IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

BRADLEY C. BAKER,	)	
	)	
Petitioner,	)	
	)	
v.	)	Civil Action No. 5144-VCP
	)	
IMPACT HOLDING, INC.,	)	
	)	
Respondent.	)	

MEMORANDUM OPINION

Submitted: April 21, 2010
Decided: July 30, 2010

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PARSONS, Vice Chancellor.

This matter is before me on a motion by Respondent, Impact Holding, Inc. ("Holding") to dismiss the most recent of four actions filed against it by Petitioner, Bradley C. Baker, and entities associated with him. In the underlying action (the "Advancement Action"), Baker seeks advancement from Holding under the terms of Holding's Certificate of Incorporation ("Certificate") for litigation expenses incurred in two of his prior actions. Baker claims he is entitled to mandatory advancement because he brought both of those actions "in defense" of allegations made and actions taken by Holding following what Baker characterizes as an investigation into his performance as a director and officer of Holding.

To receive advancement under the Certificate, Baker must show that he is "defending" a "proceeding" brought against him in his capacity as a director or officer or former director or officer of Holding. Both parties acknowledge Baker's status as a former director. Additionally, for purposes of this motion to dismiss, I accept Baker's characterization of an internal financial audit conducted by Holding as a "proceeding" that may fit within the Certificate's definition of that term. Even accepting this characterization, however, I must dismiss the Advancement Action because the Certificate does not entitle Baker to have Holding advance the costs of two preemptive, affirmative actions that he chose to file. While Baker argues that offensive actions often counteract the effects of statements made or actions taken by a corporation as part of or following a proceeding, allowing advancement for such affirmative claims effectively would eviscerate the "in defense of" requirement included in the advancement provision

of Holding's Certificate. Thus, as the Certificate does not mandate advancement for any type of affirmatively filed action, I grant Holding's motion to dismiss.

I. BACKGROUND[1]

A. Parties and Facts

Petitioner, Baker, is a Colorado citizen who formerly served as a director of Holding, the manager of Impact Investments Colorado II, LLC ("Investments"), and the trustee of the Baker Investment Trust (the "Trust"). Respondent, Holding, is a Delaware corporation.

In January 2008, Holding purchased stock in two entities beneficially owned by Baker (the "Sale"). As a result of this Sale, Baker became an officer and director of Holding and Holding took ownership over Impact Confections, Inc. ("Confections"). At Holding's request, Baker served as an officer and director of Confections from the date of the Sale until August 2009.

Sometime between late 2008 and early 2009, however, Holding initiated a financial audit at Confections that allegedly led to an investigation or inquiry into Baker's performance as an officer and director of Holding and Confections (the "Investigation"). Purportedly as a result of this Investigation, Holding removed Baker from his position as a Holding director. After his removal, Baker initiated—or caused entities controlled by

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[1] Unless otherwise noted, all facts are taken from the well-pleaded allegations contained in the Petition for Advancement (the "Petition") and the unambiguous terms of documents integral to Baker's claims that are incorporated by reference in the Petition. *See R&R Capital, LLC v. Buck & Doe Run Valley Farms, LLC*, 2008 WL 3846318, at *2 (Del. Ch. Aug. 19, 2008).

him to initiate—three actions, two of which are currently pending before this Court: (1) *Impact Investments Colorado II, LLC and Baker Investment Trust v. Impact Holding, Inc.*, C.A. No. 4323-VCP (the "Escrow Action"); (2) *Bradley C. Baker v. Impact Holding, Inc.*, C.A. No. 4960-VCP (the "Section 225 Action"); and (3) *Bradley C. Baker v. Impact Holding, Inc.*, C.A. No. 4962-VCP (the "Declaratory Judgment Action" and, together with the Section 225 Action, the "Related Actions").[2] Baker filed this Advancement Action seeking advancement of his fees and expenses incurred in the Related Actions.

In a counterclaim filed in the Escrow Action (the "Counterclaim"), Holding alleged that Baker breached his fiduciary duties to Holding and Confections but did not assert any claims against Baker for these alleged breaches.[3] Baker asserts that Holding's allegations arose as a result of Holding's internal Investigation and that he filed the

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[2] On May 13, 2010, I granted Holding's Rule 12(b)(3) motion to dismiss Baker's Section 225 Action "for improper venue based on a forum selection clause in an agreement among Holding's shareholders that requires all actions related to that agreement to be brought in a court in Dallas, Texas." *See Baker v. Impact Holding, Inc.*, 2010 WL 1931032, at *1 (Del. Ch. May 13, 2010). For purposes of Holding's motion to dismiss the Advancement Action, I presume that Baker intends to pursue the equivalent of his Section 225 Action in Texas.

[3] Holding filed the original Counterclaim on April 7, 2009. Escrow Action Docket Item ("D.I.") 8. After receiving leave from the Court, Holding filed an amended Counterclaim on December 4, 2009. Escrow Action D.I. 16, Counterclaim. In his answering brief, Baker relies on this amended Counterclaim to support his allegation that Holding conducted an Investigation into Baker's performance of his duties as an officer and director of Holding and Confections and that the Investigation, thus, constitutes a proceeding under the Certificate. Resp.'s Ans. Br. ("RAB") 8-10. The specific allegations and the nature of the Investigation referred to in the Counterclaim are detailed *infra* Part II.B.1.

