Real Property and Business Litigation Report

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Manuel Farach

U.S. Bank N. A. v. Village at Lakeridge, LLC, Case No. 15–1509 (2018).
A bankruptcy court's determination of a mixed question of law and fact (such as who is a non-statutory "insider" under the Bankruptcy Code) is reviewed under a "clear" error and not a *de novo* standard of review.

Heyward v. Wells Fargo Bank, N.A., Case No. 2D16-339 (Fla. 2d DCA 2018).
The successor national bank from a merger becomes the owner of the assets of the target bank under 12 U.S.C. § 215a(e).

Ferk Family, LP v. Frank, Case No. 3D16-448 (Fla. 3d DCA 2018).
The Third District re-affirms *Dinuro Investments, LLC v. Camacho*, 141 So. 3d 731 (Fla. 3d DCA 2014), and holds that a direct (as opposed to derivative) action may be brought by one member of a LLC against another member if "(1) there is a direct harm to the shareholder or members such that the alleged injury does not flow subsequently from an initial harm to the company and (2) there is a special injury to the shareholder or member that is separate and distinct from those sustained by the other shareholders or members," or as in this case, the operating or shareholder's agreement provides for such action.

Hemingway Villa Condominium Owners Association, Inc. v. Wells Fargo Bank, N.A., Case No. 3D17-926 (Fla. 3d DCA 2018).
The Third District adopts *Beltway Capital, LLC v. Greens COA, Inc.*, 153 So. 3d 330 (Fla. 5th DCA 2014), and holds that a "first mortgagee" for the purposes of the Safe Harbor provision regarding association fees "is simply one who holds the first mortgage, whether that be the original lender or a subsequent holder."

Niagara Industries, Inc. v. Giaquinto Electric LLC, Case No. 4D17-1473 (Fla. 4th DCA 2018).
On rehearing, the Fourth District re-affirms trade secrets are protected by Florida Statute section 90.506, and that a trial court must engage in a two-step analysis before requiring that trade secrets be disclosed: 1) determine whether the information is truly a trade secret, and 2) shift the burden to the party requesting disclosure to demonstrate that disclosure is reasonably necessary.

Meyrowitz v. Andrew M. Schwartz, P.A., Case No. 4D17-1983 (Fla. 4th DCA 2018).
The "tried on the following docket" exception to Florida Rule of Civil Procedure 1.442's requirement that a Proposal for Settlement is timely only if made 45 days before the beginning of the trial docket or the date of trial, whichever is earlier, is if all parties know the case is to be tried on a following docket.

Deutsche Bank Trust Company Americas v. Merced, Case No. 5D16-3486 (Fla. 5th DCA 2018).
Proof of contractual authority to testify is not required for a witness to lay the predicate to testify under the Business Records Exception to the Hearsay Rule because a witness may testify to matters within his or her personal knowledge.

IN THE DISTRICT COURT OF APPEAL OF THE STATE OF FLORIDA
FIFTH DISTRICT

NOT FINAL UNTIL TIME EXPIRES TO
FILE MOTION FOR REHEARING AND
DISPOSITION THEREOF IF FILED

DEUTSCHE BANK TRUST COMPANY
AMERICAS, AS TRUSTEE FOR RESIDENTIAL
ACCREDIT LOANS, INC., MORTGAGE
ASSET BACKED PASS-THROUGH
CERTIFICATES SERIES 2007-QS11,

Appellant,

v. Case No. 5D16-3486

CARLOS MERCED, JR.
and ALETHEA MERCED,

Appellees.
_____/

Opinion filed March 2, 2018

Appeal from the Circuit Court for
Brevard County,
John Dean Moxley, Jr., Senior
Judge.

William L. Grimsley and N. Mark New ll, of McGlinchey Stafford, Jacksonville, and Jennifer M. Chapkin of McGlinchey Stafford, Fort Lauderdale, for Appellant.

Mark P. Stopa, of Stopa Law Firm, Tampa, for Appellees.

COHEN, C.J.,

Deutsche Bank Trust Company Americas, as Trustee for Residential Accredit Loans, Inc., Mortgage Asset Backed Pass-Through Certificates Series 2007-QS11 ("Deutsche Bank"), appeals a final judgment of involuntary dismissal entered in favor of Carlos Merced, Jr. and Alethea Merced. We reverse and remand for a new trial.

In 2015, Deutsche Bank filed a complaint seeking to foreclose the Merceds' residential mortgage. Before trial, the court entered a partial summary judgment finding that Deutsche Bank had standing to foreclose, and that ruling has not been challenged on appeal. The court held a non-jury trial on the remaining issues of compliance with conditions precedent and the amount due and owing on the note.

At trial, Deutsche Bank presented Dorothy Thomas as a witness. Thomas is a corporate representative of PNC Bank, National Association S/B/M to National City Mortgage, a division of National City Bank ("PNC"), the servicer of the subject loan. Thomas testified that she had worked as a senior default litigation specialist for PNC since 2009. She also testified that she had worked in the same position at a division of National City Bank since 1992. National City was the original servicer and merged with PNC in 2009.

Thomas testified that she was familiar with the Merceds' mortgage account based on her review of the payment history, correspondence such as PNC's demand letter to the Merceds, system notes, and copies of the note, mortgage, and assignments that were contained in PNC's system of record. She testified to the programs PNC used to maintain records and that the records in the system were true and accurate copies of what was scanned into PNC's system.

Deutsche Bank then moved to enter a series of business record exhibits into evidence, including a limited power of attorney and a copy of a loan modification document. Thomas testified to recognizing and personally reviewing all of the proposed documents, her familiarity with PNC's and National City's policies and procedures regarding the documents, that the documents were created near or at the time of the

respective event by a person with knowledge, and to PNC's duty to maintain the documents truthfully and accurately in its regular course of business. The Merceds stipulated to the entry of several of the documents into evidence but moved to exclude the power of attorney for lack of foundation. The court excluded the power of attorney, finding that it did not qualify for the business records exception to hearsay.

The Merceds then moved to strike Thomas as a witness based on the exclusion of the power of attorney, arguing that she lacked contractual authority to appear on behalf of Deutsche Bank. The court agreed and struck Thomas as a witness. Therefore, Deutsche Bank was unable to enter several business records into evidence, including a copy of the loan modification document. Ultimately, the trial court granted the Merceds' motion for involuntary dismissal based on the absence of the loan modification document, concluding that it was unable to calculate the amount due and owing. This appeal followed.

The dispositive issue on appeal is that the trial court abused its discretion in striking Thomas as a witness based on the exclusion of the power of attorney. Proof of contractual authority to testify is not required for a witness to lay the foundation for the business records exception to hearsay because a witness may testify to matters within his or her personal knowledge. See U.S. Bank Nat'l Ass'n v. Clarke, 192 So. 3d 620, 621 n.1 (Fla. 4th DCA 2016). Section 90.803(6), Florida Statutes, provides that business records may be "shown by the testimony of the custodian or other qualified witness" and does not impose the requirement that such individuals be contractually authorized to so testify.[1]

[1] Although the power of attorney was excluded, it was irrelevant to Thomas's ability to testify on behalf of PNC. The excluded power of attorney would be relevant to the issue of PNC's standing to foreclose as servicer of the loan. See Russell v. Aurora Loan Servs.,

Thomas was a qualified witness, and the court abused its discretion in striking her testimony. Under the business records exception, a party must present the business record via one of the following: "(1) testimony of the records custodian or other qualified witness, pursuant to section 90.803(6)(a), Florida Statutes; (2) stipulation; or (3) certification or declaration . . . . [T]he authenticating witness need not be 'the person who actually prepared the business records.'" Nationstar Mortg., LLC. v. Berdecia, 169 So. 3d 209, 213 (Fla. 5th DCA 2015) (citations omitted). The party must then establish that "(1) the record was made at or near the time of the event; (2) was made by or from information transmitted by a person with knowledge; (3) was kept in the ordinary course of a regularly conducted business activity; and (4) that it was a regular practice of that business to make such a record." Id. at 212–13 (citing Yisrael v. State, 993 So. 2d 952, 956 (Fla. 2008)).

Thomas testified that she had worked as a senior default litigation specialist for National City and PNC for twenty-four years, that she was familiar with National City and PNC's policies and procedures with respect to servicing loans, and that PNC was the servicer of the loan at issue. She also testified that she was familiar with the Merceds' mortgage account, the documents in their account were created near or at the time of the occurrence of the event by a person with knowledge, PNC had a duty to maintain those documents truthfully and accurately, and PNC kept the documents in its regular course of business. Thus, Thomas's testimony demonstrated sufficient personal knowledge of PNC's business relationship with Deutsche Bank and PNC's record-keeping system to

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163 So. 3d 639 (Fla. 2d DCA 2015) (finding that power of attorney by which trustee that owned mortgage loan granted limited powers to current loan servicer was insufficient to establish that prior loan servicer, and therefore current loan servicer, had standing to foreclose at the time it filed the foreclosure action). Here, however, PNC was not the party attempting to foreclose.

lay the foundation for Deutsche Bank's business records, including the dispositive copy of the loan modification document. Cf. Bank of N.Y. v. Calloway, 157 So. 3d 1064 (Fla. 4th DCA 2015) (finding that mortgagee's witness laid a proper foundation to admit mortgagor's payment history under the business records hearsay exception based on her "demonstrated knowledge of the accuracy of the records").

We decline the Merceds' invitation to treat the error in excluding Thomas as harmless. The effect of the court striking Deutsche Bank's sole witness was to deny it the right to introduce dispositive evidence. See Dobson v. U.S. Bank Nat'l Ass'n, 217 So. 3d 1173, 1174 (Fla. 5th DCA 2017) (explaining that the due process right to be heard includes the right "to introduce evidence at a meaningful time and in a meaningful manner," as well as the right "to testify and call witnesses on [a party's] behalf" (citations omitted)). Accordingly, we reverse and remand for a new trial.

REVERSED AND REMANDED.

SAWAYA and BERGER, JJ., concur.

Third District Court of Appeal

State of Florida

Opinion filed February 28, 2018.
Not final until disposition of timely filed motion for rehearing.

No. 3D16-448
Lower Tribunal No. 13-24371

Ferk Family, LP,
Appellant,

vs.

Gail Frank, etc., et al.,
Appellees.

An Appeal from the Circuit Court for Miami-Dade County, John W. Thornton, Jr., Judge.

Robin Bresky and Jonathan Mann (Boca Raton), for appellant.

Mark, Migdal & Hayden, LLC, and Donald J. Hayden and Lara O'Donnell Grillo, for appellees.

Before SALTER, EMAS and LOGUE, JJ.

EMAS, J.

I. INTRODUCTION

Ferk Family, LP (defendant and counter/third-party plaintiff below) appeals two final summary judgment orders entered in favor of Gail Frank, COJO Holdings, Swastic Srihari Kaveeshwar, Joe Mitchell and the Estate of Walter Frank (plaintiffs and counter/third-party defendants below). For the reasons that follow, we affirm in part and reverse in part.

II. FACTS AND PROCEDURAL HISTORY

a. The Creation and Operation of Med-Rite

Med-Rite Laboratories, LLC ("Med-Rite" or "the Company") was formed in April 2010 for the purpose of manufacturing, marketing and selling a medical device to treat hemorrhoids, which was developed by Frank Melendez. Melendez partnered with Larry Ferk and Ted Morgan to find investors for the startup, and successfully obtained investments from, *inter alia*, Gail and Walter Frank, a married couple. The original Members of the Company were Alex Melendez,[1] Gail Frank, Larry Ferk, Swastic Srihari Kaveeshwar ("Swastic Srihari") and Ted Morgan.

Early on, there were serious disagreements between the Members over issues related to financing, the location of the device's manufacturing plant,[2] and

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[1] Alex Melendez is Frank Melendez's son, and obtained his shares in exchange for Frank's contribution of the patent, existing inventory and equipment.

[2] At the time, the manufacturing plant was in Medellin, Colombia, but the Franks

termination of key personnel. In July 2011, the members agreed to raise at least $1 million in capital, which they were able to secure with a capital investment of $1 million from Joe Mitchell at the end of 2011.[3]

b. The Relevant Provisions of the Operating Agreement

On January 16, 2012, an Amended and Restated Limited Liability Company Operating Agreement (the "Operating Agreement") was executed. At the time of this Operating Agreement, the Members were: Larry Ferk, Gail Frank, Mas-Rite, LLC, Alternative Technologies International, Inc., Swastic Srihari, and Joe and Connie Mitchell. The Operating Agreement identified the managers in section 5.1 as: Larry Ferk, Gail Frank, Walter Frank, Joe Mitchell and Ted Morgan.

Under the terms of the Operating Agreement:

- A Manager may be removed at any time from the Board of Management, including for "Cause" (as defined below) as determined by the Members holding a Majority in Interest. . . . In the event of the death, incapacity, removal or resignation of any of the Managers, a successor Manager shall be selected by the Members holding a Majority of the Interests. For purposes of Article V, "Cause" shall mean fraud, willful misconduct, gross negligence, breach of fiduciary duty or other gross misconduct by a Manager with respect to a material matter relating to the affairs of the Company. § 5.1(e), Operating Agreement.

- A "Majority in Interest" is defined as "the affirmative vote of the Members holding greater than 60% of the Percentage Interests or the affirmative vote

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sought to move the plant to Texas.

[3] There were also negotiations with another potential investor, GreenHill Ventures, but the Franks and Joe Mitchell were concerned that the GreenHill Ventures deal would dilute their shares, and therefore, the negotiations never came to fruition.

or presence of greater than 60% of the Managers." § 1.1, Operating Agreement.

- Any Member may loan Med-Rite an aggregate of $500,000 with approval of a Majority of the Board of Management. § 3.1(c), Operating Agreement.

- A Member may not transfer his interest in the company, with certain exceptions, without the prior written consent of the Members holding a majority-in-interest. Any such transfer is void and shall not bind the company. § 9.1, Operating Agreement.

- In the event any Member wants to transfer his interest, the Member shall notify the company and the other Members in writing, offering to sell the interest to the company or the other Members pro-rata. § 9.3(a), Operating Agreement.

