I. BACKGROUND

The pertinent facts are derived from the amended complaint and extrinsic documents properly incorporated therein by reference.[1]

Encore (which was not joined as a party) is a Delaware corporation with its principal place of business in Plantation, Florida. Before 1997, the Company had three lines of business: (1) it designed, manufactured, and distributed data storage, data retrieval and sharing technologies for mixed platform processing environments (the "Storage Products Business"); (2) it also developed clustering software (the "Clustering Software Business"); and (3) it designed, manufactured, distributed and supported scalable real-time computer systems software used for computer simulations (the "Real-Time Business").

Until November 24, 1997, Encore had a four member Board of Directors that consisted of defendants Kenneth G. Fisher ("Fisher"), Rowland H. Thomas ("Thomas"), Robert J. Fedor ("Fedor"), and C. David Ferguson ("Ferguson"). After November 24, 1997, the Board was expanded to include two additional directors, defendants Thomas N. Rich ("Rich") and Michael C. Veysey ("Veysey").

Also named as a defendant is Encore's 48.5% stockholder, Gould, which (in turn) is a wholly owned subsidiary of Japanese Energy Group ("JEC"), a Japanese corporation. Fedor, Ferguson, Rich and Veysey are Gould's representatives on Encore's Board of Directors.

In 1989, Gould sold its computer systems business to Encore. Unable to generate enough revenue to sustain itself, Encore came to rely primarily on Gould to fund its operations. From 1989 through November 1997, Gould loaned Encore approximately $496 million. That loan was secured by a first priority security interest in Encore's assets, including its Storage Products business. As additional security for those loans, in 1991 Encore licensed to Gould substantially all of its intellectual property, including that relating to Encore's Storage Products business.

During this period Gould also agreed to accept convertible preferred stock in satisfaction of approximately $420 million of secured debt that Encore owed to Gould. The preferred stock gave Gould a liquidation preference totaling approximately $420 million. Despite that debt reduction, Encore found itself unable to pay cash dividends on the preferred stock, and as a result, it issued to Gould additional preferred shares with a liquidation

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[1]The documents incorporated by reference include the Sun Asset Purchase Agreement, the Gould Agreement, the Retention Agreements, the Sun Proxy Statement, the third quarter 1998 Form 10-Q, and the Gores Group Proxy Statement.

preference of about $41 million. By 1997, Encore had unpaid dividends arrearages to Gould that totaled $29.5 million.

In January 1997, Encore's independent auditors expressed substantial doubt about the Company's ability to continue as a going concern. At that point, Gould decided to stop providing funding to Encore. Having had no source of capital other than Gould, Encore faced bankruptcy and liquidation. An analysis prepared by Price Waterhouse showed that in a liquidation, Encore's liquidation value would be only $24.4 million. On that basis Encore's common shareholders would receive no liquidating distribution, since $24.4 million would not be nearly enough to pay off Encore's debts to Gould and to Encore's other creditors.

A. The Sun Transaction

On July 17, 1997, the Encore Board entered into an Asset Purchase Agreement with Sun Microsystems, Inc. ("Sun"), in which Sun agreed to purchase Encore's Storage Products business for $185 million (the "Sun Transaction"). Sun would pay the purchase price in two installments: $150 million at closing and the remaining $35 million in July 1998.

As part of the Sun Transaction, Encore entered into an agreement with Gould on July 16, 1997 (the "Gould Agreement"), in which Gould agreed to release its security interest in the Storage Products business and to transfer its intellectual property license in that business to Sun. Gould also agreed: (i) to convert a portion of its Encore preferred stock into Encore common stock (thereby increasing Gould's holdings to 48.5% of Encore's outstanding shares), and (ii) until November 24, 1999, to forego its right to participate in the first $30 million of any liquidating distribution by Encore to its common shareholders. Moreover, Gould agreed to (iii) guarantee Encore's contractual representations and warranties to Sun, (iv) guarantee to Sun that Encore would remain solvent for at least one year after the Sun Transaction closing, and (v) to indemnify Sun against damages if Encore became insolvent after that first year.

In return for these undertakings by Gould -- without which the Sun Transaction could not take place -- Encore agreed that it would devote a portion of the proceeds from the Sun transaction: (i) to pay the principal amount and accrued interest owed on Encore's secured indebtedness to Gould (estimated at $93 million); and (ii) to redeem the Encore preferred stock held by Gould -- which had a liquidation preference of over $400 million -- for $60 million.

At the time the Gould Agreement was being considered, the Encore Board consisted of four directors, two of whom (Ferguson and Fedor) were officers of Gould. Ferguson and Fedor did not vote on the Gould Agree-

ment. The remaining two directors, Fisher and Thomas, were not affiliated with Gould, and did vote to approve the Gould Agreement.

B. The Retention Agreements

To retain Encore's employees through the closing of the Sun Transaction, Encore, at the recommendation of an outside consultant, entered into Retention Agreements in May 1997 with 49 of its key employees. The outside consultant recommended this approach to give Encore's employees an incentive to remain and assist the Company in its efforts, "to seek a sale or merger of the Company, a joint venture which a strategic partner or substantial new investment in the Company." Under the Retention Agreements, Fisher and Thomas received payments of $566,525 and $398,750, respectively. Thomas also received a $50,000 bonus in November 1997. All these payments were disclosed to Encore shareholders in the Sun Proxy Statement, which is next described.

C. The Sun Proxy Statement

In November 1997, Encore distributed a proxy statement (the "Sun Proxy Statement") for the upcoming shareholders meeting at which the Sun Transaction would be voted upon. The Sun Proxy Statement disclosed the terms of the Sun Transaction and the Gould Agreement. To approve the Sun Transaction, the affirmative vote of the holders of 75% of the Encore common stock being voted (as well as a majority of all Encore's outstanding common stock) was required.

The Sun Proxy Statement disclosed that Gould had discontinued funding Encore, and that if the Sun Transaction did not close, Encore would become insolvent. The Sun Proxy Statement included Price Waterhouse's liquidation analysis, which had estimated Encore's liquidation value at $24.4 million. The Sun Proxy Statement also disclosed that if the Sun Transaction was approved, the Encore Board of Directors would consider future opportunities, such as (1) continuing the Real-Time business, (2) developing software to enable standard computer hardware units to be operated so as to create larger computer versions of the computer hardware, or (3) selling the Real-Time business. Finally, the Sun Proxy Statement disclosed the prospects for the Real-Time business, and that it was a declining business for Encore.

Importantly, the Sun Proxy Statement advised shareholders of the specific "risk factors" relating to Encore's business after the Sun Transaction as follows:

> (i) the Company will be left with only the real-time business (unless and until it determines to enter the clustering software market), resulting in a change in the Company's primary business activities from the Storage Products Business to the real-time business; (ii) there is no assurance that the real-time business will operate profitably; (iii) there can be no assurance that Encore will be able to retain employees that would be critical to a clustering software initiative; (iv) there can be no assurance that any clustering software initiative would have access to sufficient amounts of funds; (v) there can be no assurance that any clustering software initiative would be successful; and (vi) none of the alternatives available to the Company . . . is without substantial risk.

On November 24, 1997, the Encore shareholders voted to approve the Sun Transaction, which closed shortly thereafter.

D. The Gores Transaction

Meanwhile, Encore's Real-Time business had continued to decline, and in December 1997, Encore retained McDonald & Company Securities, Inc. ("McDonald"), an investment banker, to solicit potential acquirors for that business. McDonald conducted a diligent search and contacted eight potential acquirors. After this process was completed, Encore and the Gores Technology Group (the "Gores Group") executed a letter of intent for the Gores Group to purchase Encore's Real-Time business for $5.5 million. After the Gores Group later became unwilling to pay that amount,[2] Encore entered into an agreement to sell the Real-Time business to the Gores Group for $3 million (the "Gores Transaction"). To enable that transaction to proceed, Gould agreed to become jointly and severally liable with Encore for Encore's indemnification obligations under the Gores Asset Purchase Agreement.

E. The Gores Proxy Statement

In August 1998, Encore disseminated a Proxy Statement (the "Gores Proxy Statement") for the upcoming shareholder meeting to vote on the Gores Transaction. As with the earlier asset sale to Sun, the affirmative vote of the holders of 75% of the voting shares (plus a majority of Encore's

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[2]The record does not explain why the Gores Group was unwilling to pay $5.5 million for the Real-Time business.

outstanding shares) were required to approve the Gores Transaction. The Gores Proxy Statement disclosed, among other things, that the Encore directors had unanimously approved the Gores Transaction, and that if the Gores Transaction did not go forward, Encore would become insolvent and have to be liquidated. The Gores Transaction received shareholder approval and closed on December 31, 1998.

As of July 15, 1999, the date of the amended complaint, the defendants were planning to dissolve the Company at some future time, subject to shareholder approval. According to the complaint, Encore's common shareholders will receive nothing when the defendants dissolve the Company, because Gould's liquidation preference will exhaust any liquidation proceeds.

II. THE CONTENTIONS

The plaintiffs allege four separate breach of fiduciary duty claims arising out of the Sun and the Gores Transactions which, the plaintiffs allege, amounted to a de facto liquidation of Encore. Two claims are for breach of the defendants' duty of loyalty; the remaining two claims are for breaches of their duty of disclosure.

The duty of loyalty claims challenge the Encore Board's decisions: (i) to allocate to Gould, Encore's largest creditor and stockholder, $60 million of the $185 million proceeds from the sale of Encore's Storage Technology business to Sun, and (ii) to sell the Real-Time business to the Gores Group, the claim being that there was no justification for selling the Real-Time business, which (plaintiffs contend) Encore should have continued to own and operate.

The duty of disclosure claims attack the proxy statements that were disseminated (respectively) to Encore shareholders in connection with the Sun and the Gores Transactions. The disclosure claims are that: (i) the directors of Encore concealed their plan to liquidate Encore in its entirety, and (ii) the proxy statements falsely and misleadingly held out the hope that if both transactions were approved, Encore's common stockholders would receive some of the proceeds.

In support of their motion to dismiss, the defendants argue that the Sun and Gores Transactions did not violate the Encore directors' duty of loyalty, because only disinterested board members voted on these deals. Second, the defendants contend that there was a legitimate business justification for both the Sun and Gores Transactions.

The defendants also urge the dismissal of the disclosure claims as legally unsupported. Responding to the claim that the Encore Board had a "secret" plan to liquidate, the defendants argue that the amended complaint

pleads no facts supporting the conclusory allegation of a "secret" plan. Regarding the second disclosure claim -- that the Sun Proxy Statement falsely promised that shareholders would receive distributions from the Sun Transaction proceeds -- the defendants argue that the proxy statement made no such "promise," but, rather disclosed that a shareholder distribution was one of several possible ways in which the Sun Transaction proceeds might be used.

III. ANALYSIS

The standard governing a Rule 12(b)(6) motion to dismiss is well-established. The motion will be granted where it is clear from the allegations of the complaint that the plaintiffs would not be entitled to relief under any set of facts that could be proven to support the claim.[3] All well-pleaded facts alleged in the complaint will be accepted as true, but inferences and conclusions that are not supported by specific factual allegations will not be accepted as true.[4]

A. The Duty of Loyalty Claims

It is well-established Delaware law that the business judgement rule creates a "powerful presumption in favor of actions taken by the directors in that a decision made by a loyal and informed board will not be overturned by the courts unless it cannot be 'attributed to any rational business purpose.'"[5] To rebut that presumption, the plaintiffs may allege facts sufficient to plead a cognizable claim for a breach of duty of loyalty, more specifically, that the defendants were materially interested in the transaction or failed to act independently on behalf of the corporation.[6]

I conclude that the plaintiffs have failed to allege facts sufficient to establish that the Encore directors either had a material self-interest in, or failed to act independently with respect to, the challenged transactions. I find also that the complaint in fact alleges that the Sun and the Gores Transactions served legitimate business purposes. My reasons follow.

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[3]In re Tri-Star Pictures, Inc. Litig., Del. Supr., 634 A.2d 319, 326 (1993); see also Loudon v. Archer-Daniels-Midland Co., Del. Supr., 700 A.2d 135, 140 (1997).

[4]Weinberger v. UOP, Inc., Del. Ch., 409 A.2d 1262, 1264 (1979).

[5]Cede & Co. v. Technicolor, Inc., Del. Supr., 634 A.2d 345, 361 (1993) (citing Sinclair Oil Corp. v. Levien, Del. Supr., 280 A.2d 717, 720 (1971)), see also Mills Acquisition Co. v. MacMillan, Inc., Del. Supr., 559 A.2d 1261, 1279 (1989).

[6]Grobow v. Perot, Del. Supr., 539 A.2d 180, 188 (1988).

1. The Sun Transaction

As earlier stated, the Sun Transaction involved the sale of Encore's Storage Technology business to Sun for $185 million. The sale proceeds were used to pay all of Gould's secured indebtedness (approximately $95 million), and to redeem the Encore preferred shares held by Gould (approximately $60 million). The balance of the purchase price (about $30 million) was paid to Encore.

The plaintiffs' claim that the board breached its duty of loyalty by agreeing to redeem, for $60 million, Encore preferred stock that had a liquidation value of over $400 million. Plaintiffs contend that the claim must be decided under the entire fairness standard of review, because the non-Gould directors who voted to approve the sale were conflicted, their vote having been induced by the Retention Agreements. Alternatively, plaintiffs argue, even if the business judgment standard does apply, they have stated a cognizable claim because the amended complaint alleges that the redemption of the preferred was irrational and lacked any business justification.

These arguments are now addressed.

The plaintiffs challenge the disinterest and independence of the Encore Board on the basis that the Gould-appointed directors were in a position to approve the Sun Transaction unilaterally. The infirmity in that argument is that the amended complaint makes no allegations which support that claim. Only the two directors who had no connection to Gould -- Messrs. Fisher and Thomas -- actually voted; the other two directors -- Fedor and Ferguson -- recused themselves. Moreover, the Sun Transaction could not be approved without the affirmative vote of the holders of at least 75% of the shares of the common stock present and voting at the meeting. Accordingly, there is no factual or legal basis to claim that the Gould-appointed directors were in a position unilaterally to approve the Sun Transaction.

