IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

GENERAL VIDEO CORPORATION, a Delaware corporation, and AUDEO LLC, a Delaware limited liability company,	)	
Plaintiffs,	)	
v.	)	C.A. No. 1922-VCL
EMERY KERTESZ, DANIEL R. SOLIN, PRO ACOUSTICS, LLP, a Delaware limited liability partnership, and PRO ACOUSTICS, LTD., a Delaware corporation,	)	
Defendants.	)	

MEMORANDUM OPINION AND ORDER

Submitted: November 26, 2007
Decided: February 25, 2008

J. Travis Laster, Esquire, Matthew F. Davis, Esquire, ABRAMS & LASTER, LLP, Wilmington, Delaware, *Attorneys for the Plaintiffs.*

Peter J. Walsh, Jr., Esquire, Melony R. Anderson, Esquire, POTTER ANDERSON & CORROON, LLP, Wilmington, Delaware, *Attorneys for the Defendants.*

LAMB, Vice Chancellor.

In 2001, the parties to this litigation entered into a licensing agreement related to certain patented technology that included a representation by the patent holder as to the continued validity of the patent. In December 2005, the patent holder disclosed that the patent had expired in 1996. In February 2006, the licensee filed a complaint that includes claims for fraud and breach of contract arising out of the 2001 licensing agreement. The defendants have moved to dismiss those claims, relying on the applicable three-year statute of limitations. The issue presented by this motion is whether the complaint alleges any basis on which to toll the limitations period under a theory of either fraudulent concealment or equitable tolling. Because the complaint does not reveal any act of concealment and because the invalidity of the patent was easily discoverable by the licensee, the court concludes that no basis exists on which to toll the operation of the limitations period.

I.

A. The Parties

Plaintiff General Video Corporation ("GVC") is a privately-held Delaware corporation in the business of designing, manufacturing, and selling specialized audio and video equipment. Plaintiff Audeo LLC is a Delaware limited liability company that formerly sold specialized speaker equipment as a licensee of GVC.

Justin Korn, a New York resident and a non-party to this litigation, owns a controlling interest in GVC and is the sole owner of Audeo.

Defendant Emery Kertesz, a Texas resident, was the president and one of two directors of GVC (the other was Korn), as well as the president of Audeo at all times relevant to this proceeding. As president of GVC and Audeo, Kertesz was responsible for the day-to-day operations of both companies. Defendant Daniel R. Solin, a Florida resident, initially served as outside counsel to GVC and through this representation allegedly formed a business relationship with Kertesz that resulted in the formation of the two Delaware business entities that are also named as defendants. The first of the business entities is defendant Pro Acoustics LLP, a Delaware limited liability partnership with its principal place of business in Harker Heights, Texas. The second is defendant Pro Acoustics Ltd., a Delaware corporation with its principal place of business in Harker Heights, Texas. These two entities were, allegedly, formed by Kertesz and Solin for the purpose of effecting a scheme to usurp GVC's speciality audio speaker business.

B. The Facts[1]

In 1991, Korn and Kertesz agreed to pursue the commercial development of a speaker system known as the Super Dispersion Ceiling System (the "System").

[1] The brief statement of pertinent facts is taken from the well pleaded allegations of the complaint. This court assumes, as it must, all well pleaded allegations as true. *In re Tyson Foods, Inc.*, 919 A.2d 563, 571 (Del. Ch. 2007).

Kertesz invented the System and held a patent protecting its design. In order to facilitate production of the System, Kertesz agreed to grant a license, permitting distribution of the System and any future variation thereof, to a corporation jointly owned by Korn and Kertesz, namely GVC. The parties agreed that Korn would receive a majority interest in return for funding the business and Kertesz would receive a minority interest and royalty payments on sales of the System. Korn and Kertesz formalized this understanding in a letter agreement dated September 24, 1991 (the "First License Agreement").

