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**IN THE SUPREME COURT OF THE STATE OF DELAWARE**

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| **KIM WALTERS, JOSEPH AYLOR, E.S.G., INC. and ENVIRONMENTAL SOLUTIONS GROUP, INC.,** | ) | |
| | ) | **No. 460, 2012** |
| **Defendants-below / Appellants** | ) | |
| | ) | **On appeal from the** |
| **v.** | ) | **Court of Chancery in** |
| | ) | **C.A. No. 4156-VCP** |
| **ENVO, INC.,** | ) | |
| | ) | |
| **Plaintiff-below/ Appellee.** | ) | |

# APPELLEE'S ANSWERING BRIEF ON APPEAL

COOCH AND TAYLOR, P.A.

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Date: November 12, 2012

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## NATURE OF THE PROCEEDING

Envo, Inc. ("Envo") filed its initial Complaint on November 11, 2008. Vice-Chancellor Parsons granted Defendant Kim Walters' ("Walters") initial Motion to Dismiss for Lack of Subject Matter Jurisdiction on June 26, 2009 in a bench ruling (D.I. 27), but granted Envo leave to amend to assert a basis for equitable jurisdiction. Envo filed its Amended Complaint on July 15, 2009 (D.I. 28). On July 24, 2009, Walters filed a Second Motion to Dismiss for failure to state a claim pursuant to Court of Chancery Rule 12(b)(6) and lack of subject matter jurisdiction pursuant to Court of Chancery Rule 12(b)(1) (the "Motion to Dismiss")(D.I. 32).

Vice-Chancellor Parsons issued a Memorandum Opinion on December 30, 2009 and, except for the Count V seeking Reformation, denied the Motion to Dismiss. Envo, Inc. v. Walters et al., 2009 WL 5173807 (Del. Ch. Dec. 30, 2009) (the "2009 Memorandum Opinion") (D.I. 38; Appellants' Opening Brief Ex. A).

In the 2009 Memorandum Opinion, Vice-Chancellor Parsons found ". . . that Envo has demonstrated a sufficient justification for a remedy that only equity can afford . . . and that on the basis of that and the clean-up doctrine, this Court has subject matter jurisdiction over Envo's Complaint. Finally, Defendants have failed to show that they are entitled to

dismissal of any of the remaining counts of the Complaint based on laches or a statute of limitations." (2009 Memorandum Opinion 1).

On January 14, 2010, Walters and Environmental Solutions Group, Inc. ("New Environmental") filed their Answer to the Amended Complaint without alleging either the affirmative defense of Laches or Statute of Limitations (D.I. 39). On April 28, 2010, Joseph Aylor ("Aylor") filed his Answer to the Amended Complaint and Cross-claim against Walters and ESG, Inc. ("ESG")(D.I.40). On August 5, 2011, Walters and New Environmental filed a Motion for Summary Judgment and Opening Brief (D.I. 55). On August 19, 2011, Envo filed its Answering Brief, asserting that the Motion for Summary Judgment should be denied *inter alia*, based on the Law of the Case Doctrine and Collateral Estoppel (D.I. 63).

Vice-Chancellor Parsons heard oral argument on Defendants' Summary Judgment Motion on September 7, 2011 and ruled, "I think I decided the equitable jurisdiction. I might have been wrong. I don't know. But I decided it in the December 30, 2009 decision, and I'm not planning to revisit that at this stage." (B 11-12).

Trial began on September 12, 2011. Following a full day of testimony, the trial was continued after issues arose during the testimony of Aylor. Trial continued on December 9, 2011 and

concluded with additional testimony from Aylor and the proffer of additional evidence which was objected to by Envo.

Vice-Chancellor Parsons issued a Memorandum Opinion in Envo, Inc. v. Walters, et al., 2012 WL 2926522 (Del. Ch. July 18, 2012)(the "2012 Memorandum Opinion")(D.I. 90, Appellants' Opening Brief Ex. B). A Final Order was entered on July 31, 2012 (D.I. 92) and an Amended Final Order was entered on August 17, 2012 (D.I. 94).

Appellants filed a timely Notice of Appeal (D.I. 95). Thereafter, on November 1, 2012, Appellant Joseph Aylor filed a Notice of Voluntary Dismissal of his Appeal (Supreme Court D.I. 13). Thus, the only remaining Appellants are Kim Walters and Environmental Solutions Group, Inc. This is Appellee's Answering Brief on Appeal.

## SUMMARY OF THE ARGUMENT

1. Denied. The Court of Chancery did not err in determining that there was a basis for equitable jurisdiction, as there was no legal remedy available to Envo that would provide it with full, fair and complete relief. It was for the Vice-Chancellor to create an appropriate form of relief.

2. Denied. The Court of Chancery did not err in refusing to dismiss the case based on Statute of Limitations or Laches. Envo's claim arose from the Promissory Notes proffered to Envo as payment for the assets of Envo. Hence, the analogous Statute of Limitations would be 10 Del.C. §8109, which provides for six years to pursue a cause of action based on a promissory note.

