IN THE SUPREME COURT OF THE STATE OF NEVADA

RUSSELL HAWLEY, Appellant, vs. CHARLES E. KAUFMAN, III, Respondent.	No. 46634
RESTROOM FACILITIES, LTD., Appellant/Cross-Respondent, vs. CHARLES E. KAUFMAN, III, Respondent/Cross-Appellant.	No. 46705
CHARLES E. KAUFMAN, III, Appellant, vs. HLK, LLC; RUSSELL HAWLEY; AND PENNY MELLO, Respondents.	No. 46706

FILED

MAY 08 2008

TRACIE K. LINDEMAN
CLERK OF SUPREME COURT
BY
CHIEF DEPUTY CLERK

ORDER GRANTING REHEARING (DOCKET NO. 46705 AND 46706), AND AFFIRMING IN PART, REVERSING IN PART, AND REMANDING WITH INSTRUCTIONS

These are consolidated appeals from district court judgments in actions involving a deed of trust and a business dispute. On January 24, 2008, this panel entered an order affirming in part, reversing in part, and remanding with instructions. In response, respondent/cross-appellant Charles E. Kaufman, III, filed a petition for rehearing in Docket No. 46705, and respondents HLK, LLC, Russell Hawley, and Penny Mello (collectively HLK) filed a petition for rehearing in Docket No. 46706.[1] Answers to these petitions have been filed.

[1]Neither party in Docket No. 46634 filed a petition for rehearing from our January 24, 2008, order. Accordingly, we have not considered

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08-11504

NRAP 40

NRAP 40 governs petitions for rehearing. Under NRAP 40(a)(1), this court will grant a petition for a rehearing in a civil case only if the petitioner shows that this court "overlooked or misapprehended a material fact," "overlooked or misapprehended a material question of law," or "overlooked, misapplied or failed to consider controlling authority."

We grant Kaufman's petition for rehearing in Docket No. 46705 because we misapprehended a material question of law concerning the statute of limitation's application to equitable recoupments, and we did not discuss the merits of his cross-appeal. Because this is a consolidated appeal involving complex procedural issues and complicated questions of law and fact, we also grant HLK's petition for rehearing in Docket No. 46706.

Standard of review

This court reviews issues of law de novo and issues of fact for substantial evidence in the record.[2] When a statute's language is clear, this court interprets the Legislature's intent from the statute's plain meaning.[3]

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our prior order as to Docket No. 46634. The instant order only replaces our January 24, 2008, order with respect to our decisions in Docket Nos. 46705 and 46706.

[2]Keife v. Logan, 119 Nev. 372, 374, 75 P.3d 357, 359 (2003).

[3]McKay v. Bd. of Supervisors, 102 Nev. 644, 648, 730 P.2d 438, 441 (1986).

Docket No. 46706: Kaufman v. HLK, LLC; Russell Hawley; and Penny Mello

First, we consider whether the district court abused its discretion when it placed Kaufman's ownership interest in HLK into a constructive trust for the benefit of RFL. We conclude that the district court abused its discretion because a charging order is RFL's exclusive remedy under NRS 86.401.

"A constructive trust has been defined as a remedial device by which the holder of legal title to property is held to be a trustee for the benefit of another who in good conscience is entitled to it."[4] A district court properly imposes a constructive trust when the holder of legal title inequitably obtains it from another, a confidential relationship exists between them, and the imposition of the trust prevents injustice.[5]

NRS 86.401 governs the rights of a judgment creditor to a member's interest in an LLC. NRS 86.401 states, in pertinent part:

> 1. On application to a court of competent jurisdiction by a judgment creditor of a member, the court may charge the member's interest with payment of the unsatisfied amount of the judgment with interest. To the extent so charged, the judgment creditor has only the rights of an assignee of the member's interest.
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> 2. This section:
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> (a) Provides the exclusive remedy by which a judgment creditor of a member or an

[4]Danning v. Lum's, Inc., 86 Nev. 868, 871, 478 P.2d 166, 167 (1970).

[5]Schmidt v. Merriweather, 82 Nev. 372, 375, 418 P.2d 991, 993 (1966).

