injunctive or prospective relief."[18] The defendant's motion to dismiss the supplemental complaint is denied.

(ii) The Merits of the Complaint

[19-20] Plaintiffs may obtain a preliminary injunction if they establish the following three elements: (1) a reasonable likelihood of success on the merits, (2) imminent, irreparable harm will result if an injunction is not granted and (3) the damage to Plaintiff if the injunction does not issue will exceed the damage to the defendants if the injunction does issue.[19] For a permanent injunction the factors are the same, except that the plaintiff must actually succeed on the merits. This relief is extraordinary and the test is stringent.

(a) Success on the Merits

The plaintiffs not only demonstrate reasonable likelihood of success but they have conclusively shown that the Partnership Agreement prohibits advances to the general partner for any litigation in which the limited partners are plaintiffs.

§ 4.6C of the Partnership Agreement[20] states, in pertinent part:

> Expenses incurred by an Indemnitee in defending any legal action subject to this Section 4.6 shall, from time to time, be advanced by the Partnership prior to the final disposition of such legal action; provided that (i) such legal action relates to the performance of duties or services by such Indemnitee on behalf of the Partnership, (ii) such legal action is initiated by a third party who is not a Limited Partner, and (iii) the Partnership has received an undertaking given by or on behalf of the Indemnitee to repay such amount unless it shall be determined that such an Indemnitee is entitled to be indemnified as authorized in Section 4.6.[21]

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[18] *Grimes v. Donald*, Del. Supr., 673 A.2d 1207, 1213 (1996) (quoting § 7.01 Comment D, The American Law Institute Principles of Corporate Governance: Analysis and Recommendations (1992)).

[19] *Mills Acquisition Co. v. Macmillan, Inc.*, Del. Supr., 559 A.2d 1261, 1279 (1989).

[20] Supplemental Compl., Ex. 2.

[21] "Indemnitee" is defined as "the General Partner and its affiliates" individually. The Agreement, § 4.6B.

I am asked to choose here between two readings of this provision. The plaintiffs argue that this provision sets out the only conditions under which the general partner will be advanced litigation expenses. They say the above three limitations, in particular the limitation conditioning advances on the plaintiffs' not being limited partners, must be fulfilled or no advances will be paid.

The defendant answers that the use of the word "shall" means that § 4.6C merely specifies conditions under which advances are mandatory. Defendant suggests that, absent a mandatory negative limitation, it may make these advances discretionarily, pursuant to its exclusive authority to "manage and control the business affairs of the Partnership. . .and to take all such actions. . .as it deems necessary or appropriate to accomplish the purposes of the Partnership."[22] Defendant also contends its right to these advances is consistent with its right to indemnification under the Agreement and under Delaware limited partnership law, 6 *Del. C.* § 17-108 (1990).

I reject the defendant's arguments wholesale. First, I find that the defendant's reading of this provision would render the limiting language completely superfluous:

> "Expenses incurred by an Indemnitee. . .shall be advanced. . . provided that. . . (ii) such legal action is initiated by a third party who is not a Limited Partner."

From this the parties present two conflicting readings:

(1) Plaintiffs reading:

> The legal action for which the general partner seeks advancement must have been initiated a third party, not a limited partner or the expenses incurred by an Indemnitee (the general partner) shall not be advanced.

(2) Defendant's reading:

> Even if this legal action is initiated by a Limited Partner, expenses incurred by an Indemnitee (the general partner) *may* be advanced based on the Indemnitee's general discretion.

In my view, the defendant's reading simply does not comport with the existence of the limiting language, because it renders the limitation on the

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[22] § 4.1 of the Agreement.

Indemnitee wholly illusory. The only reasonable reading of § 4.6C is that while it ensures the conditions under which advances shall be made, it also specifies, by reverse inference, when the advances shall *not* be made.

[21] After misconstruing the language of § 4.6C, defendant goes on to argue that it has "discretionary" authority to award these advances based on its own broad, general management powers under § 4.1 of the Agreement. I find this highly dubious, given the clarity of the § 4.6C limitation. In short, defendant asks me to believe that § 4.1 grants it the discretionary power to circumvent the plain limitation of § 4.6C. It is obvious that the defendant did not have the benefit of reading the Court's recent decision in *Saunders v. Wang*[23] which reflects an adherence to the principle that general discretionary provisions in contracts, such as found in § 4.1 here, may not be fairly read as negating explicit limitations found elsewhere in the contract. Accordingly, defendant violates the Partnership Agreement by advancing itself any Partnership funds in this litigation.

(b) Balancing of the Equities

I find that the equities heavily favor the plaintiffs. The plaintiffs are passive investors who have raised colorable claims about the defendant's conduct. Further, § 4.6C provides them a reasonable expectation that their investment will not be drained by the general partner in defending itself against their grievances. No investor in an entity party to an agreement *with a provision such as § 4.6C* should expect to be forced to fund the litigation for the very party that it has hailed into court.

Conversely, I find the defendant's advances indefensible. Defendant's actions are precisely the conduct that the Agreement sought to prevent: the general partner's draining the fixed resources of the partnership to defend itself from claims brought by limited partners.

(c) Imminent, Irreparable Harm

I find that the element of imminent, irreparable harm also favors the plaintiff. The partnership is possessed of fixed assets at this stage and the insurance proceeds from which it may draw have a definite ceiling. The fact that this litigation has not even reached trial indicates that any advancement of funds to the general partner to defend itself will continue to deplete partnership assets at increasing risk to the limited partners.

It is true that this complaint seeks return of monies already paid. It also seeks to prevent further actions breaching a clear agreement which

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[23] Del. Ch., C.A. No. 16640, mem. op. at 9, Steele, V.C. (November 10, 1999).

makes injunctive relief inappropriate. The fact that this relief consists of easily calculable dollar amounts or that they are merely advances which *may* be repaid at some late date does not convince me that injunctive relief should not be awarded here.[24] The bottom line is that, quantifiable or not, the funds were wrongfully advanced and will continue to be absent injunctive relief. Imminent, irreparable harm will continue absent immediate injunction relief and the mandatory return of improperly advanced funds.

IV. Conclusion

I grant plaintiffs' motion for a permanent injunction. Defendant is ordered to cease any further use of partnership funds in this action, to account for all funds already advanced, and to return these funds to the partnership's general account.

Defendant's Motion for Judgment on the Pleadings and to Dismiss the Supplemental Complant ***are denied.*** Plaintiffs Motion for Class Certification is ***granted.***

Plaintiff will provide an appropriate order approved as to form.

COCHRAN v. STIFEL FINANCIAL CORP.

No. 17,350

Court of Chancery of the State of Delaware, New Castle

March 8, 2000

Defendant filed a motion to dismiss plaintiff's complaint seeking indemnification from Stifel Financial predicated on plaintiff's service as a director, officer, and employee of Stifel Nicolaus & Co., Inc., a wholly-owned subsidiary of Stifel Financial. Plaintiff alleges he served Stifel Nicolaus at the request of Stifel Financial, thereby becoming an agent of

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[24]*See Cantor Fitzgerald, L.P. v. Cantor*, Del. Ch., 724 A.2d 571, 579 (1998) (holding the elements of an injunction are not necessarily evenly weighted, and a strong showing on one element may overcome a weak showing on another element).

Stifel Financial. In addition, defendant requests dismissal of plaintiff's claim for fees.

The court of chancery, per Vice Chancellor Strine, denied defendant's motion to dismiss except as to plaintiff's claim under section 145(c) and plaintiff's claim for fees. The court found plaintiff had failed to establish that he was Stifel's agent as required by section 145(c).

1. Pretrial Procedure ⚿ 679, 681

On dismissal for failure to state a claim, all well-pleaded facts in the complaint must be accepted as true and all reasonable inferences must be drawn from those facts in the manner most favorable to the plaintiff.

2. Pretrial Procedure ⚿ 679, 681

A motion to dismiss is granted if, after the court accepts all well-pleaded facts in the complaint as true and draws all reasonable inferences from those facts in the manner most favorable to the nonmoving party, the court is reasonably certain that the nonmoving party would not be entitled to relief if it proved those facts at trial.

3. Limitation of Actions ⚿ 16, 17, 21(3)
Master and Servant ⚿ 80(2)

No action for recovery upon a claim for wages, salary, or overtime for work, labor, or personal services performed, or for damages (actual, compensatory or punitive, liquidated or otherwise), or for interest or penalties resulting from the failure to pay any such claim, or for any other benefits arising from such work, labor, or personal services performed or in connection with any such action, shall be brought after the expiration of one year from the accruing of the cause of action on which such action is based. DEL. CODE ANN. tit. 10, § 8111 (2000).

4. Contracts ⚿ 329
Limitation of Actions ⚿ 16, 17, 21(1)

No action based on a promise shall be brought after the expiration of three years from the accruing of the cause of such action subject however to the provisions of sections 8108-8110, 8119, and 8127. DEL. CODE ANN. tit. 10, § 8106 (2000).

5. Corporations ⟹ 308(11), 319(4)
Limitation of Actions ⟹ 16, 17, 21(3)
Master and Servant ⟹ 80(2)

When a plaintiff's claims arise from services which have been performed, the one year period in section 8111 applies. DEL. CODE ANN. tit. 10, § 8111 (2000).

6. Corporations ⟹ 294, 308(11), 319(4)
Limitation of Actions ⟹ 16, 17, 21(3)
Master and Servant ⟹ 80(2)

When a plaintiff's claims arise upon or after termination of the employer-employee relationship, then section 8106 applies and the statute of limitation is three years. DEL. CODE ANN. tit. 10, § 8106 (2000).

7. Corporations ⟹ 294, 308(11), 319(4)
Limitation of Actions ⟹ 16, 17, 21(3)
Master and Servant ⟹ 80(2)

Section 8111 was intended to bar all claims arising out of the period of the employer-employee relationship and not after its termination. DEL. CODE ANN. tit. 10, § 8111 (2000).

8. Corporations ⟹ 319(4), 484(2)
Indemnity ⟹ 15(5)
Limitation of Actions ⟹ 16, 17

Claims for indemnification for officers and directors of Delaware corporations and those who serve other corporations at their Delaware corporation's request are subject to section 106's three-year statute of limitations. DEL. CODE ANN. tit. 10, § 8106 (2000).

9. Corporations ⟹ 189(7), 208, 319(1), 484(2)
Indemnity ⟹ 15(.5)

Section 145(k) vests exclusive jurisdiction independent of prior demand by the plaintiff seeking indemnity in the court of chancery 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. DEL. CODE ANN. tit. 8, § 145 (2000).

10. Corporations ⚷ 189(7), 208, 319(1), 484(2)
Indemnity ⚷ 1, 15(.5), 15(2)

Section 145(d) contemplates that a judicial determination that indemnity is due can be made in lieu of a corporate determination. DEL. CODE ANN. tit. 8, § 145 (2000).

11. Corporations ⚷ 204, 207, 319(.5), 484(2)
Indemnity ⚷ 1, 15(.5), 15(1), 15(2)

Under section 145(a), indemnification is permitted for officers, directors, employees, or agents for attorneys fees and other expenses as well as judgments where the action is not brought by or in the right of the corporation; such indemnification applies only to third party actions where the person seeking to be in or indemnification acted in good faith and in a manner he reasonably believed not opposed to the best interests of the corporation. DEL. CODE ANN. tit. 8, § 145 (2000).

12. Corporations ⚷ 207, 319(.5), 484(2)
Indemnity ⚷ 1, 15(.5), 15(1), 15(2)

Under section 145(b), indemnification is only permitted for expenses (including attorneys fees) arising out of suits by the corporation or shareholder derivative suits and is not permitted for those adjudged liable to the corporation unless and only to the extent that the court of chancery determines that entitlement is fair and reasonable. DEL. CODE ANN. tit. 8, § 145 (2000).

13. Corporations ⚷ 207, 319(.5), 484(2)
Indemnity ⚷ 1, 15(.5), 15(1), 15(2)

Section 145(b) applies to an action, whether direct or derivative, brought by or in the right of the corporation from which indemnity is sought. DEL. CODE ANN. tit. 8, § 145 (2000).

14. Statutes ⚷ 174, 176, 180, 181, 182, 187, 188, 189

Although the courts may adopt a nonliteral reading of a statute where necessary to avoid an unreasonable or absurd result at odds with the General Assembly's clear intent, there should be compelling evidence that the General Assembly's intentions would certainly be frustrated by a literal interpretation for the court to exercise that power.

15. Corporations ⚷ 310(1), 319(.5), 484(2)
Indemnity ⚷ 15(.5)

Section 145(b) does not impose the obligation on a parent corporation to indemnify a director it asks to serve as a subsidiary board; rather, it simply gives the parent corporation that option if the conditions set forth in section 145(a) exist. DEL. CODE ANN. tit. 8, § 145 (2000).

16. Corporations ⚷ 1.3, 1.4(1), 1.4(4), 1.5(3), 484(2)
Indemnity ⚷ 15(.5)

Section 145 is not an automatic conflation of a parent corporation and its wholly-owned subsidiary; Delaware law has traditionally respected the separate existences of a parent corporation and its wholly-owned subsidiary absent circumstances justifying veil piercing on the conclusion that the wholly-owned subsidiary was the parent's agent. DEL. CODE ANN. tit. 8, § 145 (2000).