Related Actions "to defend against" the effects of this Investigation, *i.e.*, his removal as a director of Holding and the damage to his reputation caused by Holding's accusations.[4]

Holding's Certificate provides mandatory advancement for any director "who was, is, or is threatened to be made a party to a proceeding" by reason of her status as a director.[5] Article VIII of the Certificate (the "Advancement Provision") governs indemnification and advancement and mandates advancement in certain limited circumstances. In pertinent part, Article VIII provides that:

> [Holding] shall indemnify any person who was, is, or is threatened to be made a party to a proceeding (as hereinafter defined) by reason of the fact that he or she (i) is or was a director or officer of [Holding] or (ii) while a director or officer of [Holding], is or was serving at the request of [Holding] as a director, officer, . . . or similar functionary of another foreign or domestic corporation . . . or other enterprise, to the fullest extent permitted under the Delaware General Corporation Law, as the same exists or may hereafter be amended. . . . Such right shall include the right to be paid by [Holding] expenses (including without limitation attorneys' fees) actually and reasonably incurred by him in defending any such proceeding in advance of its final disposition to the maximum extent permitted under the Delaware General Corporation Law, as the same exists or may hereafter be amended.

Additionally, the Advancement Provision broadly defines a "proceeding" as "any threatened, pending, or completed action, suit, or proceeding, whether civil, criminal,

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[4] Pet. ¶ 14. Specifically, Baker claims that, as a result of Holding's Investigation, he was forced to seek a judicial determination that he has not been lawfully removed as a director and that he did not breach his fiduciary duties to Holding or Confections.

[5] McGee Aff. Ex. A, Cert. of Incorp.

administrative, arbitrative, or investigative, any appeal in such an action, suit, or proceeding, [or] any inquiry or investigation that could lead to such an action, suit, or proceeding."[6]

On October 12, 2009, Baker sent a letter to Holding demanding advancement for fees and expenses incurred in connection with the Related Actions.[7] Holding refused that demand and Baker filed his Petition in this Advancement Action on December 16, 2009. Holding moved to dismiss the Petition on January 6, 2010. After the parties briefed this motion, I heard argument on April 21.

B. The Parties' Contentions

Neither party disputes that Baker served as a Holding director nor that he served as an officer and director at Confections at Holding's request. Instead, Holding seeks to dismiss Baker's Petition by arguing, first, that the Petition does not sufficiently allege the existence of the Investigation or show how that Investigation—which was nothing more than an audit of Confection's financial records—constitutes a "proceeding" under the Advancement Provision. Holding also argues that, even if the Court accepts the Investigation as a proceeding, Baker affirmatively filed the Related Actions not to defend

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[6] Cert. of Incorp. Art. VIII. The Advancement Provision does not contain a conjunction between the second and third serial clauses. Drawing all inferences in the nonmovant's favor, I presume the parties meant to use 'or' as the operative conjunction. In any event, this presumption does not affect my ruling.

[7] This letter requests advancement from Holding of $40,955 in fees and expenses incurred as of the date of the letter. Pet. Ex. A.

against that proceeding, but to preemptively ameliorate certain negative effects he claims resulted from the Investigation.

Baker asserts that the Petition adequately alleges that Holding's Investigation of Baker's conduct constitutes a "proceeding" under the expansive definition in the Certificate because Holding used information gained during the Investigation (1) to support its allegations in the Counterclaim that Baker breached his fiduciary duties and (2) as the basis for removing him as a director of Holding. Additionally, Baker contends that, much like a patent holder filing a declaratory judgment to defend against marketplace infringement, he filed the Related Actions to defend himself from the allegations in and results of the purported Investigation in what is essentially the only way open to him: final, binding judicial adjudication through the Related Actions.

II. ANALYSIS

A. Standard for a Rule 12(b)(6) Motion to Dismiss

In considering a motion to dismiss under the plaintiff-friendly Rule 12(b)(6) standard, the Court assumes the truthfulness of all well-pleaded allegations in the complaint and affords the plaintiff "the benefit of all reasonable inferences."[8] As such, the Court will deny a Rule 12(b)(6) motion "unless it can be determined with reasonable certainty that the plaintiff could not prevail on any set of facts reasonably inferable" from

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[8] *Superwire.com, Inc. v. Hampton*, 805 A.2d 904, 908 (Del. Ch. 2002) (citing *Solomon v. Pathe Commc'ns Corp.*, 672 A.2d 35, 38 (Del. 1996)); *see also Savor, Inc. v. FMR Corp.*, 812 A.2d 894, 896-97 (Del. 2002) ("[E]ven vague allegations are 'well-pleaded' if they give the opposing party notice of the claim.").

the pleadings.[9] "What this effectively means is that the court must consider the various factual permutations reasonably possible within the framework of the plaintiffs allegations and conclude whether any one conceivable set of facts could possibly merit granting [the] plaintiff relief. If so, the claim cannot be dismissed."[10] The Court will not accept mere conclusions as true absent specific allegations of fact to support them.[11]

B. Is Baker Entitled to Advancement for Litigation He Initiated?

Section 145(e) of the Delaware General Corporation Law ("DGCL") grants a corporation authority to advance expenses, including attorneys' fees incurred "in defending" a covered proceeding, to a director or officer.[12] This authority is

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9 *Superwire.com*, 805 A.2d at 908.

