionally used Walz Energy funds for their own personal use. Second, they assert that expenditures on Haman Management Service were provided for under the construction management agreement and not for Haman and Kellogg's personal benefit. Third, they assert that the construction management agreement shows that the Defendants acted in good faith and had no intent to assert a right inconsistent with Supreme Beef's possessory right. Fourth, the Defendants argue that section 6.4(a)(vi) of the Operating Agreement gave Haman and Kellogg, as the managers of Walz Energy, the authority to spend some of the money because some of the expenditures were for

Walz Energy expenses. Fifth, the Defendants assert that Feeder Creek Group and Feeder Creek Development's capital contribution of \$337,902.07 show that there was no conversion or serious interference. Sixth, the Defendants assert that any diverted funds were repaid through the capital contribution.

II. Walz Energy Operating Agreement

Between February 2017 and March 2017, Supreme Beef and Feeder Creek Energy entered into an Operating Agreement for Walz Energy.⁵ The Operating Agreement has an Article that addresses management of Walz Energy and that names Heath Kellogg and Jon Haman as the managing members of the company. The relevant provisions of the Operating Agreement are as follows:

ARTICLE VI Management of the Company

Section 6.1. Management. Management of the Company is vested in its Members, except to the extent delegated to the Managing Member(s) in this Agreement.

Section 6.2. Identity and Number of Managing Members. The Initial Managing Member(s) shall be Jon Haman and Heath Kellogg. The number of Managing Members shall be two (2), except as otherwise provided by Unanimous Consent.⁶

Section 6.4. Authority and Powers of Managing Member.

(a) Authority. Except to the extent this Agreement requires an action to be taken by Unanimous Consent, the Managing Member is authorized, at the Company's expense,

⁵ The Court notes that the parties have produced three Operating Agreements for Walz Energy during the course of this action. The first Operating Agreement is dated February 1, 2017. The second and third Operating Agreements are dated March 20, 2017. The Plaintiffs reference the February Agreement while the Defendants reference the third March Agreement. While the issue of which Operating Agreement is the governing Operating Agreement remains an issue, the sections of the Operating Agreement that are relevant to this Motion are nearly identical (except otherwise noted). Therefore, the Court will make reference to the relevant section of the Operating Agreements. However, the Court takes no position as to which Operating Agreement is the governing Operating Agreement at this time.

⁶ The February 2017 Operating Agreement and the second March 2017 Operating Agreement names Jon Haman and Heath Kellogg as the managing members. However, the first March 2017 Agreement names Heath Kellogg as the only managing member. The parties' arguments and assertions to this point indicate that Haman and Kellogg were the managers of Walz Energy.

to do all acts necessary to carry out the Company's business in its ordinary course, including, but not limited to, the right to:

(i) Buy, sell, and lease Company property (not real estate or improvements) that do not represent a material part of the Company's aggregate property;

(ii) Pursuant to a budget approved by Unanimous Consent, borrow money and procure temporary, permanent, conventional, or other financing or refinancing on such terms and conditions, at such rates, and from such parties as are approved, and, if security is required for the loan, to mortgage or subject to another security in a material portion of the Company assets;

(iii) Insure the Company's activities and property;

(iv) Pursuant to a budget approved by Unanimous Consent, enter into contracts or agreements with persons for routine matters of operation, and pay from the Company's funds the consideration required under the contracts or agreements;

(v) Pay out of the Company's funds all fees and expenses incurred in the organization of the Company, as well as all operating expenses;

(vi) Perform all other acts or activities customary or incident to the routine and day—to-day operation of a business such as that conducted by the Company;

(vii) Establish and maintain books and records for the Company;

(viii) Establish bank and money market accounts for the Company's benefit.

(b) No Other Representatives. Only the Managing Member has authority to execute documents on behalf of and in the name of the Company except as actually authorized by Unanimous Consent, and no Person shall be obligated to inquire into the authority of the Managing Member to bind the Company. This Section 6.4(b) constitutes a restriction on the management rights and duties of the Members to the extent those rights and duties have been delegated to the Managing Member (in the Managing Member's role as such) pursuant to the terms of this Agreement.

Section 6.5 Restrictions on Authority of Managing Member.

(a) Absolute Restrictions. The Managing Member shall not have the authority to:

(i) Do any act that is in contravention of applicable law or this Agreement or that would make it impossible to carry on the ordinary business of the Company;

(ii) Possess Company property, or assign rights in specific Company property, for other than a Company purpose; or

(iii) Perform any act that would subject the Members to liability in any jurisdiction except as expressly provided in this Agreement.

(b) Restriction Without Unanimous Consent. Without Unanimous Consent, the Managing Member(s) shall not have the authority to:

(i) Sell or otherwise dispose of all or substantially all of the Company's assets or sell any real estate or improvements of the Company;

(ii) Except as provided in Section 6.4(a)(ii), above, borrow money or procure financing or refinancing, or mortgage or subject to another security interest any material portion of the Company's assets;

(iii) Except as provided in Section 6.4(a)(iv), above, enter into contracts or agreements with Persons for routine matters of operation, and pay from the Company's funds the consideration required under the contracts or agreements;

(iv) Make capital improvements to the Company's properties;

(v) Issue additional Membership Units (except as set forth in Section 7.1);

(vi) Confess a judgment against the Company;

(vii) Make any changes or amendments to the Company's Articles of Organization or Operating Agreement;

(viii) Authorize or pay any salary, wages, or compensation to any Member or Managing Members of the Company; or

(ix) Enter into any contracts, transactions, purchase any assets, or incur any expenses which exceed \$100,000.00 per occurrence.

III. Walz Energy Bank Account

The following facts about Walz Energy funds are undisputed.⁷ On February 1, 2017, Haman and Kellogg, opened a bank account at Iowa State Bank (ISB), in the name of Feeder Creek Farms LLC dba Feeder Creek Energy and started using the bank account as the Walz

⁷ Plaintiffs' SMF ¶¶ 16–17, 19–35; Defendants' Response to Plaintiffs' SMF ¶¶ 16–17, 19–35.

Energy checking account. Credits of \$9,953,587.94 were made to the ISB account. The two primary sources of funding for the ISB account were from (1) a People State Bank money transfer in the amount \$6,501,176.84, pursuant to a loan agreement with Walz Energy and (2) multiple W6 Farms checks totaling \$3,450,000.

Over an almost two year period, money was withdrawn from ISB account. The following amounts were paid to the respective individuals and entities: a total of \$39,500 to Jon Haman; \$137,500 to Haman Management Services, Haman Management, and HMS; \$30,000 to Laurie Haman, Jon Haman's spouse; \$6,000 to Bailey Kellogg, a relative of Heath Kellogg; \$77,212.85 to Tactical Beef and Tactical Beef Solutions; \$15,362.50 to North Iowa Area Community College (NIACC); \$1,109 to Perfect Game, a baseball and softball scouting service; and \$1,625 to the Clear Creek Amana Booster Club. There was also \$16,491.62 in cash withdrawals, \$12,743.54 in convenience store purchases, \$5,050.64 spent at restaurants, and \$18,166.23 at various retail stores. By June 18, 2018, the balance of the ISB account was below \$500, and since January 4, 2019, the ISB account had a zero balance. (Plaintiffs' Affidavit of Rhonda Marshall). Neither manager of Walz Energy ever provided Supreme Beef with a proposed budget for any of the aforementioned purchases. Supreme Beef never signed or agreed to a Consent Resolution or amendment to the Walz Energy Operating Agreement that authorized the aforementioned transactions. Before April 30, 2019, Haman and Kellogg did not establish books or records for the company.