17. Corporations ⚷ 189(7), 202, 206(4)

Plaintiff must meet the relevant demand excusal test not only with respect to the parent corporation board but also with respect to the board of the parent's wholly-owned subsidiary.

18. Corporations ⚷ 180, 189(.5), 202, 207.5, 307, 319(.5)

A double derivative action is ultimately brought in the right of the subsidiary and not the parent.

19. Corporations ⚷ 1.4(4), 484(2)
Indemnity ⚷ 15(.5), 15(2)

A director or officer of a wholly-owned subsidiary is only an agent of the parent for purposes of section 145(c) if the common law agency test is satisfied; a showing that the director merely served as the request of the parent is insufficient under section 145 to prove agency — the director must go further and demonstrate that he was the parent's agent under the traditional agency definition. DEL. CODE ANN. tit. 8, § 145 (2000).

*20. Corporations ⟹ 204, 207, 307, 319(.5), 484(2)
Indemnity ⟹ 15(.5), 15(1), 15(2)

The key purpose of section 145 and its predecessor is to permit corporate executives to be indemnified in situations where the propriety of their activities as corporate officials is brought under attack. DEL. CODE ANN. tit. 8, § 145 (2000).

21. Corporations ⟹ 484(2)
Indemnity ⟹ 15(.5), 15(2)

Although section 145(a) contains expansive language governing actions against a person by reason of the fact that the person was serving another corporation at the request of the parent, the obvious intent of the statute is to govern actions against such a person as a result of his actions in his official capacity. DEL. CODE ANN. tit. 8, § 145 (2000).

22. Corporations ⟹ 484(2)
Indemnity ⟹ 1, 15(.5), 15(2)

Prior to July 1, 1997, section 145(c) provided for mandatory indemnification of a director, officer, employee, or agent of the corporation who had been successful on the merits or otherwise in defense of any action, suit, or proceeding referred to in subsections (a) and (b) of section 145. DEL. CODE ANN. tit. 8, § 145 (2000).

23. Corporations ⟹ 180, 484(2)
Indemnity ⟹ 15(.5), 15(2)

When a 100% stockholder elects a director to the board of a subsidiary, that director thereafter serves at the request of the stockholder within the meaning of section 145(a). DEL. CODE ANN. tit. 8, § 145 (2000).

24. Corporations ⟹ 1.4(4), 180
Principal and Agent ⟹ 1, 3(1), 5

A person is not automatically the agent of the parent corporation when that person serves another corporation at the request of the parent corporation.

25. Principal and Agent ⟹ 1, 3(1), 24

The determination of whether an agency relationship exists is normally a question of fact, requiring the plaintiff to plead facts that, if true, satisfy the definition of an agency relationship under Delaware law.

26. Corporations ⟹ 180
Principal and Agent ⟹ 1, 3(1), 5

An agency relationship is created when one party consents to having another party act on its behalf, with the principal controlling and directing the acts of the agent.

27. Corporations ⟹ 484(2)
Indemnity ⟹ 15(.5), 15(2)

Delaware law mandates indemnification of directors and officers who satisfy the success criteria of section 145(c) regardless of their good faith. DEL. CODE ANN. tit. 8, § 145 (2000).

28. Corporations ⟹ 484(2)
Indemnity ⟹ 1, 15(.5), 15(2)

Section 145(f) provides that the indemnification rights provided by, or granted pursuant to other subsections of section 145 shall not be deemed exclusive of any other rights to which those seeking indemnification may be entitled under any bylaw, agreement or otherwise. DEL. CODE ANN. tit. 8, § 145 (2000).

29. Corporations ⟹ 484(2)
Indemnity ⟹ 15(.5)

Section 145(f) suggests that a corporation's decision to provide broader indemnification rights should not be disturbed unless those broader rights are contrary to the limitations or prohibitions set forth in the other section 145 subsections, other statutes, court decisions, or public policy. DEL. CODE ANN. tit. 8, § 145 (2000).

30. Corporations ⚷ 484(2)
Indemnity ⚷ 15(.5), 15(2)

No public policy interest precludes contractual indemnification of a person who satisfies section 145(c)'s success criteria. DEL. CODE ANN. tit. 8, § 145 (2000).

31. Corporations ⚷ 484(2)
Indemnity ⚷ 15(.5), 15(2)

Delaware law does not permit indemnification of a director assuming that the director — had not met the success standard of section 145(c) — unless the director met the good faith standard of section 145(a); thus section 145(f) cannot, in those circumstances, be relied upon as authorizing indemnification of a director who did not act in good faith. DEL. CODE ANN. tit. 8, §§ 145(c), 145(f) (2000).

32. Corporations ⚷ 58, 204, 214, 319(.5), 484(2)

The right to indemnification against fees and expenses incurred in a successful action to obtain indemnification is not found in section 145 and must be based on the express provisions found either in corporate bylaws or separate agreements. DEL. CODE ANN. tit. 8, § 145 (2000).

Jan A.T. van Amerongen, Jr., Esquire, of Duane, Morris & Heckscher, Wilmington, Delaware; Robert J. Valihura, Jr., Esquire, Wilmington, Delaware; and Matthew A. Taylor, Esquire, of Duane, Morris & Heckscher, Philadelphia, Pennsylvania, of counsel, for plaintiff.

Edward P. Welch, Esquire, of Skadden, Arps, Slate, Meagher & Flom, Wilmington, Delaware; and Dennis M. Kelleher, Esquire, of Skadden, Arps, Slate, Meagher & Flom, Boston, Massachusetts, of counsel, for defendants.

STRINE, *Vice Chancellor*

Defendant Stifel Financial Corporation seeks to dismiss plaintiff Robert M. Cochran's complaint seeking indemnification from Stifel Financial pursuant to that company's bylaws and 8 Del. C. § 145. Cochran's claims for indemnity are predicated on his service as a director, officer, and employee of Stifel Financial's wholly-owned subsidiary, Stifel Nicolaus & Company, Inc. Cochran alleges that he served Stifel Nicolaus in those

capacities at the request of Stifel Financial and was therefore Stifel Financial's agent.

Stifel Financial's motion to dismiss raises a veritable cornucopia of interesting indemnification issues. The issues raised include:

(1) What statute of limitations applies to an indemnification claim?

(2) Must a person seeking indemnity file a demand with the corporation before bringing suit in this court pursuant to 8 Del. C. § 145(k)?

(3) Is a suit brought by a wholly-owned subsidiary an action "by or in the right of" the parent corporation for the purposes of 8 Del. C. § 145(b)?

(4) Is a person who serves as a director, officer, and employee of a wholly-owned subsidiary "at the request of" the parent corporation automatically considered an "agent" of that parent for purposes of 8 Del. C. § 145(c)?

For the reasons set forth in this opinion I answer these questions as follows:

(1) A three-year statute of limitations applies to indemnification claims, and thus Cochran's claims are not time-barred.

(2) There is no demand requirement implicit in § 145, and Cochran's failure to make a demand therefore does not bar his suit.

(3) Under the plain language of the statute and traditional principles of corporate law that respect separate corporate identities absent grounds for veil piercing, a suit brought by a wholly-owned subsidiary is not brought "by or in the right of" its parent under 8 Del. C. § 145(b). Thus § 145(b) does not bar Cochran's indemnity claim.

(4) A person who serves as a director, officer, and employee of a wholly-owned subsidiary "at the request of" the parent corporation is not automatically an agent of the parent. Because Cochran has failed to plead facts demonstrating that he was Stifel Financial's agent, his § 145(c) claim will be

dismissed without prejudice, and his request to amend his complaint to allege facts supporting an agency relationship is granted.

In addition to addressing these questions, I also consider and grant Stifel Financial's request to dismiss Cochran's claim for "fees for fees" but otherwise deny its remaining arguments.

I. *Factual Background*

Cochran's complaint alleges that at all relevant times he was a director, officer, and employee of Stifel Nicolaus, which is a wholly-owned subsidiary of Stifel Financial. More specifically, the complaint alleges that Cochran worked for twenty-four years as an investment banker at Stifel Nicolaus's Oklahoma City Municipal Bond Underwriting Department. In recent years, Cochran served Stifel Nicolaus as a director and Executive Vice President, "having long been [its] largest revenue producer . . . ."[1] The complaint does not allege that Cochran ever served as a director, officer, or employee of Stifel Financial itself.

Cochran did not name Stifel Nicolaus as a party and does not seek indemnification from it. Rather, he seeks indemnification and reimbursement from Stifel Financial based on the allegation that he was "an agent of Stifel [Financial]" because he "served as a director, officer, and employee of [Stifel Nicolaus] at the request of Stifel [Financial]."[2] The complaint further states that on August 23, 1994, "Stifel [Financial] and [Stifel Nicolaus] advised Mr. Cochran that his employment contract had been terminated for cause."[3]

The complaint does not allege who at Stifel Financial requested Cochran to serve Stifel Nicolaus on behalf of Stifel Financial; it simply states that Cochran was Stifel Financial's "agent" because it "request[ed]" that Cochran serve Stifel Nicolaus. Similarly, the complaint does not allege who at Stifel Financial told Cochran he was being terminated by Stifel Nicolaus for cause; it simply states that Stifel Financial, together with Stifel Nicolaus, "advised" him of that fact.

Cochran bases his claim on provisions in Stifel Financial's bylaws and 8 Del. C. § 145. The bylaw (the "Indemnification Bylaw") on which he relies states:

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[1]Compl. ¶ 6.
[2]*Id.* ¶ 2.
[3]*Id.* ¶ 7.

> *The Corporation [Stifel Financial] shall indemnify to the full extent authorized by law any person made or threatened to be made a party to any action, suit, or proceeding,* whether criminal, civil, administrative or investigative, *by reason of the fact that he* . . . is or was a director, officer or employee of the Corporation or any predecessor of the Corporation or serves or *served any other enterprise as a director, officer or employee at the request of the Corporation* or any predecessor of the Corporation.[4]

Cochran also relies upon the version of 8 Del. C. § 145(c) that existed before July 1, 1997 to support his claim. Section 145(c) then stated:

> 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, suit or proceeding referred to in subsections (a) and (b) of this section, or in defense of any claim, issue or matter therein, he shall be indemnified against expenses (including attorneys' fees) actually and reasonably incurred by him in connection therewith.[5]

Cochran contends that he was an "agent" of Stifel Financial and thus is entitled to mandatory indemnification under former § 145(c) if he satisfies the other requirements of that statute. In the alternative, he contends that even if he is not an agent, it is permissible under Delaware law and therefore mandatory under the Indemnification Bylaw for Stifel Financial to indemnify him if he meets the "success" standard in § 145(c).

There are two major matters for which Cochran seeks statutory and contractual indemnification. The first involves a Securities and Exchange Commission investigation into Stifel Nicolaus's Oklahoma City Municipal Bond Underwriting Department (the "SEC Investigation"). According to the complaint, the SEC focused on Stifel Nicolaus's involvement with certain municipal bond issues and cash management programs in Oklahoma.

As a result of the SEC investigation, Cochran alleges that he and another Stifel Nicolaus employee were indicted by the U.S. Attorney in Oklahoma City for criminal fraud (the "Criminal Proceeding"). The crux of

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[4]Stifel Financial Amended And Restated By-Laws § 6.4 (Compl., Ex. A) (emphasis added).

[5]R.F. BALOTTI & J. A. FINKELSTEIN, 2 THE DELAWARE LAW OF CORPORATIONS AND BUSINESS ORGANIZATIONS § 145, at IV-44 (3d ed. 1999) (hereinafter "BALOTTI & FINKELSTEIN") (*quoting* 8 Del. C. § 145(c), effective July 1, 1994) (emphasis added).

the government's claim was that Cochran had engaged in fraud that allegedly resulted in the receipt by Stifel Nicolaus of improper fees from third-party financial institutions for certain contracts entered into by bond issuers in connection with bond issues in which Stifel Nicolaus represented the issuer. The issuers were allegedly unaware that Stifel Nicolaus received a fee as a part of the contracts. The complaint alleges that the "SEC Investigation and subsequent Criminal Proceeding were brought against Mr. Cochran in his capacity as an agent of Stifel [Financial] and as an employee, officer, and director of an enterprise [Stifel Nicolaus] he was serving at the request of Stifel [Financial]."[6]

After a lengthy trial, Cochran was acquitted on thirteen counts of fraud but convicted on eight counts. His co-defendant was acquitted on all charges. Cochran then took an appeal to the U.S. Court of Appeals for the Tenth Circuit. A panel of that court reversed his conviction.[7] The federal government's request for *en banc* review was denied, and the government did not seek *certiorari* from the U.S. Supreme Court. Thus Cochran's acquittal became final during the summer of 1997.

As a result of his acquittal, Cochran claims he was completely "successful on the merits or otherwise" with respect to the SEC Investigation and the Criminal Proceeding, thus satisfying the standard in 8 Del. C. § 145(c) and triggering his right to indemnity under that statute and the Indemnification Bylaw.[8] Alternatively, he claims that he met the requirement in 8 Del. C. § 145(a) that he must have acted in good faith at all times with respect to the subject matter of the SEC Investigation and Criminal Proceeding and in a manner he reasonably believed to be in or not opposed to the best interest of Stifel Nicolaus. Therefore, he contends that he is entitled to indemnification under the Indemnification Bylaw for the costs he incurred in responding to the SEC Investigation and the Criminal Proceeding.

