

UNITED STATES DISTRICT COURT  
FOR THE DISTRICT OF NEW JERSEY

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MILESTONE SCIENTIFIC, INC. :  
and SPINTECH, INC., : Civil Action No.  
 : 97-1503  
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Plaintiffs, : **MEMORANDUM OPINION**  
 :  
v. :  
 :  
RONALD P. SPINELLO, :  
 :  
Defendant. :  
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The matters are before the Court on defendant Ronald P. Spinello's appeal of Magistrate Judge Joel A. Pisano's May 5, 1998 Order ("the Order") denying Spinello's demand for a jury trial and his motion for leave to amend the Counterclaim ("the Appeal"). Plaintiffs Milestone Scientific, Inc. ("Milestone") and Spintech, Inc. ("Spintech") oppose the Appeal, joined by proposed third-party defendant, Leonard Osser. Spinello also objects to Magistrate Pisano's Report and Recommendation filed on May 6, 1998 ("the R&R") recommending granting Milestone and Spintech's motion to dismiss Counts Two, Three, and Four of Spinello's original Counterclaim for failure to state a cause of action upon which relief may be granted pursuant to Federal Rule of Civil Procedure 12(b)(6). The Court has decided the matters pursuant to Federal Rule of Civil Procedure 78. For the reasons set forth herein, the Appeal will be denied and the Order affirmed in its entirety. Further, the R&R will be adopted as the opinion of this Court and Counts Two, Three and Four of the original Counterclaim will be dismissed.

## BACKGROUND

Magistrate Pisano's May 5, 1998 Opinion sets forth the background underlying the current actions before the Court and will be reiterated, verbatim, herein.

This lawsuit arises out of a multi-faceted dispute between the corporate plaintiffs and a director-employee. Both plaintiffs, Milestone and Spintech, are Delaware corporations with their principal places of business in Livingston, New Jersey. Spintech and Milestone<sup>1</sup> are engaged in the business of developing and selling products for use by dental practitioners and other health-related professionals. Defendant Spinello, who resides in Pennsylvania, was and is an employee and Chairman of the Board of Directors of Spintech.

On September 19, 1994, Spinello and other directors of Spintech approved an agreement with Milestone, whereby Milestone would provide financing to Spintech and purchase a 65% interest in the company for 2.7 million dollars. To formalize these terms, the corporations entered into a written agreement ("the Stock Purchase Agreement"), which provides, inter alia:

The obligations of [Milestone] shall be subject to the following additional conditions: . . . (iii) Dr. Robert Spinello and Glenn Spinello shall each have entered into five-year employment agreements substantially in the form now under discussion with Spintech.

In accordance with this agreement, Spinello entered into a five-year written employment contract ("the Employment Agreement), engaging him as Spintech's Chairman of the Board and Director of Research. The majority shareholder, President, and CEO of Milestone, Leonard Osser, also became a Director and Officer of Spintech.

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<sup>1</sup> Prior to October 1996, Milestone was known as U.S. Opportunity Search, Inc. Throughout this Opinion, the Court refers to this corporation as "Milestone."

Furthermore, on November 3, 1995, Spinello and other Spintech shareholders sold a 65% controlling interest in Spintech to Milestone. On April 9, 1997, plaintiffs terminated Spinello's employment agreement. Plaintiffs filed this lawsuit on March 25, 1997, seeking damages for the defendant's alleged tortious interference with Milestone's contractual relations (First Claim for Relief); a declaration that plaintiffs are the rightful owners of certain dental technologies,<sup>2</sup> and that plaintiffs have not breached the Employment or Stock Purchase Agreements (Second Claim for Relief); damages for Spinello's alleged breach of the Employment Agreement (Third Claim for Relief); and an injunction preventing Spinello from infringing on plaintiff's alleged rights with respect to The Wand and certain other technologies (Fourth Claim for Relief).

Defendant filed an Answer and Counterclaim against Milestone on May 5, 1997. Spinello alleges that plaintiffs breached his employment contract (Count One)<sup>3</sup>; oppressed minority shareholders (Count Two); committed civil conspiracy (Count Three); and are required to indemnify him for litigation expenses and judgments (Count Four). No party demanded a jury trial at that time.

On December 30, 1997, Spinello filed a motion to amend the Counterclaim, seeking to add Osser as a third-party defendant, and to add an additional claim of fraud in the inducement against both Milestone and Osser. In his Proposed Amended Counterclaim, Spinello also requested a jury trial.

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<sup>2</sup> According to the Complaint, Spinello and other individuals assigned the patent rights to certain dental technologies, including "the Wand," to Spintech shortly after its incorporation. "The Wand" is allegedly a computer-controlled, virtually painless injection system used to anesthetize patients. Plaintiffs contend that they now own the rights to "the Wand" and other technologies.

<sup>3</sup> The defendant alleges that the plaintiffs breached the Employment Agreement by terminating his employment despite his adequate performance. The current actions do not involve this claim for relief.

Plaintiffs and Osser filed opposition to both the defendant's motion to amend and the defendant's demand for a jury trial. In addition, plaintiffs filed a motion to dismiss the defendant's original claims concerning the minority shareholders' derivative action, civil conspiracy, and indemnification. Magistrate Pisano decided the motions without oral argument pursuant to Federal Rule of Civil Procedure 78. As set forth above, the Magistrate denied Spinello's demand for a jury trial and the motion to amend by way of a May 5, 1998 Opinion and Order. And in the R&R filed on May 6, 1998, Magistrate Pisano recommended that plaintiffs' motion to dismiss Counts Two, Three, and Four of the defendant's original Counterclaims be granted. Spinello's Appeal of the May 5, 1998 Order and his objections to the R&R are currently before this Court. (See 5/5/98 Opinion at 2-5 (citations omitted).)

## **DISCUSSION**

### **I. Appeal of Magistrate Judge Pisano's Order**

#### **A. Standard of Review**

At issue is whether Magistrate Judge Pisano abused his discretion in denying Spinello's motion to amend and demand for a jury trial.

A magistrate judge's order adjudicating a non-dispositive motion will be set aside only if the order is found to be clearly erroneous or contrary to law. See Fed. R. Civ. P. 72(a) (review of magistrate judge's pretrial orders of nondispositive matters); 28 U.S.C. § 636(b)(1)(A); L. Civ. R. 72.1(c)(1); Cipollone v. Liggett Group, Inc., 785 F.2d 1108, 1120 (3d Cir. 1986) (citing 28 U.S.C. § 636(b)(1)(A)), cert. denied, 484 U.S. 976 (1987). The burden is on the moving party to demonstrate that the magistrate judge's finding is clearly erroneous or contrary to law. See Exxon Corp. v. Halcon

Shipping Co.. Ltd., 156 F.R.D. 589 (D.N.J. 1994); see also Harrington v. Lauer, 893 F. Supp. 352, 357 (D.N.J. 1995).

A finding is clearly erroneous when "although there is evidence to support it, the reviewing court on the entire evidence is left with the definite and firm conviction that a mistake has been committed." Anderson v. City of Bessemer City, 470 U.S. 564, 573 (1985)(citations omitted). "[A] Magistrate has wide discretion to make interstitial rulings of law in the interests of justice and fairness, provided that the Magistrate's opinion is based on clearly articulated principles." Schroeder v. Boeing Commercial Airplane Co., 123 F.R.D. 166, 169 (D.N.J. 1988).

Under the clearly erroneous standard of review, "the magistrate judge's findings should not be rejected even if a reviewing court could have decided the issue differently." Cardona v. General Motors Corp., 942 F. Supp. 968, 971 (D.N.J. 1996) (quoting Toth v. Alice Pearl, Inc., 158 F.R.D. 47, 50 (D.N.J. 1994) (citing Anderson v. City of Bessemer City, 470 U.S. 564, 574 (1985) ("Where there are two permissible views of the evidence, the fact-finder's choice between them cannot be clearly erroneous."))).

**B. Magistrate Judge Pisano's Order Denying Spinello's Motion to Amend and Demand for a Jury Trial Will Be Affirmed**

Magistrate Pisano determined that Spinello's Proposed Amended Counterclaims were futile and could not withstand a motion to dismiss under Federal Rule of Civil Procedure 12(b)(6). The Magistrate further denied defendant's right to a jury trial.

A motion to amend to add a new claim is non-dispositive. See Harter v. GAF Corp., 150 F.R.D. 502, 508 (D.N.J. 1993), aff'd, 26 F.3d 122 (3d Cir. 1994); Jordan v. Tapper, 143 F.R.D. 567, 571 (D.N.J. 1992) (same). The parties do not dispute that the

motion to amend was a nondispositive motion. (See Def. Br. at 8-9; Plf. Opp. at 9.) Accordingly, the Court will apply the "clearly erroneous or contrary to law" standard of review to the current Appeal, mindful of the considerable deference provided to a magistrate judge in determinations made in a non-dispositive matter.

The Federal Rules of Civil Procedure provide that after a responsive pleading is served, "a party may amend the party's pleading only by leave of court or by written consent of the adverse party." And "leave [to amend] shall be freely given." Fed. R. Civ. Pro. 15(a). Leave should be freely granted in order "to promote the goal of deciding cases on the merits instead of disposing of them on technicalities." Voilas v. General Motors Corp., 173 F.R.D. 389, 395 (D.N.J. 1997) (citing 6 Wright & Miller, Federal Practice and Procedure § 1471 at 502-07 (1990)).