ANALYSIS

I. Partial Summary Judgment Standard

Summary judgment is appropriate "if the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no

genuine issue as to any material fact and that the moving party is entitled to a judgment as a matter of law.” Iowa R. Civ. P. 1.981(3). Partial summary judgment is appropriate if there is no genuine issue of material fact on certain issues, and the moving party is entitled to judgment on those issues as a matter of law. Iowa R. Civ. P. 1.981(4); *see also Lamantia v. Sojka*, 298 N.W.2d 245, 248 (Iowa 1980).

The moving party carries the burden of proving the absence of an issue of material fact and affirmatively demonstrating that it is entitled to judgment as a matter of law. *Hallett Const. Co. v. Meister*, 713 N.W.2d 225, 229 (Iowa 2006) (citation omitted). “If reasonable minds may differ on the resolution of an issue, a genuine issue of material fact exists.” *McIlravy v. N. River Ins. Co.*, 653 N.W.2d 323, 328 (Iowa 2002) (citations omitted). “An issue of fact is ‘genuine’ if the evidence is such that a reasonable finder of fact could return a verdict or decision for the nonmoving party.” *Parish v. Jumpking, Inc.*, 719 N.W.2d 540, 543 (Iowa 2006). “A fact is material if it will affect the outcome of the suit, given the applicable law.” *Id.* However, speculation and mere allegations are not material facts. *Hlubek v. Pelecky*, 701 N.W.2d 93, 95–96 (Iowa 2005) (citations omitted).

In ruling on a motion for summary judgment, the facts must be viewed in the light most favorable to the non-moving party. *Id.* at 95. Thus, the Court “consider[s] on behalf of the nonmoving party every legitimate inference that can be reasonably deduced from the record.” *Phillips v. Covenant Clinic*, 625 N.W.2d 714, 717–18 (Iowa 2001) (citations omitted). “An inference is legitimate if it is ‘rational, reasonable, and otherwise permissible under the governing substantive law.’” *Id.* (quoting *Butler v. Hoover Nature Trail, Inc.*, 530 N.W.2d 85, 88 (Iowa Ct. App. 1994)). An inference cannot be based on mere speculation or conjecture. *Id.*

However, “summary judgment is not a dress rehearsal or practice run; ‘it is the put up or shut up moment in a lawsuit...’” *Slaughter v. Des Moines Univ. Coll. of Osteopathic Med.*, 925 N.W.2d 793, 808 (Iowa 2019) (internal citations omitted). Therefore, a nonmoving party “cannot rely on the mere assertions in his pleadings but must come forward with evidence to demonstrate that a genuine issue of fact is presented.” *Linn v. Montgomery*, 903 N.W.2d 337, 342 (Iowa 2017) (quoting *Stevens v. Iowa Newspapers, Inc.*, 728 N.W.2d 823, 827 (Iowa 2007)). If the record establishes that the “resisting party has no evidence to factually support an outcome determinative element of that party’s claim, the moving party will prevail on summary judgment.” *Wilson v. Darr*, 553 N.W.2d 579, 582 (Iowa 1996). Even where factual disputes exist, summary judgment may nevertheless be appropriate if those in dispute are not material to the resolution of the case, and the uncontroverted facts establish that the moving party is entitled to judgment in its favor. *See Linn*, 903 N.W.2d at 345–47.

II. Managers’ Authority under the Operating Agreement

Because the Plaintiffs’ claims that the Defendants breached their fiduciary duties and converted \$360,761.38 of Walz Energy funds are centered upon the Operating Agreement, the Court finds it necessary to first discuss the managers’ authority under the Operating Agreement and whether their actions are violations of the Operating Agreement.

An operating agreement is a contract. *See Iowa Code* § 489.110 (2019) (stating the scope, functions, and limitations that an operating agreement can govern for an LLC). “Generally, both contract interpretation and construction are legal issues.” *Urbandale Best, LLC v. R & R Realty Group, LLC*, No. 15-2015, 2017 WL 363239, at *4 (Iowa Ct. App. Jan. 25, 2017) (citing *Pillsbury Co., Inc. v. Wells Dairy, Inc.*, 752 N.W.2d 430, 436 (Iowa 2008)). “Because an agreement is to be interpreted as a whole, it is assumed in the first instance that no part of it is

superfluous; an interpretation which gives a reasonable, lawful, and effective meaning to all terms is preferred to an interpretation which leaves a part unreasonable, unlawful, or of no effect.” *Fashion Fabrics of Iowa, Inc. v. Retail Inv’rs Corp.*, 266 N.W.2d 22, 26 (Iowa 1978).

Furthermore, one principle of contract construction is “that when a contract contains both general and specific provisions on a particular issue, the specific provisions are controlling.” *Iowa Fuel & Minerals, Inc. v. Iowa State Bd. of Regents*, 471 N.W.2d 859, 863 (Iowa 1991).

Under section 6.4(a)(iv), the Operating Agreement provides that the managers of the company have the authority to “enter into contracts or agreements with persons for routine matters of operation, and pay from the Company’s funds the consideration required under the contracts or agreements” if a budget has been approved by unanimous consent. The Court finds that unanimous consent means that both of Walz Energy’s members, Supreme Beef and Feeder Creek Energy, would have to approve a budget. Since the site is still being built and is not operational on a daily basis, the Court finds that routine matters of operation are the matters that concern the site being built.

Under section 6.4(a)(v), the Operating Agreement provides that the managers have the authority to pay for operating expenses. Section 6.4(a)(vi) of the Operating Agreement also provides that managers have the authority to “[p]erform all other acts or activities customary or incident to the routine and day—to-day operation of a business such as that conducted by the Company.” After reviewing the aforementioned sections of the Operating Agreement, the Court finds that when it comes to managers having the authority to enter into contracts and agreement with people for routine matters of operation, section 6.4(a)(iv) is a specific and controlling provision while sections 6.4(a)(v)-(vi) are general provisions.

Therefore, the Court finds that any agreement or contract that the managers entered into for routine matters of operation in getting the site built required budget approval and unanimous consent from both Supreme Beef and Feeder Creek Energy members. Furthermore, because section 6.5(b)(iii) of the Operating Agreement provides that managers do not have the authority to enter into contracts or agreements for routine matters of operation without unanimous consent and subject to section 6.4(a)(iv), the Court also finds that any contract or agreement that was entered into by the managers for routine matters of operation without a budget approved by unanimous consent violates the Operating Agreement.

Under section 6.5(b)(viii) of the Operating Agreement, managers are not allowed to authorize or pay any salary, wage, or compensation to any member or managing members without unanimous consent. The Court finds, that as it relates to paying managing members a salary, wage, or compensation, section 6.5(b)(viii) is a specific and controlling provision while sections 6.4(a)(v)-(vi) are general provisions. Therefore the Court finds that any compensation paid to the managing members under any agreement from Walz Energy funds required unanimous consent from both Supreme Beef and Feeder Creek Energy.

