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IN THE COURT OF APPEALS OF NORTH CAROLINA

No. COA18-171

Filed: 6 November 2018

Alamance County, No. 15 CVS 0124

STONEWALL CONSTRUCTION SERVICES, LLC, Plaintiff,

v.

FROSTY PARROTT BURLINGTON, AND FROSTY PARROTT CARY, LLC, SHANE SMITH AND TOM DEWITT, Defendants.

Appeal by plaintiff from order entered 2 February 2016 by Judge John O. Craig, III in Alamance County Superior Court. Heard in the Court of Appeals 20 August 2018.

Oertel, Koonts & Oertel, PLLC, by F. Paul Koonts, for plaintiff-appellant.

Gordon & Rees, by Robin K. Vinson, Esq., for defendant-appellee.

DIETZ, Judge.

Stonewall Construction Company performed work for two limited liability companies that planned to open frozen yogurt shops at retail locations in Burlington and Cary. After those LLCs failed to pay, Stonewall sued them and also sued the member-managers of the LLCs on a claim to pierce the corporate veil. The trial court

granted summary judgment on the claim to pierce the corporate veil. Stonewall challenges that ruling on appeal.

As explained below, we affirm the trial court's judgment. Applying the applicable "instrumentality" test, Stonewall did not present sufficient evidence that the member-managers of these LLCs exercised the degree of improper control and dominion necessary to sustain a claim to pierce the corporate veil. *Glenn v. Wagner*, 313 N.C. 450, 454, 329 S.E.2d 326, 330 (1985). Similarly, Stonewall failed to show that its *quantum meruit* claim against the LLCs involved the necessary "element of injustice or abuse of corporate privilege" necessary to sustain a claim to pierce the corporate veil. *Id.* at 458, 329 S.E.2d at 332. Accordingly, the trial court properly rejected this claim as a matter of law.

Facts and Procedural History

In 2013, Shane Smith and Tom DeWitt began laying the groundwork to open frozen yogurt shops at retail locations in North Carolina. The two hired a law firm to organize Frosty Parrott Burlington, LLC and Frosty Parrott Cary, LLC. Both Frosty Parrott companies were organized under the laws of Virginia.

In February 2013, Frosty Parrott Burlington, LLC leased space at New Market Square, a retail outlet in Burlington. In April 2013, Smith asked Stonewall Construction to submit a quote for renovations to this new Frosty Parrott location. Stonewall prepared a written estimate of $56,182.00 addressed to "Frosty Parrot."

During negotiations, Stonewall stated that construction would be completed between April and May of 2013—before the summer season, which is the peak sales period for frozen yogurt businesses.

After receiving the quote, Smith instructed Stonewall to begin work on the renovations. There was no written contract governing this work.

On 4 June 2013, Stonewall sent a revised estimate, again addressed to "Frosty Parrot 'Burlington,'" which encompassed additional work requested by Smith and DeWitt in the amount of $76,912.00. Later that day, Stonewall presented an invoice to "Frosty Parrot Attn: Shane Smith" in the amount of $24,665.60. When Stonewall asked about payment, Smith explained that payment would not be an issue and that Stonewall would be paid in full when the project was completed.

Before construction of the Burlington location was completed, Smith asked Stonewall to take on a demolition and renovation project in Cary for a new Frosty Parrott located there. The record does not contain an initial estimate for this work, but Stonewall later submitted an invoice for $30,000.00 of demolition services at the Cary location.

In July 2013, Stonewall completed its improvements to the Frosty Parrott in Burlington and, in August 2013, sent an invoice for $144,856.73 for the work performed. This invoice was again sent to "Frosty Parrot Atten: Mr. Shane Smith." Smith later informed Stonewall that it would not pay the invoice because the work

was completed long past the original timeframe for completion and was more than double the original estimate. Smith also told Stonewall to stop work at the Frosty Parrott in Cary.

In 2014, the Frosty Parrott in Burlington closed. In January 2015, Stonewall sued Frosty Parrott Burlington, LLC, Frosty Parrott Cary, LLC, Smith, and DeWitt. The complaint asserted five claims: a contract and a quantum meruit claim against each of the two limited liability companies, and a fifth claim seeking to pierce the corporate veil and hold Smith and DeWitt personally liable.