In the 2012 Memorandum Opinion, Vice-Chancellor Parsons, in *obiter dictum,* found that Envo's claims would not be barred, even if the basis for the decision was the three year statute of limitations, 10 Del.C. §8106, since the statute of limitations would have been tolled by the "discovery rule".

3. Denied. The Court of Chancery did not err in finding Kim Walters and Joseph Aylor personally liable. The purported Buyer of Envo's assets pursuant to the APA did not exist at the time of the Closing and in fact, was never created. New Environmental, created for Walters and Aylor by their attorney Thomas Marconi, Esq., was not the successor in interest to the

Buyer by merger, name change, purchase, assumption, or assignment of the Buyer's rights pursuant to the APA. The day after the Closing, the Defendants began to use Old Environmental's office, personalty and contracts without at any time advising Kollias of the problem with the non-existent Buyer or attempting to rectify the problem. Vice-Chancellor Parsons found that the Defendants exacerbated the problems by allowing their attorney to withdraw for non-payment and not procuring another attorney to conclude the transaction.

## COUNTER-STATEMENT OF FACTS

The issues in this case arise from an Asset Purchase Agreement, including its annexed Exhibits and Promissory Notes, (the "APA") (A 46-77[1]) dated July 21, 2005 by and between Seller, Environmental Solutions Group, Inc. ("Old Environmental" [2], sometimes known as "Appellee", "Envo" or "Seller"), and Buyer, an entity that was to have been to have been a Delaware corporation called ESG, Inc. ("ESG"), to be owned by Walters and Aylor (sometimes referred to jointly with Environmental Solutions Group, Inc., incorporated August 15, 2005 ("New Environmental") as the "Appellants").

The factual scenario that played out among Basil Kollias ("Kollias"), Kim Walters ("Walters"), Aylor ("Joseph Aylor"), Old Environmental and New Environmental is reasonably simple and in large measure undisputed. The closing on the transaction took place on July 21, 2005 (the "Closing")(D.I. 72)(B 36 #8).

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[1] References to Appellants' Appendix to Opening Brief shall be "A__". References to Appellee's Appendix to Opening Brief shall be "B___".

[2] A corporation named Environmental Solutions Group, Inc. ("Old Environmental") was incorporated by Basil Kollias in 1991 and changed its name to Envo, Inc. on August 15, 2005 in accordance with Article VII of the APA which required the name change of the Seller, to allow the name Environmental Solutions Group, Inc. ("New Environmental"), incorporated August 15, 2005, to be used by the Buyer in order to avoid confusion in connection with the existing contracts of Old Environmental.

A corporation by the name of ESG, Inc. was incorporated on February 23, 1982 and its charter was voided on March 31, 1984 (B 36 #1). E S G, Inc. resulted from the name change of Autta Werk, Inc. on July 26, 1991 (B 36 #3). Although a corporation with the name ESG, Inc. or E S G, Inc. might have existed on July 21, 2005, its existence was a coincidence, as neither Walters nor Aylor had any affiliation with it.

Old Environmental was incorporated by Basil Kollias on December 6, 1991 (B 36 #4). The APA called for the Seller, Old Environmental/Envo, to receive $300,000 as the purchase price for the assets of Old Environmental, paid in the following manner: $10,000 at closing, a Short Term Promissory Note for $71,632 due September 15, 2005 ("STPN") and a Long Term Promissory Note for $218,368, the first installment of which was due October 15, 2005 ("LTPN")(B 36 #8). Other payments were to be made to Seller when there was recovery of advanced costs that had been made by Old Environmental on behalf of its clients, and upon the sale of certain of Old Environmental's vehicles and equipment (A 67-69).

It is undisputed that neither Walters nor Aylor nor counsel for Walters and Aylor, Thomas Marconi, Esquire ("Marconi"), formed any corporation by the name of ESG, Inc. (or any derivative or alternate name) either (i) at the time of

execution of the APA, or (ii) on the Closing Date. Further, at no time have the Appellants formed or had any affiliation with an entity called ESG, Inc. (B 36 #1, 2).

On August 15, 2005, approximately twenty-one days after Closing, Marconi formed a corporation called Environmental Solutions Group, Inc. one minute after Old Environmental changed its name to Envo (B 37 #16, 17). Marconi incorporated this new Delaware corporation for Walters and Aylor, with Envo's old name, Environmental Solutions Group, Inc. The name change of Old Environmental to Envo was a requirement of the APA (A 56 §7.1). At all relevant times, Marconi was retained by and represented Walters and Aylor (B 36 #5, 6, 8).

In the negotiations leading to the execution of the APA, at Closing, and after Closing, Walters and Aylor affirmatively represented to Seller that they owned ESG, the purported buyer under the APA (A 71-75; B 65-67, 71). Both Walters and Aylor averred in the STPN and LTPN that they were the President and Vice-President respectively of ESG, Inc. and Marconi notarized the averment and swore that Walters and Aylor were in fact the President and Vice-President of ESG, and known to him to be such. (A 71-78, 127; B 49 ¶(p)).