The other major matter for which Cochran seeks indemnification is an arbitration initiated by Stifel Nicolaus against him before the National Association of Securities Dealers, Inc. (the "Arbitration Action"). Stifel Nicolaus asserted four claims against Cochran in the Arbitration Action: (1) a claim alleging that Cochran received unearned compensation (the "Compensation Claim"); (2) a claim based on a promissory note (the "Promissory Note Claim"); (3) a claim that Cochran breached his fiduciary duties to Stifel Nicolaus relating to his role in refinancing certain municipal bonds for which Stifel Nicolaus was the underwriter (the "Breach of Duty

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[6]Compl. ¶ 9.
[7]*United States v. Cochran*, 109 F.3d 660, 662 (10th Cir. 1997).
[8]Compl. ¶ 11.

claim"); and (4) a claim alleging that Cochran had breached the non-competition clause in his employment contract (the "Non-Compete Claim"). Before the final hearing in the Arbitration Action commenced, Stifel Nicolaus abandoned the Non-Compete Claim.

The hearing on the other three claims was held in September 1996. On October 8, 1996, the arbitration panel issued a final award. The award concluded that Stifel Nicolaus was entitled to a judgment of over $1.2 million on its Compensation and Promissory Note Claims but that Cochran was not liable on the Breach of Duty Claim. Therefore, Cochran contends that he was completely successful on the Breach of Duty and Non-Compete Claims and should be indemnified for his expenses in defending against them.

For different reasons, Cochran claims he is entitled to indemnity on the Compensation and Promissory Note Claims. In this respect, Cochran relies on the fact that he claims to have met the good faith standard of 8 Del. C. ¶ 145(a). Because such indemnification is "authorized by law," in the words of the Indemnification Bylaw, Cochran asserts that Stifel Financial must indemnify him for the expenses he incurred and the money judgments obtained by Stifel Nicolaus against Cochran on those claims — even though such indemnification would have the practical effect of negating those judgments and arguably leaving Cochran unjustly enriched.

II. Stifel Financial's Motion To Dismiss

[1-2] Stifel Financial advances several arguments as to why Cochran has failed to state a proper claim for indemnification. In addressing these arguments, I must accept all well-pleaded facts in the complaint as true and draw all reasonable inferences from those facts in the manner most favorable to Cochran.[9] If, after so doing, it is reasonably certain that Cochran would not be entitled to relief if he proved those facts at trial, then Stifel Financial's motion must be granted.[10] Otherwise, Cochran is entitled to press on.

Stifel Financial makes several arguments in support of dismissal:

- First, it claims that the entire complaint must be dismissed as barred by the statute of limitations set forth in 8 Del. C. § 8111 because Cochran filed suit over a year after his indemnification claims accrued.

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[9] *E.g., Grimes v. Donald*, Del. Supr., 673 A.2d 1207, 1213-14 (1996).
[10] *E.g., In re Tri-Star Pictures, Inc., Litig.*, Del. Supr., 634 A.2d 319, 326 (1993).

- Second, Stifel Financial claims that the complaint must be dismissed in its entirety because Cochran did not make a demand for indemnification to Stifel Financial before commencing this action pursuant to 8 Del. C. § 145.

- Third, Stifel Financial argues that Cochran is not entitled to indemnification from Stifel Financial for the Compensation and Promissory Note Claims because those Claims were brought "by or in the right of" Stifel Financial by its wholly-owned Stifel Nicolaus subsidiary, by the terms of § 145(b).

- Fourth, Stifel Financial contends the complaint fails to allege facts sufficient, if true, to support an agency relationship between Stifel Financial and Cochran. As a result, Stifel Financial asserts that Cochran cannot rely upon the former § 145(c). Nor, says Stifel Financial, may Cochran obtain indemnification under the Indemnification Bylaw's "full extent authorized by law" clause simply by meeting the success standard of § 145(c). Instead Cochran must meet the good faith criteria set forth in § 145(a).

- Finally, Stifel Financial asserts that the Indemnification Bylaw does not provide for an award of "fees for fees" and that Cochran's claim for his attorneys' fees in this action must be dismissed.

A. Does the Statute Of Limitations Bar Cochran's Claim?

[3] Stifel Financial contends that all of Cochran's claims for indemnity are barred by the applicable statute of limitations because they were brought more than one year (albeit less than three years) after his claims accrued. Because his claim to indemnity arises out of his former status as a director, officer, and employee of Stifel Nicolaus, Stifel Financial asserts that the one-year statute of limitations set forth in 10 Del. C. § 8111 applies. That section of the Delaware Code states in pertinent part:

> *No action for recovery upon a claim for wages, salary, or overtime for work, labor or personal services performed,* or for damages (actual, compensatory or punitive, liquidated or otherwise), or for interest or penalties resulting from the failure to pay any such claim, *or for any other benefits arising from*

> *such work, labor or personal services performed* or in connection with any such action, shall be brought after the expiration of one year from the accruing of the cause of action on which such action is based.[11]

[4] For his part, Cochran claims that the three-year statute of limitations found in 10 Del. C. § 8106 is applicable because his right to indemnification is contractual in nature. Section 8106 states in pertinent part:

> [N]o action . . . based on a promise . . . shall be brought after the expiration of 3 years from the accruing of the cause of such action; subject, however to the provisions of § 8108-8110, 8119 and 8127 of this title.[12]

Delaware courts have grappled with the overlap between §§ 8106 and 8111 for many years. As Judge Wright of Delaware's U.S. District Court has noted, "[e]mployment litigation in Delaware often implicates both sections because nearly every claim for wages is based on an underlying promise . . . ."[13] Thus courts are "often able to construe a plaintiffs claim as either a breach of contract action or as an attempt to recover employment benefits."[14]

Making this case all the more difficult is the split in authority over whether a claim for indemnification filed by the officer or director of a Delaware corporation is governed by § 8106 or § 8111. The best way to illustrate the pickle the current dispute puts me in is to set forth the respective arguments of Stifel Financial and Cochran.

1. Stifel Financial's Argument That § 8111 Governs Claims For Indemnification

Stifel Financial argues that Cochran's claim for indemnification clearly constitutes, in the words of § 8111, an "action [to recover] . . . benefits arising from . . . work, labor, or personal services performed" by Cochran for Stifel Nicolaus. As a result of his service at Stifel Nicolaus, he received the "benefit" of indemnification rights — rights he seeks to enforce in this lawsuit. Therefore, says Stifel Financial, Cochran's claim fall squarely within the language of § 8111.

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[11] 10 Del. C. § 8111 (emphasis added).

[12] 10 Del. C. § 8106.

[13] *Roos v. Delaware Valley Radiology P.A.*, C.A. No. 88-85-CMW, slip op. at 9, 1989 U.S. Dist. LEXIS 4023, at *11, Wright, J. (D. Del. Apr. 3, 1989).

[14] *Id.*

In support of this plain language argument, Stifel cites *Sorensen v. The Overland Corp.*[15] In *Sorensen*, a former officer and director sought indemnification for fees and expenses he had incurred defending two lawsuits brought against him as a result of his service in those capacities. The corporation defended by asserting that the complaint was untimely because the one-year period set forth in the predecessor to § 8111 applied.

Chief Judge Leahy of the United States District Court for the District of Delaware agreed with this argument, stating:

> The one year statute has a comprehensive sweep. It was intended to bar all claims arising out of the employer-employee relationship. The Act bars claims for "wages", "salary", and it likewise applies to "overtime" and to any other "benefits" arising from the corporate-officer employment relationship. The word "benefits" is embracing and covers all advantages growing out of the employment.
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> Indemnification has been referred to as a "form of compensation" and as to directors is more equitable than a "fixed salary". Professor Washington contrasts "direct rewards for services", such as salaries, bonuses and options, with indemnification against litigation expenses as "another type of reward". Risks potential in a corporate office, he states, must be cushioned by "higher pay, either in cash or in an agreement to reimburse him for his expenditures." All indemnity agreements are based on a *quid pro quo* for services rendered. It has been said the indemnification device is "part of the contract of service" and unless so regarded "there would be a lack of consideration for the agreement." Here, the agreement to indemnify, i.e., By-Law XXIII, is a benefit to be received for officer or director service and a claim thereunder is subject to the one year period of limitation.[16]

In *Goldman v. Braunstein 's, Inc.*,[17] the Delaware Supreme Court cited and commented upon the *Sorensen* case. *Goldman* involved a claim that the defendant store had wrongfully terminated the employment of its

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[15]*Sorensen v. The Overland Corp.*, 142 F.Supp. 354 (D. Del. 1956), *aff'd*, 242 F.2d 70 (3d Cir. 1957). *See also Roos*, slip op. at 10-11, 1989 U.S. Dist. LEXIS 4023, at *13 (in reliance on *Sorensen*, rejecting the assertion that § 8111 is "limited to only claims for wages" because "[t]he section governs actions for employment benefits, not just wages").

[16]*Sorensen*, 142 F.Supp. at 360-61 (citations omitted).

[17]*Goldman v. Braunstein's, Inc.*, Del. Supr., 240 A.2d 577 (1968).

store manager. The manager had been paid all of his wages and benefits for the period before his firing, and his suit sought damages for wages and benefits he would have received during the remainder of his one-year employment agreement had his contract not been wrongfully terminated. [5-6] The Court held that this claim was not governed by the one-year statute of limitations set forth in § 8111[18] but instead by the three-year statute of limitations for breach of contract claims set forth in § 8106. In so ruling the Court drew a line to help distinguish where § 8111 ended and where § 8106 began in cases arising out of an employment relationship. Where a plaintiff's claims arise from services "which have been performed,"[19] then the one-year period in § 8111 applies. In contrast, where a plaintiff's claims arise "upon or after termination of the employer-employee relationship,"[20] then § 8111 is inapplicable and § 8106 applies. Because the manager's claim was for the loss of payments he would have received had he not been wrongfully discharged, it was not a claim for benefits arising from already performed work and, as such, was not subject to the one-year statute of limitations.

[7] The Court stated that its ruling was "not inconsistent" with the *Sorensen* court's statement that § 8111 "' was intended to bar all claims arising out of the employer-employee relationship[.]'"[21] Why? "[F]or the reason that a claim arising out of that relationship would necessarily be one referable to the period during which the relationship existed, not after its termination."[22]

Delaware courts have since followed the temporal line drawn by *Goldman*. In situations where the benefit sought by the plaintiff arose out of the plaintiff's past service as an employee, Delaware courts have applied § 8111.[23] But where the damages sought by the plaintiff were for benefits connected with services the plaintiff would have performed but for his

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[18]Again, the court was actually addressing the predecessor to current § 8111, then § 8110, which was not different in any respect material to this issue. For the reader's ease, I refer only to § 8111.

[19]*Goldman*, 240 A.2d at 578.

[20]*Id.*

[21]*Id.* at 578 (*quoting Sorensen*, 142 F.Supp. at 360).

[22]*Goldman*, 240 A.2d at 578.

[23]*See, e.g., Baio v. Frank A. Robino, Inc.*, Del. Super., C.A. No. 86A-MY-4, let. op. at 5-7, 1987 Del. Supr. LEXIS 1183, at *7-11, Martin, R.A.J. (May 28, 1987) (where plaintiff sought workers' compensation payments under an Industrial Accident Board-approved compensation agreement, the claim was governed by the one-year statute of limitations set forth in 10 Del. C. § 8111); *Roos*, slip op. at 11, 1989 U.S. Dist. LEXIS 4023, at *14 (where a doctor was seeking to recover salary and pension contributions for services already performed, § 8111 governed his claims; "the fact that Dr. Roos is seeking to recover employment benefits for services *already performed* is controlling") (emphasis in original).

allegedly wrongful termination, our courts have applied § 8106.[24] The Superior Court has explained the distinction as follows:

> No doubt most employment relationships, even if fully executed on the part of the employee, are originally undertaken on the strength of some sort of promise. What then is the distinction between actions based on work performed and actions based on a promise? The distinction which the *Goldman* case sets forth is this:
>
> The one-year statute applies to claims based on work or services that have been completed, even though the work may have originally been undertaken on the strength of a promise. Since the services have been completed, the action is based upon the service performed rather than on the original promise. The three-year statute applies to claims based on work or services not yet completed as to which a promise has been made. Since the work remains uncompleted, an action with respect such work is necessarily based upon the underlying promise.[25]

Stifel Financial claims that Cochran's claim clearly falls out on the § 8111 side of the *Goldman* divide. Cochran's is a backward-looking claim seeking to vindicate the indemnification rights due him for his past service as officer and director of Stifel Nicolaus. Because his claim is for a benefit incident to already performed services, Stifel Financial says that Cochran's claim is time-barred per the teaching of both *Sorensen* and *Goldman*.

2. Cochran's Argument That § 8106 Governs Claims For Indemnification

Like Stifel Financial, Cochran relies heavily on both the text of the Delaware Code and on a judicial decision. Cochran's textual argument is

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[24]*See, e.g., Brown v. Colonial Chevrolet Co.*, Del. Super., 249 A.2d 439, 441 (1968) (where plaintiff's claim sought year-end bonus that was payable to employees only if they were employed until the end of the year and the plaintiff had been terminated earlier, that claim was for benefits flowing from future, not past, services and was covered by § 8106 rather than the one year statute of limitations); *Henze v. Alloy Surfaces Co., Inc.*, Del. Super., CA. No. 91C-06-20, let. op. at 2, 1992 Del. Super. LEXIS 553, at *3, Bifferato, J. (Mar. 16, 1992) (plaintiff's wrongful discharge claim did not involve any "claim for services already performed" and was therefore governed, per *Goldman*, by § 8106) (*citing Goldman*, 240 A.2d at 578).

