COURT OF APPEALS
DECISION
DATED AND FILED

December 29, 2005

Cornelia G. Clark
Clerk of Court of Appeals

Appeal No. 2005AP208 **Cir. Ct. No. 2003CV844**

STATE OF WISCONSIN **IN COURT OF APPEALS**
DISTRICT IV

CB DISTRIBUTORS, INC.,

PLAINTIFF-RESPONDENT,

V.

LAUREL MOUNTAIN SALES, INC. AND KETOGENICS, INC.,

DEFENDANTS,

JAMES R. SIMS AND DYNACOM INDUSTRIES, INC.,

DEFENDANTS-APPELLANTS.

APPEAL from a judgment of the circuit court for Rock County: JAMES E. WELKER, Judge. *Reversed.*

Before Dykman, Vergeront and Deininger, JJ.

¶1 PER CURIAM. James Sims and Dynacom Industries, Inc., appeal from a judgment requiring them, jointly and severally with Laurel Mountain Sales, Inc., and Ketogenics, Inc., to pay CB Distributors, Inc., $131,006.83. For the reasons discussed below, we reverse the judgment with respect to both Sims and Dynacom Industries.

BACKGROUND

¶2 CB Distributors entered into an agreement with Laurel Mountain whereby CB Distributors would market and distribute certain pharmaceutical products manufactured by Laurel Mountain Sales. CB Distributors bought a batch of Ephedrine decongestant gel caps approaching their expiration date from Laurel Mountain with a written guarantee that they could be returned for credit if they did not sell in a timely manner. CB Distributors ultimately did return some of the Ephedrine, but Laurel Mountain refused to apply the credit to other products CB Distributors had ordered because Laurel Mountain had already sold CB Distributors' receivables account to a factoring company.

¶3 CB Distributors sued and obtained a judgment against Laurel Mountain which has not been appealed. However, the lawsuit also named James Sims, Dynacom, and Ketogenics as co-defendants. Sims was a shareholder and member of Laurel Mountain's board of directors and Sims was also an officer and shareholder of Ketogenics. Dynacom was a defense contractor which leased office space and sold administrative services, such as e-mail and fax capability and use of office employees, to both Laurel Mountain and Ketogenics. Sims' son also owned about a 2% shareholder interest in Dynacom. Although Dynacom, Laurel Mountain, and Ketogenics kept separate payrolls and accounting, all three companies listed the same address and same agent on their incorporation papers in

Delaware, and several employees, including Sims, worked at times for all three companies. Furthermore, employees of Dynacom and Ketogenics sent internal e-mails discussing Laurel Mountain's pharmaceutical inventories.

¶4 Carlos Bengoa, the C.E.O. of CB Distributors, testified that one of the reasons he agreed to distribute the gel caps was that he had been assured by Sims that Dynacom had political connections that would ensure that Laurel Mountain could provide a continuous supply of Ephedrine, notwithstanding increased DEA enforcement efforts in the wake of the drug's abuse in the manufacture of methamphetamine. Bengoa said he believed all three of the companies "were one and the same" because he had meetings with several employees of the companies including Sims, and "they always recommend themselves to doing business as Ketogenics, Dynacom, and Laurel Mountain."

¶5 After Bengoa informed Sims that CB Distributors had not been able to sell the product and asked for a refund, Sims sent Bengoa a letter on Laurel Mountain letterhead reiterating their prior agreement that Laurel Mountain would take the product back for credit, and Sims told Bengoa that he had Sims' "word and personal guarantee that [he] would be taking care of it."

¶6 The circuit court found that both Laurel Mountain and Ketogenics were "creatures" of Dynacom and that all three companies "were acting as one entity" through their employees and agents, and had represented to CB Distributors that it was dealing with all three companies. Based on those findings, the court concluded that the contract between CB Distributors and Laurel Mountain bound Ketogenics and Dynacom as well. The court further found that Sims had "personally guaranteed payment of the amount owed to [CB Distributors]," which had induced CB Distributors to return the gel caps, and that

Sims had made unspecified "false, misleading and fraudulent statements" to obtain an unspecified financial benefit from CB Distributors.

DISCUSSION

Dynacom's Liability

¶7 CB Distributors argues that Dynacom should be liable for Laurel Mountain's breach of contract because Dynacom "held [its]self out though [its] agents and employees as party to the contract and the plaintiff believed them." Although not well developed, it appears that CB Distributors' argument is based either upon the alter ego doctrine or the capacity in which Sims was acting when entering into the parties' agreement.

