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COURT OF CHANCERY
OF THE
STATE OF DELAWARE

LEO E. STRINE, JR.
VICE CHANCELLOR

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

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Daniel V. Folt, Esquire
Duane Morris LLP
1100 North Market Street, 12th Floor
Wilmington, DE 19801

Barry M. Klayman, Esquire
Cozen O'Connor
1201 North Market Street
Wilmington, DE 19801

RE: *SOC-SMG, Inc. v. Day & Zimmermann, Inc., et al.*
C.A. No. 5375-VCS

Dear Counsel:

To distill a rather complex transaction down to its essence, in November 2008, the petitioner, SOC-SMG, Inc. ("SMG"), and the respondent Day Zimmermann,[1] executed a Contribution Agreement creating a limited liability company, or the "LLC,"[2] into which both Day Zimmermann and SMG contributed assets and in which both parties would have an ownership interest.[3] Because SMG represented that the assets it was contributing to the LLC were more valuable than those contributed by Day Zimmermann, and because

[1] Day Zimmermann refers to the two entities named as respondents in this action: Day & Zimmermann, Inc. and The Day & Zimmermann Group, Inc.
[2] Specifically, the name of the LLC is SOC LLC. Resp. Ans. Br. Ex. 2 (Operating Agreement) § 1.4.
[3] Contribution Agreement § 2.4.

Day Zimmermann was to acquire a 60% controlling interest in the LLC, Day Zimmermann agreed to pay SMG $42 million, payable as $30 million cash at closing and a promissory note in the amount of $12 million, to be paid in three installments, the first of which was due on January 1, 2009.[4] Shortly after the transaction closed, however, Day Zimmermann became suspicious that SMG had made materially false statements regarding SMG's financial health and the value of its contributed assets during the due diligence and negotiation process preceding the execution of the Contribution Agreement and the formation of the LLC. In January 2009,[5] in order to confirm these suspicions, Day Zimmermann requested through its Pennsylvania counsel, Philip G. Kircher, and obtained from the LLC, a large quantity of electronically stored information (the "ESI").[6] The ESI had been transferred to the LLC by SMG as part of the operating assets it contributed.

When Day Zimmermann refused to pay the $12 million, SMG initiated a JAMS arbitration against Day Zimmermann in Pennsylvania on April 15, 2009 (the "Arbitration") pursuant to a broadly drafted arbitration clause (the "Arbitration Clause") which provides that:

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[4] Contribution Agreement § 2.4(b).
[5] Resp. Ans. Br. Ex. 3 (email from Phil Kircher to Thomas Alborg, SMG's outside counsel (January 19, 2009)).
[6] Although I do not reach the merits on SMG's breach of contract claims it presses in the Arbitration, it is relevant that Operating Agreement § 3.7 provides that "each member [of the LLC] shall be entitled for any purpose reasonably related to the member's membership: (a) To obtain any information in the [LLC's] possession or control; and (b) To inspect and . . . to copy any documents and other media in the [LLC's] possession or control . . . ."

> *[a]ny dispute, claim or controversy arising out of or relating to this Agreement or the breach, termination, enforcement, interpretation or validity thereof, including the determination of the scope or applicability of this agreement to arbitrate*, shall be determined by arbitration, before three arbitrators. The arbitration shall be administered by JAMS pursuant to its Comprehensive Arbitration Rules and Procedures. Judgment on the arbitration award may be entered in any court having jurisdiction. This clause shall not preclude the Parties from seeking provisional remedies in aid of arbitration from a court of appropriate jurisdiction.[7]

In its Arbitration pleading, SMG alleged that Day Zimmermann's possession and use of the ESI breached the confidentiality provision of the Contribution Agreement and later amended that pleading to seek the $12 million it claimed was due under the promissory note.[8]

Despite the fact that SMG itself pled in the Arbitration that the misuse of the ESI by Kircher was a breach of the Contribution Agreement, and although the Arbitration panel has already issued a discovery order addressing in part SMG's concerns about Kircher's use of the ESI (including claims of privilege),[9] SMG presses forward with this action that it filed on March 26, 2010, after the Arbitration had progressed for nearly a year, attempting to have this court declare it the winner of the Arbitration. Specifically, SMG seeks in its petition to disqualify Kircher and his law firm, Cozen O'Connor LLP,