10 *In re New Valley Corp. Deriv. Litig.*, 2001 WL 50212, at *4 (Del. Ch. Jan. 11, 2001).

11 *Solomon*, 672 A.2d at 38.

12 *See Gentile v. Singlepoint Fin., Inc.*, 787 A.2d 102, 105 (Del. Ch. 2001) (citing 8 *Del. C.* § 145(e)). Section 145(k) of the DGCL vests the Court of Chancery with exclusive jurisdiction "to hear and determine all actions for advancement of expenses or indemnification brought under [Section 145] or under any bylaw, agreement, vote of stockholders or disinterested directors, or otherwise."

Although it does not affect my analysis here, I note that the Delaware Legislature recently passed an act striking and replacing Section 145(e). Del. H.B. 375, 145th Gen. Assem. § 6 (2010). Effective August 2, 2010, Section 145(e) will read as follows:

> (e) Expenses (including attorneys' fees) incurred by an officer or director of the corporation in defending any civil, criminal, administrative or investigative action, suit or proceeding may be paid by the corporation in advance of the final disposition of such action, suit or proceeding upon receipt of an undertaking by or on behalf of such director or officer to

"permissive"[13] as Section 145(e) provides only that a corporation "may" pay the defensive expenses of its directors, officers, or employees in advance of the final disposition of a covered proceeding.[14] Yet, corporations can, and frequently do, "make the right to advancement of expenses mandatory, through a provision in its certificate or bylaws or . . . a contract specifically addressing the issue."[15] When thus made mandatory, as in this case, advancement is a contractual right.[16] To determine whether a director has a right to advancement under a particular advancement provision, therefore,

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> repay such amount if it shall ultimately be determined that such person is not entitled to be indemnified by the corporation as authorized in this section. Such expenses (including attorneys' fees) incurred by former directors and officers or other employees and agents *of the corporation or by persons serving at the request of the corporation as directors, officers, employees or agents of another corporation, partnership, joint venture, trust or other enterprise* may be so paid upon such terms and conditions, if any, as the corporation deems appropriate.

Id. (emphasis added to reflect language different from prior version of Section 145(e)).

13 *Citadel Hldg. Corp. v. Roven*, 603 A.2d 818, 823 (Del. 1992).

14 8 *Del. C.* § 145(e).

15 *Gentile*, 787 A.2d at 106 (citing *Advanced Min. Sys. Inc. v. Fricke*, 623 A.2d 82 (Del. Ch. 1992)).

16 *Yuen v. Gemstar-TV Guide Int'l, Inc.*, 2004 WL 1517133, at *3 (Del. Ch. June 30, 2004) ("[A]dvancement is merely a contractual right that parties can agree to in the instruments that govern their relationship."); *Gentile*, 787 A.2d at 106 ("Where such a mandatory provision exists, the rights of potential recipients of such advancements will be enforced as a contract.") (citing *Hibbert v. Hollywood Park, Inc.*, 457 A.2d 339, 342-43 (1983)).

the Court looks to the language of the relevant provision.[17] Therefore, I begin with an examination of the Advancement Provision.

As suggested by the terms of the Advancement Provision, resolution of Holding's motion hinges on whether Baker can establish (1) the existence of a "proceeding" brought against him by virtue of his status as a director and (2) that he reasonably incurred expenses "in defending" any such proceeding for which he is entitled to advancement.

After reviewing the Petition and the documents it references in light of the plain and unambiguous language of the Advancement Provision, I find that Baker has alleged facts sufficient to show that Holding's Investigation may fit within the definition of a "proceeding." Yet, even accepting that point for purposes of the pending motion, I grant Holding's motion to dismiss the Advancement Action because I find that Baker did not bring the Related Actions in defense of that Investigation. Instead, Baker preemptively filed these affirmative actions to offensively counter the perceived negative effects of the Investigation. That tactic, while fully within Baker's rights, does not entitle him to advancement of attorneys' fees he incurred in those Related Actions. To hold otherwise

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[17] "[T]he rules which are used to interpret statutes, contracts, and other written instruments are applicable when construing corporate charters and bylaws . . . . We only construe the bylaw as it is written, and we give language which is clear, simple, and unambiguous the force and effect required." *Hibbert*, 457 A.2d at 343 (citing *Ellingwood v. Wolf's Head Oil Ref. Co.*, 38 A.2d 743, 747 (Del. 1944); *Lawson v. Household Fin. Corp.*, 152 A. 723, 726 (Del. Ch. 1930); *In re Osteopathic Hosp. Ass'n*, 191 A.2d 333, 335 (Del. Ch. 1963), *aff'd*, 195 A.2d 759 (Del. 1963); *Hajoca Corp. v. Sec. Trust Co.*, 25 A.2d 378, 383 (Del. 1942)).

effectively would read the "in defending" language out of the Advancement Provision, thereby allowing covered persons to file preemptive actions in "defense" of any number of corporation actions that ostensibly could affect them adversely, whether the company has brought a claim against them or not.

