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McFadden Ranch, Inc., a Nebraska corporation, appellee, v. John "Jake" McFadden, appellant.

807 N.W.2d 785

Filed December 6, 2011. No. A-11-260.

1. **Summary Judgment: Appeal and Error.** An appellate court will affirm a lower court's grant of summary judgment if the pleadings and admitted evidence show that there is no genuine issue as to any material facts or as to the ultimate inferences that may be drawn from the facts and that the moving party is entitled to judgment as a matter of law.
2. ____: ____. In reviewing a summary judgment, an appellate court views the evidence in the light most favorable to the party against whom the judgment is granted and gives such party the benefit of all reasonable inferences deducible from the evidence.
3. **Negligence.** The elements of negligence constitute the elements of a breach of fiduciary duty cause of action.
4. **Fraud: Words and Phrases.** Constructive fraud is the breach of a duty arising out of a fiduciary or confidential relationship.
5. **Summary Judgment: Proof.** A party moving for summary judgment must make a prima facie case by producing enough evidence to demonstrate that the movant is entitled to judgment if the evidence were uncontroverted at trial. Once the moving party makes a prima facie case, the burden to produce evidence showing the existence of a material issue of fact that prevents judgment as a matter of law shifts to the party opposing the motion.
6. **Corporations.** An officer or director of a corporation occupies a fiduciary relation toward the corporation and its stockholders.
7. ____. The use of corporate property by a corporate director or officer to secure his or her personal debt constitutes a breach of fiduciary duty if the action was without corporate authority.
8. ____. Corporate officers and directors are required to discharge their duties with the care an ordinarily prudent person in a like position would exercise under similar circumstances.
9. **Corporations: Presumptions.** Generally, there is a presumption that the acts of corporate officers pertaining to ordinary business transactions are authorized by the corporation. This presumption does not apply when an officer diverts or pledges corporate property as security for a personal debt.
10. **Principal and Agent: Proof.** The burden of proof is upon a party holding a confidential or fiduciary relation to establish the fairness, adequacy, and equity of a transaction with the party with whom he or she holds such relation.

Appeal from the District Court for Keith County: John P. Murphy, Judge. Affirmed in part as modified, and in part reversed and remanded for further proceedings.

William J. Troshynski, of Brouillette Law Office, P.C., L.L.O., for appellant.

Terrance O. Waite and S. David Schreiber, of Waite, McWha & Schreiber, for appellee.

IRWIN, MOORE, and CASSEL, Judges.

CASSEL, Judge.

I. INTRODUCTION

John "Jake" McFadden (Jake) appeals from the order of the district court entering summary judgment in favor of McFadden Ranch, Inc., on its breach of fiduciary duty, constructive fraud, and conversion causes of action. Because McFadden Ranch adduced sufficient evidence to establish that it was entitled to judgment as a matter of law for breach of fiduciary duty and fraud, but not for conversion, we adjust the damages award accordingly and affirm in part as modified, and in part reverse and remand for further proceedings consistent with this opinion.

II. BACKGROUND

McFadden Ranch was a family-owned ranching corporation that was managed by Jake from approximately 2000 to 2008. Jake was also a shareholder, officer, and director of the company at that time.

During his time as manager, Jake and his wife, Cherri McFadden, took out several loans using McFadden Ranch's property as collateral.

In June 2005, American Mortgage Company (AMC) loaned McFadden Ranch $641,000, which was used to pay off four of Jake and Cherri's debts with the Bank of Paxton. Before AMC would approve this loan, it required Jake to provide a corporate resolution approving the use of McFadden Ranch's land as collateral. In response, Jake provided AMC with three purported corporate records, including a resolution allegedly passed on June 12 authorizing Jake "to mortgage, pledge, assign, and grant security interests in any assets of the Corporation including after acquired property as security for current and future

obligations." Jake secured the loan with a deed of trust for McFadden Ranch's land.

Approximately 2 years later, Jake and Cherri secured a second loan from the Bank of Paxton in the amount of $514,961.83. They used $383,933.98 to pay off their personal debts with the Bank of Paxton and deposited $100,000 into the bank account for "McFadden Cattle and Hay" (Jake and Cherri's farm account). They deposited the remaining $31,027.85 into McFadden Ranch's bank account. This loan was also secured by a deed of trust for McFadden Ranch's land.

