

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

GENERAL VIDEO CORPORATION,)
a Delaware corporation, and)
AUDEO LLC, a Delaware limited)
liability company,)

Plaintiffs,)

v.)

C.A. No. 1922-N

EMERY KERTESZ, DANIEL R. SOLIN,)
PRO ACOUSTICS, LLP, a Delaware)
limited liability partnership, and PRO)
ACOUSTICS, LTD., a Delaware)
corporation,)

Defendants.)

MEMORANDUM OPINION AND ORDER

Submitted: June 20, 2006

Decided: July 19, 2006

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Wilmington, Delaware, *Attorneys for the Plaintiffs.*

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LAMB, Vice Chancellor.

The defendants seek to dismiss or stay this action in deference to prior-filed actions in Texas state and federal courts. Applying the familiar *McWane* standard, the court concludes that the Texas actions were first filed and involve sufficiently similar issues and parties to warrant a stay of this action.

I.¹

A. Parties

The plaintiffs in this action are General Video Corporation (“GVC”), a privately held Delaware corporation in the business of designing, manufacturing, and selling specialized audio and video equipment, formed in 1991 by Justin Korn, who holds 68.5% of its common stock, and Audeo, LLC, a Delaware limited liability company owned entirely by Korn. The defendants are Emery Kertesz, a resident of Belton, Texas, and a director and president of GVC and former president of Audeo;² Daniel R. Solin, former outside counsel for GVC; and Pro Acoustics, LLP and Pro Acoustics, Ltd., both Delaware business entities having their principal places of business in Harker Heights, Texas. These two entities were, allegedly, formed by Kertesz and Solin for the purpose of carrying into effect a scheme to usurp GVC’s speciality audio speaker business.

¹ The facts recited in this opinion are taken from the well pleaded allegations of the complaint, unless otherwise noted, and are presumed to be true for the purposes of this motion.

² Kertesz is alleged to own the remaining 31.5% of the GVC common stock.

B. Background

In 1991, Kertesz and Korn formed GVC to capitalize on a patented audio speaker system invented by Kertesz called the “super dispersion ceiling system.” Pursuant to the First License Agreement, Korn contributed the capital for the business, and Kertesz granted GVC an exclusive 99-year license to distribute his patented speaker system. Korn, Kertesz, and GVC later entered into a Second License Agreement to confirm and update the arrangements set forth in the prior license agreement.³

In 2001, Korn and Kertesz decided to focus GVC’s business on its profitable specialized audio speaker business, conducted under the trade names “SD technologies” and later “pro acoustics.” In late 2002, the parties agreed to conduct the pro acoustics business through a new Delaware entity, Audeo, that would act as the agent of GVC and a sublicensee of GVC’s exclusive licensing rights.⁴ Korn owned 100% of Audeo’s equity, however the parties understood that, consistent with the First License Agreement and the Second License Agreement,

³ Compl. ¶ 25. The terms of the Second License Agreement predominantly reiterate the terms of the First License Agreement. Because Korn and Kertesz viewed the revised agreement as a confirmation of their original intention and understanding, the Second License Agreement was backdated to as of November 1, 1991, when GVC began operations.

⁴ *Id.* ¶ 31. Allegedly, at the time, GVC was involved in multiple litigations and Korn and Kertesz were concerned that these litigations would jeopardize the pro acoustics business. Therefore, they formed Audeo, in which GVC would not have a formal ownership interest, but would sublicense to Audeo its exclusive license for the super dispersion ceiling system and receive licensing and management fees. Ultimately, Audeo would conduct the pro acoustics business as an agent and sublicensee of GVC.

Kertesz was entitled to approximately 30% of Audeo's equity. Allegedly, from September 2002 until March 2003, the parties expended significant efforts to develop the pro acoustic business and Audeo.⁵

In March of 2003, Solin, who at the time was representing GVC in an arbitration, allegedly convinced Kertesz at a dinner meeting to "betray GVC, Audeo and Korn and instead pursue the Pro Acoustics business" with him.⁶ Shortly thereafter, allegedly Kertesz and Solin formed Delaware entities, Pro Acoustics, LLP and Pro Acoustics, Ltd. (referred to as "Pro Acoustics") to carry out this plan. It is alleged that Kertesz took property and assets of GVC and Audeo that were essential to the pro acoustics business and moved them to his newly formed company. Furthermore, Pro Acoustics allegedly pursued the same business model and marketing plan as GVC and Audeo, including the use of GVC's website to market and sell its products.