1. Is the Investigation a proceeding?

As noted above, Section 145(e) of the DGCL provides that a corporation may advance a director those expenses incurred in defending a "civil, criminal, administrative or investigative action, suit or proceeding," but does not define "proceeding."[18] Here, the Advancement Provision broadly defines "proceeding" as "any threatened, pending, or completed action, suit, or proceeding, whether civil, criminal, administrative, arbitrative, or investigative, any appeal in such an action, suit, or proceeding, [or] any inquiry or investigation that could lead to such an action, suit, or proceeding."[19]

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[18] Section 145(e) defines the permissive scope of advancement and enables the corporation to determine whether and in what way to make such permissible advancement mandatory. 8 *Del. C.* § 145(e).

[19] For purposes of an indemnification and advancement clause, this definition of "proceeding" is not uncommon. *See, e.g.*, 1 JAMES ROBERT BROWN ET AL., RAISING CAPITAL: PRIVATE PLACEMENT FORMS & TECHNIQUES 81 (2002) (defining a "proceeding," in part, as a "suit, or proceeding, . . . *or* any inquiry or investigation which could lead to such action, suit, or proceeding"); By-Laws Art. 5 § 1(a), Merck & Co., Inc. (Nov. 3, 2009), *available at* http://www.merck.com/about/leadership/New_Merck_bylaws_11_3_09.pdf ("suit or proceeding, . . . *and* any inquiry or investigation which could lead to such action, suit, or proceeding"); *Form of Indemnity Agreement – Loislaw.com Inc.*, FINDLAW, http://contracts.corporate.findlaw.com/corporate/indemn/2185.html (last visited July 27, 2010) (a "suit or proceeding, . . . *and* any inquiry or investigation that could lead to such an action, suit or proceeding") (emphases added). Indeed, a nearly identical definition appears in at least one prior decision by this Court. *See Gentile*, 787

Baker claims that the Investigation is a proceeding covered by the Advancement Provision. In support of its allegation that Holding conducted an Investigation into Baker's performance as a director and officer of Holding and Confections, however, the Petition states only that: (1) "[i]n late 2008 or early 2009 Holding started an investigation or inquiry . . . into Brad Baker's performance of his duties as an officer and director of Holding and . . . Confections";[20] (2) this Investigation is a proceeding under the Advancement Provision;[21] and (3) as a result of this Investigation, Holding accused Baker of breaching his fiduciary duties to Holding and removed him as a director of Holding.[22] Holding argues that the Petition fails to adequately allege the existence of a qualified proceeding because these three statements amount to nothing more than a bare-bones, conclusory allegation and the Investigation does not meet the definition of a "proceeding."

A.2d at 106 ("[Section] 7.1(c) defines a 'Proceeding' to mean 'any threatened, pending or completed action, suite [sic] or proceeding, whether civil or criminal, administrative, arbitrative or investigative, any appeal in such an action, suite or proceeding, and any inquiry or investigation that could lead to such an action, suit or proceeding.'").

20 Pet. ¶ 6.

21 *Id*. ¶ 9.

22 *Id*. ¶¶ 11-12 ("Holding has also alleged that the Investigation revealed that Brad Baker has breached his fiduciary duties to Holding and Confections . . . . As a result of those allegations[,] Brad Baker has brought a proceeding in this Court seeking a declaratory judgment that Brad Baker has not breached his fiduciary duties to Holding and Confections . . . .").

If I viewed the language of the Petition in isolation, I might agree with Holding that Baker's factual allegations lack the required level of specificity necessary to survive a Rule 12(b)(6) motion to dismiss.[23] But, the Petition also references and relies on Holding's Counterclaim in the Escrow Action and, as such, incorporates the characterization and factual explanation of the Investigation found in that document.[24]

Pertinently, the Counterclaim makes the following statements regarding the Investigation which Baker purports to defend against in the Related Actions:

> - On January 14, 2009, Impact Holding sent to the Baker Sellers a Claim Notice . . . detailing certain breaches of representations and warranties . . . . These claims are the result of Impact Holding's recent discovery of significant departures from GAAP in the preparation of the Impact Confections financial statements . . . .
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> - [T]he Bakers . . . misrepresented these financial matters to the [Holding and Confection's] boards until suspicions were raised in December 2008 by (i) repeated delays in preparation of the 2008 opening balance sheet and (ii) communications to the Board by [Confection's] controller, who before his retaliatory termination by the Bakers, detailed a range of accounting improprieties to the Board.
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> - As Impact Confection's 2008 fiscal year neared its end . . . it became apparent that the Bakers were not providing the Impact Confections and

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[23] *See Solomon v. Pathe Commc'ns Corp.*, 672 A.2d 35, 38 (Del. 1996) ("Conclusions [in a complaint] . . . will not be accepted as true without specific allegations of fact to support them.") (quoting *In re Tri-Star Pictures, Inc., Litig.*, 634 A.2d 319, 326 (Del. 1995)).

