

COURT OF CHANCERY  
OF THE  
STATE OF DELAWARE

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Case No. 5019-VCL



J. TRAVIS LASTER  
VICE CHANCELLOR

New Castle County Courthouse  
500 N. King Street, Suite 11400  
Wilmington, Delaware 19801-3734

December 1, 2009

Joel Friedlander, Esquire  
Bouchard Margules & Friedlander  
222 Delaware Avenue, Suite 1400  
Wilmington, DE 19801

Stephen E. Jenkins, Esquire  
Ashby & Geddes  
500 Delaware Avenue  
P.O. Box 1150  
Wilmington, DE 19899

Kenneth J. Nachbar, Esquire  
Morris Nichols Arsht & Tunnell LLP  
1201 North Market Street  
P.O. Box 1647  
Wilmington, DE 19899-1647

RE: Kurz, *et al.* v. Holbrook, *et al.*, C.A. No. 5019-VCL

Dear Counsel:

This is an expedited case in which I am scheduled to conduct a hearing on plaintiffs' application for a preliminary injunction in three days, *viz.*, on Friday, December 4, 2009. On November 29, defendant Crown EMAK Partners LLC ("Crown") moved to compel the production of documents and to take further deposition testimony. On November 30, the individual defendants joined in Crown's motion and filed their own motion to compel seeking other documents and depositions. I deny both motions.

## I. FACTUAL BACKGROUND

Because I shortly will be considering and expect to issue a written opinion ruling on plaintiffs' application for a preliminary injunction, I offer only a high-level sketch of the facts. More is not necessary to rule on the motions.

This case arises out of a contest for control of the board of directors of EMAK Worldwide, Inc. ("EMAK" or the "Company"). Stockholders operating through an entity called Take Back EMAK, LLC are currently soliciting consents to replace three of the six members of the EMAK board. Plaintiff Donald A. Kurz is a stockholder and director of EMAK who supports the Take Back EMAK consent solicitation. If the solicitation is

successful, Kurz and the three Take Back EMAK nominees will constitute a majority of the EMAK board.

Crown is a critical player in the drama. Prior to October 19, 2009, Crown held all of the issued and outstanding shares of the Company's Series AA Preferred Stock. This issuance did not have the right to vote in the election of directors, although it voted with the common stock on all other matters on an as-converted basis. When it voted, the Series AA Preferred Stock carried approximately 28% of the Company's total outstanding voting power.

On October 12, 2009, a stockholder allied with Kurz delivered a written consent to EMAK that initiated the consent solicitation. During a special meeting of the EMAK board on Sunday, October 19, over Kurz's objection, the board approved a transaction in which Crown exchanged its Series AA Preferred Stock for a new issuance of Series B Preferred Stock (the "Exchange Transaction"). Among other rights, the new Series B Preferred Stock votes on an as-converted basis with the common stock in the election of directors. The EMAK board set October 22 as the record date for the consent solicitation.

The overly simplified upshot of the board's actions on October 19 was to confer on Crown the right to vote 28% of the Company's total outstanding voting power in the Take Back EMAK consent solicitation. Prior to October 19, Crown did not have the right to vote in the solicitation.

On October 26, 2009, Kurz and SEMS Diversified Value, L.P., filed this action challenging the Exchange Transaction as a breach of fiduciary duty. The suit names as defendants Crown and the directors of EMAK other than Kurz. In the plaintiffs' injunction application, they seek an order preventing the Series B Preferred Stock from voting in the consent solicitation.

On October 30, 2009, I granted the plaintiffs' application for expedited proceedings and scheduled an injunction hearing for December 4. Since then, the parties have exchanged thousands of documents, taken at least twelve fact depositions, and exchanged expert affidavits and taken expert depositions.

On November 23, 2009, plaintiffs filed their opening brief in support of their injunction application. On November 24, plaintiffs sought my assistance with a discovery dispute. It turned out that in response to the filing of this litigation, EMAK's board commenced its own consent solicitation in which it sought to have stockholders ratify the Exchange Transaction. On Saturday, November 22, the defendants advised the

plaintiffs that they would be arguing to me that the Exchange Transaction had been ratified.