GVC began distributing the System in 1991 and Kertesz began receiving royalties, which, according to the complaint, he received uninterrupted through 2003. The plaintiffs contend that GVC's business thrived from 1991 to 1999 and the company expanded to include the manufacture, marketing, and sale of a range of audio and video products. Despite the additional products, GVC's core business was its specialized audio-speaker products, which GVC branded as Pro Acoustics (the "Pro Acoustics Business").[2] The Pro Acoustics Business was stable, consistently profitable, and enjoyed high margins.

[2] The products offered under the Pro Acoustics Business are based on Kertesz's patent to the System.

Due to certain business developments, Korn and Kertesz amended the First License Agreement in a Second License Agreement on January 3, 2001.[3] In connection with the amendment, Korn formed Audeo LLC in September 2002 to assume the Pro Acoustics business as a sub-licensee of GVC. Korn was initially the sole owner of Audeo, however, the parties understood that Kertesz would receive approximately 30% of Audeo's equity.[4] Kertesz became president of Audeo and assumed responsibility for its day-to-day operations. In the Second License Agreement, Kertesz represented that the patent he held on the technology was valid and in good standing.[5]

For reasons alleged in the complaint, Korn and Kertesz had a falling out in 2003. Thereafter, it is alleged, Kertesz and Solin usurped the Pro Acoustics Business and now operate it through Pro Acoustics LLP and Pro Acoustics, Ltd., entities they control. As the complaint alleges:

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[3] Since this agreement largely confirmed the terms in the First License Agreement, GVC and Kertesz dated this agreement "as of November 1, 1991," when GVC operations began. Compl. Ex. C.; Pls.' Answering Br. 9.

[4] Korn, on behalf of Audeo, further memorialized this understanding in an Audeo resolution on September 12, 2002, stating "[b]efore the earlier of the formal launch of its new website or May 5, 2003, [Audeo] will issue to Kertesz a 30% . . . ownership interest in [Audeo] . . . ." Korn Aff. Ex. A. The relationship between the parties deteriorated before either triggering event and Kertesz has not acquired a 30% interest.

[5] The Second License Agreement states, in pertinent part "Emery Kertesz is the owner of patent number 5,088,974 with respect to a Super Dispersion Ceiling System DS-48 speaker system (the "Speaker System") . . . . [Kertesz] represents and warrants that (a) he is the owner of the patent for the Speaker System and (b) no one other than GVC has the right to distribute the Speaker System." Compl. Ex. C 1.

> Kertesz and Solin took GVC[’s] and Audeo’s tangible and intangible assets and used them for their new business, including the essential tooling for manufacturing the [System]. They even used the same name for the business – Pro Acoustics – and the same website pages for the internet sales portal Audeo was prepared to launch, right down to the same URL: www. ProACoustics.com.[6]

Following these developments, lawsuits were filed in state court in New York and both state and federal courts in Texas. In December 2005, in connection with related litigation in Texas federal court,[7] Kertesz revealed that his patent had expired in February 1996 because he failed to make the required maintenance payments. The facts are unclear as to when Kertesz first learned of the expiration.

II.

The plaintiffs advance 14 counts for relief in their second amended complaint. The claims relevant to this opinion are counts XIII and XIV. Count XIII claims Kertesz committed fraud in entering into the Second License Agreement and in receiving royalty payments based on the expired patent. Count

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[6] Compl. ¶ 81. Plaintiffs further allege that:

- Kertesz took the intangible property and assets of GVC and Audeo that were used in the Pro Acoustics Business, as well as the trade secrets and trade information associated with the business. Compl. ¶ 84.
- Kertesz took GVC’s and Audeo’s computer hardware and software, their website development files, their company files, their customer lists and account information, drawings, photographs and specifications, and general know-how. *Id*.

[7] On November 20, 2006, the United States District Court for the Western District of Texas dismissed the Texas federal action for lack of jurisdiction over Korn. The United States Court of Appeals for the Fifth Circuit affirmed the decision on May 24, 2007. Pls.’ Answering Br. 18.

