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IN THE IOWA DISTRICT COURT
IN AND FOR POLK COUNTY

TIMOTHY HANES, Plaintiff, v. NATIONAL COMFORT INSTITUTE, INC., DOMINICK S. GUARINO, and GREGORY R. FALKE, Defendants.	CASE NO.: EQCE076363 ORDER: FINDINGS OF FACT, CONCLUSIONS OF LAW AND ORDER OF JUDGMENT
NATIONAL COMFORT INSTITUTE, INC., DOMINICK S. GUARINO, and GREGORY R. FALKE, Counterclaim Plaintiffs, v. TIMOTHY HANES, Counterclaim Defendant.	

This matter came before the Court for trial and was submitted on June 28, 2017. Plaintiff / Counterclaim Defendant personally appeared and was represented by attorneys Gregory Witke and Jennifer Jaschen. Attorneys John E. Schiller, Jamie A. Price, and Michael A. Dee represented Defendants / Counterclaiming Plaintiffs, who also personally appeared. After hearing the testimony from the witnesses, studying the admitted exhibits, and reviewing the trial transcript, the Court enters the following Findings of Fact, Conclusions of Law and Order of Judgment.

I. INTRODUCTION

A. THE PARTIES & KEY ACTORS

1. DOMINIC GUARINO

Dominic Guarino (Guarino) has worked in the HVAC industry for over 30 years and has served on boards of national and international trade organizations and published in the trade industry. Guarino is a twenty-five percent (25%) shareholder of Energy Stewards International, Inc. (ESI) and a co-owner and Chief Executive Officer (CEO) of National Comfort Institute (NCI), which Guarino and Gregory Faulke formed in 1994. NCI is an Ohio corporation, which provides contractors in the HVAC industry with training,

methodology, and tools to evaluate and correct deficiencies in and ensure the efficiency of HVAC systems. In 2005, NCI developed a web-based software program for contractors to use in the field named ComfortMaxx® to test and measure the energy efficiency of HVAC systems.

2. GREGORY FALKE

Gregory Falke ("Falke") is a twenty-five percent (25%) shareholder of ESI and a co-owner and President of NCI. Falke has worked in the HVAC industry for over 30 years and served on committees and boards of numerous national and international industry organizations. He is currently leading a committee of the American Society of Heating, Refrigerating and Air-Conditioning Engineers to develop new practical industry standards to measure the energy efficiency of HVAC systems.

3. MICHAEL KEPPLER

Michael Keppler (Keppler) is NCI's Chief Financial Officer and head of Human Resource Benefits.[1] Keppler is a licensed Certified Public Accountant (CPA) and has worked in the accounting industry for over thirty years. Keppler, on behalf of NCI, maintained ESI's financial records in tax years 2012 and 2013.

4. ROBERT BRICE

Robert Brice (Brice) was twenty-five percent (25%) shareholder of ESI. When ESI was formed, Brice was given the title of President of ESI. From 2008 through 2011, Brice maintained ESI's financial records. Because, however ESI was formed without by-laws, shareholder agreements, or a buy/sell agreements, Brice had no other clearly defined duties or responsibilities. Brice also co-owned a business with Hanes named Cynergy from approximately 2004 through 2012. For all intents and purposes, Cynergy was a home energy consulting firm. By 2012, Cynergy was "in the process of collapse"[2] and in August 2013 Cynergy was administratively dissolved by the Iowa Secretary of State.[3] Brice

[1] Keppler, along with another NCI employee, David Holt, was previously named by Mr. Hanes as a defendant in this case. Prior to trial, Hanes dismissed Keppler and Holt and filed a Second Amended Petition eliminating his claims of fraud, negligence, intentional interference with existing and prospective business relations and conspiracy. (*See* Notice of Dismissal; Amended Petition; Second Amended Petition.)

[2] Trial Tr. 82:24-25, 83:1, 10-11.

[3] Trial Ex. DF.

remained as ESI's President and shareholder until he resigned on November 18, 2013. Brice also transferred his twenty-five percent (25%) ownership interest in ESI to Timothy Hanes.[4]

5. TIMOTHY HANES

Timothy Hanes (Hanes) was originally a twenty-five percent (25%) shareholder of ESI. When ESI was formed, Hanes served as Vice President. Hanes' role with ESI was to work with outside computer programmers on software development and to perform trainings as a subcontractor for NCI. By his own admission, Hanes lacked any business and financial acumen. Naturally, Hanes was never involved in ESI's bookkeeping.[5] Instead, Hanes and John Von Harz were responsible for procuring customers and clients. Currently, Hanes works as an independent contractor for ESI.

6. JOHN VON HARZ

John von Harz (von Harz), through his business, JVH Solutions, LLC (JVH Solutions), was retained by ESI in August 2012 as an independent contractor to serve as the acting interim CEO of ESI.[6] After Brice's resignation, von Harz ostensibly took on the responsibilities of President. Like Hanes, one of von Harz's responsibilities was to procure customers. Midwest Energy Efficiency Alliance (MEEA) is an association of utilities companies. They are also an ESI client. Obtaining and maintaining the contract with MEEA was the direct result of von Harz and Hanes' efforts. Alhough there are no records detailing the work performed by von Harz, he was also apparently responsible for ESI's day–to–day operations, with the exception of software development.

7. FRED KREYKES

Fred Kreykes (Kreykes) and his law firm, The Kreykes Law Office (Kreykes Firm), were retained by Hanes and Brice to represent ESI in connection with Hanes' complaints against Guarino and Falke.[7] Kreykes and the Kreykes Firm ostensibly provided advice to Hanes, Brice, and von Harz in their representative capacities with ESI.

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[4] Trial Ex. Y.

[5] Volume I of the Deposition of Mr. Hanes was filed with the Court by Mr. Hanes on January 9, 2017. (*See* Docket.)

[6] Trial Ex. #4.

[7] Trial Tr. 70:18-20 and 24-25, 71:1-6 and 13-19, 315:5-13, 423:14.

B. HISTORY OF ESI

In 2008, Guarino and Falke entered into business with Brice to set up a company in Iowa to help accelerate the development of NCI's ComfortMaxx® software.[8] Brice vouched for Hanes and convinced Guarino and Falke to allow Hanes to be a partial owner of the new company, which they named ESI. At the time, Hanes was a field technician. Brice and Hanes knew of NCI's business and knew of Guarino and Falke's ownership of NCI at the time they formed ESI.[9] In fact, Brice and Hanes attended NCI trainings prior to the formation of ESI. Similarly, they knew Guarino and Falke were going to continue as owners of NCI and NCI was going to continue its business operations following ESI's formation. At the time ESI was formed, NCI was already doing business with Southern California Edison (SOCAL) and had other existing customers throughout the country utilizing NCI's training and ComfortMaxx® software.[10]

Each of the four owners received a twenty-five percent interest in ESI. Brice acted as President of ESI and Hanes was given the title of Vice President of Software Development for marketing purposes. ESI has never had any employees. At the time of trial, ESI had two independent contractors – Hanes and von Harz.[11]

From its inception until 2013, when ESI began receiving revenue from its first independent customer, MEEA, ESI was primarily funded by NCI.[12] Messrs. Guarino and Falke caused NCI to make capital contributions to ESI. Additionally, until ESI's software was operational, NCI allowed ESI to use its existing ComfortMaxx® software and gave ESI all revenue from NCI customers' use of the software. Once ESI had software to offer, NCI marketed the product to its customers in lieu of its original product. For those customers that elected to utilize ESI's software, NCI provided one-hundred percent (100%) of the

[8] *See* Plaintiff Trial Ex. 7.

[9] Guarino Trial Test.; Trial Tr. 82: 7-12, 282:5-17; Hanes Trial Test. June 2017; *see* Trial Tr. 23:15-22.

[10] Guarino Trial Test.; Falke Depo. at 46:7-25, 47:1-2.

[11] Trial Tr.: 89:23-25, 249:11-18, 275:9-14; Trial Ex. 4.

