"Indemnification encourages corporate service by capable individuals by protecting their personal financial resources from depletion by the expenses they incur during an investigation or litigation that results by reason of that service."\(^{38}\) As an important corollary to indemnification, "[a]dvancement provides corporate officials with immediate interim relief from the personal out-of-pocket financial burden of paying the significant on-going expenses inevitably involved with investigations and legal proceedings."\(^{39}\)

"A company's bylaws are contractual in nature."\(^{40}\) Thus, "indemnification is a right conferred by contract, under statutory auspice."\(^{41}\) Section 145 of the DGCL provides the statutory framework for when and how a corporation may provide advancement to an officer, director, employee, or agent of the corporation.\(^{42}\) "[T]he indemnification statute should be broadly interpreted to further the goals it was enacted to achieve," which are to "promote the desirable end that corporate officials will resist what they consider unjustified suits and claims, secure in the knowledge that their reasonable expenses will be borne by the corporation they have served if they are vindicated," and "encourage capable [persons] to serve as corporate directors, secure in the knowledge that expenses incurred by them in upholding their honesty and integrity as directors will be borne by the corporation they serve."\(^{43}\)

Courts use the tools of contractual interpretation when construing bylaw provisions relating to indemnification and advancement.\(^{44}\) In that context,

\(^{38}\)Tafeen, 888 A.2d at 211 (citing VonFeldt v. Stifel Fin. Corp., 714 A.2d 79, 84 (Del. 1998)).

\(^{39}\)Id. at 211. The Court in Tafeen further noted that although "the right to indemnification and advancement are correlative, they are separate and distinct legal actions. The right to advancement is not dependent on the right to indemnification." Id. at 212 (citing Citadel Holding Corp. v. Roven, 603 A.2d 818, 822 (Del. 1992)).


\(^{41}\)Stifel Fin. Corp. v. Cochran, 809 A.2d 555, 559 (Del. 2002).

\(^{42}\)See 8 Del. C. § 145. As to advancement, Section 145(e) states in pertinent part: Expenses (including attorneys' fees) incurred by an officer or director in defending any civil, criminal, administrative or investigative action, suit or proceeding may be paid by the corporation in advance of the final disposition of such action, suit or proceeding upon receipt of an undertaking by or on behalf of such director or officer to repay such amount if it shall ultimately be determined that such person is not entitled to be indemnified by the corporation as authorized in this section. Such expenses (including attorneys' fees) incurred by former directors and officers or other employees and agents may be so paid upon such terms and conditions, if any, as the corporation deems appropriate.

\(^{43}\)Cochran, 809 A.2d at 561 (quoting RODMAN WARD, JR., EDWARD P. WELCH, & ANDREW J. TUREZYN, FOLK ON DELAWARE GENERAL CORPORATION LAW § 145 (4th ed. 2001)).

Delaware courts "simultaneously apply the patina of section 145's policy." At the same time, "courts should be reluctant to interpret § 145 and bylaws that implement it as displacing the more specific contractual arrangements that are typically drafted between corporations and outside contractors, such as attorneys, investment bankers, engineers, and information technology providers."  

C. Spira's Bylaws  

Although the advancement authority conferred by Section 145(e) is permissive, mandatory advancement provisions are set forth in many corporate charters, bylaws and indemnification agreements. Spira's mandatory advancement provision states:  

Expenses (including, without limitation, reasonable attorneys' fees and expenses) incurred in defending a civil or criminal action, suit or proceeding shall be paid by the Corporation in advance of the final disposition of such action, suit or proceeding upon receipt of an undertaking by or on behalf of the Director, officer, employee or agent to repay such amount if it shall ultimately be determined that such Director, officer, employee or agent is not entitled to be indemnified by the Corporation under this article or under any other contract or agreement between such Director, officer, employee or agent and the Corporation.  

Spira's Bylaws also provide for mandatory indemnification rights to the full extent permitted by law.  

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Single Point Fin., Inc., 788 A.2d 111, 113 (Del. 2001); Reinhard & Kreinberg, 2008 WL 868108, at *2. "In the interpretation of charter and by-law provisions, 'courts must give effect to the intent of the parties as revealed by the language of the certificate and the circumstances surrounding its creation and adoption.'" Centaur Partners, 582 A.2d at 928 (quoting Waggoner v. Laster, 581 A.2d 1127, 1134 (Del. 1990)).  

Reinhard & Kreinberg, 2008 WL 868108, at *2; Underbrink, 2008 WL 2262316, at *7 (citing id.).  


Homestore, Inc. v. Tafeen, 888 A.2d 204, 212 (Del. 2005) (citing Citadel Holding Corp. v. Roven, 603 A.2d 818 (Del. 1992)).  

Amended and Restated Bylaws of Spira ("Bylaws") Art. VI, § 2, available at Chamagua Aff. Ex. C.  

Section 1 of Article VI of the Bylaws addresses indemnification, and states in pertinent part:  

The Corporation shall indemnify, in accordance with and to the full extent now or hereafter permitted by law, any person who was or is a party or is threatened to be made a party to any threatened, pending or completed action, suit or proceeding . . . by reason of the fact that such
Thus, to receive advancement of its reasonable litigation expenses under Spira's Bylaws, Jackson Walker must prove: (1) that it is a party to the El Paso Action by reason of the fact that it was an agent of Spira, and (2) that it has provided Spira with the necessary undertaking. The parties' dispute centers on whether in the circumstances of this case Jackson Walker qualifies as Spira's agent for purposes of advancement; Spira does not dispute Jackson Walker provided it with an appropriate undertaking as required under the Bylaws.

D. Is Jackson Walker an Agent under the Applicable Bylaw Provision?

To qualify for advancement of expenses incurred in the El Paso Action, Jackson Walker must prove it is a party by reason of the fact it was an agent of Spira. There is no dispute Jackson Walker is a party to the El Paso Action because it was outside counsel to Spira. Thus, the only dispute is whether Jackson Walker qualifies as an "agent" of Spira under its Bylaws. I conclude that it does.

1. The meaning of "agent" under DGCL § 145

Both parties rely on this court's decision in Fasciana v. Electronic Data Systems Corp., for their positions as to why Jackson Walker does, or does not, qualify as Spira's agent. In that case, the plaintiff Fasciana was an attorney who represented a target company and its shareholders in connection with its sale to the defendant corporation. By and large, Fasciana performed corporate transactional work. After the acquisition, Fasciana continued to provide legal advice and services as an attorney for the defendant corporation. Later, based on certain actions he took in connection with the sale of the target company, he was indicted on criminal charges and named as a defendant by the acquiring corporation in a civil suit, alleging malpractice and fraud on his part, together with other misdeeds. In seeking advancement of his litigation

[51] See POB at 9; DRB at 1.
[52] Fasciana was "alleged to have engaged in misconduct in his capacity as a legal advisor to [the corporation], by assisting [the chief executive officer] in various acts of improper internal accounting . . . [and] to have violated his law firm's duties as escrow agent . . . ." Fasciana, 829 A.2d at 172-73.
expenses, Fasciana contended that, based on his actions as an attorney for the acquiring corporation, he satisfied the statutory term, "agent," and thus had a right to advancement.53

The court in Fasciana noted that the "term agent is thrown around in many legal contexts and often without great precision,"54 but held that the Delaware General Assembly intended "§ 145 as embracing the more restrictive common law definition of agent, which generally applies only when a person (the agent) acts on behalf of another (the principal) in relations with third parties."55 The court further noted that Section 145's grant of indemnification tracks the concept of agent indemnification found in agency law. Thus, a person may be an "agent" for purposes of Section 145 when she may otherwise look to her principal for indemnity for those acts within the scope of the agency that are fairly said to be the actions of the principal.56 Conversely, the court held the concept of an "agent" under § 145 does not include a lawyer who acts as a legal advisor to a corporate client, but does not act on the client's behalf in relations with third parties.57

On the basis of its relatively restrictive definition of agent, the court found Fasciana, a lawyer who engaged in corporate advisory work, generally not to be an agent under § 145. The court recognized one exception, however, and held that Fasciana did act as an agent of the corporation in communications he allegedly made on its behalf in negotiations with two of its customers regarding how to characterize a transaction under an incentive compensation plan.58

53See id. at 164-66.
54Id. at 168.
55Id. at 163; see also id. at 169 (quoting Borders v. Townsend Assocs., 2002 WL 725266, at *5 (Del. Super. Apr. 17, 2002)).

The court in Fasciana articulated this same concept alternatively as "acting as an arm of the corporation vis-a-vis the outside world," id. at 163; encompassing "outside contractors who acted on behalf of the corporation in dealings with third parties," id. at 170; and involving the situation "when one party consents to have another act on its behalf, with the principal controlling and directing the acts of the agent," id. at 169 n.30 (quoting Fisher v. Townsend, Inc., 695 A.2d 53, 57-58 (Del. 1997)). See also id. at 169 n.30 (quoting J.E. Rhoads & Sons, Inc. v. Ammeraal, Inc., 1988 WL 32012, at *4 (Del. Super. Mar. 30, 1988), for the proposition that "essential elements of an agency relationship include: (1) the agent having the power to act on behalf of the principal with respect to third parties; (2) the agent doing something at the behest of the principal and for his benefit; and (3) the principal having the right to control the conduct of the agent."). All of these articulations represent variations on the same theme.
56See id. at 171.
57See id. at 172-73.
58See id. at 173-74.
2. Was Jackson Walker an "agent"?

The crux of this case is whether Jackson Walker's actions as Spira's outside litigation counsel constitute actions of an agent of the corporation under the Bylaws and DGCL § 145. This appears to be an issue of first impression under Delaware law.

Under Fasciana, Jackson Walker would be an agent if it acted on behalf of Spira in relations with third parties. The actions of Jackson Walker that form the basis for the claims asserted by Spira in the El Paso Action all relate to its role as litigation counsel to Spira. I find that in that role Jackson Walker acted on behalf of Spira in relations with third parties.

The claims Spira asserts in the El Paso Action do not involve allegations of malpractice, but rather criticize Jackson Walker's failure to countermand the former Spira management's decisions. Spira alleges, for example, that its intervention in the El Paso Action, when under the control of previous management, "was an action blatantly designed to further the interest of the LeBows, [David] and [LeVert] to the detriment of Spira." In that regard, Jackson Walker is alleged to have "follow[ed] the specific direction of the LeBows," and to have "failed to exercise the care that reasonable attorneys . . . would have exercised in directing SPIRA to file the Plea in Intervention

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59Jackson Walker argues for a broader definition of "agent" that would include, for example, providing legal advice because, unlike the provisions at issue in Fasciana, Spira's advancement and indemnification provisions contain no explicit reference to Section 145. See POB at 11-12. The court in Fasciana predicated its analysis on an assumption, "that [the corporation]'s bylaws were intended to track the meaning of agent in § 145." 829 A.2d at 168.

The underlying bylaw in Fasciana stated, "Each person who at any time shall serve or shall have served as a[n] . . . agent of the Corporation . . . shall be entitled to . . . the advancement of expenses incurred by such person from the Corporation as, and to the fullest extent, permitted by Section 143 of the DGCL or any successor statutory provision, as from time to time amended." Id. at 167 (emphasis added). Section 1 of Article VI of Spira's Bylaws addresses indemnification, and states, "[t]he Corporation shall indemnify, in accordance with and to the fullest extent now or hereafter permitted by law . . . ." (Emphasis added). The parties dispute whether Spira intended this seemingly broader language to expand the definition of agent beyond the confines of § 145. Because I find Jackson Walker is entitled to advancement in the El Paso Action as an agent within the meaning of § 145, I need not resolve this issue.

60Subsequent Delaware cases that have applied Fasciana's definition of agent under § 145 have not involved litigation counsel. In Bernstein v. Tractmanager, Inc., the court found that a corporation's attorney who provided advisory services was not an agent for purposes of advancement where the underlying litigation involved a claim of legal malpractice, among others. 2007 Del. Ch. LEXIS 172, at *26-27 (Nov. 20, 2007). Similarly, in Zaman v. Amedeo Holdings, Inc., the court found that lawyers entrusted with broad managerial and financial authority over the corporation were agents under § 145. 2008 WL 2168397, at *17 n.65 (Del. Ch. May 23, 2008).

61Second Am. Plea ¶ 18. Spira contends its claims are "based upon the fact [Jackson Walker] took, from the outset, a position which was clearly in the interest of the . . . then-management, even though ostensibly that position was not in the best interest of Spira." Tr. at 22.
and in conducting the litigation."  

Spira asserts that "the basis for the breach of fiduciary duty and negligence claim[s] is that Jackson Walker had an obligation to Spira, and disregard[ed] what was in the best interests of its client, and followed the direction of somebody who clearly was acting in their own interest."  