The plaintiffs next claim that the two directors who did vote on the transaction, Messrs. Fisher and Thomas, had a disabling financial interest by reason of the Retention Agreements. This claim also finds no support in the amended complaint. That pleading alleges that Fisher and Thomas received $566,525 and $398,750 respectively under the Retention Agreements, and that Thomas received a $50,000 incentive bonus. But those payments alone, and without more, do not suffice legally to negate those directors' independence. According to the amended complaint, payments of a similar character were made to 49 other Encore employees, after being recommended by an independent consultant, to ensure their continued service through the closing of the Sun Transaction. The Retention

Agreements did not contractually obligate Thomas or Fisher to vote as directors in any particular way. Accordingly, the Retention Agreement payments that had been independently recommended, shared by others, and made for legitimate business reasons, do not constitute a disabling financial self-interest that would taint the directors who voted in favor of the Sun Transaction.[7]

The Retention Agreement payments did not constitute a disabling financial interest for other reasons. Those payments were made months before the Board voted on the Sun Transaction and over a year before the vote on the Gores Transaction. Mr. Thomas' bonus received Board approval four months after the Sun deal was approved. Thus, any connection between these events is far too remote to support the inference that those payments disabled Fisher and Thomas from impartially determining whether or not the Sun Transaction served the best interest of Encore and its common stockholders. Any such inference would be especially problematic in the case of Mr. Fisher, who, after Gould, was Encore's largest single stockholder. Mr. Fisher owned 4 million shares of Encore, and had a significant self-interest in maximizing the value of that investment. If any inference is to be drawn, it is that Fisher's and the shareholders' financial interests were aligned.

Because the plaintiffs have not sufficiently pleaded facts demonstrating that Thomas or Fisher were subject to a disabling interest, the Encore Board's decision to approve the Sun Transaction is entitled to review under the business judgment rule.

The plaintiffs next argue, in the alternative, that even under the business judgment standard they have stated a claim, because the complaint sufficiently alleges that the Sun Transaction lacked any valid business justification. I disagree. Without the Sun Transaction the Encore stockholders would have received nothing. That transaction enabled Encore to discharge significant amounts of debt, while still retaining $30 million for operating purposes. For that to occur, however, it was necessary for Gould to surrender several valuable assets to Sun, including Gould's security interest in the Storage Products Business assets and the Gould License that covered the intellectual property for the Storage Products Business. The consideration for Gould's cooperation was Encore's agreement for Gould to receive $60 million of the Sun Transaction proceeds, which would be used to redeem the preferred stock. Even in that connection, Gould agreed that in any liquidation it would not participate in the first $30 million of

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[7]See Grobow, 539 A.2d at 188 (where only alleged financial interest on the part of the directors is payment paid for services as directors, no cognizable financial interest exists); see also Unocal Corp. v. Mesa Petroleum Co., Del. Supr., 493 A.2d 946 (1985).

distributable assets--a significant concession because the net proceeds available after paying Gould would be $30 million.

Thus, the complaint fairly alleges that the agreed-to allocation of the Sun Transaction proceeds netted Encore $30 million that Encore would not have otherwise received. As a consequence, the decision to approve the Sun Transaction was a rational business judgment that must be respected.

2. The Gores Transaction

The Gores transaction involved the sale of the Real-Time business to the Gores Group for $3 million. The plaintiffs challenge only the directors' decision to sell that business, claiming that the sale did not serve the Company's interests because the Real-Time business was profitable and the transaction costs exceeded the sale proceeds. Essentially, what the plaintiffs claim is that the sale of the Real-Time business benefitted only Encore's majority stockholder, Gould.

But the pleaded facts show otherwise. The amended complaint does allege that the transaction costs of the Gores Transaction exceeded the amount received from the sale of the Real-Time business, thereby leaving the Encore shareholders with nothing when the Company was dissolved. But this allegation is based upon the plaintiffs' erroneous inclusion of the estimated costs of an Encore liquidation in calculating the "transaction costs" of the Gores Transaction. Plaintiffs allege that "Encore estimated the cost for completing the Gores Transaction and dissolving the Company at approximately $10.6 million," but that misrepresents what Encore actually stated in its third quarter 1998 Form 10-Q.[8] That document disclosed that the amount of any possible distribution to shareholders would be the sum of (i) the Company's assets, (ii) the second payment from the Sun Transaction, and (iii) the net loss or gain from the Gores transaction, minus the cost of liquidating Encore. The plaintiffs' effort to treat the cost of liquidating Encore as a cost of the Gores Transaction finds no support in the Form 10Q.

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[8]Because the third quarter 1998 Form 10-Q is included in and is integral to the Amended Complaint, its content may be considered on this motion to dismiss. That document stated:

> If the sale of the real-time business is consummated, the assets of the Company available for distribution to shareholders on liquidation would be: (i) the Company's assets at September 27, 1998 plus any additional amounts received with regard to the second Payment [from the Sun Transaction], less its liabilities at September 27, 1998 including the $9,692,000 payable to Gould, plus or minus; . . . (iii) the gain or loss from the sale of the Company's real-time computer systems business; minus (iv) costs of the liquidation and reserves for any contingent liabilities, including any pending litigation, estimated by the Company to be approximately $10,624,000, which has not been recorded on the books of the Company as of September 27, 1998.

Nor have plaintiffs shown, as a matter of pleaded fact or logic, how it makes any sense to argue that the cost of the liquidating Encore was a cost of the Gores Transaction. Indeed, the amended complaint alleges that the Gores Transaction was completed in December 1998, before Encore was liquidated.

The plaintiffs also attack the Gores Transaction on the ground that the Real-Time business was profitable at the time it was sold, but the plaintiffs' own pleading undermines that claim. The amended complaint alleges that the 1997 sales of the Real-Time business were approximately $25 million. By 1998, that figure had dropped to $20 million,[9] reflecting a further decline of the Real-Time business.[10] Finally, the amended complaint contains no fact-specific allegations from which one could infer that the Real-Time business was profitable. All that it contains is the conclusory averment that business was "profitable," which by any pleading standard is inadequate and also contrary to the specifically pleaded facts.

For these reasons the Board's decision to approve the Gores Transaction must be upheld under the business judgment rule. According to the complaint, the Encore Board determined that the sale of the Real-Time business would be the best way for the Encore shareholders to realize any return on their investment. Because the Gores Transaction therefore had a rational business purpose, this claim must also be dismissed.

B. The Disclosure Claims

The plaintiffs next claim that the proxy statement disclosures were materially misleading in two separate respects: (1) they failed to disclose the directors' "strategy to liquidate all of Encore's assets," and (2) they made a false promise to distribute the proceeds to Encore's shareholders. Neither of these allegations states a claim upon which relief can be granted.

Directors of Delaware corporations are required, fully and fairly, to disclose all material information within the board's control when the corporation seeks shareholder action.[11] A fact is material only if there is a substantial likelihood that a reasonable stockholder would consider it important in deciding how to vote.[12] There must be a substantial likelihood that the disclosure of the omitted fact would have significantly altered the

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[9]Compl. ¶ 106.

[10]Defendant's Opening Brief, Ex. B. at 5. (1998 Real-Time sales of products and services were down from $41 million in 1996, and were substantially below the peak rate in 1990 when sales of Real-Time systems totaled $133 million dn sales of services totaled $82 million).

[11]Stroud v. Grace, Del. Supr., 606 A.2d 75, 84 (1992).

[12]Loudon, 700 A.2d at 143.

total mix of information made available.[13] The disclosure claims are evaluated in light of this standard.

1. The Undisclosed Alleged Plan to Liquidate

The plaintiffs first claim that the defendants failed to disclose their plan to liquidate Encore in the proxy statements for the Sun and Gore Transactions. That is essentially a "fraud by hindsight" claim, based solely on the fact that after the Sun Transaction closed, Encore hired an investment banker to explore the possibility of selling the Real-Time business, and that thereafter, the Board decided to sell that business. But it does not follow from those facts that the board had always intended to liquidate the entire Company. The alleged facts are fully consistent with a much more benign scenario -- that liquidation was one of several possibilities, that after the Sun Transaction the Board decided to explore that possibility, and that as a result of that exploration, the Board later decided upon that course of action. That latter scenario was disclosed in the Sun Proxy Statement:

> As discussed below, [Encore's] Board of Directors will be considering whether Encore should (i) continue, and attempt to expand, its real-time business, (ii) attempt to develop and market clustering software for various types of computer hardware, or (iii) attempt to sell its real-time business and distribute the proceeds of sale, together with the remaining proceeds of the Sun Transaction, to its stockholders as a liquidating distribution.

Moreover, the proxy statement for the Gores Transaction disclosed that one of the items the shareholders would vote on at the meeting called to approve the Gores Transaction was:

> To approve the proposed Plan of Dissolution and Liquidation (the "Plan"), pursuant to which [Encore] would be dissolved and liquidated following the consummation of the Gores Transaction.

That is, in the Gores Transaction Proxy Statement the Board was explicitly proposing a plan of liquidation and asking the shareholders to approve it. The shareholders were clearly told that liquidation was a real

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[13] Zim v. VLI Corp., Del. Supr., 681 A.2d 1050, 1056 (1996); see also TSC Indus. Inc. v. Northway, Inc., 426 U. S. 438, 449 (1976).

possibility, and they voted to authorize the directors to take that course if they so chose. Because no material fact was misdisclosed or concealed, these disclosures are not actionable.

2. The Alleged Misdisclosure that Funds Would Be Available for Distribution

Finally the plaintiffs claim that the Encore shareholders were lulled into a false sense of security, and were induced to vote for the Sun Transaction, by being led to believe (incorrectly) that Encore's remaining business would be operated profitably and provide them a return. That claim is unsupported by the proxy statements, which disclose no such promise. All those documents disclosed was the possibility of a future return.[14] The complaint also lacks any specific factual allegation to support the implicit assumption upon which this claim rests, namely, that there was no possibility that the shareholders would ever receive a distribution of the proceeds. For these reasons this disclosure claim must also be dismissed.

IV. CONCLUSION

The motion to dismiss the amended complaint is granted. IT IS SO ORDERED.

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[14]The Sun Proxy Statement disclosed that the Board would consider "whether Encore should (i) continue, and attempt to expand, its Real-Time business, (ii) attempt to develop and market clustering software for various types of computer hardware, or (iii) attempt to sell its Real-Time business and distribute the proceeds of that sale, together with the remaining proceeds of the Sun Transaction, to its stockholders as a liquidating distribution." Defendant's Opening Brief, Ex. A at 15.

RYPAC PACKAGING MACHINERY INC. v. COAKLEY

No. 16,069

Court of Chancery of the State of Delaware, New Castle

May 1, 2000
Revised May 26, 2000

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Laurence V. Cronin, Esquire, and Michele C. Gott, Esquire, of Smith, Katzenstein & Furlow LLP, Wilmington, Delaware, for defendants and counterclaim-plaintiffs.

Collins J. Seitz, Jr., Esquire, of Connolly Bove Lodge & Hutz, LLP, Wilmington, Delaware; and Mark T. Mullen, Esquire, of Cozen and O'Connor, Philadelphia, Pennsylvania, of counsel, for intervening defendants.

JACOBS, *Vice Chancellor*

In this action the plaintiff, Rypac Packaging Machinery Incorporated (" plaintiff" or "Rypac"), claims that defendant Daniel Coakley ("Coakley"), a Rypac former director and officer, breached his fiduciary and contractual duties to Rypac by competing with Rypac after he purported to resign from it. Rypac also charges Coakley with various tort violations. Named as a co-defendant is Package Automation Company ("PAC"), a company that Coakley owns and controls.

PAC has asserted counterclaims against Rypac and Joseph Poges ("Poges"), Rypac's sole remaining officer, for wrongfully causing Rypac to withhold commissions due Coakley on sales that Coakley made before he resigned from Rypac.

Thereafter, Robert Wischhusen ("Wischhusen") and Paul Osborne ("Osborne"), two sales representatives who also had left Rypac, (collectively, "Intervening Defendants") intervened in this action.[1] The Intervening Defendants claim that Rypac owes them commissions that Poges wrongfully

[1]A third Intervening Defendant is Penndel Packaging, Inc. ("Penndel"), a Wischhussen-owned company.

withheld. In response, Rypac has asserted a claim against the Intervening Defendants for aiding and abetting Coakley in breaching his fiduciary duties to Rypac.

This is the Opinion of the Court after a trial on the merits of all these claims. For the reasons discussed below, I conclude that all but one of Rypac's claims lack merit, and will therefore grant judgment for the defendants and Intervening Defendants on those claims. The sole exception is the plaintiff's claim to recover certain commissions diverted from Rypac by Coakley and the Intervening Defendants, on which claim I will grant judgment for Rypac. Lastly, I determine that the defendants and Intervening Defendants are entitled to judgment on their counterclaims, except for their Delaware Wage Act claim for liquidated damages.

I. RELEVANT FACTS

In 1986, Daniel Coakley and Joseph Poges left their employment with Professional Packaging Associates ("PPA"), to start their own business. They formed a partnership named "Rypac." In their new capacities as Rypac partners, Coakley and Poges acted as independent sales representatives for manufacturers of packaging machinery in substantially the same territories they had previously serviced for PPA. Poges covered New Jersey, and Coakley covered New York and Connecticut.[2] Both partners agreed that each would be responsible for generating all sales within his assigned territory, and that each would receive 80% of the gross commissions due them based upon the sales they respectively generated. The remaining 20% of the gross commissions would be paid to Rypac to defray joint expenses and to make contributions to each partner's individual retirement account.[3]

In December 1987, because of concerns about individual liability risks, Poges and Coakley decided to incorporate Rypac.[4] Accordingly, they formed a Delaware corporation named Rypac, to which they transferred the partnership assets. The two former partners each received Rypac's stock, and also were elected as Rypac's sole directors and officers, with Coakley serving as President and Poges as Vice-President and Secretary/Treasurer.[5] Coakley and Poges also agreed to, and later did, enter into a Shareholder's and Officer's Agreements with Rypac. The relevant provisions of the Officer's Agreement are discussed infra in greater detail.[6]

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[2]TR Poges 19; TR Coakley at 264.
[3]TR Coakley 265.
[4]TR Poges 8-9; TR Coakley 266-67.
[5]PX 30; DX4; PX 31.
[6]Id.