[12] Guarino Trial Test.; Keppler Trial Test; Trial Ex. 60 at 19:14-16; *see* Trial Ex. CL, CM, CN at NCI00258-00273.

revenue to ESI.[13] NCI also hired ESI as a subcontractor to perform some of its trainings, and provided ESI with revenue for performing the trainings.[14]

In 2013, ESI had three sources of revenue through NCI: (1) one-hundred percent (100%) of the revenue NCI customers paid to use the ESI software (for those customers that elected to use the software); (2) one-hundred percent (100%) of the revenue NCI customer SOCAL paid to utilize the ESI software plus one-hundred percent (100%) of all computer programming fees charged by ESI; and (3) a flat fee plus a percentage of revenues NCI received for its trainings for which it hired ESI, as a subcontractor, to conduct.[15] The financial records submitted by the parties would seem to indicate that ESI would not have survived but-for NCI's financial support.[16]

II. FINDINGS OF FACT

A. NCI'S MAINTENANCE OF ESI FINANCIAL RECORDS

NCI maintained ESI's books and financial records from 2012 through 2013 and was responsible for the filing of ESI's 2012 tax return. NCI was unable to complete the books in 2013 or file the 2013 ESI tax returns because Hanes diverted MEEA checks. The evidence presented at trial established that NCI, at all times, properly maintained the books and funds of ESI. Keppler testified that ESI had its own set of books separate from NCI. Once ESI began receiving funds from MEEA in 2013, ESI had its own bank account in Ohio and all checks to ESI were deposited in this account.[17] Both Brice and Guarino were signers on the ESI bank account in Ohio. At no time were ESI funds co-mingled with NCI funds.

Pursuant to the oral agreements prior to 2012 and the commencement of von Harz's tenure as acting CEO, ESI was to receive credit for: (1) one-hundred percent (100%) of the software revenue from NCI's contract with SOCAL plus any additional ESI programming costs billed to SOCAL; (2) one-hundred percent (100%) of the software

[13] Guarino Trial Test.; Keppler Trial Test.; *see* Trial Ex. CL, CN at NCI00259-00273, CO at NCI00276-00299, 52, 53.

[14] *Id*.

[15] Keppler Trial Test.; Guarino Trial Test.; Trial Ex. 60 at 47:16-25, 48:1-16; *see* Trial Tr. 111:11-20, 155:23-25, 156:1-4; Trial Ex. CO at NCI00276-00299.

[16] *See* Trial Ex. CL, CM, CN at NCI00258-00273, CV; *see also* Trial Ex. CK; Keppler Trial Test.

[17] Trial Ex. CY.

revenue from software usage by NCI's customers (that elected to utilize the ESI software); and (3) a flat fee plus a percentage of the revenue generated from trainings ESI, as a subcontractor, performed for NCI's customers on behalf of NCI.[18]

In 2012, ESI's only revenues came from NCI. Additionally, NCI extended loans to ESI to pay its bills. Accordingly, Keppler's practice, known to von Harz, was to record all ESI expenses paid by NCI on ESI's books as monies "due to" NCI. Keppler similarly recorded all software and training revenues owed by NCI to ESI as monies "due from" NCI. Keppler reconciled the "due to" and "due from" periodically throughout the year to determine whether ESI owed NCI funds or whether NCI owed ESI funds. If NCI owed ESI funds after the reconciliation, NCI would remit funds to ESI. If ESI owed NCI funds after the reconciliation, ESI would pay NCI if it had cash to do so. In 2012, ESI owed more funds to NCI than NCI owed to ESI.[19]

In 2013, ESI entered into a one-year contract with MEEA and began generating its own revenue.[20] Keppler continued his practice of recording monies "due to" and "due from" NCI on ESI's books but began transitioning expenses NCI paid on behalf of ESI back to ESI. As ESI finally had funds of its own from MEEA, it remitted monies due to NCI as part of reconciliation in April 2013. However, per "due to" and "due from" entries starting May 1, 2014, ESI owed NCI, but did not pay, $6,680.15 at the end of 2013. This amount is reflected on ESI's 2013 Balance Sheet and supported by the 2013 Profit and Loss statement.

Keppler's testimony as to the pattern and practice of maintaining the books of ESI and that NCI, at all times, credited ESI with all funds to which it was entitled per the verbal agreements between ESI and NCI was not controverted by Hanes or von Harz. Furthermore, there is no evidence that Defendants misappropriated ESI funds for their own personal benefit.

[18] Guarino Trial Test.; Keppler Trial Test.; Trial Tr. Trial Ex. 60 at 47:16-25, 48:1-16; *see* Trial Tr. 111:11-20, 155:23-25, 156:1-4; Trial Ex. CO at NCO00276-00299.

[19] Trial Ex. CN at NCI00258-00273.

[20] Keppler Trial Test.; Trial Tr. 105:3-4 and 13-21, 107:14-22.

B. Breach of Fiduciary Duties

1. Hanes as ESI President and Control of ESI's Finances

In mid to late 2013, Hanes openly acknowledged that had been "a terrible partner" for ESI and was personally in "financial ruin."[21] However, by his own admission, Hanes needed to keep his job with ESI at all costs.[22]

By the end of 2013, all parties realized their relationship was irreparably broken and dissolution of ESI was likely.[23] Specifically, on November 18, 2013, Brice announced he was transferring his ownership interest in ESI to Hanes as well as the duties of the President.[24] Hanes decided that dissolution would be the worst possible outcome because he would lose his job and had no money to buy Guarino and Falke's interests in ESI or the ESI software if it were sold following dissolution.[25] Hanes also admitted to having no use for Guarino and Falke and believed ESI would be "better off" without them.[26] Moreover, Hanes knew MEEA had agreed to a multi-year contract starting in January 2014 that would bring in more revenue to ESI.[27] As a result, Hanes developed a plan to wrest full ownership of ESI.

First, Hanes, who had no involvement with the finances of ESI and admittedly no aptitude for maintaining ESI financial records, seized control of the company finances from NCI and its CFO, Keppler, who had maintained ESI's financial records for the preceding two years.[28]

Second, Hanes, with the assistance of acting interim CEO von Harz, opened a new bank account in Iowa, in which Hanes was the only signer, and diverted payments from MEEA from the established ESI bank account in Ohio to the new account in Iowa.[29]

Third, Hanes directed von Harz to take over the ESI bookkeeping from NCI, who, in turn, started a new set of financial records on January 1, 2014.[30] While in control of

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[21] Trial Ex. J.

[22] Id.

[23] Trial Ex. BR.

[24] Trial Ex. Y.

[25] *See* Trial Ex. J; Trial Tr. 83:5-11; Hanes Trial Test. June 2017.

[26] *See* Hanes Depo. Vol. I at 180:7-15, 181:16-20.

[27] *See* Trial Tr. 105:6-12; Trial Ex. 9; Guarino Trial Test.; Hanes Trial Test. June 2017.

[28] *See* Trial Ex. B, Q.

[29] Trial Tr. 208:11-19, 25, 209:1-8; Trial Ex. B, Q, AA, AB, AU, GD(1)-(2).

ESI's finances, von Harz, per Hanes' direction, began recording purported receivables and retained earnings on ESI's financial records and caused tax returns to be filed containing inaccurate financial information.[31] Furthermore, von Harz created modified profit and loss statements for 2012 and 2013, per Hanes' direction, that did not accurately reflect ESI's true financial picture and were not proper business records.[32]

Finally, on December 30, 2013, Hanes formally declared himself President of ESI. More importantly, Hanes declared that, as President, he now controlled the tie-breaking vote among the owners.[33] Specifically, Hanes wrote to Guarino and Falke stating: "I own 50% of the company and I hold the tiebreaking vote as president of the company. That means I have the legal authority to make all decisions regarding ESI."[34] Although he may have been given Brice's ownership interest in ESI in November 2013, there is no evidence in this record that Hanes' fifty percent (50%) share or his self-appointed presidency meant he had the tie-breaking vote among the shareholders.

2. UNDISCLOSED BONUSES AND INCREASED COMPENSATION

Immediately upon announcing he was in total control of ESI, Hanes gave himself and von Harz raises and undisclosed bonuses.[35] As detailed in this Court's November 8, 2016 injunction, Hanes, who was a salaried employee of NCI at the time, received yearly compensation of $94,615.29 in tax year 2013[36], which was substantially more than his yearly compensation of $76,923 in 2012.[37] Additionally, von Harz was paid $109,190.40 in tax year 2013.[38] On January 2, 2014, Hanes gave himself and von Harz a bonus of $6,500

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[30] Trial Tr. 96:9-16; 98: 5-8, 9-16; 99: 5-7, 304:24-25, 305:1-9, 308:9-11.