The alleged wrongs for which Spira has sued Jackson Walker all represent instances where Jackson Walker acted on behalf of Spira in relations with third parties. As outside litigation counsel, Jackson Walker was Spira's agent because it had the "power to act on behalf of the principal with third persons." Trial lawyers have the ability to bind their client in dealings with the court and other parties to the litigation. Thus, in litigation, attorneys regularly "act[] as an arm of the corporation vis-à-vis the outside world."  

Stated slightly differently, as Spira's outside counsel, Jackson Walker was given "the power to act on behalf of [Spira] with respect to third parties," litigated "at the behest of [Spira] and for his benefit," and remained subject to Spira's control. Jackson Walker, therefore, meets the definition of an agent under § 145 as set forth in *Fasciana.*

In a further attempt to avoid advancement, Spira contends "Jackson Walker's time sheets ... reveal that [its] role was not in fact limited to litigation, but extended to giving substantive and strategic advice on governance and stockholder-related issues." In particular, Spira notes that Jackson Walker billed it for the preparation of stockholder meeting notices, and was "involved in advising [Spira] with respect to closing the transaction

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62Second Am. Plea ¶¶ 28(b), 30.
63Tr. at 33. In its reply brief, Spira summarized its claims against Jackson Walker in the El Paso Action as follows:

As alleged in the underlying El Paso proceeding, the LeBows sought to avoid the terms of the Shareholders Agreement, the enforcement of which clearly was in the interests of Spira and the outside investors. Jackson Walker knew or should have known that by intervening on behalf of Spira and seeking to have the Shareholder Agreement declared invalid, it was not complying with its ethical or fiduciary obligations. Even when Steven LeBow sent an email to Jackson Walker describing his plan to effectively loot Spira, Jackson Walker took no action to protect the interest of Spira and its outside investors. These and other actions form the basis of Spira's claims against Jackson Walker.

DRB at 4. According to Jackson Walker, the referenced email from LeBow represented a privileged communication mistakenly sent to Jackson Walker, which it promptly returned and deleted. *See* Krafsur Aff. Ex. R. Based on my review of that email, I do not consider it material to the issues before me.

64*Fasciana,* 829 A.2d at 169.
65Id. at 163.
67DRB at 5; *see also* Tr. at 21-22.
[contemplated by the tentative settlement], giving advice on corporate governance issues, solvency and operational concerns."

A summary review of Jackson Walker's invoiced timesheets, however, indicates that the vast majority of its time spent on behalf of Spira related to its role as litigation counsel. Much of the time involves work directly related to the litigation. Other activities, such as Jackson Walker's efforts regarding the settlement of the El Paso Action plainly pertain to the litigation and constitute instances where the law firm acted on behalf of Spira in relations with third parties. That Jackson Walker provided some legal services not directly related to the litigation is immaterial. Jackson Walker's primary role was to represent Spira in the El Paso Action. Indeed, Spira admits that its claims stem from Jackson Walker's actions to enable Spira to intervene to seek to have the February 2005 shareholders agreement declared invalid.

In addition, while Jackson Walker concedes that some of its time spent with Spira was not litigation related, nothing in the record indicates that Spira's claims against Jackson Walker relate to any of those services. Moreover, Spira's contention that "Jackson Walker's non-litigation advice is inextricably intertwined with the positions it took in the El Paso proceeding, purportedly on behalf of Spira," cuts both ways. In fact, it confirms that Jackson Walker's services to Spira primarily related to litigating the El Paso Action, conduct which qualifies Jackson Walker as an agent under Fasciana for purposes of DGCL § 145.

Spira further attempts to avoid a finding of agency by arguing it "has not asserted any claims based on representations by Jackson Walker to third parties," and that its claims instead are based on Jackson Walker's breaches of its duties "to exercise professional care and judgment in its representation of Spira." Although the court in Fasciana did find advanceable a claim based on false representations Fasciana allegedly made to a third party on behalf of

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68Tr. at 24.
69See, e.g., PRB Ex. A at Invoice No. 937232, p. 2 (6/15/06, Sone, "Review litigation background materials . . ."); 6/15/06, S. Hollan, "Legal research regarding intervention and abatement in derivative suits"); 6/18/06, Hollan, "Continue research, review transaction documents, begin preparation of pleadings"); 6/19/06 "Prepare intervention and plea to the jurisdiction . . . ."); id. at Invoice No. 937233, pp. 2-3; id. at Invoice No. 94388, pp. 2-5.
70See, e.g., id. at Invoice No. 94388, p. 7 (8/4/06, Josephs, "Travel to El Paso, attend settlement conference, and return travel from settlement conference.").
71See DRB at 4.
72See PRB at 5-6. Spira has not shown, for example, that Jackson Walker's work on behalf of Spira in relation to a stockholders meeting forms the basis for any of its claims in the El Paso Action. See, e.g., id. Ex. A at Invoice No. 952577, p. 2; id. at Invoice No. 961234, pp. 3-4.
73DRB at 6.
74DRB at 4-5; see also Tr. at 28.
his corporate client, that holding derived from the fact that, in that one instance, Fasciana acted on behalf of the corporation in relations with a third party. Spira incorrectly suggests that similar allegations of misrepresentations to third parties are necessary for Jackson Walker to qualify as an agent entitled to advancement in this case. The appropriate inquiry is broader: whether the claim asserted by the former corporate client emanates from actions taken by the attorney on behalf of the company and in relation to a third party. Under that test, as explicated in Fasciana, I hold Jackson Walker qualifies as an agent of Spira. That is, Jackson Walker was an agent of Spira when it made representations to, and otherwise acted on behalf of Spira in dealings with, the court and the other parties to the El Paso Action. 75

Spira further cites a California case, Channel Lumber Co. v. Porter Simon, for the court's finding that outside litigation counsel were not agents for purposes of California's indemnification statute, Cal. Corp. Code § 317. 76 I find Channel Lumber inapposite because it involved a different factual scenario -- there, the corporation sued the attorney for legal malpractice. 77 In particular, the corporation "asserted that, among other shortcomings, [the attorney] had failed to assure a record of compliance with discovery requests, failed to undertake proper discovery, and failed to assert the res judicata effect of prior litigation."78 In addition, unlike the situation in Fasciana, the law firm seeking advancement in Channel Lumber was litigation counsel, as was Jackson Walker here. Thus, the Fasciana decision did not squarely address the application of the term "agent" in Section 145 to a corporation's litigation counsel accused of legal malpractice. 79

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75 Jackson Walker may claim advancement when it is being sued for actions it took as Spira's litigation counsel made "by reason of the fact that [it] . . . was a[n] . . . agent of [Spira] . . . ." 8 Del. C. § 145(a); Bylaws Art. VI, § 1.
76 93 Cal. Rptr. 2d 482, 484 (Cal. Ct. App. 2000). Section 317 states in pertinent part:
A corporation shall have power to indemnify any person who was or is a party or is threatened to be made a party to any proceeding (other than an action by or in the right of the corporation to procure a judgment in its favor) by reason of the fact that the person is or was an agent of the corporation against expenses, judgments, fines, settlements, and other amounts actually and reasonably incurred in connection with the proceeding . . . .
Cal. Corp. Code § 317(b). For the purposes of Section 317, an "agent" includes "any person who is or was a director, officer, employee or other agent of the corporation . . . ." Id. § 317(a).
77 Here, Spira does not purport to have asserted any claims for legal malpractice. See DRB at 6-7.
78 Channel Lumber, 93 Cal. Rptr. 2d at 485.
79 In Fasciana, Vice Chancellor Strine did state that by adopting an approach that excluded from the agents within § 145's reach outside attorneys who "provide specialized legal advice about a particular problem," he reached a result like that "reached by some other state courts in interpreting the term agent in their own corporation codes," such as in Channel Lumber. 829 A.2d at 172 &
Focusing on the fact that the law firm sought indemnification as to a claim against it for malpractice, the California court in Channel Lumber stated:

[When outside counsel ... is retained by a corporation to represent it at trial and then is sued by the corporation for allegedly committing legal malpractice while representing the corporation, outside counsel is a party to the malpractice suit by reason of his or her actions in the capacity of an independent contractor, not "by reason of the fact that outside counsel is or was an agent of the corporation," within the meaning and purposes of section 317.]

The Delaware courts ultimately might reach the same result, when and if that specific issue arises. The issue did not arise in Fasciana, however, because the attorney had not served as litigation counsel. Similarly, the issue is not before me in this case due to the absence of any claim of malpractice.

Holding Jackson Walker eligible for advancement in the El Paso Action here comports with the court's finding in Fasciana that "indemnification statutes are 'designed to protect persons exercising corporate discretion and authority, not the attorneys those persons hire to give them legal advice.'" 81 In addition, the record suggests Jackson Walker acted with at least the same level of "corporate discretion and authority" as existed in the situation underlying the claim for which Fasciana received advancement. 82

Delaware courts understandably proceed with caution in granting advancement and indemnification to agents in general, and to attorneys in particular. In that regard, Vice Chancellor Strine noted in Fasciana:

The public policy served by permitting corporations to provide advancement and indemnification rights to agents is a bit less clear [than for directors and officers]. On the one hand, it seems apparent that corporations are probably presented with no

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n.43. The court in Fasciana also recognized that one of the benefits of using a more constrained and traditional definition of agency was the ability to thereby avoid such an "odd result" as providing mandatory advancement to a lawyer involved in a malpractice dispute with the corporation. Id. at 171-72 & n.38.

80 93 Cal. Rptr. 2d at 484 (internal punctuation omitted).


82 See Fasciana, 829 A.2d at 173-74.
shortage of outside contractors seeking to perform contractual services for them. On the other hand, it is also probably the case that contractual providers are interested in ensuring that they do not unfairly bear the risk of litigation for acting on behalf of their employing corporation.\textsuperscript{83}

Nevertheless, the General Assembly has provided Delaware corporations with the option of advancing and indemnifying litigation expenses for their agents. Spira was, and is, free to craft a narrower bylaw, and then to provide narrower advancement and indemnification rights in its contracts with outside contractors. The Bylaws governing this dispute, however, contain no such limitations.

\textbf{E. Jackson Walker is entitled to its reasonable attorneys' fees in prosecuting this action}

Jackson Walker seeks its attorneys' fees in prosecuting this action for advancement.\textsuperscript{84} As the Supreme Court noted in \textit{Stifel Financial Corp. v. Cochran}, "indemnification for expenses incurred in successfully prosecuting an indemnification suit is permissible under § 145(a), and therefore 'authorized by law.'\textsuperscript{85} The Court further held that when a corporation's bylaws provide for indemnification "to the fullest extent permitted by law" that corporation must indemnify a director for his "fees on fees" in pursuing an action to vindicate his indemnification rights.\textsuperscript{86}

Allowing indemnification for the expenses incurred by a director in pursuing his indemnification rights gives recognition to the reality that the corporation itself is responsible for putting the director through the process of litigation. Further, giving full effect to § 145 prevents a corporation from using its "deep pockets" to wear down a former director, with a valid claim to indemnification, through expensive litigation. Finally, corporations will not be unduly punished by this result. They remain

\textsuperscript{83}\textit{id.} at 170.
\textsuperscript{84}See \textit{POB} at 17; \textit{PRB} at 9-10.
\textsuperscript{85}809 A.2d 555, 561 (Del. 2002).
\textsuperscript{86}\textit{id.}
free to tailor their indemnification bylaws to exclude "fees on fees," if that is a desirable goal.\footnote{\textit{Id.} at 561-62.}


Spira makes no colorable argument to the contrary. Instead, it bases its opposition to fees on fees in this action on its argument that Jackson Walker has no right to advancement. Having rejected that argument, I likewise reject Spira's opposition to Jackson Walker's request for reimbursement of the fees it incurred in prosecuting this action.

Finally, I note that both DGCL § 145 and bylaw provisions like that adopted by Spira are subject to an implied reasonableness requirement.\footnote{\textit{See Fasciana II}, 829 A.2d at 184 (citing \textit{Citadel Holding Corp. v. Roven}, 603 A.2d 818, 823 (Del. 1992)).} Thus, because Jackson Walker essentially achieved full success in this action, it is entitled to advancement of all of the fees and expenses it reasonably incurred in prosecuting this action.\footnote{\textit{Id.} In \textit{Fasciana II}, the court further noted: Limiting fees on fees awards by imposing a proportionality requirement encourages parties seeking advancement or indemnification to raise only substantial claims and encourages corporations to compromise worthy claims (lest they suffer a fees on fees award) and resist less meritorious claims (knowing that success will bar a fees on fees recovery for the plaintiff).}

\section*{III. CONCLUSION}

Jackson Walker's motion for summary judgment is granted. Spira's motion for summary judgment is denied. Jackson Walker is entitled to advancement for its reasonable fees and expenses incurred in the El Paso Action and in this action for advancement.

