IN THE UNITED STATES DISTRICT COURT

FOR THE DISTRICT OF DELAWARE

DAMAGE RECOVERY SYSTEMS, INC.,	)	
	)	
Plaintiff,	)	
	)	
v.	)	Civ. No. 02-1647-SLR
	)	
MICHAEL R. TUCKER,	)	
	)	
Defendant.	)	

M. Duncan Grant, Esquire, Joseph S. Naylor, Esquire, Pepper Hamilton LLP, Wilmington, DE; Sean P. Fahey, Esquire, Barry Boise, Esquire, Pepper Hamilton LLP, Philadelphia, PA. Counsel for Plaintiff.

Edward B. Rosenthal, Rosenthal, Monhait, Gross & Goddess, Wilmington, DE; Michael A. Fitzhugh, Amy Cashore Mariani, Fitzhugh, Parker & Alvaro, Boston, MA. Counsel for Defendant.

MEMORANDUM OPINION

Dated: September 28, 2004
Wilmington, Delaware

ROBINSON, Chief Judge

I. INTRODUCTION

Plaintiff Damage Recovery Systems, Inc. ("DRS-DE")[1] brought suit against defendant Michael R. Tucker, alleging breach of contract and aiding and abetting breach of fiduciary duties owed to plaintiff. (D.I. 36, ex. 1) Currently before the court are the parties' cross-motions for summary judgment. (D.I. 34, 37) For the reasons set forth below, the court denies defendant's motion for summary judgment and grants plaintiff's motion for summary judgment.

II. BACKGROUND

A. The Packaged Groceries Industry

This case arises in the context of the packaged groceries industry. Packaged groceries are sold on consignment. (D.I. 46 at 4) Manufacturers of packaged groceries sell these products to grocery stores, which in turn sell the products to consumers. (Id.) However, if a packaged grocery product arrives at a grocery store in damaged condition, or if the store determines it

[1] This case involves two distinct corporations named Damage Recovery Systems. The first was a Pennsylvania corporation founded by the defendant. The second is a Delaware corporation which purchased the assets and goodwill of the first Damage Recovery Systems from the defendant. In order to preserve customer relationships and goodwill, the second corporation also took the name Damage Recovery Systems. For the sake of clarity, the former corporation will be referred to as DSR-PA, while the latter will be referred to as DSR-DE.

will be unable to sell the product to consumers, the store then ships the product to a "reclamation center." (Id. at 5-6)

Reclamation centers are warehouses, often run by grocery stores, which inventory items returned by grocery stores and submit invoices to manufacturers. (Id. at 6) Based on these invoices, manufacturers either give the grocery stores a reimbursement or a credit on future purchases. (Id. at 7)

Once a product is sent to a reclamation center, the manufacturer regains control of the product. (Id.) A manufacturer has three options for products sent to a reclamation center: (1) destroy the product; (2) donate the product to charity; or (3) hire a company to perform "reverse logistics" on the product. (Id. at 7-8)

Reverse logistics consists of servicing, reporting, handling and controlling the sale, destruction or other disposition of damaged or unsaleable packaged groceries. (D.I. 36, ex. 1 at 2) Companies performing reverse logistics assess damaged or unsaleable products to determine whether the goods are salvageable. (Id.) Salvageable products are resold, while unsalvageable products are destroyed. (Id.) Since many of the products sent to reclamation centers are rejected because of packaging flaws (e.g., the box is dented or the packaging is no longer trendy), reverse logistics presents an opportunity for manufacturers to recoup losses on products returned by grocery

stores.

B. Damage Recovery Systems

In October 1990 defendant co-founded a Pennsylvania corporation called Damage Recovery Systems, Inc. ("DRS-PA"). (D.I. 35 at 5) DRS-PA provided reverse logistics services to grocery stores and consumer packaged goods manufacturers. (D.I. 36, ex. 1 at 2) Specifically, DRS-PA traveled to reclamation centers, collected returned products, transported the products to its warehouse, and examined the products to determine whether they were salvageable. (Id.) If the returned goods were salvageable, DRS-PA would prepare the product for resale and then sell it in the secondary market. (Id.) If the returned products were unsalvageable, DRS-PA would destroy the products. (Id.)

