IN THE SUPERIOR COURT OF THE STATE OF DELAWARE

ISN SOFTWARE CORPORATION, Plaintiff, v. RICHARDS LAYTON & FINGER, P.A., RAYMOND J. DICAMILLO and MARK J. GENTILE, Defendants.	)	C.A. No: N18C-08-016-MMJ [CCLD] TRIAL BY JURY OF TWELVE DEMANDED

Factual Summary

I. STATEMENT OF FACTS

RLF has represented ISN in various corporate matters since 2008.[1] In 2012, ISN requested Advice from RLF regarding converting from a C-Corp to an S-Corp.[2] ISN was aware that to convert from a C-Corp to an S-Corp, all stockholders of ISN must be S-Corp qualifying stockholders.[3] At that time, four of its eight stockholders were not S-Corp qualifying.[4] ISN had saved and put more than $34 million in a

[1] *Compl*. ¶ 5.
[2] *Id*. ¶¶ 6-10.
[3] *Id*.
[4] *Id*.

reserve fund (the "Buyout Fund") to buy back as many shares of its stock from these non-qualifying stockholders as possible.[5] ISN requested that RLF advise it of its options to buy back its own shares of stock from these stockholders in furtherance of becoming an S-Corp.[6]

RLF advised ISN that it could engage in a cash-out merger of some or all non-qualifying stockholders.[7] The cashed-out stockholders would have the option of accepting ISN's cash offer for their shares or they would be able to exercise appraisal rights under Delaware law.[8] RLF informed ISN that, should the stockholders exercise their appraisal rights, the Delaware Court of Chancery would decide the price per share at the conclusion of an appraisal action.[9] The four non-qualifying stockholders collectively held 900 shares of ISN stock.[10] One stockholder, Stockholder D, held 544 shares alone.[11]

ISN believed that simultaneously cashing out all four non-qualifying stockholders via a cash-out merger would be too financially risky.[12] Should all four stockholders exercise their appraisal rights, the Court of Chancery may issue an

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[5] *Id*.
[6] *Id*.
[7] *Id*. ¶¶ 11-17.
[8] *Id*.
[9] *Id*.
[10] *Id*.
[11] *Id*.
[12] *Id*.

appraisal value that might exceed ISN's Buyout Fund.[13] Understanding ISN's concern, RLF developed a cash-out merger designed to cash-out three of the four non-qualifying stockholders at $38,317 per share, which both RLF and ISN believed to be a generous and equitable price per share.[14] RLF advised ISN that this plan reduced ISN's appraisal risk.[15]

RLF advised ISN that under this plan, only three cashed-out non-qualifying stockholders would obtain appraisal rights and Stockholder D, the fourth non-qualifying stockholder, would remain a stockholder of the company and would not receive appraisal rights (*i.e.*, the "Bad Advice").[16] As reflected in ISN's Board minutes from January 9, 2013, ISN's Buyout Reserve held sufficient funds to potentially buy out all 900 shares at $38,317 per share, but the financial risk of such a gambit was unacceptable. Therefore, ISN accepted the RLF advice, and on January 9, 2013 ISN proceeded with the cash-out merger of three non-qualifying stockholders with RLF's assistance.[17]

On January 15, 2013, RLF realized that it gave incorrect advice to ISN regarding who would receive appraisal rights.[18] The cash-out merger gave ***all four***

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[13] *Id*.
[14] *Id*.
[15] *Id*.
[16] *Id*.
[17] *Id*. ¶¶ 20-22.
[18] *Id*. ¶ 23.

of the non-qualifying stockholders appraisal rights.[19] RLF notified ISN of its error on January 15, 2013 and informed ISN that it had two options: (1) RLF could make efforts to revoke the merger and expunge the record; or (2) ISN and RLF could move forward with the merger and vigorously defend against any appraisal actions that might possibly be brought by one or more of the non-qualifying stockholders.[20]

