IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

IN AND FOR NEW CASTLE COUNTY

TECHNICORP INTERNATIONAL II, INC. and STATEK CORPORATION, Plaintiffs, v. H. FREDERICK JOHNSTON, SANDRA SPILLANE, BLM HOLDING CORPORATION, BAI CORPORATION, METRODYNE CORPORATION, SAMCO INVESTORS, INC., RARE STAMPS INVESTMENTS, INC., TECHNICORP INTERNATIONAL IV LTD., TECHNICORP INTERNATIONAL V LTD., TECHN-ICORP INTERNATIONAL, INC., TECHNICORP VENTURES, INC., TECHNICORP INDUSTRIES, INC., and ECM DEVICES, INC., Defendants.	)	Civil Action No. 15084

MEMORANDUM OPINION

Date Submitted: August 10, 1999
Date Decided: May 31, 2000

Thomas J. Allingham, II, Esquire, of SKADDEN, ARPS, SLATE, MEAGHER & FLOM LLP, Wilmington, Delaware; Attorney for Plaintiffs

David A. Jenkins, Esquire, of SMITH, KATZENSTEIN & FURLOW, Wilmington, Delaware; and Allan M. Pepper, Esquire, of KAYE, SCHOLER, FIERMAN, HAYS & HANDLER, LLP, New York, New York; Attorneys for Defendants

JACOBS, VICE CHANCELLOR

Of the many corporate matters that have graced the portals of this Court, this case may be one of the most bitterly litigated. It certainly is one of the most sordid. Although this Opinion is lengthy and involves a host of complex issues, its story line is easily summarized.

In 1984, Miklos Vendel ("Vendel") and H. Frederick Johnston ("Johnston") formed Technicorp International II, Inc., a Delaware corporation ("TCI II"), to acquire a high-technology California corporation called Statek, Inc. ("Statek"). It was agreed that these two investors would own shares in TCI II (which, in turn, owned Statek) in proportion to their capital investment, and that Johnston would own 53% of TCI II's shares. Vendel, a Swiss citizen, would not be involved in managing the corporations.

From 1984 through 1995, Johnston and his associate, Sandra Spillane ("Spillane") exclusively managed and controlled TCI II and Statek, including all access to their cash and corporate records. To say it bluntly, during that period Johnston and Spillane systematically looted those companies, treating their assets as their private preserve, and during much of that time they were able to defraud Vendel into believing that all was well.

Although Johnston held himself out as TCI II's controlling shareholder, he never validly owned a majority of TCI II's stock, because he never contributed a

majority of its equity, and what equity he did invest was ultimately repaid to him. As a result, Johnston owns no equity in TCI II, nor has he owned equity since the time his debt contribution was repaid. For that reason, as discussed in this Opinion, the Court holds that Johnston's TCI II shares must be canceled or subjected to a constructive trust. Moreover, Johnston and Spillane lived like jet-setting potentates. They traveled extensively and lavishly in this country, in the Bahamas, and throughout Western Europe, all at these corporations' expense, while keeping the corporate books and records in such a way as to minimize, if not altogether avoid, the risk of being held accountable.

At some point Vendel learned that something untoward was going on at TCI II and Statek. He tried to discover what was occurring, but met with resistance at every turn. Vendel finally resorted to litigation, causing a series of lawsuits to be brought against Johnston and Spillane. This lawsuit, which is brought by TCI II and Statek (now under Vendel's control), seeks equitable relief and money damages against Johnston, Spillane, and entities owned or controlled by them,'

'These entities -- all corporate defendants owned or controlled by Johnston and/or Spillane -- are referred to as the "Johnston Entities" and include: Acosta Street Corporation, Amplifonix, Inc. ("Amplifonix"), Artafax Systems, Ltd. ("Artafax"), BAI Corporation ("BAT'), Beverly Lane Limited ("Beverly Lane"), BLM Holding Corporation ("BLM"), Digital Products, Inc. ("Digital"), ECM Devices, Inc. ("ECM"), Greenray Industries, Inc. ("Greenray"), Metrodyne Corporation ("Metrodyne"), Rare Stamps Investments, Inc. ("Rare Stamps"), Samco Investors, Inc. ("Sarnco"), Technicorp International, Inc. ("TCI"), Technicorp International III, Inc. ("TCI

based on claims of fraud, breach of fiduciary duty and corporate waste.

The defendants' past pattern of resisting accountability continues unabated. In this action that resistance takes the form of arguments (raised as affirmative defenses) that this Court lacks *in personam* jurisdiction over the defendants and that the plaintiffs' money damage claims are barred by the statute of limitations. As later discussed in this Opinion, the Court finds that those defenses lack merit.

The bulk of this Opinion concerns the plaintiffs' many and substantial claims for money damages. The plaintiffs claim that during the almost twelve years of their stewardship of TCI II and Statek, Johnston and Spillane wrongfully diverted to themselves at least $28.5 million of those corporations' assets in several different ways. The task of proving those diversions was daunting, because many of the expenditures were either inadequately documented or not documented at all. As a result, the same core issue tends to repeat itself in several different contexts: where (as here) corporate fiduciaries cause the corporation to pay moneys to themselves or to third parties, and the fiduciaries cannot document any legitimate business purpose for the expenditures, is the Court required to accept the fiduciaries' uncorroborated and self serving testimony of business

---

III"), Technicorp Industries, Inc. ("TII"), Technicorp Ventures, Inc. ("TVI"), Technicorp International IV ("TCI IV"), and Technicorp International V.

purpose? The answer, again repeated at many different points, is clearly no, particularly where (as here) the fiduciaries have given false testimony and presented falsified evidence.

It is a well established principle of equity that fiduciaries have a duty to account to their beneficiaries for their disposition of all assets that they manage in a fiduciary capacity. That duty carries with it the burden of proving that the disposition was proper. If any corollary proposition is central to this case, it is that included within the duty to account is a duty to maintain records that will discharge the fiduciaries' burden, and that if that duty is not observed, every presumption will be made against the fiduciaries. As discussed herein, the application of that principle results in the defendants being liable for most of the plaintiffs' money damage claims.

The relief that plaintiffs seek includes damages of $28.5 million, plus all other monies wrongfully diverted by the defendants, plus interest. It also includes the imposition of a constructive trust for TCI II's benefit upon the defendants' TCI II stock and upon all diverted funds in their possession, and/or the cancellation of Johnston's TCI II shares.

This is the Opinion of the Court, after trial, on the merits of the plaintiffs' claims. For the reasons next set forth, I find that, with.minor exceptions, the

plaintiffs have established their entitlement to the relief they request. In addition, I grant the defendants relief on their counterclaim, subject to the conditions set forth in Part VI of this Opinion.

I. INTRODUCTION

A. Background*

In 1984 Johnston and Miklos Vendel, a Swiss citizen ("Vendel") agreed jointly to purchase Statek, a California-based manufacturer of micro-electronic components. TCI II was formed as the acquisition vehicle, and its sole stockholders were Johnston and Vendel. At all times from and after Statek was acquired, it was operated as a wholly owned subsidiary of TCI II, and TCI II was operated solely and exclusively by Johnston and Spillane with no input from or participation by Vendel. In the early years, Johnston and Spillane constituted a majority of TCI II's board of directors. Later, they constituted TCI II's entire board. At all relevant times Johnston served as TCI II's Chairman, President, and Treasurer, while Spillane, who was Johnston's long-time business associate and companion, served as TCI II's Vice President and Secretary.

---

[2] To avoid overburdening what of necessity is a lengthy Opinion, no comprehensive statement of facts is set forth at this point. Instead, the background facts leading to the commencement of this action are narrated in this Section of the Opinion, and the facts pertaining specifically to the parties' claims and defenses are discussed in the later Sections devoted specifically to those claims and defenses.

For six years after TCI II was formed, Vendel received almost no financial information about his investment in that corporation. Moreover, critically important information was concealed from Vendel, including the fact that Johnston and Spillane had caused TCI II to make interest-free "loans" to themselves totaling almost $6 million. Also concealed was the fact that Johnston had failed to contribute his agreed-to share of equity capital -- a fact that rendered false Johnston's representations to Vendel that he (Johnston) was TCI II's majority shareholder.

After repeated requests for information, in October, 1993 Vendel brought an action under 8 Del. C. § 220 on behalf of himself and his nominee, Arbitrium (Cayman Islands) Handels A.G. ("Arbitrium"), to inspect TCI II books and records that Johnston and Spillane had refused to produce to Vendel.[3] That action (the "$220 action") was ultimately settled. As part of the settlement, Vendel was furnished certain documents, including documents TCI II's then-counsel had previously represented did not exist. Based on those documents, Vendel concluded that he -- not Johnston -- was TCI II's majority stockholder. Accordingly, in April 1994, Vendel executed a written consent removing Johnston

---

[3] *Arbitrium (Cayman Islands) Handels v. Technicorp International II, Del. Ch.,* C.A. No. *13240,* Mem. Op., Chandler, V.C. (Feb. 4, 1994).

and Spillane as directors of TCI II. Those defendants refused to honor that consent. As a consequence, Vendel and Arbitrium brought an action under 8 Del. C. § 225 (the "$225 action") for a determination that they were TCI II's majority stockholder, and in that capacity had validly removed Johnston and Spillane as officers and directors of TCI II.[4]

On January 5, 1996, after a six day trial on the merits, this Court issued an Opinion (the "January 5 Opinion") upholding the consent.' On January 11, 1996, the Court entered an Order (the "January 11 Order") removing Johnston and Spillane as officers and directors of TCI II and directing them to surrender control of TCI II's and Statek's property, including all records, to Vendel. Ever since control was surrendered, TCI II and Statek have been operated by Vendel and persons under his direction.

Following the change in control, plaintiffs' accounting expert, Mr. John Garvey of Chicago Partners LLC ("Garvey"), conducted a five month

---

[4] *Arbitrium (Cayman Islands) Handels v. Johnston,* Del. Ch., C.A. No *13506,* Mem. Op., Jacobs, V.C. (Jan. 5, 1996), *aff'd,* Del. Supr., 638 A.2d 59 (1996).

[5] *Id.* (Jan. 5, 1996). That bitterly fought litigation generated several Opinions during its pretrial stage. *Id.* (Oct. 6, 1995); *Id., (Nov.* 21, 1994); *Id.* (Oct. 19, 1994); *Id.* (Sept. 23, 1994), as well as after the trial. In an Opinion handed down on May 27, 1997, the Court held that Johnston and Spillane had defended the $225 action in bad faith and, accordingly, were liable to Vendel for the attorneys' and expert witness fees he incurred in that action. *Arbitrium (Cayman Islands) Handels AG, et al. v. Johnston, et al.,* Del. Ch., 705 A. 2d 225 (1997), *aff'd,* Del. Supr., 720 A.2d 542 (1998). Those fees and expenses totaled approximately $1.6 million.

investigation of TCI II's and Statek's books and records. Garvey's investigation caused him to report that Johnston and Spillane had diverted more than $28.5 million from both corporations during their tenure. Accordingly, on June 26, 1996, the plaintiffs commenced this action to recover the diverted assets!

In response, the defendants denied liability, interposed affirmative defenses, and asserted counterclaims for the value of the services they claimed to have provided to TCI II and Statek. On August 22, 1997, the Court issued an Opinion denying the plaintiffs' motion for partial summary judgment.[7] Discovery then ensued, and after two years the case was tried on its merits for eight trial days, between September 14, 1998 and November 16, 1998. Post-trial briefing and oral argument, based upon a voluminous trial record, were concluded on August 10, 1999.

B. The Structure of This Opinion

To treat most clearly and directly the plethora of claims, defenses, and counterclaims being advanced by both sides, this Opinion is structured to address the issues in their most logical order. Accordingly, Section II of this Opinion is

---

[6] *Technicorp International II, Inc. v. Johnston,* Del. Ch., C.A. No. 15084, Mem. Op., Jacobs, V.C. (Aug. 25, 1997).

[7] *Id.* (Aug. *22,* 1997).

devoted to the defendants' affirmative defenses, ***i.e., their*** contentions that this Court lacks personal jurisdiction over Johnston and Spillane and that the plaintiffs' claims are time-barred. Next considered, in Sections III, IV, and V, are the plaintiffs' affirmative claims that (i) Johnston's TCI II stock should be canceled or subjected to a constructive trust because Johnston has no equity in TCI II (Section III); and that (ii) a money judgment should be entered against Johnston and Spillane for over $28.5 million that they improperly diverted from TCI II (Section IV) and Statek (Section V) by reason of fraud, waste, and/or breaches of fiduciary duty. Finally, Section VI addresses Johnston's and Spillane's counterclaim that they are entitled to reasonable compensation for services they performed for TCI II and Statek.

II. THE AFFIRMATIVE DEFENSES

A. The Personal Jurisdiction Defense

Service of process over Johnston and Spillane was effected under 10 Del. C. §§ 3 114 and 3 **104. The** defendants do not contest this Court's in personam jurisdiction over them with respect to TCI II's claims to recover monies wrongfully diverted *from TCI II.* Nor could they, because those claims are asserted against Johnston and Spillane in their capacity as directors of TCI II, and therefore come within $3 114, which relevantly provides that a person who serves

as a director of a Delaware corporation is deemed to have consented to the jurisdiction of the Delaware Courts "in any action or proceeding against such director...for violation of a duty in such capacity."'

What the defendants do contest is the Court's personal jurisdiction over them with respect to the plaintiffs' remaining claims (i) to cancel and/or impose a constructive trust upon Johnston's TCI II shares, and (ii) to recover monies wrongfully diverted from Statek. With respect to the first claim, the defendants argue that if Johnston failed to pay into TCI II the equity capital he had agreed to contribute, that failure was in his individual capacity as a stockholder, not in his fiduciary capacity as a director. With respect to the second claim, the defendants argue that if they wrongfully diverted monies from Statek, they did so in their capacities as directors of Statek, which is not a Delaware corporation. For that reason (defendants say) this latter claim is not covered by $3 114 either.

These arguments are now addressed.

1. Jurisdiction Over Claims Respecting Statek

Statek is a California corporation that is asserting a direct claim against Johnston and Spillane for wrongful diversion of Statek's funds. If Statek were the

---

[8]Nor do the defendants contest personal jurisdiction over the Johnston Entities, most if not all of which are Delaware corporations.

only plaintiff asserting that claim, the defendants' jurisdictional argument would have merit, because $3 114 relevantly encompasses only claims "made by or on behalf' of a Delaware corporation in "any action or proceeding against [a] director....for violation of a duty in such capacity...." What defendants overlook, however, is that TCI II is a Delaware corporation and that Statek is not only TCI II's wholly owned subsidiary, but also it is its sole asset and business. Therefore, plaintiffs argue, the wrongful diversions from both TCI II and Statek were breaches of Johnston and Spillane's duties, as TCI II directors, to preserve the assets of Statek, which was TCI II's only operating asset and source of income.' Thus, the wrongful diversions from Statek constituted breaches of fiduciary duty owed to TCI II as well as to Statek.

In *Hoover Industries, Inc.v. Chase,* [10] a director and officer of a corporation and its subsidiary was charged with wrongfully diverting assets of both the parent and the subsidiary. The director claimed jurisdiction under $3 114 was unavailable because the challenged transactions were performed in his capacity as an "officer" rather than as a director. Rejecting that contention, former Chancellor Allen stated

---

[9] See *Hoover Indus., Inc. v. Chase,* Del. Ch., C.A. No. 9276, Mem. Op., Allen, C. (July 13, 1988); see *also Anadarko Petroleum Corp. v. Panhandle Eastern Corp.,* Del. Supr., 545 A. 2d 1171, 1174 (1988).

[10] *Id.*

that "[t]he duty of loyalty of a director is...a special obligation upon a director in ***any*** of his relationships with the corporation." The Chancellor also observed that it well may be that " a director qua director owes a duty to the corporation to so conduct himself in all of his capacities so as not to inflict an intentional, wrongful injury upon the corporation,"[11] but the Court found it unnecessary to explore the Statek.[12]

"*Hoover Indus., Inc.*, C.A. No. 9276 at 4, 5 (emphasis added).

[12]Because the Court has direct personal jurisdiction over TCI II's claim to recover for the wrongful diversion of Statek's assets, under principles of ancillary jurisdiction the Court may also entertain Statek's direct claim for that same relief, because (i) the latter claim arises out of the same core facts as the former, and because (ii) it therefore was reasonably foreseeable that Statek as well as TCI II would seek to recover those diverted funds in the same lawsuit. In this context it is artificial to separate the defendants' role as directors of Statek from their role as directors of TCI II. See ***Technicorp Int'l II, Inc. v. Johnston***, Del. Ch., C.A. 15084, Mem. Op. at 40, Jacobs, V.C. (August 22, 1997).

2. Jurisdiction Over Claims Concerning Johnston's Shares of TCI II Stock

I also conclude that personal jurisdiction lies under §3114 with respect to the plaintiffs' claim to cancel and/or impose a constructive trust upon Johnston's TCI II stock. That is because the theory of liability upon which that claim rests is that Johnston and Spillane abused their positions *as directors* by causing TCI II to issue stock to Johnston without consideration.[13]

In *Jaffe v. Regensberg*, the director defendants argued that Section 3 114 could not be invoked as the basis to assert personal jurisdiction over them, because the claim -- for cancellation of stock issued to a director -- was in reality being asserted against the director in his individual capacity as a stockholder. Rejecting that argument, the Court held:

> . ..It is alleged, in essence, that acting in their capacities as the majority of the board of directors...the individual defendants violated their duty as directors by authorizing the issuance of...shares...for no corporate purpose and for no reason other than to attempt to enable Regensberg and his associates to remain in control of [the corporation], knowing full well at the time that if existing stock purchase agreements were exercised by others the issuance of the...shares to Regensberg would result in]the corporation] having issued...more shares of stock than authorized by its certificate of incorporation. The fact that the relief might work against one or more of the individual

[13] *See Maclary v. Pleasant Hills, Inc.*, Del. Ch., 109 A.2d 830 (1954); *Cahall v. Burbage*, Del. Ch., 121 A. 646 (1923).

> defendants in their personal capacities in order to rectify the situation does not detract from the theory of liability which activates the provision of $3 1 14.[14]

The only distinction between *Regensberg* and this case is that the issuance of *the* TCI II shares is said to be invalid for a different reason, i.e., it was issued for no consideration as distinguished from being issued to perpetuate control. That distinction, however, is of no significance in this context.

For these reasons, the affirmative defense that this Court lacks personal jurisdiction over the defendants lacks merit and is rejected.

B. The Time Bar Defense

The defendants next argue that the plaintiffs' money damage claims are all time-barred by application of the analogous three-year statute of limitations, because on and before June 26, 1993 (three years before this action was filed), Vendel had reason to know the facts giving rise to the present claims, and because those facts must be imputed to the corporate plaintiffs.[15] The defendants rely

---

[14] *Jaffe* v. *Regensberg,* Del. Ch., C.A. No. 5965, Brown, V.C., Mem. Op. at 6, (Jan. 10, 1980).

[15] "Where a plaintiff seeks a legal remedy in a court of equity and a statute of limitations exists for an analogous action at law, the statutory period may create a presumptive time period for application of laches to bar a claim." U.S. *Cellular v. Bell Atlantic Mobile Systems, Inc.,* Del. Supr., 677 A.2d 497,502 (1996). In this case the analogous statutory period is conceded to be three years. This defense is relevant only to the plaintiffs' claims for money damages. It leaves unaffected the claims for equitable relief, including, specifically, the claims for a constructive trust for all property derived from the wrongfully diverted funds and the claim to cancel

upon Delaware decisions holding that in corporate fiduciary cases where self-dealing is alleged, the disclosure of facts that create a shareholder duty of inquiry will cause the limitations period to run from the time the plaintiff shareholder knew or had reason to know the facts constituting the wrong?

Specifically, the defendants point to two events that predated June 26, 1993, each of which (defendants argue) establishes that the plaintiffs (through Vendel) were on inquiry notice of the facts underlying their claims before the three-year period preceding the filing of this action. The first event was the issuance of a March 29, 1993 report by a Swiss forensic accounting firm, Derungs Treuhandgesellschafi AG ("Derungs"), which Vendel had hired to review certain information about TCI II that Vendel had accumulated up to that point. Vendel first became suspicious of Johnston 's management of TCI II in August 1991, when he received (under cover of an unsigned letter about which Johnston and Spillane implausibly denied any knowledge) a TCI II balance sheet showing total equity of only $175,000, even though Vendel had invested $250,000 of equity

---

unaffected the claims for equitable relief, including, specifically, the claims for a constructive trust for all property derived from the wrongfully diverted funds and the claim to cancel Johnston's TCI II shares.

[16] *See, e.g., Kahn v. Seaboard Corp,* Del. Ch., 625 A.2d 269 (1993); In *re USACafes, L.P. Litig.,* Del. Ch., Consol. C.A. No. 11146, Allen, C. (Jan. 21, 1993); U.S. *Cellular, 677* A.2d at 497, n.15.

capital when TCI II was formed. Vendel promptly sought explanations from Johnston and later from Samuel Greenspoon, TCI's then-counsel and a director. Those inquiries were "stonewalled" and as a result, Vendel retained Derungs which issued a report in March 1993, concluding preliminarily that Johnston had defrauded Vendel of his investment, and also had failed to honor his own commitment to contribute capital. The Derungs report also stated that the limited number of available documents did not provide any explanation of where or how the funds that had been upstreamed from Statek to TCI II had been disposed of. Derungs therefore recommended that Vendel file suit to obtain other documents that would enable him to determine what had happened.

The second event, which occurred shortly after Vendel received the Derungs report (but before June 26, 1993), was Vendel's filing of a lawsuit in Connecticut against Johnston and Spillane (the "Connecticut action") for an accounting, a constructive trust, and damages for alleged asset misappropriations. The Connecticut complaint alleged that Johnston had misrepresented the amount of his capital contribution, that Johnston and Spillane had misappropriated and diverted at least $3,86 1,910 of funds upstreamed from Statek, and that they had improperly caused Statek to pay Johnston at least $1,813,3 17 in the form of "administrative service fees." The Connecticut court dismissed the action with

leave to amend, on the basis that the claims were derivative in nature and the complaint failed to plead fraud with particularity. In a conference with the Connecticut Magistrate Judge during which Johnston refused to give Vendel access to any of TCI II's books and records, the Magistrate Judge suggested that Vendel initiate proceedings in Delaware to obtain access to those records.

Despite having engaged in these litigation tactics, the defendants argue that had Vendel pursued his Connecticut action "he would have uncovered all of the facts which form the basis of the current allegations."[17] Indeed, the defendants even assert, somewhat hyperbolically, that:

> The evidence is overwhelming...that Vendel had sufficient knowledge to put him on notice of his claims as early as the summer of 1991--when, in his own words, he had "suspicion[s]"...--when he received the Derungs Report in March, 1993--when Derungs told him that Johnston had diverted millions of dollars from TCI II and never had put up his capital contribution...--and certainly by June 18, 1993, when he filed the Connecticut Action--which mimics the allegations in this action....'*

The defendants' "time bar" defense is flawed for a host of reasons.

---

[17]Def. Post-Trial Answering Br. at 17.

[18]*Id.* at 18.

First, as a threshold matter the rule that "a court of equity will deny a plaintiff relief when suit is brought after the analogous statutory period," applies only "[a]bsent...unusual circumstances" that justify tolling the statute.[19] In the § 225 action, this Court earlier held that the trial record and Johnston's and Spillane's conduct both before and during that proceeding, "established a highly disturbing pattern of deceitful, bad faith conduct, that could only have been intended to delay the inevitable day of reckoning, and to enable the defendants to continue mulcting the corporation without detection." The Court found that that conduct constituted "highly unusual circumstances" that justified an award of attorneys fees and costs incurred in the $225 action.[20] It would be ironic, indeed inexplicable, if that determination -- supported by intermediate findings that the defendants had perpetrated "promiscuous alterations of testimony," "wholesale shifting of positions," and "fabrication of evidence to present even the semblance of a defense...,"[21] were found insufficient to negate the defense of laches. I conclude that finding should be -- and is -- conclusive on the laches question.

---

[19] *U.S. Cellular, 677* A.2d at 502, n.15.

[20] *Arbitrium (Cayman Islands) Handels,* Del. Ch., 705 A.2d at 233 (1997) (emphasis added).

[21] *Id.* at *237*

Moreover, the Court's summary judgment ruling in this case compels the identical-result. It is a well-established doctrine that fraudulent concealment tolls the running of the statute.[22] During the pretrial stage this Court denied the defendants' motion for summary judgment based on limitations grounds, on the basis that findings made in the § 225 action "point to intentional concealment by the defendants of material facts relating to, among other things, the finances of TCI II and Statek as well.... Those findings alone, in my view, would be sufficient to require denial of the motion on this record."[23]

Second, the defendants' "inquiry notice" argument rests upon the premise that the facts of which Vendel was aware before June 26, 1993, if pursued, would have led to the timely discovery of the defendants' fraudulent scheme. That premise is long on generalities but short on specifics as to what facts Vendel supposedly knew. Moreover, it is also belied by the record. Vendel did, to be sure, have reason to suspect wrongdoing of some kind before 1993, but he did not know the specific facts giving rise to the claims in this action until after he legally

---

[22] *See, e.g., Kahn,* Del. Ch., 625 A.2d at 275 (1993).