A. Construction Management Agreements & Payments to Managers

The Defendants assert that expenditures to Jon Haman, Haman Management Services, Haman Management, and HMS were provided for under the construction management agreement and not for Haman and Kellogg's personal benefit.

The Court notes that the construction management agreements are between Feeder Creek and each of the managers. The construction management agreements are not between each of the managers and Walz Energy. The Defendants have not provided any reason, affidavit, or evidence as to why the construction management agreements are not between Walz Energy and each of

the managers. The Court notes that the first Operating Agreement and the construction management agreements were all executed on February 1, 2017. Even if the Operating Agreement had been amended in March 2017, there is no reason as to why the managers would not have entered into the construction management agreements on behalf of Walz Energy. It is also undisputed that Haman and Kellogg never obtained the consent of Walz Energy or the other Plaintiffs for these construction management agreements.

The Court finds that the managers' entry into and expenditures on the construction management agreements violate the Operating Agreement in two ways. First, there is no budget approved by unanimous consent, pursuant to section 6.4(a)(iv) of the Operating Agreement, which approved the expenditures under the construction management agreements. Furthermore, section 6.5(b)(iii) prohibits the managers from entering into contracts and agreement on behalf of the company and paying out on those contracts and agreements without unanimous consent. Second, pursuant to section 6.5(b)(viii), the Operating Agreement provides that managers are not allowed to authorize or pay *any* salary, wage, or compensation to *any* member or managing members without unanimous consent. Haman and Kellogg did not get unanimous consent to pay themselves compensation under the construction management agreements. Therefore, the Court finds that Haman and Kellogg entering into the construction management agreements and making expenditures from Walz Energy funds under the construction management agreements violated sections 6.5(b)(iii) and 6.5(b)(viii) of the Operating Agreement.

B. Payments to Laurie Haman, Bailey Kellogg, and Tactical Beef Solutions

At the hearing on this matter, the Defendants asserted that the payments to Laurie Haman, Bailey Kellogg, and Tactical Beef Solutions were for work on the company or the project site. However, the Defendants did not provide any affidavits from these parties as to the

nature of the work that each party performed. *See* Iowa R. Civ. P. 1.981(5). Nonetheless, out of an abundance of caution, the Court will consider the Defendants' oral assertions because a motion for summary judgment requires the Court to consider every legitimate inference on the Defendants' behalf.

The Defendants assert that the \$30,000 in total payments to Laurie Haman were for marketing services. The Court notes that on the \$10,000 check and \$7,500 check that Jon Haman wrote to Laurie Haman, each of the memo lines state "marketing consult." (Plaintiffs' Exh. 2, pp. 66, 73) While it is certainly questionable what marketing consultation and services can be provided for a project site that is still under construction, the Court finds that based on the memo line of each check, it is a legitimate inference that Laurie Haman could have provided marketing services to Walz Energy.

The Defendants also assert that the \$6000 check that Heath Kellogg wrote to Bailey Kellogg in October 2017 was for PR. The Court notes that the memo line of the check states "PR." (Plaintiffs' Exh. 2, p. 49). Once again, while it is certainly questionable what PR services can be provided for a project site that was under early construction at the time the services were provided, the Court finds that based on the memo line of the check, it is a legitimate inference that Bailey Kellogg could have provided PR services to Walz Energy.

The Defendants assert that the \$77,212.85 in total payments to Tactical Beef and Tactical Beef Solutions were for project consultations. The Court notes that the memo lines of the \$6,687.85 check, \$6,384.20 check, \$5000 checks, \$1,656.50 check each state "consult" or "consulting." (Plaintiffs' Exh. 2, pp. 26, 30, 44, 80, 85, 90). The Court finds that based on the memo lines of the checks, it is a legitimate inference that Tactical Beef provided consulting on the project.

However, even if these inferences are true as to the nature of the expenditures to Laurie Haman, Heath Kellogg, and Tactical Beef, Haman and Kellogg did not have the authority for the expenditures on these individuals and entities. Even in the absence of any affidavits from these individuals or the Defendants, the Court infers that there was some type of contract or agreement to pay them for their services. Haman and Kellogg did not get approval to enter into contracts and agreements with these individuals and entities and did not get a budget approved by unanimous consent for these expenditures pursuant to section 6.4(a)(iv) of the Operating Agreement. Additionally, Haman and Kellogg have not provided any affidavit or evidence as to how they had the authority to pay money to these individuals and entities for their alleged services. As the Court has already found, section 6.4(a)(iv) of the Operating Agreement is a specific and controlling provision over the general provisions of sections 6.5(a)(v)-(vi). Therefore, the Court finds that Haman and Kellogg's expenditures on these individuals without unanimous consent budget approval violates section 6.5(b)(iii) of the Operating Agreement.

C. Credit Card, Debit Card, and ACH Purchases, Cash Withdrawals, and Other Payments

The Defendants assert that some of the credit card purchases, debit card purchases, ACH purchases, cash withdrawals, and other payments from the ISB account may have been for business expenses and thus allowable under section 6.4(a)(vi) of the Operating Agreement. However, the Defendants have not provided any affidavits or evidence as to the nature of the purchases, payments, or cash withdrawals to support their assertions. The Plaintiffs have provided a forensic accounting report from a certified public accountant (CPA) who analyzed the ISB account and an affidavit from an ISB representative that all of the debit card transactions for the ISB account were related to Kellogg's debit card. (Plaintiffs' Exh. 5; Affidavit of Rhonda Marshall).

Because a majority of the credit card purchases, debit card purchases, ACH purchases, and cash withdrawals are for smaller monetary amounts, section 6.4(a)(vi) of the Operating Agreement is more applicable at this time to evaluate the purchases. *See* Plaintiffs' Exh.2 (providing the monetary amounts and specific locations of the purchases). After reviewing the bank records of the ISB account and the CPA's report, the Court finds that a legitimate inference can be made that *some* of these payments, purchases, and cash withdrawals were customary or incident to the routine and day-to-day business of the project site's construction. Therefore, the Court finds that a genuine issue of material fact exists as to whether Haman and Kellogg had the authority under section 6.4(a)(vi) of the Operating Agreement to make *some* of these payments, purchases, and cash withdrawals to conduct business on behalf of Walz Energy.

Under section 6.5(a)(ii) of the Operating Agreement, the managers are prohibited from possessing company property for other than a company purpose. With regards to the \$15,362.50 in total payments to NIACC, \$1,109 to Perfect Game, and \$1,625 spent on the Clear Creek Amana Booster Club, the Court finds that there is no legitimate inference that can be made on the Defendants' behalf that justifies spending company funds on a family member's community college, scouting services, and the family's booster club affiliation. These were plainly expenditures of company funds for the Defendants' personal benefit, and the Defendants do not attempt to argue otherwise. The Plaintiffs have provided evidence that a relative of Heath Kellogg attended NIACC during the period that the payments were made to NIACC for that relative's student account. The Plaintiffs have also provided evidence that the payments made to Perfect Game were for provided for the benefit of Heath Kellogg's relative. The Plaintiffs have also provided an affidavit that all of the debit card transactions for the ISB account were related to Kellogg's debit card. Furthermore, the Defendants have not provided affidavits or evidence as

to how a booster club affiliation, a family member's community college, and baseball scouting services relate to Walz Energy's cattle feeding operation and anaerobic digester business, the company's operating expenses, or are customary and incidental expenses to building the site. Therefore, the Court finds that the expenditures on the booster club, community college, and scouting services violate section 6.5(a)(ii) of the Operating Agreement.

