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STATE OF NORTH DAKOTA

IN THE SUPREME COURT
STATE OF NORTH DAKOTA
SUPREME COURT NO. 20210235

Susan Sproule, Sandra Crary, and Lynnell Stegman, — Plaintiffs and Appellees

v.

Brian Johnson, Rodger Johnson, Lyle Johnson, New Partnership, and Nor-Agra, Inc., — Defendants and Appellants

and

Al Johnson, — Defendant and Appellee

On Appeal from Amended Judgment entered on June 29, 2021
Northeast Central Judicial District, Grand Forks County, North Dakota
Case No. 18-2017-CV-31

The Honorable Donald Hager

REPLY BRIEF OF APPELLANTS

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I. THE COMMON CAPITAL GAINS AND DIVIDEND TAXES RELATED TO SHILO ARE NOT SPECULATIVE AND CANNOT BE IGNORED.

[1] Plaintiffs cling to the proposition that the obvious tax burdens facing Shilo are too speculative to consider. Capital gains and dividend taxes are routine, not speculative. For the indirect, North Dakota owners of Shilo to access Shilo's assets or funds – its value – those taxes will be paid. App. 94-95. Plaintiffs want to exit Shilo with a payment of almost $16 million, leaving the four remaining partners to pay the taxes.

[2] Every partner, shareholder, and LLC member in a tax-burdened entity would like to exit tax-free. That is not the law in the United States. See App. Br. at ¶¶ 67-72. Here the capital gains and dividend taxes have been calculated and quantified by MNP, Shilo's long-time accountants. App. 94-95. They have been confirmed by Harris Widmer, Johnson Farms' long-time accountant. App. 195-207. Neither the law nor the economic reality changes because a sale is not imminent. If an "imminent" liquidity event was the test, owners would leave tax-burdened entities in droves so only those remaining behind would face the tax burden.

[3] A simple example makes the point. Assume a North Dakota partnership holds appreciated assets worth $1 million, but with only a $100,000 basis. Partner A, like Plaintiffs, seeks to exit for one-half of the full value – $500,000. If that is paid without accounting for the approximately $225,000 of capital gains, Partner A has received a tremendous windfall. When Partner B wants to realize the value of those assets, Partner B must sell them for $1 million and pay the $225,000 of tax. Partner A leaves with $500,000. Partner B leaves with only $275,000 (the $1 million value, minus the $500,000 paid to Partner A, minus the $225,000 paid in tax).

[4] Plaintiffs want to be Partner A. Everyone would want to be Partner A. Here, capital gains taxes will be paid on the substantially appreciated assets of Shilo. When money is distributed out of Shilo for the benefit of the indirect owners in North Dakota, dividend taxes will be paid. That is a matter of basic and undisputed Canadian tax law – fully supported by admissible evidence.

[5] MNP's December 1, 2017, letter – admitted at trial by stipulation – sets forth both tax burdens to the penny. MNP accepted the 2017 appraised value of Shilo to be $40,660,802 (CAD). App. 93-98. MNP subtracted Shilo's corporate debt, to obtain what MNP called the "Net Fair Market Value" at $36,213,556 (CAD). App. 94. MNP calculated a capital gains tax in the amount of $4,926,751 (CAD) that would be owing upon a sale or liquidation. Id. MNP next calculated the dividend taxes that would be paid in delivering the remaining $31,286,805 (CAD) to the North Dakota partners of JFP and shareholders of Nor-Agra. That dividend tax was $7,746,260 (CAD). App. 95. MNP thus calculated that the total amount available to the North Dakota owners would be $23,840,544 (CAD) – the net assets less the taxes. Id.

[6] The conclusions of MNP were confirmed by Mr. Widmer. He provided the only other admissible evidence regarding tax burdens – confirming that the indirect owners of Shilo living in North Dakota faced the two layers of tax detailed by MNP. App. 195-207. Plaintiffs cannot dispute that the taxes exist. No admissible evidence at trial supports such a counter-intuitive and flatly incorrect position. Indeed, Plaintiffs agreed to the accuracy of the 2017 appraisals and the resulting "Net Fair Market Value." App. 68. Plaintiffs did not want to pay any portion of the taxes. App. 68-70. They wanted then and now to be "Partner A" and have Defendants be "Partner B."

