COURT OF APPEALS
DECISION
DATED AND FILED

May 14, 2019

Sheila T. Reiff
Clerk of Court of Appeals

NOTICE

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A party may file with the Supreme Court a petition to review an adverse decision by the Court of Appeals. *See* WIS. STAT. § 808.10 and RULE 809.62.

Appeal No. 2018AP1419 **Cir. Ct. No. 2017CV271**

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

NASH FINCH COMPANY,

PLAINTIFF-RESPONDENT,

V.

GORDY'S CHIPPEWA FOODS, INC., GORDY'S FOOD & LIQUOR, INC., GORDY'S EAU CLAIRE FOODS, INC., CORNELL FOODS, INC., LADYSMITH FOODS, INC., GORDY'S EAU CLAIRE SOUTH, INC., GORDY'S AUGUSTA FOODS, INC., GORDY'S EAU CLAIRE WEST, INC., GORDY'S CHETEK FOODS, INC., GORDY'S RICE LAKE FOODS, INC., GORDY'S NEILLSVILLE FOODS, INC., GORDY'S SHELL LAKE FOODS, INC., GORDY'S ARCADIA FOODS, INC., GORDY'S GALESVILLE FOODS, INC., GORDY'S LA CROSSE FOODS, INC., GORDY'S STANLEY FOODS, INC., GORDY'S BARRON FOODS, INC., GORDY'S WHITEHALL FOODS, INC., GORDY'S EAU CLAIRE CLAIREMONT FOODS, INC., GORDY'S HAYWARD FOODS, INC., GORDY'S CHIPPEWA SOUTH, INC., GORDY'S BLACK RIVER FALLS, INC., GORDY'S RICHLAND CENTER FOODS, INC., GORDY'S SPENCER FOODS, INC. AND GORDY'S TOMAH FOODS, INC.,

DEFENDANTS,

MICHAEL S. POLSKY,

RECEIVER-RESPONDENT,

SETTLERS BANK, AMERICAN FINANCIAL NETWORK, INC., CHARTER BANK, GENERAL BEER-NORTHEAST, INC., GENERAL BEER-NORTHWEST, INC., TOM & JANE PROPERTIES, LLC, SARATOGA LIQUOR CO., INC., GORDON & DONNA SCHAFER, SCHAFER PROPERTIES PARTNERS, LLC, SCHAFER PROPERTIES OF CHIPPEWA COUNTY, LP, THE BANK OF SUN PRAIRIE, STERLING BANK, BLACK RIVER FALLS MUNICIPAL AUTHORITY, CONSUMERS COOPERATIVE ASSOCIATION OF EAU CLAIRE, ROYAL CREDIT UNION ("RCU"), QUILLINS, INC., WAUMANDEE STATE BANK, HANSEN'S IGA, INC., KENG ENTERPRISES LLC, THE FONG FAMILY, LLC, CITY OF ARCADIA, CITY OF LA CROSSE, LOWTHERBROTHERS, LLC, PEPSI BOTTLING GROUP LLC, FRITO-LAY NORTH AMERICA INC., QUAKER SALES AND DISTRIBUTION INC. AND RICHLAND CENTER CITY UTILITIES,

CREDITORS,

HILCO FIXTURE FINDERS LLC,

INTERESTED PERSON,

NORTHWEST WISCONSIN REFRIGERATION SERVICES LLC AND HUIRAS CONSTRUCTION, INC.,

CREDITORS-APPELLANTS.

APPEAL from an order of the circuit court for Chippewa County: JAMES M. ISAACSON, Judge. *Affirmed in part; reversed in part and cause remanded for further proceedings*.

Before Stark, P.J., Hruz and Seidl, JJ.

¶1 PER CURIAM. This appeal involves receivership proceedings commenced under WIS. STAT. ch. 128 (2017-18).[1] Michael Polsky is the court-appointed receiver of Gordy's Chippewa Foods, Inc., and twenty-four related entities (collectively, "the Gordy's Entities"). Nash Finch Company, which instituted the receivership proceedings, had a perfected security interest in assets owned by some of the Gordy's Entities. Huiras Construction, Inc., and Northwest Wisconsin Refrigeration Services LLC (collectively, "Huiras") were unsecured creditors of the Gordy's Entities. During the course of the receivership proceedings, some assets belonging to the Gordy's Entities were sold, and the proceeds were disbursed to Nash Finch. Because the sale proceeds were insufficient to satisfy Nash Finch's secured claim, unsecured creditors of the Gordy's Entities—including Huiras—received nothing.

