

2007

# McLaughlin v. Schenk, Cookie tree, Inc., Rosemann, and Does : Brief of Appellee

Utah Supreme Court

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IN THE UTAH SUPREME COURT

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SAMUEL R. McLAUGHLIN,

Plaintiff/Appellant,

v.

GREG SCHENK, ESTATE OF BOYD  
SCHENK, ANNA SCHENK,  
COOKIEETREE, INC., HAROLD  
ROSEMAN, GAYLE SCHENK, and  
JOHN DOES 1-10,

Defendants/Appellees.

**BRIEF OF APPELLEES GREG  
SCHENK, COOKIEETREE, INC.,  
HAROLD ROSEMAN, AND GAYLE  
SCHENK**

Case No. 20070688

(Oral Argument Requested)

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On Appeal from the Third District Court in and for Salt Lake County, State of Utah

Hon. Robert K. Hilder

District Court Nos. 040924997, 050914253, and 050906729 (consolidated)

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UTAH APPELLATE COURTS  
FEB 12 2008

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## STATEMENT OF JURISDICTION

This Court has jurisdiction pursuant to Utah Code Ann. § 78-2-2(3)(j).

## STATEMENT OF ISSUES AND STANDARDS OF REVIEW

**Issue No. 1:** Did the trial court correctly determine that the August 16, 1999 transfer of 545,200 shares of Cookietree, Inc. (“Cookietree”) common stock from the Estate of Boyd Schenk (the “Estate”) to Greg Schenk did not violate the 1991 Shareholders’ Agreement? Because this issue presents a question of law, this Court reviews the trial court’s ruling for correctness. *See Mountain Fuel Supply Co. v. Salt Lake City Corp.*, 752 P.2d 884, 887 (Utah 1988). This issue was preserved in the trial court. (R. A1507.)

**Issue No. 2:** Appellant Samuel R. McLaughlin (“McLaughlin”) argues that this appeal presents an issue that is presently unsettled: “Under Utah law, what are the fiduciary duties between and among shareholders, officers and directors in a close corporation?” (Aplt’s Brief at 1.) This expansive issue, however, was not presented in the trial court and should not be decided by this Court. The specific issue presented is this: Does the president and majority stockholder of a closely held corporation owe a fiduciary duty to a minority stockholder who is employed by the corporation under a written employment contract concerning the minority shareholder’s employment? The trial court answered this question in the negative. (R. A1508.) The trial court’s ruling is reviewed for correctness. *See Mountain Fuel Supply Co.*, 752 P.2d at 887.

**Issue No. 3:** Did the trial court correctly deny McLaughlin leave to amend his complaint after the close of fact discovery and after Cookietree’s motions for summary

judgment had been granted? Whether to grant or deny a motion for leave to amend is a matter on which deference is given to the district court, and such a ruling will be disturbed only for an abuse of discretion. *See Smith v. Grand Canyon Expeditions Co.*, 2003 UT 57, ¶ 31, 84 P.3d 1154 (although “‘leave [to amend] shall be freely given when justice so requires’ . . . the dimensions of liberality are generally defined by the trial judge, who is best positioned to evaluate the motion to amend in the context of the scope and duration of the lawsuit.” (*quoting* Utah R. Civ. P. 15(a))). This issue was preserved in the trial court. (R. A1735.)

### **DETERMINATIVE AUTHORITY**

Statutes that are or may be determinative or of central importance to this appeal are as follows, and copies thereof are attached as Addendum 1: Utah Code Ann. §§ 16-10a-821, -850, -851, -852, -853.

### **STATEMENT OF THE CASE**

#### **I. Nature of the Case.**

On August 16, 1999, the Estate transferred 545,200 shares of Cookietree common stock to Greg Schenk pursuant to a Stock Purchase and Sale Agreement (the “Stock Transfer”). McLaughlin, a minority shareholder, argues that the Stock Transfer violated a 1991 agreement between the shareholders of Cookietree (the “1991 Shareholders’ Agreement”), requiring that any shareholder desiring to sell his or her shares must first offer the shares to Cookietree and, if Cookietree elects not to purchase the shares, then to Cookietree’s shareholders pro rata (the “Share Transfer Restriction”). The 1991 Shareholders’ Agreement, however, provides that the Share Transfer Restriction may be

waived with respect to any transfer by Cookietree, upon action of its Board of Directors (the “Board”), or by the owners of two thirds of the outstanding shares (excluding those shares owned by the selling shareholder). After McLaughlin commenced litigation concerning the Stock Transfer, both the Board and the owners of approximately 90 percent of Cookietree’s shares executed written consents waiving application of the Share Transfer Restriction to the Stock Transfer (collectively, the “Waivers”). The dispute between the parties centers on whether the Waivers are valid under Utah law.

McLaughlin was not only a shareholder of Cookietree, he was also an employee, employed under a written contract (the “Employment Agreement”). The Employment Agreement clearly states that McLaughlin is an at-will employee. However, it also provides that Cookietree must give McLaughlin six months’ notice before discharging him. Cookietree—through its president, Greg Schenk—terminated McLaughlin’s employment on August 17, 2004. Rather than providing six months’ notice, Cookietree paid McLaughlin six months’ salary and bonuses (at the level specified in his Employment Agreement) in lieu of notice. In this appeal, McLaughlin argues that the foregoing actions (among others) constituted a breach of the fiduciary duty owed by Greg Schenk to McLaughlin in McLaughlin’s capacity as a minority shareholder. Appellees argue that McLaughlin’s allegations of breach of fiduciary duty reduce to disputes over when and under what circumstances McLaughlin’s employment could be terminated and what he is due in terms of compensation in lieu of notice under the Employment Agreement, and that such claims are employment disputes that cannot sustain a claim of fiduciary breach under Utah law.

## **II. Course of Proceeding and Disposition Below.**

On November 24, 2004, McLaughlin filed a complaint against Cookietree, Greg Schenk, the Estate, and Anna Schenk, alleging that the Stock Transfer violated the 1991 Shareholders' Agreement (civil action no. 040924997, the "Stock Action").

Approximately five months later, on April 12, 2005, McLaughlin commenced a separate action against Greg Schenk and Cookietree, alleging that Cookietree breached the Employment Agreement by paying him six months' salary and bonuses in lieu of notice, and that Greg Schenk breached a fiduciary duty to McLaughlin by engaging in the Stock Transfer and by carrying out the termination of McLaughlin's employment by Cookietree without a business purpose (civil action no. 050906729, the "Employment Agreement Action").<sup>1</sup>

In September 2005, Cookietree moved to compel arbitration of the claims in the Employment Agreement Action. The trial court granted Cookietree's motion to compel arbitration and stayed the Stock Action pending completion of the arbitration.<sup>2</sup> On January 2, 2007, the arbitrator issued a decision resolving all issues relating to

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<sup>1</sup> On August 12, 2005, McLaughlin also commenced a purported shareholders' derivative action against Cookietree, Greg Schenk, Gayle Schenk, and Harold Rosemann, alleging certain additional causes of action based on the Stock Transfer (the "Shareholders' Derivative Action"). (R. B1.) The allegations in the Shareholders' Derivative Action are nearly identical to the allegations in the Stock Action.

<sup>2</sup> In this appeal, McLaughlin is not challenging the trial court's order compelling arbitration of the claims at issue in the Employment Agreement Action. (See Aplt's Brief at 11 n.4.)

McLaughlin's Employment Agreement.<sup>3</sup> However, the arbitrator declined to decide McLaughlin's breach of fiduciary duty claim because it implicated the Stock Action pending before Judge Hilder.<sup>4</sup> (R. A1565.)

After completion of the arbitration, Cookietree renewed its motion for summary judgment concerning the Stock Action (which was filed before the arbitration, but stayed pending completion of the arbitration). Because the arbitrator declined to decide McLaughlin's breach of fiduciary duty claim, Cookietree and Greg Schenk submitted a separate motion for summary judgment seeking dismissal of that claim. On April 25, 2007, the trial court issued a ruling dismissing all of McLaughlin's claims at issue in the Stock Action. Although the trial court was "unable to identify any factual [basis] in the Complaint that would give rise to a claim for breach of fiduciary duty," it nevertheless

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<sup>3</sup> The arbitrator determined that Cookietree did not breach the Employment Agreement by paying McLaughlin six months' salary and bonuses through the notice period but relieving him of any obligation to render services during that time. (*See* Arbitrator's Decision on Motions for Summary Judgment, R. A1562.)

The arbitrator also determined that Cookietree did not breach an implied covenant of good faith and fair dealing in the Employment Agreement by terminating McLaughlin's employment and by asking the police to remove him after he refused to leave the premises. (*See id.*)

However, the arbitrator determined that Cookietree breached an implied covenant of good faith and fair dealing in the Employment Agreement by paying McLaughlin for the notice period at the compensation level specified in his Employment Agreement and not at the compensation level in effect at the time of his discharge. (*See id.*)

<sup>4</sup> The breach of fiduciary duty claim implicated the Stock Action because McLaughlin argued that Greg Schenk breached a fiduciary duty he owed to McLaughlin by carrying out the termination of McLaughlin's employment by Cookietree and by engaging in the Stock Transfer.

“left the door open for [McLaughlin] to identify [a] factual basis for a breach of fiduciary duty.” (R. A1509.)

In response to the trial court’s ruling, McLaughlin filed a motion to amend his Complaint in the Employment Agreement Action to add two new defendants, Harold Rosemann and Gayle Schenk (both of whom were members of the Board), and to assert his breach of fiduciary duty claim against them. However, McLaughlin *again* failed to set forth any factual basis for a breach of fiduciary duty claim against *any* defendant. His motion to amend was also untimely, futile, and prejudicial. Thus the trial court entered a final order denying McLaughlin leave to amend and dismissing his breach of fiduciary duty claim. In doing so, the trial court stated:

While my April 25, 2007, Ruling left open the possibility of an amendment, I find that Mr. McLaughlin has not met the requirements to do so; namely, the identification of evidence that “has not already been addressed.” Specifically, the evidence that plaintiff posits (the 1999 stock transfer, the termination of employment, the reduction of McLaughlin’s salary and negotiation of the sale of Cookietree) has all been previously addressed. I find the absence of any “new” evidence would make the proposed amendment futile.

(R. A1737.)

### **III. Statement of Facts.**

Many of the “facts” submitted by McLaughlin in his brief are immaterial to the legal questions now before this Court. Tellingly, many of McLaughlin’s “facts” are not even cited to or relied on in the argument section of his brief. Appellees set forth their own statement of undisputed material facts as follows:

**The Parties:**

1. Cookie tree is a Utah corporation. (R. A191.)
2. Greg Schenk, his father Boyd Schenk, and Lonny E. Adams were the original shareholders of Cookie tree. (*See id.*)
3. At all relevant times, Greg Schenk was the president of Cookie tree and a member of its Board. Currently, Greg Schenk is Cookie tree's majority shareholder. (*See id.*)
4. At all relevant times, the Board consisted of three members: Greg Schenk; his wife, Gayle Schenk; and Harold Rosemann ("Rosemann"). Rosemann is Cookie tree's chief financial officer and a shareholder of Cookie tree. (R. A231, Aplt's Brief at 20.)
5. Boyd Schenk died on November 28, 1998. (R. A191.)
6. At the time of his death, Boyd Schenk's wife was Anna Schenk. Anna Schenk is Greg Schenk's stepmother. (*See id.*)
7. McLaughlin is a minority shareholder and former employee of Cookie tree. (*See id.*)

**The Shareholders' Agreements:**

8. On January 28, 1991, Cookie tree's shareholders, including Boyd and Greg Schenk, executed the 1991 Shareholders' Agreement. (*See id.*)
9. The 1991 Shareholders' Agreement contains the following restriction on the sale or transfer of Cookie tree stock (the "Share Transfer Restriction"):



If any Shareholder desires or is required to sell any Shares, or if any Shares would be transferred by operation of law or otherwise, then the Shareholder (or his successor in interest) shall first offer the Shares to Cookietree, by written notice to Cookietree

.....

In the event that Cookietree does not elect to acquire all of the Shares specified in the selling Shareholder's notice, the secretary of Cookietree shall, within thirty (30) days of receipt of a selling Shareholder's notice, give written notice thereof to the Shareholders other than the selling Shareholder. . . . Each of the other Shareholders shall be entitled to purchase that proportion of the shares available for purchase.

(1991 Shareholders' Agreement ¶¶ 2 & 4, R. A207.)

10. The 1991 Shareholders' Agreement also contains two exceptions to the Share Transfer Restriction. First, the agreement provides that a shareholder can sell or transfer stock without first offering it to the corporation or the other shareholders, if the shares are sold or transferred to an immediate family member:

Anything to the contrary contained herein notwithstanding . . ., each of Greg F. Schenk [and] Boyd F. Schenk . . . (but not their transferees or successors in interest) may transfer Shares to no more than five members of such Shareholder's immediate family . . ., either during his lifetime or on death by will or intestacy. . . "Immediate family" as used herein shall mean spouse, lineal descendant, father or mother of the Shareholder making such transfer.

(*Id.* ¶ 9, R. A211.)

11. Second, the agreement provides that a shareholder can sell or transfer stock without first offering the shares to the corporation or the other shareholders if the Share Transfer Restriction is waived by the Board or the shareholders:

The provisions of this Agreement may be waived with respect to any transfer *either* by Cookietree, upon duly authorized

action of its Board of Directors, or by the Shareholders, upon the express written consent of the owners of at least two-thirds of the Shares then subject to this Agreement (excluding those Shares owned by the selling Shareholder).

(*Id.* ¶ 11, R. A211 (emphasis added).)

12. On November 1, 1999, Cookietree's shareholders executed a new shareholders' agreement (the "1999 Shareholders' Agreement"). (R. A1080.)

13. The 1999 Shareholders' Agreement was intended to "continue" the rights granted by the 1991 Shareholders' Agreement, not to terminate them. (1999 Shareholders' Agreement, Recitals, *see* Addendum 2.) Indeed, Cookietree's shareholders enacted the 1999 Shareholders' Agreement merely to add certain shareholders "as signatories, some of whom were not direct signatories of the [1991 Shareholders' Agreement]." (*Id.*)

14. Thus the 1999 Shareholders' Agreement contains the same Share Transfer Restriction contained in the 1991 Shareholders' Agreement. It also contains an identical provision allowing the Share Transfer Restriction to be waived:

The provisions of this Agreement may be waived with respect to any transfer either by Cookietree, upon duly authorized action of its Board of Directors, or by the Shareholders, upon the express written consent of the owners of at least two-thirds of the Shares then subject to this Agreement (excluding those Shares owned by the selling Shareholder).

(*Id.* ¶ 11.)