[23] Transcript of November 14, 1996 Oral Argument on Defendants' Motion to Dismiss, at 76-78 (Bench Ruling). At that earlier stage the Court did not rest its denial of the summary judgment motion solely on that ground, but ruled that material fact disputes also compelled that result.

wrested control of TCI II and Statek -- and their books and records -- from the defendants in January 1996. During the next six months, Vendel caused those records, which were in a state of disarray, to be audited, and only after the results of Garvey's audit became known did Vendel promptly file this action. The record shows -- contrary to the defendants' naked assertion -- that at each stage Vendel diligently and doggedly pursued all facts of which he was aware, in order to obtain sufficient evidence to plead his claims with particularity. The reason Vendel did not file this action earlier is that at every bend and turn between 1991 and 1996 the defendants resisted and obstructed his efforts to obtain the necessary information.[24]

Although the defendants insist that Vendel delayed unreasonably in filing this action, the foregoing procedural history shows othexwise. Vendel did, in fact, assert in timely fashion what claims TCI II did have in the Connecticut action, with predictable lack of success because of insufficient facts. The Derungs report gave Vendel reason to believe that Johnson had fraudulently misappropriated

[24]Tab 2 of the Appendix to the Plaintiffs' Post-Trial Reply Brief (filed May 17, 1999) sets forth a time line matching Vendel's actions with the state of his knowledge at the corresponding time. That time line, corroborated by independent evidence, shows that Vendel diligently pursued every lead developed from each small morsel of information that he was able to extract from the defendants, only through persistent inquiry followed by expensive, hard-fought litigation.

funds, and led to his filing the Connecticut action, but Derungs also advised Vendel that more facts were needed. The same defendants who now insist that the Connecticut action establishes that Vendel was on inquiry notice, moved successfully to dismiss the fraud count of that action for lack of specificity, and then refused to give Vendel the books and records that he needed to cure that factual defect. The defendants' self-serving posture presumably led the Connecticut Magistrate Judge to suggest that Vendel seek to obtain the books and records in a Delaware proceeding, which Vendel did by voluntarily dismissing the Connecticut action and filing the § 220 action in this Court.

Even in that action the defendants forced Vendel to engage in months of needless litigation until it was settled in March 1994. In the settlement Vendel received, for the first time, documents which revealed that he was the controlling shareholder of TCI II and that for ten years, Johnston and Spillane had "loaned" themselves and the Johnston Entities millions of dollars that were upstreamed from Statek to TCI II.

Based on those documents, Vendel executed a written consent removing Johnston and Spillane as directors of TCI II, the validity of which the defendants refused to acknowledge. The defendants, in bad faith, forced Vendel once again to sue, this time under $225, to enforce the consent. By using delay and other tactics

later found to constitute bad faith, Johnston and Spillane were able to protract the $225 action for almost two years before the validity of the consent was upheld on January 5, 1996.

Not until this Court removed Johnston and Spillane as directors and officers of TCI II and ordered them to turn over all corporate records of TCI II and its subsidiaries -- including Statek -- was it possible to discover the full extent of Johnston's and Spillane's diversion of assets, most notably at the Statek level. It took nearly six months for Vendel (i) to obtain bank and other records and then, (ii) to trace their complex patterns of asset diversions and then (iii) to track down, organize, and tabulate hundreds of thousands of pages derived from those records -- much of which were in disorganized, incomplete, and chaotic form. Only then were TCI II and Statek -- now under Vendel's control -- in a position to file this action seeking relief for the defendants' breaches of fiduciary duty, fraud, waste, and misappropriation of corporate assets. "[A] defendant should not be permitted to use the statute of limitations as a shield where the defendant possesses information critical to the existence of an actionable claim of wrongdoing and prevents the plaintiff from discovering that information in a timely fashion."[25] BY

[25] *In re MAXXAM, Inc. Federated Dev. Shareholders Litig.*, Del. Ch., C.A. Nos. 12 11 1, 12353, Mem. Op. at 13, Jacobs V.C.(June 21, 1995); see *also Gotham Partners, L.P. v. Hallwood Realty Partners, L.P.*, Del. Ch., 714 A.2d 96, 105 (1998) ("Stonewalling by

asserting their limitations/laches defense, that is precisely what the defendants are attempting to do here.

Third, even if the analogous statute of limitations were applicable, it was tolled during the pendency of Vendel's Connecticut, § 220 and $225 actions. It is settled Delaware law that the institution of other litigation to ascertain the facts involved in the later suit will toll the statute while that litigation proceeds. As this Court stated in *Cahall v. Burbage:*

> "Delay pending other proceedings has frequently been held excusable...where the termination of such proceedings was necessary for the ascertainment of facts involved in the later suit...." No long length of time has run in this case since knowledge of the alleged wrongs was acquired, not even so long a time as the minimum period defined in the statute of limitations, and what little delay there was, is explained by the pendency of the other litigation of a character which, when considered, shows that the complainant was diligently seeking a legal determination upon a question precisely similar to the one in controversy here?

---

defendants, if it prevented [plaintiff] from learning about their wrongful conduct, is susceptible to attack under the grounds of equitable tolling or fraudulent concealment.").

[26]Del. Ch., 119 A. 574, 576-77 (1922) (quoting *Central R.R. v. Jersey City,* N.J. Dist., 199 F. 237,245 (1912). The pursuit of a books and records action under §220 has been regarded as "strong evidence that plaintiff was aggressively asserting its claims at that time..." *Gotham Partners,* 714 A.2d at 105, n. 25.

Finally, even if the delay in filing this action were assumed to be unreasonable, "mere delay alone will not give rise to the equitable defense of laches."[27] Rather, a"[c]hange of position on the part of those affected by nonaction, and the intervention of rights are factors of supreme importance."[28] In this case defendants make no claim, nor do they offer any proof, that they were in any way prejudiced by the delay that they themselves caused. That, at the end of the day, is the most telling commentary on the laches defense which, for all the foregoing reasons, is rejected on its merits.

****

The affirmative defenses having been disposed of, I turn to the plaintiffs' affirmative claims for relief.

It would be perverse if the rule were otherwise. On at least two occasions the Supreme Court has expressly encouraged potential derivative plaintiffs to utilize the "tools at hand" to obtain information bearing on the subject of their claims, in order to avoid an unseemly race to the courthouse to file "a plethora of superficial complaints that could not be sustained." *Rales v. Blasband*, Del. Supr., 634 A.2d 927, 932-35, n. 10 (1993). To accept the defendants' time-bar argument would penalize, not encourage, the use of those important tools.

[27] *Wechsler v. Abramowitz,* Del. Ch., C.A. Nos. 6861, 6862, Mem. Op. 3-4, Hartnett, V.C. (Aug.30, 1984).

[28] *Federal United Corp. v. Havender,* Del. Supr., 11 A.2d 33 1,343 (1940).

III. THE PLAINTIFFS' CLAIM TO CANCEL OR IMPOSE A CONSTRUCTIVE TRUST UPON JOHNSTON'S TCI II SHARES

A. The Plaintiffs' Contentions

The plaintiffs seek, first, an order cancelling or (alternatively) imposing a constructive trust upon Johnston's shares of TCI II stock. That relief is predicated upon the plaintiffs' contention that in fact Johnston has no equity in TCI II.

The procedural background of this claim is as follows: on January 5, 1996, this Court determined in the § 225 action that "Vendel's net equity investment in TCI II was $235,000 and Johnston's investment was $100,000," and that as a result "Vendel, through Arbitrium, is the majority stockholder of TCI II..." This Court later ruled in this action that while those $225 determinations were conclusive and binding in this proceeding, a third § 225 ruling -- that Johnston had been refunded a portion of his $100,000 investment -- would not be accorded collateral estoppel effect because (i) that ruling was not essential to determine the critical issue of voting control, and (ii) the refund issue was burdened by material fact disputes. Thus, the procedural bottom line -- that the refund issue could be relitigated in this action but could only be resolved after a trial[30] -- set the stage for

[30] *Technicorp International II v. Johnston,* C.A. No. *15084* at *17-l* 8, 46-48.

plaintiffs to press the arguments they advance here.

The plaintiffs rely upon two arguments to support their position that Johnston has no equity, and therefore is entitled to no stock, in TCI II. A meaningful articulation of those arguments requires additional factual background. In the $225 action this Court found (and there is no dispute) that during the 1970s, BAI, an entity of which Johnston was the Chairman and the indirect sole shareholder[31], became indebted in the amount of $235,800 to a company known as Société Suisse Pour L'Industrie Horlogére S.A. ("SSIH"). BAI later defaulted on that debt. Thereafter, in late 1983 and early 1984, Johnston negotiated the purchase of Statek (on behalf of TCI II) from another Swiss company named ASUAG. During the course of those negotiations, ASUAG acquired BAI's unpaid creditor, SSIH, and discovered the defaulted $235,800 debt owed by BAI, which was controlled by Johnston. ASUAG then refused to sell Statek to TCI II unless the BAI debt was repaid. ASUAG also made the repayment of the BAI debt a condition precedent to the sale in the February 16, 1984 agreement whereby Statek was sold to TCI II for $1,350,000.

[31]BAI was a subsidiary of TVI, another entity that Johnston owned.

As a consequence of ASUAG's position, it became necessary for Johnston and Vendel to raise a total of $1,585,800, $1,350,000 of which was the purchase price for Statek and $235,800 of which represented the payment of the defaulted BAI debt. That amount was raised in the following way: (i) Vendel invested $250,000 in TCI II, (ii) Johnston and certain Johnston Entities paid $335,800 to TCI II, and (iii) TCI II borrowed the $1 million balance from the Bank of America. The BAI debt was paid on February 27, 1984 when Johnston (through one of his Entities, TVI) paid $235,800 to TCI II, which then wrote a check to SSIH, which then assigned the BAI obligation to TCI II. Two days later, on February 29, 1984, the Statek transaction closed, with the $1,350,000 purchase price being injected into TCI II, which then paid over that amount to ASUAG.

A critical issue in the $225 action was whether the funds Johnston invested in TCI II were equity risk capital, debt, or a combination of both. The Court found that at most, $100,000 of Johnston's $335,800 was risk equity capital, because $235,800 had been repaid to Johnston in the years following the acquisition, leaving at most $100,000 of his contribution that (it could be argued) was equity. That finding, however, rested on the assumption that TCI II -- and not Johnston -- was legally responsible for the BAI debt. As a result, Johnston's infusion of the amount of the BAI debt ($235,800) into TCI II could be regarded as equity.

The plaintiffs contended, however, that Johnston was legally responsible for that debt and had used TCI II as a conduit to pay that debt to create a pretext to credit Johnson's $235,800 payment as his equity contribution. The Court did not resolve that issue in the $225 action, because it was unnecessary: under any scenario Vendel would be the majority stockholder of TCI II.

The plaintiffs' two arguments in this case flow from this background. The first argument is that the unresolved BAI issue should now be resolved in plaintiffs' favor, because the evidence shows that Johnston was legally responsible for the BAI debt, for which reason the Court's assumption in the $225 action -- that the BAI debt was properly an obligation of TCI II -- was incorrect. The second argument, which is distinct from and unrelated to the BAI debt issue, is that Johnston's entire $335,800 contribution was booked as a loan to TCI II and was later repaid to him, and as a result, Johnston has no investment "at risk;" i.e., has no "equity capital," in TCI II.

These arguments are now considered.

B. The BAI Debt Argument

As framed by the parties, the issue posed is whether the BAI debt was a debt of Johnston at the time the debt was repaid to SSIH using the $235,800 that Johnston had injected into TCI II. If the BAI debt was a debt of Johnson, then it

is conceded that the $235,800 should not be credited as Johnston's equity capital contribution.

The plaintiffs insist that the record establishes that the BAI debt was Johnston's debt. The defendants respond that none of the evidence upon which plaintiffs rely establishes that Johnston was the debtor, and that the evidence establishes that the debtor was BAI. Moreover, defendants argue, (i) by 1984 that debt had become unenforceable because the applicable period of limitations had expired, and (ii) the BAI debt was paid only because SSIH (ASUAG) had exerted leverage as the owner of Statek by refusing to sell Statek unless the (otherwise uncollectible) debt was paid at or before the closing on the Statek purchase. Despite the apparent inequity of the result, I conclude that the defendants' position is correct.

There is no evidence that the party legally obligated to pay the BAI debt was anyone other than BAI. Although Johnston controlled BAI, the plaintiffs have not shown any basis to pierce BAI's corporate veil. Furthermore, the plaintiffs do not dispute that the period of limitations on the BAI debt had expired by February, 1984. As a consequence, the insistence by SSIH (ASUAG) that the BAI debt be repaid in order for the Statek sale to go forward, is not unlike a seller of a parcel of land, shortly before closing, arbitrarily increasing the purchase price

as a condition to close the sale. In those circumstances the purchaser has a choice: either accede to the price increase or litigate a breach of contract claim against the seller. In this case Johnston and TCI II chose to accede. And although the party who was ultimately responsible for the breach of the contract with SSIH (Johnston, BAI's controlling stockholder) repaid the debt with his own funds, he benefited from doing that by causing his payment to count as a credit towards his equity capital contribution.

Admittedly, some inequity inheres in that outcome. Had Johnston caused BAI to pay its debt to SSIH when it came due, the additional $235,800 cost to acquire Statek would not have been incurred and Johnston would have received no $235,800 capital contribution credit. Indeed, only by investing an *additional $235,800* into TCI II could Johnston receive a capital contribution credit in that amount. Thus, by allowing BAI to default on the debt, Johnston received credit for a $235,800 capital contribution -- a credit that he would not otherwise have obtained.

That inequity is what drives the plaintiffs' effort to reduce Johnston's capital by $235,800. While plaintiffs' effort strikes a sympathetic chord in the equitable and moral sense, their argument is problematic in the legal sense. Although Johnston's conduct did cause BAI to breach its contract, and although

that conduct might give rise to a claim by Vendel for damage relief against Johnston, the plaintiffs have not shown that depriving Johnston of his $235,800 equity contribution would be a legally proper remedy for that claim.

The foregoing analysis assumes (and the record does show) that at the time the Statek transaction closed, Johnston never told Vendel the nature and origin of the additional $235,800 payment, and that after the closing Vendel discovered that the additional payment represented a debt Johnston should have caused BAI to pay years before. In those circumstances Vendel (and perhaps TCI II) could have validly claimed that they were defrauded, because Vendel would have never have consented to giving Johnston credit for a $235,800 capital contribution. To remedy that wrong, Vendel could have sought to rescind the entire. TCI II business relationship by dissolving the corporation and distributing its assets to the shareholders. Alternatively, if he elected to allow the business relationship to continue, Vendel could have caused TCI II to sue Johnston -- derivatively before 1996 and directly thereafter -- to recover $235,800 as restitution for unjust enrichment. The latter remedy would have been the equivalent of allowing his original $235,800 capital contribution credit to stand, but requiring Johnston to infuse an additional $235,800 of capital to serve as the consideration for the credit.

But neither the plaintiffs nor Vendel has ever asserted or attempted to establish those claims. Instead they assert that Johnston's wrongdoing justifies a third remedy -- the functional equivalent of canceling $235,800 of his capital --but they offer no analysis to support the assertion. To become entitled to that specific remedy, the plaintiffs must establish some nexus between the remedy and the wrong. At the very least, the plaintiffs must articulate how stripping Johnston of $235,800 of his capital is a remedy that properly flows from Johnston's conduct respecting the BAI debt. Plaintiffs have made no effort to establish that connection, except to assert that Johnston caused TCI II to pay his (Johnston's) personal debt. Because the contention that the BAI debt was Johnston's personal debt has been found to lack factual support, the plaintiffs have not shown their entitlement to the relief they seek.

For these reasons, plaintiffs' stock cancellation (or recapture) claim, insofar as it rests upon the argument that the BAI debt was a debt of Johnson, must be rejected.

C. **The Loan Repayment Argument**

The plaintiffs' second ground for the stock cancellation relief they seek stands on a different factual and legal footing. The claim, simply put, is that Johnston's entire February 1984 asserted capital contribution of $335,800 was

treated on TCI II's accounting records not as risk capital (equity), but rather as a loan from Johnston to TCI II (debt). The plaintiffs contend that because Johnston never had any of his investment at risk, and because his entire investment was repaid by 1992, Johnston has never had any equity in TCI II. Therefore, Johnston's shares must either be canceled or restored to TCI II through the remedy of a constructive trust.

The defendants do not dispute that Johnston's $335,800 contribution was treated on TCI II's books as a loan. They argue, however, that none of that amount was repaid in 1984 and therefore remained "at risk." The defendants further contend that this argument overlooks the "fact" that the booked "loan payable" of $335,800 was offset by a booked "loan receivable" in the same amount. Those facts, defendants say, persuasively support Spillane's testimony that Johnston's investment in TCI II was intended to be treated as equity risk capital.

These contentions raise two separate issues. The first is whether the evidence supports Johnston's argument that he intended for his contribution to be regarded as equity capital, regardless of how it was treated on TCI II's books. The second is whether (and, if so, to what extent) Johnston's Capital was repaid.

The analysis of these issues is complicated to some extent by this Court's January 5, 1996 Opinion in the 9225 action. There, the Court found that Johnston and Vendel agreed that Johnston would initially contribute $100,000 of equity capital, which would later be increased so that his share of TCI II's total equity capital would justify Johnston owning 53% of TCI II's shares. The Court also found that Johnston never increased his equity capital above $100,000, and that his entire $335,800 investment had been booked as a loan. $297,384 of that amount was repaid, leaving a balance of $38,416 by the end of 1992.[33] Opinion the Court implicitly recognized an inconsistency between its findings that (i) as much as $100,000 represented equity capital and that (ii) Johnston's entire loan.[34] not resolve that inconsistency, because it was not essential to the voting control dispute: under any scenario Vendel would have majority control. This lawsuit, however, requires that the inconsistency be resolved.

---

[33] *Arbitrium (Cayman Islands) Handels v. Johnston,* Del. Ch., C.A. No. 13506, Mem. Op. at 27, Jacobs, V.C. (Jan. 5, 1996). In their Post-trial Answering Brief, the defendants concede that by April 10, 1987, $238,517 of the $335,800 that Johnston and his entities had invested in TCI II had been repaid to Johnston. Def. Ans. Br. at 38.

[34] *Id.* at 34, n.20.

Regarding the first issue, I have reviewed the record and considered the positions of the parties, and conclude that in 1984 Vendel and Johnston agreed and intended for Johnston's contribution to be treated as equity capital.. Implicit in that bargain was the understanding that Johnston's contribution would be treated as risk capital -- equity -- on TCI II's books. But, Johnston never honored that understanding, nor did he disclose to Vendel that he (Johnston) had caused his capital contribution to be treated as a loan. Having chosen --unilaterally and without Vendel's consent -- to account for his capital contribution in that manner, Johnston must bear the consequence of that choice. The consequence is that Johnston cannot now be heard to claim that he intended all along for his capital contribution to be treated as equity.

Even if Johnston could be heard to so argue, his argument still fails for lack of proof. Its sole support consists of Spillane's uncorroborated testimony, plus the fact that Spillane created an offsetting bookkeeping entry as a "loan receivable" from Johnston. In the $225 action I previously determined that Spillane's and Johnston's testimony lacks any credibility. Since that time nothing has happened to change the Court's view. Therefore, unless Spillane's (or Johnston's) testimony on disputed matters is corroborated by credible documentary evidence, their unaided testimony will not be credited. In this case, the only documentary

evidence cited to support Spillane's testimony that Johnston intended for his capital contribution to be treated as equity, is the "fact" that TCI II's loan receivable ledger for 1984 contained an offsetting entry for a "loan receivable" from Johnston in the same amount as the 1984 "loan payable" entry.

That position labors under two fatal infirmities. The first is that it is conceptually flawed. No witness ever testified that creating identical ***loan*** payable and loan receivable entries is an acceptable method to account for a shareholder's *equity* contribution. Within the accounting profession there is a conventional, widely accepted method to account for an equity contribution. That method was not followed here. The argument's second fatal flaw is that it is factually incorrect. Its premise is that because the loan payable and the loan receivable entries matched identically, that somehow proves that Johnston's capital contribution was intended as "equity." Putting aside the illogic of that premise, in point of fact the "loan receivable" entry was $234,800, and the loan payable entry was $335,800. Thus, the loan entries do not match, and the contended factual "corroboration" of Spillane's accounting testimony vanishes.

The initial bargain struck between Vendel and Johnston -- as this Court found in its January 5, 1996 $225 Opinion -- was that their stock ownership in TCI II would be proportionate to the two stockholders' contributions of equity capital.

That finding is conclusive in this action, and because I have now determined that Johnston contributed debt -- not equity -- capital, that finding alone would be dispositive of the plaintiffs' claim to cancel or recapture Johnston's stock. Out of an abundance of caution, however, I will nonetheless consider the second issue, which is whether Johnston's $335,800 contribution was repaid to him. I conclude that it was.

Based on the record existing at that time, this Court determined in its January 5, 1996 Opinion in the § 225 action, that all but $38,416 of Johnston's loans had been repaid by the end of 1992. Vendel thereafter gained control over TCI II and its books and records. As a result, additional documents were uncovered which showed that by the end of 1984, Johnston and Spillane had paid themselves and the Johnston Entities over $850,000 from TCI II and Statek.[35] Those unexplained payments dwarf Johnston's assumed maximum $100,000 capital contribution, as well as the $38,416 loan balance at year-end 1992. The overwhelming inference, and the conclusion I reach, is' that Johnston's $335,800 loan balance was repaid at the latest by 1992, and most probably long before.

---

[35]PX 13-1, PX 13-5. See also Garvey trial testimony, TR (JG) 25 l-254.

Accordingly, I determine that Johnston has no' equity interest in TCI II, and that therefore his stock in that corporation must be canceled or, alternatively, be subjected to a constructive trust in the plaintiffs' favor.

IV. THE PLAINTIFFS' CLAIM FOR MONEYS WRONGFULLY DIVERTED FROM TCI II BETWEEN 1984 AND JANUARY 1996

A. Introduction

The subject that has consumed most of the parties' (and the Court's) effort are the plaintiffs' claims for money damages -- to recover fi-om Johnston and Spillane over $28.5 million those defendants wrongfully diverted from TCI II and Statek from February 1984 through January 1996. It is claimed that as a result of the defendants' fraud, waste, and breaches of fiduciary duty, $11,522,5 15 was wrongfully diverted from TCI II, and $17,143,666 was wrongfully diverted from Statek.

These claims involve multitudinous transactions in several different categories, covering the entire twelve-year period during which Johnston and Spillane controlled TCI II and Statek. The record on that subject is massive. Indeed, the problem of how even to address those claims in an orderly judicial way has been daunting and is largely the reason for the Court's delay in issuing

this Opinion.

Those difficulties were exacerbated by two additional and quite unusual circumstances. The first is the manner in which the defendants created and caused the corporate plaintiffs' records tc be maintained. Because of their faulty recordkeeping, many of the challenged expenditures lacked adequate (and, in some cases, any) documentation. Primarily for that reason it became necessary for plaintiffs to retain Mr. Garvey to perform six months of painstaking, highly intricate forensic accounting work. A separate consequence of the inadequacy of documentation was that the defense of most of the expenditures would necessarily rest upon the testimony of the defendants themselves.

The conduct of the defense was further complicated by a second factor -- Johnston's unavailability to give live testimony at the trial, because he was then (and as of this writing still is) incarcerated in a British prison.[36] As a consequence, the defense consisted of the live testimony of Spillane, the deposition testimony of

---

[36]After this Court awarded Vendel attorneys' fees of approximately $1.8 million by reason of Johnston's and Spillane's bad faith conduct in the 9225 action, Johnston was arrested by London (Scotland Yard) police, and was later tried and convicted for conspiracy to murder Vendel, Vendel's Delaware counsel and other persons. Those events led to Johnston's incarceration and inability to testify personally at the trial. Counsel were able, however, to take Johnston's deposition testimony, and to use it as evidence at the trial. The defendants advance no contention that having to proceed in that manner has prejudiced their ability to prepare or present their defense.

Johnston (taken while in prison), and of Spillane, and voluminous documents. The record upon which the plaintiffs relied consisted of the foregoing evidence, plus Mr. Garvey's analysis and testimony.

In their post-trial briefs, the parties subdivided their presentation of these claims into two categories: (i) diversions from TCI II and (ii) diversions from Statek. Of these two categories, the presentation of the latter -- diversions from Statek -- was the more complex and prolix because of the larger number and types of expenses involved. This Opinion uses the same organizational sequence as the parties. Thus, Part IV B of this Opinion treats the claimed diversions from TCI II, and Part V addresses the claimed diversions from Statek.

B. The TCI II Money Damage Claims

At the tial the plaintiffs made a prima facie showing that during the period February 1984 through January 1996, while Johnston and Spillane were in exclusive control of TCI II and its accounts,[37] they diverted $11,522, 5 15 from TCI II. As a holding company that holds the stock of Statek, TCI II never had any independent business or operations of its own, and its sole source of revenue

[37]Johnston and Spillane were TCI II's only officers and always made up at least a majority of TCI II's board. They prepared and signed all TCI II tax returns, and Spillane kept TCI II's checkbooks, maintained its stock ledger and filled out the stock certificates based solely on information provided to her by Johnston.

has always been cash generated by Statek. The only records reflecting TCI II's financial-condition during Johnston and Spillane's tenure are TCI II's ledger and its tax returns, ail of which were prepared by the defendants.

