> Joint Venture], however, Paradigm would receive 25% of the fees. The split would, however, be negotiated on a case-by-case basis if the Japanese investor was introduced by BoNY.[11]

The original complaint sought damages from Ivy Asset and Ivy International for breach of the New Bargain.

I. Ishimaru Amends Her Complaint When The Ivy Defendants Argue That The Claims Against Them Are Subject To The Arbitration Clause

The Ivy defendants responded to the original complaint by moving to stay or dismiss this case on the grounds that Ishimaru's breach of contract claims were governed by the Arbitration Clause of the Joint Venture Agreement. Ishimaru countered by amending her complaint in a manner that to a cynic would appear purposely designed to retract pled facts that, if true, made it more difficult for her to escape the Arbitration Clause. A non-exhaustive parade of some of the highlights include:

- Removing Ivy International as a defendant altogether;
- Changing the definition of Ivy to include only Ivy Asset;
- Changing an allegation that Ivy Asset and Ivy International both breached an agreement not to compete with the Joint Venture in Japan to contend that Ivy Asset alone violated an agreement by Ivy International alone not to compete with the Joint Venture, by marketing products in Japan bypassing the Joint Venture. In other words, the amended complaint is internally inconsistent as it alleges that Ivy Asset is responsible singularly for breaching an agreement made by Ivy International singularly, and by trying to keep entities distinct that Ishimaru clearly treated as indistinct in the original complaint and her business dealings;

---

[11]Compl. ¶ 51 (emphasis added).

- Changing allegations related to the behavior of the Ivy entities under the Joint Venture Agreement to contend that Ivy Asset acted wrongfully by using information gleaned from Ivy International through the Joint Venture to market Ivy Asset products in Japan outside the Joint Venture;

- Changing the allegation that Ivy International was a party to the New Bargain and alleging that Ivy Asset and Paradigm were the only parties;

- Changing the allegation that, after the New Bargain, Ishimaru invested time marketing Ivy Asset products on behalf of the Joint Venture, to allege that she invested that time only on behalf of Paradigm; and

- Changing the allegation that the New Bargain "re-affirmed" key aspects of the Joint Venture Agreement with certain "exceptions" to an allegation that Ivy Asset and Paradigm entered into the New Bargain as a "contract to settle a dispute between the members of [the Joint Venture]." That is, Ishimaru alleged that Ivy Asset settled a dispute among the Members of the Joint Venture, through a contract to which one of the alleged disputing members, Ivy International, was not even a party.

As can be seen, Ishimaru took an original complaint that told a plausible, unstrained story that rightly made little distinction between Ivy Asset—an operating company that both provided all the real work and made all the real decisions on the Ivy side related to the Joint Venture—and Ivy International—an LLC formed as the specific vehicle that for tax and liability-limiting purposes that was the direct Member of the Joint Venture—and converted it into a stilted, awkward, and implausible tale. Yet, Ishimaru claims that the amended complaint was filed to ensure the operative complaint more accurately reflected the facts, rather than to avoid the Arbitration Clause.

II. Legal Analysis

There are two critical issues before me now. The first is whether Ishimaru may assert derivative claims on behalf of Paradigm against Ivy

Asset. The second issue is whether Ishimaru can proceed derivatively on Paradigm's behalf in this court, rather than in arbitration. The second issue need only be addressed if the answer to the first issue in contention is affirmative. I therefore address them in logical order.

A. Does The Amended Complaint Plead Facts Justifying The Procession Of A Derivative Action By Ishimaru On Paradigm's Behalf?

The procedural posture in which this issue arises has been unnecessarily complicated, by both Ishimaru and Fung. The complications started with the odd nature of the complaint. Instead of simply alleging facts demonstrating why Ishimaru should be permitted to proceed as a derivative plaintiff on Paradigm's behalf, Ishimaru concocted a fiduciary duty claim against Fung premised on his failure to take any action against Ivy Asset for breaching the New Bargain.

For his part, Fung confused things by his responses to the complaint and amended complaint. Fung did not move to dismiss on the grounds that Ishimaru had not shown a basis to proceed with a derivative claim—in other words, by arguing that he as managing member of Paradigm could disinterestedly determine that matter. Instead, Fung simply moved to stay the fiduciary duty claim, arguing that it was premature to litigate that count against him until the claim Ishimaru asserted on Paradigm's behalf against Ivy Asset was adjudicated, in whatever forum.[12] Fung's theory was that if Paradigm's claim failed, he could not have harmed Paradigm by failing to assert it. Because of this approach, Ishimaru rightly claims that Fung led her and the court to believe that he would not assert that she could not proceed derivatively on Paradigm's behalf.

As motion practice on Ivy Asset's motion to dismiss this case in favor of arbitration evolved, however, Fung gummed up the works by attempting to back-track on that position. He began raising objections to Ishimaru's right to proceed.

In order to clarify matters, I instructed Ishimaru to seek judgment on the pleadings as to her right to proceed derivatively, and gave Fung an opportunity to answer the amended complaint. That opportunity was without prejudice to Ishimaru's right to argue that Fung had waived the

---

[12]In two letters to the court, Fung plainly said that the New Bargain Claim should be arbitrated. *See* Fung Letter at 3-4, April 18, 2005; Fung Letter at 2-3, June 10, 2005. Fung even argued that he would like to bring claims against Ishimaru if the New Bargain Claim was remitted to arbitration and that this was a further reason to stay the claim against him. Fung Letter at 2, June 10, 2005.

arguments he recently came to embrace. Briefing on the question of the procession of the derivative action was recently completed. After considering the arguments of the parties, I conclude that Ishimaru is entitled to proceed derivatively on Paradigm's behalf for two reasons.

The first is that Fung, by his conduct in this litigation, waived any argument that Ishimaru cannot proceed derivatively for Paradigm. By necessity, it is important that the question of whether a complaint pleads sufficient grounds to justify the procession of a derivative suit be addressed early in litigation. On not one but two occasions, Fung responded to complaints by urging this court to defer action on the fiduciary duty count against him until Ishimaru, on behalf of Paradigm, duked it out with Ivy Asset on the merits. Therefore, Fung waived the right to withdraw that position, for tactical reasons, and now claim that he, as managing member of Paradigm, should determine whether Paradigm sues Ivy Asset.

Delaware law rightly takes seriously the task of evaluating when a suit by an entity should proceed at the instance of a derivative plaintiff, rather than the entity's governing authority. That is why our corporate law imposes a specific burden to plead demand futility,[13] and why that has been replicated in our statute addressing LLCs.[14] But it is also the obligation of a defendant resisting the procession of a derivative suit to make a demand excusal argument promptly and not waste the resources of the plaintiff and court.[15] Here, Fung not once, but twice, expressed the view that the New Bargain claim should be decided on its merits. He is now rightly stuck with that position.

Second, even if Fung had properly preserved an objection to Ishimaru's attempt to proceed derivatively for Paradigm, the amended complaint pleads particularized facts demonstrating that Fung, as managing member, cannot disinterestedly determine whether Paradigm should sue Ivy Asset.[16]

---

[13]*E.g.*, *Aronson v Lewis*, 473 A.2d 805 (Del. 1984).

[14]6 *Del. C.* § 18-1003.

[15]Ironically, Fung's earlier argument that arbitration of the New Bargain Claim should be the first order of business was justified as the best way to avoid "a highly inefficient use of judicial and the parties' resources . . . ." Fung Letter at 3, June 10, 2005.

[16]It is possible to conceive of this as a case where demand was made and refused because Ishimaru raised the issue of Ivy Asset's purported breaches with Fung and attempted to discuss a strategy for dealing with Ivy Asset. The test for determining whether a communication constitutes a demand was articulated by then Vice Chancellor, now Justice Jacobs in *Yaw v. Talley*, 1994 WL 89019, at *7 (Del. Ch. Mar. 2, 1994): "to constitute a demand, a communication must specifically state: (i) the identity of the alleged wrongdoers, (ii) the wrongdoing they allegedly perpetrated and the resultant injury to the corporation, and (iii) the legal action the shareholder wants the board to take on the corporation's behalf." Neither party has argued that the demand refusal standard applies, both have instead argued this as a demand excusal motion and I accept their rubic. Specifically, Fung does not allege that Ishimaru's communications to him

The Delaware Limited Liability Company Act provides that "a member . . . of a limited liability company . . . may bring an action in the Court of Chancery . . . to recover a judgment in its favor if managers or members with authority to do so have refused to bring the action or if an effort to cause those managers or members to bring the action is not likely to succeed."[17] A derivative complaint filed by an LLC member must also set forth with particularity "the effort, if any, of the plaintiff to secure initiation of the action by a manager or member or the reasons for not making the effort."[18] The standard governing demand by an LLC member, whether such demand is "likely to succeed," is the same standard governing demand in limited partnerships.[19] This court has recognized, despite the statutory basis for demand in the limited partnership context, that "the issues in determining demand futility for partnership law appear identical to those in corporation law"[20] and, therefore, has applied the familiar test for corporate demand futility. Similarly, we have applied the *Aronson* test to demand futility in the LLC context.[21] I will, therefore, look to precedent on corporate demand futility in determining whether Ishimaru was excused from making demand on Fung as the managing member of Paradigm.

Under the substantive law of Delaware, a court will find demand futility where "the particularized factual allegations of a derivative stockholder complaint create a reasonable doubt that, as of the time the complaint is filed, the board of directors could have properly exercised its independent and disinterested business judgment in responding to a demand."[22] Ishimaru easily satisfies the statutory requirement to plead demand excusal with particularity. She sets forth with particularity that Fung sought to strike a deal for himself personally with Ivy Asset in Europe that would have permitted him, to the exclusion of the Joint Venture and Paradigm, to exploit the benefits of PILS in Europe. Part of Fung's strategy was to compromise away the Joint Venture's and Paradigm's rights in Japan so as to further his own personal ends.

Fung's contention that the Paradigm LLC Agreement made him managing member with the initial authority to decide whether to sue does

---

satisfied the *Yaw* criteria. Additionally, even if Fung had raised the demand refusal standard, Ishimaru has articulated particularized facts in her amended complaint that create a reasonable doubt as to the good faith and reasonableness of Fung's investigation. *See Levine v. Smith*, 591 A.2d 194, 212 (Del. 1991).

[17] 6 *Del. C.* §18-1001.

[18] 6 *Del. C.* §18-1003.

[19] 6 *Del. C.* §17-1001.

[20] *Litman v. Prudential-Bache Properties, Inc.*, 1993 WL 5922 (Del. Ch. Jan. 4, 1993).

[21] *VGS, Inc. v. Castiel*, 2003 WL 723285 (Del. Ch. Feb. 28, 2003).

[22] *Rales v. Blasband*, 634 A.2d 927, 934 (Del. 1993).

not aid him in opposing Ishimaru's wish to proceed as a derivative plaintiff, nor do the provisions of the LLC Agreement that permit Fung to consider his own interests in making certain decisions for Paradigm. As is common in LLC Agreements these days, the provisions dealing with the managing member's duties and rights in the Paradigm LLC Agreement can be read as contradictory and confusing. But the Paradigm LLC Agreement denies exculpation to the managing member for conduct that constitutes fraud, gross negligence, willful misconduct, or an intentional breach of the LLC Agreement.

The behavior that Ishimaru alleges is, if true, obviously the kind of willful misconduct that cannot be exculpated. In other words, although Fung might have been free to pursue opportunities in Europe outside of Paradigm and the Joint Venture using solely his own wiles, he could not usurp, without breaching § 9.03 of the Joint Venture Agreement, proprietary information and other assets (such as claims Paradigm and the Joint Venture had against Ivy Asset and Ivy International) for himself, thereby purposely transferring wealth from them to himself.

In view of that reality, I have little difficulty in concluding that Ishimaru may press the New Bargain Claim derivatively on behalf of Paradigm.[23]

B. Must Paradigm Arbitrate Its Claim Against Ivy Asset?

Ivy Asset has moved under Rule 12(b)(1) to dismiss for lack of subject matter jurisdiction, alleging that Paradigm is bound to arbitrate its claims and may not press them in this court. In analyzing a motion to compel arbitration, "the question of whether the parties agreed to arbitrate . . . is generally one for the courts and not for the arbitrators."[24] In determining arbitrability, I must ascertain whether the dispute is one that, on its face, falls within the arbitration clause of the contract.[25]

---

[23]Without dilating on the point, I want to make clear my own recognition that the claim Ishimaru seeks to press may be better conceived of as a double derivative claim. That is, in actuality, the party that was directly injured by any breach of the New Bargain was the "unified front," the Joint Venture, which was bypassed by Ivy Asset. The harm to Paradigm is indirect, resulting from the failure of Ivy Asset to conduct its business in Japan through the Joint Venture and to share the agreed-upon fees with the Members of the Joint Venture. Even more clearly, the claims against Ivy Asset that supposedly led it to agree to the New Bargain were ones possessed by the Joint Venture in the first instance. Neither party has picked up on the double derivative aspect of the New Bargain Claim, perhaps because it is obvious that Ivy International could block the Joint Venture from pressing claims and that Ivy International cannot impartially decide whether the Joint Venture should sue Ivy Asset.

[24]*SBC Interactive, Inc. v. Corporate Media Partners*, 714 A.2d 758, 761 (Del. 1998).

[25]*Id.*

In interpreting the Arbitration Clause, Delaware public policy comes into play and requires that doubts should be resolved in favor of arbitrability when a reasonable interpretation in that direction exists.[26] The strong federal policy to the same effect also applies in this case because the parties chose to submit their disputes to arbitration in a manner implicating the Federal Arbitration Act. In applying state-law principles of contract interpretation to an arbitration agreement "within the scope of the [FAA]," "due regard must be given to the federal policy favoring arbitration, and ambiguities as to the scope of the arbitration clause" must be resolved in favor of arbitration.[27] But, when there is no reasonable contractual or other legal or equitable basis for subjecting a resisting party to arbitration, the court cannot mandate resort to that process.[28]

Here, the ultimate question of arbitrability hinges on two subordinate inquiries. One inquiry is whether the New Bargain Claim has a sufficient relationship to the Joint Venture Agreement to fall within the scope of the Arbitration Clause. If the answer is yes, then it must be determined whether Ivy Asset, which is neither formally a "Member" of the Joint Venture nor mentioned in the Arbitration Clause, may nonetheless require Paradigm, which is a Member mentioned in the Arbitration Clause, to arbitrate, rather than litigate, the New Bargain Claim. As I will make clear, the factual allegations of Ishimaru's complaints that make clear that the New Bargain Claim falls within the scope of the Arbitration Clause also bear on the question of whether Ivy Asset may require Paradigm to arbitrate.