[31] *See* Trial Tr. 152:15-25, 153:1-7, 168:2-13, 169:1-10, 188:8-25, 189:1-6, 220:3-5 and 11-24, 221:2-25, 222:1-8, 223:2-20; Keppler Trial Test.; Trial Ex. CH, CI, GE, GG, 52, 54, 55.

[32] *See* Trial Tr. 152:15-25, 153:1-13; Keppler Trial Test.; Trial Ex. CN at HANES283-288, CO at HANES277-282, 48 at page 2, 50 at p. 3.

[33] Trial Ex. B, Q.

[34] *Id*.

[35] (Trial Tr. 200:16-25, 201:1-2, 203:1-10, 209:19-23, 242:2-4, 243:4-11; Hanes Trial Test. June 2017; Trial Ex. GP, GQ, GD(1)-(2).

[36] *See* Trial Ex. DJ.

[37] *Id.*

[38] As explained by Keppler at trial, the total of $114,059.85 reflected as monies paid to von Harz on the 2013 Profit and Loss Statement created by von Harz includes compensation, a commission and expense reimbursement. This is supported by the 2013 Profit and Loss Detail prepared by Keppler contained in

each.[39] In each subsequent year, Hanes and von Harz increased their compensation.[40] As noted by the Court in its November 8, 2016 Order on Defendants' Motion for Temporary Injunction and as reflected in the 2014 ESI Profit and Loss Statement submitted by Hanes, Hanes received a total of $156,499.98 and von Harz received a total of $150,250.00, respectively, in 2014.[41] Hanes gave himself and von Harz additional increases in compensation in 2015. Further, Hanes received a total of $161,588.31 and von Harz received a total of $167,083.48 in compensation in tax year 2015.[42]

Hanes and von Harz were on track to take even more compensation in 2016 until this Court restricted Hanes and von Harz to total yearly compensation of $118,000 in late 2016. Hanes ultimately received $160,750.15 in compensation and gave von Harz a total of $160,604.77 in compensation for tax year 2016.[43] As of June 2017, Hanes has taken a total of $189,338.44 in surplus compensation since January 1, 2014.[44] Hanes has allowed von Harz to take a total of $150,367.05 in surplus compensation from January 1, 2014 through December 31, 2016.[45]

The record demonstrates Hanes and von Harz took these bonuses and raises without Guarino and Falke's knowledge or consent. Similarly, the raises and bonuses were not justified and not based upon any independent compensation analysis. The only justification provided by Hanes during deposition for the increases in compensation was: "[t]o keep valuable employees employed."[46] He explained, "I guess to keep employees, you need to pay them properly" and, when asked if the funds would have been better spent growing ESI, he explained "I thought it was better spent the way we spent it" on "compensation for employees."[47] Von Harz's justification was that he "felt" a wage closer

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Trial Exhibit CO at NCI00283-00284. Von Harz's actual compensation for 2013 was $109,190.40. (*See generally* Trial Exhibit CO at NCI00283-00284.)

[39] Trial Ex. GP, GQ.

[40] *Id.*

[41] Nov. 8, 2016 Order; Trial Ex. 52.

[42] *Id.*

[43] Trial Ex. 55.

[44] *See* Trial Ex. DJ, GG, 52, 54, 55.

[45] *See* Trial Ex. GG, 52, 54, 55.

[46] Hanes Depo. Vol. I at 167:2-6.

[47] Hanes Depo. Vol. I at 106:18-24, 107:1-4; 163:2-5.

to what he had previously been used to prior to starting with ESI in 2012 was appropriate. However, this Court has previously noted:

> The difficulty with Plaintiff's summation, however, is that it fails to explain what additional responsibilities he and Mr. Von Harz assumed. As a factual matter, the Court accepts Plaintiff and Mr. Von Harz's contention that they assumed more responsibility when Brice stepped aside. Furthermore, the Court does not believe, per se, that [Hanes] and Mr. Von Harz shouldn't be compensated for taking on additional responsibilities. However, as a matter of law, [Hanes] and Mr. Von Harz have not provided sufficient explanation as to the nature and breadth of the "increase [to] their respective responsibilities," which would justify a 67% and 68% salary increase. Those details are particularly important when their compensation increases represent in an existential threat to ESI.[48]

The evidence at trial did not support Hanes and von Harz's "increased workload" rationale. More importantly, this rationale is undermined by an e-mail from Attorney Kreykes dated April 8, 2014 in which he advises:

> My opinion is that the relationship between ESI and NCI is done.
>
> The shareholder issue persists and there may be two or more options concerning that issue:
>
> 1. Do nothing regarding Dom & Rob. Any ESI "profit" can be taken by Tim and John as salary. Eventually the software will run its course and the company can fade away.
> 2. Offer to sell a copy of the software to NCI for a reasonable price, such as $1.00. Then also sell a copy to Newco called ESI Energy (owned by Tim & John) for a $1.00. Allow ESI to go dormant and Sec of State administratively dissolve it.[49]

[48] Nov. 8, 2016 Order.

[49] Trial Ex. FH.

Tellingly, neither Hanes nor von Harz mentioned this advice before or during trial. Ostensibly on the advice of counsel, Hanes stripped ESI of its profits is evidenced by the ESI financial records and tax returns.[50] Accordingly, ESI operated at a loss for several years.[51] In 2015 and 2016, ESI had total losses of net income of -$96,991.58 and -$62,482.40, respectively.[52] In addition, as of May 2017, ESI had a negative net income: -$37,984.91.[53]

The tax returns for ESI reveal that it had de minimis profitability in 2013 and 2014 and operated at a loss in 2015 and 2016.[54] The profit and loss statement from January through May 2017 reveals that ESI is currently operating at a loss. Unquestionably, Hanes and von Harz's salary increases have caused significant financial hardship to ESI. And, but-for the unauthorized and undisclosed increases in compensation and bonuses taken by Hanes and von Harz, ESI may have been profitable.

3. THE ONE MILLION DOLLAR INVOICE

In conjunction with declaring himself President of ESI and awarding himself and von Harz undisclosed bonuses and compensation increases, Hanes also sent NCI an invoice dated January 2, 2014 for the immediate payment of $1,051,000.[55] The uncontroverted evidence at trial was that all revenue from NCI customers and SOCAL was one-hundred percent (100%) passed through to ESI. Moreover, the acting interim CEO, von Harz, testified that NCI had no obligation to accept the new price. He further testified that the new invoice price was not really a receivable because NCI never agreed to pay the new price.

4. TERMINATION OF RELATIONSHIP WITH NCI AND CONTROL OF ESI

The evidence generated at trial supports Guarino and Falke's contention that the true purpose behind Hanes's threat to terminate the ESI/NCI relationship if the one

[50] Trial Ex. 52, 53, 54, 55, CH, CI, GE, GF.
[51] *See* Trial Ex. 54, 55, GG.
[52] Trial Ex. 54, 55.
[53] Trial Ex. GG.
[54] Trial Ex. CG, CH, CI, GE.
[55] Trial Ex. E.

million dollar invoice was not paid was to take control of ESI for himself.[56] Along with the threat of termination, Hanes communicated to Guarino and Falke that ESI would forgive the one million dollar invoice to NCI, if they would surrender their ESI ownership interest to him. When Guarino and Falke refused to surrender their equity, Hanes terminated the ESI/NCI relationship and blocked NCI and its customers from accessing their data for which they had already paid.[57] The termination of the ESI/NCI relationship cost ESI over $85,000.00 in revenue in 2014 alone.[58]

C. ROLES OF MR. VON HARZ, AND ATTORNEY KREYKES

1. JOHN VON HARZ

The evidence in the record demonstrates that although von Harz investigated Hanes' complaints and decided not to file suit against Defendants, he was nevertheless assisting Hanes in his efforts to force Guarino and Falke to surrender their interest in ESI instead of remaining neutral and representing the best interests of ESI. Furthmore, von Harz provided this assistance to Hanes despite his testimony that he had an obligation to be honest and forthright with all of the shareholders of ESI.

Von Harz knew about, and was involved in, developing the justification for the one million dollar invoice even though he acknowledged that it was a change in price and NCI was not obligated to pay it.[59] Further, he accepted bonuses and substantial increases in compensation without notifying Guarino and Falke, which was contrary to his obligation to be forthright with them.