[25]*Brown v. Colonial Chevrolet Co.*, 249 A.2d at 441.

quite simple. Cochran's claim for indemnification is based on the bylaws of Stifel Financial. "Under Delaware law, Stifel [Financial]'s Indemnification Bylaw represents a contract between Stifel [Financial] and its officers, directors and those who serve other corporations, at Stifel [Financial]'s request, as officers and directors; thus any indemnification coverage offered to Mr. Cochran under those contracts constitutes [a] contractual right[]."[26] Because an action on a contract is an action to enforce a promise, the three-year statute of limitations of § 8106 is implicated by Cochran's claim.

To bolster this argument, Cochran points out that this court recently held that indemnification claims by corporate officers and directors are subject to § 8106 rather than § 8111. In *Scharf v. Edgcomb Corp.*,[27] the plaintiff Scharf sought indemnification from Edgcomb, a corporation he had served as Chairman, Chief Executive Officer, and director for costs he had incurred in responding to a Securities and Exchange Commission investigation. He based his claim on provisions in a merger agreement, Edgcomb's bylaws, and § 145 of Title 8, but he brought his suit more than a year after his claim had accrued.

Scharf argued that *Sorensen* did not bar his suit because that case was: (i) a federal opinion not binding on the Chancery Court; and (ii) not good law because it was decided before the current provisions of § 145 were enacted making indemnification a statutory right in some instances. "Thus, according to Scharf, it is no longer proper to consider indemnification as a benefit accompanying the role of director, and a request for indemnification should not be subject to the one-year statute of limitations found in 10 Del. C. § 811 l."[28]

Vice Chancellor Steele agreed with Scharf and held:

> Scharf's right to indemnification is based on the provisions in the Agreement and Plan of Merger, Edgcomb's by-laws and Delaware statutory law. This contractual right is not a personal benefit payable as a result of his individual effort as a director. Delaware's corporation code authorizes liberal indemnification provisions for officers and directors of its corporations for sound policy reasons that benefit all of a corporation's constituencies. Indemnification provisions authorized by

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[26]Pls. Br. at 10. *See, e.g., Salaman v. National Media Corp.*, Del. Super., C.A. No. 92C-01-161, slip op. at 11, 1992 Del. Super. LEXIS 564, at *17, Del Pesco, J. (Oct. 8, 1992) ("Generally, corporate documents such as bylaws have the force of a contract between the corporation and the directors.").

[27]*Scharf v. Edgcomb Corp.*, Del. Ch., C.A. No. 15224, mem. op., 1997 Del. Ch. LEXIS 169, Steele, V.C. (Dec. 2, 1997), *appeal denied*, Del. Supr., 705 A.2d 243 (1998).

[28]*Scharf*, mem. op. at 8, 1997 Del. Ch. LEXIS 169, at *10.

> statute and incorporated into bylaws by shareholder action demonstrate the desire to broaden the flexibility of decision making by eliminating the chilling effect of potential personal liability on the part of officers and directors. Shareholder democracies want directors and officers to engage in broadly based decision making in order to enhance shareholder value by encouraging prudent risk taking to their and the other corporate constituencies' advantage. Indemnification for officers and directors should be seen as less an individual benefit arising from personal employment than as a desirable underwriting of risk by the corporation in anticipation of greater corporate-wide rewards. Analyzing director and officer indemnification provisions as if they were salary, company cars or other personal corporate [per]quisites simply makes no sense. More simply put, director and officer indemnification benefits the corporation more than the director or the officer covered. A three year statute should apply in order to recognize the weighted exchange appropriately.[29]

Since *Scharf*, two of the three leading treatises dealing with the Delaware General Corporation Law seem to view the statute of limitations issue as having been settled by that case until the Supreme Court addresses the question. One simply states: "Claims for indemnification are subject to a three-year statute of limitations."[30] The other discusses *Sorensen* but indicates that "*Scharf* appears to put to rest any contention that the one-year limitation imposed by 8 Del. C. § 8111 is applicable to indemnification claims . . . ."[31] The third major treatise quotes the rationale for the holding in *Scharf* but expresses no opinion about the issue.[32]

3. Because There Is Doubt About Which Statute To Apply, § 8111 Governs Cochran's Claim

Both sides have made substantial and appealing arguments in support of their view about which statute to apply. For example, Stifel Financial's

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[29] *Scharf*, mem. op. at 11-12, 1997 Del. Ch. LEXIS 169, at *14-15.

[30] 1 BALOTTI & FINKELSTEIN § 4.22, at 4-81.

[31] D.A. DREXLER, L.S. BLACK, JR. & A.G. SPARKS, III, 1 DELAWARE CORPORATION LAW AND PRACTICE § 16.07, at 16-18 (1999) (hereinafter "DREXLER, BLACK & SPARKS").

[32] R. WARD, JR., E.P. WELCH, & A.J. TUREZYN, 1 FOLK ON THE DELAWARE GENERAL CORPORATION LAW § 145.3, at GCL-IV-226-27 & GCL-IV-227 n. 6 (4th ed. 1998).

argument that the indemnification Cochran seeks falls out on the § 8106 side of the *Goldman* line is one with which I cannot quibble. Also persuasive is Stifel Financial's further argument that the more specific statute, in this case the one specifically directed at claims arising out of employment contracts, i.e., § 8106, should govern over a more general statute dealing with all contract claims, i.e., § 8111.[33] Moreover, there is no practical reason why it should be difficult to assert an indemnification claim within one year; indeed, such claims are obvious and involve virtually no risk of non-discovery. Nor is it clear that any public policy interest is served by enabling plaintiffs who want to seek indemnity to delay doing so for three years.[34]

On the other hand, Cochran's claim for indemnification — like most such claims — is heavily based on a statutory enactment of the General Assembly: 8 Del. C. § 145. As Vice Chancellor Steele well articulated in *Scharf*, that statute "authorizes liberal indemnification provisions for officers and directors of its corporations for sound policy reasons that benefit all of a corporation's constituencies."[35] Our Supreme Court has also given a broad construction to § 145, so as to advance the purposes served by the statute's generally pro-indemnification approach.[36] Thus this court should be cautious about applying a relatively restrictive statute of limitations to indemnification claims, especially when the rationale for doing so is based not on a statute directly addressed to indemnification, but on the somewhat illusive temporal distinction used to determine where § 8106 ends and § 8111 begins.[37]

In this regard, it is also important to note that it was only in the 1990s that subsection (k) was added to § 145. That subsection vests exclusive jurisdiction in this court over indemnification claims. Since that amendment, *Scharf* is the only case addressing what statute of limitations should apply to claims within § 145(k)'s purview. One of the most important

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[33]*E.g., Turnbull v. Fink*, Del. Supr., 668 A.2d 1370, 1377 (1995).

[34]*See Sorensen*, 142 F.Supp. at 362 (one-year limitations period "is best in tune with practical necessity of insuring a speedy disposition of claims for corporate indemnity"). On the other hand, it is true that persons often seek indemnification for several matters with different dates of finality (as is the case here). A three-year limitations period may therefore afford a greater opportunity for such persons to bring all their claims in one simultaneously filed action than the shorter one-year period does.

[35]*Scharf*, mem. op. at 11, 1997 Del. Ch., LEXIS 169, at *14.

[36]*VonFeldt v. Stifel Financial Corp.*, Del. Supr., 714 A.2d 79, 84 (1998).

[37]*Cf. Rich v. Zeneca, Inc.*, 845 F.Supp. 162, 166 (D.Del. 1994) (Under the *Sorensen/Goldman* line of cases, § 8111 "should not be read as being so comprehensive as to bar all claims arising out of the employer-employee relationship. Rather 10 Del. C. § 8111 is directed to claims alleging a breach of a duty to pay wages, salary or overtime for work performed. Where, as here, a plaintiff alleges that a defendant has breached a different duty arising out of the employer-employee relationship, another statute of limitations may apply to the plaintiff's claim.").

features of Delaware's corporation law is its predictability, which allows parties to order their affairs with some confidence. I am therefore disinclined to diverge from the approach taken by *Scharf*, absent some inequity that would result from following that decision. I perceive none.

[8] Most important, in this situation, where "there is doubt as to which of two statutes of limitations applies, that doubt should be resolved in favor of the longer period."[38] Given the different approaches taken in *Sorensen* and *Scharf* and the rather malleable distinction between employment-related cases governed by § 8106 and those governed by § 8111,[39] that maxim applies with full force here. To the extent that the General Assembly believes that the shorter period should apply as a matter of public policy, it, of course, may legislate on the issue. But until it does so, or the Delaware Supreme Court issues a binding ruling on the issue, this court must apply the longer limitations period. Therefore the longer, three-year period set forth in § 8106 applies to Cochran's claims, and he is not time-barred from asserting them.

B. Did Cochran Have To Demand Indemnification From Stifel Financial Before Filing This Suit?

Stifel Financial argues that this suit should be dismissed because Cochran failed to demand indemnification from Stifel Financial before filing this action and failed to attach to his complaint a detailed summary of the fees and expenses for which he seeks compensation. Specifically, Cochran argues:

> Directors and officers seeking indemnification should be required to first present their request to the Delaware corporation and supply sufficient information to provide the corporation with an opportunity to evaluate the request and make an informed decision consistent with their fiduciary

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[38] *Sonne v. Sacks*, Del. Supr., 314 A.2d 194, 196 (1973) (citation omitted).

[39] The facts of the case from which I quote this rule is a good example. In *Sonne v. Sacks*, the Supreme Court confronted a case where an employee had received salary checks that bounced. The employee sued his former employer to recover the salary he was due but did so more than a year after the checks had bounced. The Superior Court dismissed his suit, holding that the suit was one for benefits for already performed services and was thus governed by the predecessor to current § 8111, then § 8110. On appeal, the Supreme Court reversed. The Court acknowledged that the employee's claim had its origins in already performed work but noted that the "gravam[e]n of his claim is an action upon the checks" and that it was "incidental that he acquired those checks as consideration for his services . . . ." *Sonne v. Sacks*, 314 A.2d at 196. Therefore, the Court found that the employee's claim implicated the six-year statute of limitations then set forth in § 8108 to deal with causes of action arising from bills of exchange.

> duties. Cochran does not allege in his Complaint that he made a proper indemnification demand or that he supplied any information to the corporation for it to make any decision. On the face of his Complaint, Cochran is seeking to have this Court, rather than the Delaware corporation, make the initial decision regarding his entitlement to indemnification and the reasonableness of fees and costs associated with any such indemnification. That seems an inappropriate use of this Court's time and energy — at least in the first instance.[40]

As a sensible policy proposal, Stifel Financial's argument has appeal. Why should this court consider a claim for indemnity until the corporation has had the opportunity to consider it? Shouldn't the corporation get the first crack? At the very least, wouldn't this narrow the issues that the court must address?

[9] But the problem with this argument is that it finds no support in § 145. Subsection (k) of § 145 vests exclusive jurisdiction in this court "to hear and determine all actions for advancement of expenses or indemnification brought under this section or under any bylaw, agreement, vote of stockholders or disinterested directors, or otherwise." This authority is not dependent on a prior demand by the plaintiff seeking indemnity. When the General Assembly wishes to predicate this court's jurisdiction on a prior demand, it knows how to do so. Section 220 of Title 8 is a good example of this capability.[41]

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[40]Defs. Op. Br. at 16.

[41]*Cf.* Ch. Ct. R. 23.1; *Levine v. Smith*, Del. Supr., 591 A.2d 194, 200 (1991) (under Delaware law, 8 Del. C. § 141, directors manage corporation and decide whether to litigate cases and a "derivative suit is . . . a qualified or conditional remedy" available because of the potential for conflicts of interest; Rule 23.1 represents "a procedural restatement of these bedrock principles").

At oral argument, Stifel Financial's counsel pointed out that the demand requirement for derivative suits is imposed by judicial rule rather than legislative mandate, that such a mandate is not reflected in 8 Del. C. § 327, and that I should therefore feel less inhibited in reading a demand requirement into § 145. As a historical matter, however, it appears that the derivative suit was a common law development designed to ensure basic fairness and that the demand requirement was judicially created to guarantee that the statutory power of directors to manage the legal affairs of the company was not disregarded except when necessary to serve the policy purpose justifying the recognition of the derivative suit in the first instance. The Delaware case law recognizing the demand requirement pre-dates 8 Del. C. § 327 and its predecessors by a significant number of years. *Compare* 2 DREXLER, BLACK, & SPARKS § 42.01, at 42-2 ("[E]quity courts have recognized for at least a century that stockholders should have a means to redress injuries inflicted upon their corporation where management wrongfully refuses to seek recovery. The judicial approach to stockholder derivative actions has been a conscious effort to balance these competing interests by applying special procedural and substantive rules to derivative suits.") *and id.* § 42.03[2][a], at 42-10 ("The demand requirement has been part of Delaware law for 75 years.") (*citing Ellis v. Penn Beef Corp.*, Del. Ch., 80 A. 666, 668 (1911)) *with Rosenthal v. Burvy Biscuit Corp.*, Del. Ch., 60 A.2d 106, 111 (1948) (Delaware adopted contemporaneous ownership rule by statute in 1945;

[10] Moreover, the text of § 145(d) contemplates that a judicial determination that indemnity is due can be made in lieu of a corporate determination. That subsection outlines the methods by which a corporation may grant indemnity pursuant to § 145(a) and (b). In so doing, subsection (d) states that "[a]ny indemnification under subsections (a) and (b) of this section *(unless ordered by a court)* shall be made by the corporation" only in accordance with certain conditions."[42] Furthermore, a corporation that wishes to make a demand a predicate to permissive indemnity under § 145(a) and (b) can do so by requiring such a demand in its bylaws. Stifel Financial chose not to exercise that option.