Jackson Walker shall prepare and file, within ten days of the date of this opinion, after notice to Spira's counsel, an appropriate form of Order and Judgment to implement this ruling. All claims Jackson Walker makes for
reimbursement of fees and expenses in accordance with this opinion should conform to the guidelines provided in Fasciana.  

IT IS SO ORDERED.

LONDON v. TYRRELL  
No. 3321-CC  
Court of Chancery of the State of Delaware, New Castle  
June 24, 2008  

David A. Jenkins, Esquire, Michele C. Gott, Esquire, and Kathleen M. Miller, Esquire, of Smith, Katzenstein & Furlow LLP, Wilmington, Delaware, for plaintiffs.  


CHANDLER, Chancellor  

On October 31, 2007, plaintiffs Craig London and James Hunt filed their derivative complaint alleging that defendants Michael Tyrrell, Patrick  

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Neven, and Walter Hupalo were harming the company in which all parties own shares. Specifically, plaintiffs allege that defendants have caused the company to issue stock options in contravention of an equity incentive plan by setting the exercise price of the issued options at an unfairly low value. On March 24, 2008, defendants moved to dismiss this complaint under Rules 9(b), 12(b)(6), and 23.1. Defendants argue that the plaintiffs have failed to meet the heightened pleading requirements of fraud and demand futility and that the complaint otherwise fails to state a claim. Briefing on defendants' motion was completed on May 8, 2008. Although defendants have thrown nearly every rule in the book at plaintiffs' complaint in the hope of getting it dismissed, the complaint easily survives. For the reasons explained below in this Opinion, defendants' motion is denied.

I. FACTS

In 1996, plaintiffs London and Hunt, defendants Neven and Hupalo, and others founded MA Federal, Inc., which does business as iGov ("iGov" or the "Company"). iGov is a government contracting firm that initially focused on participating in the reseller market for information technology hardware, primarily selling to federal military and civilian agencies. After nine years in the low margin, highly competitive reseller market, however, the Company decided to change its focus from product sales to the higher margin government services market. Consequently, since October 2005, iGov has competed for government services contracts, and has begun to reap the financial rewards of its shift in focus.

The facts pertinent to plaintiffs' claims occurred in 2006. At that time, iGov's board of directors consisted of London, Hunt, Neven, and Hupalo, and Tyrrell was the chief financial officer, having been brought to iGov by Neven the previous year. Plaintiffs allege that "[s]ometime in 2006, the Defendants secretly decided to implement an options plan at an unfair price to benefit themselves at the expense of the other stockholders."¹ To allow defendants to value the stock of iGov and thus set the price of options, defendants caused the Company to retain Chessiecap Securities, Inc. ("Chessiecap"). Plaintiffs do not allege the precise time by which Chessiecap was retained, but they do allege that Chessiecap's analysis valued the Company as of July 31, 2006. Despite the date of the valuation, Chessiecap did not deliver its initial draft until late September 2006 and did not offer its final draft until later that year. iGov used the Chessiecap valuation to set the price of the stock options

¹Compl. ¶ 26.
granted in February and May 2007. Those options were granted pursuant to a plan that required the options' exercise price to be set with a value of at least 100% of the fair market value of the Company's stock as of the date of the grant.

Plaintiffs cite two problems with the options granted by defendants to themselves and others. First, the valuation on which the price of the options was based was fundamentally flawed because Tyrrell provided misleading and incomplete information to Chessiecap. Second, the options were granted in contravention of the stock option plan because the Chessiecap report valued the Company as of July 2006 but the options were not granted until February and May 2007.

A. The Chessiecap Valuation

Chessiecap was not the only financial institution receiving projections and information from Tyrrell in 2006. During that year, iGov was looking for a lender to provide it with an approximately $12 million line of credit. One of the potential lenders was Textron Financial ("Textron"). To induce Textron to provide the needed credit, Mr. Tyrrell kept Textron apprised of iGov's financial condition—creating and approving the financial information transmitted, which included monthly income statements, balance sheets, and updated forecasts for fiscal years 2006 and 2007. Moreover, Tyrrell frequently wrote to Textron, consistently boasting of how well iGov was performing. Specifically, Tyrrell sent Textron a 2007 forecast projecting an EBITDA of over $3 million. That figure took into account the fact that iGov was likely to be awarded—but had not yet been awarded—a lucrative contract from the Department of Homeland Security ("DHS"). Tyrrell also highlighted iGov's future cost-cutting plans and predicted sustained profitability going forward.

The complaint alleges that Textron granted the requested line of credit based on these assurances and projections.

Yet, the projections Tyrrell provided to Chessiecap were markedly different. First, after receiving a draft of the Chessiecap report that valued Gov at $5.5 million, defendants sought to revise the data given to Chessiecap because the $5.5 million figure was "probably on the high side." Second, defendants excluded from the projections given to Chessiecap any income from the DHS contract because that contract had not yet technically been awarded. Third, the defendants, in their revisions following the $5.5 million valuation, made material changes to the 2007 forecast based on decisions that

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2Id. at ¶ 28 (quoting an email from Tyrrell to Chessiecap).
were made after the valuation date of July 31, 2006. For example, based on the announcement on October 4, 2006 that iGov was going to shut down a subsidiary, the revenue projection for this unit went from $25,150,000 in the initial forecast to $0 in the revised forecast. Mr. Tyrrell also revised the projected revenue for another unit from $6 million to $900,000 because he thought that unit might be closed by the end of November. Moreover, although the revised forecast took account of negative events that occurred after July 31, 2006, it did not reflect positive developments that occurred after the valuation date, such as the award of a $7 million contract with the U.S. Patent and Trademark Office or the significant increase in profitability in another, preexisting contract. Moreover, in December 2006, DHS announced that iGov was the winning bidder for the contract, pending only the customary small business size protest period.

The revised forecast was allegedly never disclosed to Textron, and was allegedly never used by the Company in managing its business. Rather, plaintiffs allege, the revised forecast was purposely designed to suppress the value of the Company and only for use by Chessiecap. Based on this revised forecast, Chessiecap valued iGov at $4.7 million as of July 31, 2006. Chessiecap, of course, did not offer this valuation until late in the fall or winter of 2006. The Chessiecap final report was provided to plaintiffs on or around December 29, 2006. Thereafter, London and Hunt asked to be provided with the financial information that Chessiecap used to render its valuation. This information was provided on January 11, 2007, and five days later London objected to iGov's relying on the Chessiecap report, stating that the valuation was stale. One day later, on January 17, 2007, Hunt offered to buy all of Neven's shares at $28 per share and made clear that his offer applied to all shareholders. At the price offered by Hunt, iGov would be worth $20 million. His offer, however, was summarily rejected.

Two days after Hunt made this offer and three days after London criticized the Chessiecap valuation, Neven and Hupalo caused plaintiffs to be removed from the Board through a written consent. They also elected Tyrrell to the board by written consent. Thus, as of January 19, 2007, the defendants comprised the entire board of iGov. The new board contacted Chessiecap about the Hunt offer of $28 per share. Chessiecap responded by preparing an addendum—not by modifying its final report. In the addendum, Chessiecap stated simply that the Hunt "offer in no way affects or changes" the $4.7 million valuation as of July 31, 2006, and concluded that the value of iGov's common stock as of that July 31, 2006 valuation date was $4.92 per share.
However, this per share price was calculated by including 65,000 shares and 300,000 options that were not outstanding as of July 31, 2006.  

B. The Granting of the Options

On January 30, 2007, the defendants held a telephonic meeting of the board of directors and unanimously voted to adopt the 2007 Equity Incentive Plan. This plan provides, in part, that the exercise price of an option "shall be not less than one hundred percent (100%) of the Fair Market Value of the Common Stock subject to the Option on the date the Option is granted." For stockholders holding more than ten percent of iGov's stock . . . the exercise price shall be "at least one hundred ten percent (110%) of the Fair Market Value of the Common Stock on the date of the grant." The director defendants authorized themselves to submit this plan to the stockholders for approval within twelve months.

In addition to adopting the Equity Incentive Plan, the defendants also voted unanimously to approve a resolution adopting the $4.92 per share price of the Chessiecap report "to be appropriate for purposes of determining the fair market value of the Company's Common Stock." With the price set, the defendants then approved the grant of 300,000 options to sixteen employees pursuant to the Equity Incentive Plan. Among those 300,000 options were 80,000 for Tyrrell, 50,000 for Neven, and 50,000 for Hupalo. Finally, the defendants also authorized the sale of 65,000 additional shares to Tyrrell at the $4.92 per share price. The options were granted and the sale to Tyrrell was consummated on February 1, 2007.

As iGov had long anticipated, DHS had all-but-announced in December, and Tyrrell had long promised to shareholders and Textron, iGov announced on March 7, 2007 that it was officially awarded the contract with DHS. The second quarter results for fiscal year 2007 were available in April 2007, and iGov showed an operating income in excess of $1.4 million. Between this and the DHS contract, it seemed clear that iGov would outperform its own projections for 2007. Despite this, however, the defendants granted 25,000 options to another employee on May 30, 2007 priced at $4.92 per share. In their unanimous written consent authorizing the grant, the defendants justified

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3 These shares and options were presumably contemplated at the time the addendum was prepared, but were not actually approved until after the addendum was issued, on January 30, 2007.

4 Compl. ¶ 38 (emphasis removed).

5 Id.

6 Id. at ¶ 39.
using the $4.92 per share price because they "concluded that [since February 1, 2007] there ha[d] been no material changes affecting [iGov'v's] financial operations or prospects which would affect the [Chessiecap valuation opinion]."

II. STANDARD

Defendants have moved to dismiss the complaint pursuant to Rules 9(b), 12(b)(6), and 23.1. The standards governing such a motion are "familiar" to this Court. Under Rule 12(b)(6), a complaint may be dismissed where the plaintiff fails to state a claim upon which relief can be granted. In determining whether or not a complaint states such a claim, the Court must accept all well pleaded allegations as true and must draw all reasonable inferences in favor of the plaintiff. Of course, the Court neither heeds nor draws inferences from conclusory allegations.

Those general precepts of motions under Rule 12(b)(6) are augmented by Rules 9(b) and 23.1, which require particularized pleading where a complaint asserts allegations of fraud or derivative claims, respectively. This standard of particularity represents "a marked departure from the 'notice' pleading philosophy" of Rule 8 and makes pleading under Rules 9(b) and 23.1 "more onerous." Nevertheless, the burden remains on the movant to demonstrate that the plaintiff has not met the requirements of Rules 9(b), 12(b)(6), and 23.1.

III. DEMAND FUTILITY

Defendants' primary argument charges that plaintiffs failed to make a demand on the board of directors and failed to adequately plead why demand would be futile. Rule 23.1 requires plaintiffs in a derivative suit to "allege

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7Harbor Fin. Partners v. Huizenga, 751 A.2d 879, 889 (Del. Ch. 1999) ("In deciding the defendant's motion to dismiss, I will apply the familiar standard.").
with particularity the efforts, if any, made by plaintiff to obtain the action the plaintiff desires from the directors . . . [or] the reasons . . . for not making the effort." The purpose of the demand requirement has been explained elsewhere, and where, as here, the plaintiff alleges that demand would have been futile, the Court proceeds under the analysis of one of two decisions: Aronson v. Lewis or Rales v. Blasband. Because the complaint here challenges a decision made by the current board of directors of the corporation on whose behalf the suit was filed, the Aronson test applies. Under Aronson, a plaintiff demonstrates demand futility when "a reasonable doubt is created that: (1) the directors are disinterested and independent; or (2) the challenged transaction was otherwise the product of a valid exercise of business judgment." Here, plaintiffs have satisfied demand futility under both prongs.

A. A Majority of the Board Was Interested in the Challenged Transactions

Under the first prong of Aronson, demand will be excused where the plaintiff has alleged facts that create a reasonable doubt that a majority of the directors were disinterested. The Court has explained that there are two ways a director can be deemed "interested" in a transaction. The first occurs where a director received in the challenged transaction a benefit that was not generally shared with the other shareholders of the corporation and where that benefit is "of such subjective material significance to that particular director that it is reasonable to question whether that director objectively considered the advisability of the challenged transaction to the corporation and its shareholders." The second occurs where "a director stands on both sides of the challenged transaction." In that latter instance, the plaintiff need not show that the director received some sort of material benefit.