Based on his analysis of those records, the plaintiffs' expert, John Garvey, testified at the trial that the monies that the defendants diverted from TCI II totaled $11,622,5 15. He arrived at that result by tracing the dividends and "gross receipts or sales" from management service fees (as shown on the respective ledgers and the tax returns) that were upstreamed from Statek to TCI II for each of the twelve years in question.[38] The total received by TCI II from Statek from these sources was $12,67 1,670. To that amount Garvey added a $290,500 loan that TCI II received from Statek in 1984, and then subtracted (i) the payments made by TCI II to Vendel ($554,735) and (ii) the cash balance existing in TCI II's accounts when Vendel took control of TCI II in January 1996 ($784,920). The subtotal was $11,622,5 15. From that subtotal Garvey deducted $100,000 (the balance of Johnston's February 1984 loan which was fully repaid in July 1984) to arrive at the net amount of $11,522,5 15. The question then became: where did those moneys go?

---

[38]Garvey and the plaintiffs relied upon these documentary sources, because the figures they generated were consistent with each other, and because potential corroborating documents, particularly checks written on TCI II and Statek accounts, were incomplete. See note 43, infra.

In this case the burden of providing a satisfactory answer falls squarely upon the defendants, who were in exclusive control of TCI II, its funds, and its accounts and records. Corporate officers and directors, like all fiduciaries, have the burden of showing that they dealt properly with corporate funds and other assets entrusted to their care. Where, as here, fiduciaries exercise exclusive power to control the disposition of corporate funds and their exercise is challenged by a beneficiary, the fiduciaries have a duty to account for their disposition of those funds, i.e., to establish the purpose, amount, and propriety of the disbursements.[39] And where, as here, the fiduciaries cause those funds to be used for self-interested purposes, i.e., to be paid to themselves or to others for the fiduciaries' benefit, they have "the burden of establishing [the transactions'] entire fairness, sufficient to pass the test of careful scrutiny by the court."[40] As the Supreme Judicial Court of Massachusetts has stated:

---

[39] *Samia v. Central Oil Co.,* Mass. S. J.C., 158 N.E.2d 469, 484-85 (1959); *Heritage Village Church and Missionary Fellowship, Inc. v. Bakker,* U.S. Bankr. Ct., 92 BR. 1000 (1988) (*"Bakker"*); *see also Steiner v.* Meyerson, C.A. No. 13 139, Allen, C. (July 18, 1995) (directors violate their duty of loyalty by misusing their "power over corporate property or processes in order to benefit...[themselves] rather than advance corporate purposes"); *Lawson v. Rogers, S.C.* Supr., 435 S.E.2d 853,857 (1993); *Pantages v. Arge,* Utah Supr., 262 P.2d 745,747 (1953); *Stevens v. Gray,* Utah Supr., 259 P.2d 889, 891 (1953); *Guntle v. Bamett,* Wash. Ct. App., 871 P.2d 627, 632-33 (1994).

[40] *Nixon v. Blackwell,* Del. Supr., 626 A.2d 1366, 1376 (1993) (quoting *Weinberger v. UOP, Inc.,* Del. Supr., 457 A.2d 701,710 (1983)); *Rosenblatt v. Getty Oil Co.,* Del. Supr., 493 A.2d 929,937 (1985).

> An agent or fiduciary is under a duty to keep and render accounts and., when called upon for an accounting, has the burden of proving that he properly disposed of funds which he is shown to have received for his principal or trust. See *Restatement 2d: Agency,* §§ 382,399, comment e; see *also Restatement: Trusts,* §§172, 244-245; Scott, *Trusts* (2d ed.) §§172, 244-245.2. Substantially the same principles are applicable to corporate directors and officers.[41]

In furtherance of that duty, TCI II's By-laws required the Treasurer--'Johnston -- to keep accurate accounts and to support corporate disbursements with adequate documentation:

> The treasurer shall have the custody of the corporate funds and securities and shall keen full and accurate accounts of receipts and disbursements in books belonging to the corporation and shall deposit all monevs and other valuable effects in the name and to the credit of the corporation in such depositories as may be designated by the board of directors.
>
> He shall disburse the funds of the corporation as may be ordered by the board of directors, taking proper vouchers for such disbursements...[42]

In short, the defendants have the burden to account for the proper disposition of $11,522,5*15* of TCI II funds that the plaintiffs have established,

---

[41] *Samia,* 158 N.E.2d at 484-85.

[42] PX 13-1 l(b) at B-328. (emphasis added).

prima facie, were paid to Johnston, Spillane, and the Johnston entities, all of whom Spillane confirmed were the recipients of those funds.[43] I conclude, for the reasons next discussed, that the defendants have failed to carry their burden.

The defendants respond that they have fully accounted for those moneys. Their argument runs as follows: The TCI II loan ledger reflects loans receivable totaling $8,553,930. Of that amount, $8,239,509 can be accounted for as follows?

Funds Going Into TCI II (per Mr. Garvey's testimony)	$6,000.000+
Less Expenses	($1,411,025)
Less Income Taxes	($ 205,186)
Statek Dividends Payable to TCI	$3,300,000
Checks to Cash	$ 174,000

---

[43]Q. What happened to the minimum $12 million?
MR. PEPPER: Object to the form of the question.
A. I know that money was declared a dividend by Statek and was--it went to TCI II, and TCI II lent the money to various entities of Mr. Johnston and myself and made investments.
Q. That's where it went?
A. That's what I know. (SS 118, 10/08/97; see also TR (SS)137-139).

The two sets of TCI II financial records kept by Johnston and Spillane -- the tax returns and the ledger, are consistent and support this conclusion. TCI II's 1994 Connecticut State tax return reported that as of December 3 1, 1994, TCI II loans receivable amounted to $9,110, 504 and "Trade notes and Accounts Receivable" were $976,297, totaling receivables of $10,086 801. The corresponding entries in Spillane's ledger show that the funds went to Johnston, Spillane, and the Johnston Entities. JX5 (225 PX 21 at 1,4). Although the defendants did not produce a ledger for 1995 or January 1996, the canceled checks and bank statements for that 13 month period show continued disbursements to Johnston, Spillane, and Johnston Entities totaling over $750,000.

[44]The sources of the dollar amounts used in the defendants' proposed accounting are the defendants' Post-Trial Brief and a Chart used by defendants' counsel at post-trial argument.

Personal Expenses	$ 189,478
Personal Consultant Payments	$ 166,370
Johnston Entity Obligations	$ 25,872
	$ 8,239,509

The approximately $330,000 difference between $8,239,509 and the $8,553,930 loan receivable balance may be attributed (defendants suggest) to "miscellaneous Johnston personal charges."

The defendants next assert that from the $8,553,930 loan balance there must be deducted the payments made by TCI II to Vendel ($554,735) and the TCI II January 1996 cash balance ($784,920), resulting in a loan balance of $7,214, 275. Of that amount, the defendants urge that $1,249,68 1 can be accounted for, as follows:

Purchase Price of Additional TCI II Shares (Later Declared Invalid)	$425,000
Artafax Loans (Investment)	$150,000
Digital Products Loans (Investment)	$250,000
ECM Loan (Investment)	$424.68 1
	$1,249,68 1

Deducting $1,249,681 from $7,214,275, the defendants arrive at a net loan balance of $5,964,594, which is what they claim they owe to TCI II.[45]

The above "accounting" is flawed for several reasons.

First, its essential premise is that "only about $6 million of cash went into TCI II and only about that amount came out,"[46] but that premise finds no support in the record. The TCI II tax returns, prepared and signed under oath by Johnston and/or Spillane, show from 1984 through 1995 TCI II received over $12.6 million from Statek. The incomplete documentation in plaintiffs' possession shows that at least $8.2 million flowed out of TCI II,[47] and if the defendants' assertion that TCI II paid out $1.4 million of expenses is correct, the dollar outflow increases to at least $9.6 million. Thus, the argument that only $6 million flowed into TCI II cannot withstand scrutiny, since far more was paid out by TCI II, a holding company that had no operations and generated no cash.

---

[45] To be precise, the defendants contend that they owe $9 16,084, which is what remains after $5,048,510 -- the compensation to which they claim entitlement in their counterclaim -- is offset against the $5,964,594 net loan balance..

[46] Def. Post-Trial Ans. Br. at 40.

[47] Approximately $6.2 million was paid directly to Johnston, Spillane, and the Johnston Entities (PX 13-5); approximately $1,025,000 was paid, half to Johnston and half to Vendel, as dividends (JX6; 225 DX 46); at least $205,186 was paid in taxes; more than $2 1,000 was paid to third parties (PX 13-5); and checks totaling $816,000 were made payable to Statek. (Appendix II, Tab II-A to Def. Post-Trial Ans. Br.)

The only evidence that defendants are able to cite to support their theory is the testimony of Mr. Garvey, which they misread. Garvey did *not* testify (as defendants assert) that only $6 million went into TCI II. What Garvey said was that he attempted to locate the checks showing payments from Statek to TCI II, and that $6 million was the amount shown by the checks that he was able to find. Garvey cautioned, however, that the records were incomplete.[48]

Second, the defendants' accounting assumes that TCI II paid approximately $1.4 million of expenses for the years 1984-1994. The tax returns do report expenses totaling $1,4 11,025 for "telephone and telex," "entertainment," "travel," "legal and audit," "autos," "insurance," "office expense," "consulting," and "rent."[49] But, TCI II has no invoices, receipts, checks, accounting or other records which support these "expenses." In contrast, Statek has a multitude of checks showing that Statek paid precisely those same categories of expense listed in the schedules to its tax returns, yet for TCI II there was not one single check.[50]

---

[48]Trial Tr. at 201, 204, 257-259.

[49]JX5 (225 PX 7, 25-32), PX 13-12.

[50]The inconsistency between this Court's acceptance of the cash receipt figures shown on the TCI II tax returns, and its rejection of the expense deduction figures shown on those returns, is apparent, not real, because the cash receipt figures are inherently more reliable than the undocumented expense entries. The cash receipt figures, which are corroborated by the ledgers, are functionally tantamount to "admissions against interest," in the sense that they created a basis for tax liability. Thus, the defendants had an interest in understating those receipts_ The expense

The absence of expense documents hardly comes as a surprise. TCI II was a holding company that had no operations and, therefore, had little or no reason to incur expense. Although TCI II had its principal place of business at 20 Acosta Street, Stamford, Connecticut,[51] it was never qualified by the Connecticut Secretary of State to conduct business there. TCI II could not have incurred audit expenses, since (as Johnston and Spillane admitted) TCI II had no audited financials or even proper accounting records. It was Statek that paid the rent and telephone bills for that location, as well as for Johnston's and Spillane's travel and entertainment expenses, and it was the Johnston Entities that were caused to pay

---

deduction figures, on the other hand, were self-serving, in the sense that they were a basis to reduce tax liability. Thus, the defendants have an interest in overstating those figures. Accordingly, although the tax returns do establish that the defendants ***reported*** over $1.4 million in deductible corporate expense, they do not establish that those expenses were actually ***incurred.*** To prove that, corroborative documentation is needed, yet the defendants were able to produce none.

[51] This location, which is referred to in this Opinion as the "Acosta Street location," was the place where Johnston and Spillane managed Statek's (and TCI II's) numerous domestic and foreign banking accounts, health and business insurance, and other financial and personel matters. The Acosta Street location also housed the Johnston Entities. The only employees at that location, other than Johnston and Spillane, were Rhea Oberg and Peter Scannell, who defendants have conceded were Johnston Entity employees. (PX 13-22 at 8, no.1 1). Johnston and Spillane were the only authorized signatories on TCI II bank accounts, and maintained all records for those accounts and Statek's bank accounts at the Acosta Street location, even though Statek's operations -- and accounting department -- were located 3000 miles away in Orange, California.

their other expenses.[52]

The defendants had a duty to create and maintain accurate records to substantiate the expenses that they claim that TCI II paid. They also had the burden to produce those records when called to account for those expenses. The defendants have neither discharged that duty nor carried that burden. Therefore, the legal consequence should be that imposed by the Court in the *Bakker case*, where televangelists Jim and Tammy Faye Bakker had made personal loans to themselves from PTL, incurred lavish travel expenses, and paid extensive, non-business related American Express bills with corporate funds. Disallowing those expenses, the *Bakker* Court found:

> In the years 1985 and 1986, expenditures were made from the PTL general checking account in the amounts of $378,280.47 and $355,660.50, respectively for transportation, meals, lodging, entertainment, and other travel expenses for both domestic and foreign travel. These payments either directly or indirectly were for the benefit of Mr. Bakker and Mr. Taggart, and no documentation has been furnished to demonstrate that any of

---

[52]Spillane caused Greenray to pay for her automobiles and parking tickets; Statek and Metrodyne paid for Johnston's and Spillane's health and life insurance policies. And having no operations, TCI II needed no "consultants" or lawyers.

Defendants respond conclusorily by citing Spillane's testimony that while Statek and the Johnston Entities paid rent and other operating expenses, a portion of those expenses were allocated to TCI II. (See Def. Ans. Br. at 42, n. 16). But nowhere do defendants attempt to produce documents corroborating the allocation, or to explain why in the case of a non-operating company there needed to be any allocation at all or why the amounts allocated were fair.

these expenses were for proper corporate **purposes?**

Here, the approximately $1.4 million of undocumented. expenses claimed by Johnston and Spillane are indistinguishable from those disallowed by the Court in *Bakker*. Those expenses have not been properly accounted for[54] and accordingly, the defendants will be held liable for them.

Third, the defendants' "accounting" rests critically upon their ..undocumented assertion that $3.3 million of the missing funds represents a Statek "loan" to TCI, that took the roundabout form of a "dividend" being paid to TCI II, which TCI II then "loaned" to TCI and booked on TCI II's loan ledger as a $3.3 million loan. According to defendants, that was done to avoid "having Statek write dividend checks to TCI II and then having TCI II write loan checks to TCI."[55]

---

[53] *Bakker*, 92 B.R. at 1012-13.

[54] The only "corroborating evidence" the defendants were able to produce was a single page of handwritten notations (DX 225 Ex.72), purporting to show that in 1985, Johnston had informed Vendel that TCI II's expenses for the ten months of 1984 were $118,000, or $14 1,000 if extrapolated for the full year. The defendants assert that it is "fair to infer" that if that extrapolated $141,000 expense had been incurred in each succeeding year for the next ten years, the total would add up to about $1.4 million. Putting aside Mr. Johnston's testimony that he could not identify the figures on that sheet as being in his handwriting, as well as the absence of any documentary corroboration of the actual expenses -- if any -- TCI II incurred, the defendants "fair inference" that TCI II incurred $14 1,000 of expense each year between 1984 and 1994 is sheer speculation, without record support, that falls abysmally short of discharging the defendants' duty and burden to account.

[55] Def. Post-Trial Ans. Br. at 45.

Not one shred of documentary evidence supports this dividend/loan scenario. Moreover, it lacks credibility. Spillane had no record of this transaction, except a "piece of paper" that she did not retain? Nor could she explain or even recall any discussion of why dividends to TCI II should be paid in the form of checks to TCI.[57] Lastly, the tale that TCI wanted to avoid the inconvenience of having Statek write dividend checks to TCI II and then having TCI II write loan checks to TCI, is fatally undercut by the fact that over the years TCI II wrote a multitude of checks to TCI totaling more than $2.6 million.[58] Manifestly, defendants' attempt to explain the disappearance of $3.3 million of TCI II's funds by offering this "explanation" through Spillane, was an eleventh hour effort to cobble together an "accounting" by creating a fiction that even after casual scrutiny cannot hang together.[59]

---

[56]TR (SS) at 946-947.

[57]TR (SS) at 900.

[58]PX 13-5.

[59]A similar effort to recharacterize transactions to appear more benign (from a liability standpoint) is the defendants' assertion that the loans to Artafax, Digital Products, and ECM, totaling $824,68 1, were "investments." These expenditures were booked as loans, and the recipients of those loans were entities that Johnston controlled. No post hoc explanation to the contrary can change that.

For these reasons, I find that the defendants have failed to account for most of the monies that were upstreamed from Statek to TCI II. It does not follow that the defendants are liable for the entire $11,522,515, however, because the defendants were not, but should have been, credited for two legitimate payments. The first is the $205,186 of income taxes that TCI II paid during the period in question. The second consists of payments aggregating $816,000, documented by TCI II checks made payable to Statek over the February 1984-January 1996 period.[60] Deducting those two items ($205,186+$816,000= $1,021,186) from $11,522,515, leaves the net amount of $10,501,329 that was diverted from TCI II and for which the defendants are unable to account. Therefore, the defendants are liable to TCI II for $10,501,329, exclusive of interest.

---

[60] See Appendix II, Tab II-A to Defendants' Post-Trial Answering Brief. The plaintiffs acknowledge that these payments were made to Statek. (Plaintiffs' Post-Trial Reply Br. at 37), with the result those moneys, originally paid by Statek to TCI II, were ultimately repaid to Statek. Not crediting defendants with that amount would allow the plaintiffs to "double count" since, it appears, they include the $816,000 within the amount that they claim was wrongfully diverted from Statek.

V. THE PLAINTIFFS'CLAIMS FOB MONEYS WRONGFULLY DIVERTED FROM STATEK BETWEEN 1984 AND JANUARY 1996

The plaintiffs' remaining affirmative claims seek to recover $17,143,676 that plaintiffs contend Johnston and Spillane wrongfully diverted from Statek during their twelve year stewardship. Those claims fall into four categories: (a) claims against Johnston for converting $593,108 of Statek's petty cash; (b) claims against Johnston and Spillane for causing Statek to pay $926,662 of salaries to persons at the Acosta Street location who (it is claimed) were employees of the Johnston Entities; (c) claims against Johnston and Spillane for charging $1,142,032 of their personal charges on Statek corporate American Express credit cards; and (d) claims against Johnston and Spillane for diverting $14,48 1,874 from Statek in checks and wire transfers.

Before these claims are considered on their merits, it is analytically helpful to address first a threshold, generic defense that the defendants insist "largely undermines [all of] Statek's claims." [61] That defense runs as follows: At all times Statek was audited by Arthur Anderson & Co. ("Andersen"), which gave Statek "clean" opinions in every year that Johnston and Spillane managed Statek. That

---

[61] Def. Answering Post-trial Br. at 5.

fact (defendants contend) leads to several inferences: First, if the defendants intended to divert large sums from Statek, they would not likely have hired an international accounting firm to audit Statek's financial records. Therefore, it should be inferred that in all likelihood no diversions took place. Second, if, as plaintiffs contend, the defendants diverted more than $28.5 million from Statek, then Andersen's certifications that Statek's financial statements correctly reflected its financial condition, would be untrue. Yet, plaintiffs produced no evidence that Andersen's statements were untrue, for which reason the Court should infer that Andersen was satisfied that the financial statements contained no material falsities. Third, these inferences, coupled with the absence of any testimony from Andersen that it was ever misled about the nature of the challenged Statek payments, make the Andersen yearly audits "powerful evidence that rebut Statek's charges."[62]

The short answer is that while one might or could draw those "inferences" from the Andersen's audited financial statements if those financial statements were considered in isolation and in a vacuum, the Court is not operating in vacuum. In this case there is a considerable body of undisputed evidence, as well

---

[62] *Id.* at 7.

as admissions, that permit (if not compel) the precise opposite inference -- indeed a finding -- that in many material respects the Statek financials were simply wrong.

To cite but two examples, the Statek audited financials reflect that certain expenses, such as the Statek American Express credit card charges and Statek checks to third parties, were legitimate corporate expenses, yet we know that that was palpably untrue because the defendants concede that many of those expenses were for Johnston's and Spillane's purely personal benefit. The certifications Andersen signed could only have been based upon the information known to it. The source of that information could only have been Johnston and Spillane, who controlled the information and its source. That information, moreover, necessarily must have included direct representations to the auditors by Johnston and Spillane as Statek's managers, as well as indirect representations in the form of Spillane's journal entries. Andersen would have had scant reason to disbelieve representations by Johnston and Spillane -- who held themselves out as the owners of Statek through TCI II[63]-- that expenses about which Andersen had specifically inquired, or which had been "booked" and that Andersen had reviewed, were

[63]TR (SS) 948.

legitimate corporate expenses.

Given the defendants' adjudicated record of fraud and attempted fraud upon this Court, Vendel, and governmental taxing authorities, must this Court now suppose that those same parties would have hesitated -- and stopped short of -- misleading Statek's auditors? The evidence of record, both here and in the § 225 action, suggests that if any inference should be drawn from the fact that the defendants retained Andersen, it would be precisely the opposite of what the defendants urge. Johnston and Spillane ask this Court to find that because they retained a prestigious international accounting firm (Andersen), they committed no wrong. But the undisputed facts and overwhelming evidence of record make it equally, if not more, likely that defendants' purpose in retaining Andersen was (unbeknownst to Andersen) to use that firm's imprimatur and prestige to aid the defendants'ongoing deception. Because the record permits, if not compels, those equally plausible counter-inferences, Statek's Andersen-certified financial statements do not warrant, nor will they be given, any significant weight in my assessment of the merits of Statek's claims.

That having been said, I turn to the Statek claims themselves.

A. Petty Cash Claim ($593,108)

The first claim is for $593,108 of Statek *petty* cash withdrawals -- surely one of the larger "petty" cash withdrawals in corporate history. The record shows that petty cash payments from Statek in that amount were disbursed to Johnston during the period of his and Spillane's control.[64] Those payments were made at Johnston's direction, and Johnston concedes that he received them. Defendants made no effort to explain the purpose of these petty cash withdrawals, nor have they cited any document or testimony that would legitimize them. In contrast, when petty cash was disbursed to Statek employees, the disbursements were supported by receipts documenting how the cash was spent.[65] No such receipts are present for disbursements to Johnston.

Having failed to show that those petty cash payments were for a proper business purpose, Johnston is liable to Statek for their full amount, $593,108.

B. Acosta Street Salaries Claim ($926,662)

The plaintiffs' next claim is to recover salaries that Statek paid to three employees who, plaintiffs contend, were employees of the Johnston Entities, but not of Statek. Specifically, plaintiffs seek to recover salaries of: (i) $37,030 paid

---

[64]PX 13-7, PX 13-8.

[65]TR(JG)

in 1985 to Peter Scannell, who was employed by TCI; (ii) $304,011 paid to Rhea Oberg, who was employed by Greenray and Metrodyne; and (iii) $585,621 paid to Spillane, who was employed by the Johnston Entities.

The defendants do not deny that Scannell and Oberg were Johnston Entity employees. Scannell was an employee of TCI; Oberg was an employee of Metrodyne. The defendants contend, however, that because these employees also performed services for Statek and TCI II, and because the Johnston Entities other than Metrodyne were corporate shells, the defendants' "business judgment" decision to compensate those employees with Statek funds should be respected.

This argument lacks merit, for two reasons. The first is that the applicable review standard is not the business judgment rule but entire fairness. The decision to compensate Scannell and Oberg -- who worked for entities owned and/or controlled by Johnston -- with funds of Statek -- which was controlled (through TCI II) by Johnston and Spillane -- was clearly self-interested. Johnston and Spillane, therefore, have the burden of showing that their decision to compensate their employees with Statek funds was entirely fair to Statek.

The second reason the argument lacks merit is that the defendants have not carried their burden. The defendants assert that although Scannell was employed by TCI, he rendered services to Statek and TCI II by "overseeing the financial

aspects of Statek for TCI II." But the only such services identified in the defendants' post-trial brief is Scannell having "prepared the information about Statek that was sent to Bowthorpe in connection with the latter's interest in purchasing Statek."[66] That information, however, was prepared and sent to Bowthorpe in '1986 -- one year after Scannell received the disputed 1985 compensation.[67] Having failed to prove that it was fair for Statek to pay Scannell's salary, the defendants are liable to Statek for that amount.

Regarding Oberg, the defendants concede that she "had functions for other Johnston entities," but attempt to minimize those "functions" by arguing that "the other Johnston entities at the Acosta Street office were all corporate shells, except for Metrodyne, which was winding down when Statek was acquired in 1984 and was out of business by 1985."[68] But nowhere do the defendants articulate, let alone support with evidence, what specific services Oberg rendered to Statek and TCI II. Given their entire fairness burden, that alone defeats their position, but even if it does not, the record also shows that the Johnston Entities at the Acosta Street office, although corporate shells, all continued to have very active bank

---

[66]Def. Post-Trial Ans. Br. at 52, 79.

[67]See JX 5 (225 PX 33, 73).

[68]Def. Post-Trial Ans. Br. at 79-80.

accounts. As plaintiffs' counsel colorfully put it at oral argument, "Mrs. Spillane moved money in huge amounts to Johnston [Entities] and back to Statek and back out of Statek, with an elan and skill of a drug cartel consiglierc. This money moves at the speed of light and in huge amounts."[69] Ms. Oberg assisted Spillane in keeping records of these accounts, and also in preparing and filing detailed state and federal income and franchise tax returns. It is therefore inferable -- and I do infer -- that Oberg did substantial work for the Johnston Entities. Because there is no evidentiary showing that Oberg performed any services for Statek, the defendants are liable to Statek for the salary they caused Statek to pay to Oberg.

The plaintiffs' claim to recover the $585,621 salary payments to Spillane stands on a less secure footing. The basis of that claim is that Spillane, like Oberg and Scannell, was actually employed by Johnston Entities and that her salary was improperly paid by Statek because Spillane rendered no services to that corporation. I cannot agree, because in Spillane's case, the defendants have shown, and I am satisfied, that Spillane did perform services for the benefit of Statek. Because the factual predicate of the plaintiffs' claim to recover her Statek

[69] Aug. 10, 1999 Post-Trial Argument TR at 262.

salary was negated as to Spillane, that claim must fail.[70]

Accordingly, the defendants are liable to Statek for $34 1,04 1, rerepresenting the combined Acosta Street salaries they caused Statek to pay to Scannell and Oberg.

