IN THE SUPREME COURT OF THE STATE OF NEVADA

HOUSE OF BRUSSELS CHOCOLATES, INC., A NEVADA CORPORATION; EVAN BAERGEN, INDIVIDUALLY AND AS AN OFFICER AND DIRECTOR OF HOUSE OF BRUSSELS CHOCOLATES, INC.; AND GRANT PETERSEN, INDIVIDUALLY AND AS AN OFFICER AND DIRECTOR OF HOUSE OF BRUSSELS CHOCOLATES, INC.,
Appellants,
vs.
STEPHEN WHITTINGTON, AN INDIVIDUAL,
Respondent.

No. 47632

FILED

NOV 03 2008

TRACIE K. LINDEMAN
CLERK OF SUPREME COURT
BY
DEPUTY CLERK

ORDER OF AFFIRMANCE

Appeal from a district court order entered after a bench trial in a business dispute and from a post-judgment award of pre-judgment interests and costs. Eighth Judicial District Court, Clark County; James A. Brennan, Judge.

This case involves alter ego and breach of contract claims by respondent Stephen Whittington, former CEO of House of Brussels Chocolates ("HOBC"), against appellants HOBC and HOBC's former CEOs, Evan Baergen and Grant Petersen (collectively "the HOBC parties").[1]

[1]Baergen was the president and chief financial officer of HOBC from May 2002 until January 2004. He was also a member of HOBC's board of directors during that time. In October 2002, Petersen became chairman of

continued on next page . . .

08-21985

HOBC was a start-up company that was formed in May 2002. Whittington joined the HOBC board of directors in June 2002 and served as the corporation's CEO from approximately September 2002 to May 2003. According to Whittington, even though he was the CEO of HOBC on paper, he sought Petersen's approval before making important decisions. In September 2002, after Whittington joined the board of directors but before he became CEO, Petersen and Baergen solicited $60,000 from him.[2] A central controversy in this case revolves around whether the $60,000 was a loan, with no performance or sales requirements, provided in exchange or shares of stocks and warrants and director shares as Whittington argues, or a non-interest bearing, unsecured loan with repayment conditioned on financing and sales targets, as the HOBC parties argue.

After Whittington became CEO of HOBC, on October 21, 2002, Petersen and Baergen approved transactions, according to Whittington without his knowledge, awarding one another 7.5 million shares of stock

---

. . . continued

the board of directors and in May 2003, he became the CEO of the corporation.

[2]Whittington characterizes himself as an "investor of last resort" that provided the $60,000 that saved the company. In this, he notes that the price of HOBC stock rose steadily after fall 2003 and, at the time of this litigation, had increased ten-fold from the time Whittington made his investment in the corporation.

and warrants in HOBC.[3] According to Whittington, because of Petersen and Baergen's allegedly "stealth transactions," HOBC did not have enough stock or warrants to compensate him for the $60,000 as promised. He further contends that Petersen and Baergen offered no prior disclosures, SEC filings, or written contracts demonstrating their entitlement to the shares and warrants that they awarded themselves. In fact, according to Whittington, Petersen and Baergen had already taken salaries of $82,000 and $70,000 respectively in the same fiscal year. The HOBC parties contend that they properly disclosed the stock and warrant transfers, which they took with Whittington's knowledge and in exchange for services rendered, and did not take salaries in the same fiscal year.

Petersen and Baergen also awarded shares of stock to their family and friends. Specifically, HOBC issued stock to Petersen's ex-girlfriend and Baergen's wife. According to the HOBC parties, the stock transfers were in exchange for significant financial contributions and services rendered to the corporation. Whittington, on the other hand, claims there is no proof of financial contributions or services rendered.