16 634 A.2d 927 (Del. 1993).
17 See In re Bally's Grand Deriv. Litig., C.A. No. 14644, 1997 WL 305803, at *3 (Del. Ch. June 4, 1997) (noting that the Rales test applies only "(1) where a business decision was made by the board of a company, but a majority of the directors making the decision have been replaced; (2) where the subject of the derivative suit is not a business decision of the board; [or] (3) where . . . the decision being challenged was made by the board of a different corporation.").
19 Aronson, 473 A.2d at 814-15.
21 Id.
22 Id.
Defendants argue that plaintiffs have failed to satisfy the requirements of the first prong of Aronson because the complaint does not allege particularized facts that the options constituted a material benefit to each individual director defendant. This argument, however, ignores well settled law. Over ten years ago, in Byrne v. Lord, this Court held that "[b]y alleging that each of the members of the Pace board has a financial interest in the challenged option plan, Plaintiffs have alleged facts that create a reasonable down as to whether the Pace board is independent and disinterested." 23 Similarly, in Lewis v. Vogelstein, former Chancellor Allen noted that directors who will receive stock options under a challenged transaction are interested in that transaction and ordinarily will have to prove its entire fairness. 24 Finally, Vice Chancellor Lamb held earlier this year that "demand will be excused [where] all five directors to consider demand received at least some of the challenged option grants" because those directors "are not disinterested." 25 None of those cases requires a showing that the options received by the director defendants constituted material benefits. Although the general rule holds that "demand is not excused simply because directors receive compensation from the company or an executive of the company," 26 the receipt of stock options is different. Directors who have received the options plaintiffs seek to challenge "have a strong financial incentive to maintain the status quo by not authorizing any corrective action that would devalue their current holdings or cause them to disgorge improperly obtained profits." 27 In sum, the defendants here stood on both sides of the transaction that plaintiffs are challenging; the defendants both granted and received the stock options. Demand is, therefore, excused under the first prong of Aronson.

B. There is a Reasonable Doubt that the Challenged Transaction Was an Exercise of Valid Business Judgment

In addition, the complaint contains sufficiently particularized allegations of fact to satisfy the second prong of Aronson. As the Court noted in Weiss v. Swanson, "[a]lthough . . . compensation decisions are typically protected by the business judgment rule, the rule applies to the directors' grant of options pursuant to a stockholder-approved plan only when the terms of the plan at

26 Id.
issue are adhered to." The Court explained that this conclusion was compelled by its holding in In re Tyson Foods, Inc. Consolidated Shareholder Litigation, where the Court made clear that "allegations in a complaint rebut the business judgment rule where they support an inference that the directors intended to violate the terms of stockholder-approved option plans."

Here, the Equity Incentive Plan under which the challenged options were granted requires that the exercise price of options be set at 100% or 110% of the stock's fair market value as of the date of the grant of the options. The complaint alleges particularized facts that lead to the reasonable inference that the defendants intentionally granted options in contravention of that fair market value requirement. It does so in two ways. First, the complaint alleges that the defendants intentionally gamed the Chessiecap valuation by withholding positive information about the Company while freely supplying the negative. In fact, the complaint alleges, after the first draft pegged iGov's value at $5.5 million, Tyrrell sent Chessiecap new numbers in order to depress the final valuation. Second, the complaint alleges that the directors intentionally violated the Equity Incentive Plan by pricing the options it granted in February and May of 2007 at the price Chessiecap said was fair as of July 2006. Plaintiffs have alleged that defendants knew Chessiecap was not provided with information of materially positive developments from the latter half of 2006 and, therefore, knew that the Chessiecap valuation could not possibly represent the fair market value of the Company as of February and May 2007.

The particularized facts of the complaint support an inference that the directors knowingly violated the Equity Incentive Plan. Consequently, under Weiss and Tyson, plaintiffs have also satisfied demand futility under the second prong of Aronson, and for this alternative reason defendants' motion to dismiss under Rule 23.1 is denied. Because plaintiffs have satisfied demand futility under both prongs of Aronson and defeated defendants Rule 23.1 motion, they have alleged sufficient facts to state a claim, and defendants' motion under Rule 12(b)(6) is likewise denied. 31

282008 WL 2267020, at *4 (footnote omitted).
29919 A.2d 563 (Del. Ch. 2007).
31See In re Tyson Foods, Inc., 919 A.2d 563, 582 (Del. Ch. 2007) (noting that "the Aronson test for demand futility closely resembles the test for determining whether a duty of loyalty claim survives a motion to dismiss under Rule 12(b)(6)" and commenting that the pleading standards under Rule 23.1 are more stringent than under Rule 8).
IV. FRAUD

Defendants have also moved to dismiss the complaint under Rule 9(b) because, they contend, plaintiffs have not alleged fraud with sufficient particularity. The basis of this argument is apparently two provisions of the General Corporation Law, 8 Del. C. §§ 152 and 157(b). Neither of these sections operates as defendants contend. First, defendants are simply wrong when they state that section 157(b) "provides that defendants' judgment is conclusive as to the consideration and exercise price of such options." On the contrary, section 157(b) authorizes boards to create and issue rights or options and protects the board's determination of appropriate "consideration for the issuance of such rights or options." It says nothing about the directors' judgment in valuing the stock to be sold pursuant to the rights or options or the resulting exercise price, which is the issue plaintiffs' complaint raises. Thus, section 157(b) is of no help to defendants.

Second, Section 152 provides for situations where stock is issued for consideration other than cash. It states that:

[t]he board of directors may authorize capital stock to be issued for consideration consisting of cash, any tangible or intangible property or any benefit to the corporation, or any combination thereof. In the absence of actual fraud in the transaction, the judgment of the directors as to the value of such consideration shall be conclusive.

As with section 157, the scope of section 152 was addressed many years ago by Chancellor Seitz. In Bennett v. Breuil Petroleum Corp., the Court held that "Section [152] deals with the judgment of the directors as to the value of property received for stock. Our case involves the value of stock issued for cash." This conclusion was more recently confirmed by Vice Chancellor Strine, who explained that "Section 152 deals with a situation in which the directors of a corporation have accepted non-cash consideration in exchange

32Defs.' Opening Br. at 2 (emphasis added).
33See Bennett v. Breuil Petroleum Corp., 99 A.2d 236, 240 (Del. Ch. 1953) ("8 Del. C. § 157 is not pertinent to the question of the value placed on the shares themselves—the issue here. It applies to the value placed on the rights, apart from the stock itself—not the issue here."); 1 EDWARD P. WELCH, ANDREW J. TUREZYN, AND ROBERT S. SAUNDERS, FOLK ON THE DELAWARE GENERAL CORPORATION LAW § 157.5 (5th ed. 2007 supp.) ("separate consideration is required for issuance of the option and for its exercise").
3499 A.2d 236 (Del. Ch. 1953).
35Id. at 240.
for company stock, and there is a dispute raised about whether the non-cash consideration was worth what the directors said it was. 36 Moreover, Vice Chancellor Strine noted, even if section 152 did apply, defendants would still not be correct in suggesting that plaintiffs need to plead the elements of common law fraud because the concept of "actual fraud" is different. 37 Defendants' briefs ignore law that has been established by this Court for over half a century. Consequently, defendants have failed to meet their burden on their motion to dismiss under Rule 9(b), because plaintiffs had no requirement to plead the elements of fraud with particularity in order to state a claim in this case.

V. CONCLUSION

For the reasons explained above, the complaint adequately pleads demand futility with particularity, does not need to plead the elements of fraud with particularity, and does indeed state a claim. As a result, defendants' motion to dismiss is denied.

IT IS SO ORDERED.


37 See id. at 1234–35 ("Even if § 152 did apply, it is not apparent that the pleading of additional counts of constructive and actual fraud would help it out. Our courts have been relatively flexible in implementing § 152's 'actual fraud' requirement, and for good reason. The term seems to have little to do with common law fraud . . . The concept of actual fraud under § 152 has to be read in the context in which it is used. When corporate directors allow the corporation to accept bananas they know to be worth $10,000 on the open market from a majority stockholder in exchange for $100,000 worth of corporate stock, they have in colloquial terms committed a 'fraud on the corporation' they are entrusted to manage." (footnotes omitted)).
NELSON v. EMERSON

No. 2937-VCS

Court of Chancery of the State of Delaware, New Castle

May 6, 2008

Martin J. Weis, Esquire, of Dilworth Paxson LLP, Wilmington, Delaware; and James J. Rodgers, Esquire, James W. Hennessey, Esquire, and Matthew Faranda-Diedrich, Esquire, of Dilworth Paxson LLP, Philadelphia, Pennsylvania, for plaintiff.

David A. Jenkins, Esquire, and Joelle E. Polesky, Esquire, of Smith, Katzenstein & Furlow LLP, Wilmington, Delaware, for defendants.

STRINE, Vice Chancellor

I. Introduction

Plaintiff William G. Nelson was the sole secured creditor of Repository Technologies, Inc. ("Repository" or the "Company"). Nelson alleges that for nearly two years Repository was insolvent and not paying the interest owed under a substantial line of credit that he had extended to the Company. When Nelson threatened to enforce his rights as a secured creditor, Repository filed for bankruptcy. Nelson now claims that defendants E. James Emerson and Kathleen Emerson, two of the Repository's directors and its majority stockholders, breached their fiduciary duties to Repository by causing the Company to file for bankruptcy and by paying themselves "excessive" compensation during the time that Repository was insolvent, both before and after the bankruptcy filing. Nelson is particularly displeased at Repository's bankruptcy filing because the Company's plan to reorganize involved using principles of bankruptcy law to attempt to recharacterize Nelson's debt as equity. In Nelson's view, the Emersons breached their fiduciary duties by undertaking that strategy because Repository was only successful in having a portion of Nelson's debt recharacterized, therefore it did not prevail in having enough debt recharacterized to allow the Company to reorganize successfully. Thus, Nelson sees the bankruptcy filing as having served no purpose other than frustrating his ability to collect on the debt owed to him by the Company and extending the length of time that the Emersons remained on the Company's payroll.
The problem with Nelson's claims is that he is seeking a second chance to win the same game. Nelson made the same arguments he raises in this case to the Bankruptcy Court for the Northern District of Illinois when he sought to have Repository's bankruptcy filing dismissed as being filed in bad faith or, alternatively, due to gross mismanagement of the Company. The Bankruptcy Court, despite dismissing Repository from Bankruptcy because it could not reorganize successfully, explicitly found that "the bankruptcy filing cannot be held to be in bad faith" and that there had not been "any mismanagement of [Repository's] assets and business." Satisfied with the dismissal of Repository's bankruptcy, but unhappy with the Bankruptcy Court's ruling that the bankruptcy had not been brought in bad faith, Nelson appealed to the District Court for the Northern District of Illinois and argued that the Bankruptcy Court's findings on the bad faith issue were dicta. In essence, Nelson was attempting to preserve his ability to present his bad faith argument to another tribunal in the hope that a new court might find the argument more substantial. The District Court rejected Nelson's argument, ruling that the bad faith determination was an essential part of the Bankruptcy Court's holding because Nelson himself had advanced the argument that the bankruptcy filing was made in bad faith.

Undeterred, Nelson filed claims in this court arguing that the Emersons breached their fiduciary duties to Repository by filing the bankruptcy action in bad faith. He contends that the Bankruptcy Court's holdings on the bad faith and gross mismanagement arguments are not preclusive because those findings were not essential to the Bankruptcy Court's final judgment. I reject that contention because the U.S. District Court held that the arguments Nelson made to the Bankruptcy Court and that the Bankruptcy Court explicitly ruled on are part of that Court's holding. Nelson is precluded from arguing otherwise. Moreover, although Nelson did not appeal the Bankruptcy Court's ruling on his excessive compensation argument by challenging its determination that there had been no mismanagement of Repository's assets, I reject Nelson's argument that Bankruptcy Court's ruling on Nelson's excessive compensation was not essential to its final judgment using the same reasoning as the U.S. District Court.

Nelson also argues that the bad faith standard used in bankruptcy law is not the same as the standards used to determine breaches of fiduciary duty under Delaware law. In making that argument, Nelson misunderstands the applicable Delaware law. It is settled Delaware law that an insolvent company is not required to turn off the lights and liquidate when that company's

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1 In re Repository Tech., Inc. ("Repository I"), 363 B.R. 868, 896 (Bankr. N.D. Ill. 2007).
benefit caused Nelson's Repository independent. that the duty excessive dismiss. claim their Emersons making their partially because law. Court's addressing this that mechanisms advantage argues time that company. directors believe that continuing operations will maximize the value of the company. Federal bankruptcy law shares this belief and provides procedures that enable an insolvent company to continue its operations while at the same time balancing the interests of the affected corporate constituencies. Nelson argues that this court should hold Repository's directors liable for taking advantage of the bankruptcy laws despite the fact the Bankruptcy Code has mechanisms to prevent abuse and that the Bankruptcy Court explicitly found that Repository had filed for bankruptcy in good faith. As a prudential matter, this court should generally defer to the Bankruptcy Court and its expertise in addressing the misuse of the bankruptcy laws. But because the parties did not address that issue, my ruling rests on the determination that the Bankruptcy Court's factual findings preclude any liability under Delaware fiduciary duty law. The directors of an insolvent company who, in good faith, undertake a strategy to benefit the company's equity holders cannot be held liable just because the strategy failed. The Bankruptcy Court has already determined that Repository's bankruptcy filing was a non-frivolous strategy and that it was partially successful. That precludes any finding that the Emersons breached their fiduciary duties by causing the Company to undertake that strategy.