As a matter of reality, neither issue has much practical relevance to the dispute between Stifel Financial and Cochran. For now, Stifel Financial denies that it owes Cochran anything. Given the aggressive litigation posture Stifel Financial has assumed in response to Cochran's claim, there seems little doubt that it would reject Cochran's demand out of hand. As a result, a dismissal or stay of this litigation to enable Cochran to make a demand would simply defer the inevitable. For the same reason, any dispute about the amount of indemnification owed to Cochran is likely to occur only after Stifel Financial's obligation to pay any indemnity is decided. Thus quibbling about whether Cochran can appropriately document the fees and expenses for which he seeks reimbursement is premature.[43]

Delaware courts had theretofore not followed *Hawes v. Oakland*, 104 U.S. 450 (1881), in adopting the contemporaneous ownership requirement as a common law prerequisite to derivative standing).

We are now in a very different era in our corporation law's development. Given the great care and attention the General Assembly has given to crafting and adjusting § 145, there is no legitimate basis for the judiciary to impose its own view of prudent policy.

[42]8 Del. C. § 145(d) (emphasis added).

[43]Stifel Financial's own authority suggests that this is so. For example, Stifel Financial cites to *MCI Telecommunications Corp. v. Wanzer*, a case in which Judge Poppiti criticized an affidavit filed in support of an indemnity claim because it did not set out how the indemnitee's lawyers spent their time or on which counts. Defs. Op. Br. at 17; Defs. Reply Br. at 20-21 (*citing MCI Telecommunications Corp. v. Wanzer*, Del. Super. C.A. Nos. 89C-MR-216 & 89C-SE-26, slip op. at 27, 1990 Del. Super. LEXIS 222, at *40-41, Poppiti, J. (June 19, 1990), *reh'g denied*, Del. Super., C.A. No. 89C-MR-216, Poppiti, J. (Oct. 10. 1990)). Yet this came in the context of the court's ruling on cross-motions for summary judgment, and Judge Poppiti allowed the party seeking indemnity on the basis of the inadequate affidavit to prove its entitlement after further factual development. *Id.* at 28, 1990 Del. Super. LEXIS 222, at *41-42.

C. Was The Arbitration An Action "By Or In The Right Of" Stifel Financial Such That § 145(b) Rather Than § 145(a) Governs Cochran's Claim That Stifel Financial Must Pay The Judgments Entered On Stifel Nicolaus's Compensation And Promissory Note Claims?

Stifel Financial argues that the Arbitration brought by Stifel Nicolaus against Cochran was, as a matter of law, also an action "by or in the right" of Stifel Financial itself. Because a wholly-owned subsidiary is to be managed solely so as to benefit its corporate parent,[44] Stifel Financial claims that any action brought by a wholly-owned subsidiary is, by definition, brought "by or in the right" of the subsidiary's corporate parent.

[11] This question is significant because of the distinction § 145 draws between third-party actions and actions by or in the right of the corporation. As a leading treatise well explains, § 145(a):

> permits indemnification of officers, directors, employees, or agents for attorneys' fees and other expenses as well as judgments or amounts paid in settlement in civil cases. *This subsection applies only to third party actions, not to actions brought by or in the right of the corporation.* The person seeking indemnification must have acted in good faith and in a manner he reasonably believed to be in or not opposed to the best interests of the corporation in respect of the claim made against him.[45]

[12] Meanwhile, § 145(b) deals with actions brought "by or in the right of the corporation." This includes both derivative actions and direct suits brought by the corporation itself.[46] Section 145(b) has much tighter restrictions on the scope and availability of indemnification than does § 145(a). Specifically, § 145(b) permits indemnification only for "expenses (including attorneys' fees)" and not for judgments. Moreover, § 145(b) does not permit indemnification for expenses "in respect of any claim . . . as to which such person shall have been adjudged liable to the corporation unless and only to the extent that the Court of Chancery . . . shall determine upon application that, despite the adjudication 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 . . . shall deem proper."

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[44] *Anadarko Petroleum Corp. v. Panhandle Eastern Corp.*, Del. Supr., 545 A.2d 1171, 1174 (1988).

[45] 1 BALOTTI & FINKELSTEIN § 4.22, at 4-82 (emphasis added).

[46] *Id.* § 4. 22, at 4-82; 1 DREXLER, BLACK & SPARKS § 16.01, at 16-3.

The distinction between § 145(a) and 145(b) is critical in this case because the Indemnification Bylaw requires Stifel Financial to indemnify to the full extent authorized by law any person serving another corporation at its request. If § 145(a) governs the Arbitration, then Cochran is arguably entitled to indemnification for the Compensation and Promissory Note Claims so long as he "acted in good faith and in a manner [he] reasonably believed to be in or not opposed to the best interests of" Stifel Financial in connection with those Claims. By contrast, if § 145(b) governs those Claims, Cochran will be entitled solely to recoup his expenses and only then if he can convince me that, despite his liability on those Claims, he is "fairly and reasonably entitled" to indemnity for those expenses.

[13] With that context in mind, I turn to an analysis of the statute. As written, § 145(b) does not appear to be ambiguous, in the sense of being "reasonably susceptible to different . . . interpretations."[47] Rather, it clearly applies to an action brought "by or in the right of the corporation" from which indemnity is sought. The words "by or in the right of" encompass both direct actions by the corporation from which indemnity is sought and derivative actions brought "in the right of" the corporation from which indemnity is sought.

Citing reasons that have, I must admit, substantial logic from a policy perspective, Stifel Financial would have me read the words "by or in the right of the corporation" as implicitly including the concept that any action brought by or in the right of a wholly-owned subsidiary must also be deemed one "by or in the right of" the parent corporation. Otherwise, Stifel Financial argues, the clear intent of § 145(b) — to narrow the availability of indemnification for directors and officers found liable to their own corporations — will be thwarted.[48] After all, what could be more absurd than to require Stifel Financial to indemnify Cochran for judgments he owes to Stifel Financial's wholly-owned subsidiary? Such a result would let Cochran off scot-free, to the detriment of both Stifel Financial and Stifel Nicolaus. Therefore, Stifel Financial argues, I should invoke the court's authority to read a statute non-literally when "a literal interpretation of the words of the statute would lead to an absurd or unreasonable result that could not have been intended by the legislature."[49]

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[47]*Grand Ventures, Inc. v. Whaley*, Del. Supr., 632 A.2d 63, 68 (1993).

[48]*See* 1 BALOTTI & FINKELSTEIN § 4.22, at 4-84 ("The policy behind the distinction is based on the fact that in a derivative action the ultimate plaintiff is the corporation on whose behalf the suit is brought. Consequently, any resulting money judgment against, or settlement funds provided by the defendant is paid to the corporation in order to make it whole. The corporation would not receive that benefit if it were to reimburse a defendant the amount of the judgment or settlement funds which the same defendant is required to pay the corporation").

[49]*Whaley*, 632 A.2d at 68.

For several reasons, I cannot interpret § 145(b) in the manner suggested by Stifel Financial. The most important is that the language of the statute cannot bear the construction Stifel Financial advances. By its plain language, the "corporation" that is referred to in the phrase "by or in the right of the corporation" is the corporation from which indemnity is sought. In this case, that corporation is Stifel Financial, not Stifel Nicolaus. Had the General Assembly wished § 145(b) to apply to suits "by or in the right of the corporation or the wholly-owned subsidiary of the corporation," it could have easily written § 145(b) in that manner. It did not do so. A decision by me that the statute incorporates, *sub silentio*, this concept is more akin to a legislative, than a judicial judgment.[50]

Moreover, the pertinent legislative history is consistent with a plain language approach. Indeed, the most important source of legislative history for § 145(b) states that "by or in the right of the corporation . . . [a]pplies only to suits by the corporation or shareholder derivative suits."[51]

[14] Although the courts may adopt a non-literal reading of a statute where necessary to avoid an unreasonable or absurd result at odds with the General Assembly's clear intent, use of such authority comes close to an exercise in judicial legislation. As a result, there should be compelling evidence that the General Assembly's intentions would certainly be frustrated by a literal interpretation.[52] Such evidence is lacking here.

A review of the legislative history reveals no indication, one way or the other, regarding the General Assembly's view of § 145(b)' s applicability in parent-wholly-owned subsidiary contexts. It is clear, however, that the initial drafters of § 145 were cognizant of the need to address subsidiaries; this issue seems to have in part inspired the "at the request of" category.[53]

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[50]*HMG/ Courtland Properties, Inc. v. Gray*, Del. Ch., 129 A.2d 300, 306 (1999) ("This court should be chary about reading words into a statute that the General Assembly could have easily added itself."); *Jacobs v. Metropolitan Life Ins. Co.*, Del, Super., 1 A.2d 601, 603 (1937) ("Words will not be added [to a statute] except to conform to the obvious intent of the Legislature and cannot be added when the words may have been purposely omitted from the statute."), *aff'd*, Del. Supr., 1 A.2d 603 (1938).

[51]Ernest L. Folk, III, *Review of The Delaware General Corporation Law for the Delaware Corporation Law Revision Committee* 1965-1967, at 95 & 95 n. 11 (1968) (hereinafter "*Folk Review*"); *see also id.* at 76 (" The statute should also recognize and act upon the distinction between indemnifying derivative and non-derivative suits."); *id.* at 85-91 (discussing recommendations as to provision that became § 145(b) under rubric of "Indemnification in Derivative Actions").

[52]*Coastal Barge Corp. v. Coastal Zone Industrial Control Board*, Del. Supr., 492 A.2d 1242, 1246 (1985) (Ambiguity may also arise from the fact that giving a literal interpretation to words of the statute would lead *to such unreasonable or absurd consequences as to compel a conviction* that they could not have been intended by the legislature.") (citations omitted) (emphasis added).

[53]*Folk Review*, at 82 (indicating that "at the request of" category was designed in part to address "subsidiaries").

Moreover, while there is great first-blush appeal to Stifel Financial's argument, that argument also ignores the fact that many corporations have controlled subsidiaries that are not wholly-owned. Section 145(b) may be written the way it is for rational reasons. Posit, for example, a parent corporation that owns 80% of the stock of a subsidiary. Assume that the parent purchases a division of the subsidiary. The directors of the subsidiary, who serve at the request of the parent, approve the sale. The public stockholders of the subsidiary then file a derivative action alleging that the directors of the subsidiary breached their fiduciary duties because the sale was unfair to the subsidiary and overly advantageous to the parent. Under a plain reading of § 145(b), that situation would implicate § 145(a), not § 145(b). And under § 145(a), the parent corporation could indemnify the subsidiary directors for an adverse judgment against them so long as the directors "acted in good faith and in a manner [they] reasonably believed to be in or not opposed to the best interests of the [parent] corporation."

Although this scenario is obviously different from one involving a wholly-owned subsidiary, it does illustrate one reason why the General Assembly may have chosen to craft § 145(b) the way it did and to give flexibility to a parent corporation under § 145(a) to indemnify a director it asks to serve on a subsidiary's board.

[15] The latter point bears emphasis. A plain reading of § 145(b) does not impose the obligation on a parent corporation to indemnify a director it asks to serve on a subsidiary board; rather, it simply gives the parent corporation that option if the conditions set forth in § 145(a) exist. Parent corporations can avoid the absurd result Stifel Financial believes Cochran's claim presents through careful drafting of their own bylaws.

[16] Nor am I inclined to read into § 145 an automatic conflation of a parent corporation and its wholly-owned subsidiary. Our law has traditionally respected the separate existences of a parent corporation and its wholly-owned subsidiary, absent circumstances justifying veil piercing or the conclusion that the wholly-owned subsidiary was the parent's agent.[54]

[17] Even in our state's rather sparse case law regarding double derivative suits, an adherence to formalism has been maintained. In *Razes v. Blasband*,[55] for example, the Supreme Court held that a plaintiff had to meet

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[54]*See, e.g., Red Sail Easter Limited Partners, L.P. v. Radio City Music Hall Productions, Inc.*, Del. Ch., C.A. No. 12036, mem. op. at 7-8, 1991 Del. Ch. LEXIS 113, at *11-12, Allen, C. (July 10, 1991); *Mabon, Nugent & Co. v. Texas American Energy Corp.*, Del. Ch., C.A. No. 8578, mem. op. at 7-8, Berger, V.C. (Jan. 27, 1988); *cf. VonFeldt*, 714 A.2d at 85 (stressing that its decision that a director elected to the board of a wholly-owned subsidiary served in that capacity by "request of the" parent did not "perforate the limitations on inter-firm liability that are a *raison d'etre* of wholly-owned subsidiaries").