#### **The Challenged Stock Transfer:**

15. On or about March 9, 1991, Boyd Schenk was issued stock Certificate No. 11 representing 1,363,200 shares of Cookietree common stock. (R. A193.)

16. On March 26, 1998, Certificate No. 11 was surrendered and replacement Certificate Nos. 17 and 18 were issued in the amounts of 818,000 shares and 545,200 shares, respectively. (*See id.*)

17. On April 1, 1998, Boyd Schenk transferred the shares represented by Certificate No. 17 (818,000 shares) to Greg Schenk.<sup>5</sup> (*See id.*)

18. Approximately seven months later, on November 28, 1998, Boyd Schenk died. At the time of his death, Boyd Schenk owned 545,200 shares of Cookietree common stock represented by Certificate No. 18. (*See id.*)

19. The shares represented by Certificate No. 18 became part of Boyd Schenk's Estate. (*See id.*)

20. On or about August 16, 1999, approximately nine months after Boyd Schenk's death, the Estate transferred the shares represented by Certificate No. 18 to Greg Schenk pursuant to the Stock Transfer. (*See id.*)

**McLaughlin's Employment with Cookietree:**

21. McLaughlin was hired by Cookietree on December 14, 1992. (R. 1239.)

22. Thereafter, McLaughlin and Cookietree executed the Employment Agreement to govern the terms of McLaughlin's employment. (*See* Employment Agreement, R. A1257.)

23. Pursuant to the Employment Agreement, McLaughlin was employed on an at will basis. (*See id.* ¶ 5(a), R. A1259.)

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<sup>5</sup> McLaughlin does not argue that the April 1, 1998 transfer is invalid, because it was between immediate family members.

24. The Employment Agreement also contains a notice provision, which provides as follows:

Either the Company or Associate may terminate this Agreement, *for any or no reason, at any time* upon at least three (3) months prior written notice during the first six (6) months of employment and six (6) months notice following the first six (6) months of employment.

(*Id.* ¶ 5(b), R. A1259 (emphasis added).)

25. With regard to McLaughlin's salary, the Employment Agreement provides: "Commencing from the effective date of this Agreement, the Company shall pay Associate an annual gross salary of \$130,000 (pro-rated for any partial employment period), payable in accordance with the Company's customary pay schedule." (*Id.* ¶ 3(a), R. A1257.)

26. According to McLaughlin, in 2003, Greg Schenk began to express a desire to sell Cookietree. (Aplt's Brief at 21, ¶ 32.)

27. McLaughlin desired to purchase the company himself. Thus, on or about March 21, 2003, McLaughlin gave Cookietree a letter of intent to purchase Cookietree for \$12,000,000. McLaughlin, however, was not able to raise the necessary financing "and the deal did not close." (*Id.* at 22, ¶ 36.)

28. During the same period, Greg Schenk entered into negotiations with another company, Otis Spunkmeyer, concerning the sale of Cookietree. On or about March 30, 2004, Otis Spunkmeyer gave Cookietree a letter of intent to purchase Cookietree for \$12,000,000 to \$14,000,000. The proposed structure of the deal was an asset sale. (*Id.* at 23, ¶ 40.)

29. McLaughlin tried to match the offer, but was again unable to obtain the necessary financing. (R. A1487.)

30. The proposed sale of Cookietree to Otis Spunkmeyer was never consummated. (R. A1486.)

31. Cookietree terminated McLaughlin's employment on August 17, 2004. (R. A1240.) In lieu of providing McLaughlin six months' notice, Cookietree paid McLaughlin six months' salary and bonuses at the level specified in his Employment Agreement. Cookietree also paid McLaughlin a car allowance during the six-month notice period. (R. A1240.)

32. On or about November 24, 2004, McLaughlin commenced the Stock Action. (R. A1.) On April 12, 2005, McLaughlin commenced the Employment Agreement Action. (R. C16-17.) On August 12, 2005, McLaughlin commenced the purported Shareholders' Derivative Action. (R. B1.) Ultimately, all three actions were consolidated into the Stock Action (civil action no. 040924997) before Judge Hilder.

**The Board and Shareholder Waivers:**

33. On May 17, 2005, approximately six months after the commencement of the Stock Action, the Board adopted a resolution by unanimous written consent, by which Cookietree waived the application of the Share Transfer Restriction to the Stock Transfer (the "Board's waiver"). (See Unanimous Written Consent of Directors of Cookietree, Inc., R. A227.)

34. The Board's waiver, as permitted by Utah Code Ann. § 16-10a-821(3), was made "effective as of August 15, 1999," the day before the Stock Transfer occurred. (Board waiver at 1, R. A227.)

35. Moreover, on May 17, 2005, the owners of approximately 90 percent of the shares of Cookietree, excluding those shares owned by Boyd Schenk at the time of his death, executed a written consent waiving the application of the Share Transfer Restriction to the Stock Transfer (the "Shareholders' waiver"). (*See* Shareholders' waiver, R. A230.) (The Board and Shareholder waivers are collectively referred to as the "Waivers.")

## **SUMMARY OF ARGUMENTS**

### **I. The Trial Court Correctly Determined That the Stock Transfer Did Not Violate the 1991 Shareholders' Agreement.**

As McLaughlin correctly notes, the 1991 Shareholders' Agreement contains a Share Transfer Restriction. However, the agreement also expressly provides that the Share Transfer Restriction may be waived with respect to any transfer by either Cookietree, upon action of its Board, or the shareholders. Here, both the Board and the owners of approximately 90 percent of Cookietree's shares expressly waived the application of the Share Transfer Restriction to the Stock Transfer. Realizing this, McLaughlin argues in this appeal that the Waivers are invalid. His arguments are unfounded.

McLaughlin first argues that because the 1999 Shareholders' Agreement superseded the 1991 Shareholders' Agreement, any waiver under the 1991 Shareholders'

Agreement must have been procured before November 1, 1999. McLaughlin is wrong. Although the 1991 Shareholders' Agreement was replaced by the 1999 Shareholders' Agreement, the 1991 Shareholders' Agreement is still the controlling document with regard to the Stock Transfer, because the Stock Transfer occurred while the 1991 Shareholders' Agreement was still in effect. The fact that the 1991 Shareholders' Agreement was ultimately replaced by another agreement does not mean that the parties to the 1991 Shareholders' Agreement suddenly lost their contractual rights with regard to any transfer still subject to that agreement. Furthermore, the 1999 Shareholders' Agreement was intended to "continue" the rights granted by the 1991 Shareholders' Agreement, not to terminate them. Thus the 1999 Shareholders' Agreement contains the same Share Transfer Restriction contained in the 1991 Shareholders' Agreement. It also contains an identical provision allowing the Share Transfer Restriction to be waived with respect to any transfer either by Cookietree, by action of its Board, or the shareholders.

Regardless, the Utah Revised Business Corporation Act ("URBCA") clearly allows the board of directors of a Utah corporation to fix or establish the effective date of the board's action by written consent at any time in the past. Thus, although the Board's written consent by which Cookietree waived the Share Transfer Restriction was executed in May 2005, the Board specifically made the written consent (and thereby Cookietree's waiver of the application of the Share Transfer Restriction to the Stock Transfer) "effective as of August 15, 1999," the day before the Stock Transfer occurred. Because the Board's written consent was effective as of August 15, 1999, the Cookietree waiver occurred as of that date and the fact that the 1991 Shareholders' Agreement was

superseded by the 1999 Shareholders' Agreement at the time the written consent was executed is inconsequential.

McLaughlin next argues that the Waivers and the Stock Transfer are conflicting interest transactions. As an initial matter, the relevant "transaction" under the URBCA is the Stock Transfer, not the Waivers respecting the Stock Transfer.<sup>6</sup> Furthermore, the Stock Transfer is not a "director's conflicting interest transaction." Under the URBCA, the term "transaction" is limited to action *by the corporation itself*. Here, the Stock Transfer was not effected or proposed to be effected *by the corporation*. Thus the URBCA neither prohibits the Stock Transfer nor governs the propriety of a waiver of the Share Transfer Restriction. Even if the Stock Transfer were a director's conflicting interest transaction, the URBCA permits a *single* qualified director to approve another director's conflicting interest transaction. Rosemann is a "qualified director" within the meaning of the URBCA as concerns the Stock Transfer, and thus properly approved the waiver of the application of the Share Transfer Restriction to the Stock Transfer.

The URBCA's provisions dealing with director's conflicting interest transactions are also inapplicable to the Shareholders' waiver. Obviously, the Shareholders' waiver was not effected or proposed to be effected *by Cookietree*—it did not even involve Cookietree or one of its directors acting in his or her capacity as a director. Instead, the Shareholders' waiver was effected by individual shareholders in their *individual capacity*.

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<sup>6</sup> To the extent McLaughlin even argues that the Waivers are conflicting interest transactions, this argument was never raised in the trial court and thus cannot be raised on appeal.



The URBCA simply has no application one way or the other to such actions in which the corporation is not a party. Furthermore, in executing the Shareholders' waiver, the Shareholders were not purporting to take "action" under the URBCA respecting a director's conflicting interest transaction. Rather, the shareholders who executed the waiver were exercising a contractual right granted to them in their individual capacities as parties to the 1991 Shareholders' Agreement. Thus it is the 1991 Shareholders Agreement, not the provisions of the URBCA, that governs their action. McLaughlin fails to even make an argument that the Shareholders' waiver did not comply with the terms of the 1991 Shareholders' Agreement.

McLaughlin's third argument is that the Waivers violated Cookietree's bylaws because they were procured without a meeting or notice. Cookietree's bylaws, however, expressly permit Board action without a meeting. Further, McLaughlin is not a member of the Board (and never has been) and is not entitled to receive notice of Board action. The shareholders are also not required to convene a meeting and vote their shares in order to procure a waiver of the Share Transfer Restriction. In executing their waiver, the shareholders were not taking "shareholder action" under the URBCA, they were exercising a contractual right under the 1991 Shareholders' Agreement. Thus they properly executed their waiver and consent without a meeting.

Finally, McLaughlin argues that the Waivers were untimely. As previously noted, the URBCA allows the board of a Utah corporation to fix the effective date of its action, and imposes no time limit on how far back that date may be. Numerous courts have expressly approved the fixing of an effective date in the past long after the subject

transaction and in response to litigation. McLaughlin makes no argument that he suffered any prejudice as a result of the timing of the Waivers, nor could he. To the extent McLaughlin is claiming that he suffered some prejudice as a result of the Waivers generally, the prejudice he is claiming is the inability to purchase the shares at issue in the Stock Transfer. However, regardless of the timing, the Waivers are expressly permitted by the 1991 and 1999 Shareholders' Agreements. Thus McLaughlin could not have suffered any prejudice as a result of the Waivers.

## **II. The Trial Court Correctly Determined That McLaughlin Failed to State a Claim for Breach of Fiduciary Duty.**

The essence of McLaughlin's breach of fiduciary duty claim is this: Greg Schenk breached a fiduciary duty he owed to McLaughlin by causing Cookietree to terminate McLaughlin's employment "without a business purpose" and by failing to pay McLaughlin the correct amount of compensation in lieu of notice under the Employment Agreement. McLaughlin apparently believes that his employment status should not have been governed by the written Employment Agreement but, rather, somehow by his status as a minority shareholder and whatever duties might be owed to him in that capacity. The law is clearly opposite of what McLaughlin claims.

In his role as an officer and director of Cookietree, Greg Schenk owed no fiduciary duty to McLaughlin *in McLaughlin's capacity as an employee*. Realizing this, McLaughlin strains to allege wrongful action by Greg Schenk that affected him in his capacity *as a shareholder*, but he clearly fails in this regard. McLaughlin's allegations of breach of fiduciary duty reduce to disputes over when and under what circumstances his

employment could be terminated and what he was due in terms of compensation after his discharge pursuant to the Employment Agreement. Such claims are employment disputes that cannot sustain a claim of fiduciary breach under Utah law.

**III. The Trial Court Did Not Abuse Its Discretion in Denying McLaughlin Leave to Amend.**

On April 25, 2007, the trial court issued a ruling dismissing all of McLaughlin's claims, with the exception of his breach of fiduciary duty claim against Greg Schenk. Although the trial court was unable to identify any factual basis in the Complaint that would give rise to a claim for breach of fiduciary duty, the trial court left the door open for McLaughlin to identify a factual basis for such a claim against Greg Schenk. In response to the trial court's ruling, McLaughlin filed a motion to amend his Complaint to add two new defendants, Rosemann and Gayle Schenk, and to assert his breach of fiduciary duty claim against them. However, McLaughlin *again* failed to set forth any factual basis for a breach of fiduciary duty claim. McLaughlin's motion to amend was also untimely, futile, and prejudicial. Thus the trial court did not abuse its discretion in denying McLaughlin leave to amend.

**ARGUMENT**

**I. The Trial Court Correctly Determined That the Stock Transfer Did Not Violate the 1991 Shareholders' Agreement.**

McLaughlin argues that the Stock Transfer violated the 1991 Shareholders' Agreement because the involved shares were not first offered to Cookietree and, if Cookietree elected not to purchase the shares, then to Cookietree's shareholders pro rata. McLaughlin is correct that the 1991 Shareholders' Agreement contains such a Share

Transfer Restriction. However, the agreement also provides that the Share Transfer Restriction may be waived either by Cookietree, by action of its Board, or by the shareholders. Both the Board and the shareholders effectuated such written waivers in this case. Realizing this, McLaughlin argues that the Waivers are invalid. Specifically, McLaughlin interposes the following insubstantial objections to the Waivers: (1) at the time of the Waivers (May 2005), the 1991 Shareholders' Agreement had expired, and therefore no authority existed for the Waivers; (2) the Waivers constitute "conflicting interest transactions" under the URBCA; (3) the Waivers violated Cookietree's bylaws; and (4) the Waivers were untimely. Each of McLaughlin's arguments is unfounded.<sup>7</sup>

**A. The Execution of the 1999 Shareholders' Agreement Had No Effect on the Validity of the Waivers.**

On November 1, 1999, Cookietree's shareholders executed a new shareholders' agreement, the 1999 Shareholders' Agreement. (R. A1080.) McLaughlin argues that because the 1999 Shareholders' Agreement superseded the 1991 Shareholders' Agreement, any waiver under the 1991 Shareholders' Agreement "must have been procured before November 1, 1999." (Aplt's Brief at 64.) McLaughlin is wrong.