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[7] Contribution Agreement § 11.2(e)(i) (emphasis added).
[8] Pet. Op. Br. Ex. H.
[9] Specifically, the panel has ordered that Day Zimmermann turn over search criteria it used in connection with the performed searches of SMG's ESI, and refrain from any further searching of the ESI. It also expressly permits SMG to depose Day Zimmermann's Pennsylvania counsel, the forensic computer expert who conducted the ESI search, and provides that the parties shall "attempt to agree on a procedure for identifying documents or categories of documents" over which SMG claims a privilege. JAMS Order For Discovery Protocol (May 21, 2010).

i.e., Day Zimmermann's Pennsylvania counsel in the Arbitration, the imposition of monetary sanctions, an order prohibiting further use of the allegedly privileged ESI, and — most aggressive of all — an order *terminating all of Day Zimmermann's claims and defenses in the Arbitration.* SMG justifies this suit on the grounds that public policy dictates that a court — indeed a Delaware court — and not the Arbitration panel, should determine in the first instance whether in the course of allegedly violating the Contribution Agreement Kircher also violated his ethical responsibilities as a lawyer by misusing allegedly privileged information, and the consequences for that conduct.

Before me now is a motion by SMG in which it seeks judgment in its favor on its claim based on a paper record; in essence, SMG has filed a motion for summary judgment but did not style it as such. In addressing that motion, I put aside for present purposes the reality that when SMG sold its ESI, as part of the asset sale, to the LLC — an entity that Day Zimmermann controls,[10] it failed to retain control over the servers on which it claims privileged information rests, and instead turned them over to the LLC. I also put aside SMG's admission at oral argument that it failed to screen its ESI or negotiate carve-outs for allegedly privileged ESI before turning the ESI over to the LLC.[11] Instead, I will grapple with SMG's predicate argument about who should decide if Day Zimmermann breached the Contribution Agreement by improperly using the ESI; if that improper use involved information that was protected by an attorney-client

[10] Tr. at 4, 17, 39-40 (counsel for SMG).

privilege belonging to SMG; and whether Kircher's role in any such conduct justifies his disqualification.

SMG's argument that this court must decide these questions is simple. Because SMG has accused Day Zimmermann's counsel, a Pennsylvania lawyer, with ethical violations in connection with the alleged misuse of the ESI in breach of the Contribution Agreement, SMG says that public policy requires that this court, rather than the arbitrators, must rule on the Pennsylvania lawyer's conduct. In support of that argument, SMG cites case law that supposedly stands for the proposition that only a court may consider whether an attorney should be disqualified.[12] I am not persuaded by SMG's argument to that effect.

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[11] *Id.* at 17 (counsel for SMG).

[12] SMG's citation to several non-Delaware cases supposedly standing for the proposition that courts, and never arbitrators, should determine questions of attorney misconduct illustrates the pitfalls an advocate faces when he extrapolates sweeping generalizations from strategically excised quotations. For instance, SMG's reliance on *Dean Witter Reynolds, Inc. v. Clements, O'Neill, Pierce & Nickens, L.L.P.*, 2000 U.S. Dist. LEXIS 22852, *14-15 (S.D. Tex. Sept. 8, 2000) for the proposition that "[t]he Court similarly finds that overarching policy considerations preclude arbitrators . . . from interpreting and applying the applicable rules of professional conduct for attorneys" is undermined by the fact that in that case there was no broadly drafted arbitration clause calling for "arbitration of all controversies arising out of [the parties'] business relationship." *Id.* at *33. "Without [such a broadly drafted] arbitration contract," continues the court, "neither party may be compelled to submit to arbitration on the present disqualification dispute." *Id.* SMG also leaves out of its quotation of *Dean Witter*, that the court's inclination to confine the determination of professional misconduct to the court was premised on the fear that arbitrators, "*who are often non-lawyers*," may simply lack the requisite expertise and experience to rule on such matters. *Id.* at 14 (emphasis added). In this case, not only are the three arbitrators lawyers, but they also have a combined 39 years experience as U.S. Magistrate Judges. Resp. Ans. Br. Ex. 28. SMG itself acknowledged its difficulty in finding precedential support for the argument it presses in support of its motion. *See* Tr. at 13 (counsel for SMG) ("look, these motions [filed by SMG] don't come up very much. *We searched the entire country for a motion like this and found no clear precedent.*") (emphasis added).

