

**COURT OF APPEALS  
DECISION  
DATED AND FILED**

**November 17, 2005**

Cornelia G. Clark  
Clerk of Court of Appeals

**NOTICE**

This opinion is subject to further editing. If published, the official version will appear in the bound volume of the Official Reports.

A party may file with the Supreme Court a petition to review an adverse decision by the Court of Appeals. See WIS. STAT. § 808.10 and RULE 809.62.

**Appeal No. 2004AP3090**

**Cir. Ct. No. 2004CV28**

**STATE OF WISCONSIN**

**IN COURT OF APPEALS  
DISTRICT IV**

---

**RICHARD WILKES AND TOM WILKES,**

**PLAINTIFFS-RESPONDENTS,**

**V.**

**LAKE ARROWHEAD ASSOCIATION, INC.,**

**DEFENDANT-APPELLANT.**

---

APPEAL from an order of the circuit court for Adams County:  
CHARLES A. POLLEX, Judge. *Reversed and cause remanded with directions.*

Before Lundsten, P.J., Deininger and Higginbotham, JJ.

¶1 PER CURIAM. Lake Arrowhead Association appeals a nonfinal<sup>1</sup> order denying its motion to stay proceedings in an action filed against it by two of

---

<sup>1</sup> This court granted leave to appeal by order dated December 29, 2004.

its members, Richard and Tom Wilkes. The issue is whether the Wilkeses were required to comply with the statutory prerequisites for derivative proceedings. For the reasons discussed below, we conclude that the trial court erred in failing to treat the action as a derivative proceeding. We therefore reverse and remand for further proceedings consistent with this opinion.

### **BACKGROUND**

¶2 Lake Arrowhead is a nonstock corporation organized under Chapter 181 of the Wisconsin Statutes to manage the assets of a residential development for the property owners. Richard and Tom Wilkes are members of the association by virtue of owning parcels of land subject to its covenants. Lake Arrowhead levies an annual assessment on its members for the operating expenses of common areas and facilities, and it may issue special assessments for capital improvements.

¶3 The Wilkeses sued Lake Arrowhead, alleging that the association had levied and collected annual assessments in amounts exceeding that authorized by the covenants; it had used the annual assessments in a manner that breached the covenants; it had failed to follow the special assessment process to raise funds for capital improvements; it had improperly changed the annual assessment period; and it had diverted user fees for common facilities to another corporation. The Wilkeses sought damages based on the amount of assessments they believed they had overpaid, as well as declaratory judgment as to their rights under the covenants.

¶4 In response to a summary judgment motion brought by the Wilkeses, Lake Arrowhead moved to stay the proceedings pursuant to WIS. STAT.

§ 181.0743 (2003-04),<sup>2</sup> claiming that the action was properly characterized as a derivative proceeding, rather than a breach of contract case, and that the Wilkeses had failed to comply with the procedural requirements for derivative proceedings. The trial court denied the stay request, concluding this was not a derivative proceeding, and this interlocutory appeal followed.

## DISCUSSION

¶5 The central question before us is whether the Wilkeses’ allegations stated a direct cause of action for their own individual claims, or a derivative cause of action for claims properly belonging to the association. Generally speaking:

An action is a “direct action,” rather than a “derivative action,” when the alleged primary injury is to some subset of shareholders rather than to the corporation. In order to bring a direct action, a “complaint must allege facts sufficient, if proved, to show an injury that is personal to [the complainant], rather than an injury primarily to the corporation.” Shareholders are directly injured when they are affected “in a manner distinct from the effect upon other shareholders.” Conversely, an injury is primarily to the corporation if all shareholders are affected proportionately to the number of shares they own.

*Borne v. Gonstead Advanced Techniques, Inc.*, 2003 WI App 135, ¶24, 266 Wis. 2d 253, 667 N.W.2d 709 (Lundsten, J., dissenting) (citations omitted). Here, we are dealing with association members in a nonstock corporation rather than shareholders. We are persuaded, however, that the same principles apply.

¶6 The primary injury alleged by the Wilkeses—that is, mismanagement of the association’s annual assessment proceeds resulting in

---

<sup>2</sup> All references to the Wisconsin Statutes are to the 2003-04 version unless otherwise noted.

overpayment of dues by its members—affects all association members proportionately. The Wilkeses are not contending that they alone were overcharged due to some accounting problem or other individualized error. Rather, they are essentially contending that the association—through its board of directors—improperly diverted association assets, in which all members had an interest, to a wholly owned subsidiary golf course, and then had to charge members higher dues to cover the operational expenses of the common areas and facilities. The fact that the Wilkeses are seeking only the return of their own overpaid dues in damages does not mean that they suffered an injury “in a manner distinct from the effect upon” other association members. *Jorgensen v. Water Works, Inc.*, 2001 WI App 135, ¶16, 246 Wis. 2d 614, 630 N.W.2d 230. Nor does the fact that the Wilkeses dropped the board of directors as defendants in their amended complaint alter the fact that the true issue in the case is the board’s management of the association’s assets. If annual assessment funds were improperly diverted to a subsidiary, the association itself was injured.

¶7 The Wilkeses contend that, even if the association had a cause of action against its board from which their own claims derived, they still had a right to file their own direct cause of action based on contract. They cite to 19 AM. JUR. 2nd *Corporations* § 1957 (2004) for the proposition:

Generally, a stockholder has no individual right of action arising out of a corporation contract with a third person; however, a shareholder has a direct right of action if the cause of action is based on breach of a contract to which the shareholder is a party, even if the shareholder has not suffered an injury that is separate and distinct from that suffered by other shareholders (footnotes omitted).

The Wilkeses seem to believe this principle applies here because they are alleging violations of the Declaration of Restrictions, Covenants and Easements for Lake

Arrowhead, which applies to their parcels. As Lake Arrowhead points out, however, the association was not a party to the Declaration, but rather a creation of it. The Declaration was made by the developer, East Briar, Inc., f/k/a N.E. Isaacson of Wisconsin, Inc., who is not a party to this action. The Wilkeses have therefore failed to state any contract claim against Lake Arrowhead.

¶8 In sum, we agree with Lake Arrowhead that the Wilkeses' asserted claims are derivative in nature and that the Wilkeses should have followed the procedures set forth in Chapter 181 for derivative proceedings involving a nonstock corporation. They did not do so. We therefore reverse the order of the trial court and remand with directions to stay the action until the requirements of ch. 181 are met or to dismiss the action if the plaintiffs refuse or are unable to comply with the statutory prerequisites for a derivative proceeding.

*By the Court.*—Order reversed and cause remanded with directions.

This opinion will not be published. See WIS. STAT. RULE 809.23(1)(b)5.