XIV contends that Kertesz breached the First License Agreement and the Second License Agreement by failing to maintain the patent.

The defendants move to dismiss, under Court of Chancery Rule 12(b)(6), counts XIII and XIV as barred by the three-year statute of limitations, which both parties agree precludes these claims if the statute of limitations is not tolled. As a result, the issue before this court is whether the limitations period was tolled for counts XIII and XIV until Kertesz's December 2005 disclosure. If so, the complaint was timely filed.

The plaintiffs contend counts XIII and XIV are timely because the doctrine of fraudulent concealment, or, alternatively, the doctrine of equitable tolling suspended the running of the statute of limitations. In support of this position, the plaintiffs allege that elements of fraudulent concealment are met because Kertesz falsely represented that he owned the patent and he improperly received royalty payments following the expiration of the patent. The plaintiffs also contend that the facts support the application of equitable tolling since Kertesz made these representations in his capacity as a fiduciary and his conduct constituted self-dealing.

The defendants respond that the complaint fails to allege that Kertesz knew the patent expired at the time he made the representation and fails to allege any act of affirmative concealment on Kertesz's part. With respect to the plaintiffs'

equitable tolling allegations, the defendants argue that Kertesz was not self-dealing or acting as a fiduciary, but rather as the holder of the patent receiving royalty payments pursuant to a contract, making the application of principles of equitable tolling inappropriate.

The defendants also argue that neither theory should assist the plaintiffs since both doctrines only toll the statute of limitations until the injured party knew or should have known, through the exercise of reasonable diligence, of the injury. According to the defendants, reasonable diligence in this case required the plaintiffs to perform a simple internet search of the United States Patent and Trademark Office website to confirm the validity of the patent before entering into the Second License Agreement or at any time thereafter.

III.

"There is clear legal precedent in Delaware for granting a motion to dismiss on the ground that a plaintiff's claims are barred by operation of the statute of limitations."[8] "Although statues of limitation do not generally apply directly in equity, equity follows the law and will apply a statue of limitations by analogy in appropriate circumstances."[9] In these circumstances, "statutes of limitations that apply to actions at law are deemed to establish a time period beyond which delay

[8] *In re Dean Witter P'ship Litig.*, 1998 WL 442456, at * 3 (Del. Ch. July 17, 1998).
[9] *Id*.

in bringing a claim is presumptively unreasonable for purposes of laches."[10] Here the parties agree that 10 *Del. C.* § 8106 applies by analogy and imposes a three-year period of limitations on both claims.[11] Therefore, in the absence of the application of a tolling doctrine, "a court of equity will deny a plaintiff relief when suit is brought after the analogous statutory period."[12]

The first step in determining whether an action is time-barred is identifying when the action accrued.[13] In this case, the parties agree that the accrual date for counts XIII and XIV was the date of the execution of the Second License Agreement, January 3, 2001. Since the plaintiffs filed their complaint on February 3, 2006, there is no dispute that without an applicable tolling exception these claims are time-barred.

As noted, the plaintiffs advance two theories to support suspension of the statute of limitations: fraudulent concealment and equitable tolling. Under fraudulent concealment, there must be an "affirmative act of concealment by a

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[10] *Brady v. Pettinaro Enter.*, 870 A.2d 513, 526 (Del. Ch. 2005).
[11] *See Wal-Mart Stores Inc. v. AIG Life Ins. Co.*, 860 A.2d 312, 319 (Del. 2004) ("The starting point of the Court of Chancery's analysis . . . is that the applicable statute of limitations is 10 *Del. C.* § 8106, which imposes a three-year period of limitations on Wal-Mart's tort, contract, and fiduciary duty claims . . . .").
[12] *United States Cellular Invs. Co. v. Bell Atlantic Mobile Sys. Inc.*, 677 A.2d 497, 502 (Del. 1996).
[13] *Id.* at 503.

defendant . . . that prevents a plaintiff from gaining knowledge of the facts or some misrepresentation that is intended to put a plaintiff off the trial of inquiry."[14]