On February 3, 2006, GVC and Audeo brought this litigation against Kertesz, Solin, and Pro Acoustics, alleging that Kertesz, as director and president of GVC and president of Audeo, and Solin, as outside counsel to GVC, breached their fiduciary duties to GVC and Audeo by forming Pro Acoustics to usurp

⁵ *Id.* ¶¶ 3, 4. Korn, Kertesz, and GVC personnel developed an upgraded business model and marketing program for the business that included extensive use of direct sales over the internet to customers and dealers.

⁶ *Id.* ¶¶ 3, 4.

GVC's speciality audio speaker business.⁷ In addition, GVC and Audeo allege, *inter alia*, that Kertesz, Solin, and Pro Acoustics misappropriated GVC's and Audeo's trade secrets and breached the Second License Agreement by manufacturing, marketing, selling, and distributing the super dispersion ceiling system. The defendants moved to dismiss or stay this action in favor of other pending litigation.

C. Previously Filed Lawsuits And Pending Litigations

There are several previously filed litigations, some that have been dismissed and others that are currently pending in Texas state and federal courts, relating to GVC and the formation of Pro Acoustics by Kertesz and Solin.

1. Previously Filed New York Actions

In May 2005, Korn, GVC, and Audeo filed a lawsuit in the Supreme Court of the State of New York against Kertesz, Solin, and Pro Acoustics, advancing many of the claims that are alleged in this action.⁸ The New York action was dismissed on jurisdictional grounds with leave to replead.⁹ In June 2005, Korn filed a second complaint in the Supreme Court of the State of New York against Kertesz and his wife, Sheila Kertesz, seeking to recover contribution in connection

⁷ Korn is not a party to this litigation.

⁸ The New York action alleged, among other things, that Kertesz unlawfully and maliciously converted the tangible property of GVC and Audeo, and that Solin and Kertesz breached their fiduciary duties to GVC when they formed Pro Acoustics.

⁹ Specifically, the court found that it had no personal jurisdiction over Kertesz or Pro Acoustics.

with a bank loan to GVC allegedly personally guaranteed by Korn, Kertesz, and Kertesz's wife.¹⁰ However, the complaint was voluntarily dismissed without prejudice. The facts underlying the contribution claim are not at issue in this proceeding.

2. Pending Texas State Court Action

On July 11, 2005, Kertesz filed an action in Texas state court against Korn, alleging that Korn (1) breached his fiduciary duty to GVC by transferring assets to Audeo, (2) committed fraud and breach of contract in connection with inducing him to personally guarantee GVC's bank obligation, and (3) intentionally inflicted emotional distress by filing a frivolous lawsuit against him in New York. Korn answered the complaint and objected to the court's personal jurisdiction over him. Currently, discovery is ongoing and Korn's motion to dismiss for lack of personal jurisdiction is pending resolution.

3. Pending Texas Federal Court Action

On October 14, 2005, Pro Acoustics, Kertesz, and Sheila Kertesz filed an action against Korn in the United States District Court for the Western District of Texas seeking a declaratory judgment that Kertesz has exclusive rights to the super dispersion ceiling system and that Pro Acoustics can sell products relating to this

¹⁰ The defendants removed the complaint to the United States District Court for the Southern District of New York.

patented technology. Kertesz alleged, among other things, that he was fraudulently induced into entering into the Second License Agreement, and thereby he, and not Audeo, has exclusive rights to the patented speaker technology.¹¹ In addition, the Kerteszes sought a further declaration that they are not liable to Korn for contribution for GVC's bank debt. Again, Korn objected to the personal jurisdiction of the Texas court, which motion is *sub judice*.¹²

II.

