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Jesseph v. Digital Ally, Inc, 136 Nev. Adv. Op. 59 (Sept. 17, 2020)

Wendy Antebi

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Recommended Citation

Antebi, Wendy, "Jesseph v. Digital Ally, Inc, 136 Nev. Adv. Op. 59 (Sept. 17, 2020)" (2020). *Nevada Supreme Court Summaries*. 1340.

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SUBSTANTIAL BENEFIT DOCTRINE

ATTORNEY FEE LITIGATION

Summary

The Nevada Supreme Court held that predicate litigation is an essential element for a party to be awarded attorney fees under substantial benefit doctrine. The Court affirmed the district court's dismissal of plaintiff's claim for attorney's fees because there was no predicate litigation.

Background

Plaintiff-appellants, Charles Jesseph and Charles Churchwell owned or own common stock in defendant-respondent Digital Ally, a Nevada corporation that produces digital video imaging and storage products. Under the company requirements for amendments, Digital Ally stockholders must affirmatively submit voting instructions to their brokers in order for the brokers to vote on the amendments. Brokers themselves do not have discretionary authority to vote on amendments.

Digital Ally proposed two amendments to its articles of incorporation and reported a majority of stockholders approved the amendments. It was later discovered that Digital Ally permitted brokers to vote in favor of the amendments even when the beneficial owners did not instruct them to, resulting in "broker non-vote." Neither amendment would have received the necessary votes for approval without the invalid broker votes. Upon discovery, Jesseph and Churchwell served a demand letter to Digital Ally, asserting that they would commence litigation unless Digital Ally took corrective actions. Digital Ally admitted the amendments were invalid and rescinded them.

After the issue in the demand letter was resolved, Jesseph and Churchwell filed suit against Digital Ally, claiming they are entitled to an award of \$250,000 in attorney fees because the demand letter "conferred a fundamental and substantial benefit on the Company's stockholders." The plaintiffs alleged that but for the corrective actions their demand letter caused, the company would have been exposed to damages due to failed capital structure. The plaintiffs claimed that their actions saved Digital Ally from substantial harm, thus entitling them to attorney fees under the substantial benefit doctrine.

The district court dismissed the claim, finding that "predicate litigation is an essential element to maintaining a claim for attorney's fees under the substantial benefit doctrine found in Nevada common law." Plaintiffs now appeal, arguing that predicate litigation is not required under the substantial benefit doctrine, and that their demand letter was enough to be considered litigation.

Discussion

This court analyzes a claim by its substance, not its title, and the amount in controversy was met

Digital Ally argued the district court court's dismissal should be affirmed because it did not have subject matter jurisdiction over the independent fee claim. It claimed that plaintiffs have

¹ By Wendy Antebi.

not met the monetary threshold required and that attorney fee is a remedy, not an independent claim. The Court has consistently analyzed claims based on its substance, rather than the label.² The amount also exceeds the jurisdictional threshold for Nevada's district courts.³ Here, the Court declines to affirm the dismissal order based on the lack of jurisdiction argument.

The substantial benefit doctrine does not allow for attorney fees absent predicate litigation.

The Court affirms the district court's dismissal based on the argument that the substantial benefit doctrine is not applicable unless there is predicate litigation. "Nevada follows the American rule that attorney fees may not be awarded absent a statute, rule, or contract authorizing [the] award."⁴ The judicially created "substantial benefit doctrine" is an exception to the American rule.⁵ "This doctrine allows recovery of attorney fees when a successful party confers a substantial benefit on the members of an ascertainable class, and where the court's jurisdiction over the subject matter of the suit makes possible an award that will operate to spread the costs proportionately among them."⁶ To recover an award of attorney fees under the doctrine, a party must show that "(1) the class of beneficiaries is small in number and easily identifiable; (2) the benefit can be traced with some accuracy; and (3) the costs can be shifted with some exactitude to those benefitting."⁷ The prevailing party must also show that the losing party received a benefit from the litigation.⁸

Other jurisdictions have held that attorney fees cannot be awarded absent filed litigation. The Illinois Appellate Court has previously held that "[a]bsent the filing of an underlying meritorious lawsuit, there can be no suit for the recovery of fees under the [substantial benefit doctrine]."⁹ The Alaska Supreme Court has also held that predicate litigation is necessary under the doctrine.¹⁰ Furthermore, the New York appellate court held that shareholders are not entitled to receive attorney fees for making demand that cause corporation to take action.¹¹

The Nevada Supreme Court agrees with these cases and adopts the "no suit, no fee" approach. NRS 41.520(2) and NRCP 23.1 sets out requirements for a party to enumerate its efforts to obtain the action the party desire in derivative lawsuit complaints.¹² The purpose of the requirements is to encourage shareholders to make their demands before filing a complaint, allowing corporations to resolve their own disputes without judicial interference.¹³ Allowing plaintiffs to receive attorney fees without predicate litigation would expose corporations to fees and potential litigation regarding fees, hindering the purpose of NRS 41.520(2) and NRCP 23.1.