At Closing or immediately thereafter, Old Environmental tendered the purchased assets and Walters and Aylor tendered the

executed STPN and the LTPN, but the $10,000 closing payment was not made (B 49 ¶(l)). Shortly after the Closing Date, the $10,000 was provided to Marconi, but Marconi was directed by Walters not to pay Kollias and as a result, Marconi put the funds in escrow (A 119; B 64).[3]

The day after the Closing, Walters and Aylor began occupying Old Environmental's business office (B 37 #9; B 50¶ (q)). There were some minor irregularities as to some assets that Walters claimed were stolen (B 50 ¶(r), 62, 64, 66). These matters were essentially resolved. (A 183; B 50 ¶ (u)). With that limited exception, Envo and Kollias[4] complied with their obligations pursuant to the APA (A 183).

Beginning almost immediately after the Closing, Aylor decided that he wanted to disassociate himself from Walters and the purchase of the business (A 259). According to Marconi, Aylor "got cold feet about going out on his own in business" and "just sort of disappeared" (A 116). Since Marconi had represented both Walters and Aylor, Marconi disqualified himself from representing either of them in the dissolution of their

[3] Envo did not receive the $10,000 until shortly before trial, as a result of a settlement of an interpleader action (A 177).

[4] Kollias was obligated to provide introductions to some of Old Environmental's clients, assist the Buyers as needed and execute an Agreement not to compete.

business relationship (B 37 #19). Neither Envo nor Kollias were involved with or condoned the attempted dissolution of the business relationship, nor did Envo or Kollias participate in the negotiations of any agreement between Walters and Aylor (A 189). Kollias testified that he did not know that Aylor had left the business until several months or a year after Closing (A 189).

To further complicate matters, Walters and Aylor had a falling out with Marconi shortly after Closing when they refused to pay him (A 151, 157, 158-159; B 73). Marconi testified that he stopped speaking to Walters and Aylor and they stopped speaking to him (A 157, 158-159). Shortly thereafter, on September 30, 2005, Marconi filed suit in the Court of Common Pleas against Walters and Aylor (B 38 #25).

Both before and after Aylor left the company, Walters used and operated the environmental services company, using the name Environmental Solutions Group, Inc. (B 51 ¶(y)), 71). Walters took over the contracts, collected the accounts receivable, had possession of all of the hard assets including equipment and vehicles, and sold assets of the company including equipment and vehicles (B 38 #26-27, 51 ¶(y –z), 75). The Tax Returns for New Environmental for 2005-2009 demonstrate that New Environmental,

hence Walters, generated significant income during those years (B 38 #31-34, 76-132).

The APA also required that Envo receive the return of costs advanced as accounts receivable on Exhibit B to the APA totaling $60,911.88 were collected (A 67). The repayment of the costs advanced was separate and independent from any other obligation that the buyers had under the Notes or the APA. Kollias testified that Envo did receive certain payments for accounts receivable that New Environmental collected, but it did not get paid for all of the account receivables that were due under the APA (A 186).

## ARGUMENT

### I. THE COURT OF CHANCERY PROPERLY DETERMINED THAT ENVO COULD PROCEED IN THE COURT OF CHANCERY BECAUSE IT HAD PLED PROMISSORY ESTOPPEL IN THE AMENDED COMPLAINT AND THE COURT HAD JURISDICTION OVER THE REMAINING CLAIMS THROUGH THE APPLICATION OF THE CLEAN-UP DOCTRINE.

#### A. Question Presented

Did the Court of Chancery err in determining that it had equitable jurisdiction over Envo's claims, as there was no legal remedy that would provide Envo with full, fair and complete relief; and, if there was equitable jurisdiction, was it for the Vice-Chancellor to create an appropriate form of relief?

#### B. Scope of Review

This is a mixed question of law and fact. The Court reviews matters of law *de novo* and issues of fact based on whether there is a sufficient basis in the record and whether the Court abused its discretion by being arbitrary or capricious.

When there is a mixed question of law and fact, it has been settled Delaware law for at least fifty years that the standard of review of factual findings is whether the findings "by a trial judge . . . are sufficiently supported by the record and are the product of an orderly and logical deductive process [that] must be accepted even though the reviewing Court might have reached opposite conclusions." Levitt v. Bouvier, 287 A.2d

671 (Del. 1972); Pitts v. White, 109 A.2d 786, 788 (Del. 1954). While Levitt v. Bouvier, supra itself involved an appeal from the Superior Court, its holding has also been applied to appeals to the Supreme Court from decisions from the Court of Chancery. Apartment Communities Corp. v. State, 422 A.2d 342 (Del. 1980). The Supreme Court has held that the Court will overturn those factual findings only if "clearly wrong." Cede & Co. v. Technicolor, Inc., 634 A.2d 345, 360 (Del. 1993). Questions of law are reviewed *de novo*. USA Cable v. World Wrestling Federation Entertainment, Inc., 766 A.2d 462 (Del. 2000).