[24] *See R&R Capital, LLC v. Buck & Doe Run Valley Farms, LLC*, 2008 WL 3846318, at *2 (Del. Ch. Aug. 19, 2008) (noting that, on a Rule 12(b)(6) motion to dismiss, "the Court may also 'consider the unambiguous terms of documents incorporated by reference in the complaint when the documents are integral to the plaintiff's claims.'") (quoting *Encite v. Soni*, 2008 WL 2973015, at *5 (Del. Ch. Aug. 1, 2008)).

> Impact Holding boards adequate information to evaluate the true financial condition of [Confections] . . . . As a result, the two boards (i) directed that a new independent auditor chosen by the boards be retained to prepare the audit of Impact Confections' 2008 Financial Statements . . . and (ii) retained independent consultants to evaluate [Confection's] financial statements.
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> - The results of these efforts now show that the Baker Sellers[25] . . . intentionally and knowingly misrepresented the financial condition of [Confections] at the time of the sale.
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> - The investigation into the problems with the Impact Confections Financial Statements revealed fundamental failures in the representations and warranties.

Additionally, the Counterclaim contains allegations about various actions and omissions by Baker purportedly revealed by the Investigation.[26]

Based on the allegations in the Counterclaim and, specifically, its characterization of the Investigation, I consider dubious Baker's contention that Holding conducted an internal investigation *specifically into his conduct as a director of Holding or*

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[25] The Counterclaim defines Baker Sellers as consisting of Investments and the Trust.

[26] Specifically, the Counterclaim contains the following allegations regarding Baker's supposed breach of fiduciary duties: (1) "in breach of their fiduciary obligations to [Confections and Holding], the Bakers . . . misrepresented . . . financial matters"; (2) "any deficiency [in the Claim Notice] is the result of the Baker Sellers' misconduct and unclean hands"; (3) "it became apparent that the Bakers were not providing . . . adequate information to evaluate the true financial condition of [Confections]"; (4) "[t]he results of these efforts now show that the Baker Sellers . . . intentionally and knowingly misrepresented the financial condition of [Confections] at the time of the sale"; (5) "[d]espite their knowledge of the misrepresentations, the Bakers . . . repeatedly informed Impact Holding that the Financial Statements were accurate and could be relied upon. The Bakers continued their deceit following the closing by presenting the boards of [Confections and Holding] with material misleading financial information, and also concealing from the boards other information about [Confections]."

Confections. Rather, the investigation referred to in the Counterclaim appears to be primarily an audit of Confections financial records that happened to lead, as an understandable by-product, to the accusations about which Baker complains. The Counterclaim does not seem to support Baker's contention that he was the object of the Investigation. Indeed, the Counterclaim describes the focus of the purported Investigation as being on the financial condition of Confections, alleging Baker's breach of fiduciary duty only insofar as necessary to support its claim that the Baker Sellers breached the Stock Purchase Agreement and fraudulently misrepresented material facts to Holding.[27] As such, the Counterclaim arguably fails to support the Petition's claim that Holding conducted an Investigation "into Brad Baker's performance of his duties as an officer and director of Holding and . . . Confections."[28]

Nevertheless, based on the rather broad definition of "proceeding" in the Certificate, I cannot wholly disregard or dismiss Baker's contention that the Investigation constitutes a "proceeding." Indeed, the language of that definition seems broad enough to encompass, at its widest point, even a *threatened inquiry* that *could* lead to an action,

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[27] Holding filed the Counterclaim in the Escrow Action largely to counter the Baker Sellers' argument that the Claim Notice that Holding sent did not meet the requirements of the SPA because it did not contain enough detail regarding purported breaches of the SPA or the amount of damages Holding suffered. Specifically, Holding contends that its Claim Notice satisfies the SPA and other relevant agreements or, if not, that "any deficiency is the result of the Baker Sellers' misconduct and unclean hands" because they "hid the information necessary for [Holding] to provide the minute detail the Baker Sellers . . . allege is required in the Notice." Countercl. at 3.

[28] Pet. ¶ 6.

suit, or formal proceeding against Baker. Under this expansive designation, it is conceivable that the financial audit of Confections could constitute an "inquiry . . . that could lead to such an action, suit, or proceeding" against Baker, including a possible further investigation specifically into his conduct as a director. Thus, drawing all inferences in Baker's favor, I find that the Petition sufficiently alleges the existence of a "proceeding" under the Advancement Provision. I therefore turn to whether Baker has met the other requirement for advancement under the Certificate.