Jake and Cherri subsequently defaulted on both the loan from AMC and the loan from the Bank of Paxton. Both lenders initiated foreclosure actions on the deeds of trust. Ultimately, McFadden Ranch sold a portion of its land by private sale and paid off the debts before foreclosure was complete.

Following the sale of some of McFadden Ranch's land, McFadden Ranch filed a complaint against Jake in the district court for Keith County, Nebraska, alleging that during his time as manager, he breached his fiduciary duty to the company and committed conversion and fraud. Jake denied the allegations in his answer.

McFadden Ranch filed a motion for summary judgment in November 2010. At a hearing in February 2011, the parties adduced evidence in the form of affidavits and the court took the matter under advisement. In a written order released on March 7, the court entered summary judgment for McFadden Ranch on all three causes of action and awarded it $1,247,167.79.

Jake timely appeals. Pursuant to authority granted to this court under Neb. Ct. R. App. P. § 2-111(B)(1) (rev. 2008), this case was ordered submitted without oral argument.

III. ASSIGNMENTS OF ERROR

Jake alleges that the trial court erred (1) in finding that there was no material issue of fact to be decided by the trier of fact in regard to Jake's breaching his fiduciary duty and committing fraud against McFadden Ranch, (2) in implicitly ruling that Jake converted corporate property for his own

use and benefit, and (3) in granting judgment in the amount of $1,247,167.79.

IV. STANDARD OF REVIEW

[1,2] An appellate court will affirm a lower court's grant of summary judgment if the pleadings and admitted evidence show that there is no genuine issue as to any material facts or as to the ultimate inferences that may be drawn from the facts and that the moving party is entitled to judgment as a matter of law. *Mandolfo v. Mandolfo*, 281 Neb. 443, 796 N.W.2d 603 (2011). In reviewing a summary judgment, an appellate court views the evidence in the light most favorable to the party against whom the judgment is granted and gives such party the benefit of all reasonable inferences deducible from the evidence. *Id.*

V. ANALYSIS

1. Breach of Fiduciary Duty and Fraud

[3] The elements of a breach of fiduciary duty claim have not to date been clearly outlined in Nebraska case law. However, the breach of professional or fiduciary duties has been likened to professional malpractice. See *Community First State Bank v. Olsen*, 255 Neb. 617, 587 N.W.2d 364 (1998). Malpractice is itself "[a]n instance of negligence or incompetence on the part of a professional." Black's Law Dictionary 1044 (9th ed. 2009). Consequently, in the case of several professions, the Nebraska Supreme Court has identified the elements of malpractice as identical to the elements of negligence—duty, breach, causation, and damages. See, e.g., *Frank v. Lockwood*, 275 Neb. 735, 749 N.W.2d 443 (2008); *Stansbery v. Schroeder*, 226 Neb. 492, 412 N.W.2d 447 (1987). Because breach of fiduciary duty is akin to malpractice under Nebraska law and because malpractice is a form of negligence, we hold that the elements of negligence constitute the elements of a breach of fiduciary duty cause of action. In doing so, we note that other states, including Iowa, Missouri, and Minnesota, have reached the same conclusion. See, e.g., *Union County, Iowa v. Piper Jaffray & Co., Inc.*, 788 F. Supp. 2d 902 (S.D. Iowa 2011); *Pool v. Farm Bureau Town & Country Ins.*, 311 S.W.3d 895

(Mo. App. 2010); *Padco, Inc. v. Kinney & Lange*, 444 N.W.2d 889 (Minn. App. 1989).

Thus, in order to prove that it was entitled to judgment on the breach of fiduciary duty issue, McFadden Ranch needed to adduce evidence (1) that Jake owed it a fiduciary duty, (2) that he breached the duty, (3) that his breach was the cause of the injury to the company, and (4) that the company was damaged.

[4] McFadden Ranch also alleged that Jake committed fraud by his actions. Constructive fraud is the breach of a duty arising out of a fiduciary or confidential relationship. *In re Estate of Hedke*, 278 Neb. 727, 775 N.W.2d 13 (2009). Because constructive fraud is by definition the breach of a fiduciary duty, we engage in a single analysis.

