

IN THE CIRCUIT COURT FOR MONTGOMERY COUNTY, MARYLAND

RAYMOND SCHETTINO, et al.,	*	
Plaintiffs,	*	
vs.	*	Civil No. 220156
NADER MODANLO, et al.,	*	
Defendants/Third Party Plaintiffs,	*	
vs.	*	
MICHAEL AHAN,	*	
Third Party Defendant.	*	

OPINION AND ORDER

This matter comes before the Court, most recently on Third Party Plaintiff – Nader Modanlo’s (Modanlo) Motion to Reconsider Ruling on Post-Trial Motions. The opposition of the Third Party Defendant and Counter Plaintiff, Michael Ahan (Ahan), was presented orally at the hearing on the December 21, 2004.

Because of the number and the complexity of the issues raised in Modanlo’s Motion for Judgment Notwithstanding Verdict (JNOV), after reading the motion to reconsider, the Court agreed to entertain further argument on a limited issue. At the conclusion of the hearing, the Court took the matter under advisement. For reasons set forth below, those previously set forth in Ahan’s Opposition to the Motion for JNOV and those presented at argument on the motion for reconsideration, the Court shall deny the Motion to Reconsider.

Many significant issues are raised in the JNOV and the motion to reconsider. Time, however, does not permit the Court to address each in writing. In this Opinion, the Court will focus on the principal question addressed at the hearing: whether Ahan, a stockholder of Final Analysis, Inc. (FAI), has standing to maintain an action individually against Modanlo for an injury suffered by the corporation. Given the limited issue, the Court will not set forth the facts of this case in great detail. The Court will only set forth those facts relevant to an understanding of the decision reached herein.

FACTS

Initially, certain shareholders of Final Analysis Communication Systems (FACS) brought a derivative action for fraud and related claims against the company's president and chairman of the board, Nader Modanlo. In response, Modanlo brought a third party action against Ahan and others for contribution and indemnity. Ahan in turn filed a counterclaim against Modanlo that included claims for breach of contract and breach of fiduciary duty. Certain of Modanlo's third party claims against Ahan and Ahan's counterclaims against Modanlo were severed from FACS' derivative claims for a separate trial. The derivative claims were tried first, June 16 to July 1, 2003. The claims at issue here were tried between October 4 and 22, 2004. Following the trial of the instant claims, the jury awarded Ahan approximately \$104 Million Dollars in damages on each of the two counts against Modanlo, breach of contract and breach of fiduciary duty. The parties agreed that the injury was the same under both claims, so there could only be one recovery.

The claims between Ahan and Modanlo individually arose out of the interest they held in two corporations, FAI and FACS. They each owned 50 percent of all the outstanding

shares of FAI. FAI in turn owned a controlling interest in FACS and all of the voting stock. FACS was created to establish a low earth orbit satellite communication system. FAI provided the engineering and related services necessary to design, test and construct the satellites needed to operate the system.

Because neither stockholder owned a majority of the stock of FAI, each exercised negative control over the company and, in turn, over FACS. Initially, this negative control presented few, if any, difficulties. The parties shared a common vision for the companies and were in agreement on all significant issues. However, as time passed and the number of decisions to be made increased, it became increasingly difficult to reach agreement on all issues of importance to the companies. Absent unanimous agreement, the companies could not act. This eventually led the parties to recognize that the existing arrangement threatened the companies' very existence.

Recognizing the danger, Modanlo and Ahan entered into an agreement to attempt to restructure FAI and FACS in such a way as to break the impasse and yet preserve their respective investments in both companies. The initial agreement was set forth in a Memorandum of Agreement dated April 19, 1999. This in turn led to the adoption of a Shareholders' Agreement, October 3, 1999. It is this agreement which Ahan alleges Modanlo breached.

In the Memorandum of Agreement, Ahan and Modanlo acknowledged that both parties were presently involved in the day-to-day operations of both companies. They expressed the desire to establish two independent companies to separately and independently operate the business of FAI and FACS. Ahan would operate one and Modanlo the other. While some steps that might be taken to achieve this objective were set out in the

Memorandum of Agreement, no precise method was agreed upon. The parties expressly agreed that the Memorandum of Agreement was not binding, except insofar as to require them to use good faith efforts to achieve their objective.