As an initial matter, although the 1991 Shareholders' Agreement was replaced by the 1999 Shareholders' Agreement, the 1991 Shareholders' Agreement is still the

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<sup>7</sup> In his brief, McLaughlin argues that "summary judgment was improperly granted given the existence of factual issues surrounding the 200[5] 'Ratification' by the Cookietree Board and some of its shareholders." (Aplt's Brief at 61.) However, McLaughlin fails to marshal any record evidence that supports the challenged finding, as required by Utah Rule of Appellate Procedure 24(a)(9). Indeed, McLaughlin never identifies the "factual issues" that purportedly prevent summary judgment. This is because there are no such issues.

controlling document with regard to the Stock Transfer, because the Stock Transfer occurred while the 1991 Shareholders' Agreement was still in effect. The fact that the 1991 Shareholders' Agreement was ultimately replaced by another agreement, does not mean that the parties to the 1991 Shareholders' Agreement suddenly lost their contractual rights with regard to any transfer subject to that agreement. McLaughlin has failed to cite a single case or other authority suggesting otherwise.<sup>8</sup> Thus the Board and the shareholders' waivers of the application of the Share Transfer Restriction to the Stock Transfer were valid, because the 1991 Shareholders' Agreement is still the controlling document with regard to the Stock Transfer.

Furthermore, the 1999 Shareholders' Agreement was intended to "continue" the rights granted by the 1991 Shareholders' Agreement, not to terminate those rights. (1999 Shareholders' Agreement, Recitals, *see* Addendum 2.) Indeed, Cookietree's shareholders enacted the 1999 Shareholders' Agreement merely to add certain shareholders "as signatories, some of whom were not direct signatories of the [1991 Shareholders' Agreement]." (*Id.*) The 1999 Shareholders' Agreement contains the same Share Transfer Restriction contained in the 1991 Shareholders' Agreement. It also contains an identical provision allowing the Share Transfer Restriction to be waived by either Cookietree, by action of its Board, or the shareholders by express written consent. (*Id.* ¶ 11.) Thus the Waivers need not have been procured before November 1, 1999, as suggested by McLaughlin.

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<sup>8</sup> Moreover, McLaughlin has cited no authority for the proposition that contractual rights cannot be waived after expiration of the contract at issue.

Regardless, the URBCA clearly allows the board of directors of a Utah corporation to fix or establish the effective date of the board's action by written consent at any time in the past. *See* Utah Code Ann. § 16-10a-821(3) ("Action under this section is effective at the time it is taken . . . , *unless the board of directors establishes a different effective date.*" (emphasis added)). *Cf. Cohen v. Ayers*, 449 F. Supp. 298, 308 (D.C. Ill. 1978) ("Ratification is by definition retroactive, *but it is nevertheless equivalent to prior authority.*" (emphasis added; citations and internal quotation marks omitted)); 2A Fletcher, *Cyclopedia of the Law of Private Corporations* § 782 (corporation's ratification of unauthorized act relates back to time of act and is "equivalent to original authority"); 18B Am. Jur. 2d *Corporation's* § 1415 ("[D]irectors of a corporation may ratify any [act] . . . that they could have originally authorized."). Again, McLaughlin has failed to cite a single case or other authority suggesting otherwise.

Although the Board's written consent by which Cookietree waived the Share Transfer Restriction was executed in May 2005, the written consent, and thereby the waiver, was made "effective as of August 15, 1999," the day before the Stock Transfer occurred. Because the Board's written consent was effective as of August 15, 1999, the Cookietree waiver occurred as of that date and the fact that the 1991 Shareholders' Agreement was superseded by the 1999 Shareholders' Agreement at the time the written consent was executed is inconsequential.

**B. Neither the Board's Waiver nor the Stock Transfer Is a Conflicting Interest Transaction.**

**1. McLaughlin's Argument That the Board's Waiver Is a Conflicting Interest Transaction Was Not Preserved for Appeal.**

McLaughlin next argues that the Board's waiver was a "conflicting interest transaction" under the URBCA. This argument, however, is being presented for the first time on appeal. Before the trial court, McLaughlin argued that the *Stock Transfer* (not the Waivers) was a conflicting interest transaction. He never argued that the Board's *waiver* constituted such a transaction.<sup>9</sup> (See McLaughlin's Memo. in Opp. to Def.'s Mot. for S.J., R. A417 (arguing that "[t]he transfer of the Estate's stock to Defendant Schenk was a 'conflicting interest transaction' within the meaning of this Statute").) Tellingly, McLaughlin makes no attempt to provide a citation to the record indicating that such an argument was, in fact, raised.

Utah law is clear that prior to asking an appellate court to reverse a trial court, the appellant must have first brought the alleged error to the attention of the trial court and then been denied relief. See *Brookside Mobile Home Park v. Peebles*, 2002 UT 48, ¶ 14, 48 P.3d 968. Thus, because McLaughlin failed to raise his argument that the Board's

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<sup>9</sup> Apparently realizing that his latest argument was never raised in the trial court, McLaughlin states as follows: "In the proceedings below, Defendants argued that the 'transaction' was the 1999 stock transfer between Greg Schenk and Anna Schenk. . . . Indeed, the 'transaction' . . . was the ex post facto ratification of the transfer. . . ." (Aplt's Brief at 65 n.15.) This statement is disingenuous and misleading. As McLaughlin correctly notes, Defendants argued below that the Stock Transfer was not a conflicting interest transaction. Of course, Defendants' argument was in response to McLaughlin's erroneous argument that the Stock Transfer constituted such a transaction. McLaughlin never raised the issue of whether the Waivers (as opposed to the Stock Transfer) constituted a conflicting interest transaction.

waiver constitutes a conflicting interest transaction in the trial court, it cannot be raised on appeal.

**2. Regardless, the Board's Waiver Is Not a Conflicting Interest Transaction.**

Even if McLaughlin had preserved his argument that the Board's waiver is a conflicting interest transaction, the argument is wrong. The relevant "transaction" under the URBCA is the Stock Transfer, not the Waivers respecting the Stock Transfer. Indeed, as defined by the URBCA, the Board's waiver constitutes "action respecting a transaction," not the "transaction" itself. Utah Code Ann. § 16-10a-852(1) ("Directors' action *respecting a transaction*." (emphasis added)); *see also* Official Commentary to URBCA § 850(b)(1) (2007) ("To constitute a director's conflicting interest transaction, there must first be a transaction by the corporation . . . in which the director has a financial interest.").<sup>10</sup>

**3. The Stock Transfer Is Not a Conflicting Interest Transaction.**

Furthermore, the Stock Transfer was not a conflicting interest transaction under the URBCA.<sup>11</sup> Section 16-10a-850(2) of the URBCA defines a conflicting interest transaction as "a transaction effected or proposed to be effected *by the corporation*, or by any entity controlled by the corporation respecting which a director has a conflicting

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<sup>10</sup> Moreover, a "transaction" typically involves two or more parties. The Board's waiver, however, did not involve two or more parties. It was merely an action by the Corporation respecting a transaction to which it was not a party.

<sup>11</sup> Although McLaughlin argued in the trial court that the Stock Transfer is a director's conflicting interest transaction, he has apparently abandoned this argument on appeal.



interest.” (Emphasis added.) Thus the term “transaction,” as used in this section, is limited to action *by the corporation itself*. This principle is confirmed by the official commentary to section 16-10a-850:

As another feature of the key term “transaction,” the text . . . emphasizes that the term implies and is limited to action by the corporation itself. *The language . . . has no application one way or the other to economic actions by the director in which the corporation is not a party . . . .*

Official Commentary to URBCA § 850(b)(1) (2007) (emphasis added).

Because section 16-10a-850 has no application to economic actions by a director in which the corporation is not a party, it is settled law that a purchase by a director of the corporation’s shares is not a “transaction” within the scope of the URBCA. This issue is also squarely addressed in the official commentary to section 16-10a-850:

[A] purchase by the director of the corporation’s shares on the open market or from a third party is not a “transaction” within the scope of [section 16-10a-850] *and the [section] does not govern an attack made on the propriety of such a share purchase.*

*Id.* (emphasis added).

Here, the challenged transaction, the Stock Transfer, involved two parties—the Estate and Greg Schenk; it did not involve Cookietree. Thus the Stock Transfer was not “effected or proposed to be effected *by the corporation.*” Utah Code Ann. § 16-10a-850(2) (emphasis added). Although Cookietree had a potential right of refusal with respect to the shares at issue, that did not make Cookietree a party to the transaction. *See* Official Commentary to URBCA § 850(b)(1) (2007) (“The language of subpart E has no

application one way or the other to economic actions by the director in which the corporation is not a party.”).

In sum, the Stock Transfer is not a conflicting interest transaction within the scope of the URBCA as a matter of law. Thus the URBCA neither prohibits the Stock Transfer nor governs the propriety of a waiver of the Share Transfer Restriction. *See id.* (“To constitute a director’s conflicting transaction, there must first be a transaction by the corporation . . . in which the director has a financial interest . . . . [T]he safe harbor provisions provided in subpart E have no application to circumstances in which there is no ‘transaction’ by the corporation, *however apparent the director’s conflicting interest.*” (emphasis added)); *see also* Utah Code Ann. § 16-10a-851(1) (“A transaction effected or proposed to be effected by the corporation . . . that is not a director’s conflicting interest transaction may not be enjoined, be set aside, or give rise to an award of damages or other sanctions, in a proceeding by a shareholder or by or in the right of the corporation. . .”).

**4. Even if the Board’s Waiver or the Stock Transfer Is Deemed to Be a Conflicting Interest Transaction, the Waiver Is Still Valid.**

**a. The Board’s Waiver Was Approved by a Majority of the “Qualified Directors.”**

Section 16-10a-851 of the URBCA provides that a conflicting interest transaction may not be set aside if a “director’s action respecting the transaction was at any time taken in compliance with section 16-10a-852.” Section 16-10a-852(1) provides a safe harbor for conflicting interest transactions if “the transaction received the affirmative vote of a majority of those qualified directors on the board of directors.” Importantly,

“[a] majority of the qualified directors on the board of directors . . . constitutes a quorum for purposes of [section 16-10a-852].” Utah Code Ann. § 16-10a-852(3). The URBCA therefore “permits a *single* qualified director to approve another director’s conflicting interest transaction.” Official Commentary to URBCA § 852(a) (2007) (emphasis added).

Here, each member of the Board—Greg Schenk, Gayle Schenk, and Harold Rosemann—expressly voted (by written consent) to authorize Cookietree’s waiver of the application of the Share Transfer Restriction to the Stock Transfer. McLaughlin’s argument that none of the directors was “qualified” is wrong. Rosemann was a qualified director, and his action respecting Cookietree’s waiver “is not affected by the presence or vote of a director who is not a qualified director.” Utah Code Ann. § 16-10a-852(3).

Under the URBCA, “qualified director” means,

with respect to a director’s conflicting interest transaction, any director who does not have either a conflicting interest respecting the transaction, or a familial, financial, professional, or employment relationship with a second director who does have a conflicting interest respecting the transaction, which relationship would, in the circumstances, reasonably be expected to exert an influence on the first director’s judgment when voting on the transaction.

Utah Code Ann. § 16-10a-850(3). McLaughlin does not argue that Rosemann had a conflicting interest respecting the Stock Transfer. (*See* Aplt’s Brief at 68.) Nor could he make such an argument. It is undisputed that Rosemann was not a party to the Stock Transfer and did not have a beneficial financial interest in it. McLaughlin also does not argue that Rosemann had a familial, financial, or professional relationship with Greg

Schenk that would render him unqualified.<sup>12</sup> Instead, McLaughlin argues that “Rosemann could not have been a ‘qualified director’ because he has an ‘employment relationship with a second director [Greg Schenk] who does have a conflicting interest’” in the Stock Transfer. (Aplt’s Brief at 68.)

As an initial matter, McLaughlin’s argument that Rosemann has an “employment relationship” with Greg Schenk was never raised before the trial court, and therefore cannot be raised on appeal. (*See supra* Section I.B.1.) Regardless, McLaughlin’s argument is untenable. It is undisputed that Rosemann has an employment relationship *with Cookietree*. (*See* McLaughlin’s Memo. in Opp. to Def.’s Mot. for S.J., R. A1007 (stating that “Harold Rosemann is an employee of Cookietree, Inc.”).) Nevertheless, McLaughlin apparently now believes that Rosemann also has an “employment relationship” with Greg Schenk, because Mr. Schenk is the president of Cookietree. (*See* Aplt’s Brief at 68.) In addition to the fact that McLaughlin has flip-flopped in his position concerning who is Mr. Rosemann’s employer, his interpretation of section 16-10a-850(3) is at odds with its commonly understood language.

Section 16-10a-850(3) does not state that a director is unqualified because a second director who has an interest in the underlying transaction is in a position to influence the first director’s employment relationship *with the corporation*. Instead, the statute states that a director is unqualified if he or she has an “employment relationship

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<sup>12</sup> McLaughlin cannot raise such an argument in his reply brief. *See Brown v. Glover*, 2000 UT 89, ¶ 23, 16 P.3d 540; *State v. Arviso*, 1999 UT App 381, ¶ 4 n. 2, 993 P.2d 894.

*with a second director.*” (Emphasis added.) This Court should “presume that the legislature used each word [in a statute] advisedly and . . . give effect to each term according to its ordinary and accepted meaning.” *Li v. Enter. Rent-A-Car Co. of Utah*, 2006 UT 80, ¶ 21, 150 P.3d 471; *see also Sindt v. Ret. Bd.*, 2007 UT 16, ¶ 8, 157 P.3d 797 (“Under this Court’s rules of statutory construction, the Court should “look first to the statute’s plain language to determine its meaning.” (internal quotation marks omitted)). Indeed, if the legislature intended to disqualify directors whose employment relationship *with the corporation* may be influenced by a second director who has an interest in the underlying transaction, it could have easily stated as much. It did not. This Court should not make an interpretive leap to reach a result that the legislature could have easily made explicit using commonly understood language. *See Lorenzo v. Workforce Appeals Bd.*, 2002 UT App 371, ¶ 13, 58 P.3d 873 (“If the legislature intended to extend continuous jurisdiction to collection of civil penalties, it could have so stated its intention.” (internal quotation marks omitted)); *Hebertson v. Bank One, Utah*, 1999 UT App 342, ¶ 13, 995 P.2d 7 (if legislature intended certain result, it should have so stated); *Bourgeois v. Utah Dep’t of Commerce*, 2002 UT App 5, ¶ 21, 41 P.3d 461 (same).

In addition to the fact that McLaughlin’s definition of “employment relationship” conflicts with the plain language of the statute, it will also lead to illogical results. Indeed, by McLaughlin’s definition, every manager, supervisor, or officer of a corporation would, as a necessary extension of McLaughlin’s argument, be deemed to be the “employer” of the individuals over whom he or she exerts supervisory control. This result is clearly inconsistent with well-established law. *Cf. Waldo v. Salt Lake County*

*Sheriff's Dep't*, No. 03-4060, 2003 WL 21774022, at \*1 (D. Utah Aug. 1, 2003) (supervisor not employer within meaning of Title VII); *Pinkard v. Lozano*, Civ. no. 06-cv-02523-PSF-BNB2007, WL 4116019, at \*2 (D. Colo. Nov. 16, 2007) (supervisor not employer within meaning of Age Discrimination in Employment Act or Americans with Disabilities Act); *United States ex rel. Siewick v. Jamieson Sci. & Eng. Inc.*, 322 F.3d 738, 740 (D.C. Cir. 2003) (president and chief executive officer of government contractor was not “employer” within meaning of False Claims Act, notwithstanding that CEO owned 85 percent of shares of company, served as president and chairman of board of directors, ran day-to-day operations, set salaries, and made hiring and firing decisions).

