

IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

ZVI LEVINHAR, GILEAD ASSEO,
MICHAEL COHEN-ALLORO, AND
DAVID HAITIN,

Petitioners,

v.

MDG MEDICAL, INC., 4202
CORPORATION, LSKW INVESTMENTS, LP,
MARK SAFFRAN, STEVEN SCHNEIER,
KEN TAUBER, MICHAEL SIEGEL, AND
JACOB SCHUSTER,

Respondents.

C.A. No. 4301-VCS

MEMORANDUM OPINION

Date Submitted: August 31, 2009

Date Decided: November 24, 2009

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Saffran, Steven Schneier, Ken Tauber, Michael Siegel, and Jacob Schuster.*

STRINE, Vice Chancellor.

I. Introduction

The founders of a company, MDG Medical, Inc., sought capital from new investors to fund the company's growth. In connection with the capital infusions, the founders and new investors forged a stockholders agreement (the "Stockholders Agreement") that entitled the founders, who held common stock, to appoint two board members (the "Common Stock Directors"), despite the fact that the new investors purchased sufficient shares to obtain majority voting control over the company. Over time, as they continued to put capital into the company, the new investors apparently grew reluctant to invest more money in MDG Medical, Inc. while continuing to allow the founders to control two board seats.

Therefore, coincident with approving a new round of funding, a majority of the MDG board approved an amendment to the certificate of incorporation that eliminated the right of the founders to appoint the two Common Stock Directors, and the investors purported to approve this certificate amendment using only their own voting power. The founders then sued in Israel protesting this maneuver and arguing that their rights to appoint the Common Stock Directors could not be eliminated by a certificate amendment to which they did not consent. After negotiations with the defendants in the Israeli action, that action was dismissed, and two of the founders — the two who had sat as Common Stock Directors on the MDG board — brought an action in this court under 8 *Del. C.* § 225 (the "Section 225 Action") arguing that their ouster from the board was wrongful.

Expedited proceedings and a trial were scheduled. Before the trial occurred, the MDG board majority elected by the new investors changed course. Purporting to rescind the challenged certificate amendment, the MDG board restored the status quo but then almost immediately acted to approve a merger of MDG into a successor corporation. Under the terms of the certificate of incorporation for the successor corporation, the founders did not have the right to appoint two members to the successor corporation board or have other rights granted to them by the Stockholders Agreement.

Rather than amending their complaint to challenge the merger itself or the failure of the successor corporation to recognize the founders' continuing right to appoint two directors, the founders settled the Section 225 Action by agreeing to dismiss the case with prejudice in exchange for the new investors' agreement to pay certain of the founders' attorneys' fees. The founders agreed to dismissal of the case despite their belief that the merger was wrongful because it was inequitably and solely motivated by a desire to deprive the founders of their contractual rights, and despite their contention that the terms of the Stockholders Agreement providing them with the right to appoint the two Common Stock Directors were as binding on the successor corporation as they were on the original MDG entity. By their own admission, the founders realized that they would have to prove those contentions in the pending Section 225 Action and they preferred not to do that. Instead, they settled the case.

Then, a couple of months later, the founders brought this action. One of the claims they assert is not controversial. The merger had accorded stockholders appraisal rights, and the founders are exercising them. The defendants to this action, who include the new investors who were parties to the founders' Israeli lawsuit and the Section 225 Action, do not challenge that claim. What the defendants do challenge is the founders' claims for breach of the Stockholders Agreement and breach of fiduciary duty, all of which depend on the notion that the merger wrongfully deprived the founders of their rights under the Stockholders Agreement — particularly the right to select two board members.

Because these claims could and therefore should have been pressed in the prior Section 225 Action, I grant the defendants' motion for judgment on the pleadings as to those claims on grounds of *res judicata*. Having forsaken the chance to make and present at an expedited trial in the Section 225 Action the argument that they were entitled to an ongoing presence on the MDG board, either because the merger was inequitable and should be rescinded or because the rights in the Stockholders Agreement survived the merger and applied to the successor MDG board, the founders cannot now avoid the consequences of the final judgment by bringing a later lawsuit. All of the founders' claims except for their appraisal claim will be dismissed.

II. Factual Background

The facts are drawn from the pleadings, the documents incorporated in the founders' complaint, and the record in the prior Section 225 Action.¹

A. The Parties

In 2001, plaintiffs Zvi Levinhar, Gilead Asseo, Michael Cohen-Alloro, and David Haitin (collectively, the "Founders") created MDG Medical, Inc. ("MDG I") for the purposes of exploiting computer technology they had developed that helps hospitals control drug distribution to patients. All of the Founders were common stockholders in MDG I, and Levinhar and Asseo were the two Common Stock Directors of MDG I.

Shortly after establishing MDG I, the Founders sought funding from outside investors to grow the company. In 2001 and 2002, LSKW Investments, a Delaware limited partnership, invested \$2.5 million in MDG I in exchange for shares of Class A and Class B preferred stock. In 2004, defendant 4202 Corporation, an investment group incorporated in Delaware and primarily managed by defendant Jacob Schuster, agreed to inject approximately \$10 million of additional funding into MDG I in exchange for Class B preferred shares. In 2005, 4202 Corporation invested an additional \$10 million for newly-issued Class C preferred stock. As a result of these infusions, 4202 Corporation became MDG

¹ See, e.g., Petition for Declaratory Judgment, Levinhar v. MDG Medical, Inc., No. 3889-VCS (Del. Ch. Jul. 14, 2008) (the "Section 225 Petition").

I's majority shareholder, and the preferred stockholders had sufficient voting power to control stockholder votes.²

B. The Stockholders Agreement

In connection with the new investors' investments in MDG, the Founders and the new investors, who all held preferred stock, entered into a stockholders agreement that ameliorated, to some extent, the loss of voting clout suffered by the Founders as a result of the new infusions of capital. Section 5(a) of the Stockholders Agreement required all of the stockholders to vote all of their shares in favor of two directors nominated by the common stockholders — *i.e.*, the Founders.³ Using this provision, the Founders appointed Zvi Levinhar and Gilead Asseo, who were then elected to MDG I's board of directors. Under the terms of the Stockholders Agreement, the holders of preferred stock had the right to appoint the remainder of MDG I's directors (the "Preferred Stock Directors").⁴ The Preferred Stock Directors were defendants Mark Saffran, who was also the CEO of MDG I, Steven Schneier, Ken Tauber, Michael Siegel, and Jacob Schuster (collectively, with 4202 Corporation and LSKW Investments, the "New Investors").⁵

² After issuance of the Class C Preferred stock, 85% of the total voting stock in MDG I was in the form of preferred stock. Because 4202 Corporation held the majority of this preferred stock and also a majority of the total voting stock, it was MDG I's majority shareholder. Pet. ¶ 20.

³ Res.' Op. Br. Ex. A § 5(a) (hereinafter the "Stockholders Agreement").

⁴ *Id.*

⁵ Petitioner Levinhar also held a small amount of shares of Class B preferred stock in MDG I. For simplicity's sake, any references to "preferred stockholders" will only include the New Investors and not Levinhar, who is a Founder.

