

IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

GILA DWECK, SUCCESS APPAREL LLC, and)
PREMIUM APPAREL BRANDS LLC,)
)
Plaintiffs and Counterclaim-Defendants,)
)
v.) Consol. C.A. No. 1353-VCL
)
ALBERT NASSER and KIDS INTERNATIONAL)
CORPORATION,)
)
Defendants and Counterclaim-Plaintiffs.)
)

ALBERT NASSER and KIDS INTERNATIONAL)
CORPORATION,)
)
Third-Party Plaintiffs,)
)
v.)
)
KEVIN TAXIN and BRUCE FINE,)
)
Third-Party Defendants.)

MEMORANDUM OPINION

Date Submitted: July 24, 2012
Date Decided: August 2, 2012

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LASTER, Vice Chancellor.

This Court's post-trial order dated February 8, 2012 (the "Post-Trial Order") required the parties to submit accountings. As clarified by order dated February 27, 2012 (the "Clarification Order"), the Post-Trial Order directed plaintiff Gila Dweck and counterclaim-defendants Kevin Taxin and Bruce Fine to account for various corporate opportunities that they misappropriated through two companies that Dweck and Taxin formed: Success Apparel LLC ("Success") and Premium Apparel Brands LLC ("Premium"). The Post-Trial Order directed defendant Albert Nasser to account for his use of funds during his period of sole control over Kids International Corporation ("Kids"). Each side challenged the accuracy and completeness of the other side's accounting. An evidentiary hearing was held on July 23-24, 2012.

Having reviewed both sides' submissions and considered the evidentiary record, I find that Dweck, Taxin, Success, and Premium are liable to Kids, jointly and severally, for an additional \$539,947.20. Nasser is liable to Kids for an additional \$2,461,085.

I. FACTUAL BACKGROUND

The factual background of this dispute is set forth in this Court's post-trial opinion dated January 18, 2012. *Dweck v. Nasser*, 2012 WL 161590 (Del. Ch. Jan. 18, 2012) (the "Post-Trial Opinion" or "Post-Trial Op."). In the Post-Trial Opinion and implementing Post-Trial Order, I held Dweck, Taxin, Fine, Success, and Premium (the "Dweck Group") liable to Kids for \$9,365,191, comprising lost profits from misappropriated corporate opportunities and personal expenses that Dweck charged improperly to Kids. I held Nasser liable to Kids for \$3,864,583, comprising unjustified consulting fees that he

caused Kids to pay to his affiliates. I ordered the parties to account for additional categories of potential damages.

The Dweck Group was ordered to address three areas in their accounting: (i) profits from business diverted to Success and Premium between January 1 and May 18, 2005 (the “Stub Period”); (ii) profits generated by Success and Premium after May 18, 2005, from all license agreements in effect as of that date (the “Branded Business”); and (iii) profits generated by Success in its non-branded business for the Holiday 2005 and Spring 2006 seasons (the “Non-Branded Business”). Post-Trial Order ¶¶ 1-3. Nasser was ordered to account for “all changes in Kids’ cash account from January 1, 2006, through December 31, 2008,” the date Nasser shut down Kids. Clarification Order at 1.

II. LEGAL ANALYSIS

“An accounting is an equitable remedy that consists of the adjustment of accounts between parties and a rendering of a judgment for the amount ascertained to be due to either as a result.” *Albert v. Alex. Brown Mgmt. Servs., Inc.*, 2005 WL 2130607, at *11 (Del. Ch. Aug. 26, 2005). “It is elementary that in this accounting phase, [the party submitting the accounting] bears the burden of proving both the accuracy of its accounting and the propriety of the underlying transactions.” *Dolby v. Key Box “5” Operatives, Inc.*, 1996 WL 741883, at *1 (Del. Ch. Dec. 17, 1996) (Allen, C.).

A. The Dweck Group’s Accounting

The Dweck Group’s accounting shows a loss during the Stub Period of \$180,759, a loss from the Non-Branded Business of \$152,998, and a profit from the Branded Business of \$602,773. The three categories together yield a net profit of \$269,016. The

Dweck Group's submission ties out to Success and Premium's audited financial statements and tracks the requirements of the Post-Trial Order. Although I rule against the Dweck Group on three issues set forth below, they submitted an adequate and credible accounting and generally carried their burden of proof.