In furtherance of that goal, six months later the parties entered into the Shareholders' Agreement. Up to this point, the parties had been unable to agree on what form the restructuring would take. To resolve the matter, they agreed that they would submit the competing proposals on the restructuring to a third party, the FACS Board, and would be bound by their decision. To accomplish this, they executed irrevocable proxies to that Board authorizing them to exercise the parties' votes as 100% shareholders of FAI. They further agreed that neither party would "use his powers as an officer of FAI to harm or prejudice the other's rights as an officer and shareholders of FAI" (Shareholders' Agreement, Ex. C).

Ahan alleges that Modanlo violated this provision, as well as a general obligation to act in good faith and fair dealing, by using his power as Chairman and President of FAI to conspire with and/or direct the companies' corporate counsel, Grammas, to undertake numerous actions which were designed to destroy Ahan's interest in both companies. Ahan maintained that these acts not only breached the contract but also a fiduciary duty that Modanlo owed directly to Ahan. The Court has previously ruled that because both Ahan and Modanlo were 50 percent shareholders of FAI and because of Modanlo's position in the companies, he owed a fiduciary duty directly to Ahan separate and apart from the fiduciary duty he owed to the corporations.

Ahan maintains that as a result of Modanlo's actions, the restructuring became impossible. FACS was forced to pursue litigation in an attempt to establish who controlled the company. This made it impossible for the company to engage in ongoing business. As

well, it made it impossible for FACS to go forward with a planned public offering to obtain funds it desperately needed to survive. Without those funds, FACS' work on the satellite communication system came to a halt. This in turn led FAI to declare bankruptcy. Ahan claimed that as a result of Modanlo's actions, Ahan's shares in FAI and his beneficial interest in FACS became worthless. He presented expert testimony that the value of those shares, but for the acts alleged, would have been hundreds of millions of dollars. Accordingly, he maintained that he was entitled to recover those lost profits as damages for the breach of contract or in the alternative the breach of the independent fiduciary duty.

The jury agreed. Although the trial took more than a week, the jury took only a few hours to find that Modanlo was liable to Ahan for both breach of contract and breach of fiduciary duty. They awarded damages to Ahan in the amount of \$103,930,000.

Following the verdict, Modanlo filed a timely Motion for JNOV. Plaintiffs filed an opposition thereto. Both sides presented extensive memoranda in support of their respective positions. After hearing argument and considering the memoranda, the Court denied the motion. The Defendant now seeks reconsideration of that decision.

ANALYSIS

As previously noted, while many issues are raised in the motions, the Court limited argument at the hearing on the motion to reconsider to one. Initially, the issue was framed as whether the judgment violated the "one recovery" rule in light of FAI's settlement with Modanlo ostensibly of the same claim. Consideration of that issue quickly turned to whether Ahan, a stockholder, had standing to bring any claim against Modanlo for an injury to FAI/FACS.

Both sides cite as authority *Waller v. Waller*, 187 Md. 185 (1946), the seminal case in Maryland on this issue. Modanlo, focusing on the nature of the injury, argues that Ahan has no standing. In his view, *Waller* holds that where a stockholder suffers no injury distinct from that suffered by the corporation he cannot recover against a director for an injury to it. Ahan insists he does have standing. He focuses on the duty underlying the claim. He argues *Waller* stands for the proposition that where a duty to the stockholder exists independent of the duty that the director owes to the corporation, the stockholder may bring an action against the director for the breach of that duty, even though the company suffers the same or similar injury as the shareholder.¹ Modanlo urges the Court to read *Waller* carefully before deciding whether to reconsider its earlier ruling on this issue.

Support for both positions can be found in the language of that opinion. In *Waller*, suit was brought by an officer/shareholder of the M. Waller Corporation against his brother, the secretary and sales manager of the company and other directors. The plaintiff sought to recover damages for the decrease in the value of his stock. He alleged that while he was president and general manager, the defendant and other directors devised a plan to ruin him financially by depressing the value of the stock and seizing control of the company. The plaintiff appealed from the trial court's grant of a judgment on demurrer in favor of the defendants. The trial court acted based on the general rule that only a corporation can bring an action at law for an injury done to it, even though the injury indirectly or incidentally results in diminishing or destroying the value of the stock.

¹ Ahan seems to acknowledge, however, that under certain circumstances the shareholder could be precluded from exercising this right by application of the "one recovery" rule. That is, both the corporation and the stockholder may not recover damages for the same injury. However, they argue that that rule has no application here since the corporation did not recover for its injury. FAI settled any and all claims that it might have against Modanlo without Modanlo acknowledging any liability, for the sum of \$250,000.