> assignee of a member may satisfy a judgment out of the member's interest of the judgment debtor.

NRS 86.401 is "the exclusive remedy" for a judgment creditor against a judgment debtor's interest in a partnership or limited liability corporation.[6]

The district court improperly placed Kaufman's interest in HLK into a constructive trust because RFL's only available remedy was to seek a charging order under NRS 86.401. Instead, NRS 86.401 only permits RFL to obtain the rights of an assignee of Kaufman's interest, which is limited to Kaufman's economic interests. In passing title under a constructive trust remedy, RFL would also inappropriately acquire Kaufman's managerial interests. Accordingly, we conclude that the district court abused its discretion in ordering Kaufman's interest to be placed in a constructive trust because a charging order was RFL's exclusive remedy under NRS 86.401.

Docket No. 46705: RFL v. Kaufman

This court reviews the application of a statute of limitations de novo.[7]

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[6]See Brant v. Krilich, 835 N.E.2d 582, 592 (Ind. Ct. App. 2005) (holding "that a charging order is the only remedy for a judgment creditor against a member's interest in an LLC," after interpreting a similar Indiana statute).

[7]See Day v. Zubel, 112 Nev. 972, 977, 922 P.2d 536, 539 (1996) (stating that determining the date upon which the statute of limitations begins to run is a question of law if the facts are uncontroverted).

I. The district court erred when it offset Kaufman's unpaid salary

In this appeal, Kaufman argues that the district court properly allowed him to recoup his unpaid salary from 1991 through 1998 and offset it against RFL's claims for unauthorized loans and advances. He specifically contends that the statute of limitations never bars an affirmative defense for an equitable recoupment but may bar the affirmative defense for an equitable offset. RFL argues that regardless of whether Kaufman's claim to offset his past salary is cast as equitable recoupment or equitable offset, the district court erred because Kaufman's own conduct was inequitable.

The equitable recoupment and equitable offset doctrines mostly share the same characteristics, but there are some important differences. Equitable recoupment has five essential characteristics. First, it is an affirmative defense.[8] Second, the defendant's claim must arise out of the same transaction or occurrence as the plaintiff's judgment award.[9] In determining whether the same transaction or occurrence is

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[8]Nevada State Bank v. Jamison Partnership, 106 Nev. 792, 798, 801 P.2d 1377, 1382 (1990).

[9]See, e.g., Beach v. Ocwen Fed. Bank, 523 U.S. 410, 415 (1998) (explaining that recoupment is a "'defense arising out of some feature of the transaction upon which the plaintiff's action is grounded'" (quoting Rothensies v. Electric Storage Battery Co., 329 U.S. 296, 299 (1946))); Klemens v. Air Line Pilots Ass'n, Intern., 736 F.2d 491, 501 (9th Cir. 1984) ("A claim for recoupment that would otherwise be barred by the statute of limitation may be brought to defeat a claim arising out of the same transaction."); Vari-Build, Inc. v. City of Reno, 622 F. Supp. 97, 100 (D. Nev. 1985) (concluding that "the claim in recoupment must concern matters arising out of the same transaction that is the basis for the plaintiff's claim for relief"); Nevada State Bank, 106 Nev. at 797, 801 P.2d

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involved, the United States District Court of Nevada concluded in Vari-Build, Inc. v. City of Reno that "a liberal construction is applied" and the claims must be "logically related."[10] Third, the defendant cannot pursue damages that are greater than the plaintiff's damage award.[11] Fourth, the statute of limitations does not apply to a recoupment defense, even though the statute of limitations would otherwise apply if the recoupment was instituted as an independent action.[12] Fifth, because recoupment is

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at 1381 (concluding that the defendant's "deficiency judgments were compulsory counterclaims because they arose out of the same transaction or occurrence as the subject matter of the opposing complaint"); 51 Am. Jur. 2d Limitation of Actions § 123 (2000) (explaining that recoupment is "a defense arising out of some feature of the transaction upon which the plaintiff's action is grounded").

[10]622 F. Supp. at 100.

[11]Nevada State Bank, 106 Nev. at 797 n.2, 801 P.2d at 1381 n.2.