Von Harz testified he did not provide any input regarding Hanes's decision to cause ESI to shut off customer access (other than the aging of a receivable). However, e-mails reflect von Harz did, in fact, advise Hanes that it was in Hanes's best interest to shut off customer access and refrain from maintaining the *status quo*. Von Harz also suggested language to support Hanes's proposals to leverage Guarino and Falke's ownership interests in ESI in exchange for eliminating the one million dollar receivable and threats to shut off NCI customer access should NCI refuse to pay the invoice. Von

[56] *See* Trial Ex. F, G, Q, AD, AH, AL, AP, AP, EL, 33, *see also* Trial Ex. AJ.

[57] Trial Tr. 345:5-9; Trial Ex. EY; Hanes Trial Test. June 2017; Guarino Trial Test; *see* Trial Ex. 52, 53.

[58] *See* Trial Ex. CO at NCI00276-00299.

[59] Trial Tr. 212:12-15, 213:21-25, 214:1-2 and 20-25, 215:2-6 and 13-17, 216:10-12; Trial Ex. DW.

Harz also sent drafts of e-mails to all the shareholders regarding the shareholder disputes first to Hanes for his input.[60] This and other evidence in the record leads this Court to conclude that von Harz became an active participant in what he considered to be an "ownership dispute."

2. ATTORNEY KREYKES AND THE KREYKES FIRM

Attorney Kreykes's and the Kreykes Firm's involvement in this matter apparently began in November of 2013 with a meeting that Attorney Kreykes had with Hanes, Brice, and von Harz. There is no engagement letter between the Kreykes Firm and ESI. There are no billing invoices for that meeting. And, it is unclear as to what was discussed at the meeting.

Attorney Kreykes testified at trial and represented to Defendants that he, at all times relevant hereto, provided only legal advice to ESI.[61] Despite his testimony, e-mails and Kreykes Firm invoices reveal that he was in fact providing advice to Hanes as a shareholder of ESI.[62] Undisputedly, Attorney Kreykes suggested tactics and strategies to Hanes as a shareholder in dealing with the co-owners of ESI, Guarino and Falke, and provided advice that was favorable to Hanes but detrimental to ESI as an entity and to Guarino and Falke.[63]

In addition to advising Hanes to take all of the profits out of ESI and start a competing company with von Harz, other troubling examples detrimental to resolving the shareholder dispute include e-mails in which Attorney Kreykes wrote to Hanes that "[w]e do not want them to think that they are directors, only shareholders," and "it behooves you to look as reasonable as possible in the event that [t]his ends up in front of a judge or arbitrator."[64] The Court is profoundly concerned about Attorney Kreykes' advice and considers it advocacy by deception and bad faith.

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[60] *See* Trial Ex. DX.

[61] Trial Tr. 382: 17-19, 413:11-13, 416: 14-16, 423:14, 435:15-16; Trial Ex. Q.

[62] *See, e.g.*, Trial Ex. DK, FH, F, AH, AI, AJ. Though requested from Mr. Kreykes in two separate subpoenas, Mr. Kreykes never produced the Kreykes Firm invoices. It was not until Defendants requested them from ESI's new counsel that they were provided in June 2017. (*See* June 2017 Trial Trans.)

[63] Trial Ex. F, AH, AI, AJ, FH.

[64] Trial Ex. G, AI, EL, FH.

Attorney Kreykes also reviewed the Petition in this case prior to it being filed and did not object.[65] This is an extraordinary fact given that he claimed to be representing ESI, whose acting interim CEO, von Harz, decided not to file any lawsuit. More troubling is that Attorney Kreykes billed ESI for this review and ESI, through von Harz, paid the bill.[66] Attorney Kreykes also withheld e-mails that were material and responsive to a subpoena in this case until the third day of the trial in February 2017.[67]

The Court finds that there is substantial evidence that Attorney Kreykes was providing legal advice to Hanes' benefit, which was directly related to his shareholder dispute with Guarino and Falke and detrimental to ESI.

D. JOHN VON HARZ'S INVESTIGATION

In January 2014, prior to filing this action, Hanes raised concerns about Defendants to acting interim CEO von Harz. Hanes addressed these complaints with von Harz again in April 2014 and demanded von Harz cause ESI to file suit against Defendants.[68] According to Hanes, von Harz was responsible for determining whether ESI would file a lawsuit against the defendants.[69] Specifically, Hanes testified that von Harz "had the authority to make the decision" as to whether to file suit.[70] Moreover, Hanes testified that he respected von Harz's decision and was not there to second-guess von Harz's decision.[71] It is further evidenced by Hanes' trial testimony that he directed his demand to file suit to von Harz because he did not believe it to be appropriate for him to make the decision to sue Defendants on behalf of ESI.[72]

Von Harz conducted an investigation into these claims and declined to file suit on behalf of ESI.[73] Von Harz testified that Hanes' concerns were tantamount to "a dispute among the owners" of ESI. Furthermore, von Harz believed NCI had no obligation to pay the price increase that Hanes' was demanding. As a result, von Harz acknowledged that

[65] Trial Ex. DK at 4/11/14, FJ.

[66] Trial Ex. DK, DL; Hanes Trial Test. June 2017.

[67] Trial Tr. 391:5-19 and 24-25, 391:1-10.

[68] Trial Ex. C, D; Trial Tr. 183:23-25, 184:1-19, 185:5-16; Hanes Trial Test. June 2017.

[69] Trial Ex. C; Hanes Depo. Vol. I at 28:7-14, 47:18-23.

[70] *Id*.

[71] *Id*.

[72] Trial Tr. 370:2-16.

[73] Trial Ex. C; Trial Tr. 185:5-16; 229:12-25, 230:1-9, 248:16-18.

NCI would hold certain funds relative to software usage from January through March 2014 in the ESI Ohio account until the shareholder disputes were resolved.[74] Von Harz's decision not to file suit on behalf of ESI, as well as his underlying rationale is evidenced in an e-mail to Attorney Kreykes dated October 15, 2015. Therein, von Harz writes:

> Anyway, I recall making the decision for ESI to not sue NCI because I believed that was in our best interests at the time. NCI had software services under contract out in California and ESI was selling a lot of training here in Iowa. It just seemed logical to me that something could still be worked out.[75]

E. HANES FILES A SHAREHOLDER DERIVATIVE SUIT

Hanes initiated a purported shareholder derivative suit on April 14, 2014 alleging a breach of contract and other claims against Defendants. The Court is troubled by the manner in which this case was filed. The circumstances surrounding the presentation of Hanes's demand to von Harz that ESI file suit against Defendants is misleading. The record at trial established that Hanes raised his complaints with von Harz as early as mid-to-late 2013 and since that time von Harz investigated the claims and had numerous communications with all shareholders, Brice, and Attorney Kreykes about these issues. Yet the Affidavit submitted by Hanes with his Petition states that he orally requested ESI take action on January 13, 2014 and that, following his written demand on April 10, 2014, von Harz immediately rejected the demand.[76]

Then, on April 11, 2014, the day after von Harz advised Hanes that it was not in ESI's best interest to file suit against Defendants, counsel for Hanes sent a draft shareholder derivative petition to Attorney Kreykes, stating in relevant part:

> Fred, attached is our proposed petition for our shareholder derivative lawsuit. We have the inclination and intention to file this today unless you have major objections. As you review this, please also consider whether you believe we are missing something. Our plan is to file immediately but not

[74] Trial Tr. 214:20-23, 215:2-17, 216:10-12; 230:10-14; Trial Ex. BU. Mr. von Harz's acknowledgement that NCI would be holding certain funds relative to software usage from January through March 2014 in the ESI Ohio account until the shareholder disputes were resolved eliminates any claim that NCI converted or otherwise improperly held ESI's funds for software usage.

[75] Trial Ex. FZ.

[76] Trial Ex. C, D.