The trial court granted summary judgment in favor of Smith and DeWitt on the claim concerning piercing the corporate veil. Stonewall Construction immediately appealed that ruling but the appeal was dismissed by this Court for lack of appellate jurisdiction. *Stonewall Constr. Servs., LLC v. Frosty Parrott Burlington*, __ N.C. App. __, 797 S.E.2d 533 (2017). The remaining four claims went to trial. The jury returned a verdict in favor of Stonewall on the two *quantum meruit* claims and awarded Stonewall $60,000, which was substantially less than the amount Stonewall sought for the work it performed. The jury found the Frosty Parrott companies not liable on the breach of contract claims. Stonewall timely appealed the judgment. On appeal, Stonewall challenges only the trial court's grant of summary judgment on its fifth claim, which sought to pierce the corporate veil and hold Smith and DeWitt personally liable for the *quantum meruit* award.

Analysis

Stonewall Construction argues that the trial court erred by granting summary judgment in favor of Smith and DeWitt on the claim to pierce the corporate veil.

This Court reviews the grant of summary judgment *de novo*. *Summey v. Barker*, 357 N.C. 492, 496, 586 S.E.2d 247, 249 (2003). Summary judgment is appropriate "only when the record shows that there is no genuine issue as to any material fact and that any party is entitled to a judgment as a matter of law." *In re Will of Jones*, 362 N.C. 569, 573, 669 S.E.2d 572, 576 (2008).

Under North Carolina law, member-managers of a limited liability company are "shielded from liability when acting as LLC managers." *Hamby v. Profile Prod., L.L.C.*, 361 N.C. 630, 638, 652 S.E.2d 231, 236 (2007). But the shield afforded by the corporate form is not absolute. "[C]ourts will disregard the corporate form or 'pierce the corporate veil,' and extend liability for corporate obligations beyond the confines of a corporation's separate entity, whenever necessary to prevent fraud or to achieve equity." *Glenn v. Wagner*, 313 N.C. 450, 454, 329 S.E.2d 326, 330 (1985). The legal test to pierce the corporate veil in North Carolina is known as the "instrumentality rule." *Id.* Under this test, a party seeking to pierce the corporate veil must prove three elements:

> (1) Control, not mere majority or complete stock control, but complete domination, not only of finances, but of 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) Such control must have been used by the defendant to commit fraud or wrong, to perpetrate the violation of a statutory or other positive legal duty, or a dishonest and unjust act in contravention of plaintiff's legal rights; and
>
> (3) The aforesaid control and breach of duty must proximately cause the injury or unjust loss complained of.

Id. at 455, 329 S.E.2d at 330.

Stonewall Construction states the crux of its instrumentality argument succinctly in its brief. It contends that the LLCs suffered from "gross undercapitalization . . . and lack of debt financing" and that "Smith and DeWitt planned to fund the payment of LLC obligations from what they hoped to be a profitable ongoing business operation. When their business enterprise was not as successful as they had hoped, they refused to pay Stonewall and only then raised the existence of the LLCs as a shield to liability."

The trial court properly concluded that there were no genuine issues of material fact concerning this instrumentality argument and that it could be resolved in favor of Smith and DeWitt as a matter of law. First, the record does not support Stonewall's claim that the LLCs were improperly undercapitalized when they engaged Stonewall to perform the work. To be sure, the LLCs had little cash on hand when they engaged Stonewall. But this is not unusual for a new small business like a frozen yogurt shop in a suburban strip mall. The undisputed evidence in the record

indicates that these LLCs properly were formed under Virginia law and that DeWitt provided an initial capital contribution to fund their start-up that exceeded $100,000. That these newly-formed frozen yogurt businesses depended on future revenue from their successful launch to ultimately pay their start-up expenses is neither unusual nor a basis to disregard the corporate form.