Recognizing that they would have the burden to prove full disclosure as a predicate to the validity of any potential ratifying effect, the defendants offered to provide the plaintiffs with their official written solicitation materials. The defendants refused to permit the plaintiffs to obtain discovery into any other types of communications with EMAK's stockholder base. The defendants took this position even though their consent solicitation materials prominently invited stockholders to call or email EMAK's primary outside counsel. As support, the defendants cited *Mainiero v. Microbyx Corp.*, 699 A.2d 320 (Del. Ch. 1997), which applied the settled principle that an inspector of elections counting proxies cannot contact a stockholder to obtain extrinsic evidence about how the stockholder intended to vote but rather must rule on the face of the card. From this quite different rule in a quite different context, the defendants leveraged an argument that discovery into communications with stockholders was irrelevant – or at least discovery into communications other than the official communications that the defendants wanted to provide. The defendants failed to consider or account for the cases which have turned on the Court's consideration of informal written or oral communications. *See, e.g., Portnoy v. Cryo-Cell Intern., Inc.*, 940 A.2d 43 (Del. Ch. 2008); *Hewlett v. Hewlett-Packard Co.*, 2002 WL 181091 (Del. Ch. Apr. 30, 2002).

I granted the plaintiffs' motion to compel and directed the defendants to produce the requested documents and three witnesses for deposition. I also shifted fees. I denied the defendants' request – made during the teleconference – to permit reciprocal discovery of Kurz. I noted that the defendants had put their own consent solicitation at issue by raising the ratification defense, but no one had asserted any claims against Kurz or articulated any reason why his or Take Back EMAK's solicitation activities should be explored.

On November 29, 2009, the defendants filed their answering briefs in opposition to the injunction application. Crown and the individual defendants filed separate briefs, resulting in 98 pages of combined briefing. In addition, Crown filed its motion to compel. On the next day, the individual defendants filed their own motion.

## II. ANALYSIS

Under Rule 26, “[p]arties may obtain discovery regarding any matter, not privileged, which is relevant to the subject matter involved in the pending action.” Ct. Ch. R. 26(b)(1). “Nevertheless, even where discovery is relevant, this court may narrow its scope to guard against ‘fishing expeditions’ or to ensure that the discovery sought is properly related to the issues presented in the litigation.” *Sokol Holdings, Inc. v. Dorsey*

*& Whitney, LLP*, 2009 WL 2501542, at \*9 (Del. Ch. Aug 5, 2009) (internal quotation omitted). Rule 26(b)(1)(iii) permits this Court to limit discovery that is “unduly burdensome or expensive, taking into account the needs of the case, the amount in controversy, limitations on the parties' resources, and the importance of the issues at stake in the litigation.” Ct. Ch. R. 26(b)(1)(iii). The rule vests the trial judge “with broad discretion to tailor discovery narrowly and to dictate the sequence of discovery.” *Sokol Holdings*, 2009 WL 2501542, at \*9 (internal quotation omitted).

#### **A. CROWN'S MOTION TO COMPEL.**

Crown seeks to conduct discovery into the relationship between Kurz and Take Back EMAK. Crown notes that Kurz's opening brief asserted that Take Back EMAK was formed “independently of Kurz.” Crown also cites Kurz's testimony regarding the limited scope of his involvement in Take Back EMAK activities. Crown contrasts these statements with Kurz's privilege log, which identifies communications between Kurz and John S. Kirkland, an attorney who represents Kurz and other members of the Schedule 13D group in litigation against EMAK in California. Some of the Section 13D group members are principals of Take Back EMAK. Crown notes that privilege was asserted during Kurz's deposition to block inquiry into these matters. Crown contends that the alleged conflicts in Kurz's testimony are relevant to his credibility and to the defendants' ability to defeat the injunction by invoking the equitable doctrine of unclean hands.

I do not believe that Kurz improperly invoked privilege for the entries that Crown identifies on Kurz's log. The communications are between Kurz and his counsel. The fact that other members of the Section 13D group were included on some communications does not take those communications outside the scope of Delaware Rule of Evidence 502(b) because the parties involved shared a common interest.