**C. Merits of the Argument**

**1. Legal Standards**

When the Court of Chancery is asked to exercise its equitable jurisdiction to remedy a legal wrong, the critical jurisdictional question of fact is whether an adequate remedy at law exists. IBM Corp. v. Comdisco, Inc., 602 A.2d 74, 78 (Del. Ch. 1991). If a litigant can seek a remedy in a law court, or other adequate venue that would provide full, fair, and practical relief, the Court of Chancery is without subject matter jurisdiction to hear the matter. Id.; Hughes Tool Co. v. Fawcett Publications, Inc., 315 A.2d 577, 579 (Del. 1974); and 10 Del. C. §342.

Hence, the determination of whether the Court of Chancery has jurisdiction is based on the factual analysis of the availability of "full, fair and adequate relief" at law. Even the existence of a remedy at law may not suffice, hence, equitable remedies, "may be applied even where the right sued on 'is essentially legal in nature, but with respect to which the available remedy at law is not fully sufficient to protect or redress the resulting injury under the circumstances.'" Christiana Town Center, LLC v. New Castle County, 2003 WL 21314499 at *3 (Del.Ch., June 6, 2003); El Paso Natural Gas Co. v. TransAmerican Natural Gas Corp., 669 A.2d 36, 39 (Del. 1995) (quoting Hughes Tool Co. supra).

Oft times, only the Court of Chancery can resolve controversies "that encompass both equitable and legal claims." Nicastro v. Rudegeair, 2007 WL 4054757, at *2 (Del.Ch. Nov.13, 2007). As the Court of Chancery has stated, "[t]he Court must look beyond the remedies nominally being sought, and focus upon the allegations of the complaint in light of what the plaintiff really seeks to gain by bringing his or her claim." Candlewood Timber Group v. Pan American Energy, 859 A.2d 989, 997 (Del. 2004); See also Diebold Computer Leasing, Inc. v. Commercial Credit Corp., 267 A.2d 586, 588 (Del. 1970); IMO Indus., Inc. v.

Sierra Int'l, Inc., 2001 WL 1192201, at *2 (Del. Ch. Oct. 1, 2001).

"[I]f a controversy is vested with 'equitable features' which would support Chancery jurisdiction of at least part of the controversy, then the Chancellor *has discretion* to resolve the remaining portions of the controversy as well." Getty Ref. & Mktg. Co. v. Park Oil, Inc., 385 A.2d 147, 149 (Del. Ch. 1978) (emphasis added). This concept is known as the "clean-up doctrine." Prestancia Mgmt. Group v. Va. Heritage Found., II LLC, 2005 WL 1364616 at *3 (Del. Ch. May 27, 2005); Beal Bank SSB v. Lucks, 2000 WL 710194 at *2 (Del. Ch. May 23, 2000). Once the Court of Chancery establishes subject matter jurisdiction, in its discretion, the Court may continue to hear and decide "the legal features of the claim." Triton Construction Co. v. Eastern Shore Electrical Services., Inc., 2009 WL 1387115 at n. 171 (Del. Ch. May 18, 2009); See also, Pitts v. City of Wilmington, 2009 WL 1204492 (Del. Ch. Feb. 24, 2009); Quereguan v. New Castle County, 2006 WL 2522214 (Del. Ch. Aug. 18, 2006).

Further, once the Court determines that equitable relief is warranted, "even if subsequent events moot all equitable causes of action or if the court ultimately determines that equitable relief is not warranted, the court retains the power to decide

the legal features of the claim pursuant to the cleanup doctrine." Prestancia Mgmt. at *3.

In this case, the Court of Chancery determined that it had subject matter jurisdiction because Envo had made out a claim under the Doctrine of Promissory Estoppel.

To succeed pursuant to the Doctrine of Promissory Estoppel, Envo must show by clear and convincing evidence that: "(1) a promise was made; (2) it was the reasonable expectation of the promisor to induce action or forbearance on the part of the promisee (3) the promisee reasonably relied on the promise and took action to his detriment; and (4) such promise is binding because injustice can be avoided only by enforcement of the promise". Lord v. Souder, 748 A.2d 393, 399 (Del. 2000). Further, the promise must be "reasonably definite and certain." Continental Insurance Co. v. Rutledge & Co., 750 A.2d 1219, 1233 (Del. Ch. 2000).