Moreover, there is no evidence that Smith or DeWitt ever misrepresented the financial state of these LLCs—instead, the record indicates that Stonewall never asked, despite the opportunity to do so. This is a critical distinction between this case and those on which Stonewall relies, such as *East Market Street Square, Inc. v. Tycorp Pizza IV, Inc.*, 175 N.C. App. 628, 639, 625 S.E.2d 191, 200 (2006). In *East Market*, for example, it was not merely that the corporation—a small business organized to lease the premises for a pizza shop—lacked sufficient assets to pay, but that the owner of that corporation affirmatively "misrepresented the financial state of his corporations" in discussions with the plaintiff. *Id.* Here, by contrast, Smith and DeWitt did not misrepresent anything to Stonewall. The record indicates that Stonewall never asked for information about these businesses—information that might have led Stonewall to request upfront payment, a personal guaranty from Smith or DeWitt, or some other form of collateral before agreeing to perform the work.

Stonewall also points to several other factors that courts have considered in evaluating the first prong of the instrumentality test. Again, the record does not

support Stonewall's claims. For example, Stonewall contends that the LLCs did not adhere to various corporate formalities, such as executing an operating agreement, filing proper tax returns, and registering to do business in North Carolina. But the record indicates that these LLCs executed all documents necessary for formation under Virginia law. The LLCs also engaged a certified public accountant to handle their taxes and that accountant explained in an affidavit how the LLCs complied with their tax-filing obligations. This leaves only the failure to register to do business in North Carolina which, while potentially improper, is not enough standing alone to justify piercing the corporate veil. *See Hildreth v. Tidewater Equip. Co.*, 378 Md. 724, 733–34, 838 A.2d 1204, 1209 (2003).

Stonewall likewise points to Smith's and DeWitt's purported "complete dominion and control" of the LLCs' activities. According to Stonewall, this allowed the two men to "manipulate the relationship with Stonewall to Smith and DeWitt's personal benefit" by misleading Stonewall about the nature of the entity with which it was doing business. But the record demonstrates that Stonewall *knew* it was dealing with a business entity of some kind—the invoices for Stonewall's work state that it performed the work for "Frosty Parrot," not for Smith or DeWitt. Likewise, as noted above, Stonewall did not present any evidence that Smith or DeWitt misrepresented any information about the existence or organization of the LLCs. Instead, the record demonstrates that Stonewall performed work for a business

known as "Frosty Parrot" without a written contract and without requesting information about the business for which it was performing the work. Without evidence that Smith and DeWitt affirmatively misled Stonewall about the existence of the LLCs, the mere fact that these member-managers acted as the face of the LLCs in which they were members is not grounds to pierce the corporate veil. *Cf. Bridger v. Mangum*, 35 N.C. App. 569, 570, 241 S.E.2d 726, 727 (1978) (rejecting a corporate shield argument where the contract named the corporate owner as the contracting party and the owner "did not inform the Plaintiff that the corporation or anyone else would be responsible for the work involved in the contract").

In any event, even assuming Stonewall had forecast sufficient evidence to satisfy the control prong of the instrumentality test, it failed to show that Smith and DeWitt used that improper control to "commit fraud or wrong, to perpetrate the violation of a statutory or other positive legal duty, or a dishonest and unjust act in contravention of plaintiff's legal rights." *Glenn*, 313 N.C. at 455, 329 S.E.2d at 330.

This Court has held that an enforceable contract creates a "positive legal duty" and therefore a breach of contract can satisfy this prong of the instrumentality test even without a separate showing of fraud or dishonesty. *E. Mkt. St. Square, Inc.*, 175 N.C. App. at 638, 625 S.E.2d at 199. But this is not a breach of contract case. The jury rejected Stonewall's breach of contract claim, likely because there was no written contract. Instead, the jury awarded damages on Stonewall's *quantum meruit* claim.

Those damages were far less than the amount Stonewall invoiced for the work performed. Moreover, the evidence showed that the work Stonewall performed took substantially longer, and cost substantially more, than it estimated when it agreed to handle the project. Thus, as the jury's verdict confirmed, the LLCs were justified in not paying the full amount Stonewall demanded. In this context, we agree with the trial court that Stonewall's *quantum meruit* claim does not involve the sort of "element of injustice or abuse of corporate privilege" that is necessary to sustain a claim to pierce the corporate veil. *Glenn*, 313 N.C. at 458, 329 S.E.2d at 332. We therefore affirm the trial court's judgment in this case.

AFFIRMED.

Chief Judge McGEE and Judge CALABRIA concur.

Report per Rule 30(e).