Having reviewed the testimony in question, I also do not believe that the conflict is as significant as the defendants claim. Regardless, Crown already devoted eight pages of its answering brief in opposition to plaintiffs' injunction application to addressing “Mr. Kurz's Hidden Involvement with TBE.” That section describes in detail the communications that appear on Kurz's privilege log and contrasts them with Kurz's statements and testimony. For purposes of Friday's hearing, the defendants' point has been ably made.

Equally important, in considering the injunction application, I will not be making final determinations of fact. Consistent with the familiar standard for a preliminary injunction, I will be making preliminary determinations. My task is to weigh the record as a whole. I will not be making a final determination as to whether Kurz mis-described

his involvement in an August 2009 request by Take Back EMAC for a special meeting of stockholders that never occurred.

I have also taken into account the stage of the case and the timing of the motion. I suspect a bit of “tit-for-tat” is at work, since plaintiffs filed their successful motion to compel the day after they filed their opening brief. But the two situations are different. The plaintiffs moved based on a ratification defense that the defendants made the tactical choice to assert. Crown is moving based on privilege logs it has possessed since November 11 and a deposition of Kurz that it conducted on November 17.

I therefore deny Crown’s motion to compel.

**B. THE INDIVIDUAL DEFENDANTS MOTION TO COMPEL.**

In addition to joining in Crown’s motion, the individual defendants have a motion of their own. They seek to reopen four depositions and to have me conduct an *in camera* review of the documents identified on the plaintiffs’ privilege logs, all before December 4. The motion throws about aggressive accusations of criminal conduct without factual support. The motion does not identify any effort by the individual defendants to meet and confer with plaintiff prior to bringing the motion, and the plaintiffs tell me none was made. The motion does not even provide me with the underlying requests for discovery, the responses to them, or the third party subpoena that it breezily mentions in passing.

In lieu of filing discovery requests and responses with the Court, Rule 5(d) makes the counsel who served the discovery its custodian. Rule 5(d)(3) provides that if discovery requests or responses are “to be used at trial or necessary to a pretrial or post-trial motion, the verbatim portions thereof considered pertinent by the parties shall be filed with the Court when relied upon.” The individual defendants have not complied with this rule. They have not given me anything except the plaintiffs’ privilege logs. This is no mere technicality. It is counsel’s obligation to provide the Court with a basis on which to rule in their clients’ favor. I deny the individual defendants’ motion in its entirety for failure to comply with Rule 5(d)(3).

I also reject individual aspects of the motion on their merits. I deny the motion to the extent it seeks to pierce the attorney-client privilege and obtain discovery under the crime-fraud exception. This aspect of the motion rests on conclusory accusations, unsupported by any facts. The individual defendants assert that upon “knowledge and belief, Plaintiffs have engaged in securities transactions while in possession of material, non-public information.” They also “believe that Plaintiffs and other persons associated with Plaintiffs have engaged in market manipulation.” They offer nothing – literally nothing – in support of these quite serious allegations. I will not grant a motion to

compel or permit discovery based on name calling. If the defendants have legitimate claims, they should bring them. If they have legitimate bases to seek discovery, they should articulate them.

I deny for similar reasons the defendants' requests for discovery into the plaintiffs' solicitation efforts. The individual defendants assert that "Plaintiffs have been involved in a campaign to appeal to EMAK employees and stockholders using a variety of inappropriate inducements and tools." To bolster this conclusory assertion, the individual defendants offer only that "upon Defendants' knowledge and belief," the plaintiffs made "offers of continued or new employment" to EMAK employees. Presumably the defendants seek to conjure the specter of vote buying, but they make no effort to identify specifics or to frame their vague assertions within any recognized legal doctrine. The individual defendants also have not filed a counterclaim in this case seeking to invalidate the consents that plaintiffs obtained or to enjoin their solicitation.