The Stockholders Agreement also contained certain anti-dilution protections for the Founders. These provisions ensured that the Founders' collective ownership percentage of MDG I stock would not fall below 5% of MDG I's outstanding shares, unless MDG closed an IPO of its common stock at a certain value or MDG I achieved a valuation of at least \$80 million as measured by specific contractual criteria.⁶ The Stockholders Agreement stated that the anti-dilution provisions were to survive termination of the Agreement:

This Article 7 shall survive termination of this Agreement and shall not be amended, modified or waived unless such modification, amendment or waiver is approved in writing by the majority in interest of the Common Stock held by the Founders and the majority interest of the Preferred Stock held by the Company's Preferred Stockholders.⁷

⁶ The relevant provisions state in full:

7.1 Until the earlier of (i) an IPO (ii) an M&A or (iii) such time that the Company shall reach a valuation of at least US \$80,000,000, to be determined either by (a) an investment to be made of no less than \$3,000,000 by external investors or by (b) a good faith resolution of the Board, the aggregate percentage holding represented by all the Common Stock held by the Founders as of the date hereof shall not be reduced to less than 5% of all of the Company's then outstanding shares on a fully diluted basis ("Minimum Percentage").

7.2 Upon the occurrence of an event which will cause the aggregate Common Stock held by the Founders to be reduced to less than 5% of all the Company's then outstanding shares on a fully diluted basis, the Company will issue the Founders, for no consideration, additional shares of Common Stock, to be divided between them on a pro-rata basis, in an amount which will cause the aggregate percentage holding represented by the Common Stock held by the Founders to be equal to 5% of all the Company's outstanding shares on a fully diluted basis following such issuance.

Stockholders Agreement §§ 7.1-7.2.

⁷ *Id.* at § 7.5.

Finally, the Stockholders Agreement also included a successor provision that provided in relevant part that “this Agreement shall be binding upon and inure to the benefit of the parties hereto and their respective successors, estates, heirs, legal representatives and permitted assigns and transferees.”⁸ But, the Stockholders Agreement did not contain any express terms addressing what rights, if any, were to continue under the Agreement in the event that MDG engaged in a merger in which it was not the surviving corporation.

C. Origins Of The Present Dispute

In late 2007, MDG I needed another round of financing. The New Investors, particularly 4202 Corporation, apparently did not wish to continue pouring funds into MDG I without greater control over the MDG board. Therefore, 4202 Corporation and Mark Saffran put together a financing package that proposed amending MDG I’s certificate of incorporation as a condition to further financing. The proposed amendment to the certificate of incorporation reduced MDG I’s board from seven to five directors, three of whom would be designated by the preferred stockholders,⁹ one of whom would be MDG I’s CEO, and one of whom would be an industry expert appointed by the board. Because the board would appoint the CEO, and because under the terms of the proposed plan the board would also appoint the industry expert, this financing plan meant

⁸ *Id.* at § 11.6.

⁹ In particular, the holders of Class D preferred stock would have the right to elect two directors, and the holders of Class C preferred stock would have the right to elect one director. Section 225 Petition Ex. A. § 8.

that the New Investors, either directly or through their majority representatives on the board, would also have strong influence over all of MDG I's directors. As a result of these proposed changes, the Founders' right to appoint Common Stock Directors under the Stockholders Agreement would be eliminated. Therefore, the Founders' viewed this financing proposal as an attempt to make them "second class citizens" within the company.¹⁰

Under these terms, 4202 Corporation and an unrelated outside investor, Emigrant Capital Corporation,¹¹ were prepared to provide MDG I with additional financing in exchange for Class D preferred stock with voting rights. At a meeting held on January 31, 2008, the MDG I board considered this financing package. A majority of the board approved the package, the amendment to MDG I's certificate of incorporation, and the issuance of the Class D preferred stock. Founders Levinhar and Asseo abstained from the vote.

Because the financing package approved by the board included changes to MDG I's certificate of incorporation and the Stockholders Agreement, stockholder approval was necessary to implement the financing plan. On February 5, 2008, the package that had been approved by the board was sent to the stockholders for approval. The New Investors, using their majority voting power, voted in favor of the financing package and therefore purported to approve the issuance of the Class D preferred stock and the amendment to MDG I's certificate of incorporation.

¹⁰ Pet. ¶ 21.

¹¹ Emigrant Capital Corporation was not named as a party in either the present suit or the Section 225 Action.

But, because of the proposed revision to MDG I's certificate of incorporation that the financing packaged required, which reduced the size of the board to five members and eliminated the Founders' right to designate the two Common Stock Directors, the Founders refused to vote their common shares in favor of the financing package. The certificate amendment therefore did not receive approval by a majority of the common stockholders, when considered separately as a class.

On February 18, 2008, another meeting of MDG I's board of directors was held. At that meeting, a majority of the board voted to terminate those provisions of the Stockholders Agreement that were inconsistent with the approved revision to the certificate of incorporation, including the provisions granting the Founders the right to appoint two Common Stock Directors to the board. Levinhar and Asseo dissented again. Nonetheless, the board majority acted as if the proposed certificate amendment had received all the necessary approvals and, despite the Founders' protests, filed the revised certificate of incorporation (the "February Restated Certificate of Incorporation") and issued the Class D preferred stock. On March 6, 2008, the New Investors reconstituted the board to include only Siegel, Schuster, and Saffran, and removed Levinhar and Asseo.¹²

On March 3, 2008, all four of the Founders filed an action in Israel (the "Israeli Action") seeking (1) a declaration that the New Investors had breached the Stockholders Agreement by eliminating the Founders' right to appoint the Common Stock Directors and (2) a declaration that the Founders' right to appoint

¹² Respondents Schneier and Tauber had already resigned from the board by this time.

two directors to MDG I's board could not be eliminated without the approval of MDG I's common stockholders.

But, on July 10, 2008, the four Founders voluntarily dismissed their Israeli Action after they agreed with the New Investors that the Founders would apply to the Delaware Court of Chancery for a decision on the Founders' right to designate Common Stock Directors under the Stockholders Agreement.¹³ The two Founders who had been ousted from the MDG board — Levinhar and Asseo — then filed the Section 225 Action in this court on July 14, 2008. In their petition for the Section 225 Action, these two Founders challenged the February Restated Certificate of Incorporation on the grounds that it (1) was not approved by the common stockholders as required under 8 *Del. C.* § 242 and (2) improperly eliminated the Founders' contractual right under the Stockholders Agreement to appoint two directors to MDG I's board. The Section 225 Action was filed by the same lawyers who had represented the Founders in the Israeli Action.¹⁴ Expedited proceedings for the Section 225 Action were scheduled, with a trial to be held on November 20, 2008.¹⁵

Realizing that the amendment contained in the February Restated Certificate of Incorporation was likely invalid because it did not receive approval from a majority of MDG's common stockholders, the New Investors changed

¹³ Section 225 Petition ¶ 18.

¹⁴ *See id.*

¹⁵ *See Levinhar v. MDG Medical, Inc.*, No. 3889-VCS (Del. Ch. Aug. 12, 2008) (ORDER) (scheduling trial on an expedited schedule).

tactics. On September 25, 2008, a special telephonic board meeting was held. It is unclear in the record, but it appears that Levinhar and Asseo were given notice of this board meeting and invited to participate as if they were still directors.¹⁶ At that meeting, the board majority — *i.e.*, the Preferred Stock Directors — approved filing a certificate of correction declaring the February Restated Certificate of Incorporation null and void, and, subsequently, approving a new revised certificate of incorporation (the “September Restated Certificate of Incorporation”). The September Restated Certificate of Incorporation restored the Founders’ right to appoint two Common Stock Directors.