C. **The American Express Credit Card Claims ($1,142,032)**

During their tenure, Johnston and Spillane charged $1,142,032 of expenses on their Statek American Express credit cards, which they caused Statek to pay. The plaintiffs contend that on their face those charges appear unrelated to any business purposes of Statek, and that because the defendants have not produced any documentary or other persuasive evidence showing that the charges were legitimate business expenses of Statek, the defendants are liable for the full amount of those charges.

The defendants' response is an admixture of substantive and procedural arguments. Defendants concede that some of these credit card charges were personal, but assert that the underlying documents show that many of those

---

[70] The scope of this ruling is quite limited. Its sole significance is that Spillane's salary from Statek cannot validly be challenged on the basis that it was not validly earned from Statek. Spillane's salary (and claim for additional compensation) still remains subject to attack on the independent ground that because Spillane breached her fiduciary duty to Statek in numerous respects, she should forfeit that salary and any claim she may have for additional compensation from TCI II. That latter issue, however, is the subject of the defendants' counterclaim, which is considered in Part VI of this Opinion.

charges were business-related. For that reason, defendants urge, the Court cannot properly make broad-based, categorical liability rulings at this stage. Rather, it must determine, on an individualized basis, the propriety of each of the over 3,000 credit card transactions in dispute, which in turn will require additional fact finding by a special master or this Court after an additional hearing.

These widely disparate positions complicate the resolution of this dispute, because they overlay the substantive issues with a procedural question that tends to obscure the substantive matters that must be decided. To determine how best to analyze this claim, it is helpful first to sumtnarize the relevant factual and procedural background.

1. Factual Background

Beginning in 1984, Johnston and Spillane had American Express issue Statek credit cards to themselves. Section 14 of Statek's bylaws provided that "[d]irectors and members of committees may receive....such reimbursement of expenses, as may be fixed or determined by resolution of the Board of Directors." Statek also had a detailed travel policy that required any requests for expense reimbursements to include receipts and vouchers, and prohibited charging purely

personal expenses to the corporation.[71] Statek's board minutes contain no resolutions authorizing the payment of Johnston's or Spillane's travel or living expenses;[72] nor did Johnston and Spillane make any effort to adhere to Statek's travel policy, even though they expected all other Statek credit card holders to do so.[73] They never submitted a single expense report or receipt, or made any effort to document in any way their many purported business trips,[74] and they freely admitted that they routinely charged personal items.[75] When questioned why he did not adhere to Statek's travel policy, Johnston stated that he:

> ...was the controlling stockholder. I was the management. I represented the management group of two people--the ownership group, excuse me--and I did not consider myself bound to that. I drew it up.[76]

The credit card charge practice employed by Johnston and Spillane was that Spillane would review both her own and Johnston's itemized credit card statements, and then approve the charges, even when they included charges she

---

[71] PX 13-14, Spillane Dep. 254-261 (10/09/97).

[72] PX 13-10(c), PX 13-11; see e.g., TR (SS) 132-133; TR (JG) 236-237.

[73] Spillane Dep. 246-248 (10/09/97); Johnston Dep. 44-45 (10/20/97).

[74] Spillane Dep. 357 (10/09/97); Johnston Dep. 45 (10/20/97).

[75] Spillane Dep. 92, 254-256; 694-695 (10/09/97); Johnston Dep. 40 (10/20/97).

[76] Johnston Dep. at 44 (10/20/97). Spillane's testimony was to the same effect. See Spillane Dep. 246-248 (10/09/97).

knew were personal.[77] Spillane testified that she considered all of Johnston's travel expenses to be business expenses, because in her view Johnston had no principal residence after his divorce in 1990, and therefore was always traveling. For that reason Spillane considered all of Johnston's living expenses as reimbursable travel expenses.[78] Moreover, in preparing a summary of her direct testimony purporting to establish the business purpose of the contested credit charges, Spillane "assumed" from the fact that she and Johnston were in the same city at the same time that any charge at that location during that period was a proper business expense[79]-- an assumption that led her to claim as business expenses tens of thousands of dollars worth of stuffed animals, chocolate, flowers, cases of fine wine, fine china, videotapes, picture frames, Waterford and Baccarat crystal, furniture, Christmas decorations, and dry cleaning." Spillane also "assumed" that if a charge was on her Statek American Express card, it automatically was a legitimate business expense.[81] As earlier noted, Spillane never

---

[77]TR (SS) 125-126.

[78]Spillane Dep. at 386 (10/09/97), 480 (10/10/97).

[79]TR (SS) 1097.

[80]TR (SS) 1099, 1100-l 101; Spillane Dep. at 572-73, 583-8, 592 (10/10/97); Johnston Dep. at 507 (10/22/97).

[81]TR (SS) 1099.

required or maintained any supporting vouchers or other backup for the credit card reimbursements other than the charge slips and itemized statements themselves.

After Vendel assumed control over TCI II and Statek, his counsel caused Mr. Garvey's firm to review those corporations' financial records that were available, including the Statek American Express credit card charge records. The result was a summary of the challenged American Express charges (PX 13-3) and of the underlying statements (PX 13-4) which were supplied to defendants almost two years before the trial. Thereafter, the plaintiffs took the depositions of Johnston and Spillane, who were unable to shed any significant light on the business purpose for the disputed American Express charges.

Next, in an effort to force the defendants to articulate and commit of record their positions on the American Express charges, the plaintiffs propounded Requests for Admissions respecting each of those charges. In their Responses to those Requests, however, the defendants repeatedly took the position either that:

> Defendants deny but admit that the charge was made on Spillane's Statek Corporation American Express card. Spillane recalls occasions when she traveled with Johnston on business and believes that this charge may have been made in connection with one of those occasions.

or that:

> Defendants neither admit nor deny after making a reasonable inquiry, including Spillane's review of documents produced in this action to refresh her recollection and Johnston's reliance on Spillane's review and recollection, and that the information known or readily obtainable by defendants is insufficient to enable them to admit or deny.[82]

Thereafter, midway through the trial, Spillane produced (in lieu of giving live direct testimony) a 262 page written compilation, in chart form, of her direct testimony setting forth Spillane's knowledge with respect to the disputed Statek American Express credit card transactions. That compilation ("SS- 1 ")[83] was remarkable in several respects. First, it was inconsistent with Spillane's trial deposition testimony and her sworn Responses to plaintiffs' Requests for Admission that defendants filed one month before the trial. In SS- 1, Spillane now claimed to recall the business purposes for numerous charges that she had been unable to recall one month before in her August 1998 Responses.

Second, SS-1 does not even address -- that is, offer any business purpose -- for Statek credit card transactions that are claimed to total $563,065.[84]

---

[82]PX 13-45.

[83]The written summary was introduced into evidence, and is referred to in the post-trial briefs and oral argument, as "SS-1".

[84] Plaintiffs' Opening Post-trial Brief at 64, n-30. Spillane conceded that she was "not offering to the Court any information in this trial as to the business purpose of transactions not

Third, except for a small percentage of the transactions, Spillane had no specific recollection of most of the charges, and in SS-1 gave only nonspecific "stock" or "formulaic" descriptions of their business purpose.[85] When questioned about these transactions at the trial, Spillane testified that her statements of "business purpose" were based upon the arbitrary (and self-serving) "assumptions" previously discussed (e.g., all charges on her personal Statek credit . card were assumed to be business expenses; any charge incurred in a city in which she and Johnston were both present was assumed to be for business purposes). The transactions falling under this category (no specific recollection and formulaic descriptions of business purpose) are claimed to total $483,820.[86]

Lastly, and for reasons that are not altogether clear, the defendants filed together with their Post-trial Answering Brief, a 246 page Appendix,[87] purporting (yet again) to summarize the challenged Statek American Express credit card

---

included in [SS-1]." TR (SS) 1094. The list of challenged charges that are unaddressed (i.e., do not appear) on SS-1 are listed in Appendix B to the Plaintiffs' Opening Post-Trial Brief.

[85]For example, at page 196 of SS-1, Spillane states that she generally recalls traveling to Europe and believes an American Express charge transaction took place on one of those trips, but has no specific recollection. As for the listed credit card transactions regarding which Spillane had a specific recollection, the plaintiffs represent that only 159 of the approximately 3,610 transactions listed in SS-1 fall into that category.

[86]Plaintiffs' Opening Post-Trial Brief, Appendix B at 9 1.

[87]See Appendix IV to Defendants' Post-Trial Answering Brief.

transactions. That Appendix -- which apparently was prepared by lawyers, not by witnesses -- adds little of evidentiary or analytical value, because: (i) most of the transactions listed on Appendix IV cite SS-1 to support the stated business purpose, and thus add nothing of evidentiary substance not already found in SS-1;[88] (ii) for many listed charges (claimed to total $109,084) no business purpose is stated at all; (iii) for many listed charges (claimed to total $126,519) the stated business purpose does not show that the charge was related to Statek business; (iv) for many listed charges (claimed to total $355,313) no record citation is offered;[89] and (v) for other listed charges, the record citation does not support the stated business purpose.[90] For these reasons, Appendix IV cannot be regarded either as evidence or as a reliable summary of evidence, and accordingly, will not

---

[88]Indeed, the "business purpose" descriptions are sometimes broader than the evidence cited to support them. See n.87, supra.

[89]See Plaintiffs' Post-Trial Reply Brief at 83, notes 49-51.

[90]For example, the defendants charged British crystal at Harrods on July 12, 1995. (PX 13-4 (135)). Defendants' Appendix IV, citing SS-1, represents that the "business purpose" for these Harrods charges was "Business expense for trip to Europe by Spillane and/or Johnston re: meetings with Statek European advisors and consultants." (Def.App. IV at 221). But, SS-1 supports those charges in a far less specific way, viz.:

> Spillane generally recalls occasions during which she traveled to Europe on Statek business (at times with Johnston), including discussions with Statek advisors and consultants regarding Statek Europe business and incurred expenses in connection with those trips. Spillane believes that this was one of those occasions.

be considered in the Court's evaluation of the evidence bearing on the challenged American Express transactions.

The foregoing background facilitates the analysis that next follows.

2. Analysis of the Issues

Because the defendants charged the challenged expenses to their Statek American Express credit cards, and also determined that Statek would pay those charged expenses, the defendants have the burden of showing that these charges represented legitimate business expenses of Statek.[91] It is undisputed that the challenged Statek American Express charges are not supported by any voucher or backup document other than the charge slips and monthly invoices themselves. Because the defendants had a duty to create and maintain books and records that would enable them to render a complete account of Statek's business, in cases where they failed to observe that duty every presumption will be made against them.[92]

Spillane was the person responsible for approving the Statek American Express credit card payments, and Johnston relied upon her review of and

---

[91] *See Bakker,* 92 B.R at 1012-13, 1015-17; ***Samia,*** Mass. Supr., 158 N.E.2d at 484-85; *Guntle,* 871 P.2d at 632-33; *Lawson,* 435 S.E.2d at 857.

[92] *Guntle,* 871 P.2d at 633; *Lawson, 435* S.E.2d at 857.

decisions concerning those matters. Thus, the primary (if not sole) evidence of the business purpose of the challenged transactions is Spillane's testimony, specifically SS-1, which the defendants offered as Spillane's direct trial testimony.

The analytical centrality of SS-1 is significant, because although the defendants argue the contrary, it is not necessary that the Court analyze and rule separately upon each of the 36 10 challenged American Express transactions. The challenged credit card transactions lend themselves to grouping into three analytically discrete categories, with each group including numerous transactions. Accordingly, only the categories themselves need be separately considered.

The category most easily addressed is the first, which represents $563,065 of challenged credit card transactions that are not included or addressed in SS-1. Because Spillane represented that she was not offering to the Court any information as to the business purpose of transactions that were not included in SS-1, it follows that the defendants have failed to adduce any evidence that these transactions -- which represent almost 50% of the total American Express charges -- were legitimate business expenses of Statek. Accordingly, the defendants are liable to Statek for the amount of the expenses falling into this category.[93]

---

[93]The Court has not independently verified the amounts that are claimed to fall into each of the three categories. Accordingly, its liability rulings are subject to verification of those amounts.

The challenged credit card transactions in the second category, claimed to total $483,820, are listed in SS-1 but their stated business purpose is generic and nonspecific. As for this category, the issue is whether defendants' generic and unspecific belief is sufficient to satisfy their evidentiary burden. I conclude, for factual and legal reasons, that it is not. Factually, defendants' nonspecific, formulaically stated belief is insufficient precisely because it is unspecific, and because to accept such testimony would take the defendants' self-serving characterizations at face value. Given the defendants' adjudicated propensity to falsify evidence and change their sworn testimony to suit their needs, for this Court to credit Spillane's repeated stock answers to the effect that she "generally recalls occasions" or "believes that" a particular purchase had a business purpose, would emasculate the duty to account owed by corporate fiduciaries to their corporation and its stockholders. It would also turn on its head the principle that where fiduciaries fail to keep books and records that would justify the expenses they caused the corporation to incur, every presumption will be made against them. As a result, the defendants are liable to Statek for the amount of the charges falling into this category.

I recognize that this liability may well include some expenses (e.g., airline and car rental, hotel) incurred on trips that, at least in part, did further the business

of Statek. Surely some of the defendants' travels must have been related to legitimate Statek business. The problem is that on most, if not all, of these trips, Johnston and Spillane charged personal expenses as well. It was the defendants' burden to sort out those personal and the business-related components? Had they done that at the trial in a meaningful way, their liability would not include amounts representing possibly legitimate business expenses falling into this category. But having made no serious effort to separate the legitimate from the personal, the defendants cannot now be heard to argue that the Court should do that for them, nor can the defendants be permitted yet another opportunity to justify their expenses at a second trial. The defendants' opportunity to render their account was the 1998 trial on the merits. The defendants alone must bear the procedural and economic consequences of failing to avail themselves of that opportunity.

The third, and final, category includes the credit card transactions listed on SS-1 as to which Spillane did have a specific recollection of business purpose.[95]

---

[94]Indeed, the defendants had a duty to do so before the trial, in response to the plaintiffs' legitimate discovery requests -- a duty the defendants breached.

[95]In quantitative terms this category is insignificant in comparison with the first two categories. The amount represented by the third category ($95,147) is the difference between the total Statek American Express credit card claim ($1,142,032) and the sum of the claims represented by the first two categories ($563,065+$483,820=$1,046,885).

The issue is whether her more specific recollected statements of business purposes are sufficient to discharge the defendants' burden of proof That question is more problematic than at first blush might appear.

The plaintiffs argue that the Court should reject Spillane's entire testimony out of hand, on the basis of her previously adjudicated lack of credibility as well as the absence of supporting documentation. And so I could, but in this specific instance to do that might work an injustice because there are, at least arguably, cogent reasons to credit that testimony. By not including on SS-1, or even attempting to explain, over $560,000 of challenged credit card charges, Spillane had to know that she was virtually conceding her inability to justify those transactions. By describing the business purpose of over $483,000 of those charges in nonspecific, generic terms, Spillane had to know that she was assuming a significant risk that those justifications would be rejected as well. Given the magnitude of the liability to which these responses would expose Spillane (and Johnston), and given Spillane's understandable interest in minimizing that exposure, Spillane would have been motivated to, and could have, claimed to have recalled all of the challenged American Express transactions and then (to put it bluntly) fabricated specific explanations for each of them. Yet she did not do that, and only with respect to approximately $95,000 -- less than 10 % of the total

dollar amount of the challenged credit card transactions -- did Spillane offer a specific recollection. In this specific setting (and for this seemingly perverse reason), there is a plausible basis to believe that Spillane was attempting to be honest in her explanations of the purpose of those charges, and, therefore, that those explanations might be true.

That alone would not necessarily carry the day for the defendants, however, because the explanations themselves might be insufficient for any number of reasons that the plaintiffs could identify. But, those explanations have at least prima facie validity; that is, they are sufficient to impose upon the plaintiffs the burden to advance some specific reason(s) why the specificrecollected explanation(s) were factually or legally insufficient. But the plaintiffs have not attempted to respond, on an individualized or even a generalized basis, to Spillane's specifically recollected explanations of the transactions falling into this category. The result is to leave the Court with no way to assess those transactions, other than to credit them all (on the basis that the plaintiffs had and failed to carry the burden to challenge the explanations with specificity) or to reject them all (on the basis that Spillane's uncorroborated testimony, no matter how facially specific, lacks credibility). The question is: which of these choices is more appropriate?

I conclude, in this one instance, that the correct approach is to credit Spillane's explanations. I reach that result not solely on the procedurally technical basis that those explanations may be plausible and because plaintiffs failed to join issue with them (although that would be reason enough), but also because (as noted above) the "second category" of credit card charges for which defendants are being held liable likely includes amounts representing legitimate Statek business expenses. Crediting the defendants for the approximately $95,000 of expenses falling into this category will offset to some extent -- albeit in a rough, imprecise way -- any unidentified legitimate business expenses for which the defendants, had they met their burden, would not be liable. The need to "do equity" in this "rough justice" manner tips the balance and leads me to conclude that the defendants ought not to be held liable for the $95,147 of Statek American Express credit card charges falling into this third category.

Accordingly, the defendants are liable to Statek in the amount of $1,046,885 with respect to this claim.[96]

[96] Again, subject to verification of that amount.

D. The Check and Wire Transfer Diversion Claims ($14,481,874)

Of the numerous claims being asserted against the defendants, the largest and most complex are for moneys wrongfully diverted from Statek in the form of checks and wire transfers. That is not only because of the magnitude of those claims ($14,48 1,874) but also because those claims fall into nine separate categories, some of which are broken down into numerous subcategories. The nine categories of wrongful transfer claims are: (1) for $6,499,255 of payments diverted to Johnston, Spillane, and the Johnston Entities; (2) for $267,197 diverted by Johnston and Spillane to third parties for purely personal expenditures; (3) for $761,322 diverted by Johnston and Spillane to third parties for Johnston Entity obligations; (4) for $2,117,797 that defendants caused Statek to pay to "consultants;" (5) for $3,747,829 that Statek was caused to pay to lawyers who did not work for Statek; (6) for $1,706,946.84 that Statek was caused to pay to obtain unnecessary lines of credit; (7) for $697,565.45 of payments that Statek was caused to make to unknown or undocumented bank accounts; (8) for $1,722,366 in payments made from Statek accounts to unknown payees; and (9) for at least $350,990 of personal living expenses that Johnston and Spillane caused Statek to pay.

These claim categories are addressed in the above-listed order.

1. The Claim For $6,499,255 That Statek Paid To Defendants By Checks Or Wire Transfers

The first category of claims, totaling $6,499,255,[97] covers amounts that the defendants caused Statek to pay to themselves in the form of checks or wire transfers. Two componentsmake up that total: $174,063 of Statek checks made payable to "cash," and $6,325,192 of Statek checks and wire transfers. These two components are treated separately.

a. The Claim For $174,063 In Statek Checks Made Payable To "Cash"

Johnston and Spillane do not dispute that they wrote checks, totaling $174,063 and made payable to "cash," from a Statek UTO account in Zurich, Switzerland and from a Barclays Bank account in London, England. Nor do they dispute that the cash went to Johnston and that the disposition of the funds was undocumented. The defendants made no effort to show that these funds were spent for Statek business purposes. Indeed, their sole response to this claim -- that the $174,063 was charged to Johnston's "professional fees," and as a consequence, to his TCI II loan account as well -- concedes that there was no

---

[97] "Those' figures appear on Tab 1 to Plaintiffs' Opening Post-Trial Brief. Tab 2 shows $9,917,359 in debits and $3,418,104 in credits, for net diversions of $6,499,255. PX 13-1.

business purpose for these transactions.

Therefore, a single issue is presented: have the defendants carried their burden to show that the $174,063 was, in fact, charged to Johnston's TCI II loan account? If it was, then this claim has already been resolved in plaintiffs' favor and cannot be "double counted," because the claim would have been subsumed in the approximately $11 million of TCI II claims previously validated in Part III, supra, of this Opinion. On the other hand, if the defendants have not carried their burden of proof on this issue, then they are liable to S tatek for the $174,063.

The sole evidence that supports the defendants' position is Spillane's uncorroborated testimony. No document of record shows that this amount was actually booked to Johnston's loan account, and two circumstances strongly suggest that it was not. First, these were moneys disbursed on *Statek* accounts. Why, therefore, would they have been booked as loans from *TCI II*? *No* explanation is provided. Second, the difficulty with the defendants' claim that the $174,063 was booked as a loan payable by Johnston to Statek, is that this same explanation is used to account for millions of dollars of other moneys paid out of TCI II and Statek to Johnston and Spillane. If in fact Johnston's TCI II loan account included all the moneys that the defendants claim were charged

("booked") to it, then that account would exceed $11 million? Yet, defendants concede that the amount of the Johnston loan account shown on TCI II loan ledger was $8,553,930.[99]

For these reasons, I conclude that the defendants have not met their burden to account for the $174,063 of Statek checks that were written to cash and whose proceeds were paid to Johnston. The defendants are liable to Statek for that amount.

b. The Claim for $6,325,192 of Statek Checks And Wire Transfers That Defendants Diverted to Themselves

The second component, representing the balance of this claim category, is for $6,325,192 of Statek checks and wire transfers paid to Johnston, Spillane, and the Johnston Entities? The defendants concede that they paid these monies to themselves and to those Entities, and that they carry the burden to account for

---

[98]That total includes $6.2 million in checks directly from TCI II to Johnston and Johnston Entities (PX13-5), plus $3.3 million from Statek to TCI (TR (SS) 641-42), plus sums totaling $885,000 identified in Spillane's September 14, 1995 affidavit (JX2C at Tab 1), plus $128,000 from TCI II in "professional expenses" (Id.), plus sums totaling $530,429 that are identified at page 46, footnote 19 of the Defendants' Post-Trial Answering Brief.

[99]PX 13-l 7; Oral Argument Tr. (August 2, 1999) at 90.

[100]PX 13-2 (l-147).

those self-interested transactions and to establish their propriety."' I conclude, for the following reasons, that the defendants have not discharged that burden.

To begin with, the defendants never produced any Statek board resolutions or any bills, vouchers, accounting or other records to support or otherwise document those payments.[102] In their depositions Johnston was largely unable to explain any of these self-interested payments,[103] and Spillane had difficulty explaining the purpose of many of them.[104]

At the trial, Spillane's recollection improved dramatically, however. When asked to explain the purpose of the payments made from Statek to Johnston, herself, or the Johnston Entities, Spillane was able to claim that the payments were either (i) dividends paid to TCI ($3.3 million), (ii) "short term borrowings" that

---

[101]TR (SS) 891; Def. Post-Trial Answering Br. at 44.

[102]TR (SS) 950-953.

[103] See e.g., Johnston Dep. 186 (10/20/97) (To BLM: ". ..I have no recollection of the purpose for the BLM payments."); 250-25 1 (To ECM: "I can only guess..."); 262 (To Greenray: "I just don't know what they were for"); 292 (To Johnston himself: "I don't have any idea."); 306,326 (10/21/97)(Johnston did not know the purpose of the Metrodyne and Samco payments); 329 (1 0/21/97)(Johnston did not know the purpose of the payments to Spillane); 332 (Johnston did not know the purpose of the payments to TCI. ". . ..Mrs. Spillane might well have an answer because that was her assignment.")

[104]*See* e.g., Spillane Dep. 456 (10/9/97)(Payments to Johnston: "I am not sure."); 405 (10/9/97)(Amplifonix: payments may have been made to pay for engineering services to Greenray); and 5 18 (10/10/97)(Samco: "I am not sure.")

were repaid in full ($4,708,010), or (iii) "expenses."[105] Apart from the fact that these numbers add up to more than the claim itself, I find, for the reasons next discussed, that Spillane's explanations have no credible record support.

The defendants' claim that $3.3 million of the $6,325,192 claim represented dividends from Statek to TCI II, has previously been rejected for the reasons set forth at pages 50-5 1 supra of this Opinion. The $3.3 million payment by Statek to TCI could not have been a dividend to TCI II, because a dividend is "a distribution by a corporation to its shareholders of a share of the earnings of the corporation,"[106] and TCI was never a shareholder of Statek or TCI II. But even if it is assumed (as Spillane claimed) that the $3.3 million was intended as a dividend to TCI II, and was routed around TCI II and booked directly as a loan to TCI, the result would be a loan balance for TCI of $5.9 million.[107] Yet, the TCI column on the TCI II loan receivable ledger, which Spillane prepared long before

---

[105] TR (SS) 3 10. Although Spillane claimed that some of the payments represented expense reimbursements, she never identified those expenses or provided evidence that any such expenses were incurred. For that reason her "expense" contention is rejected and is not addressed further in this Opinion.

[106] *Fulweiler v. Spruance,* Del. Supr., 222 A.2d 555,558 (1966)

[107] $3.3 million plus $2.6 million of checks written by TCI II to TCI. If $2.6 million was loaned to TCI in the form of those checks, the total loan balance would be $5.9 million.

this dispute arose, showed a balance of only $3.4 million.[108] The credibility of the "TCI II dividend" argument, already raised and rejected, does not improve in this second incarnation.

Nor does the record support the defendants' attempt to account for $4.7 million of additional payments to the defendants as "short term borrowings" that were fully repaid. There are no Statek board resolutions authorizing such loans; Statek's financial statements and tax returns do not disclose any loans to officers or their affiliates; and there are no loan agreements, amortization schedules, security agreements or other documents which evidence that those payments were "borrowings." Spillane admitted that there were no formal documents, and that Statek never received any interest on those "short term borrowings."[109] Finally, the short-term loan scenario contradicts the defendants' sworn pre- and post-trial answers to interrogatories concerning this subject.[110] That alone suffices to

---

[108]PX 13-21.