After incorporating Rypac, Coakley and Poges continued operating the business as they did when Rypac was a partnership, except that eventually Coakley and Poges each employed subagents to help expand their respective (and separate) territories.[7] Coakley brought into the firm as subagents his brother Donald Coakley as well as Andy Grospin ("Grospin") and Rick Marshall ("Marshall"). Poges brought into his firm as subagents Osborne, Wischhusen and Dan Willis ("Willis").[8]

Coakley and Poges each continued to be exclusively responsible for the sales in his respective territory, and neither received any income from sales generated by the other.[9] As compensation for their sales efforts, Coakley and Poges received 75% of the gross commissions collected on their individual sales, payable within 30 days after Rypac received the commissions.[10] Of the remaining 25% of gross commissions, 10% was deposited in the retirement plan of the person responsible for the sale, and 15% was paid to Rypac to defray expenses that Rypac incurred.[11]

Rypac did not retain the amounts that were contributed to it for expenses.[12] That is because expenses were classified as either corporate (in which case they were shared equally between Coakley and Poges)[13] or individual[14] (in which case they were allocated among, and paid by, Coakley, Poges and their subagents).[15] Once Rypac's expenses were thus allocated, if the total contributions to Rypac for expenses exceeded the amount of expenses Rypac actually incurred, the excess was distributed *pro rata* as additional compensation to Coakley and Poges.[16] If, on the other hand, the amounts contributed by each officer and his subagents fell short of the total

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[7]TR Coakley 267.

[8]PX 1 to 5 and 10-12.

[9]TR Coakley 267.

[10]Although the Officer's Agreement provided that each officer would receive 80% of the gross payments, at some point Coakley and Poges informally agreed to receive 75%, thereby amending the Agreement in that respect. TR Poges 17-18.

[11]Id. Coakley and Poges compensated their subagents differently, however. Poges' subagents received 90% of each gross commission that they earned with the remaining 10% going to Rypac for expenses, whereas Coakley's subagents received 75% with the remaining 25% going to Rypac for expenses. TR Osborn 346; TR Wischhusen 426.

[12]TR Poges 116-24.

[13]Corporate expenses included items such as professional fees, licenses and permits, lease and office expenses, and taxes. Typically, these expenses amounted to approximately $40,000 per year. DX 39; TR Poges 121-22.

[14]DX 39.

[15]For example, DX 36 and DX 39 show how each representative was charged separately for the amount of time Rypac's secretary, Linda Newberger, spent working on its projects.

[16]TR Poges 116-24. In calculating the amount of any such distribution, Coakley and Poges were each charged with the expenses allocated to all their subagents in their respective territories. TR Poges 116-24; TR Coakley 269-27; DX 36-DX 39.

expenses attributed to that officer's "side" of the business, that officer would pay Rypac the difference.[17]

By the very nature of this expense allocation system, at the end of each year Rypac always had no income.[18]

A. The Sales Representative's Role

In this industry, persons associated with companies such as Rypac typically serve as independent sales representatives for manufacturers of packaging machinery. Those manufacturers are called "principals."[19] A sales representative's role involves not only negotiating the sale, but also working closely with the customer and the principal to customize the specifications for the customer's particular process.[20] Typically, a potential sale is identified by a principal, who then contracts with a sales representative at a company like Rypac to call upon the potential customer and negotiate an order.[21] After an order is placed, the sales representative continues to serve as the contact between the principal and customer, to coordinate the delivery and installation of the equipment ordered, and to respond to any customer questions or problems in connection with the sale.[22] The sales representative has the authority to bind the principal throughout the entire process, which may take months to conclude.[23] Given the importance of the independent sales representative's role, the principal has a strong interest in choosing a sales representative with experience and a record of good relationships with customers.[24]

Principals and sales representatives frequently enter into agreements that give the sales representative an exclusive right to market the principal's machinery. But, such agreements are usually terminable on thirty days notice.[25] Under the industry practice, once an exclusive agreement is terminated, the principal is free to choose a new sales representative to complete the sale on which the former representative had been working.

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[17]TR Poges 18-19; TR Coakley 271.

[18]TR Poges 117; TR Willis 226 (stating that "year to year the corporation was run as a zero sum gain").

[19]TR Poges 5-8; TR Coakley 266.

[20]TR Poges 5-6, 59-65.

[21]TR Poges 59-65.

[22]Id.

[23]Id.

[24]TR Wolford 382; TR Fissel 415.

[25]TR Poges 98, 196-97; TR Willis 226-27; TR Fissel 405; PX 12; DX 68; IDX 45; IDX 43, ¶ 16.

Unless he receives "commission protection," the former representative loses any right to a commission generated by that sale.[26]

To protect his commission interest, a sales representative often will request "commission protection," which usually takes the form of a fixed contractual time period during which the sales representative is allowed to, and must, complete the contract in order to receive the commission.[27]

B. Coakley Leaves Rypac

In September 1997, Coakley decided to leave Rypac and continue in the business of selling packaging machinery through his own company.[28] On October 10, 1997, Coakley met Poges for breakfast and told Poges that he had been unhappy with their relationship for some time, that he was resigning from Rypac, and that he would continue working in the packaging machinery industry in competition with Rypac.[29] Poges voiced no objection.[30]

Coakley then called Rypac subagents Donald Coakley, Wischhusen, Osborne, and Grospin, to inform them that he had resigned.[31] Coakley also sent a letter to certain principals, advising them of his resignation.[32]

3. Events After Coakley's Resignation Announcement

1. Wischhusen and Osborne Resign

On October 11, 1997, all of Rypac's employees went to Las Vegas to attend a trade show.[33] After arriving, Coakley met with Wischhusen, Osborne and others for a previously arranged golf outing.[34] Coakley was asked about his resignation from Rypac and about his future plans, but felt it was inappropriate to discuss the matter at the golf outing.[35] Coakley scheduled a breakfast meeting to discuss his plans with Wischhusen and Osborne for the following Monday, October 13, 1997.[36]

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[26]TR Wolford 393-94.
[27]TR Poges 137, 140-41; TR Wolford 393-94; TR Fissel 406-407.
[28]TR Coakley 276-79. That company later became PAC.
[29]TR Poges 29; TR Coakley 282.
[30]TR Poges 127-29; TR Coakley 283.
[31]TR Coakley 283.
[32]TR Coakley 282-83.
[33]TR Coakley 284.
[34]Id.
[35]TR Coakley 285-86.
[36]TR Coakley 285-87; TR Osborne 366; TR Wischhusen 432, 444.

At that breakfast meeting, Coakley outlined his plans, and invited Wischhusen and Osborne to join his new firm, Both agreed to join Coakley.[37] Wischhusen and Osborne then sought out Poges, who was also attending the trade show, and told Poges that they were resigning from Rypac.[38] Osborne and Wischhusen were free to do that, since neither had ever entered into a non-compete agreement with Rypac.[39]

2. Rypac and PAC Compete

Over the next three weeks, Coakley and Poges each made presentations to Rypac principals, including those who had retained Rypac on an exclusive basis.[40] As the sales manager of one principal (Hi-Speed) explained, it was important for the principals to decide quickly who would represent them, to assure that they would not lose business.[41]

Certain of Rypac's exclusive agreements permitted the principal to terminate the contract if there was a change in Rypac's ownership. For example, Rypac's exclusive agreement with Mateer-Burt permitted Mateer-Burt to terminate "immediately on notice to [Rypac] in the event that . . . (ii) either Poges or Coakley ceases to own, individually, shares of [Rypac] which represent at least 26% of the regular voting power of [Rypac], (iii) Poges or Coakley ceases to participate actively [Rypac's] activities pursuant to this Agreement. . ."[42] Rypac's exclusive agreement with SASIB was similarly subject to immediate termination by SASIB "upon a change in ownership, management or geographical location of [Rypac]. . ."[43]

After hearing presentations from PAC and Rypac, three principals decided to terminate their exclusive contracts with Rypac and enter into new exclusive contracts with PAC.[44] At that point, Poges and Rypac became free

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[37]Id.

[38]TR Osborne 366-67; TR Wischhuseen 433.

[39]TR Poges 23-24; TR Osborne 346; TR Wischhusen 425-26.

[40]TR Poges 43-44; 127-29; TR Coakley 292; TR Fissel 410-15; TR Wolford 387-92.

[41]TR Wolford 387.

[42]PX 12, ¶ 12.2.

[43]IDX 45, ¶ 10.D. Rypac's agreement with Hi-Speed did not literally provide for termination upon a change in ownership of Rypac, but it did define the representative, Rypac, as "consisting of Daniel P. Coakley located at 23 Dingle Brook Lane, Newtown, Connecticut 06270 and Joseph Poges located at 27 Warren Cutting, New Jersey 07930." In this way, the practical effect of a change of Rypac's ownership would be the same. DX 68.

[44]TR Coakley 292-93. Hi-Speed, chose PAC because Rypac's presentation "was not clear enough for Hi-Speed to feel comfortable" with Rypac's ability to support continued sales growth. TR Wolford 381, 387-92. Hi-Speed was also concerned with the fact that Poges, who was requesting to continue the relationship with Hi-Speed, did not take the lead in presenting Rypac's proposal. TR Wolford 388-89. Another principal, Mateer-Burt, felt that the personnel at PAC could obtain more business for Mateer-Burt based on their experience, relationships with customers and knowledge of equipment. TR Fissel 415.

to -- and did -- seek commission protection on sales that Rypac was currently pursuing for SASIB, Mateer-Burt and Hi-Speed, and they received such protection on some of the projects on which Poges was working.[45] Importantly, Poges did not ask for (or receive) commission protection on the ongoing projects of the sales representatives who were leaving Rypac to join Coakley.[46]

Shortly after PAC and Rypac began competing against each other, Poges began withholding -- from Coakley and the other sales representatives who had left Rypac -- commissions earned on sales that had been completed before their resignations but that were paid to Rypac after their departure.[47] In an effort to resolve this dispute, Coakley tried to contact Poges by telephone and letter on several occasions, but Poges refused to communicate with him.[48]

Coakley reacted to Poges' stonewalling by writing letters to certain Rypac principals, asking them to send commission checks on sales they had completed under Rypac, directly to Coakley rather than to Poges.[49] Coakley intended to deposit those checks in a bank account he had created in the name of Rypac, and from that account he would disburse funds in the manner Rypac had historically employed to compensate Rypac's representatives.[50]

In an apparent further effort to procure the release of the withheld commissions, Coakley wrote a letter to Poges on December 11, 1997, stating that he had "not terminated [his] presidency or officers [sic] position with Rypac."[51]

This lawsuit by Rypac followed.

II. THE CONTENTIONS

Each side has asserted numerous claims against the other. The plaintiff, Rypac, claims that Coakley: (1) breached his fiduciary duty by usurping a corporate opportunity belonging to Rypac, (2) breached the provision of the Officers' Agreement that required Coakley to devote his time exclusively to performing his duties as a Rypac officer, (3) committed tortious interference with Rypac's existing contracts, and (4) unfairly

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[45]TR Poges 137-38.
[46]TR Poges 137-41.
[47]TR Coakley 297-302.
[48]Id.
[49]TR Coakley 297-302, 335-36; PX 38; PX 39.
[50]TR Coakley 297-302, 335-36.
[51]TR Coakley 301-302; PX 45.

competed with Rypac. The plaintiff also claims that the Intervening Defendants aided and abetted Coakley's breaches of duty.

The defendants counterclaim that Rypac wrongfully withheld commissions that Coakley had earned before his resignation. The Intervening Defendants claim that they also are owed commissions that Rypac has wrongfully withheld.

These claims are now addressed.

III. THE PLAINTIFF'S CLAIMS

All of the plaintiff's liability theories are asserted as a basis for Rypac's claim to recover the commissions earned by Coakley and PAC through December 22, 1997.

A. The Corporate Opportunity Claim

Rypac's first claim is that Coakley usurped corporate opportunities belonging to it by causing his corporation, PAC, to acquire several of Rypac's contracts between October 10, 1997 and December 22, 1997. Rypac claims that because Coakley did not validly resign until December 22, 1997, Coakley continued to owe a fiduciary duty to Rypac until that time, and that he breached that duty by obtaining contracts from Rypac principals in competition with Rypac.

Coakley responds that he had no fiduciary duty to Rypac after October 10, 1997 because he validly retired on that date, and not on December 22, 1997 as the plaintiffs contend. The defendants argue that there is no evidence that Coakley appropriated any opportunity or contract from Rypac before October 10, 1997,[52] and that after that date Coakley was no longer prohibited from competing with Rypac. Alternatively, the defendants argue that even if Coakley did not retire until December 22, 1997, the plaintiff has failed to establish that Rypac's contracts with the third party principals were "corporate opportunities."

These contentions raise two issues. The first issue is when did Coakley retire -- October 10 or December 22, 1997? The second issue is whether Rypac's contracts with principals which the principals terminated after October 10, 1997, were "corporate opportunities."

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[52]That argument is valid. Coakley testified that the only actions he took before meeting with Poges on October 10, 1997 were to discuss his plans with his wife and brother and to prepare letters to certain principals advising them of his resignation. TR Coakley 277, 282-83. That testimony is uncontroverted.

1. When Coakley Resigned

The first dispute concerns when Coakley resigned. Rypac claims that Coakley did not resign until December 22, 1997. The defendants contend that Coakley resigned on October 10, 1997 and from that point on was free to compete with Rypac, because after October 10 Coakley no longer owed Rypac any fiduciary duties.

To aid the analysis of this issue, it is helpful to set forth the relevant events in chronological order, as follows:

- October 10, 1997 -- Breakfast meeting where Coakley tells Poges that he had been unhappy with their relationship for some time and was resigning from Rypac.

- October and November 1997 -- Poges removes Coakley from the Rypac telephone recording, as a signatory on Rypac's bank accounts, and from Rypac's health plan.

- October 16, 1997 -- Coakley sends Poges a letter stating that he is in the "process [of] terminating [his] relationship with Rypac."

- November 1997 -- Coakley holds himself out to third parties as Rypac's president.

- December 8, 1997 -- Poges sends Coakley a letter stating that "[y]ou have terminated your relationship with Rypac and are no longer an officer or director of the company."

- December 11, 1997 -- Coakley responds that he had "not terminated [his] presidency to officers [sic] position with Rypac."