[12]Beach, 523 U.S. at 415 (explaining that the recoupment "survives the expiration of the period provided by a statute of limitation that would otherwise bar the recoupment claim as an independent cause of action"); Klemens, 736 F.2d at 501 ("A claim for recoupment that would otherwise be barred by the statute of limitation may be brought to defeat a claim arising out of the same transaction."); Luckenbach Steamship Co. v. United States, 312 F.2d 545, 551 (2d Cir. 1963) ("'The defense of reduction or recoupment which arises out of the same transaction as the note or claim survives as long as the cause of action upon the note or claim exists, although an affirmative action upon the subject of it may be barred by the statute of limitations.'" (quoting Williams v. Neely, 134 F. 1, 13 (8th Cir. 1904))); Vari-Build, 622 F. Supp. at 100 ("[W]here the defendants' claim is for recoupment, the statute of limitations is not a bar; it may be availed of defensively so long as the plaintiff's cause of action exists."); Nevada State Bank, 106 Nev. at 799, 801 P.2d at 1382 ("We also affirm the district

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brought in equity,[13] equitable defenses, like unclean hands, laches, and estoppel, potentially apply.[14] An equitable offset has the same characteristics as equitable recoupment, except that an offset (1) is a claim that does not arise out of the same transaction or occurrence as the plaintiff's judgment award[15] and (2) the statute of limitations applies as if it were instituted as an independent action.[16]

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court's conclusion that while the statute of limitations is not tolled, the defendant can nonetheless assert his claim as an affirmative defense of recoupment.").

[13]Nevada State Bank, 106 Nev. at 798, 801 P.2d at 1382.

[14]Evans v. Dean Witter Reynolds, Inc., 116 Nev. 598, 609-10, 5 P.3d 1043, 1050 (2000) (concluding that "tortfeasors, including persons found liable in conversion and persons in conspiracy with them, may not apply [an equitable offset] from settlements by their joint tortfeasors . . . in reduction of judgments against them arising from the intentional misconduct"); see Nevada State Bank v. Jamison Partnership, 106 Nev. 792, 799, 801 P.2d 1377, 1382 (1990) (discussing equitable estoppel as a method for tolling the statute of limitations).

[15]Aviation Ventures v. Joan Morris, Inc., 121 Nev. 113, 120, 110 P.3d 59, 63 (2005) ("[T]he claims that give rise to a setoff need not arise out of the same transaction; they may be entirely unrelated.").

[16]Matter of Gober, 100 F.3d 1195, 1208 (5th Cir. 1996) ("Counterclaims for setoff, however, are subject to the applicable statute of limitations just as if they were asserted as independent actions."); In re Smith, 737 F.2d 1549, 1552 (11th Cir. 1984) ("A setoff, unlike a recoupment, is subject to the statute of limitations."); In re Gibson, 176 B.R. 910, 917 (Bankr. D. Or. 1994) ("Setoff is in the nature of an affirmative action as it arises out of a transaction or occurrence separate from that out of which the plaintiff's claim arose. It is subject to any applicable statute of limitations."); cf. Collard v. Nagle Const., Inc., 57

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A. Kaufman's claim is more properly characterized as an equitable offset

While the district court correctly ruled that a recoupment claim is not barred by the statute of limitations,[17] it erred when it interpreted Kaufman's claim as an affirmative defense of equitable recoupment because his unpaid salary did not arise out of the same transaction or occurrence as RFL's claim for the outstanding draws, advances, and transfers. Even after applying a liberal construction, under the logical relationship test, these claims are not connected for three reasons. First, RFL's claims for conversion and breach of fiduciary duty are tort claims, whereas Kaufman's defense, based upon RFL's inability to pay his salary, is a contract action. Second, Kaufman's draws, advances, and transfers were unilateral transactions with no predetermined disbursement date or fixed amount; conversely, Kaufman's salary was paid annually at a fixed amount. Third, salary is a taxable event, whereas Kaufman avoided paying taxes by characterizing the disbursements as advances and transfers.