Notwithstanding the liberality afforded amendment, it is well established that a proposed amendment should not be permitted if amendment would be futile. This Court has recognized that "an amendment is 'futile' when it would not survive a motion to dismiss under Rule 12(b)(6)." McPherson's Ltd. v. Never Dull. Inc., No. 90-2070, 1990 U.S. Dist. LEXIS 17442, at \*12 (D.N.J. Dec. 26, 1990) (Wolin, J.); see Foman v. Davis, 371 U.S. 178, 182 (1962); see also Adams v. Gould. Inc., 739 F.2d 858, 864 (3d Cir. 1984), cert. denied, 469 U.S. 1122 (1985); Massarsky v. General Motors Corp., 706 F.2d 111, 125 (3d Cir.), cert. denied, 464 U.S. 937 (1983).)

Rule 12(b)(6) of the Federal Rules of Civil Procedure provides that a claim for relief may be dismissed if it fails to state a claim upon which relief may be granted.<sup>4</sup> In determining whether a pleading should be dismissed for failure to state a claim pursuant to Rule 12(b)(6), the Court must limit its consideration to the facts alleged in the pleading. See Biesenbach v. Guenther, 588 F.2d 400, 402 (3d Cir. 1978). Moreover, in its examination of the claim for relief, the Court required to accept all of the allegations contained therein and all inferences arising therefrom as true. See Hishon v. King & Spalding, 467 U.S. 69, 73 (1984). If a party can prove any set of facts in support of his claim that would entitle him to relief, his pleading should not be dismissed. See Conley v. Gibson, 355 U.S. 41, 45-46 (1957); D.P. Enterprises v. Bucks County Community College, 725 F.2d 943, 944 (3d Cir. 1984).

The Federal Rules of Civil Procedure only require that a pleader present a short and plain statement of the claim showing that the pleader is entitled to relief. See Fed. R. Civ. P. 8. Generally, a claim for relief is sufficient if it enables the other party to file a responsive pleading. See Hickman v. Taylor, 329 U.S. 495, 501 (1947). However, although the court must assume that all alleged facts are true, "[i]t is not ... proper to assume that the [pleader] can prove any facts that it has not alleged." Associated Gen. Contractors of Cal., Inc. v. California State Council of Carpenters, 459 U.S. 519, 526 (1983). Also, when "[c]onfronted with [a 12(b)(6)] motion, the court must review the allegations of fact contained in the [pleading]; for this purpose the court does not

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<sup>4</sup> Rule 12 expressly provides:

(b) . . . Every defense . . . to a claim for relief in any pleading, whether a claim, counterclaim, cross-claim . . . shall be asserted in the responsive pleading . . . except that the following defenses may at the option of the pleader be made by motion: . . . (6) failure to state a claim upon which relief can be granted . . ."

Fed. R. Civ. Proc. 12(b)(6).

consider conclusory recitations of law." Commonwealth of Pa. v. PepsiCo. Inc., 836 F.2d 173, 179 (3d Cir. 1988) (emphasis added).

As this Court stated, "the Court must consider the merits of each of plaintiff's proposed amendments before granting leave to amend." Johnson v. New Jersey, No. 94-3600, 1995 U.S. Dist. LEXIS 1466, \*7 (D.N.J. Jan. 31, 1995) (Wolin, J.). Accord McPherson's Ltd., 1990 U.S. Dist. LEXIS 17742, at \*12 ("the Court will grant defendants' motion to amend only if the claims brought under the proposed amended counterclaim are sufficient to satisfy defendants' pleading obligation . . . .").

The parties do not dispute that futility is a valid ground to deny a motion to amend. Rather, Spinello maintains that Magistrate Pisano failed to make a determination of futility in light of the liberal standard for granting leave to amend.<sup>5</sup> (See Def. Br. at 11.) The Court finds that Magistrate Pisano correctly determined that each of the defendant's proposed amendments was futile and appropriate for disposition by a motion to dismiss for failure to state a claim upon which relief can be granted.

**1. Magistrate Pisano correctly determined that the proposed fraud in the inducement claim was futile and would not withstand a motion to dismiss.**

In his Appeal, Spinello argues that Magistrate Judge Pisano clearly erred in refusing to allow the proposed fraud in the inducement amendment on the grounds that the Magistrate "[m]isunderstands, [m]isstates, and [m]ischaracterizes" the

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<sup>5</sup> As discussed *infra*, Spinello argues that the Magistrate improperly went beyond the allegations in defendant's proposed amended pleading in order to make factual determinations; misunderstood, misstated, and mischaracterized the allegations in the proposed amended pleading; overlooked, ignored, and misapplied legal precedent demonstrating that the fraud in the inducement claim was not futile; overlooked, ignored, and misapplied legal precedent demonstrating that defendant exhausted his intracorporate remedies and properly stated a shareholder's derivative action; improperly failed to consider the jury trial demand; erroneously concluded that the civil conspiracy claim was futile; and failed to provide Spinello with the opportunity to replead or otherwise cure any and all deficiencies in his proposed pleading. (See Def. Br. at 6.)



proposed allegations. (Def. Br. at 12.) Defendant asserts that his "proposed fraud claim is based on Milestone and Osser's outward representation that, as part of the transaction whereby Milestone acquired a controlling interest in Spintech, Spinello would personally retain the patent rights to his inventions . . . ." (Id.) Further, while Milestone and Osser made these "outward representations," they "secretly planned to later argue that they never agreed to allow Spinello to personally retain his patent rights." (Id.)

However, in reviewing the allegations presented in defendant's proposed amended pleading, Magistrate Pisano found that the fraud claim was founded upon a theory not recognized in law. The Magistrate stated:

Spinello alleges in his proposed pleadings that Milestone and Osser fraudulently induced him to enter into employment and stock agreements by failing to disclose the fact that, pursuant to these agreements, Spinello would not retain the patent rights to the 'Wand' and his inventions . . . . [T]his silence constituted a 'fraudulent misrepresentation because [Milestone and Osser] intended their non-disclosure to induce Spinello to enter into the employment agreement and to sell his Spintech stock to Milestone.

. . . .

[T]he Court finds that Milestone and Osser had no duty to disclose to Spinello 'their understanding of the law' and the potential ramifications of the contractual terms . . . . In sum, Milestone and Osser's failure to explain the legal ramifications of the agreements does not constitute legal fraud because they had no duty to speak, and because the allegedly non-disclosed information does not concern a past or present 'fact.'

(Opinion at 7-8, 12-13.)

The Court agrees with Magistrate Pisano's determination that the fraud claim is based on Milestone and Osser's alleged silence and nondisclosure. (See Proposed

Amended CC Count Three ¶¶ 31-35.) Spinello's assertions of "outward representations" -whether in words or actions -- are not found in defendant's proposed pleading. (See id. ¶¶ 27-35.) As such, defendant cannot now raise new arguments before the district court on appeal from a magistrate judge's ruling. See, e.g., Jordan v. Tapper, 143 F.R.D. 567, 570-71 (D.N.J. 1992); Greenhow v. Secretary of Health & Human Servs., 863 F.2d 633, 638 (9th Cir. 1988) ("[A]llowing parties to litigate fully their case before the magistrate and, if unsuccessful, to change their strategy and present a different theory to the district court would frustrate the purposes of the Magistrate Judges Act. We do not believe that the Magistrate Judges Act was intended to give litigants an opportunity to run one version of their case past the magistrate then another past the district court."). Accordingly, Spinello effectively waived any rights he may have had to make his "outward representation" argument to this Court; defendant failed to present these allegations in both his Proposed Amended Answer and Counterclaim and before Magistrate Judge Pisano. See Lithuanian Commerce Corp. v. Sara Lee Hosiery, 177 F.R.D. 205, 206 (D.N.J. 1997) ("a party's failure to raise issues before a magistrate judge in the first instance constitutes a waiver of those issues on appeal to the district court from the magistrate judge's determination of a non-dispositive issue."). Thus, Spinello cannot now rely on assertions of "outward misrepresentations" in the current Appeal.

As alleged in the Proposed Answer and Amended Counterclaims, the fraud in the inducement claim (Count Three) asserts that Milestone and Osser's "non-disclosure" intended to "induce Spinello to sign the agreement" -- thereby obligating him to assign all of his patent rights to Spintech -- although Milestone and

Osser knew that defendant "believed that the agreement's silence on the issue of patent rights meant that he would retain exclusive control of those rights." The foregoing allegedly constitutes fraud in the inducement.<sup>6</sup> ( Proposed Amended CC Count Three ¶¶ 32-33, 35.)

In reviewing the actual allegations presented in Spinello's proposed pleadings, Magistrate Judge Pisano -- as set forth supra at 11-12 -- recognized that fraud is not constituted by a contracting party's failure to render legal advice to the other contracting party under both New Jersey and Pennsylvania law. See, e.g., P.H. Caller, Inc. v. Simon, 91 F. Supp. 5, 7 (D.N.J. 1950) (holding that affirmative statements as to the law of the legal effect of a document is not fraud); In re Estate of Bach, 426 Pa. 350, 356-57, 231 A.2d 125, 129 (1967) (same). And, as determined this Court, no assertion has been set forth in the proposed pleading or before the Magistrate Judge that "outward misrepresentations" were made.

