IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE
IN AND FOR NEW CASTLE COUNTY

GILA DWECK, SUCCESS APPAREL, LLC and PREMIUM APPAREL, LLC,	)	
Plaintiffs/Counterclaim Defendants,	)	
v.	)	C.A. No. 1353-N
ALBERT NASSAR and KIDS INTERNATIONAL CORPORATION,	)	
Defendants/Counterclaim Plaintiffs.	)	

MEMORANDUM OPINION AND ORDER

Submitted: November 3, 2005
Decided: November 23, 2005

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LAMB, Vice Chancellor.

A minority stockholder and former president, chief executive officer, and director filed this suit against the controlling stockholder of the company, alleging breach of a purported unsigned stockholders agreement. The complaint alleges that the plaintiff and the majority stockholder exchanged drafts of such an agreement, providing for a four-member board of directors to which the plaintiff and her brother could appoint two directors and the controller could appoint two directors. The plaintiff claims that this unsigned draft agreement was breached when the controller used his power as a majority stockholder to add a fifth member to the board of directors, elect all of the company's directors, terminate the plaintiff's employment at the company, and appoint his allegedly unqualified nephew to manage the operations of the company. Due to the controller's alleged breach of fiduciary and contract duties, the plaintiff seeks the appointment of a custodian under 8 *Del. C.* § 226 and specific performance of the purported stockholders agreement.

The defendant moves for judgment on the pleadings, contending that the alleged stockholders agreement is a voting agreement governed by 8 *Del. C.* § 218 and is, therefore, invalid since it is unsigned. The court concludes that the unsigned draft stockholder agreement constitutes an unenforceable voting agreement under Section 218, which the plaintiff could not have reasonably relied

on. Accordingly, the court concludes that the controller had the right to vote his shares to appoint a fifth director to the board and elect all of the company's board members. However, the complaint sufficiently pleads that the controller did not act in the best interest of the company when he replaced the plaintiff with his allegedly unfit nephew. Therefore, the defendants' motion for judgment on the pleadings will be granted in part and denied in part.

I.[1]

A. The Parties

The plaintiff, Gila Dweck, is a minority stockholder and former president, chief executive officer, and director of Kids International, Inc. Dweck allegedly controls 30% of Kids's shares.[2] The defendant, Albert Nasser, is the chairman of the board of directors and controlling stockholder of Kids, owning 52.5% of the company's stock.[3] Kids is a closely held Delaware corporation with its principal place of business in New York, New York.

[1] The facts recited herein are taken from the well pleaded allegations of the complaint filed May 18, 2005.
[2] Compl. ¶ 3. Dweck personally owns shares of Kids and is the trustee of the Naomi Dweck Kids International Trust and Maurice Dweck Kids International Trust which owns Kids's shares.
[3] Compl. ¶ 4. Nasser is the trustee of the Alicia Elena Nasser Trust, Rafael Nasser Trust, and James Nasser Trust which controls 52.5% of the company's stock.

B. The Purported Stockholders Agreement

In 1993, Dweck and her brother, Haim Dabah, together with Nasser formed Kids International to design, manufacture, and sell children's clothing.[4] The parties agreed that Nasser would make the initial capital contribution and that Dweck would run the daily operations of the company.[5] In return for his initial capital contribution of $1 million, Nasser received 100% of the shares of the company, subject to the understanding that Dweck and Dabah would purchase some of those shares at a later date. In 1996, Dabah and Dweck purchased 45% of the company's shares for $450,000.

The parties did not enter into a written agreement governing the operations of the company.[6] Instead, the complaint alleges that they orally agreed that Kids would have a four-member board of directors to which Dweck together with Dabah could appoint two directors and Nasser could appoint two directors.[7] The complaint further alleges that the parties agreed that Dweck and Dabah would control the operations of the company, Dweck serving as the president and chief executive officer, and Nasser overseeing the company by serving as the chairman

[4] The parties initially formed the company under the name New Kids Corp., and in 1994 they changed it to its present name. The company was formed out of the sale of an existing business called EJ Gitano for which Dweck had worked for ten years.
[5] Compl. ¶ 6.
[6] Compl. ¶ 7.
[7] *Id.*

of the board of directors.[8] According to the complaint, Kids operated for over a year pursuant to this oral agreement.[9] Dweck and Dabah served on the company's board with Nasser and his son, James.