RLF expressly advised ISN that seeking to revoke the merger and expunge the record was not the best option.[21] RLF advised ISN that it should move forward with the merger and **that it should allow RLF to defend ISN against any appraisal actions brought by the non-qualifying stockholders.**[22] RLF advised ISN that, given RLF's expertise, it could very well achieve a result whereby ISN would spend less than the Buyout Reserve to purchase all 900 shares.[23] ISN accepted RLF's advice to move forward with the merger.[24] On January 16, 2013, all four non-qualifying stockholders were informed of their appraisal rights.[25]

On January 17, 2013 (the next day), Stockholder A, which held 155 shares, accepted the cash merger consideration of $38,317 per share.[26] The fact that

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[19] *Id.*
[20] *Id.* ¶ 24.
[21] *Id.*
[22] *Id.* ¶¶ 24, 26.
[23] *Id.* ¶ 26.
[24] *Id.*
[25] *Id.* ¶¶ 25-26.
[26] *Id.*

Stockholder A accepted the $38,317 so quickly indicated that Stockholder A believed $38,317 per share overvalued ISN. If Stockholders B, C and D accepted the cash merger consideration of $38,317 per share, then the total amount that ISN would have to pay would be $34,485,300, which was within the Buyout Reserve. Given this information, RLF told ISN that if any stockholders sought appraisal, it was highly possible that the Court of Chancery might appraise ISN's shares below the cash merger consideration price, ***which would result in ISN spending less than it had put in the Buyout Reserve***.[27]

On January 30, 2013, Stockholders B, C and D, which collectively held 745 shares, all preliminarily indicated that they ***might*** seek appraisal on their shares. This preliminary indication could have been withdrawn at any time over the following ninety days.

Between January 15, 2013 and February 13, 2013, RLF continued to communicate to ISN that they should work together to reach the best possible outcome.

On February 13, 2013 and in anticipation that ISN would retain RLF to represent it in the potentially ensuing appraisal actions, RLF sent ISN a draft conflict consent agreement letter (the "Consent Letter"), which ISN amended and RLF

[27] *Id*. ¶¶ 26-28.

reviewed internally.[28] After some negotiation, a final version of the Consent Letter was prepared. In the final version of the Consent Letter, RLF states that its continued representation of ISN created a "***potential conflict***"[29] because "litigating issues arising from a law firm's prior legal work may generate a conflict of interest[.]"[30] The Consent Letter further states that "there ***may be*** an issue" concerning RLF's prior advice as to "the availability of appraisal rights in connection with the merger[.]"[31] However, RLF advised that it believed "the availability of appraisal rights is ***not likely to be at issue in an appraisal proceeding***."[32] RLF added that it did "not believe that [its] commitment, dedication, and ability to effectively represent the Company's interests will be adversely affected by our own interests, and we believe that we will be able to provide the Company with competent and diligent representation."[33] RLF concluded the Consent Letter by stating that neither "ISN's consent nor any other provision of this letter constitutes a waiver or release of ***potential*** causes of action the Company may have against the firm, ***if any***."[34]

Because RLF knew that ISN had a large Buyout Reserve and because RLF advised that (a) the availability of appraisal rights was not likely to be an issue, (b)

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[28] *Id*. ¶ 26.
[29] All emphasis supplied in unless otherwise noted.
[30] *See* Exhibit A to the Complaint.
[31] *Id*.
[32] *Id*.
[33] *Id*.
[34] *Id*.

that they could effectively represent ISN's interests, and (c) ISN preserved its right to sue RLF if, at the conclusion of any appraisal proceeding, ISN was damaged, ISN and RLF jointly executed the Consent Letter and ISN continued to retain RLF for the potential appraisal litigation.[35] In March 2013, Stockholders B, C, and D perfected their appraisal rights, and in April 2013 the appraisal action commenced.[36]

Over the next three and a half years, RLF represented ISN in the appraisal action and continued to advise ISN optimistically that it would likely spend less than the amount it had in the Buyout Reserve to buy back these shares.[37] ISN had no reason to disbelieve RLF, especially when RLF's expert Daniel Beaulne of Duff and Phelps valued ISN at $29,360 per share.[38] At $29,360 per share, the cost to purchase all 900 shares would have been $27,812,335.[39] ISN's hopes were further buoyed when, during discovery, RLF learned that, in late 2012, the non-qualifying stockholders had been trading ISN stock amongst themselves for about $20,000 per share. At $20,000 per share, ISN could buy back all 900 shares for about $20 million. Based on RLF's assurances and information learned during discovery, ISN

[35] *Compl.* ¶ 26.
[36] *Id.* ¶ 27.
[37] *Id.* ¶ 28-29.
[38] *Id.*
[39] *Id.*

remained optimistic. ISN had not been injured and it appeared more likely than not that ISN would not be injured.