Neither Greg Schenk’s ownership nor his control of Cookiecree makes him Rosemann’s “employer” or creates an “employment relationship” between the two individuals within the statutory terms commonly understood meaning. *Cf. United States ex rel. Siewick*, 322 F.3d at 740. Only the corporation is the employer of the corporation’s employees. *Cf. Meyer v. Holley*, 537 U.S. 280, 286 (2003) A corporation is a distinct entity from its shareholders, *see d’Elia v. Rice Dev., Inc.*, 2006 UT App 416, ¶ 30, 147 P.3d 515 (“Ordinarily, a corporation is regarded as a separate and distinct legal entity from its stockholders.”),<sup>13</sup> and its corporate officers, even when they may seem to function as an employer, act only as agents on behalf of the corporation. *See Diversified Holdings, L.C. v. Turner*, 2002 UT 129, ¶ 36, 63 P.3d 686 (Utah 2002) (“Corporations ordinarily act only through their agents, and, when the agent acts within the scope of his

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<sup>13</sup> *Dole Food Co. v. Patrickson*, 538 U.S. 468, 474 (2003) (“A basic tenet of American corporate law is that the corporation and its shareholders are distinct entities.”).

employment, the agent's liability generally becomes the liability of the employer."); *Orlob v. Wasatch Mgmt.*, 2001 UT App 287, ¶ 18, 33 P.3d 1078 ("Corporations can only act through agents, be they officers or employees."). The principle applies with no less force when an individual, like Greg Schenk, has a significant ownership interest in the corporation and substantially controls its actions. *Cf. United States ex rel. Siewick*, 322 F.3d at 740.

In sum, Rosemann did not have an "employment relationship" with another director who had an interest in the Stock Transfer. Therefore Rosemann was a "qualified director" within the meaning of the URBCA and properly approved as a "qualified director" Cookietree's waiver of the application of the Share Transfer Restriction to the Stock Transfer.

**b. The Required Disclosures Were Made to Rosemann.**

Finally, all required disclosures concerning the Stock Transfer were made to Rosemann at the time of the Board's waiver, or were already known to him. "Required disclosure" means disclosure of (1) the existence and nature of the conflicting interest; and (2) all facts respecting the subject matter of the transaction that an ordinary prudent person would reasonably believe to be material to a judgment about whether or not to proceed with the transaction. *See* Utah Code Ann. § 16-10a-850(4)(a)-(b). Importantly, a required disclosure need not be made if the information is already known to the director taking action. *Id.* § 16-10a-852(1)

In the Board's waiver regarding the Stock Transfer, each Board member (Greg Schenk, Gayle Schenk, and Harold Rosemann) expressly acknowledged that he or she

was aware of the Share Transfer Restriction in the 1991 Shareholders' Agreement, was aware of the terms of the Stock Transfer, and was aware of the other Board members' potential interests in the Stock Transfer. Indeed, the Board's written consent specifically states:

<u>Director</u>	<u>Potential Interest in Transactions</u>
Greg Schenk	In the 1999 Transfer, Boyd F. Schenk, Greg Schenk's father, transferred to Greg Schenk 545,200 Shares. Greg Schenk is the president of the Company.
Gayle Schenk	Gayle Schenk is the wife of Greg Schenk. See potential interest in transactions for Greg Schenk above.
Harold Rosemann	Harold Rosemann is the secretary and treasurer of the Company

(Board Waiver at 1, R. A227.) The Board's written consent also expressly states that each Board member had "been apprised of the interests of the potentially conflicted directors"; that each Board member "had a full opportunity to inquire into and understand the extent and nature of those interests"; and that each Board member determined "that it is in the best interest of the Company and its shareholders for the Company to waive any restrictions relating to the transfer or sale to Greg Schenk of the Shares transferred in the 1999 Transfer . . . ." (*Id.*)



Notwithstanding the foregoing, McLaughlin argues that the Board's written consent should also have disclosed that "Rosemann was given additional Cookietree shares at the same time he helped facilitate the 1999 stock transaction." (Aplt's Brief at 69.) It is completely unclear what McLaughlin means by his statement: Rosemann "helped facilitate the 1999 stock transaction." To the extent McLaughlin is suggesting that Rosemann was "given" additional shares at the time he signed the Board's waiver (in May 2005), this is incorrect. Rosemann exercised an option to purchase certain shares of Cookietree stock in 1998 (he was not "given" the shares), before the Stock Transfer occurred. He did not purchase, nor was he given, any shares in May 2005. (See R. A1142.) Rosemann's 1998 stock purchase had nothing to do with the subsequent Stock Transfer between the Estate and Greg Schenk or the Waivers respecting that transaction. Thus there was no obligation to disclose such facts. Regardless, Rosemann was obviously aware of all relevant facts surrounding *his* 1998 stock purchase, negating any obligation to disclose such facts in the Board's written consent. See Utah Code Ann. § 16-10a-852(1) (required disclosure need not be made if information is already known to director taking action).

McLaughlin also argues that the Board's written consent should have disclosed that "the Stock Transfer made Greg Schenk the majority shareholder of all authorized shares"; that "Greg Schenk never disclosed the [Stock Transfer] until challenged by McLaughlin in 2004"; and that "other 1999 stock transfers were disclosed and approved in 1999 Board meetings and Minutes, but the one with Anna was not." (Aplt's Brief at 69-70.) To the extent McLaughlin is asserting that Greg Schenk did not disclose the

Stock Transfer to Rosemann until 2004, this is, again, factually incorrect. Rosemann, as the corporate treasurer and secretary, was aware of the Stock Transfer at the time it occurred. (*See* Deposition of Harold Rosemann 22:20, excerpts attached to Addendum 3 (“I knew everything that was going on.”).) Moreover, as the corporate treasurer and secretary and a member of the Board, Rosemann was aware that the Stock Transfer made Greg Schenk the majority shareholder of all authorized shares and that other 1999 stock transfers were disclosed and approved in 1999 Board meetings. McLaughlin does not offer one shred of evidence to the contrary. Because Rosemann was obviously aware of such facts, there was no obligation to disclose such facts in the Board’s written consent. *See* Utah Code Ann. § 16-10a-852(1).

In sum, neither the Stock Transfer nor the Board’s waiver respecting that transaction constitutes a conflicting interest transaction. Regardless, Cookietree’s waiver of the Share Transfer Restriction was authorized by a “qualified director,” Rosemann, who was apprised of the interests of the potentially conflicted directors/shareholders and had a full opportunity to inquire into and understand the extent and nature of those interests and the subject matter of the Stock Transfer. For all these reasons, the Board’s waiver is valid as a matter of law.

### **C. The URBCA Is Inapplicable to the Shareholders’ Waiver.**

In addition to arguing that the Board’s waiver is ineffective under the URBCA, McLaughlin makes the same argument concerning the Shareholders’ waiver. Specifically, McLaughlin argues that the Shareholders’ waiver is ineffective because certain “non-qualified shares [*i.e.*, Greg Schenk’s shares] were included *in the vote*” and

certain “qualified” shares, *i.e.*, Sam and Kim McLaughlin’s shares, “were not included *in the vote*.” (Aplt’s Brief at 69 (emphasis added).) McLaughlin’s suggestion that there was a “shareholders’ vote” with respect to the waiver of the Share Transfer Restriction is factually incorrect. Instead, the holders of approximately 90 percent of the outstanding shares executed a written consent waiving the application of the Share Transfer Restriction to the Stock Transfer. For the reasons discussed below, the URBCA’s provisions dealing with “shareholders’ action” respecting a director’s conflicting interest transaction are inapplicable to the Shareholders’ consent and waiver.

First, for the same reasons discussed above, neither the Stock Transfer nor the Shareholders’ waiver is a “director’s conflicting interest transaction” within the meaning of the URCBA, and therefore the requirements of the URBCA are inapplicable.<sup>14</sup> Clearly, the Shareholders’ waiver was not effected or proposed to be effected by *Cookietree*—it did not even involve *Cookietree* or one of its directors acting in his or her capacity as a director.<sup>15</sup> Instead, the Shareholders’ waiver was effected by individual shareholders in their *individual capacity*. The URBCA simply has no application one way or the other to such actions in which the corporation is not a party.

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<sup>14</sup> As noted above, McLaughlin has abandoned his argument (made in the trial court) that the Stock Transfer is a director’s conflicting interest transaction.

<sup>15</sup> There is a radical difference when a stockholder is acting strictly as a stockholder and when he or she is acting as a director. When acting as a stockholder he or she has the legal right to act with a view of his or her own benefit and is representing him- or herself only.

Second, in executing their waiver and consent, the shareholders were not purporting to take “action” under the URBCA respecting a director’s conflicting interest transaction. Rather, the shareholders who executed the waiver and consent were exercising a contractual right granted to them in their individual capacities as parties to the 1991 Shareholders’ Agreement. Thus it is the 1991 Shareholders’ Agreement, not the provisions of the URBCA, that governs their action. Importantly, the 1991 Shareholders’ Agreement does not require that to effectuate a waiver of the Share Transfer Restriction, the shareholders must conduct a meeting and cast their votes in accordance with the requirements of the URBCA. Nor does it require that only the holders of “qualified shares” may cast votes. The 1991 Shareholders’ Agreement merely states that the Share Transfer Restriction “may be waived with respect to any transfer either by Cookietree . . . or by the Shareholders, upon the *express written consent* of the owners of at least two-thirds of the Shares then subject to this Agreement (excluding those Shares owned by the selling Shareholder).” (Emphasis added.) Here, it is undisputed that the owners of more than two-thirds of the outstanding Shares (excluding those Shares owned by the Estate) gave their express written consent to waive the application of the Share Transfer Restriction to the Stock Transfer. The Shareholders’ waiver is therefore valid.

**D. The Waivers Did Not Violate Cookietree’s Bylaws.**

McLaughlin next argues that Cookietree’s bylaws “were not followed, rendering the attempted ‘waiver’ void.” (Aplt’s Brief at 71.) According to McLaughlin, the Waivers violated the bylaws because (1) action cannot be taken without a meeting, and

(2) he did not receive notice of the action to waive the application of the Share Transfer Restriction to the Stock Transfer. Both of McLaughlin's arguments are unfounded.

Cookietree's bylaws and the URBCA each permit Board action without a meeting.

Cookietree's bylaws provide in pertinent part:

Any action required to be taken at a meeting of the directors of the corporation or any other action which may be taken at a meeting of the Board of Directors or of a committee, may be taken without a meeting if a consent in writing, setting forth the actions so taken, shall be signed by all of the directors. . . . Such consent shall have the same legal effect as a unanimous vote of all the directors or members of the committee.

(Bylaws § 3.14, R. A1040.) The URBCA similarly provides:

Unless the articles of incorporation, bylaws, or this chapter provide otherwise, action required or permitted by this chapter to be taken at a board of directors' meeting may be taken without a meeting if all members of the board consent to the action in writing . . . .

Utah Code Ann. § 16-10a-821(1).

Here, although the Board action waiving application of the Share Transfer Restriction to the Stock Transfer was taken without a meeting, each director consented to the action in writing. Indeed, the Board's waiver states: "[T]he undersigned, being all of the directors of Cookietree . . . hereby adopt the following resolution by unanimous written consent *without a meeting* pursuant to Section 821 of [the URBCA] to be effective as of August 15, 1999." (Board Waiver, R. A227 (emphasis added).) Thus the Board's action did not violate Cookietree's bylaws.<sup>16</sup>

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<sup>16</sup> To the extent McLaughlin argues that he and his wife, Kim McLaughlin, were entitled to receive notice of the Board's action, this assertion is also unfounded. (continued...)

Moreover, the shareholders were not required to convene a “meeting” and give Sam and Kim McLaughlin notice thereof in order to execute a waiver of the Share Transfer Restriction. As explained above, the shareholders who executed the waiver and consent were exercising a contractual right granted to them in their individual capacities as parties to the 1991 Shareholders’ Agreement. The 1991 Shareholders’ Agreement does not require a meeting or notice to all shareholders. It merely provides that the owners of at least two-thirds of the shares (excluding those shares owned by the Estate) give their express written consent to waive the Share Transfer Restriction.<sup>17</sup>

**E. The Waivers Were Not Untimely.**

Finally, McLaughlin argues that the Waivers are ineffective because “[too] much time [approximately six years] passed between the date of the [Stock T]ransfer and the [Waivers],” and because the Waivers are in response to litigation. (Aplt’s Brief at 72.) McLaughlin is wrong.

Despite McLaughlin’s suggestion to the contrary, section 16-10a-821 of the URBCA expressly allows a Utah corporation’s board of directors to establish the effective date of its action by written consent at any time in the past and imposes no time limit on how far back that date may be. *See* Utah Code Ann. § 16-10a-821(1), (3), (4).

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(...continued) Neither McLaughlin nor his wife is a member of the Board. Therefore they are not entitled to receive notice of Board meetings or Board action taken without a meeting in accordance with Cookietree’s bylaws.

<sup>17</sup> Even if McLaughlin had been allowed to object to the Shareholders’ waiver and/or the Stock Transfer, his objection would have been an exercise in futility. Neither his shares nor his wife’s shares were needed to obtain the two-thirds necessary to execute the waiver and consent.

Moreover, courts have expressly approved board of director action to approve or ratify a transaction even when the board's action occurred long after the subject transaction and in response to litigation.

For example, in *Dolan v. Airpark, Inc.*, 513 N.E.2d 217 (Mass. App. 1987), the court was faced with a dispute nearly identical to the case at hand. There, the corporation's articles of incorporation, like the 1991 Shareholders' Agreement at issue here, provided that the corporation had a right of first refusal on any proposed sale or transfer of stock. *See id.* at 217. However, by bill of sale, one of the shareholders conveyed 15 of his 100 shares to his wife following their divorce. *See id.* The stock was never offered to the corporation before being transferred. Consequently, the corporation's treasurer noted in the stock register that the shares had been transferred without corporate consent and were therefore void. *See id.* Approximately one year after the transfer occurred, the corporation, through its board of directors, voted to approve the transfer. *See id.* Although the approval occurred long after the stock transfer *and in response to litigation*, the court determined that the share transfer restriction had been effectively waived by the board of directors and the transfer was therefore valid. *See id.* *Cf. Cohen*, 449 F. Supp. at 308 ("Ratification . . . is effective even though initiated in response to a lawsuit."); *Putnam v. Juvenile Shoe Corp.*, 269 S.W. 593, 598 (Mo. 1925) (directors' vote to pay bonuses to employees was properly ratified after commencement of suit).