[55]Del. Supr., 634 A.2d 927 (1993).

the relevant demand excusal test not only with respect to the parent corporation board, but also as to the board of the parent's wholly-owned subsidiary.[56] In so doing, the Court implicitly recognized the presumptive independence of the subsidiary board. The Court's formalistic approach also reflects the fact that the subsidiary's board, per 8 Del. C. § 141, is statutorily empowered to decide whether to assert the claim, that the parent theoretically can assert the claim only derivatively and only if demand excusal is proven, and that a stockholder of the parent wishing to assert a double derivative claim must therefore show that neither of the boards can fairly determine whether to bring the claims belonging to the subsidiary.

[18] Put simply, under *Rales*, a double derivative action is ultimately brought "in the right of" the subsidiary, not the parent. Thus *Rales* cuts against the construction of § 145(b) advanced by Stifel Financial. The formulation of *Rales* is no aberration, but reflects bedrock principles of Delaware law with which the drafters of § 145 were well-versed.

[19] My resistance to reading § 145(b) non-literally is also heightened by the imbalanced approach to indemnification in the parent-wholly-owned subsidiary context I would have to attribute to the General Assembly were I to adopt Stifel Financial's view of the scope of § 145(b). In Section II(D) of this opinion, I adopt Stifel Financial's argument that a director or officer of a wholly-owned subsidiary is only an agent of the parent for the purposes of § 145(c) if the common law agency test is satisfied. That is, I conclude that the General Assembly took a formalistic approach to the relationship between a parent corporation and the director of a subsidiary the parent elected, and did not assume that corporate parents invariably direct and control the directors of their subsidiaries. Rather, a showing that the director merely "served as the request of" the parent is insufficient under § 145 to prove "agency" status; the director must go farther and demonstrate that he was the parent's agent under the traditional agency definition.

While I have no wish to adhere to a foolish consistency,[57] I see no principled basis for disregarding the separate corporate existences of a parent and its wholly-owned subsidiary as a matter of course under § 145(b) unless one is willing to do the same under § 145(c). Otherwise, the playing field will be tilted inequitably against persons seeking indemnity in parent corporation-wholly-owned subsidiary contexts, and towards parent corporations seeking to avoid indemnification. Nothing in the statutory text or legislative history suggests a legislative intent to create such a skewed approach.

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[56] *Id.* at 934.

[57] Lest I run afoul of Emerson's maxim.

Lastly, it is important to note that giving a plain reading to § 145(b) produces a result no more irrational or absurd than the fact that a director found liable for a breach of fiduciary duty in a direct action brought by the company's stockholders can be indemnified under § 145(a).[58] As learned commentators have noted, " third party actions . . . include stockholders' class action suits, in which the type of conduct challenged is often difficult to distinguish from that challenged in stockholders' derivative suits." In that scenario, the legislature appears to believe that the good faith safeguard in § 145(a) is sufficient even though the underlying breach may be no different in nature than that involved in a derivative action. The General Assembly may have thought the same was true in the parent — wholly-owned subsidiary context.

In rejecting Stifel Financial's argument, I, of course, in no way imply that Cochran will ultimately be entitled to indemnity for the Compensation and Promissory Note judgments. For example, if Cochran knowingly took excessive or unearned compensation or failed to repay sums he clearly owed on a promissory note, then his conduct would not have been in good faith or in the best interests of Stifel Financial. Cochran could not simultaneously act in bad faith toward Stifel Nicolaus while acting in good faith towards Stifel Financial when he bases his claim to indemnification on Stifel Financial's alleged request that he serve Stifel Nicolaus as a director, employee, and officer.

[20] In this respect, I also have grave doubt that a person can sign a binding agreement with a wholly-owned subsidiary, commit himself to abide by the contract, and then refuse as a matter of economic reality (by seeking indemnity from the subsidiary's parent) to repay sums that the relevant decisionmaker under the contract had ruled were owed to the subsidiary. In such a situation, the key purpose of § 145 (and its predecessor) — "to permit corporate executives to be indemnified in situations where the propriety of their actions as corporate officials is brought under attack" — is not implicated.[59]

[21] Here, for example, it appears that Cochran bound himself to an employment contract and a promissory note with Stifel Nicolaus that contained arbitration clauses. Although § 145(a) contains expansive language governing actions against a person "by reason of the fact that the person" was serving another corporation "at the request of the parent," the obvious intent of the statute is to govern actions against such a person as a result of his actions in his official capacity. When a person signs an

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[58]DREXLER, BLACK & SPARKS § 16.01, at 16-3.

[59]*Essential Enterprises Corp. v. Automatic Steel Products, Inc.*, Del. Ch., 164 A.2d 437, 441 (1960).

employment agreement or promissory note with the corporation he serves, he is, one would think, acting as an individual. To the extent that a dispute about his compliance with such an agreement later arises, it would appear to be "by reason of the fact that the person" allegedly breached his individual obligation to the corporation, and not "by reason of the fact that the person" incidentally was serving the corporation in a position "at the request of" another corporation.

But because this precise argument was not made by Stifel Financial and therefore I have not had the benefit of briefing on this question and because its resolution may turn on the substance of the underlying contracts, I cannot dismiss the complaint on this basis.

D. Stifel Financial's Argument That Cochran Has Not Adequately Alleged That An Agency Relationship Existed Between Himself and Stifel Financial And Therefore That Cochran Has Not Stated A Claim For Indemnification Under 8 Del. C. § 145(c)

As to those claims on which he was exonerated or not held liable — the criminal charges brought in the Criminal Proceedings (allegedly as a result of the SEC investigation) and the Breach of Duty and Non-Compete Claims brought in the Arbitration — Cochran seeks mandatory indemnification pursuant to 8 Del. C. § 145(c).

As Cochran points out, the current version of 8 Del. C. § 145(c) is not applicable to his claim for indemnification because all of the proceedings from which his claim for indemnification arises were directed to acts of Cochran that occurred before July 1, 1997. Therefore, the version of 8 Del. C. § 145(c) in effect until that date applies to his claim.[60]

[22] That version of § 145 (c) provides for mandatory indemnification of a "director, officer, employee or agent of a corporation" who "has been successful on the merits or otherwise in defense of any action, suit or proceeding referred to in subsections (a) and (b) [of § 1451 . . . ."[61] The fact that the prior version applies is important here, because the 1997 amendment to § 145(c) eliminated any reference to the term "agent," thus ending the right of a corporate agent to demand mandatory indemnification from his corporate principal if the agent otherwise satisfied the terms of the subsection.

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[60]See 71 Del. Laws, ch. 120, § 32 (stating that the Act amending § 145(c) "shall be effective on July 1, 1997, except that Section 5 of this Act shall become effective with respect to indemnification of expenses (including attorneys' fees) for acts or omissions occurring on or after July 1, 1997").

[61]8 Del. C. § 145(c) (version pre-dating July 1, 1997).

Conceding that the prior version of the statute applies, Stifel Financial nonetheless contends that dismissal of those counts that rely on § 145(c) is in order because Cochran has failed to plead facts that support the conclusion that he was Stifel Financial's agent. Rather, Cochran has simply pled the conclusion that he was Stifel Financial's agent because he was asked to serve as a director, officer, and employee of Stifel Nicolaus by Stifel Financial.

[23] In pressing this point, Stifel Financial admits that, as a matter of law, Cochran's election as a director of Stifel Nicolaus by Stifel Financial has important consequences. In the case of *VonFeldt v. Stifel Financial Corp.*[62] the Delaware Supreme Court dealt with the issue of whether a director of Stifel Nicolaus served as a director, officer, and employee of Stifel Nicolaus "at the request of" Stifel Financial for purposes of 8 Del. C. § 145(a). The Supreme Court held that he did, stating as follows:

> The vote of a 100% stockholder is a public expression of support for the elected candidate. In unmistakable fashion, it broadcasts the stockholder's preference to have the candidate serve on the subsidiary's board. This must amount to a 'request' in the eyes of the law.... Accordingly, where a 100% stockholder elects a director to the board of a subsidiary, that director thereafter serves the subsidiary 'at the request of the stockholder, within the meaning of 8 Del. C. § 145(a)....
>
> We are aware that the pleadings in [one of the actions for which VonFeldt sought indemnity] named VonFeldt in his capacity as an officer and employee of [Stifel Nicolaus], rather than as [a Stifel Nicolaus] director. This distinction is immaterial. In keeping with the aversion to undue formalism, we decline to engage in the hyper-technical exercise of trying to measure the 'scope' of Stifel Financial's request against the various roles VonFeldt filled at [Stifel Nicolaus].... We hold that, as a matter of law, the request to serve as an officer and employee of a wholly-owned subsidiary is inferred from the director's election to the subsidiary's board.[63]

But, as Stifel Financial points out, the drafters of the prior § 145(c) had the option of including persons who served "at the request of" the corporation from which indemnity is sought but chose not to do so and

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[62] *VonFeldt*, 714 A.2d 79.
[63] *VonFeldt*, 714 A.2d at 85.

instead to include only "agents" of the corporation. This choice would appear to reflect a considered decision to apply stricter criteria and to limit mandatory indemnification to those persons who can demonstrate that, pursuant to Delaware's law of agency, the corporation from which they seek indemnity acted as their principal.[64]

[24] Moreover, the term "agent of the corporation" is included in § 145(a) and (b) alongside language covering persons who serve another corporation in certain capacities (including as an agent) "at the request of" the parent. Therefore, the mere fact that one serves another corporation "at the request of" the parent does not automatically make that person an "agent of the corporation."[65] As a result, the General Assembly cannot have intended that the use of the word "agent" in § 145(c) encompassed any person serving another corporation as an officer, director, employee, or agent "at the request" of a parent corporation.[66] Rather, the hardly uncommon term "agent" must be given its usual meaning.

[25-26] Under Delaware law, "[t]he determination of whether an agency relationship exists is normally a question of fact."[67] This does not mean, of course, that a plaintiff can simply assert that he was the agent of a defendant and survive a motion to dismiss. Rather, the plaintiff must plead facts that, if true, satisfy the definition of an agency relationship under Delaware law.[68] Our Supreme Court recently articulated that definition as follows: "'An agency relationship is created when one party consents to have another act on its behalf, with the principal controlling and directing the acts of the agent.'"[69]

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[64]*See In re Adoption of Swanson*, Del. Supr., 623 A.2d 1095, 1097 (1993) ("A court may not engraft upon a statute language which has been clearly excluded therefrom. Thus, where, as here, provisions are expressly included in one part of a statute, but omitted from another, it is reasonable to conclude that the legislature was aware of the omission and intended it.") (citations omitted).

[65]*In re Estate of Webb*, Del. Ch. 269 A.2d 413, 416 (1970) ("[u]nder familiar rules of statutory construction, the Court cannot regard [statutory language] as surplusage or as legislative redundancy"), *aff'd*, Del. Supr., 276 A.2d 457 (1971).

[66]*Jacobs*, 1 A.2d at 603 ("Words will not be added [to a statute] except to conform to the obvious intent of the Legislature and cannot be added when the words may have been purposely omitted from the statute.").

[67]*Fisher v. Townsends, Inc.*, Del. Supr., 695 A.2d 53, 61 (1997) (citations omitted).

[68]*Eisenmann Corp. v. General Motels Corp.*, Del. Super., C.A. No. 99C-07-260-WTQ, slip op. at 23, Quillen, J. (Jan. 28, 2000) (*citing Rand Bond of North America, Inc. v. Saul Stone & Co.*, 726 F. Supp. 684, 687 (N. D. Ill. 1989)).

[69]*Fisher*, 695 A.2d at 57 (*quoting Sears Mortgage Corp. v. Rose*, 634 A.2d 74, 79 (N.J. 1993)). In the only Delaware case addressing this subject in the indemnification context, the Delaware Superior Court held that an officer and director of a wholly-owned subsidiary was an agent of the parent because he had an employment agreement in which he managed certain functions of the parent "subject to [its] direction and control." *Merritt-Chapman & Scott Corp. v. Wolfson*, Del. Super., 321 A.2d 138, 141-42 (1974). Because the court found that the plaintiff was an agent, it declined to consider the parent's argument that the exclusion of the "at the request of" category

As a matter of law, the first aspect of the agency definition would appear to be satisfied. Under the *VonFeldt* decision, the fact that Stifel Financial elected Cochran as a director of Stifel Financial is deemed to constitute a decision by Stifel Financial to have Cochran act at its request as a director, officer, and employee of Stifel Nicolaus. This would appear to go a long way toward establishing that Stifel Financial had "consent[ed] to have [Cochran] act [in those capacities] on its behalf," in accordance with the Supreme Court's definition of the agency relationship.