After several years of operation, defendant and his co-founder sold DRS-PA to plaintiff ("DRS-DE"), a Delaware corporation which retained the name Damage Recovery Systems. (D.I. 35 at 5) As part of the sale, defendant entered into a consulting agreement (the "Consulting Agreement") with DRS-DE. (Id.) In clause 3(a) of the Consulting Agreement defendant promised that he,

> whether on his own behalf or as a director, officer, employee, partner, consultant, representative or otherwise of another party, person or corporation, shall not, without [plaintiff's] prior written consent, directly or indirectly, own, manage, operate, join, control or participate in the ownership, management, operation or control of, or be connected as a director, officer, employee, partner, consultant, representative, agent or otherwise with, or take

> any direct or indirect action to set up or engage in any of the foregoing with, any entity or individual in any part of the United States in which [plaintiff] has done, is doing or has planned or is planning to commence conducting business, which, directly or indirectly, competes with the Business.

(D.I. 35 at 6) In other words, defendant agreed not to compete with DRS-DE's (i.e., plaintiff's) "Business." Clause 3(c) went on to state that "[t]he term 'Business' . . . shall have the same meaning given to such term in the Purchasing Agreement." (Id.) The Asset Purchase Agreement ("APA"), which transferred the assets and goodwill of DRS-PA to DRS-DE, defined "Business"[2] as:

> Seller processes, on behalf of manufacturers, vendors and other entities in or related to the grocery and consumer packaged goods industry, the requirements (commonly known as reverse logistics) of servicing, reporting, handling and controlling the sale, destruction or other disposition of such industry's damaged or unsaleable goods (the "Business").

(D.I. 38, ex. A at 1-2) Finally, in clause 3(b) of the APA defendant promised that

> he shall not and shall not permit any of his representatives, to, directly or indirectly, in any manner to hire or solicit, on his behalf, for employment or induce or attempt to induce any personnel, consultant, customer, supplier, provider, licensee or other business relation of [plaintiff] to leave or cease doing business with [plaintiff] or in any way interfere with the relationship between [plaintiff] and any personnel, consultant, customer, supplier, provider, licensee or other business relation thereof.

(D.I. 35 at 6)

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[2] "Business" is defined on page two of the APA as having "the meaning assigned to such term in paragraph A of the Recitals herein . . . ." (D.I. 38, ex. A at 2) The definition above is Recital A on page one of the APA.

DRS-DE continued to provide the same reverse logistics services that DRS-PA provided. (D.I. 36, ex. 1 at 2-3) It functioned primarily as the agent of manufacturers, holding and selling returned product pursuant to the manufacturers' specifications. (D.I. 46 at 8, 24-25) DRS-DE sold the product at a price predetermined by the manufacturer and received a commission based on what it sold.[3] (Id. at 25)

C. The Soost Entities

Charles E. Soost ("Soost") owned and operated seven Florida corporations ("the Soost Entities").[4] (D.I. 38 at 6) Initially, the Soost Entities were "salvage dealers" which purchased returned product from DRS-PA (and later DRS-DE) and sold this product in secondary retail stores. (D.I. 35 at 7) However, Soost came up with a new business model which he called a "hub

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[3] This description of DRS-DE's business practice is primarily that of Michael Fitzhugh, counsel for defendant. (D.I. 46 at 24-25) However, Sean Fahey, counsel for plaintiff, on two separate occasions, made statements which suggest that this is an accurate description of DRS-DE's business. First, Fahey indicated that DRS-DE went into reclamation centers on behalf of manufacturers. (Id. at 8) This suggests that DRS-DE did, in fact, act as an agent for the manufacturers. Furthermore, Fahey stated, "So the fact that DRS doesn't take title of [returned items], which isn't entirely true, because they do take title of some product. . . [is] a distinction without difference." (Id. at 39) Fahey's statement that DRS-DE does take title to some product once again suggests that DRS-DE usually does not take title and, therefore, functions as the agent of manufacturers.