In 1994, in conjunction with Dweck's and Dabah's plan to purchase 45% of the company's shares from Nasser, Dweck asked Nasser to reduce this oral arrangement to writing.[10] Nasser ultimately gave such an instruction to his lawyer who produced a draft agreement that reflected the parties' prior oral understanding and contained additional provisions.[11] That draft provided that "the directors shall not be removed without the consent of the shareholders who designated them and if any directors are so removed, the designating stockholders shall have the right to appoint their successor directors." In addition, the draft provided for Dweck and Dabah to appoint the president, chief executive officer, and chief operating officer of the company, and for Nasser to appoint the chairman, secretary, and treasurer. From 1994 to 1998, the parties exchanged drafts but never signed an agreement.[12]

[8] Compl. ¶¶ 8-9. The complaint also alleges that the parties orally agreed that they were permitted to operate and control businesses that compete with the company. Allegedly, at the time the company was formed, Nasser and Dweck controlled and operated several companies which manufactured children's clothing and competed with Kids. While these facts are important to the case, they are not relevant to the motion at hand.
[9] Compl. ¶ 10.
[10] Compl. ¶ 11.
[11] The plaintiff has not submitted this agreement to the court. The plaintiff only cites to specific clauses of the agreement in her complaint and her briefs.
[12] Compl. ¶ 16.

Dweck alleges that because the terms of the draft were identical to the parties' prior oral understanding, she had no reason to doubt that the unsigned draft agreement would be enforceable.[13] Furthermore, the complaint alleges, "because she bought her shares in 1996, in the middle of the exchange of drafts, Ms. Dweck reasonably relied on the draft agreement as setting forth the operative terms that would govern her rights as a minority stockholder, officer and director of the company."[14] Allegedly, the parties abided by the oral agreement or unsigned drafts from 1993 to 2005.[15]

C. Dweck's Termination

On December 31, 2004, Nasser called a board meeting for January 5, 2005.[16] At that meeting, Nasser used his power as the controlling stockholder to unilaterally appoint a fifth member, his nephew, Itzhak Djemal, to the board of directors.[17] Nasser told Dweck that Djemal would serve as vice-chairman of the

[13] *Id.*
[14] *Id.*
[15] Compl. ¶¶ 17, 19. Dweck alleges that she reasonably relied to her ultimate detriment on the unsigned stockholders agreement based on the fact that the company's operations mirrored the agreement in all key respects for 12 years.
[16] Compl. ¶ 30.
[17] Compl. ¶¶ 31, 32. According to the complaint, the only prior reference to a fifth board member appears in the exchange of drafts of the stockholders agreement. A draft provided that, if the warrant holder, Nasser's lawyer, Amnon Shiboleth, exercised his warrant to purchase 5% of the company, he would have the power to designate a fifth board member. In approximately 1998, Shiboleth exercised his warrant but did not appoint a fifth board member. In 2001, Shiboleth sold his 5% interest to Nasser and Dweck, who each purchased 2.5% of the shares. A fifth board seat was never created while Shiboleth held his shares.

company and would "have control over the operations of the company and that she would answer to Djemal."[18] According to the complaint, Djemal's appointment caused great disruption among the company's employees, adversely affecting employee morale and the functioning of the company.[19] Dweck alleges that this disruption and resulting restriction on her ability to perform the functions of her job caused her to believe that she could not effectively work for the company.[20] Shortly thereafter, Dweck and Dabah contested the legitimacy of the January 5 board meeting.[21] To settle the dispute, Dweck offered to purchase Nasser's shares of the company, or, in the alternative, sell her shares and Dabah's shares to Nasser. Nasser rejected both of these offers but agreed to hold another meeting on March 11.

In the interim, Nasser found out that Dweck was operating competing businesses on Kids's premises using Kids's resources.[22] Dweck admits that she was running several businesses out of the company's offices, namely Kids Cool, Success Apparel, and Premium Apparel, that competed directly with Kids by designing, manufacturing, and selling children's clothing.[23] At the March 11 board

[18] Compl. ¶ 33.
[19] Compl. ¶ 34.
[20] *Id.*
[21] Compl. ¶ 35.
[22] Compl. ¶ 27.
[23] Compl. ¶¶ 26, 27.

meeting, Nasser terminated Dweck's employment with the company and installed Djemal as its chief executive officer. Dweck claims that she was unjustly terminated, arguing that Nasser's justification for her termination was pretextual since he was aware of and previously consented to her operating competing businesses on Kids's premises.[24] According to the complaint, "without justification or notice, therefore, and contrary to the shareholders' long-standing agreement and practice, Ms. Dweck has been ousted from a company in which she not only invested money but which was her life's work."[25] In addition, Dweck alleges that Djemal was not qualified to successfully operate Kids,[26] and that "Mr. Nasser's decision to replace Ms. Dweck with his nephew was not in the best interest of the company."[27]