1. The New Bargain Claim Is A Dispute "Concerning" The Joint Venture Agreement

Although she denies her purpose was tactical, Ishimaru recast her complaint in a manner that helps her argue that the New Bargain was a stand-alone contract existing wholly apart from, and not as an evolutionary amendment of, the Joint Venture Agreement. She contends that the Arbitration Clause is narrow because it only addresses disputes "concerning" the Joint Venture Agreement, and not disputes "relating in any way" to that Agreement, as some arbitration clauses state. In an athlete, sheer force can sometimes render excusable or irrelevant a lack of

---

[26] *Id.*

[27] *Dresser Indus., Inc. v. Global Indus. Tech., Inc.*, 1999 WL 413401, at *4 (Del. Ch. June 9, 1999) (quoting *Volt Info. Sci., Inc. v. Bd. of Tr. of Leland Stanford Junior Univ.*, 489 U.S. 468, 475-76 (1989)).

[28] *SBC Interactive*, 714 A.2d at 761.

subtlety and grace. But the logical force of Ishimaru's argument is underwhelming and provides no cover for her ham-handed pleading amendments.

For starters, Ishimaru makes an unpersuasive argument that the Arbitration Clause in the Joint Venture Agreement is narrow. In so contending, Ishimaru relies on the Supreme Court's decision in *Parfi Holding AB v. Mirror Image Internet, Inc.*,[29] holding that when a party brings an action to compel arbitration, a court must determine whether the arbitration clause in question is broad or narrow in scope.[30] If the clause is broad, then the court must "defer to arbitration on any issues that touch on contract rights or contract performance."[31] If the clause is narrow, the court "will ask if the cause of action pursued in court directly relates to a right in the contract."[32] Here, the Arbitration Clause provides:

> each Member agrees to submit all controversies arising between Members, or one or more Members and the Company, concerning this Agreement to arbitration in accordance with the provisions set forth below . . . [a]ll controversies that may arise among Members and one or more Members and the Company concerning this Agreement shall be determined by arbitration in New York City . . . to the fullest extent permitted by law.

In *Parfi*, the Supreme Court held that a clause containing the words "any dispute, controversy, or claim arising out of or in connection with" a contract was broad.[33] Ishimaru argues that, in contrast, the language in the Arbitration Clause in the Joint Venture Agreement is much narrower.[34] I, however, do not find the distinctions in language to be of material importance in addressing the current dispute. The difference between using the words "concerning this Agreement," rather than the words "arising out of this Agreement," is slight, if extant. A primary definition of "concerning" is "relating to, regarding."[35] The expressed desire to arbitrate

---

[29]*Parfi Holding AB v. Mirror Image Internet, Inc.*, 817 A.2d 149 (Del. 2002).

[30]*Id.* at 155.

[31]*Id.*

[32]*Id.*

[33]*Id.*

[34]*Id.* (subjecting all claims "arising out of or in connection with" the agreement to arbitration).

[35]*Merriam-Webster OnLine Dictionary* (2005). *See also The Concise Oxford Dictionary of Current English* (9th ed. 1995) (defining "concerning" as "about, regarding"); *Webster's Desk Dictionary* (1996) (defining "concerning" as "relating to; regarding; about"); *Webster's Ninth New Collegiate Dictionary* (1990) (defining "concerning" as "relating to:

any claims that relate to the parties' agreement encapsulates a broad array of claims. Therefore, as the arbitration clause is broad, I consider "any issues that touch on contract rights or contract performance" to be within the scope of the Arbitration Clause.[36]

Ishimaru's allegation that Ivy Asset breached the New Bargain clearly touches on contract rights and performance under the Joint Venture Agreement. To begin with, the origins of the New Bargain are rooted entirely in the Joint Venture Agreement. Ishimaru contends that Ivy Asset had been violating obligations it owed to the Joint Venture under the Joint Venture Agreement by marketing competing products in Japan. Although Ishimaru's amended complaint attempts to root that alleged violation in Ivy Asset's use of information it learned from Ivy International through the Joint Venture, even that explanation connects Ivy Asset's allegedly wrongful behavior to the Joint Venture Agreement. In essence, Ishimaru argues that Ivy Asset was breaching obligations it owed to the Joint Venture under § 9.03 not to misuse confidential information of the Joint Venture.

More fundamentally, the amended complaint continues to accuse Ivy Asset of breaching obligations it owed to the Joint Venture simply by marketing its own products in Japan other than through the Joint Venture. The basis for this argument is block quoted in the amended complaint and is a portion of the Business Plan for 2000-2001, adopted pursuant to § 1.03(a) of the Joint Venture Agreement. That portion states that "The JV recognizes the importance of gaining investors quickly as competitors can easily establish similar offerings. Both joint venture partners remain committed to the business plan and will not engage in substantially similar businesses targeted at the Japanese market which may damage the success of the JV."[37] By Ivy, that Business Plan is clearly referring not only to Ivy International, but to Ivy Asset. Indeed, to read it otherwise would be to conclude, contrary to Ishimaru's argument, that this promise did not bind Ivy Asset at all.

As we know, eventually Paradigm and Ivy Asset conducted negotiations to resolve their disagreement about whether Ivy Asset's activities in Japan breached obligations it owed to the Joint Venture. It bears pausing a moment to emphasize that point. To the extent Ivy Asset was marketing products in Japan directly, it was bypassing the Joint Venture. Any harm to Paradigm from Ivy Asset's competitive activities in

---

regarding").

[36] *Parfi Holding*, 817 A.2d at 155.

[37] Am. Compl. ¶¶ 14-15.

Japan was indirect and arose from the direct injury to the Joint Venture's rights.

When Paradigm and Ivy Asset were haggling over their dispute, it thus is clear that they were acting in their capacities as Joint Venturers. In that process, Ivy Asset and Ivy International did not have separate negotiators. Ivy International had no operatives separate from Ivy Asset. The officers who acted for the Ivy entities, Simon and Lindenbaum, were top officers of both entities.[38] In all material respects, Ivy International was simply the liability- and tax-insulating vehicle used by Ivy Asset to conduct its Joint Venture with Paradigm. The Business Plans of the Joint Venture recognize this, by expressly treating Ivy Asset as if it were the Member and assigning it direct responsibilities.

As even the amended complaint states, the New Bargain was an agreement "to resolve the claims that Ivy International was harming PI's business by allowing its parent access to PI's Japanese contacts."[39] The problem that poses for Ishimaru's argument that her claims do not concern the Joint Venture Agreement is insurmountable.

By virtue of § 9.01 of the Joint Venture Agreement, an amendment could only be accomplished by a writing signed by both of the Members. But Ishimaru disclaims the notion that Ivy International was a party to the New Bargain, arguing that the only parties were Ivy Asset and Paradigm. That contention, which is contrary to the original complaint, seems entirely implausible, but, even if true, does not aid Ishimaru in escaping arbitration.

By its plain terms, the New Bargain had several profound implications for the Joint Venture. The New Bargain had the effect of compromising away claims of the Joint Venture against Ivy Asset, both for damages for past conduct and for injunctive relief against future competition. If the New Bargain was in place, then Ivy Asset was free to exploit the Japanese contacts it had made through the Joint Venture in order to sell its own existing products, so long as it paid the fees outlined in the New Bargain. The New Bargain also changed the fee split between the Joint Venture partners in an important, related manner. To the extent that the Joint Venture Agreement was not amended, Ivy Asset would arguably have been required to conduct the marketing of its own products in Japan (at least as to contacts first identified by the Joint Venture) through the Joint Venture and to split the fees equally between the Joint Venture partners, per §§ 3.04-3.05 of the Joint Venture Agreement. By

---

[38]In fact, it is not clear from the complaints whether Lindenbaum even had a position with Ivy International.

[39]Am. Compl. ¶ 29.

contrast, the New Bargain permitted Ivy Asset to market its existing products in Japan on a much more favorable 75%-25% split.

To salvage this part of her argument, Ishimaru seeks to distance herself from the plain language of the New Bargain. She says the New Bargain is not a "reaffirmation" of the Joint Venture Agreement, as the original complaint expressly characterized it,[40] but instead largely a complete substitute. But the words of the New Bargain itself are at odds with that claim.

The first operative part of the New Bargain flatly states: "all Ivy business in Japan will be conducted by the joint venture. The joint venture will be the unified front offering all Ivy related products and services in Japan."[41] It then goes on to explain what the economic implications would be for the Joint Venture partners depending on what product was sold in Japan and how the buyer came to be identified. By its plain terms, the New Bargain implies the Joint Venture would become the marketing force—the "unified front"— for all of Ivy Asset's products to be sold in Japan. When the product sold through the unified front was one developed by Ivy Asset alone, its Joint Venture vehicle, Ivy International, would get a higher amount. This different split obviously altered provisions of the Joint Venture Agreement.[42]

Ishimaru resists this reading, however. She contends that, after the New Bargain, the Joint Venture only would be involved in selling products it developed itself. Ivy Asset would market its own products in Japan, and Paradigm would help in that regard. If an Ivy Asset product was sold in Japan, Ivy Asset would get 75% of the proceeds, Paradigm would get 25%, and none of the funds would flow through the Joint Venture.

That construction necessarily depends on the Joint Venture being not much of a "unified front" at all despite the plain words of the New Bargain, a construction at odds with the notion that the New Bargain is clear enough to be capable of enforcement as a contract. More importantly, if true, that construction requires acceptance of the fact that Ivy Asset, a non-party to the Joint Venture Agreement, could compromise away rights of the Joint Venture through a contract with Paradigm to which Ivy International was not a party.

Stated bluntly, if Ishimaru is correct, then viable claims of the Joint Venture against Ivy Asset were compromised away in a contract that did not involve Ivy International. The New Bargain resulted in Ivy Asset being able to market its products in Japan using information derived from the

---

[40]Compl. ¶ 51.
[41]Ishimaru Ans. Br. Ex. A.
[42]*See* JVA §§ 3.04-3.05.

Joint Venture and to receive the proceeds directly so long as it later turned over to Paradigm 25% of the fees. That compromise cut the Joint Venture out entirely, and therefore meant that Ivy International, a supposedly separate entity with separate legal dignity, received nothing! Under the Joint Venture Agreement, the two Members were Paradigm and Ivy International and under § 2.01 neither was permitted to act unilaterally. Therefore, to the extent the Joint Venture was to compromise away its rights, Ivy International had to be a party to the New Bargain and, along with its fellow member Paradigm, had to assent to that compromise on the Joint Venture's behalf.

Under Delaware law, the New Bargain must be analyzed in "the context of the ongoing relationship of the parties."[43] Ishimaru will surely argue that the New Bargain is an enforceable, sensible, and understandable contract, when viewed in light of the evolving course of dealing under the Joint Venture Agreement. Likewise, Paradigm will no doubt look to the Joint Venture Agreement as the gap-filler for any unspecified details or references in the terse e-mail exchange that comprises the New Bargain. As important, Paradigm's New Bargain claim necessarily depends on the premise that the New Bargain either validly amended the Joint Venture or compromised away claims and rights of the Joint Venture, or, most likely, both. In all scenarios, the New Bargain claim rests on the assertion that rights belonging to both the Joint Venture and Ivy International could be altered in a contract exclusively between Ivy Asset and Paradigm.

In defending itself against the New Bargain claim, Ivy Asset will wish to argue that, per the terms of the Joint Venture, the New Bargain is not formal or specific enough to serve as an amendment to the Joint Venture Agreement. It will also argue that no amendment to the Joint Venture Agreement (or compromise of the Joint Venture's rights) could be made without Ivy International's assent. Perhaps of most importance, Ivy Asset will seek to explain the New Bargain in view of the limited duties Ivy Asset owed the Joint Venture and to use provisions of the Joint Venture Agreement as a defense.

The inescapable reality therefore is that any adjudication of the New Bargain will center on the Joint Venture Agreement, the parties' course of dealing under it, and the extent to which the business plans adopted pursuant to § 1.03(a) and the New Bargain modified the Joint Venture and the rights and duties of Ivy International, Ivy Asset, Paradigm, and the Joint Venture itself. Thus, the New Bargain claim clearly "concern[s] the Joint Venture Agreement in a manner governed by the Arbitration Clause."

---

[43]*Seiler v. Levitz Furniture Co. of E. Region, Inc.*, 367 A.2d 999, 1005 (Del. 1976).

2. May Ivy Asset Require Paradigm To Arbitrate Even Though Ivy Asset Was Not Formally A Member Of The Joint Venture?

The fact that Paradigm asserts a dispute concerning the Joint Venture Agreement does not suffice to determine the question of whether Ivy Asset can force Paradigm to arbitrate. By its terms, the Arbitration Clause only applies to disputes between Members, or between a Member and the Joint Venture. Member is defined early in the Joint Venture Agreement in a manner that does not sweep in affiliates like Ivy Asset, even though such affiliates are expressly dealt with in other provisions of the Joint Venture Agreement and even impressed by the Agreement with contractual duties to the Joint Venture (e.g., a duty to not to misuse the Joint Venture's confidential information[44]), as well as contractual rights (e.g., indemnification).[45] Ishimaru argues that because the Joint Venture Agreement took care to distinguish Members from their affiliates and the Arbitration Clause addresses Members only, Ivy Asset, as a non-Member, may not compel Paradigm to arbitrate the New Bargain Claim.

But, in so arguing, Paradigm slights the well-established proposition that a signatory to an Arbitration Clause, such as itself, may be required to arbitrate with a non-signatory when, among other grounds, concepts of equitable estoppel dictate that result.[46] Although there is a debate in the law at times about the precise factual circumstances in which those principles might require a signatory to arbitrate with a non-signatory, there is no debate that there are circumstances in which those principles have that effect. Indeed, principles of equitable estoppel may even operate to bind a non-signatory to an arbitration clause to arbitrate with a signatory.[47]

Here, the circumstances clearly warrant an order requiring Paradigm to arbitrate its New Bargain Claim against Ivy Asset. One of the primary justifications for estopping a signatory from denying a non-signatory a right to arbitrate is that it is unfair for the signatory to have it both ways by attributing to a non-signatory the duties of a contract signatory for purposes of pressing claims but denying the non-signatory the right to invoke the arbitration clause.[48] In this case, the justification for estoppel is compelling

---

[44]JVA § 9.03.

[45]JVA § 2.07. Other rights are contained in § 2.05 (right to compete on certain terms), § 2.06 (exculpation), § 1.08 (transfers of interest) and described earlier in this decision.

[46]*E.g.*, *First Options Of Chicago, Inc. v. Kaplan*, 514 U.S. 938, 944 (1995).

[47]The various legal and equitable principles (e.g., agency, veil piercing, equitable estoppel, assumption by conduct) that can be deployed to require a signatory to arbitrate with a non-signatory can also be used to require a non-signatory to arbitrate with a signatory. *Id. See also Thomson-CSF, S.A.*, 64 F.3d at 776 (reciting examples of theories that enable these results).

[48]*E.g.*, *Hughes Masonry Co., Inc. v. Greater Clark County School Bldg. Corp.*, 659

and rests on grounds that would support the applicability of another theory that, when applicable, can be used to require a signatory to arbitrate with a non-signatory: veil piercing. But equitable estoppel is more appropriate because it is Ishimaru who is simultaneously arguing that the separate corporate existence of Ivy International has no dignity (when that is critical to the vitality of the merits of her New Bargain Claim) and that the separate corporate existence of Ivy International must be recognized and respected (when that aids her in refusing to arbitrate with Ivy Asset).

