COURT OF APPEALS
DECISION
DATED AND FILED

August 26, 1998

Marilyn L. Graves
Clerk, Court of Appeals
of Wisconsin

No. 97-2960

STATE OF WISCONSIN **IN COURT OF APPEALS**
DISTRICT II

ALAN SCHROEDER AND BARBARA SCHROEDER, INDIVIDUALLY AND DERIVATIVELY ON BEHALF OF BROOKFIELD STORAGE, INC., A WISCONSIN CORPORATION,

PLAINTIFFS-APPELLANTS,

V.

EQUITABLE BANK, SSB., A STATE CHARTERED SAVINGS BANK,

DEFENDANT-RESPONDENT,

BROOKFIELD STORAGE, INC., A WISCONSIN CORPORATION, AND TODD W. HANSEN,

DEFENDANTS.

APPEAL from a judgment of the circuit court for Waukesha County: ROBERT G. MAWDSLEY, Judge. *Affirmed.*

Before Snyder, P.J., Nettesheim and Anderson, JJ.

NETTESHEIM, J. Alan and Barbara Schroeder appeal from a summary judgment in favor of Equitable Bank, SSB. The Schroeders lost a significant amount of money resulting from a corporate and partnership business venture with Todd W. Hansen, who subsequently diverted funds from both businesses to his personal checking account at Equitable. The Schroeders filed an action against Equitable seeking damages for their pecuniary loss, for mental anguish and emotional distress, and for punitive damages. The Schroeders claimed that Equitable acted in a commercially unreasonable manner and converted funds when it permitted Hansen to deposit the funds into his personal account.

At summary judgment, the trial court dismissed the Schroeders' claims against Equitable. The court ruled that (1) the Schroeders' action was barred on grounds of issue preclusion because they had previously failed when litigating similar claims against their escrow agent in federal court, and (2) the Schroeders lacked standing because their claims were derivative as to both the corporation and the partnership.

The parties raise a variety of issues on appeal. However, we conclude that the standing issue is dispositive. We hold that the trial court properly granted judgment in favor of Equitable because the Schroeders' claims are derivative as to both the corporation and the partnership. Because the Schroeders failed to comply with § 180.0742, STATS., before bringing a derivative claim on behalf of the corporation and because the law does not recognize a

derivative action by a general partner, we affirm the trial court's ruling that the Schroeders lacked standing to assert these claims.[1]

FACTS

In January 1989, the Schroeders formed a general partnership, Supermound Investors (SI), with Hansen and his wife, Linda. Originally, all four partners were equal managing partners. However, in May 1989, by an addendum to the partnership agreement, Hansen was named the sole managing partner. The purpose of SI was to develop an office warehouse project in Waukesha. In conjunction with the formation of SI, the Schroeders loaned money to the partnership.

In August 1989, the Schroeders and Hansen formed a corporation, Brookfield Storage, Inc. (BSI), which was to develop a mini-warehouse project in Brookfield. In conjunction with the formation of the corporation, the Schroeders guaranteed a $15,000 loan made to the corporation by Tri City Bank. The Schroeders and the Hansens each owned forty-five percent of the stock, and Mary Drangstveit owned the remaining ten percent. Hansen was president and treasurer of BSI and Drangstveit was vice president and secretary. Hansen employed Drangstveit as secretary and bookkeeper for the partnership and corporation. In

[1] Because our holding is dispositive of the appeal, we need not address the other issues raised by the parties. These include: (1) the trial court's ruling that the Schroeders' action is barred on grounds of issue preclusion; (2) Equitable's claim that the Schroeders' action is time barred by the statute of repose set forth in § 893.51(1), STATS.; (3) Equitable's claim that Hansen was authorized to endorse the checks and to make the deposits; and (4) the Schroeders' claim that Equitable acted in a commercially unreasonable manner and converted the business funds when it permitted Hansen to deposit business funds in his personal account at Equitable. *See* ***Gross v. Hoffman***, 227 Wis. 296, 300, 277 N.W. 663, 665 (1938) (only dispositive issue need be addressed).

1991, Hansen obtained possession of Drangstveit's stock in the corporation giving Hansen and his wife control over fifty-five percent of the corporation.