On August 11, 2016, the Court of Chancery issued its opinion valuing ISN at $98,783 per share – more than $67 million over and above ISN's Buyout Reserve.[40] This was the first date upon which ISN had any reason to believe that RLF's Bad Advice regarding appraisal rights would lead to actual, non-speculative damages above its Buyout Reserve. Even then, it was not guaranteed that ISN would be injured because RLF intended to appeal.[41] RLF advised that the Court of Chancery opinion would likely be overturned by the Supreme Court. The Delaware Supreme Court, however, affirmed the Court of Chancery's opinion on October 30, 2017.[42]

A. ISN's Malpractice Claim Did Not Accrue Until the Court of Chancery Issued its Appraisal Opinion on August 11, 2016 – at the Earliest

A plaintiff bringing a legal malpractice claim must establish the following elements: a) the employment of the attorney; b) the attorney's neglect of a

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[40] *Compl.* ¶ 29. The Court also awarded stockholders B, C, and D pre- and post-judgment interest. $67,883,990.00 grossed up for income tax consequences that would have a direct effect on ISN puts ISN's total damages at $107,752,365.00.
[41] *Id.* ¶ 30.
[42] *Id.*

professional obligation; ***and c) resulting loss***.[43] As to the last element, "an attorney must cause more than speculative damage to a plaintiff."[44] Even when proven or obvious, "[t]he mere breach of professional duty, causing only ... ***speculative harm, or the threat of future harm—not yet realized—does not suffice to create a cause of action for negligence[.]***"[45] Damages are speculative when there is merely a possibility rather than a reasonable probability that an injury exists.[46]

This Court's recent decision in *Young Conaway Stargatt & Taylor, LLP v. Oki Data Corporation* demonstrates when a legal malpractice claim accrues under Delaware law. Oki Data Corporation allegedly infringed upon some patents and hired Young Conaway Stargatt & Taylor, LLP ("YCST") to defend them.[47] As to one specific patent, the "690 Patent," Oki Data was originally accused of infringing all 16 claims of the patent.[48] As the case progressed, the patent holder only chose to proceed on claims 1, 2, 5, 6, 9, 10, 13, and 14 at a United States International Trade Commission hearing ("ITC hearing").[49] YCST planned to defend against these

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[43] *Id*.
[44] *Id*.
[45] *Id*.
[46] *Schueller v. Cordrey*, 2017 WL 3635570, at *6 (Del. Super. Aug. 23, 2017) *aff'd*, 2018 WL 4696979 (Del. Sept. 28, 2018).
[47] *Young Conaway Stargatt & Taylor, LLP v. Oki Data Corp. et al.*, 2014 WL 4102139, at *1-3 (Del. Super. Aug. 1, 2014).
[48] *Id*.
[49] *Id*.

claims using expert testimony offering an "on-sale defense."[50] Just prior to the expert's deposition on March 10, 2010, YCST withdrew their defense as to claims 2, 6, 10, and 14 because it had given the expert incorrect advice, which made his opinion incorrect and irrevocably tainted.[51] The matter proceeded before an Administrative Law Judge ("ALJ") between May 17, 2010 and May 25, 2010.[52] Thereafter, on September 23, 2010, the ALJ ruled against Oki Data, finding that Oki Data infringed upon plaintiff's patents.[53]