- December 22, 1997 -- Coakley sends Poges a formal resignation letter.

Despite this somewhat erratic sequence of events, I conclude that Coakley resigned on October 10, 1997. During the October 10 breakfast meeting, Coakley told Poges that he was resigning.[53] Poges and Coakley both understood that to mean that Coakley was resigning all his positions in the company, including President, director, and employee, effective

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[53]TR Poges 29-32.

immediately.[54] Poges's subsequent conduct was consistent with that understanding. Poges immediately advised sales representatives and principals that Coakley had resigned,[55] and he also removed Coakley from Rypac's telephone message recording, bank accounts and health plans.[56]

Although his actions were ill-advised and possibly actionable on noncontractual grounds, Coakley's representations to third parties that he was Rypac's president and his December 11, 1997 letter, did not legally alter the fact that Coakley had resigned on October 10, 1 997.[57] At most, that conduct would have constituted a unilateral, revisionist attempt by Coakley to rescind his termination for strategic reasons known only to him. Because both parties had relied on the resignation that Coakley orally communicated a month and a half before, and because they understood that communication to mean that Coakley's resignation was effective immediately, Coakley was powerless to rescind that resignation unilaterally and six weeks later without Poges' concurrence, which was never granted.[58]

Accordingly, I conclude that the only legally sensible interpretation of the evidence is that Coakley resigned on October 10, 1997, and that Poges, Rypac's only other shareholder, knew that.

2. Whether Rypac Contracts Were "Corporate Opportunities"

Even if one could conclude that Coakley did not resign until December 22, 1997, the corporate opportunity claim must fail, because Rypac's sales contracts with principals were not "corporate opportunities." In approaching this fact-intensive issue, several factors must be considered, including the availability of the opportunity to the corporation; the

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[54]At trial, Poges admitted that he understood that Coakley had resigned as of October 10, 1997:

> Q. Now at what point, on October 10 or thereabouts in 1997, in your mind did you actually think that Mr. Coakley had resigned?
>
> A. Yes. (TR Poges 31-32.)
>
> * * *
>
> Q. Now, as you previously testified, you understood that when Dan Coakley met with you on October 10, 1997, that he had resigned from Rypac as an office and director, correct?
>
> A. Correct. (TR Poges 127.)

[55]TR Wischhusen 428; TR Fissel 408.

[56]TR Poges 130-35.

[57]In his December 11th letter, Coakley wrote, "I have terminated my sales position with Rypac, but I have not terminated my presidency or officers [sic] position with Rypac." TR Coakley 301-302; PX 45.

[58]Eleven days later, Coakley sent Rypac a formal letter of resignation which, as a purely legal matter, was superfluous. TR Coakley 301-302.

corporation's interest or expectancy in the opportunity; and whether by taking the opportunity the corporate fiduciary has placed himself in a position adverse to the interests of the corporation.[59]

Neither side disputes that the pre-resignation ongoing sales contracts fell within Rypac's "line of business," and would have been advantageous to Rypac's officers. But, those contracts contained terms that negated the other elements of a corporate opportunity; that is, the readily terminable nature of the contracts deprived them of the status of an "interest or expectancy" to which Rypac had an equitable ownership claim.

As earlier stated, given the sales representative's important role in negotiating and facilitating the contracts,[60] principals in this industry have a strong interest in choosing for themselves who will represent them in these transactions. Although principals sometimes enter into exclusive agreements for companies such as Rypac to represent them in specified geographic areas, such agreements are typically terminable on only thirty days notice to enable the principals to change sales representatives quickly. When an exclusive agreement is terminated, the principal is free to choose a new sales representative to complete the sale on which the former representative had been working, with the new representative being entitled to collect the commission.[61]

Thus, even if instead of competing, Coakley had simply stopped doing business after his resignation, it cannot be assumed that the principals would have permitted Rypac to complete the sales Coakley was pursuing before he resigned. Given the national and highly competitive nature of this particular market, there is no basis to assume that any principal would have automatically chosen Rypac to complete the sales.

Moreover, Rypac's manner of operating undercuts its claim that the potential sales were corporate opportunities. As this Court recognized in Balin v. Amerimar Realty Co.,[62] where the corporation could never have

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[59]1 R. Franklin Balotti & Jesse A. Finkelstein, The Delaware Law of Corporations & Business Organizations § 4.36 (2d ed. 1999); see also Balin v. Amerimar Realty Co., Del. Ch., C.A. No. 12896, Jacobs, V.C., Mem. Op. at 6 (Nov. 15, 1996).

[60]See pages 6-7, supra.

[61]The exception arises in cases where representatives seek commission protection, which takes the form of the principal agreeing that once the sales representative begins working on a particular project, the sales representative has a fixed period of time in which to complete the sale and earn the commission. Poges' own conduct after Coakley and the other representatives resigned evidences that Poges did not consider the contracts at issue as opportunities belonging to Rypac. After four principals terminated their exclusive agreements with Rypac, Poges requested commission protection only on those sales that he was pursuing. Poges never asked for protection on the sales being pursued only by Coakley or his subagents. TR Poges 137-41.

[62]Balin v. Amerimar Realty Co., Del. Ch., C.A. No. 12896, Jacobs, V.C. (Nov. 15, 1996). In Balin, the Court rejected the claim that real estate investments represented opportunities belonging to the corporation on the basis that the corporation was formed and always operated solely

profited from or been advantaged by the claimed opportunity, the opportunity cannot be fairly said to be one belonging to the corporation.

In this case, Rypac was an umbrella entity for two separate businesses, one operated by Coakley, the other by Poges. Coakley and Poges were each responsible for sales in their respective territories, and Rypac earned no profit from those sales. Commissions that Coakley and Poges earned were immediately paid to the individual responsible for the sale, except for a small percentage that was paid to Rypac as reimbursement for its expenses. Rypac never profited from the sales of its subagents. Rather (as with Coakley and Poges) commissions earned by the subagents were paid immediately to the responsible subagent, again with a percentage going to Rypac for expenses. To the extent the amounts contributed to Rypac exceeded the expenses, the excess was distributed *pro rata* to Coakley and Poges. Because under this arrangement Rypac was little more than a disbursing agent with no business of its own, it is not practically meaningful to characterize Rypac's contract with a principal as a Rypac "corporate opportunity."

For these reasons the corporate opportunity claim must be rejected.

B. The Officer's Agreement Claim

Next, Rypac claims that Coakley violated Paragraph 3.b of the Officer's Agreement, which (Rypac contends) obligated Coakley not to compete with Rypac until the Agreement was terminated. Paragraph 3.b states:

> Officer shall devote all of his time, attention and energy exclusively to the performance of the duties enumerated in this Agreement and as may be requested by Corporation in connection with Corporation's business.

Rypac argues that the Coakley violated Paragraph 3.b in two different respects. First, Rypac argues that because Coakley devoted some of his time and efforts to his brother's corporation, Rypac N.E., before October 10, 1997, during which time Coakley was a Rypac employee, director and officer, Coakley's Rypac N.E.-related activities violated paragraph 3(b). Second, Rypac claims that the Officer's Agreement was never validly terminated, and therefore Coakley remained obligated not to compete with Rypac even after his October 10 resignation. Therefore, the plaintiff

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as an "overhead" entity to centralize costs, and was never intended to nor did it earn a profit from the investments in question.

concludes, all contracts PAC entered into after October 10, 1997 constituted breaches of Paragraph 3.b.

These claims are separately considered.

1. The Rypac N.E. Claim

Beginning in 1993 or 1994, Coakley sold machinery through his brother Donald's company Rypac N.E., to generate additional income for the purpose of funding a second retirement account.[63] Coakley contends that these sales were not competitive with Rypac, because Rypac N.E. provided lines of equipment that Rypac did not sell,[64] and also because Coakley typically spent over sixty hours per week on Rypac business. Coakley also argues that because Poges acquiesced in his Rypac N.E. activities, Poges cannot now be heard to complain of them.

The record shows that Coakley did discuss his involvement in Rypac N.E. with Poges, and Poges told him that it was not a problem.[65] At trial, Poges did not deny that he and Coakley had that discussion, and admitted he could not recall ever objecting to Coakley's activities with Rypac N.E.[66] As Rypac's only officers, directors and shareholders, Poges and Coakley also had the power to amend or waive any restriction imposed by the Officer's Agreement. Accordingly, I find that Poges orally waived Paragraph 3(b) with respect to Coakley's activities on behalf of Rypac N.E.

But, even if it is assumed that Coakley's activities with Rypac N.E. violated Paragraph 3(b), Rypac suffered no resulting harm. Coakley regularly devoted over 60 hours weekly to Rypac. Indeed, Poges held Coakley out as an exemplary employee and model for others to mold their work habits.[67] Moreover, Rypac N.E. did not compete with Rypac, because Rypac N.E. sold only machinery that was unavailable through Rypac. For these reasons, the Rypac N.E. claim lacks merit and must be rejected.

2. The Officers Agreement Claim

Rypac's second claim is that Coakley's competitive activity violated the Officer's Agreement because that Agreement (and its "non competition"

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[63]TR Coakley 274-75.

[64]TR Coakley 274.

[65]TR Coakley 275-76. Coakley testified that after Paul Osborne and Bob Wischhusen mentioned that they had a meeting with Poges and that Poges was unhappy with Rypac N.E. and activities with Rypac N.E., Coakley confronted him. Coakley testified: "when I saw Joe the next time -- and it was with Bob and Paul -- I asked him if he had any problems. And Joe said that I had no problems." Id. at 276.

[66]TR Poges 114-15.

[67]TR Coakley 105-106.

provision) remained in effect after October 10, 1997. This argument rests upon Rypac's reading of Paragraph 7 of the Officer's Agreement, which provides that the Agreement "shall be terminated upon purchase of the Officer's stock in the Corporation pursuant to paragraph 4 through 7 of the Shareholder's Agreement."[68] Rypac argues that this provision means that the Officer's Agreement could not be terminated until Coakley "agreed to surrender his Rypac stock pursuant to the buy-back provisions of the Stockholder Agreement," which did not occur until the end of August 1998.[69]

This argument also lacks merit. Paragraph 7 does not state that it is the only method by which the Officers Agreement may be terminated. Rather, that paragraph essentially provides for a stock buy-back if the Agreement is terminated, and is intended to ensure that the Agreement will terminate if an officer sells his Rypac stock to the other stockholder. Paragraph 7 does not preclude a termination of the Agreement in any other manner permitted by Delaware law.[70]

In this case, Coakley implicitly terminated the Officer's Agreement when he resigned from Rypac on October 10, 1997. The first paragraph of the two-page Agreement provides:

> Officer shall be employed by Corporation as President, and as salesperson with such duties as may be determined and assigned to him by unanimous vote of the Board of Directors.[71]

I read that paragraph to require that for the Officer's Agreement to remain in effect, the officer must be employed by Rypac as President and as a salesperson. Coakley ceased to satisfy these requirements when he resigned on October 10, 1997. Therefore, I find that by resigning, Coakley also implicitly terminated the Officers Agreement, because at that point he no longer occupied the positions that formed the premise for the Officers Agreement's applicability.

Poges' behavior from and after the date Coakley resigned was consistent with this understanding. The Officer's Agreement provided that Rypac "shall provide health insurance coverage for [officer] and all family members,"[72] yet Rypac terminated Coakley's insurance coverage after October 10. In addition, on November 17, 1997, Poges sent Coakley a letter that stated, "[t]his letter also serves as a notice of termination of the Officers

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[68]PX 30.
[69]Plaintiff's Op. Br. 14.
[70]See Artesian Water Co. v. State, Del. Supr., 330 A.2d 441, 443 (1974).
[71]PX 30, ¶ 1.
[72]PX 30, ¶ 5(a).

[sic] Agreement by and between Rypac and you."[73] Poges' actions after Coakley's resignation demonstrate that he thought the Agreement was no longer in effect once Coakley resigned.

Because the Officer's Agreement was no longer effective after October 10, 1997, the breach-of-Officer's-Agreement claim must be rejected.

C. The Unfair Competition Claim

Rypac next claims that Coakley engaged in unfair competition with it by (a) diverting Rypac commission checks to himself, (b) inducing a manufacturer not to pay Rypac because of a debt Rypac N.E. owed the manufacturer, and (c) using confidential business information to make sales in competition with Rypac.

The elements of the tort of unfair competition are that the plaintiff has a reasonable expectancy of entering a valid business relationship, with which the defendant wrongfully interferes, and thereby the plaintiff's legitimate expectancy and causes him harm.[74] Each of the plaintiffs' unfair competition claims is evaluated in light of these elements.

1. The Claim That Coakley Wrongfully Diverted Rypac Checks and Induced a Manufacturer Not To Pay Rypac.

Coakley admits that he advised certain manufacturers to send commission checks directly to him instead of to Rypac.[75] Coakley also admits that he attempted to offset debts that Rypac N.E. owed the manufacturer by the amount of commissions owed to Rypac and for which Coakley was responsible.[76] Coakley explained these as attempts on his part to assure that Rypac's former sales agents would be paid the commissions Rypac owed them. Coakley stated that he intended to deposit all funds received into a bank account under the name of Rypac, to be distributed from that account in the manner that Rypac historically employed.[77] Finally, Coakley testified that when he took these actions he was not advised by legal counsel, and that his conduct was in reaction to Poges' unresponsiveness.

I conclude that Coakley is not liable on a theory of unfair competition because his competitive activity against Rypac was not "unfair." To express

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[73]DX 2.

[74]International Business Machines Corp. v Comdisco, Inc., Del. Super., C.A. No. 91-C-07-199, Goldstein, J., Mem. Op. at 20, (June 30, 1993).

[75]TR Coakley 297-302, 335-36.

[76]TR Coakley 231-32.

[77]Id.

it differently, once Coakley resigned from Rypac he was free to compete with it, because (i) the principals had lawfully terminated their contracts with Rypac, and (ii) Coakley had done nothing "wrongful" by persuading the principals to terminate their contracts with Rypac and to enter into new contractual relationships with Coakley and PAC.

Although Coakley is not liable on unfair competition grounds, he is liable in contract for diverting commissions properly owed to Rypac. Despite Coakley's efforts to excuse his conduct, Coakley's diversions of Rypac checks to himself, and his inducing a manufacturer to offset the amount it owed to Rypac by the amount Coakley owed the manufacturer, were wrongful.