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<sup>6</sup> Count Three further provides, in part:

Milestone and Osser retracted the assignment agreement and employment agreement with the non-disclosure/non-competition provision, and instead presented Spinello with an employment agreement and sale of stock agreement which were silent regarding Spinello's ownership of and obligation to assign the patent rights to his future inventions.

...

Even though Milestone and Osser believed the contrary, i.e., that the agreements' silence on the issue of patent rights meant that Spinello would be obligated by law to assign all of his patent rights to Spintech, in order to induce Spinello to sign the agreements, Milestone and Osser did not correct Spinello's belief.

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Further, Milestone's and Osser's non-disclosure constituted a fraudulent misrepresentation because they intended their non-disclosure to induce Spinello to enter into the employment agreement and to sell his Spintech stock to Milestone.

(Proposed Amended CC Count Three ¶¶ 31, 33, 35.)

Magistrate Pisano undertook a thorough and reasoned analysis of the elements necessary to establish a claim for fraud under Pennsylvania or New Jersey law:<sup>7</sup> (1) a party made a false statement of material fact; (2) knowing that it was false; (3) with intent to induce that person to rely upon it; (4) the person must have reasonably relied upon it; (5) to his or her detriment or damage. (See Opinion at 9 (citing Caplan v. International Fidelity Ins. Co., 885 F. Supp. 175, 178 (N.D. Ill. 1995) (applying New Jersey law); R.A. Intile Realty Co. v. Raho, 259 N.J. Super. 438, 475 (1992); Hotel and Restaurant Employees' Alliance, Local No. 237, of the Hotel and Restaurant Employees' Int'l Union and Bartenders' Int'l League of America. AFL-CIO, et al. v. Allegheny Hotel Co., ("Hotel and Employee's Restaurant Alliance"), 374 F. Supp. 1259, 1265 (W.D. Pa. 1974)).) Further, to constitute a legal fraud, the alleged material misrepresentation must involve "a presently existing or past fact." (Id. (quoting Berman v. Gurwicz, 189 N.J. Super. 89, 92 (Ch. Div. 1981), aff'd, 189 N.J. Super. 49 (N.J. Super. App. Div.), cert. denied, 94 N.J. 549 (1983); see also Huddleston v. Infertility Center of America. Inc., 700 A.2d 453, 461 (Pa. Super. 1997)).)

An affirmative misrepresentation or an intentional nondisclosure may give rise to a fraud claim. This Circuit has held that an intentional non-disclosure claim's elements are basically the same as that of the tort of fraudulent misrepresentation. (See Opinion at 9 (citing City of Rome v. Glanton, 958 F. Supp. 1026, 1038 (E.D. Pa.), aff'd, 133 F.3d 909 (3d Cir. 1997)).) However, as recognized by Magistrate Judge Pisano, New Jersey and Pennsylvania law direct that "there is no liability for nondisclosure absent a

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<sup>7</sup> Spinello does not dispute Magistrate Judge Pisano's conclusion that he did not need to determine the choice of law issue because the law of New Jersey and Pennsylvania "are substantially similar" with respect to the issues before the court. (See Def. Br. at 16 n.3; Opinion at 9 n.5.)

duty to speak." (Opinion at 10 (citing, in part, Duquesne Light Co. v. Westinghouse Elec. Corp., 66 F.3d 604, 612 (3d Cir. 1995) (applying Pennsylvania law); United Jersey Bank v. Kensey, 1997 WL 784485, at \*5 (N.J. Super. App. Div. 1997)).)

Both New Jersey and Pennsylvania courts rely on the Restatement (Second) of Torts § 551 to determine the scope of the duty of disclosure. (See id. (citing Duquesne Light Co., 66 F.3d at 611-12 (applying Pennsylvania law and determining that a defendant has no duty to speak where the two parties are sophisticated business entities with equal and ample access to legal representation); United Jersey Bank v. Kensey, 306 N.J. Super. 540, 557-558 (App. Div. 1997), cert. denied, 153 N.J. 402 (1998).) Subsection 2(e) of this Restatement directs that a party has a duty to disclose to another "facts basic to the transaction, if he knows that the other is about to enter it under a mistake . . . ." (Id. (quoting Restatement (Second) of Torts § 551, Subsection 2(e)).)

Magistrate Pisano cited to case law directing when a duty to disclose arises and does not arise in certain factual circumstances.<sup>8</sup> In the current case, Magistrate Pisano found -and the Court is in agreement -- that Milestone and Osser did not have a duty to disclose to Spinello their understanding of the law or the contractual terms' potential ramifications. The current case involves sophisticated parties who were represented by legal counsel throughout the employment and stock agreements negotiations.

Magistrate Pisano cited to the case of Duquesne Light, 66 F.3d at 612, which analyzed section 551 of the Restatement (Second) of Torts and which noted that "there is virtually

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<sup>8</sup> For example, a duty to disclose arises "where one party is the only source of information to the other party, or where subsequently acquired knowledge makes a previous representation false." (Opinion at 10 (citing City of Rome v. Glanton, 958 F. Supp. 1026, 1038 (E.D. Pa.), aff'd, 133 F.3d 909 (3d Cir. 1997); United Jersey Bank, 1997 WL 784485, at \*7).) A duty to disclose also arises in a situation where one party is encouraged "to repose a special trust or confidence in [the other party's] advice." (Id. (quoting United Jersey Bank, 1997 WL 784485, at \*5, 8 (citations omitted); citing City of Rome, 958 F. Supp. at 1038).)

no Pennsylvania case in which a defendant has been held to have a duty to speak when both the plaintiff and defendant were sophisticated business entities, entrusted with equal knowledge of the facts." (Opinion at 10-11 (also citing to, among other cases, Berman, 198 N.J. Super. at 89 (holding that condominium purchasers who were represented by and relied upon counsel at the time of sale could not recover on a theory of fraud; the purchasers would be held accountable to the terms of a recreation lease, despite the sellers' failure to disclose those terms)).)

Spinello relies heavily upon the case of Martin v. Hale Products, Inc., 699 A.2d 1283, 1285-88 (Pa. Super. 1997) to support his argument that Magistrate Pisano's denial of leave to amend the fraud in inducement claim was clearly erroneous and contrary to law. (See Def. Br. at 18-19.) In that case, the court concluded that the plaintiff properly stated a claim for fraud in inducement in the context of employment and employment related issues.<sup>9</sup> However, in Martin, the plaintiff was not a sophisticated commercial party; she was apparently an unsophisticated job applicant without an attorney representing her interests.

Spinello does not dispute that he was represented during the negotiations.<sup>10</sup> Nor is this case a "recruiting case." And both parties to the transaction had equal and ample access to legal representation. (See Opinion at 8.) Further, the proposed amended pleading evidences the parties' ongoing negotiation of Spinello's employment agreements. Defendant expressly sets forth the issue of patent rights and his refusal to

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<sup>9</sup> Specifically, during her preemployment interviews, plaintiff asked and received assurances from the company's president that there was no threat of a corporate takeover. Because the plaintiff accepted a position with the company based on the president's representations, but lost her job after the takeover, the Court concluded that a claim for fraud in the inducement was properly stated. (See id. at 1285-88).

<sup>10</sup> See opinion at 8 n.4 (inferring that defendant was represented by legal counsel "in light of the plaintiffs' and Osser's un rebutted assertions in their briefs to this effect.").

sign two proposed agreements on the basis that neither permitted him to retain patent rights to his future inventions. (See Proposed Amended CC Count Three ¶¶ 28, 29, 30.) For Spinello to allege that, when he was presented with and signed the third agreement, he was somehow unaware of or unclear about the patent issue -- which was the subject of the parties' negotiations -- is contrary to common sense and reason. As Magistrate Pisano noted, "[t]hat Spinello allegedly contested the terms within earlier drafts of the agreement only underscores the arm-length nature of the transactions. Spinello and his attorney, after objecting to the format of prior agreements, should have been all the more wary with regard to the effects of the contentious terms." (Opinion at 12.)

Moreover, as noted by the Magistrate, defendant does not argue that he was denied access to the agreements that he signed or that any of the contractual provisions were hidden from him. (See id. at 8.) Nor does Spinello allege that Milestone and Osser's earlier representations were rendered false by subsequently acquired knowledge. And Milestone and Osser allegedly failed to disclose their understanding of a legal document's future effect; the defendant's claim does not concern non-disclosure of a "presently existing or past fact" as required to establish fraud. (Opinion at 9 (quoting Berman, 189 N.J. Super. at 92 and citing other cases setting forth the elements of a fraud claim).) Coupled with the absence of any duty to speak, the Court finds that Magistrate Judge Pisano did not misstate Spinello's fraud in the inducement claim. Rather, the Magistrate applied an appropriate, thorough, and well-reasoned analysis to a reasonable interpretation of the defendant's claim. Magistrate Pisano's denial of Spinello's motion to amend to include a count of fraud in the inducement on the basis of futility is neither clearly erroneous nor contrary to law.