But, the restoration of the Founders’ right to appoint members to the board was short-lived because, at that same meeting, the Preferred Stock Directors also authorized the merger of MDG I with and into a newly-formed Delaware shell corporation, MDG Merger Corp., consistent with a fully-baked Merger Agreement

¹⁶ The record does not explicitly indicate that Levinhar and Asseo were given notice of the meeting and invited to participate. But, the Founders’ petition in this action contains the following paragraph that suggests this was the case:

[O]n September 24, 2008 MDG I notified the Board of a meeting to take place the next day at which the Board would be asked to void the original Sixth COI, authorize a new Sixth COI that would include provisions under which the common stock would designate two directors to the Board, a stockholders’ consent that purported to elect Levinhar and Asseo to the Board (despite the fact that Levinhar and Asseo claimed that they remained on the Board because they had never resigned or been removed legally), and then immediately approve a merger (the “Merger”) into another company that had just been formed by MDG I for the purpose of eliminating both the common stockholders’ right to designate two directors to the Board and the Anti-Dilution Provisions.

Pet. ¶ 36. For the Founders to know that (1) the meeting was to be held the following day and (2) the purpose of the meeting, I presume that they were given notice of the meeting. Because the Common Stock Directors were briefly returned to their board positions at that meeting, I further assume that they were invited to participate as directors.

that apparently was presented at the meeting without any previous notice or distribution to the Founders. Although it is not clear in the record, Levinhar and Asseo presumably dissented or at least abstained from the vote to approve the Merger Agreement.

The terms of the Merger Agreement essentially gave each MDG I stockholder one share of the equivalent class of stock of the surviving corporation (“MDG II”) for each share they held in MDG I. But, the Merger Agreement provided that the certificate of incorporation of the surviving corporation, MDG II, would not include any right on the part of the common stockholders to designate two directors. Instead, the directors would be elected by a majority of the voting power of the corporation. Furthermore, the Merger Agreement did not contemplate the survival of the anti-dilution protections in the existing Stockholders Agreement. If stockholders were dissatisfied with that consideration, they were given the option to seek appraisal.

Using their voting power, the New Investors approved the merger at the September 25, 2008 meeting. Apparently, the common stockholders were not asked to vote on the merger. Upon completion of the merger that day, MDG I ceased to exist, the surviving corporation dropped the name MDG Merger Corp. to assume the original name of MDG Medical, Inc., and all of MDG I’s stockholders became shareholders of MDG II. Following the merger, a new stockholders agreement was executed among the New Investors, which did not include any of

the Founders as signatories. The new stockholders agreement did not include any special voting rights or anti-dilution provisions for the common stockholders.

After the merger, the Founders did not seek to amend their complaint in the Section 225 Action to challenge the new method by which the Common Stock Directors were removed from the board. This is despite the fact that the Founders believed that, because of the successor provisions in the contract, the Stockholders Agreement survived the merger and entitled Levinhar and Asseo to seats on the board of MDG II. That is, the Founders viewed the contractual rights provided by the Stockholders Agreement as binding upon the stockholders of MDG II. Indeed, the Founders believed that the merger itself was inequitable and invalid if these protections were not continued — a belief that, if pressed successfully, could have buttressed a request to rescind the merger.¹⁷ But, by their own admission, the Founders realized that the New Investors would not agree with them and that they would have to prove their entitlement to be directors of MDG (either MDG I or

¹⁷ Other grounds to challenge the merger existed. For example, Levinhar and Asseo could have argued that it was inequitable for the Preferred Stock Directors to restore them to the board and then immediately present Levinhar and Asseo with a fully executed Merger Agreement for their consideration without giving them any prior notice or opportunity to review the terms of the agreement before the meeting. Likewise, it is easy to conceive of straightforward equitable arguments against the merger if, as the Founders allege, there was no good faith reason to implement the merger. This is, of course, not to suggest that such good faith reasons might not have justified the merger given MDG's undisputed need for additional capital, but simply to illustrate that the Founders had various theories available to them before they resolved the Section 225 Action to seek the restoration of the Common Stock Directors to the MDG board. These include theories asserting that the merger was invalid or inequitable and should be rescinded, restoring the effectiveness of the Stockholders Agreement.

MDG II) in the Section 225 Action.¹⁸ Rather than incur the costs of litigating over that matter, the Founders chose to settle the Section 225 Action in return for the majority of the attorneys' fees they had accrued. The Founders described their motivation for settling the Section 225 Action as follows:

[I]t was evident to [the Founders] that they would not be able to get the common stockholders' right to designate directors established in MDG II without litigation and, unless the common stockholders had board representation, they would have to fund any litigation to enforce their rights themselves.

[The Founders] were faced with a similar dilemma with respect to the Anti-dilution Provisions [in the Stockholders Agreement]. While [the Founders] believed that the Anti-dilution Provisions survived the Merger and were binding on MDG II, it was evident that the controlling stockholder and management did not agree with that view. Indeed they had created MDG II and effected the Merger in significant part to eliminate the Anti-dilution Provisions. Thus, [the Founders] realized that they would have to litigate to preserve their rights under the Anti-dilution Provisions.¹⁹

Therefore, the Founders eschewed the chance to go to trial as scheduled in the pending Section 225 Action and decided to dismiss the Section 225 Action *with prejudice*. A stipulated order dismissing the case with prejudice was executed on December 29, 2008 in accordance with the settlement.

¹⁸ Pet.'s Ans. Br. 11 (“[The Founders] had learned that it would take litigation to force the [New Investors] and management to comply with the law.”).

¹⁹ *Id.* at 12; *see also* Pet. ¶ 41 (stating that “[the Founders] would have to fund any litigation to enforce their rights themselves.”); *Id.* ¶ 43 (admitting that “if [the Founders] accepted the Merger and became stockholders of [MDG II], they would likely have to litigate again to maintain those rights in the future”).

D. The Founders File An Appraisal Case But Also Seek To Resurrect Their Claims Regarding The Deprivation Of The Common Stockholders' Right To Appoint Directors Of MDG

The Founders filed the present action on January 21, 2009, seeking in Count I of their complaint appraisal of the value of their shares in MDG II and naming MDG II as the respondent to that count. That count is uncontroversial because the merger explicitly gave common stockholders the right to seek appraisal rather than accept shares in MDG II in exchange for their MDG I shares.

Surprisingly, however, the Founders' complaint also contains counts against several other parties as defendants that all depend on the assertion that the rights belonging to the MDG common stockholders under the Stockholders Agreement were wrongfully eliminated in the merger. Counts II and III of the complaint claim that the New Investors, by effecting the merger, breached the express and implied terms of the Stockholders Agreement. Count IV alleges that the Preferred Stock Directors breached their fiduciary duties by approving a merger designed only to eliminate the rights granted to the common stockholders by the Stockholders Agreement. Count V seeks to hold Mark Saffran and 4202 Corporation accountable for tortiously interfering with the Stockholders Agreement. That is, Counts II through V are simply different theories for remediating the same alleged harm: that the Founders incurred damages when the New Investors eliminated both their right to appoint two directors to MDG I's board and the protection of the anti-dilution provisions in the Stockholders Agreement. I refer to these claims as the "Resurrected Claims" because they are

all claims based on facts that were known before the dismissal of the Section 225 Action.

The New Investors move for a partial judgment on the pleadings, which would dispose of the Resurrected Claims but not the demand for appraisal, based upon a number of grounds.²⁰ Because I can resolve the motion by addressing the New Investors' *res judicata* argument alone, I focus my analysis on that issue.