Furthermore, at the March 11 board meeting Nasser maintained the right as the controlling stockholder to appoint all five board members.[28] Nasser asked Dweck to remain as a member on the board, but she declined the appointment, stating that she "realized that under the circumstances, her own service on the

[24] Compl. ¶¶ 36, 40. The complaint also states that, upon information and belief, Djemal was the chief operating officer of a business that Nasser controls which also competes with Kids in the children's clothing business.
[25] Compl. ¶ 40.
[26] Compl. ¶¶ 38-39. According to the complaint, Djemal has alienated many of the long-time and key employees through repeated threats, intimidation, and harassment. Additionally, Dweck alleges that Djemal lacks the necessary contacts and relationships with key customers to ensure that the business will continue to be successful.
[27] Compl. ¶ 39.
[28] Compl. ¶ 41.

board was not desirable."[29] The complaint alleges that Nasser appointed all of the members of the board of directors to "consolidate control of the company in his hand,"[30] thereby "depriving Dabah and Dweck of their right to appoint one-half of the [b]oard."[31] Allegedly, Nasser breached the stockholders agreement and his fiduciary duties by "using his majority position to take unlawfully Mr. Dabah's and Ms. Dweck's right to operate the company and eliminate or dilute improperly their role in their board of directors."[32] As a result, the complaint alleges, Nasser's "improper and unlawful actions have rendered it impossible for the shareholders to continue in business together."[33]

On May 18, 2005, Dweck filed the complaint in this action against Nasser for breach of fiduciary and contractual duties, seeking (1) the appointment of a custodian under 8 *Del. C.* § 226; (2) specific performance of the alleged stockholders agreement; (3) and a declaratory judgment concerning her right to compete with the company. On June 14, the defendants filed an answer and counterclaimed that Dweck breached her fiduciary duties by wrongfully operating competing businesses out of the company's premises, tortiously interfering with

[29] *Id.*
[30] Compl. ¶ 30.
[31] Compl. ¶¶ 38-39.
[32] Compl. ¶ 29.
[33] Compl. ¶ 42.

the company's business relations, misappropriating the company's trade secrets, engaging in deceptive trade practices, and converting the company's assets.

On September 16, 2005, Dweck filed an answer to the counterclaims, and, on September 30, 2005, the defendants filed this motion for partial judgment on the pleadings. The defendants contend that the alleged stockholders agreement is an invalid voting agreement and unenforceable. They move for judgment on the pleadings with respect to (1) Count I, appointment of a custodian under 8 *Del. C.* § 226; (2) Count IV, breach of the alleged stockholders agreement; (3) Count V, promissory estoppel of the stockholders' understanding; and (4) Count VII, breach of fiduciary duties.[34]

II.

The standard for judgment on the pleadings pursuant to Court of Chancery Rule 12(c) is well settled. A motion for judgment on the pleadings will be granted "where it appears from the pleadings that there are no material issues of fact and the movant is entitled to judgment as a matter of law."[35] Similar to a Rule 12(b)(6) motion to dismiss, that determination is generally limited to the factual allegations contained in the complaint. In considering this motion, the court is required to

[34] The defendants are not moving for judgment on the pleadings on Counts II, III, or VI, which deal with Dweck's right to compete with the company.
[35] *CL Invs., L.P. v. Advanced Radio Telecom Corp*., 2000 Del. Ch. LEXIS 178, *8-9 (Del. Ch. Dec. 15, 2000); *Desert Equities, Inc. v. Morgan Stanley Leveraged Equity Fund*, 624 A.2d 1199, 1205 (Del. 1993).

"take the well-[pleaded] facts in the complaint as true, and view those facts and any inferences drawn therefrom in the light most favorable to the non-moving party."[36] However, "[a] trial court need not blindly accept as true all allegations, nor must it draw all inferences from them in [the non-moving party's] favor unless they are reasonable inferences."[37]

III.