[109]TR (SS) 953-954; 957.

[110]The short term loans were identified as moneys supposedly loaned by Statek to Johnston Entities and to David F. McNeil Alford, a friend of Johnston. Interrogatory No. 34 (p.24) of Plaintiffs' First Set of Interrogatories asked whether Statek or TCI II provided loans to Johnston, Spillane, Alford or the Johnston Entities. The answer (which should have been "yes") was that *TCI II* loaned moneys to Johnston, Spillane and certain Johnston entities, but there is no reference to loans from Statek or to Mr. Alford. To the same effect is Interrogatory No 52, which asked whether TCI II or Statek loaned money to Mr. Alford. The answer was "no." Yet, the Appendix upon which the defendants rely includes short term loans (debits) to and repayments

defeat the defendants' claim that they have accounted for the over $4.7 million in issue. As the Supreme Court trenchantly described similar "borrowings" in *Guth v. Loft*:

> Guth's abstractions of Loft's money and materials are complacently referred to as borrowings....[B]ut certain it is that borrowing is not descriptive of them. A borrowing presumes a lender acting freely. Guth took without limit or stint from a helpless corporation, in violation of a statute enacted for the protection of corporation against such abuses...."'

Those observations are equally appropriate here.

Apart from these fatal gaps in their proof, the evidence upon which the defendants rely is hopelessly flawed for other, independent reasons. That evidence consists primarily of an Appendix[112] Spillane put together shortly before the trial (and which she amended during her testimony), that listed the moneys which flowed out of Statek and the moneys Spillane claimed were repaid to Statek by the Johnston Entities. But the Appendix (in some cases) selectively includes and (in other cases) excludes certain material transactions without satisfactory

---

(credits) from Mr. Alford.

"'Del. Supr., 5 A.2d 503, 515 (1939).

[1] "Appendix of Short Term Loans, found at Appendix II to Defendants' Post-trial Answering Brief.

explanation.

A representative example is the inclusion in the Spillane Appendix of $1.6 million of undocumented "source unknown" payments as "repayments" to Statek ***from the*** Johnston Entities, yet only $300,000 of "payee unknown" payments made by Statek to the Johnston Entities. When asked to explain the $1.3 million discrepancy, Spillane claimed that she remembered *all* of the "source unknown" credits, but none of the "payee unknown" debits.[113] That Spillane could remember any of these undocumented transactions six to eight years after the fact is, to say the least, highly doubtful. That she could remember in precise detail each and every "credit" that favored the defendants' position, but none of the "debits" that disfavored it, defies credulity.

Spillane's Appendix is plagued by other similarly arbitrary exclusions. For example, without explanation Johnston and Spillane excluded the first $15,575 of debits to BLM Holdings Corp., $269,630.50 of debits to Johnston, $245,442 of debits to Metrodyne, $2,070 of debits to Spillane, and $3,638,377 of debits to TCI.[114] Similarly, and again without explanation, Johnston and Spillane included only two "payee unknown" debits (totaling approximately $350,000) in their

---

[113] TR (SS) 651-652, 1024-1028.

[114] These debits and credits are listed at Tab 1 of Plaintiffs' Post-Trial Opening Brief.

Appendix, without identifying the payees, yet excluded $664,739.50 of other "payee unknown" debits that were listed in the table at Tab 8 of Plaintiffs' Opening Post-Trial Brief. These arbitrary inclusions and exclusions further detract from any argument that the Appendix is reliable or credible.

Finally, the defendants' argument that the "source unknown" credits for moneys paid into Statek should be treated as repayments by the defendants also lacks credibility. The defendants had possession of their own bank statements, checks, and similar documents, yet they produced no checks, bank statement entries, or other documentary evidence that matched a disbursement out of a defendant account with any "source unknown" credit into Statek.

The defendants' contention that $4,708,010 of the Statek payments to themselves were "short term borrowings," lacks credible evidentiary support. [115] Accordingly, the defendants are liable to Statek for $6,325,192 that they took from Statek in the form of checks and wire transfers.

---

[115] The same is true for the defendants' claim that the short term loans were repaid. Spillane's evidence consisted of a handwritten repayment schedule that she prepared late one night during trial, after the plaintiffs had rested their case. TR (SS) 933-934. Spillane admitted that that schedule had "mistakes," including errors totaling more than $1 million dollars. Id. at 930-93 1. Moreover, the Johnston Entities could not have repaid any "borrowings," because they had no means of generating income and spent the "borrowed" money on non-business expenses. See e.g., PX 13-52 to PX 13-55.

The plaintiffs' next claim is for $267,197, representing monies that the defendants caused Statek to pay for their purely personal expenditures. Examples are payments of $3,027 to Christie's (the auction house); $38,880 to W. Greenspoon, an art auctioneer; $25,510 to Jakubek Co. for rare stamps; $8,107 to Maggs, a book dealer; $63,990 to Roy Miles, a Johnston friend and art dealer; $45,940 to Roberts & Holland for personal tax advice; and approximately $6000 to Chinese language teachers.[116]

The defendants concede that $164,124 of those payments were personal to Johnston, but insist that that amount was charged to Johnston's professional fees which, in turn, were charged to his personal loan account."[117] The balance of the payments, the defendants insist, were legitimate Statek business expenses. But the defendants cite no evidence to support their assertion that the concededly personal payments were charged to Johnston's personal loan account, and their characterization of the remaining (disputed) payments as legitimate expenses is either unsupported by their own testimony or amounts to uncorroborated

---

[116]These expenses are listed in Tab 2 to the Plaintiffs' Post-Trial Opening Brief

[117]Def. Post-Trial Answering Brief at 49. In fact, the defendants' arithmetic is incorrect. The payments that are conceded to be "personal charges of Johnston" add up to $189,478.

ipse dixit.

The record related to the remaining disputed payments discloses the following:

Churchill Clinic: The defendants argue that a $5,762 payment to Churchill clinic (a London hospital) was for Johnston's medical treatment, for which Statek was reimbursed by insurance. But Johnston's belief that Statek was reimbursed was based upon his recollection that Spillane told him that, [118] and Spillane's testimony was that Johnston deposited the health insurance checks into his own account and "that could have included some of that." When asked if she had any evidence that the money paid to Churchill Clinic was ever returned to Statek, she testified: "I don't."' [19]

Conran and International Facsimile Limited: The defendants argue that the purpose of a $15,594 payment to Conran was to buy furniture for the London apartment rented by Statek, and that the purpose of a $2,652 payment to International Facsimile Limited was to purchase a fax machine for the London apartment. Defendants assert that Statek presumably still has that furniture or has abandoned it. This explanation overlooks the fact that the payment to Conran was also made to buy furniture for a house in the Bahamas that is owned by Beverly Lane, a Johnston Entity.[120] Defendants had a duty to surrender Statek's property in their possession to Statek, not to abandon it and conceal its existence. In fact, defendants never disclosed that they had made these purchases with Statek funds until their depositions two years later. Therefore, if in fact the furniture and fax machine were abandoned, the loss should be borne by the defendants.

Hello; The defendants argue that a $344 payment, which was made to subscribe to Hello, a British magazine, was charged to Johnston's -professional fees, yet (unlike the other professional fees that defendants concede were

---

"'Johnston Dep. 211 (10/21/97).

[119]TR (SS) 149.

[120]TR (SS) 149-150; PX 13-12.

personal) was a legitimate Statek expense because Johnston bought the magazine "for the people at Statek."[121] That explanation does not explain the fact that the publication was a British magazine purchased by Johnston, who was living in London, while the "people at Statek" were located in California.

Pepe: The defendants argue that a $1,499 payment to Pepe was to sponsor certain racing events where Johnston "plastered Statek's logo all over a bunch of cars in Spain.[122] But this explanation omits Johnston's qualification that he was "just guessing," and Spillane's testimony that this expenditure was personal.[123]

Roberts & Holland: The defendants claim in their brief that a $45,940 payment by Statek to Roberts & Holland was for tax advice to ***Statek*** to accomplish a settlement of the 9225 action with Vendel in a tax-advantageous manner. But, Johnston testified that Roberts & Holland provided tax advice to ***him*** personally. [124] If, in fact, this advice was to Statek, then presumably the defendants would have produced the records of that advice or the underlying invoices pursuant to this Court's February 23, 1996 Order. They never did.

Theresa Tseng and Dr. Mao Yan: The defendants claim that the purpose of $5,928 in payments made by Statek to these Chinese language teachers was for Johnston's Chinese lessons "to help to communicate with Dr. Chuang at Statek and 'to perhaps get closer to him. ' Also, it helped Johnston communicate with prospective new hires in the engineering department. Johnston also hoped to speak some Chinese in connection with prospective Statek business in China."[125] These self-serving explanations that Johnston's Chinese lessons were for Statek's benefit are far-fetched and, in any event, unsupported.

"'Johnston Dep. 28 l-282 (10/21/97); Spillane Dep. 450 (10/09/97).

[122]Johnston Dep. 3 16 (10/21/97); Def. Post-Trial Answering Br. at 50.

'"Johnston Dep. 3 16 (1 O/21/97); Spillane Dep. 460,507 (1 O/l 0/97).

[124]Johnston Dep. 80 (1 0/20/97), 325 (1 0/21/97).

[125]Def. Post-Trial Answering Br. at 50.

I conclude, for these reasons, that the defendants have not carried their burden of showing that these payments to third parties were for legitimate Statek business purposes. Accordingly, the defendants are liable for these payments, totaling $267,197.

3. The Claim for $761,322 That Statek Paid To Third Parties For Johnston Entity Obligations

The plaintiffs next claim that Johnston and Spillane are liable for $586,322 that they caused Statek to pay for obligations of the Johnston Entities.[126] The defendants do not dispute that they have the burden of proving the entire fairness of those payments, or that the payments were made with respect to contracts with, or invoices directed to, the Johnston Entities. They concede that three payments for life insurance premiums, totaling $25,872, were personal, but urge that the remainder were for the benefit of TCI II and Statek. The reasons, defendants say, are that: (i) all of the Johnston Entities were corporate shells that had no business from 1984, except for Metrodyne, which had ceased operations by 1985; (ii) therefore, the Johnston Entities had no reason to make expenditures for medical expenses, rent, and the like, and (iii) ergo, those expenses could only have been

[126] Those payments are identified under Tab 3 to the Plaintiffs' Post-Trial Opening Brief.

incurred for the benefit of TCI II and Statek.

This argument is flawed, both conceptually and factually. Conceptually it is flawed because it rests upon the defendants' position that it is "nonsensical" for plaintiffs to argue that "a contract with or invoice to a Johnston entity was an 'obligation' of that entity."[127] But why? If (as was the case here) a Johnston Entity was a party to a contract, why would the basic contract principle that a party to a contract is bound by its terms not apply? If (as defendants argue), the payments were for the benefit of Statek or TCI II, then the invoices and bills would have been addressed to Statek or TCI II or, failing that, the defendants should have offered a convincing explanation for why the invoices and bills for these goods and services were addressed to the Johnston Entities. No explanation was offered.

The argument is flawed factually for two reasons. First, it is a reversal of the position the defendants took when this Court was deciding the form of final order in the § 225 action. In that context, counsel for Johnston and Spillane represented that "the premises at 20 Acosta Street, Stamford, Connecticut that are currently used by TCI-II are leased by a different corporate entity other than TCI-II and

---

[127] Def. Ans. Br. at 50.

used by entities controlled by Mr. Johnston other than TCI-II. Accordingly....it would be inappropriate to order defendants to vacate premises in which they conduct business for other corporate entities, nor should defendants surrender their keys to these premises."[128]

Second, and in all events, the defendants' explanations for the specific contested payments are uncorroborated, self-serving, and in the end, not credible.[129]

---

[128]Letter from defendants' counsel to Court dated January 10, 1996 (Appendix to Plaintiffs' Post-Trial Reply Br., Ex. 1 l)(emphasis added). If, as defendants now contend, the Johnston Entities "had no business," then why was there a need for such large cash infusions into those Entities through as late as 1995? The defendants' current position that the Johnston Entities are mere shells -- a position supported by the record -- strengthens the plaintiffs' contention that the only possible purpose for the cash infusions was to divert Statek monies to Johnston and Spillane. See Tab 1 of Plaintiffs' Post-trial Opening Brief.

[129]Statek was caused to pay numerous charges on invoices that were billed to Metrodyne, a Johnston Entity. A $1,508 invoice from A Copy was directed to Metrodyne and the purchase contract was signed by Spillane as Metrodyne's Vice President. The defendants assert, nonetheless, that this purchase was for a fax machine in TCI II's office. Even if that were true, the machine was never turned over to Statek or TCI II. Payments of a similar character were made to E.B.M. ($1,523 for a typewriter) and to American Teletypewriter Systems ($237 for a teletypewriter rental agreement signed by Spillane as Vice President of Metrodyne. Defendants' explanation -- that the purchase was for a teletype machine for TCI II -- is not supported by the cited deposition testimony, nor was that machine (or the E.B.M. typewriter) ever turned over to Statek or TCI II. The defendants explain another invoice to Metrodyne (for $165 from Atlantic Interstate Messengers), by describing the services AIM provided, but cite no evidence that those payments had anything to do with Statek. Spillane also decided, without any effort at justification, that a $966 telephone bill from SNET to Metrodyne should be paid by Statek. The defendants also caused Statek to pay $13,988 to Dow Jones for a news service at the Acosta Street office. The bills were sent to Metrodyne, the subscriber, which received all the refunds when Statek made an overpayment. There is no persuasive tie-in between that service and Statek's business, as evidenced by a similar payment by Statek, totaling $36,718, of invoices by Quotron Systems, Inc. to Metrodyne, for the Quotron machine at 20 Acosta Street. The evidence

cited by defendants (Johnston Dep. at 222-223 (10/21/97)) strongly suggests that these expenses were incurred for Johnston's personal investment purposes. Statek was also caused to pay $30,974 to Blue Cross for a health insurance policy for Johnston, Spillane and Oberg. The invoices are addressed to Metrodyne, and the policy was issued in Metrodyne's name, yet the payments were made by Statek. Spillane was unable to provide any explanation for why the payment was a proper expense of Statek Spillane Dep. at 416 (10/9/97). Finally, the defendants caused Statek to pay $291,674 of rent payments for the 20 Acosta Street lease which was in Metrodyne's name. Similarly, Statek was caused to pay $11,230 of invoices from Xerox, addressed to Metrodyne for a photocopying and fax machine at 20 Acosta Street. The defendants attempt to justify this by asserting that "the only business operating out of 20 Acosta Street was TCI II." (Def. Ans. Br. at 52). That assertion, unsupported by any record citation, also represents a complete reversal of the defendants' contrary representation to the Court in the $225 action.

The defendants explain a $27,927 payment to Aircraft Charter Group, Inc. as an "attempt to get Amplifonix Statek and Greenray to develop business together." Def. Ans. Br. at 5 1. No supporting record citation is given, nor do the defendants explain why it was fair for Statek to pay almost $30,000 to benefit Amplifonix and Greenray, which are Johnston Entities.

Johnston's explanation for a $9,736 payment by Statek to American Express was "to pay Carl DeJoya, who worked for the insurance agent for work done to keep Statek afloat after a death of a Statek employee." (Def. Ans. Br. at 51). But elsewhere in his deposition, Johnston testified that he was not sure of the purpose for the payments. Johnston Dep. 177 (10/20/97). Nor does the explanation make sense, because the accident occurred in the 1980s (id.) but the checks were not written until 1993. (PX 13-2,287).

Although $10 1,455 of statements, of Bocuzzi/Mincpac, a Connecticut chauffeur service, were addressed to Metrodyne, Spillane created fictitious invoices to Statek for "travel services," and caused Statek to pay the bills. The defendants explain that the payments were for a driver who drove the company car between Stamford, "where the TCI II office was, New York and the airports....and also drove the company car into the city for meetings." Def Ans Post-trial Br. at 5 1. But the deposition testimony cited to support this explanation does not mention TCI II, nor does it connect the persons being chauffeured to the business of TCI II or Statek. Johnston Dep. 188 (10/20/97), Spillane Dep. 417 (10/9/97).

Statek was caused to pay $7,000 to "H.Bombeck," for a study concerning whether to move the TCI II or Statek office -- a study that Johnston retrospectively decided was "useless, a waste." Johnston Dep. 190 (10/20/97). No other evidence supports the purpose of this expenditure, and no invoice for that study was ever produced.

Statek was caused to pay $2,500 to Gordon Flynn & Vancko, which were the **auditors for** Greenray, a Johnston Entity. Although defendants assert that "Statek hired them for a project"

Accordingly, the defendants are liable for the $76 1,322 of payments by Statek to third parties for Johnston Entity obligations.

4. The Claim for $2,392,668 That Defendants Caused Statek To Pay For "Consultants"

The fourth category of Statek claims is for $2392,668 that the defendants caused Statek to pay for so-called "consultants," but which in fact (plaintiffs contend) were made to rare art, book, and stamp dealers or to long-time friends of Johnston, all for non-Statek purposes [130] Of this total, $1,883,134 represents net payments to "D. Alford."[131] The remaining $509,534 were payments to other third

---

(Def. Ans. Post-Trial Br. at 52), citing page 679 of Spillane's deposition, that page contains no supporting deposition testimony.

Statek was caused to pay New England Telephone $1,952 for a telephone for ECM (a Johnston Entity). Although the defendants explain that "ECM was an investment made by and for the benefit of TCI II" (Def. Ans. Post-Trial Br. at 52), TCI II was not an investor in ECM (JX5 225 PX 21 at 1), and the defendants offer no support for their apparent position that an investor is obligated to pay the bills of a company in which it invests.

Finally, there are two miscellaneous payments by Statek. The first was for $3,920 to Personal Computer Service for computer equipment that has never been turned over to Statek or TCI II or otherwise been accounted for. The second was for $16,974 to "P.Scannell," who was Technicorp's (TCI's) Chief Financial Officer for services defendants claim were rendered to TCI, TCI II and Statek. The defendants' only support for this position is their own uncorroborated testimony.

[130] The payments falling into this category are listed in Tab 4 to the Plaintiffs' Post-Trial Opening Brief.

[131] $2,667,539 in debits and $549,742 in credits, for net disbursements of $1,883,134.

persons. Of that latter amount ($309,534), the defendants conceded in their Answering Brief that five of those payments, totaling $166,370, were personal.[132] Accordingly, the $343,164 balance and the Alford payments remain in dispute.

Before addressing the specific disputed payments, it should be noted that there is no credible documentation to support the characterization of these payments as being to "consultants" or for "consulting services." Statek never issued an IRS Form 1099 or W-2 to any of these payees for such services, none of these "consultants" entered into a written consulting or fee agreement with Statek; and none ever issued a written consultant's report. Indeed, there is no record of "advice" that any of them gave to Statek,[133] and unlike the situations where Statek did retain legitimate consultants, there are no board resolutions authorizing Statek to retain any of these consultants.[134] The only "paper trail" documenting these payments are the canceled checks and so-called "Fictitious Invoices."[135] The latter were invoices that Spillane herself manufactured on blank paper (as distinguished from invoices sent by the supplier of goods or services), and then

---

[132]Def. Post-Trial Answering Brief, at. 54.

[133]TR(SS) 1044-1046; Spillane Dep. 663 (10/10/97); Johnston Dep. 344 (10/21/97).

[134]See PX13-10 (Statek Minutes); see *also,* Id. (c-10) (Statek minutes of July 12, 1984 containing board authorization to retain Technomics).

[135]TR (JG) 238.

Statek or TCI II,[138] and there is no record of the expenses that Alford supposedly incurred.

Alford did hold Statek money in accounts when and where Johnston asked him to,[139] but there is no showing that this "service" yieided any benefit to Statek. Spillane testified that she ". ..believe[d] those were...held by Mr. Alford in an account for Statek....[Mr. Johnston] wanted to have Mr. Alford hold money for the account of Statek operation...He wanted to have money set out of the regular bank, out of the normal banking system that he had. He wanted it held in Europe in case he wanted to make acquisitions or just to have it over there for his reasons."[140] Johnston testified that ". ..Very early in the game...I decided I wanted to keep a certain amount of money out somewhere so that...if anybody were to say adios we would be in a position, if we needed it, to have some money to continue until we replaced the bank....I wanted to keep a million dollars out. I decided to do this through David Alford in England."[141]

---

[138]TR (SS) 1046-49. Alford was a director of several Johnston Entities, including Beverly Lane, TCI and TVI, and he was also a nominee shareholder for Johnston in many companies. TR (SS) 1046-1047. Alford was not paid by Johnston or the Johnston Entities for these services. TR (SS) 1046-49.

[139]TR (SS) 1047.

[140]Spillane Dep. 388-389 (1 0/09/97).

[141]Johnston Dep. 158-160 (10/20/97).

forwarded to Statek, when she wrote checks on a Bank of America account that was separately maintained (3000 miles away from Statek's accounting department) at the Acosta Street location.[136] Notably, the Fictitious Invoices for the five admittedly personal payments are exactly the same as the Fictitious Invoices for the other "consultants." Accordingly, the evidentiary support for the disputed payments -- which are next addressed -- consists solely of the canceled checks and the defendants' uncorroborated testimony.

The bulk of the payments that make up this claim ($193,134) were to David Alford, either as checks signed by Spillane or as wire transfers from the Acosta Street accounts. The defendants contend that the payments to Alford were for either (i) consulting services, (ii) reimbursement of expenses, or (iii) holding money abroad for Statek in non-Statek accounts. But, Spillane was unable to identify what specific Statek problems Alford was consulted about,[137] and although the Fictitious Invoices list three types of charges by Alford -- "fees," "directors' fees," and "reimbursement of expenses"-- Alford was not a director of

---

[136] When Spillane wrote a check on that account (BoA checking account #1454-3-00376), she generally forwarded to Statek's accounting department a copy of the check, together with the Fictitious Invoice. TR (JG) 206-210; TR (SS) 117-I 8, 162.

[137] TR (SS) 1049-50.

Johnston did not explain who might say "adios" to him, or what that might mean, but given Johnston's pattern of behavior, little imagination is needed to draw the (I believe highly likely) inference that Johnston "parked" funds with Alford in Europe, and possibly with others elsewhere, not to benefit Statek but to assure Johnston's continued lavish lifestyle should his actions come to light and require a quick exit ("adios") from the United States to more sympathetic regimes.

As a fallback argument, the defendants also insist that all Statek moneys that were paid out to Alford were repaid to Statek. Mr. Garvey's compilation sets forth almost $550,000 of Alford credits to which plaintiffs concede the defendants are entitled. The argument that Alford restored to Statek all that he received is supported only by Spillane's testimony which, besides being self-serving, is demonstrably unreliable. [142] I find that the defendants have not met their burden of

---

[142] Spillane's own testimony on the subject (at pp.1035-1036) proves the point:

> Q: Now you also did an analysis of funds moved back and forth to Mr. Alford?
> A: That is correct.
> Q: And in those cases, you also incorporated a number of "source unknown" transactions in the repayment side of the ledger. Is that right?
> A: I believe so.
> Q: And with respect to those, you also didn't have any documentation. That was, again, just your memory that those transactions, source unknown, in fact came from Mr. Alford?
> A: Yes.

proving that the payments to Alford totaling $1,883,134 were made for legitimate business purposes of Statek.

Nor have the defendants established the propriety of the remaining disputed payments. As earlier noted, the defendants concede that $166,370 of those payments were personal, leaving in issue the payments to nine other persons, totaling $66,293. As now discussed, none of these payments has shown to be a legitimate business expense either.

W.R. Knobloch ($30,406): These undocumented expenses (except for a few Fictitious Invoices) were to Johnston's close friend, who Spillane "believe[d] was a director of Statek."[143] The problem is that Knobloch resigned as a Statek director in January, 1986, yet Spillane was still issuing Fictitious Invoices to Statek describing the payments to Knobloch as "directors' fees" almost two years after his resignation and could not explain why.[144] Johnston could not explain what $16,000 of those payments were for,[145] and his only explanation (apparently for the remaining balance) was that Knoblauch and he used to meet "to look at options which we had, other facilities, people, what do you buy, how do you sell, to whom do you sell Statek."[146] But even if that testimony is credited, it shows only that they talked about options that "we," not *Statek*, had.

---

[143]Johnston Dep. 294 (10/21/97); Spillane Dep. 460 (10/09/97).

[144]TR (SS) 1050- 1052

[145]Johnston Dep. 298 (10/21/97).

[146]*Id* at 290.

Hank Lawson ($96,627): Like the payments to Knobloch, these payments were to a personal friend of Johnston.[147] The services purportedly rendered by Lawson are completely undocumented, except for some Fictitious Invoices for "Directors fees," "Expenses," or "Consulting-Operation/Organization and Member Advisory Committee." The Fictitious Invoices describing payments to Lawson as "directors fees" were created years after he resigned from Statek's board,[148] and defendants' explanation that Lawson went to Statek "quite a bit" and was an expert in crystallography who "spent time with [Dr.] Chuang reviewing what they were doing from a business point of view...,"[149] is based solely on Johnston's self-serving (and unspecific) testimony, which I find insufficient to carry the defendants' burden of proof

H. Lange ($17,296) and R&H Enterprises ($22,404): Although defendants claim that Lange and his company, R&H Enterprises, were consultants to Statek, there is no documentary support for these payments other than Fictitious Invoices, and no documentation of any kind that evidences the services Lange supposedly rendered. The only evidence supporting defendants' contention is the testimony of Johnston and Spillane, which is insufficient not only because it is self-serving and uncorroborated, but also because they could not agree on what services Lange performed. Johnston testified that he helped with manufacturing, while Spillane testified that he helped with advertising and marketing?'