**2. The facts, which the Court of Chancery determined after trial, support the Court's application of the doctrine of Promissory Estoppel.**

The Court of Chancery made determinations of fact which established the liability of all the Defendants to Envo under the Doctrine of Promissory Estoppel. Specifically, in the 2012 Memorandum Opinion, the Court found as follows:

1) Old Environmental agreed that it would change its name after closing to Envo or something else, so that ESG then could change its name to New Environmental (p. 2, 11);

2) ESG did not exist as the buyer of the assets (p. 1, n.2, 3, 5, 11);

3) ESG could not change its name to New Environmental (p. 11);

4) Walters and Aylor discovered that ESG did not exist, and they decided without the knowledge of Kollias, but with the assistance of their attorney, to create a new corporation with the name "Environmental Solutions Group, Inc." and to have that corporation use the assets of Old Environmental to operate a similar business (p. 1, 2, 3, 7, 11);

5) Rather than being a successor corporation of ESG, as Kollias expected, New Environmental was an entirely new entity with no formal, legal relationship to Old Environmental or the APA (p. 3, 11);

6) Walters and Aylor continuously represented that ESG existed (p. 1, 9, 11, 12);

7) Walters and Aylor had authority to promise that ESG would pay for the assets purchased from Old Environmental (p. 11);

8) The parties agreed in the APA that ESG, not New Environmental, would buy the assets of Old Environmental (p. 2, 11);

9) At least Walters took control of the Purchased Assets after the closing and used them to operate New Environmental (p. 2, 4, 7, 11);

10) There is no evidence that Old Environmental's assets ever were legally transferred to New Environmental by Walters or Aylor or to any business entity they controlled (p. 11);

11) Walters and Aylor did misrepresent, even if unintentionally, that they were principals of a business entity named ESG (p. 12);

12) By accepting the Purchased Assets and using them to operate New Environmental, Walters and Aylor promised, as officers of New Environmental, that they or New Environmental would pay for those assets (p. 7, 12);

13) Walters and Aylor should have expected that Kollias would be induced into transferring the Purchased Assets to them (p. 12);

14) Walters and Aylor misrepresented that they were authorized to bind ESG to pay the purchase price for the Purchased Assets under the APA; (p. 11);

15) Kollias received other offers to buy the assets (p. 1, 12);

16) Kollias probably would not have transferred the assets to Walters and Aylor if he had known that Walters and Aylor failed to create ESG and would attempt to use that fact to avoid the obligations imposed under the APA (p. 12);

If the Court of Chancery finds a party liable pursuant to the doctrine of Promissory Estoppel, it does not need to discuss or consider alternate theories of liability. See EDIX Media Group., Inc. v. Mahani, 2006 WL 3742595 at *11 (Del. Ch. Dec. 12, 2006) (declining to give redundant claims more than "only cursory consideration").

In fact, however, the Court of Chancery did consider other causes of action pled by Envo in the Amended Complaint in the context of the Motion to Dismiss, and determined that there were sufficient facts pled to justify the retention of equitable jurisdiction.

The first and critical determination by the Court of Chancery in analyzing the Motion to Dismiss was to determine whether it had subject matter jurisdiction. Vice-Chancellor Parsons focused on two Counts in the Amended Complaint. Count IV alleged equitable fraud or negligent misrepresentation; Count VI requested relief based *inter alia* on promissory estoppel. The

relief sought pursuant to Count IV and Count VI was the imposition of a constructive trust on the assets sold through the APA and upon the past profits those assets generated for Walters, Aylor and New Environmental (Amended Complaint Count IV and Count VI).

In denying Appellants' Motion to Dismiss, Vice-Chancellor Parsons analyzed Envo's Count IV and Count VI and found that both of those counts sought the equitable remedy of imposition of a Constructive Trust. The Court stated,

> . . . I must identify the remedies Envo truly seeks in those counts and decide if any of those remedies are equitable in nature. . . .
>
> Thus, I conclude that Envo has demonstrated a basis for subject matter jurisdiction in this Court under Counts IV and VI of its Complaint, both of which seek imposition of a constructive trust.
>
> In addition, . . . the Court also has jurisdiction over all the remaining counts in this action under the clean-up doctrine.

(2009 Memorandum Opinion 6, 8).

After due deliberation, Vice-Chancellor Parsons stated: "[a]gainst this factual backdrop, I conclude that there is 'justification for a remedy that only equity can afford and the exercise of subject matter jurisdiction over at least Envo's negligent misrepresentation claim'." (2009 Memorandum Opinion 7) and (ii) that Counts IV and VI of the Amended Complaint

appropriately sought the imposition of a Constructive Trust. (2009 Memorandum Opinion 8).

Under the circumstances where the Court of Chancery correctly analyzed the law of Promissory Estoppel, the Supreme Court should limit its review to whether there is sufficient evidence in the record to support the Court of Chancery's factual findings, and whether those factual findings are the product of a logical and deliberate analysis by the Court, and not an abuse of discretion evidenced by arbitrary and capricious actions.

## II. ENVO'S CLAIMS ARE NOT BARRED BY STATUTE OF LIMITATIONS OR THE DOCTRINE OF LACHES

### A. Question Presented

Did The Court of Chancery err in not dismissing the case based on Statute of Limitations or Laches?