The corporation and the partnership obtained construction loans from Tri City Bank. Old Republic National Title Insurance Company, f/k/a Title Insurance Company of Minnesota (Old Republic), acted as the escrow agent for the disbursement of the corporation's funds.

Beginning in early 1989, Hansen began diverting funds belonging to SI and BSI and converting them for his personal use without the knowledge, consent or authorization of the Schroeders, the partnership or the corporation. On or about August 9, 1989, Hansen opened a personal checking account at Equitable's Waukesha branch office. Hansen thereafter made unauthorized deposits of checks made payable to the partnership and the corporation to his personal account. He also deposited checks from the corporation made payable to Equitable into his personal checking account.

The Schroeders did not discover Hansen's diversion of funds until April or May of 1991.[2] As a result of Hansen's actions, both SI and BSI went into foreclosure, and the Schroeders lost their investment in both entities. In addition, the Schroeders lost the money they had loaned to SI, and they were forced to pay the BSI loan guarantee to Tri City Bank.

[2] Upon discovering Hansen's actions, the Schroeders notified the Brookfield police department. Their investigation revealed that Hansen had converted approximately $400,000 from Supermound Investors and Brookfield Storage, Inc. Hansen was charged with nine counts of felony theft. He subsequently pled no contest to two counts and the remaining seven were dismissed and read in for purposes of sentencing.

The Schroeders commenced an action in federal court against Old Republic. The crux of the Schroeders' claim was that Old Republic had breached the escrow agreement by issuing corporate checks to Hansen without the documentation required by the escrow agreement. The federal district court concluded that the Schroeders' damages were not the result of a direct injury caused by Old Republic. As such, the court concluded that the Schroeders' claims were derivative of their status as shareholders and partners. The court dismissed the action, ruling that the law does not recognize such derivative actions.

The Schroeders then commenced this action against Equitable. The complaint sought damages for the Schroeders' pecuniary losses, and for their mental anguish and emotional distress. In addition, the Schroeders sought punitive damages. At this time, neither SI nor BSI owned any assets. The Schroeders' complaint alleged that Hansen was liable for breach of fiduciary duty, fraud and intentional deceit. The complaint also alleged that Equitable had acted in a commercially unreasonable manner and thereby had converted funds under § 403.419, STATS., 1993-94, by allowing Hansen to deposit corporate checks into his personal account.

Equitable moved for summary judgment, arguing four grounds in support. First, Equitable argued that the Schroeders lacked standing to sue on grounds of issue preclusion because they had previously and unsuccessfully sued Old Republic, the escrow agent, in federal court for breach of the escrow agreement. Second, Equitable argued that the Schroeders lacked standing to sue as individual shareholders and individual partners. Third, Equitable argued that Hansen, as managing partner of SI and president of BSI, was authorized to endorse and deposit the checks. Fourth, Equitable argued that the Schroeders' claims were barred by the statute of limitations.

In a written decision, the trial court granted summary judgment in favor of Equitable. The court's ruling was based on the same logic underlying the federal court's decision in the Schroeders' case against Old Republic—that the Schroeders' claims were derivative because Hansen's actions did not directly injure the Schroeders but rather injured the partnership and the corporation. The court dismissed the derivative claims as to the corporation because the Schroeders had failed to comply with § 180.0742, STATS., which requires that a shareholder may commence a derivative suit only after making a written demand upon the corporation to take suitable action. The court additionally ruled that the Schroeders lacked standing to bring a derivative claim on behalf of the partnership.

The Schroeders appeal.

DISCUSSION

"We review a motion for summary judgment using the same methodology as the trial court." ***M & I First Nat'l Bank v. Episcopal Homes Management, Inc.***, 195 Wis.2d 485, 496, 536 N.W.2d 175, 182 (Ct. App. 1995); *see also* § 802.08(2), STATS. "Although summary judgment presents a question of law which we review de novo, we nevertheless value a trial court's decision on such a question." ***M & I First Nat'l Bank***, 195 Wis.2d at 497, 536 N.W.2d at 182.