In other words, the New Bargain Claim is premised on the notion that Ivy Asset, as matter of fact, was so dominant of, and so indistinct from, its mere tool Ivy International that it could act unilaterally as if it were a Member of the Joint Venture. As already explained, the New Bargain, if enforceable in the manner Ishimaru suggests, compromised away claims of the Joint Venture and altered the fee split contained in the Joint Venture Agreement. The New Bargain therefore affected both the rights of Ivy International and the Joint Venture, a result that could only be accomplished through an agreement between the Members of the Joint Venture. Because Ishimaru claims that Ivy International was not a party to the New Bargain, she is indisputably arguing that its separate existence need not be respected because Ivy Asset could compromise away the Joint Venture's and Ivy International's rights without any act by Ivy International itself. Ishimaru therefore plainly argues that Paradigm treated Ivy Asset as a Member of the Joint Venture and that Ivy Asset should be held responsible in that capacity.

Having taken this tack, Ishimaru must accept the consequences that accompany it. Under much less clear circumstances, courts have bound a signatory to arbitrate "at the nonsignatory's insistence because of the 'close relationship between the entities involved, as well as the relationship of the alleged wrong to the nonsignatory's obligations and duties in the contract . . . and [because] the claims were intimately founded in and intertwined with the underlying contract obligations.'"[49] In this case, Ishimaru has herself attributed to the non-signatory, Ivy Asset, the duties and powers of

---

F.2d 836, 838-39 (7th Cir. 1981) ("we believe it would be manifestly inequitable to permit Hughes to both claim that J.A. is liable to Hughes for its failure to perform the contractual duties described in the . . . agreement and at the same time deny that J.A. is a party to that agreement in order to avoid arbitration of claims clearly within the ambit of the arbitration clause"); *Grigson*, 210 F.3d at 528 (quoting *MS Dealer Serv. Corp. v. Franklin*, 177 F.3d 942, 947 (11th Cir. 1999)) ("a signatory . . . cannot 'have it both ways': it cannot, on the one hand, seek to hold the non-signatory liable pursuant to duties imposed by the agreement, which contains an arbitration provision, but, on the other hand, deny arbitration's applicability because the defendant is a non-signatory").

[49] *Thomson-CSF, S.A.*, 64 F.3d at 778 (quoting *Sunkist Soft Drinks*, 10 F.3d at 757) (quoting *McBro Planning & Dev*, 741 F.2d at 344) (first set of internal quotations omitted).

a signatory, and pled that Ivy International is a nullity. Therefore, I grant Ivy Asset's motion and dismiss this case because the New Bargain claim must be arbitrated.[50]

---

[50]In so ruling, I reject Ishimaru's argument that she stands in the same position as the party, the DuPont Company, seeking to avoid arbitration in the case of *E.I. DuPont de Nemours & Co. v. Rhone Poulence Fiber and Resin Intermediates, S.A.S. et al*, 269 F.3d 187 (3d Cir. 2001). Admittedly, Ishimaru cites that case for good reason. Like herself, DuPont took a very tactical approach to pleading in that case. In its original complaint, DuPont pled that it was a third-party beneficiary of a joint venture agreement to which one of its subsidiaries was a party. DuPont alleged that it, and the parent company on the other side of the joint venture, entered into a later agreement whereby the two parents promised to provide loan guarantees for the joint venture and for the parents to "abide by the obligations contemplated by the [joint venture agreement]." *Id.* at 193.

When faced with a motion to refer its claim to arbitration, DuPont amended its pleading to wriggle out of arbitration. Had it continued to allege that it was a third-party beneficiary of the original joint venture agreement, DuPont appeared to recognize that it would have had to arbitrate. Therefore, it amended its complaint and alleged that the later agreement was a separate, new contract from the joint venture agreement and that DuPont, as a non-signatory to the contract containing the arbitration clause, could not be compelled to arbitrate its claim.

The facts in the case were complicated but essentially DuPont was alleging that it, as parent of one joint venturer, had reached a completely separate, new agreement with the parent of the other joint venturer, whereby each parent agreed to support the joint venture and to cause their subsidiary joint venturers to do the same. DuPont, after amending its complaint, clung to the theory that its claims found their essence only in this new agreement and therefore were outside the arbitration clause of the original joint venture agreement. The U.S. Court of Appeals for the Third Circuit ultimately bought that argument, while admitting that it was making a "close call." *Id.* at 201.

The court's decision involved different facts than this case, and those differences are legally material. For one thing, unlike in this case, the supposedly new contract that DuPont entered into did not have the effect of negatively affecting the rights of the joint venture or one of the joint venturer subsidiaries in a contract to which neither the joint venture nor the subsidiaries were a party. Here, if the New Bargain is enforceable, it compromised rights of the Joint Venture and changed the Joint Venture Agreement, the type of contract only the two Members of the Joint Venture could execute. Unlike the new agreement in *E.I. DuPont*, which perpetuated the existing joint venture, but with additional promises by the parents to provide support, the New Bargain changed the rights of the Joint Venture and the economic returns to the Members of the Joint Venture. Therefore, Ishimaru is alleging that Ivy Asset could act as a Member but is also seeking to deny it the rights of a Member. That was not as plainly the case in *E.I. DuPont*.

Equally important, in *E.I. DuPont*, the parties seeking to require DuPont to arbitrate argued that it did not matter that DuPont was a non-signatory rather than a signatory of the joint venture agreement containing the arbitration clause. Therefore, they contended that the court should feel as comfortable requiring DuPont to arbitrate as if it would have been in compelling a signatory to arbitrate with a non-signatory. The court expressly rejected that argument, stating that there was an important distinction between the two contexts, and that "'the circuits have been [more] willing to estop a signatory from avoiding arbitration with a nonsignatory when the issues the nonsignatory is seeking to resolve in arbitration are intertwined with the agreement that the estopped party has signed.'" *Id.* at 202 (quoting *Thomson-CSF, S.A.*, 64 F.3d at 779); *see also CD Partners, LLC v. Grizzle*, 424 F.3d 795, 799 (8th Cir. 2005) (recognizing that it is less difficult to obtain an order requiring a signatory to arbitrate with a non-signatory than vice versa).

III. Conclusion

For the foregoing reasons, Ishimaru is entitled to an order permitting her to press Paradigm's New Bargain Claim against Ivy Asset as a derivative plaintiff. But she must press that Claim in arbitration, in accordance with the procedures in the Arbitration Clause. The parties shall confer and submit an implementing final judgment within five days.

NEWCASTLE PARTNERS, L.P. v. VESTA INSURANCE GROUP, INC.

No. 1485-N

Court of Chancery of the State of Delaware, New Castle

November 15, 2005
Revised November 16, 2005

Bruce L. Silverstein, Esquire, Melanie K. Sharp, Esquire, Martin S. Lessner, Esquire, and Christian Douglas Wright, Esquire, of Young Conaway Stargatt & Taylor, LLP, Wilmington, Delaware; and Steven Wolosky, Esquire, of Olshan Grundman Frome Rosenzweig & Wolosky LLP, New York, New York, of counsel, for plaintiff.

J. Travis Laster, Esquire, Abrams & Laster LLP, Wilmington, Delaware; and James F. Hughey, Jr., Esquire, of Balch & Bingham LLP, Birmingham, Alabama, of counsel, for defendant.

LAMB, *Vice Chancellor*

Vesta Insurance Group, Inc. has not held a meeting for the purpose of electing directors since June 2004. It has also not published its annual report or certified financial statements for the year ended December 31, 2004. On July 7, 2005, Newcastle Partners, L.P., a large stockholder of Vesta, brought suit under 8 *Del. C.* § 211 seeking an order compelling Vesta to hold an annual meeting for the election of directors. At the

conclusion of trial on August 19, 2005, the court rendered its oral decision, directing that Vesta hold its annual meeting within 90 days, or no later than November 17, 2005. The court allowed such an exceptionally long period of delay only because Vesta's trial evidence strongly suggested that it would be able to complete its 2004 financial reports by September 30 and, thus, would be able to make the necessary SEC filings to permit management to solicit proxies at the mandated meeting.

Although it is now six weeks after the date Vesta's trial witnesses confidently predicted for completion of the 2004 financial statements, that task remains incomplete. Seeking to further delay its 2005 annual meeting, Vesta now moves for relief from this court's Order, under Court of Chancery Rule 60(b), and for an interim stay of that judgment pursuant to Court of Chancery Rule 62(b). Fundamentally, Vesta's claim for relief rests on a supposed conflict between this court's Order issued pursuant to the clear mandate of Section 211(c) of the Delaware General Corporation Law and SEC proxy rules that, in normal circumstances, prohibit registered companies from convening annual meetings for the purpose of electing directors without first disseminating an annual report and either a proxy statement or an information statement. Because Vesta has not and cannot show a basis for relief from this court's judgment, its motion is denied.

I.

By Order and Final Judgment entered on September 1, 2005, the court directed Vesta, a Delaware corporation, to hold its 2005 annual meeting of stockholders no later than November 17, 2005. The court's Order further provided, as contemplated by Section 211(c), that the shares of Vesta stock represented at the annual meeting, either in person or by proxy, and entitled to vote thereat would constitute a quorum for the purpose of that meeting, notwithstanding any contrary provision found in Vesta's certificate of incorporation or bylaws.

The decision to allow Vesta 90 days to hold its meeting, rather than the usual period of 30 to 45 days, reached what the court regarded as the outer bounds of its discretion. The court agreed to such an extended delay only because Vesta's trial witnesses confidently predicted, with what appeared to be a reasonable basis in fact, that the process of finalizing Vesta's 2004 financial statements (and restating earlier ones) would be complete by September 30, 2005. If the task could be accomplished by that date, the court reasoned, Vesta would be able to disseminate its 2004 annual report and year-end financial statements in advance of the mandated meeting date. Recognizing that, if it could be done within an acceptable time frame, it was desirable that stockholders have that information in hand

in advance of the meeting, the court set the meeting date at the outer limit of the possible dates.

Vesta's confident predictions of a September 30 completion have proven to be wrong. In fact, the company's auditors, PriceWaterhouse-Coopers LLC ("PWC"), still have not finished their review of Vesta's 2004 financial statements. And, although Vesta's President and CEO now *hopes* that PWC can finish its work by December 31, 2005, he is unable to offer any assurances to that effect, stating that Vesta "cannot predict when [the 2004 financial statements] will be complete."[1] In its motion, Vesta argues that it should be relieved of its obligation to hold its 2004 annual meeting ordered by this court until those financial statements are ready because, it claims, it will otherwise be placed in jeopardy of violating the federal securities laws. Its principal argument in support of this position is that members of the staff of the United States Securities and Exchange Commission have suggested to Vesta's lawyers, on at least two occasions, that it cannot hold the meeting in compliance with this court's Order without violating the SEC's proxy rules.

The first such communication came in a letter received on November 9, 2005, in which an examiner in the SEC Division of Corporate Finance requested clarification of Vesta's plans in light of SEC rules on proxy solicitations and information statements. Thereafter, in a telephone conversation another Corporation Finance staff member, presumably senior in status to the examiner, recommended that Vesta "not proceed with the meeting without compliance with the proxy rules."[2] According to the affidavit of its counsel submitted by Vesta, this advice was preceded by the following statement:

> He stated that the staff had seen similar situations in the past, but that the staff had never dealt with a situation where ultimately a company required by court order to hold a meeting was not also able to distribute a proxy statement in compliance with the proxy rules. He stated that the staff did not want to be in a position to decide what position it would have to take if, in fact, Vesta held its meeting without compliance with the proxy rules.

Vesta argues that these ambiguous communications from members of the SEC staff leave Vesta in the uncomfortable position of having to disobey either this court or the SEC. Vesta therefore requests relief from

---

[1]Def.'s Mot. For Relief from J., Gayle Aff. ¶ 4.
[2]Def.'s Mot for Relief from J., Waters Aff., 7.

the court's prior judgment, seeking to have the deadline before which it must hold its annual meeting delayed indefinitely.

The plaintiff, Newcastle Partners, L.P., opposes Vesta's attempt to delay the annual meeting, arguing that none of the facts presented by the defendant would prevent the planned annual meeting from going forward as required on November 17, 2005. Rather, the plaintiff argues, the defendant's motion is an attempt to circumvent the court's September 1, 2005 Order, leaving shareholders with no definite date for Vesta's already overdue annual meeting.

Vesta seeks reconsideration on the basis of Court of Chancery Rules 60(b) and 62(b). Rule 60(b) permits a party to seek relief from a final judgment or order, based on six enumerated grounds.[3] The two on which the defendant relies in this case are those that allow relief for "newly discovered evidence," and for "any other reason justifying relief from the operation of the judgment." Under Court of Chancery Rule 62(b), the court may in its discretion stay the execution of any order pending the disposition of a motion for relief from a judgment pursuant to Rule 60.

II.

The shareholder meeting to elect directors is a cornerstone of Delaware corporate law. Therefore, the Delaware courts have repeatedly recognized that the policy justifications behind 8 *Del. C.* § 211 are so strong that if the statutory elements required to compel a shareholder's meeting are shown, the right to relief is "virtually absolute."[4] In this case, the defendants conceded that no annual meeting had been held since June 1, 2004, exceeding the maximum 13-month period between meetings allowed by statute. Vesta having failed to prove any possible ground for denying the relief sought by Newcastle Partners, the court summarily ordered Vesta to hold its 2005 annual meeting. In requiring that the meeting be held no later than November 17, 2005, the court exercised the full measure of its discretion to grant the company additional time to complete preparations

---

[3]Rule 60(b) contemplates relief in the following circumstances: "On motion and upon such terms as are just, the Court may relieve a party . . . from a final judgment, order, or proceeding for the following reasons: (1) Mistake, inadvertence, surprise, or excusable neglect; (2) newly discovered evidence; (3) fraud (whether heretofore denominated intrinsic or extrinsic), misrepresentation or other misconduct of an adverse party; (4) the judgment is void; (5) the judgment has been satisfied, released, or discharged, or a prior judgment upon which it is based has been reversed or otherwise vacated, or it is no longer equitable that the judgment should have prospective application; or (6) any other reason justifying relief from the operation of the judgment."

[4]*Speiser v. Baker*, 525 A.2d 1001 (Del. Ch. 1987).

for that meeting. As already discussed, the court relied on the testimony of Vesta's witnesses suggesting that it would be ready to distribute updated financial information to its stockholders in time for a November 17 meeting.[5]

As the court recognized at the time of trial, Vesta could not, of its own volition, convene a meeting at this time in conformity with SEC proxy regulations. This is because the prior dissemination of an annual report is required to solicit proxies under Rule 14a-3;[6] moreover, both an annual report and an information statement are required to be furnished to stockholders pursuant to Rules 14c-2 and 14c-3,[7] where the registrant plans to hold an annual meeting to elect directors but does not intend to solicit proxies.