III. Breaches of Fiduciary Duties of Loyalty and Care

The LLC manager of “a [manager]-managed limited liability company owes to the company and...the other members the fiduciary duties of loyalty and care.” Iowa Code § 489.409(1) (2019). A LLC manager's duty of loyalty includes the duty “[t]o account to the company and to hold as trustee for it any property, profit, or benefit derived by the [manager] regarding...the conduct...of the company's activities...[and] [f]rom a use by the [manager] of the company's property.” Iowa Code § 489.409(2)(a)(1)-(2) (2019). A LLC manager's duty of care encompasses acting “with the care that a person in a like position would reasonably exercise under similar circumstances and in a manner the [manager] reasonably believes to be in the best interests of the company.” Iowa Code § 489.409(3) (2019). However, the LLC's manager's duty of care is satisfied if the manager meets all of the following requirements of the business judgment rule:

- (1) The [manager] is not interested in the subject matter of the business judgment.
- (2) The [manager] is informed with respect to the subject of the business judgment to the extent the [manager] reasonably believes to be appropriate in the circumstances.
- (3) The [manager] has a rational basis for believing that the business judgment is in the best interests of the limited liability company.

Iowa Code § 489.409(7)(a)(1)-(3) (2019).

In the present case, the Plaintiffs assert that Haman and Kellogg, as managing members of Walz Energy, breached their fiduciary duties of loyalty and care to Walz Energy and Supreme

Beef. The Plaintiffs asserts that Haman and Kellogg's breach occurred in the following ways: (1) by paying themselves a salary, wages, or compensation; (2) by using Walz Energy funds to pay for various personal expenses; (3) depositing Walz Energy funds into a bank account for another company instead of setting up a bank account for Walz Energy; (4) failing to account for the company's money.

The Defendants assert the same arguments for why they did not commit conversion as to why they did not breach their fiduciary duties.⁸ The Defendants also imply that they did not breach their fiduciary duty of care because the business judgment rule applies to their actions. Additionally, the Defendants assert that they have always wanted the company to be successful.

A. Duty to Account for Walz Energy's Expenditures

A LLC manager's duty of loyalty includes the duty "[t]o account to the company and to hold as trustee for it any property, profit, or benefit derived by the [manager] regarding...the conduct...of the company's activities..." Iowa Code § 489.409(2)(a)(1) (2019). Under section 6.4(a)(vii) of the Operating Agreement, the managers have the authority to establish and maintain books and records for Walz Energy. While section 6.4(a)(vii) of the Operating Agreement does not explicitly state that the managers *have to* establish and maintain books and records, section 489.409(2)(a)(1) of the Iowa Code does say that the managers *have to* account to the company for the conduct of the company's activities. The Court finds that section 6.4(a)(vii) of the Operating Agreement gave Haman and Kellogg the authority to do what section 489.409(2)(a)(1) of the Iowa Code required them to do as managers of Walz Energy.

Haman and Kellogg have admitted that prior to April 30, 2019, they did not establish books or records for the company because the cattle feeding operation was not operational. The assertion that the construction of a multi-million dollar cattle feeding operation does not

⁸ See Section IV (describing the Defendants' assertions as to why they did not commit conversion).

constitute the conducting of company business, and thus no books, records, or accounting needed to be provided until the facility was operational, is patently absurd.

The Court finds that Haman and Kellogg, as managers of Walz Energy, had an obligation to keep an accounting of the company's money. The Court also finds that Haman and Kellogg's duty to account for the Walz Energy funds started in February 2017, when the first deposit was placed into the account. Furthermore, the Court finds that Haman and Kellogg's failure to account for Walz Energy funds when they were conducting company business, making payments, and withdrawing money from the ISB account on a regular basis constitutes a violation of their duty of loyalty pursuant to section 489.409(2)(a)(1) of the Iowa Code.

B. Duty to Act as Trustee of Walz Energy Property from Improper Use

A LLC manager's duty of loyalty also includes the duty "[t]o hold as trustee for it any property, profit, or benefit derived by the [manager]...from a use by the [manager] of the company's property." Iowa Code § 489.409(2)(a)(2) (2019). The Court finds this requirement of the duty of loyalty to mean that a LLC manager's responsibility as a trustee of the company's property, profits, and other benefits also includes the responsibility to prevent other managers, including themselves, from improperly using the company's property. The Court finds that the best way to determine whether the defendants have improperly used Walz Energy funds is to determine whether the expenditures violate the Operating Agreement. The Court finds that looking to the Operating Agreement is appropriate in determining whether the Defendants' expenditures are considered improper because section 489.409(4) of the Iowa Code requires that a manager discharge their duties under the operating agreement. Iowa Code § 489.409(4) (2019); *see Urbandale Best, LLC*, 2017 WL 363239, at *4–5 (determining whether the managing

members' breached their fiduciary duties by looking to the provisions of the operating agreement).

Money is property, and Haman and Kellogg each had a duty to act as trustee of the \$9,953,587.94 credited into the ISB account and to make sure that it was not improperly used. As the Court has already found, Haman and Kellogg violated the Operating Agreement when they spent money from the ISB account on payments to Jon Haman, Haman Management Service, Haman Management, HMS, Laurie Haman, Bailey Kellogg, and Tactical Beef, without having the expenditures approved through a unanimous budget. Therefore, any money that was spent from the ISB account without the required unanimous budget approval was improperly used.

The Court has also already found that they violated the Operating Agreement by paying themselves compensation even though the Operating Agreement prohibits managers from receiving compensation. Therefore, payments that were made from the ISB account to Haman and Kellogg are another improper use of the company's property. The Court has further already found that payments to the booster club, community college, and scouting service are violations of the Operating Agreement because those expenditures were not for a company purpose. Therefore, these expenditures are also an improper use of the company's property.

Even if the Court were to take the Defendants' assertion as true that some of the expenditures from the ISB account were for a company purpose, there are expenditures in the account that were clearly not for a company purpose and violated the Operating Agreement. The Court finds that Haman and Kellogg had a duty to Walz Energy and its members to prevent each other from improperly using the company's funds and to not misuse the funds themselves. In sum, the Court finds that Haman and Kellogg's misuse of Walz Energy funds and failure to

prevent each other from misusing the company's funds constitutes a violation of their duty of loyalty pursuant to section 489.409(2)(a)(2) of the Iowa Code.