Ignoring section 16-10a-821 of the URBCA and the other authority cited above, McLaughlin cites *Lake Creek Irrigation Co. v. Clyde*, 451 P.2d 375, 377 (Utah 1969), for

the proposition that the timeliness of a ratification may present a question of fact that would preclude summary judgment. *Lake Creek*, however, did not address the issue of the timeliness of a ratification. Instead, it addressed whether certain conduct of the directors was sufficient to constitute a ratification. No such factual issues are presented here. Indeed, it is undisputed that the Board expressly authorized the Cookietree waiver and the owners of approximately 90 percent of the shares of Cookietree executed a separate written waiver of the application of the Share Transfer Restriction to the Stock Transfer.

McLaughlin also relies on *U.S. v. 40,438 Square Feet of Land*, 66 F. Supp. 659 (D. Mass. 1946), for the general proposition that when the rights of a third person have intervened between the unauthorized act of an agent and the alleged ratification of that act by the principal, it would be unjust to allow the principal to later ratify the act of the agent. However, such facts are not present here. No rights of a third person intervened between the Stock Transfer and the Waivers. Indeed, McLaughlin has failed to even allege that he (or some other party) suffered prejudice or harm as a result of the *timing* of the Waivers, nor could he. To the extent McLaughlin is claiming that he suffered some prejudice as a result of the Waivers generally, the prejudice he is claiming is the inability to purchase the shares at issue in the Stock Transfer. However, regardless of the timing, the Waivers are expressly permitted by the 1991 and 1999 Shareholders' Agreements. Because McLaughlin had no right to purchase the shares at issue, he could have suffered no prejudice as a result of the Waivers. The timing of the Waivers is simply immaterial.



For all the foregoing reasons, this Court should affirm the trial court's entry of summary judgment in Appellees' favor with regard to the validity of the Stock Transfer.

## **II. McLaughlin's Breach of Fiduciary Duty Claim Fails as a Matter of Law.**

McLaughlin argues that this appeal presents an issue of first impression: "What are the fiduciary duties between and among shareholders, officers and directors in a close corporation?" (Aplt's Brief at 1.) McLaughlin asks this Court to "define the law of close corporations in Utah and to set forth the fiduciary duties between and among shareholders, officers and directors." (*Id.* at 39.) McLaughlin then embarks on a 13-page discussion of the purported "majority" and "minority" positions regarding such issues. However, the expansive issue McLaughlin raises on appeal was not raised before the trial court and should not be decided by this Court. The issue presented is this: Does the president and majority stockholder of a closely held corporation owe a fiduciary duty to a minority stockholder who is employed by the corporation under a written employment agreement *concerning the minority shareholder's employment?*

With regard to the actual issue presented, McLaughlin apparently believes that as a minority shareholder of a closely held corporation, employed as an at-will employee under a written contract, he is nevertheless protected from discharge by fiduciary duties allegedly owed to him because of his status as a minority shareholder. His theory is that his employment status should not be governed by his written Employment Agreement but, rather, because he is a minority shareholder, his employment rights should flow only from a special duty of good faith. Essentially, McLaughlin would have this Court determine that his Employment Agreement (which he signed before he became a

shareholder) was rendered meaningless the moment he acquired a single share of Cookietree stock.

The law is clearly opposite of what McLaughlin claims. As explained below, as an officer and director of Cookietree, Greg Schenk owed no fiduciary duty to McLaughlin *in McLaughlin's capacity as an employee of Cookietree*. As also explained below, although McLaughlin strains to establish that Greg Schenk's alleged wrongful actions affected him in his capacity as a shareholder, he clearly fails in this regard. McLaughlin's allegations reduce to disputes over when and under what circumstances his employment could be terminated and what he was due in terms of compensation in lieu of notice after his discharge pursuant to the Employment Agreement. Such claims are employment disputes that cannot sustain a claim of fiduciary breach under Utah law. McLaughlin has actively pursued his contractual rights as an employee before the arbitrator, and all issues involving McLaughlin's status as an employee have been resolved.

**A. Greg Schenk Owed No Fiduciary Duty to McLaughlin as an Employee.**

Clearly, Cookietree (not Greg Schenk) owed certain employment-related obligations to McLaughlin under the parties' Employment Agreement. However, that fact does not translate into Greg Schenk individually owing fiduciary duties to McLaughlin relating to McLaughlin's employment. To the contrary, a universal principle of corporate governance is that a corporation's officers and directors owe a fiduciary duty only to the corporation itself, not to its employees. *See Berman v. Physical Med. Assocs., Ltd.*, 225 F.3d 429, 433 (4th Cir. 2000) ("Nor did the directors owe [the

plaintiff] as an employee a fiduciary duty; directors cannot act as fiduciaries in their relationship with employees and at the same time discharge their fiduciary duties to the corporation of which they are directors.”); *O’Byrne v. Santa Monica-UCLA Med. Ctr.*, 94 Cal. App. 4th 797, 811 (2001) (“In general, employment-type relationships are not fiduciary relationships.”); *Jordan v. The Earthgrains Cos.*, 576 S.E.2d 336, 339 (N.C. Ct. App. 2003) (“In his position as the director of a corporation, [the director] only owed a duty of care to the corporation and not to individual employees.”).

**B. McLaughlin’s Allegations of Fiduciary Breach Implicate His Status as an Employee, Not as a Shareholder.**

Ignoring the foregoing principles, McLaughlin argues that Schenk breached his fiduciary duty to McLaughlin by (1) “conducting a secret stock transaction” and refusing to allow McLaughlin to purchase the shares at issue (Aplt’s Brief at 56); (2) refusing to allow McLaughlin to “purchase, or even negotiate to purchase, the corporation in 2003-2004” (*id.* at 57); and (3) terminating McLaughlin’s employment without a “business purpose,” paying McLaughlin insufficient compensation in lieu of notice, escorting McLaughlin from company property after he refused to leave following his discharge, and refusing to give McLaughlin employment references. (*See id.*) For the reasons set forth below, none of these alleged actions can form the basis of McLaughlin’s breach of fiduciary duty claim as a matter of law.

**1. McLaughlin Cannot Base His Breach of Fiduciary Duty Claim on the Stock Transfer.**

McLaughlin cannot base his breach of fiduciary duty claim on the Stock Transfer for two independent, but equally important, reasons. First, the Stock Transfer was

governed by the terms of a contract—the 1991 Shareholders’ Agreement. For the reasons set forth above, the Stock Transfer was valid; it did not violate the 1991 Shareholders’ Agreement as a matter of law. Because the Stock Transfer is valid, it cannot constitute a breach of fiduciary duty. *See generally Deauville Corp. v. Federated Dep’t Stores, Inc.*, 756 F.2d 1183, 1194 (5th Cir. 1985) (holding that joint venturer did not breach fiduciary duty by withdrawing from joint venture when joint venture agreement did not prohibit withdrawal); *AON Prop., Inc. v. Riveraine Corp.*, No. 14-96-00229-CV, 1999 WL 12739, at \*10 (Tex. Ct. App. Jan. 14, 1999) (“Clearly, [defendant’s] lawful exercise of its contractual right . . . is not a breach of fiduciary duty.”). McLaughlin has failed to cite even a single case holding that the lawful exercise of a contractual right can give rise to a breach of fiduciary duty. And this Court should not hold that Greg Schenk’s fiduciary duty extends so far as to create duties in derogation of the express terms of the 1991 Shareholders’ Agreement.

Furthermore, McLaughlin’s claim that he should have been allowed to buy the shares involved in the Stock Transfer is pure speculation. Cookietree, not McLaughlin, had the right of first refusal (assuming the Share Transfer Restriction was not properly waived by the Board or the shareholders). If Cookietree had elected to purchase the shares, McLaughlin would have had no opportunity to purchase them himself. Moreover, if Cookietree had elected not to purchase the shares, the shares would have been offered to all shareholders pro rata. It is pure speculation for McLaughlin to assume that only he would have been interested in purchasing the shares at issue. Thus, even if the Stock

Transfer was in violation of the 1991 Shareholders' Agreement, McLaughlin cannot prove he was damaged by the alleged breach.

Finally, McLaughlin's breach of fiduciary duty claim, to the extent it is based on the Stock Transfer, is entirely duplicative of his claim for breach of the 1991 Shareholders' Agreement. With regard to the Stock Transfer, the fiduciary duty claim alleges nothing beyond the allegations in the breach of contract claim—it is premised on the same allegations and seeks damages for the same alleged wrong. As such, the breach of fiduciary duty claim (to the extent it is based on the Stock Transfer) should be dismissed as duplicative of the breach of contract claim. *See, e.g., Cal Distrib., Inc. v. Cadbury Schweppes Americas Beverages, Inc.*, No. 06 Civ.0496, 2007 WL 54534, at \*9 (S.D.N.Y. Jan. 5, 2007) (“A cause of action for breach of fiduciary duty which is merely duplicative of a breach of contract claim cannot stand.’ This general rule is derived from the fact that . . . parties to an express contract are bound by an implied duty of good faith, but breach of that duty is merely a breach of the underlying contract.” (*quoting William Kaufman Org., Ltd. v. Graham & James LLP*, 703 N.Y.S.2d 439, 442 (1st Dept. 2000))); *Lightbody v. Rust*, No. 80927, 2003 WL 21710601, at \*6 (Ohio Ct. App. July 24, 2003) (“[A] suit arising from a single instance cannot be classified as both a tort and breach of contract. . . . It is not a tort to breach a contract, no matter how willful or malicious the breach.” (internal quotation marks and citations omitted)); *Solow v. Aspect Res., LLC*, No. Civ.A. 20397, 2004 WL 2694916, at \*4 (Del. Ch. Oct. 19, 2004) (“Because the four fiduciary duty counts in the complaint arise not from general fiduciary principles, but

from specific contractual obligations agreed upon by the parties, the fiduciary duty claims are precluded by the contractual claims.”).

**2. McLaughlin Cannot Base His Breach of Fiduciary Duty Claim on the Proposed Sale to Otis Spunkmeyer or Greg Schenk’s Alleged Refusal to Sell Cookietree to McLaughlin.**

Before the trial court, McLaughlin argued that Greg Schenk breached a fiduciary duty he owed to McLaughlin by “negotiating” with another company, Otis Spunkmeyer, to sell Cookietree. On appeal, McLaughlin also argues that Greg Schenk breached a fiduciary duty he owed to McLaughlin by refusing to allow McLaughlin to “purchase, or even negotiate to purchase, the corporation” himself. (Aplt’s Brief at 57.) Neither of these allegations can support a claim for breach of fiduciary duty. It is undisputed that the proposed sale of Cookietree to Otis Spunkmeyer never occurred. (*See* McLaughlin’s Memo. in Opp. to Def.’s Mot. for S.J. at 18, R. A1287 (“Ultimately, the sale to Otis has not been consummated.”).) It is also undisputed that although McLaughlin attempted to “try to obtain loans and to find partners to meet Otis’ offer,” he was ultimately not able to obtain the necessary financing to do so.<sup>18</sup> (*See* R. A1279.) In light of these undisputed facts, McLaughlin cannot prove any damages arising from the contemplated sale of

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<sup>18</sup> Although this argument was not raised in the trial court, McLaughlin argues on appeal that Greg Schenk refused to give him additional days to obtain financial backing. (Aplt’s Brief at 51 n.12.) However, McLaughlin points to no authority suggesting that Greg Schenk was obligated to provide additional time for McLaughlin to obtain financing, or that, if Greg Schenk had provided the additional time, McLaughlin would ultimately have been able to obtain the necessary financing. McLaughlin’s arguments are based on bald speculation.

Cookietree to Otis Spunkmeyer or from his inability to purchase Cookietree himself.<sup>19</sup> Indeed, McLaughlin fails to even allege such damages. Because McLaughlin cannot prove any damages, his allegations concerning the contemplated sale and his inability to purchase the company are inconsequential—they cannot state a claim for breach of fiduciary duty as a matter of law. *See generally Bennett v. Jones, Waldo, Holbrook & McDonough*, 2003 UT 9, ¶ 41 n.6, 70 P.3d 17 (damage is essential element of breach of fiduciary duty claim).

**3. McLaughlin Cannot Base His Breach of Fiduciary Duty Claim on Issues Concerning the Termination of His Employment.**

Finally, McLaughlin argues that Greg Schenk breached a fiduciary duty he owed McLaughlin by causing Cookietree to terminate McLaughlin’s employment without a “business purpose,” by causing Cookietree to pay McLaughlin in lieu of notice at the level specified in the Employment Agreement (not at the level in place at the time of McLaughlin’s discharge), by escorting McLaughlin from company property after McLaughlin refused to leave following his discharge, and by refusing to give McLaughlin employment references after his discharge. (Aplt’s Brief at 57.) Such claims are clearly employment disputes that cannot sustain a claim of fiduciary breach under Utah law. McLaughlin cannot argue that his termination amounted to a breach of

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<sup>19</sup> McLaughlin is in essence requesting an advisory opinion that *if* Cookietree had been sold to Otis Spunkmeyer, the sale would have constituted a breach of Greg Schenk’s fiduciary duty to McLaughlin. *See Aetna Life Ins. Co. of Hartford v. Haworth*, 300 U.S. 227, 241 (1937) (courts may not advise as to what law would be on hypothetical facts); *Hoyle v. Monson*, 606 P.2d 240, 242 (Utah 1980) (“courts do not busy themselves with advisory opinions”). In fact, McLaughlin seeks more than an advisory opinion. He seeks an award of damages based on a transaction that never occurred.

Greg Schenk’s fiduciary duties, because the termination of an employment agreement does not implicate fiduciary duties. It is well-established that when an employment contract has been put in place (as is the case here), the parties to that contract are governed by its terms, not by fiduciary obligations, even in a closely held corporation.

Defendants have cited two cases—*Berman*, 225 F.3d 429 and *Riblet Prod. Corp. v. Nagy*, 683 A.2d 37 (Del. 1996)—which, although not from this jurisdiction, address the precise issue presented here: Can a majority stockholder of a closely held corporation be held liable for violation of a fiduciary duty to a minority stockholder who is an employee of the corporation under a written employment contract *with respect to issues involving that employment*? According to *Berman* and *Riblet*, the answer to this question, as a matter of law, is no.

