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CORPORATE LAW – SHAREHOLDER DERIVATIVE ACTION

Summary

An appeal from an order to dismiss a shareholder derivative claim.

Disposition/Outcome

The district court’s dismissal affirmed in part because a prior settlement barred certain claims and Appellants failed to plead sufficient facts for certain causes of action. The district court’s dismissal reversed in part because the court incorrectly conflated the concepts and standing and in pari delicto and Appellants sufficiently plead facts for other causes of action.

Factual and Procedural History

Leonard Shoen founded AMERCO, a Nevada corporation, in 1945. AMERCO is the parent company of the wholly owned subsidiary U-Haul International Inc. (“U-Haul”). Through U-Haul, AMERCO rents trucks, trailers and storage units to the public. Amerco Real Estate Corporation (“AREC”), another subsidiary of AMERCO, controls the purchase, sale, and lease of properties used by AMERCO. Leonard eventually transferred most of his AMERCO stock to his children.

In 1993, Leonard Shoen’s sons Joe, James and Mark Shoen formed two SAC entities to serve as real estate holding corporations and evenly split the common stock. About one year later, Joe and James sold their stock to Mark (allegedly for one-hundred dollars) and filed for personal bankruptcy. The two SAC entities were merged to form a new SAC entity. Many additional SAC corporations and partnerships were formed thereafter, with Mark controlling each one.

In 2002 and 2003, Leonard Shoen’s son Paul Shoen and other AMERCO shareholders (“Appellants”) filed individual derivative suits against Joe, James, Mark, multiple SAC entities, and current and former AMERCO directors (“Respondents”). The suits were consolidated. Appellants alleged Respondents breached their fiduciary obligations to AMERCO by engaging in improper and unfair transactions with SAC entities to AMERCO’s detriment. Respondents filed, and the district court granted, a motion to dismiss for failure to adequately plead demand futility. Appellants appealed to the Supreme Court of Nevada and the Court clarified the pleading requirements for shareholder derivative suits and remanded the case for further proceedings on demand futility.

The Court also permitted Appellants to file an amended complaint. In the amended complaint, Appellants alleged: (1) breach of fiduciary duty of loyalty by engaging in self dealing against all directors; (2) aiding and abetting a breach of the fiduciary duty of loyalty and unjust enrichment against the SAC entities; (3) usurpation of corporate opportunities against Mark; and against all respondents: (4) engaging in ultra vires acts; (5) wrongful interference with AMERCO’s prospective economic advantage; (6) abuse of control. Appellants sought to end and unwind a series of transfers of storage properties and two hundred million from AMERCO to SAC.

1 By Jennifer DelCarmen
In the amended complaint, Appellants also set forth three reasons why the AMERCO and SAC transactions were improper. First, AMERCO sold properties to SAC at unfairly low prices and failed to seek approval for these transactions from the board of directors of AMERCO. Second, AMERCO financed these purchases by SAC by providing over six hundred million in non-recourse loans. Some of the loans were made when AMERCO was in need of the capital for its own business. Third, AMERCO entered into management agreements pursuant to which U-Haul operated self-storage facilities on behalf of SAC entities. U-Haul was responsible for running the self-storage businesses and in return received a management fee equal to 6% of the gross revenue generated. Appellants alleged this arrangement was inequitable because Mark and the SAC entities keep the remaining 94% of revenue generated.

Appellants further alleged that from 1995-2002 AMERCO’s public filings misled shareholders by referring to the SAC entities in a confusing and distorted manner. AMERCO’s public filings also failed to disclose the amount of revenue collected from the SAC entities and the SAC transactions. Also, Appellants alleged a demand on the board would be futile because a majority of the board had a material interest in the subject of the demand. Further, Joe, James, and Mark dominated and controlled the AMERCO board; thus, the board is not independent of them.

AMERCO, through its board of directors, filed a motion to dismiss for failing to allege demand futility adequately. All other Respondents filed motions to dismiss because the claims were barred by the Goldwasser settlement, the in pari delicto doctrine, failure to state a claim on which relief could be granted, and the statute of limitations had run.

The Goldwasser settlement arose out of a 1994 shareholder derivative suit on behalf of AMERCO against AMERCO management, which included Joe, James, and Mark. AMERCO shareholders originally sued in 1988 challenging a stock transaction that gave Joe, James, and Mark control. The 1988 suit resulted in the shareholders winning billions in a jury trial. The shareholders brought the subsequent 1994 shareholder derivative suit in part to obtain an injunction to prevent Joe, James, and Mark from causing AMERCO to indemnify them from the 1988 judgment. The Goldwasser plaintiffs were also concerned about AMERCO’s transactions with SAC entities. In 1995, the parties settled the 1994 suit. The settlement included a release clause that released claims and matters related to the SAC transactions.

