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In Re: Parametric Sound Corp. Shareholders' Litigation, 140 Nev. Adv. Op. 36 (Jun. 6, 2024)

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A DISTRICT COURT CAN AWARD A NRCP 52(C) JUDGMENT WHEN THERE ARE NO DIRECT CLAIMS AND THE PLAINTIFF DOES NOT HAVE STANDING TO BRING DERIVATIVE CLAIMS; A DISTRICT COURT CANNOT AWARD PRE-LITIGATION COSTS; THE DISTRICT COURT CANNOT DENY ATTORNEY FEES WHEN THE PARTY IS ENTITLED TO THEM BY STATUTE.

Summary

The Court finds that PAMTP's claims are not direct because stock dilution is exclusively derivative and their control was not shifted from a group of investors to a single controlling stockholder and PAMTP consists only of former stockholders so they cannot bring derivative claims. Thus, the Court affirms the district court granting judgment pursuant to NRCP 52(c). Next, the Court finds it was an abuse of discretion for the district court to award pre-litigation costs because PAMTP intended to forgo benefits of the settlement. Finally, the Court reverses the Court reverses the district court's order denying respondents' request for attorney fees and remand to the district court to determine the amount that should be awarded. The Court found that the district court erroneously shifted the burden to the respondents and considered PAMTP's costs when they were not at issue.

Background

Parametric merged with VTBH in a reverse triangular merger. The merger required Parametric to issue new shares to VTBH owners as consideration for the merger, while the Parametric shareholders kept their shares which were diluted from 100% ownership to roughly 19% ownership.

After the merger, Parametric shareholders filed a class action lawsuit against Parametric, VTBH, and six members of Parametric's board of directors including the CEO, Kenneth Potashner. The Nevada Supreme Court determined that the complaint should be dismissed for failure to plead a direct claim, but granted the class members leave to replead. After the class repleaded, the parties stipulated to a settlement and the district court entered a final judgment on May 19, 2020.

On May 20, 2020, Parametric shareholders who opted out of the settlement ("PAMTP"), brought new case. PAMTP filed claims for breach of fiduciary duty against five of the six members of the Parametric board and aiding and abetting the breach of fiduciary duty against various parties including VTBH.

While in negotiations, the respondents made two offers of judgment to PAMTP, one for $1 and another for $150,000 both of which excluded a separate award for costs, attorney fees, and interest. PAMTP denied both offers.

In August 2021, prior to a bench trial, all the directors except Potashner settled with PAMTP. Thus, the claims now are only relevant to Postashner. These claims include that he knew the merger would be unfair to Parametric but mislead the shareholders and directors by creating an overly optimistic financial outlook. Also, that he purposefully stalled business growth to keep the merger costs down for VTBH. The district court granted judgment for the respondents pursuant to NRCP 52(c) and denied respondents' subsequent motion for attorney

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[1] By Hannah Bleak.

fees but granted respondents $1,169,983.86 in costs. Nearly 70% of these costs were incurred litigating *Parametric I*, before PAMTP filed its complaint.

PAMTP now appeals the judgment and costs order. Respondents appeal the order denying the attorney fees.

Discussion

The district court did not err in granting respondents judgment pursuant to NRCP 52(c)

"NRCP 52(c) allows the district court in a bench trial to enter judgment on partial findings against a party when the party has been fully heard on an issue and judgment cannot be maintained without a favorable finding on that issue."[2] The court will only reverse a question of fact where it is clearly erroneous. Here, it was not. The district court granted respondents an NRCP 52(c) judgment because PAMTP failed to show their claims were direct, not derivative; PAMTP failed to rebut the business judgment ruled presumption and failed to show actual fraud, which is required by NRS 78.211(1); and because PAMTP failed to show a breach of fiduciary duty against Potashner, it had no claim for aiding and abetting against the nondirector parties.

PAMTP did not plead a direct claim

In ruling for the respondents, the district court relied on *Gentile*, which was overruled by the Delaware Supreme Court days after the bench trial; however, its conclusions were correct.

A derivative claim is one brought on behalf of the corporation to recover for harm done to the corporation.[3] Shareholders also have standing to bring a suit for direct injuries they have suffered.[4] To determine whether an action is derivative or direct, the court asks (1) who suffered the alleged harm; and (2) who would receive the benefit of the recovery or other remedy. *Parametric I* determined that the class action should not proceed because they were derivative claims. Thus, PAMTP couched the claims that were nearly identical to those brought in *Parametric I*.

Here, PAMTP alleged that the merger was accomplished by breaches of fiduciary duty and diluted the Parametric shareholders' equity interest. The district court disagreed stating that PAMTP failed to prove that Parametric had a controlling shareholder; thus, it did not meet an essential element of equity expropriation under Nevada law.

The Court notes that this conclusion was erroneous because *Parametric I* clearly allowed a *Gentile* claim via a director's expropriation of value and Potashner's status may have given rise to the claim. However, the Court finds this was harmless error.