¶2 On appeal, Huiras argues the receivership proceedings were not conducted in a lawful manner because it was clear from the outset that there was no "reasonable possibility" the Gordy's Entities' unsecured creditors would receive a dividend from the receivership estate.[2] In essence, Huiras argues that unless there is a reasonable possibility unsecured creditors will receive a dividend, a secured creditor may not use WIS. STAT. ch. 128 receivership proceedings to collect on its security interest. Huiras further argues that by improperly participating in the ch. 128 proceedings, Nash Finch waived its security interest, and the proceeds of the receivership estate should therefore be distributed pro rata

[1] All references to the Wisconsin Statutes are to the 2017-18 version unless otherwise noted.

[2] As used in WIS. STAT. ch.128, the term "dividend" refers to a distribution of funds to a creditor from the receivership estate in payment of the debt owed to the creditor. *See* ***Admanco, Inc. v. 700 Stanton Drive, LLC***, 2010 WI 76, ¶44, 326 Wis. 2d 586, 786 N.W.2d 759.

between Nash Finch and the Gordy's Entities' unsecured creditors. Huiras also argues that the circuit court erred by ordering it to pay Polsky's attorney fees and costs as a sanction under WIS. STAT. § 802.05(3).

¶3 We reject Huiras's argument that Nash Finch's participation in the WIS. STAT. ch. 128 receivership proceedings was improper and thus resulted in a waiver of Nash Finch's security interest. We therefore affirm in part. However, we conclude the circuit court erred by sanctioning Huiras on the court's own initiative without following the procedure set forth in WIS. STAT. § 802.05(3)(a)2. Moreover, the sanction the court imposed—i.e., the payment of Polsky's attorney fees and costs—is not available when a court orders sanctions on its own initiative. *See* § 802.05(3)(b). We therefore reverse that portion of the court's order requiring Huiras to pay Polsky's attorney fees and costs as a sanction under § 802.05(3), and we remand for the court to reconsider the issue of sanctions using the proper legal standards.

BACKGROUND

¶4 The Gordy's Entities operated twenty-six grocery and liquor stores throughout northwestern Wisconsin. On August 23, 2017, Nash Finch—a grocery store supplier—filed a summons and complaint against the Gordy's Entities in Chippewa County. The complaint alleged that the Gordy's Entities had entered into supply agreements with Nash Finch, and that to secure their obligations under those agreements, the Gordy's Entities had granted Nash Finch a security interest in the assets of twenty-one of the Gordy's Entities' stores. The complaint further alleged that Nash Finch had properly perfected its security interest. The complaint also alleged that as of July 17, 2017, the Gordy's Entities owed Nash Finch over $86 million. Finally, the complaint alleged, upon information and belief, that the

Gordy's Entities were insolvent or in imminent danger of insolvency. The complaint therefore asked the circuit court to appoint a receiver for the Gordy's Entities under WIS. STAT. ch. 128.

¶5 On the same day Nash Finch filed its complaint—and with the Gordy's Entities' consent—the circuit court entered an order appointing Polsky as receiver for the Gordy's Entities. The Gordy's Entities subsequently filed an answer, in which they admitted the allegations in Nash Finch's complaint. Addressing the amount of their debt to Nash Finch, the Gordy's Entities admitted that they were jointly and severally liable to Nash Finch in the principal amount of $44,154,136, plus liquidated damages, attorney fees, and costs.

¶6 In addition to appointing Polsky receiver, the circuit court also entered an order authorizing Polsky to borrow funds and grant additional liens and security interests in the Gordy's Entities' assets. That order approved a financing agreement between Polsky, as receiver, and SpartanNash Company, of which Nash Finch is a wholly owned subsidiary. Pursuant to the financing agreement, Nash Finch would continue to loan funds to the Gordy's Entities during the receivership, subject to Nash Finch's existing security interest, so that the Gordy's Entities' stores could continue operating as going concerns until sold.

¶7 On September 1, 2017, Polsky filed a motion to sell substantially all of the Gordy's Entities' assets. On the same day, Polsky served the Gordy's Entities' unsecured creditors with notice of the receivership proceedings and of the bar date for filing claims. Unsecured creditors ultimately filed over 1400 verified

claims totaling more than $49 million.[3] Nash Finch did not file an unsecured deficiency claim.