### B. Scope of Review

This is a mixed question of law and fact. The Court reviews matters of law de novo and issues of fact on whether there is a sufficient basis in the record and whether the Court abused its discretion by being arbitrary or capricious. See Levitt v. Bouvier, supra; USA Cable v. World Wrestling Federation Entertainment, Inc., supra.

### C. Merits of the Argument

#### 1. Legal Standards

Statutes of limitations operate as a time bar to actions at law, but are not controlling in equity. Rather, under the equitable doctrine of laches, a court of equity accords great weight to the analogous statute of limitations. Whittington v. Dragon Group, LLC., 991 A.2d 1, 8 (Del. 2009). To determine whether a legal claim is analogous to an equitable claim, the Court uses the following test; "[w]here the statute bars the legal remedy, it shall bar the equitable remedy in analogous cases, or in reference to the same subject matter, and where the legal and equitable claim so far correspond, that the only

difference is that the one remedy may be enforced in a court of law and the other in a court of equity." Id. at 9 citing Artesian Water Co. v. Lynch, 283 A.2d 690, 692 (Del. Ch. 1971)(quoting Perkins v. Carmell's Adm'r, 4 Del. 270, 274 (Del. 1845)).

**2. The Court of Chancery properly determined that Envo's claims were not barred by Laches as the doctrine of inherently unknowable injury tolled the analogous statute of limitations of 10 Del.C. §8106.**

Vice-Chancellor Parsons, in his 2012 Memorandum Opinion, as an alternate basis, discussed in *obiter dictum* the ramifications of the situation in which the three year statute of limitations, 10 Del.C. §8106, would apply, and concluded that the result would be the same as if the Court accepted Envo's previously espoused argument that 10 Del.C. §8109 would be the analogous statute of limitations.

10 Del.C. §8106 provides that

> No action . . . to recover a debt not evidenced by a record or by an instrument under seal,. . . no action based on a promise, shall be brought after the expiration of 3 years from the accruing of the cause of such action. . . .

The Court explained that there are exceptions which can toll the running of the statute of limitations. (2012 Memorandum Opinion 8) One of the exceptions, and the one applicable to this

case, is the "doctrine of inherently unknowable injuries, sometimes referred to as the 'discovery rule'."

**Inherently Unknowable Injury**

Under the inherently unknowable injury doctrine, also known as the "discovery rule", the statute of limitations is tolled "where it would be practically impossible for a plaintiff to discover the existence of a cause of action", In re Tyson Foods, Inc., 919 A.2d 563, 584 (Del. Ch. 2007), and "the claimant is blamelessly ignorant of the wrongful act and the injury complained of." Wal-Mart Stores, Inc. v. AIG Life Ins. Co., 860 A.2d 312, 319 (Del. 2004)(citation and internal quotation marks omitted). If this "narrowly confined" exception applies, the running of the statute will not start until the date on which the plaintiff is on inquiry notice of . . . [its] claims, meaning that . . . [it] becomes aware of "facts sufficient to put a person of ordinary intelligence and prudence on inquiry which, if pursued, would lead to the discovery [of injury]." Kaufman v. C.L. McCabe & Sons, Inc., 603 A.2d 831, 835 (Del. 1992).

To justify a delay in filing an action under the doctrine, the plaintiff bears the burden of factually demonstrating that he was "blamelessly ignorant" of both the wrongful act and the resulting harm. In re Tyson Foods, Inc. at 585.

The arguments of Envo, notwithstanding the Appellants' assertions, factually established the basis for the tolling of the Statute of Limitations. (2012 Memorandum Opinion 8-10) Specifically, the Court found that the nonpayment of the $10,000 at Closing did not signal to Kollias a breach of, or even Defendants' intent to breach the APA, as much as it was an act of self-help by Appellants while the parties were working out post-closing issues. The Court found that Appellants' actions signaled a willingness to continue with the transaction despite Kollias' inability to immediately provide all of the Purchased Assets called for under the APA. (2012 Memorandum Opinion 8).

The Court further found that that Kollias did not know or have reason to know of Defendants' breach until at least one year after Closing, because during that time period Kollias and Walters had numerous discussions concerning the APA and Walters was paying Envo on the accounts receivable until approximately a year after Closing. (2012 Memorandum Opinion 9). Therefore, the Court found that Envo's claims were tolled until July or August 2006. The original complaint in this action was filed on November 11, 2008, well within the analogous limitations period, whether it be 10 Del.C. §8106 or 10 Del.C. §8109, therefore Envo's claims are not barred by laches. (2012 Memorandum Opinion 10).

### 3. Alternatively, the Court of Chancery previously held in the 2009 Memorandum Opinion that the analogous Statute of Limitations was six years as set forth in 10 Del.C. §8109.

In this case, the Court of Chancery found factual justification to support its previous decision that the nearest analogous statute of limitations for Counts III and VI of the Amended Complaint was the six year statute of limitations contained in 10 Del.C. §8109. This section provides that "[w]hen a cause of action arises from a promissory note, bill of exchange, or an acknowledgment under the hand of the party of a subsisting demand, the action may be commenced at any time within 6 years from the accruing of such cause of action." 10 Del.C. §8109.