The methodology of summary judgment is well known and we will not repeat it here except to observe that summary judgment is appropriate when there is no genuine issue of material fact and the moving party is entitled to judgment as a matter of law. *See* ***id***. at 496-97, 536 N.W.2d at 182. If a dispute of any material fact exists, or if the material presented on the motion is subject to conflicting factual interpretations or inferences, summary judgment must be

denied. *See* ***State Bank of La Crosse v. Elsen***, 128 Wis.2d 508, 512, 383 N.W.2d 916, 918 (Ct. App. 1986).

1. THE CORPORATE CLAIM

We first address the corporate aspect of the Schroeders' claim. The Schroeders contend that they "sustained an injury distinct to them as compared to the corporation or any other shareholder" because they paid $15,000 to Tri City Bank pursuant to the loan guarantee they made on behalf of the corporation and because they incurred legal fees in connection with that obligation. However, this argument overlooks that Hansen did not divert funds from the Schroeders personally. Rather, the Schroeders' losses resulted indirectly from the losses which Hansen's conduct directly inflicted on the corporation.

Like the federal district court in the Schroeders' action against Old Republic and like the trial court in this case, we conclude that any damage suffered by the Schroeders was not because of any conduct by Hansen directly against the Schroeders. Rather, the Schroeders' damage is derivative of Hansen's conduct against the corporation. Therefore, the corporation is the aggrieved party and the corporation must redress the wrong in its own name and in its own right. *See* ***Mid-State Fertilizer v. Exchange Nat'l Bank***, 877 F.2d 1333, 1335 (7th Cir. 1989); *see also* ***Read v. Read***, 205 Wis.2d 558, 570, 556 N.W.2d 768, 773 (Ct. App. 1996) ("[A]bsent an individual right, a shareholder may not bring suit for actions accruing to the corporation.").

We recognize, as did the federal district court in the Schroeders' action against Old Republic, that the direct injury requirement can work harsh results on a guarantor in a setting involving a closely held corporation and a partnership. But those are the risks a guarantor assumes. We also recognize, as

did the concurring opinion in ***Mid-State Fertilizer***, that there may be situations where the direct injury requirement should be relaxed. *See* ***Mid-State Fertilizer***, 877 F.2d at 1340 (Ripple, J., concurring). However, those situations contemplate that the defendant bank is also the holder of the guarantee and the bank has imposed conditions on the guarantor which, in conjunction with the relationship between the corporation and the guarantor, require that the guarantor be given standing. *See* ***id***.; *see also* ***Swerdloff v. Miami Nat'l Bank***, 584 F.2d 54 (5th Cir. 1978). That is not the situation here. Equitable did not hold the Schroeders' guarantee and it had no relationship with the Schroeders. The same point was noted by Judge Stadtmueller in his decision dismissing the Schroeders' claim against Old Republic: "However, the key point is that in this case, the defendant Old Republic had no role in making the Schroeders be guarantors."

Since the Schroeders' claim is not direct, we next address whether they had standing to bring a derivative claim against Equitable. Although a derivative action is one in equity, *see* ***Read***, 205 Wis.2d at 563-65, 556 N.W.2d at 770-71, the issue as to the Schroeders' standing to bring a derivative action hinges on whether the Schroeders have complied with § 180.0742, STATS. That inquiry presents a question of law which we review de novo. *See* ***Grube v. Daun***, 210 Wis.2d 681, 687, 563 N.W.2d 523, 526 (1997).

> Section 180.0742, STATS., provides:
>
> No shareholder or beneficial owner may commence a derivative proceeding until all of the following occur:
>
> **(1)** A written demand is made upon the corporation to take suitable action.
>
> **(2)** Ninety days expire from the date on which the demand was made, unless the shareholder or beneficial owner is notified before the expiration of 90 days that the corporation has rejected the demand or unless irreparable

> injury to the corporation would result by waiting for the expiration of the 90-day period.

The Schroeders concede in their complaint that they did not comply with the demand requirement. They contend, however, that they should not be held to the requirement of the statute because "a demand that Hansen bring an action against himself or against Equitable would be futile or useless."