Shortly after the Operating Agreement was executed, Ted Morgan resigned from the management board and the other Members bought him out.

c. The Member Interests in Med-Rite

Following Ted Morgan's resignation and the buyout of his interest in the Company, and during the relevant time periods thereafter, the Member interests in Med-Rite were as follows:

	MEMBER	MANAGER	% INTEREST
Ferk Family, LP (Larry Ferk)	√	√	26.49%
Gail Frank	√	√	28.99%
COJO Holdings (Joe Mitchell)	√	√	24.90%
Mas-Rite, LLC (Alex/Frank Melendez)	√		16.21%
Swastic Srihari	√		3.41%
Walter Frank		√	0%

The remaining members continued to have problems. On June 26, 2012, Ferk sent an email to Gail Frank, stating that he refused to continue working with Swastic Srihari. On June 28, 2012, Walter Frank wrote to Larry Ferk to inform him that he was being terminated for cause from the board of management, pursuant to section 5.1(e) of the Operating Agreement.

d. The Transfer of Interest in *Mas-Rite* to Ferk Family

Shortly thereafter, on July 17, 2012, Mas-Rite, LLC ("Mas-Rite") transferred Alex Melendez's majority interest in Mas-Rite to Ferk Family, which, as a practical matter, resulted in a transfer of Mas-Rite's voting interest in Med-Rite to Ferk Family.

e. The Litigation

On August 1, 2012, Ferk Family filed a member derivative action on behalf of Med-Rite against Gail and Walter Frank and Joe Mitchell, alleging a breach of fiduciary duty, and seeking to inspect records. The trial court appointed Herbert Stettin to conduct an independent investigation, and Mr. Stettin issued a report, finding it was not in the best interest of the company for the derivative action to proceed. Thereafter, the trial court dismissed the derivative action.

During the discovery process it came to light that Ferk Family had purchased a majority interest in Mas-Rite, giving it voting rights in Med-Rite. However, because the Operating Agreement prohibits the transfer of interest in

Med-Rite without the consent of the other members, and also requires compliance with a right-of-first-offer clause, Gail Frank, along with COJO Holdings (Joe Mitchell) and Swastic Srihari filed suit against Ferk Family, Mas-Rite and Alex Melendez, seeking declaratory relief and damages for breach of contract and specific performance. The complaint was later amended, and the operative Second Amended Complaint added claims for breach of implied covenant of good faith and fair dealing.

Ferk Family answered, asserted affirmative defenses, counterclaimed, and asserted third-party claims against Joe Mitchell and Walter Frank, claiming Larry Ferk was wrongfully removed as a manager in violation of the Operating Agreement, depriving Ferk Family and other minority members of their voice in the operation and management of Med-Rite, as well as virtually destroying their investment and equity interest in the company. In addition, it was alleged that Gail and Walter Frank had loaned more than the permissible amount for loans by members, in violation of the Operating Agreement. Counts were alleged against the counter-defendants and the third-party defendants, collectively, for breach of fiduciary duty, two counts of breach of contract, and two counts of breach of implied covenant of good faith and fair dealing.

Gail Frank, COJO Holdings, Joe Mitchell, Swastic Srihari and the Estate of Walter Frank[4] moved for summary judgment on their Second Amended Complaint,

and on Ferk Family's counterclaim and third-party claims. Ferk Family also moved for summary judgment on the Second Amended Complaint. The court denied the motions for summary judgment.

Thereafter, Counts One and Two of the Second Amended Complaint for declaratory judgment were withdrawn, and all parties later agreed to submit the summary judgment papers and existing record for the trial court's final determination in lieu of a trial on the remaining claims of the Second Amended Complaint.

The court conducted a bench trial on the counterclaims and third party claims, following which it entered an order in favor of counter/third-party defendants Gail Frank, COJO Holdings, Joe Mitchell, Swastic Srihari and the Estate of Walter Frank.

f. The Orders on Appeal

On January 28, 2016, the trial court entered two orders: (1) granting final summary judgment in favor of Gail Frank, COJO Holdings and Swastic Srihari on the remaining claims in their Second Amended Complaint; and (2) entering judgment in favor of counter/third-party defendants Gail Frank, COJO Holdings, Joe Mitchell, Swastic Srihari and the Estate of Walter Frank on Ferk Family's counterclaims/third-party claims.

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[4] Walter Frank passed away during the pendency of the proceedings.

g. The Issues on Appeal

On appeal, Ferk Family asserts, *inter alia*, the trial court:

1. Erred in granting summary judgment on the Second Amended Complaint upon a determination that Melendez's transfer of his interest in Mas-Rite was void because it violated the Right of First Offer Provision of the Operating Agreement;

2. Incorrectly construed the Operating Agreement, resulting in an erroneous finding for counter/third-party defendants on Ferk Family's claim for improper removal of Larry Ferk as manager;

3. Incorrectly found Ferk Family's claims were derivative, where the claims fell within the exception for claims based on a special contractual or statutory duty.

4. Improperly concluded that the business judgment rule applied and protected Med-Rite's officers and managers, because the Operating Agreement excluded application of the business judgment rule and because, as a matter of law, the business judgment rule did not apply to Gail Frank or Joe Mitchell.

5. Erred in finding Ferk Family failed to establish a viable damage model.

III. ANALYSIS

a. Did the trial court err in granting summary judgment in favor of plaintiffs on their Second Amended Complaint?

At the time summary judgment was granted by the court, the only counts which remained in the operative Second Amended Complaint were Count III (breach of contract); Count IV (breach of implied covenant of good faith and fair

dealing); and Count V (specific performance). All three of these claims related to Melendez's transfer of his majority interest in Mas-Rite to Ferk Family, which resulted in giving Ferk Family Mas-Rite's 16.21% interest in Med-Rite (in addition to the 26.49% interest Ferk Family already had in Med-Rite). The breach of contract claim alleged that Ferk Family materially breached the Operating Agreement, which prohibited the transfer of such interest absent "prior written consent of the Members holding a Majority-in-Interest of the Interests;" and which required the tendering of a Right of First Offer Notice to plaintiffs before the transfer of Mas-Rite's interest to Ferk Family.

These same allegations were made in the breach of implied covenant count, and both the breach of contract and breach of implied covenant counts sought damages. The specific performance count sought for the defendants to accept the plaintiffs' election to purchase Mas-Rite's interest in Med-Rite, and asserted that "money damages alone would be an inadequate remedy to compensate Plaintiffs for Defendants' material breaches of the Operating Agreement."

Defendant Ferk Family contended below, and on appeal, that Med-Rite's Operating Agreement restricts only a transfer of interests in Med-Rite, and therefore, had no effect on Melendez's transfer of his interest in Mas-Rite to Ferk Family. We agree.

In its summary judgment order, the trial court determined that the transfer provisions of the Operating Agreement in section nine applied and controlled, and therefore the attempted transfer of Mas-Rite's interests in Med-Rite to Ferk Family was void because Mas-Rite failed to comply with the provisions. The court also concluded that the Operating Agreement's Right of First Offer applied and Gail Frank and the other plaintiffs were entitled to specific performance.

We review the court's determinations on summary judgment de novo, Volusia Cty. v. Aberdeen at Ormond Beach, L.P., 760 So. 2d 126, 130 (Fla. 2000), and conclude that the trial court erred in its determination that the plaintiffs below were entitled to summary judgment on their claims for breach of contract, breach of fiduciary duty, and specific performance.

Article IX of the Operating Agreement provides:

TRANSFERS OF INTERESTS OF MEMBERS

9.1 General Provisions.

(a) Except as otherwise set forth in this Agreement or as otherwise provided in the Act, a Member[5] may not Transfer[6] his, her or its Interest in the Company without the prior written consent of the Members holding a Majority-in-Interest[7] of the Interests[8] (which

[5] The term "Member" or "Members" is defined as "the persons and/or entities whose names appear on Exhibit A annexed hereto." Exhibit A identifies Larry Ferk, Gail Frank, Mas-Rite, LLC, Alternative Technologies International, Inc., Swastic Kaveeshwar Srihari, and Joe and Connie Mitchell.

[6] The term "Transfer" is defined as "the mortgage, pledge, transfer, sale, assignment, gift or other disposition, in whole or in part, of an Interest, whether voluntarily, by operation of law or otherwise."

consent to any Transfer may be withheld without any liability or accountability to any Person). Notwithstanding anything to the contrary in this Agreement, any Transfer of an Interest (a) in violation of the provisions of this Agreement . . . shall be void and shall not bind the Company.

(b) Notwithstanding anything in this Agreement to the contrary:

. . .

(ii) A Member that is a legal entity may Transfer all of its interest to any Affiliate.[9]

. . .

(c) Any Member making or permitting a Transfer allowed pursuant to any of the above permitted Transfers must send immediate written notice thereof to the Board of Management together with reasonable evidence that the conditions or restrictions applicable thereto as set forth above have been complied with. . . .

9.2 General Conditions to Permitted Transfers.

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[7] The term "Majority-in-Interest" is defined as "the affirmative vote of the Members holding greater than 60% of the Percentage Interests or the affirmative vote or presence of greater than 60% of the Managers."

[8] The term "Interest" is defined as "the ownership interest of a Member in the Company as reflected on Exhibit A annexed hereto, as the same may, from time to time, be required to be amended."

[9] The term "Affiliate" is defined as "a Person that directly or indirectly through, one or more intermediaries, controls or is controlled by, or is under common control with the Person specified. For this purpose "control" of a Person means that power (whether or not exercised) to direct the policies, operations or activities of such Person by or through ownership of, or right to vote, or to direct the manner of voting of such Person, or pursuant to law, or agreement or otherwise. No Member shall be deemed to be an Affiliate of another Member by virtue of this Agreement or their respective ownership of Interests in the Company." The term "Person" includes "an individual, corporation, partnership, limited liability company, trust, unincorporated organization, association or other entity."

> (a) No Transfer of an Interest permitted by the terms of this Agreement shall be effective unless:
>
> (i) such Transfer shall have satisfied the provisions of Section 9.1;
>
> . . .
>
> **<u>9.3 Right of First Offer.</u>**
>
> (a) Subject to Section 9.1(a) above, in the event that any Member desires to Transfer all or part of his, her or its Interests to an un-Affiliated third party (the "Offered Interests"), such Member (the "Selling Member") shall notify the Company and the other Members in writing of his, her, or its desire to effect such a Transfer and of the terms and conditions upon which such Selling Member would be willing to effect such a proposed Transfer (the "Right of First Offer Notice"). The Selling Member shall not be required to have obtained an un-Affiliated third party offer in this instance. The Right of First Offer Notice from the Selling Member to the Company and the other Members shall include a written offer to sell the Offered Interests to the Company or the other Members, pro-rata based on their relative Percentage Interests, at the price and on the terms and conditions specified in the Right of First Offer Notice.
>
> . . .

It is undisputed that neither Melendez nor Mas-Rite complied with the Notice, Consent, or Right of First Offer provisions in the Operating Agreement. It is also undisputed that Mas-Rite's only asset was its 16.21% interest in Med-Rite, and that, by this transfer between Melendez and Ferk Family, Ferk Family obtained Mas-Rite's voting rights in Med-Rite. Importantly, Mas-Rite (the "Member"), retained its interest in Med-Rite.

Under the plain language of the Med-Rite Operating Agreement, Mas-Rite (a "Member") could not transfer its ownership interest in Med-Rite without prior written consent and without providing the requisite notice. However, the issue presented in this case is whether Melendez, who is not identified in the Operating Agreement as a "Member," violated the terms of the Operating Agreement by transferring his majority interest in Mas-Rite without following the dictates of the Med-Rite Operating Agreement.

Under well-established principles of contract interpretation, the clear and unambiguous terms of an agreement should be given their plain meaning and enforced accordingly. Hahamovitch v. Hahamovitch, 174 So. 3d 983 (Fla. 2015); Crawford v. Baker, 64 So. 3d 1246 (Fla. 2011); Sheen v. Lyon, 485 So. 2d 422 (Fla. 1986); Idearc Media Corp. v. M.R. Friedman and G.A. Friedman, P.A., 985 So. 2d 1159 (Fla. 3d DCA 2008); Anthony v. Anthony, 949 So. 2d 226 (Fla. 3d DCA 2007); BAC Intern. Credit Corp. v. Macia, 626 So. 2d 1037 (Fla. 3d DCA 1993). We conclude that Melendez was not required to comply with the Operating Agreement before transferring his own interest in Mas-Rite to the Ferk Family. He did not transfer Mas-Rite's interest in Med-Rite, and thus, the provisions of section nine in the Operating Agreement were never triggered. In finding otherwise, the trial court erred. Accordingly, we reverse and remand with instructions to enter

judgment in favor of Ferk Family on Counts III, IV, and V of the operative complaint.

b. <u>Did the trial court err in entering judgment against Ferk Family on its counterclaim/third-party claims?</u>

The claims raised by Ferk Family and Mas-Rite in their counterclaim and third-party claim against Gail Frank, Swastic Srihari, COJO Holdings, Joe Mitchell and the Estate of Walter Frank included: (I) breach of fiduciary duty arising out of the operation of Med-Rite and decision-making relative to said operation; (II) breach of contract, arising out of its reorganization and material changes to Med-Rite's business; (III) breach of implied covenant of good faith and fair dealing; (IV) breach of contract, arising out of the improper termination of Ferk from his position on the board of management and unauthorized loans to Med-Rite by Gail Ferk (alleged by Ferk Family only); and (V) breach of implied covenant of good faith and fair dealing (alleged by Ferk Family only).

Gail Frank, Swastic Srihari, COJO Holdings, Joe Mitchell and the Estate of Walter Frank contended that the counterclaims were derivative, not direct; were not viable under the business judgment rule; and that Ferk Family failed to establish a breach of the Operating Agreement, or a breach of the implied covenant of good faith and fair dealing as a matter of law. Following a bench trial, the trial court determined, *inter alia*:

1. Counter/third-party defendants did not breach the Operating Agreement in their removal of Larry Ferk as a manager;

2. Ferk Family and Mas-Rite's claims were solely derivative and could not be maintained as direct actions.

3. Florida's business judgment rule shielded counter/third-party defendants from liability;

4. Ferk Family and Mas-Rite failed to establish a breach of loyalty and care, and counter/third-party defendants exercised their business judgment in all relevant aspects; and

5. Ferk Family and Mas-Rite failed to establish the existence of damages arising from any alleged breach and failed to present a viable damage model.