² *Otak Nev., LLC v. Eight Judicial Dist. Court*, 129 Nev. 799, 809, 312 P.3d 491, 498 (2013).

³ See Nev. Const. art. 6, § 6(1) (granting the district courts original jurisdiction over matters outside the justice courts' original jurisdiction); NEV. REV. STAT. 4.370(1)(b) (providing that Nevada's justice courts have jurisdiction over cases seeking damages of \$15,000 or less); *Morrison v. Beach City LLC*, 116 Nev. 34, 38, 991 P.2d 982, 984 (2000) (holding that a claim should only be dismissed for not meeting the amount-in-controversy requirement when it "appear[s] to a legal certainty that the claim is worth less than the jurisdictional amount").

⁴ *Thomas v. City of N. Las Vegas*, 122 Nev. 82, 90, 127 P.3d 1057, 1063 (2006).

⁵ *Id.* at 90–91, 1127 P.3d at 1063.

⁶ *Id.* at 91, 127 P.3d at 1063 (internal quotation marks omitted).

⁷ *Id.* (internal quotation omitted).

⁸ *Id.* at 85, 127 P.3d at 1060.

⁹ *Foley v. Santa Fe Pacific Corp.*, 641 N.E.2d 992, 996 (1994).

¹⁰ See *Jerue v. Millet*, 66 P.3d 736, 747–48 (Alaska 2003).

¹¹ See *Ripley v. Int'l Rys. of Cent. Am.*, 227 N.Y.S.2d 64, 68 (App. Div. 1962).

¹² NEV. REV. STAT. 41.520(2) (2020); Nev. R. Civ. P. 23.1.

¹³ See *Shoen v. SAC Holding Corp.*, 122 Nev. 621, 633, 137 P.3d 1181, 1179 (2006).

Furthermore, the context of the substantial doctrine suggest it does not apply when there is no predicate litigation. The doctrine is an exception to the American rule that “[e]ach litigant pay his [or her] own attorney’s fees, win or lose, unless a statute or contract provides otherwise.”¹⁴ Therefore, the doctrine only applies when a *litigant* seeks to recover attorney fees. Jesseph and Churchwell never advanced their demand letter to a formal complaint in the district court, thus the doctrine does not apply to them.¹⁵

The Court also did not consider the demand letter s “litigation” for the purpose of the doctrine. By definition, “litigation” does not encompass a pre-litigation demand letter.¹⁶ Based on the reason above, the Nevada Supreme Court affirms the district court’s dismissal of this case.

Conclusion

The Court affirmed the district court’s dismissal of Jesseph and Churchwell’s claim for attorney’s fee under the substantial benefit doctrine. Jesseph and Churchwell did not file a lawsuit against Digital Ally based on allegations in their demand letter. Predicate litigation is an essential element under the substantial benefit doctrine. While Jesseph and Churchwell raised a cognizable claim and met the jurisdictional threshold, they are not entitled to attorney fees under the doctrine.

Dissent

Justice Hardesty, joined by Chief Justice Pickering, wrote in a separate opinion, concurring in part and dissenting in part. The opinion agrees with the majority conclusions that Jesseph and Churchwell did raise an actionable claim under the substantial benefit doctrine and that the relief sought met the jurisdictional threshold. However, the opinion disagrees that predicate litigation is an essential element. Following the Delaware Chancery Court’s reasoning in *Bird*, the key issue should be based on whether the claim was meritorious, not whether the claim was actually filed.¹⁷ Thus, the case should be remanded for determination of whether the demand was meritorious.

¹⁴ *Hardt v. Reliance Standard Life Ins. Co.*, 560 U.S. 242, 253 (2010).

¹⁵ *See Thomas v. City of N. Las Vegas*, 122 Nev. 82, 90, 127 P.3d 1057, 1063 (2006).

¹⁶ *See Litigation*, BLACK’S LAW DICTIONARY (11th ed. 2019).

¹⁷ *Bird v. Lida, Inc.*, 681 A.2d 399, 404–405 (Del. Ch. 1996).