IN THE UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF VIRGINIA
ROANOKE DIVISION

BELLAGIO INSURANCE, LTD.,	**)**	
	)	
Plaintiff,	**)**	**Civil Action No.: 7:03cv00557**
	)	
v.	**)**	**MEMORANDUM OPINION**
	)	
DIGITAL BROADCAST	**)**	
CORPORATION,	**)**	**By: Samuel G. Wilson**
	)	**United States District Judge**
Defendant.	**)**	

Plaintiff Bellagio Insurance, Ltd. (Bellagio), brought this suit seeking enforcement of two loan agreements with defendant Digital Broadcast Corporation (DBC). The court has diversity jurisdiction under 28 U.S.C. § 1332(a)(1).[1] DBC admits that Bellagio loaned it money but has raised the affirmative defenses of usury and accord and satisfaction, and it has counterclaimed for unjust enrichment and breach of fiduciary duty. The parties tried the case before the court. The court finds that DBC has failed to prove its affirmative defenses and its claims for unjust enrichment and breach of fiduciary duty. Accordingly, the court grants judgment to Bellagio for principal and interest, orders specific performance of DBC's agreement to issue shares of stock to Bellagio, and awards Bellagio attorneys fees and costs.

I.

DBC operates a subscription-based television programming service. In 2001, DBC was experiencing financial difficulty and approached Brian Lee, who previously had helped raise venture

[1]Bellagio is a British Virgin Islands corporation with its principal place of business in Nevada. DBC is a Delaware corporation with its principal place of business in New Jersey. The amount in controversy exceeds $75,000.

capital for DBC, about procuring a "bridge loan" that would allow DBC to continue its efforts to recruit new subscribers and raise more venture capital. Lee, the president and sole shareholder of Bellagio, agreed for Bellagio to loan DBC $50,000. The note, which Lee prepared and DBC's Chief Operating Officer, Gary Nerlinger, signed on March 28, 2001, called for repayment within 30 days; for DBC to pay $6,000 in "interest, loan costs, loan fees and documentation costs"; and for DBC to issue 100,000 shares of DBC stock for no additional consideration. The note provided that, in the event of nonpayment, interest would accrue at 10% per annum and that DBC would issue Bellagio 50,000 shares every 30 days until DBC paid the loan in full. DBC pledged transmitters belonging to a partially owned subsidiary, Air Cable of Roanoke, LLC, as collateral for the loan. DBC did not repay the loan on its due date.

On May 11, 2001, DBC and Bellagio entered into a second loan agreement with similar terms. Bellagio agreed to loan DBC $25,000 more. The note called for repayment within 30 days; for DBC to pay $3000 in "interest, loan costs, loan fees and documentation costs"; and for DBC to issue 50,000 shares of DBC for no additional consideration. The note provided that, in the event of nonpayment, interest would accrue at 10% per annum and that DBC would issue Bellagio 25,000 shares every 30 days until DBC paid the loan in full. DBC again pledged the transmitters as collateral, and DBC again failed to repay the loan on its due date.

Having failed to repay, DBC initially issued shares to Bellagio in accordance with the two loan agreements, issuing a total of 608,000 shares until October 2001 when it stopped issuing them. Bellagio brought this suit, seeking damages, specific performance and attorneys fees.

On January 12, 2005, the parties tried this case to the court. Nerlinger and Lee gave conflicting accounts regarding the signing of the March loan agreement. Nerlinger testified that Lee, who was in Virginia at the time, faxed the agreement to him at DBC's New York office and that he signed the agreement there. Lee testified that he faxed the agreement to Nerlinger at his Virginia home and that Nerlinger signed it there. They gave similarly conflicting accounts concerning the May agreement. Nerlinger testified that he also signed that agreement at DBC's New York office, and he identified a return fax number at the top of the agreement as the New York office number. Lee again claimed that Nerlinger signed the agreement in Virginia.

The court also heard testimony bearing on the value of DBC stock. Nerlinger testified that DBC is not publicly traded but that it is currently selling shares at $8 per share in the United States and $12 per share in Europe. Nerlinger also testified that DBC was selling shares at $5 per share when they entered the loan agreements with Bellagio. The par value of a share of DBC is one cent. According to Nerlinger, DBC has authorized issue of 25,000,000 shares and has sold most of those shares. As for the actual value of the corporation, Nerlinger testified that DBC currently has fewer than 100 subscribers and that DBC's primary assets are exclusive use licenses for certain video compression methods. Nerlinger testified that a consultant had valued the company at $150 million and that the "book value"[2] of the company was in excess of $12 million.