We review the trial court's factual findings to determine whether there is competent substantial evidence to support those findings, and review the trial court's legal conclusions and contract interpretations de novo. Telemundo Media, LLC v. Mintz, 194 So. 3d 434, 435 (Fla. 3d DCA 2016); Pages v. Seliman-Tapia, 134 So. 3d 536, 538 (Fla. 3d DCA 2014).

1. The removal of Larry Ferk from the Board of Management

Ferk Family asserts on appeal that the trial court erred in its construction of the terms of the Operating Agreement with regard to Larry Ferk's removal from the Board of Management. Ferk Family contends that, under the terms of the Operating Agreement, a Manager cannot be removed from the Board unless 60% of the Members determine that the Manager should be removed. We agree with Ferk Family's interpretation of the Operating Agreement.

It is undisputed that at the time of Ferk's removal on June 28, 2012, the Members of Med-Rite were: Gail Frank, Ferk Family, COJO Holdings, Mas-Rite, and Swastic Srahiri. The Managers at that time were: Larry Ferk, Gail Frank, Walter Frank and Joe Mitchell. The letter terminating Larry Ferk was signed by Gail Frank, Walter Frank, and Joe Mitchell: 75% of the Managers, but the only "Member" who signed the letter was Gail Frank, who held a 28.99% interest in the Company. The sole issue then is whether the Operating Agreement authorized Ferk's removal by a determination of 75% of the Managers alone.

Article V, Section 5.1(e) of the Operating Agreement covers removal of a Manager:

> **Removals; Vacancies**. A Manager may be removed at any time from the Board of Management, including for "Cause" (as defined below) as determined by the Members holding a Majority in Interest. . . . For purposes of Article V, "Cause" shall mean fraud, willful misconduct, gross negligence, breach of fiduciary duty or other gross misconduct by a Manager with respect to a material matter relating to the affairs of the Company.

As discussed above, the term "Members" is defined as those "persons and/or entities whose names appear on Exhibit A:" Gail Frank, Ferk Family, COJO Holdings, Mas-Rite and Swastic Srahiri. However, the term "Majority-in-Interest" is defined as "the affirmative vote of the Members holding greater than 60% of the Percentage Interests **or the affirmative vote or presence of greater than 60% of the Managers.**" (Emphasis added).

The trial court construed this provision of the Operating Agreement to authorize the removal of Ferk (a Manager) for "Cause" as determined by **either** the Members holding greater than 60% of the Percentage Interest or the Members holding the "affirmative vote or presence of greater than 60% of the Managers."

We hold that the trial court erred in its construction of this portion of the Operating Agreement. Article I, section 1.1, the Definitions section of the Operating Agreement provides: "Unless otherwise expressly provided herein or **unless the context clearly requires otherwise**, the following terms as used in this Agreement shall have the following meanings:" (emphasis added). The definition of "Majority in Interest" is clearly one such instance which, when viewed in context, would allow for only one interpretation as it relates to removal of a Manager. The Agreement cannot be read to allow the removal of a Manager by the "affirmative vote or presence of greater than 60% of the Managers," because section 5.1(e) plainly authorizes removal only "by the **Members** holding a Majority in Interest."

This point is further illustrated, and placed in proper context, when one looks to other provisions of the Agreement, such as section 5.1(d), which deals with voting and quorums, and provides: "A quorum for the transaction of meetings of the Board of Management shall consist of a Majority-in-Interest of the

Managers present in person." In that context, it would make sense that "Majority-in-Interest" means more than 60% of the Managers.

By way of another example, section 5.2(a), which sets forth the authority of the Board of Management, provides: "Except with the consent of the Members holding a Majority-in-Interest of the Interests, the Board of Management shall not: (i) Enter into a merger, consolidation, recapitalization or other reorganization of the Company or a sale of all or substantially all of the Company's assets. . . ." If we employed the trial court's interpretation, 60% of the Managers (as the trial court would define "Members holding a Majority-in-Interest") could take action, such as selling substantially all of the Company's assets, without consent of 60% of the Members. This would render the limitations on the Board's authority completely meaningless because a majority of the Managers could take any action they saw fit, including actions which under the Operating Agreement are reserved solely to the Members with a Majority-in-Interest.

Accordingly, the trial court erroneously determined that there was no breach of contract arising out of Ferk's removal.[10] We conclude that, under the terms of the Operating Agreement, this determination was required to be made by the Members who collectively held at least a 60% interest in the company. The termination letter was signed by only one member – Gail Frank, whose interest

[10] We note that Ferk has not challenged the "for cause" determination itself.

was 28.99%. And even if we attribute COJO Holding's 24.90% membership interest to Joe Mitchell (COJO Holding's president), this nevertheless fails to reach the requisite 60%.[11]

2. The determination that Ferk Family's and Mas-Rite's claims were solely derivative and could not be maintained as direct actions

Even if this conduct constituted a breach of contract, we must still determine whether affirmance is nonetheless warranted due to the trial court's additional finding that Ferk Family's claims were derivative, and therefore, not cognizable in Florida. Generally, although a shareholder may bring a derivative action on behalf of an injured corporation, a shareholder may only bring a direct action individually under certain limited circumstances.

In Dinuro Investments, LLC v. Camacho, 141 So. 3d 731 (Fla. 3d DCA 2014), this court analyzed Florida law with regard to whether a member of an LLC has standing to bring an action individually against other members of the LLC (as opposed to bringing a derivative action on behalf of the company). We held that such "an action may be brought directly only if (1) there is a direct harm to the shareholder or members such that the alleged injury does not flow subsequently from an initial harm to the company **and** (2) there is a special injury to the shareholder or member that is separate and distinct from those sustained by the

[11] Walter Frank, the third signatory to the termination letter, had 0% interest in the company at the time of Ferk's termination.

other shareholders or members. Id. at 739-40 (citing Citizens Nat'l Bank of St. Petersburg v. Peters, 175 So. 2d 54, 56 (Fla. 2d DCA 1965)). However, Camacho also held that there is an exception to this rule under Florida law: "A shareholder or member need not satisfy this two-prong test when there is a separate duty owed by the defendant(s) to the individual plaintiff under contractual or statutory mandates." Camacho, 141 So. 3d at 740.

Ferk Family asserts that its claims against the counter/third-party defendants were authorized under Florida law because not only was there the requisite direct harm and special injury to Ferk Family but, in addition, its claims qualified for the exception because under the Operating Agreement, Members are expressly permitted to bring suit against one another directly for breach of its provisions, and further, the Members owed Ferk Family a statutory duty under section 608.4225(1), as alleged by Ferk Family in its count for breach of the duty of loyalty and due care.

Section 11.12 of the Agreement provides:

> **Additional Remedies.** The rights and remedies of the Members shall not be mutually exclusive. The respective rights and obligations hereunder shall be enforceable by specific performance, injunction or other equitable remedy, but ***nothing herein contained is intended to, nor shall it limit or affect, any other rights in equity or any rights at law or by statute or otherwise of any Member aggrieved as against the other Members, for breach or threatened breach of any provision thereof,*** it being the intention of this Section to make clear the

> agreement of the Members that their obligations hereunder shall be enforceable in equity as well as at law or otherwise.

(Emphasis added in bold italics).

In Camacho, 141 So. 3d at 742, which held that the plaintiff's claims should have been brought as a derivative action, this court specifically noted that "[c]onspicuously missing from the operating agreement is any provision stating that the members shall be directly liable to each other for breaches of the terms of the operating agreement." For that reason, we held that the shareholder in that case could not bring its direct action.

However, in the present case, the Operating Agreement unequivocally provides that Members who are aggrieved by other Members may bring direct claims for breach of the provisions of the Operating Agreement.

Interestingly, the Camacho opinion cited to section 608.4227(1), Florida Statutes (2011) for the proposition that "members are typically shielded from individual liability for their involvement with an LLC unless the terms of the articles of incorporation or the operating agreement provide otherwise." However, shortly after the Camacho opinion was released, section 608.4227 was repealed, and in its place, effective January 1, 2015, was Florida's Revised Limited Liability Company Act (Chapter 605).

This provisions of the Revised LLC Act apply to the instant case. Specifically, section 605.0801, Florida Statutes (2016), titled "Direct action by member," provides:

> (1) Subject to subsection (2), a member may maintain a direct action against another member, a manager, or the limited liability company to enforce the member's rights and otherwise protect the member's interests, including rights and interests under the operating agreement of this chapter or arising independently of the membership relationship.
>
> (2) A member maintaining a direct action under this section must plead and prove an actual or threatened injury that is not solely the result of an injury suffered or threatened to be suffered by the limited liability company.

It might appear at first blush that this statute eliminated the exception, recognized by this court in Camacho, and instead requires the member to plead and prove both direct harm and special injury. However, upon considering section 605.0105, relating to LLC operating agreements, it is clear that the exception recognized in Camacho remains viable:

> (1) **Except as otherwise provided in subsections (3) and (4), the operating agreement governs the following**:
> (a) **Relations among the members as members** and between the members and the limited liability company.
> (b) The rights and duties under this chapter of a person in the capacity of manager.
> (c) The activities and affairs of the company and the conduct of those activities and affairs.

(d) The means and conditions for amending the operating agreement.
(2) **To the extent <u>the operating agreement does not otherwise</u> provide for a matter described in subsection (1), this chapter governs the matter.**
(3) **An operating agreement may not do any of the following**:
(a) **Vary a limited liability company's capacity under s. 605.0109 to sue and be sued in its own name**.
(b) Vary the law applicable under s. 605.0104.
(c) Vary the requirement, procedure, or other provision of this chapter pertaining to:
1. Registered agents; or
2. The department, including provisions pertaining to records authorized or required to be delivered to the department for filing under this chapter.
(d) Vary the provisions of s. 605.0204.
(e) Eliminate the duty of loyalty or the duty of care under s. 605.04091, except as otherwise provided in subsection (4).
(f) Eliminate the obligation of good faith and fair dealing under s. 605.04091, but the operating agreement may prescribe the standards by which the performance of the obligation is to be measured if the standards are not manifestly unreasonable.
(g) Relieve or exonerate a person from liability for conduct involving bad faith, willful or intentional misconduct, or a knowing violation of law.
(h) Unreasonably restrict the duties and rights stated in s. 605.0410, but the operating agreement may impose reasonable restrictions on the availability and use of information obtained under that section and may define appropriate remedies, including liquidated damages, for a breach of a reasonable restriction on use.
(i) Vary the grounds for dissolution specified in s. 605.0702.

> (j) Vary the requirement to wind up the company's business, activities, and affairs as specified in s. 605.0709(1), (2)(a), and (5).
> (k) **Unreasonably restrict the right of a member to maintain an action under ss. 605.0801-605.0806.**
>
> (Emphasis added).

Under section 605.0105(2), the statute governs only where the operating agreement does not otherwise provide for that matter and, under subsection (3)(a), although an operating agreement may not vary an LLC's capacity to sue or be sued, there is no similar provision regarding a member's right to sue under the operating agreement. Further, under subsection (3)(k), an operating agreement may not unreasonably restrict such right of action. Thus, the plain language of the statute clearly provides that a member may still bring a direct action against another member where the operating agreement so provides, and thus, the exception under Camacho remains applicable under Florida law.

Both this court and the Fourth District have continued to follow Camacho and recognize the existence of an exception. See Demir v. Schollmeier, 199 So. 3d 442 (Fla. 3d DCA 2016) (continuing to apply Camacho but finding that the exception did not apply in that case); Strazzulla v. Riverside Banking Co., 175 So. 3d 879 (Fla. 4th DCA 2015). See also Fritz v. Fritz, 219 So. 3d 234 (Fla. 3d DCA 2017) (recognizing, though not applicable to the instant case, the existence of the

exception in a partnership case where section 620.2001(2) (partnership law) is similar to the Revised LLC Act).

Accordingly, we find merit in Ferk Family's arguments and hold that, under Florida law, it met the exception to the rule against bringing direct claims, and was therefore not required to satisfy the two-prong direct harm/special injury test.[12]

3. Application of the Business Judgment Rule

Notwithstanding our determinations (favorable to Ferk Family) regarding the construction of the Operating Agreement and Ferk Family's ability to bring a direct claim, we affirm the final judgment against Ferk Family on its counterclaim and third-party claim, because the trial court correctly determined that all of the claims brought by Ferk Family (including the claim arising out of Larry Ferk's removal as manager) were barred by the business judgment rule.[13]

The business judgment rule, codified in section 608.4228, Florida Statutes (2012)[14] provides:

> (1) A manager or a managing member shall not be personally liable for monetary damages to the limited

[12] We therefore need not reach the additional argument, made by Ferk Family, that it alleged and established a direct harm and special injury.

[13] Ferk Family sought only money damages in connection with its claim arising out of Larry Ferk's wrongful removal. Ferk Family did not seek equitable relief, such as returning Larry Ferk to his position on the management board. Therefore, and as discussed below, the business judgment rule applies.

[14] The statute has since been renumbered to section 605.04093, Florida Statutes (2016), but there is no meaningful difference in the relevant portions of the two statutes.

liability company, its members, or any other person for any statement, vote, decision, or failure to act regarding management or policy decisions by a manager or a managing member unless:

(a) The manager or managing member breached or failed to perform the duties as a manager or managing member; and

(b) The manager's or managing member's breach of, or failure to perform, those duties constitutes any of the following:

1. A violation of the criminal law, unless the manager or managing member had a reasonable cause to believe his or her conduct was lawful or had no reasonable cause to believe such conduct was unlawful. A judgment or other final adjudication against a manager or managing member in any criminal proceeding for a violation of the criminal law estops that manager or managing member from contesting the fact that such breach, or failure to perform, constitutes a violation of the criminal law, but does not estop the manager or managing member from establishing that he or she had reasonable cause to believe that his or her conduct was lawful or had no reasonable cause to believe that such conduct was unlawful.