¶8 The circuit court considered Polsky's motion to sell the Gordy's Entities' assets at a hearing on September 15, 2017. During the hearing, Polsky presented an expert witness's testimony that the Gordy's Entities' assets had a book value of $40.4 million as of July 21, 2017, and that their actual value was likely below book value. At the close of the hearing, the circuit court approved the sales of three of the Gordy's Entities' stores. The court also approved the disbursement of the sale proceeds to Nash Finch and Settlers Bank, which had a perfected security interest in one of the stores subject to the sale.

¶9 The Gordy's Entities' remaining operating stores were ultimately sold at two auctions. Nash Finch purchased nine of those stores using credit bids totaling $19,450,000. The remaining, nonoperating stores were eventually abandoned from the receivership estate. It is undisputed that the unsecured creditors received nothing from the sales of the Gordy's Entities' assets.

¶10 At various stages of the receivership proceedings, Huiras objected to the financing agreement between Nash Finch and Polsky, to the sales of the Gordy's Entities' assets, and to the disbursement of the sale proceeds to Nash Finch. In essence, Huiras argued the receivership was an "illegal" attempt by Nash Finch to enforce its rights as a secured creditor of the Gordy's Entities. Huiras contended Nash Finch's participation in the proceedings was improper

[3] Huiras Construction filed a claim for $228,105.32. Northwest Wisconsin Refrigeration Services did not file a claim. However, Polsky has acknowledged Northwest Wisconsin Refrigeration Services' status as an unsecured creditor.

because the sole purpose of a WIS. STAT. ch. 128 receivership is "to provide a distribution to unsecured creditors, not to facilitate the liquidation of a secured creditor['s] collateral." (Formatting altered.) Huiras argued that "by improperly using [the ch. 128] proceeding to collect its secured claim, Nash Finch waived its security and [was] an unsecured creditor." (Formatting altered.) Huiras also contended that Polsky had breached his fiduciary duties to the unsecured creditors and should therefore be removed as receiver.

¶11 On October 4, 2017, Huiras served Polsky with written discovery requests. Polsky did not respond to those requests; instead, he filed a motion for a protective order, alleging Huiras's discovery requests "[fell] outside the scope of allowable discovery" and were "harassing and oppressive." The circuit court granted Polsky's motion for a protective order during a hearing on December 11, 2017, and ordered briefing on Huiras's objections to the receivership proceedings.

¶12 On July 16, 2018, the circuit court entered an order denying Huiras's objections. The court also—on its own initiative—imposed sanctions against Huiras under WIS. STAT. § 802.05(3). Specifically, the court ordered Huiras to pay Polsky $26,660.50, representing the actual attorney fees and costs Polsky had incurred to defend against Huiras's objections since December 11, 2017. Huiras now appeals, challenging both the circuit court's denial of its objections to the receivership proceedings and the court's decision to award sanctions under § 802.05(3). Additional facts are included below.

DISCUSSION

I. Denial of Huiras's objections

¶13 Huiras's primary argument on appeal is that the receivership proceedings were improper and illegal because there was never any reasonable possibility that any of the Gordy's Entities' unsecured creditors would receive a dividend from the receivership estate. Huiras contends the "driving purpose" of WIS. STAT. ch. 128 "is the conservation of corporate assets for the benefit of unsecured creditors," and circuit courts therefore have a "duty to vigilantly protect" unsecured creditors in ch. 128 proceedings. In light of this purpose, Huiras argues a secured creditor cannot initiate or participate in ch. 128 proceedings unless it is reasonably possible that the debtor's unsecured creditors will receive a dividend. Huiras contends that in this case, it was clear from the outset that none of the Gordy's Entities' unsecured creditors would receive a dividend from the receivership estate. Huiras therefore argues that Nash Finch's participation in the receivership proceedings was improper, and by virtue of its improper participation, Nash Finch waived its security interest and should be treated as an unsecured creditor. Accordingly, Huiras argues the circuit court erred by denying its objections to various aspects of the receivership proceedings.[4]

¶14 Huiras's arguments are without legal support. Huiras cites no case law or other legal authority directly corroborating its novel claim that a secured

[4] Citing ***Linton v. Schmidt***, 88 Wis. 2d 183, 194, 277 N.W.2d 136 (1979), Huiras argues the circuit court's rulings in this case should be reviewed for an erroneous exercise of discretion. In contrast, Nash Finch argues Huiras's challenges to the receivership proceedings involve issues of statutory interpretation and are therefore subject to de novo review. We need not resolve this dispute because, even applying de novo review, we agree with Nash Finch that the circuit court properly denied Huiras's objections to the receivership proceedings.