²⁰ In their briefing, the New Investors also argue that that the contract-related counts should be rejected under *Shields v. Shields*, 498 A.2d 161 (Del. Ch. 1985) (finding a shareholders agreement “moot” upon consummation of a stock-for-stock merger). They also argue with substantial force that the Founders’ decision to give up their MDG II shares and seek appraisal prevents them from asserting claims premised on the idea that they continue to be MDG stockholders. Having had the chance to remain as MDG II stockholders and having forsaken it to seek appraisal, the Founders, say the New Investors, have elected their remedy. This seems to be a sound argument in the context of a stock for stock merger when the appraisal petitioner has had the chance to remain a stockholder and seek to preserve its existing rights. Admittedly, *Rabkin*, *Cede*, and their progeny, which allow appraisal litigation to be prosecuted concurrently with an action challenging a merger based on breaches of fiduciary duty, can be read as cutting against this notion. See *Rabkin v. Philip A. Hunt Chem. Corp.*, 498 A.2d 1099 (Del. 1985); *Cede & Co. v. Technicolor, Inc.*, 542 A.2d 1182 (Del. 1988). But, the *Rabkin* line of cases involves cash-out mergers in which the departing stockholder had no option to remain and fight for her pre-existing rights. See *Wood v. Best*, 1999 WL 504779, at *6 (Del. Ch. Jul. 9, 1999) (“The current state of our corporation law is that where, as here, *cashed out* minority shareholders have plead facts sufficient to indicate a breach of fiduciary duty, which they seek to bring against not only the surviving corporation but against individual directors or majority shareholders as well, the plaintiffs need not demonstrate inadequacy of the appraisal remedy to survive a motion to dismiss.”) (emphasis added). The disputes in both *Rabkin* and *Cede* themselves involved a cash-out merger, which forced the dissenting minority shareholders to choose between taking the cash offered in the merger and demanding the fair value of their stock as determined through an appraisal proceeding. *Rabkin*, 498 A.2d at 1100; *Cede*, 542 A.2d at 1185. In any event, I need not and do not resolve whether either of these two additional arguments is correct.

III. Legal Analysis

A. The Standard For Judgment On The Pleadings

Under Court of Chancery Rule 12(c), “[a]fter the pleadings are closed but within such time as not to delay the trial, any party may move for judgment on the pleadings.” A grant of judgment on the pleadings is appropriate when, “accepting as true all of the non-moving party’s well-pleaded factual allegations, ‘there is no material fact in dispute and the moving party is entitled to judgment as a matter of law.’”²¹ The court may consider the unambiguous terms of exhibits attached to the pleadings and those incorporated into them by reference.²² “A trial court need not blindly accept as true all allegations, nor must it draw all inferences from them in [the non-moving party’s] favor unless they are reasonable inferences.”²³ If, after these principles are applied, there is no material question of fact and the movant is entitled to judgment as a matter of law, its motion will be granted.²⁴

²¹ *Interactive Corp. v. Vivendi Univ., S.A.*, 2004 WL 1572932, at *8 (Del. Ch. Jun. 30, 2004) (internal citations omitted).

²² *E.g., Rag Am. Coal Co. v. AEI Res., Inc.*, 1999 WL 1261376, at *9 n.33 (Del. Ch. Dec. 7, 1999).

²³ *Grobow v. Perot*, 539 A.2d 180, 187 n.6 (Del. 1988), *quoted in Werner v. Miller Tech. Mgmt., L.P.*, 831 A.2d 318, 327 (Del. Ch. 2003) *and West Coast Mgmt. & Capital, LLC v. Carrier Access Corp.*, 914 A.2d 636, 641 (Del. Ch. 2006).

²⁴ *See Desert Equities, Inc. v. Morgan Stanley Leveraged Equity Fund, II, L.P.*, 624 A.2d 1199, 1205 (Del. 1993). The Founders argue that a number of facts cited in the New Investors’ briefs are disputed. *See* Pet.’s Ans. Br. 13-16. But, upon reviewing the briefs, I find that none of the alleged factual questions are material. Rather, the Founders are quibbling with the New Investors’ characterization of facts ancillary to this case’s primary issues. Therefore, proceeding with a judgment on the pleadings is appropriate.

B. Res Judicata Precludes All Of The Founders' Resurrected Claims Except For Their Appraisal Claim

The Founders' Resurrected Claims are precluded under the doctrine of *res judicata* because the Founders could and therefore should have brought the Resurrected Claims as part of the Section 225 Action. The doctrine of *res judicata* forecloses a party from "bringing a second suit based on the same cause of action after a judgment has been entered in a prior suit involving the same parties."²⁵ The public's interest in promoting judicial efficiency and protecting defendants from repetitious litigation is the reasoning behind the doctrine.²⁶ *Res judicata* bars a subsequent action where: (1) the court adjudicating the prior action had proper jurisdiction; (2) the parties to both actions are either the same or in privity thereto; (3) the cause of action in the original action was the same as in the case at bar, or the issues necessarily decided in the prior action were the same as those that have been raised in the case at bar; (4) the issues in the prior action were decided adversely to the plaintiff in the pending case; and (5) the prior decree was a final judgment on the merits.²⁷

²⁵ *Betts v. Townsends*, 765 A.2d 531, 534 (Del. 2000). The U.S. Supreme Court gave the classic formulation over a century ago:

[T]he judgment, if rendered upon the merits, constitutes an absolute bar to a subsequent action. It is a finality as to the claim or demand in controversy, concluding parties and those in privity with them, not only as to every matter which was offered and received to sustain or defeat the claim or demand, but as to any other admissible matter which might have been offered for that purpose.

Cromwell v. County of Sac, 94 U.S. 351, 352 (1876).

²⁶ See *Malone Freight Lines, Inc. v. Johnson Motor Lines, Inc.*, 148 A.2d 770, 775 (Del. 1959) ("The fundamental basis of the doctrine of *res judicata*, and of its subsidiary rule, collateral estoppel, is that in the public interest a litigant may have one day in court but

Of these elements, the first, fourth, and fifth are easily satisfied here, and the Founders do not even bother to address them in their brief.²⁸ The first element is satisfied because this court obviously had jurisdiction over the Section 225 Action. The fourth element is satisfied because the issues in the prior action were decided against the Founders because a dismissal *with prejudice* (whether voluntary or involuntary) is an adverse decision against the Founders.²⁹ And the fifth element is satisfied because this court's order dismissing the Section 225 Action with prejudice is a final judgment for *res judicata* purposes.³⁰

The Founders did fairly contest whether the second and third elements were satisfied.³¹ I analyze those elements in turn now.

1. There Is Privity Between The Parties To This Action And The Section 225 Action

The second element of the *res judicata* analysis — whether the parties to both actions are either the same or in privity thereto — presents an issue in this

not two.”); *Williams v. Daisy*, 180 A. 908, 910 (Del. Super. 1935) (“[*Res judicata*] is primarily a rule of public policy, founded on a Latin maxim, adopted by the common law, which, when translated, means that it is to the interest of the state that there should be an end to litigation Another and subordinate rule . . . is also based on a Latin maxim adopted by the common law, and which, when translated, means that it would be a hardship on a person for him to be vexed twice for the same cause.”) (internal citations omitted).

²⁷ *Dover Historical Soc’y, Inc. v. City of Dover Planning Comm’n*, 902 A.2d 1084, 1092 (Del. 2006); *Bailey v. City of Wilmington*, 766 A.2d 477, 481 (Del. 2001); *Bradley v. Div. of Child Support Enforcement*, 582 A.2d 478, 480 (Del. 1990).