[4] These corporations were: (1) Sacks Processing; (2) Resaleables; (3) Sacks Wholesale; (4) J.J. of Central Florida; (5) Sacks Salvage; (6) Sacks of Jax; and (7) Gulley's Surplus. (D.I. 38 at 6)

and spoke" model. (D.I. 38 at 7) Under this model, the "hub" warehouse purchased un-worked returned goods from reclamation centers, transported these goods to the "hub" warehouse, re-worked those returned goods, and then distributed the salvageable product through its "spoke" retail operations which sold the product in the secondary market. (Id.) Sacks Processing, Inc. ("Sacks Processing") served as the "hub" with the remaining six Soost corporations serving as the retail store "spokes." (D.I. 35 at 8) Under this model the Soost Entities were independent of manufacturers and obtained title to the product purchased from the reclamation centers. (D.I. 46 at 25)

Shortly after plaintiff purchased DRS-PA from defendant, Soost approached Darryl Moll ("Moll"), Chief Financial Officer ("CFO") of plaintiff, with an opportunity to invest in Soost's "hub and spoke" business concept. (D.I. 35 at 7) Moll, in turn, brought the business opportunity to defendant. (Id.) In August 1999 defendant loaned $300,000 to Moll, who in turn loaned the money to Sacks Processing, the "hub" in Soost's business concept. (Id. at 10) In January of 2000 defendant loaned an additional $125,000 to Moll, who once again loaned the money to Soost, this time to establish a new grocery store named Sacks Resaleables of Eustis, Inc. ("Eustis"). (Id. at 10) Eventually the businesses in which defendant invested began obtaining products from companies such as Kimberly-Clark and Campbell's Soup and selling

these products in the secondary market. (D.I. 42, ex. 3 at 225-26; D.I. 46 at 37)

As a condition of defendant's loans to Soost, Moll was named an officer and director of the Soost Entities. (D.I. 35 at 10-11; D.I. 36, ex. 2 at 69) At the time of Moll's appointment he was still CFO of plaintiff. (D.I. 38 at 8) Shortly after Moll was appointed an officer and director of Sacks Processing and Eustis, the Soost Entities ceased paying for the product purchased from plaintiff. (D.I. 38 at 13) Despite this failure to pay, the Soost Entities were allowed to continue to purchase product from plaintiff. (Id.) In May 2000, Robert Harner, Moll's Assistant Controller, "[went] around" Moll and brought the handling of the Soost account to the attention of Thomas Conoscenti ("Conoscenti"), plaintiff's Executive Vice-President. (Id.; D.I. 38, ex. K) Conoscenti was "very concerned" about the amount of Soost's debt. (D.I. 38, ex. K) On July 31, 2000, Moll's employment with plaintiff ceased. (D.I. 38 at 13)

On May 1, 2000 Soost incorporated Resaleables Northeast, Inc. ("Resaleables"), a business which originally cleaned frozen food products for a frozen food distributor. (D.I. 41 at 15) On January 5, 2001 Soost incorporated another business named American Shelf Ready, Inc. ("American Shelf"). (D.I. 36, ex. 6) Both of these companies eventually provided reverse logistics services directly to manufacturers. (Id.)

III. STANDARD OF REVIEW

A court shall grant summary judgment only if "the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to judgment as a matter of law." Fed. R. Civ. P. 56(c). The moving party bears the burden of proving that no genuine issue of material fact exists. See Matsushita Elec. Indus. Co. v. Zenith Radio Corp., 475 U.S. 574, 586 n.10 (1986). "Facts that could alter the outcome are 'material,' and disputes are 'genuine' if evidence exists from which a rational person could conclude that the position of the person with the burden of proof on the disputed issue is correct." Horowitz v. Fed. Kemper Life Assurance Co., 57 F.3d 300, 302 n.1 (3d Cir. 1995) (internal citations omitted). If the moving party has demonstrated an absence of material fact, the nonmoving party then "must come forward with 'specific facts showing that there is a genuine issue for trial.'" Matsushita, 475 U.S. at 587 (quoting Fed. R. Civ. P. 56(e)). The court will "view the underlying facts and all reasonable inferences therefrom in the light most favorable to the party opposing the motion." Pa. Coal Ass'n v. Babbitt, 63 F.3d 231, 236 (3d Cir. 1995). The mere existence of some evidence in support of the nonmoving party, however, will not be