In response to a breach of contract claim brought by YCST against Oki Data for failure to pay legal fees, Oki Data countersued YCST on May 7, 2013 alleging legal malpractice.[54] YCST moved for summary judgment arguing that the three-year statute of limitations began running on March 10, 2010 (when YCST and Oki Data became aware of YCST's incorrect advice) and that Oki Data's claim was time-barred.[55] Oki Data responded that the "continuous representation rule" tolled the

[50] *Id*.
[51] *Id*.
[52] *Id*.
[53] *Id*.
[54] *Id*.
[55] *Id*.

statute of limitations until YCST's representation ended, which was at some point in early 2011.[56]

This Court held that: "While [it] is not willing to stretch the statute of limitations to the degree argued by [Oki Data], ***whether the alleged errors would constitute malpractice could not have been ascertained until the ALJ decision was issued***."[57] The Court concluded that Oki Data's malpractice claim did not accrue until the ALJ issued its opinion on September 23, 2010, finding that Oki Data had infringed upon the patents.[58] Oki Data, therefore, timely filed its malpractice counterclaim on May 7, 2013.[59]

Until the Court of Chancery issued its appraisal action opinion on August 11, 2016, it was not only impossible to ascertain whether ISN would suffer damages from RLF's Bad Advice, it was impossible to ascertain whether ISN would benefit from RLF's Bad Advice. Indeed, RLF expressly acknowledges this fact in the Consent Letter, in which RLF states that "ISN's consent nor any other provision of this letter constitutes a waiver or release of potential causes of action the Company may have against the firm, ***if any***."

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[56] *Id*. *See In re Kaiser Grp. Int'l Inc.*, 2010 WL 3271198, at *3 (Bankr. Del. Aug. 17, 2010) (The continuous representation rule "tolls the statute of limitations until the attorney ceases to represent the client in the matter.")
[57] *Oki Data Corp.*, 2014 WL 4102139, at *1-3.
[58] *Id*.
[59] *Id*.

The last sentence of the Consent Letter and, in particular, the last two words of the last sentence may be the most important part of the document. By including "***if any***," RLF explicitly recognized at the time of the Consent Letter that, even though they had given the Bad Advice, there was no actionable legal malpractice claim. A legal malpractice claim would only exist ***if any*** damages resulted from the Bad Advice. As of February 14, 2013, it was uncertain whether or not any stockholders would seek appraisal. The only way that ISN could suffer damages because of RLF's Bad Advice would be if: (a) one or more of the stockholders pursued appraisal litigation; and (b) the Court of Chancery valued ISN's shares significantly higher than RLF deemed possible.

B. RLF's Refusal to Provide ISN with its Entire File Precludes Dismissal

RLF asserts that, despite not having suffered any damages in 2013, ISN had actual notice of a claim against RLF and no tolling exception can "possibly apply." RLF further argues that ISN "failed to plead any facts that would support tolling" in its complaint. RLF acknowledges that, if RLF committed fraud, that would toll the statute of limitations, writing "claims of concealment require an affirmative act of concealment by a defendant – an actual artifice that prevents a plaintiff from gaining knowledge of the facts or some misrepresentation that is intended to put a plaintiff off the trail of inquiry."

As this Court knows, RLF has refused to provide ISN's entire file, despite ISN's repeated requests. As demonstrated in ISN's opposition to RLF's Motion to Stay Discovery and in ISN's Motion to Compel, a client of a Delaware attorney is entitled to both its external file (*e.g.*, court filings and communications between attorney and client) and its internal file (*e.g.*, internal communications, memoranda, notes, etc.). RLF has not provided any internal files nor has it denied that they exist.