T.S. Magnusson ($49.530) and W.Nicolay ($3,000): Except for Fictitious Invoices that describe these payments as being for "Miscellaneous expenses for the account of Statek" or for "Consulting/Growth plan," there is no documentation of their purpose. Defendants, who describe Magnusson as a"Swede living in Switzerland," explain that Magnusson "found Hoffmann, who became the head of Statek Europe," and also "introduced Johnston and Spillane to a headhunter in

[147]Spillane Dep. 462-463 (10/09/97).

[148]TR (SS) 1052; PX 13-2 (518-557).

[149]Johnston Dep. 301-302 (10/21/97; Def. Post-Trial Ans. Br. at 55.

"'Johnston Dep. 301 (10/21/97); Spillane Dep. 461 (1 0/09/97).

Copenhagen to conduct a search for Hoffmann's replacement."[151] Apart from the fact that the sole evidence offered to support this position is the defendants' uncorroborated testimony, no effort is made to show how these introductions warranted payments totaling almost $50,000. As for the payments to Mr. Nicolay, Spillane testified that he was 'fhelping Mr. Johnston" in 1985, and Johnston testified that he used Nicolay "for a little bit to help in whatever I was doing at Statek."[152] Again, this uncorroborated, self-serving'testimony is too unspecific to be acceptable as satisfactory proof that these payments were legitimate business expenses.

A.H. Plaisted ($85,80 1) and Soleras ($14.600): The defendants' explanation for over $100,000 of payments to Mr. Plaisted and his company is that Plaisted consulted in connection with manufacturing problems at Statek and also served (for a short time) as president of Statek, for which he was not paid a salary, but was paid fees and expenses.[153] Again, it was defendants' burden to justify these payments with more than nonspecific testimony. Apart from Fictitious Invoices, there is no documentation for these payments, such as board resolutions or even invoices from Plaisted himself.

Dr. Arthur Riben ($4.500): Dr. Riben was the head of Amplifonix, a Johnston Entity. There is no documentation for these payments other than Fictitious Invoices. The defendants explain that "Johnston 'had [Riben] come out and help[] in the technology area, the manufacturing area,' and probably sales." Moreover, "Johnston also wanted Riben to help in combining Amplofonix, Statek and Greenray."[154] This explanation is inadequate, because it rests upon uncorroborated and nonspecific testimony, and also because no justification is offered for why Statek should pay for discussions that benefit Johnston Entities or a venture owned by Dr. Riben.

---

[151] Def. Post-Trial Ans. Br. at 55.

[152] Spillane Dep. 498 (1 0/10/97); Johnston Dep. 3 10 (1 0/21/97).

[153] Def. Post-Trial Ans. Br. at 56.

[154] *Id.*

R.F. Wright ($19,000): Bob Wright was a friend of Johnston and a retired partner at Arthur Anderson. Although defendants point out that Johnston testified that Wright "helped for some time as an adviser,"[155] nowhere does Johnston state that Wright was an adviser to Statek, and he could not remember what Wright advised him about.[156] Nor do defendants offer any documentary evidence (including any work product attributable to Mr. Wright) that would legitimize these payments as business expenses properly chargeable to Statek.

Accordingly, the defendants are liable to Statek for the payments, totaling $2,117,797, that they caused Statek to make to "consultants."

5. The Claim For $3,747,829 That The Defendants Caused Statek To Pay To Lawyers Who Did Not Work For Statek

The plaintiffs' next claim is for payments, totaling $3,747,829, that the defendants caused Statek to pay to different law firms and/or lawyers. Plaintiffs contend that, in fact, those lawyers did not work for Statek and that the payments (i) were used as conduits or "fronts" to conceal the defendants' misappropriation of Statek funds for their own personal benefit, or (ii) were payments that defendants could not prove were made for the benefit of Statek.[157]

---

[155] *Id.*

[156] Johnston Dep. at 339.

[157] "The challenged payments to law firms are listed in Tab 5 to the Plaintiffs' Post-Trial Opening Brief.

Not all of the law firm payments made by Statek are challenged. Not contested are payments made to firms that actually performed for Statek legal work that was properly documented in Statek's accounts payable records by invoices which detailed the legal services provided.[158] The payments that are contested took the form of checks, issued by Spillane from the Acosta Street location, that were either (i) completely unsubstantiated, i.e., supported only by a Fictitious Invoice for "legal services" or "legal fees," or (ii) documented only after the fact, by invoices produced by certain law firms (not by the defendants) in response to this Court's Orders in the $225 action and this action. Those invoices show that the beneficiaries of those payments were Johnston and Spillane, not Statek.

The plaintiffs have analyzed the contested law firm payments in four separate categories. I will do likewise.

(a) Payments to Dupuch & Turnquest ($547,245)

The largest group of challenged payments are those made to Dupuch & Turnquest, a law firm located in the Bahamas ("Dupuch"). The defendants caused over $1 million of Statek funds to be paid to Dupuch, in three different ways: (i)

[158] TR (JG) 246-47.

Statek paid $547,245 in checks directly to DuPuch; (ii) Statek paid monies to Samuel Greenspoon ("Greenspoon")[159] personally and to Greenspoon's law firm, which monies were then paid to Dupuch; and (iii) Statek paid funds to Metrodyne, from whose account checks were then issued and sent to Dupuch.[160] Only the claim for $547,245 of direct payments by Statek to Dupuch is addressed in this Section. [161]

These facts prompt at least two questions. The first is: why was Statek paying, either directly or indirectly, over $1 million of its funds to a Bahamian law firm? To that question the only answer Spillane could provide was that "Mr. Johnston wanted to have it done that way."[162] The second question is: what was the money used for? The answer to that question came to light only after the trial.

Despite this Court's Order in the § 225 action directing the production of documents supporting the payments by Statek to law firms, the defendants never

---

[159]Greenspoon was a former director of TCI II and, until his death, was also the primary attorney who represented Johnston and Spillane's interests.

[160]TR (SS) 10651067.

[161]The claims for moneys paid to Dupuch either by Metrodyne, Greenspoon personally, and/or Greenspoon's firms, are discussed in the Sections of this Opinion that concern payments to the Johnston Entities, or that address payments to Greenspoon, Jeffrey Daichman, and their firms.

[162]TR (SS) 1066.

produced any Dupuch statements describing specific work that Dupuch performed for Statek. The Dupuch "invoices" that Spillane maintained at Acosta Street provide no insight into that subject. They simply repeat the following mantra:

> To: PROFESSIONAL SERVICES RENDERED with the above-captioned Company taking your instructions in connection therewith, rendering advice and attending you generally[163]

Spillane herself conceded that she could not tell from looking at the invoices what legal services Dupuch provided,[164] and at their depositions neither she nor Johnston were able to describe what legal or professional services Dupuch rendered to Statek. Despite her numerous trips to the Bahamas to "liaise" with Dupuch, Spillane claimed to have no personal knowledge of the nature of the services that Dupuch performed, other than her understanding that Johnston was "consulting and speaking with Mr. Turnquest."[165] And even though the payments were of a seven figure order of magnitude, Johnston inexplicably professed similar ignorance:

---

[163]PX ss 8.

[164]TR (SS) 1065.

[165]Spillane Dep. 437-438 (10/09/97), 473-4 (10/10/97).

Q. What legal services did Dupuch & Turnquest perform for Statek?
A. I can only say that it was whatever was -- whatever was required in the Bahamas. And if anything else came up, and I do not specifically recall.
Q. Tell me everything you can recall about legal services that were required for Statek in the Bahamas.
A. I can't. I really cannot recall. But they -- whatever forms they had to fill out, whatever they had to do, I just really cannot recall. [166]

Only after the trial did it become clear that the defendants' inability to recall was feigned and that their testimony was false. Indeed, the record shows that for years Johnston and Spillane deceived Statek's accountants and auditors, plaintiffs, and ultimately this Court, about the nature of the payments to Dupuch. In a memorandum dated May 1, 1995, Spillane represented to Statek's auditors that the payments to Dupuch were for "[c]orporate strategy, business enhancement, corporate, legal."[167] In an affidavit filed in this action on October 25, 1996, Spillane represented to this Court that the payments to Dupuch were "for legal fees."[168] Then, at their depositions, the defendants testified for the first time that some of those payments were for "rent" on a house in the Bahamas, but insisted

---

[166] Johnston Dep. at 224-225.

[167] TR (SS) 169; PX 13-49.

[168] JX 2C(5) at ¶7.

that they had no idea who owned or leased the house.[169] Because several of Statek's checks to Dupuch had been endorsed to "Beverly Lane, Ltd.," Spillane was asked specifically about that company at her trial deposition in November, 1998. Initially she denied all knowledge of that company, but ultimately testified that she and Johnston "probably" had set up a company in the Bahamas called Beverly Lane Limited. ("Beverly Lane"). [170]

After Spillane's deposition, the plaintiffs requested and received information on Beverly Lane from the Bahamian Registrar of Companies. The September 10, 1998 corporate filing that plaintiffs received showed that Spillane is Beverly Lane's President and a director, together with two other "close friends of Johnston," David Alford and Edith Turnquest.[171] At the trial, Spillane nonetheless continued to insist that she had no involvement with Beverly Lane, did not recall forming Beverly Lane, did not know its shareholders or whether it was still active, and did not know whether Beverly Lane owned the Bahamas property. [172] The plaintiffs then made, and the Court granted, a request that the trial

---

[169]Spillane Dep. 133-34 (10/08/97); TR (SS) 995-996; Johnston Dep. 224-225,228, 247 (10/21/97).

[170]TR (SS) 998-1001.

[171]TR (SS) 1006; PX SS 12.

[172]TR (SS) 998-1001.

record be held open while the plaintiffs sought to discover the Beverly Lane records from the defendants.

On December 2, 1998, the defendants produced the Beverly Lane records that should have been produced in response to discovery requests that had been outstanding for two years. On December 3, 1998, defendants faxed copies of the stock certificates and trust agreements showing the beneficial owners of the stock. The records produced on December 3 showed that Johnston is the beneficial owner of all of Beverly Lane's stock.[173] The records produced on December 2 showed that: (i) Beverly Lane was incorporated on May 9, 1989 with the assistance of Dupuch; [174] (ii) Beverly Lane's first directors were, and (with the exception of Greenspoon) still are, Spillane, Edith Tumquest, David Alford and Greenspoon--all close friends of Johnston;"' (iii) the mortgage indenture, signed by Greenspoon as Vice President of Beverly Lane, shows that Beverly Lane disbursed $709,290 to purchase in fee simple a house with a pool in Beverly Lane in Lyford Cay, an exclusive beachfront community in Nassau, Bahamas, on

---

[173]PX BL 5. Tellingly, the stock certificates are signed by Spillane as President of Beverly Lane.

[174]PX BL 1.

[175]*Id.* at 4.

August 30, 1989; (iv) the purchase was subject to a six year mortgage of $500,000 on the property, with Canadian Imperial Bank of Commerce;[176] and (v) Beverly Lane made monthly principal and interest payments of $10,800 on that mortgage, which was fully paid and satisfied as of January 13, 1995.[177]

In response to these facts, defendants cite only Johnston's testimony and a letter from Edith Turnquest. Johnston's testimony was that Dupuch did "whatever was required in the Bahamas" and "whatever forms they had to fill out, whatever they had to do, I just cannot recall," and also that he desired "to establish a second base of operations in technology and a second facility located in the Bahamas."[178] Mrs. Turnquest's letter to plaintiffs counsel stated that $250,000-$300,000 of the payments covered "professional services."[179]

These "explanations" are (to put it charitably) totally insufficient to satisfy the defendants' duty to account and to demonstrate the entire fairness of these payments to Statek. The defendants insisted that the house was necessary for

---

[176]PX BL 2; BL 0079-82.

[177]PX BL 2 and 3; BL 0061-62.

[178]Def. Ans. Post-Trial Br. at 57, citing Johnston Dep. at 226-3 1.

[179]PX 13-50.

Statek business in the Bahamas,[180] yet at trial Spillane admitted that "Statek never did any business in the Bahamas."[181] That alone exposes Johnston's testimony regarding Statek's "business" plans in the Bahamas as a fabrication. As for the statements in Mrs. Tumquest's letter, even if true, they refer to Dupuch's services to *Johnston*, not Statek, in connection with the formation and the acquisition and maintenance of the Bahamas house.[182] Moreover, Johnston and Spillane also paid Statek funds to Dupuch to be held in non-Statek Bahamian accounts.[183]

The foregoing facts persuade me that most of the monies the defendants caused Statek to pay Dupuch were used to purchase the house in the Bahamas, that the defendants fraudulently concealed those payments, and that the defendants are unable to account for the balance of the moneys paid to Dupuch. Accordingly, the defendants are liable to Statek for the $547,245 of direct payments to Dupuch. Moreover, a constructive trust shall be imposed upon the defendants' stock in

---

[180]Spillane Dep. 33-34 (10/08/97); Johnston Dep. 236 (10/21/97).

[181]TR (SS) 996.

[182]This conclusion is borne out by documents produced by defendants after trial, including (i) a memorandum from Dupuch to Beverly Lane Limited regarding the "Lyford Cay House" dated April 1, 1998, listing expenditures for a three month period of over $20,000 for, among other things, landscaping, electricity, telephone, pressure cleaning house, plumbing, pool service, corporate fee for property taxes, homeowners fees, housekeeping and repairs (BL 0 186); and (ii) various corporate records, including corporate filings, stock lists and Articles of Association, prepared and kept by Dupuch for Beverly Lane. (BL l-40).

[183]TR (SS)168, 1062; PX 13-51.

Beverly Lane and upon the Bahamas house, to secure the payment of the judgment.

(b) Payments Made to Beharrell Thompson & Co. ($46.73 1) And to Coudert Brothers ($74,090)

The plaintiffs also challenge payments that the defendants caused Statek to make to two London firms of which attorney Stephen Beharrel was a partner: Beharrell Thompson ($46,73 1), which later became part of Coudert Brothers ($74,090). Although Spillane was designated as Statek's "liaison" with Stephen Beharrell, she could not describe the legal services Beharrell provided. She testified: "[whatever he did you know...I don't know."[184] And despite this Court's February 23, 1996 Order in the § 225 action directing the defendants to produce all records of legal services provided to Statek and TCI II,[185] they never produced any records for Beharrell and his firms. Plaintiffs did obtain limited records from Mr. Beharrell, but the invoices Beharrel supplied state only that the fees were for "professional charges in connection with advice on setting up a UK-distribution company."[186] The cover letter to one of those invoices explains that

---

[184]Spillane Dep. 433 (10/09/97).

[185]Exhibit 12 to the Appendix to Plaintiffs' Post-Trial Reply Brief.

[186]PX ss 9.

the fees:

> are in respect to the advice given regarding the flat rented by Fred in London and that the disbursements sum includes a £100 deposit paid by us on behalf of Statek for the supply of electricity to the flat.

Because they show that Beharrell's services concerned Johnston's flat in London and were rendered by Beharrell and his firms for the benefit of the defendants, and not Statek, the disclosures on the Beharrell invoices cannot be presumed to be truthful. If for no other reason, that places squarely upon the defendants the burden to show that the payments to Beharrell were made for the benefit of Statek.

As with the Dupuch and other payments previously discussed, the defendants have not discharged that burden. They rely solely upon Johnston's non-specific testimony that Beharrell did "legal work for Statek Europe; and he advised."[187] But once again, Johnston could not specify the nature of this legal work or advice, and he admitted that none of Beharrell's work or advice was in writing because he (Johnston) "never wanted it" in writing.[188] This

---

[187]*Johnston Dep. 182-83 (10/20/97). Defendants also cite Johnston's testimony that "Werner Tebleman was paid through Coudert or through Stephen Beharrell or Coudert at some point....1 just don't know." *Id.* at 218.

[188]*Id.* at 184.

uncorroborated testimony hardly satisfies the test of entire fairness. The record contains.evidence that when Johnston and Spillane retained law firms to do legitimate work for Statek, they obtained detailed law firm invoices in proper form.[189] The record also shows that when the law firms were paid with Statek funds for services that were not rendered to Statek, the defendants attempted to conceal that fact by creating Fictitious ("dummy") Invoices reciting, with no detail or explanation, that the payments were for services rendered to Statek; or by having the law firms submit similarly conclusory invoices. The Beharrell payments are of that latter character.

Accordingly, the defendants are liable to Statek for $120,821 of payments that they caused Statek to make to Stephen Beharrell's law firms.

(c) The Claim for $2,846,118 That Defendants Caused Statek to Pay Samuel Greenspoon, Jeffrey Daichman, and Their Law Firms

The third category consists of claims to recover $2,796,118 paid by Statek to certain law firms. Specifically, it includes: (i) payments made both to Samuel Greenspoon personally (totaling $476,258) and to five law firms with which

[189] TR (JG) 246-247.

Greenspoon was affiliated at different times (totaling $1,633,969)[190]; as well as (ii) payments (totaling $685,891) made to two law firms with which Greenspoon's partner, Jeffrey Daichman, was affiliated.[191] The basis for the claim is that the services rendered by these firms benefited only the defendants, and not Statek.[192]

With respect to the payments made to Greenspoon personally, Spillane testified that those payments were for "legal services,"[193] yet Statek's files contain no invoices or work product from Greenspoon, and neither Spillane nor Johnston could explain why Greenspoon should have been paid legal fees personally at the same time that Statek was paying hundreds of thousands of dollars to his law

---

[190]Carb, Luria, Glassner, Cook & Kufeld ($722,110); Greenspoon, Siaga, Gaynin & Daichman ($15,000); Greenspoon, Gaynin., Daichman & Marino ($380,603); Grutman, Miller, Greenspoon, Hendley & Blank (S 141,405); and Dunnington, Bartholow & Miller ($374,85 1).

[191]Feltman, Karesh, Major & Farbman ($5 17,487), and Kane Kessler ($168,404).

[192]The payments that are challenged on this basis are found at PX 13-l and PX 13-2. Plaintiffs devote a portion of their Opening Post-Trial Brief (see pages 5 I-52) to arguing that Daichman and Greenspoon "actively participated in Defendants' fraud and concealment" in several respects. While it is the case that the services provided by those "hired guns" enabled Johnston and Spillane to perpetrate their ongoing fraud, and that some of those services should have imposed upon those attorneys a duty to inquire more deeply into what their clients were asking them to do, the plaintiffs have made no reasoned effort to show that Daichrnan and Greenspoon actually and specifically knew that their activities as lawyers were part of a fraudulent scheme. Accordingly, this claim is evaluated solely on the basis that Statek was caused improperly to pay for legal services that benefited only Johnston, Spillane, and/or the Johnston Entities.

[193]TR (SS) 1084-1085.

firms.[194] Moreover, Spillane admitted that some unspecified portion of the payments to Greenspoon and Daichman were then funneled to Dupuch for payments on the Bahamas house.[195] I conclude that the defendants have failed to meet their burden to account for the Statek monies that were paid to Greenspoon personally, and therefore are liable to Statek for that amount.

As for the payments to the law firms with which Greenspoon was associated, the picture is somewhat murkier. In support of their position the defendants submitted, together with their Post-Trial Answering Brief, an Appendix that included a list of certain invoices submitted by the various law firrns with which Greenspoon and Daichman were (at different times) affiliated. The attachments to that Appendix included "back up" materials such as time sheets and itemized invoices. Those submissions show that while some of the invoices were directed to Statek or TCI II as the "client," the majority were addressed to Johnston, Spillane, or one or more of the Johnston Entities (BVI, ECM, TCI, and Greenray).

To the extent that the Appendix is intended as an "accounting," it is fatally flawed because it attempts to explain only $859,024 of the $3,747,829 in

---

[194] TR (SS) 1086- 1087; Johnston Dep. 266-267 (10/21/97).

[195] TR (SS) 1065.

challenged transactions, and also because only $149,117 of the bills that are included are actually addressed to Statek. A nonexhaustive sample of the bills addressed to Statek showed that the amounts of at least three Statek checks that Spillane issued to the Carb Luria law firm vastly exceeded the amount of the underlying invoices, resulting in "overpayments" in those three instances alone of almost $84,000.[196] Lastly, the Appendix reflects that many of the bills addressed to Statek double (and, in one case, triple) counted the charges. There are errors of other kinds as well.

To this showing the defendants' response consists of assertions that (i) surely the law firms must have performed some bona fide legal services for Statek, and that (ii) "a few complaints about what [the law firms] did can hardly justify plaintiffs' broad-scale attack on all of the legal services rendered by these firms."[197] Moreover, the defendants insist, (iii) "even...[if]...Greenspoon's and

---

[196]At trial, Spillane admitted that she had issued and signed Statek check #14095 for $26,650 to Carb Luria in payment of a $42 invoice to Statek, and was unable to explain the overpayment. TR (SS) 1089; compare PX 13-2 (602) with PX 13-2 (595). Spillane issued and signed Statek check #14109 for $28,720 to pay a Carb Luria invoice to Statek for $65. PX 13-2 (595,603). She also issued Statek check #14117 for $28,742 to pay an invoice to Statek for $135. PX 13-2 (595,604). The consistency and magnitude of these overpayments makes it highly questionable whether they were "mistakes," as defendants have suggested, and raise the inference that the overpayments were deliberate funneling of monies to third parties, including Dupuch.

[197]The defendants also mention a few examples of what they contend were bona fide legal services performed by Greenspoon's and Daichman's firms, but as support cite only the

Daichman's services in certain areas should be charged to Johnston and Spillane, in order to determine which charges of these various firms should be charged to them personally, it is necessary to examine all of the legal bills submitted by these firms to determine who did what work."[198]

The difficulty with this argument is that if an examination of each and every legal bill is necessary, that was a task for the defendants, not the Court, to perform. It is the duty of the defendants, not the Court, to sort out the accounting mess that they themselves created. It may be true that some of the moneys Statek paid to these law firms were for bona fide legal services, but it is certainly the case that many (if not most) of the "legal fees" that Statek paid were not. The defendants' own Appendix demonstrates that the defendants used Statek moneys (i) to pay bills for law firm services that were rendered to persons and entities other than Statek, (ii) to pay amounts that were far in excess of some of the invoices submitted to Statek, and (iii) to pay amounts, disguised as "legal fees," that in fact were Statek funds being diverted to pay for the Bahamas house.

In the face of these incontrovertible facts, this Court is not required to -- and it will not -- presume the regularity or bona fides of any payments made by

---

uncorroborated deposition testimony of Johnston and Spillane. Def. Post-Trial Ans. Br. at 61-62.

[198] *Id.*

Statek to these law firms. While at first blush that result may seem harsh, it bears repetition that to the extent any of those charges were valid, it was the defendants' duty, as fiduciaries, to so demonstrate and to show the amounts of all valid payments. Their opportunity to do that was at the trial. If defendants believed more time was needed to prepare their case, they could have alerted the Court and requested a postponement, but they did not. Instead, they elected to go to trial on this and all other issues, which entitled the plaintiffs and the Court to assume that the defendants were fully able -- and intended -- to present their defense and whatever accounting they deemed to be appropriate at that time. The defendants cannot be permitted to use their failure to do that as an opportunity to seek yet another trial, or to foist upon the Court a duty that was always theirs and theirs alone.

For having failed to satisfy their burden of proof and their duty to account, the defendants are liable to Statek for the payments, totaling $2,796,118, to Greenspoon personally and to Greenspoon's and Daichman's law firms.[199]

---

[199] To the extent those payments include moneys paid by the Greenspoon/Daichman law firms to Dupuch, a recovery of those moneys may involve "double counting," since the moneys paid to the Dupuch firm are the subject of a separate recovery. To the extent that is the case, an appropriate adjustment should be made in settling the form of final decree.

(d) The Claim For $85,875 That The Defendants Caused Statek To Pay To Foreign Lawyers And Law Firms For Undocumented "Legal Services"

The fourth category of claims concerns undocumented payments to foreign lawyers and law firms. These include payments to Doser, Amereller & Noack ($2,200); Schurmann, Rausch & Rohrer ($10,250); A. DeBeer ($53,899) and 0. Etienne ($19,526). It is conceded that Spillane, at Johnston's direction , "liaised" with these attorneys and wrote and signed the Statek checks to them. If any records ever existed of legal services these firms or lawyers may have rendered, those records were never produced. Accordingly, the support for the propriety of these payments consisted of the uncorroborated testimony of Johnston and Spillane.

Neither Spillane nor Johnston could recall the purpose of the undocumented payments to, or the services rendered by, the Doser or Schurmann firms.[200] As for DeBeer, Spillane testified that he was a Swiss attorney who opened bank accounts for Statek in Switzerland, and was "taking care of [the Swiss office]....Again, you had to take care of. You had to -- whatever."[201] Johnston testified that DeBeer "was the attorney for Statek Europe when we acquired Statek. And he continued

---

[200]Spillane Dep. 435,521 (10/09/97); Johnston Dep. 221-222,327 (10/21/97).