2. **Magistrate Judge Pisano appropriately denied Spinello leave to file an amended shareholders' derivative action brought against Spintech and Milestone**

Spinello next argues in his Appeal that Magistrate Judge Pisano clearly erred in refusing to grant leave to file an amendment of the shareholder's derivative action. Spinello contends that he properly exhausted his intracorporate remedies before advancing this claim.

Magistrate Pisano denied Spinello leave file an amended shareholders' derivative claim on the basis that such claim was futile and would not withstand a motion to dismiss. (See Opinion at 20.) Defendant sought leave to amend his derivative action claim to initiate a Shareholders' Derivative action on behalf of Spintech's minority shareholders against Osser, in addition to his existing Shareholders' Derivative action claim against Milestone and abandoning his existing Shareholders' Derivative action against Spintech. (See id. at 13.) The Magistrate denied Spinello leave to amend his Counterclaim on the basis that the Proposed Amended Counterclaim failed to plead with particularity "(1) the efforts made concerning Spinello's prior demand [-"[f]irstly, . . . the Proposed Amended Counterclaim alleges neither that Spinello made a prior demand on Spintech, nor that the making of a demand on Spintech would be futile" and, "[s]econdly, the Proposed Amended Counterclaim does not plead with particularity the efforts made regarding Spinello's demand to the Milestone board of directors"--]; and (2) facts sufficient to create a doubt as to the good faith and reasonableness of the Board's subsequent investigation and decision to refuse to the demand." (Id. at 18, 19.) In effect, Spinello's proposed amended pleading failed to satisfy the pleading requirements of



Rule 23.1 of the Delaware Chancery Court and the Federal Rules of Civil Procedure.

(See id. at 18, 14.)

Rule 23.1 of the Federal Rules of Civil Procedure, entitled "Derivative Actions by Shareholders," provides:

In a derivative action brought by one or more shareholders or members to enforce a right of a corporation . . . the corporation or association having failed to enforce a right which may properly be asserted by it, the complaint . . . shall allege (1) that the plaintiff was a shareholder or member at the time of the transaction of which the plaintiff complains . . . and (2) . . . [t]he complaint shall also allege with particularity the efforts, if any, made by the plaintiff to obtain the action the plaintiff desires from the directors or comparable authority and, if necessary, from the shareholders or members, and the reasons for the plaintiff's failure to obtain the action or for not making the effort.

Fed. R. Civ. Proc. 23.1. The demand requirement of Rule 23.1 "clearly is a matter of 'substance', not 'procedure'." Kamen v. Kemper Fin. Servs., Inc., 500 U.S. 90, 96-97 (1991); see Levine v. Smith, 591 A.2d 194, 207, 210 (Del. 1991) (directing that the demand requirement is not a mere formality, "but rather an important 'stricture[]of substantive law'.").<sup>11</sup>

The manner in which demand was made or cogent reasons that it was not must be pled with particularity by a derivative plaintiff. See Kamen, 500 U.S. at 95-96. The demand requirement is rigorously enforced in light of the important policies underlying

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<sup>11</sup> As set forth by Magistrate Pisano, "[b]ecause Spintech and Milestone are Delaware corporations, the Court applies Delaware law to determine the sufficiency of Spinello's prior demands upon these entities. See Kamen v. Kemper Fin. Servs., Inc., 500 U.S. 90 (1991) (determining that a board of director's power to continue a cause of action on behalf of the corporation is governed by the law of the state of incorporation); Cover v. Hemmer, 901 F. Supp. 872, 882 (D.N.J. 1995) (applying Delaware law to determine whether demand was excused by the board of directors of a Delaware corporation)." (Opinion at 15 note 8.)

Rule 23.1. See Cramer v. General Tel. & Elecs. Corp., 582 F.2d 259, 275 (3d Cir. 1978), cert. denied, 439 U.S. 1129 (1979).

The requirement that demand must be pled with particularity is widely understood to be a deliberate departure from the relaxed policy of 'notice' pleadings. See Allison v. General Motors Corp., 604 F. Supp. 1106, 1112 (D. Del.), aff'd mem., 782 F.2d 1026 (3d Cir. 1985). In a derivative pleading, "[c]onclusory allegations of fact or law [which are] not supported by allegations of specific fact may not be taken as true" and a plaintiff's pleading burden is "more onerous than that required to withstand a Rule 12(b)(6) motion to dismiss." Levine, 591 A.2d at 207.

Review of the complaint's allegations are the sole gauge, under Delaware law, by which a determination is made as to the adequacy of demand and issues of demand futility. See Allison, 604 F. Supp. at 1112; Aronson v. Lewis, 473 A.2d 805, 814 (Del. 1984) (construing Delaware Chancery Court Rule 23.1); Pogostin v. Rice, 480 A.2d 619, 622, 624 (Del. 1984) (same). (See Opinion at 18 (recognizing the proposition that "[t]o determine whether the plaintiff satisfies a demand requirement, the court restricts its inquiries to the allegations of the complaint.") (citing to Spiegel v. Buntrock, 571 A.2d 767, 774 (Del. 1990)).)

As to the demand issue, Spinello's Proposed Amended Counterclaim states only that "[p]rior demand has been made upon Milestone's Board to address these matters but the Board has refused. Any further demand would be a futility." (Proposed Amended CC Count Two ¶ 24.)

Magistrate Pisano appropriately determined that, although Spinello was required to make a demand on Spintech, "the Proposed Amended Counterclaim alleges neither

that Spinello made a prior demand on Spintech, nor that the making of a demand on Spintech would be futile. "<sup>12</sup> (Opinion at 19.) The Court reiterates that a Rule 23.1 analysis is restricted to the pleadings' factual allegations. The Magistrate reasonably concluded that defendant's proposed pleadings were insufficient to establish a demand; Spinello failed to satisfy the particularity requirements of Rule 23.1.

As set forth above, extrinsic evidence is not admissible to establish a demand and, as the Magistrate recognized, a court "restricts its Rule 23.1 analysis to the factual allegations of the pleadings." (Opinion at 19 note 11.) Magistrate Pisano found that "the demand-excused . . . standard is inapplicable to the instant case" (Id. at 16 note 9) on the basis of Spinello's allegation that he "made a prior demand on the Board." (Id.; see Proposed Amended CC ¶ 24.) The Magistrate further reasoned that a shareholder claiming that he made a demand cannot also plead that a demand would be futile, citing "Spiegel, 571 A.2d at 775 ('[b]y making a demand, a stockholder tacitly acknowledges the absence of facts to support a finding of futility'); Stotland v. GAF Corp., 469 A.2d 421, 422-23 (Del. 1983) ('when a demand is made, the question of whether demand was excused is moot'). Consequently, the [Magistrate-limited his] review to the 'demand-refused' analysis under Rule 23.1." (Opinion at 16 note 9.)

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<sup>12</sup> Specifically, the Opinion states:

The Court finds that the defendant's proposed derivative action claim is futile for its failure to satisfy the prerequisites of Rule 23.1 of the Delaware Chancery Court and the Federal Rules of Civil Procedure. The proposed pleadings do not demonstrate that Spinello satisfied his obligations under Rule 23.1 to exhaust intracorporate remedies prior to filing suit in court. Specifically, the Proposed Amendment is deficient because it does not: (1) allege that Spinello made a demand on Spintech's directors to take action before filing his Counterclaim; (2) allege with specificity the efforts Spinello made to demand action from the Milestone and Spintech directors prior to filing his Counterclaims; (3) allege with specificity facts to create a doubt that the Business Judgment Rule should apply to Milestone and Spintech's decision to reject the demand.

(Opinion at 14-15.)

However, Spinello grounds his Appeal of this proposed claim on the assertion that he was not required to make a formal demand on Spintech's board of directors because such demand would be futile. (See Def. Br. at 22.)

Milestone and Spintech characterize this assertion as "a feat of alchemy" given that defendant's argument before the Magistrate was directly contrary; Spinello is "now arguing that this is a 'demand-futility' case and not a 'demand-excused' case." (Plf. Opp. at 28.) When before the Magistrate Judge, Spinello apparently argued that he had made a demand on Spintech. (See id. at 28.)

Plaintiffs set forth that in defendant's Reply Brief to the Magistrate, he specifically argued that Milestone and Spintech "should be estopped from claiming that Spinello failed to make a demand before filing suit. . . ." (See id.: (quoting Def. Reply Br. at 11).) Milestone and Spintech maintain that because Spinello previously argued that a legal demand had been made on Spintech, defendant is now precluded from asserting that no such demand was made. In support of this argument, plaintiffs cite to the case of Grimes v. Donald, 673 A.2d 1207 (Del. Super. 1996) for the proposition that when a "derivative plaintiff alleges that a demand was made, he cannot later contend that the demand was excused." (Plf. Opp. at 29.)

However, defendant maintains that "Milestone's notation of the 'holding' of Grimes is simply wrong." (Def. Reply at 8.) Rather, Grimes held that "after making a demand, a plaintiff could not then assert that demand was futile." (Id. (citing to 673 A.2d at 1219).) Spinello now argues on appeal that he never made such a demand.<sup>13</sup>

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<sup>13</sup> In fact, he maintains that "the Magistrate Judge expressly concluded, as a matter of law, that no demand was made." (Def. Reply at 8 n.7.)