The Delaware Supreme Court overruled *Gentile* via *Brookfield* which concludes that "when a corporation exchanges equity for assets of a stockholder who is already a controlling stockholder for allegedly inadequate consideration, the dilution/overpayment claims is *exclusively derivative*."[5] Thus, overruling *Gentile* foreclosed a direct claim under the theory of equity expropriation as argued by PAMTP's complaint.

Further, PAMTP's claims do not fit into the "shift of control" exception identified in *Brookfield* for two reasons. First, PAMTP alleged that they were harmed by dilution, not sale of their shares. Second, *Brookfield* implied that its exception applies where there is a change in control a diverse group of investors to a single controlling stockholder.

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[2] Certified Fire Prot., Inc. v. Precision Constr., Inc., 128 Nev. 371, 377, 283 P.3d 250, 254 (2012).

[3] Parametric I, 133 Nev. 417, 423, 401 P. 3d 1100, 1105 (2017).

[4] *Id.*

[5] Brookfield Asset Mgmt., Inc. v. Rosson, 261 A. 3d 1251, 1266 (Del 2021).

Finally, because PAMTP only consists of former shareholders, it has no standing to bring a derivative claim.

The district court abused its discretion in awarding respondents pre-complaint costs

After the bench trial, the district court awarded respondents $1,169,983.86 in costs which included about $857,000 in costs incurred while litigating *Parametric I*. PAMTP challenges the entire costs award and alternatively asserts that pre-complaint costs must be stricken.

The Court finds that because the district court did not err in entering an NRCP 52(c) judgment, the respondents were also entitled to costs pursuant to NRS. 18.020. Thus, the district court did not abuse its discretion in awarding respondents costs. However, the district court did abuse its discretion by awarding pre-complaint costs.

The district court relied on a paragraph from the PAMTP's complaint to mean that by virtue of PAMTP's assignments of certain shareholders' rights, titles, and interests arising from the merger, that PAMTP received and accepted all risks and benefits of the class litigation starting when the individuals became involved in the lawsuit. Under this logic, the district court felt it was appropriate to award costs since the start of *Parametric I.* The Court however, finds that the point of PAMTP opting out of the class action was to *forgo* the risks and benefits of the action.

Further, the district court concluded that because PAMTP would have sought entitlement to pre-judgment interest accruing from the date of the merger if they had won, it was consistent to allow the respondents recover from the same time. The Court again disagrees with this logic and explains that PAMTP would have sought damages from the period which are a distinct category from costs. Thus, the Court reverses the portion of costs from *Parametric I* amounting to about $857,000.

The district court abused its discretion in denying respondents' motion for attorney fees

After the trial, the respondents moved for attorney fees under NRCP 68, which allows an award of attorney fees and costs to a party if the opposing party rejected an offer of judgment and fails to obtain a more favorable judgment.[6] The district court denied this motion after looking at both offers brought by the respondents.

First, the district court looked at the $1 offer given on May 20, 2020. The district court concluded that the offer did not entitle the respondents to fees under NRCP 68 because it was not reasonable nor made in good faith. The Court finds no errors in this conclusion.

Second, the district court looked at the $150,000 offer give on May 28, 2021. The district court determined that the burden is on the respondents to demonstrate the $150,000 exceeded the amount PAMTP incurred in attorney's fees, costs, and expenses between May 20, 2020 and May 28, 2021. The district court also concluded that because the respondents had incurred over $3 million in attorney fees during that period, PAMTP's legal fees also likely exceeded $150,000. Thus, the district court found that the respondents did not meet their burden. The Court finds it was an abuse of discretion because it is not the respondents' burden to offer proof of PAMTP's attorney fees. Also, the Court found it improper that the district court considered PAMTP's attorney fees because there is no indication that they were entitled to fees. Further, the Court found it was improper for the district court to have guessed the amount of PAMTP's fees without any evidence before it. Finally, without any evidence regarding PAMTP's pre-offer taxable

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[6] Nev. R. Civ. P. 68.

costs, expenses, or interest, it is obvious that PAMTP did not attain a more favorable judgment than respondents' offer of $150,000. Thus, the Court reversed the district court order denying attorney fees and remand for the district court to determine an amount that may be properly awarded.

Conclusion

The Court affirms in part and reverses in part the consolidated appeals. First, it affirms the district court's pretrial findings to respondents because PAMTP failed to plead direct claims. The Court finds that while the district court did not use the correct reasoning, it did come to the correct conclusion and that *Gentile's* overturn did not change the outcome for PAMTP. Second, the Court reverses the district court's award of pre-litigation costs because by removing themselves from the class action PAMTP intended to forgo the benefits of the settlement and PAMTP would have been requesting damages not costs had they won. Finally, the Court reverses the district court's order denying respondents' request for attorney fees and remand to the district court to determine the amount that should be awarded. The Court found that the district court erroneously shifted the burden to the respondents and considered PAMTP's costs when they were not at issue.