Filed 10/22/12 Paula Radke Dichroics, Inc. v. Grose CA2/6

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IN THE COURT OF APPEAL OF THE STATE OF CALIFORNIA

SECOND APPELLATE DISTRICT

DIVISION SIX

PAULA RADKE DICHROICS, INC., Plaintiff and Respondent, v. DALE GROSE, Defendant and Appellant.	2d Crim. No. B237382 (Super. Ct. No. CV081123) (San Luis Obispo County)

Dale Grose appeals the judgment in favor of Paula Radke Dichroics, Inc. (PRD) on a complaint for breach of contract. Appellant contends the evidence is insufficient to support the trial court's finding that he is personally liable for PRD's damages under the alter ego doctrine. We affirm.

FACTS AND PROCEDURAL HISTORY

PRD, a corporation headquartered in Morro Bay, is a manufacturer and wholesaler of glass beads and similar products. Paula Radke is PRD's sole shareholder.

Pure Allure was a corporation formed in 1991 that designed, manufactured, and distributed jewelry and related components to distributors and retail sellers. Grose and his wife Daylene were the sole officers and directors of Pure Allure and owned 100 percent of the common stock. Prior to its dissolution in 2008, Pure Allure had approximately 200 employees and an annual gross sale volume of approximately $25

million. Approximately half of Pure Allure's annual sales were to Michael's Stores, Inc. (Michael's), which owns and operates over 1,000 retail stores nationwide. The company's capitalization included a line of credit from Discovery Bank (the bank) that was both secured by a UCC financial statement and personally guaranteed by the Groses.

For several years prior to 2008, Pure Allure purchased glass beads and other products from PRD on an ongoing basis. Although there was no written contract between the parties, they had an agreement that Pure Allure's purchases from PRD were to be made on a cash on delivery (COD) basis.

Between June 26, 2007, and August 7, 2007, Pure Allure placed three purchase orders with PRD for just under $1 million worth of products. On August 13, 2007, the parties altered the COD payment agreement to give Pure Allure five days to inspect PRD's products before payment was due.

After receiving the three purchase orders, Radke purchased materials and arranged to have the requisite number of products manufactured at locations in Morro Bay, Mexico, and China. The completed products were then shipped to Pure Allure's warehouse in Oceanside.

Pure Allure did not make payments on any of the purchase orders within five days of delivery, as contemplated by the parties' agreement.[1] In September of 2007, the New York Attorney General and the United States Consumer Product Safety Commission issued a product recall for certain non-PRD merchandise Pure Allure had sold to Michael's. The merchandise, which Pure Allure had imported from China, was deemed a public safety hazard due to excessive lead content. In response to the recall, Michael's returned all of the approximately $2 million in unsold merchandise it had purchased from Pure Allure.

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[1] According to Pure Allure's opening brief, the company "was forced to buy product on credit" at some point in 2007 after Michael's stopped making payments to Pure Allure for an unspecified period of time due to a computer problem. The record contains no evidence, however, that PRD ever agreed to any delay in payment on the products it had already shipped to Pure Allure.

In an attempt to minimize PRD's losses, Radke's son travelled to Oceanside to pick up the PRD products shipped to Pure Allure that were still in the company's possession. Approximately $216,000 worth of PRD products was recovered. Additional PRD products in Pure Allure's possession worth approximately $128,000 could not be returned because they had been packaged with other materials.

As a result of the product recall, Pure Allure lacked the financial resources to continue business. At the time operations ceased, Pure Allure owed $2.1 million on its line of credit from the bank. The bank's predecessor in interest subsequently took possession of all of Pure Allure's inventory, which was valued at approximately $5.5 million, and liquidated it for $900,000. The bank also foreclosed on Pure Allure's office building and settled with the Groses on their personal guarantee by having Grose sign a $244,000 promissory note payable over a 12-year period.

At a board meeting held on November 15, 2008, the decision was made to liquidate and dissolve the corporation. That same date, Grose signed under penalty of perjury a domestic stock corporation certificate of dissolution stating that all of the corporation's debts and liabilities had been actually paid. The document was subsequently filed with the Secretary of State. On May 5, 2009, Grose signed and filed another domestic stock corporation certificate stating under penalty of perjury that all corporate debts and liabilities had been paid.

PRD subsequently filed the instant action against Pure Allure and Grose alleging breach of contract, account stated, and other claims. PRD sought to hold Grose personally liable for Pure Allure's debts on an alter ego theory. At trial, Grose testified among other things that to his knowledge all corporate documents relating to Pure Allure had been inadvertently shredded in 2008. He further claimed that all electronic copies of the records were also lost during a crash of Pure Allure's computer system. Grose also testified that he did not receive any salary or other compensation from the company from 2003 until 2008. Instead, all of the income to which he would have been entitled was instead paid to his wife Daylene in order to increase her Social Security benefits.

At the conclusion of the trial, the court found that PRD had suffered $128,426.90 in damages and that Grose was personally liable for those damages as the alter ego of Pure Allure. A judgment was subsequently entered ordering Grose to pay PRD's damages plus $47,330.55 in prejudgment interest. This appeal followed.

DISCUSSION

Grose's sole contention on appeal is that the court erred in finding he was the alter ego of Pure Allure. This contention lacks merit.

"The alter ego doctrine arises when a plaintiff comes into court claiming that an opposing party is using the corporate form unjustly and in derogation of the plaintiff's interests. [Citation.] In certain circumstances the court will disregard the corporate entity and will hold the individual shareholders liable for the actions of the corporation: 'As the separate personality of the corporation is a statutory privilege, it must be used for legitimate business purposes and must not be perverted. When it is abused it will be disregarded and the corporation looked at as a collection or association of individuals, so that the corporation will be liable for acts of the stockholders or the stockholders liable for acts done in the name of the corporation.' [Citation.]" (*Mesler v. Bragg Management Co.* (1985) 39 Cal.3d 290, 300.)