In affirming the trial court, the Court of Appeals observed that the reason for the rule is that the cause of action for the injury to the corporation is in the corporation and such an injury is not primarily or necessarily a damage to the stockholder. They noted that the rule is advantageous for two reasons. First, it avoids the possibility of a multiplicity of lawsuits by affected stockholders. Second, any damages recovered would first be available to pay any debts of the corporation and only thereafter for the shareholders in proportion to their shares.

In arriving at its decision, the Court opined that the rule did not bar a stockholder from bringing suit against an officer or director of a corporation for a violation of duties owing to the corporation if the acts also violated a contract or duty “owing directly from the officer to the injured shareholder ...” 187 Md. at 192. The Court cited a number of cases in support of that principle.

In *Waller*, the court found there was no such duty owing directly to the plaintiff. The only duty alleged to have been violated was that which the defendants owed to the corporation. While the law recognized such a duty to the corporation, it did not give rise to a separate duty flowing directly to the shareholders. There was no privity or immediate connection between the directors and the stockholder. Accordingly, no individual action by the stockholder would lie.

Modanlo points to the *Waller* court’s discussion of the nature of the injury and the reasons for the rule to support its argument that the injury must be the focus of the analysis in determining whether a cause of action will lie. Ahan points to the court’s language about the nature of the duty to argue that the duty owed must be the focus of the analysis. In *Waller*, under either analysis the same result is reached. The only injury claimed was to the corporation. The only duty was that which was owed to it as well. In order to determine

which analysis controls when they lead to different results, it is necessary to look at those cases cited in *Waller* for the proposition that an individual action by a shareholder is not always barred.

One such case is *General Rubber Co. v. Benedict*, 215 N.Y. 18, 109 N.E. 96 (1915). General Rubber Co. (GRC) owned all but 18 shares of a subsidiary, General Rubber Co. of Brazil (GRB). The subsidiary faced competition from the Moju Company. The defendant was a director of GRC but had no similar relationship with GRB. He also owned 25 percent of Moju. The general manager of GRB, who also held an interest in Moju, improperly diverted approximately \$185,000 of GRB's monies to Moju. GRC filed suit against the defendant alleging that he was aware of the misappropriation of GRB's monies and acquiesced in and approved it. Further, he concealed that information from GRC. General Rubber brought suit against the defendant for \$185,000, the decrease in the value of its shares in GRB.

In a four to two opinion, Cardozza, J. writing for the majority, the Court of Appeals of New York held that an action by the shareholder, General Rubber, would lie. The Court observed that generally a shareholder cannot maintain an action against a third party for an injury done to a corporation, even though that injury results in a devaluation of the shares. However, they opined that "the principle has no application where the wrongful acts are not only wrongs against the corporation, but are also violations by the wrongdoer of a duty arising from contract or otherwise, and owing directly by him to the stockholders." 215 N.Y. at 22.

The Court reasoned that since the defendant was a director of GRC, the plaintiff, he owed a duty directly to it. The duty was to use reasonable care to protect the plaintiff's property, including its investment in GRB. A violation of that duty rendered the defendant

liable to the plaintiff for the harm done to GRB. In arriving at its decision, the Court stated that the fact that the plaintiff was a corporation and owned almost all of the shares of GRB made no difference. The result would have been the same if the plaintiff was an individual and was one of many stockholders.

The two judges that dissented arrived at the opposite result analyzing the case by the nature of the injury. They reasoned that since the injury was suffered primarily by GRB, the action could only be brought by that company. It could not be maintained by a shareholder who is injured only indirectly. They explained:

There was but a single loss, although that loss may indirectly and collaterally affect the creditors and stockholders.... A single recovery by the Brazil company would afford complete indemnity to the plaintiff and all interested parties. Each of the Brazil company and the plaintiff has not the right to recover \$185,000. 215 N.Y. at 29.

In its opinion, the majority responded to this argument stating, “The argument confuses the cause of action with the damages.” 215 N.Y. at 24. The Court distinguished the decrease in the value of GRC’s shares from the actual injury to GRB, the loss of \$185,000. They acknowledged that it was possible that the decrease in the values of the share might equal \$185,000. However, they observed the more the company recovered, or the more likely recovery appeared, the less likely the shares were to depreciate. They felt the likelihood of a double recovery was illusory. Such an unlikely event would not and should not in the majority’s view operate as a bar to the stockholder’s claim.