Vesta's reading of its communications with the SEC, however, is entirely too strong. The cited letter does not order Vesta to stop the annual meeting, or to take any other action inconsistent with this court's Order.[8] Rather, it merely asks for further explanation of how precisely Vesta's proposed action fits into the structure of the SEC regulations. Apparently, that request was not answered in writing. Similarly, the telephonic communication discussed above neither threatened enforcement action against Vesta nor even suggested that the responsible SEC staff have formulated a view that compliance with this court's Order could violate any SEC rules. Obviously, this communication falls far short of a definitive interpretation of the SEC rules.

It is also unlikely that the SEC would ever undertake to stop an annual meeting of stockholders ordered by this court, because to do so would cut directly against the policy of a strong stockholder franchise that underlies the SEC's rules on the distribution of proxy and information statements. A brief history of the proxy rules illustrates the point. For the first forty years after the enactment of the Securities Exchange Act of 1934, the contemporary equivalent of Rule 14a-3 was the only provision that required companies to provide information to stockholders in connection with shareholder meetings. But just as today, Rule 14a-3 only required the company to provide information when it was actively soliciting proxies. When a company did not solicit proxies in connection with a shareholder

---

[5]The court noted in its previous oral decision that it was "not aware of any authority in this Court that has allowed or ordered setting of a meeting more than 90 days post [judgment]." *See Walsh v. Search Exploration Inc.*, 1990 Del. Ch. LEXIS 132 (setting a period of 90 days after judgment); *Hecco Ventures v. Texas American Energy Corp.*, 1986 Del. Ch. LEXIS 435 (approximately two months); *Shay v. Morlan Int'l, Inc.*, 1983 Del. Ch. LEXIS 405 (70 days).

[6]17 C.F.R. § 240.14a-3.

[7]17 C.F.R. §§ 240.14c-2 and 14c-3.

[8]Def.'s Mot. For Relief from J., Ex. C.

meeting, the company had no duty at all under federal law to send notice of the meeting to shareholders. This dichotomy between the company's duties when it chose to solicit proxies and when it did not inevitably gave companies keen to save themselves the expense or potentially embarrassing disclosures of a proxy statement a strong incentive to proceed without soliciting proxies. As early as 1939, in fact, observers began to notice the results of the perverse incentives created by the existence of what is now Rule 14a-3. As one academic commentator noted:

> [I]t is understood that from October 1, 1938 to April 1, 1939, approximately 70 corporations whose securities are listed on the New York Stock Exchange out of approximately 775 such corporations adopted the policy of not soliciting proxies from their stockholders in connection with annual meetings. Under the former proxy rules of the Commission it is understood that only 12 out of approximately 775 such corporations did not solicit proxies.[9]

The effects that the circumvention of the proxy regulations had on shareholders and on corporate governance were significant. Presented with the possibility of governing the corporation without soliciting proxies, directors saw a method to govern without accountability. A study of the Glidden corporation in 1950 demonstrates the danger: by simply refusing to solicit proxies, the Glidden directors made sure that no quorum was present at their annual meeting. Unable to elect new directors, then, the company determined that "the directors and officers must hold over until their successors are elected and qualified," leaving the shareholders with almost no way to exercise their franchise.[10] As evident as the problem was to observers, however, the academic consensus in 1950 was that the Commission lacked the power to solve the problem with the tools at hand.[11] In 1964, Congress responded to the SEC's lack of authority by enacting Section 14(c), requiring substantially the same filings for meetings at which no proxies are be solicited as the SEC then required for solicitations.[12]

This history suggests that the purpose of Section 14(c) and the rules promulgated thereunder is to prevent registrants from avoiding their disclosure obligations by the simple expedient of declining to solicit

---

[9]Arthur H. Dean, *Non-Compliance with Proxy Regulations*, 24 CORNELL L. Q. 483, 487 n.8 (1939).

[10]David C. Bayne, *Around and Beyond the SEC*, 26 IND. L.J. 207, 212 (1950).

[11]*Id.* at 211, *citing* Friedman, *SEC Regulation of Corporate Proxies*, 63 HARV. L. REV. 796, 819 (1950).

[12]Louis Loss & Joel Seligman, SECURITIES REGULATIONS, § 6-C-7 (1989).

proxies in connection with any meeting of stockholders. This is consistent with Congress's original purpose in including proxy regulation in the 1934 Act that "management of properties owned by the investing public should not be permitted to perpetuate themselves by the misuse of corporate proxies."[13] Nothing in either that statute or regulation suggests any purpose to interfere with the power of state courts to require that stockholder meetings be held in accordance with the requirements of state corporation law in situations where the registrant corporation is delinquent in its SEC filing obligations and, thus, is unable to comply with the literal terms of the SEC proxy rules.[14] Indeed, the fact that neither party in this case can point the court to authority that has raised the potential conflict between Section 211 or similar provisions under other state corporation statutes and Section 14(c), or the rules thereunder, in some 40 years of coexistence is strong evidence that the two provisions do not actually conflict. Rather, they both serve the same purpose of helping to safeguard the shareholders' foundational voting rights.

The basic compatability between the state and federal laws is especially evident in this case. None of Vesta's shareholders have had the opportunity to vote their shares in 18 months, and Vesta cannot provide reliable guidance on when the audited financial statements required to prepare an annual report may become available. Few circumstances could be more consistent with the federal law's purpose of protecting the shareholders' franchise than this court's Order directing that Vesta's shareholders be allowed to vote and, if they choose, to replace one or more of the directors standing for reelection.

The court also notes that its Order is consistent with the important policies underlying the internal affairs doctrine that the power of the state of incorporation to mandate stockholder meetings in appropriate circumstances not be lightly overturned. As the Delaware Supreme Court has recently explained, the internal affairs doctrine is the basic understanding that "only the law of the state of incorporation governs and determines issues relating to a corporation's internal affairs.[15] The doctrine is rooted not only in the decisions of the United States Supreme Court,[16] but

---

[13]Dean, *supra* note 6, at 485, *citing* H.R. REP. NO. 1383 (1934).

[14]Indeed, the SEC sometimes uses its discretion to issue orders exempting companies from the requirements of that section when the protection of public shareholders is not as keenly at stake as in cases of potential entrenchment. Loss & Seligman, *supra* note 9.

[15]*Vantagepoint Venture Partners 1996 v. Examen, Inc.*, 871 A.2d 1108, 1113 (Del. 2005).

[16] *Examen, Inc. v. Vantagepoint Venture Partners 1996*, 873 A.2d 318 (Del. Ch., 2005), *citing CTS Corp. v. Dynamics Corp. of Am.*, 481 U.S. 69, 89 (1987); *Edgar v. MITE Corp.*, 457 U.S. 624, 645 (1982).

also in the Fourteenth Amendment's implicit guarantee of the stockholder's right to "know to what standards of accountability they may hold those managing the corporation's business and affairs."[17] There are, of course, some circumstances in which a state's governance of internal corporate affairs is preempted by federal law, but those instances are rare, and occur only when the law of the state of incorporation is "inconsistent with a national policy on foreign or interstate commerce."[18]

The issue presented in this case, in its most simple form, is whether a shareholder meeting will happen on November 17, 2005, or will be indefinitely delayed. This determination is paradigmatically within the internal affairs doctrine as explained by the courts of this state and of the United States.[19] Any suggestion that there is an irreconcilable conflict between the mandate of this court's Order and Final Judgment and SEC statutes and regulations would both misconstrue the scheme of federal proxy regulation and weaken a basic premise of American corporate law that is a defining characteristic of our federal system.[20]

For all the foregoing reasons, the court concludes that Vesta has shown no basis for relief under Court of Chancery Rule 60(b). The plaintiff has a clear right under Delaware law to convene an annual meeting. The fact that the reason Vesta delayed in calling its 2005 meeting was its inability to complete its 2004 financial statements does not diminish the right of Vesta stockholders to meet for the purpose of choosing directors.

III.

For the foregoing reasons, the defendant's motion for relief under Court of Chancery Rules 60(b) and 62(b) is DENIED. IT IS SO ORDERED.

---

[17] *Vantagepoint*, 871 A.2d at 1113, *citing McDermott, Inc. v. Lewis*, 531 A.2d 206, 214 (Del. 1987).

[18] *Vantagepoint*, 871 A.2d at 1113.

[19] *McDermott*, 531 A.2d at 215 ("[T]he [internal affairs] doctrine governs the choice of law determinations involving matters *peculiar* to corporations, that is, those activities concerning the relationships *inter se* of the corporation, its directors, officers, and shareholders.").

[20] Frederick Tung, *Origins of the Internal Affairs Doctrine* (2005) http://papers.ssrn.com/sol3/papers.cfm?abstract_id=686592 (tracing the history of the internal affairs doctrine, and attempting to explain why states uniformly maintained the doctrine even though it is facially a limitation on their own power over corporations doing business within their borders but which are domiciled elsewhere.).

ORLOFF v. SHULMAN

No. 852-N

Court of Chancery of the State of Delaware, New Castle

November 23, 2005

Stephen E. Jenkins, Esquire, and Steven T. Margolin, Esquire, of Ashby & Geddes, Wilmington, Delaware; and Matthew J. Sava, Esquire, of Shapiro Forman Allen Sava & McPherson LLP, New York, New York, of counsel, for plaintiffs.

Donald J. Wolfe, Jr., Esquire, Matthew E. Fischer, Esquire, and Sarah E. DiLuzio, Esquire, of Potter Anderson & Corroon, Wilmington, Delaware; and Joseph P. Augustine, Esquire, of Nicholl & Davis LLP, New York, New York, of counsel, for defendants.

William O. LaMotte, Esquire, and Samuel T. Hirzel, II, Esquire, of Morris, Nichols, Arsht & Tunnell, Wilmington, Delaware, for nominal defendant.

LAMB, *Vice Chancellor*

This is a case brought individually and derivatively on behalf of Weinstein Enterprises, Inc., claiming that the defendants violated their fiduciary duties and committed waste by mismanaging Weinstein, and that the defendants disseminated misleading information to the company's minority shareholders. The defendants have moved to dismiss the case on the basis of res judicata, laches, failure to state a claim on which relief can be granted, and lack of standing. This is the court's decision on that motion.

I.

Weinstein is a closely held company originally founded by the patriarch of the once famed Mays department stores, Joseph Weinstein, in

order to hold some of the stores' real estate.[1] In 1982, Mays filed for bankruptcy, closed all its stores, and reemerged as a real estate company in 1989. Weinstein's assets now chiefly consist of a combination of real property and securities that include approximately 45.15% of the outstanding common stock of Mays.[2]

A. The Parties

Lloyd Shulman, a grandson of Joseph Weinstein, succeeded his father, Max, to become CEO and Chairman of Weinstein in 1997. Together, Lloyd Shulman and his family own 66% of Weinstein. In addition to controlling Weinstein, the Shulmans are closely involved in the company's management. Sylvia Shulman, Lloyd's mother, is both a director and a vice president of Weinstein. Joseph Weinstein's daughter, Gail S. Koster, also sits on the Weinstein board. Ward Lyke, a long-time associate of the Shulmans, has been a Weinstein director for many years and formerly was a member of Weinstein's executive committee.

In addition to Weinstein's ownership of a near majority of Mays's common stock, the Shulman family and the J. Weinstein Foundation, Inc., a charitable foundation of which Sylvia and Lloyd Shulman are the officers and directors, together hold an additional 11.72% of Mays.[3] The ties between Weinstein and Mays are strengthened by the fact that some of the directors and officers of Weinstein have similar roles in Mays. Lloyd and Sylvia Shulman are Mays directors, while Lyke is currently Mays's Vice President of Management Information Systems. Lloyd and Sylvia Shulman, Lyke, and Koster are all named as defendants in this action.

The plaintiffs, Madeline Orloff and her son, George Orloff, are minority stockholders of Weinstein and are related to the Shulmans. Madeline Orloff has been a record shareholder since approximately 1972, and until 2004 sat on the board of Weinstein. In 2004, however, she was removed from the board, allegedly without her knowledge and without notice.[4] George Orloff inherited his shares from his grandmother in 2002. Until recently, the Orloffs held approximately 34% of Weinstein's stock. On June 28, 2004, however, the Orloffs sold their minority position in Weinstein, less 62 shares, to J.W. Acquisitions, LLC ("JWA") for over $26 million. JWA, which is a plaintiff in this case, is a New York limited liability company owned by members of the Cayre and Adjmi families, and

---

[1]Compl. ¶ 4.
[2]Compl. ¶ 2.
[3]Compl. ¶ 25.
[4]Compl. ¶ 6.

is currently managed by Robert Cayre.[5] The Orloffs' remaining shares, which constitute over 1% of the 6,000 shares outstanding in Weinstein, are valued by them in excess of $1 million.[6]

B. Prior Litigation

The parties in this case have a long and acrimonious history of litigation. A recent episode, filed in 1992 and referred to throughout this opinion as the "New York action," was resolved by the New York Appellate Division on September 10, 1998. In that case, Madeline Orloff and her sister, Linda Jessogne, brought suit against Weinstein, as well as both Shulman defendants in their individual capacities, making a range of allegations as to breaches of fiduciary duty and oppressive conduct towards the minority Weinstein shareholders under New York law.[7] The trial court in the New York action, following what the Appellate Division called "extensive discovery,"[8] dismissed the Orloffs' claims as to fraud or illegality, but held that the "defendants' conduct in this regard [i.e., the exclusion of Madeline Orloff from meetings of the board of directors and other corporate affairs] is clearly oppressive."[9] This decision was reversed by the Appellate Division, which held that none of the plaintiffs' allegations rose "to a level entitling plaintiff[s] to any of the relief sought in the complaint or which was granted by the motion court."[10]

In January 2004, George Orloff filed an action in this court pursuant to 8 *Del. C.* § 220(c) "to obtain the information necessary to obtain a

---

[5]The JWA plaintiffs concede that they have standing only to challenge continuing wrongs allegedly committed by the defendants, including the causes of action relating to Rockridge Farm and the Middle Bay Country Club lease. Compl. ¶ 17.

[6]Compl. ¶ 17.

[7]The claims were as follows: (1) that the Shulmans caused Weinstein to wastefully buy Rockridge Farm, a property in Putnam County, New York; (2) that the Shulmans in their individual capacities charged Lloyd Shulman below market rent to live at Rockridge Farm; (3) that Weinstein, as a corporate entity, charged the individual defendants below market rents while they lived at Rockridge Farm; (4) that Weinstein paid Max and Lloyd Shulman inappropriate and excessive compensation; (5) that Weinstein improperly pledged its own securities as collateral for a $3 million loan to Mays; (6) that Weinstein redeemed shares held in trust by Celia Weinstein, but refused requests by the plaintiffs that the corporation redeem its own shares; (7) that the individual defendants caused the corporation to promote their interests by using funds to acquire additional shares of Mays; (8) that the defendants excluded the plaintiffs from occupying residences at Rockridge Farm; (9) that the defendants excluded Madeline Orloff from board of directors meetings and denied her access to the corporate books and records.