> serve right away to take advantage of time for possible negotiations.[77]

The Kreykes Firm invoices reveal Attorney Kreykes reviewed this draft petition and had further communication with Hanes' counsel, however, said communications were never produced.[78]

It is axiomatic that in a shareholder derivative case the corporation is antagonistic to the plaintiff and not a confederate. This evidence, coupled with additional evidence produced by Attorney Kreykes during the middle of trial in February 2017, reflect that Attorney Kreykes was working on behalf of Hanes and not ESI and this suit was not properly filed. Simply put, Attorney Kreykes failed to act in the best interest of ESI or properly represent the company; rather, Attorney Kreykes worked with Hanes to deprive Guarino and Falke of their ownership interest in ESI.[79]

F. NCI Did Not Convert Funds Due to ESI for Software Usage for January Through March 2014

Evidence presented at trial established that NCI did not convert, or otherwise withhold, funds due to ESI for the software usage by its customers. Consistent with Keppler's pattern and practice of recording monies "due to" and "due from" ESI on ESI's books and reconciling the amounts once or twice a year, NCI recorded revenues "due to" ESI from NCI on ESI's books for software usage by NCI's customers, including SOCAL, for January, February, and March 2014, respectively. Keppler provided these books to von Harz. Indeed, the 2014 financials offered and admitted into evidence by Hanes reflect the revenues "due to" ESI from NCI for NCI customer software usage for January, February and March 2014 at the contractually agreed-upon rate from 2012 and 2013 were recorded on ESI's books and totaled $25,481.45. Since Hanes and von Harz seized control of ESI's

[77] Trial Ex. FJ, *see also* Trial Ex. C.

[78] Trial Ex. DK at 4/11/14.

[79] The Court is further troubled that Mr. Hanes, his previous attorneys, Attorney Kreykes and the Kreykes Firm all withheld the fact that they were working hand-in-hand to file this action against Defendants, as well as other key pieces of evidence that directly bear upon the claims and defenses in this action, from this Court and the federal court, despite their obligations to disclose the evidence. (*See, e.g.,* Trial Ex. EJ, FC, FD, FE, FH, FJ, FN, FR.) But for this Court ordering Attorney Kreykes to appear with his file during the middle of trial in February 2017 and Attorney Kreykes hurriedly printing e-mails from his account and producing them the next day without first reading them, Defendants and this Court would never have been made aware of these key facts. (*See* Trial Tr. 391:5-21, 392:5-10, 425:8-11.)

finances and checks from MEEA, NCI was unable to record all amounts on ESI's books and complete the reconciliation in mid-2014.

Evidence further establishes that the amounts due from ESI to NCI for January through March 2014 exceed the amount of funds due to ESI from NCI for software usage. Keppler testified, and the 2014 Profit and Loss Detail submitted by Hanes establish, that ESI owed $6,680.15 to NCI at the end of 2013.[80] The 2014 ESI financials further reflect ESI did not remit payment to NCI for MEEA training revenue for January, February and March 2014 that it had been remitting to NCI in 2013.[81] Per the oral agreement in place in 2013 between ESI and NCI, ESI was obligated to remit roughly thirty-three percent of MEEA training revenue to NCI. From January through March 2014, this totaled over $43,000.[82] Reconciling the $25,481.45 in software revenue due to ESI with the $6,680.15 and over $43,000 in MEEA training revenue due to NCI, the evidence establishes that ESI owes NCI more than NCI owes ESI from January through March 2014.

G. NCI vs. ESI

The evidence at trial established that NCI did not compete with ESI. As the dissolution of ESI seemed imminent in late 2013, NCI began pursuing other software platform options to ensure it could meet its contractual obligations with existing customers, including its largest customer, SOCAL. The uncontroverted testimony proves NCI hired Hashrocket, a programmer using the same software used by companies such as Amazon and Zappos, to develop its software from scratch – without the knowledge or use of ESI's software. It is similarly uncontroverted that NCI's new software was not ready for use until after Hanes caused ESI to terminate the relationship with NCI in late March 2014. There is no evidence that NCI did not approach ESI's sole customer, MEEA, with the new software platform. Indeed, Hanes conceded he has not seen NCI's new software and did not offer any testimony or evidence to demonstrate that NCI utilized code from ESI's software or competed with ESI. Ultimately, there is no evidence proving NCI was a competitor of ESI.

[80] Keppler Trial Test.; Trial Ex. 53.

[81] Trial Ex. 52, 53; *see* Trial Ex. CO; 50.

[82] *See* Trial Ex. 52.

III. CONCLUSIONS OF LAW

A. HANES VS. GUARINO AND FALKE (DIRECT CLAIM)

1. BECAUSE ESI CEO, JOHN VON HARZ, INVESTIGATED THE CLAIMS AT ISSUE AND ACTED IN GOOD FAITH WHEN DETERMINING NOT TO BRING A DIRECT LAWSUIT AGAINST THE DEFENDANTS, HANES' CLAIMS SHOULD BE AND ARE HEREBY DISMISSED

A derivative lawsuit is an action that allows a shareholder to challenge the decision of management not to bring a lawsuit. The purpose of the derivative lawsuit is to allow a shareholder, in good faith, to challenge a decision of management it believes is against the best interest of the corporation.[83] It alleges a corporation has been harmed by management's decision not to bring a lawsuit against a third party.[84] A predicate to standing to bring a derivative lawsuit is that the plaintiff has requested management take legal action and that management has improperly determined not to take legal action.[85] A condition for having standing to bring a derivative lawsuit is that the plaintiff fairly and adequately represents the interests of the corporation.[86] There is a legal presumption that when management has investigated a shareholder demand, management has acted in good faith when deciding it was not in the corporation's best interest to file a lawsuit.[87]

As noted by United States District Court Magistrate Judge Bremer when she ordered this case remanded to state court, the essence of a derivative lawsuit is that the corporation is antagonistic to the shareholder.[88] Under Iowa law, to have standing to assert a derivative case, a person must fairly and adequately represent the interests of the corporation.[89]

This case involves a close corporation owned by three persons at the time the lawsuit was filed. Hanes allegedly owned fifty percent of ESI and Guarino and Falke owned twenty-five percent each. There were no formal officers and the company hired von Harz (through his company JVH Solutions) to act as an interim CEO. Importantly, the Court notes that von Harz believed he had limitations within his authority and that,

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[83] *See generally Weltzin v. Nail*, 618 N.W.2d 293, 295 (Iowa 2000).

[84] *See Gill v. Vorhes*, 885 N.W.2d 829, 2016 WL 4051643, *10 (Iowa App. 2016), citing *Des Moines Bank & Trust Co. v. George M. Bechtel & Co.*, 51 N.W. 2d 174, 217 (Iowa 1952).

[85] *See Whalen v. Connelly*, 593 N.W.2d 147, 152-53 (Iowa 1999).

[86] See Iowa Code §490.741 (2017).

[87] *Whalen,* 593 N.W.2d at 153-54.

[88] *See* May 5, 2015 Order; see also *PVI, Inc. v. Ratiopharm GmbH*, 253 F.3d 320, 328 (8th Cir. 2001).

[89] Iowa Code §490.741 (2017).

in the end, Hanes was the person with ultimate authority to make decisions for ESI. Nevertheless, Hanes chose to bring this derivative action and allege von Harz was the person with the authority to make the decision for ESI regarding whether to bring a lawsuit.

Hanes brought his complaints about NCI and Guarino and Falke to von Harz in January 2014. Von Harz testified he did receive complaints from Hanes but, after investigating the matter, decided not to initiate legal action. Hanes' chief complaint involved his belief that NCI was required to pay additional fees for ESI software. The Court notes, however, von Harz testified multiple times that NCI had no obligation, legal or otherwise, to pay the price increase in the January invoice from ESI to NCI. Most notably, within von Harz's judgment, NCI's failure to pay the invoice was not tantamount to a breach of contract. Von Harz was also aware that NCI would be holding certain funds until issues were resolved among the shareholders and he acknowledged it was appropriate to do so. Thus, the Court finds that von Harz did investigate the grievances Hanes had brought to his attention and that he was justified in deciding not to bring a lawsuit. He also considered the claims in the lawsuit to be a "dispute among the owners," i.e., a shareholder dispute.

In a "demand refused" derivative action such as this, "[i]n determining whether a demand was wrongfully refused, a court reviews the decision according to the traditional business judgment rule."[90] The business judgment rule presumes a demand was denied based on an informed decision, made independently and in a good faith, honest belief that the decision was in the best interest of the company.[91] The burden is then on the party challenging the decision to establish facts to rebut that presumption.[92]

Hanes has failed to establish facts to overcome the presumption. Von Harz made an independent, informed decision not to have ESI file suit, which was made in an honest, good faith belief that he was acting in the best interest of ESI. As noted in the Court's Findings of Fact, Hanes conceded he considered von Harz the person responsible

[90] *Whalen*, 593 N.W.2d at 153-54 (citations omitted).