What is more problematic is whether Stifel Financial retained the power to "control" and "direct" Cochran's actions in those capacities. Although Stifel Nicolaus's board was duty-bound to manage that corporation for the best interest of its corporate parent, that does not mean that the Stifel Nicolaus board was bound to take orders from Stifel Financial. As noted previously, Delaware law does not disrespect separate corporate identities lightly. Without more, the mere fact that Cochran was a director of Stifel Nicolaus and elected by Stifel Financial would not make him subject to Stifel Financial's control and direction in that capacity. If Stifel Financial was displeased with him, it could of course seek to remove him, but without pled facts on the point, our law requires us to assume that it could not and did not direct Cochran's actions as a director.[70]

Similarly, there is no basis to believe that Stifel Financial had the legal authority to direct Cochran in his managerial role at Stifel Nicolaus. Undoubtedly, a person in Cochran's situation would not last very long if he did not perform in accord with the expectations of the corporate parent. But as a matter of law, one would think that an employee of Stifel Nicolaus would be directed and controlled by the Chief Executive Officer of that subsidiary, not by the CEO or directors of the parent.

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from § 145(c) was intentional. *Id.*

[70]As one commentator has noted:

> Even when the parent owns all the stock in the subsidiary, its directors are not agents of the parent. The parent, once having elected directors, does not have a right thereafter to interfere. To impose a duty of obedience on directors, moreover, would conflict with the fundamental point that corporate law assigns ultimate managerial power and responsibility to directors. The parent thus lacks the right to assert control through interim instructions, a defining hallmark of a legal agency relationship.

Deborah A. DeMott, *The Mechanisms of Control*, 13 CONN. J. INT'L L. 238, 253 (1999). One would well retort that a wholly-owned subsidiary has no authentic separate identity and that its directors should be seen as direct subordinates of the parent. If, however, one is to take this approach, one must also ask why the liability protections flowing from the separate corporate identities should be respected. The traditional approach of our law is to respect the separate identities and to assume that the subsidiary's board governs it, until there is some showing to the contrary. This enables those parents that allow their subsidiaries to operate with the requisite formalities and financial wherewithal to enjoy the benefits of limited liability our law offers, while denying those benefits to parents who do not.

Therefore, the complaint has failed to set forth facts supporting a principal-agent relationship between Stifel Financial and Cochran. Rather than dismiss those counts relying upon § 145(c), however, I will grant Cochran's request that he be given the opportunity to replead and to attempt to set forth facts that are adequate to support his claim that he was Stifel Financial's agent.[71]

[27] In any event, it is likely that this issue is a matter of little actual substance to the parties. As the Delaware Supreme Court has noted, "Stifel Financial's indemnification bylaw is maximally broad, mandating indemnification to the full extent permitted by Delaware law."[72] The question thus raised is whether Cochran, even if he is not found to be an "agent" of Stifel Financial, may require Stifel Financial to indemnify him because such indemnification would be lawful if Cochran were a director, officer, or agent of Stifel Financial. That is, because Delaware permits — nay, mandates — indemnification of directors and officers who satisfy the success criteria in § 145(c) regardless of their good faith,[73] Cochran argues that Delaware should surely permit a corporation to provide contractual indemnification rights to a person who serves another corporation at its request and who shows, per § 145(c), that he was "successful on the merits or otherwise in defense of any action, suit or proceeding referred to in subsections (a) and (b) [of § 145]."

[28-29] For several reasons, I agree with Cochran's argument. Section 145(f) expressly provides that the indemnification rights "provided by, or granted pursuant to" other subsections of § 145 "shall not be deemed

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[71]While I putatively have discretion to deny this request at this early stage of the litigation I can perceive no undue prejudice to Stifel Financial in permitting an amendment. Moreover, given that certain appellate opinions *sua sponte* grant plaintiffs leave to amend in situations where the plaintiff had not even asked for such leave at the trial court level, a denial of leave to amend in this instance appears to be beyond my authority. *See Brehm v. Eisner*, Del. Supr., __A.2d __, slip op. at 44-45 (Feb. 9, 2000) (affirming merits of dismissal but reversing trial court for dismissing with prejudice an 88-page amended complaint); *Malone v. Brincat*, Del. Supr., 722 A.2d 5, 14 (1998) (affirming merits of dismissal of the complaint actually at issue on motion to dismiss but reversing trial court to extent that dismissal was with prejudice).

[72]*VonFeldt*, 714 A.2d at 81.

[73]E. Norman Veasey, J. A. Finkelstein, and C. Stephen Bigler, *Delaware Supports Directors With A Three-Legged Stool of Limited Liability, Indemnification, and Insurance*, 42 BUS. LAW. 399, 406 (1987) ((hereinafter "*Delaware Supports Directors*") ("The phrase found in section 145(c), 'on the merits or otherwise,' permits the indemnitee to be indemnified as a matter of right in the event that he wins a judgment on the merits in his favor or if he successfully asserts a 'technical' defense, such as a defense based on the statute of limitations."); *see also Merritt-Chapman & Scott Corp. v. Wolfson*, 321 A.2d at 141 (in criminal prosecution, success under § 145 does not mean only dismissal because of "innocence" but instead that "any result other than conviction must be considered success"); *Waltuch v. Conticommodity Services, Inc.*, 88 F.3d 87, 96 (2d. Cir. 1996) (applying *Merritt*'s construction of § 145(c), under which success "does not mean moral exoneration. Escape from an adverse judgment or other detriment, for whatever reason, is enough.").

exclusive of any other rights to which those seeking indemnification . . . may be entitled under any bylaw, agreement, . . . or otherwise . . . ."[74] This is obviously a difficult provision to implement in actual practice because it appears to collide with other provisions of § 145, particularly subsections (a) and (b). Nonetheless, § 145(f) suggests that a corporation's decision to provide broader indemnification rights should not be disturbed unless those broader rights are "contrary to the limitations or prohibitions set forth in the other section 145 subsections, other statutes, court decisions, or public policy. . ."[75]

It is difficult to see why it would offend public policy or conflict with the other subsections of § 145 to permit corporations voluntarily to indemnify persons who are not within the class of persons entitled to mandatory statutory indemnification but who otherwise satisfy the requirements of § 145(c). Indeed, our law typically applies the most rigorous indemnification procedures to directors and officers, who are entitled to mandatory indemnification under § 145(c) and more flexible procedures in the case of mere employees or corporate agents.[76] This reflects the greater responsibility of directors and officers and the greater likelihood that indemnification decisions as to them might be tainted by possible conflicts of interest. To the extent our public policy permits such high-ranking corporate officials to receive indemnification on a showing of success (regardless of whether it was because of a merely technical defense), it is difficult to conceive why it would offend public policy for a corporation to accord equal treatment to employees and agents who can demonstrate success.[77]

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[74]*See also Hibbert v. Hollywood Park, Inc.*, Del. Supr., 457 A.2d 339, 344 (1983) (citing § 145(f) for the proposition that "[t]he corporation can also grant indemnification rights beyond those provided by the statute").

[75]Veasey et al, *Delaware Supports Directors*, 42 BUS. LAW. at 415; *see also VonFeldt v. Stifel Financial Corp.*, Del. Ch., C.A. No. 15688, mem. op. at 7, 1997 Del. Ch. LEXIS 108, at *8, Chandler, C. (Aug. 18, 1997) ("While § 145(f) permits indemnification on terms other than as set forth in the rest of § 145, such other indemnification must be consistent with the policies expressed in the other parts of § 145."), *aff'd in part, rev'd in part*, 714 A.2d 79 (1998); *Waltuch*, 88 F.3d at 91-92 (rendering same interpretation of § 145(f)).

[76]The recent legislative amendment to 8 Del. C. § 145(d) that "eliminate[d] the requirement that indemnification of employees and agents who are not directors or officers be authorized by directors, independent counsel or the stockholders" is a good example of this distinction. *See* S. B. 106, 139th General Assembly, at 7 (1997), 71 Del. Laws. C. 120 (hereinafter "S.B. 106"); *see also* Lawrence A. Hamermesh to Delaware State Bar Association Corporation Law Section Council, at 4-6 (Oct. 11, 1995) (hereinafter "*Hamermesh*") (proposing this amendment and explaining why the heightened protections appropriate for director and officer indemnification should not apply to employees and agents).

[77]*Cf. VonFeldt*, 714 A.2d at 84 (emphasizing the important public policies served by a liberal approach to indemnification and "eschew[ing] narrow construction of the statute where an overliteral reading would disserve these policies").

[30] The legislative history of the most recent change to 8 Del. C. § 145(c) also supports the proposition that no public policy interest precludes contractual indemnification of a person who satisfies that subsection's success criteria. In 1997, the General Assembly removed "employees" and "agents" of the corporation from § 145(c), thereby eliminating their entitlement to statutory indemnification as a matter of right. But the rationale for this change had nothing to do with restricting the ability of corporations to provide indemnification to employees and agents, and everything to do with permitting corporations greater freedom to decide what indemnification coverage to provide to them. This rationale was well-stated by Professor Lawrence Hamermesh in his memorandum to the Delaware State Bar Association Corporate Law Section Council proposing the amendment:

> The recitation in Section 145(a) and (b) of corporate power to indemnify explicitly includes the power to indemnify employees and agents who are neither directors nor officers. There should be no quarrel with that empowerment. Section 145(c), however, goes beyond conferring authority to indemnify: in its present form, that statute *requires* the corporation to indemnify any employee or agent for defense costs, where that employee or agent is "successful on the merits or otherwise."
>
> This requirement as applied to employees and agents who are neither officers nor directors, was eliminated from the Model Business Corporation Act last year. The Committee on Corporate Laws explained that change as follows:
>
>> [T]he rights of employees and agents to indemnification and advance for expenses derive from principles of agency, the doctrine of respondeat superior, collective bargaining, or other contractual arrangements rather than from a corporation statute. It would be presumptuous for a corporation statute to seek to limit the indemnification bargain that a corporation may wish to make with those it hires or retains. The same standard applicable to directors and officers may not be appropriate for office workers and hazardous waste workers, brokers and custodians, engineers, and farm workers. None of their roles or responsibilities are prescribed by the Model Act.

> Committee on Corporate Laws, *Changes in the Model Business Corporation Act — Amendments Pertaining to Indemnification and Advance for Expenses*, 49 BUS. LAW. 741, 776 (1994).
>
> This discussion correctly analyzes the scope of "internal corporate affairs." Certainly, state corporation law properly defines the extent of corporate *powers* (to indemnify employees and agents, for example) and the rights and responsibilities *inter se* of the corporation and its officers and directors. *It seems just as clear, however, that rights and responsibilities as between the corporation and its agents and employees generally are not within the purview of the law of the state of incorporation. For a jurisdiction which attaches great significance to observing the line between the internal and external affairs of the corporation, it seems incongruous for Delaware to attempt, as Section 145(c) has historically done, to impose a corporate law rule to determine rights between the corporation and agents or employees which would otherwise be defined by the agency, contract or labor law of the jurisdiction in which the agency or employment relationship is created, as opposed to the state of incorporation.*[78]

Professor Hamermesh's recommendations were adopted by the Council and forwarded to the General Assembly in bill form. The synopsis of that bill expressly provides that:

> The amendment to Section 145(c) establishes that the Act does not prescribe mandatory indemnification with respect to employees and agents of the corporation who are neither officers nor directors of the corporation. Mandatory indemnification for such persons who satisfy the statutory standard of conduct will continue to be permissible under the Act.[79]

While Stifel Financial would read the term "statutory standard of conduct" to refer to that specified in § 145(a) and (b), the overall intent of the amendment seems to be inconsistent with that cramped reading. Rather,

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[78] *Hamermesh*, at 1-3 (latter emphasis added).
[79] S.B. 106, at 7.

the amendment appears to have been intended to give corporations the choice whether to indemnify employees or agents or other persons in a situation where § 145(c) would have previously mandated indemnification, as well as when § 145(a) or (b) would permit such indemnification.

This intent makes sense in view of the overall statutory scheme. In his complaint, Cochran has pled that he was successful in defending the SEC Investigation, the Criminal Proceeding, the Breach of Duty Claim, and the Non-Compete Claim. If Cochran was the former Chairman of the Board and CEO of Stifel Financial and was correct about the outcome of those matters, Stifel Financial would be statutorily required to indemnify him. Therefore, what Delaware public policy would be offended if Stifel Financial afforded indemnification to Cochran where he has been successful in defending actions brought against him in his capacity as a director or officer of Stifel Nicolaus, which he served at Stifel Financial's request? To conclude otherwise would require a determination that the General Assembly intended to accord corporations greater flexibility to indemnify their most important corporate officials — *i.e.*, their directors and officers — than to indemnify mere employees, agents, or persons serving other corporations on an "at request of" basis. I see no basis for so concluding.

[31] I note, moreover, that this outcome does not conflict with the well-reasoned opinion of Chancellor Chandler in *VonFeldt v. Stifel Financial Corp.*[80] In that case, the Chancellor concluded that Delaware law would not permit Stifel Financial to indemnify a director — *assuming that the director had not met the success standard of 145(c)* — unless the director met the good faith standard of § 145(a). He reasoned that the good faith standard was "central to the policy underlying the statutory language" of § 145(a) and that permitting a corporation to indemnify a director when the director acted in bad faith would violate this public policy.[81] Thus § 145(f) could not, in those circumstances, be relied upon as authorizing indemnification of a director who did not act in good faith.[82]

Stifel Financial reads the Chancellor's decision as prohibiting contractual indemnification of a person in an "at the request of" status except upon a finding of good faith even when that person, if she were a director or officer of the indemnifying corporation, would have been entitled to mandatory indemnification under § 145(c). But the Chancellor's decision cannot be read so broadly. In *VonFeldt*, the Chancellor never reached the plaintiff's claim for indemnity under § 145(c) because he found that Stifel

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[80] *VonFeldt v. Stifel Financial Corp.*, Del. Ch., C.A. No. 15688, let. op., 1999 Del. Ch. LEXIS 131, Chandler, C. (June 11, 1999) (opinion after remand).