Whittington filed suit alleging, among other things, breach of contract for failure to award him promised stocks and warrants. He also asserted that the alter ego doctrine should apply. After a bench trial, the district court found in favor of Whittington on the breach of contract claim and awarded him approximately $2.7 million, or the value of the 6 million shares of stock and warrants that he claimed he was promised in exchange

---

[3]Whittington further argues that Petersen and Baergen only paid taxes on $75,000 worth of shares and warrants even though the value of those shares and warrants was much greater.

for his $60,000 loan. The district court also pierced the corporate veil and held Baergen and Petersen individually liable for damages to Whittington.

The HOBC parties subsequently filed this timely appeal. They contend that the district court erred in (1) piercing the corporate veil and (2) finding for Whittington on the breach of contract claim because there were conditions precedent, in the form of sales and marketing targets, to his receipt of 6 million shares of stock and warrants in exchange for his $60,000 loan.

Piercing the corporate veil

The alter ego doctrine applies if the plaintiff can prove, by a preponderance of the evidence, that (1) the corporation is governed and influenced by the people asserted to be its alter egos,[4] (2) there is a unity of interest and ownership such that the two are inseparable, and (3) "[t]he facts must be such that adherence to the fiction of separate entity would . . . sanction a fraud or promote injustice."[5] "A district court's findings [of fact] will not be disturbed on appeal unless they are clearly erroneous and

---

[4]Whittington argues that the HOBC parties do not dispute that the first element of the alter ego test is met. In this, he contends that because they comprised two of the three members of the board of directors and controlled 52 percent of HOBC's stock, they controlled the company's day-to-day operations and long term strategic decisions. We conclude that Whittington's argument has merit as Petersen and Baergen do not contest the first element of the alter ego test and the facts indicate that they controlled the company.

[5]Ecklund v. Nevada Wholesale Lumber Co., 93 Nev. 196, 197, 562 P.2d 479-80 (1977).

not based on substantial evidence."[6] Also, it is for the district court to weigh the evidence and judge the credibility of witnesses.[7]

We will affirm an alter ego decision if it is supported by substantial evidence.[8] While we have stated that the "corporate cloak is not lightly thrown aside,"[9] we nonetheless will only make an exception to the deferential substantial evidence standard when "it is clear that a wrong conclusion has been reached"[10] by the district court. Here, because there is substantial evidence to support each element of the alter ego doctrine, we affirm the district court's decision to pierce the corporate veil.

Unity of Interest

In order to demonstrate a unity of interest, "it is incumbent upon the one seeking to pierce the corporate veil, to show by a preponderance of the evidence, that the financial setup of the corporation is only a sham and caused an injustice."[11] In determining whether a company is merely a sham, this court considers "(1) commingling of funds; (2) undercapitalization; (3) unauthorized diversion of funds; (4) treatment

---

[6]Gibellini v. Klindt, 110 Nev. 1201, 1204, 885 P.2d 540, 542 (1994).

[7]Rowland v. Lepire, 99 Nev. 308, 312, 662 P.2d 1332, 1334 (1983).

[8]LFC Mktg. Group, Inc. v. Loomis, 116 Nev. 896, 904, 8 P.3d 841, 846 (2000).

[9]Baer v. Amos J. Walker, Inc., 85 Nev. 219, 220, 452 P.2d 916, 916 (1969).

[10]LFC Mktg. Group, 116 Nev. at 904, 8 P.3d at 846.

[11]North Arlington Med. v. Sanchez Const., 86 Nev. 515, 522, 471 P.2d 240, 244 (1970).

of corporate assets as the individual's own; and (5) failure to observe corporate formalities."[12] However, no one factor is wholly determinative.[13]

Here, we conclude, despite the HOBC parties' objections to the contrary, that there is substantial evidence supporting a finding of unity of interest. First, there is evidence, in the form of witness testimony, to support the theory that Petersen and Baergen transferred 7.5 million shares of HOBC stock to one another without the approval of Whittington, who was the acting CEO at the time, after they had taken significant salaries for the year. Second, witness testimony supported the claim that Petersen, and not Whittington, actually made decisions when Whittington served as CEO.[14] Third, there is witness testimony indicating that HOBC failed to follow corporate formalities. Specifically, Petersen and Baergen arguably circumvented Whittington in approving the October 21, 2002

---

[12]LFC Marketing Group, 116 Nev. at 904, 8 P.3d at 847.