Finally, DBC claims that Lee and DBC shared a fiduciary relationship and that Lee breached his fiduciary duties. Nerlinger testified that Lee breached his fiduciary duties by deterring potential investors in an effort to force DBC to borrow money from him under oppressive terms. According to

[2]Nerlinger explained that he was using the term "book value" to refer to the amount DBC could raise by selling off its assets piecemeal.

Nerlinger, Lee's actions were part of a conspiracy between Lee and would-be investors to seize control of DBC.

Based upon the evidence, including the credibility of the witnesses, the court makes the following findings of fact:

1) DBC entered into two loan agreements with Bellagio;

2) in the first loan agreement, DBC agreed to issue 50,000 shares of DBC stock every thirty days beyond maturity until the loan was paid;

3) in the second loan agreement, DBC agreed to issue 25,000 shares of DBC stock every thirty days beyond maturity until that loan was paid;

4) DBC signed each of the loan agreements while in New York;

5) DBC failed to prove that the fair market value of its shares equaled or exceeded par value; and

6) DBC failed to prove that Brian Lee breached a fiduciary duty owed to DBC.

II.

In this diversity action, the court must apply Virginia's choice of law rules. See Ferens v. John Deere Co., 494 U.S. 516, 519 (1990) (citing Klaxon Co. v. Stentor Electric Mfg. Co., 313 U.S. 487, 496 (1941)). Under Virginia law, the state in which the parties "made" the contract governs questions of interpretation and validity, Lexie v. State Farm Mut. Auto. Ins. Co., 469 S.E.2d 61, 63 (Va. 1996), and the contract is "made" in "the state where the final act is done which is necessary to make it binding." Hogue-Kellogg Co. v. G.L. Webster Canning Co., 22 F.2d 384, 385 (4th Cir. 1927). Based upon the court's findings that Nerlinger signed both loan agreements in New York, the parties "made" the loan agreements in New York, and New York law governs their validity and interpretation.[3]

Under New York law, a corporate borrower may raise the defense of usury only if the lender has committed criminal usury by knowingly charging interest exceeding twenty-five percent per year, N.Y. GEN. OBLIG. LAW § 5-521.3; N.Y. PENAL LAW § 190.40, and "there is no usury where an excessive rate of interest is made payable after maturity." Heelan v. Security Nat. Bank, 343 N.Y.S.2d 417, 421-22 (N.Y. Dist. Ct. 1973) (citing Flynn v. Dick, 215 N.Y.S.2d 382 (N.Y. App. Div. 1961)).

With these precepts in mind, the court finds that DBC failed to prove that the loan agreements are usurious. DBC had the burden to show with clear and cogent evidence that the interest rate applied to the loans was usurious and that Bellagio knew that it was .[4] To that end, DBC had the burden of proving a share value for DBC stock at the time of contracting that would render the interest rates in question usurious, and DBC had to show that Bellagio was aware of that value. The court finds that

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[3] Under Virginia law, a corporate borrower cannot raise a usury defense. VA. CODE § 6.1-330.75. Because DBC has failed to prove the terms usurious under New York law and because those terms cannot be usurious in Virginia, the court's finding that Nerlinger signed both loan agreements in New York is immaterial to the outcome.

[4] In New York, a corporate borrower must prove each and every element of usury by clear and convincing evidence. Freitas v. Geddes Sav. and Loan Ass'n, 63 N.Y.2d 254, 260-61 (N.Y. 1984) ("The imposition of civil liability for usury is closely circumscribed by the rules of construction traditionally applied to usury statutes, and the substantial burden of proof to be borne by the borrower which is only satisfied by clear and convincing evidence of each element of usury, including usurious intent."). Virginia imposes a similar burden: "usury... must be shown by clear and cogent proof." Radford v. Community Mortgage and Investment Corp., 312 S.E.2d 282, 602 (Va. 1984). Virginia law controls "all questions a procedure," including the burden of proof. Vicars v. Atlantic Discount Co., 140 S.E.2d 667, 670 (Va. 1965).

DBC failed to satisfy that burden.[5]

Nerlinger testified that DBC was worth at least $12 million, if not $150 million. He did not convince the court, however. DBC seemed to lack subscribers; its financial position seemed tenuous, as evidenced by the very fact that the company needed these relatively small bridge loans but could not secure them from an actual bank; and DBC offered no other evidence the court found credible on the issue.[6] Indeed, DBC failed to convince the court that it had any substantial assets or that its exclusive licensing agreements were as valuable as claimed. In short, DBC failed to establish a value for its shares when it obtained the loan or to otherwise demonstrate that the loan was usurious, with the loan date as a benchmark.[7]

Even had DBC established a value for its shares, DBC would still have been hard-pressed to prove the loan agreements usurious because DBC's obligation to issue shares on a monthly basis only

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[5]Additionally, DBC failed to show by clear and convincing evidence that the $6,000 and $3,000 payments required for the March and May loans, respectively, constituted interest. The agreements described the fees as covering "interest, loan costs, loan fees and documentation costs." Therefore, the court could only treat the full sums as interest upon a showing that none of the fees would actually be used to cover "loan costs, loan fees and documentation costs."