[8]*Orloff v. Weinstein Enters., Inc.*, 247 A.D.2d 63, 65 (N.Y. App. Div. 1998).

[9]*Orloff v. Weinstein Enters., Inc.*, Index No. 44504/92, Pl.'s Ex. A.

[10]*Orloff*, 247 A.D.2d at 67.

meaningful bid for the Orloff shares from third parties."[11] Ultimately, Orloff was granted access to a portion of the documents he sought.[12]

In August 2004, Weinstein filed an action in New York Supreme Court against the present plaintiffs, among others, asserting a wide range of fiduciary duty violations, torts, and breaches of contract relating to the sale of the Orloffs' shares.[13] In November 2004, the current plaintiffs responded by filing this case, alleging violations of fiduciary duties and waste. They then moved to stay or dismiss the 2004 New York action in favor of this one, and, on July 29, 2005, the New York Supreme Court agreed and dismissed the Shulmans' action on the condition that the Orloffs would consent to Delaware jurisdiction.[14]

The amended complaint in this case alleges six causes of action, the facts underlying which are set forth below: (i) breach of fiduciary duty and waste in connection with certain transactions between Weinstein and Mays;[15] (ii) breach of fiduciary duty and waste in approving a series of "third-party" transactions;[16] (iii) breach of fiduciary duty and waste in relation to certain vacant lots and loss-making properties; [17] (iv) breach of fiduciary duty and waste in relation to Rockridge Farm;[18] (v) breach of fiduciary duty in relation to both a bylaw amendment and an amended certificate of incorporation;[19] and (vi) breach of fiduciary duty in relation to faulty disclosure.[20]

Some of these allegations, if true, would tend to reduce the income available to Weinstein, and thus to its managers and controlling shareholders. The complaint, therefore, also alleges that the apparent inconsistency between the defendants' actions and their normal incentives to maximize the income of Weinstein can be explained in two ways—first, by the fact that the defendants wished to purchase the Orloffs' shares for less than their fair value, and thus were willing to depress the value of their own Weinstein shares until they achieved their goal; alternatively, the

---

[11]Compl. ¶ 8.

[12]*Orloff v. Weinstein Enters.*, 2004 Del. Ch. LEXIS 85 (Del. Ch. June 22, 2004), *rev'd sub. nom. Weinstein Enters. v. Orloff*, 870 A.2d 499 (Del. 2005).

[13]Specifically, the defendants in this action claimed in New York that the Orloffs breached their duties to Weinstein, violated a confidentiality agreement by sharing Weinstein's information, fraudulently induced Weinstein to enter into the Confidentiality Agreement, tortuously interfered with Weinstein's business relationship, defamed and slandered the Shulmans, and conspired with JWA to harm Weinstein and the Shulmans. Compl. ¶¶ 1, 2, 4.

[14]*Weinstein Enters., Inc. v. Orloff*, Index No. 602497/2004, Pl.'s Reply Br. Ex. A.

[15]Compl. ¶¶ 95-97.

[16]Compl. ¶¶ 98-102.

[17]Compl. ¶¶ 103-105.

[18]Compl. ¶¶ 106-110.

[19]Compl. ¶¶ 111-114.

[20]Compl. ¶¶ 115-117.

plaintiffs suggest that depriving Weinstein of income could have been useful to the defendants for estate planning purposes.[21]

C. The Mays Transactions

The complaint alleges that the defendants violated their fiduciary duty of loyalty and committed waste in the following three transactions with Mays.

1. Levittown

Weinstein owns a two-story and basement store property in Levittown, New York. Before 1983, Weinstein leased the property to Mays.[22] The lease, which was scheduled to run until 2004, contains a "use" clause which requires Mays to maintain the premises as a retail department store. In 1983, in the course of bankruptcy, Mays negotiated a modification and assignment of the lease to Trade Town, Inc., at a substantially higher rent, for use as a flea market.[23] Weinstein objected, citing the "use" clause, and Mays and Weinstein agreed to share the excess rental equally.[24] Mays then petitioned the bankruptcy court for permission to assume the lease and assign it to Trade Town.[25] After notice, the bankruptcy court entered an order granting the relief requested, finding that it was in the best interest of Mays's creditors.[26] Ignoring the bankruptcy courts review and approval, the plaintiffs allege that this arrangement improperly diverted over $8 million of revenues from Weinstein to Mays over the next 20 years, in violation of the defendants' fiduciary duty to Weinstein.[27] This is so, they claim, because Weinstein could have simply refused to agree to the assignment unless it received substantially all of the excess rental income for the property, rather than only half.

2. Fulton Street

Fulton Street is a major shopping artery in Brooklyn, New York. Weinstein owns a parcel at 504-506 Fulton Street, on which there is a

---

[21]Compl. ¶ 29.

[22]The property was technically leased through a Weinstein subsidiary, Celwyn. The complaint treats Celwyn as equivalent to Weinstein for the purposes of this case. Compl. ¶ 31.

[23]Fischer Aff. Ex. D.

[24]*Id.*

[25]*Id.*

[26]Fischer Aff. Ex. C.

[27]Compl. ¶ 31.

multi-story building. This property and building is leased to Mays, which rents out space in the building to its own retail tenants. The original 1928 lease on the property, at a rental rate of $60,000 per year, expired in 1995. Weinstein extended the lease to 2011 at an initial rental rate of $99,000 per year, which was increased in 2001 to $108,000 per year.[28] The complaint alleges that, given the rental rates on Fulton Street in 1995, the property could have been rented to a third party for at least $500,000 per year, and could have been rented to Mays for even more because Mays would have violated its own subleases to tenants by allowing the property to revert to Weinstein. Furthermore, the plaintiffs allege that the defendants' valuation of the property at $1.2 million in 2001 was erroneous, and that the fair market value of the property in that year was far more than that amount. The plaintiffs allege that all of these facts establish that the defendants breached their fiduciary duties in connection with the Fulton Street property.

3. Jamaica Avenue

Weinstein owns the ground at 168-21-52 Jamaica Avenue (approximately 73,575 square feet) in Queens, New York, which it leases to Mays. Mays owns a 250,000 square foot building on the parcel, which it carries on its books at $17 million and which it rents to many tenants, including Toys-R-Us. In 1958, the Weinstein predecessor leased the ground to Mays at $60,000 per year. That lease expired in 1985, subject to Mays's right to extend for two 21-year periods, based on rent calculated at 6% of the unimproved value of the ground. Mays opted to extend the lease in 1985, paying $61,800 based on an estimated value of the ground of $1.03 million. This constitutes a rental rate of $.84 per square foot of ground space. The complaint alleges that the value of the ground was actually "more than $5 million in 1985."[29] According to the complaint, therefore, a proper valuation of the property in 1985 would have yielded rent in excess of $300,000 per year, or roughly $4 per square foot of ground space. The plaintiffs argue, on this basis, that the defendants breached their fiduciary duties by undervaluing the land in 1985 and renting the land to Mays at an insufficient price.

---

[28]Compl. ¶ 37.
[29]Compl. ¶ 43.

D. Third-Party Transactions

The plaintiffs' claim that the defendants violated their fiduciary duties and committed waste in the following four transactions with third parties.

1. Jimmy Jazz

Weinstein owns a 12,000 square foot retail property at 518-520 Fulton Street, which it rents to Jimmy Jazz, a women's clothing store. In 2003, Jimmy Jazz became the sole tenant and entered into a 16-year triple net lease with Weinstein. The lease was initially set at $290,000 per year, or $24.17 per square foot. The plaintiffs allege that this is $22,500 less than the rents Weinstein had been receiving under the old leases prior to 2003.[30] The complaint also alleges that the market rent for the property should have been at least $1 million per year, or at least $100 per square foot, as measured by the fact that new leases on Fulton Street in 2003 were almost uniformly over $100 per square foot.

2. Modell's

Weinstein owns retail property at 360 Fulton Street, which it rents on a triple net basis to Modell's Sporting Goods, a sporting goods retailer. Prior to 2003, this rent was $172,000 per year. In 2003, the lease with Modell's was renewed at a rate of $179,000 per year, with 2% annual increases, and extends until 2015 with an automatic right to renew for another five years. At the current rate, the rent approximates $15 per square foot. The plaintiffs allege, however, that if the property were rented to a third party on arm's length terms the market rent would have been at least $1 million per year.[31] The complaint further alleges that Weinstein should have been able to demand a premium from Modell's because the space at 360 Fulton Street is part of a larger building, the remainder of which is owned by Modell's. Without the Weinstein space, the plaintiffs argue, Modell's would have been deprived of a viable store. By renting the property at less than 20% of the alleged fair market value, therefore, the plaintiffs allege that the defendants violated their fiduciary duties.

---

[30]Compl. ¶¶ 50-51.
[31]Compl. ¶¶ 54-56.

3. Westchester Foreign Autos

Weinstein leases a 15,000 square foot property at 75 Vredenburgh Avenue in Yonkers, New York, to Westchester Foreign Autos, which operates a Toyota dealership on the premises. In 1993, Weinstein entered into a 10-year lease with Westchester at $110,000 for the first year, with 3% increases annually. Under the original lease, Westchester had a two-year renewal option. In 1999, however, Weinstein agreed to give Westchester a seven-year lease extension right, which Westchester immediately exercised at the 1993 rates plus the annual 3% increases. At the time Weinstein agreed to extend the renewal term, the tenant's rent payment equaled approximately $8.50 per square foot. The plaintiffs contend that the fair market rate would have been "at least twice that amount."[32] The plaintiffs therefore argue that the defendants' decision to extend the lease in 1999, and the low price subsequently demanded, constitutes a violation of the defendants' fiduciary duties.

4. Middle Bay Country Club

Weinstein owns the land under the Middle Bay Country Club in Oceanside, New York, which it has leased to the Middle Bay Golfers Association for the period 1968 through 2017. The complaint alleges that the 168-acre property is worth more than $11 million but is currently generating only $160,000 per year in rental income. If the lease were terminated, the plaintiffs argue, the property could be sold for a substantial profit, or rented at current market rates which are allegedly multiples of the amount now being paid in rent. The plaintiffs further claim that the Middle Bay Country Club is in breach of its lease agreement for failure to repair a bulkhead on the property, affording Weinstein the right to either terminate the lease or sue the tenant for breach. The defendants have allegedly failed to enforce their rights against the country club. The plaintiffs argue that this failure to maximize the value of the Middle Bay Country Club property constitutes a violation of the defendants' fiduciary duties.[33]

E. Vacant Properties, Loss-Making Properties, And Rockridge Farm

The complaint alleges that the defendants violated their fiduciary duties and committed waste in the following three transactions, which they designate as the vacant and loss-making properties.

---

[32]Compl. ¶¶ 57-59.
[33]Compl. ¶¶ 62-64.

1. Nine Vacant Properties

The plaintiffs allege that nine of Weinstein's properties are currently vacant. Six of the nine vacant properties form "one contiguous parcel across Jamaica Avenue from the property Weinstein leases to Mays."[34] The complaint specifies that the original cost of these properties was $941,799, and, in 1999, they were appraised to be worth between $1.75 million and $2.2 million. In 1998, the plaintiffs allege that Weinstein removed tenants and cleared buildings on the property in order to make the properties available for future development. But despite what the plaintiffs call potentially lucrative offers from developers and brokers, the plaintiffs argue that the defendants have done nothing with these six properties. The plaintiffs believe that they have identified three additional vacant lots located in Yonkers, New York. According to the plaintiffs, these properties had an original cost of about $420,000, have annual expenses of approximately $130,000, and were appraised in 2003 at close to $1 million. The plaintiffs allege that the defendants have violated their fiduciary duties by making "no attempt to develop or generate income" from these properties.[35]

2. Four Loss-Making Properties

The plaintiffs claim that the defendants own a number of potentially lucrative properties which are being operated at significant losses to Weinstein. The bulk of these properties are in Kansas City, Missouri, and were purchased initially for an investment of $11.6 million. For example, the complaint alleges that the 32-story Kansas City Power and Light building, owned by Weinstein, is only 30% occupied, and was operated at a net loss of $100,278 in 2003. The plaintiffs claim that the defendants' "failure to make economically productive use of these properties" constitutes a breach of their fiduciary duties.

3. Rockridge Farm

Rockridge Farm is a 114-acre estate in Putnam County, New York. The property contains a 1,800 square foot wooden office building which serves as the corporate headquarters of Weinstein, and separate homes which serve as the residences of Lloyd and Sylvia Shulman. According to Weinstein's 2003 financial statement, the land has a cost basis of $177,484,

---

[34]Compl. ¶ 66.
[35]Compl. ¶ 66.

while the buildings and equipment cost $2.6 million. In fiscal year 2003, the plaintiffs claim, Weinstein spent 30.4% of its average net income for the last three years, or $423,810 in cash plus $74,949 in depreciation charges, for upkeep of the properties. In contrast, the plaintiffs allege, in 2003 the Shulmans paid Weinstein only $18,000 in rent for the privilege of residing at the estate and for using the property's garages for the Shulmans' collection of classic cars. The plaintiffs, therefore, allege that Weinstein's maintenance of Rockridge Farm in lieu of renting appropriate corporate headquarters elsewhere, and the below market rent paid to Weinstein by the Shulmans, constitute a breach of the defendants' fiduciary duties.

F. The Advancement Bylaw And Section 102(b)(7) Provision

The complaint alleges that on March 12, 2004, the Weinstein board held a meeting in which the directors approved new bylaws and approved an amendment to the certificate of incorporation. The new bylaws contain provisions giving the directors the right to have attorneys fees advanced during litigation. The certificate amendment also contains a Section 102(b)(7) provision limiting directors liability for breaches of fiduciary duty.[36] Crucially, say the plaintiffs, these changes were made in conjunction with the plaintiffs' books and records claim under 8 *Del. C.* § 220.[37] Each of the defendants voted in favor of the provisions, while Madeline Orloff voted against them. Therefore, the plaintiffs allege, it is apparent that the defendants approved each of these provisions under the threat of imminent litigation, and breached their fiduciary duties by self-interestedly protecting themselves against litigation that they knew would soon name them as defendants.

G. Disclosure Claims

The complaint alleges that in 2003 the defendants provided false documentation to the Orloffs in the form of a flawed list of properties owned by Weinstein.[38] For example, the plaintiffs claim that the 2003 document falsely lists the 168-21-52 property at Jamaica Avenue as being much smaller than it actually is, thus making the property's low rental price per square foot seem more in keeping with the market rate. The plaintiffs additionally allege that Lloyd Shulman provided a "fraudulent[ly]" low

---

[36]Compl. ¶ 78.
[37]Compl. ¶ 79.
[38]Compl. ¶ 82.

appraisal of the Orloffs' shares on November 24, 2003,[39] in an effort to purchase the shares for an artificially depressed price. Moreover, the plaintiffs claim that Lloyd Shulman caused Weinstein to attempt to commit securities fraud by depressing the apparent value of Weinstein, and hiding information that could have allowed the plaintiffs to stop the defendants' misconduct earlier. Finally, the complaint alleges that the defendants have violated their duty of disclosure by refusing to provide the Orloffs with the company's 2004 annual report unless they agree to an unreasonable confidentiality agreement,[40] while JWA was denied the information outright. This, the plaintiffs claim, was a violation of the defendants' fiduciary duties.