[13]Lorenz v. Beltio, Inc., 114 Nev. 795, 808, 963 P.2d 488, 497 (1998).

[14]The HOBC parties claim that under Catawba Indian Tribe v. State of S.C. it is unjust to permit Whittington to pierce the corporate veil for acts that occurred during his tenure. 978 F.2d 1334 (4th Cir. 1992). However, the rule set forth in Catawba is that it is inappropriate to pierce the company's corporate veil when, even though all other elements of the alter ego doctrine are satisfied, it would benefit a parent corporation or the company's shareholders to do so. Given that Whittington was neither acting on behalf of a parent corporation nor an HOBC shareholder, the Catawba exception does not apply here. We further note that because Whittington was not a shareholder, he could not have sought justice by filing a shareholder derivative suit under the requirements set forth in NRCP 23.1. See Gascue v. Saralegui Land & Livestock Co., 70 Nev. 83, 255 P. 2d 335 (1953). Accordingly, disallowing him from piercing the corporate veil solely by virtue of his CEO status would have denied him any possibility of a remedy in the instant case.

transactions, took part in the transactions despite the fact that they were interested parties, and Petersen seemingly controlled the board of directors when Whittington was acting CEO. Given that it is the role of the district court to assess the credibility of witnesses, and there is substantial evidence, in the form of witness testimony, demonstrating that unauthorized diversion of funds, treatment of corporate assets as the individuals own, and failure to observe corporate formalities, we find no abuse of discretion on the part of the district court.

Fraud or injustice

Fraud or injustice exists when the facts are such that adherence to the fiction of a separate corporate entity would sanction a fraud or promote an injustice.[15] Here, there is substantial evidence to support the district court's finding that fraud or injustice would result from a failure to apply the alter ego doctrine. Specifically, it appears that Baergen, Petersen, and their family and friends would unjustly benefit from their control over HOBC while Whittington would fail to receive compensation for his loan to the corporation. In this, we note that Petersen seemingly exercised control over HOBC, circumventing Whittington's position as CEO, when the decisions that deprived Whittington of shares and warrants were made. He and Baergen, and not Whittington, also made the decisions to transfer additional shares of stock to family and friends. Accordingly, we conclude that the district court did not abuse its discretion in finding fraud or injustice.[16]

---

[15]Ecklund, 93 Nev. at 197, 562 P.2d at 479-80.

[16]The HOBC parties contend that applying the alter ego doctrine here would be inconsistent with this court's previous application of that

continued on next page . . .

Breach of contract

"Contract interpretation is subject to a de novo standard of review. However, the question of whether a contract exists is one of fact, requiring this court to defer to the district court's findings unless they are clearly erroneous or not based on substantial evidence."[17] Because the question here concerns the existence or non-existence of conditions

---

. . . continued

doctrine. Specifically, they claim that this court may only pierce the corporate veil when the corporation is a sham, a clear shield for individual liability, and has no independent basis for existence. They also claim that this court should adopt the rule followed by other courts across the country and require a showing of fraud before piercing the corporate veil in breach of contract cases. See Rimade Ltd. v. Hubbard Enterprises, Inc., 388 F.3d 138 (5th Cir. 2004).