Rather, he "previously asserted that a legal demand had been made on Spintech."<sup>14</sup> And, as Milestone has repeatedly argued, and the Magistrate Judge concluded, no legal demand was made on Spintech." (Def. Reply at 8-9.) Because no prior demand was made on Spintech by defendant, Spinello maintains that he cannot be precluded from advancing a demand excused argument. (See id. at 8 n.7.) And a "plausible interpretation of the allegation 'any further demand would be a futility' is that it encompasses the allegation that a formal demand on Spintech would be futile." (Def. Br. at 25 n.6.)

The Court holds that Magistrate Pisano reasonably interpreted the express language of the shareholders' derivative claim in concluding that Spinello made a demand on the Spintech Board. The Magistrate found, and this Court agrees, that Spinello makes no allegations in the Proposed Amended Counterclaim dealing with demand, let alone the required specific factual allegations. See supra text at 24 (text of ¶ 24).

Although Spinello now argues the futility of a demand, his contention fails as he neglects to set forth the factual allegations of the futility of a demand on Spintech. The plain language of the allegation refers to Milestone, as the Magistrate so found. In short -- whether arguing that he made a demand or alleged futility of a demand -- in either case, the Proposed Amended Counterclaim does not even begin to satisfy the particularity requirements of Rule 23.1. See supra text at 22 (text of Rule).

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<sup>14</sup> Indeed, the Magistrate considered Spinello's attempt to urge the Magistrate to decipher a demand on Spintech "by examining various correspondence that he submitted to the Board prior to filing this lawsuit." (Plf. Opp. at 26 (citing Opinion at 19 note 11.)) However, Magistrate Pisano reasoned that "pursuant to Massarsky v. General Motors Corp., 706 F.2d 111 (3d Cir.), cert. denied, 464 U.S. 937 (1983)] . . . the determination of whether a proposed amendment would be futile requires a 12(b)(6) analysis. As such, the Court looks only to the facts alleged in the pleadings and their attachments. Similarly, under Spiegel, the Court restricts its Rule 23.1 analysis to the factual allegations of the pleadings." (Opinion at 19 note 11.)

Defendant does argue that "a demand on the Board of Directors of Spintech would clearly have been futile in light of Spinello's numerous allegations that Milestone and Osser acted without independence and engaged in oppressive conduct designed to maximize their own self-interests." (Def. Br. at 25.) Spinello also relies on other allegations in the Proposed Amended Counterclaim to support this proposition, but those allegations only address Milestone and Osser. Milestone was not a Spintech board member and Osser was only one of six Spintech Board members (which included Spinello and his son). (See Def. Br. at 25 (citing to Proposed Amended CC ¶¶ 19, 17-37, 41); Plf. Opp. at 31.) These arguments are insufficient to establish, with particularity, the futility of making a demand on the Spintech Board for the reasons set forth in Grimes.<sup>15</sup> Indeed, Spinello quotes a Delaware Supreme Court case directing that "the standard for pleading such futility" in part involves alleging "particularized facts." (Def. Br. at 24 (quoting Heineman v. Datapoint Corp., 611 A.2d 950, 952 (Del. 1992 (quoting Aronson v. Lewis, 473 A.2d 805 (Del. 1984)).)

Thereby, the Court finds that Magistrate Judge Pisano's finding that Spinello failed either to make a demand or to allege futility in the making of a demand was neither clearly erroneous nor contrary to law. Indeed, defendant "readily concedes" that

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<sup>15</sup> Grimes opined that "[t]he basis for claiming excuse [from making a demand] would normally be that: (1) a majority of the board has a material financial or familial interest; (2) a majority of the board is incapable of acting independently for some other reason such as domination or control; or (3) the underlying transaction is not the product of a valid exercise of business judgment." Grimes, 673 A.2d at 1216 (citations omitted); see Def. Br. at 25 and Plf. Reply at 30 (quoting this passage from Grimes).

Magistrate Pisano's interpretation of this claim "was due, in part, to some less than clear allegations in Spinello's complaint."<sup>16</sup> ( Def. Reply at 7 n.6.)

Turning to the Magistrate's denial of leave to amend the derivative action as to Milestone, the Court will affirm Magistrate Judge Pisano as to this determination. The Magistrate found Spinello's proposed shareholders' derivative claim futile after concluding that defendant failed to allege, with particularity, facts regarding his efforts to make a formal demand on Milestone's Board of Directors, in addition to failing to set forth factual allegations sufficient to create a doubt as to the good faith and reasonableness of the Milestone Board's refusal of such demand. (See Opinion at 17-20.)

Spinello maintains now that he was not required to make a formal demand upon Milestone's Board of Directors as his proposed derivative claim is not a "double derivative" action. (See Def. Br. at 27.) Defendant is not advancing a shareholder's derivative action on behalf of Milestone as he is not a shareholder of Milestone. "Rather, Spinello seeks to advance a shareholders' derivative action on behalf of Spintech (of which he is a minority shareholder) against Milestone (as the majority shareholder of Spintech), Osser (as a Director of Spintech), and Spintech which is, of course, a nominal defendant." (Id.) As such, Magistrate Pisano's finding that defendant's

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<sup>16</sup> This erroneous interpretation by the Magistrate was in concluding that defendant was advancing a "double derivative" action against Milestone and that he was advancing a shareholder's derivative "demand-refused" action against Spintech. (See Def. Reply at 7 n.6.) Spinello then offered to submit yet another amended pleading to clarify the proposed amended pleading. (See id.)

demand on Milestone's Board was insufficient should be set aside.<sup>17</sup> (See Def. Br. at 27-29; Opinion at 19-20.)

Magistrate Judge Pisano reviewed the allegations of the proposed amended pleading. As set forth prior, Spinello alleged that "[p]rior demand has been made upon Milestone's Board to address these matters but the Board has refused. Any further demand would be a futility." (Proposed Amended CC ¶ 24.) A "double derivative" action is one involving a suit brought against a parent company and a subsidiary company. "In general, to bring a double derivative suit, '[a] plaintiff shareholder must make a demand twice, once of the subsidiary company and once of the holding company.'" Blasband v. Rales, 971 F.2d 1034, 1050 (3d Cir. 1992) (quotation and citations omitted). The Third Circuit has held that considering the demand requirements in a double derivative suit, "we believe the Delaware Supreme Court would require demand upon both the parent and subsidiary corporations in such a suit in view of the strong policy of preventing shareholders from impinging upon the managerial freedom of the board of directors." Id. (citation omitted).

The pleadings aver that a demand was made on Milestone by Spinello. Indeed, the Proposed Amended Counterclaim specifically sets forth that a demand was made on Milestone and is silent as to Spintech. See supra text. In fact, Milestone and Spintech respond to the defendant's contention that no demand was required to be made on Milestone only by arguing that Spinello "ignores that it was his own proposed

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<sup>17</sup> Spinello relies on the persuasive authority of Price v. Standard Oil Co., 55 N.Y.S. 2d 890, 894-96 (1945) to support his argument. (See Def. Br. at 28-29.) However, as distinguished from the current case, no demand was made on defendant Standard Oil (the holding company of the subsidiary company). See infra text.



pleading that alleged a demand on the Milestone Board." (Plf. Opp. at 28 note 11 (citing to Proposed Amended CC ¶ 24).)

As discussed above, the Magistrate applied the "demand-refused" standard to the current case on the basis of this allegation. The Court need not go further. The Court agrees with the Magistrate's characterization of the pleading as "threadbare assertions." (Opinion at 20.) It was for Spinello, and not the Magistrate, to allege in the pleadings that a demand on the Milestone Board of Directors was not required. Or, at the least, it was for Spinello to avoid making an allegation like that found in the proposed amended pleading -- a "[p]rior demand has been made upon Milestone's Board -- which reasonably goes to an interpretation that the proposed derivative claim is intended to be a double derivative action. As such, the Magistrate reviewed the allegations, appropriately restricting his analysis to the pleadings' factual allegations, and rendered a reasonable interpretation in determining that defendant was bringing a double derivative action, that Spinello had made a demand on Milestone, but that that demand failed to comport with the requirements of Rule 23.1 of the Delaware Chancery Court and the Federal Rules of Civil Procedure. In correctly applying the demand analysis, Magistrate Pisano determined that the allegations lacked the requisite factual particularity and failed to create a doubt as to the good faith and reasonableness of the Milestone Board's decision to refuse the demand. In light of the allegations set forth in the proposed amended counterclaim, the Court cannot find the Opinion and Order at issue to be clearly erroneous or contrary to law in denying the Spinello's motion to amend as to the derivative claim.

3. **Magistrate Judge Pisano correctly denied Spinello leave to amend the proposed civil conspiracy claim on the basis of futility**

Spinello next argues that the Magistrate clearly erred in concluding that defendant's proposed civil conspiracy claim was futile where the claim is based on the underlying causes of action of fraud in the inducement and minority shareholder oppression. (See Def. Br. at 31.)

