20220068
FILED
IN THE OFFICE OF THE
CLERK OF SUPREME COURT
SEPTEMBER 16, 2022
STATE OF NORTH DAKOTA

IN THE SUPREME COURT STATE OF NORTH DAKOTA

Supreme Court No. 20220068

District Court Case No. 53-2020-CV-00920

Scotty Fain, Sr., Scotty Fain, Jr., and Kris Durham,

Plaintiffs and Appellants,

v.

Integrity Environmental, LLC, Andrea Vigen, Lewis Vigen, and Kelly Harrelson,

Defendants and Appellees.

APPELLANTS' REPLY BRIEF

ORAL ARGUMENT REQUESTED

APPEAL OF CORRECTED MEMORANDUM OPINION, CONCLUSIONS OF LAW, ORDER FOR JUDGMENT, AND JUDGMENT ENTERED DECEMBER 29, 2021 IN THE DISTRICT COURT, NORTHWEST JUDICIAL DISTRICT, WILLIAMS COUNTY, NORTH DAKOTA THE HONORABLE PAUL JACOBSON

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A. The District Court's Finding that the Operating Agreement was not a Valid Contract was Clearly Erroneous.

[1] The Operating Agreement dated June 20, 2019 is a valid contract enforceable under North Dakota law and successfully conveyed ownership of Integrity Environmental, LLC ("Integrity"). The district court's findings were induced by an erroneous view of the law, there was no evidence to support it, and it is clear that a definite mistake has been made, and as such, this Court should reverse the district court's ruling and find that the Operating Agreement is enforceable. See B.J. Kadrmas, Inc. v. Oxbow Energy, LLC, 2007 ND 12, ¶ 7, 727 N.W.2d 270.

[2] The District Court erred in its findings by concluding that a valid contract was not formed, as there is no evidence in the record to support this finding and based on all of the documents in the record a clear and firm mistake has been made. In fact, all of the evidence in the record indicates that there was an intent to form a partnership, a document was signed solidifying that partnership (i.e., the Operating Agreement), the parties performed under the Operating Agreement for over six (6) months where they regularly referred to each other as "Partners" or "Members" and they behaved in a way that business partners typically do, and the Appellants contributed $150,000 in capital contributions towards the project. There is absolutely no argument that the intention of the parties was to enter into a business partnership in common ownership of Integrity Environmental, LLC. As such, the Court should reverse the district court and find that the Operating Agreement is a valid contract under North Dakota law entitling the Appellants a collective 30% ownership interest.

i. The Business Venture of the Parties Fully Came to Fruition Under the Terms of the Operating Agreement.

[3] Contrary to the argument of the Appellees, the business venture between the parties under the operating agreement came to full fruition, as they operated, managed, and communicated with one another for over six (6) months about their business. (R145, 149, 153, 162). Further during this time period, the Appellees sent the Appellants financial data, photographs, master service agreements, invoices, cost estimates, margin reports, tax documents, liability insurance documents, and various other documents that are typically kept confidential in a business. (R3, 5, 7, 8, 10, 11, 13, 14, 15, 19, 22, 23, 35, 37). To argue that this business venture never came to "fruition" is clearly erroneous given the facts of this case.

[4] The district court erred in determining that there was no mutual assent as to the Operating Agreement based on the fact that there were negotiations to replace the Operating Agreement. This argument is intrinsically flawed, as the evidence produced at trial highlighted the numerous documents, negotiations, loan proposals, and other proposals that floated around between the parties in an attempt to replace the Operating Agreement. If this was a true loan agreement, where are the loan agreements outlining the amount, interest rate, terms of the loan, repayment schedule, collection procedures, etc. (i.e., a note payable, term loan, promissory note, lending agreement, etc.)? The fact of the matter remains—**No document signed by all parties replacing the Operating Agreement and entering into a creditor-debtor relationship exists.**

[5] Appellees further contend that the September 2019 recording somehow is an admission by the Appellants that the transaction was a loan, but that simply is not the case. The entirety of the September 2019 recording was revolving around **negotiations** between the parties for a document to replace the Operating Agreement and is not the "smoking gun"

that Appellees claim it to be. This is evidenced by the numerous documents entered into the record that were floating around at this time to replace the Operating Agreement (R26, 27, 30). This is clearly what was occurring when the September 2019 recording was taken place, as this was in the height of the negotiations to replace the Operating Agreement with a loan agreement, new operating agreement, or a consulting agreement. The bottom line is that **no other document was ever signed and nothing else was ever agreed to.** All parties testified that there were numerous negotiations that took place for a replacement document, but none of them were ever implemented.