²⁸ See Pet.’s Ans. Br. 18-30 (discussing only whether the parties are in privity and whether the Resurrected Claims could have been brought in the Section 225 Action).

²⁹ See *Ingram v. 1101 Stone Assocs., LLC*, 2004 WL 691770, at *8 (Del. Super. Mar. 18, 2004); *Glaser v. Norris*, 1992 WL 14960, at *16 (Del. Ch. Jan. 6, 1992).

³⁰ See *Cordis Corp. v. Boston Scientific Corp.*, 431 F.Supp.2d 442 (D. Del. 2006); *Braddock v. Zimmerman*, 906 A.2d 776, 784 (Del. 2006).

³¹ See Pet.’s Ans. Br. 18-30.

case because some of the Founders who are petitioning the court in the present case were not named parties in the earlier Section 225 Action. Of the plaintiffs in the current action, only Levinhar and Asseo were parties in the Section 225 Action. Therefore, the Founders argue that *res judicata* does not apply here because the plaintiffs in the current action who were not part of the Section 225 Action — namely, Michael Cohen-Alloro and David Haitin — are not in privity with the Founders who were parties to the Section 225 Action.

That argument is unconvincing. Two parties are in privity where “the relationship between two or more persons is such that a judgment involving one of them may justly be conclusive on the others, although those others were not party to the lawsuit.”³² A critical factor for the privity analysis is whether the interests of a party to the first suit and the party in question in the second suit are aligned.³³ This court has noted that “a substantial identity of parties’ interests has been held to place two superficially separate parties in privity”³⁴ and that, at bottom, “the test

³² *Higgins v. Walls*, 901 A.2d 122, 138 (Del. Super. 2005) (citing 18 MOORE’S FEDERAL PRACTICE § 132.04[1][b] (3d ed. 2004)).

³³ *See Foltz v. Pullman, Inc.*, 319 A.2d 38, 41 (Del. Super. 1974) (“The concept of privity pertains to the relationship between a party to a suit and a person who was not a party but whose interest in the action was such that he [or she] will be bound by the final judgment as if he [or she] were a party.”), *overruled on other grounds by Messick v. Star Enter.*, 655 A.2d 1209 (Del. 1995); *see also Bradley v. Div. of Child Support Enforcement ex rel. Patterson*, 582 A.2d 478, 480 (Del. 1990) (citing *Foltz*, 901 A.2d at 41); 18 MOORE’S FEDERAL PRACTICE § 131.40[3][a], at 131-135 (3d ed. 2009) (“‘[P]arties’ as used in discussing the requirement for identity of parties as a basis for claim preclusion refers to parties in interest, *i.e.*, those parties whose *interests* are so closely aligned that a judgment against one should be preclusive as to all.”) (emphasis added).

³⁴ *Orloff v. Shulman*, 2005 WL 3272355, at *9 (Del. Ch. Nov. 23, 2005).

of privity is whether there is a ‘close or significant relationship between successive defendants.’”³⁵

Under this standard, it is obvious that the Founders who were not parties to the Section 225 Action are in privity with those Founders who were parties to the Section 225 Action. Cohen-Alloro and Haitin founded MDG I along with Levinhar and Asseo, and all four share identical interests as common stockholders. That identity of interest is not a subject of speculation; it is a matter of undisputed fact. The same quartet of Founders bringing the present action also brought the original Israeli Action. They agreed as a quartet to dismiss the Israeli action and pursue their claims in this court through the duet of Levinhar and Asseo, using the same counsel who represented them in the Israeli Action and the same counsel who represents them in this action.

Therefore, those Founders who were not named parties in the Section 225 Action are in privity with those Founders who were named.

In finding the privity factor satisfied, I also reject their argument that none of the Founders — including Levinhar and Asseo — are in privity with the plaintiffs in the Section 225 Action because Levinhar and Asseo say they brought that action only in their capacity as Common Stock Directors, not MDG stockholders, and that, by critical contrast, the Founders are parties to the current action in their stockholder capacity.

³⁵ *Id.* at *9 n.60 (citing *Goel v. Heller*, 667 F. Supp. 144, 150 (D.N.J. 1987)).

Citing no case law to support their position, the Founders argue that requiring directors to plead their personally-interested claims in the Section 225 Action would (1) require them to make claims for which they could not typically receive indemnification and (2) require them to forego money damages, which are not available in a Section 225 action.

The Founders' argument fails for several reasons. Initially, the petition to the Section 225 Action (the "Section 225 Petition") itself makes clear that it was brought on behalf of common stockholders seeking to determine their right to designate directors to MDG I. To wit, the Section 225 Petition plainly states that "Counsel for Plaintiffs would apply to the Delaware Court for a decision on the right of the *common stockholders* to designate directors."³⁶ Later in the Section 225 Petition, the Founders claim that "[t]his Petition presents a straightforward issue: Is the right of MDG's *common stockholders* to designate two directors to the board a right protected under 8 *Del. C.* § 242(b)(2), such that it could not be eliminated without an affirmative class vote of the *common stockholders*?"³⁷ Furthermore, the Section 225 Petition indicates that the relief the Founders sought included a declaration that "the *common stockholders* of MDG are entitled to designate two members of MDG's board of directors."³⁸ As these excerpts make clear, the Founders brought the Section 225 Action in their capacity as stockholders, not simply as directors seeking reinstatement, and desired a binding

³⁶ Section 225 Petition ¶ 18 (emphasis added).

³⁷ *Id.* ¶ 23 (emphasis added).

³⁸ *Id.* (emphasis added).

ruling that would benefit the common stockholders as a class. And the fact that this same quartet of common stockholders — Levinhar, Asseo, Cohen-Alloro, and Haitin — together brought the Israeli Action to contest the removal of their board representatives³⁹ but agreed to dismiss that action in favor of fighting over the same issues in the Section 225 Action confirms the conclusion that Levinhar and Asseo were seeking in the Section 225 Action to advance their rights as stockholders, and not simply as directors.

Second, even if the Founders were acting as directors in the Section 225 Action, the Founders’ argument fails because bringing claims under different capacities is not a formalistic bar to the application of *res judicata*. Where a person appearing in a representative capacity has a personal interest in the outcome of the litigation, his or her status will not shield that person from the operation of *res judicata*.⁴⁰ Here, both Levinhar and Asseo, even if they had

³⁹ *Id.* ¶ 15 (“On March 3, 2008, the *common stockholders* of MDG (including Petitioners) filed an action in Israel . . . that included, among other things, two counts related to the issue of Petitioners’ board membership.”) (emphasis added).

⁴⁰ See 18 MOORE’S FEDERAL PRACTICE §131.40[2][a] (3d ed. 2009); see also *Corcoran v. Chesapeake & Ohio Canal Co.*, 94 U.S. 741, 745 (1876) (holding that a party was barred from relitigating a case in an individual capacity where he was a holder of bonds in question during prior litigation as a trustee of bonds); *Freeman v. Lester Coggins Trucking, Inc.*, 771 F.2d 860, 862 (5th Cir. 1985) (finding that, where a party seeks damages for himself in successive actions, individual and representative distinction collapses and collateral estoppel or *res judicata* applies); *Meagher v. Bd. of Trs. of Pension Plan of Cement and Concrete Workers Dist. Pension Fund*, 921 F.Supp. 161, 165-66 (S.D.N.Y. 1995), *aff’d*, 79 F.3d 256 (1996); *Howell v. Vito's Trucking & Excavating Co.*, 191 N.W.2d 313, 316 (Mich. 1971) (stating that *res judicata* applies “where a party to one action in his individual capacity and to another in his representative capacity is in each case asserting or protecting his individual rights”); *Bernhard v. Bank of Am. Nat’l Trust & Sav. Ass’n*, 122 P.2d 892, 896 (Cal. 1942) (“Where a party though appearing in two suits in different capacities is in fact litigating the same right, the

brought the Section 225 Action solely in their capacity as Common Stock Directors, also had a personal interest in that litigation as stockholders. Therefore, they cannot now bring their Resurrected Claims simply because they purport for tactical reasons to have switched roles.