"There is no litmus test to determine when the corporate veil will be pierced; rather the result will depend on the circumstances of each particular case." (*Mesler v. Bragg Management Co., supra*, 39 Cal.3d at p. 300.) "The essence of the alter ego doctrine is that justice be done." (*Id.* at p. 301.) "[S]ince this determination is primarily one for the trial court and is not a question of law, the conclusion of the trier of fact will not be disturbed if it is supported by substantial evidence." (*Alexander v. Abbey of the Chimes* (1980) 104 Cal.App.3d 39, 47.) In making this determination, """[w]e must resolve all evidentiary conflicts and draw all legitimate and reasonable inferences in favor of the trial court's decision. [Citations.] Where the evidence supports more than one inference, we may not substitute our deductions for the trial court's. [Citation.] We may overturn the trial court's factual findings only if the evidence before the trial court is

insufficient as a matter of law to sustain those findings. [Citation.]"' [Citations.]" (*Lake v. Reed* (1997) 16 Cal.4th 448, 457.)

"In California, two conditions must be met before the alter ego doctrine will be invoked. First, there must be such a unity of interest and ownership between the corporation and its equitable owner that the separate personalities of the corporation and the shareholder do not in reality exist. Second, there must be an inequitable result if the acts in question are treated as those of the corporation alone." (*Sonora Diamond Corp. v. Superior Court* (2000) 83 Cal.App.4th 523, 538.) The second prong may be satisfied by a showing that application of the doctrine is necessary to prevent either fraud or injustice. (*Tomaselli v. Transamerica Ins. Co.* (1994) 25 Cal.App.4th 1269, 1285, fn. 13.)

In assessing whether the alter ego doctrine applies, courts consider numerous factors, including (1) the failure to maintain corporate records; (2) the disregard of corporate formalities, (3) the diversion of assets from a corporation to a shareholder or other person to the detriment of creditors; (4) identical directors and officers; (5) the treatment by an individual of the assets of the corporation as his or her own; and (6) the unauthorized diversion of corporate funds or assets to other than corporate uses. (*Zoran Corp. v. Chen* (2010) 185 Cal.App.4th 799, 811–812; *Virtualmagic Asia, Inc. v. Fil–Cartoons, Inc.* (2002) 99 Cal.App.4th 228, 245.) "No single factor is determinative, and instead a court must examine all the circumstances to determine whether to apply the doctrine." (*Virtualmagic*, at p. 245.)

Substantial evidence supports the court's alter ego finding against Grose. The undisputed evidence demonstrates that in seeking dissolution of Pure Allure, Grose signed two domestic stock corporation certificates falsely stating that all known corporate debts and liabilities had been paid. Although Grose claimed this misrepresentation was inadvertent, the court reasonably found "it does not suffice at all to blame it on an accountant or to say that Mr. Grose signed these documents without realizing they were wrong. They were wrong and they were materially wrong." As the court noted, Grose also violated his duty to follow the proper formalities by failing to give PRD and its other

creditors written notice of the liquidation and dissolution of Pure Allure, as required under Corporations Code section 1903, subdivision (c).

In addition to his disregard for legal formalities, Grose also violated the duty to ensure that corporate records were maintained. In addressing Grose's claim that 128 boxes of corporate documents had inadvertently been shredded in 2008, the court stated: "Those documents were destroyed at least six months before Pure Allure was dissolved. [¶] So at best it was a questionable destruction. I received no explanation as to why that happened or why there wasn't a material effort to resurrect or reconstruct the corporate records.[2] [¶] Similarly, and relatedly, the computer system crashed. So the court and the plaintiff, in attempting to show that there were questionable payment practices, are left with an absence of records. [¶] In the court's view it was incumbent upon Mr. Grose, given the financial calamity that befell Pure Allure and the long list of unpaid creditors, that he rigorously, and I emphasize rigorously, follow the procedures for maintaining books and records in a corporate dissolution."

By failing to maintain corporate records, Grose precluded PRD from establishing that assets had been diverted from the corporation to either him or his wife to PRD's detriment or that he had otherwise treated the corporation's assets as if they were his own. The court found that the purportedly inadvertent destruction of 17 years worth of corporate records was "at best . . . questionable." This reasonable inference, coupled with Grose's failure to follow corporate formalities in liquidating and dissolving Pure Allure, is sufficient to support the court's finding of alter ego liability. Grose's arguments to the contrary essentially ignore the controlling standard of review.[3]

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[2] At trial, Grose merely offered that Pure Allure's "warehousemen" shredded the documents without his permission after removing them from Pure Allure's office building.

[3] In his briefs, Grose asserts that his failure to observe corporate formalities cannot be considered in deciding whether to impose alter ego liability because Pure Allure was a close corporation as defined under Corporations Code section 158. The statute he cites in support of this claim merely provides in pertinent part, however, that "[t]he failure of a close corporation to observe corporate formalities *relating to meetings* of directors or shareholders . . . shall not be considered a factor tending to establish that the shareholders have personal liability for corporate obligations." (Corp. Code, § 300, subd. (e), italics

The judgment is affirmed. Respondent is entitled to costs on appeal.

NOT TO BE PUBLISHED.

PERREN, J.

We concur:

GILBERT, P.J.

YEGAN, J.

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added.) As the preceding discussion demonstrates, the court did not purport to base its ruling on the fact that Grose failed to observe corporate formalities in conducting meetings.

Charles S. Crandall, Judge

Superior Court County of San Luis Obispo

Richard R. Leuthold for Appellant.

P. Terence Schubert for Respondent.