[6] Appellees cite to the case of Kruger v. Goossen to assert that the "parties' conduct and the surrounding circumstances are relevant in determining whether the parties intended to form a binding legal contract." See Kruger v. Goossen, 2021 ND 88, ¶ 8, 959 N.W.2d 847 (citing B.J. Kadrmas, Inc. v. Oxbow Energy, LLC, 2007 ND 12, ¶ 14, 727 N.W.2d 270). This case directly contradicts the Appellees' argument, in that by the facts of this case, the parties unequivocally intended to create a binding legal contract. Based upon the testimony of the parties at trial, they operated under this agreement for approximately six (6) months from June 2019 through December of 2019. During this period, the parties regularly referred to each other as "Partners" or "Integrity Members" and they behaved in a way that business partners typically do. Scotty Sr. permitted Integrity Environmental to use his shop space free of rent, paid two months of rent for Integrity Environmental, offered equipment to the company free of charge, paid his own personal accountant to come help start up the books, paid his own personal employees to come help with jobs for Integrity Environmental, and, at one point, even offered to pay the factoring fee for the company. Kris and Scotty Jr. both came out and provided free manual labor to Integrity Environmental that they were never paid for. These

are not typical actions of individuals that are in a "lending" capacity would make. Why would an "investor" take on this type of role without an ownership stake?

[7] Appellees further argue that because Scotty Sr. testified that he knew that he could not own a Tier 1 Company that it somehow invalidated the Operating Agreement, although nowhere in the entire Operating Agreement does it say anything about only performing work that required a Tier 1 Status. (R71). Even if the parties misunderstood the implications of the contract in relation to the Tier-1 status, the Operating Agreement would still be valid as there have never been any allegations of fraud or other recognized grounds for setting aside the contract. Again, this argument clearly seems to be a last-ditch effort to squeeze the Appellants out of the sizeable profits that the Appellees were able to make after receiving the Capital Contributions of the Appellants as required under the Operating Agreement. As such, the Court should find that there was mutual assent of all of the parties as their conduct clearly evidenced the intention to enter into a binding contract and find that the Operating Agreement is enforceable under North Dakota Law.

ii. The $150,000 Transferred to the Appellees from the Appellants as their Capital Contribution was Sufficient Consideration for an Enforceable Contract.

[8] The Capital Contributions provided by the Appellants to the Appellees was sufficient consideration for an enforceable contract. The Appellees seemingly argued at trial and in their Answer Brief that because the money was ultimately returned (without the consent of the Appellants) that it somehow no longer counts as consideration. This argument is intrinsically flawed for a number of reasons, and as such the Court should find that there was valid consideration for the contract making it legally enforceable under North Dakota Law.

[9] The district court's analysis improperly treated the Appellants' money as a loan, rather

than a capital contribution. “The distinction between a shareholder loan and a capital contribution rests on ‘whether the investment, analyzed in terms of its economic reality, constitutes risk capital entirely subject to the fortunes of the corporate venture or represents a strict debtor-creditor relationship.’” Fin Hay Realty Co. v. United States, 398 F.2d 694,697 (3d Cir. 1968). In Smith v. NRC Inspection & Testing, LLC, (District Court Case No. 53-2020-CV-00488), the district court gave a nonexclusive list of factors considered by courts when evaluating the transfer of funds:

> "(1) the names given to the documents that would be evidence of the purported loans; (2) the presence or absence of a fixed maturity date; (3) the likely source of repayment; (4) the right to enforce payments; (5) participation in management as a result of the advances; (6) subordination of the purported loans to the loans of the corporation's creditors; (7) the intent of the parties; (8) the capitalization of the corporation; (9) the ability of the corporation to obtain financing from outside sources; (10) thinness of capital structure in relation to debt; (11) use to which the funds were put; (12) the failure of the corporation to repay; and (13) the risk involved in making the transfers."