The district court initially denied AMERCO’s motion to dismiss for failing to allege demand futility because appellants had shown a majority of AMERCO’s board of directors were interested in the SAC transaction. However, after a hearing on the alternative bases for dismissal, the district court granted the motion to dismiss because the Goldwasser settlement barred claims arising out of the SAC transactions and AMERCO had participated in the challenged transactions.

Discussion

Standard of review

When reviewing a motion to dismiss, all factual assertions in the complaint are considered to be true and all reasonable inferences are drawn in favor of the plaintiff. A order to

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dismiss is “rigorously reviewed.” If any set of facts entitle plaintiffs’ to relief, the complaint survives dismissal. All legal determinations by the district court receive a de novo review.

The Goldwasser Settlement

The Court began its analysis by noting that contract interpretation issues receive de novo review. Settlement agreements are contracts and thus “governed by…contract law.” When a release is unambiguous, it is construed from the language contained within. While the ultimate goal is to effectuate contracting parties intent, the Court will only consider circumstances surrounding the agreement when the intent is not clearly expressed in the contractual language. Unless specifically contracted for, contractual release terms typically do not apply to future causes of action.

The Goldwasser settlement’s definition of released claims referred to any claims that were, or could have, been asserted in the litigation, including unknown claims. The settlement further states it “fully, finally, and forever settled and released claims…which now exist or heretofore have existed.”

The express language of the Goldwasser settlement referred to an intent to release only claims that existed at the time of signing the settlement. Further, the settlement agreement lacks language indicating an intent to bar future claims. The clear and explicit terms of the release bar any claims that were in existence of the time of signing the Goldwasser settlement, including claims relating to the two SAC entities that existed at the time. However, the settlement agreement does not bar any claims that arose after the date of the release. Thus, the Court affirmed the district court’s dismissal of appellant’s derivative claims relating to pre-Goldwasser SAC transactions, but reversed the district court’s order finding post-Goldwasser SAC transactions were barred by the Goldwasser settlement.

The in pari delicto Defense

The district court imputed Respondents’ actions to AMERCO and then relied on the in pari delicto defense to preclude the derivative shareholder claims because AMERCO participated in the transactions. The Supreme Court of Nevada stated the district court incorrectly conflated the concepts of standing and the in pari delicto defense. Standing and the in pari delicto equitable defense are separate issues that warrant distinct analysis. Generally, standing requires a “case or controversy” and a prudential requirement. Although state courts do not have constitutional Article III standing, Nevada has a historical requirement of a justiciable controversy in order for a party to obtain judicial relief. The collusion of corporate insiders

3 Id.
5 Id.
does not deprive the corporation of standing, but may allow for the assertion of an equitable defense (in pari delicto). Thus, the district court improperly concluded AMERCO’s participation in wrongdoing divested it of standing.

After finding the district court erred in dismissing the claims due to lack of standing, the Court then clarified Nevada’s approach to the in pari delicto doctrine. The doctrine prevents recovery when the party who suffered injury participated in the wrongdoing. The rationale behind this doctrine is that society lacks an interest in providing accounting between wrongdoers. In addition, permitting corporations to sue their co-conspirators would “diminish board’s incentive to supervise their own agents.” To assess whether in pari delicto applies in shareholder derivative suits, a court must first determine whether the acts of the director or officer are imputed to the corporation and, if so, address the elements of the in pari delicto defense.

The Court recognized that basic corporate agency law allows actions of corporate agents to be imputed to the corporation. This encourages careful selection and monitoring of those chosen to act on the corporation’s behalf. However, if agents are acting on their own behalf, their actions will not be imputed to the corporation. This exception is referred to as the ‘adverse interest’ exception. While Nevada previously recognized the exception, the Court never set forth its proper application and took this opportunity to do so now.

The Court held that, under the “adverse interest” exception, the agent’s actions must be completely and totally adverse to the corporation to invoke the exception. The exception is narrow. The rule avoids ambiguity when there is a benefit to both the wrongdoer and the corporation. A mere conflict of interest will not invoke the exception.

The Court then recognized a limited exception to the “adverse interest” exception, the “sole actor” rule. If the agent is the sole agent or shareholder of a corporation, then his acts are imputed to the corporation. The Court stated the rule also applies when there are multiple owners/managers each engage in fraud against the corporation. The agent’s knowledge is imputed in such circumstances because the “principal and agent are virtually the same person.”

