COURT OF CHANCERY
OF THE
STATE OF DELAWARE

LEO E. STRINE, JR.
CHANCELLOR

New Castle County Courthouse
500 N. King Street, Suite 11400
Wilmington, Delaware 19801-3734

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RE: *McElroy v. Schornstein*
Civil Action No. 7233-CS

Dear Counsel:

Petitioner Ron McElroy has asked for a judicial dissolution of Fluid Rx Inc., a Delaware corporation, under 8 *Del. C.* § 273. His co-investor in Fluid Rx, respondent Ronald Schornstein, has moved to stay or dismiss the proceeding in favor of first-filed litigation in New Jersey Superior Court in which Schornstein is the plaintiff and counterclaim defendant and McElroy is the defendant and counterclaim plaintiff (the "New Jersey Action").

Under *McWane* and its progeny, this court's discretion may be exercised in favor of a stay or dismissal "when there is a prior action pending elsewhere, in a court capable

of doing prompt and complete justice, involving the same parties and the same issues."[1] If a "foreign action is the first-filed action, principles of fairness, comity, judicial economy and the possibility of inconsistent results generally favor the granting of a stay."[2]

Summary statutory proceedings such as this one under § 273 obviously require special attention when considering a motion to stay or dismiss under *McWane*. This court has often considered Delaware to be a more appropriate forum than a foreign court when a component of multi-forum litigation involves a summary proceeding under the Delaware General Corporation Law.[3] Delaware has a strong interest in resolving issues concerning the internal affairs of a Delaware corporation promptly and efficiently, and given this interest, "a summary proceeding initiated in the Court of Chancery will often be allowed to proceed despite the pendency in a foreign court of a related prior-filed action between the same litigants."[4] But, even though the "summary nature" of a later-filed Delaware action "is relevant in determining whether to stay or dismiss [that action]

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[1] *McWane Cast Iron Pipe Corp. v. McDowell-Wellman Eng'g Co.*, 263 A.2d 281, 283 (Del. 1970); *see also Chadwick v. Metro Corp.*, 856 A.2d 1066, 2004 WL 1874652, at *2 (Del. 2004) (TABLE).
[2] *ODN Hldg. Corp. v. Hsu*, 2012 WL 1096095, at *6 (Del. Ch. Mar. 30, 2012) (citations and internal quotation marks omitted).
[3] *See, e.g.*, *In re Data Processing Consultants, Ltd.*, 1987 WL 25360, at *5 (Del. Ch. Nov. 25, 1987) (denying stay of § 273 action); *Kirkland v. Int'l Cmty. Corp.*, 1984 WL 8222, at *2 (Del. Ch. May 29, 1984) (denying stay of § 225 action); *see generally* Donald J. Wolfe, Jr. & Michael A. Pittenger, *Corporate and Commercial Practice in the Delaware Court of Chancery* § 5.01[d], at 5-27 (2011).
[4] *Xpress Mgmt., Inc. v. Hot Wings Int'l, Inc.*, 2007 WL 1660741, at *5 (Del. Ch. May 30, 2007).

in favor of a foreign-filed action, it is not dispositive."[5] The court still must weigh "the need for swift and expeditious resolution" of these summary proceedings "against the *McWane* policies of comity and promoting the efficient administration of justice."[6]

Allowing the § 273 proceeding brought by McElroy to go forward at this juncture would not result in an efficient administration of justice. This proceeding arises from the same "nucleus of operative facts"[7] as the New Jersey Action that preceded it by nearly five months. That action focuses on the disagreements between Schornstein and McElroy, who each own 50% of the equity of Fluid Rx, over the business of Fluid Rx, which is a company they formed to market products to test automotive fluids and oils. The issues in this proceeding and in the New Jersey Action are not identical, but they overlap substantially. The key issues in the New Jersey Action include whether McElroy and Schornstein have breached their fiduciary duties they owe to Fluid Rx and each other, breached the terms of the Fluid Rx stockholders agreement, wrongfully converted copyrights over which each party claims ownership, or mismanaged Fluid Rx so as to warrant a court-ordered sale of one party's interest in Fluid Rx to the other party under a New Jersey statute that provides remedies for shareholders in closely-held corporations under circumstances where "those in control [of the corporation] have acted fraudulently

[5] *Choice Hotels Int'l, Inc. v. Columbus-Hunt Park Dr. BNK Investors, LLC*, 2009 WL 3335332, at *5 (Del. Ch. Oct. 15, 2009); *see also Xpress Mgmt.*, 2007 WL 1660741, at *5; *Carvel v. Andreas Hldg. Corp.*, 698 A.2d 375, 379 (Del. Ch. 1995).
[6] *Choice Hotels*, 2009 WL 3335332, at *4.
[7] *Diedenhofen-Lennartz v. Diedenhofen*, 931 A.2d 439, 446 (Del. Ch. 2007).

or illegally, mismanaged the corporation, or abused their authority as officers or directors or have acted oppressively or unfairly toward one or more minority shareholders in their capacities as shareholders, directors, officers or employees."[8] Thus, I must, in my discretion, balance the lack of complete identity of the issues against the possibility of inconsistent and conflicting rulings that could be made if both the § 273 proceeding in this court and the New Jersey Action were to proceed at the same time.[9] Perhaps most relevant for present purposes, in November 2011 – more than six months ago – the New Jersey court entered an order limiting the Fluid Rx-related business activities of McElroy and Schornstein, requiring McElroy and Schornstein to keep each other in the loop by,