Finally, there is no unfairness in finding privity. Even if it is the case that Levinhar and Asseo would have somehow been diminished in their indemnification rights if they sued both as directors and stockholders in the Section 225 Action (an argument they do not support), commercial life is full of choices. When one chooses to sue, one is supposed to bring all of her related claims at one time, and not burden the defendants with serial litigation. Having clearly and plainly sought relief for the common stockholders of MDG in those express terms, it comes with little grace for Levinhar and Asseo to say that they were solely suing as directors. Likewise, although it is true that Section 225 actions are summary and confined in focus, that reality has no logical connection to the privity analysis, nor as I next find, does it mean that the claims the Founders now press could not have been litigated in the Section 225 Action. The reality is that the most obvious relief for a breach of the Stockholders Agreement was an

judgment in one estops him in the other.”) (citations omitted); RESTATEMENT (SECOND) OF JUDGMENTS § 42, cmt. g. (“A person who appears in his own behalf in litigation has had his day in court and is bound by the judgment. Just as he may not himself relitigate the claims thus decided, neither may he do so in a subsequent action prosecuted or defended through a representative.”); RESTATEMENT OF JUDGMENTS § 80(1), cmt. k (“Ordinarily as stated in § 85 a person on whose account and for whose benefit an action is brought by a fiduciary has the benefits and is subject to the burdens of the rules of res judicata with reference to the subject matter of the action. For this reason if the fiduciary is also one of the beneficiaries he is bound by the judgment as are the other beneficiaries.”).

order vindicating the director appointment rights in that Agreement. That was in fact what was sought in the Israeli Action and what Levinhar and Asseo sought on behalf of the common stockholders in the Section 225 Action. Had they won on those claims, there would have been no damages to award because the specific rights at issue would have been vindicated. Moreover, as will be mentioned later, parties may press a Section 225 action, file a companion complaint, and have the court consolidate those actions for a simultaneous trial when claims triable in a Section 225 action might provide a basis for broader relief.

In summary, there is privity between the Founders in the prior and present actions.⁴¹

⁴¹ The Founders also argue that *res judicata* does not apply because some of the New Investors named as defendants in the present case were not named as parties in the Section 225 Action. (Of the defendants in the current action, only MDG Medical, Inc., Jacob Schuster, Michael Siegel, and Mark Saffran were parties to the Section 225 Action.) I reject this argument because there clearly is privity among the defendants in this case who were not named in the Section 225 Action and the defendants who were named in the Section 225 Action. The interests and relationships among Schuster, Siegel, Saffran, and MDG Medical, Inc. — who were named in the Section 225 Action — and the additional defendants named in the current action are sufficiently close to conclude that all of the current defendants are in privity. The additional New Investors named in this action are all either former directors of MDG (in the case of Schneier and Tauber) or holders of MDG preferred stock who elected the directors who were parties to the Section 225 Action (in the case of LSKW Investments and 4202 Corporation). Indeed, the Founders essentially argue that all of the defendants are affiliates and co-conspirators. For example, the Founders’ petition in this case notes that Schneier and Siegel were both partners with signing authority at LSKW Investments, that LSKW Investments held stock in MDG Medical, Inc. beneficially for 4202 Corporation, Siegel, Schneier, and Schuster, and that the “majority of the Board served at the whim of 4202 [Corporation].” Pet. ¶¶ 9, 11, 13; Pet.’s Ans. Br. 6. Furthermore, the Founders assert that 4202 Corporation and Saffran together “cooked up” the scheme to deny the Founders their rights under the Stockholders Agreement, and that 4202 Corporation “worked with” Saffran to execute that plan. *Id.* at 2, 6. The Founders also argue that 4202 Corporation and LSKW Investments acted in concert by reconstituting the MDG I board to exclude Levinhar and Asseo, and that the “4202 [Corporation] dominated Board approved” the certificate

2. The Resurrected Claims Could Have Been Argued In The Section 225 Action

The final issue in the *res judicata* analysis is whether the Founders' Resurrected Claims are barred because they could and should have been asserted in the Section 225 Action. As discussed above, these claims, though based on alternative grounds, essentially request the same thing: relief for the elimination of (1) the Founders' right to appoint two Common Stock Directors under the Stockholders Agreement and (2) the anti-dilution provisions in the Stockholders Agreement. For *res judicata* to be applicable, the Resurrected Claims must have

amendment that 4202 Corporation and Saffran proposed. *Id.* at 9-10. Therefore, the Founders' own allegations indicate that the defendants are closely affiliated and that the defendants worked together to deny the Founders their rights under the Stockholders Agreement.

Because of their close relationships with one another, all of the defendants in the current action had an equal interest in the Section 225 Action and were equally affected by the outcome of that action. To deny the application of *res judicata* because some of the current defendants were not named in the Section 225 Action would allow the Founders unfairly to prosecute repetitious claims simply because they belatedly filed a second action naming new parties, who could and should have been joined in the earlier proceeding. This would create an unhealthy incentive for gamesmanship and contravene our state's long-standing public policy. *See Malone Freight Lines*, 148 A.2d at 775. As the United States Court of Appeals for the Fifth Circuit has noted:

Where a plaintiff has sued parties in serial litigation over the same transaction; where [the] plaintiff chose the original forum and had the opportunity to raise all its claims relating to the disputed transaction in the first action; where there was a 'special relationship' between the defendants in each action, if not complete identity of parties; and where, although the prior action was concluded, the plaintiff's later suit continued to seek essentially similar relief — the courts have denied the plaintiff a second bite at the apple."

Lubrizol Corp. v. Exxon Corp., 871 F.2d 1279, 1288 (5th Cir. 1989); *see also Ruskay v. Jensen*, 342 F.Supp. 264, 271 (S.D.N.Y.1972) (applying *res judicata*, reasoning that the plaintiffs "were fully aware of the role played by the present defendants who were not parties to the earlier proceeding" when they settled their claims), *aff'd*, 552 F.2d 392 (2d Cir.1977), *cert. denied*, 434 U.S. 911 (1977).

arisen out of the same transaction at issue in the Section 225 Action and must have been able to be presented in that action.

The same transaction requirement is easily satisfied. As a general rule, and as spelled out in the *Restatement (Second) of Judgments* which Delaware follows as its own law, *res judicata* bars “all rights of the plaintiff to remedies against the defendant with respect to all or any part of the transaction, or series of connected transactions, out of which the actions arose.”⁴² What constitutes a “transaction” or “series of connected transactions” is to be determined “pragmatically, giving weight to such considerations as whether the facts are related in time, space, origin, or motivation, whether they form a convenient trial unit, and whether their treatment as a unit conforms to the parties’ expectations or business understanding or usage.”⁴³

Here, the same transaction underlies both the Section 225 Action and the present claims. Both lawsuits involve the same continuous series of activity. According to the Founders’ recitation of the facts, the New Investors employed two different tactics — first, the steps leading to the February Restated Certificate of Incorporation and, second, the merger of MDG I into MDG II — to achieve the same goal of eliminating the Founders’ rights under the Stockholders Agreement in connection with making new capital investments in MDG. Indeed, the

⁴² RESTATEMENT (SECOND) OF JUDGMENTS § 24(1); accord *Maldonado v. Flynn*, 417 A.2d 378, 380-82 (Del. Ch. 1980); *LaPoint v. AmerisourceBergen Co.*, 970 A.2d 185, 193 (Del. 2009).