It is well established that a Delaware court typically will defer to a first-filed action in another forum and stay Delaware litigation pending adjudication of the same or similar issues in the competing forum. In *McWane Cast Iron Pipe Corp. v. McDowell-Wellman Engineering Co.*, the Delaware Supreme Court explained that, although a stay in favor of a prior-pending litigation in another forum is not granted as a matter of right, such stay may be warranted by facts and circumstances sufficient to move the discretion of the court.¹³ “Such discretion should be

¹¹ Kertesz alleges in the Texas federal action that, in an effort to hide assets from creditors of GVC, Korn backdated the Second License Agreement to “as of November 1, 1991.” This agreement allegedly reaffirmed the First License Agreement to GVC but provided that, in the event GVC went out of business, or Korn ceased to own a controlling interest in GVC, Kertesz could license the patented technology to another corporation in which Korn or a Korn family entity held 70% or more of the stock and further provided that Kertesz was offered 30% of the ownership interest in the new entity.

¹² On May 31, 2006, the Texas court provided the parties with a scheduling order for the case, which signals that the court plans to consider the case despite Korn's lack of personal jurisdiction objection. The scheduling order provides that any new parties to the action must be joined by July 10, 2006.

¹³ 263 A.2d 281, 283 (Del. 1970).

exercised freely in favor of the stay when there is a prior action pending elsewhere, in a court capable of doing prompt and complete justice.”¹⁴ This is because a defendant should not be permitted to defeat a plaintiff’s choice of forum in a pending suit by commencing litigation involving the same or substantially similar parties and causes of action in another jurisdiction of its own choosing.¹⁵ Furthermore, in exercising its discretion to stay or dismiss a later-filed action in favor of a prior-pending suit in another jurisdiction, this court must consider comity, specifically the “wasteful duplication of time, effort, and expense” as well as “the possibility of inconsistent and conflicting rulings and judgments” that may result from simultaneous adjudications.¹⁶

Here, the parties dispute whether the Texas actions are first-filed and whether they involve similar parties and issues. The plaintiffs argue that the Texas actions should not be considered first-filed, but rather should be treated as contemporaneously-filed, because they were filed in reaction to the New York lawsuits. In addition, the plaintiffs argue that *McWane* is not implicated because the Texas litigations involve different parties, *i.e.*, GVC, Audeo, and Solin are not parties to the Texas actions and Korn and Sheila Kertesz are not parties to this

¹⁴ *Id.*

¹⁵ *Id.*

¹⁶ *Id.*

action. Lastly, the plaintiffs argue that the Texas litigations involve substantially different issues than those in this action.

III.

A. The Texas Actions Are First-Filed

The simple facts of the case demonstrate that the Texas actions are first-filed. The Texas state and federal court actions were filed on July 11, 2005 and October 14, 2005, respectively, while this action was filed on February 3, 2006. Clearly, this is not a case where the parties were engaged in a race to the courthouse, but rather the plaintiffs filed this action months after the Texas litigations were filed and discovery was ongoing.¹⁷ Moreover, the fact that the Texas litigations were filed after the New York litigations were voluntarily dismissed does not permit this court to treat the Texas litigations as contemporaneously filed with this action. Had the plaintiffs wanted to replead their first-filed New York action, they could have done so in a court with proper jurisdiction before the Texas actions were filed. Indeed, Korn decided instead to file another more narrow action against the Kerteszes in the Supreme Court of New

¹⁷ Compare, *In re IBP, Inc. S'holders Litig.*, 2001 Del. Ch. LEXIS 40, *23 (Del. Ch. Apr. 18, 2001) (Delaware action filed within five business hours of Arkansas suit); *Azurix Corp. v. Synagro Tech., Inc.*, 2000 Del. Ch. LEXIS 25, *11 (Del. Ch. Feb. 3, 2000) (Delaware action and Texas suit filed “only scant minutes apart”).

York. Accordingly, the court concludes that the Texas actions were in fact first-filed.¹⁸

B. The Delaware Action And The Texas Action Involve Substantially The Same Parties and Issues

While the parties and issues to this action are not identical to the parties and issues in the Texas actions, they are sufficiently similar to warrant a stay of this action in favor of the prior-pending actions in Texas. An absolute identity of the parties and issues is not necessary for a dismissal or stay under *McWane*.¹⁹ Here, Korn owns and controls GVC and Audeo, and therefore the parties in the Texas actions are sufficiently similar to the parties involved in this action to satisfy this element of the analysis.²⁰ Moreover, GVC and Audeo can easily be joined, along with Solin, to the Texas federal action.²¹

¹⁸ Furthermore, the court does not find that the filing of the Texas actions were tactical maneuvers or for an improper manipulation of the litigation process. *See e.g., In re Walt Disney Co. Deriv. Litig.*, 1997 Del. Ch. LEXIS 25, *9-10 (Del. Ch. Mar. 13, 1997).