Alternatively, I note that even if Nelson were not precluded from making his fiduciary duty claim, his pleadings fail to state a claim that the Emersons breached their fiduciary duties. Repository's charter contains a § 102(b)(7) clause that exculpates its directors from liability for breaches of their duty of care. Nelson must, therefore, plead facts supporting a viable claim for a breach of the duty of loyalty to survive the Emersons' motion to dismiss. Nelson's assertion that the Emersons caused Repository to pay them excessive compensation while the Company was insolvent does not support a duty of loyalty claim because the complaint neither quantifies the amount of the allegedly excessive compensation nor describes which directors approved that compensation or suggests that those unknown directors were not independent. Likewise, Nelson's contention that the Emersons caused Repository to file for bankruptcy in bad faith for the purpose of frustrating Nelson's efforts to collect the debt owed to him by Repository does not support a duty of loyalty claim. The pled facts merely suggest that the Emersons caused Repository to file a non-frivolous recharacterization claim for the benefit of its equity holders, a business decision that, although not ultimately successful, is protected by the business judgment rule.
II. Factual Background

A. The Path To Bankruptcy

Repository markets, supplies, and maintains customer relationship software pursuant to licensing agreements with its customers. Repository filed for bankruptcy in April 2006, was dismissed from bankruptcy in February 2007, and was later sold to plaintiff William G. Nelson, IV, its only secured creditor, via a secured party sale in March 2007. The events relevant to this lawsuit are those that occurred before the sale of Repository to Nelson. During the relevant time period, there were two primary factions that had an interest in Repository. One faction was comprised of defendants E. James Emerson and his wife Kathleen Emerson. The Emersons were Repository’s majority stockholders and served as officers and directors of the Company. The other faction consisted of plaintiff Nelson. Beginning in 1996, Nelson was a minority stockholder in Repository. But Nelson was not a passive minority stockholder. Nelson was a Repository director from 1996 until April 11, 2006, a mere two weeks before Repository filed for bankruptcy. Nelson also served as the Company’s Chief Executive Officer from mid-2002 through mid-2004.

Nelson’s resignation as director and Repository’s bankruptcy filing were related to Nelson’s other role at Repository, his status as a secured creditor of the Company since 2002. Nelson, who at the time of bankruptcy had a secured claim against Repository of over $2 million, triggered Repository’s voluntary bankruptcy filing by sending Repository a notice of default letter (the “Default Letter”) on the same day he resigned from Repository’s board. Nelson first became a creditor of Repository in August 2002, when Repository and he executed agreements creating a secured $500,000 line of credit with a

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2The facts are drawn from the complaint, the documents it incorporates, and other publicly filed documents, including documents filed in the related federal court proceedings. See, e.g., West Coast Mgmt. & Capital, LLC v. Carrier Access Corp., 914 A.2d 636, 641 (Del. Ch. 2006) (taking “judicial notice of the federal court decisions and orders” in the context of a motion to dismiss); In re Wheelabrator Techs., Inc. S’holders Litig., 1992 WL 212595, at *12 (Sept. 1, Del. Ch. 1992) (stating that this court may take judicial notice of publicly filed documents on a motion to dismiss).

3In re Repository Tech., Inc. (“Repository II”), 381 B.R. 852, 862 (N.D. Ill. 2008).

4Repository I, 363 B.R. at 873 (“Mr. Emerson and Mrs. Emerson own 37.02% and 29.82% of the equity interests in RTI, respectively, for a combined 66.84% of the equity interests.”). During the relevant time period, as best as can be gathered from the complaint, Repository’s board varied in size from three directors to five directors. Compl. ¶¶ 4-6, 10, 33; see also Repository I, 363 B.R. at 872 (“Since 1996, RTI’s Board of Directors had between three and five directors and Mr. Nelson had only one seat on the Debtor’s Board of Directors while the principal shareholders, [the Emersons], had two seats, so Mr. Nelson was never in control of the Board of Directors.”).
15% interest rate (the "Nelson Line of Credit"). By December 31, 2002, Nelson had advanced Repository the full $500,000 under the Nelson Line of Credit. Approximately a year later, in December 2003, the Repository board voted to increase the line of credit to $1,500,000. Thereafter, Nelson advanced funds totaling over $1,740,000 under the Nelson Line of Credit and received interest payments on the outstanding amounts. But the advances—and the Company's interest payments to Nelson—stopped in June 2004 when Nelson announced that he would not advance any more funds under the Nelson Line of Credit.

Nelson alleges that by June 2004, Repository had become insolvent because it stopped paying its debts as they became due, specifically the interest on the Nelson Line of Credit. Moreover, Repository's June 30, 2004 balance sheet showed assets of $494,451 compared to liabilities of $2,528,453. Whether by coincidence or not, mid-2004 was also when Nelson left his post as Repository's CEO.

Repository, despite its seemingly bleak financial condition, was able to obtain one last inflow of cash from debt financing. In October 2004, Repository obtained $202,461 from West Suburban Bank in return for granting the Bank a promissory note and related security interest in Repository's assets (the "Bank Note"). Repository, although it was not making the required interest payments on the Nelson Line of Credit, stayed current on its obligations under the Bank Note through the time it filed for bankruptcy.

After not receiving interest payments on the Nelson Line of Credit for nearly two years, Nelson forced the issue in the Spring of 2006. The first thing Nelson did was to purchase the Bank Loan, which at that time had a balance of $126,484, on April 10, 2006. This made Nelson Repository's only secured creditor. The following day, Nelson resigned from Repository's board and sent the Default Letter. The Default Letter did not declare an immediate default, but instead requested that the obligations under the Nelson Line of Credit be made current within 15 days or Nelson would consider an act of default to have occurred. The letter put Repository in a difficult situation because it owed over $509,687 in interest payments under the Nelson Line of Credit.

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5Repository's board, excluding Nelson who abstained, voted unanimously to approve the Nelson Line of Credit.

6The board approved the increased in the Nelson Line of Credit by a vote of three to zero, with Nelson and Mrs. Emerson abstaining.
B. Repository Files For Bankruptcy

Repository responded to Nelson's demand that it act upon his Default Letter within 15 days, but not in the manner that he requested. On April 25, 2007, Repository filed a Chapter 11 bankruptcy petition in the United States Bankruptcy Court for the Northern District of Illinois. Nelson alleges that the bankruptcy filing was "authorized by [Repository's] board at the insistence of Mr. Emerson." 7 Nelson also contends that Repository was "substantially current on all its debts and obligations but for those that are[0]se under the [Nelson Line of Credit]." 8 Nelson's secured claims against the bankruptcy estate totaled at least $2,377,148. 9 In contrast, the unsecured claims against the estate, excluding approximately $400,000 in unearned maintenance for Repository's future requirements to maintain its customers' software, totaled less than $35,000. 10 Thus, the bankruptcy proceedings were in essence a dispute between Nelson and Repository.

After the bankruptcy was filed, Nelson made the first move by moving to dismiss the bankruptcy case for cause under § 1112(b) of the Bankruptcy Code. 11 Among the reasons Nelson argued that the bankruptcy case should be dismissed were that Repository could not effectuate a plan in Chapter 11, that there was continuing loss to or diminution of the estate during the bankruptcy, that Repository's assets and business had been grossly mismanaged, and that the bankruptcy petition was filed in bad faith. 12 Repository, in turn, filed an adversary action against Nelson in bankruptcy seeking recharacterization of Nelson's loans to equity and equitable subordination of Nelson's loans 13 as well as a recovery from Nelson for breach of fiduciary duty. 14 The Bankruptcy

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7Compl. ¶ 21.
8Id. ¶ 26.
9Id. ¶¶ 39, 44 (alleging that Repository owed Nelson principal of not less than $1,665,000 on the Nelson Line of Credit and related accrued interest of $509,687 in addition to $126,484 in principal on the Bank Loan).
12Motion To Dismiss Bankruptcy Case at 6-11.
13Recharacterization of loans from debt to equity and equitable subordination are two distinct doctrines that can have a similar practical effect on a party's indebtedness. See Emersons Op. Br. Ex. D ("Bankruptcy Court Findings & Conclusions") at 1. Recharacterization of debt to equity looks at whether a debt is really an equity contribution disguised as a debt. See, e.g., In re Outboard Marine Corp. v. Quantum Indus. Partners, LDC, 2003 WL 21697357, at *2-5 (N.D. Ill. July 22, 2003). Equitable subordination is a doctrine that, based on a creditor's inequitable conduct and its effect on other creditors, allows that creditor's debt to be subordinated to other claims in bankruptcy or allows the creditor's liens to be transferred to the bankruptcy estate. 11 U.S.C. § 510; see also In re Lifschultz; Fast Freight, 132 F.3d 339, 343-45 (7th Cir. 1997).
14Bankruptcy Court Findings & Conclusions at 1. The alleged breaches of fiduciary duty
Court consolidated the motion to dismiss the bankruptcy case and the adversary action and held a trial on those issues.

1. Nelson's Claims In This Court And His Arguments To The Bankruptcy Court

In describing the arguments Nelson made to the Bankruptcy Court to support his motion to dismiss the bankruptcy case, I will juxtapose the claims he makes in this action because the comparison between the two is critical to the proper resolution of this motion to dismiss. To support his assertion that Repository had been grossly mismanaged, Nelson argued to the Bankruptcy Court that "during the entirety of the time period in which [Repository's] financial difficulties [had] become apparent . . . [Repository's] officers, [the Emersons], [had] chosen to divert [Repository's] assets to their own pockets by richly compensating themselves and members of their immediate family through inflated compensation and commission structures."15 Here and now, Nelson contends that the Emersons breached their fiduciary duties by "authorizing exorbitant salaries and benefits for themselves when the company was insolvent."16

To support his assertion that the bankruptcy was filed in bad faith, Nelson argued that Repository filed for bankruptcy "with the sole purpose of preventing Mr. Nelson from potentially exercising his state court rights" and that "evidence of self-dealing and mismanagement suggest a filing other than in good faith."17 Here, Nelson asserts that the Emersons breached their fiduciary duties by "causing [Repository] to file for bankruptcy in order to frustrate the efforts of [Repository's] creditors, as well as to maintain their control over [Repository] and to continue the flow of excessive salaries and benefits for their personal gain."18 Moreover, Nelson argued to the Bankruptcy Court that the bankruptcy filing was in bad faith because it risked damaging Repository's "single most valuable asset," its customers who were creditors due to their ongoing maintenance contracts with Repository.19 In this action, Nelson also points to the bankruptcy filing as having a detrimental


15 Motion To Dismiss Bankruptcy Case ¶ 24; see also Emersons Op. Br. Ex. A ("Nelson Brief To Bankruptcy Court") at 4-5.
16 Compl. ¶ 62, see also id. ¶¶ 63-65.
17 Motion To Dismiss Bankruptcy Case ¶¶ 47, 48; see also Nelson Brief To Bankruptcy Court at 12-13.
18 Compl. ¶ 62
19 Motion To Dismiss Bankruptcy Case ¶ 43; see also Nelson Brief To Bankruptcy Court at 13.
effect on Repository's "reputation among customers in the software community." 20

2. The Bankruptcy Court's Findings

After a full trial, the Bankruptcy Court granted Nelson's motion to dismiss the bankruptcy case on February 13, 2007. But it did so only on the basis that Repository could not effectuate a plan in Chapter 11 because the Court decided that it would only recharacterize $240,000 of the Nelson Line of Credit to equity rather than a larger portion of the Nelson debt. 21 The Bankruptcy Court found against Nelson on his other arguments. The Court explicitly stated:

Other grounds were argued in favor of dismissal, but they were not established. Nelson has not shown:

a. continuing loss to or diminution of the estate during the bankruptcy;
b. any mismanagement of Debtor's assets and business; or
c. the filing of a bankruptcy case and petition in bad faith.

Present management has kept the Debtor's business stable and operations have shown progress and efficient operation. The filing of this bankruptcy was a rational reaction to Nelson's action, and was partially successful. Therefore, the bankruptcy filing cannot be held to be in bad faith. 22

In other words, the Bankruptcy Court specifically found that Nelson failed to establish the very same arguments that Nelson now repeats in this action.