[10] Like the Smith case, the case at bar contains an operating agreement that shows Appellants as the primary investors in the company. Furthermore, it was testified that Integrity Environmental did not receive any other capitalization other than Appellants’ capital contribution and their own $400. Furthermore, there is no evidence of a promissory note or other loan paperwork that would indicate that the $150,000 was in fact a loan. Rather, the evidence offered by the signed Operating Agreement specifically defines “Capital Contribution” as “the aggregate amount of money and the fair market value of any property (other than money) contributed to the Company pursuant to Section 4.1 with respect to such Member’s Interest.” (R142:2). Under Section 4.1, the signed Operating Agreement states that each member has contributed or is deemed to have contributed to the capital of the Company the amount set forth opposite the Member’s name on the attached Schedule A (collective 30%

ownership to the Appellants). (R142:6); (R142:22).

[11] Appellees argue in their Answer Brief that the factors in the Smith v. NRC Inspection & Testing, LLC weigh "heavily" in favor of the formation of a loan arrangement between the parties; however, that simply is not the case. Relying on the factors: (1) the names given to the documents in this matter (i.e., the Operating Agreement) is clearly indicative of an intent to form a partnership; (2) the operating agreement is wholly absent of a fixed maturity date; (3) there are no mentions of "repayment" other than that by shareholder distributions; (4) there are no terms to enforce payments; (5) the Parties all participated in management of the company including project management, shop rentals, physical labor, equipment use, and employees; (6) N/A; (7) the intent of the parties was **clearly** to enter into a partnership given the actions of the Parties and surrounding circumstances; (8) Integrity was almost entirely funded by the capital contributions of the Appellants; (9) the Appellees explicitly testified that they were trying to obtain outside funding but were unable to and that Lewis did not want to ask his father for funding; (10) the only substantial capital funding was provided by the Appellants as part of their capital contributions; (11) the capital contributions were paid to Integrity for the purposes of gaining ownership equity in Integrity pursuant to the Operating Agreement; (12) the Appellees unilaterally decided to repay the Appellants and refer to the money as a "loan" after six months of working side by side as partners; (13) the Appellants had serious risk in contributing such a large sum of money to a new business venture. See Smith v. NRC Inspection & Testing, LLC, (District Court Case No. 53-2020-CV-00488).

[12] Using the district court's logic in relation to this case, individuals would be permitted to cancel any contract that they deem fit by simply returning the money that had

been invested as a capital contribution and calling it a loan; or, in legal terms, returning the consideration for a contract. This premise is dangerous for the sanctity of contract law in North Dakota and cannot be upheld. The district court's finding that the Appellants voluntarily waived their right to enforce the contract by accepting the reimbursement of $150,000 is clearly erroneous and must be overturned. For these reasons, the Court should find that the district court erred in its finding that there was no consideration of the contract, that the contract failed under accord and satisfaction, and that the contract failed under novation. Accordingly, the Court should find that the Operating Agreement is a valid, enforceable contract under North Dakota Law.

iii. The Operating Agreement Transferred a Collective 30% Ownership to the Appellants in Integrity Environmental, LLC.

[13] The District Court erred in its conclusion that the Operating Agreement did not convey ownership of Integrity Environmental, LLC to the Appellants. It was testified to numerous times at trial that there was a mutual mistake in the drafting of the Operating Agreement as to the name and that it was supposed to have read "Integrity Environmental, LLC." (R168); (2 Tr. 33:18-24, 34:1-5). The district court improperly interpreted the Operating Agreement as to not convey ownership, as the numerous communications and testimony produced at trial and in the record clearly demonstrate the mutual mistake made by the parties in this matter, and should be treated as such by this Court.