sufficient for denial of a motion for summary judgment; there must be enough evidence to enable a jury reasonably to find for the nonmoving party on that issue. See Anderson v. Liberty Lobby, Inc., 477 U.S. 242, 249 (1986). If the nonmoving party fails to make a sufficient showing on an essential element of its case with respect to which it has the burden of proof, the moving party is entitled to judgment as a matter of law. See Celotex Corp. v. Catrett, 477 U.S. 317, 322 (1986).

IV. DISCUSSION

The parties have filed cross-motions for summary judgment. (D.I. 34, 37) Each party divided its memorandum in support of its motion for summary judgment into two parts, a breach of contract claim, and an aiding and abetting breach of fiduciary duty claim. (D.I. 35, 38) The court will address the parties' claims in the order presented.

A. Breach of Contract Claim

The court finds that defendant breached the Consulting Agreement by investing in the Soost Entities. In clause 3(a) of the Consulting Agreement, defendant promised not to compete with the "Business" of plaintiff as that term was defined in the APA. (D.I. 36, ex. 1-B at 3) The APA defines "Business" as providing reverse logistics services "on behalf of" manufacturers, vendors and other entities. (D.I. 36, ex. 1-A at 1) Defendant invested in Sacks Processing, which performed services similar, if not

identical, to the reverse logistics performed by plaintiff. (D.I. 36, ex. 1 at 2, 5-6) Sacks Processing then sent the salvageable product to six separate retail stores owned by Soost, which sold the salvageable goods on the secondary retail market. Clearly, these six separate Soost Entities are either "vendors" or "other entities" as those terms are generally defined.[5] Consequently, Sacks Processing provided reverse logistics "on behalf of"[6] "vendors" or "other entities," making defendant's investment in Sacks' Processing a violation of the APA.

Furthermore, clause 3(b) of the Consulting Agreement states that defendant would not interfere with the business relationship plaintiff had with any of its customers. (D.I. 35 at 6) When the Soost Entities began obtaining the business of companies such as Kimberly-Clark and Campbell's Soup, both of which were former customers of plaintiff, defendant once again breached the

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[5] The retail stores are vendors in the sense that they sell, or vend, salvaged groceries. Moreover, Sacks Processing and the six retail stores are separate corporations and, under traditional notions of corporate law, should be treated as separate entities.

[6] "On behalf of" is generally understood to mean conducting oneself to benefit or support another party or acting in the interest of or as the representative of another party. The fact that these various corporate entities were commonly owned does not mean that one corporation could not benefit another, absent specific language in the contract to that effect or a finding that the corporate entities should be disregarded. The record does not justify an interpretation other than that commonly understood.

Consulting Agreement.[7] (D.I. 42, ex. 3 at 225-26; D.I. 46 at 17, 37)

Finally, although defendant does identify a difference between the Soost Entities and plaintiff's business, namely, that the Soost Entities take title to goods while plaintiff does not, this distinction is unpersuasive. Both businesses travel to reclamation centers, obtain returned packaged groceries from the centers, transport these returned groceries to each company's respective warehouse, examine the products to determine which were salvageable, and sell the salvaged products on the secondary retail market. (D.I. 36, ex. 1 at 2, 5-6) Furthermore, both plaintiff and the Soost Entities compete for the same customers. (D.I. 42, ex. 3 at 225-26; D.I. 46 at 37) As a result, the court holds that the two businesses are in competition. There are no genuine issues of material fact with respect to whether defendant

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[7] In the deposition of Darryl Moll, counsel for plaintiff elicited the following admissions:

Q: I understand. But you told him [defendant] that you were doing Kimberley-Clark's work?
A: Yes.
Q: And by "you" I mean the Soost companies.
A: Correct.
Q: The companies that were invested in.
A: I am assuming that is your colloquialism. If I am not to assume that, please correct me.
Q: You are to assume that.
. . .
Q: Did you tell him about the Campbell's work?
A: Yes.
(D.I. 42, ex. 3 at 225-26)

breached the Consulting Agreement by funding the Soost Entities.