[7] The net value of Shilo, after adjusting for taxes as calculated by MNP, was $23,840,544 (CAD). App. 95. Accordingly, the appropriate dissociation payment to Plaintiffs in 2017 was as follows, with prejudgment interest to be added:

Shilo Value After Debt and Capital Gains Tax $23,840,544 (CAD)	
Nor-Agra (50%)	Johnson Farms (50%)
$11,920,272	$11,920,272
X	X
Plaintiffs' 30% interest	Plaintiff's 37.5% interest
= $3,576,081.60	= $4,470,102
Total $8,046,183.60 (CAD)	

[8] Plaintiffs' wanted a tax-free exit at $12,222,075 (CAD). App. 69. Plaintiffs' argument to avoid their share of the known taxes is based on hearsay opinions from Grant Thornton and Taylor McCaffrey. App. 68-80. Neither opinion suggests that the taxes are not real. Rather, the opinions simply suggest that, under Canadian law, the absence of an "imminent" sale might allow a Canadian Court to ignore the tax burdens. Both opinions are pure hearsay and were improperly admitted over objection. They should have been further excluded as an improper attempt to establish foreign law. See N.D.R.Civ.P. 44.1; Malin Int'l Ship Repair & Drydock, Inc. v. Oceanografia, S.A. de C.V., 817 F.3d 241, 247 (5th Cir. 2016) (referring to the identical provision in the Federal Rules of Civil Procedure, "[i]n the absence of sufficient proof to establish with reasonable certainty the substance of the foreign principles of law, the modern view is that the law of the forum should be applied."). The hearsay opinions discussing Canadian law became the sole support for the Court's conclusion that tax burdens faced by North Dakotans could be ignored. App. 141-144.

[9] The rights of the North Dakota parties here are governed by the laws of this Country and this state. See Nodak Mut. Ins. Co. v. Wamsley, 2004 ND 174, ¶ 9, 687 N.W.2d 226. Under the law of this Country, "a hypothetical willing buyer-willing seller must always be assumed to immediately liquidate the corporation, triggering a tax on the built-in gains" and the fact that an actual liquidation is not, "imminent or even likely" is a "red herring." Estate of Jelke, 507 F.3d 1317, 1328 (11th Cir. 2007) (quoting Estate of Dunn v. Comm'r, 301 F.3d 339, 354 (5th Cir. 2002)).

[10] The Court's decision to ignore taxes here is made all the worse because the ordered dissolution of Johnson Farms actually triggered those tax burdens. See Canadian Income Tax Act §§ 98(2) and 102(1). Had a Grant Thornton representative testified, presumably they would have conceded that triggered taxes are not speculative.

[11] Two layers of taxes have been triggered by the Court order. They would again be triggered whenever the remaining partners attempt to realize on the value of Shilo either to pay the departing partners or for other purposes. North Dakota should not set itself apart from the rest of the country regarding matters of partnership, corporate, and LLC governance controlled by uniform acts. See App. Br. at ¶¶ 61-66. North Dakota should not provide an incentive for owners of taxed-burdened entities to exit at fair value before a sale is imminent and leave the tax burdens to those who remain.

II. MIXING THE INCOMPATIBLE REMEDIES OF DISSOLUTION AND DISSOCIATION WAS LEGAL ERROR, CONTRARY TO THE PARTNERSHIP AGREEMENT AND RUPA, UNNECESSARY AND HIGHLY PREJUDICIAL.