[201]TR (SS) 1071-1072; Spillane Dep. 434 (10/09/97).

to be the attorney for Statek Europe, I suppose, until we moved it to England."[202] As for-Etienne, defendants cite to (i) Johnston's testimony that Etienne was an attorney in Switzerland who took over "...I think -- it's been so long ago -- who took over from DeBeer to take care of the Swiss office legal affairs. There were plenty of legal affairs in Switzerland..., " and (ii) Spillane's testimony that Etienne had an account at UTO Bank from which he made payments for Walter Hoffman, who was at one time the head of Statek Europe.[203]

These explanations -- based upon the defendants' inability to recall anything about the first two undocumented payments, and their bare assertions that the latter two payments were for the benefit of Statek Europe, without providing any detail or description of those services -- cannot satisfy the defendants' burden to show that these payments were for services rendered to Statek. Accordingly, the defendants are liable to Statek for these payments, totaling $85,875, to those foreign lawyers and firms.

---

[202]Johnston Dep. 219-220 (10/21/97). Defendants state that Johnston believed Statek may have used DeBeer when ASUAG raised a patent question in Switzerland. Def. Post-Trial Ans. Br. at 62.

[203]Def. Post-Trial Ans. Br. at 63 (citing Johnston Dep. 251 and Spillane Dep. 504).

(e) The Claim That Defendants Caused Statek To Pay $1,605,769 in Personal Legal Fees, Including Those To Defend The Connecticut Action and The Delaware §220 and §225 Actions

Finally, the plaintiffs seek to recover personal legal fees that the defendants improperly caused Statek to pay, including to defend Vendel's action in Connecticut and his §220 and 9225 actions in this Court and the Delaware Supreme Court. All but $197,768 has been previously addressed and awarded to Statek on different grounds in Subsection 5 (c), above.[204] Because the Court must in all events determine whether the plaintiffs are entitled to recover the $197,768 on this alternative ground, the entire claim will be considered on this alternative basis as well.

The plaintiffs rest their claim on two separate grounds. The first is that the defenses for which Statek funds were used to pay were in fact personal to Johnston and Spillane, who should have borne those defense costs themselves. The second ground is that the defense of all three actions was conducted in bad

[204] The $197,768 of fees not previously addressed include charges by Goldstein & Peck ($2796 to fight a speeding ticket issued to Johnston, see Spillane Dep. 444 (10/09/97)); Cooper, Epstein & Hurewitz ($1248); Kaye, Scholer, Fierman, Hays, & Handler ($89,620); Potter, Anderson & Corroon ($103,504); and Walder Wyss & Partners ($600). The fees previously addressed include charges by Carb Luria ($722,110); Feltman Karesh ($5 17,487); and Kane Kessler ($168,404). It is not altogether clear what portion of those fees was incurred to defend the Connecticut and the Delaware $220 and $225 actions.

faith. The defendants' response is that the defense of those actions was not personal but, rather, were defenses of TCI II, and that because Statek would ultimately have had to pay the legal fees of TCI II, it should not matter that Statek paid the fees directly in the first instance.

The Connecticut action is perhaps most easily analyzed, because in that case, Johnston and Spillane were the defendants who incurred the defense costs in their personal capacities. TCI II was never a defendant until it was added as a nominal defendant only two days before the recommended ruling dismissing the complaint. Because Johnston and Spillane were sued as individuals, the only legally proper way their fees could be paid by TCI II (or Statek) was by way of indemnification or advancement of indemnification under 8 Del. C. $145, but the defendants never invoked the machinery, or satisfied the legal requirements, for indemnification.[205] For that reason the fees paid by Statek to fund Johnston's and Spillane's defense of the Connecticut action were improper.

The analysis of the $220 and $225 actions is more difficult, because from a technical standpoint the only party before the Court in an in personam sense was

---

[205] Those requirements were either: (i) a majority vote of the corporation's disinterested stockholders -- impossible in this case; (ii) approval of the corporation's disinterested directors -- also impossible, or (iii) a written opinion from independent outside counsel -- which was never obtained. See 8 Del. C. § 145 (d); Cal. Corp Code §317 (e).

TCI II. In the $220 action Johnston and Spillane were not parties at all, and in the $225 action they were only parties respondent. The plaintiffs' contrary argument is that the corporation was a party only in the nominal sense, that at all times the true parties in interest were Johnston and Spillane, and that they caused Statek to pay legal fees solely to advance their personal interests, and not any independent interest of Statek or TCI II. The problem, however, is that in a realistic sense, the same can be said of most §220 or §225 proceedings that involve nonpublic closely-held corporations. In such cases the corporation customarily pays the legal costs of opposing the $220 or $225 claim, even though the opposition often serves the interests (or the position being taken) by the incumbent management, yet in such cases that fact is not viewed as controversial. That is because in such cases there is normally a good faith dispute about the merits of the claim, which implicates an independent corporate interest in the claim's resolution.

This case, however, differs markedly from the "ordinary" or "typical" fact pattern out of most $220 or $225 proceedings arise. Indeed, this case is exceptional if not unique, for at least two reasons. The first is that the defendants' litigating position amounted virtually to a concession that no independent corporate interest was implicated. During discovery in this lawsuit, the plaintiffs moved to compel the production of the defendants' attorneys' files in the $220 and

the §225 actions. The defendants opposed **the** motion, on the ground that the attorneyswere ***their*** counsel, and that therefore the files were privileged and belonged to them personally.[206] The second reason, which in my view is dispositive, is that those actions were defended in bad faith, such that the fees paid by Statek to finance the defense should never have been expended in the first place.

This Court has already held, and the Delaware Supreme Court has affirmed, that Johnston and Spillane defended the $225 action in bad faith and were personally liable to pay Vendel's attorneys' fees and expenses.[207] This Court found (in the words of the Supreme Court) that "the conduct of the Defendants rose to the level of bad faith because they had no valid defense and knew it."[208] This Court also found that "...that conduct also supports the conclusion that the defendants in bad faith forced Vendel to commence and prosecute [the §225] action."[209]

---

[206]Def. Memorandum of Law in Opposition to Plaintiffs' Motion to Compel the Production of Documents, at 10-15.

[207]*Arbitrium (Cayman Islands) Handels v. Johnston,* Del. Ch., 705 A.2d 225 (1997); *aff'd*, Del. Supr., 720 A.2d 542 (1998).

[208]*Arbitrium (Cayman Islands) Handels, 720* A.2d at 546.

[209]*Arbitrium (Cayman Islands) Handels, 705* A.2d at 237.

From these findings it follows (in my opinion, inescapably) that the defendants also acted in bad faith by causing Statek to finance their defense, which was found to be a "sham" and "intended to delay the inevitable day of reckoning, and to enable the defendants to continue mulcting the corporation without detection."[210] To say it differently, had defendants not acted in bad faith, the $225 action would never have been prosecuted and there would have been no defense costs for Statek to bear. The same fiduciary duty considerations that justified shifting to the defendants the liability to pay Vendel's fees, also warrant shifting to those defendants the fees and other defense costs they improperly caused Statek to incur. Because there was no "good faith" dispute about the merits of the claim in the $225 action, the defendants are liable to Statek for the fees and expenses it paid to defend that action.

The availability of a fully developed record now permits the Court to draw the same conclusion regarding the $220 (and Connecticut) actions as well. In the same Opinion where it awarded fees to Vendel against Johnston and Spillane in the §225 action, the Court declined to shift fees by reason of the defendants' conduct of their defense of the $220 (books and records) action. The reason was

---

[210] *Id.* at 233.

that the record then before the Court was "insufficient to support the conclusion that the defendants' opposition was in bad faith."[211] Although that ruling is now final, the record of the defendants' conduct was later significantly expanded. As a consequence it has now become clear (albeit in hindsight) that the defendants' bad faith motive also permeated and drove their defense of the $220 (and Connecticut) actions.[212]

Indeed, it is now abundantly manifest that ever since Statek was acquired in 1984, the defendants have engaged in a pattern of massive fraudulent diversions of Statek's (and TCI II's) assets, and concealments of the same. The defendants' knowledge that they had no defense, and their need to deploy obstructive and dilatory litigation tactics ". ..to delay the inevitable day of reckoning and...enable the defendants to continue mulcting the corporation without detection," could not have sprung full blown from the head of Zeus in 1994 when the $225 action was filed. As the present, significantly expanded, record shows, that knowledge and motive must have preexisted all of the the successive lawsuits, and must also have

---

[211] *Id.* The Court so ruled "with reluctance" and despite its observation that "the defendants' pre-litigation conduct is highly suspect." *Id.*

[212] Had the present record been available to the Court in 1997, it would have ruled differently on the bad faith issue in connection with the §220 action. The 1997 ruling is the law of that case, however, and this post hoc observation should not be construed as an invitation to move to reopen the (now-final) 1997 judgment.

driven the defense of those lawsuits in which Vendel and Johnston and Spillane were the. antagonists.

For these reasons, the defendants are liable for $197,768 they caused Statek to pay for their personal legal fees, including to defend the $220, the $225, and the Connecticut actions.[213]

6. The Claim That The Defendants Caused Statek To Pay $1,706,947 For Unnecessary Lines of Credit

Next, the plaintiffs seek to recover $1,706,947 of costs that defendants caused Statek to incur in order to finance lines of credit from First National Bank of Boston ("FNBB") and Chemical Bank.[214] The basis for the claim is that the lines of credit were unnecessary, and the costs incurred to maintain them constituted a breach of fiduciary duty, because: (i) Statek was internally financed and had no need for any credit line, and (ii) insofar as the record discloses, all

---

[213]This finding does not, of course, entitle the plaintiffs to a double recovery. To the extent Statek has been held entitled to recover on these "legal fee" claims in Subsection 5 (c) above, the rulings made here simply constitute an alternative ground for recovery. Because $197,768 of these claims were not addressed in Subsection 5 (c), that amount represents the net amount independently recoverable under this Subsection.

[214]These costs, which are detailed on PX 13-2A, include: (i) legal fees paid to Bingham, Dana & Gould ($3,845) and Diserio, Martin, O"Connor & Castieglioni ($13,745) for services in connection with establishing the FNBB and Chemical Bank lines of credit; (ii) commitment fees paid to Chemical Bank ($71,703 and $16,537) on the unused portion of the credit line; and (iii) interest charges paid to FNBB ($407,96 1) and to Chemical Bank ($1,193,156) on the used portion of the respective credit lines.

proceeds of the credit lines were diverted to the defendants, particularly the Johnston Entities, and were never used for any legitimate Statek business purpose.

It is difficult to imagine a more "business judgment"-intensive issue than whether an enterprise should incur a cost to obtain a line of credit. For that reason, my first-blush reaction to this claim was that the plaintiffs were overreaching. No case was cited where a corporate fiduciary was held liable for the costs of obtaining a corporate line of credit. Further reflection, however, persuaded me that the reasoning that supports plaintiffs' liability theory appears incontrovertible so long as its premises are factually correct. If corporate fiduciaries divert corporate assets to themselves for non-corporate purposes, they are liable for the amounts wrongfully diverted. Similarly, if the fiduciaries cause the corporation to borrow money which the fiduciaries then wrongfully divert to their personal use, then they would be liable for the borrowed funds. And, if the fiduciaries are liable, in these circumstances, for the diverted principal amount(s)_ that were borrowed, it follows that they should also be liable for the costs of the borrowing, i.e., the interest and commitment fees.

Thus, the plaintiffs' theory is sound. The issue is whether the borrowed proceeds of the lines of credit were (as plaintiffs contend) wrongfully diverted by the defendants, or whether (as defendants argue) those proceeds were used for

valid corporate purposes. I conclude that to the extent the record contains evidence of how the funds borrowed against the Statek line(s) of credit were spent, that evidence shows that those proceeds were used by the defendants for non-Statek purposes.

At the trial Mr. Garvey testified that he had concluded, based upon his analysis, that "these lines of credit were unneeded by Statek, because Statek was self-financing during the entire period. They were really taken out to finance the diversions of cash."[215] Garvey's testimony is uncontroverted, and with the exception of his conclusion, is corroborated by the defendants' own testimony. Spillane admitted that Statek had a positive cash flow "all the time" during the period. At her deposition, she referred all questions about the purposes of the credit lines to Johnston,[216] who also admitted that Statek was a "cash business" that could fund its operational needs out of cash flow from operations and did not need a loan.[217] Why, then, did Statek open up lines of credit? Johnston testified that he did that, and "drew down" the lines by $1.5 to $1.9 million, "to have a certain amount of cash available, that if the bank said good-bye, the company

---

[215]TR (JG) 247-248.

[216]Spillane Dep. 65-66, 424 (10/09/97).

[217]Johnston Dep. 197 (10/20/97).

would be sufficiently independent for a sufficient amount of time to replace the line."[218] But the defendants presented no evidence that Statek's regular bankers were about (or had ever threatened) to bolt or say "adios." Johnston's "safety net" cost Statek nearly $2 million in fees and expenses at the same time Johnston and Spillane were having Alford hold over $1 million in offshore, non-Statek *non-interest bearing* accounts.[219]

Johnston's other asserted justifications for opening the lines of credit are also unsubstantiated and make no sense. Johnston contended that "it was good business practice to have a loan account in order to have a meaningful relationship with a bank" because such a relationship "would help to sell the company," but he did not explain how and why unnecessary lines of credit would make a company attractive to potential acquirors.[220] His other asserted justification -- to purchase equipment -- is contradicted by the record, which shows that no significant equipment purchases occurred during Johnston's tenure.[221] The defendants were unable to point to any document showing that the proceeds of the credit lines were

---

[218] *Id.* at 197-198.

[219] Johnston Dep. 157-l 76 (1 0/20/97); Spillane Dep. 388-406 (1 0/09/97).

[220] Johnston Dep. 199-202; Def. Post-Trial Ans. Br. 64-65.

[221] Statek's audited financials show that equipment was leased, and that depreciation far exceeded expenditures on equipment. PX 13-13; JX5 (225 PX 34-42).

used to purchase equipment or for any other genuine Statek expense. To the extent there is evidence of what the credit line borrowings were used for, that evidence shows that those proceeds were paid to Johnston, Spillane, or the Johnston Entities.

When the credit lines were established at FNBB and, later, at Chemical Bank, checking accounts at those same banks were also established, and all monies borrowed against the line of credit were deposited into -- and disbursed from -- those accounts. Many, if not most, of the Chemical Bank checking account withdrawals are listed in Tab 1 to the Plaintiffs' Post-trial Opening Brief, which shows that the payees of those checks were Johnston Entities or Johnston himself. For example, the defendants paid Johnston personally $430,600, they paid Metrodyne $906,500, and they paid TCI $509,273. As for the FNBB account, the record is incomplete, because Spillane destroyed the records for the FNBB accounts.[222] Nonetheless, the record does show that $465,809 paid from

[222]See PX 13-1 (Tab 8); TR (SS) 1038-1039. The plaintiffs ask the Court to draw a "spoliation inference" from Spillane's destruction of these records; i.e., that the destroyed evidence would have been unfavorable to their position in this litigation. The defendants oppose any such inference. I need not decide the issue, because even without a spoliation inference the conclusion would be the same. The overwhelming weight of evidence shows that the credit line borrowings were diverted by the defendants for their personal use. What evidence exists with respect to the FNBB account is consistent with that conclusion. If defendants seek to argue the contrary, it is their burden to account for the disposition of the monies from the FNBB account, which they have failed to do.

Statek's FNBB account was reported in Statek's annual audit book as "corporate charges." Statek's audit books also reflect payments from the FNBB account of $265,000 to TCI III, a Johnston Entity,[223] and Mr. Garvey testified that Johnston and Spillane hid many of their diversions under the "corporate charges" label.[224]

In summary, the defendants have failed to show that the credit lines were created for any valid business purpose of Statek. They also have failed to account for the disposition of the borrowed funds or to overcome the persuasive force of the evidence that those funds were diverted by the defendants for their personal use. Accordingly, the defendants are liable for $1,706,947, representing the commitment fees and interest expense paid by Statek with respect to the unnecessary lines of credit.

7. The Claim That The Defendants Caused Statek To Make Payments To Unknown Or To Undocumented Bank Accounts

The plaintiffs next claim that the defendants are liable to Statek for approximately $1,134,065, representing payments they caused Statek to make to unknown or undocumented bank accounts. Those payments took the form of either (i) checks written to "Statek" that cleared through accounts other than

---

[223] PX 13-2 (144-147).

[224] TR (JG) 2 10.

Statek accounts, or (ii) funds transferred to Statek accounts that Johnston and Spillane controlled but for which they withheld or destroyed the records. It is undisputed that Spillane wrote the checks and that she or Johnston transferred the funds.[225]

---

[225]These payments, which are listed at Tab 7 to the Plaintiffs' Post-Trial Opening Brief, are as follows:

- Statek Bank of America Checks #13320 ($10,000) and #13321($15,000): These checks, both made payable to Statek Corporation, were deposited by Johnston into unknown accounts with Barklay's Bank in London. The deposits are not reflected in the records of Statek's Barclay's accounts. (PX 13-2 (189); see TR (JG) 248).

- Bankers Trust Wires Januarv 3. 1991 ($ 100.020). February 11. 1992 ($185.020) and February 20. 1992 ($ 190.020): These moneys were transferred to Barclays Bank, but the records of Statek's Barclays accounts do not show any corresponding credits. (PX 13-2 (191,198); see TR(JG) 235).

- Bank of America Wire Transfers. PX 13-2 (192--$25,000); (193--$2,000); (194--$8,000); (196--$20,000); (197--$25,000); (199--$25,000): The Bank of America statements show identically worded transfers to Statek Corporation, but there are no corresponding credits to any Statek account.

- Wire Transfers to Barclays Account # 3837614: The available records show wire transfers to this Barclays Bank account. The defendants did not produce, and the plaintiffs were unable to obtain, any records for this account.

- Wire Transfers Totaling $79.824 to Statek's 'Credit Suisse Account: These funds were deposited to Statek's account at Credit Suisse, but (according to plaintiffs) do not appear as credits in the available bank records.

- Check to Handelsbank ($2.370): Spillane signed this check, but could not testify what the check was for. Spillane Dep. 444 (10/09/97). Statek has no record of an account with Handelsbank. Garvey Dep. 114.

- Checks Totaling $3 17.000 Drawn on Statek Bank of America Account and Paid to Statek's Bankers Trust Account #00-0120-997 (see PX 13-2B (12-l 7): The defendants did not produce records for the Bankers Trust Account (of which Johnston and Spillane

The defendants do not dispute that they bear the burden of showing what became of these funds with which they, as fiduciaries, were entrusted. The issue is whether the defendants have met that burden. I conclude that they have not, except for the checks that were deposited into Statek accounts.

I find, first, that the checks and wire transfers that were deposited or made into Statek accounts do not give rise to a claim that triggers the defendants' duty to account. Those payments were merely a shift of Statek assets from one "pocket" to another, as distinguished from a shift of Statek funds to an unknown account that would cause those funds to be "missing." The plaintiffs' sole basis for challenging these payments, which total $509,358,[226] is that the records for those accounts are missing. That fact, even if true, does not give rise to an

---

were the sole signatories), and at their depositions were unable to account for the Statek funds they transferred to this account..

- Union Bank of Switzerland ($2.277 Transfer): It appears that $2,277 was wired to account #20727930 at the Union Bank of Switzerland (PX 13-2B 18-19); however, Statek has no records of such an account at Union Bank of Switzerland.

- Checks to UTO Bank: Spillane signed checks totaling $15,000 payable to UTO Bank. (PX13-2B (20-21). Neither Spillane or Johnston knew the purpose of these payments. (Spillane Dep. 550-55 1 (10/10/97); Johnston Dep. 336 (10/21/97).

[226]This amount includes payments of $79,824 to Statek's Credit Suisse Accounts and $3 17,000 to the Statek Bankers Trust account, and the transfer totaling $112,534 to Barklay's Bank account #3837614.

inference that the funds were diverted.[227] Thus, the defendants are not liable for this category of payments.

The remaining payments -- those made to unknown accounts -- stand on a different footing. As previously discussed, the defendants controlled Statek's funds. In cases where they transferred those funds to accounts other than Statek accounts, they had a duty to explain where and for what purpose the funds were transferred. The defendants have not explained where the money went or what it was spent for. Accordingly, they are liable to Statek for the amount of those payments, which total $624,707.[228]

8. The Claim for $1,480,995 The Defendants Paid From Statek Accounts to Unknown Payees

The plaintiffs' penultimate claim is for $1,480,995, representing payments to unknown or undocumented payees from accounts which Johnston and Spillane opened or over which they had control.[229] These payments break out into two categories: (i) "corporate charges" ($465,809) and (ii) "payees unknown"

---

[227] Such an inference would arise if the defendants, once having deposited the funds into the Statek account, then withdrew the funds and could not explain the purpose and recipient of the withdrawal. That, however, is not the fact pattern upon which this claim rests.

[228] This amount, as well as all other amounts, for which the defendants are held liable in this Opinion, is subject to mathematical verification by counsel.

[229] These payments are listed under Tab 8 of the 'Plaintiffs' Post-Trial Opening Brief.

($1,014,771), except for one payment (for $375) to "Jane Harrison."

These categories are separately considered.

Corporate Charges: These payments, totaling $465,809, were made from the Statek FNBB checking account, which Spillane and Johnston opened, of which they were the sole signatories, and for which they kept all the records at Acosta Street until they destroyed those records.[230] The plaintiffs have no records of this account, and neither Johnston and Spillane was able to explain the purpose of these "corporate charges."[231] Lastly, the testimony of plaintiffs' expert, Mr. Garvey, that his review of the records showed that the defendants concealed many of their diversions as "corporate charges," [232] stands uncontroverted.

Payees Unknown: These payments, totaling $ 1,0 14,771,[233] fall into three subgroups: payments from Barclays Bank, payments from UTO Bank, and payments from Bankers Trust.

With respect to the Barclays' payments, neither Johnston nor Spillane could identify the payee or the business purpose of any of these payments. Johnston

---

[230]PX 13-2B (22-23); TR (SS) 117,761, 1038-1039.

[231]TR (SS) 1038-1039.

[232]TR (JG) 210.

[233]PX 13-2B (27-28, 30-33, 35-39, 41-43).

testified that "I would assume that these were checks I wrote. I don't know who else would have written the checks;"" and Spillane testified that the payments from Barclays were personal to Johnston? Johnston also testified that he kept the Barclays checkbook in the London apartment, and that when he left that apartment after January 5, 1996, he could not recall whether he took the checkbook with him. He said: "I do not recall. I threw most everything that was in the London apartment out...So it may very well have gone out with everything else."[236]

The one identified payee from the Barclays account is on a $375 check made payable to one Jane Harrison. Because Spillane testified that payments out of this account were personal to Johnston,[237] presumably this payment was personal as well.

The payments from UTO were from Statek accounts at UTO Bank maintained by Swiss attorney DeBeer, to whom the accounts were sent. DeBeer had signing powers over those accounts, which were opened and then controlled

---

[234]Johnston Dep. 311 (10/21/97).

[235]Spillane Dep. 502 (1 O/l 0/97).

[236]Johnston Dep. 311-313 (10/21/97).

[237]Spillane Dep. 501-502 (10/10/97); 460 (10/09/97).

by Johnston.[238] In his deposition Johnston claimed to have "no idea who wrote the checks or the purpose for them.[239]

As for the Bankers Trust payments, the only records evidencing such payments are two Bankers Trust statements addressed to Spillane at Acosta Street.[240] The canceled check for a $50,000 payment is missing from the records defendants produced from Acosta Street, and the account to which $32,500 was wire-transferred is unidentified. Neither Johnston nor Spillane could explain these payments.[241]

Defendants' response is to argue that those payments are protected by the business judgment rule, because there is no evidence that they were made for Johnston's and Spillane's benefit. The short answer is that the payments cannot be protected by the business judgment rule unless they were incurred for Statek business, and it was the defendants' burden to show that, which they failed to do. It was the defendants who wrote the checks and maintained control of the checkbooks. It was the defendants who had a duty to account for the payments

---

[238]PX13-2B (28-32); TR (SS) 1071-1073; 114-115; Johnston Dep. 413 (10/22/97).

[239]Johnston Dep. 314 (10/21/97).

[240]PX 13-2B (34, 40).

[241]Spillane Dep. 504 (1 0/10/97); Johnston Dep. 3 15 (1 0/21/97).

and keep records, and it is they who should know to whom the checks were written.

In *Kennard v. Glick*,[242] a fiduciary was held liable for missing funds once the plaintiffs proved that the account records were incomplete, inaccurate, and untrustworthy, and that the amounts available for deposit had not been deposited and could not be accounted for. In language that is particularly appropriate in this setting, the *Court* stated:

> An agent who fails to keep an account raises thereby a suspicion of infidelity or neglect, creates a presumption against himself, and brings upon himself the burden of accounting to the utmost for all that has come into his hands; and in such case every doubt will be resolved against the agent, and in favor of the principal; and if he renders an untrue account, giving a false balance, he becomes at once liable to his principal....The agent's duty ordinarily includes not only the duty of stating to his principal the amount that is due, but also a duty of keeping an accurate records of the persons involved, of the dates and amounts of things received, and of payments made....[243]

Nor is it correct (as defendants assert) that there is "no evidence that Johnston or Spillane received any financial benefit from these payments."[244]

---

[242]Cal. Ct. App., 183 Cal. App.2d 246 (1960).

[243]*Id.* at 25 1-52 (citations omitted).

[244]Def. Post-Trial Ans. Br. at 67-68.