While the Schroeders recognize that § 180.0742, STATS., does not provide for any exceptions, they nevertheless request this court to apply a futility exception to the statute. We decline to do so. The futility exception was recognized in an earlier version of § 180.0742 which required that a plaintiff in a derivative action allege "his efforts to secure from the board of directors such action as he desires … or the reasons for not making such effort." Section 180.405(1)(b), STATS., 1987-88. However, that version of the statute was repealed and recreated by 1991 Wis. Act 16, § 25. The present version mandates, without exception, that the shareholder demand that the corporation file suit. *See* § 180.0742. We reject the Schroeders' contention that they did not have to comply with the demand requirement because it would have been futile.

2. THE PARTNERSHIP CLAIM

We next turn to the partnership aspect of the Schroeders' claim. The Schroeders contend that the trial court erroneously relied upon the holdings in ***Hauer v. Bankers Trust New York Corp.***, 65 F.R.D. 1 (E.D. Wis. 1974), and ***Hauer v. Bankers Trust New York Corp.***, 509 F. Supp. 168 (E.D. Wis. 1981), *aff'd*, ***Hauer v. BT Advisors, Inc.,*** 671 F.2d 1020 (7th Cir. 1982) (per curiam). In those cases, the courts concluded that Wisconsin law does not permit a partner to sue derivatively on behalf of a partnership. *See, e.g.,* ***Hauer***, 65 F.R.D. at 4. The court noted that while Wisconsin statutes permit a shareholder to bring a

derivative suit, *see* § 180.0742, STATS., there is no such provision regarding general partnerships.

The correctness of these holdings is reinforced by developments on the legislative front. Since the federal district court's first decision in ***Hauer***, the legislature enacted a provision under the Uniform Limited Partnership Act which expressly permits a limited partner to bring a derivative action "if general partners with authority to do so have refused to bring the action or if an effort to cause those general partners to bring the action is not likely to succeed." Section 179.91, STATS. However, to date, no similar provision exists with respect to general partnerships such as SI. Therefore, if Hansen acted improperly toward the partnership, it is the partnership's exclusive right to redress any wrongs suffered as a result. *See* ***Hauer***, 509 F. Supp. at 175.

The Schroeders attempt to distinguish ***Hauer*** on the basis that Hauer did not have the support of the majority of the managing partners in bringing a derivative suit. *See* ***Hauer,*** 65 F.R.D. at 4. The Schroeders contend that in the instant case, "the effective majority of SI's Managing Partners have agreed to pursue a claim against Equitable Bank, given Hansen's clear breach of his fiduciary duty to SI." Even if we accepted this distinction, it would not undo the effect of the statutory interpretation we have just recited. Moreover, the May 1989 addendum to the partnership agreement made Hansen the sole managing partner. The Schroeders' argument asks this court to assume that Hansen was no longer a managing partner of SI following his diversion of funds or that Hansen's wife would join the Schroeders in constituting a majority of the managing partners. However, we find nothing in the record which supports this assumption.

In addition, even if we considered only the original partnership agreement which recited four equal managing partners (the Schroeders and the Hansens), the Schroeders, as a couple, would not constitute a majority of the four partners.

Finally, the Schroeders contend that § 803.01(2), STATS., permits them to sue on behalf of the partnership. This statute provides in relevant part: "A partner asserting a partnership claim may sue in the partner's name without joining the other members of the partnership, but the partner shall indicate in the pleading that the claim asserted belongs to the partnership." ***Id.*** However, this statute is part of the rules of civil procedure which "govern procedure and practice" in the circuit court. Section 801.01(2), STATS. Whether a person has standing to sue is a substantive, not a procedural, question. Once standing is satisfied, then § 803.01(2) instructs as to who may bring an action in a representative capacity.

CONCLUSION

We conclude that the Schroeders' claims with respect to both the corporation and the partnership are derivative. Because the Schroeders have failed to comply with the demand requirement of § 180.0742, STATS., the trial court properly dismissed the corporate aspect of the Schroeders' claim. In addition, the trial court properly dismissed the partnership aspect of the Schroeders' claim because the law does not recognize such a derivative action. We affirm the grant of summary judgment to Equitable.

By the Court.—Judgment affirmed.

Recommended for publication in the official reports.