I likewise deny the plaintiffs' request for discovery based on the assertion that Take Back EMAK made automated telephone calls to EMAK stockholders which falsely represented that the Take Back EMAK consents were being solicited on behalf of the EMAK board. In a declaration, EMAK executive Teresa L. Tormay avers that one such call was transcribed as follows:

Hello. I'm calling on behalf of the shareholders for the Take Back EMAK. You should have recently received a mailing for those investors who are here to return the white consent card that was mailed to you. The shareholder group for Take Back EMAK is asking that you consider the new information provided with the white consent card that you received and support their efforts to Take Back EMAK by signing, dating and mailing the white consent card. You have until December 21, 2009. However, the Board is asking that you return the signed and dated consent card as soon as possible. If you have not received the white consent card we ask that you contact your broker and instruct them to fill out and return the white consent card on your behalf before the new deadline date of December 21, 2009. For any questions, please contact D.F. King, which is assisting the shareholder group in its effort to Take Back EMAK at 1-800-769-4414. Thank you.

Tormay Aff. ¶ 12. Without citing or providing me with any discovery request calling for the information, the defendants tell me that they "should be permitted to explore in discovery these communications as well as the existence of any other similar communications...." Motion ¶ 3.

As with the request for discovery into the alleged inducements, the defendants have not asserted a claim to which this discovery could relate. If the defendants believe that this automated call could entitle them to an injunction or other relief against the Take Back EMAK solicitation, whether under *Empire Southern Gas Co. v. Gray*, 46 A.2d 741 (Del. Ch. 1946), or otherwise, they know how to file a claim and seek relief. They have not done so.

Rather than asserting claims, the individual defendants fall back on the defense of unclean hands. Pervading the individual defendants' motion is the implicit theme that I am refereeing the entire consent solicitation process. I am not. The plaintiffs have filed a complaint asserting colorable claims against the Exchange Transaction. The defendants have not filed any counterclaims. On Friday, I will consider an application for a preliminary injunction based on the plaintiffs' claims. The defendants have not sought relief against the plaintiffs' solicitation. Although they raised unclean hands in their answer, they did so in conclusory fashion without providing any supporting allegations. The rote recitation of an unclean hands defense is not a free pass to conduct discovery of a plaintiff. This is particularly so given the timing and manner in which the motions were filed.

I do not believe that further discovery into the automated call is warranted at this time on the basis of an unclean hands defense. Recall that in an effort to moot this litigation, the individual defendants commenced their own consent solicitation. The statement that the defendants cite – “the Board is asking that you return the signed and dated consent card as soon as possible” – refers to that consent solicitation. As the defendants note in their answering brief in opposition to the plaintiffs' injunction application, the Board's written consent materials ask EMAK stockholders to return the Board's consent “as soon as possible.” The call taken as a whole makes clear that Take Back EMAK is conducting the solicitation and asking stockholders to return the Take Back EMAK consent card. The questionable probative value of discovery into the call is far outweighed by its minimal relevance and the burden that it would impose at this stage of the proceedings. I therefore deny this aspect of the motion.

Finally, the individual defendants challenge the plaintiffs' assertions of privilege. According to the motion, the plaintiffs' privilege logs suggest a pattern of asserting privilege for communications that were merely copied to an attorney, regardless of whether the document in fact satisfied the requirements for the privilege. The defendants ask me to take matters in my own hands by conducting an *in camera* review. While I agree that an automatic assertion of privilege for any document copied to a lawyer would be improper, the motion is untimely. In an expedited proceeding like this one, a motion

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to compel on this point should have been brought promptly after the privilege logs were provided to the defendants on November 11.

I further believe the probative value of the communications at this stage of the case would be slight. Against this is the significant burden I would bear in conducting an *in camera* review of hundreds of documents prior to Friday. I will not undertake this step when the individual defendants should have moved with greater alacrity. But as to this privilege issue, in the post-injunction hearing phase of this litigation, the individual defendants should feel free to pursue these points with the plaintiffs. If counsel are unsuccessful in their efforts to meet and confer, the defendants may renew their motion.

Sincerely yours,

*/s/ J. Travis Laster*

J. Travis Laster  
Vice Chancellor

JTL/krw