Under the Officer's Agreement, (as informally amended by the parties) each officer would receive 75% of the gross commission payments, Rypac would receive 15% and 10% would go to fund Coakley's and Poges' individual retirement accounts.[78] To the extent Rypac has not yet received the commission it is owed, Coakley remains liable for that commission. Accordingly, Rypac is entitled to its 15% share of (a) the commission checks that Coakley wrongfully diverted from Rypac, and (b) the commission that Coakley induced the manufacturer not to pay Rypac.[79]

2. The Confidential Information Claim

The plaintiff also claims that Coakley unfairly competed with Rypac because by virtue of his former employment relationship, Coakley had knowledge of the identities and requirements of Rypac's customers and used those "trade secrets" to solicit Rypac's customers. I disagree.

Delaware case law provides that in the absence of a covenant not to compete:

> [A]n employee who achieves technical expertise or general knowledge while in the employ of another may thereafter use that knowledge in competition with his former employer, so

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[78]TR Poges 16-18.

[79]Coakley, Osborne, and Wischhusen are liable to Rypac for the percentage of the commission they respectively owe to Rypac, 15% in the case of Coakley and 10% in the case of Osborne and Wischhusen, as follows:

1. Dan Coakley	$29,336.70	This represents the $19,438 and $4,800 deposits in the Connecticut bank (TR Poges 53; PX 44); and a $5,098.70 Rypac check that Coakley gave his brother to cash. PX 43.
2. Paul Osborne	$17,330.30	Ex. 15-17; TR Osborne 373-75.
3. Bob Wischhusen	$ 9,967.50	PX 9.

long as he does not use or disclose protected trade secrets in the process.[80]

Thus, to succeed on this claim, the plaintiff must show that the information constituted a "trade secret."[81] Information rises to the level of a "trade secret" if it derives independent economic value from not being generally known or readily ascertainable by other persons, and is the subject of efforts that are reasonable under the circumstances to maintain its secrecy.[82]

Under this he plaintiff's claim fails, because Rypac did not take reasonable measures to protect the secrecy of the contested information. Rypac's own Internet web page disclosed the identities of many of its customers, Rypac made no effort to maintain the secrecy of that information, and it never told its employees that the identities and requirements of its customers was confidential. Rypac's employees never signed confidentiality agreements covering that information, nor did Rypac ever create guidelines or procedures to protect the information.

Accordingly, the plaintiff has failed to establish its unfair competition claim.

D. The Claim of Interference With a Prospective Contractual Relationship

The plaintiff next claims that the defendants tortiously interfered with prospective contractual relationships. The elements of this tort are: (1) the existence of a valid business relationship or expectancy; (2) knowledge of the relationship or expectancy on the part of the interferer; (3) intentional interference that induces or causes a breach or termination of the relationship or expectancy; and (4) resulting damages to the party whose relationship or expectancy has been disrupted.[83]

Plaintiff's tortious interference claims fails because: (1) given the nature of this particular market, the plaintiff cannot claim to have an "expectancy" of a continuous business relationship with its principals, and (2) in any event, the plaintiff has not shown that it suffered any damages as

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[80] Wilmington Trust Co. v. Consistent Asset Management Co. Inc., Del. Ch., C.A. No. 8867, Allen, C., Mem. Op. at 7 (March 25, 1987).

[81] Id.

[82] Marsico v. Cole, Del. Ch., C.A. No. 13104, Mem. Op. at 4, Chandler, V.C. (Aug. 15, 1995), Interim Health Care v. Fournier, Del. Ch., C.A. No. 13003, Mem. Op. at 7, Jacobs, V.C. (Feb. 28, 1994).

[83] Bowl-Mor Co. Inc. v. Brunswick Corp., Del. Ch., 297 A.2d 61, 64, appeal dismissed, Del. Supr., 297 A.2d 67 (1972); Irwin & Leighton, Inc. v. W.M. Anderson Co., Del. Ch., 532 A.2d 983, 992 (1987).

a result of the defendants' conduct. As previously discussed, given Rypac's internal structure and role in the packaging industry, there is no basis to find that Rypac had a valid expectancy of a continued exclusive relationship with its principals. In this industry, "exclusive" contracts are terminable on relatively short notice, and that is what occurred here. Nor did Rypac suffer economic harm, because it was a "pass through" entity -- it never made or retained any profit from sales negotiated by its representatives.

IV. THE COUNTERCLAIM

Coakley and the Intervening Defendants have counterclaimed for the unpaid commissions owed to them. These include commissions placed into escrow,[84] as well as commissions yet to be paid by manufacturers. [85]In addition, Coakley and the Intervening Defendants claim entitlement to liquidated damages and attorneys' fees under the Delaware Wage Payment and Collection Act (the "Wage Act").[86]

Poges claims that all commissions earned by Coakley and the other subagents while they were employees of Rypac should be awarded to him as damages for Coakley's usurpations of corporate opportunities. Because Poges has failed to establish that the contracts were "corporate opportunities" of Rypac, that argument fails for lack of a valid premise. Accordingly, the plaintiff is liable to Coakley and his subagents, including the Intervening Defendants, as a matter of contract, for all commissions owed to those parties, subject to a set-off equal to the amounts that Coakley owed Rypac for wrongfully diverting and cashing Rypac commission checks.

That ruling does not dispose of all counterclaim issues, however, because Poges also contends, on various grounds, that he is not liable for certain specific commissions addressed in Part IV(A), infra. Moreover, Coakley and the Intervening Defendants have counterclaimed for liquidated damages, costs and attorneys' fees under the Delaware Wage Act. If that statutory claim is valid, Rypac and Poges would be liable for double the commission owed to persons who were "employees" under the Wage Act. Poges contends that (i) Coakley and the Intervening Defendants are not

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[84]By Stipulation and Order entered March 3, 1998 the parties agreed to establish an escrow account and to deposit in that account pending the outcome of this litigation (1) funds received by Coakley between October 10, 1997 through December 22,1997, and (2) funds received by Rypac and Poges attributable to sales made by Coakley and the other sales representatives. Coakley and the Intervening Defendants now seek the latter funds.

[85]The record does not show the precise amounts owed to Coakley and each subagent. The record only contains photocopies of checks for commissions that were deposited into the escrow account, without explaining what portion is owed to which subagent or accounting for tax withholdings.

[86]19 Del. C. §§ 1101-1115.

entitled to those statutory liquidated damages, because they were not Rypac "employees," and (ii) even if they were "employees," Rypac is not liable for the statutory penalties because it had "reasonable grounds for dispute."[87] The Wage Act claim is addressed in Part B, infra.

A. The Four Disputed Commissions

I first address the four disputed commission claims.

1. The Hi-Speed Commission

The Intervening Defendants, while acting as subagents for Rypac on behalf of Hi-Speed, a manufacturer, earned a commission that Hi-Speed withheld from Rypac as a set off against a debt owed by Rypac N.E. (Donald Coakley's company owed the manufacturer). The parties agree that Wischhusen is owed $17,971.24, and that Osborne is owed $3,432.00, of the total commission generated by that transaction.[88] The Intervenors request, and I will enter an order directing, that if and when Hi-Speed pays those commissions to Rypac, Rypac shall pay those amounts to Wischhusen and Osborne.

2. The EDL Commission

Rypac and Wischhusen have stipulated that in 1996 Wischhusen earned a commission that the manufacturer paid to Rypac,[89] and that Rypac then mistakenly paid that commission to Coakley. Wischhusen's claim for that commission is valid, and Rypac will be ordered to pay Wischhusen the $5,589.81 amount. Because it was Rypac that erroneously paid the commission to Coakley, Rypac may assert any claim it may have for reimbursement directly against Coakley.

3. The Serpa Packaging Commission

Coakley contends that he earned a commission from Serpa Packaging. Poges responds that that commission was paid. The dispute arises out of the sale of a cartoning machine on behalf of Serpa Packaging Solutions to 8-in-1

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[87] 19 Del. C. § 1103(b).
[88] Stipulation Regarding Damages of Intervening Defendants ¶ 4.
[89] IDX 19; TR Poges 181.

Pet Products.[90] The parties agree that Rypac was paid a $2,625 commission on this sale.[91]

Initially Poges refused to pay Coakley, because Poges claimed that the machine had been returned. Poges later admitted that he was mistaken after Coakley testified that he had seen the machine at 8-in-1 Pet on recent visits to its facility.[92] Poges then claimed that the commission was paid to Rypac's account and had been "credited" to Coakley, but Poges could not produce any document or other evidence that Coakley had been paid the commission.[93] I find that Rypac owes Coakley the $2,625 commission.

4. The SASIB Commission

Wischhusen contends that Poges wrongfully sold a machine in Wischhusen's territory without telling Wischhusen, and that as a result, Wischhusen is entitled to 90% of the resulting $18,000 SASIB commission (the sales representative's share). The parties have stipulated that the SASIB commission resulted from the shipment of a machine to a customer located in Wischhusen's sales territory, and that Wischhusen is entitled to some percentage of the commission. The dispute is over how much.

In this industry, the commission earned by a sales representative (here Poges) who sells a machine in another sales representative's (here Wischhusen's) territory is payable in one of three different ways. First, if the seller representative has "poached" in another sales representative's exclusive territory, the sales representative who is assigned the territory where the sale is made is entitled to receive the full sales representative's share of the commission, on the basis that the sale should have been made by the rightful sales representative. "Poaching" occurs where a sales representative obtains an order from a customer in another sales representative's protected territory, and then receives the commission generated by that sale.[94]

Second, if the sale is a "ship-in," the representative who actually makes the sale (even if it occurs in another representative's exclusive territory) receives most of the commission, and the sales representative who has the territory receives only a nominal portion. A "ship in" occurs when the seller receives a lead from a source outside of the territory, all of the sales work for a machine is done outside the territory, and the machine is then shipped into another territory.

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[90]TR Coakley 305-306; DX 75.
[91]TR Coakley 305-306; DX 75; TR Poges 458-59.
[92]TR Coakley 305-306; TR Poges 457-58.
[93]TR Poges 457-58.
[94]TR Wischhusen 436.

Third, if the seller notifies the sales representative who works the territory where the sale is to occur, and the two representatives work together, then each sales representative receives 50% of the sales representative's share of the commission.[95]

In this case, Poges' actions amounted to poaching. Poges testified that he made a routine call to National Industrial Products in Wischhusen's territory a few weeks before negotiating the sales contract. Because there is no evidence that Poges acted upon a lead, it must be inferred that there was no lead, and that the sale was generated by Poges' admitted routine sales call to a customer in another agent's territory.[96]

Even if Poges did act on a legitimate lead, he should have notified Wischhusen of any lead he received in Wischhusen's territory. At that point Wischhusen would have pursued the lead himself, or he and Poges would have split up the work. Poges never informed Wischhusen, who learned of the sale only while making a call on the customer, and while there, observed a brand-new piece of machinery. Wischhusen asked the customer's president where he purchased the machine. The president told him he had purchased it from Joe Poges of Rypac.[97]

Poges' testimony that "it just never clicked" that the sale was taking place inside Wischhusen's territory is simply not credible.[98] Rypac's territories were assigned geographically. Poges knew that, because he printed brochures designating how these territories were assigned.[99] Wischhusen's territory was Pennsylvania and Camden, New Jersey, which included zip codes "080" and "081." The proposal (and other documents) contained the address with that zip code, documenting that the customer was in Wischhusen's territory.[100] The fact that those documents contained the address and zip code of the buyer, coupled with the fact that Poges physically visited the seller on at least one occasion, persuade me that Poges must have known that the sale was being made in Wischhusen's territory.

Thus, Poges engaged in poaching by making a routine sales call to a customer in another sales representative's territory and by making a sale to that customer without informing the sales representative specifically

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[95]TR Wischhusen 441-42.

[96]Mr. Poges testified that he received a lead from Falcon Safety Products, but the only evidence mentioning that company is dated June 13, 1997, a full year after the original proposal resulting in the sale took place. IDX 23. Moreover, in discovery Poges turned over Intervening Defendants' Exhibit Nos. 23 through 36, but neither exhibit evidenced a "lead" from Falcon Safety Products. Nor was any evidence produced that most of the work was completed outside of Wischhusen's territory.

[97]TR Wischhusen at 437.

[98]TR Poges 193.

[99]TR Poges 186-87.

[100]IDX 23; TR Poges 192.

assigned to that territory. Wischhusen is therefore entitled to $16,200, the full 90% of the $18,000 commission he would have made on the sale.

B. The Statutory Claim

I now turn to the counterclaim for liquidated damages, costs and attorneys' fees. Under the Wage Act, Coakley and the Intervening Defendants would be entitled to recover the commissions owed plus liquidated damages if: (i) Coakley and his subagents were "employees" of Rypac under 19 Del. C. § 1101 (a)(4), and (ii) if Poges did not have any reasonable grounds for withholding the commissions. Those are the issues posed by the Wage Act counterclaim.

1. The "Employee" Issue

The Wage Act was enacted by the General Assembly to provide for payment of wages and to enforce their collection.[101] Under 19 Del. C. § 1101 (a)(4), an "employee" is "any person suffered or permitted to work by an employer under a contract of employment either made in Delaware or to be performed wholly or partly therein." The legislative intent was to have the courts decide, on a case-by-case basis, whether a person is an employee for the purposes of the Act.[102]

In Fairfield Builders Inc. v. Vattilana, the Supreme Court articulated three criteria to guide that determination: (1) whether the employer retained control over the means and methods of doing the work, (2) whether the person was taxed like an employee, and (3) whether other benefits consistent with a standard employment contract were provided.[103]

The issue is whether Osborne, Wischhusen and Daniel Coakley were Rypac employees under the Wage Act. Although Osborne and Wischhusen never signed the document, their Subagent Agreement provides that they were "independent private contractor[s] and [are] not employee[s] of Rypac Packaging Machinery Incorporated, as . . . independent contractor[s] [are] responsible for [their] own operating expenses."[104] By its terms, the Subagent Agreement (i) required that they fund their own retirement accounts,[105] (ii) stated that they would not receive any employee benefits from Rypac,[106] and (iii) provided that they would not be taxed as

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[101] State of Delaware v. Planet Insurance Co., Del. Super., 321 A.2d 128, 133 (1974).
[102] Fairfield Builders, Inc. v. Vattilana, Del. Sup., 304 A.2d 58, 60 (1973).
[103] Id.
[104] PX 2 and 11, ¶ 1.
[105] Id. at ¶ 16.
[106] Id. at ¶ 20.

employees.[107] Osborne and Wischhusen testified that the only reason they did not sign the Subagent Agreement was that they objected to its non-compete clause, not because they disagreed with its other provisions. That evidence leads me to conclude that Osborne and Wischhusen orally agreed that Osborne and Wischhusen would not be employees for purposes of the Wage Act or any other purpose.