[5] We review the evidence presented at the summary judgment hearing to determine whether McFadden Ranch adduced sufficient evidence to establish a prima facie case for summary judgment. A party moving for summary judgment must make a prima facie case by producing enough evidence to demonstrate that the movant is entitled to judgment if the evidence were uncontroverted at trial. Once the moving party makes a prima facie case, the burden to produce evidence showing the existence of a material issue of fact that prevents judgment as a matter of law shifts to the party opposing the motion. *Marksmeier v. McGregor Corp.*, 272 Neb. 401, 722 N.W.2d 65 (2006).

(a) Duty

[6] The fact that Jake owed McFadden Ranch fiduciary duties was clearly established by the evidence. Jake's siblings testified in their affidavits that Jake was an officer, director, and manager of McFadden Ranch from 2000 to 2008. An officer or director of a corporation occupies a fiduciary relation toward the corporation and its stockholders. *Jardine v. McVey*, 276 Neb. 1023, 759 N.W.2d 690 (2009). Because Jake was an officer and director of McFadden Ranch, he owed fiduciary duties to the company in both capacities.

Jake offered no evidence that called into question the fact that he owed McFadden Ranch these fiduciary duties.

Therefore, he did not rebut the prima facie case for summary judgment on this element of the breach of fiduciary duty cause of action.

(b) Breach

In addition to establishing that Jake owed the company fiduciary duties, the evidence adduced by McFadden Ranch also showed that Jake breached these fiduciary duties through his use of company property to secure loans used to repay his personal debts.

[7,8] The use of corporate property by a corporate director or officer to secure his or her personal debt constitutes a breach of fiduciary duty if the action was without corporate authority. See *Fisher v. National Mtg. Loan Co.*, 132 Neb. 185, 271 N.W. 433 (1937), *modified on other grounds* 133 Neb. 280, 274 N.W. 568. Because it is not allowed by corporate law, an ordinarily prudent person in the position of officer or director would not use corporate property to secure his personal debt unless he had specific authority to do so. Under Neb. Rev. Stat. §§ 21-2099 and 21-2095 (Reissue 2007), corporate officers and directors, respectively, are required to discharge their duties with the care an ordinarily prudent person in a like position would exercise under similar circumstances. Therefore, in the absence of corporate authority, securing personal loans with corporate property constitutes a breach of fiduciary duty.

The evidence presented by McFadden Ranch showed that Jake used corporate property to secure two separate loans used to repay his personal debts. Jake took out the first of these loans from AMC in June 2005. The loan papers show that Jake secured this loan with a deed of trust for McFadden Ranch's land. But the president of AMC testified that Jake wanted the loan mainly to refinance Jake and Cherri's personal debt. Similarly, in July 2007, Jake took out a loan from the Bank of Paxton in order to pay off Jake and Cherri's personal debt and to fund their personal cattle and hay operation. Jake used $383,933.98 of the loan to pay off a loan in the name of "JOHN K MCFADDEN[,] CHERRI R MCFADDEN Dba McFadden Cattle & Hay." And he deposited $100,000 into Jake

and Cherri's "farm account." Jake deposited only $31,027.85 of the loan into a McFadden Ranch account. The bank records again show that Jake secured the loan with a deed of trust for McFadden Ranch's land.

[9] In order to establish that Jake breached his fiduciary duty by taking out these loans, McFadden Ranch needed to show that Jake acted in these transactions without corporate authority. Because of the self-dealing nature of these transactions, however, establishing this lack of authority did not necessarily require the production of actual evidence. Generally, there is a presumption that the acts of corporate officers pertaining to ordinary business transactions are authorized by the corporation. *Val-U Constr. Co. v. Contractors, Inc.*, 213 Neb. 291, 328 N.W.2d 774 (1983). However, this presumption does not apply when an officer diverts or pledges corporate property as security for a personal debt. *Id.* Therefore, by proving that Jake used corporate property to secure personal debts, McFadden Ranch also implicitly established that Jake acted without authority.

[10] Once McFadden Ranch established that Jake used corporate property as security for a personal debt and thus presumably acted without authority, the burden of proof shifted to Jake, as the fiduciary, to exculpate himself from these allegations of wrongdoing. The burden of proof is upon a party holding a confidential or fiduciary relation to establish the fairness, adequacy, and equity of a transaction with the party with whom he or she holds such relation. *Woodward v. Andersen*, 261 Neb. 980, 627 N.W.2d 742 (2001).