[12] Dissociation and dissolution are wholly different and incompatible remedies set forth by different chapters of the Revised Uniform Partnership Act ("RUPA"). Compare N.D.C.C. Chapter 45-19 to Chapter 45-20. Dissolution entails

selling partnership assets, paying off liabilities, distributing funds to the partners, and winding up the partnership. N.D.C.C. §§ 45-20-01 through 08. Dissociation allows partners to exit a partnership while receiving a fair value payment. N.D.C.C. § 45-19-01 through 05. Dissolution is disfavored, can be waived by the partnership agreement, and can be stopped at any time prior to completion. Robertson v. Jacobs Cattle Co., 830 N.W.2d 191, 200-203 (Neb. 2013); Jones v. Jones, 310 N.W.2d 753, 755 (N.D. 1981); N.D.C.C. § 45-20-02(2).

[13] The distinct remedies cannot be combined as a matter of law or as a matter of practicality. Partnership assets cannot be sold, debts paid, and pro-rata distributions made (dissolution under Chapter 45-20), while also requiring a fair value payment to some partners (dissociation under Chapter 45-19). Defendants can find no case in which the two remedies have been combined. Neither Plaintiffs nor the Court cited to such an unusual precedent.

[14] Requiring dissolution is also directly contrary to the controlling partnership agreement. That decades-old agreement contains numerous provisions allowing for the continuation of the partnership when one or more partners exit. App. 100-101, ¶¶ 6-8. Dissolution is also contrary to the plain language and intent of RUPA – to allow for partnerships to continue beyond the exit of one or more partners. Robertson, 830 N.W.2d at 200 (discussing how RUPA, "sought to avoid mandatory dissolution of partnerships by making a partnership a distinct entity from its partners," and "allows for the partnership to continue even with the departure of a member" because the entity is more than the sum of its parts). Partners can also stop dissolution after it has started. N.D.C.C. § 45-20-02(2). The partnership agreement is the controlling authority under

RUPA and case law. Jones, 310 N.W.2d at 755 (agreement between parties is controlling as to features of partnership and is "law of the partnership").

[15] The Court directly confused the two distinct remedies holding that the exiting partners could not waive their rights to dissolution. App. 149-150. The Court then cited to a dissociation section, not a dissolution section. Partners certainly can waive the right to dissolution through the partnership agreement as was done here. See Robertson, 830 N.W.2d at 200; Jones, 310 N.W.2d at 755.

[16] Moreover, no purpose was served by ordering the two incompatible remedies. All parties contemplated that Shilo would continue to operate, as it still does. That calls for dissociation. The notion of selling Shilo assets, paying liabilities, and distributing funds (dissolution) was not pursued by either party, because that triggers the very tax consequences Plaintiffs seek to avoid and leave for Defendants.

[17] The Court's primary reason for ordering dissolution on top of a dissociation payment appears to be the initial statements of prior counsel in 2017 and the Agreement in Principle ("AIP"). As explained in the opening brief, neither provides a proper basis for an obviously erroneous legal result and incompatible remedies. App. Br. ¶¶ 108-118. Moreover, dissolution can be stopped at any time. N.D.C.C. § 45-20-02(2) Statements of counsel in 2017 did not require an unnecessary dissolution in 2020.

III. RELYING ON THE AGREEMENT IN PRINCIPLE TO RESOLVE ALL ISSUES AS OF 2017, OTHER THAN THE ISSUES REGARDING SHILO, WAS LEGAL ERROR, AND CONTRARY TO BOTH UNIFORM STATUTES AND WELL-ESTABLISHED CASE LAW.

[18] Plaintiffs argued and the Court agreed that the AIP was binding and should be followed. Defendants objected and disagreed. The significant point is that either the AIP should be followed as a whole, or not at all. The Court chose to follow the

AIP when it benefited the Plaintiffs. The Court then ignored the AIP regarding the Shilo issues. North Dakota law does not allow for the selective enforcement of certain contractual provisions. N.D.C.C. § 9-07-06.

[19] The 2017 AIP contemplated a resolution of all partnership issues in 2017 based upon 2017 assets and business results. The 2017 distribution of North Dakota farmland was ordered under the AIP. A detailed 2017 crop reconciliation was ordered under the AIP. The agreed-to buyout of Shilo based upon 2017 appraisals and 2017 tax calculations was rejected.