Daniel Coakley, however, was an employee under the Wage Act. He signed an Employment Agreement with Rypac, which expressly provides that Daniel Coakley was an employee of Rypac.[108] His Employment Agreement provided that 15% of his sales commission would be allocated to his retirement plan. Although the Employment plan did not describe any health plan, the Officer's Agreement did.

2. Reasonable Grounds to Dispute Payment

Having determined that Daniel Coakley was a Rypac employee, I turn to the next issue: whether at the time it failed to pay the commissions, Rypac had any reasonable grounds to dispute its claimed obligation to pay those commissions. Section 1103(b) pertinently provides:

> "If an employer, without any reasonable grounds for dispute, fails to pay an employee wages, as required under this chapter, the employer shall, in addition, be liable to the employee for liquidated damages in the amount of 10 percent of the unpaid wages for each day . . . or in an amount equal to the unpaid wages, whichever is smaller."

Thus, the employee's right to recover liquidated damages for improperly withheld wages depends upon whether the employer had "reasonable grounds for dispute." Rypac argues that the pendency of this lawsuit establishes the requisite "reasonable grounds for disput[ing]" what Daniel Coakley claimed was owed.

I find that Rypac is not liable for the statutory doubling penalty,[109] because it had "reasonable grounds [to] dispute" the commission claim. Those grounds consisted of Rypac's belief that Coakley had breached his fiduciary duties to Rypac by having wrongfully cashed commission checks, and directing third parties not to pay Rypac. On that basis, I conclude that

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[107] Id. at ¶ 18. (Providing that Rypac would issue a 1099 miscellaneous tax form to Osborne and Wischhusen every year, which is a form issued for commission owed to non-employees for services.)

[108] PX 30.

[109] Peirson v. Hollingsworth, Del. Super., 251 A.2d 350 (1969).

Coakley's statutory claim for liquidated damages under the statute lacks merit.

Accordingly, the counterclaim shall be dismissed.

V. CONCLUSION

Counsel shall promptly confer and submit an appropriate form of order implementing the rulings made herein.

TECHNICORP INTERNATIONAL II, INC. v. JOHNSTON

No. 15,084

Court of Chancery of the State of Delaware, New Castle

May 31, 2000

Thomas J. Allingham, II, Esquire, of Skadden, Arps, Slate, Meagher & Flom LLP, Wilmington, Delaware, for plaintiffs.

David A. Jenkins, Esquire, of Smith, Katzenstein & Furlow, Wilmington, Delaware; and Allan M. Pepper, Esquire, of Kaye, Scholer, Fierman, Hays & Handler, LLP, New York, New York, for defendants.

JACOBS, *Vice Chancellor*

Of the many corporate matters that have graced the portals of this Court, this case may be one of the most bitterly litigated. It certainly is one of the most sordid. Although this Opinion is lengthy and involves a host of complex issues, its story line is easily summarized.

In 1984, Miklos Vendel ("Vendel") and H. Frederick Johnston ("Johnston") formed Technicorp International II, Inc., a Delaware corporation ("TCI II"), to acquire a high-technology California corporation called Statek, Inc. ("Statek"). It was agreed that these two investors would own shares in TCI II (which, in turn, owned Statek) in proportion to their capital investment, and that Johnston would own 53% of TCI II's shares.

Vendel, a Swiss citizen, would not be involved in managing the corporations.

From 1984 through 1995, Johnston and his associate, Sandra Spillane ("Spillane") exclusively managed and controlled TCI II and Statek, including all access to their cash and corporate records. To say it bluntly, during that period Johnston and Spillane systematically looted those companies, treating their assets as their private preserve, and during much of that time they were able to defraud Vendel into believing that all was well.

Although Johnston held himself out as TCI II's controlling shareholder, he never validly owned a majority of TCI II's stock, because he never contributed a majority of its equity, and what equity he did invest was ultimately repaid to him. As a result, Johnston owns no equity in TCI II, nor has he owned equity since the time his debt contribution was repaid. For that reason, as discussed in this Opinion, the Court holds that Johnston's TCI II shares must be canceled or subjected to a constructive trust. Moreover, Johnston and Spillane lived like jet-setting potentates. They traveled extensively and lavishly in this country, in the Bahamas, and throughout Western Europe, all at these corporations' expense, while keeping the corporate books and records in such a way as to minimize, if not altogether avoid, the risk of being held accountable.

At some point Vendel learned that something untoward was going on at TCI II and Statek. He tried to discover what was occurring, but met with resistance at every turn. Vendel finally resorted to litigation, causing a series of lawsuits to be brought against Johnston and Spillane. This lawsuit, which is brought by TCI II and Statek (now under Vendel's control), seeks equitable relief and money damages against Johnston, Spillane, and entities owned or controlled by them,[1] based on claims of fraud, breach of fiduciary duty and corporate waste.

The defendants' past pattern of resisting accountability continues unabated. In this action that resistance takes the form of arguments (raised as affirmative defenses) that this Court lacks in personam jurisdiction over the defendants and that the plaintiffs' money damage claims are barred by the statute of limitations. As later discussed in this Opinion, the Court finds that those defenses lack merit.

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[1]These entities -- all corporate defendants owned or controlled by Johnston and/or Spillane -- are referred to as the "Johnston Entities" and include: Acosta Street Corporation, Amplifonix, Inc. ("Amplifonix"), Artafax Systems, Ltd. ("Artafax"), BAI Corporation ("BAI"), Beverly Lane Limited ("Beverly Lane"), BLM Holding Corporation ("BLM"), Digital Products, Inc. ("Digital"), ECM Devices, Inc. ("ECM"), Greenray Industries, Inc. ("Greenray"), Metrodyne Corporation ("Metrodyne"), Rare Stamps Investments, Inc. ("Rare Stamps"), Samco Investors, Inc. ("Samco"), Technicorp International, Inc. ("TCI"), Technicorp International III, Inc. ("TCI III"), Technicorp Industries, Inc. ("TII"), Technicorp Ventures, Inc. ("TVI"), Technicorp International IV ("TCI IV"), and Technicorp International V.

The bulk of this Opinion concerns the plaintiffs' many and substantial claims for money damages. The plaintiffs claim that during the almost twelve years of their stewardship of TCI II and Statek, Johnston and Spillane wrongfully diverted to themselves at least $28.5 million of those corporations' assets in several different ways. The task of proving those diversions was daunting, because many of the expenditures were either inadequately documented or not documented at all. As a result, the same core issue tends to repeat itself in several different contexts: where (as here) corporate fiduciaries cause the corporation to pay moneys to themselves or to third parties, and the fiduciaries cannot document any legitimate business purpose for the expenditures, is the Court required to accept the fiduciaries' uncorroborated and self serving testimony of business purpose? The answer, again repeated at many different points, is clearly no, particularly where (as here) the fiduciaries have given false testimony and presented falsified evidence.

It is a well established principle of equity that fiduciaries have a duty to account to their beneficiaries for their disposition of all assets that they manage in a fiduciary capacity. That duty carries with it the burden of proving that the disposition was proper. If any corollary proposition is central to this case, it is that included within the duty to account is a duty to maintain records that will discharge the fiduciaries' burden, and that if that duty is not observed, every presumption will be made against the fiduciaries. As discussed herein, the application of that principle results in the defendants being liable for most of the plaintiffs' money damage claims.

The relief that plaintiffs seek includes damages of $28.5 million, plus all other monies wrongfully diverted by the defendants, plus interest. It also includes the imposition of a constructive trust for TCI II's benefit upon the defendants' TCI II stock and upon all diverted funds in their possession, and/or the cancellation of Johnston's TCI II shares.

This is the Opinion of the Court, after trial, on the merits of the plaintiffs' claims. For the reasons next set forth, I find that, with minor exceptions, the plaintiffs have established their entitlement to the relief they request. In addition, I grant the defendants relief on their counterclaim, subject to the conditions set forth in Part VI of this Opinion.

I. INTRODUCTION

A. Background[2]

In 1984 Johnston and Miklos Vendel, a Swiss citizen ("Vendel") agreed jointly to purchase Statek, a California-based manufacturer of micro-electronic components. TCI II was formed as the acquisition vehicle, and its sole stockholders were Johnston and Vendel. At all times from and after Statek was acquired, it was operated as a wholly owned subsidiary of TCI II, and TCI II was operated solely and exclusively by Johnston and Spillane with no input from or participation by Vendel. In the early years, Johnston and Spillane constituted a majority of TCI II's board of directors. Later, they constituted TCI II's entire board. At all relevant times Johnston served as TCI II's Chairman, President, and Treasurer, while Spillane, who was Johnston's long-time business associate and companion, served as TCI II's Vice President and Secretary.

For six years after TCI II was formed, Vendel received almost no financial information about his investment in that corporation. Moreover, critically important information was concealed from Vendel, including the fact that Johnston and Spillane had caused TCI II to make interest-free "loans" to themselves totaling almost $6 million. Also concealed was the fact that Johnston had failed to contribute his agreed-to share of equity capital -- a fact that rendered false Johnston's representations to Vendel that he (Johnston) was TCI II's majority shareholder.

After repeated requests for information, in October, 1993 Vendel brought an action under 8 Del. C. § 220 on behalf of himself and his nominee, Arbitrium (Cayman Islands) Handels A.G. ("Arbitrium"), to inspect TCI II books and records that Johnston and Spillane had refused to produce to Vendel.[3] That action (the "§220 action") was ultimately settled. As part of the settlement, Vendel was furnished certain documents, including documents TCI II's then-counsel had previously represented did not exist. Based on those documents, Vendel concluded that he -- not Johnston -- TCI II's majority stockholder. Accordingly, in April 1994, Vendel executed a written consent removing Johnston and Spillane as directors of TCI II. Those defendants refused to honor that consent. As a consequence, Vendel

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[2]To avoid overburdening what of necessity is a lengthy Opinion, no comprehensive statement of facts is set forth at this point. Instead, the background facts leading to the commencement of this action are narrated in this Section of the Opinion, and the facts pertaining specifically to the parties' claims and defenses are discussed in the later Sections devoted specifically to those claims and defenses.

[3]*Arbitrium (Cayman Islands) Handels v. Technicorp International II*, Del. Ch., C.A. No. 13240, Mem. Op., Chandler, V.C. (Feb. 4, 1994).

and Arbitrium brought an action under 8 Del. C. § 225 (the "§225 action") for a determination that they were TCI II's majority stockholder, and in that capacity had validly removed Johnston and Spillane as officers and directors of TCI II.[4]

On January 5, 1996, after a six day trial on the merits, this Court issued an Opinion (the "January 5 Opinion") upholding the consent.[5] On January 11, 1996, the Court entered an Order (the "January 11 Order") removing Johnston and Spillane as officers and directors of TCI II and directing them to surrender control of TCI II's and Statek's property, including all records, to Vendel. Ever since control was surrendered, TCI II and Statek have been operated by Vendel and persons under his direction.

Following the change in control, plaintiffs' accounting expert, Mr. John Garvey of Chicago Partners LLC ("Garvey"), conducted a five month investigation of TCI II's and Statek's books and records. Garvey's investigation caused him to report that Johnston and Spillane had diverted more than $28.5 million from both corporations during their tenure. Accordingly, on June 26, 1996, the plaintiffs commenced this action to recover the diverted assets.[6]

In response, the defendants denied liability, interposed affirmative defenses, and asserted counterclaims for the value of the services they claimed to have provided to TCI II and Statek. On August 22, 1997, the Court issued an Opinion denying the plaintiffs' motion for partial summary judgment.[7] Discovery then ensued, and after two years the case was tried on its merits for eight trial days, between September 14, 1998 and November 16, 1998. Post-trial briefing and oral argument, based upon a voluminous trial record, were concluded on August 10, 1999.

B. The Structure of This Opinion

To treat most clearly and directly the plethora of claims, defenses, and counterclaims being advanced by both sides, this Opinion is structured to

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[4]*Arbitrium (Cayman Islands) Handels v. Johnston*, Del. Ch., CA. No 13506, Mem. Op., Jacobs, V.C. (Jan. 5, 1996), *aff'd*, Del. Supr., 638 A.2d 59 (1996).

[5]*Id.* (Jan. 5, 1996). That bitterly fought litigation generated several Opinions during its pretrial stage. *Id.* (Oct. 6, 1995); *Id.*, (Nov. 21, 1994); *Id.* (Oct. 19, 1994); *Id.* (Sept. 23, 1994), as well as after the trial. In an Opinion handed down on May 27, 1997, the Court held that Johnston and Spillane had defended the §225 action in bad faith and, accordingly, were liable to Vendel for the attorneys' and expert witness fees he incurred in that action. *Arbitrium (Cayman Islands) Handels AG, et al. v. Johnston, et al.*, Del. Ch., 705 A. 2d 225 (1997), *aff'd*, Del. Supr., 720 A.2d 542 (1998). Those fees and expenses totaled approximately $1.6 million.

[6]*Technicorp International II, Inc. v. Johnston*, Del. Ch., C.A. No. 15084, Mem. Op., Jacobs, V.C. (Aug. 25, 1997).

[7]*Id.* (Aug. 22, 1997).

address the issues in their most logical order. Accordingly, Section II of this Opinion is devoted to the defendants' affirmative defenses, *i.e.*, their contentions that this Court lacks personal jurisdiction over Johnston and Spillane and that the plaintiffs' claims are time-barred. Next considered, in Sections III, IV, and V, are the plaintiffs' affirmative claims that (i) Johnston's TCI II stock should be canceled or subjected to a constructive trust because Johnston has no equity in TCI II (Section III); and that (ii) a money judgment should be entered against Johnston and Spillane for over $28.5 million that they improperly diverted from TCI II (Section IV) and Statek (Section V) by reason of fraud, waste, and/or breaches of fiduciary duty. Finally, Section VI addresses Johnston's and Spillane's counterclaim that they are entitled to reasonable compensation for services they performed for TCI II and Statek.