In *Berman*, the plaintiff, a physician, alleged that the directors of the closely held corporation of which he was both a shareholder and an employee breached a fiduciary duty to him by terminating his employment. McLaughlin makes the same erroneous claim here. The trial court dismissed the plaintiff’s fiduciary duty claim while allowing the breach of contract claim to proceed to trial. After judgment was later entered against the plaintiff on his contract claims, the plaintiff appealed the dismissal of his fiduciary duty claim. *See* 225 F.3d at 433. In affirming the trial court’s decision, the Fourth Circuit recognized that the plaintiff’s “claim for breach of fiduciary duty . . . implicate[d] his status not as a stockholder, but as an employee.” *Id.* The court then explained that “any injury caused by the termination decision itself would be an injury to his interests as an employee, not as a stockholder . . . [and] [a]ny injury to his interests as an employee



would arise from breach of contractual duties by the corporation, not from breach of any fiduciary duties by the directors.” *Id.* As a result, the court concluded that “[a]t bottom, [the plaintiff’s] claims [we]re garden-variety contract claims for breach of an employment agreement . . . . He cannot, simply by calling [the corporation’s officers and directors] fiduciaries, convert these claims into anything more than what they are.” *Id.* at 434.

The Delaware Supreme Court has also addressed and resolved this issue. In *Riblet*, the court stated:

We consider whether or not majority stockholders of a closely-held Delaware corporation can be found to have breached a fiduciary duty owing to a minority stockholder who is also the chief executive officer (“CEO”) of the corporation and thus an employee of the corporation under written contract when the dispute arises solely with respect to that employment contract. We hold that, although majority stockholders have fiduciary duties to minority stockholders *qua* stockholders, *those duties are not implicated when the issue involves the rights of the minority stockholder qua employee under an employment contract. The duties of the corporation to the CEO are contractual.*

*Id.* at 37 (emphasis added).

McLaughlin attempts to distinguish *Riblet* and *Berman* by arguing that he is not asserting disputes merely in relation to his Employment Agreement, but is alleging breaches of the fiduciary duty owed to him as a minority shareholder. However, McLaughlin then proceeds to state that Greg Schenk breached his fiduciary duty to McLaughlin by “terminat[ing] his employment” and by reducing his salary.

McLaughlin’s argument is circular. In this case, the issues of how and when McLaughlin

can be discharged are completely controlled by the Employment Agreement (not by fiduciary obligations). Clearly, like the circumstances presented in *Riblet* and *Berman*, this dispute arises solely in relation to McLaughlin's Employment Agreement.

Not only does McLaughlin fail to distinguish *Berman* and *Riblet*, he also fails to cite a *single* applicable case reaching a different conclusion. Although McLaughlin relies on certain cases for the proposition that a majority shareholder can, under certain circumstances, breach his fiduciary duty by “freezing out” a minority shareholder—*e.g.*, *Donohue v. Rodd Electrotpe*, 328 N.E.2d 505 (Mass. 1975); *Gigax v. Repka*, 615 N.E.2d 644 (Ohio Ct. App. 1992); *Wilkes v. Springside Nursing Home, Inc.*, 353 N.E.2d 657 (Mass. 1976); and *Walta v. Gallegos Law Firm, P.C.*, 40 P.3d 449 (N.M. Ct. App. 2001)—each of these cases is distinguishable. None of the above cases involved a claim similar to the one made by McLaughlin here: that an officer/majority shareholder can breach a fiduciary duty by discharging an at-will employee/minority shareholder whose employment is governed by a *written employment contract*.

Unlike McLaughlin, the plaintiff in the *Donohue* case was not even discharged. The facts in *Donohue* concerned a minority stockholder in a close corporation who sued the directors and controlling shareholder, seeking to rescind the corporation's purchase of a former controlling shareholder's shares. The court examined the duties of good faith and loyalty surrounding the repurchase transaction alone. *See* 328 N.E.2d at 509-11.

Likewise, *Wilkes* did not involve a claim that a majority shareholder breached a fiduciary duty by discharging an at-will employee/minority shareholder pursuant to a written employment contract. In *Wilkes*, the court held that the majority shareholders in a

close corporation breached a fiduciary duty to a minority shareholder when they removed him from the position of director and salaried officer. However, the court based its holding on the fact that the corporation had never paid dividends but rather had provided returns to its shareholders in the form of salary, and on the fact that the termination decision was in disregard of a long-standing policy of the stockholders that each would be a director and that employment within the corporation would go hand-in-hand with ownership. *See* 353 N.E.2d at 664. Such facts are not present here. This is not a unique situation in which a shareholder depends on employment with the corporation for his or her livelihood because the corporation never pays dividends but rather provides returns to its shareholders in the form of salary. Cookietree has always paid dividends to McLaughlin and continues to do so to this day. Finally, McLaughlin has failed to allege a policy of the stockholders of Cookietree that employment within the corporation would go hand-in-hand with ownership, nor could he. There are various Cookietree stockholders (other than McLaughlin) who are not employees of the company.

*Walta* also did not involve a claim that a majority shareholder breached a fiduciary duty merely by discharging an at-will employee/minority shareholder pursuant to a written employment contract. Like *Wilkes*, *Walta* is a “freeze out” case. There, the majority shareholder of a law firm converted the law firm to a corporation with a sole shareholder, himself, and removed only one attorney, the plaintiff, contrary to the majority shareholder’s prior representations. In doing so, the majority shareholder substantially undervalued the plaintiff’s shares (which was the critical issue in the case)

and failed to disclose material facts affecting the value of the stock that were known to him, but not known to the minority shareholder. *See* 40 P.3d at 453-55.

*Gigax* is also factually distinguishable. Each of the three individual members of the close corporation involved in the *Gigax* case were directors of the corporation and also worked as employees; they all earned the same salary. *No employment agreement was entered into by the parties*, but there was an agreement among the parties that each principal would work for the corporation *in addition to owning stock* until the corporation was sold or phased out to provide a retirement fund. The court held that, under these unique circumstances (not presented here), the principal serving as president of the corporation could not discharge another principal without a legitimate reason. However, the court's decision clearly suggests that the decision may have been different if the discharged principal had a written employment contract stating that he could be discharged at any time for any reason, like McLaughlin's Employment Agreement. Moreover, a concurring judge indicated that the discharged principal had made \$70,000 in equity contributions to the corporation which was consideration for his employment in addition to the services he provided, taking the relationship outside the "at-will" definition. Such circumstances are clearly not present here. Indeed, McLaughlin fails to even allege such facts.<sup>20</sup>

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<sup>20</sup> Finally, McLaughlin cites the following additional cases with no analysis or even a parenthetical, none of which involve a claim that a majority shareholder breached a fiduciary duty merely by discharging an at-will employee/minority shareholder pursuant to a written employment contract: *Knaebel v. Heiner*, 663 P.2d 551 (Alaska 1983); *River Mgmt. Corp. v. Lodge Prop., Inc.*, 829 P.2d 389 (Colo. Ct. App. 1991); *Battaglia v. Battaglia*, 596 N.E.2d 712 (Ill. Ct. App. 1992); *Evans v. Blesi*, 345 N.W.2d

Despite McLaughlin's suggestion to the contrary, McLaughlin is not alleging a "freeze out"—he is merely alleging a wrongful termination. Cookietree and Greg Schenk have done *nothing* to eliminate McLaughlin's rights as a shareholder. It is undisputed that neither Cookietree nor Greg Schenk has attempted to force McLaughlin to sell his shares—he still owns his shares. (R. A1245.) It is also undisputed that neither Cookietree nor Greg Schenk has eliminated the only return on McLaughlin's investment, *i.e.*, the payment of dividends (the circumstances presented in *Wilkes*). Cookietree pays dividends to all shareholders (including McLaughlin) on a regular basis.<sup>21</sup> (*See id.*) Indeed, according to McLaughlin, "Cookietree dividends constitute half the McLaughlin family's annual income." (Aplt's Brief at 21.) Finally, it is undisputed that neither Cookietree nor Greg Schenk has prevented McLaughlin from seeking and accessing financial information concerning the company. (*See id.*) The only action Cookietree took *vis-à-vis* McLaughlin was to terminate his employment—an action affecting his interests as an employee. Since Cookietree terminated McLaughlin's employment, McLaughlin has remained a stockholder and can exercise *all* the rights available to him as a stockholder, none of which he alleges to have been denied.

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775 (Minn. Ct. App. 1984); *Fought v. Morris*, 543 So. 2d 167 (Miss. 1989); *Russell v. First York Sav. Co.*, 352 N.W.2d 871 (Neb. 1984); *Van Pelt v. Greathouse*, 352 N.W.2d 871 (Neb. 1984); *68th Street Apts., Inc. v. Lauricella*, 362 A.2d 78 (N.J. Super. L. Div. 1976); *A. Teixeira & Co. v. Tiexeira*, 699 A.2d 1383 (R.I. 1997); *Hall v. Tenn. Dressed Beef Co.*, 957 S.W.2d 536, 541 (Tenn. 1997).

<sup>21</sup> As noted above, this is not a unique situation in which a shareholder depends on employment with the corporation for his or her livelihood because the corporation never pays dividends but rather provides returns to its shareholders in the form of salary.

In sum, as the plaintiffs in *Berman* and *Riblet* attempted to do, McLaughlin is attempting to impose personal liability on Greg Schenk for the termination of McLaughlin's employment by Cookietree, by recharacterizing a "garden-variety" employment contract claim as a purported breach of fiduciary duty. As a matter of law, this claim fails. McLaughlin's employment relationship with Cookietree was governed by the Employment Agreement, and his claims in that regard have been resolved by the arbitrator. A breach of the Employment Agreement would sound in contract, and would not implicate fiduciary duties. There is simply no reason to allow McLaughlin a "second bite at the apple" through a misguided appeal to general fiduciary law as a pretext for evading contractual rights.<sup>22</sup> Thus McLaughlin's breach of fiduciary duty claim against Schenk was properly dismissed by the trial court.

### **III. The Trial Court Did Not Abuse Its Discretion in Denying McLaughlin Leave to Amend.**

On April 25, 2007, the trial court issued an order dismissing all of the claims asserted by McLaughlin, with the exception of the breach of fiduciary duty claim. Although the trial court did not (at that time) dismiss the breach of fiduciary duty claim, it clearly stated in its ruling that McLaughlin cannot base his breach of fiduciary duty claim on (1) the Stock Transfer; (2) any employment related issues, *e.g.*, the termination of McLaughlin's employment or the reduction of McLaughlin's salary during the notice

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<sup>22</sup> A requirement of strict adherence to the continued employment of a minority shareholder as a fiduciary requirement would, in addition to rendering the minority shareholder's employment contract meaningless, saddle the corporation with a millstone (the unproductive, unprofitable employee) whose continued employment could drag the corporation under to the detriment of all the shareholders—majority and minority alike.

period; or (3) the negotiation of the sale of Cookietree to Otis Spunkmeyer (a sale that never occurred). Indeed, the ruling stated that the trial court was “unable to identify *any* factual [basis] in [McLaughlin’s] Complaint that would give rise to a claim for breach of fiduciary duty.” (R. A1508 (emphasis added).) Nevertheless, the trial court “left the door open for [McLaughlin] to identify some as yet unidentified factual basis for a breach of fiduciary duty.” (R. A1510.) The trial court was clear that “the burden is on [McLaughlin] to come forward with facts and evidence that would support a breach of fiduciary duty that has not already been addressed.” (R. A1510-11.)

In response to the trial court’s order, McLaughlin inexplicably filed a motion to amend his complaint to add two new defendants, Harold Rosemann and Gayle Schenk (both of whom are members of the Board), and to assert his breach of fiduciary duty claim against them. However, McLaughlin *again* completely failed to set forth *any* factual basis for a breach of fiduciary duty claim against *any* defendant. In an attempt to comply with the court’s ruling, McLaughlin identified the following allegations that he claimed support his breach of fiduciary duty claim:

- The Stock Transfer violated the terms of the Shareholders’ Agreement, and the Board improperly ratified the Stock Transfer. (*See* McLaughlin’s Memo. in Supp. of Mot. to Amend Complaint to Add Parties and Causes of Action at 6-7, R. A1579-81.)
- Cookietree terminated McLaughlin’s employment, cut his salary, and refused to provide references. (*See id.*)

Each of these allegations, however, had already been addressed by the trial court in its ruling. Regardless, the Court again correctly determined, for the same reasons

discussed in Sections II.B.1. and .2 above, that such allegations merely attempt to impose personal liability on Greg Schenk for his discharge by recharacterizing a “garden-variety” contract claim as a breach of Greg Schenk’s purported fiduciary duties. An alleged breach of the Employment Agreement sounds in contract, and does not implicate fiduciary duties. Thus the trial court correctly refused to allow McLaughlin to amend his complaint.

Even if McLaughlin had identified a factual basis for his breach of fiduciary duty claim against Greg Schenk (which he did not), he still should not be allowed to amend his complaint to assert his fiduciary duty claim against completely new parties.

McLaughlin’s motion to amend was brought *two and one-half years* after his original complaint was filed; over a year after the deadline for amending pleadings and adding parties (March 22, 2006); approximately a year after the close of discovery (June 30, 2006); and more than a month after the trial court issued its ruling granting defendants’ motions for summary judgment.

More troublesome, however, is the fact that McLaughlin’s proposed amendment is not based on facts unknown until now. To the contrary, McLaughlin undeniably knew of his claim against Rosemann and Gayle Schenk at the time he filed the original complaint. Indeed, he deposed Rosemann and Gayle Schenk in November 2005, shortly after commencing the Stock Action—two-and-one-half years ago. His substantial delay is fatal to this motion to amend. *See Kelly v. Hard Money Funding, Inc.*, 2004 UT App. 44, ¶ 42, 87 P.3d 734 (“[A] court’s ruling on a motion to amend can be predicated on only one or two of the particular factors[, such as timeliness]”); *Jones v. Salt Lake City Corp.*,



2003 UT App. 355, ¶ 17, 78 P.3d 988 (upholding denial of motion to amend when motion was filed “nearly a year after the cutoff date for amending pleadings in the trial court’s scheduling order”).

Finally, if McLaughlin were allowed to amend his complaint, Cookietree, Greg Schenk, and the new parties would be substantially prejudiced. At the time of the motion to amend, fact discovery had been completed and dispositive motions had been decided by the court. The litigation before the trial court was essentially completed. If the amendment were allowed, Cookietree and the new parties (who were members of the Board) would have to defend against a breach of fiduciary duty claim that simply has no merit. Cookietree would incur considerable expense to defend against this groundless claim. Such a result is clearly not in the interest of justice. Thus the trial court did not abuse its discretion in denying McLaughlin leave to amend his complaint.