creditor cannot participate in WIS. STAT. ch. 128 proceedings unless there is a reasonable possibility that unsecured creditors will receive a dividend from the receivership estate. Both ch. 128 and the cases interpreting it recognize the ability of secured creditors to participate in ch. 128 proceedings. And, contrary to Huiras's assertion, neither ch. 128 nor any relevant case conditions that participation on the likelihood that unsecured creditors will receive a dividend.[5]

¶15 WISCONSIN STAT. § 128.15(2) expressly acknowledges the ability of secured creditors to participate in WIS. STAT. ch. 128 proceedings. It provides:

> Claims of secured creditors may be allowed to enable such creditors to participate in the proceedings but shall be allowed for such sums only as shall be proved to be due, over and above the value of the securities, and dividends shall be paid only upon the excess of the claim over the value of the security at the time of the commencement of the proceedings.

Sec. 128.15(2). Huiras reads § 128.15(2) as requiring a secured creditor to waive its security interest and be treated as an unsecured creditor in order to participate in ch. 128 proceedings. However, our supreme court has recognized that § 128.15(2) addresses only the unsecured portion of a secured creditor's claim—

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[5] A treatise discussing WIS. STAT. ch. 128 has reached a similar conclusion, stating:

> **Is the process [i.e., a ch. 128 receivership] available if no funds are likely to be distributed to unsecured creditors?**
>
> There is no requirement that the unsecured creditors receive any dividend. In fact, proceedings that pay no dividend to unsecured creditors are common. However, the court has discretion in appointing a receiver and may decline to appoint a receiver in an appropriate case.

JONATHAN P. FRIEDLAND, STRATEGIC ALTERNATIVES FOR AND AGAINST DISTRESSED BUSINESSES, § 37:4 (Jan. 2019).

i.e., the "deficiency over the value of the security." *See* ***Wisconsin Brick & Block Corp. v. Vogel***, 54 Wis. 2d 321, 326, 195 N.W.2d 664 (1972). The statute does not limit the secured creditor's ability to collect on its secured claim. Instead, a secured creditor

> "may readily agree to administration and liquidation of collateral in a chapter 128 proceeding because this is often an economical means of realizing on collateral." If the secured creditor does consent to the sale free and clear of its security interest, it is entitled to the proceeds of the sale of its collateral in order of priority.

BNP Paribas v. Olsen's Mill, Inc., 2011 WI 61, ¶51, 335 Wis. 2d 427, 799 N.W.2d 792 (citation omitted).

¶16 Contrary to Huiras's assertion, nothing in ***BNP Paribas*** indicates that a secured creditor may only participate in WIS. STAT. ch. 128 proceedings when there is a reasonable possibility that unsecured creditors will receive a dividend. That argument was not at issue in ***BNP Paribas***, and Huiras's attempts to support its position by selectively citing language from ***BNP Paribas*** and applying that language out of context are unpersuasive.

¶17 Moreover, Huiras fails to recognize the ***BNP Paribas*** court's acknowledgement that unsecured creditors may not always receive a dividend in WIS. STAT. ch. 128 proceedings involving secured creditors. The court stated that "unsecured creditors are entitled to distribution of any proceeds of a sale [of the debtor's assets] *only after priority claims have been satisfied*." ***BNP Paribas***, 335 Wis. 2d 427, ¶43 (emphasis added). This statement necessarily presumes that unsecured creditors may not receive a dividend where the proceeds of a sale are insufficient to satisfy secured creditors' claims.

¶18 As noted above, the ***BNP Paribas*** court also stated that if a secured creditor consents to the sale of its collateral in a WIS. STAT. ch. 128 proceeding free and clear of its security interest, "it is entitled to the proceeds of the sale of its collateral in order of priority." ***BNP Paribas***, 335 Wis. 2d 427, ¶51. The court did not state that a secured creditor is entitled to the proceeds of the sale only if there is a surplus available to pay a dividend to unsecured creditors.

¶19 The ***BNP Paribas*** court also recognized that WIS. STAT. § 128.17(1) "mandates the order of distribution of the proceeds of a liquidation sale when those proceeds are insufficient to satisfy the estate's debts and obligations." ***BNP Paribas***, 335 Wis. 2d 427, ¶70. Nothing in § 128.17(1) suggests that a WIS. STAT. ch. 128 receivership is improper or illegal unless there is a reasonable possibility that unsecured creditors will receive a dividend. In fact, the statute expressly states that unsecured creditors are not entitled to receive a dividend until all of the following expenses have been paid:

> (a) The actual and necessary costs of preserving the estate subsequent to the commencement of the proceedings.
>
> (b) Costs of administration including a reasonable attorney's fee for the representation of the debtor.
>
> (d) Wages, including pension, welfare and vacation benefits, due to workmen, clerks, traveling or city salespersons or servants, which have been earned within 3 months before the date of the commencement of the proceedings, not to exceed $600 to each claimant.
>
> (e) Taxes, assessments and debts due the United States, this state or any county, district or municipality.
>
> (f) Other debts entitled to priority.