H. The Defendants' Response

The defendants contest the plaintiffs' allegations that they breached their fiduciary duties. First, they maintain that none of the plaintiffs in this case has standing to pursue many of the claims raised in the complaint because JWA purchased their shares after the claims accrued, and because the Orloffs effectively sold their claims in transferring most of their shares to JWA while intentionally keeping only in their own hands the minimum required to justify a law suit. This conduct, the defendants argue, constitutes champerty, and is forbidden under Delaware law. The defendants next argue that the plaintiffs' claims as to the Mays transactions and as to Westchester Foreign Autos lease are barred by laches. Second, even if these two causes of action are not time barred, the defendants claim that those causes of action, as well as the plaintiffs' allegations as to any of the third-party transactions in connection with vacant lots, as to Rockridge Farm, and as to faulty disclosure, are barred by res judicata because those issues were already adjudicated in the New York action. Finally, the defendants argue that any of the plaintiffs' claims that survive laches and res judicata fail to rebut the business judgment presumption, or to properly allege a claim of waste against the defendants.[41] Therefore, the defendants

---

[39]Compl. ¶ 83.

[40]Compl. ¶ 87.

[41]The defendants' forum non conveniens argument is somewhat dependent on the concurrent action initiated by the Shulmans in New York. Def's Opening Br. 61. Because that action has now been stayed in favor of this litigation, the defendants cannot meet the heavy burden required to invoke the court's discretionary power to decline jurisdiction over this case. *Candlewood Timber Group v. Forestal Santa Barbara SRL*, 2004 Del. LEXIS 458 (Del. Oct. 4, 2004).

maintain, all counts of the amended complaint should be dismissed under Court of Chancery Rule 12(b)(6) for failure to state a claim.[42]

II.

In order to dismiss a claim under Court of Chancery Rule 12(b)(6), a court "must determine with reasonable certainty that, under any set of facts that could be proven to support the claims asserted, the plaintiffs would not be entitled to relief." When making its decision, a court must accept as true all well pleaded factual allegations in the complaint and all reasonable inferences to be drawn from those facts.[43] But a court need not "blindly accept as true all allegations, nor must it draw all inferences from them in plaintiffs' favor unless they are reasonable inferences."[44]

III.

A. Res Judicata

The doctrine of res judicata provides that a final judgment on the merits rendered by a court of competent jurisdiction may, in the absence of fraud or collusion, be raised as an absolute bar to the maintenance of a second suit in a different court upon the same matter by the same party or his privies.[45] Res judicata is a not a mere technicality. Rather, the doctrine stands as a foundation of the legal system, judicially created in order to ensure a definitive end to litigation. Res judicata permits a litigant to press his claims but once, and requires him to be bound by the determination of the forum he has chosen, so that he "may have one day in court but not two."[46] Although courts formerly limited res judicata to actions that were actually already litigated and determined, the modern view of the doctrine

---

[42]The defendants concentrate their argument on showing that the plaintiffs have not satisfied the pleading requirements of Rule 12(b)(6). The court notes, however, that the defendants have also moved to dismiss the plaintiffs' derivative claims under the higher pleading standards required to excuse demand under Court of Chancery Rule 23.1. Def.'s Opening Br. 19; Def.'s Reply Br. 40. The court has conducted its review of the plaintiffs' fiduciary duty claims under the higher standard required by Rule 23.1, and concludes that the plaintiffs' claims survive under that rule to the same extent as they survive under Rule 12(b)(6).

[43]*Grobow v. Perot*, 539 A.2d 180, 187 n.6 (Del. 1988).

[44]*Id.* at 187.

[45]*Epstein v. Chatham Park, Inc.*, 153 A.2d 180, 184 (Del. Super. 1959).

[46]*Maldonado v. Flynn*, 417 A.2d 378, 381 (Del. 1959) (*quoting Malone Freight Line, Inc. v. Johnson Motor Lines, Inc.* 148 A.2d 770, 775 (Del. 1959)).

is transactional in nature. Causes of action that arise out of the same transaction are precluded if brought in a subsequent action.[47]

The defendants argue that most of the claims in the complaint are barred by the adjudication of the New York action. Specifically, the defendants claim that all of the plaintiffs' claims except Count V (the bylaw amendments and the amended certificate of incorporation) are barred by res judicata.[48] The court agrees with the defendants as to Count IV, but concludes that Counts I, II, III, and VI are not barred by the prior adjudication.

The plaintiffs' claims as to the Rockridge Farm lease are barred by res judicata because they were previously litigated by Madeline Orloff and Jessogne in the New York action. Rockridge Farm was expressly part of the previous litigation. The complaint in the New York action alleged substantially identical breaches of fiduciary duty by the Shulmans as those raised in the current case, including below market rents charged to the defendants and waste.[49]

The current complaint makes some superficially different allegations as to the Rockridge Farm property. For example, the Orloffs now claim that the maintenance of Rockridge Farm constitutes waste because corporate headquarters could be rented in Manhattan for less money than Weinstein spends to maintain Rockridge Farm,[50] but such claims are plainly of the same kind and about the same transaction advanced in the New York action.

The plaintiffs argue that the present claim can be distinguished from the New York action because the latter was a direct suit against the corporation and the current claims are derivative.[51] It is not entirely clear that the plaintiffs are correct. The New York Court of Appeals has explained that a Section 1104 oppression action is the kind of relief available to allegedly oppressed minority shareholders when a derivative claim is unavailable for whatever reason.[52] But some of the plaintiffs'

---

[47]The extent to which separate events constitute one transaction is a matter to be determined flexibly by the court. RESTATEMENT (SECOND) OF JUDGMENTS § 24(b) (1982); the requirements for res judicata in Delaware are described in *Bradley v. Div. of Child Support Enforcement*, 582 A.2d 478, 480 (Del. 1990).

[48]Def.'s Opening Br. 44. The bylaw amendment and amended certificate of incorporation, which form the basis of the plaintiffs' fifth cause of action, indisputably post date the earlier litigation in New York. Compl. ¶ 22.

[49]Def.'s Ex. 4 21-26.50 Compl. ¶ 75.

[50]Compl. ¶ 75.

[51]Pl.'s Opening Br. 52.

[52]*In Re Kemp & Beatley, Inc.*, 64 N.Y.2d 63, 70 (1984). The only Delaware case that has squarely addressed the issue of oppression is *Litle v. Waters*, 1992 Del. Ch. LEXIS 25 (Del. Ch. Feb. 10, 1992). In that case, the court rejected the defendants' arguments that oppression was

claims in the prior case seem to be derivative in nature under Delaware law, alleging financial mismanagement that would harm the corporation as a whole, and for which the corporation should be compensated.[53] The court need not decide this issue, however, because even if the court assumes that the plaintiffs' prior claims were direct, and the current claims derivative, the court concludes that the plaintiffs' pre-1998 claims are barred by res judicata.

As a rule of black-letter law, suits brought by the same party in another capacity are not subject to claim preclusion.[54] The general rule yields, however, to considerations of public policy. Courts need not spare plaintiffs from the bar of res judicata if the important purposes of judicial efficiency and finality that the doctrine serves would be foiled.[55] This case presents precisely such an instance. Weinstein is a closely held corporation which has long had only one minority shareholder group. As such, the nexus of interest between the derivative action and the individual action is likely to be especially close. In that context, to allow the Orloffs to proceed with a derivative suit would be to cut the heart out of the previous adjudication, conducted at great length and expense in New York.[56] Courts have no duty to allow such laborious re-litigations by identical parties, and this court declines to sanction one now. While some other plaintiff could hypothetically bring a derivative claim on behalf of Weinstein, the Orloffs have already had their opportunity to do so.[57]

The plaintiffs note, correctly, that George Orloff was not a plaintiff in the New York action. In normal circumstances, a third party is not barred by res judicata as a result of claims made by a different plaintiff with whom he is not in privity. A parent-child relationship, without more, does

---

available only under "special state statutes," and instead defined the action as "a violation of the reasonable expectations of the minority." *Id.* at *22 (*quoting Gimpel v. Bolstein*, 477 N.Y.S.2d 1014, 1017 (N.Y. Sup. Ct. 1984)). *Gimpel*, where the plaintiff had brought both derivative claims and a statutory oppression action, strongly suggests that oppression is an individual claim under New York law.

[53]*Tooley v. Donaldson, Lufkin, & Jenrette, Inc.*, 845 A.2d 1031, 1035-36 (Del. 2004).

[54]*Carlton Invs. TLC Beatrice*, 1997 Del. Ch. LEXIS 62, *7-8 (Del. Ch. Apr. 21, 1997).

[55]*Satterfield v. Pharmacia Corp.*, 2002 Del. Ch. LEXIS 70, *4 n.5 (Del. Ch. June 17, 2002), *aff'd*, 812 A.2d 224 (Del. 2002) (holding that res judicata applied where identical plaintiff attempted to relitigate a claim as an administrator that he had already lost in his individual capacity).

[56]*Boothe v. Baker Industries*, 262 F. Supp. 168 (D. Del. 1966).

[57]*Liken v. Shaffer*, 64 F. Supp. 432, 442 (D.Iowa 1946) annunciates an important principle with resonance here. In that case, the court held that "the fact that one stockholder has discovered fraud and is guilty of laches does not prevent another stockholder who is not guilty of laches from instituting a stockholder's derivative action." It is the same as to res judicata in this case. The corporation is not barred from bringing its claim because of the Orloffs' prior action. But the Orloffs are indeed barred in equity from doing so.

not generally create privity between two plaintiffs.[58] Thus, in normal circumstances, George Orloff would be permitted to bring claims his mother is barred from advancing.

In some cases, however, a substantial identity of parties interests has been held to place two superficially separate parties in privity.[59] Here, it is fair to conclude that the entire Orloff family has long been intricately intertwined in this litigation.[60] The claims and disagreements identified by the various members of the family are so similar that the court cannot conclude that the claims raised by Madeline Orloff in the New York action and those alleged by George Orloff in this case are anything other than functionally one legal right.[61] The law simply does not allow already litigated claims to be passed from one generation of the Orloff family to another in the hope that some court, someday, will eventually grant relief. George Orloff's claims as to Rockridge Farm are therefore barred to the same extent as his mother's claims.

The remaining claims, Counts I, II, III, and VI, are not barred by res judicata. Some of the claims in these counts occurred after judgment in the New York action. Those claims, of course, are not barred. None of the other claims at issue arise from the same transaction as that alleged in the New York action. Examining the complaint filed in New York, the gravamen of the plaintiffs' argument there plainly centered around Rockridge Farm and accusations of excessive compensation and minority shareholder oppression under the New York statute. The claims at issue in this case arise from entirely different circumstances.

---

[58]RESTATEMENT (SECOND) OF JUDGMENTS § 663 (1982).

[59]*Id.*

[60]The Delaware Supreme Court has defined privity as pertaining to "the relationship between a party to a suit and a person who was not a party but whose interest in the action was such that he [or she] will be bound by the final judgment as if he or she were a party. *Bradley*, 582 A.2d at 478. An important discussion of privity in res judicata can be found in a persuasive federal district court case, *Goel v. Heller*, 667 F. Supp. 144 (D.N.J. 1987). In that case, the court held that a group of defendants were in privity with each other (and therefore entitled to res judicata) where the plaintiffs were clearly abusing the concept of privity to repeatedly bring substantially identical claims against closely associated defendants. As the court held in that case, the test of privity is whether there is a "close or significant relationship between successive defendants." *Id.* at 150.

[61]In *VanDeWalle v. Albion Nat. Bank*, 500 N.W.2d 566 (Neb. 1993), the Nebraska Supreme Court faced a situation much like that before this court. In that case, two brothers who were part of a particularly litigious family attempted to bring a suit in state court after their parents had already been defeated in federal court on the same claims. The court in that case, though it acknowledged that the plaintiffs in the two cases were different, barred the brothers' claims by res judicata, noting that "the facts remain that the parents and sons had a close, mutual, relationship with respect to the property and that all [the] suits arise out of the same occurrence." *Id.* at 506. The court concluded with the observation that "under the circumstances, the entire VanDeWalle clan is in privity for the purposes of these suits." *Id.*

The disputed Mays transactions, for example, concern discrete transactions between the two companies controlled by the Shulmans that cannot be captured by either the general allegations of breaches of fiduciary duty in the New York action or the more specific counts as to Rockridge Farm. The same is true of those other transactions, such as the Westchester Foreign Autos lease, which occurred before the New York action. The court, therefore, cannot dismiss any of the plaintiffs' other claims on the basis of res judicata.

B. Laches

Of the claims remaining after the application of res judicata, the defendants argue that the plaintiffs' allegations as to the Mays transactions and as to the Westchester Foreign Autos lease are time barred. As the defendants correctly note, none of these claims accrued more recently than 1999, and claims for breach of fiduciary duty are governed by a three-year statute of limitations. Therefore, the defendants' claim, the plaintiffs are barred by laches from bringing their claims for unreasonable delay.[62]

The equitable defense of laches, rooted in the basic sense that those seeking equity must not slumber on their rights, interacts strongly with the statute of limitations. As the Delaware Supreme Court has held, great weight is placed on analogous statutes of limitations in determining whether a plaintiff's claim should be barred by laches, or allowed to continue.[63] Indeed, Delaware courts have consistently held that analogous statutory provisions create a "presumptive time period for application of laches to bar a claim,"[64] thereby relieving courts of the need to conduct the traditional equitable test. When applied by a court of equity, however, the statute of limitations is not applied inflexibly or arbitrarily.[65] Thus, under the doctrine of equitable tolling, the statute does not run against the plaintiff until he or she had reason to know the facts alleged to give rise to the wrong.[66]

---

[62]*United States Cellular Inv. Co. of Allentown v. Bell Atl. Mobile Sys., Inc.*, 677 A.2d 497, 502 (Del. 1996).

[63]DONALD J. WOLFE, JR. AND MICHAEL A. PITTENGER, CORPORATE AND COMMERCIAL PRACTICE IN THE DELAWARE COURT OF CHANCERY, § 11.5(c) (2005 ed.).

[64]*Id.*

[65]Especially important is the concept that "fiduciaries who benefit personally from their wrongdoing, especially as a result of fraudulent self-dealing, will not be afforded the protection" of the statute of limitations. *Yaw v. Talley*, 1994 Del. Ch. LEXIS 35, *17-18 (Del. Ch. Mar. 2, 1994).

[66]WOLFE & PITTENGER, *supra* note 59.