In deciding the role of the innocent decision-makers, the Court considered other courts approaches. These approaches include assessing how much control the innocent decision-maker had to thwart the fraud, the amount of authority bestowed upon the agent, and the irrelevancy of innocent-decision makers. The Court concluded that since the “sole actor” rule imputes

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13 In re Senor Cottages of Am. LLC., 482 F.3d at 1003; Am. Int’l. Group, Inc. v. Greenberg 965 A.2d 763, 824 n. 234 (Del. Ch. 2009).
15 Id. at 883.
19 Kirschner v KPMG LLP., 938 N.E.2d 941, 952 (N.Y. 2010).
20 Id.
21 In re Mediators, Inc v. Manney, 105 F.3d 822, 827 (2d Cir. 1997).
22 In re 1031 Tax Group, LLC., 420 B.R. 178, 202-03 (Bankr. S.D. N.Y. 2009); Baena V. KPMG LLP., 453 F.3d 1, 8-9 (1st Cir. 2006); Breeden v. Kirkpatrick & Lockhart, LLP., 268 B.R. 704, 709-10 (S.D. N.Y. 2001).
conduct otherwise subject to the “adverse interest” exception when the agent and the corporation are indistinguishable, the proper analysis is that the presence of innocent decision-makers is only relevant to assess whether there is a sole actor.

The Court then determined the actions of Respondents could be imputed to AMERCO because they were agents of the corporation and the “adverse interest” exception (and thus, the “sole actor” rule) did not apply to this case. The Court pointed out Appellants’ did not allege that Respondents totally abandoned AMERCO’s interests. While Respondents’ actions benefitted them, they also benefitted the corporation, as evidenced by the management agreement. The allegations show less than total abandonment of AMERCO’s interests.

However, the imputation of the acts did not end the Court’s inquiry into the in pari delicto defense. The defense should not preclude a shareholder derivative suit if: (1) the public could not be protected because the transaction is complete; (2) no serious moral turpitude is involved; (3) the defendant is the one guilty of the greatest moral fault; and (4) applying the rule will result in defendant being unjustly enriched at the expense of plaintiff. The Court then remanded the issue back to the district court to assess the factors and determine whether the defense may assert it in this case.

Demand Futility

Pursuant to NRCP 23.1, persons filing a shareholder derivative suit face a heightened pleading requirement. Shareholders either must state with particulars the demands made on the board to take corrective action and why it failed to obtain such action, or give reasons why such a demand was not made. If the pleading requirement is not satisfied, the suit is dismissed for failure to state a claim upon which relief may be granted.

To determine whether a demand on the board is excused Nevada either applies the Aaronson test or the Rales test. The Aaronson test applied when the wrong was a business decision of the board. The Rales test applies when the board considering the demand is not implicated in the challenged transaction. Since there were no challenges to board decisions, the Court held the Aaronson test does not apply; rather, the Rales test does.

Under the Rales test, a court must evaluate whether particularized facts in the complaint raise reasonable doubt that the board could exercise its independent and disinterested judgment. Directors’ impartiality either can be shown by demonstrating a majority are beholden to potentially liable directors or would be materially affected in a manner not shared by the corporation and the stockholders. Mere threats of holding directors who approve the wrongdoing liable is not enough. If at least half of the board members are interested, a demand is not required.

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24 Aaronson v Lewis, 473 A.2d 805, 814 (Del. 1984); Rales v Blasband, 634 A.2d 927, 936 (Del. 1993).
26 Id. at 638-39; 1183.
27 Id. 642; 1185.
28 Id. 639; 1183.
29 Id. 639-40; 1183.
30 Beneville v York, 769 A.2d 80, 86 (Del Ch. 2000).
The Court then considered whether at least half of AMERCO’s eight member board were interested. Appellants alleged that board members Bayer, Carty, and Dodds all filed false annual AMERCO reports. Appellants further alleged that while Bayer was president of AREC, he approved the sale of 100 properties to SAC at unfair prices and used AREC resources to aid SAC in the purchase of self-storage properties without disclosing the information to AMERCO stockholders. In his capacity as director of another AMERCO subsidiary, Bayer approved over 100 million in non-recourse loans to SAC, which SAC used to purchase AREC properties, and concealed the nature and scope of AMERCO relationship with SAC entities.

Appellants further alleged that Carty and Dodds, acting as directors of U-Haul, authorized millions in non-recourse loans to SAC entities. Moreover, as directors of AREC, Carty and Dodds consented to the sale of hundreds of properties to the SAC entities. Appellants also alleged that Joe, James, and Mark so dominated and controlled the AMERCO board that the three men would never act out against them because the Shoen brothers had the power to fire them and end their pension benefits.