2. A transaction from which the manager or managing member derived an improper personal benefit, either directly or indirectly.

3. A distribution in violation of s. 608.426

4. In a proceeding by or in the right of the limited liability company to procure a judgment in its favor or by or in the right of a member, conscious disregard of the best interest of the limited liability company, or willful misconduct.

5. In a proceeding by or in the right of someone other than the limited liability company or a member, recklessness or an act or omission which was committed

> in bad faith or with malicious purpose or in a manner exhibiting wanton and willful disregard of human rights, safety, or property.
> (2) For the purposes of this section, the term "recklessness" means acting, or failing to act, in conscious disregard of a risk known, or so obvious that it should have been known, to the manager or managing member, and known to the manager or managing member, or so obvious that it should have been known, to be so great as to make it highly probable that harm would follow from such action or failure to act.
> (3) A manager or managing member is deemed not to have derived an improper personal benefit from any transaction if the transaction and the nature of any personal benefit derived by the manager or managing member are not prohibited by state or federal law or the articles of incorporation or operating agreement and, without further limitation, the transaction and the nature of any personal benefit derived by a manager or managing member are disclosed or known to the members, and the transaction was authorized, approved, or ratified by the vote of a majority-in-interest of the members other than the managing member, or the transaction was fair and reasonable to the limited liability company at the time it was authorized by the manager or managing member, notwithstanding that a manager or managing member received a personal benefit.
> (4) The circumstances set forth in subsection (3) are not exclusive and do not preclude the existence of other circumstances under which a manager will be deemed not to have derived an improper benefit. (Emphasis added).

See Lobato-Bleidt v. Lobato, 688 So. 2d 431, 434 (Fla. 5th DCA 1997) (noting that "under the 'business judgment' rule, a board of directors is given wide

discretion to make decisions and a court generally will not substitute its judgment for that of the directors."). Upon our review, we hold that the trial court properly applied the business judgment rule, and the trial court's determination that the counter- and third-party defendants exercised business judgment in the complained-of actions is supported by competent substantial evidence.[15,16]

IV. CONCLUSION

We affirm the final judgment entered in favor of Gail Frank, COJO Holdings, Joe Mitchell, Swastic Srihari and the Estate of Walter Frank on Ferk Family's counterclaims and third-party claims. We reverse the final summary judgment entered in favor of Gail Frank, COJO Holdings and Swastic Srihari on their Second Amended Complaint and remand for further proceedings consistent with this opinion.

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[15] We reject without further discussion Ferk Family's additional argument that the Operating Agreement provided for a higher standard of care than that required under the business judgment rule.

[16] Because we affirm on the basis of the trial court's proper application of the business judgment rule, we do not reach the remaining points raised on appeal by Ferk Family.

Third District Court of Appeal

State of Florida

Opinion filed February 28, 2018.
Not final until disposition of timely filed motion for rehearing.

No. 3D17-926
Lower Tribunal No. 16-2402

Hemingway Villa Condominium Owners Association, Inc.,
Appellant,

vs.

Wells Fargo Bank, N.A.,
Appellee.

An Appeal from the Circuit Court for Miami-Dade County, Thomas J. Rebull, Judge.

Paul A. McKenna & Associates, P.A. and Andrew H. Braaksma, for appellant.

Aldridge & Pite, LLP and Avri S. Ben-Hamo and Steven B. Greenfield (Boca Raton), for appellee.

Before SALTER, EMAS and FERNANDEZ, JJ.

EMAS, J.

Hemingway Villa Condominium Owners Association, Inc. ("the Association"), the defendant below, appeals from a final summary judgment entered in favor of Wells Fargo Bank, N.A., the plaintiff below. We affirm.

The lawsuit below stemmed from a foreclosure action filed against a unit owner in the Hemingway Villa Condominium. The foreclosure was filed by JP Morgan Chase Bank, the then-servicer and holder of the note, acting on behalf of the Federal National Mortgage Association ("Fannie Mae"), the owner of the loan in the foreclosure action. The Association was named as a defendant in the foreclosure action. Final judgment of foreclosure was later entered in favor of JP Morgan.

Fannie Mae was the successful bidder at the foreclosure sale, and took title to the unit. Shortly thereafter, Fannie Mae, through its subsequent servicer, Wells Fargo, sought to sell the unit and requested an estoppel certificate from the Association in order to determine the amount of unpaid assessments, and specifically sought the "Safe Harbor" amounts pursuant to section 718.116(1)(b)1., Florida Statutes (2017).[1] The Association issued a letter in response, but failed to

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[1] Section 718.116(1)(a), Florida Statutes (2017), makes a condominium unit owner liable not only for association assessments that come due while he or she is the owner, but also "jointly and severally liable with the previous owner for all unpaid assessments that came due up to the time of transfer of title." However, subsection (1)(b), known as the "Safe Harbor" provision, provides a limitation to this joint and several liability for past unpaid assessments, capping the potential liability of a "first mortgagee or its successor or assignees." That subsection provides:

account for the Safe Harbor protection offered to first mortgagees under section 718.116(1)(b). When the Association refused to revise the estoppel certificate, Wells Fargo paid the assessment amounts under protest with a reservation of all rights, later determining that the payment was in excess of the assessments it was required to pay pursuant to the Safe Harbor provisions.[2]

Wells Fargo then filed a complaint in circuit court which sought, inter alia, compliance with and entitlement to the Safe Harbor provisions of section 718.116(1)(b) and damages against the Association for unjust enrichment. Wells Fargo later moved for summary judgment, which was supported by affidavits, and asserted that Wells Fargo established all of the requisites for relief under the Safe

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> The liability of a first mortgagee or its successor or assignees who acquire title to a unit by foreclosure or by deed in lieu of foreclosure for the unpaid assessments that became due before the mortgagee's acquisition of title is limited to the lesser of:
>
> a. The unit's unpaid common expenses and regular periodic assessments which accrued or came due during the 12 months immediately preceding the acquisition of title and for which payment in full has not been received by the association; or
> b. One percent of the original mortgage debt. The provisions of this paragraph apply only if the first mortgagee joined the association as a defendant in the foreclosure action. Joinder of the association is not required if, on the date the complaint is filed, the association was dissolved or did not maintain an office or agent for service of process at a location which was known to or reasonably discoverable by the mortgagee.

[2] The Association demanded payment of $22,411.13, but one percent of the original mortgage would amount to only $1,232.80, plus any assessments subsequent to Fannie Mae taking title.

Harbor provisions. Following a hearing, the trial court granted Wells Fargo's motion and entered final summary judgment in its favor. This appeal followed.

On appeal, the Association contends that summary judgment was improperly entered because there remained a disputed issue of material fact regarding who actually owned the loan, and asserts that, during the relevant time period in question, JP Morgan (and not Fannie Mae) owned the loan such that Fannie Mae was not entitled to safe harbor under section 718.116(1)(b).

Upon our de novo review, Volusia County v. Aberdeen at Ormond Beach, L.P., 760 So. 2d 126 (Fla. 2000), we hold that the trial court correctly determined no genuine issue of material fact existed; that Wells Fargo established Fannie Mae owned the loan at all relevant times from 2007 through the sale of the unit in 2013; and that all of the remaining requirements of section 718.116 had been met, entitling it to the Safe Harbor provisions.

We find the instant case indistinguishable on its relevant facts from our sister court's decision in Beltway Capital, LLC v. Greens COA, Inc., 153 So. 3d 330 (Fla. 5th DCA 2014). We agree with Beltway's holding, applicable here, that, as the owner of first mortgage, Fannie Mae was the "first mortgagee" as required by the Safe Harbor provision, without regard to whether it was also an assignee. Id. at 333. The term "first mortgagee" "is simply one who holds the first

mortgage, whether that be the original lender or a subsequent holder." Id.[3] The trial court correctly entered final summary judgment in favor of Wells Fargo.

Affirmed.

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[3] The Association's reliance on Bermuda Dunes Private Residences v. Bank of America, 133 So. 3d 609 (Fla. 5th DCA 2014) is misplaced; the summary judgment in that case was reversed because, unlike the instant case, Bank of America failed to carry its burden of establishing no genuine issue of material fact existed:

> [A]lthough Bank of America argued below that it took title to the condominium unit through foreclosure as the first mortgagee based upon its assertion that it merely assigned to Federal Home Mortgage Corporation the right to service the mortgage, it did not carry its burden of presenting evidence of such. The assignment of mortgage simply reveals that Bank of America assigned the mortgage and note to Federal Home Mortgage Corporation, including all of the attendant rights and obligations. The key is who had rights and obligations under the mortgage at the time of foreclosure, whether as a first mortgagee or as a successor or assignee. If that entity takes title to the condominium unit by the foreclosure, its liability for unpaid, past-due assessments is limited pursuant to section 718.116(1)(b)1. Here, based upon the record evidence, the entity having rights and obligations under the mortgage at the time of foreclosure was Federal Home Loan Mortgage Corporation as assignee of the mortgage, not Bank of America. Although Bank of America took title to the condominium unit by foreclosure, the record does not show that it did so as first mortgagee.

Id. at 615 (emphasis added).

NOT FINAL UNTIL TIME EXPIRES TO FILE REHEARING
MOTION AND, IF FILED, DETERMINED

IN THE DISTRICT COURT OF APPEAL
OF FLORIDA
SECOND DISTRICT

JAMES M. HEYWARD, Appellant, v. WELLS FARGO BANK, N.A., Appellee.	))))))))))	Case No. 2D16-339

Opinion filed March 2, 2018.

Appeal from the Circuit Court for Sarasota County; Nancy K. Donnellan, Senior Judge and Rochelle T. Curley, Judge.

Michael P. Fuino of Weidner Law, P.A., St. Petersburg, for Appellant.

Kimberly S. Mello and Robert Schneider of Greenberg Traurig, P.A., Tampa, and Michele L. Stocker of Greenberg Traurig, P.A., Ft. Lauderdale, for Appellee.

KELLY, Judge.

James Heyward appeals the final judgment of foreclosure entered in favor of Wells Fargo Bank, N.A. Heyward raises a variety of issues in this appeal, none of which provide a basis to reverse the final judgment. We write only to address his contention that Wells Fargo's evidence was insufficient to prove it had standing.

In August 2007 Heyward executed and delivered a note and mortgage to World Savings Bank, F.S.B. The note was payable to "World Savings Bank, FSB, a Federal Savings Bank, its successors and/or assignees, or anyone to whom this note is transferred." In December 2007, World Savings amended its charter and bylaws to change its name to Wachovia Mortgage, F.S.B.[1] Heyward later defaulted on the note, so in early 2009 Wachovia sued to foreclose. Later that year, Wachovia was converted into a national bank with the name Wells Fargo Bank Southwest, National Association, which then merged simultaneously into Wells Fargo Bank, N.A. Because of the merger, Wachovia had Wells Fargo substituted as Plaintiff in the foreclosure action. In the operative complaint, Wells Fargo alleges it "holds [the] Note and Mortgage by virtue of a merger or chain of mergers with and/or name change of the original lender."

Wells Fargo's evidence at trial consisted of a copy of the original note and mortgage, the originals of which had been filed with the court, the testimony of a Wells Fargo loan verification analyst, and certifications from the Office of the Comptroller of the Currency certifying that World Bank had changed its name to Wachovia in 2007 and that Wachovia had merged into Wells Fargo in 2009. The note bore no endorsements nor were any assignments attached to the note.

Heyward first contends Wells Fargo did not prove Wachovia had standing when it filed to foreclose "because there was no evidence that Wachovia acquired the Homeowner's note and mortgage via merger or that it possessed the original note on the day the lawsuit was filed." This argument is nonsensical because it rests on the

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[1]In 2006 World Bank's parent company merged with Wachovia. The name change to Wachovia was part of the integration procedures the banks went through after the merger.

fallacy that World Bank and Wachovia merged and therefore, the note must have changed hands. It ignores the actual evidence introduced at trial. The evidence showed that after Heyward executed and delivered the note to World Savings Bank, World Savings Bank changed its name to Wachovia. The note along with the certificate showing World Bank changed its name to Wachovia proved that Wachovia was the originating lender and, thus, the owner and holder of the note and mortgage when it filed to foreclose in 2009. See Wachovia Mortg., F.S.B. v. Goodwill, 199 So. 3d 346, 347 (Fla. 4th DCA 2016); see also Lewis v. J.P. Morgan Chase Bank, 138 So. 3d 1212, 1213 (Fla. 4th DCA 2014).

Continuing in the same vein, Heyward argues Wells Fargo did not prove standing at the time of trial. His argument, however, is that Wells Fargo was required to prove its entitlement to enforce the note under section 673.3091, Florida Statutes (2014), which provides for the enforcement of lost, destroyed, or stolen instruments. The inapplicability of this statute is obvious. No evidence suggests the note was lost, destroyed, or stolen. Rather, it shows that Wachovia merged into Wells Fargo. As a result of this merger, Wells Fargo became Wachovia's successor and the owner and holder of the note by operation of law. See 12 U.S.C. § 215a(e) (2012) (providing that when a national bank merges with another banking entity, the "receiving association shall be deemed to be the same corporation as each bank or banking association participating in the merger" and that "[a]ll rights, franchises, and interests of the individual merging banks or banking associations in and to every type of property (real, personal, and mixed) and choses in action shall be transferred to and vested in the receiving association by virtue of such merger without any deed or other transfer");

Goodwill, 199 So. 3d at 348. The testimony of Wells Fargo's loan analyst confirmed that Wells Fargo, Wachovia, and World Bank were the same entity.

In conclusion, Heyward's standing arguments fail because, among other things, he bases them entirely on the notion that his note changed hands in some fashion after he delivered it to World Savings Bank in 2007. On the contrary, the evidence establishes that the note was never endorsed, assigned, or transferred and that from the time Heyward executed it in 2007 until the time of trial, the note continued to be held by the original lender despite the name change and the merger. Accordingly, we affirm.

Affirmed.

SILBERMAN and ROTHSTEIN-YOUAKIM, JJ., Concur.