[81] *VonFeldt*, let. op. at 5, 1999 Del. Ch. LEXIS 131, at *5.

[82] *VonFeldt*, let. op. at 7, 1999 Del. Ch. LEXIS 131, at *8.

Financial had not shown that the plaintiff did not act in good faith.[83] Thus it was unnecessary to consider this independent basis for indemnification. Had the Chancellor had reached the § 145(c) issue, however, it was clearly open to him to award indemnification to the plaintiff upon a showing of success on the merits and without a finding of good faith.[84] As a result, I do not believe that one can read *VonFeldt* as embracing the notion that it is mandatory as a matter of Delaware public policy to indemnify a director or officer solely upon a showing of success but impermissible as a matter of Delaware public policy for a corporation contractually to indemnify an employee, agent, or person in an "at the request of" status in the identical circumstances.

E. Has Cochran Stated A Claim For "Fees For Fees"?

Stifel Financial contends that the count of Cochran's complaint seeking indemnification for his fees and expenses in litigating this action must be dismissed. It is correct.

[32] In Chancellor Chandler's first *VonFeldt* decision, he held that the same Indemnification Bylaw Cochran relies upon could not buttress a claim for "fees for fees," stating:

> This court has clearly held that the right to . . . indemnification against fees and expenses incurred in a successful action to obtain indemnification is not found in section 145 and must be based on express provisions found either in corporate by-laws or separate agreements. [The Stifel Financial Indemnification Bylaw] do[es] not expressly provide for such advancement or indemnification. Thus, neither section 145(a) nor section 145(b) read in connection with [the Stifel Financial Indemnification Bylaw] provides a basis for VonFeldt's . . . claim[] for [fees for fees].[85]

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[83]The Chancellor held that under the Indemnification Bylaw, Stifel Financial had assumed the burden to demonstrate the plaintiffs lack of good faith. *Id.*, let. op. at 10, 1999 Del. Ch. LEXIS 131, at *11.

[84]*See Waltuch*, 88 F.3d at 95 (Where corporate officer seeking indemnification could demonstrate success — regardless of how that success was achieved — indemnification was required under § 145(c). But the officer could not, in instances where he was not successful, be indemnified under the corporation's bylaws without satisfying the good faith requirement of § 145(a)).

[85]*VonFeldt*, mem. op at 3-4, 1997 Del. Ch. LEXIS 108, at *5.

The Chancellor's decision was in accord with Vice Chancellor Jacobs's well-reasoned decision in *Mayer v. Executive Telecard, Ltd.*[86] Under these authorities, Cochran's claim for fees for fees must be dismissed.

III. Conclusion

For the foregoing reasons, Stifel Financial's motion to dismiss is denied except as to Cochran's claim under § 145(c), which is dismissed without prejudice, and as to Cochran's claim for "fees for fees," which is dismissed with prejudice. IT IS SO ORDERED.

IN RE FREDERICK'S OF HOLLYWOOD, INC. SHAREHOLDERS LITIGATION

No. 15,944 (Consolidated)

Court of Chancery of the State of Delaware

January 31, 2000

Plaintiffs filed a complaint charging breach of the fiduciary duties of care and loyalty against former director defendants by failing to obtain the highest available price for shareholders in the sale of the corporation and by misstating and omitting material information for the Consent Solicitation Statement distributed to shareholders in connection with the merger. Defendants moved under Court of Chancery Rule 12(b)(6) to dismiss for failure to state a claim upon which relief can be granted.

The court of chancery, per Vice Chancellor Jacobs, concluded that, because the complaint failed to allege facts that established the merger was not approved by a majority of disinterested directors, the breach of care and loyalty claims were dismissed. The court also held that any misstatement or omission in the consent solicitation statement was immaterial. The court granted defendant's motion to dismiss the complaint.

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[86]*Mayer v. Executive Telecard, Ltd.*, Del. Ch., 705 A.2d 220, 225 (1997).

1. Judgment ⚿ 183, 228

A motion to dismiss under Court of Chancery Rule 12(b)(6) will be granted where it is clear from the allegations of the complaint that plaintiff would not be entitled to relief under any set of facts that could be proven to support the claim. DEL. CH. CT. R. 12(b)(6).

2. Pretrial Procedure ⚿ 679, 681

All well-pleaded facts alleged in the complaint will be accepted as true but inferences and conclusions that are unsupported by specific factual allegations will not be accepted as true.

3. Corporations ⚿ 182.4(1), 182.4(2), 307, 310(1), 310(2)

A corporate board's failure to obtain the best value reasonably available to its stockholders may be the result of illicit motivation (bad faith), personal interest divergent from shareholder (disloyalty) or a lack of due care.

4. Corporations ⚿ 307, 310(1), 310(2)
Pretrial Procedure ⚿ 551

The court may dismiss a claim under Court of Chancery Rule 12(b)(6) on the basis of an exculpatory charter provision, when directors breach their fiduciary duty of care, so long as a dismissal on that ground does not prevent plaintiff from pursuing well-pleaded claims that the directors breached their fiduciary duty of loyalty. DEL. CH. CT. R. 12(b)(6).

5. Corporations ⚿ 307, 310(1), 320(9)
Pretrial Procedure ⚿ 551, 679, 681

Where complaint alleges actionable disloyalty, the burden of proof will shift to defendants to show the immunizing effect of the charter provision, but where the complaint only alleges a breach of the duty of care, that claim may be dismissed at the pleading stage.

6. Corporations ⟹ 307, 314(.5)

To be sufficient to trigger entire fairness review, a complaint must allege that the sole interested director dominated or controlled the remaining directors.

7. Corporations ⟹ 307, 310(1), 314(.5)
Pretrial Procedure ⟹ 531, 679, 681

Breach of loyalty claims cannot survive a motion to dismiss unless the complaint alleges facts that establish a merger was not approved by a majority of disinterested directors.

8. Corporations ⟹ 307, 310(1)

The fiduciary duty of disclosure requires that solicitation materials disclose all information in the corporation's possession material to the transaction at issue.

9. Corporations ⟹ 307, 310(1)

The test of materiality of information is whether there is a substantial likelihood that a reasonable shareholder would consider it important in deciding how to vote; there must be a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the total mix of information made available.

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A. Gilchrist Sparks, III, Esquire, Jon E. Abramczyk, Esquire, and Jeffrey R. Wolters, Esquire, of Morris, Nichols, Arsht & Tunnell, Wilmington, Delaware, for defendants George W. Townson, Richard O. Starbird, William J. Barrett, and Merle A. Johnston.

Stephen E. Jenkins, Esquire, and Regina A. Iorii, Esquire, of Ashby & Geddes, Wilmington, Delaware, for defendant Hugh V. Hunter.

JACOBS, *Vice Chancellor*

The plaintiffs in this consolidated class action, who are former shareholders of Frederick's of Hollywood, Inc., ("Frederick's"), attack a cash merger whereby Knightsbridge Capital Corp. ("Knightsbridge") acquired Frederick's on September 29, 1997. The individual defendants, who were the directors of Frederick's at the time of the merger (the "Director Defendants"), are charged with having breached their fiduciary duties of care and loyalty by failing to obtain the highest available price for shareholders in the sale of Frederick's, and also by misstating and omitting material information from the Consent Solicitation Statement ("CSS") disseminated to shareholders in connection with the merger.

The Director Defendants have moved under Court of Chancery Rule 12 (b)(6) to dismiss the amended complaint for failure to state a claim upon which relief can be granted. The four dismissal grounds being advanced are that: (i) the exculpatory clause in Frederick's certificate of incorporation bars any money damages recovery against the directors for a breach of the duty of care; (ii) the plaintiffs have alleged no cognizable breach of the directors' duty of loyalty and seek no relief other than money damages; and (iii) the plaintiffs have failed to allege any misdisclosures that are material. Defendant Hugh H. Hunter has also moved separately for dismissal on the independent ground that he cannot be held liable for actions taken by the Frederick's board after he resigned as a director.[1]

I. BACKGROUND

The pertinent facts, as disclosed by the complaint, are as follows:

A. The Parties

Frederick's is a Delaware corporation with its principal executive offices located in Los Angeles, California. It operates a nationwide mail order business and a chain of women's intimate apparel stores in 39 states. As of December 6, 1996, Frederick's had issued and outstanding (a)

[1]Shortly after filing their complaint the plaintiffs moved to enjoin the merger between Knightsbridge and Frederick's. The Court denied that motion on September 29, 1997. On October 29, 1998, the plaintiffs filed an Amended Complaint, which the Knightsbridge Defendants moved to dismiss as to them. In a memorandum opinion issued on July 9, 1998, the Court granted that motion, leaving only the former Frederick's directors as parties defendant in the case.

2,995,309 shares of Frederick's Class A stock (which had one vote per share) that were held by approximately 500 shareholders of record, and (b) 5,903,118 shares of Class B common stock (which were non-voting) that were held by approximately 504 shareholders of record. Frederick's shares were traded on the New York Stock Exchange.

The plaintiffs are a class consisting of the holders of Class A and/or Class B Frederick's common stock at the time of the merger. The Director Defendants are Frederick's board of directors (the "Board") at the time of the transaction. Those directors were: George W. Townson ("Townson") who was Frederick's Chairman of the Board, President and Chief Executive Officer; William J. Barrett ("Barrett") who was a Senior Vice President of Janney Montgomery Scott, Inc., Frederick's investment advisor ("JMS"); Richard O. Starbird ("Starbird"); Merle A. Johnston ("Johnston"); and Hugh V. Hunter ("Hunter") who was Co-Trustee of the Harriet R. Mellinger Trust and the Frederick N. Mellinger Trust (the "Trusts").[2]

These five directors all voted to approve the first merger agreement under which Knightsbridge would acquire Frederick's for $6.14 cash per share. Except for Hunter (who had previously retired), these directors also voted to approve the ultimate merger agreement being challenged here, in which Knightsbridge acquired Frederick's for $7.75 per share cash.

B. Frederick's Commences an Auction

In June 1996, Frederick's announced that it had retained JMS as its financial advisor in connection with a possible sale of Frederick's. During the next fifteen months, JMS conferred with over one hundred prospective purchasers including Knightsbridge. In April 1997, Knightsbridge proposed to purchase all of Frederick's outstanding common stock for between $6.00 and $6.25 per share, cash, in a two-step tender offer/merger transaction. That offer was conditioned upon Knightsbridge having the exclusive opportunity to conduct due diligence.

C. The $6.14 Knightsbridge Offer

On June 13, 1997, Frederick's and Knightsbridge executed an agreement whereby Knightsbridge would acquire Frederick's for $6.14 per share cash in a merger. The merger agreement permitted the Board to pursue transactions proposed by third parties if their fiduciary obligations so required, but it prohibited Frederick's from soliciting any indications of

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[2]As Co-Trustee of the Trusts, Mr. Hunter voted the Trusts' shares, which represented 41% of Frederick's Class A stock and 51% of its Class B stock.

interest by potential third party acquirers. The merger agreement also permitted Frederick's to terminate the Merger unilaterally if the Board approved a transaction with an acquirer other than Knightsbridge, but in that case Knightsbridge would be entitled to a breakup fee of $1.8 million.

The complaint alleges that Townson, who was Frederick's CEO, would receive significant sums of money under agreements he entered into with Knightsbridge in connection with the merger. Under a Termination and Release Agreement, Townson would receive $750,000 when the merger became effective; and under a Non-Competition and Consulting Agreement, Townson would receive $250,000, plus sixteen additional $100,000 quarterly payments beginning the calendar quarter after the merger effective date. The complaint further alleges that Townson would receive (in addition to the merger consideration of $6.14 per share for each of his Frederick's shares) a cash payment of $.05 for each option having an exercise price over $6.14 -- a payment claimed to represent value for "underwater options" that otherwise would be valueless in the merger.

The plaintiffs also allege that Barrett, as a Senior Vice President of JMS, also stood to benefit financially from the merger, in that a May 14, 1996 engagement agreement entitled JMS to an approximately $2 million fee if the merger was consummated.

Before the Board voted on that proposed merger, two directors, Sylvan Lefcoe and Morton Fields resigned on June 12, 1997 and June 13, 1997, respectively. The plaintiffs claim that the reasons for those resignations were material facts that Frederick's should have disclosed in the solicitation materials sent to shareholders.[3]

The Frederick's board approved the $6.14 per share Knightsbridge offer at a special meeting held later on in the day of June 13, 1997. Thereafter, the board caused a Consent Solicitation Statement ("CSS") to be mailed, seeking stockholder approval of the merger. Stockholders were asked to deliver their consents no later than August 27, 1997, the expected merger closing date.

D. Frederick's Receives Other Offers

While the $6.14 per share Knightsbridge merger proposal was pending, Milton Partners submitted, on August 21, 1997, a fully financed offer to acquire Frederick's for $7.00 per share cash. In response, and while the Board was considering that offer, Knightsbridge and the Trusts entered into an agreement (the "Stock Purchase Agreement") under which Knightsbridge obtained the right to buy the Trusts' Frederick's stock, which

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[3]The record does not disclose the reasons why those directors resigned.