A. Breach Of The Alleged Stockholders Agreement

The complaint alleges that at the time of the formation of the company, Dweck, Dabah, and Nasser agreed to several terms regarding the operations of the company. Specifically, they allegedly agreed that Dweck and Dabah would select two members of the board and Nasser would select two members of the board. This agreement was later reduced to written drafts but was never finalized or signed by the parties. Nevertheless, the plaintiff claims that Nasser breached this stockholders agreement when he terminated Dweck and used his controlling equity interest in the company to add a fifth member to the board and elect all the members of the board.[38]

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[36] *Meades v. Wilmington Hous. Auth.*, 2003 Del. Ch. LEXIS 20 at *7 (Del. Ch. Mar. 6, 2003).
[37] *Grobow v. Perot*, 539 A.2d 180, 187 n.6 (Del. 1988) (*quoted in Werner v. Miller Tech. Mgmt., L.P.*, 831 A.2d 318, 327 (Del. Ch. 2003)).
[38] Compl. ¶¶ 68-69. According to the complaint, "Ms. Dweck and Mr. Dabah never would have agreed to invest time or money in the company had they known that they would be subjecting themselves to the whims of Mr. Nasser."

The defendants argue that this stockholders agreement alleged to have been breached constituted an invalid voting agreement under the plain language of 8 *Del. C.* § 218(c). Section 218(c) recognizes the validity of a voting agreement between any two or more stockholders. According to the statute,

> An agreement between two or more stockholders, if in writing and signed by the parties thereto, may provide that in exercising any voting rights, the shares held by them shall be voted as provided by the agreement, or as the parties may agree, or as determined in accordance with a procedure agreed upon by them.

The defendants claim that Section 218(c) required that the stockholders agreement relating to their voting rights be in writing and signed by the parties to be enforceable. Conversely, Dweck contends that the stockholders agreement fell outside the scope of Section 218(c), arguing that the stockholders did not agree to vote their shares in a particular manner, but rather "agreed only that each group of shareholders would receive the right to appoint two of the company's four directors."[39]

Dweck's argument elevates form over substance. While the stockholders may not have expressly agreed to restrict the exercise of their voting rights, they did so, in fact, by agreeing to each appoint two of the company's directors. Effectively, this agreement required Nasser, the holder at various times of 100%, 55%, and 52.5% of the company's equity, to vote for Dweck's and Dabah's board

[39] Pl.'s Answering Br. 6.

designees.[40] Therefore, it is clearly "an agreement between two or more stockholders" to vote their shares "as provided by the agreement" within the regulatory framework of Section 218(c).[41]

Since the "shareholders exchanged drafts of the agreement for several years . . . but never signed the agreement,"[42] it is not legally enforceable.[43] Nasser, as the controlling stockholder of Kids, had the right to vote his shares to elect the members of the board, remove directors from the board, and create additional directorships, in accordance with the company's certificate of incorporation and bylaws. Dweck does not allege that the company's certificate of incorporation provided otherwise. Indeed, Nasser exercised these rights and elected Dweck to the company's board, but she declined the appointment.[44]

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[40] *See* 8 *Del. C.* § 212(a) ("Unless otherwise provided by the certificate of incorporation and subject to § 213 of this title, each stockholder shall be entitled to one vote for each share of capital stock held by such stockholder."). Dweck does not allege that the company's certificate of incorporation altered this one share/one vote default rule. *See also* 8 *Del. C.* § 212 on the election of directors.

[41] 8 *Del. C.* § 218(c).

[42] Compl. ¶ 6.

[43] *Venture First L.P. v. DeKovacsy*, 1990 Del. Ch. LEXIS 177 at * 5 (Del. Ch. Oct. 19, 1990) (holding that an agreement affecting voting rights has to be in writing to be legally binding); *But see Independent Cellular Tel., Inc v. Barker*, 1997 WL 153816 at * 4 (Del. Ch. Mar. 21, 1997) (holding that the agreement to dissolve the company was not a voting agreement pursuant to Section 218(c) because a stockholder vote was not the only way to carry out the dissolution of the company).

[44] Compl. ¶ 41.

Because the purported stockholders agreement is unenforceable, Dweck is also not entitled to the appointment of a custodian under 8 *Del. C.* § 226.[45] Section 226 provides for the appointment of a custodian for a corporation when "the business of the corporation is suffering or is threatened with irreparable injury because the directors are so divided respecting the management of the affairs of the corporation that the required vote for action by the board of directors cannot be obtained."[46] Here, Nasser had the right, by virtue of his 52.5% control, to elect the company's board members, and there is no allegation that these directors are deadlocked.[47] Therefore, Section 226 is inapplicable. Accordingly, the court will grant judgment in the defendants' favor on Count I and Count IV.