DISTRICT COURT OF APPEAL OF THE STATE OF FLORIDA
FOURTH DISTRICT

SCOTT B. MEYROWITZ,
Appellant,

v.

ANDREW M. SCHWARTZ, P.A.,
Appellee.

No. 4D17-1983

[February 28, 2018]

Appeal from the Circuit Court for the Fifteenth Judicial Circuit, Palm Beach County; Edward Garrison, Acting Judge; L.T. Case No. 50-2016-CA-008984-XXXX-MB.

Michael D. Moccia of Law Office of Michael D. Moccia, P.A., Boca Raton, for appellant.

Andrew M. Schwartz of Andrew M. Schwartz, P.A., Boca Raton, for appellee.

LEVINE, J.

Scott Meyrowitz appeals a final judgment awarding attorney's fees in favor of Andrew M. Schwartz, P.A. ("the firm") pursuant to the offer of judgment rule. Meyrowitz argues that the proposal for settlement was untimely under 1.442(b). We agree and therefore reverse.

The firm filed an action against Meyrowitz for $49,121.07 in unpaid legal bills. The clerk entered a default against Meyrowitz for failure to file any pleading. On December 1, 2016, Judge Colin entered an order setting the case for a non-jury trial on the eight week trial calendar beginning March 20 and ending May 12, 2017. On March 1, Judge Garrison entered an order setting the case for non-jury trial before him on May 2. The order stated that the case "came before the Court upon referral by Judge David French regarding Plaintiff's Notice for Trial." The order directed that any motions prior to trial be set before Judge French.

On March 3, the firm served a proposal for settlement on Meyrowitz, offering to settle the case for $38,500. Meyrowitz did not accept the

proposal. After trial, Judge Garrison entered a judgment in favor of the firm for $49,121.07, the amount sought in the complaint. Based on the judgment, the firm filed a motion for attorney's fees pursuant to its proposal for settlement. Meyrowitz objected on the grounds that the proposal for settlement was not timely served pursuant to rule 1.442(b). The trial court found that the service of the motion complied with rule 1.442 and entered an order awarding the firm $24,825 in attorney's fees.

On appeal, Meyrowitz argues that the proposal for settlement was not timely because it was served later than forty-five days before the first day of the docket on which the case was set for trial. The firm responds that affirmance is warranted because the proposal was served two days after an order removing the case from Judge French's trial calendar and reassigning it to Judge Garrison for a special set trial.

A de novo standard of review applies in determining whether a proposal for settlement complies with rule 1.442. *Regions Bank v. Rhodes*, 126 So. 3d 1259, 1260 (Fla. 4th DCA 2013).

Florida Rule of Civil Procedure 1.442(b) states that "[n]o proposal [for settlement] shall be served later than 45 days before the date set for trial or the first day of the docket on which the case is set for trial, whichever is earlier." Rule 1.442 must be strictly construed because it is punitive in nature in that it imposes sanctions upon the losing party and is in derogation of the common law. *Schussel v. Ladd Hairdressers, Inc.*, 736 So. 2d 776, 778 (Fla. 4th DCA 1999). Additionally, the rule must be construed in accordance with the principles of statutory construction. *R.T.G. Furniture Corp. v. Coates*, 93 So. 3d 1151, 1153 (Fla. 4th DCA 2012). As this court has explained:

> When the language at issue is clear and unambiguous and conveys a clear and definite meaning, there is no occasion for resorting to the rules of statutory interpretation and construction. Rather, the court must give unambiguous language its plain and ordinary meaning, unless it leads to a result that is either unreasonable or clearly contrary to legislative intent.

Id. (citation omitted).

As stated above, rule 1.442 requires service more than "45 days before the date set for trial **or** the first day of the docket on which the case is set for trial, **whichever is earlier**." (emphasis added). In this case, forty-five days before the first day of the docket was earlier than forty-five days

before the date set for trial. Forty-five days before the May 2 trial was March 18. However, forty-five days before the first day of the March 20 docket was February 3. Because February 3 is the earlier and thus the operative date, the March 3 proposal was untimely because it was served after this date.

The firm argues that *Liguori v. Daly*, 756 So. 2d 268 (Fla. 4th DCA 2000), supports the trial court's ruling. In *Liguori*, the court set the case for trial on a six-week docket. The case was not called for trial during the first five weeks, and parties had been excused from the final week (April 6 through 13) by court order. Appellee filed a proposal for settlement during the last week on April 7. Subsequently, trial was reset on other dockets, and the case went to trial on August 24. This court recognized that "an offer of judgment is untimely, and, thus, unenforceable, when it is made less than forty-five days before the first day of the docket on which the case is initially set for trial, regardless of when the case actually goes to trial." *Id.* at 269. Nevertheless, this court found the proposal timely and enforceable because it was "directed to the next, as yet, unscheduled docket." *Id.*

Citing *Liguori*, the court in *Progressive Casualty Insurance Co. v. Radiology & Imaging Center of South Florida, Inc.*, 761 So. 2d 399, 400 (Fla. 3d DCA 2000), stated:

> If an Offer of Judgment is made at a point in time in which it appears, from the facts of the individual case, that the Offer of Judgment is not directed to the current trial period, but, rather, is intended for the next, as yet, unscheduled trial period, then in that situation, and in that situation only, the Offer of Judgment is not a nullity and is considered timely. In order to rely upon this exception, there must be some evidence in the record that both parties know that the case will not be tried during the current trial period and that the Offer of Judgment is made in anticipation of the next, as yet, unscheduled trial period.

The *Progressive Casualty* court concluded that "[t]his is a very limited exception which must be strictly applied to these narrow circumstances." *Id.*

Contrary to the firm's assertion, the exception carved out in *Liguori* does not apply in this case. Unlike in *Liguori*, here the case went to trial during the initially set docket. The case was set for trial on the eight-week trial calendar beginning March 20 and ending May 12. The case actually went

to trial on May 2.

Further, in *Liguori* the proposal was served during the last week of the docket when the case could not have gone to trial because the parties had been previously excused. Thus, the proposal was made in anticipation of the "next, as yet, unscheduled docket." *Liguori*, 756 So. 2d at 269. Here, in contrast, the proposal was made two days after the order which scheduled trial for a date during the originally scheduled docket. Thus, the proposal was "directed to the current trial period," not the "next, as yet, unscheduled trial period." *Progressive Cas.*, 761 So. 2d at 400 (citing *Liguori*, 756 So. 2d at 269).

The fact that the case was ultimately heard by Judge Garrison instead of Judge French does not render the proposal for settlement timely. *See Liguori*, 756 So. 2d at 269 (stating that a continuance cannot "breathe[] life back into an otherwise untimely offer of judgment") (quoting *Schussel*, 736 So. 2d at 778). The order setting the case for the trial docket did not specify which judge would be presiding. Further, rule 1.442(b) speaks to dockets generally and does not address dockets before specific judges. The rule is concerned with the timing of a proposal for settlement, not with the specific judge who ultimately presides over a trial. Which particular judge ultimately presides over the trial does not have any bearing on the timeliness of a proposal.

In sum, the proposal for settlement was untimely. The case was scheduled for trial during an eight-week calendar, and the trial occurred during that calendar. Although the proposal was served more than forty-five days before the date set for trial, it was not served more than forty-five days before the first date of the docket as required under rule 1.442(b). As such, we reverse.

Reversed.

CIKLIN and KLINGENSMITH, JJ., concur.

* * *

Not final until disposition of timely filed motion for rehearing.

DISTRICT COURT OF APPEAL OF THE STATE OF FLORIDA
FOURTH DISTRICT

NIAGARA INDUSTRIES, INC. and **RHEEM SALES COMPANY,**
Petitioners,

v.

GIAQUINTO ELECTRIC LLC, a Florida Limited Liability Company,
GUARDIAN AMERICAN PROPERTIES, LLC, f/k/a **GUARDIAN AMERICAN RESIDENTIAL PROPERTIES OF BROWARD COUNTY, LLC,** a Florida Limited Liability Company,
H20 PLUMBING SERVICES, INC., a Florida Corporation,
FUENMAYOR & LINDA ENTERPRISES, LLC, d/b/a **ACE FLOOD & INSPECTIONS, LLC,** a Florida Limited Liability Company,
MARK BECKERMAN, individually, and
SCOTT WESLEY FRANK, Sr., individually,
Respondents.

No. 4D17-1473

[February 28, 2018]

Petition for writ of certiorari to the Circuit Court for the Seventeenth Judicial Circuit, Broward County; Patti Englander-Henning, Judge; L.T. Case No. CACE 16-11632 05.

Diane H. Tutt, Thomas J. McCausland, and Evan Roberts of Conroy Simberg, Hollywood, for Petitioners.

Daniel M. Schwarz of Cole, Scott & Kissane, P.A., Plantation, for Respondent H20 Plumbing Services, Inc.

Glen R. Goldsmith of Glen R. Goldsmith, P.A., Miami, for Respondent Giaquinto Electric, LLC.

Armando P. Rubio of Fields Howell LLP, Miami, for Respondent Guardian American Properties, LLC.

ON MOTION FOR REHEARING AND/OR CLARIFICATION

KUNTZ, J.

We deny Respondent, H20 Plumbing Services, Inc.'s motion for rehearing, grant the motion for clarification in part, withdraw our prior opinion, and issue this opinion in its place.

In this proceeding, the Petitioners—Niagara Industries, Inc. and Rheem Sales Company—challenge the second prong of the two-part test for disclosure of trade secrets. The issue before us is whether the production of material containing trade secrets was "reasonably necessary." We conclude the circuit court departed from the essential requirements of law when it ordered the Petitioners to disclose their trade secrets, because the party requesting the disclosure failed to present any evidence to establish that the production of the privileged information was reasonably necessary. We therefore quash the order.

Background

Scott Wesley Frank, Sr. purchased a tankless water heater from Rheem Sales Company, and designed by Niagara Industries, Inc. At some point later, Mr. Frank experienced problems with the water heater and hired H20 Plumbing Services, Inc. While Mr. Frank's water heater was being repaired, it exploded, causing Mr. Frank physical injury. As a result of the injuries, he filed a four-count complaint against the Petitioners, asserting claims of negligence and strict liability against both.

During the pendency of Mr. Frank's lawsuit against the Petitioners, the court required them to disclose what they describe as "their confidential and highly confidential documents, including Niagara's trade secrets, relating to the manufacturing and testing of the subject tankless water heater." Pursuant to a protective order that permitted only certain people to view them, the Petitioners disclosed the documents. Testimony indicates the documents were disclosed to a total of four people. The case proceeded to a jury trial. One of the experts permitted to view the documents testified at the trial and, in this case, the circuit court stated that the expert "opined at trial that the product failed in an unreasonably safe manner." However, the parties dispute whether the actual documents were ever presented to the jury. Regardless, prior to the jury returning a verdict, the parties filed a stipulation of dismissal, which the court accepted. At the conclusion of the case, the previously-disclosed documents were returned to the Petitioners.

After the dismissal of the lawsuit against the Petitioners, Mr. Frank filed a new lawsuit against Giaquinto Electric, which he later amended to add claims against Guardian American Properties, LLC, H20 Plumbing Services, Inc., Fuenmayor & Linda Enterprises, LLC, and Mark Beckerman.

Guardian American Properties, LLC, one of the defendants in the second lawsuit, served a notice of production from non-parties and a subpoena duces tecum without deposition, indicating they intended to seek various documents from the Petitioners. Among the documents at issue were those contained in the seventy-ninth category of documents sought, which asked for those documents from Mr. Frank's first lawsuit: "Any and all documents received pursuant to any subpoenas and/or request for copies in the case Scott Wesley Frank v. Niagara Industries, Inc. and Rheem Sales, Case. No. CACE 15-002998 (03)." Later, H20 Plumbing, another defendant in the second lawsuit, served a notice of intent to subpoena similar information.

The Petitioners timely objected to the notices of production and the subpoenas. In their objections, they argued that: the documents contained trade secrets; the water heater's failure was not the result of a defectively-manufactured or defectively-designed product; and that Guardian and H20, the requesting parties, were merely on a "fishing expedition" to escape an incident resulting from its installation of the water heater.

The court held an evidentiary hearing on the Petitioners' objections. The only witness to testify at the hearing was the owner of Niagara Industries, who testified that the release of the trade secrets "would be devastating" to his company. He also answered questions regarding the Petitioners' belief as to the cause of the water heater's explosion. Guardian and H20 relied upon the arguments of its counsel and did not present any testimony or evidence on its behalf.

During the hearing, the court expressed concern that different parties from the two lawsuits would not have access to the same materials. The court drew this concern from the fact that it was "not sure . . . why all of the defendants weren't brought in on the first trial." With that in mind, at the conclusion of the hearing the court orally ruled as follows:

THE COURT: We're going to take it in some sort of baby steps.

First, the Court find[s] that it is indeed a trade secret.

> Second, the Court finds that there's a reasonable necessity for [production] of some of the items because there is testimony that the product failed; there is no ability to test the specific heater in question. This is the exact case and issues of the product litigated before. That the Court finds really no other way regarding it that the parties that could have been even if not, should have been sued in the first trial would have had access to the information at that time. And it places all of the parties in a fair position to move forward.

The court subsequently issued a written order, specifying its previously stated reasons for the required production. The Petitioners now petition this Court for a writ of certiorari.

Analysis

Subject to certain limitations, trade secrets are privileged from disclosure. § 90.506, Fla. Stat. (2017). An improper order piercing this privilege and requiring the disclosure of trade secrets may cause irreparable harm to the disclosing party and, in some cases, a person not even aware of the proceeding. Because the protected information will be known once disclosed, the harm sustained cannot be remedied on appeal. Therefore, our certiorari jurisdiction is properly invoked when a circuit court improperly requires the disclosure of trade secrets. *Cooper Tire & Rubber Co. v. Cabrera*, 112 So. 3d 731, 733 (Fla. 3d DCA 2013) (citing *Grooms v. Distinctive Cabinet Designs, Inc.*, 846 So. 2d 652 (Fla. 2d DCA 2003)).