Sec. 128.17(1)(a)-(f).

¶20 Huiras relies on ***Louisville Joint Stock Land Bank v. Radford***, 295 U.S. 555 (1935), for the proposition that a sale of a debtor's property should not be approved unless it is reasonably expected to produce a surplus above the amount of the liens on the property to be sold. However, the portion of ***Radford*** upon which Huiras relies addresses the tenet that a court cannot force the sale of a secured creditor's collateral for less than the debt owed because such a sale would be "made to the prejudice of the lienor." ***Id.*** at 584. The ***Radford*** Court recognized that, in a bankruptcy proceeding, a court is authorized to direct that the debtor's property "be sold free of encumbrances; and that the rights of all lienholders be transferred to the proceeds of the sale—a power which 'had long been exercised by federal courts sitting in equity when ordering sales by receivers or on foreclosure.'" ***Id.*** at 583-84 (citation omitted).

¶21 Huiras relies on several additional cases from other jurisdictions in an attempt to support its position. However, because those cases do not interpret WIS. STAT. ch. 128, we do not find them persuasive. Huiras also cites ***Littlejohn v. Turner***, 73 Wis. 113, 40 N.W. 612 (1888), a Wisconsin case. In ***Littlejohn***, Benjamin Boorman made a voluntary assignment of all his property—real and personal—to Chester Blodgett, as assignee. ***Littlejohn***, 73 Wis. at 114-15. Blodgett attempted to find a purchaser for the real estate, and the highest offer he received was $17,000. ***Id.*** at 115-16. At the time of the sale, the uncontested liens on the real estate totaled $17,500. ***Id.*** at 119-20. The circuit court approved the sale, and the purchase price was applied to the satisfaction of the liens on the real estate. ***Id.*** at 120. Our supreme court affirmed the circuit court's decision and raised no issue regarding the fact that the liens on the real estate exceeded the sale price. ***Id.*** at 125. As such, ***Littlejohn*** does not support Huiras's argument that a

secured creditor cannot participate in ch. 128 proceedings unless there is a reasonable possibility that a dividend will be paid to unsecured creditors.

¶22 Huiras also appears to contend that Nash Finch commenced the receivership proceedings under false pretenses—that is, that by seeking a receivership under WIS. STAT. ch. 128 and directing unsecured creditors to file claims with the circuit court, Nash Finch falsely represented that there would be assets available to distribute to the unsecured creditors. The record belies this assertion. Nash Finch's complaint alleged that the Gordy's Entities were insolvent or in imminent danger of insolvency; that Nash Finch had a properly perfected security interest in the assets of twenty-one of the Gordy's Entities; and that the Gordy's Entities owed Nash Finch over $86 million. In their answer, the Gordy's Entities admitted that they owed Nash Finch $44 million, plus liquidated damages, attorney fees, and costs. Shortly after Nash Finch filed its complaint, an expert witness testified that the Gordy's Entities' assets had a book value of $40.4 million and that their actual value was likely below book value. Thus, it was clear from the beginning of the receivership proceedings that it was highly unlikely there would be any funds available to pay unsecured creditors. Accordingly, there is no merit to Huiras's contention that Nash Finch commenced the receivership proceedings under false pretenses.

¶23 Because we conclude Nash Finch did not improperly commence or participate in the WIS. STAT. ch. 128 receivership proceedings, we reject Huiras's argument that Nash Finch waived its security interest in the Gordy's Entities' assets. Nash Finch has clearly asserted its status as a secured creditor at all stages of the receivership proceedings. As recognized in ***BNP Paribas***, Nash Finch's participation as a secured creditor was permissible, and having consented to a sale of the Gordy's Entities' assets, Nash Finch was "entitled to the proceeds of the

sale of its collateral in order of priority." *See* ***BNP Paribas***, 335 Wis. 2d 427, ¶51. Although Nash Finch could have filed a deficiency claim under WIS. STAT. § 128.15(2) regarding the unsecured portion of its claim against the Gordy's Entities, Huiras cites no authority holding that Nash Finch was required to do so in order to pursue its secured claim under ch. 128.