II. THE AFFIRMATIVE DEFENSES

A. The Personal Jurisdiction Defense

Service of process over Johnston and Spillane was effected under 10 Del. C. § § 3114 and 3104. The defendants do not contest this Court's in personam jurisdiction over them with respect to TCI II's claims to recover monies wrongfully diverted *from TCI II.* Nor could they, because those claims are asserted against Johnston and Spillane in their capacity as directors of TCI II, and therefore come within §3114, which relevantly provides that a person who serves as a director of a Delaware corporation is deemed to have consented to the jurisdiction of the Delaware Courts "in any action or proceeding against such director . . . for violation of a duty in such capacity."[8]

What the defendants do contest is the Court's personal jurisdiction over them with respect to the plaintiffs' remaining claims (i) to cancel and/or impose a constructive trust upon Johnston's TCI II shares, and (ii) to recover monies wrongfully diverted from Statek. With respect to the first claim, the defendants argue that if Johnston failed to pay into TCI II the equity capital he had agreed to contribute, that failure was in his individual capacity as a stockholder, not in his fiduciary capacity as a director. With respect to the second claim, the defendants argue that if they wrongfully diverted monies from Statek, they did so in their capacities as directors of Statek, which is not a Delaware corporation. For that reason (defendants say) this latter claim is not covered by §3114 either.

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[8]Nor do the defendants contest personal jurisdiction over the Johnston Entities, most if not all of which are Delaware corporations.

These arguments are now addressed.

1. Jurisdiction Over Claims Respecting Statek

Statek is a California corporation that is asserting a direct claim against Johnston and Spillane for wrongful diversion of Statek's funds. If Statek were the only plaintiff asserting that claim, the defendants' jurisdictional argument would have merit, because §3114 relevantly encompasses only claims "made by or on behalf" of a Delaware corporation in "any action or proceeding against [a] director . . . for violation of a duty in such capacity . . . ." What defendants overlook, however, is that TCI II is a Delaware corporation and that Statek is not only TCI II's wholly owned subsidiary, but also it is its sole asset and business. Therefore, plaintiffs argue, the wrongful diversions from both TCI II and Statek were breaches of Johnston and Spillane's duties, as TCI II directors, to preserve the assets of Statek, which was TCI II's only operating asset and source of income.[9] Thus, the wrongful diversions from Statek constituted breaches of fiduciary duty owed to TCI II as well as to Statek.

In *Hoover Industries, Inc. v. Chase*,[10] a director and officer of a corporation and its subsidiary was charged with wrongfully diverting assets of both the parent and the subsidiary. The director claimed jurisdiction under §3114 was unavailable because the challenged transactions were performed in his capacity as an "officer" rather than as a director. Rejecting that contention, former Chancellor Allen stated that "[t]he duty of loyalty of a director is . . . a special obligation upon a director in *any* of his relationships with the corporation." The Chancellor also observed that it well may be that " a director qua director owes a duty to the corporation to so conduct himself in all of his capacities so as not to inflict an intentional, wrongful injury upon the corporation,"[11] but the Court found it unnecessary to explore the soundness of that proposition in that particular case. In this case, I conclude that that proposition is axiomatic and subsumed within the director's broader duty of loyalty. Thus, Johnston and Spillane had a duty as directors "in any of their relationships" with TCI II, not to injure that corporation or its assets, including its wholly-owned subsidiary, Statek. This Court, therefore, has personal jurisdiction over the defendants under §3114 with respect to TCI II's claim for wrongfully diverting assets of Statek.[12]

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[9]*See Hoover Indus., Inc. v. Chase*, Del. Ch., C.A. No. 9276, Mem. Op., Allen, C. (July 13, 1988); *see also Anadarko Petroleum Corp. v. Panhandle Eastern Corp.*, Del. Supr., 545 A.2d 1171, 1174 (1988).

[10]*Id.*

[11]*Hoover Indus., Inc.*, C.A. No. 9276 at 4, 5 (emphasis added).

[12]Because the Court has direct personal jurisdiction over TCI II's claim to recover for the

2. Jurisdiction Over Claims Concerning Johnston's Shares of TCI II Stock

I also conclude that personal jurisdiction lies under §3114 with respect to the plaintiffs' claim to cancel and/or impose a constructive trust upon Johnston's TCI II stock. That is because the theory of liability upon which that claim rests is that Johnston and Spillane abused their positions *as directors* by causing TCI II to issue stock to Johnston without consideration.[13]

In *Jaffe v. Regensberg*, the director defendants argued that Section 3114 could not be invoked as the basis to assert personal jurisdiction over them, because the claim -- for cancellation of stock issued to a director -- was in reality being asserted against the director in his individual capacity as a stockholder. Rejecting that argument, the Court held:

> ... It is alleged, in essence, that acting in their capacities as the majority of the board of directors ... the individual defendants violated their duty as directors by authorizing the issuance of ... shares ... for no corporate purpose and for no reason other than to attempt to enable Regensberg and his associates to remain in control of [the corporation], knowing full well at the time that if existing stock purchase agreements were exercised by others the issuance of the ... shares to Regensberg would result in]the corporation] having issued ... more shares of stock than authorized by its certificate of incorporation. The fact that the relief might work against one or more of the individual defendants in their personal capacities in order to rectify the situation does not detract from the theory of liability which activates the provision of §3114.[14]

The only distinction between *Regensberg* and this case is that the issuance of the TCI II shares is said to be invalid for a different reason, i.e.,

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wrongful diversion of Statek's assets, under principles of ancillary jurisdiction the Court may also entertain Statek's direct claim for that same relief, because (i) the latter claim arises out of the same core facts as the former, and because (ii) it therefore was reasonably foreseeable that Statek as well as TCI II would seek to recover those diverted funds in the same lawsuit. In this context it is artificial to separate the defendants' role as directors of Statek from their role as directors of TCI II. *See Technicorp Int'l II, Inc. v. Johnston*, Del. Ch., C.A. 15084, Mem. Op. at 40, Jacobs, V.C. (August 22, 1997).

[13] *See Maclary v. Pleasant Hills, Inc.*, Del. Ch., 109 A.2d 830 (1954); *Cahall v. Burbage*, Del. Ch., 121 A. 646 (1923).

[14] *Jaffe v. Regensberg*, Del. Ch., C.A. No. 5965, Brown, V.C., Mem. Op. at 6, (Jan. 10, 1980).

it was issued for no consideration as distinguished from being issued to perpetuate control. That distinction, however, is of no significance in this context.

For these reasons, the affirmative defense that this Court lacks personal jurisdiction over the defendants lacks merit and is rejected.

B. The Time Bar Defense

The defendants next argue that the plaintiffs' money damage claims are all time-barred by application of the analogous three-year statute of limitations, because on and before June 26, 1993 (three years before this action was filed), Vendel had reason to know the facts giving rise to the present claims, and because those facts must be imputed to the corporate plaintiffs.[15] The defendants rely upon Delaware decisions holding that in corporate fiduciary cases where self-dealing is alleged, the disclosure of facts that create a shareholder duty of inquiry will cause the limitations period to run from the time the plaintiff shareholder knew or had reason to know the facts constituting the wrong.[16]

Specifically, the defendants point to two events that predated June 26, 1993, each of which (defendants argue) establishes that the plaintiffs (through Vendel) were on inquiry notice of the facts underlying their claims before the three-year period preceding the filing of this action. The first event was the issuance of a March 29, 1993 report by a Swiss forensic accounting firm, Derungs Treuhandgesellschaft AG ("Derungs"), which Vendel had hired to review certain information about TCI II that Vendel had accumulated up to that point. Vendel first became suspicious of Johnston 's management of TCI II in August 1991, when he received (under cover of an unsigned letter about which Johnston and Spillane implausibly denied any knowledge) a TCI II balance sheet showing total equity of only $175,000, even though Vendel had invested $250,000 of equity capital when TCI II was formed. Vendel promptly sought explanations from Johnston and later

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[15]"Where a plaintiff seeks a legal remedy in a court of equity and a statute of limitations exists for an analogous action at law, the statutory period may create a presumptive time period for application of laches to bar a claim." *U.S. Cellular v. Bell Atlantic Mobile Systems, Inc.*, Del. Supr., 677 A.2d 497, 502 (1996). In this case the analogous statutory period is conceded to be three years. This defense is relevant only to the plaintiffs' claims for money damages. It leaves unaffected the claims for equitable relief, including, specifically, the claims for a constructive trust for all property derived from the wrongfully diverted funds and the claim to cancel unaffected the claims for equitable relief, including, specifically, the claims for a constructive trust for all property derived from the wrongfully diverted funds and the claim to cancel Johnston's TCI II shares.

[16]*See, e.g., Kahn v. Seaboard Corp*, Del. Ch., 625 A.2d 269 (1993); *In re USACafes, L.P. Litig.*, Del. Ch., Consol. C.A. No. 11146, Allen, C. (Jan. 21, 1993); *U.S. Cellular*, 677 A.2d at 497, n.15.

from Samuel Greenspoon, TCI's then-counsel and a director. Those inquiries were "stonewalled" and as a result, Vendel retained Derungs which issued a report in March 1993, concluding preliminarily that Johnston had defrauded Vendel of his investment, and also had failed to honor his own commitment to contribute capital. The Derungs report also stated that the limited number of available documents did not provide any explanation of where or how the funds that had been upstreamed from Statek to TCI II had been disposed of. Derungs therefore recommended that Vendel file suit to obtain other documents that would enable him to determine what had happened.

The second event, which occurred shortly after Vendel received the Derungs report (but before June 26, 1993), was Vendel's filing of a lawsuit in Connecticut against Johnston and Spillane (the "Connecticut action") for an accounting, a constructive trust, and damages for alleged asset misappropriations. The Connecticut complaint alleged that Johnston had misrepresented the amount of his capital contribution, that Johnston and Spillane had misappropriated and diverted at least $3,861,910 of funds upstreamed from Statek, and that they had improperly caused Statek to pay Johnston at least $1,813,317 in the form of "administrative service fees." The Connecticut court dismissed the action with leave to amend, on the basis that the claims were derivative in nature and the complaint failed to plead fraud with particularity. In a conference with the Connecticut Magistrate Judge during which Johnston refused to give Vendel access to any of TCI II's books and records, the Magistrate Judge suggested that Vendel initiate proceedings in Delaware to obtain access to those records.

Despite having engaged in these litigation tactics, the defendants argue that had Vendel pursued his Connecticut action "he would have uncovered all of the facts which form the basis of the current allegations."[17] Indeed, the defendants even assert, somewhat hyperbolically, that:

> The evidence is overwhelming . . . that Vendel had sufficient knowledge to put him on notice of his claims as early as the summer of 1991--when, in his own words, he had "suspicion[s]" . . . --when he received the Derungs Report in March, 1993--when Derungs told him that Johnston had diverted millions of dollars from TCI II and never had put up his capital contribution . . . --and certainly by June 18, 1993, when he filed the Connecticut Action--which mimics the allegations in this action . . . .[18]

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[17]Def. Post-Trial Answering Br. at 17.
[18]*Id.* at 18.

The defendants' "time bar" defense is flawed for a host of reasons.

First, as a threshold matter the rule that "a court of equity will deny a plaintiff relief when suit is brought after the analogous statutory period," applies only "[a]bsent . . . unusual circumstances" that justify tolling the statute.[19] In the § 225 action, this Court earlier held that the trial record and Johnston's and Spillane's conduct both before and during that proceeding, "established a highly disturbing pattern of deceitful, bad faith conduct, that could only have been intended to delay the inevitable day of reckoning, and to enable the defendants to continue mulcting the corporation without detection." The Court found that that conduct constituted "highly unusual circumstances" that justified an award of attorneys fees and costs incurred in the § 225 action.[20] It would be ironic, indeed inexplicable, if that determination -- supported by intermediate findings that the defendants had perpetrated "promiscuous alterations of testimony," "wholesale shifting of positions," and "fabrication of evidence to present even the semblance of a defense . . .,"[21] were found insufficient to negate the defense of laches. I conclude that finding should be -- and is -- conclusive on the laches question.

Moreover, the Court's summary judgment ruling in this case compels the identical result. It is a well-established doctrine that fraudulent concealment tolls the running of the statute.[22] During the pretrial stage this Court denied the defendants' motion for summary judgment based on limitations grounds, on the basis that findings made in the § 225 action "point to intentional concealment by the defendants of material facts relating to, among other things, the finances of TCI II and Statek as well . . . . Those findings alone, in my view, would be sufficient to require denial of the motion on this record."[23]

Second, the defendants' "inquiry notice" argument rests upon the premise that the facts of which Vendel was aware before June 26, 1993, if pursued, would have led to the timely discovery of the defendants' fraudulent scheme. That premise is long on generalities but short on specifics as to what facts Vendel supposedly knew. Moreover, it is also belied by the record. Vendel did, to be sure, have reason to suspect wrongdoing of some kind before 1993, but he did not know the specific facts giving rise to the

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[19] *U.S. Cellular*, 677 A.2d at 502, n.15.

[20] *Arbitrium (Cayman Islands) Handels*, Del. Ch., 705 A.2d at 233 (1997) (emphasis added).

[21] *Id.* at 237

[22] *See, e.g., Kahn*, Del. Ch., 625 A.2d at 275 (1993).