2. Are the Related Actions brought in defense of the Investigation?

The Advancement Provision expressly limits advancement to expenses incurred by a covered person "in defending" a proceeding to which that person "was, is, or is threatened to be made a party."

Delaware courts frequently have analyzed the "in defending" limiting language, which originates in Section 145(e) of the DGCL and is incorporated into many mandatory advancement provisions. For example, the Supreme Court in *Citadel Holding v. Roven* found that, in addition to expenses normally incurred in the context of litigation naming a covered person as a defendant, *i.e.*, attorneys' fees accrued while defending that litigation, the "in defending" language also covers (1) a covered person's affirmative defenses and (2) compulsory counterclaims directly responding to and negating an affirmative claim against that person.[29] In doing so, the Court noted that, although including compulsory counterclaims within the definition of defense "present[ed] a . . .

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[29] *Citadel Hldg. Corp. v. Roven*, 603 A.2d 818, 824 (Del. 1992).

difficult problem" because such claims technically "represent separate causes of action,"[30] the broad definition of "defense" seemed to encompass such counterclaims.[31]

Holding's Certificate expressly limits the right of advancement to expenses incurred by a covered person "in defending" a proceeding asserted against that person. In the circumstances of this case, however, Holding has not asserted *any claims* against

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30 *Id*.

31 Specifically, the Court stated that "[i]n a litigation context the term 'defense' has a broad meaning and [the corporation] has not shown that the parties intended to accord it a restrictive definition in their relationship." *Id*. (citing BLACK'S LAW DICTIONARY 377 (5th ed. 1979)).

In *Zaman v. Amedeo Holdings,* Vice Chancellor Strine elaborated on the *Roven* decision, concluding that

> . . . the interpretation of the "in defending" limitation most faithful to the Supreme Court's teaching in *Roven*, is that the costs of prosecuting a counterclaim should be subject to advancement if the counterclaims would qualify as a compulsory counterclaims [sic] under the traditional counterclaim test used by both Delaware and federal civil procedure *and* when that counterclaim so directly relates to a claim against a corporate official such that success on the counterclaim would operate to defeat the affirmative claims against the corporate official. In other words, a counterclaim fits within the "in defending" language if it defends the corporate official by [1] directly responding to *and* [2] negating the affirmative claim.

2008 WL 2168397, at *35 (Del. Ch. May 23, 2008). This analysis does not suggest, however, that affirmative actions brought by a party should be subject to indemnification and advancement simply because a party claims that those actions are defensive in nature. Instead, *Roven* and *Zaman* hold only that Delaware courts consider the "in defending" language broad enough to cover affirmative defenses and compulsory counterclaims, in certain circumstances.

Baker.[32] As Baker cannot reasonably argue that the Related Actions directly relate to and negate nonexistent claims, his reliance on *Roven* and *Zaman* to establish a right to advancement in this case is not persuasive.[33]

While Baker admits that neither Holding nor Confections ever sued him, he claims that he should still receive advancement for costs incurred as part of the Related Actions because those Actions were the only way he reasonably could defend himself against Holding's detrimental actions and allegations. Specifically, Baker claims the right to receive advancement because "the named plaintiff in a declaratory judgment action [such as the Section 225 Action and the Declaratory Judgment Action] is actually defending

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[32] Holding has not asserted a counterclaim in either of the Related Actions. The sole Counterclaim filed by Holding in the Escrow Action was not asserted against Baker himself, but against entities related to him.

[33] Additionally, I do not read *Roven* and *Zaman* as providing a basis for taking the unprecedented step of finding affirmatively filed, preemptive declaratory judgment actions "defensive." If anything, these cases support the opposite conclusion. *See Roven*, 603 A.2d at 824-25 (holding that permissive counterclaims are not defensive in nature and, consequently, not subject to advancement); *Reinhard & Kreinberg v. Dow Chem. Co.*, 2008 WL 868108, at *3 (Del. Ch. Mar. 28, 2008) ("Legal fees incurred in pursuit of merely permissive counterclaims, which do 'not aris[e] out of the transaction or occurrence that is the subject matter of the opposing party's claim' . . . cannot justifiably be construed as part of a director's 'defense' of claims brought against her by a corporation.").

Although I also am mindful of *Zaman*'s caution against interpreting the "in defense of" language in advancement provisions too formalistically, *see* 2008 WL 2168397, at *34, I consider it important to set and adhere to certain boundaries consistent with that language if the "in defense of" limitation on advancement is to have any effect.

against claims raised by the nominal defendant."[34] The facts of this case do not support that argument. Holding simply has not asserted a claim against Baker. Therefore, I decline to read the Advancement Provision so broadly as to turn what amounts to a preemptive attack into a defense.

Baker did not file the Related Actions in defense of the Investigation, but as preemptive strikes against Holding to blunt the negative effects of the Investigation. While the old sports adage that a good offense is the best defense may ring true in certain situations,[35] if taken to an extreme, that idea would require corporations to advance a director her attorneys' fees and expenses for any number of affirmatively filed actions which that director believes necessary to defend against a proceeding or its effects, real or perceived. Here, Baker filed the Related Actions independently of, and in a different forum than, the alleged Investigation and in the absence of any threat by Holding or Confections to proceed against him personally for relief for an alleged breach of fiduciary duty. Hence, the Related Actions cannot be said to be filed "in defense" of the

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34 PAB 12.