1. The Fall 2005 Season

The Dweck Group's net profit figure omitted profits that the Non-Branded Business generated during the Fall 2005 season. The Dweck Group left out these amounts because the Post-Trial Order mentioned specifically the Holiday 2005 season and the Spring 2006 season, but not the intervening Fall 2005 season. This literalist reading ignored the purpose of the lost profits award and created a remedial doughnut hole between the Stub Period and the Holiday 2005 season.

The lost profits award sought to remedy the harm that Dweck and her colleagues inflicted on Kids by awarding the profits that Kids would have earned if Dweck and her team departed without breaching their fiduciary duties. Under those circumstances, "Kids would have had an intact employee base, access to its records, and a much better shot at preserving some element of its relationships with Wal-Mart and Target." Post-Trial Op. at *18. The Post-Trial Opinion recognized that "Dweck and Taxin likely would have captured the non-branded business eventually, but it would have taken time." *Id.* The Post-Trial Opinion approximated the amount of time during which Kids could have continued earning profits from the Non-Branded Business by awarding Kids lost profits for the Stub Period through Spring 2006. Although not called out explicitly in the Post-Trial Order, the Fall 2005 season falls within this time period.

It would be nonsensical to exclude Fall 2005 from the damages award. The bulk of the orders that generated profits for the Fall 2005 season were diverted during the Stub Period and explicitly covered by the Post-Trial Opinion and Order. Profits for the Fall 2005 season also were covered by the logic and spirit of the Post-Trial Opinion and Order. To the extent greater specificity is necessary, the Post-Trial Opinion and Order are clarified to hold the Dweck Group liable for lost profits from the Fall 2005 season.

The Dweck Group identified \$97,227 in 2005 profits attributable to Non-Branded Business for the Fall 2005 season. I accept that figure and hold the Dweck Group liable for this additional amount.

2. Target Direct

The Dweck Group's net profit figure omitted profits generated by the Target Direct business. The Post-Trial Opinion held that Target Direct was a Kids corporate opportunity that Dweck misappropriated. *See* Post-Trial Op. at *13. Accordingly, profits generated by Success and Premium on the 2005 Target Direct business are awarded to Kids. The Dweck Group's accounting attributed \$63,318 in 2005 profits to Target Direct. I accept that figure and hold the Dweck Group liable for this additional amount.

3. Dweck's Personal Expenses

Nasser contended that Success and Premium's profits should be increased because Dweck continued her practice of charging hundreds of thousands of dollars of personal expenses to her companies. According to Nasser, these expenses improperly reduced Success and Premium's profits.

If Dweck and her team had left Kids without breaching their fiduciary duties, then once free of Kids they could pay themselves as much as they wanted. In lieu of the claimed expenses, Dweck could have paid herself a greater salary. Both are forms of compensation, distinguished only by the tax treatment afforded the different categories by the Internal Revenue Service. Whether Dweck properly claimed her personal expenses as compensation after she left Kids would be an issue for Dweck and the United States Treasury, not this litigation.

The Post-Trial Opinion held, however, that Dweck and her team did not leave Kids properly. Dweck, Taxin, and Fine breached their fiduciary duties to Kids by misappropriating corporate opportunities and, in Dweck's case, by supplementing her salary before leaving through the reimbursement of personal expenses. As a remedy, Kids is entitled to the profits it would have received if Dweck and her colleagues had not breached their fiduciary duties, which is an award of profits unreduced by Dweck's personal expenditures.

The parties agreed during the evidentiary hearing that if I found that an award of personal expenses was appropriate, Dweck's pre-departure run rate of approximately \$114,000 in personal expenses annually would serve as a fair proxy for Dweck's post-departure reimbursement practices. Dweck, however, only should have to account to Kids for the portion of her expenses borne by revenue generated by the misappropriated business lines. Over time, that portion of Success and Premium's business declined. To calculate the relevant percentage, I use gross sales figures from the Dweck Group's accounting. The resulting calculation follows:

Year	Misappropriated Gross Sales %	Attributable Personal Expenses
2006	57.63%	\$65,698.20
2007	23.89%	\$27,234.60
2008	15.31%	\$17,453.40
Total		\$110,386.20

The Dweck Group is therefore liable for an additional \$110,386.20.