Equitable tolling invokes a less stringent pleading standard than fraudulent concealment.[15] Under this doctrine, "the statute of limitations is tolled for claims of wrongful self-dealing, even in the absence of actual fraudulent concealment, where a plaintiff reasonably relies on the competence and good faith of a fiduciary."[16] Significantly, tolling will only be available under either doctrine until "the plaintiff discovers (or exercising reasonable diligence should have discovered) his injury."[17] "A plaintiff who contends that the limitations period is tolled under either doctrine has the burden of pleading specific facts that, if true, would establish tolling."[18]

The plaintiffs do not adequately allege fraudulent concealment. The complaint does allege enough to create an issue of fact about whether Kertesz actually knew of the falsity of the representation he made in the January 3, 2001 amendment. While the plaintiffs only concede that it is not enough to allege (as the complaint does) that Kertesz "knew or should have known" that the patent had expired at the time of the Second License Agreement, they ask the court to infer

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[14] *Dean Witter*, 1998 WL 442456, at * 5.
[15] *See In re MAXXAM, Inc./Federated Dev. S'holders Litig.*, 1995 WL 376942, at *7 (Del. Ch. June 21, 1995).
[16] *Dean Witter*, 1998 WL 442456, at *6.
[17] *Id*.
[18] *In re MAXXAM*, 1995 WL 376942, at *7.

actual knowledge from numerous other allegations in the complaint asserting that Kertesz must have received notices as the registered holder of the patent. More specifically, the complaint alleges, "Kertesz knew of this obligation because the United States Patent Office requires standardized maintenance payments 3½, 7½ and 11½ years after the original patent is granted."[19] The plaintiffs argue that since Kertesz did not change addresses, he must have received notices from the Patent Office and, thus, knowingly failed to maintain the patent. In addition, the plaintiffs argue that Kertesz and Korn spoke about the importance of maintaining the patent, indicating Kertesz's awareness of the obligations associated with maintaining the patent.

Nevertheless, even assuming that Kertesz knew the patent expired, there are insufficient allegations that he took affirmative steps to conceal the expiration of the patent. The plaintiffs argue that the affirmative act requirement is met because Kertesz told Korn he would keep the patent in force and Kertesz "actively concealed the falsity of his misrepresentations by continuing to work and pay himself royalties as if the patent were valid."[20] But these royalty payments were made and received pursuant to the terms of a contract and do not constitute

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[19] Compl. ¶ 56.

[20] Compl. ¶¶ 58, 59. The plaintiffs also cite a fax dated February 3, 2000, in which Kertesz wrote to Korn that he was "going to draw up a distributor agreement between myself and GVC to protect the patent and my rights." Compl. ¶ 58.

affirmative acts designed to "put the plaintiff of the trail of inquiry."[21] Nor can any ambiguous general statement made by Kertesz or his silence regarding the expiration of the patent represent an affirmative act of concealment.[22]

More clearly, the claim of fraudulent concealment fails because reasonable diligence obligated the plaintiffs to confirm the validity of the patent before entering into the Second License Agreement. The doctrine of fraudulent concealment will only toll a claim until the injured party, exercising reasonable diligence, should have discovered the alleged injury.[23] Given the minimal steps necessary to confirm the continued validity of the patent and the importance of the patent in the framework of the Second License Agreement, the conclusion is inescapable that the plaintiffs' failure to exercise reasonable diligence makes tolling of the statute of limitations inappropriate.