B. Promissory Estoppel

The complaint asserts in the alternative that, assuming the stockholders agreement was not an enforceable contract, Dweck and Dabah purchased shares of the company in reliance on Nasser's promise to allow them to be the "operating" stockholders with the power to select two members of the company's board.[48]

[45] Compl. ¶¶ 52-54. The complaint alleges that, once the board is properly constituted in accordance with the stockholders agreement with Dweck and Dabah appointing two directors and Nasser appointing two directors, the board will be deadlocked with respect to the management and affairs of the company.
[46] 8 *Del. C.* § 226(a)(2).
[47] Compl. ¶ 47. The four directors who were elected to the company's board are Nasser, Dabah, Djemal, and Lidia Lozovsky.
[48] Compl. ¶ 72.

As explained above, the alleged stockholders agreement is a voting agreement pursuant to Section 218(c), which regulates contractual arrangements that interfere with stock ownership rights.[49] The court cannot reasonably estop the defendants from denying the enforceability of a voting agreement that is invalid under this section.[50] To do so would circumvent the statute's plain requirement that a stockholder voting agreement to be in writing and signed by the parties.

Furthermore, to succeed on a claim for promissory estoppel, Dweck would need to plead sufficient facts to suggest that Nasser made a promise with the intent to induce action or forbearance, that she actually and reasonably relied on the promise, and that she suffered an injury as a result.[51] Here, the court cannot infer that Dweck reasonably relied on drafts that were never signed by any of the parties.[52] Therefore, the court will grant judgment in favor of the defendants on the promissory estoppel claim.

C. Breach Of Fiduciary Duty Claims

The complaint alleges, in the alternative to the breach of contract claims, that Nasser breached his fiduciary duties to the company's stockholders when he

[49] *Oceanic Exploration Co. v. Grynberg*, 428 A.2d 1, 7 (Del. 1981).
[50] *STAAR Surgical Co. v. Waggoner*, 588 A.2d 1130, 1137 n.2 (Del. 1991) ("we emphasize that our courts must act with caution and restraint when granting equitable relief in derogation of established principles of corporate law.").
[51] *VonFeldt v. Stifel Fin. Corp.*, 714 A.2d 79, 87 (Del. 1998).
[52] Compl. ¶ 16.

terminated Dweck as president of Kids and hired his nephew, Djemal, to manage the company. Allegedly, Djemal was not qualified to operate the business of the company and lacked the necessary contacts and relationships with the key customers to ensure that the business will continue to be successful.[53] Djemal had also allegedly alienated several of the employees through repeated threats, intimidation, and harassment. Thus, according to the complaint, Nasser's decision to replace Dweck with his nephew was motivated by nepotism rather than the best interest of the company or its stockholders.[54]

Dweck's allegations of wrongdoing in connection with her termination as president and CEO of Kids are insufficient to support a claim for breach of fiduciary duty. While Nasser, as a director and controlling stockholder, owed fiduciary duties of care and loyalty to the Kids, nothing in the complaint suggests that he breached those duties by terminating Dweck. Dweck's claims regarding her wrongful termination are personal and contractual in nature and are separate from her rights as a stockholder. "Fiduciary duties are not implicated when the issue involves the rights of the minority stockholder qua employee under an

[53] Compl. ¶ 39.
[54] *Id*.

employment contract."[55] Apart from the unenforceable stockholders agreement, there is nothing to suggest that Nasser or any director of Kids' had a fiduciary obligation to leave the management of the business to Dweck.

In contrast, the allegation of breach of fiduciary duty by Nasser in hiring his nephew, Djemal, to replace Dweck, despite its obvious weakness, survives this facial attack. The complaint alleges that Djemal is unsuited to the job and that his only qualification is his relationship to Nasser. It also alleges that his appointment has caused substantial disruption at the company and has injured the company's business and prospects. As much as the decision may ultimately be shown to have been properly motivated, the court cannot conclude at this juncture that Nasser is entitled to judgment on this claim.

IV.

For the reasons stated herein, the motion for judgment on the pleadings is GRANTED as to Counts I, IV, and V and DENIED as to Count VII. IT IS SO ORDERED.

[55] *Riblet Prods. Corp. v. Nagy*, 683 A.2d 37 (Del. 1996); *Juran v. Bron*, 2000 Del. Ch. LEXIS 143 *30 (Del. Ch. Oct. 6, 2000) (holding that where a minority shareholder is injured as an employee, such as in a breach of an employment contract situation, his remedy would be under the contract).