Accordingly, we conclude that district court erred when it allowed Kaufman to recoup his unpaid salary against RFL's judgment

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P.3d 603, 609 (Utah Ct. App. 2002) ("Allowing an offset or recoupment in circumstances where a defendant's affirmative claims are barred by the statute of limitations is based on a sound policy of preventing a plaintiff from waiting to assert a claim until after a defendant's counterclaim is barred.").

[17]See supra note 6.

because the statute of limitations barred Kaufman equitable offset defense.

B. Equitable defenses also bar Kaufman's claim

Alternatively, and as another independent basis for reversal, we conclude that the district court erred when it allowed Kaufman's offset because equitable defenses also apply. Regardless of whether Kaufman's claim is cast as a recoupment or an offset, it remains an affirmative equitable defense. As Kaufman is seeking equity, we conclude that the equitable defense of unclean hands bars his offset. Specifically, the district court found that he breached his fiduciary duties to RFL when he diverted company funds, without board approval, for his own personal use.

II. Kaufman is obligated to repay the two outstanding promissory notes

Kaufman argues that the district court erred in concluding that he was obligated to repay the two promissory notes because NRS 11.190(2)(c), the four-year statute of limitations governing oral contracts, applies. RFL contends that the district court properly concluded that NRS 11.190(3)(d), the three year statute of limitations governing breaches of fiduciary duty, applies. Kaufman contends that substantial evidence does not support the district court's findings of fact. Lastly, with respect to the interest calculation, Kaufman argues that "[i]t is also clear that this Court could not have intended to affirm the district court with respect to the issues raised by the Cross-Appeal because RFL essentially conceded on appeal that there is no explanation for the amount of interest awarded by the district court on the notes." In RFL's response, it denies conceding the point and argues that the district court appropriately calculated interest from the time Kaufman started diverting funds. However, in cross-respondent's answering brief, RFL acknowledges that "[t]he Trial Court did not explain its [interest] calculation."

A. Fiduciary duties and the statute of limitations

A corporate officer owes the corporation fiduciary duties.[18] The duties impose the obligation that the officer act in good faith, with honesty, and fully disclose any conflicts of interest.[19] Whether the officer breached his fiduciary duty is a question of fact, which requires the trier of fact to examine all of the evidence.[20]

NRS 11.190 is the statute governing periods of limitation. In the case of fraud, NRS 11.190(3)(d) creates a three-year period, which "will not commence to run until the aggrieved party knew, or reasonably should have known, of the facts giving rise to the breach."[21] A breach of fiduciary duty is considered fraud for purposes of NRS 11.190(3)(d).[22] Whether a party was aware of the fraudulent actions giving rise to the breach is a question of fact.[23] In the case of contracts, under NRS 11.190(2)(c), there is a four-year period for instituting oral contract claims. For written contracts, NRS 11.190(1)(b) extends the period to six years.

Here, while the actual notes were not admitted at trial, Kaufman acknowledged that he executed two promissory notes in favor of

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[18]Leavitt v. Leisure Sports Inc., 103 Nev. 81, 86, 734 P.2d 1221, 1224 (1987).

[19]Id.

[20]Id.

[21]Nevada State Bank v. Jamison Partnership, 106 Nev. 792, 800, 801 P.2d 1377, 1382 (1990).

[22]Shupe v. Ham, 98 Nev. 61, 64, 639 P.2d 540, 542 (1982).

[23]Nevada State Bank, 106 Nev. at 800, 801 P.2d at 1382.

RFL. At trial, RFL introduced a financial statement, which indicated that on June 30, 1991, RFL's predecessor-in-interest had executed the following two promissory notes with Kaufman: (1) $40,000 that was due in five years at 10 percent interest and (2) $79,573 that was due in five years at 6 percent interest. Thus, the promissory notes became due on June 30, 1996, the four-year oral contract statute of limitation expired on June 30, 2000, and the six-year written contract statute of limitation expired on June 30, 2002. Because RFL did not file its action against Kaufman until December 20, 2002, its claim is time barred under both the four and six-year statutes if it is considered a contract action.