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20Compl. ¶ 63.
21 Repository I, 363 B.R. at 882, 895. The $240,000 represents the amount advanced under the Nelson Line of Credit in excess of the $1,500,000 limit approved by Repository's board. Id. at 882. The Bankruptcy Court also found that Nelson had not breached his fiduciary duty to Repository. Id. at 894.
22 Repository I, 363 B.R. at 896 (emphasis added).
3. The Bankruptcy Court’s Decision Is Affirmed On Appeal

Both parties appealed the Bankruptcy Court decision to the U.S. District Court for the Northern District of Illinois. The District Court affirmed the Bankruptcy Court’s decision in full. The only argument made on appeal that is directly relevant to this action is Nelson’s contention that the District Court should strike the language indicating the bankruptcy was a "rational reaction to Nelson's actions" and that the "bankruptcy filing [could] not be held to be in bad faith." The District Court rejected Nelson's contention and stated that the "language [was] part of the Bankruptcy Court's holding because Nelson based his dismissal motion on [Repository's] bad faith." The District Court further observed that "Nelson's argument that the Bankruptcy Court's language is dictum is defeated by his own motion requesting a finding of bad faith in support of dismissing RTT's bankruptcy case."

C. The Events After Repository Was Dismissed From Bankruptcy

Immediately after the bankruptcy case was dismissed, Nelson sought relief from the U.S. District Court for the Northern District of Illinois in the form of an order precluding Repository from dissipating its assets. The District Court granted Nelson's request for a temporary restraining order. Repository, however, frustrated at least one of Nelson's goals in seeking the order because it transferred $100,000 to its bankruptcy counsel "just minutes before the Court issued [the] temporary restraining order."

In March 2007, the month after Repository was dismissed from bankruptcy, the District Court appointed a receiver for Repository. That same month Nelson purchased all of Repository's assets, including its claims against the Emersons, in a transaction that was approved by the receiver.

D. Nelson Files A Complaint In This Court In An Attempt To Relitigate The Arguments Denied By The Bankruptcy Court

On May 1, 2007, Nelson filed a complaint in this court seeking recovery on behalf of Repository (and as the holder of Repository's claims) against the

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23 Repository II, 381 B.R. at 874.
24 Id. at 873.
25 Id.
26 Id.
27 Compl. ¶ 55.
28 Repository II, 381 B.R. at 862.
Emersons for their alleged breach of fiduciary duties to Repository.\textsuperscript{29} As discussed above, Nelson's complaint alleges that the Emersons breached their fiduciary duties to Repository by paying themselves excessive compensation while Repository was insolvent and by filing for bankruptcy. The alleged facts and related arguments are essentially the same as those Nelson made in the Bankruptcy Court.

III. Procedural Framework

The Emersons have moved to dismiss Nelson's complaint pursuant to Court of Chancery Rule 12(b)(6). In addressing a motion to dismiss, I must assume the truthfulness of all well-pled facts in the complaint and draw all reasonable inferences in the light most favorable to Nelson, the nonmoving party.\textsuperscript{30} I need not, however, accept as true conclusory allegations that are unsupported by facts contained in the complaint.\textsuperscript{31} After evaluating the complaint in this manner, I must dismiss any claim that Nelson would not be entitled to recover upon under any reasonable set of facts properly supported by the complaint.\textsuperscript{32}

IV. Legal Analysis

The Emersons have moved to dismiss Nelson's bad faith bankruptcy filing and excessive compensation claims on the grounds that those claims are barred by the doctrine of collateral estoppel,\textsuperscript{33} also known as issue preclusion, and that those claims fail to state a claim upon which relief can be granted.

\textsuperscript{29}Nelson, as a creditor, also filed a direct action against the Emersons alleging breaches of their fiduciary duties. Nelson agrees that this claim should be dismissed in light of a recent decision by the Delaware Supreme Court holding that creditors cannot bring direct actions for breaches of fiduciary duties. See \textit{N. Am. Catholic Educ. Programming Found., Inc. v. Gheewalla}, 930 A.2d 92 (Del. 2007).

\textsuperscript{30}\textit{E.g., In re General Motors (Hughes) S'holder Litig.}, 897 A.2d 162, 168 (Del. 2006) (quoting \textit{Savor, Inc. v. FMR Corp.}, 812 A.2d 894, 896-97 (Del. 2002)).

\textsuperscript{31}\textit{E.g., Hughes}, 897 A.2d at 168 (quoting \textit{In re Santa Fe Pac. Corp. S'holder Litig.}, 669 A.2d 59, 65-66 (Del. 1995)).

\textsuperscript{32}\textit{E.g., Hughes}, 897 A.2d at 168 (quoting \textit{Savor}, 812 A.2d at 896-97).

\textsuperscript{33}The Emersons do not assert that Nelson is barred from bringing his claims by the doctrine of claim preclusion because the Emersons were not named parties in the bankruptcy case. Tr. of Oral Arg. (Feb. 5, 2008) at 4-5. Candidly, this ruling would rest more comfortably on the doctrine of claim preclusion given the identity of interests between Repository and the Emersons as equity holders. Judicial, litigative, and business efficiency are all best served by a rule that requires litigants in bankruptcy to press as many of their claims as they are able during the bankruptcy proceeding itself. The elimination of rear view issues is a key part of the bankruptcy process for all concerned, and needless claim splitting is economically wasteful and taxes scarce societal dispute
A. Collateral Estoppel

The doctrine of collateral estoppel "precludes a party to a second suit involving a different claim or cause of action from the first from relitigating an issue necessarily decided in a first action involving a party to the first case." The preclusive effect of a foreign judgment is measured by [the] standards [used by] the rendering forum. The Emersons base their collateral estoppel claim on the findings and conclusions of the U.S. Bankruptcy Court for the Northern District of Illinois and the U.S. District Court for the Northern District of Illinois, and therefore the collateral estoppel standard of the U.S. Court of Appeals for the Seventh Circuit applies. The Seventh Circuit requires that a party establish four elements before a court may invoke collateral estoppel: "(1) the issue sought to be precluded must be the same as that involved in the prior litigation, (2) the issue must have been actually litigated, (3) the determination of the issue must have been essential to the final judgment, and (4) the party against whom estoppel is invoked must [have been] fully represented in the prior action.

Here, the parties' dispute over the application of collateral estoppel involves two of the four elements. Nelson argues that collateral estoppel does not apply because the only issue essential to the District Court judgment was that Repository could not effectively reorganize and that the rest of its findings are dicta. Nelson also argues that the bad faith filing issue in this case is not the same issue determined by the Bankruptcy Court because the legal standards are different.

1. The Essential To The Judgment Element

a. The Bad Faith Filing Claim

Nelson argues that collateral estoppel does not bar its bad faith filing claim because the Bankruptcy Court's finding on the bad faith filing issue was dicta and therefore collateral estoppel does not apply because the court's determination on that issue was not essential to the court's final judgment.

resolution resources.

36 The Emersons note that there is a possibility that Delaware law on collateral estoppel might apply, but acknowledge that the difference between the Delaware and Seventh Circuit standard for collateral estoppel is not material in this case. Emersons Rep. Br. at 1.
37 See, e.g., Universal Guar. Life Ins. Co. v. Coughlin, 481 F.3d 458, 462 (7th Cir. 2007) (internal quotation and citation omitted).
According to Nelson, the Bankruptcy Court's final judgment was based on Repository's inability to effectuate a valid plan under Chapter 11 and nothing else in the decision is entitled to preclusive effect. But the U.S. District Court ruling on appeal collaterally estops that argument because it rejected that same argument when Nelson made it on appeal. Although one might have thought that Nelson would drop this argument after the District Court issued its ruling, Nelson continued to make this argument at oral argument after the District Court had issued its ruling. The District Court ruling was plainly correct on its merits. Nelson himself pled the issue of bad faith, and a Bankruptcy Court ruling in his favor could have not only provided an independent basis for dismissing Repository's bankruptcy case, but also could have resulted in a fee recovery by Nelson and served as collateral estoppel. That collateral estoppel effect might have been beneficial to Nelson in an action such as this fiduciary duty action against the Emersons or in the federal court action Nelson brought against Repository's bankruptcy counsel that alleges counsel harmed Nelson by conspiring with Emersons to breach their fiduciary duties and cause Repository to breach its loan contract with Nelson. More important, the Bankruptcy Court judge, knowing that Nelson had reserved the right to seek "other and further relief as [the Bankruptcy Court] deems just and equitable," had to decide the bad faith issue because two common types of such further

38Repository II, 381 B.R. at 873.
39Tr. of Oral Arg. (Feb. 5, 2008) at 38. The colloquy at oral argument went as follows:
THE COURT: [Y]ou are going to now say that the finding of bad faith was not essential to the judgment?
[Counsel for Nelson]: That's correct. My reason for that is that the judgment of the Court is a dismissal of the case. The fact that those issues were lost by Mr. Nelson were not essential to the judgment of the Court. The judgment of the Court stands upon — upon a dismissal because of the inability to reorganize . . . .

Id.

40Id. at 38-39 (Nelson's counsel acknowledging upon questioning that a successful bad faith ruling could have potentially resulted in some type of attorney fee relief for Nelson, whether it was the shifting of the fees for Nelson's counsel to Repository or an order affirmatively prohibiting the Company from paying its own counsel, and that such a ruling would have been eligible for collateral estoppel effect).
41See Letter from Joelle E. Polesky to Vice Chancellor Leo E. Strine, Jr. (Feb. 8, 2008) Ex. E ¶¶ 27, 32 (first amended complaint in the District Court action by Nelson against Repository's counsel). I say might because to use collateral estoppel offensively against Repository's counsel or the Emersons, they would have had to have had the interests fairly represented by Repository on the issue. See 18A CHARLES A. WRIGHT & ARTHUR R. MILLER, FEDERAL PRACTICE AND PROCEDURE § 4448 (2008); see also id. § 4460 (stating that "[m]any of the decisions that extend preclusion through corporate relationships involve controlling owners" and that "[t]he easiest cases are those in which a controlling owner has in fact participated extensively in directing litigation by or against the corporation"). Given their role in the filing, that requirement might well have been satisfied.
42Motion To Dismiss Bankruptcy Case at 15.
relief, fee shifting and an order requiring the debtor's counsel to disgorge its fees, could have been premised on a finding that the bankruptcy filing and recharacterization action were frivolous and filed in bad faith.\textsuperscript{43} The Bankruptcy Court therefore had to address this issue, which Nelson himself put in contention. Thus, Nelson is collaterally estopped from raising that issue here.

b. The Excessive Compensation Claim

Equally undeterred by his loss before the District Court, Nelson argues that the Bankruptcy Court’s determination on excessive compensation was dicta and not essential to the Bankruptcy Court’s judgment.\textsuperscript{44} Nelson did not make that same argument on appeal to the District Court, so (somewhat counterintuitively) he is not collaterally estopped from making that argument here.\textsuperscript{45} But the reasoning that the District Court used in finding that the

\textsuperscript{43}Nelson argued that the bankruptcy filing was made in bad faith and presented evidence at trial on that argument, but did not convince the Bankruptcy Court. See Motion to Dismiss Bankruptcy Case ¶ 39 (quoting the statement in \textit{In re James Wilson Associates}, 965 F.2d 160, 170 (7th Cir. 1992), that "[t]he clearest case of bad faith is where the debtor enters Chapter 11 knowing that there is no chance to reorganize [its] business and hoping merely to stave off the evil day when the creditors take control of [its] property."). Had Nelson established that the bankruptcy was filed in bad faith, Nelson would likely have filed a Rule 9011 motion for sanctions in an attempt to have his fees shifted to Repository and have Repository’s counsel disgorge the interim fee awards it had received. Fed. R. Bankr. P. 9011; see \textit{In re McCormick Road Associates}, 127 B.R. 410, 413 (N.D. Ill. 1991) (suggesting the use of Rule 9011 in response to bankruptcy petitions filed in subjective bad faith); see also \textit{Matter of Wolpert}, 110 F.3d 494, 501 n.11 (7th Cir. 1997) ("Under Rule 9011, a bankruptcy court may sanction parties who file documents in bad faith or for an 'improper purpose, such as to harass or to cause unnecessary delay or . . . cost.'") (quoting Fed. R. Bankr. P. 9011(b)(1)); \textit{Matter of Taxman Clothing Co.}, 49 F.3d 310, 312 (7th Cir. 1995) (stating "all interim awards of attorney's fees [to the debtor's counsel] in bankruptcy cases are tentative" and can be undone by a later order of the court); \textit{In re Charter Tech. Inc.}, 160 B.R. 925, 931-32 (Bankr. W.D. Pa. 1993) (finding that debtor's counsel had forgotten who he was representing and became "hostile to the [d]ebtor corporation and its creditors" and ordering, as sanctions pursuant to Rule 9011, "that [the debtor's counsel's] retainer be disgorged, that he be allowed no fees in the within bankruptcy proceeding and that any fees to be collected by him shall be collected from his real client, [the debtor's president and principal stockholder]").