⁴³ RESTATEMENT (SECOND) OF JUDGMENTS § 24(2); see also *LaPoint*, 970 A.2d at 193.

Founders' own brief states that "[f]rom late 2007 through late 2008, 4202 [Corporation] and Saffran tried a number of methods to eliminate common stockholders' right to designate two directors to the board."⁴⁴ In other words, the Founders admit that a single overarching scheme to eliminate their rights under the Stockholders Agreement precipitated both the Section 225 Action and the current action. Therefore, the same transaction requirement is satisfied.

The next issue for the court to decide is whether the particular claims advanced in the present action *could have been* asserted in the prior action.⁴⁵ Therefore, if available in the prior action, claims never litigated before might nevertheless be precluded.⁴⁶ The question then is whether the Founders' present claims could have been brought in the Section 225 Action.

The answer to that question is yes. Although Section 225 actions are summary proceedings, claims that bear on the appropriate composition of the board of directors may be brought in connection with a Section 225 action. As this court has stated:

[T]he question whether an issue is properly litigable in a Section 225 action turns . . . upon a determination of whether it is necessary to decide in order to determine the validity of the election or designation by which the defendant claims to hold office.⁴⁷

⁴⁴ Pet.'s Ans. Br. 36.

⁴⁵ *Maldonado*, 417 A.2d at 383 (defendant must show that "that the claim for relief *could have been* properly presented in the prior action") (emphasis added); *see also* 18 MOORE'S FEDERAL PRACTICE § 131.20[1] (3d ed. 2009).

⁴⁶ *Id.*

⁴⁷ *Kahn Bros. & Co. v. Fishbach Corp.*, 1988 WL 122517, at *5 (Del. Ch. Nov. 15, 1988) (holding that "[the plaintiff's claims that the defendant fraudulently acquired stock in the corporation] are not issues collateral to the question of the title of the office of the directors [the defendant] has caused to be in office"); *see also Jackson v. Turnbull*, 1994

Despite the Founders' attempt to suggest that rigid, inflexible rules preclude this court from hearing anything but the narrowest arguments in Section 225 cases, the reality is otherwise. Consistent with what one would expect of a court of equity, this court has even permitted litigation over whether a stockholder had obtained his stock by defrauding the corporation.⁴⁸ Most pertinent to this case, it is common in Section 225 cases for this court to address the consequences that stockholder voting agreements have on the outcome of director elections or removal efforts.⁴⁹ Here, it is inarguable that the Founders could have argued in the Section 225 Action that the Stockholders Agreement survived the merger and that, therefore, the common stockholders of MDG II were entitled to appoint two board members of MDG II. Likewise, because such arguments would have borne directly on board composition, the Founders could have argued that the merger

WL 174668, at *2 (Del. Ch. Feb. 8, 1994) (“Although I am not unmindful of the limited scope of a § 225 proceeding, it is frequently the case that, in order to determine the rightful directors of a company, underlying transactions must be analyzed and resolved.”) (internal citations omitted), *aff’d without op.*, 653 A.2d 306 (Del. 1994).

⁴⁸ *Fishbach*, 1988 WL 122517, at *5.

⁴⁹ See, e.g., *Eliason v. Englehart*, 1998 WL 778360 (Del. Ch. Oct. 29, 1998) (finding, in the context of a § 225 proceeding, that a stockholder agreement was unenforceable for lack of consideration), *rev’d on other grounds*, 733 A.2d 944 (Del. 1999); see also *Oralco, Inc. v. Bradley*, 1992 WL 373041 (Del. Ch. Dec. 17, 1992) (determining the enforceability of a stockholders agreement in the context of a § 225 action); *Ringling v. Ringling Bros.-Barnum & Bailey Combined Shows, Inc.*, 49 A.2d 603 (Del. Ch. 1946) (enforcing the terms of a stockholders agreement in a § 225 action), *modified*, 53 A.2d 441 (Del. 1947).

was itself inequitable because it was consummated in violation of, or eviscerated in bad faith the rights granted by, the Stockholders Agreement.⁵⁰

If successful in the Section 225 Action, the Founders' rights under the Stockholders Agreement would have been vindicated and they would have been able to reinstall the Common Stock Directors. A favorable ruling of this kind — *i.e.*, essentially to the effect that the Stockholders Agreement remained in full force and effect — would have also had the collateral effect of protecting the anti-dilution rights in that Agreement.⁵¹ Moreover, to the extent that the Founders had any concern about the breadth of the remedial relief they sought, they could have filed a companion action raising those additional remedy requests and sought to have it consolidated with the Section 225 Action. Such requests have been granted by this court, and this court has tried related plenary and Section 225 claims simultaneously.⁵²

⁵⁰ See, *e.g.*, *Jackson*, 1994 WL 174668 (former Vice Chancellor, now Justice, Berger finding in a § 225 action that the underlying merger was void).

⁵¹ See *Technicorp Int'l II, Inc. v. Johnston*, 1997 WL 538671, at *5 (Del. Ch. Aug. 25, 1997) (barring further litigation of the factual findings made in a § 225 proceeding under the analogous principle of collateral estoppel).

⁵² *In re IAC/Interactive Corp.*, 948 A.2d 471 (Del. Ch. 2008) (consolidating a § 225 claim with claims of breach of fiduciary duties and of violation of a stockholders agreement); see also *Openwave Sys., Inc. v. Harbinger Capital*, 924 A.2d 228 (Del. Ch. 2007) (consolidating a § 225 action with a suit, challenging a corporation's bylaws, whose complaint was later amended to change the suit to a § 225 action as well); *Phillips v. Roche Holdings, Inc.*, 1995 WL 1791082 (Del. Ch. May 10, 1995) (consolidating claims of breach of fiduciary duty with a § 225 action); *Laster v. Waggoner*, 1989 WL 126670 (Del. Ch. Oct. 13, 1989) (consolidating a § 225 action with an action seeking to enjoin an asset sale), *aff'd*, 581 A.2d 1127 (Del. 1990); *Blasius Indus., Inc. v. Atlas Corp.*, 564 A.2d 651 (Del. Ch. 1988) (consolidating a § 225 action with a claim of breach of fiduciary duty).

In reality, victory in the Section 225 Action would have been fully sufficient to remedy the harm that the Founders contend undergirds the Resurrected Claims. Those Claims largely seek damages for the loss of the director appointment rights in the Stockholders Agreement. If the Founders won on those issues in the Section 225 Action, they would have had those rights restored to them and could have sought indemnification, if appropriate, or an award of attorneys' fees if they believed that the defendants' actions justified fee shifting under the bad faith exception to the American Rule.