C. Duty of Care and the Business Judgment Rule

A LLC manager's duty of care encompasses acting "with the care that a person in a like position would reasonably exercise under similar circumstances and in a manner the [manager] reasonably believes to be in the best interests of the company." Iowa Code § 489.409(3) (2019). In exercising the duty of care, a LLC manager "may rely in good faith upon opinions, reports, statements, or other information provided by another person that the [manager] reasonably believes is a competent and reliable source for the information." *Id.*

A LLC's manager's duty of care is satisfied if the manager meets all of the following requirements of the business judgment rule:

- (1) The [manager] is not interested in the subject matter of the business judgment.
- (2) The [manager] is informed with respect to the subject of the business judgment to the extent the [manager] reasonably believes to be appropriate in the circumstances.
- (3) The [manager] has a rational basis for believing that the business judgment is in the best interests of the limited liability company.

Iowa Code § 489.409(7)(a)(1)-(3) (2019). "A person challenging the business judgment of a [manager] has the burden of proving a breach of the duty of care, and in a damage action, the burden of proving that the breach was the legal cause of damage suffered by the limited liability company." Iowa Code § 489.409(7)(b) (2019).

The Court has already addressed the nature of the Operating Agreement, construction management agreements, and the payments to Laurie Haman, Bailey Kellogg, and Tactical Beef. The tone of the Defendants assertions is that the payments to Laurie Haman, Jon Haman, Haman Management Services, and Bailey Kellogg may have been for business purposes. The Defendants have also cited to the business judgment rule. However, the Defendants have not

provided any affidavits or evidence to support these contentions. The Court also finds it to be a beyond reasonable interpretation of the law that violations of the Operating Agreement are subject to the business judgment rule because the Operating Agreement literally has provisions for how the managers can make business decisions.⁹ Therefore, the Court finds that the business judgment rules does not apply to the payments made to Laurie Haman, Bailey Kellogg, and Tactical Beef.

Jon Haman is definitively an interested party to the payments made to himself, Haman Management Services, Haman Management, HMS, and other payments relating to his construction management agreement. On multiple occasions, Jon Haman signed these checks and endorsed eight of the checks. (Plaintiffs' SMF ¶ 23). Therefore, the Court finds that the business judgment rule does not apply to Haman as it relates to any payments relating to his construction management agreement, himself, Haman Management Services, Haman Management, or HMS.

Payments in the total of \$15,362.50 to NIACC, \$1,109 to Perfect Game, and \$1,625 to Clear Creek Amana Booster Club were made from the ISB account. The Plaintiffs have provided evidence that a relative of Heath Kellogg attended NIACC during the period that the payments were made to NIACC for that relative's student account. The Plaintiffs have also provided evidence that the payments made to Perfect Game were for provided for the benefit of Heath Kellogg's relative. As the Court has previously stated, Defendants have not provided affidavits or evidence as to how a booster club affiliation, a family member's community college, and baseball scouting services relate to Walz Energy's cattle feeding operation and anaerobic digester business, the company's operating expenses, or are customary and incidental expenses

⁹ See Article VI of the Operating Agreement (providing how Walz Energy is supposed to be managed and how business affairs are to be handled).

to building the site. Furthermore, neither Haman nor Kellogg has provided evidence as to how these expenditures were made in sound business judgment and in the best interests of Walz Energy. Heath Kellogg signed one check to Perfect Game and multiple checks to NIACC; however, the payment to the Clear Creek Amana Booster Club and the remaining payments to NIACC and Perfect Game were made electronically from the ISB account. (Plaintiffs' Exh. 2). For these specific electronic transactions, the Court finds it unnecessary to determine who specifically made the expenditures because both managers had access to the account and no reasonable manager would believe these expenditures to be appropriate or in the best interest of the company.¹⁰ Therefore, the Court finds that the business judgment rule does not apply to Haman or Kellogg as it relates to these expenditures.

The Court finds that reasonable LLC managers in like positions to Haman and Kellogg would not have continually exercised a blatant disregard for the company's Operating Agreement, spent company funds on a booster club, community college, and a scouting service, or paid themselves from company funds when it was expressly prohibited. Furthermore, the Court finds that LLC managers in like positions to Haman and Kellogg would not have believed that these expenditures were in the best interest of the company. Therefore, the Court finds that Haman and Kellogg violated the duty of care pursuant to section 489.409(3) of the Iowa Code.

D. Conclusion

For the reasons set forth above, the Court finds that there are no material issues of fact in dispute as to whether Haman and Kellogg breached their fiduciary duties. Accordingly, the Court finds that the Plaintiffs' Motion for Summary Judgment on Count III should be granted.

IV. Conversion of Walz Energy Funds

¹⁰ These were likely part of the debit card transactions that were attributed to the ISB account and related to Kellogg's debit card. (Plaintiffs' Affidavit of Rhonda Marshall).

Conversion is “the [intentional] wrongful control or dominion over another’s property contrary to that person’s possessory right to the property. The wrongful control must amount to a serious interference with the other person’s right to control the property.” *Condon Auto Sales & Serv., Inc. v. Crick*, 604 N.W.2d 587, 593 (Iowa 1999). “[T]o establish a conversion claim, the plaintiff must establish a possessory interest in the property.” *Blackford v. Prairie Meadows Racetrack and Casino, Inc.*, 778 N.W.2d 184, 188 (Iowa 2010). “[M]oney can be the subject of conversion if the specific money in question can be identified.” *Sheeder v. Jamison*, No. 15-1120, 2016 WL 5408340, at *3 (Iowa Ct. App. Sept. 28, 2016) (quoting *Allen v. Gordon*, 429 So.2d 369, 371 (Fla. Dist. Ct. App. 1983)).

If the wrongful control is a serious interference, “the actor may justly be required to pay the other the full value of the property.” *Kendall/Hunt Pub. Co. v. Rowe*, 424 N.W.2d 235, 247 (Iowa 1988). A Court can consider the following factors in determining the seriousness of an actor’s interference:

- (a) the extent and duration of the actor’s exercise of dominion or control;
- (b) the actor’s intent to assert a right in fact inconsistent with the other’s right of control;
- (c) the actor’s good faith;
- (d) the extent and duration of the resulting interference with the other’s right of control;
- (e) the harm done to the chattel;
- (f) the inconvenience and expense caused to the other.

Id. (citing Restatement (Second) of Torts § 222A(2) (1965)).

However, “[n]o conversion may be found where the exercise of control was not wrongful, as, for example, where the property was rightfully in the possession of the defendant... or where the plaintiff expressly or implicitly consented to the interference.” *Larson v. Great West Cas. Co.*, 482 N.W.2d 170, 173 (Iowa Ct. App. 1992). Even if the property is rightfully in the defendant’s possession, conversion still exists if the defendant uses the property “in an unauthorized manner.” *State v. Hollinrake*, 608 N.W.2d 806, 808 (Iowa Ct. App. 2000).

In the present case, the Plaintiffs assert that Haman and Kellogg converted \$360,761.38 from the ISB account by intentionally writing checks and using debit cards and credit cards for unauthorized expenditures. The Plaintiffs further assert that Haman and Kellogg's conduct was a serious interference with Supreme Beef's possessory rights in the Walz Energy funds for the following reasons: (1) Haman and Kellogg's wrongful control lasted over a year and interfered with the ability to use that money for the construction and operation of the company; (2) Haman and Kellogg's failure to keep financial records, present a budget to Supreme Beef for expenditures, file taxes for the company, and depositing the money into a bank account with the Feeder Creek name indicates Haman and Kellogg's lack of good faith and intent to assert a right inconsistent with Supreme Beef's right.