¶24 Huiras also argues the circuit court erred by denying its objections to the receivership proceedings because Nash Finch "improperly invoked the circuit court's equity jurisdiction." (Formatting altered.) Huiras contends that the administration of a debtor's property in a WIS. STAT. ch. 128 proceeding is an equitable remedy, and equitable remedies are not available when a party has an adequate remedy at law. Huiras asserts Nash Finch "had no need to resort to equitable relief under ch. 128 because a comprehensive remedy was already available: the enforcement of its asserted secured claim under Article 9" of the Uniform Commercial Code ("UCC"). Specifically, Huiras argues that Nash Finch could have taken possession of its collateral and sold it pursuant to WIS. STAT. §§ 409.609 and 409.610. Huiras also argues Nash Finch could have obtained a judgment under WIS. STAT. ch. 810 if the Gordy's Entities were unwilling to surrender their assets, and it could have sought the appointment of a receiver under WIS. STAT. § 813.16 to protect its property interests and continue the Gordy's Entities' operations as going concerns while it established and enforced its rights of possession and sale.

¶25 Huiras's argument fails because the existence of a remedy at law does not prevent a court from awarding an equitable remedy unless the legal remedy is "clear, adequate and complete." *See* ***Bergman v. Bernsdorf***, 271 Wis. 401, 407, 73 N.W.2d 595 (1955). Huiras fails to explain why the legal remedies that it believes Nash Finch should have pursued in this case would have been

adequate and complete under the circumstances. While Nash Finch had the option of enforcing its security interest in the Gordy's Entities' assets under Article 9 of the UCC, doing so would have likely required multiple lawsuits involving hundreds of unsecured creditors and significant delay and expense, thus decreasing the amount Nash Finch and other creditors might recover. Huiras fails to develop any argument that this hodgepodge method of enforcement of Nash Finch's security interest would have been adequate or complete. In addition, Nash Finch's pursuit of the Gordy's Entities' assets using Article 9 remedies may not have allowed for the sale of those assets as going concerns, further decreasing their value given the transient nature of some of the secured collateral.

¶26 Furthermore, as Huiras concedes, a receiver under WIS. STAT. ch. 128 acts as a fiduciary for the benefit of both the debtor and all secured and unsecured creditors. As a result, the duties of a receiver under ch. 128 are different from those of a receiver under WIS. STAT. § 813.16, who is limited to acting for the benefit of the secured creditor that procured the receiver's appointment. *See* ***Dawson v. Goldammer***, 2006 WI App 158, ¶34, 295 Wis. 2d 728, 722 N.W.2d 106. By proceeding under ch. 128, Nash Finch sought to preserve the going concern value of the Gordy's Entities' business to maximize its recovery as well as the potential for recovery by all creditors. Huiras fails to show how Nash Finch would have enhanced the recovery of its security interest through enforcement by other legal means. Nash Finch may have had other options to enforce its security interest, but Huiras fails to convince us those options would have been adequate and complete. As such, Nash Finch was not barred from seeking an equitable remedy under ch. 128.

¶27 Finally, Huiras argues the circuit court erred by failing to remove Polsky as receiver, on the grounds that Polsky breached his fiduciary duties to the

unsecured creditors. Among other things, Huiras argues Polsky placed Nash Finch's interests ahead of those of the unsecured creditors; failed to "administer any fund for unsecured claims"; "administered [the Gordy's Entities'] property for Nash Finch's benefit"; and failed to disclose material facts to the unsecured creditors. However, all of Huiras's arguments in this regard ignore one important fact: regardless of Polsky's alleged improprieties, there simply were not enough assets in the receivership estate to allow for the payment of a dividend to the unsecured creditors. Stated differently, even assuming Polsky breached his fiduciary duties in the ways claimed by Huiras, his alleged breaches did not result in any harm to the unsecured creditors because they would not have received a dividend in any event. We will not reverse based on an error or defect that did not affect a party's substantial rights. WIS. STAT. § 805.18(1). We therefore reject Huiras's argument that Polsky's alleged breaches of his fiduciary duties warrant reversal of the circuit court's order denying Huiras's objections to the receivership proceedings.

II. Award of sanctions under WIS. STAT. § 802.05(3)

¶28 Huiras also argues that the circuit court erred by ordering it to pay Polsky's actual attorney fees and costs as a sanction under WIS. STAT. § 802.05(3). Specifically, Huiras argues the court failed to follow the statutory procedure for imposing sanctions on its own initiative, as set forth in § 802.05(3)(a)2. Whether the court complied with the statutory procedure for imposing sanctions is a question of law that we review independently. *See* ***First Bank (N.A.) v. H.K.A. Enters., Inc.***, 183 Wis. 2d 418, 423, 515 N.W.2d 343 (Ct. App. 1994).