The 2012 Memorandum Opinion is not germane to the holdings in this matter, but should be considered *dicta.*

> In the circumstances of this case, I need not address each and every one of [Appellants'] contentions. Rather, I find that, even if I were to accept the proposition that the applicable statute of limitations for Envo's claims is three years, those claims would not be barred by laches, because they were tolled until well after November 11, 2005, under the doctrine of inherently unknowable injuries. Therefore, I reject Defendants' argument that Envo's claims are barred by laches.

(2012 Memorandum Opinion 7).

The use of the subjunctive tense in the above passage supports the argument that Vice-Chancellor Parsons intended that

a different analysis would be controlling. In the 2009 Memorandum Opinion, Vice-Chancellor Parsons in part II D. "Are Envo's Claims Barred by Laches?" provided an analysis as to the application of laches to the surviving counts of the Amended Complaint. (2009 Memorandum Opinion 8-11).

In the 2009 Memorandum Opinion, the Court of Chancery held that 10 Del.C. §8109, which provides for a six-year statute of limitations, was the most analogous Statute of Limitations to provide guidance to the Court under Counts III and VI of the Amended Complaint. Ultimately, the Court awarded damages based on Count VI of the Amended Complaint.

The Court found that Count III of the Amended Complaint "is analogous to a cause of action arising from a promissory note. . . . Because Envo's basis for implying a contract . . . is Walters and Aylor's signing of the promissory notes, this action arises from a promissory note and would be subject at law to the six-year statute of limitations prescribed by 10 Del.C. §8109." (2009 Memorandum Opinion 9).

The Court then stated,

> [w]hether Count VI arises from a promissory note requires a closer analysis. . . While on its face, Count VI does not refer to the promissory notes, the core of the claim is that [Appellants] have been unjustly enriched. . . Because the promissory notes were the means by which Walters and Aylor were to pay under the APA, Count VI . . . also arises from a promissory note and would be subject, by analogy, to

> Section 8109's six-year statute of limitations. Because the Complaint was filed years before the expiration of that time period, Count VI is not barred by laches for the same reasons as Count III.

(2009 Memorandum Opinion 10).

The Court determined that the STPN and the LTPN executed by Walters and Aylor on behalf of a non-existent corporation were the basis for the transaction contemplated by the APA and that underlying the APA was an exchange of the assets of Old Environmental for *inter alia* the Promissory Notes of ESG, Inc. (2009 Memorandum Opinion 10). Kollias had the right to rely on the Promissory Notes (i) based on Kollias' investigation into the existence of ESG, Inc.; (ii) the averment of Walters and Aylor in the Promissory Notes and the APA that they were President and Vice-President respectively of ESG, Inc. and (iii) the witness, averment and notarization by Marconi, the attorney for Walters and Aylor that he knew Walters and Aylor were the President and Vice-President of ESG, Inc., and the Buyer pursuant to the APA. (2012 Memorandum Opinion 9).

Given the Court of Chancery's extensive factual analysis, the Supreme Court should limit its review to whether there is sufficient evidence in the record to support the Court of Chancery's factual findings, and whether those factual findings are the product of a logical and deliberate analysis by the Court, and not an abuse of discretion.

## III. THE COURT OF CHANCERY PROPERLY DETERMINED THAT WALTERS AND AYLOR WERE PERSONALLY LIABLE ALONG WITH NEW ENVIRONMENTAL FOR THE DAMAGES AWARDED TO ENVO

### A. Question Presented

Did the Court of Chancery err in finding that Kim Walters and Joseph Aylor were personally liable?

### B. Scope of Review

This is a mixed question of Law and Fact. The Court reviews matters of law *de novo* and issues of fact on whether there is a sufficient basis in the record and whether the Court abused its discretion by being arbitrary or capricious. See Levitt v. Bouvier, supra; USA Cable v. World Wrestling Federation Entertainment, Inc., supra.

### C. Merits of the Argument

#### 1. Legal Standards

Walters asserts that he cannot be held personally liable to Envo because had ESG been formed, it would have been the obligor under the APA and the Promissory Notes, and the parties did not intend for the owners of ESG to personally guarantee the obligations to Envo. Walters then goes on to discuss cases in which the courts have recognized *de facto* corporations and declined to find personal liability. Walters, however, fails to recognize that absent extraordinary circumstances, it is axiomatic that a non-existent corporation cannot be legally

responsible for damages. Thus, ESG can have no liability to Envo. Further, although the courts have on occasion held *de facto* corporations legally liable, it is a rare and highly fact intensive inquiry.

Delaware requires a business organization to meet three requirements to be considered a *de facto* corporation: (i) a general law under which a corporation may lawfully exist; (ii) a bona fide attempt to organize under the law and colorable compliance with the statutory requirements; and (iii) actual use or exercise of corporate powers in pursuance of such laws. Read v. Tidewater Coal Exchange, Inc., 116 A. 898 (Del. Ch. 1922).