Any member of this court knows that the adjudication of disputes, and the discovery issues necessarily related to them, often involves the resolution of questions about the use of privileged information and of issues of attorney responsibility. For that reason, it is not surprising that arbitrators have ruled on disqualification and privilege motions and that courts have refused to intervene on an interlocutory basis to either first- or second-guess those rulings.[13] Rather, the interests of justice are served by charging the arbitrators with deciding the overall matter, including allegations of discovery abuse and disqualification motions, in the first instance. Indeed, the JAMS Comprehensive Arbitration Rules and Procedures that SMG and Day Zimmermann explicitly

[13] *See, e.g.*, *Glamis Gold, Ltd. v. United States*, Award (NAFTA Arb. Trib. 2009), *available at* http://www.state.gov/documents/organization/125798.pdf (arbitration panel ruling on various discovery disputes, including privilege); *In the Matter of the Arbitration between Routien and Raymond James Financial Services, Inc.*, 2004 NASD Arb. LEXIS 966 (May 4, 2004) (ruling on attorney disqualification motion); *In the Matter of the Arbitration Between Sharp and The Thornwater Company L.P.*, 2003 NASD Arb. LEXIS 1907 (Oct. 27, 2003) (same); *Wurttembergische Fire Ins. Co. v. Republic Ins. Co*, 1986 U.S. Dist Lexis 23032, *1 (S.D.N.Y. Jul. 9, 1986) (declining to issue an injunction disqualifying counsel in a pending arbitration on the grounds that were the court to do so, it "would interfere directly in a pending arbitration, to which [the parties] agreed by contract. That interference . . . would bring[] the arbitration to a dead stop."); *Canaan Venture Partners, L.P. v. Salzman*, 1996 Conn. Super. LEXIS 245, *7 (Conn. Super. Jan. 28, 1996) (dismissing motion to disqualify counsel in pending arbitration because "court will not interfere and interrupt the process of arbitration . . . [and] attorney disqualification is not within the scope of the [narrow public policy exception] . . . ."); *UBS PaineWebber Inc. v. Stone*, 2002 U.S. Dist. LEXIS 5162, *7-*8 (E.D. La. Mar. 8, 2002) (dismissing a complaint to disqualify counsel in pending arbitration whom claimant argued would be a material witness because claimant's "motion asks the district court to inject itself directly into the arbitration proceeding by *prospectively restricting the evidence to be proffered at that proceeding. . . .* It is not the province of this Court to interfere with the process [of ruling on evidentiary or discovery issues].") (emphasis added); *Tenet Healthcare Corp. v. Maharaj*, 859 So. 2d 1209 (Fla. 4th D.C.A. 2003) (dismissing an appeal from an arbitrator's order to produce certain documents that were allegedly privileged on the ground that judicial review would be improper).

incorporated into the Arbitration Clause *require* that "discovery issues" be submitted to, and determined by, the arbitrators.[14]

As SMG admitted by initiating the Arbitration in the first instance, the alleged breaches of the Contribution Agreement involving the supposed misuse of ESI fall squarely within the Arbitration Clause. As SMG also admitted at oral argument, the attorney at whom it directs its fire was at all relevant times acting in Pennsylvania as a Pennsylvania lawyer. Whatever review and use of the ESI he made was in Pennsylvania, not Delaware. The Arbitration is pending in Pennsylvania and his involvement in conducting it took place in Pennsylvania, not Delaware. Moreover, for a party who so fervently waves the public policy banner, it is striking that SMG did not file its case in the courts of the Commonwealth of Pennsylvania or file a disciplinary complaint against Day Zimmermann's Pennsylvania counsel in Pennsylvania. Pennsylvania has procedures for parties to do so.[15] Rather, SMG rushed into a Delaware court and sought, for its own selfish, tactical advantage, to use an accusation of attorney misconduct to advance its position in the pending Arbitration — indeed, to *win* in the Arbitration. Our Supreme

[14] JAMS Comprehensive Arbitration Rules & Procedures Rule 17(d) ("The Parties shall promptly notify JAMS when a dispute exists regarding discovery issues. A conference shall be arranged with the Arbitrator . . . and the Arbitrator shall decide the dispute. With the written consent of all Parties, and in accordance with an agreed written procedure, the Arbitrator may appoint a special master to assist in resolving a discovery dispute.").
[15] *E.g.*, The Disciplinary Board of the Supreme Court of Pennsylvania, *available at http://www.padisciplinaryboard.org/faqs/consumers.php*.