Magistrate Pisano denied Spinello's motion to amend his conspiracy claim, recognizing that "a cause of action for conspiracy only exists if there is a cause of action for the underlying act." (Opinion at 22 (citing Middlesex Concrete Prods. & Excavative Corp. v. Carteret Indus. Ass'n, 37 N.J. 507, 516 (N.J. 1962) ("a conspiracy cannot be made the subject of a civil action unless something has been done which, absent the conspiracy, would give a right of action"))).) As the Court has affirmed Magistrate Judge Pisano's ruling as to the proposed amended fraudulent inducement and derivative claims, there exists no underlying act to support the proposed amended civil conspiracy claim. Thus, the Court finds that Magistrate Pisano's denial of Spinello's motion to amend his conspiracy claim for futility was neither clearly erroneous nor contrary to law.

4. **Magistrate Pisano correctly denied Spinello's jury trial demand**

Lastly, the Court will affirm the Magistrate's denial in the May 5, 1998 Order of Spinello's demand for a jury trial. Defendant raised this demand for the first time in his proposed amended pleading. He contended that he did not waive his right to a jury trial because his proposed pleadings "raise [ ] new and distinct legal and factual issues which were not part and parcel of his prior pleading . . . , i.e., Spinello's fraud claims." (Opinion

at 23 (citing Def. Reply Br. in Support at p. 14).) However, Magistrate Pisano determined that "[b]ecause the Court has denied the defendant leave to either amend his conspiracy and shareholder's derivative action claims, or to add a claim for fraudulent inducement, it need not consider whether these claims would have raised new issues for purposes of Rule 38."<sup>18</sup> (Id. at 24.) This Court, having affirmed the Magistrate's denial of leave to amend Spinello's fraudulent inducement, shareholder's derivative action, and conspiracy claims, finds that Magistrate Pisano correctly ruled that whether those claims would have raised new issues for the purposes of Rule 38, see supra note 18, need not be considered in light of his denial of the Motion to Amend.

In sum, the Court finds that Spinello has failed to satisfy his burden of demonstrating that Magistrate Judge Pisano's findings in the May 5, 1998 Order are clearly erroneous or contrary to law. The Court is persuaded that the defendant failed to make a sufficient showing from which Magistrate Judge Pisano could have granted the amendment motion. Spinello has not met his burden of establishing "a definite and firm conviction that a mistake has been committed" by the Magistrate. Thereby, the Court finds that Magistrate Judge Pisano's Order denying defendant's motion to amend and demand for a jury trial is neither clearly erroneous nor contrary to law. The Order will be affirmed in its entirety.

Throughout his pleadings, Spinello has sought leave to file an amended counterclaim that will withstand a motion to dismiss should this Court affirm Magistrate

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<sup>18</sup> Rule 38 of the Federal Rules of Civil Procedure governs demand and waiver of the right to a trial by jury. Demand must be made in the original pleadings or with ten days thereafter. Else, the right to a jury trial is effectively waived. See Fed. R. Civ. Proc. 38(b) and (d); Opinion at 23-24.

Pisano's May 5, 1998 Order.<sup>19</sup> Defendant argues that neither Milestone nor Osser would be harmed should such leave be granted. "[N]one of the parties would suffer any prejudice as all have agreed to stay discovery until the instant matters are resolved." (Def. Br. at 31.)

The Court is mindful that leave to amend should be freely and liberally granted. See supra text at 7. "The federal rule policy of deciding cases on the basis of the substantive rights involved rather than technicalities requires that [a party] be given every opportunity to cure a formal defect in his [or her] pleading." (Def. Br. at 21 (quoting Resolution Trust Corp. v. DiDomenico, 837 F. Supp. 623, 631 (D.N.J. 1993) (quotation omitted).) Magistrate Judge Pisano granted such leave. Spinello now seeks for this Court to provide him leave to amend for a second time. However, defendant has, in essence, been given "every opportunity" to cure his pleadings. Spinello's proposed amended pleadings largely failed to meet even the minimum pleading requirements. The Court does not interpret the liberality afforded to amendment requests as encompassing requests to amend which, when granted, the requesting party fails to take that opportunity to cure his or her pleadings. The substance of this Opinion and Magistrate Pisano's May 5, 1998 opinion do not set forth novel directives of law; Spinello's proposed amended counterclaim could have been properly alleged with care and diligence. For these reasons, the Court will deny Spinello leave to amend his proposed amended pleadings.

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<sup>19</sup> Milestone and Spinello object to defendant's inclusion of a proposed Second Amended Answer and Counterclaim. (See Def. Reply Exh. A.) Plaintiffs maintain that the document was not a part of the record before the Magistrate. And Spinello allegedly raises new arguments that circumvent Milestone and Spintech's right to respond to an entirely new pleading. (See Plfs.' 7/28/98 & 7/31/98 letters.)

## **II. Objections to Magistrate Judge Pisano's May 5, 1998 Report and Recommendation**

### **A. Standard of Review**

A magistrate judge submits proposed findings, recommendation or report pursuant to 28 U.S.C. § 636(b)(1)(B). The Court reviews de novo those portions of the proposed findings, recommendation or report to which objection is made. See Local Civ. R. 72.1(c)(2) (entitled "Objections to Magistrate Judge's Proposed Findings, Recommendation or Report").

### **B. Magistrate Judge Pisano's recommendation that Counts Two, Three, and Four of Spinello's original Counterclaim be dismissed will be adopted as the opinion of this Court and Counts Two to Four will be dismissed pursuant to Rule 12(b)(6)**

On May 6, 1998, Magistrate Judge Pisano filed a Report and Recommendation in which he recommended that Counts Two (a shareholders' derivative action), Three (civil conspiracy), and Four (indemnification) of the defendant's original Counterclaim be dismissed for failure to state a cause of action upon which relief may be sought under Federal Rule of Civil Procedure 12(b)(6). After entering the appealed Order determining that Spinello's Proposed Amended Counterclaim failed to state a cause of action and denying defendant's motion to amend on the basis of futility (affirmed supra), the Magistrate next considered Milestone and Spintech's motion to dismiss Spinello's original Counterclaims. (See R&R at 3.) In recommending that Counts Two to Four be dismissed, Magistrate Judge Pisano referred to the May 5, 1998 Opinion and based his reasoning on a comparison of the defendant's original and amended claims "to determine whether the different language of the original pleadings resurrects the claim[s]" because "a motion to dismiss and a motion to amend invoke the same legal

standard." (Id.) See supra text at 8-10 (setting forth Rule 12(b)(6)'s motion to dismiss standard).

Magistrate Pisano documented his reasons for suggesting that this Court dismiss Counts Two to Four. Addressing specifically Count Two, Spinello does not contest the Magistrate's determination that defendant's original and amended shareholders' derivative claims differ in only two ways: "(1) the amended claim seeks to hold Milestone's CEO and President, Leonard Osser . . . directly liable as a third-party defendant in lieu of Spintech; (2) the original claim alleges that Spinello made a prior demand upon 'the Corporation's Board,' while the amended claim specifies that Spinello made a demand upon Milestone's Board." (R&R at 3 (citing Counterclaim. ¶ 24; Proposed Amended CC ¶ 24); see Def. Objecting Br. at 10 n.4.) The Magistrate found that, despite these differences, neither the original nor the amended claims "(1) allege that Spinello served a prior demand upon Spintech; (2) allege with particularity the efforts made concerning Spinello's prior demand; and (3) allege facts sufficient to create a doubt as to the good faith and reasonableness of the Board's decision to refuse this demand." (R&R at 4.) Relying upon the reasons discussed in the May 5, 1998 Opinion, the Magistrate concluded that the derivative action failed to state a claim upon which relief could be granted; the action failed to satisfy the pleading requirements of Rule 23.1 of the Federal Rules of Civil Procedure and of the Delaware Chancery Court. As such, Magistrate Pisano recommended that Milestone and Spintech's motion to dismiss this Counterclaim be granted. (See id.)

And again relying upon the reasons discussed in the May 5, 1998 Opinion and undertaking the same comparison of defendant's original and amended Civil Conspiracy

Counterclaims (Count Three), Magistrate Pisano recommended that the plaintiffs' motion to dismiss the civil conspiracy counterclaim be granted. The original and amended conspiracy counterclaims differed as follows: "(1) the amended claim seeks to hold Osser directly liable as at third-party defendant; (2) the original claim does not allege that the plaintiffs and Osser conspired to fraudulently induce the defendant 'to sell his Spintech shares to Milestone and enter into an employment agreement with Spintech.'" (Id. at 5 (quoting Proposed Amended CC ¶ 41(f)).) The Magistrate determined that neither of the differences between these claims "address or cure the flaw" in defendant's Civil Conspiracy claim, namely, the pleadings failed to "allege that the plaintiffs conspired to commit a predicate underlying act for which there exists a separate cause of action." (Id.)

In opposition to the plaintiffs' motion to dismiss, Spinello incorporates his arguments addressing both the shareholders' derivative claim and the civil conspiracy claim set forth in its pleadings in support his Appeal from the Order denying Spinello leave to amend his counterclaims. Defendant did so in light of the fact that his original shareholders' derivative claim and civil conspiracy claim are "nearly identical" to the claims proposed in the motion to amend and "in an effort to join the Magistrate Judge in avoiding duplication." (Def. Opposition at 10, 11.) Following suit, Milestone and Spintech incorporate their arguments raised in their pleadings in opposition to Spinello's Appeal as to both the derivative and the civil conspiracy claims.