### **CONCLUSION**

The trial court correctly determined that the Stock Transfer did not violate the 1991 Shareholders’ Agreement. Although the agreement contains a Share Transfer Restriction, the restriction was properly waived by Cookietree, upon duly authorized action of its Board, and by its shareholders, by express written consent, in accordance with the URBCA and the 1991 Shareholders’ Agreement. The URBCA neither prohibits the Stock Transfer nor governs the propriety of a waiver of the Share Transfer Restriction.


The trial court also correctly dismissed McLaughlin’s breach of fiduciary duty claim against Greg Schenk. In his role as an officer and director of Cookietree, Greg

Schenk owed no fiduciary duty to McLaughlin in his capacity as an employee of Cookietree. However, McLaughlin's allegations of breach of fiduciary duty reduce to disputes over when and under what circumstances his employment could be terminated and what he was due in terms of compensation in lieu of notice after his discharge pursuant to the Employment Agreement. Such claims are employment disputes that cannot sustain a claim of fiduciary breach under Utah law.

Finally, the trial court did not abuse its discretion in denying McLaughlin leave to amend. In his motion to amend, McLaughlin *again* failed to set forth any factual basis for a breach of fiduciary duty claim, rendering his amendments futile. His motion to amend was also untimely, futile, and prejudicial.

DATED this 12th day of February, 2008.

STOEL RIVES LLP

  
Matthew M. Durham  
Justin B. Palmer

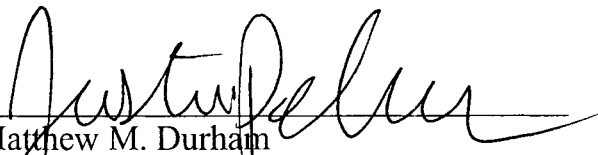
Attorneys for Appellees Greg Schenk,  
Cookietree, Inc., Harold Rosemann, and Gayle  
Schenk

## CERTIFICATE OF SERVICE

I certify that two true and correct copies of BRIEF OF APPELLEES GREG SCHENK, COOKIETREE, INC., HAROLD ROSEMAN, AND GAYLE SCHENK were served on the parties listed below by hand-delivery on the 12th day of February, 2008.

Margaret H. Olson Lincoln W. Hobbs HOBBS & OLSON, L.C. 466 East 500 South, Suite 300 Salt Lake City, Utah 84111-3342 <i>Attorneys for Appellant</i>	Richard Flint HOLME, ROBERTS & OWEN, LLP 299 S Main Street, Suite 1800 Salt Lake City, Utah 84111 <i>Attorneys for Appellees Estate of Boyd Schenk and Anna Schenk</i>
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An original and nine copies were also filed with the clerk of the Utah Supreme Court.

  
Matthew M. Durham  
Justin B. Palmer  
STOEL RIVES LLP

Attorneys for Appellees Greg Schenk,  
Cookietree, Inc., Harold Rosemann, and Gayle  
Schenk

## **ADDENDUM**

1. Utah Code Ann. §§ 16-10a-821, -850, -851, -852, -853.
2. 1999 Shareholders' Agreement.
3. Excerpts from Deposition of Harold Rosemann.

Tab 1

**16-10a-821. Action without meeting.**

- (1) Unless the articles of incorporation, bylaws, or this chapter provide otherwise, action required or permitted by this chapter to be taken at a board of directors' meeting may be taken without a meeting if all members of the board consent to the action in writing.
- (2) Action is taken under this section at the time the last director signs a writing describing the action taken, unless, prior to that time, any director has revoked a consent by a writing signed by the director and received by the secretary or any other person authorized by the bylaws or the board of directors to receive the revocation.
- (3) Action under this section is effective at the time it is taken under Subsection (2), unless the board of directors establishes a different effective date.
- (4) Action taken under this section has the same effect as action taken at a meeting of directors and maybe described as such in any document.

**16-10a-850. Definitions relating to conflicting interest transactions.**

As used in Sections 16-10a-850 through 16-10a-853:

- (1) "Conflicting interest" with respect to a corporation means the interest a director has respecting a transaction effected or proposed to be effected by the corporation or by any entity in which the corporation has a controlling interest if:
  - (a) whether or not the transaction is brought before the board of directors of the corporation for action, the director knows at the time of commitment that the director or a related person of the director is a party to the transaction or has a beneficial financial interest in or is so closely linked to, the transaction and the transaction is so financially significant to the director or a related person of the director that the interest would reasonably be expected to exert an influence on the director's judgment if the director were called upon to vote on the transaction; or
  - (b) the transaction is brought, or is of a character and significance to the corporation that it would in the normal course be brought, before the board of directors for action, and the director knows at the time of commitment that any of the following persons is either a party to the transaction or has a beneficial financial interest in, or is so closely linked to, the transaction and the transaction is so financially significant to the person that the interest would reasonably be expected to exert an influence on the director's judgment if the director were called upon to vote on the transaction:
    - (i) an entity, other than the corporation, of which the director is a director, general partner, agent, or employee or an entity to which the director owes a fiduciary duty, other than a fiduciary duty arising because the director is a director of the corporation;
    - (ii) an individual who is a general partner, principal, or employer of the director or who is a beneficiary of a fiduciary duty owed by the director, other than a fiduciary duty arising because the director is a director of the corporation; or
    - (iii) a person that controls one or more of the entities specified in

Subsection (l)(b)(i) or an entity that is controlled by, or is under common control with, one or more of the entities or individuals specified in Subsection (l)(b)(i) or (l)(b)(ii).

(2) "Director's conflicting interest transaction" with respect to a corporation means a transaction effected or proposed to be effected by the corporation, or by any entity controlled by the corporation respecting which a director has a conflicting interest.

(3) "Qualified director" means, with respect to a director's conflicting interest transaction, any director who does not have either a conflicting interest respecting the transaction, or a familial, financial, professional, or employment relationship with a second director who does have a conflicting interest respecting the transaction, which relationship would, in the circumstances, reasonably be expected to exert an influence on the first director's judgment when voting on the transaction.

(4) "Required disclosure" means disclosure by the director who has a conflicting interest of:

(a) the existence and nature of the conflicting interest; and

(b) all facts known to the director respecting the subject matter of the transaction that an ordinarily prudent person would reasonably believe to be material to a judgment about whether or not to proceed with the transaction.

(5) "Time of commitment" respecting a transaction means the time when the transaction is consummated or, if made pursuant to contract, the time when the corporation or the entity controlled by the corporation becomes contractually obligated so that its unilateral withdrawal from the transaction would entail significant loss, liability, or other damage.

#### **16-10a-851. Judicial action.**

(1) A transaction effected or proposed to be effected by a corporation or by any entity controlled by the corporation that is not a director's conflicting interest transaction may not be enjoined, be set aside, or give rise to an award of damages or other sanctions, in a proceeding by a shareholder or by or in the right of the corporation, solely because a director, or any person with whom or which the director has a personal, economic, or other association, has an interest in the transaction.

(2) A director's conflicting interest transaction may not be enjoined, be set aside, or give rise to an award of damages or other sanctions, in a proceeding by a shareholder or by or in the right of the corporation, solely because the director, or any person with whom or which the director has a personal, economic, or other association, has an interest in the transaction, if:

(a) directors' action respecting the transaction was at any time taken in compliance with Section 16-10a-852;

(b) shareholders' action respecting the transaction was at any time taken in compliance with Section 16-10a-853; or

(c) the transaction, judged according to the circumstances at the time of commitment, is established to have been fair to the corporation.

**16-10a-852. Directors' action.**

(1) Directors' action respecting a transaction is taken for purposes of Subsection 16-10a-851(2)(a) if the transaction received the affirmative vote of a majority of those qualified directors on the board of directors or on a duly empowered committee of the board who voted on the transaction after either required disclosure to them, to the extent the information was not known by them, or compliance with Subsection (2), provided that action by a committee is effective under this subsection only if:

(a) all its members are qualified directors; and

(b) its members are either all of the qualified directors or are appointed by the affirmative vote of a majority of the qualified directors.

(2) If a director has a conflicting interest respecting a transaction, but neither the director nor a related person of the director is a party to the transaction, and if the director has a duty under law or professional canon, or a duty of confidentiality to another person, respecting information relating to the transaction so that the director may not make the disclosure described in Section 16-10a-850(4)(b), then disclosure is sufficient for purposes of Subsection (1) if the director discloses to the directors voting on the transaction, before their vote, the existence and nature of the conflicting interest and informs them of the character and limitations imposed by that duty.

(3) A majority of the qualified directors on the board of directors or on the committee, as the case may be, constitutes a quorum for purposes of action that complies with this section. Directors' action that otherwise complies with this section is not affected by the presence or vote of a director who is not a qualified director.

**16-10a-853. Shareholders' action.**

(1) Shareholders' action respecting a transaction is effective for purposes of Subsection 16-10a-851(2)(b) if a quorum existed pursuant to Subsection (2) and a majority of the votes entitled to be cast by holders of qualified shares present in person or by proxy at the meeting were cast in favor of the transaction after notice to shareholders describing the director's conflicting interest transaction, provision of the information referred to in Subsection (3), and required disclosure to the shareholders who voted on the transaction, to the extent the information was not known by them.

(2) A majority of the votes entitled to be cast by the holders of all qualified shares constitutes a quorum for purposes of action that complies with this section. Subject to the provisions of Subsections (3) and (4), shareholders' action that otherwise complies with this section is not affected by the presence of holders of, or the voting of, shares that are not qualified shares.

(3) For purposes of compliance with Subsection (1), a director who has a conflicting interest respecting the non shall, before the shareholders vote, inform the secretary or officer or agent of the corporation authorized to tabulate votes of the number and the identity of persons holding or controlling the vote, of all shares that the director knows are beneficially owned, or the voting of which is controlled, by the director or by a related person of the director, or both.

(4) If a shareholders' vote does not comply with Subsection (1) solely because of a



failure of a director to comply with Subsection (3), and if the director establishes that the failure did not determine and was not intended by him to influence the outcome of the vote, the court may, with or without further proceedings under Subsection 16-10a-851(2)(c), take any action respecting the transaction and the director, and give any effect to the shareholders' vote, as it considers appropriate in the circumstances.

Tab 2

## SHAREHOLDERS' AGREEMENT

This Shareholders' Agreement (the "Agreement") is made and entered into by and among COOKIETREE, INC., a Utah corporation ("Cookietree") and each of the undersigned shareholders of Cookietree (individually a "Shareholder" and collectively the "Shareholders"), effective as of November 1, 1999.

### RECITALS

The Shareholders and Cookietree have previously entered into a Stock Purchase Agreement dated September 1, 1984 (the "Purchase Agreement") and a Shareholders' Agreement dated January 28, 1991 (the "1991 Shareholders' Agreement") which imposed certain restrictions on the transfer of the shares of Cookietree Common Stock held by them and provided a mechanism for the disposition of shares in the event a Shareholder desired to sell any Cookietree shares, including a right of refusal exercisable first by Cookietree and subsequently by the non-selling Shareholders.

The parties hereto desire to continue the concept of the rights of refusal granted by the Purchase Agreement and the 1991 Shareholders' Agreement to Cookietree and the non-selling Shareholders, but the parties hereto desire to terminate the Purchase Agreement and the 1991 Shareholders' Agreement and supercede them with this Agreement and to add the Shareholders as signatories, some of whom were not direct signatories of the earlier agreements.

NOW, THEREFORE, in consideration of the mutual promises contained in this Agreement and other valuable consideration, the receipt of which is hereby acknowledged, the parties hereto agree as follows:

1. No Shareholder shall sell, assign, pledge or in any manner transfer any shares of Cookietree Common Stock now held or hereafter acquired by him (the "Shares") or any right or interest therein, whether voluntarily or by operation of law, or by gift or otherwise, except by a transaction which meets the requirements hereinafter set forth in this Agreement.

2. If any Shareholder desires or is required to sell any Shares, or if any Shares would be transferred by operation of law or otherwise, then the Shareholder (or his successor in interest) shall first offer the Shares to Cookietree, by written notice to Cookietree. The notice shall state the number of Shares proposed to be transferred.

3. For thirty (30) days following receipt of such notice, Cookietree shall have the option to purchase all or any lesser part of the Shares specified in the notice at the price per share (the "Purchase Price") determined as set forth in paragraph seven (7) below.

4. In the event Cookietree does not elect to acquire all of the Shares specified in the selling Shareholder's notice, the Secretary of Cookietree shall, within thirty (30) days of receipt of a selling Shareholder's notice, give written notice thereof to the Shareholders other than the selling Shareholder. Said written notice shall state the number of Shares available for purchase (which shall be the same as the number contained in the selling Shareholder's notice, less the number of such Shares that Cookietree has elected to purchase). Each of the other Shareholders shall be entitled to purchase that proportion of the Shares available for purchase as the number of shares owned by each of such other Shareholders bears to the total number of Shares owned by all of such other

  
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Initials

Shareholders. Within thirty (30) days after mailing of said notice to the non-selling Shareholders, each Shareholder shall give written notice to the Secretary of Cookietree specifying the number of Shares such Shareholder will purchase, including any Shares in excess of such purchasing Shareholder's pro-rata portion that such Shareholder will purchase if additional Shares are made available. Failure to respond in writing within such thirty (30) day period to the notice given by the Secretary of Cookietree shall be deemed a rejection of such Shareholder's right to acquire his proportionate part of the Shares proposed to be sold by the selling Shareholder. In the event one or more Shareholders do not elect to acquire the Shares available to them, such Shares shall be allocated on a pro-rata basis to the Shareholders who requested Shares in addition to their pro-rata allotment.

5. In the event Cookietree and/or Shareholders, other than the selling Shareholder, elect to acquire all or any part of the Shares of the selling Shareholder as specified in such selling Shareholder's notice, the Secretary of Cookietree shall so notify the selling Shareholder within five (5) days after the end of the applicable option periods, and payment for, and transfer of, such Shares shall be made as provided in paragraph eight (8) below.

6. Except as otherwise specifically provided herein, in the event Cookietree and/or the Shareholders other than the selling Shareholder do not elect to acquire all of the Shares specified in a selling Shareholder's notice, the selling Shareholder may, within the sixty-day period following the expiration of the option rights granted to Cookietree and other Shareholders as provided herein, sell the unpurchased Shares specified in the selling Shareholder's notice elsewhere, provided that all Shares so sold by a selling Shareholder shall continue to be subject to the provisions of this Agreement in the same manner as before such transfer. Notwithstanding the foregoing, in the event a Shareholder proposes to sell Shares in a voluntary transaction for a consideration less than the Purchase Price applicable to the purchase options granted to Cookietree and the Shareholders as provided herein, then in the notice described in paragraph two (2) above the Shareholder shall identify the minimum price at which he proposes to sell the Shares, and the purchase option shall be exercisable at such lower price. A Shareholder may not sell Shares at a price lower than that at which Cookietree and the Shareholders have had the option to purchase such Shares, until such Shares have been offered for sale to Cookietree and the Shareholders at such price, in accordance with the procedure established herein.