Another case discussed in *Waller* is *Blakeslee v. Sottile*, 194 N.Y.S. 752 (1922). The plaintiff and her sister owned stock, held in trust, in the Blakeslee Cadillac Company (BCC). The defendant and two others were the sole directors of the company and trustees for the plaintiff and her sister. The defendant actively managed the company. As the company’s

franchise to sell Cadillacs neared the end of its term, the defendant persuaded Cadillac not to renew the franchise and instead grant it to a second company in which he held an interest.

The plaintiff sued the defendant for loss of the value of her stock in BCC.

The defendant filed a motion for judgment arguing that the plaintiff could not bring an independent action for the injury to the corporation. The trial court's denial of the motion was affirmed. The court reasoned:

“... Where the wrongful acts are not only wrongs against the corporation, but are also violations by the wrongdoer of a duty arising from contract or other obligation, and owing directly by him to the stockholders, ... an individual action may be maintained, regardless of the fact of a corporate right to maintain an action for relief on its own behalf.” 194 N.Y.S. 752, 754.

Clearly, the court in *Blakeslee* focused on the nature of the duty, not the injury.

The *Waller* court also cites with approval *Ritchie v. McMullen*, 79 F. 522, (1897) an opinion by the Circuit Court of Appeals for the Sixth Circuit. The plaintiff in *Ritchie* gave stock to the defendants as collateral for certain loans they had made to him. Subsequently, he defaulted on the loans. When the defendants sold the stock in satisfaction of the loan obligations, the plaintiff brought suit contesting the sale. He alleged that the defendants, who were also directors of the company in which the stock was held, had conspired to depress the value of the stock so that they could purchase it at far less than its fair market value. The trial court dismissed the plaintiff's complaint.

The Court of Appeals held that the trial court was incorrect in finding that the plaintiff as a stockholder could not bring an independent action for the alleged wrongs done to the corporation. The Court stated that the general principle which bars a shareholder from bringing an action against a third party for an injury to the corporation “... has no application

where the wrongful acts are not only wrongs against the corporation, but are also violations by the wrongdoer of a duty arising from contract, or otherwise, and owing directly by him to the stockholders.” 79 F. 522, 533. As bailees, the defendants owed a duty to the plaintiff to use reasonable care to see that no harm came to the property in their care, his stock. A violation of that duty would give rise to a cause of action by the plaintiff, even though the injury complained of was also an injury to the corporation. Nevertheless, the Court affirmed the trial court because the evidence had failed to establish any violation of that duty.

These cases read in their entirety lead inescapably to the conclusion that the focus of the analysis under *Waller* is on the duty, not the injury suffered.

Modanlo also directs the Court’s attention to the more recent case of *Danielewicz v. Arnold*, 137 Md. App. 601 (2001). The case, however, offers no support for his argument. The plaintiff, Patricia Danielewicz, appealed from the grant of a motion for summary judgment. Plaintiff was a beneficiary of two or more trusts. One trust was established upon the death of her father in 1995. That trust held certain shares in the Arnold Factory Supply Company (AFS). The company had been started by her grandfather. Prior to 1995, she had a remainder interest in a second trust which also held stock in AFS. The stock was held in trust for her father as a life tenant, with the remainder going to Plaintiff upon her father’s death. The plaintiff brought suit against the trustees, who were also directors of AFS, for negligence relating to a transaction that had occurred prior to her father’s death in 1995. The trial court granted the defendants’ motion for summary judgment.

The Court of Special Appeals affirmed the trial court holding that at the time of the alleged misdeeds, the Plaintiff had no “present possessory interest” in the stock. 137 Md. App. 615. Accordingly, she lacked standing. The Court distinguished the *Blakeslee* line of

cases cited in *Waller*. They noted that the plaintiff's claim was based solely upon the duty owed by the directors to the corporation. There was no separate duty owing directly to her alleged. At the time of the alleged negligence, her father was the trustee of her beneficial interest in the stock under her grandparents' wills. He had not been named as a defendant. The trust establishing a fiduciary duty between the defendants and the plaintiff only came into existence upon her father's death in 1995. At the time of acts complained of, there was no privity arising out of contract or any other legal relationship running directly between the plaintiff and the defendants. Accordingly, no individual action would lie.

If anything, the dicta in the case lends support to Ahan's argument. The *Danielewicz* court noted that the plaintiff attempted to distinguish *Waller* by alleging that she had suffered an individual harm, the dilution of a controlling interest in the company. The court observed that the plaintiff in *Waller* suffered a similar harm. That fact, however, did not entitle *Waller* to bring a separate claim against the director. Therefore, even assuming Ms. *Danielewicz* had a present possessory interest in the stock, and she suffered an injury distinct from that suffered by other shareholders, the *Danielewicz* court opines she nevertheless could not maintain an independent cause of action. They focus on the nature of the duty. Not the injury.