Likewise, relying upon the reasons discussed above in affirming the May 5, 1998 Order, the Court adopts, as the opinion of the Court, Magistrate Judge Pisano's recommendation that Milestone and Spintech's motion to dismiss Counts Two and

Three of Spinello's original Counterclaim be granted. Defendant's shareholders' derivative action and civil conspiracy claims -- as alleged in his original Counterclaim -- fail to state causes of action upon which relief can be granted for the reasons set forth by the Magistrate. The plaintiffs' motion will be granted and, pursuant to Rule 12(b)(6) of the Federal Rules of Civil Procedure, Counts Two and Three of Spinello's original Counterclaim will be dismissed.

Turning to Count Four, Magistrate Judge Pisano recommended that the motion to dismiss Spinello's indemnification claim be granted with the exception of expenses arising from the defense of claims, including attorney's fees. (See R&R at 10.) Plaintiffs moved to dismiss this original Counterclaim which demanded "judgment in [defendant's] favor and against Spintech and Milestone for complete indemnification against all expense, liability, loss and attorney's fees incurred in this proceeding." (Id. at 5 (quoting Counterclm. at 17).) This relief is sought "pursuant to Section 10.01 of the By-laws of Spintech and Section 145 of the Delaware Corporation Law Annotated, 8 Del. C. § 145 (1996)." (Id. at 6 (citing Counterclm. ¶¶ 35, 36).) Magistrate Pisano reviewed the provisions of Spintech's Bylaws and the Delaware Statute upon which defendant relied. Section 10.01 of Spintech's Bylaws provides, in relevant part:

(a) **Right to Indemnification.**

Each person who was or is made a party . . . in any action . . . by reason of the fact that he or she . . . is or was a director or officer of the Corporation or is or was serving at the request of the Corporation as a director, officer, employee or agent of another Corporation . . . shall be indemnified and held harmless by the Corporation to the fullest extent authorized by the Delaware General Corporation Law . . . against all expense, liability and loss (including attorneys' fees, judgments, fines, ERISA excise taxes or penalties and amounts paid or to be paid in



settlement) reasonably incurred or suffered by such person in connection therewith . . . provided, however, that . . . the Corporation shall indemnify any such person seeking indemnification in connection with a proceeding . . . initiated by such person only if authorized by the Board or Directors of the Corporation . . .

(c) Notwithstanding any limitation to the contrary contained in sub-paragraphs (a) and 8(b) of this section, the corporation shall, to the fullest extent permitted by Section 145 of the General Corporation Law of the State of Delaware . . . indemnify any and all persons whom it shall have power to indemnify under section . . . .

(R&R at 7 (quoting Section 10.01 of the Bylaws of Spintech, Inc. (Plfs' Notice of Cross-Motion Ex. 1) (emphasis supplied by Magistrate)).)

Section 145 of the Delaware Corporation Law provides, in relevant part;

(b) A corporation may indemnify any person who was or is a party . . . to any . . . action or suit by or in the right of the corporation to procure a judgment in its favor by reason of the fact that he is or was a director, officer, employee or agent of the corporation . . . against expenses (including attorneys' fees) actually and reasonably incurred by him in connection with the defense or settlement of such action or suit if he acted in good faith and in a manner he reasonably believed to be in or not opposed to the best interests of the corporation and except that no indemnification shall be made in respect of any claim, issue or matter as to which such person shall have been adjudged to be liable to the corporation unless and only to the extent that the Court of Chancery or the court in which such action or suit was brought shall determine upon application that, despite the adjudication of liability but in view of all the circumstances of the case, such person is fairly and reasonably entitled to indemnity for such expenses which the Court of Chancery or such other court shall deem proper.

(c) To the extent that a director, officer, employee or agent of a corporation has been successful on the merits or otherwise in defense of any action . . . referred to in subsections (a) and (b)

. . . he shall be indemnified against expenses (including attorneys' fees) actually and reasonably incurred by him in connection therewith.

(Id. (quoting Delaware Corporation Law Annotated, 8 Del. C. § 145(b) (1996) (emphasis supplied by Magistrate)).)

Magistrate Pisano recommended that Spinello's claim for indemnification of his fees, expenses and liability should, in large part, be dismissed pursuant to Rule 12(b)(6). Specifically, the Magistrate found that (1) no indemnification claim could be asserted against Milestone, because defendant is not now, nor ever was, an officer, director or employee of Milestone, and therefore cannot claim to enjoy rights of indemnification under Milestone's Bylaws; (2) an indemnification claim against Spintech based on expenses incurred in connection with Spinello's counterclaims could not be raised because those counterclaims do not constitute actions authorized by Spintech's Board of Directors as required by its Bylaws; and (3) Spinello could not be granted indemnification with respect to any "liability" or "loss" because, pursuant to Section 145(b) of the Delaware Code, in actions by or in the right of the corporation - - such as the instant action -- indemnification applies not to judgments, but only to expense (including attorneys' fees) actually and reasonably incurred. Lastly, Magistrate Pisano recommended that the plaintiffs' motion to dismiss to the extent that Spinello seeks indemnification for expenses relating to Milestone and Spintech's claims should be denied without prejudice pending development of a full record.

In his objection, Spinello disputes only Magistrate Pisano's recommendation as to (2) and (3) above. Defendant did not object to the recommendation as to indemnification sought from claims against Milestone -- (1) above -- and none of the

parties objected to the denial, without prejudice, of Spinello's indemnification claim for expenses in relation to plaintiffs' claims.

Spinello argues that, in dismissing his claim for indemnification for fees and expenses in pursuing his counterclaims, Magistrate Pisano erroneously relied on the provision of Spintech's Bylaws that provide for such indemnification only if the proceedings are "authorized by the Board of Directors of the Corporation." (Def. Opp. at 15-16; Bylaws at § 10.01(a).) Spinello objects to the Magistrate's recommendation to dismiss his claim for indemnification on the basis that the recommendation is "simply wrong." (See id. at 14.)

Relying exclusively on Section 145(c) of the Delaware statute, and the reference in Section 145(c) to Section 145(b), defendant asserts that his shareholders' derivative counterclaim is precisely the type of action covered by Section 145(b).<sup>20</sup> (See id. at 14-15.) Spinello argues that upon a shareholder's success in a derivative action -- such as the one brought by Spinello in this case -- indemnification of expenses and attorney's fees is required, "at a minimum." (Id. at 14.) However, as noted by plaintiffs, defendant fails to provide authority for the proposition that "indemnification is required notwithstanding any Spintech Bylaw to the contrary."<sup>21</sup> (Id.) Spinello further contends

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<sup>20</sup> Spinello "does not even attempt to justify his claim for indemnification with respect to any of his counterclaims other than the derivative claim." (Plf. Opp. at 16.)

<sup>21</sup> As stated by the Magistrate:

The Court notes that the Spintech Bylaws and the Delaware statute are not in conflict, although the Bylaws permit less indemnification than the statute. This is because "a corporation is free to invoke less than all the indemnification power granted it under . . . statute." Essential Enters. Corp. v. Dorsey Corp., E.F. Hutton Grp., Inc., 652 A.2d 578, 593 n. 19 (Del. Ch. 1994); see also Shearin v. E.F. Hutton Group, Inc., 652 A.2d 578, 593 n.19 (Del. Ch. 1994) (applying Section 145 of the Delaware Corporation Law to determine the scope of indemnification under the assumption that the relevant corporate bylaws defer to this statute).

(R&R at 8 note 3.)

that Magistrate Pisano's reasoning that a board of directors would authorize a suit against the corporation, "thereby entitling that individual to indemnification, is unsound." (Id. n.6.) Spinello maintains that "[t]hat is precisely why the Delaware law mandates indemnification for such actions." (Id.)

Plaintiffs characterize the latter argument as frivolous -and the Court agrees -- given that, "[b]y its terms, Section 145(c) only applies to a successful 'defense' of actions referred to in Section 145(a) or (b) of the Delaware Code, not the pursuit of counterclaims." (Plf. Opposition at 16 (citing to Mayer v. Executive Telecard, Ltd., 705 A.2d 220 (Del. Ch. 1997) (holding that the right to indemnification under Section 145(c) does not extend to recovery of expenses incurred in successful suit to enforce such right to indemnification)).)

Further, should Spinello succeed on his derivative counterclaim, Section 145(b) is inapplicable to the current case because, although encompassing derivative actions, "it is not the section upon which a successful shareholder plaintiff in a derivative action would recover his fees and expenses." (Id. at 17.) This section applies only to persons who are parties to a derivative action "by reason of the fact that they are a director, officer, employee, or agent of the corporation . . . ." Spinello expressly sets forth that his role in this derivative action is that of a shareholder (see Def. Opposition at 14), and not that of a director or officer. In effect, Section 145(b), on its face, does not authorize Spinello to recover fees and expenses incurred in the derivative action, even if defendant were allowed to pursue such an action.