[6] See Amodio v. Amodio, 509 N.E.2d 936, 936-37 (N.Y. 1987) ("There is no uniform rule for valuing stock in closely held corporations. 'One tailored to the particular case must be found, and that can be done only after a discriminating consideration of all information bearing upon an enlightened prediction of the future.'" (citing Snyder's Estate v. United States, 285 F.2d 857, 861 (4th Cir. 1961)).

[7]DBC argues that Bellagio conceded a value of $5 per share in its complaint and, therefore, is estopped from arguing any lesser value. Bellagio arguably conceded to a *current* value of $5 per share in its complaint, although it disputed that value at trial. But the court's inquiry focuses on share value at the time the parties executed the loan agreements. See Babcock v. Berlin, 475 N.Y.S.2d 212, 213 (N.Y. Spec. Term 1984) (looking at time of contracting to determine legal rate of interest).

took effect if and when the loan matured but remained unpaid. Ordinarily, this would not be usury under New York law. See Heelan, 343 N.Y.S.2d at 421-22 (holding that penalty for late repayment did not render loan agreement usurious because there was no evidence of intent to evade usury laws). Accordingly, the court finds that DBC has failed to prove usury.

III.

DBC also raises the defense of accord and satisfaction. Apparently, DBC claims that because the contracts are usurious it is only liable for the non-usurious amount, which DBC contends is repayment of the principal plus interest at twenty-five percent per annum.[8] According to DBC the transfer of 608,000 shares it has already made to Bellagio more than covers that amount. However, because the court has found that DBC has failed to prove that the loan agreements are usurious, DBC's accord and satisfaction defense fails, as well.

IV.

DBC bases its unjust enrichment claim on the same premise as its accord and satisfaction defense. DBC claims that because the loans are usurious, it only owes the principal plus twenty-five percent interest and that its share transfers have more than covered that amount. Therefore, DBC argues that it is entitled to a refund. Again, the court's finding that DBC has failed to prove that the loan agreements are usurious precludes the claim.

V.

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[8]The court also notes that DBC misreads New York usury law. *Had* the court found the loan agreements usurious, the agreements would be *void*, freeing DBC of *any* liability under the agreements. See N.Y. GEN. OBLIG. LAW § 5-511

Finally, the court finds that DBC did not prove its claim that Lee breached fiduciary duties owed to DBC. Nerlinger testified at length about Lee's alleged participation in a conspiracy to seize control of DBC by forcing DBC to enter into oppressive loan agreements; however, the court grants little credence to Nerlinger's testimony. In the absence of other evidence to support the claim, the court finds that DBC did not carry its burden and finds for Bellagio.

VI.

Having dispensed with DBC's defenses and counterclaim, the court finds for Bellagio and will determine an appropriate remedy under Virginia law. Hogue-Kellogg, 22 F.2d at 386 ("[T]he rule is well settled that in matters affecting the remedy the court will regard neither the place of making nor the place of performance, but the law of the state where the remedy is sought, and that in applying the lex fori the federal courts will adjudicate the rights of the parties precisely as will the courts of the state.") (citing Pritchard v. Norton, 106 U.S. 124, 129 (1882)). Because the court finds the loan agreements to be valid, the court grants judgment to Bellagio for principal and interest, orders specific performance of DBC's agreement to issue shares of stock to Bellagio, and awards Bellagio attorneys fees and costs.

While specific performance is generally not the proper remedy in a case involving the sale of stock, "specific performance may be had of a contract to deliver stock, the pecuniary value of which is uncertain and not easily ascertainable, or where the stock has no market value; the remedy at law in such cases being deemed to be inadequate." Kennerly v. Columbia Chemical Corp., 119 S.E. 265, 267 (Va. 1923); see also Dominick v. Vassar, 367 S.E.2d 487, 489-90 (Va. 1998). Because the value of DBC stock is quite unclear, the court finds it appropriate to compel DBC to issue stock to

Bellagio in accordance with the loan agreements.[9]