While RFL's claim for repayment on the promissory notes could be considered a contract claim, we conclude that the district court properly applied the three-year statute of limitations governing fraud claims for three reasons. First, RFL sued Kaufman for breach of fiduciary duty and conversion, which triggers NRS 11.190(3)(d) and not the statute of limitations governing contract claims under NRS 11.190(1)(b) and NRS 11.190(2)(c). Second, Kaufman owed fiduciary duties to RFL because he was its president and CEO from 1988 through 2002. Third, after reviewing the board minutes and various financial statements, the district court found that the board of directors did not know, or could not have reasonably known, of the facts giving rise to the beach until sometime before the conclusion of the three-year period of limitations. Accordingly, we conclude that the statute of limitations does not bar RFL's claim for repayment.

B. Substantial evidence

Substantial evidence supports the verdict if "'a reasonable mind might accept [it] as adequate to support a conclusion.'"[24]

After considering all of the evidence, the district court found that Kaufman breached his fiduciary duties when,

> in his desire to bring about that something far away, the financial success for the company, for himself, for Mr. Hawley, [he] trampled upon just about every corporate regularity there is. He trampled the company's obligation to the Internal Revenues [sic] Service, to the government of our country. He trampled upon the company's obligation to use the money withheld from employee paychecks for the 401-K program for that purpose. He trampled upon any conceivable rational bookkeeping system one can imagine. The most striking example of that that comes to mind is Mr. Kaufman's candor in saying that the payroll advances had nothing to do with payroll, absolutely nothing. . . .
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> . . . [He] trampled upon the rights of his employees. He trampled upon the rights of the creditors. He trampled upon the rights of the government. He trampled upon the rights of the investor to know in close range what was going on. He trampled on the truth.

More specifically, the district court found that Kaufman "routinely took checks for personal reasons, made them to himself, did not reimburse the corporation, as well as transfers. And the Court finds the total amount of that item is $358,889.36." The district court further stated that "[t]he

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[24]First Interstate Bank v. Jafbros Auto Body, 106 Nev. 54, 56, 787 P.2d 765, 767 (1990) (quoting State, Emp. Security v. Hilton Hotels, 102 Nev. 606, 608, 792 P.2d 497, 498 (1986)).

defendant also routinely used his American Express card for personal reasons." In its findings of fact, the district court noted that Kaufman "used company employees and material for remodeling work on his home, . . . and none of that expense was ever paid to the company."

We conclude that substantial evidence supports the district court's finding that Kaufman breached his fiduciary duties to RFL. Accordingly, as a matter of law, we conclude that the district court correctly ruled that the statute of limitations did not shield Kaufman's obligation to repay RFL the $269,452 due under the two promissory notes.

III. The district court failed to enter sufficient findings of fact regarding its calculation of the amount of interest due on the two outstanding promissory notes

This court reviews a district court's calculation of prejudgment interest for plain error.[25] In determining whether the district court properly awarded interest, this court will consider the following three items: "'(1) the rate of interest; (2) the time when it commences to run; and (3) the amount of money to which the rate of interest must be applied.'"[26]

A cause of action generally starts accruing at the moment a plaintiff is injured.[27] In contract cases, the rate of interest is calculated either under the agreement itself or, if no written agreement exists, under

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[25]Lee v. Ball, 121 Nev. 391, 395, 116 P.3d 64, 67 (2005).

[26]Kerala Properties, Inc. v. Familian, 122 Nev. 601, 604, 137 P.3d 1146, 1148-49 (2006) (quoting Schoepe v. Pacific Silver Corp., 111 Nev. 563, 565, 893 P.2d 388, 389 (1995)).

[27]Jain v. McFarland, 109 Nev. 465, 477, 851 P.2d 450, 458 (1993) ("Traditionally, a cause of action accrues the moment a plaintiff suffers an injury or wrong.").

NRS 99.040.[28] NRS 99.040(1) sets the applicable interest rate at the prime rate of the largest bank in Nevada plus 2 percent. In selecting the appropriate prime rate, courts must choose the rate in effect when the contract or agreement was executed.[29] Interest commences to run at the time the obligation under an agreement becomes due[30] and, pursuant to NRS 17.130(2), the interest continues accruing until the debt is satisfied.[31] Importantly, if a district court fails to explain the basis of its calculations, this court will remand for an explanation.[32]

We conclude that the district court did not sufficiently explain how it calculated the interest on the promissory notes in arriving at its $269,452 judgment. In its findings of fact, the district court stated:

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[28]Laughlin Recreational v. Zab Dev., 98 Nev. 285, 288, 646 P.2d 555, 557 (1982).