The Defendants assert six reasons as to why they did not convert \$360,761.38 of Walz Energy funds. First, they assert, without providing affidavits from Haman or Kellogg, that there are genuine issues of material fact as to whether Haman and Kellogg intentionally used the funds for their own personal use. Second, they assert that expenditures on Haman Management Service were provided for under the construction management agreement and not for Haman and Kellogg's personal benefit. Third, they assert that the construction management agreement shows that the Defendants acted in good faith and had no intent to assert a right inconsistent with Supreme Beef's possessory right. Fourth, the Defendants assert that section 6.4(a)(vi) of the Operating Agreement gave the Haman and Kellogg, as the managers, the authority to spend some of the money because some of the expenditures were for Walz Energy expenses. Fifth, the Defendants assert that Feeder Creek Group and Feeder Creek Development capital contribution of \$337,902.07 show that there was no conversion or serious interference. Sixth, the Defendants assert that any diverted funds were repaid through the capital contribution.

The Plaintiffs have an established possessory interest in the Walz Energy money because \$9,953,587.94 that was placed into the ISB account by the Plaintiffs was for the benefit of Walz Energy. Furthermore, the Plaintiffs have sufficiently identified \$360,761.38 that was spent out of the ISB account that is the subject of the conversion.

The analysis of Haman and Kellogg's authority to control the funds at issue, their intent to assert a right inconsistent with Supreme Beef's right of control, and their good faith in making the expenditures lies within the Operating Agreement. As the Court previously stated, section 6.4(a)(iv) of the Operating Agreement provides that a budget has to be approved by unanimous consent of the members before the managers can enter into contracts and agreements. Section 6.5(b)(iii) of the Operating Agreement provides that managers do not have the authority to enter into contracts or agreements for routine matters of operation without unanimous consent and subject to section 6.4(a)(iv). Section 6.5(b)(viii) of the Operating Agreement prohibits compensation to managers unless the members unanimously consent. Furthermore, the Court has already found that section 6.4(a)(iv), which requires contracts and agreements to be approved by unanimous consent through a budget is the controlling provision, to sections 6.5(a)(v)-(vi). Also, the title of section 6.4 is entitled "Authority and Powers of Managing Member," and the title of section 6.5 is entitled "Restrictions on Authority of Managing Member." Accordingly, the Court finds that the Operating Agreement provided the manner in which the funds were to be managed.

The money was in the rightful control of Haman and Kellogg because they were the managing members of Walz Energy. However, there are no material issues of fact in dispute about the fact that Haman and Kellogg used the funds from the ISB account in an unauthorized manner on a multitude of occasions. The Court has already found that the following expenditures from the ISB account to the following parties or entities were violations of the Operating

Agreement: Jon Haman, Haman Management Service, Haman Management, HMS, Laurie Haman, Bailey Kellogg, Tactical Beef, NIACC, Perfect Game, and the Clear Creek Amana Booster Club.¹¹ The Court finds that the expenditures on Jon Haman, Haman Management Service, Haman Management, HMS, Laurie Haman, Bailey Kellogg, and Tactical Beef show Haman and Kellogg's intent to assert a right in fact inconsistent with the Supreme Beef's right of control because they were not unanimously approved through a budget or consent resolution. The Court further finds that the expenditures on NIACC, Perfect Game, and Clear Creek Amana Booster Club show Haman and Kellogg's intent to assert a right in fact inconsistent with Supreme Beef's right of control because the funds were not used for a company purpose.

The Court has already found that a legitimate inference can be made that *some* of the credit card purchases, debit card purchases, ACH purchases, and cash withdrawals were customary or incident to the routine and day-to-day business of the project site's construction thereby making the expenditures permissible under section 6.4(a)(vi) of the Operating Agreement. The total amount of these expenditures is \$52,452.03.

Haman and Kellogg do not dispute that they never presented Supreme Beef with a proposed budget that accounted for the \$360,761.38 in expenditures from the ISB account. At the hearing on this matter, but without any supporting affidavit, the Defendants asserted that the Plaintiffs never asked for a budget on the \$360,761.38 expenditures from the ISB account. However, the Plaintiffs failure to ask for a budget does not mean that the Plaintiffs implicitly consented to Haman and Kellogg spending Walz Energy funds in the manner that occurred. As managers for Walz Energy, it was the responsibility of Haman and Kellogg to prepare a budget for the expenditures and present it to the Plaintiffs so that it could be unanimously approved. It is undisputed that Supreme Beef's consent was not obtained.

¹¹ See Section II (providing explanations as to why these expenditures were violations of the Operating Agreement).

Haman and Kellogg assert they have a desire to see Walz Energy succeed and have put a lot of effort into the company. Even if this assertion is true, it does not negate that the Defendants used Walz Energy funds in an unauthorized manner. The Court finds that the Defendants disregard for and violations of the Operating Agreement, spending Walz Energy funds on things that had nothing to do with company, and setting up the bank account in the name of Feeder Creek instead of Walz Energy show the Defendants' lack of good faith.

The Defendants submitted the affidavit of Scott England indicating that Feeder Creek Group and Feeder Creek Development paid certain Walz Energy expenses to show that they were acting in good faith. It is by no means clear that some of the expenses, such as the payment to Live Oak Bank, were for Walz Energy. However, even if these payments were for Walz Energy, they would have to be made during the period of conversion to negate the serious interference. Feeder Creek Group and Feeder Creek Development started paying the alleged Walz Energy expenses in September 2018, which was six months after the duration of the conversion ended. Therefore, the Court finds that Feeder Creek Group and Feeder Creek Development's payments of alleged Walz Energy expenses six months after the conversion ended, and after the money ran out, do not demonstrate that Defendants were acting in good faith during the time of the conversion.

The Defendants assert that Feeder Creek Group and Feeder Creek Development's payments of Walz Energy expenses demonstrates that the duration of control over the funds was limited. The Defendants' usage of the funds in unauthorized manner started on February 3, 2017, when Haman and Kellogg wrote a check to Haman Management Services. (Plaintiffs' Exh. 2, p. 93). The conversion ended on March 10, 2018 when Haman wrote a check to Tactical Beef Solutions. *Id.* at 26. Therefore, Court finds that the duration of using \$308,309.35 of Walz

Energy funds in an unauthorized manner lasted from February 2017 to March 2018, a period of fifteen months. Furthermore, the Court finds that the Defendants' unauthorized spending of \$308,309.35 in Walz Energy funds in an unauthorized manner for a period of fifteen months is not a limited amount of time.