Court, and our Rules of Professional Conduct, condemn the use of allegations of attorney misconduct as "procedural weapons."[16]

Even if Kircher were a Delaware lawyer, or the Arbitration were taking place in Delaware (or both), SMG's self-serving desire to have this court hear this motion would provide no justification for interfering with the Arbitration.[17] The arbitrators handling the Arbitration are well-positioned to consider any contractual or ethical breach that allegedly deprived SMG of its legitimate confidentiality interests and to shape discovery and merits consequences for any breach by Day Zimmermann's counsel of its ethical duties. To have a Delaware court inject itself into this situation would show disrespect toward the Arbitration panel, which has the broad authority to address these issues in the first instance,[18] and would be contrary to our state's —[19] and our nation's —[20] strong public policy favoring arbitration. Likewise, because Kircher was acting at all times as a

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[16] *See In re Appeal of Infotechnology*, 582 A.2d 215, 220 (Del. 1990) ("The Rules are to be enforced by a disciplinary agency, and are not to be subverted as procedural weapons."); Delaware Rules of Professional Responsibility, Scope (same).

[17] The tactical nature of SMG's motion in this court is further revealed by its lawyers' statements during a December 3, 2009 teleconference — nearly four months before filing its petition in this court — between itself and Day Zimmermann that if a resolution to the privilege issue could not be reached SMG's counsel would raise the issue with the Arbitration panel. Hamm Aff. ¶ 27.

[18] JAMS Comprehensive Arbitration Rules & Procedures Rule 17(d).

[19] *See Graham v. State Farm Mut. Auto Ins. Co.*, 565 A.2d 908, 911 (Del. 1989) ("In short, the public policy of this state favors the resolution of disputes through arbitration."); *Julian v. Julian*, 2009 WL 2937121, *3 (Del. Ch. Sept. 9, 2009) (noting that "Delaware's public policy strongly favors arbitration . . . ."); *IMO Indus., Inc. v. Sierra Int'l, Inc.*, 2001 WL 1192201, *2 (Del. Ch. Oct. 1, 2001) (noting that Delaware's public policy favors "resolving disputes through arbitration.").

Pennsylvania lawyer, it would also show a lack of comity for this state's courts to reach out and to act as a wide-ranging enforcement agent as to the ethical conduct of attorneys practicing law in sister states. Here, the only reason that Day Zimmermann even involved Delaware counsel in this matter is because SMG filed this suit and a prior suit in our Superior Court[21] seeking recovery under the promissory note executed by Day Zimmermann in accordance with the Contribution Agreement, despite the existence of the Arbitration Clause providing for JAMS arbitration. The Superior Court dismissed that improper suit precisely because of the broadly drafted Arbitration Clause in the Contribution Agreement.[22] Put bluntly, if SMG was genuinely concerned about public policy, it would have sought to hold Day Zimmermann's counsel accountable to the Pennsylvania disciplinary authorities, which it has not.[23] Instead, SMG is using a charge of ethical impropriety for tactical advantage to dictate the outcome of an Arbitration it itself commenced.[24]

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[20] *E.g., Moses H. Cone Memorial Hosp. v. Mercury Const. Corp.*, 460 U.S. 1, 24 (1983) ("Section 2 [of the Federal Arbitration Act] is a congressional declaration of a liberal policy favoring arbitration agreements . . . .").

[21] On April 15, 2009 — the same day SMG served its original complaint in the Arbitration complaining that Kircher had violated the Contribution Agreement by misusing the ESI — SMG filed a complaint in the Superior Court of the State of Delaware in New Castle County seeking payment of $12 million allegedly due under the promissory note. *SOC-SMG, Inc. v. Day & Zimmermann, Inc.*, C.A. No. 09C-04-138 JOH (Del. Super. July 1, 2009). Only after that suit was dismissed on the basis of the Arbitration Clause did SMG amend its JAMS pleading to include the claim for the $12 million. Pet. Op. Br. Ex. H.

[22] *Id.*

[23] Tr. at 21-22 (counsel for SMG).