In GS Petroleum, Inc. v. R and S Fuel, Inc., 2009 WL 554680 (Del. Super. June 4, 2009), cited by Appellants, the circumstances differ significantly from the case at bar. In GS Petroleum, the corporate buyer was created two weeks after the agreement was signed. Thereafter, prior to the use of the seller's assets, the buyer's certificate of incorporation was filed, a business license was obtained, a corporate bank account was opened, and a merchant change of ownership was filed. Shortly after taking over the operation, the buyer wrote checks from its corporate bank account and insured the purchased assets in the buyer's name.

Appellants' citation to American Gas Const. C. v. Licso, 241 N.W. 89 (Neb. 1932) is not relevant, since the factual situation in American Gas differs considerably from the case at issue. Lisco purchased equipment from American Gas on which there remained a balance. American Gas sued Lisco for the balance. Lisco pled a cross-claim and/or set-off against C.I. Tenney, the owner of the then void American Gas. The issues in the cross-claim and/or set off were on a different contract and Mr. Tenney was neither served nor available for service.

Effectively, when Lisco contracted with the voided (not non-existent) corporation and received the total benefit of the transaction, he could not defend against a claim by looking to the corporation's ownership.

While the Superior Court did find that the requirements for *de facto* corporate status had been satisfied in Cleary v. North Delaware A-OK Campground, Inc., 1987 WL 28317 (Del. Super. Dec. 9, 1987), that case factually differs from the case at issue in several material ways. The first requirement is met by the existence of the Delaware General Corporation Law, 8 Del.C. §101 *et seq*. As for the second prong, there was an eight month span between the earliest activities of the entity and its final incorporation. "After a two-month delay, the parties were informed that the name was unavailable, and the accountant filed

for a corrected name. Another delay regarding filing fees, which was apparently not the principal's fault". Cleary at 4. With respect to the third prong, "[t]he business did exercise its corporate power" from the beginning. As of that date, it took several steps which indicated its use of corporate powers. It began operations as a business. It obtained an IRS corporate identification number. It made an election for Subchapter S status." Cleary, supra at 4.

**2. The Court of Chancery determined after trial that the facts supported personal liability for Walters and Aylor[5]**

In the present case, the Court found that Walters and Aylor acted in a haphazard manner by failing to create an artificial entity to be the buyer of the assets and choosing to forego amending the APA after learning that there was no corporate buyer (2012 Memorandum Opinion 13). New Environmental adopted Old Environmental's name to continue contracts which brought significant remuneration, and used and sold other assets of New Environmental without paying for them. The Appellants, knowing of the lack of a corporate buyer, remained silent and took advantage of the action or non-actions of their attorney to the detriment of the Seller, and compounded the problem by not

[5] Aylor dismissed his appeal on November 1, 2012, thus he is no longer an Appellant.

hiring a replacement attorney to properly conclude the transaction. (2012 Memorandum Opinion 13).

There was no bona fide attempt to organize a buyer under Delaware general corporation law nor colorable compliance with statutory requirements to create an artificial entity as buyer for the assets. Even after knowledge that the corporate buyer was never created, the assets of the Seller were used almost immediately by a corporation (New Environmental) which never legally obtained title to the assets (e.g. by merger, name change, assumption, assignment, purchase, or substitution), and never assumed responsibility for the Buyer's contractual obligations. New Environmental continued in business for the benefit of Walters from July 2005 until at least the time of trial in 2012, yet at the time of trial, nothing had been paid for the assets except for $10,000.

New Environmental also has not established that it has met the third requirement for *de facto* corporation. Other than the Certificate of Incorporation, nothing in the record supports the proposition that New Environmental complied with the Delaware Corporation Law or exercised its corporate powers. Walters submitted no evidence of (i) bylaws; (ii) minutes of annual meetings; (iii) corporate resolutions; director's minutes or evidence of election of officers.

At least as importantly, there are no minutes or documents from New Environmental showing how it received the benefit of Old Environmental's assets. There is no evidence of any transaction by which New Environmental acquired the legal ownership of or became the titled owner of Old Environmental's assets, thus it would be inequitable to allow Walters to escape from personal liability by hiding behind New Environmental, which had no legal relationship to the deal or the assets that were used without payment.

To argue that a corporation that never existed should be solely responsible for Envo's damages is incomprehensible, as is the argument that a corporation created well after the Closing, which completely ignored any obligations under the APA and Promissory Notes, and was never legally vested with the Seller's assets, should nevertheless be the sole obligor. This Court should not permit the Delaware Corporation Law to be used in order to allow Walters to profit from his use of assets for which he admittedly did not pay.

## CONCLUSION

For all of the reasons contained herein, Plaintiff-Below, Envo, Inc. respectfully requests that this Court affirm the decision of the Court of Chancery and dismiss the Appellants' appeal.

COOCH AND TAYLOR, P.A.

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