

Bedore v. Familian, 122 Nev. Adv. Op. 2, 125 P.3d 1168 (January 19, 2006)¹

CORPORATE LAW—ORDERED DISSOLUTION AND DIRECTOR INDEMNIFICATION

Summary

Three shareholders, Rory Bedore, Bruce Familian, and Jon Athey, owned interest Silver State Gaming, Inc. (“Silver State”), which operated the gaming operations in convenience stores owned by City Stop, Inc. (“City Stop”). Following some management disagreements, Familian and Athey voted to remove Bedore from the Board of Directors of Silver State, electing themselves as the sole members of the Board. Familian and Athey decided that a different entity owned by Familian and Athey would manage the gaming activities of the convenience stores.

Bedore brought a derivative action against Familian and Athey, alleging they had breached their fiduciary duties to the corporation by taking excessive salaries and usurping corporate opportunities. The district court ruled that Familian and Athey breached their fiduciary duties to Silver State and ordered a corporate buy-out. The district court ordered Familian and Athey to return their excess salaries to Silver State, but concluded that the corporation properly indemnified Familian and Athey.

Bedore claims that the district court improperly ruled that Silver State should indemnify Familian and Athey, while Familian and Athey allege that the district court lacked the authority to order a corporate buy out based solely on its determination that they had breached their fiduciary duties.

Disposition/Outcome

The court held that the district court abused its discretion when it ordered a corporate buy-out because the directors’ misconduct by taking excess salaries and usurping corporate opportunity did not amount to gross mismanagement justifying such an extreme remedy. The district court sufficiently remedied the directors’ misconduct by ordering a return of the excess salaries and issuing an injunction. Further, the court concluded that corporate directors who act in bad faith are not entitled to indemnification by the corporation, and remanded the case to determine the amount that Familian and Athey must pay as reimbursement of the attorney’s fees Silver State paid for their indemnification.

Factual and Procedural History

Rory Bedore, Bruce Familian, and Jon Athey incorporated City Stop, for the purpose of purchasing and managing convenience stores. Bedore and Familian subsequently incorporated Silver State under NRS Chapter 78A. Athey later purchased 2.5 percent from each Bedore and Familian and became the third shareholder of Silver State. Silver State took over the gaming operations in each of the convenience stores that City Stop had acquired.

Following some management disagreements, Familian and Athey removed Bedore as a director and elected themselves as the sole members of the board of directors of Silver State. Familian and Athey began looking for additional convenience stores to purchase in the name of a

¹ By Leanne Hoskins

new entity, Nevada City Partner. Familian and Athey decided not to use Silver State as the gaming operator long-term, but only to use Silver State until they obtained a license for their own separate gaming company.

Bedore then filed a shareholder derivative action under NRCPC 23.1 on behalf of himself and Silver State. The complaint alleged that Familian and Athey had breached their fiduciary duties to the corporation by taking excessive salaries and usurping corporate opportunities.

The district court ruled that Familian and Athey's salaries were excessive and ordered them to return \$138,296.84 to Silver State. The court also concluded that Familian and Athey had acted out of self-interest when they pursued an opportunity in the same line of business as that of Silver State, but found that they had not acted maliciously, intentionally, or oppressively.

The district court ordered the parties to participate in a blind bidding process for the purchase of 100 percent of Silver State, with the highest bidder receiving the company, and appointed a receiver to protect Silver State's assets in the meantime. Familian and Athey objected claiming that the court did not have the authority to order a buy-out in this case. The district court declared Bedore the winner of the bidding process.

The district court denied Bedore's motion requesting the court order Familian and Athey to reimburse Silver State for the attorney's fees and court costs it had paid for their defense in the underlying action concluding that Silver State had properly indemnified Familian and Athey. Bedore filed an appeal, and Familian and Athey filed a cross-appeal.

Discussion

Corporate Buy-out

Under NRS 78.650, a shareholder may request dissolution and the appointment of a receiver when the corporation's directors are "guilty of fraud or collusion or gross mismanagement," when the "assets of the corporation are in danger of waste, sacrifice or loss through attachment, foreclosure, litigation or otherwise,"² or when division among the shareholders threatens "irreparable injury."³ But the appointment of a receiver of the dissolution of a corporation is "a harsh and extreme remedy and should be used sparingly and only when the securing of ultimate justice requires it."⁴ So, if another remedy is available to achieve a fair outcome, then the district court should not resort to dissolution and the appointment of a receiver.

After finding that Familian and Athey indeed breached their fiduciary duties by taking excess salaries and usurping a corporate opportunity belonging to Silver State, the district court ordered Familian and Athey to return the excess amount to Silver State and issued an injunction preventing them from forming a separate corporation to manage the gaming activities of the proposed new convenience stores. These remedies were sufficient to prevent any further damage to Silver State, making a buy-out unnecessary in this case.

Indemnification

“[I]ndemnification should be broadly interpreted to further the goals it was enacted to

² *Jefferes v. Cannon*, 80 Nev. 504, 506, 538 P.2d 580, 581 (1975).

³ NEV. REV. STAT. § 78A.140(1)(a) (2003).

⁴ *Hines v. Plante*, 99 Nev. 259, 261, P.2d 880, 881-82 (1983).

achieve.”⁵ Under NRS 78.7502, a corporation may indemnify a director if the director “acted in good faith and in a manner which he reasonably believed to be in or not opposed to the best interests of the corporation.”⁶ Indemnification is improper when the director is found liable to the corporation unless the district court finds that the director is fairly and reasonably entitled to indemnity under the circumstances.

Silver States articles of incorporation state that a director will be personally liable for actions involving intentional misconduct, fraud or a knowing violation of law. But if a director acted in good faith and in a manner they believe to be in or not opposed to the best interests of the company, the corporation may indemnify them.

The district court found Familian and Athey intentionally engaged in misconduct and acted in bad faith by taking excessive salaries, and so under Silver State’s articles of incorporation and NRS 78.7502(2), they are not entitled to indemnification.

Conclusion

A corporate buy-out is a harsh and extreme equitable remedy that should only be used when the directors are guilty of fraud, collusion, or gross mismanagement, when the assets of the corporation are in danger of waste sacrifice or loss, or when a threat of irreparable injury arises from the director’s actions. Even under these circumstances, a buy-out should only be ordered when a lesser remedy will not achieve ultimate justice.

Furthermore, if a district court finds a director acted in bad faith and contrary to the corporations best interests, Nevada law does not require the corporation to indemnify the director, and the director will be ordered to reimburse any expenses paid by the corporation for improperly indemnifying the director.

⁵ Stifel Fin. Corp. v. Cochran, 809 A.2d 555, 561 (Del. 2002).

⁶ NEV. REV. STAT. § 78.7502(2)(b) (2003).