We conclude that the HOBC parties' first argument misapprehends the alter ego doctrine. The purpose of piercing the corporate veil, as indicated above, "is to 'do justice' whenever it appears that the protections provided by the corporate form are being abused." See LFC Mktg. Group, Inc. v. Loomis, 116 Nev. 896, 903, 8 P.3d 841, 845-46 (2000) (quoting Polaris Industrial Corp. v. Kaplan, 103 Nev. 598, 603, 747 P.2d 884, 888 (1987). Because there is substantial evidence to support each element of the alter ego doctrine here, we conclude that the district court did not abuse its discretion in piercing the corporate veil. Further, we decline to adopt a new fraud requirement in breach of contract cases as required by other courts. In this, we note that relatively few jurisdictions have adopted such a fraud requirement and such a standard presupposes that the plaintiff knew that the corporation with which he was contracting was a sham when, in reality, the opposite is more likely to be the case. Accordingly, we decline to place an additional burden on the plaintiff on top of the already high standard in alter ego cases.

[17]May v. Anderson, 121 Nev. 668, 672-73, 119 P.3d 1254, 1257 (2005) (citation omitted).

precedent to Whittington's receipt of 6 million shares of stock and warrants, we consider whether the district court's decision was clearly erroneous, or not based on substantial evidence.

We conclude that there was substantial evidence to support the district court's finding that Whittington contracted with Petersen and Baergen to received 6 million shares of stocks and warrants. Specifically, there was evidence presented at trial that the SEC financial reports did not describe the $60,000 investment and accordingly could not characterize it as a loan and that the documentary evidence presented at trial, including emails between Baergen and Whittington, a subscription agreement between the parties, and the term sheet that Baergen prepared, should have laid out any conditions precedent to the repayment of the loan and award of stocks and warrants.[18] In addition, it was for the district court to determine the credibility of witness testimony presented

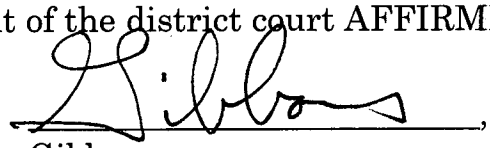
---

[18]The HOBC parties maintain that if the subscription agreement is taken at face value, then HOBC should not be held liable for breach of contract at all. In this, they assert that Whittington never returned the executed subscription agreement and thus, by the terms of the document, the $60,000 transfer must be an unsecured loan. Whittington, on the other hand, testified at trial that he signed the agreement and that HOBC failed to countersign it. Accordingly, he argues that he should not be bound by the provision that HOBC references because Baergen gave Whittington written assurances that his investment had been accepted and HOBC would execute the contract as Petersen and Baergen promised. Given that there is substantial evidence to support the district court's findings that Whittington signed the subscription agreement but HOBC failed to countersign it as promised and Whittington was given assurances that Petersen and Baergen would give him shares of stock and warrants in exchange for his loan to HOBC without any conditions precedent, the HOBC parties' argument is without merit.

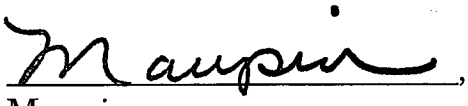
at trial and weigh their testimony appropriately. As a result, we conclude that the district court's decision was not clearly erroneous.[19]

Accordingly, we

ORDER the judgment of the district court AFFIRMED.



_____, C.J.
Gibbons



_____, J.
Maupin

_____, J.
Saitta

cc: Chief Judge, Eighth Judicial District
Hon. James A. Brennan, Senior Judge
Phillip Aurbach, Settlement Judge
Lewis & Roca, LLP/Las Vegas
David W. Affeld
Hutchison & Steffen, Ltd.
Eighth District Court Clerk

---

[19]The HOBC parties argue that Whittington was required to file a Form 4 with the SEC. However, we conclude that even if their argument has merit, Whittington did not relinquish his rights under the contract by failing to file a Form 4. See Gramanz v. T-Shirts and Souvenirs, Inc., 111 Nev. 478, 483, 894 P.3d 342, 346 (1995) (holding that waiver only occurs when "there has been an intentional relinquishment of a known right"). In addition, Whittington was not required to file a Form 4 because the relevant transaction, i.e. his receipt of stocks and warrants, never occurred for reporting purposes.