B. Aiding and Abetting Breach of Fiduciary Duty

The court also finds that defendant aided and abetted Moll's breach of fiduciary duty. There are four elements to a claim of aiding and abetting breach of fiduciary duty: (1) the existence of a fiduciary relationship; (2) a breach of the fiduciary's duty; (3) knowing participation in that breach by the defendant; and (4) damages proximately caused by the breach. Malpiede v. Townson, 780 A.2d 1075, 1096 (Del. 2001); In re Santa Fe Pac. Corp. S'holder Litig., 669 A.2d 59, 72 (Del. 1999).

The parties are in agreement that Moll owed plaintiff a fiduciary duty.[8] (D.I. 35 at 17-18; D.I. 38 at 18) Consequently, plaintiff has established the first element of its claim of aiding and abetting breach of fiduciary duty.

Furthermore, Moll breached his fiduciary relationship with plaintiff. Plaintiff and the Soost Entities were in competition. Consequently, Moll, in his role as an officer of the Soost Entities, could not honor his fiduciary obligation to plaintiff. In addition, Moll breached his fiduciary duty to plaintiff by concealing the money owed to plaintiff by the Soost Entities. Defendant contends that Moll did not have the authority to

[8] However, defendant does contest whether Moll owed a duty to plaintiff as an officer and/or director or simply as an employee. (D.I. 35 at 18) Defendant admits Moll owed plaintiff a duty of loyalty, and a duty of good faith and fair dealing. (Id.)

unilaterally extend credit to the Soost Entities and, therefore, could not have breached his fiduciary duty to plaintiff. (D.I. 41 at 27) Even assuming that Moll did not have the power to unilaterally extend credit, at the very least he reviewed documents relating to the Soost Entities' delinquent account. (D.I. 38, ex. K) Despite knowing of the Soost Entities' debt, Moll did not alert his superiors of this potential problem. (Id.) There are no genuine issues of material fact as to whether Moll breached his fiduciary duty to plaintiff.

Defendant also knowingly participated in Moll's breach of fiduciary duty. Defendant insisted, as a condition to his loans to Soost, that Moll be named an officer and director of the Soost Entities. (D.I. 36, ex. 1 at 7, D.I. 38, ex. B at 69-70) Defendant also knew that Moll was still CFO of plaintiff and that the Soost Entities purchased product from plaintiff. (D.I. 38, ex. B at 69-70) Furthermore, Moll kept defendant apprised of the development of the Soost Entities, and notified defendant that the Soost Entities had obtained the work of Kimberly-Clark and Campbell's Soup. (D.I. 42 at 225-26) In light of this evidence, defendant's argument is unpersuasive.[9] There are no genuine issues of material fact as to whether defendant knowingly participated in Moll's breach of fiduciary duty.

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[9] Defendant argued that he did not know that Moll's dual role as CFO of plaintiff and an officer/director of the Soost Entities would breach Moll's fiduciary duty.

Finally, Moll's breach of fiduciary duty proximately caused plaintiff damages. While Moll was CFO of plaintiff, the Soost entities were allowed to incur a debt of $225,000. (D.I. 36, ex. 1 at 10) According to Robert Harner, the Assistant Controller under Moll, plaintiff consistently prohibited brokers from purchasing additional product from plaintiff until all outstanding receivables were resolved. (D.I. 38, ex. K) Furthermore, when Harner went "around" Moll and informed Thomas Conoscenti, Executive Vice President of plaintiff, about the amount of Soost's debt, Conoscenti was "very concerned." (Id.) Within several days of this conversation, the Soost Enterprises were no longer able to purchase product from plaintiff. (Id.) Shortly after Harner's conversation with Conoscenti, plaintiff fired Moll. (D.I. 41 at 11) The court concludes that damages did proximately result from Moll's breach of fiduciary duty.

V. CONCLUSION

For the reasons set forth above, defendant's motion for summary judgment is denied and plaintiff's motion for summary judgment is granted. An order shall issue.