[8] N.J.S.A. 14A:12-7. I cannot help but note my puzzlement as to how such a statute could be applied to address a non-New Jersey corporation, consistent with comity and the need for New Jersey to give full faith and credit to its sister state's laws. *See CTS Corp. v. Dynamics Corp. of Am.*, 481 U.S. 69, 91 (1987) ("It [] is an accepted part of the business landscape in this country for States to create corporations, to prescribe their powers, and to define the rights that are acquired by purchasing their shares. A State has an interest in promoting stable relationships among parties involved in the corporations it charters …."); *Edgar v. MITE Corp.*, 457 U.S. 624, 645 (1982) ("The internal affairs doctrine is a conflict of laws principle which recognizes that only one State should have the authority to regulate a corporation's internal affairs – matters peculiar to the relationships among or between the corporation and its current officers, directors, and shareholders – because otherwise a corporation could be faced with conflicting demands."); *Rogers v. Guar. Trust Co. of New York*, 288 U.S. 123, 130 (1933) ("It has long been settled doctrine that a court – state or federal – sitting in one State will as a general rule decline to interfere with … the management of the internal affairs of a corporation organized under the laws of another state but will leave controversies as to such matters to the courts of the state of the domicile."). Fluid Rx is a Delaware corporation and the Delaware General Corporation Law and Delaware law clearly govern its internal affairs. That said, both McElroy and Schornstein use this New Jersey statute as a weapon against the other. *See* Crompton Aff. Ex. 2 (New Jersey Complaint) ¶¶ 70-74; Crompton Aff. Ex. 3 (New Jersey Answer and Counterclaim) ¶¶ 123-27. This is perhaps why McElroy has not argued in this action that the New Jersey statute is inapplicable to Fluid Rx.

[9] *See Playtex, Inc. v. Columbia Cas. Co.*, 1989 WL 40913, at *3 (Del. Super. Apr. 25, 1989).

for example, providing bank account statements to one another, preventing the transfer of certain copyrights for Fluid Rx products that were registered by either McElroy or Schornstein, and appointing a "Fiscal Agent" to monitor and review the financial operations of Fluid Rx.[10] Proceeding with a judicial dissolution of Fluid Rx and appointing a Delaware receiver would hazard interference with this order and with the duties of the Fiscal Agent. McElroy has failed to explain how a Delaware receiver and the Fiscal Agent might work in tandem, and from a practical standpoint, a Delaware receivership would confuse and complicate the New Jersey Action.

Moreover, as was noted in this court's decision in *Xpress Management, Inc. v. Hot Wings International, Inc.*,[11] in order for a corporation "to be dissolved and for its assets to be distributed in an orderly and final manner, some court … must first determine which assets the company owns."[12] In the proposed "Plan of Discontinuance and Distribution" attached to his § 273 petition, McElroy asks this court to appoint a receiver who "shall cause [Fluid Rx] to transfer to McElroy all rights relating to the Instant Lubricant Test Kits."[13] As Schornstein points out, the "Instant Lubricant Test Kits" referenced in this plan include at least two of the copyrights at issue in McElroy's counterclaim in the New Jersey Action, which alleges, among other things, conversion of McElroy's intellectual

[10] *See* Crompton Aff. Ex. 9 (Order to Show Cause).
[11] 2007 WL 1660741 (Del. Ch. May 30, 2007).
[12] *Id.* at *5.
[13] Pet. Ex. B ¶ 5.

property by Schornstein.[14] Thus, the New Jersey Action will resolve disputes relevant to any distribution of Fluid Rx's assets by a Delaware court-appointed receiver, and it makes sense for the New Jersey Action to be litigated before a judicial dissolution of the company by this court takes place, especially given the protections to both McElroy and Schornstein put in place by the New Jersey Superior Court's order. In this regard, McElroy's decision to press forward with a dissolution action now is also undercut by his filing of yet another action in California, the outcome of which would affect the actions of any receiver. In that action, McElroy seeks, among other things, damages and injunctive relief for Schornstein and Fluid Rx's alleged infringement of McElroy's copyrights, and asks the United States District Court for the Southern District of California to invalidate or cause to be transferred to McElroy certain copyright registrations submitted to the United States Copyright Office by Schornstein.[15] Three-ring circuses may delight children at Barnum & Bailey, but in this context, they create the sort of inefficiency, complication, and sheer waste *McWane* addresses.

[14] Resp. Op. Br. at 7-8; *see also* Crompton Aff. Ex. 3 ¶¶ 76-80; Crompton Aff. Ex. 5 (Schornstein Reply Certification in Support of Order to Show Cause) ¶ 6.
[15] *See* Crompton Aff. Ex. 15 (California Complaint) at 16.

For these reasons, Schornstein's motion to dismiss is GRANTED. The dismissal is without prejudice to McElroy's right to file a new complaint under 8 *Del. C.* § 273 once the New Jersey Action is final if he decides that relief is still warranted.[16]

Very truly yours,

/s/ Leo E. Strine, Jr.

Chancellor

LESJr/sj

[16] I make no comment on whether McElroy may press a § 273 dissolution claim in the New Jersey Action. This dismissal under *McWane*, however, does not bar him from attempting to do so immediately.