35 Vice Chancellor Strine recited this idiom in *Zaman*. *See* 2008 WL 2168397, at *35 ("[I]f *Roven* is good law, it is because it recognized that compulsory counterclaims that, if successful, negate the claim against the corporate official are defensive in the sense long recognized by sports fans, which is that a good offense is the best defense."). As noted above, however, the analysis in *Zaman* related to compulsory counterclaims that directly negate an affirmative claim made in *the same litigation*. Thus, that case does not support the proposition that the "in defending" language extends to preemptive actions filed independent of, and in a different forum than, the alleged proceeding and in the absence of a claim by the corporation.

Investigation. To conclude otherwise would practically eviscerate the limitation on advancement imposed by the "in defending" language of Article VIII and similar language in numerous other advancement provisions.

Thus, I hold that Baker has failed to state a claim upon which relief may be granted and that his claim for advancement of his fees and expenses incurred in pursuing both the Related Actions must be dismissed.

3. Do *Hibbert* and *Shearin* require advancement for the Section 225 Action?

But, Baker also argues that, under *Hibbert v. Hollywood Park*[36] and *Shearin v. E.F. Hutton Group*,[37] even if he cannot be advanced costs incurred in the Declaratory Judgment Action, he is at least entitled to advancement for reasonable expenses incurred in the Section 225 Action because he initiated that Action, at least in part, to determine whether he still owes duties to Holding as a director. The *Hibbert* and *Shearin* cases, however, do not support Baker's position. Those cases, taken together, suggest only that a corporation may, within the permissible scope of Section 145 of the DGCL, adopt a charter or bylaw provision that allows advancement for affirmatively filed actions brought as part of a director's duties to the corporation and its shareholders. As the Advancement Provision in Holding's Certificate does not mandate advancement for any affirmatively filed actions and limits advancement to expenses "actually and reasonably

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[36] 457 A.2d 339 (Del. 1983).

[37] 652 A.2d 578 (Del. Ch. 1994).

incurred . . . in defending" a proceeding, I find no merit in this aspect of Baker's argument.

In *Hibbert*, the Supreme Court examined an indemnification claim by a group of directors seeking indemnification for two affirmatively filed suits "brought . . . against an adverse group of directors, seeking to compel defendants to attend board meetings and make proper disclosure in proxy statements in a control contest."[38] The directors based their claim on an expansive indemnification provision that, in pertinent part, provided indemnity for any former or current director, officer, or employee of the corporation

> against any and all liability and reasonable expense that may be incurred . . . in connection with or resulting from *any claim, action, suit or proceeding . . . , civil or criminal . . . in which he may be involved, as a party or otherwise*, by reason of his being or having been a director, officer, or employee of the [c]orporation.[39]

The Supreme Court held that "indemnity is not limited to only those who stand as a defendant in the main action" and granted plaintiff's request for reimbursement for costs incurred "with respect to suits filed by them in their unsuccessful bid for re-election."[40]

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38 *Id*. at 594.

39 *Hibbert*, 457 A.2d at 342. This bylaw also explicitly stated that the corporation intended to indemnify its directors, officers, and employees for *any* action in which they are involved "to the maximum extent permitted by law." *Id*. While the Advancement Provision at issue in this case includes a similarly expansive phrase, the Provision explicitly limits advancement to fees and expenses incurred by a director or officer while *defending* a proceeding. Cert. of Incorp. Art. VIII.

40 *Id*. at 340, 344 (citing 8 *Del. C.* § 145(f)). The Supreme Court held that the directors were entitled to be indemnified for expenses incurred in the litigation they filed and reversed the trial court's decision because the litigation related, at

In so doing, "*Hibbert* establishe[d] 'the proposition, in Delaware, that *a plaintiff* may in proper circumstances be entitled to indemnification.'"[41]

Nearly a decade later in *Shearin*, Chancellor Allen examined that proposition more closely. Notably, *Shearin* involved a motion to dismiss a complaint that did not allege the specific language of the bylaw providing for indemnification.[42] Thus, the Chancellor assumed that the unspecified bylaw "mandate[d] indemnification payments to the full extent permissible under Section 145"—much like the broad indemnification provision at issue in *Hibbert*—and examined the director's request for indemnification under the presumption that the bylaw mandated indemnification for affirmative suits "brought as part of [the plaintiff's] duties to the corporation and its shareholders."[43]

Chancellor Allen observed that "the drafters of [Section 145] originally had in mind indemnification [and advancement] of expenses for those who were required to *defend* actions taken on behalf of the corporation."[44] Nevertheless, he held that *Hibbert* provided the necessary support for the proposition that "a plaintiff [and not just a

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least in part, to the director's duties to the corporation and was initiated by them "to uphold [their] 'honesty and integrity as directors.'" *Id*. at 344.