In addition, Appellants alleged that Carty and Dodds had close personal relationships with Joe, James and Mark Shoen. Carty was Mark and Joe’s close uncle and a father figure to the men. Close familial relationships such as these create doubt regarding impartiality. Appellants further alleged Carty always sided with Joe and James Shoen during the family feud and was even placed back on the AMERCO board by Joe after a different Shoen brother had fired him. Finally, Appellants alleged Dodds had supported Joe Shoen throughout the family feud and was rewarded by being chosen by Joe to purchase some of the AMERCO stock. Dodds did not have enough money to purchase the stock so Joe and the AMERCO board loaned him the money.

Viewing all allegations as true, the Court concluded that five members of AMERCO’s eight member board were interested. Consequently, Appellants alleged sufficient facts demonstrating a demand on the board would be futile. The Court then remanded to the district court for an evidentiary hearing to determine as a matter of law whether the demand was, in fact, futile.

**Sufficiency of the Complaint**

The Court turned its attention to whether Appellants sufficiently pleaded their causes of action. Appellants alleged the directors of AMERCO breached their fiduciary duty of loyalty by self-dealing and usurping corporate opportunities and SAC entities aided and abetted these breaches. The duty of loyalty requires directors, in good faith, to put the corporation’s and its shareholders’ interest first. To prove breach of fiduciary duties, Appellants must prove directors actions or failure to act was a breach and the breach involved intentional misconduct, fraud, or a knowing violation of the law. Since this claim includes allegations of fraud, the claim must be stated with particularity.

The Court next examined whether Appellants had set forth a claim for breach of the fiduciary duty of loyalty as to Mark Shoen. Appellants alleged that Mark was self-interested in

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32 *Shoen*, 122 Nev. at 632; 137 P.3d at 1178.
the transfer of AMERCO assets to SAC entities and placed his interest above AMERCO’s by causing AMERCO to sell properties to SAC at below market prices. Appellants further alleged that Mark usurped AMERCO’s corporate opportunities because he used knowledge he gained as an officer of AMERCO to cause SAC to purchase properties AMERCO was interested in and without obtaining disinterested director approval. Based on these facts, the Court determined Appellants had set forth a claim for breach of the fiduciary duty of loyalty for which relief could be granted against Mark Shoen.

The Court focused next on the breach of fiduciary duty claim against the remaining directors. Appellants claimed that the below market sale of Joe and James Shoen’s stock in SAC entities to Mark Shoen led to the inference they had a continuing pecuniary interest. The Court found, however, that this allegation did not meet the heightened pleading standard and therefore affirmed the dismissal of the claim in regards to Joe and James Shoen. Appellants also alleged the other AMERCO directors breached their fiduciary duty because they filed public filings that contained insufficient information. The Court found this allegation did not rise to level of intentional misconduct or fraud, and consequently affirmed the dismissal of the claim against the other directors.

The Court then took the opportunity to recognize a claim for aiding and abetting a breach of fiduciary duty. The Court adopted the Delaware standard. Under this standard, Appellants must show: (1) fiduciary relationship; (2) breach; (3) third-parties knowing participation in the breach; and (4) damages resulting from the breach. Since Mark Shoen owned and controlled the SAC entities, The court held the claim against the SAC entities for aiding and abetting a breach of fiduciary duty was improperly dismissed by the district court.

The Court next discussed the dismissal of Appellants' ultra vires claims. An act is ultra vires if it goes beyond the powers allotted by the articles of incorporation or state law. As long as the act is within corporate power, it does not matter if the act was done without authority or in an unauthorized manner. Appellants alleged that the directors acted in violation of the articles of incorporation when it conducted business without prior shareholder approval. However, AMERCO’s articles of incorporation permits such actions as long as the directors obtained shareholder approval. Thus, the acts were unauthorized, but not ultra vires.

The next allegation the Court considered was wrongful interference with prospective economic advantage against all Respondents. To show wrongful interference, five factors must be proved: (1) prospective contractual relationship between plaintiff and third party; (2) defendants knowledge; (3) preventing the relationship with intent to harm plaintiff; (4) no privilege of justification for defendant actions; and (5) actual harm resulting from defendants conduct. Since this claim is not based on fraud, it is only subject to a general pleading requirement. Appellants alleged: (1) AMERCO had prospective relationships with customers who would have rented storage facilities from U-Haul, (2) Respondents were aware and acted with intent to harm AMERCO, (3) AMERCO sold properties at below market prices to SAC

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36 Shoen, 122 Nev. at 643; 137 P.3d at 1185.
37 Id. at 643; 1186.
preventing AMERCO from realizing the profit it would have, and (4) the shareholders suffered irreparable harm. Based on these allegations, the Court held appellants stated enough to sustain this claim.