When a party asserts that material is protected by the trade-secrets privilege, the court must conduct a two-step inquiry. First, the court must determine if the documents at issue are, in fact, trade secrets. Second, if the court concludes the documents are trade secrets, the burden shifts to the requesting party to show that the disclosure is reasonably necessary. *See, e.g.*, *Am. Exp. Travel Related Services, Inc. v. Cruz*, 761 So. 2d 1206, 1208 (Fla. 4th DCA 2000)[1]; *Sea Coast Fire, Inc. v. Triangle Fire, Inc.*, 170 So. 3d 804, 809 (Fla. 3d DCA 2014).

Here, the court found the documents at issue were trade secrets. Therefore, the burden shifted to Guardian and H20 to establish that

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[1] If the court finds the requesting party has shown the disclosure of privileged material is reasonably necessary, the court is required to make written findings and take adequate measures to protect the disclosing party, the parties to the case, and the interests of justice. *See* § 90.506, Fla. Stat. (2017).

disclosure was reasonably necessary. However, the Petitioners were the only ones to present testimony or evidence, and their witness testified as to the devastating impact on its business if the documents were to be released and also provided the Petitioners' theory on the cause of the explosion.

The court departed from the essential requirements of the law when it compelled the production of the privileged documents based upon the two grounds which it stated.[2] The court's reliance on the destruction of the specific tankless water heater at issue, without more, is insufficient. Guardian and H20 did not present any evidence to support the conclusion that the information lost due to the destruction of the specific tankless water heater could only be remedied through access to trade secrets. They did not present evidence that the specific tankless water heater was necessary nor did they present evidence the purportedly necessary information could not be obtained by other means. If the mere destruction of a product is sufficient to breach the privilege, the trade-secret privilege could be breached any time a lawsuit involves a product or item that was destroyed. While it is possible the destruction of an actual item could justify requiring the disclosure of trade secrets, a party must present evidence or testimony to support that conclusion. Here, they did not.

It is also insufficient to base the disclosure of the privileged documents on the prior lawsuit. The court was clearly concerned with the fact that the plaintiff filed two separate lawsuits, stating: (i) "I still am not sure I completely understand why all of the defendants weren't brought in on the first trial"; (ii) "but had they all been in this first case"; (iii) "the Court finds really no other way regarding it that the parties that could have been even if not, should have been sued in the first trial"; and (iv) "And again, if all parties had been together at the first case."

We agree it may have been more efficient had the plaintiff chosen to bring all his claims in one lawsuit. But, the mere existence of the first lawsuit, without more, is not sufficient to invade the trade-secret privilege. Further, the Petitioners—defendants in the first lawsuit, but non-parties in the proceedings below—cannot be blamed for a plaintiff's litigation strategy and choice of defendants. Recognizing that fact, the court expounded on its concern and stated "I just don't understand why phase

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[2] The court's subsequent written order included four grounds to support its conclusion. However, the two additional findings in support can generally be grouped with the two findings provided at the hearing. Therefore, for clarity, we reference two reasons throughout this opinion.

B of the same case and the same facts shouldn't have the same evidence."[3] However, again, the Petitioners cannot be faulted for this point. And, no party to this second lawsuit has the benefit of introducing evidence derived from the trade secrets at issue in the first lawsuit. Those materials were returned and the counsel that viewed them, under penalty of violating the court's order in the first lawsuit, cannot disclose the contents.

Finally, we note that in its motion for rehearing, H20 states that we overlooked the circuit court's written finding that, in the first trial, "Plaintiff's liability expert, Edward Brill, P.E., opined at trial that the product failed in an unreasonably safe manner, irrespective of" the plumber's actions. H20 argues that the expert in the first lawsuit had access to these protected documents prior to his testimony and "[i]t follows, therefore, that H20 and the defendants' experts need the same information to likewise opine that Niagara and Rheem bear all or some of the fault." A finding that the expert in the first trial opined regarding fault does not indicate how that expert arrived at that conclusion and it is not sufficient, on its own, to support a finding that the documents are necessary for a different expert to arrive at an independent opinion. At the hearing before the circuit court, counsel for the Petitioners argued that "[the Respondents] need to bring an expert in that says I've taken one of these apart, I've looked at whatever degree of Brill's testimony the[y] have, and I can't figure out without looking at X, Y, and Z." Should the Respondents do so to the satisfaction of the circuit court, nothing in this opinion would preclude the court from addressing a renewed motion to compel.[4]

Conclusion

A party cannot obtain documents containing privileged trade secrets without establishing a reasonable necessity for breaching the privilege. Here, the court departed from the essential requirements of the law when it found the requesting party had established a reasonable necessity to breach the privilege, even though the requesting party had failed to present any evidence. We do not hold that a requesting party must always present

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[3] We also note the court's mischaracterization of this second lawsuit. The court's reference to "Phase B" is inaccurate, as the two suits were separate, distinct lawsuits.

[4] We assume a renewed motion would be based upon facts and information not presently available to the movants. Further, we note the Respondents did not have access to the entirety of the transcript from the first trial. It appears the circuit court directed the Respondents be given access to that transcript and that ruling was not a part of this original proceeding.

evidence. However, by failing to do so they are at risk of being unable to overcome the testimony of the movant.

Once the burden shifts to the requesting party, the court weighs the need for producing the document against protecting its confidentiality. Here, the Petitioners' witness testified that disclosure would be devastating and also provided the Petitioners' theory on the cause of the explosion. The requesting party did not overcome this testimony or establish a specific need for the protected documents.

Petition granted; order quashed.

GROSS and TAYLOR, JJ., concur.

* * *

FINAL UPON RELEASE; NO MOTION FOR REHEARING WILL BE ENTERTAINED; MANDATE ISSUED SIMULTANEOUSLY WITH OPINION.

Syllabus

SUPREME COURT OF THE UNITED STATES

Syllabus

U. S. BANK N. A., TRUSTEE, BY AND THROUGH CWCAPITAL ASSET MANAGEMENT LLC *v.* VILLAGE AT LAKERIDGE, LLC

CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

No. 15–1509. Argued October 31, 2017—Decided March 5, 2018

Respondent Lakeridge is a corporate entity with a single owner, MBP Equity Partners. When Lakeridge filed for Chapter 11 bankruptcy, it had a pair of substantial debts: It owed petitioner U. S. Bank over $10 million and MBP another $2.76 million. Lakeridge submitted a reorganization plan, proposing to impair the interests of both U. S. Bank and MBP. U. S. Bank refused the offer, thus blocking Lakeridge's option for reorganization through a fully consensual plan. See 11 U. S. C. §1129(a)(8). Lakeridge then turned to the so-called "cramdown" plan option for imposing a plan impairing the interests of a non-consenting class of creditors. See §1129(b). Among the prerequisites for judicial approval of such a plan is that another impaired class of creditors has consented to it. See §1129(a)(10). But crucially here, the consent of a creditor who is also an "insider" of the debtor does not count for that purpose. *Ibid.* The Bankruptcy Code's definition of an insider "includes" any director, officer, or "person in control" of the entity. §101(31)(B)(i)–(iii). Courts have devised tests for identifying other, so-called "non-statutory" insiders, focusing, in whole or in part, on whether a person's transactions with the debtor were at arm's length.

Here, MBP (an insider of Lakeridge) could not provide the partial agreement needed for a cramdown plan, and Lakeridge's reorganization was thus impeded. MBP sought to transfer its claim against Lakeridge to a non-insider who could agree to the cramdown plan. Kathleen Bartlett, an MBP board member and Lakeridge officer, offered MBP's claim to Robert Rabkin, a retired surgeon, for $5,000. Rabkin purchased the claim and consented to Lakeridge's proposed

reorganization. U. S. Bank objected, arguing that Rabkin was a non-statutory insider because he had a "romantic" relationship with Bartlett and the purchase was not an arm's-length transaction. The Bankruptcy Court rejected U. S. Bank's argument. The Ninth Circuit affirmed. Viewing the Bankruptcy Court's decision as one based on a finding that the relevant transaction was conducted at arm's length, the Ninth Circuit held that that finding was entitled to clear-error review, and could not be reversed under that deferential standard.

Held: The Ninth Circuit was right to review the Bankruptcy Court's determination for clear error (rather than *de novo*). At the heart of this case is a so-called "mixed question" of law and fact—whether the Bankruptcy Court's findings of fact satisfy the legal test chosen for conferring non-statutory insider status. U. S. Bank contends that the Bankruptcy Court's resolution of this mixed question must be reviewed *de novo*, while Lakeridge (joined by the Federal Government) argues for a clear-error standard.

For all their differences, both parties rightly point to the same query: What is the nature of the mixed question here and which kind of court (bankruptcy or appellate) is better suited to resolve it? Mixed questions are not all alike. Some require courts to expound on the law, and should typically be reviewed *de novo*. Others immerse courts in case-specific factual issues, and should usually be reviewed with deference. In short, the standard of review for a mixed question depends on whether answering it entails primarily legal or factual work.

Here, the Bankruptcy Court confronted the question whether the basic facts it had discovered (concerning Rabkin's relationships, motivations, etc.) were sufficient to make Rabkin a non-statutory insider. Using the transactional prong of the Ninth Circuit's legal test for identifying such insiders (whether the transaction was conducted at arm's length, *i.e.,* as though the two parties were strangers) the mixed question became: Given all the basic facts found, was Rabkin's purchase of MBP's claim conducted as if the two were strangers to each other? That is about as factual sounding as any mixed question gets. Such an inquiry primarily belongs in the court that has presided over the presentation of evidence, that has heard all the witnesses, and that has both the closest and deepest understanding of the record—*i.e.*, the bankruptcy court. One can arrive at the same point by asking how much legal work applying the arm's-length test requires. It is precious little—as shown by judicial opinions applying the familiar legal term without further elaboration. Appellate review of the arm's-length issue—even if conducted *de novo*—will not much clarify legal principles or provide guidance to other courts resolving

other disputes. The issue is therefore one that primarily rests with a bankruptcy court, subject only to review for clear error. Pp. 5–11.

814 F. 3d 993, affirmed.

KAGAN, J., delivered the opinion for a unanimous Court. KENNEDY, J., filed a concurring opinion. SOTOMAYOR, J., filed a concurring opinion, in which KENNEDY, THOMAS, and GORSUCH, JJ., joined.

SUPREME COURT OF THE UNITED STATES

No. 15–1509

U.S. BANK NATIONAL ASSOCIATION, TRUSTEE, BY AND THROUGH CWCAPITAL ASSET MANAGEMENT LLC, PETITIONER *v.* THE VILLAGE AT LAKERIDGE, LLC

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

[March 5, 2018]

JUSTICE KAGAN delivered the opinion of the Court.

The Bankruptcy Code places various restrictions on anyone who qualifies as an "insider" of a debtor. The statutory definition of that term lists a set of persons related to the debtor in particular ways. See 11 U. S. C. §101(31). Courts have additionally recognized as insiders some persons not on that list—commonly known as "non-statutory insiders." The conferral of that status often turns on whether the person's transactions with the debtor (or another of its insiders) were at arm's length. In this case, we address how an appellate court should review that kind of determination: *de novo* or for clear error? We hold that a clear-error standard should apply.

I

Chapter 11 of the Bankruptcy Code enables a debtor company to reorganize its business under a court-approved plan governing the distribution of assets to creditors. See 11 U. S. C. §1101 *et seq.* The plan divides claims against the debtor into discrete "classes" and speci-

fies the "treatment" each class will receive. §1123; see §1122. Usually, a bankruptcy court may approve such a plan only if every affected class of creditors agrees to its terms. See §1129(a)(8). But in certain circumstances, the court may confirm what is known as a "cramdown" plan—that is, a plan impairing the interests of some non-consenting class. See §1129(b). Among the prerequisites for judicial approval of a cramdown plan is that another impaired class of creditors has consented to it. See §1129(a)(10). But crucially for this case, the consent of a creditor who is also an "insider" of the debtor does not count for that purpose. See *ibid.* (requiring "at least one" impaired class to have "accepted the plan, determined without including any acceptance of the plan by any insider").

The Code enumerates certain insiders, but courts have added to that number. According to the Code's definitional section, an insider of a corporate debtor "includes" any director, officer, or "person in control" of the entity. §§101(31)(B)(i)–(iii). Because of the word "includes" in that section, courts have long viewed its list of insiders as non-exhaustive. See §102(3) (stating as one of the Code's "[r]ules of construction" that "'includes' and 'including' are not limiting"); 2 A. Resnick & H. Sommer, Collier on Bankruptcy ¶101.31, p. 101–142 (16th ed. 2016) (discussing cases). Accordingly, courts have devised tests for identifying other, so-called "non-statutory" insiders. The decisions are not entirely uniform, but many focus, in whole or in part, on whether a person's "transaction of business with the debtor is not at arm's length." *Ibid.* (quoting *In re U. S. Medical, Inc.*, 531 F. 3d 1272, 1280 (CA10 2008)).

This case came about because the Code's list of insiders placed an obstacle in the way of respondent Lakeridge's attempt to reorganize under Chapter 11. Lakeridge is a corporate entity which, at all relevant times, had a single

owner, MBP Equity Partners, and a pair of substantial debts. The company owed petitioner U. S. Bank over $10 million for the balance due on a loan. And it owed MBP another $2.76 million. In 2011, Lakeridge filed for Chapter 11 bankruptcy. The reorganization plan it submitted placed its two creditors in separate classes and proposed to impair both of their interests. U. S. Bank refused that offer, thus taking a fully consensual plan off the table. But likewise, a cramdown plan based only on MBP's consent could not go forward. Recall that an insider cannot provide the partial agreement needed for a cramdown plan. See *supra,* at 2; §1129(a)(10). And MBP was the consummate insider: It owned Lakeridge and so was—according to the Code's definition—"in control" of the debtor. §101(31)(B)(iii). The path to a successful reorganization was thus impeded, and Lakeridge was faced with liquidation. Unless . . .