\textsuperscript{44}The parties also spar over the effect of the Bankruptcy Court's approval of the payment of salaries and commissions during the pendency of the bankruptcy. The Emersons assert that Nelson is collaterally estopped from making his excessive compensation claim on the basis of those approvals. Nelson counters by arguing that the approvals of compensation payments during bankruptcy were not final judgments entitled to preclusive effect and that the issue is not the same as the issue presented in this case because the issue presented here also involves compensation paid after Repository became insolvent but before it filed for bankruptcy. I see no need to address the issue of the effect of the approvals because I find that the Bankruptcy Court’s ruling that there was no mismanagement of Repository’s assets is the final word on that subject.

\textsuperscript{45}There is, however, a strong argument that Nelson should not be able to collaterally attack
Bankruptcy Court's bad faith filing was not dicta results in the conclusion that the excessive compensation determination was essential to the Bankruptcy Court's holding — Nelson cannot later argue that the Bankruptcy Court's ruling on an argument he made in support of his own motion for relief to the Bankruptcy Court is dicta. Nelson's motion and brief in the Bankruptcy Court argued that the Emersons' pre- and post-petition compensation was evidence of gross mismanagement and that that mismanagement was in turn evidence of bad faith. Like his other bad faith argument, a finding in his favor on this could have resulted in fee shifting and would have been eligible for collateral estoppel effect.

2. The Same Issue Element

Nelson also argues that collateral estoppel does not bar its bad faith filing claim because the issue in this action is different from the issue considered by the Bankruptcy Court when it determined that Repository's "bankruptcy filing [could] not be held to be in bad faith." Nelson argues that the issue in this action is different because a different legal standard applies.

that ruling in this court after failing to challenge it using the appeal process.

46Repository II, 381 B.R. at 873.

47See Motion To Dismiss Bankruptcy Case ¶ 24, 48; see also Nelson Brief To Bankruptcy Court at 4-5, 12-13. The fact that Nelson's motion and his brief included these arguments as the primary support for his assertion of gross mismanagement defeats Nelson's dubious argument that it is not clear that the mismanagement ruling addressed the Emersons' pre-petition compensation.

48Although Nelson does not specifically advance the argument, his not essential to the judgment contention is much stronger with respect to the pre-petition compensation because it is arguable that the "gross mismanagement of the estate" statutory basis for dismissing a bankruptcy filing only applies to post-petition conduct. See 11 U.S.C. § 1112(b)(4)(B); In re Rey, 2006 WL 2457435, at *5 n.3 (Bankr. N.D. Ill. Aug. 21, 2006) (noting that § 1112(b)(4)(B) "refers to 'gross mismanagement of the estate,' arguably rendering pre-petition mismanagement irrelevant."). I do not find that argument persuasive, however, because Nelson specifically argued the pre-petition compensation to the Bankruptcy Court in support of his gross mismanagement contention and the Bankruptcy Court chose to explicitly rule that Nelson had not shown "any mismanagement of [Repository's] assets" rather than ruling that only post-petition conduct was relevant and confining its finding that there had been no mismanagement to post-petition conduct. In other words, I conclude that the Bankruptcy Court deliberately ruled on Nelson's own pre-petition excessive compensation claim after reviewing Nelson's arguments on that specific issue and the related evidence.

49Repository I, 363 B.R. at 896.

Nelson has made a meal out of another issue. After the Bankruptcy Court dismissed the bankruptcy petition, Nelson moved for a temporary restraining order to keep Repository from dissipating its assets. Shortly before the hearing on his motion, Repository paid its bankruptcy counsel $100,000 for its work on the dismissed case. Nelson now says that this payment was a material fact that the Bankruptcy Court did not consider when determining whether Repository's filing was made in bad faith. I reject the argument that this later-arising fact undermines the preclusive effect of the Bankruptcy Court's ruling on the bad faith issue for several reasons. First, I refuse to assume that the Emersons exist out of chronological time. Their decision to have
Nelson's different legal standard argument is that the legal standard that the Bankruptcy Court used in making its determination that the bankruptcy filing was not in bad faith differs from the Delaware relevant standard for evaluating whether that filing constituted a breach of fiduciary duty. TheRepository pay its counsel after the dismissal of the bankruptcy case has no logical bearing on whether the earlier decision to file for bankruptcy was made in good faith, and is certainly not material enough to undermine the preclusive effect of the Bankruptcy Court's ruling. See Illinois Bell Tel. Co. v. Haines & Co., Inc., 713 F. Supp. 1122, 1124 (N.D. Ill. 1989) ("Issues actually litigated in a prior action have preclusive effect if the controlling facts remain unchanged in the later action. That some minoir, subsidiary facts are different will not bar the application of collateral estoppel."); see also Ramallo Bros. Printing, Inc. v. El Dia, Inc., 490 F.3d 86, 90 (1st Cir. 2007) ("While we acknowledge that changed circumstances may defeat collateral estoppel, collateral estoppel remains appropriate where the changed circumstances are not material."); 18 CHARLES A. WRIGHT & ARTHUR R. MILLER, FEDERAL PRACTICE AND PROCEDURE § 4417 (2008) ("The possibility that new facts may surround continuation of the same basic conduct should not defeat preclusion unless it is shown that the new facts are relevant under the legal rules that control the outcome.") Nor is deciding to pay counsel who filed what a Bankruptcy Court found were non-frivolous claims an eyebrow raising act. Nelson has not pled an independent claim based on this act, and at most that payment would seem to at most give rise to some sort of cause of action on Nelson's behalf based on a failure by Repository to honor his rights as a creditor. In fact, Nelson is seeking to pursue such relief in U.S. District Court right now, having sued Repository's Bankruptcy Counsel for a return of its fees and other relief based on the theory that counsel had conspired with the Emersons to breach their fiduciary duties and cause Repository to breach its loan contract with Nelson. Letter from Joelle E. Polesky to Vice Chancellor Leo E. Strine, Jr. (Feb. 8, 2008) Ex. E ¶ 27, 32. Moreover, Nelson, who gained access to Repository's books and records rapidly after the Bankruptcy Action, failed to avail himself of options to present this supposedly troubling fact to either the Bankruptcy Court, through a Rule 60(b) motion, or to the U.S. District Court to which he addressed his application for a temporary restraining order and to which he appealed the Bankruptcy Court order. See Fed. R. Bankr. P. 9024 (making Rule 60(b) applicable in bankruptcy cases with three exceptions not relevant here); Fed. R. Civ. P. 60(b)(2) (allowing a motion for relief from a final judgment on the basis of newly discovered evidence). I acknowledge it is unusual to suggest that Nelson should have moved pursuant to Rule 60(b) in a situation where he achieved his primary goal of having Repository dismissed from bankruptcy, but Nelson's conduct in appealing the bad faith ruling indicates that he wanted that ruling overturned so he could monetarily benefit from a ruling on that issue in his favor. If, as Nelson now argues, the $100,000 payment was a material fact that would have affected the bankruptcy court's bad faith ruling, he should have addressed that argument to the Bankruptcy Court rather than bringing a second action in state court on the same issue.

Although not raised by the parties, there is a plausible argument that state law claims that allege that a bankruptcy filing was made in bad faith, such as those for breach of fiduciary duty or abuse of process, are preempted. See Casden v. Burns, 504 F. Supp.2d 272, 282 (N.D. Ohio 2007) ("Because it is distinctly the province of bankruptcy law to determine liability for improper actions relating to bankruptcy filings, [the plaintiff's claim that the decision to file for bankruptcy was a breach of fiduciary duty] is preempted."); Gonzales v. Parks, 830 F.2d 1033, 1035-36 (9th Cir. 1987) ("Implicit in the Parkses' appeal is the notion that state courts have subject matter jurisdiction to hear a claim that the filing of a bankruptcy petition constitutes an abuse of process. We disagree with that assumption. Filings of bankruptcy petitions are a matter of exclusive federal jurisdiction. State courts are not authorized to determine whether a person's claim for relief under a federal law, in a federal court, and within that court's exclusive jurisdiction, is an appropriate one. Such an exercise of authority would be inconsistent with and subvert the exclusive jurisdiction of the federal courts by allowing state courts to create their own standards as to when persons may properly seek
Emersons reply by arguing that it does not matter that the legal standard is different because "the identical factual issue is presented—did the Emersons cause RTI to file for bankruptcy in bad faith?" The critical question, however, is whether the Bankruptcy Court's factual findings would have a different effect under Delaware fiduciary duty law than under bankruptcy law. The answer to that question is that the Bankruptcy Court's finding that the bankruptcy filing was not made in bad faith, that is, it was a non-frivolous attempt to reorganize the Company by recharacterizing Nelson's debt as equity, precludes a finding that the Company's directors violated their fiduciary duties by filing for bankruptcy.

It is settled Delaware law that "[e]ven when the company is insolvent, the board may pursue, in good faith, strategies to maximize the value of the firm." Filing a Chapter 11 bankruptcy petition is a federally-sanctioned strategy for maximizing the value of an insolvent company. Here, after a full trial, the Bankruptcy Court determined that Repository used that strategy in good faith. Directors of a Delaware corporation do not commit a breach of

relief in cases Congress has specifically precluded those courts from adjudicating."). But see Davis v. Yageo Corp., 481 F.3d 661, 678 (9th Cir. 2007) ("Plaintiffs' breach of fiduciary duty claims are not preempted by federal bankruptcy law because these claims concern conduct that occurred prior to bankruptcy. The cases upon which defendants rely hold only that state law causes of action for abuse of process and malicious prosecution involving conduct that occurred during bankruptcy are preempted."); U.S. Express Lines Ltd. v. Higgins, 281 F.3d 383, 393 (3rd Cir. 2002) ("Despite the broad scope of remedies available in the Code and the general exclusivity of the federal courts in bankruptcy, we have held that a state claim for malicious abuse of process was not preempted."). See generally Brian Bix, Considering the State Law Consequences of an Allegedly Improper Bankruptcy Filing, 67 AM. BANKR. L.J. 325 (1993).

5618 CHARLES A. WRIGHT & ARTHUR R. MILLER, FEDERAL PRACTICE AND PROCEDURE § 4417 (2008) ("[C]areful examination of the controlling legal principles may show that the standards are the same, or that the fact findings have the same effect under either standard, so that the same issue is presented by both systems of law.").
58See, e.g., Trenwick, 906 A.2d at 204 ("Chapter 11 of the Bankruptcy Code expresses a societal recognition that an insolvent corporation's creditors (and society as a whole) may benefit if the corporation continues to conduct operations in the hope of turning things around."); Production Resources Group, L.L.C. v. NCT Group, Inc., 863 A.2d 772, 793 n.66 (Del. Ch. 2004) ([I]n most instances when a firm is insolvent but believes itself to have a prospect for viability, the firm will seek out the protections of the Bankruptcy Code and attempt to restructure its affairs through the well-articulated body of federal law specifically designed for that purpose."); see also Trenwick, 906 A.2d at 204 n.103 (citing numerous federal decisions explaining the purpose of federal bankruptcy protection and the discretion afforded to directors in deciding whether to take advantage of the bankruptcy process).
59Nelson's argument that good faith in bankruptcy law only considers objective factors whereas good faith in Delaware fiduciary duty law considers subjective intent is misguided. The very decision that Nelson cites to support that proposition explains that in determining whether the debtor filed for bankruptcy in bad faith a court "may consider any factors which evidence an intent
fiduciary duty against the corporation if they, in good faith, seek to benefit the equity holders by bringing a bankruptcy, in order to recharacterize certain debt as equity.\textsuperscript{57} So long as that action is not frivolous, such an exercise of business judgment to advance the interests of the equity holders is not a breach of fiduciary duty simply because the directors do not achieve ultimate success.\textsuperscript{58}

B. Failure To State A Claim

The Emursors, in the alternative, have moved to dismiss the breach of fiduciary duties claim for the failure to state a claim upon which relief can be granted. Although I have dismissed Nelson's claims on the basis of collateral estoppel, I address the Rule 12(b) arguments briefly. Before beginning the analysis, I note that the complaint must plead a viable claim that the Emursors breached their duty of loyalty to Repository to survive the Emursors' motion to dismiss because Repository's charter contains a § 102(b)(7) clause that exculpates its directors for breaches of the duty of care.