The Defendants assert that Feeder Creek Group and Feeder Creek Development's \$337,902.07 in payments of alleged Walz Energy expenses show that limited harm was done to Walz Energy and Supreme Beef. On the contrary, the Court finds that great harm was done. At the end of March 2018, the ISB account's ending balance was \$4,795.03, and by September 2018, when Feeder Creek Group and Feeder Creek Development started paying what Defendants allege were Walz Energy expenses, the ISB account had a balance of \$269.15. (Plaintiffs' Exh. 2, pp. 11, 24). If it had not been for the Defendants using \$308,309.35 in Walz Energy funds in an unauthorized manner, Walz Energy would have been able to cover a significant amount of the expenses that the Feeder Creek Group and Feeder Creek Development's payments allegedly covered. The Court finds that Feeder Creek Group and Feeder Creek Development's payments of the company's expenses are evidence that great harm was done to Walz Energy.

The Iowa Court of Appeals has previously stated that "[i]t is not an excuse to the tort of conversion to assert that the amount improperly withheld was small in comparison to the total amount that was properly acquired." *Sheeder*, 2016 WL 5408340, at *3 (citing *Mau v. Rice Bros.*, 249 N.W. 206, 208 (Iowa 1933)). The Court finds this is analogous to several of the Defendants' contentions about Feeder Creek Group and Feeder Creek Development's payments of Walz Energy's alleged expenses and that they have a desire to see Walz Energy succeed. A desire to see Walz Energy succeed and making contributions after the conversion ended do not negate and are not excuses for using Walz Energy funds in an unauthorized manner. The Court

further finds that as managers for Walz Energy they had a responsibility to not use the funds in unauthorized manner.

In sum, the Court finds that while Haman and Kellogg were in lawful possession of the funds in the ISB account, Haman and Kellogg used \$308,309.35 from the ISB account in an unauthorized manner. Accordingly, the Court finds that the Defendants converted \$308,309.35 and that the conversion amounts to a serious interference with Supreme Beef's possessory interest in the property.

For the reasons set forth above, the Court finds that there are no material issues of fact in dispute as to whether Haman and Kellogg converted \$308,309.35 and that the Plaintiffs' Motion for Summary Judgment on Count I should be granted.

V. Damages

When conversion is serious interference, "the actor may justly be required to pay the other the full value of the property." *Kendall/Hunt Pub. Co.*, 424 N.W.2d at 247. The Court has already found that the Defendants converted \$308,309.35 in company funds and that it amounted to a serious interference. The Plaintiffs assert that the Court should enter a charging order in the amount of the converted funds. At the hearing on this motion, the Defendants asserted that Feeder Creek Group and Feeder Creek Development's \$337,902.07 in payments of Walz Energy expenses offset the converted funds.

A. Feeder Creek Group and Feeder Creek Development Payments

Generally, "mitigation principles are applicable in conversion actions." *Welke v. City of Davenport*, 309 N.W.2d 450, 453 (Iowa 1981). The Defendants assert that Feeder Creek Group and Feeder Creek Development's payments of Walz Energy expenses served as repayment for

the funds that Haman and Kellogg converted. The Court notes several things about the capital contributions and Live Oak financing.

First, a discrepancy exists as to the amount of Feeder Creek Group's payment to Live Oak Bank. According to Suren Ajjarapu, the wire transfer on behalf of Feeder Creek Group to Live Oak Bank was for \$183,750. (Defendants' Affidavit of Suren Ajjarapu, pp. 1–4). However, according to Scott England, Feeder Creek Group paid \$187,000 to Live Oak Bank. (Defendants' Affidavit of Scott England, Exh. A). Therefore, the total amount of the payment to Live Oak Bank is undetermined.

Second, under section 6.4(a)(ii), the Operating Agreement provides that the managers of the company have the authority to “borrow money and procure temporary, permanent, conventional, or other financing or refinancing on such terms and conditions, at such rates, and from such parties as are approved” if a budget has been approved by unanimous consent. Furthermore, section 6.5(b)(ii) of the Operating Agreement prohibits the managers from borrowing money or procuring financing for the company unless it is approved by unanimous consent. Supreme Beef never approved the Live Oak Bank financing.

Without more information as to the nature of the Live Oak Bank financing, the actual amount that was advanced for the Live Oak Bank financing, and any amounts that the Defendants previously owed to Walz Energy, the Court is unable to determine whether the money related the Live Oak Bank Financing should count towards a repayment or setoff of the converted funds. Therefore, the issue of whether the Defendants are entitled to any credit for the payment to Live Oak Bank is unresolved.

Third, Feeder Creek Group by assignment from Feeder Creek Energy is the member of Walz Energy and not Feeder Creek Development. Additionally, the Defendants have not

provided evidence as to why the money was not deposited into the ISB account or that the expenditures would have been permitted under the Operating Agreement. Evidence of the true nature of Feeder Creek Development's relationship to Walz Energy, why the money was not deposited back into the ISB account, and whether the expenses were solely for Walz Energy business needs to be provided to the Court before the Court can determine whether the payment of Walz Energy expenses should serve as repayment for the converted funds.¹²

In sum, until the Defendants provide more evidence as to the exact amounts allegedly advanced on behalf of Walz Energy, how those expenditures were related to Walz Energy business, whether those expenditures would be permitted under the Operating Agreement, and whether or not the repayment amount would be affected by the Live Oak Bank financing, the Court cannot determine whether or not the money advanced should count towards a repayment of the converted funds.

B. Charging Order

A charging order is "a lien on a judgment debtor's transferable interest and requires the limited liability company to pay over to the person to which the charging order was issued any distribution that would otherwise be paid to the judgment debtor." Iowa Code § 489.503(1) (2019). A charging order "provide[s] a judgment creditor with the ability to satisfy a judgment from the judgment debtor's transferable interest in a LLC while simultaneously allowing the LLC to protect its other members' interests and continue operating." *Wells Fargo Equip. Fin., Inc. v. Retterath*, 928 N.W.2d 1, 7 (Iowa 2019).

A judgment creditor of a LLC member can apply to have a court enter a charging order against the member for the unsatisfied amount of the judgment. Iowa Code § 489.503(1) (2019).

¹² The list of expenses, for which Feeder Creek Group and Feeder Creek Development paid, provides the date, amount, and description of the expenses, but it does not state how these expenditures relate to Walz Energy. (Defendants' Affidavit of Scott England, Exh. A).

Under a charging order, “[t]he transfer of a transferable interest does not cause a member’s disassociation or the dissolution or winding up of the LLC’s activities.” *DuTrac Cmty. Credit Union v. Hefel*, 893 N.W.2d 282, 293 (Iowa 2017) (citing Iowa Code § 489.502(1) (2017)).

Accordingly, “[w]hen the transfer of a transferable interest occurs, the transferor... ‘retains the rights of a member other than the interest in distributions transferred and retains all duties and obligations of a member.’” *Id.* (quoting Iowa Code § 489.502(7) (2017)).

In the present case, the Plaintiffs ask the court to enter a charging order against the Defendants to satisfy the amount that the Defendants owe for the converted funds. The Defendants assert that a charging order is inequitable, unnecessary, and should only be issued if the Defendants are unable to pay a money judgment to the Plaintiffs.