Unless MBP could transfer its claim against Lakeridge to a non-insider who would then agree to the reorganization plan. So that was what MBP attempted. Kathleen Bartlett, a member of MBP's board and an officer of Lakeridge, approached Robert Rabkin, a retired surgeon, and offered to sell him MBP's $2.76 million claim for $5,000. Rabkin took the deal. And as the new holder of MBP's old loan, he consented to Lakeridge's proposed reorganization. As long as he was not himself an insider, Rabkin's agreement would satisfy one of the prerequisites for a cramdown plan. See §1129(a)(10); *supra,* at 2. That would bring Lakeridge a large step closer to reorganizing its business over U. S. Bank's objection.

Hence commenced this litigation about whether Rabkin, too, was an insider. U. S. Bank argued that he qualified as a non-statutory insider because he had a "romantic" relationship with Bartlett and his purchase of MBP's loan "was not an arm's-length transaction." Motion to Designate Claim of Robert Rabkin as an Insider Claim in No.

11–51994 (Bkrtcy. Ct. Nev.), Doc. 194, p. 11 (Motion).[1] At an evidentiary hearing, both Rabkin and Bartlett testified that their relationship was indeed "romantic." App. 128, 142–143.[2] But the Bankruptcy Court still rejected U. S. Bank's view that Rabkin was a non-statutory insider. See App. to Pet. for Cert. 66a. The court found that Rabkin purchased the MBP claim as a "speculative investment" for which he did adequate due diligence. *Id.*, at 67a. And it noted that Rabkin and Bartlett, for all their dating, lived in separate homes and managed their finances independently. See *id.,* at 66a.

The Court of Appeals for the Ninth Circuit affirmed by a divided vote. According to the court, a creditor qualifies as a non-statutory insider if two conditions are met: "(1) the closeness of its relationship with the debtor is comparable to that of the enumerated insider classifications in [the Code], and (2) the relevant transaction is negotiated at less than arm's length." *In re Village at Lakeridge, LLC,* 814 F. 3d 993, 1001 (2016). The majority viewed the Bankruptcy Court's decision as based on a finding that the relevant transaction here (Rabkin's purchase of MBP's claim) "was conducted at arm's length." *Id.,* at 1003, n. 15. That finding, the majority held, was entitled to clear-error review, and could not be reversed under that deferential

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[1] U. S. Bank also contended that Rabkin automatically inherited MBP's statutory insider status when he purchased its loan. See Motion, p. 10 ("[A]n entity which acquires a claim steps into the shoes of that claimant" (internal quotation marks omitted)). We did not grant review of that question and therefore do not address it in this opinion.

[2] Perhaps Bartlett expressed some ambivalence on that score. The transcript of her direct examination reads:

"Q. Okay. And I think the term has been a romantic relationship—you have a romantic relationship?

A. I guess.

Q. Why do you say I guess?

A. Well, no—yes." App. 142–143.

One hopes Rabkin was not listening.

standard. See *id.,* at 1001–1003. Rabkin's consent could therefore support the cramdown plan. See *id.,* at 1003. Judge Clifton dissented. He would have applied *de novo* review, but in any event thought the Bankruptcy Court committed clear error in declining to classify Rabkin as an insider. See *id.,* at 1006.

This Court granted certiorari to decide a single question: Whether the Ninth Circuit was right to review for clear error (rather than *de novo*) the Bankruptcy Court's determination that Rabkin does not qualify as a non-statutory insider because he purchased MBP's claim in an arm's-length transaction. 580 U. S. ___ (2017).

II

To decide whether a particular creditor is a non-statutory insider, a bankruptcy judge must tackle three kinds of issues—the first purely legal, the next purely factual, the last a combination of the other two. And to assess the judge's decision, an appellate court must consider all its component parts, each under the appropriate standard of review. In this case, only the standard for the final, mixed question is contested. But to resolve that dispute, we begin by describing the unalloyed legal and factual questions that both kinds of courts have to address along the way, as well as the answers that the courts below provided.

Initially, a bankruptcy court must settle on a legal test to determine whether someone is a non-statutory insider (again, a person who should be treated as an insider even though he is not listed in the Bankruptcy Code). But that choice of standard really resides with the next court: As all parties agree, an appellate panel reviews such a legal conclusion without the slightest deference. See *Highmark Inc.* v. *Allcare Health Management. System, Inc.*, 572 U. S. ___, ___ (2014) (slip op., at 4) ("Traditionally, decisions on questions of law are reviewable *de novo*" (internal quota-

tion marks omitted)); Tr. of Oral Arg. 29–30, 33. The Ninth Circuit here, as noted earlier, endorsed a two-part test for non-statutory insider status, asking whether the person's relationship with the debtor was similar to those of listed insiders and whether the relevant prior transaction was at "less than arm's length." 814 F. 3d, at 1001; see *supra,* at 4–5. And the Ninth Circuit held that the Bankruptcy Court had used just that standard—more specifically, that it had denied insider status under the test's second, transactional prong. See 814 F. 3d, at 1002–1003, and n. 15; *supra,* at 4–5. We do not address the correctness of the Ninth Circuit's legal test; indeed, we specifically rejected U. S. Bank's request to include that question in our grant of certiorari. See 580 U. S. ___; Pet. for Cert. i. We simply take that test as a given in deciding the standard-of-review issue we chose to resolve.

Along with adopting a legal standard, a bankruptcy court evaluating insider status must make findings of what we have called "basic" or "historical" fact—addressing questions of who did what, when or where, how or why. *Thompson* v. *Keohane*, 516 U. S. 99, 111 (1995). The set of relevant historical facts will of course depend on the legal test used: So under the Ninth Circuit's test, the facts found may relate to the attributes of a particular relationship or the circumstances and terms of a prior transaction. By well-settled rule, such factual findings are reviewable only for clear error—in other words, with a serious thumb on the scale for the bankruptcy court. See Fed. Rule Civ. Proc. 52(a)(6) (clear-error standard); Fed. Rules Bkrtcy. Proc. 7052 and 9014(c) (applying Rule 52 to various bankruptcy proceedings). Accordingly, as all parties again agree, the Ninth Circuit was right to review deferentially the Bankruptcy Court's findings about Rabkin's relationship with Bartlett (*e.g.,* that they did not "cohabitate" or pay each other's "bills or living expenses") and his motives for purchasing MBP's claim (*e.g.,* to make

a "speculative investment"). App. to Pet. for Cert. 66a–67a; see Tr. of Oral Arg. 8, 39.

What remains for a bankruptcy court, after all that, is to determine whether the historical facts found satisfy the legal test chosen for conferring non-statutory insider status. We here arrive at the so-called "mixed question" of law and fact at the heart of this case. *Pullman-Standard* v. *Swint*, 456 U. S. 273, 289, n. 19 (1982) (A mixed question asks whether "the historical facts . . . satisfy the statutory standard, or to put it another way, whether the rule of law as applied to the established facts is or is not violated"). As already described, the Bankruptcy Court below had found a set of basic facts about Rabkin; and it had adopted a legal test for non-statutory insider status that requires (as one of its two prongs) a less-than-arm's-length transaction. See *supra,* at 4, 6. As its last move, the court compared the one to the other—and determined that the facts found did not show the kind of preferential transaction necessary to turn a creditor into a non-statutory insider. For that decisive determination, what standard of review should apply?

The parties, after traveling so far together, part ways at this crucial point. U. S. Bank contends that the Bankruptcy Court's resolution of the mixed question must be reviewed *de novo*. That is because, U. S. Bank claims, application of the Ninth Circuit's "very general" standard to a set of basic facts requires the further elaboration of legal principles—a task primarily for appellate courts. Brief for Petitioner 35; see *id.,* at 53 (The "open-ended nature of the Ninth Circuit's standard" compels courts to "develop the norms and criteria they deem most appropriate" and so should be viewed as "quasi-legal"). By contrast, Lakeridge (joined by the Federal Government as *amicus curiae*) thinks a clear-error standard should apply. In Lakeridge's view, the ultimate law-application question is all "bound up with the case-specific details of the highly

factual circumstances below"—and thus falls naturally within the domain of bankruptcy courts. Brief for Respondent 17; see Brief for United States 21 (similarly describing the mixed question as "fact-intensive").

For all their differences, both parties rightly point us to the same query: What is the nature of the mixed question here and which kind of court (bankruptcy or appellate) is better suited to resolve it? See *Miller* v. *Fenton*, 474 U. S. 104, 114 (1985) (When an "issue falls somewhere between a pristine legal standard and a simple historical fact," the standard of review often reflects which "judicial actor is better positioned" to make the decision).[3] Mixed questions are not all alike. As U. S. Bank suggests, some require courts to expound on the law, particularly by amplifying or elaborating on a broad legal standard. When that is so—when applying the law involves developing auxiliary legal principles of use in other cases—appellate courts should typically review a decision *de novo*. See *Salve Regina College* v. *Russell*, 499 U. S. 225, 231–233 (1991) (discussing appellate courts' "institutional advantages" in giving legal guidance). But as Lakeridge replies, other mixed questions immerse courts in case-specific factual issues—compelling them to marshal and weigh evidence, make credibility judgments, and otherwise address what we have (emphatically if a tad redundantly) called "multifarious, fleeting, special, narrow facts that utterly resist generalization." *Pierce* v. *Underwood*, 487 U. S. 552, 561–562 (1988) (internal quotation marks omitted). And when that is so, appellate courts should usually review a decision with deference. See *Anderson* v. *Bessemer City*, 470 U. S. 564, 574–576 (1985) (discussing trial courts' "superi-

[3] In selecting standards of review, our decisions have also asked whether a "long history of appellate practice" supplies the answer. *Pierce* v. *Underwood*, 487 U. S. 552, 558 (1988). But we cannot find anything resembling a "historical tradition" to provide a standard for reviewing the mixed question here. *Ibid.*

ority" in resolving such issues).[4] In short, the standard of review for a mixed question all depends—on whether answering it entails primarily legal or factual work.

Now again, recall the mixed question the Bankruptcy Court confronted in this case. See *supra,* at 7. At a high level of generality, the court needed to determine whether the basic facts it had discovered (concerning Rabkin's relationships, motivations, and so on) were sufficient to make Rabkin a non-statutory insider. But the court's use of the Ninth Circuit's legal test for identifying such insiders reduced that question to a more particular one: whether the facts found showed an arm's-length transaction between Rabkin and MBP. See *ibid.*[5] And still, we can further delineate that issue just by plugging in the widely (universally?) understood definition of an arm's-length transaction: a transaction conducted as though the two parties were strangers. See, *e.g.,* Black's Law Dictionary 1726 (10th ed. 2014). Thus the mixed question becomes:

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[4] Usually but not always: In the constitutional realm, for example, the calculus changes. There, we have often held that the role of appellate courts "in marking out the limits of [a] standard through the process of case-by-case adjudication" favors *de novo* review even when answering a mixed question primarily involves plunging into a factual record. *Bose Corp.* v. *Consumers Union of United States, Inc.*, 466 U. S. 485, 503 (1984); see *Ornelas* v. *United States*, 517 U. S. 690, 697 (1996) (reasonable suspicion and probable cause under the Fourth Amendment); *Hurley* v. *Irish-American Gay, Lesbian and Bisexual Group of Boston, Inc.*, 515 U. S. 557, 567 (1995) (expression under the First Amendment); *Miller* v. *Fenton*, 474 U. S. 104, 115–116 (1985) (voluntariness of confession under the Fourteenth Amendment's Due Process Clause).

[5] A bankruptcy court applying the Ninth Circuit's test might, in another case, reach its separate, non-transactional prong: whether "the closeness of [a person's] relationship with the debtor is comparable to that of the enumerated insider classifications" in the Code. *In re Village at Lakeridge, LLC,* 814 F. 3d 993, 1001 (2016); see *supra,* at 4. We express no opinion on how an appellate court should review a bankruptcy court's application of that differently framed standard to a set of established facts.

Given all the basic facts found, was Rabkin's purchase of MBP's claim conducted as if the two were strangers to each other?

That is about as factual sounding as any mixed question gets. Indeed, application of the Ninth Circuit's arm's-length legal standard really requires what we have previously described as a "factual inference[ ] from undisputed basic facts." *Commissioner* v. *Duberstein*, 363 U. S. 278, 291 (1960) (holding that clear-error review applied to a decision that a particular transfer was a statutory "gift"). The court takes a raft of case-specific historical facts,[6] considers them as a whole, balances them one against another—all to make a determination that when two particular persons entered into a particular transaction, they were (or were not) acting like strangers. Just to describe that inquiry is to indicate where it (primarily) belongs: in the court that has presided over the presentation of evidence, that has heard all the witnesses, and that has both the closest and the deepest understanding of the record—*i.e.*, the bankruptcy court.

And we can arrive at the same point from the opposite direction—by asking how much legal work applying the arm's-length test requires. Precious little, in our view—as shown by judicial opinions addressing that concept. Our own decisions, arising in a range of contexts, have never tried to elaborate on the established idea of a transaction conducted as between strangers; nor, to our knowledge, have lower courts. See, *e.g., Jones* v. *Harris Associates L. P.*, 559 U. S. 335, 346 (2010); *Commissioner* v. *Wemyss*, 324 U. S. 303, 307 (1945); *Pepper* v. *Litton*, 308 U. S. 295, 306–307 (1939). The stock judicial method is merely to

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[6] Or, to use the more abundant description we quoted above, "multifarious, fleeting, special, narrow facts that utterly resist generalization." *Pierce*, 487 U. S., at 561–562 (internal quotation marks omitted); see *supra,* at 8.

state the requirement of such a transaction and then to do the fact-intensive job of exploring whether, in a particular case, it occurred. See, *e.g., Wemyss*, 324 U. S., at 307. Contrary to U. S. Bank's view, there is no apparent need to further develop "norms and criteria," or to devise a supplemental multi-part test, in order to apply the familiar term. Brief for Petitioner 53; see Tr. of Oral Arg. 18; *supra,* at 7. So appellate review of the arm's-length issue—even if conducted *de novo*—will not much clarify legal principles or provide guidance to other courts resolving other disputes. And that means the issue is not of the kind that appellate courts should take over.[7]

The Court of Appeals therefore applied the appropriate standard in reviewing the Bankruptcy Court's determination that Rabkin did not qualify as an insider because his transaction with MBP was conducted at arm's length. A conclusion of that kind primarily rests with a bankruptcy court, subject only to review for clear error. We accordingly affirm the judgment below.