The last cause of action the Court addressed was for unjust enrichment against the SAC entities. This claim is also measured against the general pleading standard. Unjust enrichment occurs when a person retains a benefit belonging to another.\textsuperscript{40} Appellants alleged SAC entities received and kept money and property belonging to AMERCO. Thus, the Court concluded the claim was pleaded sufficiently.

\textit{Statute of Limitations}

Finally, the Court determined whether Appellant’s claims were barred by the statute of limitations. If the statute of limitations has run on a claim, dismissal is appropriate. Because a breach of fiduciary duty is analogous to a claim for fraud, a three-year statute of limitations applies.\textsuperscript{41} The statute begins to run once Appellants knew or should have known about the breach.\textsuperscript{42} Disclosure of the transaction without disclosure of the circumstances surrounding the transaction is not enough.\textsuperscript{43} Claims for wrongful interference and unjust enrichment are subject to a four-year statute of limitations.\textsuperscript{44} Whether the statute of limitations has run is a question of fact. Since the district court never addressed this claim and the pleadings are sufficient to create a question of fact on the issue, the Court remanded the issue so the district court could make a finding.

\textbf{Concurring In Part and Dissenting In Part: Justice Pickering}

Justice Pickering concurred with the majority that neither the Goldwasser settlement nor the \textit{in pari delicto} doctrine precludes this suit as a matter of law. She also agreed with the dismissal of certain claims and with the majority’s decision to remand the case to the district court. However, she would have also dismissed Appellants claims for wrongful interference. She argued that the only wrongful acts alleged against the directors was the breach of the duty of loyalty, and since that was dismissed the wrongful interference claim must also fail.

Justice Pickering also concurred in remanding the issue of demand futility back to the district court. However, she did not like the majority taking the first stab at determining whether directors were disinterested. She claimed demand futility must be assessed at the time the amended complaint was filed. The focus of the inquiry is whether directors were interested in the decision to sue.\textsuperscript{45} Since a derivative suit reallocated authority to decide to sue from the board to shareholders, Appellants must state why the demand would be futile. While Appellants are entitled to reasonable factual inferences, conclusory allegations do not fall into that category.\textsuperscript{46}

Demand will only be excused as futile if there is a reasonable doubt a majority of the board is disinterested or independent. Justice Pickering noted the only claims that survived the

\textsuperscript{40} Nevada Indus. Dev., Inc. v. Benedetti, 103 Nev. 360, 363 n.2; 741 P.2d 802, 804 n.2 (1987).
\textsuperscript{44} Nev. Rev. Stat. 11.190(2)(c) (2007).
\textsuperscript{46} Brehm v. Eisner, 746 A.2d 244, 255 (Del. 2000).
motion to dismiss were against Mark Shoen and the SAC entities. Only Joe and James Shoen are close enough family members to be deemed disinterested automatically. Consequently, Justice Pickering would have required more facts to be alleged in order to deem the other directors as interested, especially since appellant Paul Shoen served on AMERCO’s board while some of the transactions between AMERCO and the SAC entities took place.

**Conclusion**

Nevada now recognizes the *in pari delicto* defense in shareholder derivative lawsuits. To assess whether *in pari delicto* applies in shareholder derivative suits, a court first must determine if the acts of the director or officer can be imputed to the corporation. Generally, actions are imputed to officers and directors because they are acting as agents for the corporation. Nevada also recognizes an “adverse interest” exception to the imputation of acts. If the officer or director is acting solely in his own interest and on his own behalf, then the actions will not be imputed to the corporation. A limited exception to the narrow adverse interest exception is the “sole actor” rule. If the principal and agent are virtually the same person, the acts can be imputed to the corporation. Additionally, a “sole actor” can be one person or multiple people. Innocent decision makers are only relevant to assess whether a sole actor exists. If the actions can be imputed to the corporation, the court then must determine if the suit should be precluded using the *Shimrak* factors.

Nevada also now recognizes a claim for aiding and abetting a breach of fiduciary duties. The Court adopted the Delaware standard. Under the Delaware standard, to establish aiding and abetting plaintiffs must prove: (1) prospective contractual relationship between plaintiff and third party; (2) defendants knowledge; (3) preventing the relationship with intent to harm plaintiff; (4) no privilege of justification for defendant actions; and (5) actual harm resulting from defendants conduct.