[91] *Id.* at 154 (citations omitted).

[92] *Id.*

for determining whether ESI should file a lawsuit against Defendants.[93] Moreover he elected to bring the action as a derivative case, and therefore was required to satisfy all of the predicates required by the statute. The Court must also consider the conduct of Attorney Kreykes and his review and commentary on Hanes' proposed Petition. Attorney Kreykes' conduct is problematic because a fundamental aspect of a derivative lawsuit is that the company is antagonistic to the shareholder.[94]

Accordingly, under these facts, the Court concludes that Hanes lacks standing to assert his derivative claims and all such claims must be dismissed. Furthermore, Attorney Kreykes' role in the drafting of the Petition and subsequent litigation is a separate but critical fact justifying the dismissal of the Petition.

2. HANES DOES NOT HAVE STANDING TO ASSERT THE DERIVATIVE LAWSUIT

One of the predicates for standing to assert a derivative claim is that the person fairly and adequately represents the interests of the corporation.[95] This was not the case here. Rather, the Court finds the filing of the Petition by Hanes was conducted after he tried unsuccessfully to pressure Guarino and Falke in surrendering their ownership in ESI. As detailed in the Court's findings of Fact, the pressure included: (1) submitting an invoice in January 2014 for one million dollars due on demand; (2) threatening to shut off customer access to their data if NCI did not pay the invoice; (3) offering to forgive the debt in exchange for Guarino and Falke's ownership interests; and (4) the termination of the business relationship between ESI and NCI, which in 2014 alone resulted in lost revenue of over $85,000.[96] Moreover, the uncontroverted evidence establishes that Hanes filed the Petition because "it was not in his best interest" to file an action for dissolution.[97] This fact alone evidences Hanes improper use of the derivative lawsuit.

Ultimately, the outcome sought by Hanes was at all times to obtain for himself Guarino and Falke's ownership interests in ESI. This Court cannot conclude, however,

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[93] Trial Ex. C; Hanes Depo. Vol. I at 28:7-14, 47:18-23; Trial Tr. 370:2-16.

[94] *See generally Motor Terminals.*, 92 F.Supp. at 161-162; *Smith*, 354 U.S. at 95, 97-98; *PVI, Inc.*, 253 F.3d at 328; *See also* the May 5, 2015 Order of United States District Court Magistrate Judge Bremer (who heard this matter when it was first removed to United States District Court) realigning ESI to be a nominal defendant believing that ESI was antagonistic to Mr. Hanes.

[95] Iowa Code §490.741.

[96] *See* Trial Ex. CO at NCI00276-00299.

[97] *See* Trial Ex. B, Q, FH.

this outcome fairly represents all shareholders, nor is it an outcome that was in ESI's best interest. As a result, Hanes does not have standing to bring this action.

3. HANES'S CLAIMS ARE BARRED BY THE DOCTRINE OF UNCLEAN HANDS

The Court notes that by bringing a shareholder derivative lawsuit under Iowa law, Hanes has invoked the equitable jurisdiction of this Court.[98] There is perhaps no more well-known maxim of equity that "he who comes into equity must come with clean hands."[99] This has been a hallmark of equity from time immemorial and a fundamental principle of equitable jurisprudence.

Hanes does not come before the Court with clean hands. Perhaps the most obvious and inequitable action undertaken by Hanes was to give himself and von Harz undisclosed bonuses and increases in compensation. This clearly constitutes both a breach of fiduciary duty to Guarino and Falke as well as an act of corporate waste in paying von Harz more than was fair and necessary under the circumstances. Neither the bonuses nor the salary increases were necessary, justified, or in the best interest of ESI.

A second and equally important instance of "unclean hands" was the one million dollar invoice Hanes sent to NCI dated January 2, 2014 as part of a plan to force Guarino and Falke to surrender their ownership interests in ESI. Not only was there no rationale or fair justification for the price increase, but there is substantial evidence that it was being used to leverage and improperly obtain the ownership interest in ESI.

Third, the termination of the ESI/NCI relationship, which Hanes unilaterally caused, was not in the best interest of ESI because it cost ESI over $85,000 in revenue in 2014 alone. The termination of this specific relationship was done without regard to NCI's customers or the harm it would cause them.

Fourth, ESI's financial records were altered; specifically by adding a $178,000 receivable due from NCI for Hanes's former company, Cynergy, which caused the $178,000 receivable to be included on ESI's federal tax returns from 2014 through 2016. This action benefited Hanes solely and at the expense of Guarino and Falke and NCI.

Thus, even if Hanes' claims were not barred by the business judgment rule, the Court nevertheless concludes that Hanes' claims are barred by the doctrine of unclean

[98] *See Weltzin*, 618 N.W.2d at 297, *Holi-Rest, Inc. v. Treloar*, 217 N.W.2d 517, 523 (Iowa 1974).

[99] *Grandon v. Ellingson*, 144 N.W.2d 898, 904 (Iowa 1966) (citations omitted).

hands. Hanes cannot, on the one hand, claim to be seeking relief in the best interest of all of the ESI shareholders when, on the other hand, take actions that have had an undeniable detrimental effect on the ESI shareholders and ESI itself.

4. HANES' CLAIMS ASSERTED IN THE SECOND AMENDED PETITION FAIL ON THE MERITS

Hanes had the burden of proof on all of the claims asserted in his second amended complaint: breach of contract, breach of fiduciary duty, conversion, unjust enrichment, promissory estoppel, quantum meruit, and punitive damages. As discussed previously, von Harz conceded there was no basis to accuse NCI of breaching any agreement related to the "new price."

With respect to other funds Hanes alleged NCI improperly converted, the credible evidence supports Defendants' contention that NCI had not unjustly kept money for itself but maintained accurate records of the financial transactions between the parties and that this reconciliation process was consistent with past practices. Moreover, von Harz gave written permission to Guarino for NCI to hold onto any funds until the shareholder dispute was resolved.[100]

Hanes also alleged that NCI breached its contract with ESI when it did not require most or all of its membership to use ESI's software and deliver such membership revenue to ESI. Hanes failed to provide any sufficient and credible evidence to support this claim, which, at best, was founded on suspicion and speculation.

Hanes also alleged that Guarino and Falke breached their fiduciary duty to ESI by failing to act in ESI's best interest, serving their own and NCI's interest at ESI's expense, providing themselves and NCI with improper funds, developing a competing software for NCI while shareholders of ESI, and failing to do what prudent people would do with regard to their own business.[101] Having carefully considered all the testimony and exhibits presented in this case, the Court finds that these claims are not supported by sufficient and credible evidence. The Court notes that Hanes has based his claim for breach of fiduciary duties based on specific acts undertaken by Guarino and Falke and not their status as shareholders. Presumably, this was done because Hanes was aware that, as minority shareholders, Guarino and Falke did not owe the same fiduciary duty to ESI if

[100] Trial Ex. BU.

[101] Second Amended Petition at ¶ 61.

they had been directors or majority shareholders.[102] The Court finds no evidence presented at trial that Guarino and Falke ever breached any fiduciary duties to ESI or that ESI has in any way been damaged by their conduct.

The Court finds that Hanes' complaint for breach of contract, conversion, promissory estoppel, unjust enrichment and quantum meruit are not supported by sufficient and credible evidence.

B. GUARINO AND FALKE VS HANES (COUNTERCLAIM)[103]

1. MR. HANES BREACHED HIS FIDUCIARY DUTIES

Guarino and Falke have asserted counterclaims against Hanes individually, alleging that he violated his fiduciary duties to them by doing the following:

1) Unilaterally assuming the role of President of ESI and using his purported authority to extort their ownership interest in ESI;
2) Taking unjustified and secret increases in compensation and bonuses;
3) Demanding a one million dollar payment from NCI and then, when NCI did not pay the one million dollars, terminating the ESI/NCI relationship; and
4) Directing von Harz to file federal tax returns for ESI in 2014, 2015, and 2016 that included a $178,000 receivable from NCI designed to benefit Hanes personally through his defunct company, Cynergy.