Finally, each of the loan agreements features a provision requiring DBC to pay attorney's fees and costs should Bellagio be forced to sue for repayment. An attorney's fees provision is a "mere incident to the principal contract," so the law governing interpretation of the contract also governs the validity of such a provision. See R.S. Oglesby Co. v. Bank of New York, 77 S.E. 468, 469-70 (Va. 1913). A Virginia court will enforce and attorney's fee provision so long as it is valid under the law of the state of contract formation and is not contrary to public policy. Id. Because Bellagio seeks only reasonable attorney's fees and costs and because DBC has shown no fraud, the provisions are valid under New York law. See General Lumber Corp. v. Landa, 216 N.Y.S.2d 33, 34 (N.Y. App. Div. 1961) ("A provision for a reasonable attorney's fee, contained in a promissory note, is enforcible [sic]."). Further, the attorney's fees provisions are not contrary to Virginia public policy, so a Virginia court would enforce them. See R.S. Oglesby, 77 S.E. at 469-70; Schwab v. Norris, 231 S.E.2d 222, 225-26 (Va. 1977) ("In Virginia a stipulation in a note for compensation to attorneys for collection fees incurred, if payment of the note is not made at maturity, is a valid, binding and enforceable contract.") (quoting Merchants, etc., Bank v. Forney, 31 S.E.2d 340, 345 (Va. 1944)). Therefore, the court finds the attorney's fees provisions to be valid and enforceable.

VII.

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[9]DBC argues that the loan agreements are ambiguous as to the number of shares DBC was required to issue and that the court should construe the ambiguity against the drafter, Bellagio. The court rejects this argument, though. The loan agreements are clear on their faces, and DBC complied with the agreements for months in a manner consistent with Bellagio's interpretation before abruptly ceasing to issue shares.

DBC essentially complains that Bellagio was heavy-handed in negotiating the terms of its loan agreements. The court notes that these are not consumer loan transactions, and the court finds no credible evidence that DBC failed to comprehend their terms fully. Based on the evidence presented, the court finds no reason not to enforce the parties' agreements.

For the reasons stated, the court awards judgment to Bellagio for the loan principals plus interest at 10% per annum, orders DBC to issue 2,892,000 shares of DBC stock to Bellagio, and awards Bellagio attorneys fees of $8, 690 plus taxable costs.[10]

ENTER: This ____ day of March, 2005.

____
UNITED STATES DISTRICT JUDGE

[10]Appendix I details the court's methodology in calculating the number of shares owed and attorneys fees, which the court finds reasonable.

Appendix I

Number of Shares

1) The March 27, 2001, loan was due on April 26, 2001, meaning that, as of the date of entry of the court's judgment, payment of the loan is 1,425 days overdue. The loan agreement required DBC to issue 50,000 shares at the close of each 30-day period during which payment was delinquent. Those 1,425 days constitute 47 full 30-day periods. Thus, DBC must issue 2,350,000 shares (47 x 50,000).

2) The May 11, 2001, loan was due on June 10, 2001, meaning that, as of the date of entry of the court's judgment, payment of the loan is 1, 381 days overdue. The loan agreement required DBC to issue 25,000 shares at the close of each 30-day period during which payment was delinquent. Those 1,381 days constitute 46 full 30-day periods. Thus, DBC must issue 1,150,000 shares (46 x 25,000).

3) The total number of shares owed to Bellagio under the delinquency provisions is 3,500,000 (2,350,000 shares + 1,150,000 shares).

4) DBC presented credible evidence that it had already issued 608,000 shares to Bellagio. Therefore, DBC currently owes Bellagio 2,892,000 shares of stock (3,500,000 - 608,000).

Attorneys Fees

1) Plaintiff submitted invoices from counsel showing 86.9 billable hours of work at a rate of $100 per hour, for a total of $8,690.

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BELLAGIO INSURANCE, LTD.,	**)**	
	)	
Plaintiff,	**)**	**Civil Action No.: 7:03cv00557**
	)	
v.	**)**	**<u>FINAL ORDER</u>**
	)	
DIGITAL BROADCAST	**)**	
CORPORATION,	**)**	**By: Samuel G. Wilson**
	)	**United States District Judge**
Defendant.	**)**	

In accordance with the memorandum opinion entered this day, it is hereby **ORDERED** and **ADJUDGED** as follows:

1) judgment is entered in favor of the Plaintiff and against the Defendant in the amount of the loan principals ($50,000 and $25,000) plus interest at 10% per annum;

2) Defendant is ordered to issue 2,892,000 shares of Digital Broadcast Corporation stock to the Plaintiff;

3) Defendant shall pay an attorney's fee of $8690.00;

4) Defendant shall pay taxable costs; and

5) this case is stricken from the active docket of this court.

ENTER: This ____ day of March, 2005.

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UNITED STATES DISTRICT JUDGE