4. Nasser’s Other Objections

Nasser raised other objections to the Dweck Group’s accounting. I find in favor of the Dweck Group on these issues.

First, by embracing a literalist reading of his own, Nasser argued that the Dweck Group owes an additional \$15 million in profits. In the Post-Trial Order, I stated that “[p]rofits shall be measured as gross profit less selling, general, and administrative expenses.” Post-Trial Order ¶ 12(a). In their financial statements, Success and Premium did not include “Warehousing & distribution” and “Design & production” costs under “Selling” or “General & administrative” but rather broke them out on separate lines. Nasser therefore wanted to exclude these expense categories when calculating profits.

The profits definition in the Post-Trial Order was not intended to inflate the damages award by excluding legitimate operating expenses. I drew the profits definition from the report of Brett Margolin, Nasser’s expert, on which I relied to calculate the damages award for the period ending December 31, 2004. *See* Post-Trial Op. at *17; JX 179, Ex. C. I used the Margolin Report’s definition when requiring the Dweck Group to account for lost profits during later periods to ensure that the damages award would be calculated consistently.

Unlike Success and Premium's financial statements, the Margolin Report included all operating expenses in the category "Selling, General, & Admin." JX 179, Ex. C. For an apples-to-apples remedy, the Dweck Group's accounting must deduct operating expenses like "Warehousing & distribution" and "Design & production" when determining lost profits. The Dweck Group properly subtracted these costs and other categories of operating expenses.

Second, Nasser argued that the lost profits award only should account for those opportunities that turned a profit without any offsetting losses. There are circumstances when a Court could impose on a faithless fiduciary the downside risk from a loyalty breach. *See Paradee v. Paradee*, 2010 WL 3959604, at *13 (Del. Ch. Oct. 5, 2010). This case does not call for such a remedy. After Dweck and her colleagues misappropriated Kids' core business, they believed they owned it lock, stock, and barrel. They had every reason to attempt to maximize profits across all brands and business lines. To the extent they failed with some brands, it was not due to conscious neglect or malice for Nasser and Kids, but rather because of the ever-present reality that some ventures fail. The Post-Trial Opinion netted Premium's losses against Success's profits when calculating damages. *See Post-Trial Op.* at *17; *see also* JX 179, Exs. C, J. Netting profits and losses for the accounting treats the issue consistently and places Kids in the position it would have been in if the Dweck Group had pursued all opportunities within Kids.

Third, Nasser belatedly sought to recover amounts owed to Kids by Success and Premium on inter-company balances. These matters were not part of this litigation or the

accounting. The parties in this litigation asserted claims for breach of fiduciary duty against one another. They also asserted various tort claims that recast the fiduciary duty claims under other guises, and which this Court therefore did not have to reach. *See* Post Trial Op. at * 10. The parties did not litigate, this Court did not decide, and the accounting did not address any contract claims, whether express or implied, that Kids might have against Success and Premium as a result of inter-company transfers.

Finally, Nasser sought to expand the accounting to include a men's line produced under the John Deere brand and non-branded business produced overseas for Wal-Mart and conducted through Panther Trading International Limited. Nasser did not develop these issues sufficiently at trial, and the Post-Trial Opinion did not award any relief in these areas. Unlike the profits for the Fall 2005 season, which were addressed at least implicitly in the Post-Trial Opinion, the John Deere men's line and the Panther issues were barely touched on before the accounting. Nasser had his chance to litigate these claims. It is too late to raise them now.

5. Fine Does Not Owe Any Additional Amounts.

Fine was ordered to account for the Non-Branded Business. Post-Trial Order ¶ 3. As noted, the Dweck Group's accounting shows the Non-Branded Business generated a loss of \$152,998. Even with an additional \$97,227 in Fall 2005 profits, the Non-Branded Business still generated a net loss. Unlike the remainder of the Dweck Group, Fine was not ordered to account for the Stub Period or the Branded Business. *Id.* at ¶¶ 1-2. The additional amounts assessed against the Dweck Group arise from categories for which

Fine was not ordered to account, and Fine is therefore not liable for any additional damages.