Hanes' fiduciary duties to Guarino and Falke included not only the duty of loyalty and care to ESI but also the duty not to frustrate the reasonable expectations that Guarino and Falke had under the circumstances.[104] Hanes' fiduciary duty flowed from his ownership of 50% of ESI through the bequeathing of Brice's 25% interest and, importantly, his self-proclaimed position as a *de facto* President of ESI. Once Hanes

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[102] *See generally, Cookies Food Products, Inc. v. Lakes Warehouse Distributing, Inc.*, 430 N.W2d 447 (Iowa 1988).

[103] The extraordinary facts of this case make futile the requirement that Guarino and Falke make a demand upon the management of ESI to bring their counterclaims. The Court therefore rejects the notion that Guarino and Falke's counterclaims are precluded because they did not make a demand on ESI, through Hanes and/or von Harz, to bring these claims. *See Holi-Rest, Inc. v. Treloar*, 217 N.W.2d 517, 523 (Iowa 1974).

[104] *See Baur v. Baur Farms, Inc.*, 832 N.W.2d 663 (Iowa 2013); *Spears v. Com Link, Inc.*, 837 N.W.2d 680 (Table), 2013 WL 3457171, *8 (Iowa App. 2013); *Promat Technical Services, Pvt. Ltd. v. FLSmidth, Sioux City, Inc.*, Iowa Dist. Ct. Woodbury Cty No. 152295 (June 4, 2015).

announced that he had total control of ESI in December 2013, he likewise had a duty to engage Guarino and Falke reasonably, in good faith and fairness.[105]

Hanes' fiduciary duties also included a "'prohibition against self-dealing that inheres in the fiduciary relationship' and a duty to deal fairly and honestly with the shareholders for whom he is a fiduciary."[106] Self-dealing occurs where a fiduciary derives personal profit or benefit from transactions between himself and the corporation.[107] Corporate waste occurs where "a corporation is caused to effect a transaction on terms that no person of ordinary, sound business judgment could conclude represent a fair exchange."[108]

It is axiomatic that unilaterally taking a bonus and substantial increases in compensation, without clear justification or the knowledge and consent of the other owners of ESI, is violative of Hanes' fiduciary duties and constitutes self-dealing and corporate waste. After an exhaustive search, the Court cannot find justification supporting Hanes and von Harz's bonus and salary increases in 2014, 2015, and 2016. Whatever justification that may exist becomes all the more tenuous given net losses it caused ESI to incur.[109] Hanes and von Harz's bonus and salary increases certainly were not the result of an independent and objective compensation analysis or an agreement from all owners. As discussed in the Court's Findings of Fact, there is evidence the increases in compensation and bonuses were taken as part of a plan to strip ESI of all profits until it withered away, leaving Guarino and Falke with nothing.[110] Unquestionably, Hanes and von Harz took the bonuses and compensation increases in 2014, 2015, and 2016 without notifying Guarino or Falke and obtaining their consent. These actions all constituted a breach of the fiduciary duties that Hanes owed to Guarino and Falke, as the *de facto* president of ESI.

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[105] *See Spears*, 837 N.W.2d 680; *Jochimsen v. Wapso Hunting Club, Inc.*, 803 N.W.2d 672 (Table), 2011 WL 2695272 (Iowa App. 2011); *Dennison v. Mediacomm, Inc.*, 720 N.W.2d 194, *2 (Table) (Iowa App. 2006).

[106] *Dennison*, 720 N.W.2d 194 at *2 (citations omitted); *In re Tyson Foods, Inc.*, 919 A.2d 563, 592 (Del. Chanc. 2007.

[107] *See, e.g., Matter of Estate of Snapp*, 502 N.W.2d 29, 33 (Iowa App. 1993).

[108] *Steiner v. Meyerson*, No. 13139, 1995 WL 441999, *1 (Del. Chanc. July 19, 1995).

[109] *See Treloar*, 217 N.W.2d at 525 (requiring a plaintiff to establish the reasonableness of compensation and bonuses and disgorge such amounts should the plaintiff fail to do so).

[110] *See* Trial Ex. FH.

2. STATUTORY AFFIRMATIVE DEFENSES AND SHAREHOLDER OPPRESSION

Oppressive conduct has been defined and accepted with approval as:

> burdensome, harsh and wrongful conduct; a lack of probity and fair dealing with the affairs of a company to the prejudice of some of its members, or a visual departure from the standards of fair dealing, and a violation of fair play on which every shareholder who entrusts his money to a company is entitled to rely.[111]

It must be analyzed in terms of the fiduciary duties owed by Hanes to Guarino and Falke.[112]

In 2013, Hanes admitted to being a terrible partner and acknowledged he was in financial ruin.[113] He did not have any money to buy the interests of Guarino and Falke and he could not afford to lose his employment at ESI.[114] But, Hanes knew and did not tell Guarino and Falke that MEEA had agreed to a multi-year contract starting in January 2014 that would bring in more revenue to ESI. [115] With Guarino and Falke no longer a part of ESI, Hanes would not have to share this new revenue. It is against these facts that Hanes' actions must be measured.

First, the Court reincorporates its discussion regarding the bonuses and compensation. The Court also reincorporates the discussion regarding Hanes' one million dollar invoice. Both acts were completed as means of attempting to leverage the ESI ownership interests from Guarino and Falke. More to the point, on February 14, 2014, Hanes, through Attorney Kreykes, sent a notice of special meeting of shareholders to Guarino and Falke with an accompanying motion to redeem their shares:

> Timothy Hanes moves to have the corporation redeem all outstanding shares owned by Dominick S. Guarino and Gregory R. Falke in exchange for the following consideration:
>
> 1. Guarino and Falke will receive the balance in the Ohio bank account.
> 2. The NCI account receivable is forgiven.

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[111] *Jochimsen*, 803 N.W.2d 672 at * 5, quoting *Maschmeier v. Southside Press, Ltd.*, 435 N.W.2d 377, 380 (Iowa App. 1988) (other citations omitted).

[112] Id.

[113] Trial Ex. J.

[114] *See Id.*; Trial Tr. 83:5-11; Hanes Trial Test. June 2017.)

[115] The record reveals that there was no disclosure of the multi-year MEEA beginning in 2014 to Messrs. Guarino and Falke until after this lawsuit was filed. (Guarino Trial Test.)

> The Corporation shall retain all other assets.
>
> If Shareholders are deadlocked at the end of the meeting of Shareholders on February 24, 2014, NCI access to software will be turned off immediately.[116]

Hanes' message to Guarino and Falke clearly was "if you give me your ESI ownership then the ESI invoice disappears." He confirmed this intent to Attorney Kreykes in writing, stating:

> On the motion to dissolve. NCI will not be forgiven for the outstanding balance. The only way they are forgiven for the balance is if they turn over their shares to ESI and do not receive a copy of the software.[117]

When that did not work, Hanes shut off database access to NCI's customers. At each step, however, Hanes offered to resolve these "issues" if Guarino and Falke would turn over ownership interest in ESI to him.[118] Not only was this an improper use of his position as a shareholder and *de facto* President of ESI, but it was also not in the best interest of ESI. None of Hanes' actions can be said to have been taken in good faith because all of his conduct was part of a scheme to force Guarino and Falke to surrender their ownership interests in ESI.

Based on the foregoing, the Court concludes that Hanes is not entitled to the affirmative defenses that derive from Iowa Code §490.842. These statutory defenses are available to corporate officers who have honored their fiduciary duties and otherwise acted in the best interest of the corporation. The Court finds that Hanes' conduct was designed solely to benefit his own interests at the expense of Guarino and Falke and with complete disregard for NCI's customers. As for the latter, the Court notes that Iowa law imposes a duty of good faith and fair dealing on an entity that terminates a contract. This obligation applies to the manner in which the contract is terminated. The Court finds that the disregard for customer access to data, for which the customers had already paid, violates that duty of good faith and fair dealing.

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[116] Trial Ex. AH.

[117] Trial Ex. F.

[118] *See* Trial Ex. F, G, Q, AH, AJ, AP, AR, EL, 33.