In order to show the fairness and adequacy of these two loan transactions, Jake needed to produce evidence that he acted with authority—which he failed to do. In the case of the loan from AMC, Jake did provide a corporate resolution allegedly granting him authority. But McFadden Ranch rebutted the validity of this resolution and thereby refuted Jake's showing of authority by presenting evidence that this resolution was false and that the board of directors never granted Jake authority. McFadden Ranch's board of directors supposedly granted Jake the authority to enter into the loan transaction with AMC

at a meeting on June 12, 2005. However, McFadden Ranch's corporate attorney testified that the official corporate records of the company do not include any records from a June 12 meeting. And four of the six individuals listed as attending the meeting—Jake's siblings—testified that they never knew about a June 12 meeting and never attended a meeting on that date. No evidence was presented regarding the purported attendance of Jake's mother at the meeting, and her testimony was not included in either party's evidence at the summary judgment hearing. Even Jake, who was supposedly the sixth individual at the June 12 meeting, did not admit to being there. Only one conclusion can be drawn from this evidence—that no meeting occurred during which the McFadden Ranch board of directors granted Jake the authority to enter into the loan agreement with AMC and that the resolution purporting to give him such authority is fake. Thus, the evidence shows that there is no *genuine* issue of material fact on the issue of corporate authorization of the AMC loan. In the case of the Bank of Paxton loan, Jake presented no evidence of authority. Therefore, because Jake did not produce evidence sufficient to raise a genuine issue of material fact that he acted with authority in these loan transactions, he did not meet his burden to present evidence to dispute McFadden Ranch's prima facie showing of the element of breach.

(c) Causation

McFadden Ranch presented evidence showing that Jake's breach of his fiduciary duty caused the company harm. The president of AMC, the vice president of the Bank of Paxton, and McFadden Ranch's accountant all testified that Jake breached his loan obligations to AMC and the Bank of Paxton and that company property was sold to satisfy these debts in the face of pending foreclosure actions. McFadden Ranch's accountant specifically explained:

> When the Bank of Paxton foreclosed these notes, the Company suffered the reported loss of the principal and interest on each loan because it was the Company's real property that secured the notes, which property was

eventually sold through a private sale to pay off the outstanding loans.

Jake does not deny that he defaulted on these loans or that McFadden Ranch land was sold to repay them. Therefore, there is no genuine issue of fact as to causation.

(d) Damages

Finally, McFadden Ranch adduced evidence establishing that the company was damaged by Jake's breach of fiduciary duty. The company's accountant calculated the loss to the company as $1,197,038—"the total of Jake's personal notes that were paid with the land sale proceeds, reduced by the total of the note that the corporation owed Jake." McFadden Ranch also presented evidence of the "'bad debt deduction'" that the company took on its September 30, 2009, tax return. To reach this deduction, the accountant explained that he "calculated that Jake's actions in defaulting the Company of its property[,] or more specifically by converting loan proceeds for his own use and pledging corporate property as security without Company approval, constituted a $1,197,037.79 . . . loss to the Company." Although Jake questioned the amount of damages, which we will discuss under his third assignment of error below, he did not contest that the company was harmed by his default on these loans. There is no issue of fact as to the existence of damages.

(e) Conclusion

Because McFadden Ranch adduced evidence to establish each element of the breach of fiduciary duty claim, it met its burden to show that it was entitled to judgment as a matter of law. By establishing that Jake breached his fiduciary duties, McFadden Ranch also presented a prima facie case for summary judgment for constructive fraud.

We have analyzed the evidence presented by Jake and find that he did not show the existence of a material issue of fact regarding any of the four elements of this cause of action. Consequently, the district court did not err in entering summary judgment for McFadden Ranch on either the claim for breach of fiduciary duty or the constructive fraud claim.

2. Conversion

McFadden Ranch alleged that Jake converted $50,130 of corporate assets through a series of unauthorized checks written on the company bank account. It presented evidence in the form of bank statements and canceled checks to show the unauthorized diversion of company funds.

However, the bank account on which these checks were written was owned by "RUTH I MCFADDEN OR JOHN K MCFADDEN" and not by the company. Thus, McFadden Ranch did not establish that it was entitled to judgment as a matter of law on the issue of conversion. McFadden Ranch concedes in its brief that "those suspicious withdrawals were not the proper subject of a motion for summary judgment. Accordingly, [McFadden Ranch] agrees that it would be appropriate to reverse . . . that portion of the judgment dealing with this account thereby reducing the judgment by $50,130.00." Brief for appellee at 14-15.