As to all the claims aside from those concerning the Levittown lease, the court concludes that the defendants have failed to establish their claim of laches because the plaintiffs have pleaded sufficient facts to show that they could not have brought these claims without the information gathered during the Section 220 action in 2004. The information was not available in any public way. Indeed, the plaintiffs allege that the defendants were engaged in a campaign of intentional disinformation towards the minority shareholders. It is true that Madeline Orloff was on the board of Weinstein until 2004, and therefore would normally be considered to have had access to crucial information. But in response, the plaintiffs advance well pleaded allegations that Madeline Orloff was misled in her directorial capacity, and that she was intentionally excluded from the affairs of Weinstein.[67] These allegations, if true, mean that Madeline Orloff would have been unable, exercising normal diligence, to extract sufficient information from Weinstein and the defendants to bring this complaint at an earlier date. A complaint that includes such allegations cannot be barred by laches on a motion to dismiss before discovery has established a factual record.

The allegations relating to the Levittown lease present different issues. As discussed, *infra*, the court concludes that those allegations do not state a claim for relief and, thus, must be dismissed under Court of Chancery Rule 12(b)(6). Even if this were not the case, however, the claim relating to the Levittown lease would be barred by laches. The 1983 renegotiation and assignment of the Levittown lease was a matter of public record in the Mays bankruptcy–a proceeding that was highly material to the Orloff family because of Weinstein's substantial holdings of Mays common stock, as well as Weinstein's status as lessor of a number of the Mays department store properties. It is simply implausible that the plaintiffs or their predecessors-in-interest either did not know or did not have sufficient information to cause them to inquire into the Mays bankruptcy and, more particularly, the terms of the Levittown lease assignment. To allow the plaintiffs now to litigate claims relating to this 22-year old transaction would serve only to weaken the important doctrine of laches, and the ideal of diligent prosecution that it represents.

C. Standing

As the defendants note, the Orloffs' decision to pursue this case is somewhat puzzling. The bulk of their former economic interest is now in the hands of the co-plaintiff, JWA, and the amount at issue is relatively

---

[67]Compl. ¶ 6.

minor in relation to the cash the Orloffs have extracted from the sale of their stock.[68] The defendants argue that this constitutes the offense of champerty, which consists of "an agreement between the owner of a claim and a volunteer that the latter may take the claim and collect it, dividing the proceeds if they prevail; the champertor to carry on the suit at his own expense."[69] There is no reason to believe, however, that the plaintiffs have engaged in the type of conduct that would deprive them of standing. The Orloffs maintain a substantial financial stake in Weinstein. There are no calls outstanding against their stock, and anyone who wants to buy them out must pay the price at which the Orloffs value their stake. So long as they maintain that stake, and held stock at the time of the alleged breaches of duty, they may bring their claims before this court.[70]

D. Breaches Of Fiduciary Duty And Waste

Taking into account only those claims which are not barred by res judicata, the plaintiffs allege in Counts I, II, III, V, and VI that the defendants breached their fiduciary duties and committed waste. Delaware's business judgment rule operates primarily as a presumption that directors making business decisions act in good faith, on an informed basis, and in the honest belief that their actions are in the corporations best interest.[71] The burden is on the party challenging the decision[72] to allege particularized facts creating a reasonable doubt that (1) the directors are disinterested and independent and (2) the challenged transaction was

---

[68]JWA has standing to bring only the causes of action for Rockridge Farm and the Middle Bay Country Club. Because the Orloffs are proper derivative plaintiffs, the defendants' argument that JWA's action represents a "strike suit" making allegations about transactions prior to stock ownership is unavailing. Def.'s Opening Br. 51.

[69]*Gibson v. Gillespie*, 152 A. 589, 593 (Del. Super. 1928); *In re Emerging Comm., Inc. S'holders Litig.*, 2004 Del. Ch. LEXIS 70, *106 (Del. Ch. May 3, 2004).

[70]The formal nature of the stock ownership requirement is underlined by Chancellor Chandler's recent decision in *In re New Valley Corp. Deriv. Litig.*, 2004 Del. Ch. LEXIS 107 (Del. Ch. June 28, 2004). In that case, the court held that a current and long-term shareholder in the defendant lacked standing to bring a derivative claim because of a single five-month gap in his share ownership, during which he held only non-voting warrants. In reaching that decision, the court expressly rejected the plaintiff's argument that his long-term interest in the defendant vitiated the policy concern of abusive law suits behind the "iron-clad" continuous ownership rule. *Id.* at *13. As the court stated the rule, "a plaintiff who ceases to be a shareholder, whether by reason of a merger or for any other reason, loses standing to continue a derivative suit." *Id.* The reverse proposition, as in this case, is also true. A shareholder who formally maintains continuous ownership generally has standing to bring a derivative claim, no matter how few shares he or she holds. *See also Dann v. Chrysler Corp.*, 174 A.2d 696, 699 (Del. Ch. 1961).

[71]*Aronson v. Lewis*, 473 A.2d 805, 812 (Del. 1984).

[72]*Id.* at 812 (*citing Puma v. Marriot*, 283 A.2d. 693, 695 (Del. Ch. 1971)).

otherwise the product of a valid exercise of business judgment.[73] One way of showing the latter is to allege that the defendants wasted corporate assets. But the standard for establishing a claim of waste is a high one. Indeed, it has been held that the test for finding waste of corporate assets is whether the consideration received by the corporation was so inadequate that no person of ordinary sound business judgment would deem it worth that which the corporation paid.[74] While this is not the impossibly stringent test urged on the court by the defendants,[75] merely poor, misguided, or loss-making transactions are insufficient for a finding of waste.

The complaint alleges that the defendants have violated their fiduciary duties and committed waste by approving what are alleged to be substantially below market transactions between Weinstein and Mays. The plaintiffs also point to a number of transactions between Weinstein and third parties as evidence of potential waste or breaches of fiduciary duty.

The court first considers the plaintiffs' claims as to the Levittown transaction. The plaintiffs' claim is that the defendants committed waste by "inexplicably" consenting to the assignment of the Mays Levittown store lease to Trade Town. Had they instead refused to consent, the plaintiffs allege, Weinstein could have secured all the excess revenue from the Levittown lease to itself, rather than sharing half with Mays.

The record of the bankruptcy courts approval of the Levittown lease assignment (of which the court takes judicial notice), however, fatally contradicts the complaint's blithe allegation of misconduct. Indeed, a review and consideration of Mays's bankruptcy court petition requesting approval of the Levittown assignment clearly demonstrates that there was a real issue as to whether or not Weinstein would be able to recover any of the excess value of that lease . The bankruptcy record shows that the Levittown lease was recognized as a valuable asset of the estate. Thus, in

---

[73]*Aronson*, 473 A.2d at 815.

[74]RODMAN WARD, EDWARD P. WELCH, & ANDREW TUREZYN, FOLK ON THE DELAWARE GENERAL CORPORATION LAW, § 141.2.11 (2005 ed.); *Saxe v. Brady*, 184 A.2d 602 (Del. Ch. 1962).

[75]The defendants insist that in order to state a claim for waste, a plaintiff must "demonstrate that the transaction served no corporate purpose or was so completely bereft of consideration as to constitute a gift." Def.'s Opening Br. 27. The source of this standard is the court's decision in *President & Fellows of Harvard Coll. v. Glancy*, 2003 Del. Ch. LEXIS, 25, *72 (Del. Ch. Mar. 21, 2003), which drew on Chancellor Allen's decision in *Lewis v. Vogelstein*, 699 A.2d 327, 336 (Del. Ch. 1997). Read in context, the cited language is merely an illustration of a typical claim of waste rather than the definition itself: "most often, the claim is associated with a transfer of corporate assets that serves no corporate purpose; or for which no consideration at all is received. Such a transfer is in effect a gift." *Id.* The actual legal standard for waste, as expressed in *Vogelstein*, is the traditional one: "an exchange of corporate assets for consideration so disproportionately small as to lie beyond the range at which any reasonable person might be willing to trade." *Id.*

its petition seeking authorization from the court to assume the lease and agree to the assignment, the burden was clearly on Mays to show that it was fair to Mays's creditors to pay half of the excess rents to its landlord, Weinstein. It is this dynamic that explains the reference in Mays's petition to an objection raised by counsel for Celwyn's minority shareholders (Celwyn being a subsidiary of Weinstein) during the lease reassignment negotiation process.[76]

What Mays hoped to show by including the objections raised by Celwyn in the record was not that the deal might be unfair to Celwyn, as the plaintiffs suggest, but that the deal reached was the best that Mays could achieve in the face of active opposition by someone other than the Shulmans. Because the Shulmans stood on both sides of the lease reassignment,[77] Mays's creditors might otherwise have been justly suspicious that the lease reassignment had been engineered to shift revenue from Mays to Weinstein, and thus to shield assets from the bankruptcy proceeding.

In this context, the plaintiffs' bald assertion that the defendants wasted Weinstein assets by not insisting on even better terms from Mays and its creditors is simply insufficient to rebut the business judgment rule presumption as to the Levittown lease. The situation was obviously more complex than the complaint allows, and the directors' decision to authorize a compromise that secured a substantial advantage to Weinstein is plainly one within their sound business judgment. Indeed, even if the plaintiffs are ultimately correct in their allegations that the Shulmans later systematically moved revenue from Weinstein to Mays, such an action would have made no sense at all during Mays's bankruptcy, when any money shifted to Mays would have been available to repay creditors. The plaintiffs' allegations of fiduciary duty breach as to the Levittown property, therefore, must be dismissed for failure to state a claim.

Although some of the plaintiffs' remaining allegations are more serious than others, the court concludes that the plaintiffs have pleaded sufficient facts to sustain these allegations against a motion to dismiss. As to the transactions between Weinstein and Mays, the consideration secured for Weinstein from these transactions was troublingly low, in some cases less than 20% of what the plaintiffs allege was the fair market rate. Second, the Shulmans obviously stand on both sides of the transaction, as controllers of both Weinstein and Mays. Given the possibility that the defendants might, for the self-serving reasons that the plaintiffs have

---

[76]Fischer Aff. Ex. D at ¶ 12.

[77]The bankruptcy court papers show that Max Shulman approved the lease reassignment on behalf of Celwyn, and Lloyd Shulman signed on behalf of Mays. Fischer Aff. Ex. D ¶ 20.

alleged, prefer revenues and profits to be shifted from Weinstein to Mays, the court cannot dismiss these allegations at this stage in the proceeding.

The plaintiffs' allegations as to transactions with third parties and as to the vacant and loss-making properties, if true, together suggest a striking picture of financial mismanagement. The plaintiffs have alleged, for example, that the defendants have rented many of their properties to third parties for less than 20% of their market value, as measured against the rents charged for properties on the same streets. Although there may be legitimate reasons that explain such a disparity between the alleged market price and the price Weinstein collected, the size of the gap between the two numbers means that the court cannot say that a claim of waste or breach of fiduciary duty could not be proven at trial. It is equally unclear why the defendants would leave what appear to be viable plots on Jamaica Avenue entirely vacant for years at a time, rather than generating what revenue they could.

Some of the plaintiffs' other factual allegations, such as the defendants' alleged inaction in the face of the Middle Bay Country Club's breach of its lease with Weinstein, or the loss-making properties in Kansas City, appear more within the protection of the business judgment rule. If these allegations had appeared alone, the court might well have dismissed them for failure to state a claim. But in the context of the plaintiffs' other allegations, where the plaintiffs seek to show a pervasive scheme through which Weinstein's management pursued actions designed to depress Weinstein's earnings, the plaintiffs should have the opportunity to conduct discovery into these claims. Ultimately, the plaintiffs' burden of proof on these matters remains high, especially where they seek to show waste. The defendants could have reasonable explanations for all of the alleged incidents of mismanagement. But at this stage, enough questions remain about the defendants' property transactions that the court cannot dismiss the plaintiffs' claims before discovery.

The same is not true of the plaintiffs' claim that the defendants violated their fiduciary duties by approving a bylaw amendment which provided for the advancement of legal fees during litigation. The law of Delaware is clear on the permissibility of advancing legal fees. This is especially true when, as here, the plaintiffs challenge the adoption of a bylaw that requires the corporation to advance litigation costs sometime in the future rather than challenging the directors' decision to advance particular litigation expenses.[78] Bylaw amendments mandating litigation

---

[78]Decisions to advance litigation costs in the absence of a bylaw mandate are governed by the business judgment of the board of directors. *Havens v. Attar*, 1997 Del. Ch. LEXIS 12 (Del. Ch. Jan. 30, 1997).

advances are a fundamental part of Delaware's policy to encourage qualified people to serve as corporate directors. Moreover, as the Delaware Supreme Court has held, bylaw amendments are presumed to be valid unless they are unreasonable.[79] The plaintiffs have pleaded no facts which suggest that the bylaw amendment at issue is unreasonable in this case. Therefore, it is not subject to further scrutiny by this court.

Relatedly, the plaintiffs allege that the defendants have violated their fiduciary duties by approving an amendment to Weinstein's certificate of incorporation which includes a Section 102(b)(7) provision protecting the directors from personal liability for violations of due care. This action constitutes a violation of the defendants' fiduciary duties, according to the plaintiffs, because the directors knew they were in imminent danger of being sued and thus stood on both sides of the "transaction." The court has at least twice before rejected claims of this kind, noting that they are "but variations on the 'directors suing themselves' and 'participating in the wrongs' refrain."[80] Nor do the plaintiffs' allegations in this complaint allege particularized facts creating a reasonable doubt that the directors were disinterested or independent when they made their decision to approve the certificate amendment. In the absence of such facts, the directors' decision to adopt a Section 102(b)(7) provision, which was later approved by the shareholders, does not provide any reason to depart from the court's settled precedent.[81]

Finally, the plaintiffs allege that the defendants violated their fiduciary duties by making false disclosures to the Orloffs, which, had they been truthful and complete, would have allowed the plaintiffs to mitigate the losses they attribute to the defendants' alleged mismanagement of Weinstein. The Delaware Supreme Court has held that claims for a breach of fiduciary duty of disclosure can only arise when the defendant has made statements to the corporations stockholders in connection with a request for stockholder action.[82] Of course, the statements in this case were not made in connection with any kind of corporate action, such as in a proxy statement. The courts have been willing, however, to allow plaintiffs to plead fraudulent disclosures under the rubric of the duty of loyalty.[83]

To successfully state a duty of loyalty claim against directors for providing information in the absence of a request for stockholder action, a

---

[79]*Frantz Mfg. Co. v. EAC Indus.*, 501 A.2d 401 (Del. 1985).

[80]*Decker v. Clausen*, 1989 Del. Ch. LEXIS 143 (Del. Ch. Nov. 6, 1989), *8; *Caruana v. Saligman*, 1990 Del. Ch. LEXIS 210, *11 (Del. Ch. Dec. 21, 1990).

[81]*Caruana*, 1990 Del. Ch. LEXIS at *11.