The Court does note that Hanes did receive legal advice from Attorney Kreykes, who instructed him that he could shut off access to NCI's customers, but the Court concludes that Attorney Kreykes was advising Hanes in his individual capacity, including suggesting Hanes strip all the profit out of ESI in the form of salary increases (which is precisely what was done). Attorney Kreykes was well aware of the shareholder dispute and assisted in the preparation of documents designed to help Hanes obtain the ownership interest from Guarino and Falke. Given these facts Hanes cannot be afforded the protection of advice of counsel contemplated by Iowa Code §490.842.

The Court further finds that all other affirmative defenses raised by Hanes are without merit.

3. PUNITIVE DAMAGES

The Court acknowledges an award of punitive damages should be reserved for conduct that demonstrates a willful and wanton disregard for the rights of others.[119] It is also aware that an award of punitive damages must be measuredm and take into account a number of factors, including the harm to the injured party, the financial condition of the wrongdoer, and the need to deter future like conduct.[120] The wrongdoing here consisted of oppressing the reasonable expectations and rights of Guarino and Falke as shareholders/owners.

Considering the conduct of the persons involved in assisting and advising Hanes in his dispute with Guarino and Falke, and the real economic loss to ESI, and Guarino and Falke as shareholders, the Court concludes that an award of punitive damages as set forth below is appropriate.

4. AWARD OF ATTORNEYS' FEES

Defendants are also entitled to recover their attorneys' fees from Hanes because they prevailed on the derivative claims.[121]

With respect to their individual breach of fiduciary duty claims, Guarino and Falke are allowed to recover attorneys' fees if they show that Hanes' actions rose to the level of

[119] *Williams v. Barnhill*, 791 N.W.2d 429, *7-8 (Table) (Iowa App. 2010), quoting Iowa Code § 668A.1(1)(a).

[120] *See generally Wilson v. IBP, Inc.*, 558 N.W.2d 132 (Iowa 1996); Iowa Code § 668A.1(1); *Jaeger v. Schuchat*, 2001 WL 246360, *3-4 (Iowa App. Mar. 14, 2001).

[121] Iowa Code § 490.746; *Holi-Rest, Inc. v. Treloar*, 217 N.W.2d 517, 526 (Iowa 1974); *Sauer v. Moffitt*, 363 N.W.2d 269, 275 (Iowa App. 1984).

"oppression or connivance to harass or injure [Defendants]."[122] As detailed above, the record is replete with evidence that Hanes acted with the requisite willfulness and wantonness in his multi-year plan to push out Guarino and Falke. Hanes conduct warrants an award of attorneys' fees in Guarino and Falke's favor.

C. AWARD OF OTHER EQUITABLE RELIEF

As derivative claims are equitable in nature, this Court has the power and discretion to fashion equitable relief over and above rendering a judgment for Defendants against Hanes.[123] As noted by the Iowa Supreme Court, "[w]henever a situation exists which is contrary to the principles of equity and which can be redressed within the scope of judicial action, a court of equity will devise a remedy to meet the situation though no similar relief has been granted before."[124]

The Court has considered all of the evidence in the case and the testimony of all of the witnesses who testified both at deposition and at trial. Where, as is here, a shareholder manipulates a corporate entity for his own interests, affirmative remedial measures, such as transferring managerial control of ESI, reallocating ownership interests, and imposing a constructive trust are all well within the equitable powers of the Court.[125]

The goal of the equitable relief being ordered and decreed by this Court is to remedy the breaches of fiduciary duty by Hanes and the general oppression of the rightful ownership interests of Guarino and Falke. The specific components of this Court's equitable decree are set forth below.

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[122] *Hockenberg Equipment Co. v. Hockenberg's Equipment & Supply Co. of Des Moins, Inc.*, 510 N.W.2d 152, 158-60 (Iowa 1993); *see Miller v. Rohling*, 720 N.W.2d 562 (Iowa 2006) (holding attorneys' fees appropriate where the defendant "acted in bad faith, vexatiously, wantonly, or for oppressive reasons").

[123] *Treloar*, 217 N.W.2d at 523, 527-28.

[124] *Holden v. Construction Machinery Co.*, 202 N.W.2d 348, 363-64 (Iowa 1972).

[125] *See Treloar*, 217 N.W.2d at 527-28; *Sauer v. Moffitt*, 363 N.W.2d 269, 274 (Iowa App. 1984).

ORDER OF JUDGMENT

IT IS THEREFORE ORDERED, ADJUDGED AND DECREED, as follows:

1. Judgment shall be entered in favor of Defendants National Comfort Institute, Inc., Dominick S. Guarino and Gregory R. Falke and against Plaintiff Timothy Hanes on all Counts of Plaintiff Timothy Hanes' Petition. For the reasons stated herein Plaintiff Timothy Hanes improperly brought this derivative action in a variety of ways:
    a) Not having cause to overcome the business judgment of the interim acting CEO, John von Harz, who, after investigating the claims in good faith, determined not to bring an action on behalf of ESI against the Defendants;
    b) Bringing this action for an improper purpose;
    c) Having unclean hands and taken steps to unfairly oppress his fellow owners, Messrs. Guarino and Falke, in an effort to extort from them their ownership interest in ESI;
    d) Improperly awarding himself a secret bonus and unjustified salary increases and wasting corporate assets when providing the same to Mr. von Harz; and
    e) Failing to carry his evidentiary burden with respect to all of the claims asserted in his Second Amended Petition.
2. The individual Defendants, Dominick S. Guarino and Gregory R. Falke, satisfied their evidentiary burden with respect to their Counterclaims against Mr. Hanes.
3. Plaintiff Timothy Hanes failed to carry his evidentiary burden with respect to his affirmative defenses to the Counterclaims asserted by Dominick S. Guarino and Gregory R. Falke, all of which fail as a matter of law and/or fact.
4. Judgment shall be entered in favor Defendants Dominick S. Guarino and Gregory R. Falke and against Plaintiff Timothy Hanes on all Counts of their Counterclaims.
5. Timothy Hanes is hereby ordered to disgorge to ESI the sum of $189,338.44, which constitutes the improper and unjustified compensation he took from ESI from January 1, 2014 through July 31, 2017 to the detriment of ESI and to Messrs. Guarino and Falke, along with interest at the statutory interest rate.

6. Timothy Hanes is further ordered to pay damages to ESI in the amount of $150,367.05, which represents the improper and unjustified waste of ESI funds paid to Mr. von Harz from January 1, 2014 through December 31, 2016, along with interest at the statutory interest rate.
7. The Court orders the twenty-five percent (25%) ownership interest in ESI given by Bob Brice to Timothy Hanes be reallocated so that Timothy Hanes, Dominick S. Guarino and Gregory R. Falke receive an equal percentage of that amount. The Court further decrees that Messrs. Guarino, Falke, and Hanes each own thirty-three point three three percent (33.33%) or one-third (1/3) of the equity of ESI.
8. The Court further imposes a constructive trust on Timothy Hanes' ownership interest in ESI, as reflected by this Order, which shall continue until all amounts owed by Timothy Hanes per this Order are fully satisfied.
9. The Court awards Defendants National Comfort Institute, Inc., Dominick S. Guarino and Gregory R. Falke, as the prevailing parties in a derivative action, reasonable attorneys' fees and costs as provided by Iowa Code §490.746. The Court further awards Dominick S. Guarino and Gregory R. Falke reasonable attorneys' fees and costs in connection with their Counterclaims against Timothy Hanes. Defendants National Comfort Institute, Inc., Dominick S. Guarino and Gregory R. Falke shall have fourteen (14) days from the date of this ruling to provide the Court with an application for attorneys' fees and costs, along with supporting affidavits. Timothy Hanes shall have ten days to provide a written response, and Defendants seven days to file a reply if necessary, after which the Court will conduct a hearing and thereafter determine the reasonable amount of attorney fees and costs to award to the Defendants.
10. The Court awards Dominick S. Guarino and Gregory R. Falke an award of punitive damages against Timothy Hanes in the amount of ten percent (10%) of Timothy Hanes' ownership interest in ESI, to be divided equally between Messrs. Guarino and Falke.

So Ordered.

State of Iowa Courts

Type: OTHER ORDER

Case Number	**Case Title**
EQCE076363	TIMOTHY HANES VS ENERGY STEWARDS INTERNATIONAL INC ET AL

So Ordered

David Porter, District Court Judge,
Fifth Judicial District of Iowa