¶8 When, as here, an action is tried to the court, we accept the circuit court's credibility determinations and we do not set aside any finding of fact unless it is clearly erroneous. WIS. STAT. § 805.17(2).[1] However, whether the circuit court applied a correct legal theory is a question of law, which we review de novo. ***Capsavage v. Esser***, 224 Wis. 2d 404, 413, 591 N.W.2d 888 (Ct. App. 1999).

¶9 We discuss first the alter ego doctrine. As a general matter, when a corporation enters into a contract, it incurs liability as a separate legal entity. ***Benjamin Plumbing, Inc. v. Barnes***, 162 Wis. 2d 837, 850, 470 N.W.2d 888 (1991). The corporate identity may be disregarded for liability purposes under

[1] All references to the Wisconsin Statutes are to the 2003-04 version unless otherwise noted.

certain circumstances, however. Under the alter ego doctrine, often referred to as piercing the corporate veil,

> a shareholder's act will be treated as a corporate act and the existence of the corporation as an entity apart from the natural persons comprising it will be disregarded, if corporate affairs are organized, controlled and conducted so that the corporation has no separate existence of its own and is the mere instrumentality of the shareholder and the corporate form is used to evade an obligation, to gain an unjust advantage or to commit an injustice.

Olen v. Phelps, 200 Wis. 2d 155, 162, 546 N.W.2d 176 (Ct. App. 1996); *see also* ***Wiebke v. Richardson & Sons, Inc.***, 83 Wis. 2d 359, 265 N.W.2d 571 (1978) (treating a sole shareholder's act as a corporate act when the sole shareholder commingled personal and corporate funds). Factors to consider in deciding whether to apply the alter ego doctrine include "failure to observe corporate formalities, non-payment of dividends, siphoning of funds of the corporation by the dominant stockholder, non-functioning of other officers or directors, and the absence of corporate records." ***Olen***, 200 Wis. 2d at 163 (citation omitted).

¶10 Here, CB Distributors attempts to invoke the alter ego doctrine to impose liability for Laurel Mountain's breach of contract not upon Laurel Mountain's own officers or shareholders, but upon Dynacom—essentially disregarding the corporate forms of both companies. Assuming for the sake of argument that the alter ego doctrine may properly be used to impose one corporation's liability upon another corporation, we conclude there was no evidence in the record to support the circuit court's application of this remedy.

¶11 The decision whether to apply the alter ego doctrine, which is an equitable doctrine, involves the exercise of the circuit court's discretion. ***Consumer's Co-op of Walworth County v. Olsen***, 142 Wis. 2d 465, 472-73, 419

N.W.2d 211 (1988). However, the circuit court may exercise its discretion to apply an equitable remedy only after a party has met its burden of establishing the required elements of the remedy. *See* ***Richards v. Land Star Group, Inc.***, 224 Wis. 2d 829, 846-48, 593 N.W.2d 103 (Ct. App. 1999). In order for the alter ego doctrine to be applicable, a party must prove all three of the following elements:

> (1) complete domination … of finances … policy and business practice in respect to the transaction attacked so that the corporate entity as to this transaction had at the time no separate mind, will or existence of its own; and
>
> (2) [s]uch control must have been used by the defendant to commit fraud or wrong …; and
>
> (3) [t]he aforesaid control and breach of duty must proximately cause the injury … complained of.

Consumer's Co-op, 142 Wis. 2d at 484 (footnote and citation omitted). Our review of the record here reveals no evidence that proves these elements. Here the record contains no evidence that CB Distributors proved all three of these elements.

¶12 The undisputed evidence is that Dynacom was a defense contractor that performed small precision machine work and some telecommunication functions, while Laurel Mountain was a pharmaceutical manufacturer licensed by the DEA. Although the evidence shows that Laurel Mountain and Dynacom had a close working relationship, each corporation had a different CEO and there was no evidence that the corporations were controlled by the same majority shareholders. There was no evidence from which it could be inferred that the companies did not maintain their own corporate records and there was undisputed testimony that they kept separate payrolls. There was no evidence that dividends were being improperly diverted from one corporation to the other, that corporate funds were being improperly siphoned off to majority shareholders, or that any of the officers

or directors of either company were non-functioning. In fact, there was no evidence at all as to what the assets or annual income of either company was or to whom dividends were paid.