B. Nasser's Accounting

As of January 1, 2006, Kids had \$18,166,511 in cash. As of December 31, 2008, Kids had \$832,414 in cash. Nasser was tasked with accounting for the flow of funds.

Nasser submitted as his "accounting" a three-page document that listed cash received, various categories of expenses, and a lump-sum amount for each category. The resulting flow of funds indeed totaled "exactly the amount of expenses . . . expended during the 2006-08 period." Defs.' Reply 9. Nasser claimed that the numbers were drawn from Kids' general ledger and trial balances, but his submission did not tie the categories to actual ledger accounts, expense entries, or trial balances.

Joseph Niyazov prepared Nasser's accounting. Niyazov served as Kids' controller after Bruce Fine, Kids' longstanding Chief Financial Officer and controller, left with Dweck, and after Kids went through several replacement controllers. Niyazov resigned in March 2011. Kids re-hired him to prepare the accounting at \$30 an hour and paid him approximately \$3,000.

Niyazov is not a certified public accountant, and his testimony revealed a pervasive lack of understanding of basic accounting principles and the corporate records he supposedly maintained. Niyazov admitted that he did not know the term "Generally Accepted Accounting Principles." Tr. 174. At trial, he testified that Kids had audited financial statements for 2006 and 2007, and he contended that the financial statements must have been maintained in accordance with generally accepted accounting principles

because Kids' accountants would have said something otherwise. *Id.* at 152. In fact, Kids did not have audited statements for either year. In 2006 and 2007, Kids had its statements reviewed. The cover letter from Mahoney Cohen & Company for the 2007 financial statements explained that "[a] review consists principally of inquiries of Company personnel and analytical procedures applied to financial data. It is substantially less in scope than an audit in accordance with auditing standards generally accepted in the United States of America" JX 145. Niyazov admitted that he did not understand the difference between an audit and a review. *Id.* at 152-53.

The Dweck Group identified \$4,171,143 in expenses on Nasser's accounting that were not attributable to (i) amounts previously established at trial, (ii) purchases from third parties, (iii) rent, (iv) expenses found on Kids' general ledger in accounts relating to Kids' business lines that were active during 2006-2008, and (v) expenses found on Kids' general ledger in accounts relating to a joint venture with Seabreeze Apparel. The Dweck Group contended that Nasser failed to carry his burden of proof with regard to these additional expenses.

The unsupported three-page "accounting" and Niyazov's testimony are wholly insufficient to carry Nasser's burden. To accept such evidence would require a leap of faith. The sketchy document, Niyazov's testimony, and his lack of qualifications inspire skepticism, not belief.

At trial, Kids' acting CEO Itzhak Djemal attempted to provide some support for Nasser's otherwise unsupported figures. Djemal tied \$1,604,462 in salary expenses to contemporaneous payroll records. Djemal also traced \$105,596 for samples to a

worksheet prepared by Niyazov generated by Kids' AS-400 accounting software. I credit these amounts as corresponding to legitimate expenses.

Otherwise, Djemal did not connect the figures in the accounting to Kids' general ledger or other credible documentation. He merely offered generalized explanations to the effect that yes, Kids incurred expenses in a particular category, or he speculated about the types of expenditures that might have been included. His testimony on these issues was not sufficient to carry Nasser's burden.

Nasser properly accounted for \$1,710,058 of the \$4,171,143 in unsupported expenses identified by Dweck. Nasser has not carried his burden to account for the remaining \$2,461,085. He is liable to Kids for this additional amount.

III. CONCLUSION

Dweck, Taxin, Success, and Premium are jointly and severally liable to Kids for an additional \$539,947.20. Nasser is liable to Kids for an additional \$2,461,085. Nasser's request for fee shifting is denied. Pre-judgment and post-judgment interest is due on all amounts at the legal rate, compounded quarterly. The parties shall submit a form of implementing order within two weeks of the date of this opinion. **IT IS SO ORDERED.**