[29]Kerala Properties, 122 Nev. at 604, 137 P.3d at 1149.

[30]Laughlin Recreational, 98 Nev. at 288, 646 P.2d at 557.

[31]NRS 17.130(2) states:

> When no rate of interest is provided by contract or otherwise by law, or specified in the judgment, the judgment draws interest from the time of service of the summons and complaint until satisfied . . . at a rate equal to the prime rate at the largest bank in Nevada . . . plus 2 percent.

See Lee v. Ball, 121 Nev. 391, 395-96, 116 P.3d 64, 67 (2005).

[32]See Schoepe v. Pacific Silver Corp., 111 Nev. 563, 567, 893 P.2d 388, 390 (1995) (reversing the district court because it failed to award prejudgment interest and explaining that the district court's prior order did not adequately state its findings and calculations).

> In addition to the foregoing, KAUFMAN executed Notes to the company in the amount of $70,000.00 and $49,573.00 which Notes accrued interest according to their terms. While the actual Notes were never produced and were not in evidence, the existence of these Notes was evidenced by a 1991-1992 Reviewed Financial Statement, which was admitted into evidence. The Court finds KAUFMAN should pay the company the sum of $269,452.88, which includes all interest and principal on these Notes.

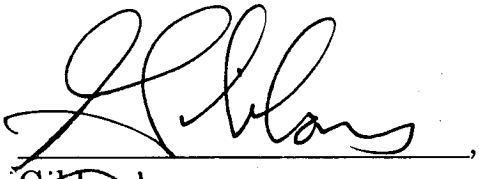
While the district court's judgment denotes one of the mandatory criteria for calculating prejudgment interest, the $70,000 and $49,573 principal amounts, its judgment above does not explain the following two mandatory criteria: (1) the rate of interest, and (2) the date when the interest commenced. Accordingly, we reverse the prejudgment interest award of $149,879 ($269,452 (judgment) minus $70,000 (promissory note 1) minus $49,573 (promissory note 2)) and remand to the district court to enter its findings and calculations on the record.

CONCLUSION

In this order, we reach the following four conclusions. First, we conclude that the statute of limitations extinguished Hawley's deed of trust because more than 10 years had passed and he did not show any bad faith conduct to toll the statute under Pro-Max Corp. v. Feenstra. Thus, we affirm that portion of the district court's judgment determining that the deed of trust was terminated. Second, we conclude that the district court abused its discretion when it placed Kaufman's interest in a limited liability company into a constructive trust because NRS 86.401 prohibits that remedy. Thus, we reverse that portion of the district court's judgment imposing a constructive trust. Third, we conclude that the district court erred when it offset Kaufman's unpaid salary against RFL's

judgment because both the statute of limitations and equitable defenses barred that claim. Thus, we reverse that portion of the judgment pertaining to the offset and remand this matter to the district court with instructions that it recalculate the amount that Kaufman is entitled to deduct from his debt to RFL. Fourth, we conclude that the district court properly ruled that Kaufman was obligated to repay the amounts due on the two promissory notes to RFL. Thus, we affirm that portion of the judgment, but we remand this matter to the district court with instructions that it enter, on the record, its findings of fact and its calculations of the applicable interest.

It is so ORDERED.



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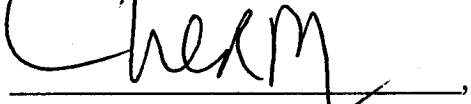

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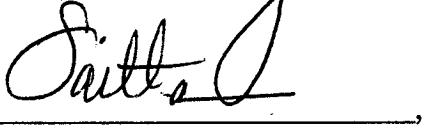

_____, J.
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cc: Hon. Brent T. Adams, District Judge
Patrick O. King, Settlement Judge
Jack I. McAuliffe, Chtd.
Molof & Vohl
Washoe District Court Clerk