Finally, Modanlo argues that in deciding whether to grant the motion to reconsider, the Court should be guided by the recent opinion issued by Judge Platt in *Michael H. Ahan and Protalex LLC vs. George Grammas and Gardner, Carten & Douglas* (hereinafter GCD), in the Circuit Court for Prince Georges County, Maryland, CAL 02-09937. There, Ahan alleged that Mr. Grammas, a principal in GCD, acting as corporate counsel, aided, assisted and encouraged Mr. Modanlo in his efforts to wrongfully deprive Ahan of his interest in FAI and FACS. The acts which give rise to the claims against Modanlo in the instant case. Ahan

maintained that because FAI was a closely held corporation, Grammas owed a duty directly to him, as one of two equal stockholders. He also claimed that, for the same reason, he was a third party beneficiary of the retainer agreement between the corporation and Grammas/GCD.

At trial, the jury found Mr. Grammas and GCD liable and awarded Ahan \$17.2 Million Dollars in damages. On Motion for JNOV, the court set aside the verdict on all counts for a multitude of reasons. Most are not directly relevant to the issue discussed herein. However, among the questions addressed by Judge Platt is the same issue now before this Court, whether Ahan, a stockholder, had standing to bring any action for an injury to the corporation.

Judge Platt held Ahan did not have standing. He concluded that the plaintiff had failed to allege or prove the existence of a duty that flowed directly from the defendants to him. More specifically, the court opined that even in a closely held corporation with only two shareholders, corporate counsel owes a duty only to the corporation and not to the individual shareholders. Further, the court found that Ahan was not the third party beneficiary of the retainer agreement between the corporation and Grammas/GCD. "...This court concludes that, as a matter of law, the plaintiff had no fiduciary relationship with the defendants, Grammas and Gardner, Carten & Douglas, arising from either contract or any source **independent** of the duty owed to all stockholders of FAI and FACS." Opinion, at p. 10, 11.

Here, unlike the Prince George's County case, Ahan established that a contractual relationship existed between himself and Modanlo. In addition, this Court has previously ruled for reasons set out elsewhere in the record that Modanlo owed Ahan an independent fiduciary duty. This duty is separate and apart from that which Modanlo owed to the company.

For the reasons foregoing, the Court holds that Ahan has standing to bring the claims filed herein for breach of contract and breach of fiduciary duty.

On a final and unrelated matter, Modanlo appeals to the Court as the “Final Arbiter of Justice” (Motion to Reconsider, p. 4) to right the wrong represented by this verdict, to set it aside or at least remit it. How can justice permit Ahan to recover so much, when the companies’ creditors and remaining shareholder have recovered so little. Justice, like beauty, is in the eye of the beholder. If Ahan and his witnesses be believed, including his experts, then the verdict is not unjust. If Modanlo and his witnesses be believed, the opposite result is reached. That decision was quickly reached by the jury herein, and the Court finds no reason to set it aside.

Insofar as Ahan being rewarded unfairly at the expense of the other shareholders and creditors, the Court observes that the trustee in bankruptcy could have pursued a claim similar to Ahan’s, if she deemed it advisable. Instead, she determined to release all claims FAI might have against Modanlo for \$250,000. Ahan has spent months and hundreds of thousands of dollars in attorney’s fees to obtain a verdict/judgment against Modanlo. No doubt he faces months and perhaps even years of additional litigation, as well as additional tens of thousands of dollars in fees to seek to have the judgment upheld. Even if Ahan is successful in that endeavor, if Modanlo can be believed², the judgment is next to worthless. Modanlo has no money or assets with which to satisfy the judgment. He is penniless. Time may prove that the trustee pursued the wiser course of action in accepting the \$250,000. Ahan may be left with only the satisfaction of knowing a jury believed him.

For the reasons set forth herein, as well as all those set forth in the Opposition to the Motion for Judgment Notwithstanding Verdict and presented in open court on December 21,

² See Nader Modanlo’s Motion to Stay Execution of Judgment Pending Appeal, filed December 14, 2004.

2004, it is this _____ day of January, 2005, by the Circuit Court for Montgomery County,
Maryland,

ORDERED, that the Motion for Reconsideration shall be and hereby is denied.

MICHAEL D. MASON, JUDGE
Circuit Court for Montgomery County, MD.