Spinello also faults the Magistrate for his reliance on Shearin v. E.F. Hutton Group, Inc., 652 A.2d 578 (Del. Ch. 1994) (see R&R at 8 note 3; see supra note 21)

because, contrary to the instant case, Spinello argues that the plaintiff's claims in Shearin were not brought on the corporation's behalf. "Spinello has filed a shareholders' derivative claim on behalf of Spintech." (Def. Opposition at 14.) However, as set forth above, neither Section 145(b) or (c) applies to defendant's derivative claim asserted in his capacity as a Spintech shareholder. And plaintiffs maintain that the Shearin court denied the plaintiff's motion for leave to amend in part because her claims did not arise "by reason of" her employment status. (Plf. Opposition at 18.) As such, Shearin buttresses Milestone and Spintech's arguments because "it is apparent that all of Spinello's counterclaims are crafted not to serve Spintech's interests, but his own." (Id. at 19.) Indeed, defendant brought his counterclaims only after Spintech terminated his employment. Further, Spinello asserted his grievances in the form of counterclaims -- waiting until plaintiffs sued him -- thereby "controverting any argument that his allegations arise 'by reason of' his employment." (Id.)

Spinello does not dispute that his derivative counterclaim does not constitute an action authorized by Spintech's Board of Directors as required by its Bylaws. Rather, he relies upon the Delaware Code which is inapposite to the instant action. As expressly set forth by defendant, the derivative claim was filed on Spintech's behalf. Thus, the Court finds that Spinello is not entitled to indemnification for fees and expenses in pursuing his counterclaims either under Spintech's Bylaws or under the Delaware Code provisions relied upon by defendant. Magistrate Pisano's recommendation will be adopted and plaintiffs' motion to dismiss will be granted with respect to expenses arising out of Spinello's counterclaims.

Spinello further disputes Magistrate Pisano's finding that defendant is not entitled to indemnification for "liability" or "loss" under Section 145(b) of the Delaware Code. The Magistrate found that Section 145(b) applies only to expenses, not monetary judgments. (See R&R at 9.)

Spinello does not challenge the Magistrate's reading of Section 145 (b)'s limited indemnity provision. Indeed, on its face, Section 145(b) grants indemnification only for litigation "expenses (including attorneys' fees) actually and reasonably incurred . . . .", 8 Del. C. § 145(b), but does not permit the broader indemnification of "judgments, fines and amounts paid in settlement actually and reasonably incurred . . ." allowed under Subsection 145(a). (Plf. Opp. at 20 (quoting R. Franklin Balotti and Jesse A. Finkelstein, 1 The Delaware Law of Corporations and Business Organizations, Section 4.12 at 4-323, 4-325 (Aspen Law & Business 1996 & 1997 Supps.)).)

Spinello now argues that Magistrate Pisano improperly concluded that Section 145(b) governed his claim for indemnification. (See Def. Opp. at 16.) The defendant asserts that Spintech's Bylaws provide for greater indemnification rights than those provided in Section 145(b). He relies on Salaman v. National Media Corp., No. 92C-01-161, 1992 WL 808095, \*4 (Del. Super. Oct. 8, 1992) for the proposition that "[t]he corporation may provide greater protection than that granted by the statute." (Def. Opp. at 16.) However, the Spintech Bylaws do not provide such greater protection but, rather, only allow for indemnification to the extent of, but not greater than, Delaware law. Specifically, the Bylaws provide for indemnification only "to the fullest extent authorized by the Delaware General Corporation Law." (Bylaws § 10.01(a)(c).) Indeed, Spinello quotes this exact language. (See Def. Opp. at 16.) Delaware law, Section 145(a),

provides for indemnification for, among other things, judgments. (See id. at 17 (citing to Section 145(a) of the Delaware Code) (text not provided).) However, Section 145(a) applies only to third-party actions -- and not to actions like the instant suit, brought by or in the right of the corporation. (See Plf. Opp. at 22 (citing to Balotti and Finkelstein, ¶ 4.12 at 4-323-325; Green v. Westcap Corp. of Delaware, 492 A.2d 260, 264 (Del. Super. 1985)).) As such, Section 145(a) is inapplicable to Spinello's indemnification claims.

Accordingly, Magistrate Judge Pisano's recommendation that the portion of Spinello's indemnification claim for "loss" or "liability" associated with Milestone and Spintech's claims against the defendant be dismissed will be adopted; the Magistrate correctly concluded that, as a matter of law, Spinello is not entitled to any indemnification for this portion of his indemnification claim.

Lastly, Spinello argues that the plaintiffs' motion to dismiss should be denied because he was not permitted to present arguments in opposition despite requesting an opportunity to do so. (See Def. Opp. at 17.) Magistrate Pisano did not respond to the parties' request to adjourn the motion to dismiss until after ruling on the motion to amend. Consequently, Spinello's fifteen page reply brief in support of his motion to amend was his "one and only opportunity to respond to not only Milestone, Spintech and Osser's arguments in opposition to Spinello's motion to amend, but also Spinello's one and only opportunity to address the arguments advanced in their motion to dismiss." (Id. at 19.) Further, the Magistrate did not hold oral argument. As such, Spinello maintains that he was prejudiced in the denial of the opportunity to "fully present his arguments in

opposition to Milestone and Spintech's motion to dismiss, prior to the time the Magistrate's recommendations were filed." (Id. at 20.)

The Court overrules Spinello's objections to the procedures adopted by Magistrate Judge Pisano. Although defendant did request additional time to respond to plaintiffs' motion to dismiss, the Magistrate was not required to grant an adjournment. Further, recognizing that the Magistrate did not grant Spinello's request for additional time, plaintiffs timely filed a Reply Brief with respect to the new arguments raised by defendant in his Reply Brief to the Cross-Motion. (See Plf. Opp. at 23 n. 5.) And, because plaintiffs raised issues in their Cross-Motion to dismiss the original derivative and civil conspiracy claims which were "exactly the same" as their opposition to Spinello's Motion to Amend, plaintiffs filed a single Brief in Opposition to the Motion to Amend and in Support of the Cross-Motion. Included in that Brief were plaintiffs' arguments on the indemnification claim, "to which they would have had to respond if the Motion to Amend was granted since that claim was included in the Proposed Amended Counterclaims." In his Reply Brief on his Motion, Spinello responded to arguments made in the plaintiffs' Brief regarding the derivative claim, the civil conspiracy claim, and the indemnification claim. (Plf. Opp. at 23-24.)

Although he did not do so, Spinello had the opportunity to submit additional arguments in his Objection that he would have made in response to the Cross-Motion. Instead, the defendant offered no new arguments for two of the three claims -- the derivative claim and the civil conspiracy claim -- subject to the motion to dismiss. As set forth above, Spinello simply incorporated into his Objection the same arguments made in his Appeal. As such, the Court finds that the defendant would not have provided new



or different arguments if he had been granted additional time on the motion to dismiss. As for the indemnification claim, the Court reiterates that Spinello had an opportunity to submit his opposition to the motion to dismiss, and he did so in his Reply Brief. Anything new or additional to include on the indemnification claim has been set forth in Spinello's Objection -- which this Court has considered de novo. Accordingly, as succinctly stated by the plaintiffs, "Spinello's argument that he was somehow deprived of an ability to make his arguments by the procedure adopted by Magistrate Judge Pisano is belied by the fact that Spinello had nothing new to say with respect to the [d]erivative and the [c]ivil [c]onspiracy [c]ounterclaims, and he has been given, and took, a full opportunity to brief the issues on the [i]ndemnification [c]ounterclaim." (Id. at 24-25.) Thus, the Court will overrule Spinello's objections to the procedures adopted by Magistrate Judge Pisano.

### **CONCLUSION**

For the reasons stated herein, the Court will deny Spinello's Appeal and affirm in its entirety Magistrate Judge Pisano's May 5, 1998 Order denying Spinello's motion to amend and demand for a jury trial. Further, the Court will adopt Magistrate Judge Pisano's recommendations in his Report and Recommendation filed on May 6, 1998 as the opinion of this Court. As such, Milestone and Spintech's motion to dismiss Counts Two, Three and Four of Spinello's original Counterclaim pursuant to Rule 12(b)(6) of the Federal Rules of Civil Procedure will be granted. Lastly, the Court will overrule Spinello's objections to the procedures adopted by Magistrate Judge Pisano.

An appropriate Order is attached.

Dated: August 24, 1998

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ALFRED M. WOLIN, U.S.D.J.

UNITED STATES DISTRICT COURT  
FOR THE DISTRICT OF NEW JERSEY

----- X  
MILESTONE SCIENTIFIC, INC. :  
and SPINTECH, INC., : Civil Action No.  
 : 97-1503  
 :  
Plaintiffs, : **ORDER**  
 :  
v. :  
 :  
RONALD P. SPINELLO, :  
 :  
Defendant. :  
----- X

In accordance with the Court's Memorandum Opinion filed herewith,

It is on this 24<sup>th</sup> day of August, 1998

ORDERED that defendant Ronald P. Spinello's appeal of Magistrate Judge Pisano's May 5, 1998 Order is denied and the Order is affirmed in its entirety; and it is further

ORDERED that defendant's appeal of Magistrate Judge Pisano's Report and Recommendation dated May 6, 1998 is denied; and it is further

ORDERED that plaintiffs Milestone Scientific, Inc. and Spintech, Inc.'s motion to dismiss Counts Two, Three and Four of Spinello's original Counterclaim pursuant to Rule 12(b)(6) of the Federal Rules of Civil Procedure are granted.

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ALFRED M. WOLIN, U.S.D.J.