Because McFadden Ranch did not establish a prima facie case for summary judgment for conversion, the district court erred in granting summary judgment in its favor on this cause of action.

3. Amount of Damages

Finally, Jake alleges on appeal that the district court erred in its calculation of the amount of damages. He argues that there is a genuine issue of material fact as to the amount of damages for two reasons.

First, Jake argues that a previous stock pledge agreement between himself and McFadden Ranch "may serve to off-set any amount that may ultimately be owed [McFadden Ranch]." Brief for appellant at 18. Under this stock pledge agreement, Jake pledged his shares in McFadden Ranch in exchange for the use of company property to secure a $208,000 loan dated June 12, 2000. In the event that Jake defaulted on his loan payments, the pledged shares were to be sold to satisfy the debt. Jake argues that this agreement applies to the current situation. But there is no language in the agreement to indicate that it should be read to apply to other loan transactions in which Jake also used company property to secure his personal debts.

Indeed, because the stock pledge agreement is specific to a June 12 loan, we cannot expand it to later loan transactions. Therefore, Jake is not entitled to an offset for the amount of company stock he pledged under this agreement.

Second, Jake argues that there is a question of fact as to the amount of damages, because the company's accountant "attributes the entire amount to [Jake], despite the fact that in paragraph 3 of his affidavit he acknowledges that part of the debt that had been defaulted on was attributed to [McFadden Ranch] itself." Brief for appellant at 18. While it is technically true that the loan from AMC was made to McFadden Ranch and is therefore a debt of the company, McFadden Ranch did so only through Jake's own actions—he obtained the loan and directed that the funds be applied toward his personal debts. McFadden Ranch sold its property to repay the loan only because Jake defaulted on the payments. In these regards, the AMC loan, although in McFadden Ranch's name, was no different than the loan from the Bank of Paxton. Neither loan was incurred for corporate purposes, but only for Jake's benefit. Therefore, the damages to the company resulting from default on both loans were properly included in the overall damages calculation.

As we explained earlier, McFadden Ranch clearly established through its accountant the amount of damages caused by Jake's default on the AMC and Bank of Paxton loans. Jake did not present any evidence to refute these damage calculations other than the stock purchase agreement, which, as we explained above, was not applicable to the loans at issue here. Thus, there is no genuine issue of material fact as to the amount of damages to McFadden Ranch on the breach of fiduciary duty and fraud causes of action.

The district court's judgment lumped all of the damages into a single amount rather than following the customary procedure of setting out a specific amount for each cause of action. And as McFadden Ranch conceded on appeal, the court erred in granting summary judgment on the cause of action for conversion. Thus, to the extent that the district court's damage award of $1,247,167.79 included damages for conversion, it was in error. However, there is no dispute in the evidence of

the amount of damages respectively attributable to the separate causes of action. The evidence clearly established that McFadden Ranch was harmed in the amount of $1,197,037.79 as a result of Jake's breach of fiduciary duty and constructive fraud, while the remaining $50,130 of the original award was the result of the alleged conversion. Because the amount of damages attributable to the conversion cause of action is separate and distinct from the damages resulting from the breach of fiduciary duty and fraud, we are thus able to modify the district court's damage award to reflect the reversal on appeal of the judgment for conversion. We reduce the damage award by $50,130 to $1,197,037.79 and affirm as so modified.

VI. CONCLUSION

Because McFadden Ranch adduced sufficient evidence to establish a prima facie case for breach of fiduciary duty and constructive fraud and Jake failed to present evidence raising a genuine issue of material fact, we affirm the district court's entry of summary judgment in McFadden Ranch's favor on those two causes of action. However, because the evidence did not show that the money Jake allegedly converted from McFadden Ranch came from an account owned by the company, we reverse the grant of summary judgment on the cause of action for conversion. Because we reverse on the conversion cause of action, we modify the district court's judgment to remove the amount attributable to the conversion claim. We therefore affirm in part as modified, and in part reverse and remand for further proceedings consistent with this opinion.

AFFIRMED IN PART AS MODIFIED, AND IN PART REVERSED AND REMANDED FOR FURTHER PROCEEDINGS.