Instead, the Founders consciously chose not to press in the Section 225 Action the argument that they were entitled to appoint two members of the MDG II board or any other of the theories they now advance as to why Levinhar and Asseo were improperly ousted from the MDG board. Rather than fight, the Founders procured a payment of attorneys' fees and dismissed the Section 225 Action with prejudice. For them to now seek to revive these arguments and to inject them into this case implicates all the key policy reasons *res judicata* exists as a doctrine.⁵³ It would be inequitable to make the New Investors now litigate

⁵³ See *Malone Freight Lines*, 148 A.2d at 775 (“The fundamental basis of the doctrine of *res judicata*, and of its subsidiary rule, collateral estoppel, is that in the public interest a litigant may have one day in court but not two.”); *Williams*, 180 A. at 910 (“[*Res judicata*] is primarily a rule of public policy, founded on a Latin maxim, adopted by the common law, which, when translated, means that it is to the interest of the state that there should be an end to litigation Another and subordinate rule . . . is also based on a Latin maxim adopted by the common law, and which, when translated, means that it would be a hardship on a person for him to be vexed twice for the same cause.”) (internal citations omitted).

over issues they reasonably thought were put to rest by the agreement to settle the Section 225 Action.⁵⁴

⁵⁴ Candidly, I find the Founders' belief that they would reap a damages award based on the loss of their rights under the Stockholders Agreement that is higher than they would receive in appraisal to be less than immediately apparent, to put it in an understated way. MDG shares are not publicly listed. As a result, a marketability discount would be applied in any sensible valuation of the Founders' shares. See, e.g., *Emerald Partners v. Berlin*, 2003 WL 21003437, at *31 (Del. Ch. Apr. 28, 2003) (applying marketability discount). This discount could easily exceed 30%. See, e.g., SHANNON PRATT, ROBERT F. REILLY & ROBERT P. SCHWEIHS, *VALUING A BUSINESS: THE ANALYSIS AND APPRAISAL OF CLOSELY HELD COMPANIES* 395-403 (4th ed. 2000) (discussing studies of minority discounts applied to prices of restricted stocks finding discounts ranging from under 15% to over 50%); see also SHANNON PRATT, *THE LAWYER'S BUSINESS VALUATION HANDBOOK: UNDERSTANDING FINANCIAL STATEMENTS, APPRAISAL REPORTS, AND EXPERT TESTIMONY* 208-11 (2000) (same). Moreover, although the Founders might have had a right to two board seats, that was a limited right and the reality is that the New Investors had majority control, leading to the potential need to apply a minority discount of some appreciable percentage. By contrast, in appraisal, the Founders get to take advantage of the petitioner-friendly standard set by our Supreme Court in *Cavalier Oil Corp. v. Harnett*, 564 A.2d 1137, 1144-45 (Del. 1989); see also *Lane v. Cancer Treatment Ctrs. of Am.*, 2004 WL 1752847, at *13 n.74 (Del. Ch. Jun. 30, 2004). Under that standard, the court does not take into account factors that would ordinarily apply in a market-based valuation of particular shares — such as marketability and minority discounts — and instead grants the petitioners their pro rata share of the firm's going concern value. *Cavalier*, 564 A.2d. at 1144 (“The dissenting shareholder's proportionate interest is determined only after the company as an entity has been valued. In that determination the Court of Chancery is not required to apply further weighting factors at the shareholder level, such as discounts to minority shares for asserted lack of marketability.”).

Furthermore, the Founders' argument that the provision in the Stockholders Agreement that protects them against dilution below 5% has economic value on top of appraisal value is unfathomable. The Founders control approximately 6.3% of MDG Medical, Inc.'s shares. See *Levinhar v. MDG Medical, Inc.*, C.A. No. 4301-VCS, at 5:5-16, 50:15-22 (Del. Ch. Aug. 31, 2009) (TRANSCRIPT) (Founders admitting that they hold 6.3% of stock in MDG Medical, Inc.). In appraisal, the Founders will be entitled to 6.3% of the firm's going concern value. A primary way firms are valued in appraisal is through the discounted cash flow method. Therefore, if MDG is expected to have future cash flows justifying a value of, say, \$20 million, the Founders will get 6.3% of that amount. I do not pretend to be a mathematics adept, but 6.3% is better than 5%. Put simply, because the merger occurred when the Founders owned more than 5%, the 5% protection will never have real world relevance.

Because the value of the Founders' board seats would be subject to marketability and minority discounts outside of appraisal, and because the anti-dilution provisions

Instead of ending the dispute over the composition of the MDG board, as the final order of dismissal of the Section 225 Action would suggest to any reasonable person, the Founders contend that the dismissal simply gave them their part of the deal — the attorneys’ fees payment — and gave them the chance to argue that they were contractually entitled to board seats at MDG II and should now receive money damages for that loss. Of course, by dismissing the Section 225 Action, the Founders intentionally abandoned their opportunity to prove that the MDG II board was improperly composed because the MDG II stockholders were entitled to appoint two of its members and that Levinhar and Asseo should be ordered seated in place of two of the other directors. Indeed, the Founders admit that they did not wish to bear the costs of litigating over their entitlement to representation on the MDG II board and thus chose to dismiss the Section 225 Action without doing so.

Having made that tactical decision, the Founders must live with it and cannot now press the Resurrected Claims, which could and should have been litigated in the Section 225 Action.⁵⁵

cannot now provide the Founders with any real-world benefit, I cannot conceive how the Founders’ Resurrected Claims could result in a recovery exceeding the fair value appraisal available under 8 *Del. C.* § 262. Indeed, given the opportunity after oral argument to outline a model showing that the value of the damages pursued in their Resurrected Claims would match or exceed a fair value appraisal of their shares, the Founders provided no rational explanation of how such was possible and simply reiterated their litany of claims against the New Investors. See Letter from Edward D. Johnson to the Honorable Leo E. Strine, Jr. (Sept. 11, 2009).

⁵⁵ It is, of course, true that Count V seeks relief against 4202 Corporation and that 4202 Corporation was not a party to the Section 225 Action. But, I have found that 4202 Corporation is in privity to the parties in the Section 225 Action. Count V is also for

IV. Conclusion

For the foregoing reasons, *res judicata* bars Counts II through V of the Founders' Complaint, and those Counts are hereby DISMISSED. IT IS SO ORDERED.

tortious interference with the same board appointment contractual rights that were at issue in the Section 225 Action, and therefore this theory could have been asserted in that action. *See Agranoff v. Miller*, 1999 WL 219650 (Del. Ch. Apr. 12, 1999) (adjudicating a tortious interference with contract claim in the context of a § 225 action). Being barred from litigating that their rights under the Stockholder Agreement were breached, the Founders cannot seek to escape that bar by bringing a tortious interference claim, which requires that a breach of the underlying contract be proven. *See* 18 MOORE'S FEDERAL PRACTICE § 131.21[3][a], at 131-43 (3d ed. 2009) ("A judgment in a prior action will preclude another action based on the same facts and asserted injury even though the subsequent action asserts a different legal theory to justify recovery."); *see also Trans World Airlines, Inc. v. Hughes*, 317 A.2d 114, 119 (Del. Ch. 1974) ("[A] plaintiff will not be permitted, after losing a case on one theory, to pursue a different theory based on the same proof which has been rejected in the first action."). Moreover, this sort of tortious interference claim is also precisely of the closely-related sort that the Founders could have pressed in a separate complaint and sought to consolidate with the Section 225 Action.

By referring to a separate complaint, I by no means suggest that multiple complaints are or are not required. By its own terms, Section 225 is an empowerment to the Court of Chancery to hear election contests when certain conditions are met. Section 225 does not indicate that a complaint may not contain a count under Section 225 and other related counts arising out of the same transaction.