[23] Transcript of November 14, 1996 Oral Argument on Defendants' Motion to Dismiss, at 76-78 (Bench Ruling). At that earlier stage the Court did not rest its denial of the summary judgment motion solely on that ground, but ruled that material fact disputes also compelled that result.

claims in this action until after he legally wrested control of TCI II and Statek -- and their books and records -- from the defendants in January 1996. During the next six months, Vendel caused those records, which were in a state of disarray, to be audited, and only after the results of Garvey's audit became known did Vendel promptly file this action. The record shows -- contrary to the defendants' naked assertion -- that at each stage Vendel diligently and doggedly pursued all facts of which he was aware, in order to obtain sufficient evidence to plead his claims with particularity. The reason Vendel did not file this action earlier is that at every bend and turn between 1991 and 1996 the defendants resisted and obstructed his efforts to obtain the necessary information.[24]

Although the defendants insist that Vendel delayed unreasonably in filing this action, the foregoing procedural history shows otherwise. Vendel did, in fact, assert in timely fashion what claims TCI II did have in the Connecticut action, with predictable lack of success because of insufficient facts. The Derungs report gave Vendel reason to believe that Johnson had fraudulently misappropriated funds, and led to his filing the Connecticut action, but Derungs also advised Vendel that more facts were needed. The same defendants who now insist that the Connecticut action establishes that Vendel was on inquiry notice, moved successfully to dismiss the fraud count of that action for lack of specificity, and then refused to give Vendel the books and records that he needed to cure that factual defect. The defendants' self-serving posture presumably led the Connecticut Magistrate Judge to suggest that Vendel seek to obtain the books and records in a Delaware proceeding, which Vendel did by voluntarily dismissing the Connecticut action and filing the § 220 action in this Court.

Even in that action the defendants forced Vendel to engage in months of needless litigation until it was settled in March 1994. In the settlement Vendel received, for the first time, documents which revealed that he was the controlling shareholder of TCI II and that for ten years, Johnston and Spillane had "loaned" themselves and the Johnston Entities millions of dollars that were upstreamed from Statek to TCI II.

Based on those documents, Vendel executed a written consent removing Johnston and Spillane as directors of TCI II, the validity of which the defendants refused to acknowledge. The defendants, in bad faith, forced Vendel once again to sue, this time under §225, to enforce the consent. By using delay and other tactics later found to constitute bad faith, Johnston and

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[24]Tab 2 of the Appendix to the Plaintiffs' Post-Trial Reply Brief (filed May 17, 1999) sets forth a time line matching Vendel's actions with the state of his knowledge at the corresponding time. That time line, corroborated by independent evidence, shows that Vendel diligently pursued every lead developed from each small morsel of information that he was able to extract from the defendants, only through persistent inquiry followed by expensive, hard-fought litigation.

Spillane were able to protract the § 225 action for almost two years before the validity of the consent was upheld on January 5, 1996.

Not until this Court removed Johnston and Spillane as directors and officers of TCI II and ordered them to turn over all corporate records of TCI II and its subsidiaries -- including Statek -- was it possible to discover the full extent of Johnston's and Spillane's diversion of assets, most notably at the Statek level. It took nearly six months for Vendel (i) to obtain bank and other records and then, (ii) to trace their complex patterns of asset diversions and then (iii) to track down, organize, and tabulate hundreds of thousands of pages derived from those records -- much of which were in disorganized, incomplete, and chaotic form. Only then were TCI II and Statek -- now under Vendel's control -- in a position to file this action seeking relief for the defendants' breaches of fiduciary duty, fraud, waste, and misappropriation of corporate assets. "[A] defendant should not be permitted to use the statute of limitations as a shield where the defendant possesses information critical to the existence of an actionable claim of wrongdoing and prevents the plaintiff from discovering that information in a timely fashion."[25] By asserting their limitations/laches defense, that is precisely what the defendants are attempting to do here.

Third, even if the analogous statute of limitations were applicable, it was tolled during the pendency of Vendel's Connecticut, § 220 and § 225 actions. It is settled Delaware law that the institution of other litigation to ascertain the facts involved in the later suit will toll the statute while that litigation proceeds. As this Court stated in *Cahall v. Burbage*:

> "Delay pending other proceedings has frequently been held excusable . . . where the termination of such proceedings was necessary for the ascertainment of facts involved in the later suit . . . ." No long length of time has run in this case since knowledge of the alleged wrongs was acquired, not even so long a time as the minimum period defined in the statute of limitations, and what little delay there was, is explained by the pendency of the other litigation of a character which, when considered, shows that the complainant was diligently seeking a legal determination upon a question precisely similar to the one in controversy here.[26]

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[25]*In re MAXXAM, Inc. Federated Dev. Shareholders Litig.*, Del. Ch., C.A. Nos. 12111, 12353, Mem. Op. at 13, Jacobs V.C. (June 21, 1995); *see also Gotham Partners, L.P. v. Hallwood Realty Partners, L.P.*, Del. Ch., 714 A.2d 96, 105 (1998) ("Stonewalling by defendants, if it prevented [plaintiff] from learning about their wrongful conduct, is susceptible to attack under the grounds of equitable tolling or fraudulent concealment.").

[26]Del. Ch., 119 A. 574, 576-77 (1922) (quoting *Central R.R. v. Jersey City*, N.J. Dist.,

Finally, even if the delay in filing this action were assumed to be unreasonable, "mere delay alone will not give rise to the equitable defense of laches."[27] Rather, a"[c]hange of position on the part of those affected by nonaction, and the intervention of rights are factors of supreme importance."[28] In this case defendants make no claim, nor do they offer any proof, that they were in any way prejudiced by the delay that they themselves caused. That, at the end of the day, is the most telling commentary on the laches defense which, for all the foregoing reasons, is rejected on its merits.

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The affirmative defenses having been disposed of, I turn to the plaintiffs' affirmative claims for relief.

III. THE PLAINTIFFS' CLAIM TO CANCEL OR IMPOSE A CONSTRUCTIVE TRUST UPON JOHNSTON'S TCI II SHARES

A. The Plaintiffs' Contentions

The plaintiffs seek, first, an order cancelling or (alternatively) imposing a constructive trust upon Johnston's shares of TCI II stock. That relief is predicated upon the plaintiffs' contention that in fact Johnston has no equity in TCI II.

The procedural background of this claim is as follows: on January 5, 1996, this Court determined in the § 225 action that "Vendel's net equity investment in TCI II was $235,000 and Johnston's investment was $100,000," and that as a result "Vendel, through Arbitrium, is the majority stockholder of TCI II . . ." This Court later ruled in this action that while those § 225 determinations were conclusive and binding in this proceeding, a third § 225 ruling -- that Johnston had been refunded a portion of his

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199 F. 237, 245 (1912). The pursuit of a books and records action under §220 has been regarded as "strong evidence that plaintiff was aggressively asserting its claims at that time . . ." *Gotham Partners*, 714 A.2d at 105, n.25.

It would be perverse if the rule were otherwise. On at least two occasions the Supreme Court has expressly encouraged potential derivative plaintiffs to utilize the "tools at hand" to obtain information bearing on the subject of their claims, in order to avoid an unseemly race to the courthouse to file "a plethora of superficial complaints that could not be sustained." *Rales v. Blasband*, Del. Supr., 634 A.2d 927, 932-35, n.10 (1993). To accept the defendants' time-bar argument would penalize, not encourage, the use of those important tools.

[27]*Wechsler v. Abramowitz*, Del. Ch., C.A. Nos. 6861, 6862, Mem. Op. 3-4, Hartnett, V.C. (Aug.30, 1984).

[28]*Federal United Corp. v. Havender*, Del. Supr., 11 A.2d 331, 343 (1940).

$100,000 investment -- would not be accorded collateral estoppel effect because (i) that ruling was not essential to determine the critical issue of voting control, and (ii) the refund issue was burdened by material fact disputes. Thus, the procedural bottom line -- that the refund issue could be relitigated in this action but could only be resolved after a trial[30] -- set the stage for plaintiffs to press the arguments they advance here.

The plaintiffs rely upon two arguments to support their position that Johnston has no equity, and therefore is entitled to no stock, in TCI II. A meaningful articulation of those arguments requires additional factual background. In the §225 action this Court found (and there is no dispute) that during the 1970s, BAI, an entity of which Johnston was the Chairman and the indirect sole shareholder[31], became indebted in the amount of $235,800 to a company known as Société Suisse Pour L'Industrie Horlogére S.A. ("SSIH"). BAI later defaulted on that debt. Thereafter, in late 1983 and early 1984, Johnston negotiated the purchase of Statek (on behalf of TCI II) from another Swiss company named ASUAG. During the course of those negotiations, ASUAG acquired BAI's unpaid creditor, SSIH, and discovered the defaulted $235,800 debt owed by BAI, which was controlled by Johnston. ASUAG then refused to sell Statek to TCI II unless the BAI debt was repaid. ASUAG also made the repayment of the BAI debt a condition precedent to the sale in the February 16, 1984 agreement whereby Statek was sold to TCI II for $1,350,000.

As a consequence of ASUAG's position, it became necessary for Johnston and Vendel to raise a total of $1,585,800, $1,350,000 of which was the purchase price for Statek and $235,800 of which represented the payment of the defaulted BAI debt. That amount was raised in the following way: (i) Vendel invested $250,000 in TCI II, (ii) Johnston and certain Johnston Entities paid $335,800 to TCI II, and (iii) TCI II borrowed the $1 million balance from the Bank of America. The BAI debt was paid on February 27, 1984 when Johnston (through one of his Entities, TVI) paid $235,800 to TCI II, which then wrote a check to SSIH, which then assigned the BAI obligation to TCI II. Two days later, on February 29, 1984, the Statek transaction closed, with the $1,350,000 purchase price being injected into TCI II, which then paid over that amount to ASUAG.

A critical issue in the §225 action was whether the funds Johnston invested in TCI II were equity risk capital, debt, or a combination of both. The Court found that at most, $100,000 of Johnston's $335,800 was risk equity capital, because $235,800 had been repaid to Johnston in the years following the acquisition, leaving at most $100,000 of his contribution that

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[30]*Technicorp International II v. Johnston*, C.A. No. 15084 at 17-18, 46-48.

[31]BAI was a subsidiary of TVI, another entity that Johnston owned.

(it could be argued) was equity. That finding, however, rested on the assumption that TCI II -- and not Johnston -- was legally responsible for the BAI debt. As a result, Johnston's infusion of the amount of the BAI debt ($235,800) into TCI II could be regarded as equity.

The plaintiffs contended, however, that Johnston was legally responsible for that debt and had used TCI II as a conduit to pay that debt to create a pretext to credit Johnson's $235,800 payment as his equity contribution. The Court did not resolve that issue in the §225 action, because it was unnecessary: under any scenario Vendel would be the majority stockholder of TCI II. The plaintiffs' two arguments in this case flow from this background. The first argument is that the unresolved BAI issue should now be resolved in plaintiffs' favor, because the evidence shows that Johnston was legally responsible for the BAI debt, for which reason the Court's assumption in the §225 action -- that the BAI debt was properly an obligation of TCI II -- was incorrect. The second argument, which is distinct from and unrelated to the BAI debt issue, is that Johnston's entire $335,800 contribution was booked as a loan to TCI II and was later repaid to him, and as a result, Johnston has no investment "at risk;" i.e., has no "equity capital," in TCI II.

These arguments are now considered.

B. The BAI Debt Argument

As framed by the parties, the issue posed is whether the BAI debt was a debt of Johnston at the time the debt was repaid to SSIH using the $235,800 that Johnston had injected into TCI II. If the BAI debt was a debt of Johnson, then it is conceded that the $235,800 should not be credited as Johnston's equity capital contribution.

The plaintiffs insist that the record establishes that the BAI debt was Johnston's debt. The defendants respond that none of the evidence upon which plaintiffs rely establishes that Johnston was the debtor, and that the evidence establishes that the debtor was BAI. Moreover, defendants argue, (i) by 1984 that debt had become unenforceable because the applicable period of limitations had expired, and (ii) the BAI debt was paid only because SSIH (ASUAG) had exerted leverage as the owner of Statek by refusing to sell Statek unless the (otherwise uncollectible) debt was paid at or before the closing on the Statek purchase. Despite the apparent inequity of the result, I conclude that the defendants' position is correct.

There is no evidence that the party legally obligated to pay the BAI debt was anyone other than BAI. Although Johnston controlled BAI, the plaintiffs have not shown any basis to pierce BAI's corporate veil. Furthermore, the plaintiffs do not dispute that the period of limitations on the

BAI debt had expired by February, 1984. As a consequence, the insistence by SSIH (ASUAG) that the BAI debt be repaid in order for the Statek sale to go forward, is not unlike a seller of a parcel of land, shortly before closing, arbitrarily increasing the purchase price as a condition to close the sale. In those circumstances the purchaser has a choice: either accede to the price increase or litigate a breach of contract claim against the seller. In this case Johnston and TCI II chose to accede. And although the party who was ultimately responsible for the breach of the contract with SSIH (Johnston, BAI's controlling stockholder) repaid the debt with his own funds, he benefited from doing that by causing his payment to count as a credit towards his equity capital contribution.

Admittedly, some inequity inheres in that outcome. Had Johnston caused BAI to pay its debt to SSIH when it came due, the additional $235,800 cost to acquire Statek would not have been incurred and Johnston would have received no $235,800 capital contribution credit. Indeed, only by investing an additional $235,800 into TCI II could Johnston receive a capital contribution credit in that amount. Thus, by allowing BAI to default on the debt, Johnston received credit for a $235,800 capital contribution -- a credit that he would not otherwise have obtained.

That inequity is what drives the plaintiffs' effort to reduce Johnston's capital by $235,800. While plaintiffs' effort strikes a sympathetic chord in the equitable and moral sense, their argument is problematic in the legal sense. Although Johnston's conduct did cause BAI to breach its contract, and although that conduct might give rise to a claim by Vendel for damage relief against Johnston, the plaintiffs have not shown that depriving Johnston of his $235,800 equity contribution would be a legally proper remedy for that claim.

The foregoing analysis assumes (and the record does show) that at the time Statek transaction closed, Johnston never told Vendel the nature and origin of additional $235,800 payment, and that after the closing Vendel discovered that additional payment represented a debt Johnston should have caused BAI to pay years before. In those circumstances Vendel (and perhaps TCI II) could have validly claimed that they were defrauded, because Vendel would have never have consented to giving Johnston credit for a $235,800 capital contribution. To remedy that wrong, Vendel could have sought to rescind the entire TCI II business relationship by dissolving the corporation and distributing its assets to the shareholders. Alternatively, if he elected to allow the business relationship to continue, Vendel could have caused TCI II to sue Johnston -- derivatively before 1996 and directly thereafter -- to recover $235,800 as restitution for unjust enrichment. The latter remedy would have been the equivalent of allowing his original $235,800 capital contribution credit to stand, but requiring Johnston to