41 *FGC Hldgs. Ltd. v. Teltronics, Inc.*, 2007 WL 241384, at *13 (Del. Ch. Jan. 22, 2007) (emphasis added) (citing *Shearin*, 652 A.2d at 594).

42 652 A.2d at 593 n.19.

43 *Id*.

44 *Id*. at 593-94 (noting "the salutary effect of . . . indemnification provisions in encouraging capable individuals to serve as officers and directors of corporations").

defendant] may . . . be entitled to indemnification [and advancement]" for affirmatively filed actions.[45] In doing so, however, he limited the permissible scope of indemnification and advancement claims to affirmatively filed actions brought by directors or other covered persons "*as part of [their] duties to the corporation and its shareholders*."[46]

Importantly, although *Hibbert* and *Shearin* allow a corporation to make indemnification or advancement mandatory for expenses incurred in lawsuits affirmatively brought by covered persons as part of their duties to the corporation and its shareholders, they do not require that it do so.[47] As such, and as with all advancement

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45 *Id*. at 594.

46 *Id*.; *see also Donohue v. Corning*, 949 A.2d 574, 578 n.17 (Del. Ch. 2008). Even though the Court in *Shearin* examined a bylaw mandating indemnification payments to the full extent permissible under Section 145, the Chancellor dismissed the plaintiff's claim for indemnification and advancement of costs in her affirmatively filed actions because "none of [her] claims [were] in any part motivated by a fiduciary or other obligation to the corporation from which she [sought] indemnification." *Shearin*, 652 A.2d at 595.

47 In this regard, I note that in at least one case, *Gentile v. Singlepoint Financial*, this Court engaged in a *Hibbert*/*Shearin* analysis despite the fact that the advancement provision mandated advancement only for "[r]easonable expenses . . . incurred by [a covered person] who was or is a witness or was or is threatened to be made a *named defendant or respondent* in a Proceeding." 787 A.2d at 106 (emphasis added). In that case, a director sought advancement of costs for two proactively filed federal actions, which he claimed were necessary to "uphold his 'honesty and integrity as a director[].'" *Id*. at 104-05, 108 (quoting *Hibbert*, 457 A.2d at 344).

Nevertheless, *Gentile* is instructive here for at least two reasons: First, it recognizes that "*Shearin* supports the conclusion that it is *impermissible*, as a matter of law, to indemnify or advance the costs associated with" any "claims that can fairly be said to be only personal in nature, and not involving [a covered person's] duties to [the corporation] and its stockholders"; and second, it implicitly *rejected* a director's claim that the corporation must advance his costs and

cases, this Court again must focus on the language of the Advancement Provision to determine if the corporate documents mandate advancement for such affirmatively filed actions. As the Court explained in *Donohue v. Corning*,

> I cannot award [plaintiff] advancement merely because [he] has a plausible argument that he brought suit, at least in part, to advance the interests of [the corporation] and that granting [him] advancement in such a situation would arguably comport with the public policy behind allowing indemnification in intracorporate disputes. Rather, . . . *[the plaintiff] must establish that he is entitled to advancement under the term's of [the Corporation's] Advancement Provision itself.*[48]

In this case, the Advancement Provision requires advancement only for reasonable expenses actually incurred "in defending" a proceeding and there is no evidence that Holding intended to or did mandate advancement for affirmative claims. Thus, even assuming Baker's alleged motive for filing the Section 225 Action is true, he is not entitled to advancement because the Certificate does not mandate advancement for affirmatively filed actions, even if brought as part of a director's duties to the corporation

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expenses in responding to an internal investigation through proactive steps—including the initiation of litigation—because he had "an absolute right to take all reasonable legal steps to take on [the corporation's] serious allegations, and thereby fend off the economic and professional impact of being accused of breach of fiduciary duty." *Id*. at 107.

[48] 949 A.2d 574, 578 (Del. Ch. 2008). In *Donohue*, the Court ultimately refused to advance expenses incurred by a former managing member of an LLC who brought suit to challenge his removal as a manager because a "for cause removal" was not a proceeding as contemplated by the advancement provision. *Id*. at 580. Additionally, I note that, although the Court there dealt with an advancement provision providing advancement for a member of an LLC, the same principle holds true in the corporate context.

and its shareholders, and, as discussed in Part II.B.2 *supra*, Baker has not adequately alleged that he brought that Action in defense of a claim by Holding or Confections. Thus, I reject Baker's contention that Holding must advance the fees and expenses of the Section 225 Action.

III. CONCLUSION

For the foregoing reasons, I grant Respondent's motion to dismiss.[49] Counsel for Holding shall submit, on notice, a proposed form of final judgment implementing the rulings set forth in this Memorandum Opinion within ten days.

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[49] Because I grant Holding's motion to dismiss for failure to state a claim, I need not address its argument that Holding's bylaws prevent advancement because they provide that if a proceeding is initiated by a covered person, Holding need only advance the fees and expenses of such a proceeding if the initiation of that proceeding was authorized by Holding's board.