The plaintiffs rely primarily on the Delaware Supreme Court decision in *Giordano v. Czerwinski*[24] for their position that their failure to consult the U.S. Patent Office at the time of the Second License Agreement does not prohibit the

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[21] *Cf. CertainTeed Corp. v. Celotex Corp.*, 2005 WL 217032, at *8 (Del. Ch. Jan. 24, 2005) (a plaintiff claiming fraudulent misrepresentation based on false representation and warranties failed to allege the requisite affirmative act under fraudulent concealment because there were no allegations of post-closing acts to "cover-up" non-compliant conditions).
[22] *See S & R Assocs., L.P. v. Shell Oil Co.*, 725 A.2d 431, 435-36 (Del. Super. 1998) ("Mere silence or failure to disclose does not constitute such fraudulent concealment as will suspend operation of [a statute of limitations].") (quoting *Lecates v. Hertrach Pontiac Buick Co.*, 515 A.2d 163, 176 (Del. Super. 1986)).
[23] *Dean Witter*, 1998 WL 442456, at *6.
[24] 216 A.2d 874 (Del. 1966).

application of fraudulent concealment. In *Giordano*, the plaintiff asked the defendant, who had previously sold him automobile insurance, to add a second vehicle to the policy. When the second vehicle was involved in an accident three days later, the plaintiff learned the second car was never added to the policy. Nevertheless, the plaintiff failed to bring suit against the agent for four years. In considering the application of fraudulent concealment, the court noted that a statute of limitations is tolled "only until his rights are discovered or could have been discovered by the exercise of reasonable diligence,"[25] and determined the statute of limitations should be tolled only until the time the plaintiff learned, at the time of the accident, that the second car had not been added to the policy. Here, the plaintiffs rely on *Giordano* for the proposition that the statute of limitations should be tolled until they learned of the misrepresentation. The plaintiffs assert that:

> The Supreme Court [in *Giordano*] had no difficulty holding that the statute of limitations was tolled until the time of the accident, even though the plaintiff could have ascertained the true facts by simply picking up the phone and calling either his insurance company or the State Insurance Commissioner. The ability to consult these sources was not sufficient to put [the plaintiff] on inquiry notice and cause the statute to run.[26]

There are many distinctions between this case and *Giordano*. The plaintiffs here are sophisticated parties who entered into a license agreement that controlled a

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[25] *Id.* at 876.
[26] Pls.' Answering Br. 31.

key aspect of the business from which they derived significant income. Failing to confirm, through a simple internet search, the validity of the patent that formed the basis of this agreement is far different from the failure of an individual to demand immediate written evidence of the binding validity of a car insurance policy when she was assured by her agent that coverage was provided.[27] Moreover, the court in *Giordano* only tolled the statute of limitations until the date of the accident, three days later, which demonstrates the courts' interest in encouraging parties to take reasonable steps to investigate their interests.

Based on the same analysis, the plaintiffs' equitable tolling argument also fails. This doctrine, like fraudulent concealment, includes the same reasonable diligence requirement.[28] Permitting the plaintiffs to invoke the protection of equitable tolling in these circumstances would offend the underlying meaning of this doctrine, that "even an attentive and diligent [investor] relying, in complete propriety, upon the good faith of [fiduciaries] may be completely ignorant of transactions that . . . constitute self-interested acts injurious to the [Partnership]."[29]

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[27] The plaintiff in *Giordano* also argued to toll the limitation period until she discovered, four years after the accident, that the "agent" she dealt with and who held himself out as a licensed insurance agent had never been licensed by the State of Delaware. The Delaware Supreme Court affirmed the decision of the trial court that the complaint failed to allege a proximate causal relationship between that misrepresentation and the plaintiff's loss. *Giordano*, 216 A.2d at 876.

[28] *Dean Witter*, 1998 WL 442456, at *6.

[29] *Id*. at *6 (quoting *Kahn v. Seaboard Corp*., 625 A.2d 269, 276 (Del. Ch. 1993)). It is also worth mentioning that the patent number represented in the Second License Agreement appears to be incorrect. The correct patent number is identified in the patent bibliographic data sheet attached to Melony R. Anderson's affidavit. Melony Aff. Ex. 1 at 3. This does not change the analysis because a search under the incorrect patent number would have led the plaintiffs to seek the real patent number from Kertesz and confirm its validity.

IV.

For the foregoing reasons, counts XIII and XIV of the complaint are dismissed. IT IS SO ORDERED.