[20] The AIP also expressly contemplated the buyout of partnership interests in Shilo based upon 2017 appraisals and MNP calculations. When the AIP was drafted and allegedly agreed to in 2017, <u>nothing</u> else existed. The Plaintiffs accepted the 2017 appraised values and the accompanying "Net Fair Market Value." App. 68-80. The Plaintiffs then and now simply do not want to pay their share of known taxes.

[21] The Court should have enforced the AIP with respect to Shilo as it enforced the AIP with respect to other issues. Instead, the Court departed from the AIP on only one issue – refusing to use 2017 appraisals and the 2017 MNP calculations regarding Shilo. The Court allowed the Plaintiffs the benefit of later, 2019 appraisals and then chose to ignore taxes altogether.

IV. THE 2017 APPRAISALS WOULD HAVE PROVIDED PLAINTIFFS WITH FULL AND FAIR VALUE FOR THEIR INDIRECT OWNERSHIP INTERESTS IN SHILO.

[22] Exiting from a corporation or partnership is a common occurrence. In each setting, the valuation date is determined at the time of the shareholders'/partners' exit. N.D.C.C. §§ 10-19.1-115(4)(a) and 45-19-01.

[23] The rationale is straightforward and consistent. Exiting owners get fair value measured at the time of their exit, and do not face the risk of later, adverse business results. The flipside is that they do not get to benefit from later positive business results. Once an owner opts out, they are out for better or worse. Brennan v. Brennan Assocs., 113 A.3d 957, 966 (Conn. 2015) ("[R]egardless of what happens to the value of the partnership's assets after the partner is dissociated, the amount for which the dissociated partner will be bought out remains unchanged.").

[24] Plaintiffs contend that the later and inflated 2019 appraisals were properly used, because Plaintiffs continued to receive K-1 tax statements as partners. That is always the case in a pass-through entity and has never been used by the Courts as a basis to extend the appraisal or valuation date. The appropriate remedy for that common situation is to use the 2017 valuation date and reimburse Plaintiffs for any taxes paid. Accepting Plaintiffs' argument would always result in moving the valuation date as close to the time of trial as possible – a result consistently rejected by the Courts.

[25] Plaintiffs should have received their pro rata share of the fair market value of Shilo, with the tax deductions as calculated by MNP, along with prejudgment interest, and reimbursement for taxes paid after 2017 – a total of well over $10 million (CAD). That is the full and legally appropriate compensation.

[26] Instead, the Court awarded Plaintiffs their share of the supposed increase in value of Shilo from 2017 through 2019, based on later, contested appraisals obtained solely for litigation purposes. That is exactly what the statutes and case law seek to avoid. Departing owners do not get to hedge their bets. They should not be encouraged to obtain inflated appraisals purporting to address results after they chose to depart. North Dakota

is not well-served by departing from uniform, statutory norms and consistent case law construing those statutes.

CONCLUSION

[27] Appellants respectfully request that paragraphs 2, 6, 8, and 12(A)-(C) of the District Court's amended judgment be reversed, allowing for dissociation of the Plaintiffs from Johnson Farms Partnership and their exit from Nor-Agra, based on the 2017 appraisals of Shilo, considering the tax burdens.

CERTIFICATE OF COMPLIANCE

[28] The undersigned attorney certifies, pursuant to N.D.R.App.P. 32(e), that the Brief of Appellants Brian Johnson, Rodger Johnson, Lyle Johnson, New Partnership and Nor-Agra, Inc., consisting of twelve (12) pages (counting this page), complies with the page limitation imposed by N.D.R.App.P. 32(a)(8)(A) for principal briefs.

Dated: December 22, 2021

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Al Johnson,	Defendant and Appellee

[1] I certify that on December 22, 2021, the following:

Reply Brief of Appellants (Oral Argument Requested)

was electronically served and filed with the North Dakota Supreme Court and e-mailed on the following:

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[3] The above was duly served in accordance with the provisions of the Rules of Civil Procedure.

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