RLF admits that fraudulent concealment is grounds for tolling the statute of limitations but wants this Court to dismiss ISN's claims without ever giving ISN a chance to determine whether RLF fraudulently concealed anything. Given the ethical duties requiring RLF to tender ISN's entire file, ISN should not now be forced speculate what might be in the files that RLF is fighting so hard to hide. At this stage, the Court should expect the worst and that ISN's entire file demonstrates that RLF fraudulently concealed material information concerning its representation of ISN. For example, it should be inferred that RLF's advice to continue with the merger was self-serving and nothing more than an effort to delay until the statute of limitations expired.[60]

[60] Under the theory of equitable tolling, "the statute of limitations is tolled for claims of wrongful self-dealing, even in the absence of actual fraudulent concealment, where a plaintiff reasonably relies on the competence and good faith of a fiduciary." *Caspian Select Credit Master Fund Ltd. v. Gohl*, 2015 WL 5718592, at *14 (Del. Ch. Sept. 28, 2015). A plaintiff's complaint does not need to plead equitable tolling. It must only "plead facts that support the existence of equitable tolling." *Seiden v. Kaneko*, 2015 WL 7289338, at *8 (Del. Ch. Nov. 3, 2015)..

Contrary to RLF's assertions, ISN pled that RLF refused to provide it with the entire file despite numerous requests. Arguably, RLF's refusal to tender the entire file is, in itself, fraudulent concealment worthy of tolling the statute of limitations.

C. Delaware Public Policy Strongly Supports Adjudicating ISN's Claims on the Merits

Aside from the axiomatic principle that Delaware public policy favors deciding cases on the merits, the Court should consider all of the ramifications and repercussions of the bright line rule that RLF is advocating. RLF asks this Court to hold that, as a matter of law, ISN was required to file a legal malpractice action within three years of the date that RLF misstated or misapplied Delaware law. RLF gave the Bad Advice in January 2013, and the Court of Chancery did not issue its appraisal opinion until August 2016 – over three and a half years later.

According to RLF, ISN would have had to file a malpractice action sometime before January 2016, while the appraisal litigation was still ongoing. Theoretically, under RLF's application of the statute of limitations, ISN could have filed a lawsuit the very next day after receiving the Bad Advice. Given that there would be no damages at that point, it is unclear exactly how RLF contends that ISN could have litigated its malpractice claim. ***At best***, the only viable option would be for the Court to stay ISN's lawsuit to wait and see if any damages materialize. Judicial economy and common-sense weigh strongly against this possibility.

Otherwise, if the Court did not stay the unripe malpractice action, it is possible that the malpractice action resolves before the "injured party" even knows whether it will be damaged. Here, if ISN filed a malpractice action in January 2013 and the Court forced the action to proceed under some theory that ISN could potentially recover nominal damages, that type of lawsuit could easily have been fully adjudicated before the Court of Chancery issued its opinion in August 2016. Under RLF's application of the statute of limitations, ISN would have no remedy for its actual damages. It cannot be that the tortfeasor gets to benefit from the delay between their misfeasance and the harm.

Worse, if ISN were forced to file a legal malpractice action on the timeline RLF advocates, ISN would have been forced to take contradictory positions in the malpractice action and the ongoing appraisal action. ISN, on the one hand, would have been forced to argue in the Superior Court malpractice action that ISN was worth significantly more than $38,317 per share. At the same time, ISN would have been forced to argue in the Court of Chancery appraisal action that ISN was worth $38,317 per share or less. This would be inefficient and unduly prejudicial to ISN.

"Statutes of limitations are intended to prevent enforcement of stale claims and are based on reasons of sound policy ... intended to exact diligence."[61] Nothing

[61] *Brooks v. Savitch*, 576 A.2d 1329, 1334–35 (Del. Super. 1989) (citing *Bovay v. H.M. Byllesby*, 29 A.2d 801 (Del. Ch. 1943)).

about RLF's proposed application supports either the policy of preventing the enforcement of stale claims or exacting diligence. Law firms are already held to a higher standard in terms of retaining files and safekeeping their clients' property,[62] minimizing the risk that they will have discarded their files after only three years. Here, not only does RLF still have the files but they are keeping them under lock and key, refusing to provide copies for ISN. In terms of diligence, ISN has acted appropriately by seeking to mitigate any possible damages through the appraisal litigation, attempting to resolve this dispute informally, and then filing this action when those efforts failed. No reasonable public policy argument can be made in support of dismissing ISN's claims.

RULING GRANTING MOTION TO DISMISS IS ATTACHED

[62] *See, e.g.*, Delaware Lawyers' Rules of Professional Conduct R. 1.15.