It is so ordered.

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[7] That conclusion still leaves some role for appellate courts in this area. They of course must decide whether a bankruptcy court committed clear error in finding that a transaction was arm's length (or not). (We express no view of that aspect of the Ninth Circuit's decision because we did not grant certiorari on the question. See *supra,* at 5.) In addition, an appellate court must correct any legal error infecting a bankruptcy court's decision. So if the bankruptcy court somehow misunderstood the nature of the arm's-length query—or if it devised some novel multi-factor test for addressing that issue—an appellate court should apply *de novo* review. And finally, if an appellate court someday finds that further refinement of the arm's-length standard is necessary to maintain uniformity among bankruptcy courts, it may step in to perform that legal function. By contrast, what it may *not* do is review independently a garden-variety decision, as here, that the various facts found amount to an arm's-length (or a non-arm's-length) transaction and so do not (or do) confer insider status.

SUPREME COURT OF THE UNITED STATES

No. 15–1509

U.S. BANK NATIONAL ASSOCIATION, TRUSTEE, BY AND THROUGH CWCAPITAL ASSET MANAGEMENT LLC, PETITIONER *v.* THE VILLAGE AT LAKERIDGE, LLC

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

[March 5, 2018]

JUSTICE KENNEDY, concurring.

I join the opinion for the Court and the concurring opinion by JUSTICE SOTOMAYOR. In doing so, it seems appropriate to add these further comments.

As the Court's opinion makes clear, courts of appeals may continue to elaborate in more detail the legal standards that will govern whether a person or entity is a nonstatutory insider under the Bankruptcy Code. *Ante,* at 6, 11, n. 7. At this stage of the doctrine's evolution, this ongoing elaboration of the principles that underlie nonstatutory insider status seems necessary to ensure uniform and accurate adjudications in this area.

In particular, courts should consider the relevance and meaning of the phrase "arms-length transaction" in this bankruptcy context. See *ibid.* As courts of appeals address these issues and make more specific rulings based on the facts and circumstances of individual cases, it may be that instructive, more specifically defined rules will develop.

This leads to an additional point. Under the test that the Court of Appeals applied here, there is some room for doubt that the Bankruptcy Judge was correct in concluding that Rabkin was not an insider, especially without

further inquiry into whether the offer Bartlett made to Rabkin could and should have been made to other parties who might have paid a higher price. See *In re Village at Lakeridge, LLC*, 814 F. 3d 993, 1006 (CA9 2016) (Clifton, J., concurring in part and dissenting in part) ("[E]ven if the clear error standard applies, the finding that Rabkin was not a non-statutory insider cannot survive scrutiny"). MBP's failure to offer its claim more widely could be a strong indication that the transaction was not conducted at arm's length. As the Court is careful and correct to note, however, certiorari was not granted on this question. See *ante,* at 11, n. 7. As a result, whether the test for non-statutory insider status as formulated and used by courts in the Ninth Circuit is sufficient is not before us; and whether on these facts it was clear error to find that Rabkin was not an insider is also not before us.

The Court's holding should not be read as indicating that the non-statutory insider test as formulated by the Court of Appeals is the proper or complete standard to use in determining insider status. Today's opinion for the Court properly limits its decision to the question whether the Court of Appeals applied the correct standard of review, and its opinion should not be read as indicating that a transaction is arm's length if the transaction was negotiated simply with a close friend, without broader solicitation of other possible buyers.

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ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

[March 5, 2018]

JUSTICE SOTOMAYOR, with whom JUSTICE KENNEDY, JUSTICE THOMAS, and JUSTICE GORSUCH join, concurring.

The Court granted certiorari to decide "[w]hether the appropriate standard of review for determining non-statutory insider status" under the Bankruptcy Code is *de novo* or clear error. Pet. for Cert. i. To answer that question, the Court "take[s] . . . as a given" the two-prong test that the Court of Appeals for the Ninth Circuit has adopted for determining whether a person or entity is an insider. *Ante,* at 6. I join the Court's opinion in full because, within that context, I agree with the Court's analysis that a determination whether a particular transaction was conducted at arm's length is a mixed question of law and fact that should be reviewed for clear error. See *ante,* at 10–11.

I write separately, however, because I am concerned that our holding eludes the more fundamental question whether the Ninth Circuit's underlying test is correct. If that test is not the right one, our holding regarding the standard of review may be for naught. That is because the appropriate standard of review is deeply intertwined with the test being applied. As the Court puts it, "the standard of review for a mixed question all depends—on whether

answering it entails primarily legal or factual work." *Ante,* at 9.

Here, the Court identifies the Ninth Circuit as having affirmed on the basis of the second prong of its test, pursuant to which the Ninth Circuit concluded that the relevant transaction between Robert Rabkin and MBP Equity Partners was conducted at arm's length. *Ante,* at 6. Because that analysis is primarily factual in nature, the Court rightly concludes that appellate review of the Bankruptcy Court's decision is for clear error. *Ante,* at 10–11. However, if the proper inquiry did not turn solely on an arm's-length analysis but rather involved a different balance of legal and factual work, the Court may have come to a different conclusion on the standard of review.

The Court's discussion of the standard of review thus begs the question of what the appropriate test for determining non-statutory insider status is. I do not seek to answer that question, as the Court expressly declined to grant certiorari on it. I have some concerns with the Ninth Circuit's test, however, that would benefit from additional consideration by the lower courts.

As the Ninth Circuit interpreted the Code, "[a] creditor is not a non-statutory insider unless: (1) the closeness of its relationship with the debtor is comparable to that of the enumerated insider classifications in [11 U. S. C.] §101(31), *and* (2) the relevant transaction is negotiated at less than arm's length." *In re Village at Lakeridge, LLC*, 814 F. 3d 993, 1001 (2016) (emphasis added). Under this test, because prongs one and two are conjunctive, a court's conclusion that the relevant transaction was conducted at arm's length necessarily defeats a finding of non-statutory insider status, regardless of how close a person's relationship with the debtor is or whether he is otherwise comparable to a statutorily enumerated insider.[1]

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[1] Other Circuits have developed analogous rules. See, *e.g., Matter of*

It is not clear to me, however, that the Ninth Circuit has explained how this two-prong test is consistent with the plain meaning of the term "insider" as it appears in the Code. The concept of "insider" generally rests on the presumption that a person or entity alleged to be an insider is so connected with the debtor that any business conducted between them necessarily cannot be conducted at arm's length. See Black's Law Dictionary 915 (10th ed. 2014) (defining "insider" as "[a]n entity or person who is so closely related to a debtor that any deal between them will not be considered an arm's-length transaction and will be subject to close scrutiny"). Title 11 U. S. C. §101(31) defines "insider" by identifying certain individuals or entities who are considered insiders merely on the basis of their status, without regard to whether any relevant transaction is conducted at arm's length. Such an individual is not under any circumstance able to vote for a reorganization plan. See §1129(a)(10).

In contrast, under prong two of the Ninth Circuit's test, an individual who is similar to, but does not fall precisely within, one of the categories of insiders listed in §101(31) will not be considered an insider and will be able to vote under §1129(a)(10) so long as the transaction relevant to the bankruptcy proceeding is determined to have been conducted at arm's length. This would include, for example, a romantic partner of an insider, even one who in all or most respects acts like a spouse.

Given that courts have interpreted "non-statutory insiders" as deriving from the same statutory definition as the enumerated insiders in §101(31), the basis for the disparate treatment of two similar individuals is not immediately

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Holloway, 955 F. 2d 1008, 1011 (CA5 1992); *In re U. S. Medical, Inc.*, 531 F. 3d 1272, 1277–1278 (CA10 2008); *In re Winstar Communications, Inc.*, 554 F. 3d 382, 396–397 (CA3 2009). But see *In re Longview Aluminum, LLC*, 657 F. 3d 507, 510 (CA7 2011).

apparent. Lower courts have concluded that the Code's use of the term "includes" in the definition of "insider" in §101(31) signals that Congress contemplated that certain other persons or entities in addition to those listed would qualify as insiders. See *ante,* at 2. Notably, this Court has never addressed that issue directly, although the Court has held in other contexts that "the term 'including' is not one of all-embracing definition, but connotes simply an illustrative application of the general principle." *Federal Land Bank of St. Paul* v. *Bismarck Lumber Co.*, 314 U. S. 95, 100 (1941).

Assuming §101(31) encompasses such "non-statutory insiders," the only clue we have as to which persons or entities fall within that category is the list of enumerated insiders and the presumption of lack of arm's length that follows from that label. Because each of those persons or entities are considered insiders regardless of whether a particular transaction appears to have been conducted at arm's length, it is not clear why the same should not be true of non-statutory insiders. That is, an enumerated "insider" does not cease being an insider just because a court finds that a relevant transaction was conducted at arm's length. Then why should a finding that a transaction was conducted at arm's length, without more, conclusively foreclose a finding that a person or entity is a "non-statutory insider"?

Of course, courts must develop some principled method of determining what other individuals or entities fall within the term "insider" other than those expressly provided. I can conceive of at least two possible legal standards that are consistent with the understanding that insider status inherently presumes that transactions are not conducted at arm's length. First, it could be that the inquiry should focus solely on a comparison between the characteristics of the alleged non-statutory insider and the enumerated insiders, and if they share sufficient common-

alities, the alleged person or entity should be deemed an insider regardless of the apparent arm's-length nature of any transaction. Cf. *In re Longview Aluminum, LLC*, 657 F. 3d 507, 510–511 (CA7 2011) (considering only whether a manager of a debtor corporation was comparable to the enumerated insiders, regardless of whether any transaction was conducted at less-than-arm's length).

Second, it could be that the test should focus on a broader comparison that includes consideration of the circumstances surrounding any relevant transaction. If a transaction is determined to have been conducted at less-than-arm's length, it may provide strong evidence in the context of the relationship as a whole that the alleged non-statutory insider should indeed be considered an insider. Relatedly, if the transaction does appear to have been undertaken at arm's length, that may be evidence, considered together with other aspects of the parties' relationship, that the alleged non-statutory insider should not, in fact, be deemed an insider.

Neither of these conceptions reflects the Ninth Circuit's test. Rather, the Ninth Circuit considered separately whether Rabkin was comparable to an enumerated insider and whether the transaction between Rabkin and MBP was conducted at arm's length. See 814 F. 3d, at 1002–1003. Because the Ninth Circuit concluded that the transaction was undertaken at arm's length, that finding was dispositive of non-statutory insider status under their test, leading this Court, in turn, to consider the standard of review only with respect to that prong.

It is conceivable, however, that if the appropriate test were different from the one articulated by the Ninth Circuit, such as the two examples I outlined above, the applicable standard of review would be different as well. See *ante,* at 6, 9, n. 5. To make more concrete how this may play out in practice, I briefly walk through how I might apply my two proposed tests to the facts of this case.

If a comparative analysis were the right test, and assuming, *arguendo*, that it involves more legal than factual work thus resulting in *de novo* review, certain aspects of Rabkin's relationship with Kathleen Bartlett, an undisputed insider of the debtor, strike me as suggesting that Rabkin should have been designated as a non-statutory insider. Rabkin purchased the claim from MBP, but Bartlett, a member of MBP's board, facilitated the transaction. Even though Rabkin and Bartlett kept separate finances and lived separately, they shared a "romantic" relationship, see *ante,* at 4; Rabkin knew that the debtor was in bankruptcy, 814 F. 3d, at 1003; and Bartlett approached only Rabkin with the offer to sell MBP's claim, *id.,* at 1002. In a strict comparative analysis, Rabkin's interactions with Bartlett and MBP suggest that he may have been acting comparable to an enumerated insider, for example, like a relative of an officer of an insider. See §101(31)(B)(vi).

Even if the comparative analysis included a broader consideration of features of the transaction that suggest it was conducted at arm's length, and assuming, *arguendo*, that *de novo* review would apply, it is not obvious that those features would outweigh the aspects of the relationship that are concerning. Even though Rabkin purportedly lacked knowledge of the cramdown plan prior to his purchase and considered the purchase a "small investment" not warranting due diligence, 814 F. 3d, at 1003, there was no evidence of negotiation over the price, *id.,* at 1004 (Clifton, J., dissenting), or any concrete evidence that MBP obtained real value in the deal aside from the prospect of Rabkin's vote in the cramdown.[2]

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[2] Outside the context of a determination of insider status, it is possible that the nature of a transaction is relevant to assessing the integrity of bankruptcy proceedings in other ways; for example, in assessing whether a vote in a reorganization plan was "not in good faith, or was not solicited or procured in good faith." §1126(e). It troubles me here

Even if the proper test for insider status called for clear error review, it is possible that the facts of this case when considered through the lens of that test, as opposed to one focused solely on arm's length, may have warranted a finding that Rabkin was a non-statutory insider.

This is all to say that I hope that courts will continue to grapple with the role that an arm's-length inquiry should play in a determination of insider status. In the event that the appropriate test for determining non-statutory insider status is different from the one that the Ninth Circuit applied, and involves a different balance of legal and factual work than the Court addresses here, it is possible I would view the applicable standard of review differently. Because I do not read the Court's opinion as foreclosing that result, I join it in full.

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that neither the Bankruptcy Court nor the Ninth Circuit considered whether Rabkin's purchase of MBP's claim for $5,000 was for value. See App. to Pet. for Cert. 67a (bankruptcy order); *In re Village at Lakeridge, LLC*, 634 Fed. Appx. 619, 621 (2016). Cf. *In re DBSD North Am., Inc.*, 634 F. 3d 79, 104 (CA2 2011) (stating that a transferee's overpayment for claims was relevant to a good-faith determination under §1126(e)); §548(c) (providing that a transfer will not be considered constructively fraudulent, and will not be voidable under §548(a), where "a transferee . . . takes for value and in good faith"). Indeed, we have no concrete information about what benefit MBP received from the transaction aside from the prospect of Rabkin's vote in the cramdown. Of course, the Ninth Circuit's decision with respect to §1126(e) is not before this Court, but it again prompts a concern with how the courts below considered the nature of the transaction.