¶29 WISCONSIN STAT. § 802.05(2) states that by presenting a pleading, written motion, or other paper to a court, a person certifies that: (1) the paper is

not being presented for an improper purpose; (2) the legal contentions in the paper are warranted by existing law or by a nonfrivolous argument for the extension, modification, or reversal of existing law or the establishment of new law; (3) the factual allegations in the paper have evidentiary support or are likely to have evidentiary support after a reasonable opportunity for further investigation; and (4) the denials of factual contentions in the paper are warranted by the evidence or are reasonably based on a lack of information or belief. *See* § 802.05(2)(a)-(d).

¶30 WISCONSIN STAT. § 802.05(3), in turn, states: "If, after notice and a reasonable opportunity to respond, the court determines that sub. (2) has been violated, the court may impose an appropriate sanction upon the attorneys, law firms, or parties that have violated sub. (2) or are responsible for the violation." Subsection (3) sets forth two ways in which sanctions may be initiated. First, sanctions may be imposed based upon a "motion" filed by a party. Sec. 802.05(3)(a)1. It is undisputed that no party in this case ever filed a motion for sanctions against Huiras.[6] Section 802.05(3)(a)1. is therefore inapplicable.

¶31 Second, and as relevant to this appeal, WIS. STAT. § 802.05(3)(a)2. permits a circuit court to impose sanctions "[o]n its own initiative." However, in order to do so, the court must first "enter an order describing the specific conduct that appears to violate sub. (2) and directing an attorney, law firm, or party to show cause why it has not violated sub. (2) with the specific conduct described in

[6] After the circuit court initially raised the issue of imposing sanctions, Polsky argued in his briefs opposing Huiras's objections to the receivership proceedings that the court should award him his actual attorney fees and costs as a sanction under WIS. STAT. § 802.05(3). However, a motion for sanctions filed by a party must be "made separately from other motions or requests." Sec. 802.05(3)(a)1. Neither Polsky nor any other party filed a separate motion for sanctions under § 802.05(3)(a)1. Moreover, Polsky concedes on appeal that the circuit court sanctioned Huiras on its own initiative, pursuant to § 802.05(3)(a)2.

the court's order." Sec. 802.05(3)(a)2. Here, although the circuit court sanctioned Huiras on its own initiative, it neither entered an order describing the specific conduct by Huiras that appeared to violate § 802.05(2), nor directed Huiras or its attorney to show cause why they had not violated that subsection.

¶32 Instead, the circuit court first raised the issue of sanctions during a December 11, 2017 hearing on Polsky's motion for a protective order. After granting that motion, the court stated:

> Mr. Polsky, I am going to direct that you file your motion forthwith, but I am also going to ask you to—and I am sure you are doing this, anyway, but separate from the rest of your duties in these matters, the costs incurred, including attorney fees, for bringing this action before the Court. It would seem to me [Huiras's counsel] set a very high bar to prove that these matters are illegal, and in the end, if illegality is not found, the Court may be in a position to award fees including actual attorney fees and costs incurred with the theory being that we're using up assets that may be there to benefit some of these creditors that we are here trying to protect, and I guess, I think that does make sense to the Court.
>
> … Here, even taking at [Huiras's counsel's] word what he claims he is going to be able to show, I can't see how it is going to benefit the creditors. Maybe I will be educated, but Mr. Polsky, please keep your time separate for these matters, because I think in the end, those may be an issue we have to address costs and fees.

¶33 Nash Finch and Polsky subsequently filed joint responses to Huiras's objections to the receivership proceedings, in which they asserted those objections were not supported by existing law and asked the circuit court to award Polsky his actual attorney fees and costs as a sanction. The court denied Huiras's objections to the receivership proceedings during a hearing on April 24, 2018. The court then stated, "Mr. Polsky, I did ask you to address the issue of costs at some point. I still ask you to do that in the future when you prepare your order, please, your actual

attorney fees incurred in addressing this issue." Huiras's attorney then inquired, "One question there. You just said Mr. Polsky should address his fees. Is it the Court's intention to impose fees on counsel, on me?" The court responded:

> I didn't say that. I didn't say that yet, but I did advise you a couple hearings ago that on its face, I thought your motion was borderline frivolous. I am not saying it's frivolous, but it's certainly from my standpoint, from what I've read, what I heard, I don't think you had much traction. We'll deal with it, all right?