Spillane testified that the Barclays account was personal to Johnston, and the payments out of that account were $877,388 -- more than half of the total in this category. Nor were the defendants able to explain the purposes of the payments made from the remaining accounts or identify the payees, yet the magnitude of the individual checks is such that that information would not easily be forgotten. For example, defendants offer no evidence to explain to whom a check for $350,000 was paid out of the Barclays account, or who received payments out of the FNBB account in amounts of $30,000, $50,000, $ 100,000, $185,809, and $200,000 were made. From this failure to explain it may be inferred -- and I do infer -- that the payments out of these remaining accounts were personal as well. The defendants have offered nothing to show otherwise, and in these circumstances are entitled to no presumption in their favor.

Accordingly, the defendants are liable to Statek for $1,480,995, representing their payments from Statek accounts to unknown payees.

9. The Claim For $350,990 That The Defendants Caused Statek To Pay For Their Personal Living Expenses

Finally, the plaintiffs claim that the defendants are liable to Statek for payments, totaling $350,990, that they caused Statek to make for their personal

lodging and transportation.[245] These include payments to the Doubletree Hotel ($13,805; PX 13-2B (78)) and the Hilton Suites ($104,610; PX 13-2B (79)) in Orange, California; and to the Connaught Hotel in London ($19,565; PX 13-2B (73-77)), purportedly for accommodations for Johnston.[246] At the same time, Statek was paying $10,196 to Radius Estates (PX 13-2B ($10,296)), $72,788 to Christine Mills (PX 13-2B (93-99)), and $116,533 to Lemada International (PX 13-2B (8 l-92)) for Johnston's London apartment. In addition, Statek was caused to pay for the limousine services of Green Flag Airport Shuttle ($11,100; PX 13-2A (65)) and Stardust Limousine ($2,293; PX 13-2A (96)). None of these payments were substantiated with the documentation required by Statek's by-laws, employment policies, and reimbursement procedures.

To this claim the defendants respond with a series of arguments, which are inadequate because the defendants have not proved to the Court's satisfaction that these payments were for legitimate Statek purposes.

The defendants first argue that unspecified other persons used these accommodations and transportation services. But Mr. Garvey testified that Statek incurred other hotel and transportation expenses for legitimate Statek business.

---

[245]These payments are listed under Tab 9 to the Plaintiffs' Post-Trial Opening Brief.

[246]Spillane Dep. 428-429 (1 0/09/97).

Those expenses, where properly documented, are not challenged. The payments challenged here are totally undocumented.*" The absence of documentation, coupled with the defendants' concession they caused Statek to pay for Johnston's and Spillane's personal living expenses amounting to at least $200,000 to $300,000 annually,[248] makes it fairly inferable that the payments being challenged here were personal to Johnston and Spillane.

That inference is strengthened by other facts. The defendants essentially concede that Statek paid Johnston's living and daily transportation expenses when he lived in Orange, California and later, in London, England. When he lived at Orange, Johnston stayed at the Doubletree Hotel and later at the Hilton Suites, where he maintained a permanent suite and kept clothes and belongings.[249] Johnston also set up a residence in London where he also kept belongings and caused Statek to pay the rent to (at various times) Radius Estates, Christine Mills, and Lemada International. [250] Although the defendants argue that Johnston

---

[247]TR (JG) 248-249.

[248]JX 2C Tab 3; Spillane Supplemental Aff. dated 2.2/96, ¶2. Many, if not most, of those payments took the form of American Express credit card charges and are the subject of the claim under that specific heading.

[249]Def. Post-Trial Ans. Br. 69-70; Johnston Dep. 282 (10/21/97).

[250]Spillane Dep. 35-37; 86 (1 0/08/97).

"stayed at the Connaught before Statek had an apartment in London,"[251] in fact the payments to the Connaught and for Johnston's London apartment are concurrent and unexplained.[252] Moreover, the defendants admit using the iimousine services, arguing that they were "a lot cheaper than a taxi."[253] In fact, however, the challenged limousine payments range from $96 to $619 per day, in contrast to the $35 to $40 which Johnston quoted as the going taxi rate.[254]

The final piece of evidence that permits -- indeed, compels -- the inference that these expenses were personal is that from and after 1990, Johnston had no primary residence, no automobile, and paid no income taxes in any state.[255] Living expenses may in some circumstances properly be considered personal compensation, but they are not reimbursable travel expenses.[256]

For these reasons, Johnston and Spillane are liable to Statek for the $350,990 they caused Statek to pay for their personal expenses.

---

[251] Def. Post-Trial Ans. Br. at 70.

[252] See Tab 9 to Plaintiffs' Post-Trial Op. Br.

[253] See note 250, *supra*.

[254] See Tab 9 to Plaintiffs' Post-Trial Op. Br; Johnston Dep. 262 (10/21/97).

*"Johnston Dep. 8-9; Spillane Dep. 656 (1 0/10/97).

[256] The same analysis applies to the American Express "living expenses," many of which are to these same payees.

****

To summarize, Johnston, Spillane, and the Johnston Entities are liable to TCI II and Statek for the amounts set forth above. Their liability rests upon each of three separate grounds, all of which have been established: fraud, breach of the fiduciary duty of loyalty, and waste. Accordingly, the Court need not, and does not, address the plaintiffs' remaining theories of recovery.

Having adjudicated the merits of the plaintiffs' affirmative claims, the Court turns, lastly, to the defendants' counterclaim for compensation.

VI. THE DEFENDANTS' COUNTERCLAIM

The defendants have asserted a counterclaim for reasonable compensation for the services they provided to TCI II and Statek during the years of their management. The claim, in essence, is that the defendants always understood that they would receive compensation from TCI II and Statek, even though no exact amount was ever fixed or promised, and that whatever amounts the defendants have already received were either reimbursement for their valid expenses or loans against future compensation. In support of this claim the defendants cite their own testimony, plus certain board minutes.

The plaintiffs hotly contest this claim, arguing that it has no basis in fact because there was no understanding that Johnston and Spillane would be

compensated The plaintiffs further argue that the claim has **no** basis in law, because as faithless fiduciaries the defendants have forfeited whatever claim they might otherwise have to compensation. Finally, the plaintiffs argue that even if the defendants have shown some entitlement to compensation, their evidence and proof of "reasonable compensation" is fatally inadequate.

This counterclaim is best analyzed as two distinct issues. The first is whether the defendants have demonstrated any entitlement to compensation. The second (assuming that entitlement is shown) is what amount of compensation is reasonable. These issues are addressed in that order.

A. The Entitlement Issue

The Court previously visited this issue in its August 22, 1997 Memorandum Opinion denying the plaintiffs' motion for partial summary judgment.[257] The Court ruled that despite the defendants' "already formidable credibility problems" in connection with their compensation claim and "[h]owever rife with credibility problems their assertions may be, the defendants have raised an issue of material fact that must be resolved at a trial." The Court also determined that the claim

---

[257] *Technicorp International II, Inc. and Statek Corporation v. Johnston, Del. Ch.,* C.A. No. *15084,* Mem. Op. at 19-35, Jacobs, V.C. (Aug. 22, 1997) ("August 22 Opinion").

could proceed on a theory of quantum meruit.[258] That is the theory upon which the defendants present their counterclaim.

In its August 22, 1997 Opinion the Court also established the legal standard that would govern this counterclaim, as follows:

> [U]nder Hall v. Isaacs and Wilderman v. Wilder-man, the defendants may be entitled to recover the reasonable value of their services on the basis of *quantum meruit* if they can demonstrate that (i) they provided services as officers with the understanding that they would be compensated, (ii) they did not grant themselves excessive compensation to unjustly enrich themselves, and (iii) TCI II and Statek benefited from those services and would be unjustly enriched if the defendants were not compensated.[259]

If this compensation claim were being asserted on a "stand-alone" basis, i.e., by itself and not as an offset to affirmative claims to recover most if not all the moneys that the defendants-counterclaimants received from TCI II and Statek, then under this standard the counterclaim would fail. There are two reasons. First, the sole evidence upon which defendants rely to prove their "understanding that would be compensated," is their own undocumented and self-serving

---

[258] August 22 Opinion, at 25, 30-31.

[259] *Id.* at 3 1, *citing Hall v. John S. Isaacs & Sons Farms,* Del. Ch., 146 A.2d 602 (1958), aff d in part and rev'd in part on other grounds, Del. Supr., 163 A.2d 288 (1960); and *Wilder-man v. Wilderman,* Del. Ch., *3* 15 A.2d 610 (1974).

testimony. That testimony is in many material respects inconsistent with TCI II and Statek minutes that the defendants themselves created.[260] And while that testimony may have been sufficient to defeat a motion for summary judgment, at the trial stage it is manifestly inadequate to establish the defendants' claimed "understanding" that they would receive additional compensation, because that evidence is entirely lacking in credibility.

Moreover, the defendants' testimony is at war with their own conduct. Johnston testified that he and Spillane always intended, at some unspecified future time in their capacities as directors, to formally award themselves compensation from TCI II and Statek.[261] Against that compensation they would then offset the millions of dollars they had received in the form of undocumented loans and "expense" payments. In fact, however, for over eleven years the defendants did nothing to effectuate their supposed "intent." Rather, they continued, year after year, to divert to themselves Statek and TCI II revenues in this undocumented,

---

[260]PX 13-10(c) (6-38); PX 13-1 l(c) (l-lo).

[261]Spillane received a salary from Statek-- reported on W-2 forms-- totaling about $53,000 annually. She claims it was understood that she, like Johnston, would receive additional compensation from TCI II. Apart from its self-serving, undocumented nature, that testimony also lacks credibility because: (i) the defendants allege in their Counterclaim (¶ 19) that "TCI II and Statek benefited from the services rendered by Johnston and Spillane...without providing either individual compensation in the form of a salary," and (ii) Spillane contended that they were not true "salary" but, rather, reimbursement for expenses. See August 22, 1997 Opinion at 24.

tax-free form, and there is no objective evidence that they ever intended to change that practice. Why should they? To declare income to themselves in the multimillion order of magnitude in a single tax year would not only create significant taxable income, but also would risk triggering an inquiry by the taxing authorities into what the defendants had been up to.

The overwhelming weight of evidence shows -- and I find, contrary to the defendants' testimony -- that their true intent was to continue this practice indefinitely -- or at least until they sold the companies or the authorities began knocking at their door, thereby forcing the defendants to abandon the companies and abscond with whatever resources they were able to secrete.

The second reason this counterclaim would fail if were being asserted on a stand-alone basis is that the defendants cannot satisfy the second requirement, namely, to show that they did not grant themselves excessive compensation to unjustly enrich themselves. In fact, the defendant' entire pattern has been one of diverting the corporations' resources (although the diversions were not labeled as "compensation") for the purpose of unjustly enriching themselves.

But it is precisely -- and ironically -- because the compensation counterclaim is not being asserted on a stand-alone basis that its denial would be problematic. In this case the counterclaim is asserted by the defendants, as counterclaimants, as an offset against substantial damage claims that are being asserted against them That distinction is important, because the plaintiffs' affirmative claims, almost all of which have now been adjudicated in plaintiffs' favor, will have the effect of stripping the defendants of practically everything they received from Statek and TCI II, including Johnston's stock interest in TCI II, for almost twelve years.[262] The result would be to create a "reverse unjust enrichment" problem: if the defendants disgorge all of the wrongfully received payments as they will be required to do, they will have devoted all those years of service to these companies (and to Vendel, the adjudicated lawful owner of TCI II) for nothing or very little in return. It cannot be supposed that Johnston and Spiilane, or for that matter any reasonable person, would have bargained beforehand for that result.

The plaintiffs respond that that result would not be unjust, because many cases hold that if corporate officers commit repeated and egregious breaches of

---

[262] Assuming, of course, that the plaintiffs are able to collect the amount of the money judgment.

duty to the corporation, as occurred here, they forfeit all right to compensation, even if some of the officer's services were properly performed.[263] Some of the authorities upon which plaintiffs rely do so hold, but they are decisions from jurisdictions other than Delaware. The sole Delaware authority upon which plaintiffs rely, *Citron v. Merritt-Chapman & Scott Corp.*,[264] is not altogether clear as to whether, or to what extent, Delaware embraces that doctrine.

In his Citron opinion granting summary judgment dismissing a compensation forfeiture claim, then-Vice Chancellor Brown held that no claim for compensation forfeiture would lie in cases where the corporation suffered no loss or damage from the breach of duty. The Court thereby suggested by implication that where resulting loss or damage is shown, a cause of action for compensation forfeiture can be maintained. But the precise nature and parameters of such a

---

[263]The plaintiffs also assert that Johnston's and Spillane's services created no benefit to TCI II or Statek for which any compensation is merited. In my view that argument attempts to prove too much. While that may be true that many of these defendants' activities did not benefit the corporations, it is also the case that the defendants were their top level managers, and that Statek, the operating company, did generate revenue and profits. It cannot be supposed that happened entirely independently of, and without relation to, any of the defendants' activities as managers. Surely some of those activities had to benefit the corporations, even if many of them did not. There are cases that support the proposition that even "faithless fiduciaries" do not automatically forfeit their right to compensation if they provided services of value to the corporation. See, e.g., *Richardson v. Blue Grass Mining Co., Ky.* Dist., 29 F. Supp 658, 670 (1939); *Burg v. Miniature Precision Components, Inc.,* Wis. Supr., 330 N.W. 2d 192, 196 (1983); *Orkin Exterminating Co., Inc. v. Rathje, 72* F.3d 206,208 (1st Cir. 1995).

[264]Del. Ch., 409 A.2d 607 (1977); *aff'd,* Del. Supr., 407 A.2d 1040 (1979).

claim were not explicated in either this Court's opinion or in the Supreme Court's affirming opinion. The Supreme Court did, however, provide helpful guidance in its holding that:

> Even if one adopts the more expansive view of liability, rejected by the Court below, and holds that derelictionof duty can result in compensation forfeiture notwithstanding the lack of actual harm to the corporation. . ..the question of forfeiture of compensation must still be governed by the circumstances in each particular case...."[265]

That guidance is particularly relevant here because under the "circumstances of [this] particular case," Statek and TCI would be unjustly enriched if Johnston and Spillane were required to forfeit all rights to compensation for services they legitimately performed during their administration. Indeed, the result would be the same as if Johnston and Spillane had been required to work for little or nothing for these companies for over eleven years.

To avoid such unjust enrichment, courts of equity, applying Delaware law, have implicitly recognized that even where a corporate fiduciary's breach of the duty of loyalty results in his being stripped of all profit flowing from the breach, it is appropriate to offset against the corporation's recovery an amount that

---

[265] *Citron*, *407* A.2d at 1045 (citations omitted).

represents reasonable compensation to the fiduciary for services legitimately performed. Thus, in *Guth* **v.** *Loft*[266] and in ***Borden v. Sinskey,***[267] ***cases*** relied upon by the plaintiffs, corporate officers and directors found to have usurped valuable corporate opportunities were required to disgorge to the corporation their stock in the company constituting the opportunity, as well as all salaries and dividends they had received as a result of their usurpation of those opportunities. Despite that, the faithless fiduciaries were permitted to offset against that recovery, an amount representing reasonable compensation for the services they had legitimately and beneficially performed for the plaintiff corporations.

These decisions do not articulate a specific reason for allowing that offset, but the reason seems readily apparent when one views the situation in equitable terms. By applying the prophylactic equitable doctrine that requires stripping a fiduciary of all profit improperly obtained, the courts, in effect, are adjusting the property rights of the parties after the fact to conform to what would have been the result had the fiduciary behaved properly before (and during) the fact. Had there been no fiduciary violation, and had the corporate officers presented the opportunity to the corporation as their duty required, then they would have

---

[266]Del. Supr., 5 A.2d 503 (1939).

[267]530 F.2d 478 (3rd Cir. 1976) (applying Delaware law).

receiving reasonable compensation.

Thus, where (as in *Guth* and *Borden)* the property rights of the parties are readjusted remedially and after the fact to implement the maxim that "equity regards as done that which should have been done," true equity requires that the readjustment operate fairly in both directions.[268] For that reason I conclude that in the peculiar circumstances of this case it would be inequitable if the plaintiffs "compensation forfeiture" argument were permitted to defeat Johnston's and Spillane's entitlement to reasonable compensation.

It is important, however, to be quite clear about the precise nature and scope of this ruling. First, Johnston's and Spillane's "'entitlement" to compensation is not grounded upon any contract, express or implied, as no such contract has been proved. Rather, their "entitlement" to reasonable compensation arises by operation of law (or, perhaps, by operation of equity) solely because of two

---

[268]To express the point in academic terms, where the model being employed is to alter the parties' rights retroactively to conform to what should have happened prospectively, that model must be applied consistently. Specifically, if the defendant-fiduciaries are to be burdened with the judicially-imposed obligation to give up all their improperly obtained profit, they cannot fairly be deprived of the benefit (i.e., reasonable compensation) that would have accompanied the burden (not receiving the profit in the first place) had the fiduciaries observed their duties to begin with. This exercise of discretion in shaping a remedy is also consistent with the flexibility the Supreme Court has afforded this **Court** to tailor just remedies for fiduciary breaches based upon the circumstances of each case. Weinberger v. UOP, Inc., Del. Supr., 457 A.2d 701 (1983).

circumstances: (i) the effect of the relief being granted will be to strip Johnston and Spillane of essentially all benefits they received from the plaintiff corporations during the years of their management, and (ii) unless an entitlement to reasonable compensation is recognized, the plaintiff corporations will be unjustly enriched at the defendants' expense.

Second, the nature of the defendants' "entitlement" to compensation is purely a matter of equitable discretion. The Court has rejected the defendants' counterclaim on factual grounds. And, if it so chose, the Court could also reject the claim on legal grounds under *Citron v. Merritt Chapman & Scott*, because here (unlike *Citron)* the defendants' conduct did cause harm and loss to the corporation(s). Thus, the Court's determination not to deprive the defendants of reasonable compensation does not rest upon any positive rule of law, but is purely and solely a matter of equitable discretion, i.e., of grace. The import of that fact, as developed more fully in Subpart B, infra, is that it fully empowers the Court to impose conditions upon the defendants' exercise of their compensation "entitlement" that will avoid abuse and injustice to the plaintiffs.

The entitlement issue having been decided, I turn to the remaining question, which is what amount of compensation is "reasonable" in these circumstances?

B. The Reasonable Amount Issue

There is an unreal quality about this issue, because the Court is being asked to what the defendants themselves never did: fix a reasonable rate of compensation. There is no contemporaneous record that the defendants ever and in fact actually determined what specific compensation level would be reasonable, nor is there any testimony by Johnston or Spillane on that subject. Consequently any determination of reasonable compensation at this point in time and by this Court (or, for that matter, any independent agency) must inevitably, and in a real sense, be hypothetical.

Implicitly recognizing this, the defendants presented their entire case on the reasonableness issue through the testimony of an executive compensation expert, Daniel Glasner ("Glasner") of the Hay Group, a national consulting firm.[269] Mr.Glasner testified that he utilized the "Hay Guide Chart Method of Position Evaluation," which is a systematic method for comparing job positions, to determine what reasonable compensation for the positions filled by Johnston and Spillane during the relevant time period would be. Glasner also used a

---

[269]The plaintiffs also presented expert testimony, by Mr. Raymond W. Fife ("Fife"), the Director of Compensation Consulting (Western Region) of Price Waterhouse Coopers, an international accounting and consulting firm. The plaintiffs do not rely upon this testimony in that portion of their brief that addresses the compensation issue.

methodology that would yield conservative results.

The amounts Mr.Glasner arrived at are set forth below:

Johnston's Position

1984: $127,300	1990: $357,100
1985: $131,300	1991: $369,800
1986: $187,800	1992: $390,100
1987: $225,800	1993: $403,400
1988: $291,700	1994: $428,700
1989: $337,300	1995: $469,500

Total: $3,719,800

Spillane's Position

1984: $68,900	1990: $118,500
1985: $77,600	1991: $122,500
1986: $85,700	1992: $124,700
1987: $95,300	1993: $132,300
1988: $108,400	1994: $133,710
1989: $114,000	1995: $147.100

Total: $1,328,710

The plaintiffs challenge Glasner's conclusions on several grounds. They argue that (i) Glasner had no competent basis to assume that the positions he attributed to Johnston and Spillane in fact corresponded to the duties they actually performed, and (ii) Glasner's conclusions rested on several incorrect assumptions, most notably that sales were approximately $15 million during the years in question (in fact, they never exceeded $12 million), and that there were between 150 and 300 employees during the years in question (in fact, the number of employees never exceeded 150). While I agree that these assumptions were incorrect in these respects, I do not agree that Glasner's testimony is unworthy of credit. At least in the case of Johnston, Glasner's compensation levels should be reduced to account for the errors. But with respect to Spillane, I reject Glasner's conclusions and determine that she should receive only minimal additional compensation from TCI II, for reasons largely independent of Glasner's testimony.

1. Spillane's Compensation

The defendants' position is that "although Spillane received annual compensation from Statek, she testified that she understood that she would receive additional compensation from TCI II for services performed, although the amount

of compensation was not fixed."[270] Spillane's total salary from Statek during the years in question was $585,621, or an average of approximately $53,300 per year. Although the record does not show how this figure was arrived at, it may be assumed that Johnston and Spillane settled on that amount because they believed that was a fair level of compensation for the services she was performing for Statek.

The difficulty with the defendants' argument is its conclusion that Spillane should receive another $1,328,710 from TCI II, representing an average of approximately $120,800 per year. But unlike Statek, TCI II had no operating business. TCI II was a holding company that would require very few administrative duties, other than perhaps preparing franchise and income tax returns and maintaining bookkeeping records. Indeed, the defendants appear to rely primarily upon the services they performed for *Statek* to support the reasonableness of the compensation that they seek from TCI II.[271] Given the average compensation figure of $53,000 as the benchmark of reasonable compensation for services Spillane rendered to Statek, and given the absence of

---

[270] Def. Post-Trial Ans. Br. at 87.

[271] *Ibid.* at 90-92. Defendants argue that "Johnston's and Spillane's services rendered for Statek entitle them to compensation from TCI II, Statek's holding company, regardless of whether they performed services for TCI II." *Id.* at 92.

any contract to pay a specific additional salary from **TCI II,** it makes no sense to compensate Spillane for her services to the holding company for a sum that is twice the average amount she received from the operating company. The undisputed facts and logic require that the salary level for services performed for TCI II be substantially less. The issue is: how much less?

Unfortunately, the record contains no facts to which any lesser amount can confidently be anchored. But since Spillane's very entitlement to compensation is discretionary, so must be the determination of the amount of any additional salary from TCI II. Based on the few available facts, I conclude that a reasonable salary fi-orn TCI II, whose requirements for service would be far less than those for Statek, would not exceed an average of $30,000 per year. Thus, I find that Spillane is entitled to total additional salary from TCI II of $330,000 for the eleven year period in question, subject to the conditions discussed infra in Part VI C of this Opinion.

2. **Johnston's Compensation**

As earlier noted, Johnston contends that a reasonable compensation level for him for the eleven year period is $3,719,800, or an average of approximately $338,160 per year. Based upon Statek's performance, and the salary levels commanded by executives of West Coast high-tech companies, and assuming

(hypothetically, as I have committed to do in order to shape a fair remedy) that Johnston was not a wrongdoer, a yearly salary of a $338,000 order of magnitude does not seem inordinately high. But since Glasner arrived at that figure based upon erroneous assumptions (on the high side) concerning the number of Statek employees and the level of Statek revenues, a downward adjustment is required. Again, the question becomes: how much?

In Johnston's case, as with Spillane, the record does not contain sufficient facts to determine in any scientific way what the amount of the adjustment should be. That determination is necessarily judgmental, and it could be wrong in either direction. But any possibility of error is leavened by the fact that Johnston's very entitlement to compensation in these circumstances is discretionary. Again, based on the few facts available to me, I conclude that a reasonable average annual salary for Johnston, after making a downward adjustment of $53,160, would be $275,000, or a total of $3,025,000 for the entire eleven year period. That compensation, like Spillane's, will also be subject to the conditions next discussed.

C. **Conditions of Compensation**

Because the very premise of the compensation award to the defendants is that they never wrongfully diverted assets from Statek and TCI II, the

compensation must be subject to a condition that is consistent with that premise. That is, for the defendants' discretionary award of compensation to ripen into an enforceable legal entitlement, the defendants must first restore to Statek and TCI II the moneys they were found to have wrongfully diverted, and they cannot offset the amount of the plaintiffs' judgment by the amount of their compensation award. To put it differently, the entire amount of the final money judgment to be entered in plaintiffs' favor and against the defendants,[272] must first be formally satisfied before the defendants' judgment will become effective in the sense that it will become enforceable against the plaintiffs. For that reason also, the amount of the defendants' judgment shall not be offset against the amount of the plaintiffs' judgment while the plaintiffs' judgment remains unsatisfied.

That condition is necessary because if past is prologue, it is predictable that the defendants will attempt to delay and obstruct the plaintiffs' efforts to collect the judgment, including not voluntarily disclosing the whereabouts of domestic and offshore bank accounts into which Statek and TCI II assets are on deposit, as well as the whereabouts of other corporate assets. The purpose of the condition is to afford the defendants an incentive to abide cooperatively with what this and any

[272] Or such lesser amount as the plaintiffs may deem to be satisfactory.

reviewing Court determines is their legal obligation to the plaintiffs. If the defendants do cooperate and fulfill the condition, the compensation award will become effective upon the satisfaction of the judgment against them. If they do not, then their compensation award shall be forfeited, and the judgment entered on the defendants' counterclaim will be of no force and effect.

VII. CONCLUSION

Counsel shall confer and submit a form of final order and judgment that appropriately implements the rulings made in this Opinion. Should the parties be unable to agree on a form of order, they shall apply to the Court, on notice, to settle a final order and decree.