¶13 The circuit court's finding that the corporations "were acting as one entity" was apparently based on their use of the same office building, e-mail addresses, fax equipment, and personnel. There was uncontradicted testimony, however, that Laurel Mountain was paying Dynacom to sublet space in its building and make use of its administrative services and personnel. There is no reasonable inference from this office-sharing arrangement that Laurel Mountain's corporate existence was a "sham." We conclude there was no evidence to show that Laurel Mountain was operating solely as an alter ego of Dynacom, and therefore the alter ego doctrine is inapplicable to these facts.

¶14 CB Distributors' argument might also be construed as a contention that Sims was acting on behalf of Dynacom as well as Laurel Mountain when he negotiated the Ephedrine agreement with Bengoa. However, there was no evidence that Sims signed the contract in the name of Dynacom or that he would have had any actual authority to act on Dynacom's behalf in doing so. Sims was not a shareholder or officer of Dynacom, and Jeffrey Carr, an officer of Dynacom and the president of Laurel Mountain at the time of the relevant transactions, testified that Sims was acting as Laurel Mountain's agent. One of Laurel Mountain's independent contractors testified that Sims sometimes "did act in roles of that for each different company," but she did not specify when Sims might have worked for Dynacom or what the nature or scope of his employment with that company was. Therefore, a finding that Dynacom was bound by Sims' actions would have to be based upon a theory of apparent authority.

¶15 "[A]pparent authority binds a principal to acts of another who reasonably appears to a third person to be authorized to act as the principal's agent, because of acts of the principal or agent if the principal had knowledge of those acts and acquiesced to them." ***Mared Indus., Inc. v. Mansfield***, 2005 WI 5, ¶22, 277 Wis. 2d 350, 690 N.W.2d 835. Bengoa's testimony that Sims led him to believe that he represented Dynacom as well as Laurel Mountain could arguably satisfy the first part of the test for apparent authority.[2] What is lacking, however, is any indication that the actual principals or agents of Dynacom were aware of any representations made by Sims to Bengoa and acquiesced to them. There was no testimony as to who the officers of Dynacom were at the time the Ephedrine agreement was reached, aside from Carr, who testified that Sims was acting on Laurel Mountain's behalf and that Dynacom had no involvement in the transaction through any of its agents or employees. Bengoa testified that he had never met Carr. We therefore conclude there is no support in the record for a determination that Dynacom was bound by the contract between Laurel Mountain and CB Distributors based on any actions taken by Sims under apparent authority to act on Dynacom's behalf.

[2] The circuit court found that the companies represented to CB Distributors that it was dealing with Dynacom as well as Laurel Mountain, as "illustrated by the various emails that went back and forth and the employees that were involved." We note, however, that none of the e-mails mentioned by the circuit court as giving contact information for both Laurel Mountain and Dynacom were sent to CB Distributors; they were solely internal documents. The only written communication to CB Distributors introduced into evidence was on Laurel Mountain letterhead.

Sims' Personal Liability

¶16 CB Distributors contends that "Sims made a personal guarantee which rose to the level of a contract," when he told Bengoa that CB Distributors would be paid for any returned product. As Sims points out, however, any guarantee or promise to answer for the debt of another is void if it is not in writing. WIS. STAT. § 241.02(1)(b). Therefore, any oral guarantee which Sims may have made to Bengoa is unenforceable.

¶17 The circuit court also held Sims personally liable to CB Distributors on a theory of misrepresentation. Although it did not specify what this misrepresentation was, we gather the circuit court was again referring to Sims' promise to Bengoa that CB Distributors would be paid what it was owed if it returned the product. The problem with this theory, however, is that there was no evidence that Sims did not intend to keep his promise at the time he made it. Therefore, the promise, even if unperformed, could not constitute a misrepresentation of fact. In sum, we see nothing in the record that would support a liability determination against Sims in his personal capacity.

¶18 In light of our conclusion that there was insufficient evidence to impose liability on either Dynacom or Sims, we do not address the parties' arguments about the adequacy of the pleadings or whether it was appropriate to conform the pleadings to the evidence presented.

By the Court.—Judgment reversed.

This opinion will not be published. *See* WIS. STAT. RULE 809.23(1)(b)5.