¹⁹ DONALD J. WOLFE, JR. & MICHAEL A. PITTENGER, CORPORATE AND COMMERCIAL PRACTICE IN THE DELAWARE COURT OF CHANCERY § 5-1 (2005) (“Although the complete identity of parties and issues can greatly simplify the analysis, complete identity is rare, and an absolute identity of parties and issues is not a necessary prerequisite to a stay of a later-filed action in favor of a prior-pending action.”).

²⁰ *Macklowe v. Planet Hollywood, Inc.*, 1994 Del. Ch. LEXIS 176, *9 (Del. Ch. Oct. 6, 1994).

²¹ At oral argument, the defendants represented to the court that Solin would not object to jurisdiction if joined in the Texas action. *Transamerica Corp. v. Reliance Ins.*, 1995 Del. Super. LEXIS 424, *25-27 (Del. Super. Aug. 30, 1995) (holding that although certain parties appearing in a Delaware action were not present in a first-filed California action, the parties were “substantially identical,” and that nonidentical parties could be properly joined in the California action).

Furthermore, the legal and factual issues involved in the Texas actions overlap with the issues in this case. In determining whether the issues are sufficiently related to warrant a stay under *McWane*, the court must focus on whether the issues arise out a “common nucleus of operative facts.”²² Additionally, the court must “balance the present lack of complete identity of parties [and issues] against the possibility of conflicting rulings if both actions were allowed to proceed simultaneously.”²³ A stay of the action is favored when the court in the prior-pending action can do prompt and complete justice.²⁴

The Texas actions involve the same underlying facts and arise from the same core dispute as this action. Specifically, in the Texas state court action, Kertesz alleges that Korn breached his fiduciary duty by improperly transferring GVC’s assets to Audeo, which Kertesz claims is solely owned by Korn. In the Texas federal court action, it is alleged that Korn fraudulently induced Kertesz to sign the Second License Agreement, and that Kertesz and Pro Acoustics have the exclusive right to distribute the patented speaker system. Therefore, undeniably, the Texas courts will have to decide such issues of fact and law, as this court would have to in this action, of whether Kertesz was a fiduciary of Audeo, whether the Second

²² *Schnell v. Porta System Corp.*, 1994 Del. Ch. LEXIS 47, *11 (Del. Ch. Apr. 12, 1994) (applying *McWane* to “claims arising out of common nucleus of operative facts”).

²³ *Playtex, Inc. v. Columbia Cas. Co.*, 1989 Del. Super. LEXIS 179, *9-10 (Del. Super. Apr. 25, 1989).

²⁴ *Id.*

License Agreement is void, and who has the exclusive right to distribute the patented speaker system.²⁵

In addition, in order to defend against the claim in the Texas state court action that Korn breached his fiduciary duty by transferring assets to Audeo, it is probable that Korn must assert in a compulsory counterclaim the same claim that is asserted in this action, *i.e.*, that Kertesz breached his fiduciary duty to both GVC and Audeo by transferring assets to Pro Acoustics. Accordingly, based on the substantial overlap of issues between the actions and the real possibility of inconsistent rulings if all actions were allowed to proceed simultaneously, the court concludes, in the exercise of its discretion, to stay this action pending the outcome of the first-filed Texas actions.

At the same time, the court declines to dismiss this action because of the possibility that the Texas federal action, which has several overlapping claims with this action, will be dismissed on jurisdictional grounds and the issues between the parties will not be completely resolved.²⁶ If that happens, it could be necessary or appropriate to lift the stay and allow this action to proceed to trial.

²⁵ Moreover, it is also alleged in the Texas state court action that the claims asserted in the first New York action, which predominantly mirror the claims in this action, are frivolous and were filed to harass Kertesz and Pro Acoustics. Therefore, the Texas court will have to look into the nature of the New York claims in order to decide whether they are baseless.

²⁶ *Transamerica Corp.*, 1995 Del. Super. LEXIS 424, *28.

IV.

For all the foregoing reasons, the court grants the alternative motion to stay this action in favor of the two actions pending in Texas. IT IS SO ORDERED.