[14] Based on all of the evidence before the Court, it is clear that the parties' intent can be determined from the language of the contract alone entitling the Court to interpretation as a matter of law. On Appellants' Exhibit 1, the Operating Agreement, it clearly states that the "Members" of the company are Andrea Vigen, Lewis Vigen, Kelly Harrelson, Scotty Fain Sr., Scotty Fain II, and Kris Durham. (R142:1). Further, on the Operating Agreement at

"Schedule A" it lists each person's "Member Interest" in percentages totaling up to 100% with Andrea Vigen at 30%, Lewis Vigen at 20%, Kelly Harrelson at 20%, Scotty Fain Sr. at 10%, Kris Durham at 10%, and Scotty Fain II at 10%. Id. at 22. There is absolutely no question as to the interpretation of this—**All of the parties were intended to be equity owners of Integrity Environmental in accordance with the "Member Interest" schedule in the written contract.**

[15] As such, the Court should conclude that the Operating Agreement unequivocally evidenced and confirmed ownership to the Appellants and Appellees with Andrea Vigen at 30%, Lewis Vigen at 20%, Kelly Harrelson at 20%, Scotty Fain Sr. at 10%, Kris Durham at 10%, and Scotty Fain II at 10%. In accordance with this Membership Interest, the Court should also conclude that they are also entitled to distributions of the net cash flow in proportion to the percentage interests of each individual member as well as a 30% equity stake in all items owned by the company including, but not limited to, machinery, master service agreements, real property, and other tangible items.

B. The District Court Erred in Not Finding that the Appellees have Breached their Fiduciary Duties Under the Operating Agreement.

[16] Appellees breached their fiduciary duties to Appellants due to their refusal to pay out Net Cash Flow distributions in accordance with the membership interests as provided for under the agreement. Pursuant to North Dakota law, fiduciary duties exist between limited and general partners and limited liability companies are subject to veil piercing the same as a corporation. See, e.g., Red River Wings, Inc. v. Hoot, Inc., 2008 ND 117, ¶ 26, 751 N.W.2d 206 (fiduciary duty exists between limited and general partners); N.D.C.C. § 10-32-29(3) (limited liability company subject to veil piercing same as a corporation).

[17] Based upon the facts of this case, it is undoubtedly true that Appellees

breached their fiduciary duties to Appellants by acting in a manner that is unfairly prejudicial toward the Appellants by refusing to pay out proceeds and locking the Appellants out of any business records, and they should be held responsible. As such, the Court should find that the Appellees breached their fiduciary duties to the Appellants and remand to the district court for a hearing on damages.

C. CONCLUSION

[18] Because the district court incorrectly applied the law and reached a conclusion, which, when the entire evidence is reviewed, is unsupported, Appellants respectfully request that this Court (1) reverse the district court's decision and find, as a matter of law, that the ownership interests of Integrity Environmental, LLC pursuant to the Operating Agreement as of June 20, 2019: (1) Andrea Vigen (30%); (2) Lewis Vigen (20%); (3) Kelly Harrelson (20%); (4) Scotty Fain Sr. (10%); (5) Kris Durham (10%); and (6) Scotty Fain II (10%), and (b) remand to the district court for an evidentiary hearing as to the issues of breach of fiduciary duties and damages.

[19] DATED this 16th day of September, 2022.

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CERTIFICATE OF COMPLIANCE

[20] I, Emily M. Ramage, the attorney of the law firm of Ramage Geltel Law Firm, PLLC, hereby certify that the foregoing brief complies with the page limitation in Rule 32, N.D.R.App.P., as it is a total of 12 pages (from the cover page through the signature line after the Conclusion).

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CERTIFICATE OF SERVICE.

[21] Emily M. Ramage, the attorney of the law firm of Ramage Geltel Law Firm, PLLC, hereby certifies that on this 16th day of September, 2022, true and correct copies of the **APPELLANTS' REPLY BRIEF** was served via **E-Mail** as follows:

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