[24] In the alternative, SMG argues that its motion in this suit is for a "provisional remedy in aid of arbitration," thereby escaping the Arbitration Clause in the Contribution Agreement and making

Just as a trial judge should deal in the first instance with alleged discovery abuses or attorney misconduct in cases before her, so should an arbitration panel. The law provides an opportunity for judicial review of arbitration decisions.[25] If SMG believes that the arbitrators have improperly addressed its claims regarding wrongful use of the ESI, discovery abuse, and ethical misconduct, SMG can seek judicial review in an application made after the Arbitrators have entered their final award. To the extent that SMG is unhappy that it chose arbitration to resolve its differences with Day Zimmermann, it is free to eschew arbitration in the future. What SMG has not done

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this court the appropriate forum to settle SMG's claim of alleged attorney misconduct. Section 6.1(b) of the Contribution Agreement provides that "[e]ach Party . . . submits to the jurisdiction of any Delaware state court sitting in New Castle County or any federal court sitting in the District of Delaware in any action arising out of or relating to this Agreement or the Operating Agreement . . . ." This provision is, of course, qualified by the broad Arbitration Clause in § 6.1(e). Section 6.1(e) provides that notwithstanding the agreement to arbitrate, the Clause "shall not preclude the Parties from seeking *provisional remedies in aid of arbitration from a court of appropriate jurisdiction*." (emphasis added). But a motion to disqualify counsel can hardly be characterized as a provisional remedy, much less one "in aid" of the pending Arbitration in which SMG has made no attempt to press its allegations of attorney misconduct. Tr. at 31 (counsel for SMG). "A [provisional] remedy provide[s] for [a] present need for *the immediate occasion*; one adapted to meet a *particular exigency*. Particularly, [it is] a *temporary* process available to a plaintiff in a civil action, which secures him against loss, *irreparable injury, dissipation of the property, etc., while the action is pending*. Such include the remedies of injunction, appointment of a receiver, attachment, or arrest." BLACK'S LAW DICTIONARY 1102 (West Publishing Co. 5th ed. 1979) (emphasis added). SMG has made no showing that the Arbitration panel cannot competently deal with SMG's claims, nor has it convinced me that any exigent circumstance exists such that this court's intrusion into the panel's jurisdiction would be proper. Indeed, the remedy sought here — disqualification of Day Zimmermans's counsel in the Arbitration and an order dismissing all of its claims or defenses — far from protecting SMG from any irreparable injury "while the action is pending" or "aiding" the Arbitration, would hand it a victory in the Arbitration and put an end to that action in its entirety. Simply put, the relief sought here can not be deemed "provisional" in any rational sense of the word.

however is provide any persuasive reason for this court to address issues that are properly the province of arbitrators under a broad Arbitration Clause SMG freely agreed to and in an Arbitration it initiated.

Finally, if there is any dispute about whether the arbitrators should decide whether Kircher's use of the ESI on behalf of Day Zimmermann was improper, the question of arbitrability is one that SMG agreed would be decided in the first instance by the arbitrators, not a court.[26]

For the foregoing reasons, SMG's motion to disqualify counsel, terminate the defenses and claims of Day Zimmermann in the Arbitration, prohibit Day Zimmermann's further use of the allegedly privileged ESI, and to impose monetary sanctions against Day Zimmermann and its Pennsylvania counsel is DENIED. Because the factual record is undisputed on relevant points, SMG itself sought a judgment on the record presented, and judgment as a matter of law is owed to Day Zimmermann, I enter summary judgment *sua sponte* for it.[27] IT IS SO ORDERED.

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[25] *See, e.g.*, 9 U.S.C. § 10 (standard for vacating an arbitration award); 9 U.S.C. § 11 (standard for modifying an arbitration award); 9 U.S.C. § 16 (providing for appeals from confirmation of an arbitration award).

[26] Arbitration Clause; *see also* JAMS Comprehensive Arbitration Rules and Procedures Rule 11 ("Jurisdictional and arbitrability disputes, including disputes over the existence, validity, interpretation or scope of the agreement under which Arbitration is sought . . . *shall be submitted to and ruled on by the Arbitrator*.") (emphasis added).

[27] *Stroud v. Grace*, 606 A.2d 75, 81 (Del. 1992) (finding "that in the interests of judicial economy, Chancery Court Rule 56 gives that court the inherent authority to grant summary judgment *sua sponte* against a party seeking summary judgment."); *see also* CHARLES ALAN WRIGHT, ARTHUR R. MILLER & MARY KAY KANE, FEDERAL PRACTICE & PROCEDURE § 2720 (3d ed. 2008) (same as to federal district courts).

Very truly yours,

/s/ Leo E. Strine, Jr.

Vice Chancellor

LESJr/eb