7. The per share price to be paid for Shares offered for sale to Cookietree and the Shareholders as provided herein (the "Purchase Price") shall, except as otherwise specifically provided herein, be the price which represents the fair market value per share of the Cookietree Shares, as most recently determined by the Cookietree Board of Directors in its sole discretion. The Board of Directors is to make a determination, at least annually, as to the fair market value of the Shares. If, at the time of a proposed transfer of Shares as provided herein, the Board of Directors has not established a Purchase Price within the preceding one year period, it shall do so promptly after Cookietree's receipt of a notice of a proposed transfer of Shares, and the Purchase Price so determined shall apply to the transactions to which the notice relates. In such an event, the option periods referenced above shall be extended by the amount of time required following the written notice of a proposed transfer for the Board of Directors to establish a Purchase Price. Fair market value shall be determined by the Board of Directors on the basis of the price at which Shares could reasonably be expected to be sold in an arms-length transaction, for cash, to a person not employed by, controlled by, in control of, or under common control with, Cookietree. In making such determination, the Board of Directors is to give consideration to such factors as recent transactions involving Cookietree Shares, book value, earnings per share, dividend records, Cookietree's growth potential and projected earnings, the effect of transfer restrictions to which the Shares are subject under law and this Agreement, and other factors as the Board of Directors may determine to be appropriate.

8. In the event CookieTree and/or one or more Shareholders exercise an option to purchase any Shares proposed to be sold by a Shareholder as provided herein, a closing (the "Closing") shall be held within thirty (30) days following the delivery of the notice of exercise. At the Closing:

(a) Each purchasing party shall deliver to the selling Shareholder (or his successor in interest) each of the following:

(i) A down-payment of at least five percent (5%) of the total applicable Purchase Price for the Shares being acquired, in cash or by certified or cashier's check.

(ii) A duly executed installment note (a "Note") for the balance of the Purchase Price, with the outstanding principal balance of the Note, together with accrued interest, payable in forty (40) equal quarterly installments. The first quarterly installment payment will be due on the first day immediately following the completion of the calendar quarter commencing on the Closing. The outstanding principal balance of each Note shall bear interest at the "prime rate" being charged by First Security Bank of Utah effective as of the date of issuance of the Note. Failure to make any payment required by a Note shall constitute a default of the Note and shall cause the remaining unpaid balance to become immediately due and payable and the selling Shareholder shall have all the rights and remedies to enforce payment of the unpaid balance authorized by law; provided however, that before taking any remedial action to enforce payment, the selling Shareholder (or his successor in interest) shall deliver written notice of the default to the purchaser and if the payment in default is paid in full within ten (10) days from the date such notice is delivered, the default will be deemed not to have occurred. The Note shall be in a form approved by the Board of Directors of CookieTree.

(iii) A duly executed stock pledge or security agreement, in a form approved by the Board of Directors of CookieTree, pursuant to which the Shares purchased by each purchaser shall be pledged to secure payment of the Note delivered by the purchaser.

(b) The selling Shareholder (or his successor in interest) shall deliver to the purchasing parties or to the Secretary of CookieTree on behalf of the purchasing parties:

(i) Share certificates for all the Shares that are to be purchased, either duly endorsed in blank for transfer to the purchasing parties or with duly executed stock powers attached.

(ii) A certificate dated as of the date of the Closing and signed by the selling Shareholder, containing a representation and warranty that as of such date the selling Shareholder has transferred, or caused to be transferred, to the purchasing parties good and marketable title to all Shares in question, free and clear of all claims, liens, charges and encumbrances.

The Secretary of CookieTree shall act as escrow agent under the pledge agreement referenced above, and hold the certificates representing the Shares sold, until payment of the Note relating thereto. As long as a Note is not in default, the purchaser of the Shares securing the obligation evidenced by the Note shall be entitled to receive all dividends on the pledged Shares and to exercise all voting rights with respect to the pledged Shares.

9. Anything to the contrary contained herein notwithstanding, subject to the provisions of paragraph ten (10) below, each of the Shareholders (but not their transferees or successors in interest) may transfer Shares to no more than five members of each such Shareholder's respective immediate family (or to a Qualified Subchapter S Trust for the benefit of members of each such Shareholder's respective immediate family), either during the respective Shareholder's lifetime or on death by will or intestacy. Once any of the Shareholders has transferred Shares to a total of five persons or entities pursuant to this paragraph, any further transactions shall be subject to all of the provisions of this Agreement. "Immediate family" as used herein shall mean spouse, lineal descendant, father or mother of the respective Shareholder making such transfer.

In the case of any permitted transfer, the transferee, assignee or other recipient shall receive and hold such Shares subject to the provisions of this Agreement and there shall be no further transfer of any Shares except in accordance with this Agreement. As a condition to a transfer of any Shares, Cookietree may require the transferee, assignee or recipient to sign a counterpart of this Agreement, and to agree to be bound by the terms of this Agreement as if it were a Shareholder named herein.

10. For so long as Cookietree is an S Corporation as defined in the Internal Revenue Code, no Shareholder shall take any action or make any transfer of Shares which would result in the termination or revocation of Cookietree's Subchapter S election.

11. The provisions of this Agreement may be waived with respect to any transfer either by Cookietree, upon duly authorized action of its Board of Directors, or by the Shareholders, upon the express written consent of the owners of at least two-thirds of the Shares then subject to this Agreement (excluding those Shares owned by the selling Shareholder).

12. Any sale or transfer, or purported sale or transfer, of Cookietree Shares shall be null and void unless the terms, conditions, and provisions of this Agreement are strictly observed and followed.

13. This Agreement shall expire on October 31, 2006, but such expiration date shall automatically be extended to October 31, 2011 if no due action of the Cookietree Board of Directors (the "Board") is taken prior to October 31, 2006, as hereinafter provided, to cause this Agreement to expire on October 31, 2006, or if this Agreement is not otherwise extended or earlier terminated by the parties as provided herein. The Board is hereby granted the authority, by resolution of the Board duly adopted by a majority of the members of the Board, to cause this Agreement to expire on October 31, 2006, and not to be automatically extended beyond such date as provided herein.

14. The certificates representing Shares subject to this Agreement shall bear a restrictive legend similar to the following:

"The shares represented by this certificate are subject to a right of first refusal option in favor of the corporation and certain of its shareholders, as provided in a Shareholders' Agreement dated as of November 1, 1999."

15. When fully executed, this Agreement will supersede and replace the Purchase Agreement, and upon the effectiveness of this Agreement, the Purchase Agreement will be of no further force or effect.

16. Cookietree shall have the right at any time and from time to time to have additional shareholders of Cookietree added as parties to this Agreement. Upon the execution of this Agreement by such additional parties, they shall be considered and treated for all purposes under this


Agreement as Shareholders as defined herein, and all shares of CookieTree Common Stock then held or thereafter acquired by such parties shall be treated as Shares as defined herein.

17. Each party hereto agrees to perform any further acts and execute and deliver any documents which may be reasonably necessary to carry out the provisions of this Agreement. This Agreement may be executed in one or more counterparts, each of which shall be considered an original and all of which shall be considered one and the same Agreement. This Agreement shall be binding on and inure to the benefit of the parties hereto and their respective assigns. This Agreement shall be construed in accordance with, and governed by the laws of the State of Utah applicable to contracts entered into and to be performed entirely within such State. In the event that any party hereto breaches this Agreement, he shall be liable to the other parties hereto for all loss, costs, damages and expenses, including attorneys' fees, incurred as a result of any such breach. This Agreement may be amended or canceled by the written consent of the holders of two-thirds of the Shares then subject to this Agreement; provided however, that no additional restrictions shall be imposed on the transfer of any Shares held by a Shareholder without the prior written consent of such Shareholder.


18. The Purchase Agreement and the 1991 Shareholders' Agreement are hereby terminated and of no further force or effect.

IN WITNESS WHEREOF, this Agreement is executed effective as of the date first above written.

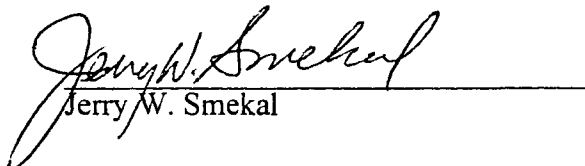
COOKIE TREE, INC.:

By:   
Title: PRESIDENT

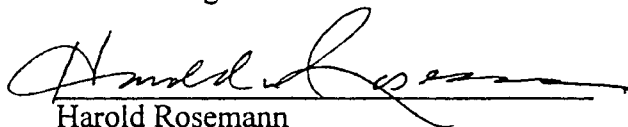
SHAREHOLDERS:

  
Greg F. Schenk

\_\_\_\_\_  
Kim McLaughlin

  
Jerry W. Smekal

\_\_\_\_\_  
Sam McLaughlin

  
Harold Rosemann

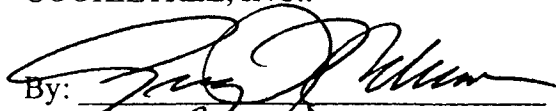
Agreement as Shareholders as defined herein, and all shares of CookieTree Common Stock then held or thereafter acquired by such parties shall be treated as Shares as defined herein.

17. Each party hereto agrees to perform any further acts and execute and deliver any documents which may be reasonably necessary to carry out the provisions of this Agreement. This Agreement may be executed in one or more counterparts, each of which shall be considered an original and all of which shall be considered one and the same Agreement. This Agreement shall be binding on and inure to the benefit of the parties hereto and their respective assigns. This Agreement shall be construed in accordance with, and governed by the laws of the State of Utah applicable to contracts entered into and to be performed entirely within such State. In the event that any party hereto breaches this Agreement, he shall be liable to the other parties hereto for all loss, costs, damages and expenses, including attorneys' fees, incurred as a result of any such breach. This Agreement may be amended or canceled by the written consent of the holders of two-thirds of the Shares then subject to this Agreement; provided however, that no additional restrictions shall be imposed on the transfer of any Shares held by a Shareholder without the prior written consent of such Shareholder.

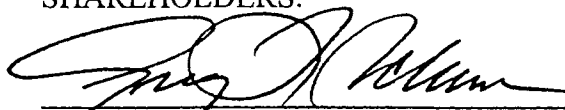
18. The Purchase Agreement and the 1991 Shareholders' Agreement are hereby terminated and of no further force or effect.

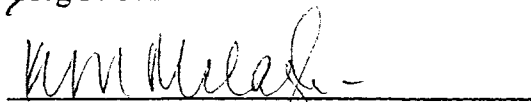
IN WITNESS WHEREOF, this Agreement is executed effective as of the date first above written.

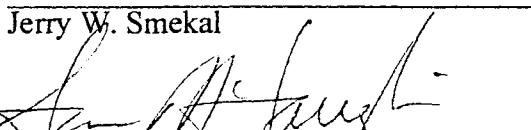
COOKIEETREE, INC.:

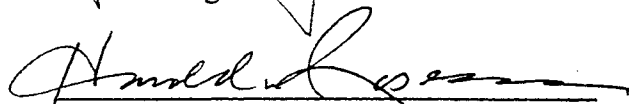
By:   
Title: PRESIDENT

SHAREHOLDERS:

  
Greg F. Schenk

  
Kim McLaughlin

Jerry W. Smekal  
  
Sam McLaughlin

  
Harold Rosemann



Tab 3

IN THE THIRD JUDICIAL DISTRICT COURT  
IN AND FOR SALT LAKE COUNTY, STATE OF UTAH

COPY

SAMUEL R. McLAUGHLIN and  
JOHN DOES 1-10,

Plaintiffs,

vs.

GREG SCHENK; ESTATE OF  
BOYD SCHENK; ANNA SCHENK;  
COOKIEETREE, INC., a Utah  
corporation; and JOHN  
DOES 1-10,

Defendants.

CIVIL NO. 040924997

DEPOSITION OF:  
HAROLD ROSEMAN

Held November 9, 2005

REPORTED BY:  
RENEE L. STACY, CSR, RPR

SAMUEL R. McLAUGHLIN,

Plaintiff,

vs.

COOKIEETREE, INC., a Utah  
corporation, and GREG  
SCHENK,

Defendants.



333 SOUTH RIO GRANDE, SUITE F.  
SALT LAKE CITY, UTAH 84101  
(801) 328-1188 / 1-800-DEPOMAX  
FAX 328-1189



Deposition of HAROLD ROSEMANN, taken on behalf of the Plaintiffs, at 525 South 300 East, Salt Lake City, Utah, commencing at 9:15 a.m. on November 9, 2005, before RENEE L. STACY, Certified Shorthand Reporter, Registered Professional Reporter and Notary Public in and for the State of Utah, pursuant to Notice.

\* \* \* \*

ROSEMANN, EXAM BY HOBBS

1 shares?

2 MR. HINDLEY: Can you repeat one more time?  
3 I just want to make sure that I understood the  
4 question.

5 Q (BY MR. HOBBS) Did you -- well, what  
6 discussions did you have with Greg with respect to  
7 Greg's understanding of his father's intentions  
8 respecting his shares?

9 A That the shares at some time would be  
10 transferred to Greg from his father.

11 Q Nothing more specific than "at some time"?

12 A Nothing more specific.

13 Q Did you ever have any discussions with  
14 either Greg or Boyd as to why the shares weren't  
15 transferred in 1998?

16 A No.

17 Q When the shares were transferred in 1999 --  
18 and you were involved in the transfer of the shares,  
19 correct?

20 A I knew everything that was going on, yes.

21 Q At that time did you review the shareholder  
22 agreement?

23 A Yes.

24 Q Did you have any concerns about whether or  
25 not the shareholder agreement was being complied with

**ROSEMAN, EXAM BY HOBBS**

1 in the manner in which the shares were being  
2 transferred?

3 A No.

4 Q And why was that?

5 A Attorney representation and the way --

6 MR. HINDLEY: And with that, don't go  
7 further into that conversation.

8 THE WITNESS: Okay.

9 MR. HINDLEY: I do think that the record  
10 will reflect that there was an attorney involved, but  
11 don't get into any specific conversations.

12 THE WITNESS: Okay.

13 Q (BY MR. HOBBS) Who was the attorney with  
14 whom you had discussions respecting this transfer?

15 A It should be on record. Bob Rogers.

16 Q Okay. There was a transfer of the stock,  
17 before the death, of 818,000 shares. Were you  
18 involved in that?

19 A Yes.

20 Q What do you know about that transfer?

21 A That Greg and Boyd signed a transaction to  
22 sell 818,000 shares to Greg.

23 Q Did you have discussions with Boyd Schenk  
24 about that transfer?

25 A Yes, that Boyd wanted to initiate the stock