The Court finds that the issuance of a charging order is not appropriate at this time for a number of reasons. First, the Plaintiffs have not shown that the Defendants have an inability to pay a money judgment that would be awarded to the Plaintiffs. The Plaintiffs need to show that the Defendants have an inability to pay the money judgment because section 489.503 of the Iowa Code contemplates a party’s ability to pay. Specifically, section 489.503(4) of the Iowa Code states the following:

4. At any time before foreclosure [of the lien], the member or transferee whose transferable interest is subject to a charging order under subsection 1 *may extinguish the charging order by satisfying the judgment* and filing a certified copy of the satisfaction with the court that issued the charging order.

Iowa Code § 489.503(4) (2019) (emphasis added). The Court finds this provision to mean that a charging order can be satisfied if the party can pay the money judgment. Therefore, the issuance of a charging order before giving the Defendants an opportunity to pay the judgment would be premature and a waste of judicial resources if the Defendants readily have the ability to pay a money judgment.

Second, the issuance of a charging order depends on the transferable interest of the Defendants and the unpaid amount of the judgment. Under section 7.1 of the Operating Agreement, on January 1st of every year from 2018 to 2025, Feeder Creek Energy is required to transfer 12 membership units to Walz Energy who then transfers twelve membership units to Supreme Beef. However, the Court has insufficient information with which to determine if this has been done. Therefore, the Court is unable to determine what transferable interest the Defendants currently have in Walz Energy.

Third, it is the Court's understanding that the Walz Energy project is not operational. There is certainly insufficient information with which to ascertain the company's current value without further evidence. It certainly cannot be done based off of the summary judgment record alone. The true value of Walz Energy at this time remains undetermined. Without the current value of Walz Energy, the Court would be unable to determine the amount of the Defendants' transferable interest that would be subject to a charging order.

Fourth, the Plaintiffs have made multiple allegations against the Defendants, which if proven, could result in additional monetary damages being awarded to the Plaintiffs. At this early stage of the proceedings, the Court is reluctant to issue a charging order when multiple monetary damage awards could be awarded and necessitate the issuance of more charging orders. While the Court does acknowledge that there is no specific Iowa statute or case law that expressly limits the number of charging orders that can be issued, the Court finds it to be imprudent to start issuing what could be the first of multiple charging orders without more information.

C. Conclusion

The Court finds that judgment should be entered in the amount of \$308,309.35 without prejudice to the Plaintiffs' right to seek such additional damages as proved by the evidence at trial. The Court further finds that a charging order would be premature at this time.

VI. Dissociation from Walz Energy

A person can be dissociated as a member of a LLC when the company applies to the court to expel a member. Iowa Code § 489.602(5) (2019). A court can expel a member by judicial order if the person has done any of the following:

- a. Has engaged, or is engaging, in wrongful conduct that has adversely and materially affected, or will adversely and materially affect, the company's activities.
- b. Has willfully or persistently committed, or is willfully and persistently committing, a material breach of the operating agreement or the person's duties or obligations under section 489.409 [of the Iowa Code].
- c. Has engaged in, or is engaging in, conduct relating to the company's activities which makes it not reasonably practicable to carry on the activities with the person as a member.

Iowa Code § 489.602(5)(a)-(c) (2019).

In addition to upholding the fiduciary duties of loyalty and care, “[a manager] in...a manager-managed limited liability company shall discharge the duties...under the operating agreement and exercise any rights consistently with the contractual obligation of good faith and fair dealing.” Iowa Code §489.409(4) (2019). Accordingly, a violation of a company's operating agreement can be considered conduct that adversely and materially affects a LLC's activities.

Batinich v. Renander, No. 15-2053, 2017 WL 1086220, at *7 (Iowa Ct. App. Mar. 22, 2017).

Iowa case law also supports the dissociation of a member, when a member materially breaches the operating agreement and breaches their fiduciary duties to the company. *Id.* When a person or entity is dissociated as a LLC member, the following apply:

- a. The person's [or entity's] right to participate as a member in the management and conduct of the company's activities terminates.
- b. If the company is member-managed, the person's fiduciary duties as a member end with regard to matters arising and events occurring after the person's dissociation.

- c. Subject to section 489.504 [of the Iowa Code] and article 10, any transferable interest owned by the person [or entity] immediately before dissociation in the person's [or entity's] capacity as a member is owned by the person [or entity] solely as a transferee.
2. A person's [or entity's] dissociation as a member of a limited liability company does not of itself discharge the person [or entity] from any debt, obligation, or other liability to the company or the other members which the person [or entity] incurred while a member.

Iowa Code § 489.603(1)-(2) (2019).

In the present case, Supreme Beef applied for Feeder Creek Group to be dissociated from Walz Energy in Count VI of the petition for this action and requested it as a remedy for Haman Kellogg's breaches of their fiduciary duties. The Defendants assert that dissociating them from Walz Energy would be inequitable because they have put two years of work into the project site and allege that the appraised value of the site is greater than the liens. However the value of the site in its current state or even in the future once it is completed is disputed.

While Haman and Kellogg provided no affidavits detailing their work on the project, the Court will assume they in fact provided significant work towards the project. However, the Court cannot ignore the multiple breaches of fiduciary duties and conversion committed by Haman and Kellogg. The Court also notes that Haman and Kellogg have already been removed as managers of Walz Energy and replaced by a receiver.

The Court finds that the dissociation of Feeder Creek Group and Feeder Creek related entities from Walz Energy is appropriate. The Court further finds that a desire to see the company succeed and the amount of work that the Defendants put into the company does not excuse, negate, or outweigh violating the Operating Agreement, breaching fiduciary duties, or converting company funds.

In conclusion, the Court finds that the dissociation of Feeder Creek Group and any Feeder Creek related entity is appropriate. Kellogg and Haman engaged in conduct that adversely and materially affected Walz Energy. They also materially breached the Operating Agreement in

multiple ways and their duties and obligations under section 489.409 of the Iowa Code by breaching their duties of loyalty and care. The Operating Agreement provided Haman and Kellogg the means to manage Walz Energy properly, and instead of using it, they violated it and the law.

RULING

For all of the above-stated reasons, it is the ruling of the Court that the Plaintiffs' Motion for Partial Summary Judgment on Count I and Count III should be and hereby is GRANTED.

IT IS THEREFORE ORDERED that judgment is entered in favor of the Plaintiffs and against the Defendants in the amount of \$308,309.35 without prejudice to the Plaintiffs' right to seek such additional damages as proved by the evidence at trial.

IT IS FURTHER ORDERED that the Plaintiffs' request for a charging order should be and hereby is DENIED at this time because such an order would be premature.

IT IS FURTHER ORDERED that Feeder Creek Group and any Feeder Creek related entity should be and hereby is dissociated from Walz Energy, LLC pursuant to section 489.602(5) of the Iowa Code.

IT IS FURTHER ORDERED that the any and all transferable interest owned by Feeder Creek Group or any Feeder Creek related entity is now solely owned by Feeder Creek Group or any Feeder Creek related entity as a transferee pursuant to section 489.603 of the Iowa Code.



State of Iowa Courts

Type: OTHER ORDER

Case Number EQCV010637
Case Title MICHAEL WALZ ET AL VS FEEDER CREEK ET AL/BUSINESS
SPEC COURT

So Ordered



John Telleen, District Court Judge,
Seventh Judicial District of Iowa