[82]*Steinman v. Levine*, 2002 Del. Ch. LEXIS 132, *46-47 (Del. Ch. Nov. 27, 2002),*aff'd* 822 A.2d 397 (Del. 2003).

[83]*Id.*

stockholder must allege that he received "false communications" from directors who were "deliberately misinforming shareholders about the business of the corporation."[84] In this case, the plaintiffs have pleaded sufficient facts claiming that the defendants misled the Orloff shareholders. The alleged fraudulent appraisal of the Orloffs' shares, for example, could have, but did not, persuade the Orloffs to sell their shares at an insufficient price. As for the 2003 document that allegedly misstates the size of certain properties, the faulted disclosures could have been, but were not, material in keeping the minority shareholders quiescent while funds were shifted from Weinstein to Mays. In sum, therefore, the plaintiffs' allegations, if true, could demonstrate a violation of the defendants' duty of loyalty to the plaintiffs.

IV.

For the foregoing reasons, the defendants' motion to dismiss pursuant to Rule 12(b)6 is GRANTED as to Counts IV and V, GRANTED IN PART AND DENIED IN PART as to Count I, and DENIED as to Counts II, III, and VI. IT IS SO ORDERED.

SEINFELD v. VERIZON COMMUNICATIONS, INC.

No. 1100-N

Court of Chancery of the State of Delaware, New Castle

November 23, 2005

Robert D. Goldberg, Esquire, of Biggs & Battaglia, Wilmington, Delaware; and Irving Bizar, Esquire, and A. Arnold Gershon, Esquire, of Ballon Stoll Bader & Nadler, P.C., New York, New York, of counsel, for plaintiff.

---

[84] *Jackson Nat'l Life Ins. Co. v. Kennedy*, 741 A.2d 377, 389 (Del. Ch. 1999).

Edward P. Welch, Esquire, and Michael A. Barlow, Esquire, of Skadden Arps Slate Meagher & Flom, LLP, Wilmington, Delaware, for defendant.

LAMB, *Vice Chancellor*

A stockholder filed an action pursuant to Section 220 of the Delaware General Corporation Law seeking to compel inspection of books and records related to three senior executives' compensation that he claims is excessive and wasteful. To support the propriety of his purpose, the stockholder alleges that the three executives were all functioning in the same job and were paid amounts above the minimum requirements in their employment contracts. On cross-motions for summary judgment, the record, including the plaintiff's own deposition, fails to reveal any substantial factual basis to support the alleged mismanagement or waste. Therefore, the court concludes, viewing the evidence in the light most favorable to the stockholder plaintiff, that he has not met his evidentiary burden under Section 220 to demonstrate a proper purpose to justify the inspection.

I.

Verizon Communications, Inc. is a Delaware corporation. Frank D. Seinfeld, the plaintiff, is a purported beneficial owner of approximately 3,884 shares of Verizon, held in street name through a brokerage firm.[1]

On January 28, 2005, Seinfeld sent a written demand in compliance with 8 *Del. C.* § 220 to Verizon, seeking to inspect and make copies of Verizon's books, records, and minutes of its board meetings, claiming that Verizon overcompensated its three top executives. Specifically, Seinfeld alleges that he is concerned that these executives were paid compensation far in excess of the minimum amounts that they were entitled to receive under their employment contracts.[2] In particular, the plaintiff claims that during 2000-2002, Ivan G. Seidenberg, Lawrence P. Babbio, Jr., and Charles R. Lee "received total compensation of $205 million, ostensibly performing the same services as co-chief executives."[3] According to the

---

[1]Tr. Ex. A.

[2]Seinfeld Dep. 17-18 ("I'm concerned with the amounts because according to what I've read here, there were minimum amounts that should be received as bonuses. And this is considerably more than the maximum stated. And I'm surprised there's no maximum stated. But let's talk about the minimum. The, the amounts received were considerably more. And I'd like to know on what basis those higher amounts were given out.").

[3]Mem. in Supp. of Pl.'s Mot. for Summ. J. 1.

plaintiff, "to have three co-chief executive officers running one enterprise and having each receiving such extraordinary compensation is unusual."[4]

Additionally, the plaintiff contends that Verizon's long-term bonus plan under which options were granted was "conveniently" amended shortly after at least two of the three employment contracts were entered into and that this amendment caused an increase in the executives' total compensation packages.[5] In effect, the plaintiff claims that the directors committed corporate waste when they gave excessive compensation packages to the executives, including excessive option grants.[6]

On February 7, 2005, Verizon refused the demand. Seinfeld filed suit on February 15, 2005. On July 28, 2005, Seinfeld moved for summary judgment, submitting several affidavits in support of his motion, including his own. After Seinfeld resisted giving a deposition, the court ordered that he be deposed. Thereafter, Verizon cross-moved for summary judgment, arguing that Seinfeld had not shown a credible basis to infer wrongdoing or mismanagement in Verizon's compensation of its executives. The court heard argument on the cross-motions on October 25, 2005.

II.

Section 220 sets out the procedure that a stockholder must follow in order to be entitled to inspect a corporation's books and records.[7] Such stockholder must first establish that (1) he, she, or it is a stockholder, (2) he, she, or it has complied with the section respecting the form and manner of making demand for inspection of such documents, and (3) the inspection such stockholder seeks is for a proper purpose.[8] "The paramount factor in determining whether a stockholder is entitled to inspection of corporate books and records is the propriety of the stockholder's purpose in seeking

---

[4] *Id.*

[5] Pl.'s Br. in Supp. of Mot. for Summ. J. 2. According to the plaintiff's brief, "the long term bonus plan, under which the 'compensation' in options was paid, was amended in January 2001. How very convenient. Were the extravagant bonus provisions inserted in the contracts with the view that shortly afterwards, the long term bonus plan would be amended, thus making those provisions even more exceedingly valuable?"

[6] The plaintiff also asserted in his opening brief that the executives were granted options in violation of their employment agreements. However, in his deposition he replied that there was no doubt in his mind that the executives were entitled to receive the stock options under their employment agreements. Seinfeld Dep. 42-44, 52, 60. This claim was then re-stated by the plaintiff in a later brief, "he is concerned with the contracts for their failure to provide expressly for options, the failure to set limits to option grants and the options granted thereunder."

[7] Section 220 was recently amended to allow beneficial owners, such as the plaintiff in this case, a right of inspection.

[8] 8 *Del. C.* § 220.

such inspection."[9] Section 220 defines a proper purpose as one "reasonably related to such person's interest as a stockholder."[10]

While it is well established that an investigation into corporate waste and mismanagement is a proper purpose for books and records inspection under Section 220, a mere suspicion of wrongdoing, such as the claim the plaintiff is making in this action, is insufficient.[11] The statute places the burden of proving a proper purpose on the stockholder who seeks inspection of the company's books and records.[12] This burden is not insubstantial, and "mere curiosity or a desire for a fishing expedition will not suffice."[13] The stockholder must "present some credible basis from which the court can infer that waste or mismanagement may have occurred."[14] Although the plaintiff does not have to prove actual wrongdoing, "a mere statement of a purpose to investigate possible general mismanagement, without more, will not entitle a shareholder to broad Section 220 inspection relief."[15]

On a motion for summary judgment pursuant to Rule 56, judgment will be granted where the moving party demonstrates that there are no genuine issues of material fact in dispute and that the moving party is entitled to judgment as a matter of law.[16] When determining whether to grant summary judgment, a court must view the facts in the light most favorable to the nonmoving party.[17]

III.

Seinfeld filed this Section 220 action so that he could investigate why the three executives received total compensation in amounts that he alleges exceeded $200 million. Seinfeld does not allege facts challenging

---

[9]*CM & M Group, Inc. v. Carroll*, 453 A.2d 788, 792 (Del. 1982).

[10]8 *Del. C.* § 220 (b).

[11]*Security First Corp. v. U.S. Die Casting & Dev. Co.*, 687 A.2d 563, 568 (Del. 1997); *Thomas & Betts Corp. v. Leviton Mfg. Co.*, 681 A.2d 1026, 1031 (Del. 1996).

[12]8 *Del. C.* § 220(c) (placing the burden of proving proper purpose on the stockholder when he seeks inspection of records other than the corporation's stock ledger or list of stockholders).

[13]*Security First*, 687 A.2d at 568.

[14]*Thomas & Betts*, 681 A.2d at 1031.

[15]*Security First*, 687 A.2d at 568 (*citing Helmsman Mgmt. Servs. v. A&S Consultants, Inc.*, 525 A.2d 160, 166 (Del. Ch. 1987)); *Thomas & Betts*, 681 A.2d at 1032 (explaining that the plaintiff's subjective belief that wrongdoing has occurred is insufficient to meet the evidentiary burden required to compel inspection).

[16]*Scureman v. Judge*, 626 A.2d 5, 10 (Del. Ch. 1992).

[17]*Haas v. Indian River Volunteer Fire Co.*, 2000 Del. Ch. LEXIS 116, *11 (Del. Ch. Aug. 14, 2000), *aff'd*, 768 A.2d 469 (Del. 2001).

the process by which these compensation decisions were made.[18] Rather, he and his complaint appear to focus principally on the fact that the actual compensation amounts paid exceeded the minimum amounts specified by contract. For example, the complaint alleges that the amounts paid to two of the three executives in base salary in most years exceeded the minimum amounts due under their contracts. Moreover, one executive is alleged to have received option grants far in excess of the minimum grants specified in his contract. The complaint also alleges that the other two executives were awarded stock options despite the fact that their employment contracts do not expressly provide for option grants. Colorfully, the complaint appears to allege (and Seinfeld's briefs repeat the claim) that these three executives were actually all paid to do the same job.[19]

Not surprisingly, Seinfeld was unable to provide any factual support for this assertion at his deposition.[20] At his deposition, Seinfeld similarly conceded that he has no basis in fact to allege the executives "did not earn" the amounts paid to them under their employment agreements.[21] He also conceded, in effect, that he has no facts establishing a credible basis of any violation of the duties of loyalty or care in the directors' approval of these executives' compensation.[22] All Seinfeld was able to say at his deposition is that he is concerned about the large amounts paid to the three executives in compensation.[23] In sum, Seinfeld offers no evidence from which the

---

[18]Seinfeld Dep. 34.

Q. And you're not personally challenging the process through which the compensation decisions were made?

A. Not at this time.

[19]Compl. ¶ 6 ("For a telephone company to have had one $25 million-a-year CEO is bad enough, but to have had three, is intolerable.").

[20]In 2000, following the acquisition of GTE Corporation by Bell Atlantic Corporation, the latter of which was renamed Verizon, Lee and Seidenberg were named co-CEOs of Verizon. They served as co-CEOs for a period of less than two years, and, in April 2002, Seidenberg became the sole CEO of Verizon. At no time did Verizon have three co-CEOs. Babbio served as President and Vice Chairman, but has never been the CEO of Verizon. Seinfeld Dep. 102-103.

Q. Now, as you sit here today, do you have any evidence that Mr. Lee or Mr. Seidenberg ever did identical or duplicative work?

A. I don't have any evidence, no.

[21]Seinfeld Dep. 63.

Q. Do you have any reason, as you sit here today, to believe that they didn't earn the benefits under the contract?

A. No. I don't have anything at this point.

[22]Seinfeld Dep. 33-35.

[23]Seinfeld Dep. 19.

Q. So your concern is the excessive monies?

A. Yes.

Q. And that's it?

A. Yes.

And, further at 105.

court could evaluate whether there is a reasonable ground for suspicion that the executives' compensation rises to the level of waste.[24]

Furthermore, Seinfeld's claim that Verizon's long-term bonus plan was "conveniently" amended to provide the executives with more valuable stock options is purely speculative.[25] Seinfeld did not submit any evidence showing that the executives were not entitled to these options or that any amendments to the plan were intended to improperly benefit them.[26] Simply stated, Section 220 does not permit a plaintiff to inspect the books and records of a company based on wholly unsupported allegations or mere suspicions.

Similarly, it is not enough under Section 220 for Seinfeld to state that he disagrees with the business judgment of Verizon's board of directors.[27] A mere difference of opinion with the board's human resource committee's compensation decision does not evidence wrongdoing and will not satisfy Seinfeld's burden. Accordingly, even viewing the evidence in the light most favorable to Seinfeld, the court must conclude that he has not carried

---

Q. Do you have any information, other than what was provided, obviously, in the various proxy materials which you read, with respect to the work that they were doing?

A. I don't know what work they were doing. These, these jobs, these positions are very flexible timewise and value-wise; and whatever they do they can do various things. I don't know- I go back to the, to the same thing. I don't know if they- what they did, actually did to, to earn the, the amounts given. The contracts provide for all this; I understand that. But that doesn't meant that they did it.

Q. And you have no reason to believe that they didn't do it?

A. I don't have any reason that they didn't. But I'd like to see something to show me that they did.

[24]The only explanation for the derivation of the amounts of compensation alleged in the complaint is found in an affidavit of counsel stating that he asked an expert, who did not submit an affidavit, to compute the valuations using the variables disclosed by Verizon in its filings with the Securities and Exchange Commission. This affidavit does not disclose the expert's work or otherwise explain how Seinfeld or his counsel derived the $205 million figure for total compensation purportedly received by the executives.

[25]The court cannot reasonably find, based on the plaintiff's conclusory allegations, unsupported by evidence, that the board members conspired to amend the executives' compensation agreements to provide them with more valuable options. Moreover, the options about which the plaintiff complains have never been exercised and are all currently out-of-the money. Toohey Aff. ¶ 3.

[26]Seinfeld Dep. 70-76, 80-87. The executives' employment agreements, which were approved by Verizon's stockholders in 2001, provided for an award of stock options pursuant to Verizon's long-term incentive plan. This incentive compensation was a bonus program administered by the human resources committee of Verizon's board.

[27]*Marathon Ptnrs. L.P. v. M&F Worldwide Corp.*, 2004 Del. Ch. LEXIS 101, *11 (Del. Ch. 2004) ("Stockholders cannot satisfy this burden merely by expressing disagreement with a business decision.").

his burden of showing that there is a credible basis from which the court can infer that the Verizon board of directors committed waste or mismanagement in compensating these three executives during the relevant period of time.[28] Instead, the record clearly establishes that Seinfeld's Section 220 demand was made merely on the basis of suspicion or curiosity.

IV.

For the foregoing reasons, the court finds that the plaintiff has not met the statutory requirements of Section 220. Thus, the plaintiff's motion for summary judgment is DENIED and the defendant's cross-motion for summary judgment pursuant to Rule 56 is GRANTED. IT IS SO ORDERED.

---

[28]*Security First*, 687 A.2d at 568 (explaining that this threshold may be satisfied by a credible showing, through documents, logic, testimony, or otherwise, that there are legitimate claims of corporate mismanagement); *Brehm v. Eisner*, 746 A.2d 244, 266-267 (Del. 2000); *Helmsman*, 525 A.2d at 166 (explaining that there must be some evidence of possible mismanagement as would warrant further investigation of the matter in order to receive Section 220 inspection relief).