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Summary of Weddell v. H2O, Inc., 128 Nev. Adv. Op. No. 9

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Weddell v. H2O, Inc., 128 Nev. Adv. Op. No. 9 (Mar. 07, 2012)¹

BUSINESS LAW- LLC CHARGING ORDER, LIS PENDENS

Summary

The Court considered an appeal from an action seeking contract, tort, and declaratory relief.

Disposition/ Outcome

The Supreme Court of Nevada reversed the decision of the district court in allowing a charging order to transfer managerial interests of a LLC to the creditor, and remanded the case for further proceedings. The Court affirmed the district court in canceling a lis pendens action that did not involve real property. Finally, the Court affirmed the district court's holding that there was substantial evidence that no ownership interest was held in a LLC.

Factual and Procedural History

Rolland P. Weddell ("Weddell") and Michael B. Stewart ("Stewart") cooperated to establish many business ventures that varied from geothermal energy to garlic farming. Weddell and Stewart's business relationships lasted from 2000 to 2007. These relationships included participation in Granite Investment Group, LLC. & High Rock Holding, LLC.; Empire Geothermal Power, LLC.; and H2O, Inc. These entities are embroiled in the instant dispute.

Granite Investment Group, LLC. & High Rock Holding, LLC:

Weddell and Stewart's dispute involving Granite Investment Group and High Rock Holding begins when Stewart removed Wendell as manager from both of these entities in October of 2007. Wendell's removal from Granite Investment Group was disputed pursuant to the company's operating agreement, despite a majority vote, because the agreement required an unanimous affirmative vote and Wendell did not vote with the majority. Weddell's removal from High Rock Holding was not disputed on these grounds, as Stewart was able to achieve a majority vote and the operating agreement did not require a unanimous vote.

In 2008, a creditor was allowed by a district court in an unrelated case to charge Wendell's membership interest in these entities for the amount due.² As a result, Stewart purchased Wendell's remaining interest for a nominal sum. The district court, where this appeal derives from, held that the 2008 charging order divested Wendell of both managerial and membership rights in these entities and that Stewart was the only manager.

¹ By Matthew Vantusko

² The scope of the creditor's rights under this order is defined by NEV. REV. STAT. § 86.401(2007). As noted by the Court, this statute was revised by the Nevada legislature in 2011.

Empire Geothermal Power, LLC:

After litigation began, Wendell filed a lis pendens against Empire Geothermal Power and Stewart due to a disputed options agreement between the parties. Empire Geothermal Power sought to cancel this lis pendens by claiming that NEV. REV. STAT. § 14.015 in conjunction with § 14.010 does not allow such a filing, as it does not affect the title or possession of real property. The district court held that the lis pendens should be cancelled because the underlying options agreement represented a claim for personal property.

H2O, Inc.:

In 1999, Wendell helped Stewart to negotiate with a bank to reduce the amount of debt owed in consideration for certain concessions from Stewart. These concessions included a 15-percent interest in High Rock Holding, LLC. and a disputed \$2.5 million payment that was contingent on the availability of funds. In 2004, Stewart tendered a check for this amount to Wendell. Wendell used these funds to purchase the entire ownership interest in H2O, Inc., and then assigned this interest to a company owned and operated by Stewart. In 2007, all H2O interests owned by Wendell were further transferred to Stewart. Stewart and Wendell disputed whether Wendell ever purchased H2O stock for his own benefit. The district court held that Wendell only purchased this stock as an agent for Stewart, and denied any claim of fraud.

Discussion

Justice Cherry wrote for the unanimous, three justice panel. The Court's standard of review for factual issues in the case was the clearly erroneous standard. For any contractual or statutory interpretation, the Court gave no deference through a de novo review.

Granite Investment Group, LLC. & High Rock Holding, LLC:

Nevada was one of the first states to allow LLC formation. LLCs in Nevada are governed by chapter 86 of the Nevada Revised Statutes. Typically, management of an LLC is in proportion to contributed capital, but this can be abrogated through the articles of organization or operating agreement.³ NEV. REV. STAT. §86.401 limits the remedies available against the member interests of an LLC.⁴ One such remedy is the charging order, which allows a judgment creditor to seek redress through a member's interest in an LLC. The charging order allows the judgment creditor to receive payment distributions due to the member, but not partnership assets. Charging orders, however, are limited to the debtor's rights to profits and distributions, not any management interest.

Thus, the Court limited the charging order against Wendell's interests in Granite Investment Group to profits and distributions. The creditor had no recourse against Wendell's managerial rights for this reason. This fulfills the standard policy goal behind LLCs of allowing members to choose who they associate with. Despite the creditor not having any interest in Wendell's managerial rights, Granite's operating agreement may have limited Wendell's managerial rights due to the charging order affecting a non-transferability clause. The Court

³ NEV. REV. STAT. § 86.291(2007).

⁴ NEV. REV. STAT. § 86.401 (2007).

remanded this question to the district court, but affirmed the district court in its finding that the High Rock Operating Agreement posed no such question, making Stewart the sole manager of this LLC.

Empire Geothermal Power, LLC:

The underlying policy behind a lis pendens is to provide notice of an ongoing real property dispute.⁵ In Nevada, lis pendens are limited to application involving the title or possession or real property or foreclosure of a real property mortgage.⁶ Member interests of a LLC are considered personal and not real property.⁷ Thus, the court held that the disputed option agreement to purchase shares of Empire Geothermal Power was a dispute with personal property and not appropriate for a lis pendens. For this reason, the Court affirmed the lower court's cancellation of Wendell's lis pendens.

H2O, Inc.:

The Court did not reach the question of whether Wendell ever owned shares in H2O, Inc. because of the 2004 assignment of all shares to the LLC owned by Stewart and the 2007 transfer of all interests in these shares to Stewart. The combination of the assignment and the transfer of these rights provided substantial evidence to the Court that Wendell has no ownership interest in H2O, Inc. The Court rejects Wendell's arguments claiming fraud, estoppel, and waiver because fraud is never presumed, and it held that the lower court has substantial evidence to support its conclusions.

Conclusion

The Court held that a charging order does not transfer managerial rights to the creditor, but only concerns profits, losses, and distributions. Lis pendens are limited in application to real property.

⁵ See NEV. REV. STAT. § 14.010(1) (2007).

⁶ NEV. REV. STAT. § 14.015(2)(a) (2007).

⁷ NEV. REV. STAT. § 86.351(1) (2007).