COURT OF CHANCERY
OF THE
STATE OF DELAWARE

STEPHEN P. LAMB
VICE CHANCELLOR

New Castle County Court House
500 N. King Street, Suite 11400
Wilmington, Delaware 19801

Submitted: January 13, 2009
Decided: January 13, 2009

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RE: General Video Corp. and Audeo LLC v. Emery Kertesz, Daniel Solin, Pro Acoustics LLP and ProAcoustics Ltd.
C.A. No. 1922-VCL

Dear Counsel:

I have reviewed and considered the briefs filed by the parties, as well as the oral argument in connection with the defendants' motion for award of attorneys' fees and expenses. For the reasons set forth below, the court will deny the defendants' motion.

I.

In American jurisprudence, unlike in the English system, the rule is that parties are responsible for their own litigation expenses, absent exceptional circumstances warranting otherwise.[1] Of the small set of special circumstances which have been held to constitute exceptions to the American Rule, only one of them is potentially applicable in the instant case: the so-called "bad faith exception."[2] "To award fees under the bad faith exception, the party against whom

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[1] *See, e.g.*, *Barrows v. Bowen*, 1994 WL 514868, at *1 (Del. Ch.); *see also Alyeska Pipeline Servs. Co. v. Wilderness Soc'y*, 421 U.S. 240, 248-50 (1975).
[2] *See Barrows*, 1994 WL 514868, at *1-2; *accord Arbitrium (Cayman Islands) Handels AG v. Johnston*, 705 A.2d 225, 231 (Del. Ch. 1997).

the fee award is sought must be found to have acted in *subjective* bad faith."[3] A finding of bad faith involves a higher standard of proof than is normally required in civil actions—"clear evidence."[4]

The plaintiffs' claims failed, as a whole, as matters of fact, not law. Although the facts underlying many of the allegations in the complaint turned out not to be as alleged, the plaintiffs could have had a subjective good faith belief in those allegations at the time that the complaint was filed.[5] Obviously, not every lawsuit which fails as a question of fact constitutes bad faith. To hold otherwise would make bad faith the exception that swallows the American Rule. Thus, the simple fact that the plaintiffs' allegations were disproven at trial is not itself clear evidence of bad faith.

The only colorable argument the defendants make with respect to bad faith on the part of the plaintiffs is with regard to the 1995 Non-Compete Agreement. Although the "court conclude[d] that Korn's version of events is a fabrication, and that the 1995 Non-Compete Agreement is therefore not authentic," that conclusion was made in the context of deciding an action in which Korn had the burden of proof. Thus, even though the court was ultimately incredulous as to Korn's account (and therefore found that the 1995 Non-Compete Agreement was not supported by sufficient evidence to deem it authentic), this is not equivalent to a finding based upon clear evidence that the document was forged. There is not sufficient evidence for such a finding, and in fact no positive evidence of its falsity was ever offered.

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[3] *Arbitrium*, 705 A.2d at 232 (citing *Chambers v. NASCO*, 501 U.S. 32, 47 n.11 (1991)).
[4] *Id.* (citing *Chambers*, 501 U.S. at 44); *see also Batson v. Neal Spelce Assocs., Inc.*, 805 F.2d 546, 550 (5th Cir. 1986) (requiring a "stringent" standard for a finding of bad faith); *Sierra Club v. U.S. Army Corps of Eng'rs*, 776 F.2d 383, 390 (2d Cir. 1985) (requiring "clear evidence" that party's claims were without color and brought for an improper purpose in order to invoke the bad faith exception).
[5] For example, the claims based on breach of fiduciary duty centered on when exactly Kertesz resigned as an officer and director of General Video. Although the court ultimately concluded that his resignation was effective prior to any of the acts that might have given rise to liability, there was not insignificant *bona fide* evidence adduced at trial by the plaintiffs that could have proven otherwise.

II.

The defendants also seek to pierce the corporate veil of General Video and Audeo, such that any award of attorneys' fees would be equally enforceable against Korn personally. At oral argument the court questioned defendants' counsel how, hypothetically, the court could enter a judgment against a non-party to the suit. Defendants' counsel suggested that Rule 21 of the Court of Chancery Rules permit the court to join additional parties *sua sponte* when it appears to the court that the non-joined parties are the real parties in interest (citing the opinion which characterized Korn as such). This suggestion, however, completely misinterprets the purpose of Rule 21. As one of the two cases cited by defendants' counsel stated, "[t]he purpose of the rule is to eliminate the serious consequences of nonjoinder or misjoinder of parties which existed at common law. Thus, an indispensable party to a lawsuit, either plaintiff or defendant, may be added at any stage of the proceeding . . . ."

A brief perusal of the cases offered by defendants' counsel illustrates the point. In *Diner Foods, Inc. v. City of Dover*,[6] the plaintiff had entered into a contract with the defendant obligating the plaintiff to install a water main. In exchange, the defendant obligated itself to collect and pay to the plaintiff all fees received for tapping into that water main for the 10-year life of the contract. Six years into the 10-year term, the plaintiff assigned its rights under the contract to another party. Three years later, the plaintiff brought an action to enforce the terms of the agreement. During the course of hearing the case, the assignment came to light, and the defendant moved to dismiss the action because it had not been instituted by the real party in interest. The plaintiff then moved to join the assignee as a plaintiff under Rule 21. The Vice Chancellor mistakenly treated the plaintiff's motion as a motion to substitute party plaintiffs under Rule 25(c), and denied the motion and dismissed the case. The Supreme Court, reversing the Court of Chancery, remanded with instructions to add the assignee as a plaintiff and proceed with the case. The court found Rule 21 to codify a practice which "has been followed in the Court of Chancery for a long period of time."[7] The court thus availed itself of Rule 21 in order to avoid the unfortunate consequence that the action be dismissed for failure to join an indispensable party.

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[6] 229 A.2d 495 (Del. 1967).
[7] *Id.* at 496 (citing *Hunter v. McCarthy*, 36 A.2d 261 (Del. Ch. 1944)).

In *Hunter v. McCarthy*, the plaintiff had, as agent for a non-party, entered into a contract for the purchase of certain real property from the defendant. The defendant balked when it came time to convey the property, and the plaintiff instituted an action for specific performance. Because a suit in equity cannot be maintained without the real interested person (which does not include a mere agent who makes a contract in his own name for the sole benefit of another) being a party, the Chancellor permitted the plaintiff to amend his pleadings to join the principal as a party rather than dismissing the suit.

Here, Korn is not an indispensable party at all. In fact, the claims brought by the plaintiffs are claims belonging to General Video and Audeo. The court characterized Korn as the "real party in interest" not in a technical legal sense, but rather by way of recognizing that any recovery by the corporate plaintiffs really only stands to benefit him. Because Korn is not an indispensable party, the court does not have resort to Rule 21 as a means to join him.

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For the foregoing reasons, the defendants' motion for the award of attorneys' fees is DENIED. The defendants, as the prevailing parties, are entitled to recover their costs in accordance with Court of Chancery Rule 54(d). IT IS SO ORDERED.

/s/ Stephen P. Lamb
Vice Chancellor