The hearing was then adjourned, without any further discussion of the sanctions issue.

¶34 Polsky subsequently submitted a proposed order to the circuit court, which included language ordering Huiras to pay Polsky $26,660.50 in attorney fees and costs. The proposed order did not include any findings of fact or conclusions of law regarding the sanctions issue. Huiras objected to the proposed order, arguing the court had not made an oral ruling granting Polsky attorney fees and costs during the April 24, 2018 hearing, and, in any event, Huiras's objections to the receivership proceedings were not frivolous. In response, Polsky argued "frivolity" was only one basis to impose sanctions. Polsky noted the court could also impose sanctions if it found that Huiras's pleadings "were presented for an improper purpose, such as to harass or to cause unnecessary delay or to needlessly increase … the cost of litigation." However, Polsky did not assert the court had ever made such a finding. The court later signed Polsky's proposed order, which—again—did not include any findings of fact or conclusions of law pertaining to sanctions.

¶35 As the above summary shows, the circuit court failed to comply with the procedure set forth in WIS. STAT. § 802.05(3)(a)2. when sanctioning Huiras.

The court never issued an order to show cause or described the specific conduct by Huiras that appeared to violate § 802.05(2). Although Polsky and Nash Finch initially claimed that Huiras's objections to the receivership proceedings were frivolous—in that they were not supported by existing law or a good faith argument for the extension of existing law—the court never made a finding that the objections were frivolous. And, while Polsky and Nash Finch later asserted that the court could impose sanctions if it found the objections were presented for an improper purpose, the court never made such a finding.

¶36 In addition, the circuit court's choice of sanction—i.e., ordering Huiras to pay Polsky's actual attorney fees and costs—was inappropriate under the circumstances. WISCONSIN STAT. § 802.05(3)(b) states:

> A sanction imposed for violation of this rule shall be limited to what is sufficient to deter repetition of such conduct or comparable conduct by others similarly situated. Subject to the limitations in subds. 1. and 2., the sanction may consist of, or include, directives of a nonmonetary nature, an order to pay a penalty into court, or, *if imposed on motion* and warranted for effective deterrence, *an order directing payment to the movant of some or all of the reasonable attorney fees and other expenses incurred as a direct result of the violation* subject to all of the following ….

(Emphasis added.) This language unambiguously provides that a court may award attorney fees and costs as a sanction only in cases where sanctions are imposed "on motion," as opposed to on the court's own initiative.[7] Here, it is undisputed

[7] The Wisconsin Practice Series: Civil Procedure is in accord, stating: "Sanctions imposed on the court's initiative are limited to penalties payable to the court. Thus, any award of attorney fees under [WIS. STAT. §] 802.05(3)(b) as part of a monetary sanction for litigation misconduct must be upon motion of a party and cannot be imposed on the trial court's own initiative." 3 JAY E. GRENIG, WISCONSIN PRACTICE SERIES: CIVIL PROCEDURE § 205.7 (4th ed. 2010) (citing ***Johnson v. Waddell & Reed, Inc.***, 74 F.3d 147 (7th Cir. 1996)).

that the circuit court sanctioned Huiras on its own initiative, rather than on motion. The court's decision to award Polsky his actual attorney fees and costs as a sanction was therefore improper.[8]

¶37 Because the circuit court failed to follow the procedure set forth in WIS. STAT. § 802.05(3)(a)2. when imposing sanctions on its own initiative, and because the court imposed a sanction not authorized by § 802.05(3)(b), we reverse that portion of the court's order requiring Huiras to pay Polsky's actual attorney fees and costs. We remand for the court to reconsider the issue of sanctions using the proper procedure, and keeping in mind the types of sanctions permitted by § 802.05(3)(b).

¶38 No WIS. STAT. RULE 809.25 costs are allowed to the parties.

By the Court.—Order affirmed in part; reversed in part and cause remanded for further proceedings.

This opinion will not be published. *See* WIS. STAT. RULE 809.23(1)(b)5.

[8] In addition, we observe that WIS. STAT. § 802.05(3)(b)1. states "[m]onetary sanctions may not be awarded against a represented party for a violation of sub. (2)(b)." Thus, the circuit court could not impose a monetary sanction against Huiras—a represented party—based on a finding that Huiras's arguments were not "warranted by existing law or by a nonfrivolous argument for the extension, modification, or reversal of existing law or the establishment of new law." *See* § 802.05(2)(b).