1. The Bad Faith Bankruptcy Filing Claim

Nelson asserts that the complaint pleads a viable claim that the Emursors breached their fiduciary duty of loyalty by filing for bankruptcy for the purpose of frustrating Nelson's efforts to collect on his secured claims to abuse the judicial process and the purposes of the reorganization provisions." \textit{In re McCormick Road Associates}, 127 B.R. at 413 (quoting \textit{In re Phoenix Piccadilly Ltd.}, 849 F.2d 1393, 1394 (11th Cir. 1988) (emphasis added); \textit{see also id.} at 415 ("[O]nce a court has properly found that the debtor has failed to satisfy the court's objective good faith inquiry—i.e., whether reorganization is the proper course of action in a particular debtor's case—it may properly dismiss the debtor's petition without considering the debtor's subjective good faith. In other words, a finding of subjective bad faith—i.e., intentional abuse of the bankruptcy laws—is not a necessary prerequisite to dismissal for bad faith filing.") (internal quotation and citations omitted). Moreover, the use of objective factors as a proxy for subjective intent makes sense. \textit{See Production Resources}, 863 A.2d at 793 n.85 ("Because it is impossible for non-divine judges to peer into the hearts and souls of directors, this court has recognized the importance of considering relevant circumstantial facts that bear on scienter, which include the substance and effects of the defendants' conduct."). The reality is that Nelson received a trial on, among other issues, whether Repository's bankruptcy filing was made in subjective bad faith. That he failed to prevail on that contention does not mean his argument was not fairly considered.

\textsuperscript{57} \textit{See Cheewalla}, 930 A.2d at 103 (explaining that its rationale for not recognizing direct fiduciary duty claims by creditors was that "[d]irectors of insolvent corporations must retain the freedom to engage in vigorous, good faith negotiations with individual creditors for the benefit of the corporation") (citing \textit{Production Resources}, 863 A.2d. at 797).

\textsuperscript{58} \textit{See id.} ("Recognizing that directors of an insolvent corporation owe direct fiduciary duties to creditors, would create uncertainty for directors who have a fiduciary duty to exercise their business judgment in the best interest of the insolvent corporation.").
against the Company. As discussed previously, the directors of a Delaware corporation do not commit a breach of fiduciary duty if they have the corporation file a non-frivolous claim, seeking to recharacterize certain debt to equity in order to protect the interests of the company's equity holders. In such a circumstance, the non-frivolous, good faith nature of the lawsuit makes filing that lawsuit a decision that is protected by the business judgment rule. To hold that this sort of decision is a basis for director liability if the company loses in Bankruptcy Court would discourage directors from exercising their business judgment by subjecting them to a judicially invented English Rule that makes them personally liable for the winner's costs and damages simply because of an adverse judgment.

2. The Excessive Compensation Claim

To state a claim for excessive compensation, a plaintiff "must either plead facts from which it may reasonably be inferred that the board or the relevant committee that awarded the compensation lacked independence (e.g., was dominated or controlled by the individual receiving the compensation), in which event proof of such allegations would cast upon the officer the burden to

59 Nelson argues that in Production Resources Group, L.L.C. v. NCT Group, Inc. this Court recognized that facts demonstrating that directors acted to frustrate a creditor's collection efforts could suggest self-interest and bad faith and thus support a claim for breach of the duty of loyalty by a creditor. 863 A.2d at 799-800. Nelson ignores the explicitly tentative tactic taken by Production Resources to this issue. Production Resources questioned whether a direct claim for breach of fiduciary duty could be brought by a particular creditor but determined that it was unnecessary and imprudent to decide that question prematurely at the dismissal stage because venerable Delaware case law was confusing on whether a creditor could bring a direct claim and the plaintiff had asserted viable derivative claims that would allow the case to survive the defendant's motion to dismiss. Id. at 800-01; see also id. at 798 (citing Asmussen v. Quaker City Corp., 156 A. 180, 181 (Del. Ch. 1931), for the general rule that directors of insolvent corporations may appropriately prefer particular creditors and Pennsylvania Co. for Insurances on Lives and Granting Annuities v. South Broad St. Theatre Co., 174 A. 112, 115-16 (Del. Ch. 1934), for the exception that the board's preference of one creditor over another could be a breach of fiduciary duty if motivated by self-interest). Fortunately, the Delaware Supreme Court soon clarified this area of our law, by holding that creditors may not bring direct claims against directors for breach of fiduciary duty but must rely on statutory, contractual, and other nonfiduciary claims available to creditors. Gheewalla, 930 A.2d at 103 ("[I]ndividual creditors of an insolvent corporation have no right to assert direct claims for breach of fiduciary duty against corporate directors. Creditors may nonetheless protect their interest by bringing derivative claims on behalf of the insolvent corporation or any other direct nonfiduciary claim, as discussed earlier in this opinion, that may be available for individual creditors.") see also id, 930 A.2d at 99 ("[C]reditors are afforded protection through contractual agreements, fraud and fraudulent conveyance law, implied covenants of good faith and fair dealing, bankruptcy law, general commercial law and other sources of creditor rights."). As to an insolvent corporation, a creditor may prosecute a derivative suit but only to advance fiduciary duty claims belonging to the corporation itself. Id. at 101-02.
prove that the compensation paid was objectively reasonable in the circumstances or plead facts from which it may reasonably be inferred that the board, while independent, nevertheless lacked good faith (i.e., lacked an actual intention to advance corporate welfare) in making the award.\textsuperscript{60}

Nelson falls woefully short of the mark. In two key areas, Nelson's complaint is devoid of any pled facts, as opposed to mere conclusory accusation. First, the complaint does not state who approved the Emersons' compensation. Second, the complaint does describe the specifics of the compensation, including the amount of the compensation. This is not at all excused by any lack of information on his part. For one thing, Nelson has had access to all of Repository's books and records since March 2007 when he purchased the Company. More important, Nelson was a Repository director at all relevant times until two weeks before the bankruptcy filing. His complaint fails to indicate any dissent on his part to the compensation of the Emersons.

First, the complaint does not provide any factual support for Nelson's allegation that Repository's board was controlled and dominated by the Emersons.\textsuperscript{61} The complaint does not state who was on Repository's board at the time of the alleged excessive compensation or describe who—e.g., the board or the board compensation committee—approved or acquiesced to the Emersons' compensation. This failure is particularly problematic because, as discussed, Nelson himself was on Repository's board at all relevant times until two weeks before the bankruptcy filing.\textsuperscript{62} Moreover, the simple assertion that the Emersons controlled the board is questionable because the complaint itself acknowledges that in December 2003, albeit at a time before the alleged excessive compensation was paid, the Repository board had five members, only two of whom were the Emersons.\textsuperscript{63} Thus, no inference of pure numerical control of the board by the Emersons can reasonably be made.

Second and even more fatally to Nelson's claim, his complaint provides no information about the amount or specific instances of the alleged excessive compensation.\textsuperscript{64} By no facts, I mean none that quantify what compensation the

\textsuperscript{60}Gagliardi v. TriFoods Intern., Inc., 683 A.2d 1049, 1051 (Del. Ch. 1996).

\textsuperscript{61}Compl. ¶ 11.

\textsuperscript{62}id. ¶ 4.

\textsuperscript{63}id. ¶ 33.

\textsuperscript{64}See id. ¶ 2 (alleging that the Emersons enriched "themselves and members of their family through the payment of exorbitant salaries, benefits and expenses"); id. ¶ 13 (alleging that "Mrs. Emerson received excessive commissions in that commissions were paid for customer service, rather than sales activities"); id. ¶ 14 (alleging that the Emersons "both dined frequently at [Repository's] expense, charging meals to the company American Express Card"); id. ¶ 20 (alleging that the "continued payment of excessive salaries and commissions further diminished [Repository's] cash reserves"). Nelson's contention that amounts and specifics are not necessary because the payment of "any compensation during insolvency was exorbitant" is absurd and
Emersons received and when, much less any that support an inference that the non-pled amounts exceeded what was rational and proper. As explained above, Nelson has no excuse for the lack information about the alleged excessive compensation. Therefore, "[i]n the absence of [pled] facts casting a legitimate shadow over the exercise of business judgment reflected in compensation decisions," this claim must be dismissed.\textsuperscript{65}

V. Conclusion

For the foregoing reasons, the Emersons' motion to dismiss is granted because Nelson is collaterally estopped from relitigating his fiduciary duty claim and Nelson's complaint fails to state a viable claim for breach of fiduciary duty. IT IS SO ORDERED.

\textsuperscript{65}Gagliardi, 683 A.2d at 1051.
This is an action for breach of contract, breach of fiduciary duty, and an accounting. Plaintiffs are limited partners in a hedge fund who withdrew from membership in the limited partnership and expected to receive a distribution equal to their liquidating share at the time they withdrew. Upon withdrawal, Plaintiffs requested that their distributions be in kind and ratable. Defendants made distributions that were in kind but not ratable and, due to a decline in value of the designated securities by the time of distribution, had a value significantly below that of the limited partners' capital accounts.

Plaintiffs' complaint asserts claims against the hedge fund, its general partner, and the general partner of the general partner. Defendants moved to dismiss all the counts in the complaint for failure to state a claim. The parties' dispute boils down to two main issues: (1) was the general partner required to make any in kind distributions on a pro rata basis; and (2) were the withdrawing partners entitled to the securities the general partner specified at the time of retirement, even if they had declined in value at the time of distribution, or to assets whose aggregated value equaled the withdrawing partners' share of the fund as of the date of their retirement? For the reasons stated, I conclude the partnership agreement did not require ratable in kind distributions; rather, the general partner could make in kind distributions in his sole discretion. Further, I conclude the withdrawing limited partners conceivably could prove they were entitled to assets whose aggregated value equaled their share of the fund at the time of retirement. In the context of
Plaintiffs' other allegations, Defendants' alleged failure to comply with that requirement is sufficient to support each of the three counts of the complaint. Accordingly, I grant in part and deny in part Defendants' motion to dismiss.

I. FACTS

A. The Parties

Defendant Penfield Partners, L.P. ("Penfield") is a Delaware limited partnership which operates a hedge fund. It was formed in November 1988 pursuant to an Amended and Restated Agreement of Limited Partnership of Penfield Partners, L.P. (the "LPA" or "Partnership Agreement").

Defendant Pine Creek Advisers Limited Partnership ("Pine Creek"), a Delaware limited partnership, is Penfield's general partner (the "General Partner").

Defendant William D. Witter, Inc. ("Witter") is a New York corporation which serves as the general partner of the General Partner, Pine Creek. Witter is also the investment adviser to Penfield.

Plaintiff Jeffrey E. Schuss is a former limited partner of Penfield and Pine Creek, who withdrew from Pine Creek on or before December 31, 2006. Until Schuss resigned effective November 21, 2006, he was an employee of Witter and acted as Penfield's chief portfolio manager. Following his resignation, Schuss formed a new investment fund initially named Emerald Partners, L.P. ("Emerald"), which he later renamed JES Partners, L.P. ("JES").

The other plaintiffs are individuals, trusts, IRA accounts, and entities that are former limited partners of Penfield and who, along with Schuss, withdrew from Penfield on or before December 31, 2006, and directed Penfield to transfer all or a substantial portion of their investments in Penfield to Emerald (together with Schuss, "Plaintiffs"). Each withdrawing limited partner, including Schuss, requested that the withdrawal and transfer be in kind and ratable.

B. The LPA

Article VIII of the LPA governs the withdrawal of a limited partner. Sections 8.01 and 8.02 provide, inter alia, that on fifteen days prior written notice a limited partner may withdraw all or any part of its capital account as of

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1Unless otherwise indicated, the facts recited in this Memorandum Opinion are drawn from the allegations in the Verified Amended Complaint (the "Complaint"), filed on August 17, 2007.

2The LPA was subsequently amended. The most recent amendment was in 2004.
each June 30 or December 31. The withdrawing limited partner is entitled to a distribution. Section 8.05 addresses whether the distribution is in cash or in kind, providing:

All distributions to a Partner by reason of the Partner's partial or complete withdrawal or retirement from the Partnership shall be made in cash or, in the sole discretion of the General Partner, in securities selected by the General Partner or partly in cash and partly in securities selected by the General Partner.\(^3\)

Additionally, if a limited partner withdraws all of its account, the withdrawal is treated as a "retirement" and is governed by Article X of the Partnership Agreement.\(^4\)

Under § 10.01 of the LPA, within thirty days of retirement, the Partnership is obligated to pay or distribute to a retiring partner:

[A]n amount in cash or, as determined by the General Partner, in securities selected by the General Partner or in cash and securities selected by the General Partner, equal in value to not less than 90% of the estimated amount of the Liquidating Share [i.e., Capital Account, as defined in the LPA, as of the retirement date] . . . of such Partner.

Promptly after the General Partner determines the actual amount of the retiring partner's Liquidating Share, the LPA requires Penfield to pay in cash, securities, or both, as determined by the General Partner, the balance due to the retiring partner with interest at the then-existing federal funds rate.

Plaintiffs' Complaint asserts claims against the General Partner, Pine Creek, and its general partner, Witter, as well as Penfield. The Partnership Agreement contains a provision limiting the liability of the General Partner, including liability for breaches of fiduciary duty. Specifically, LPA § 3.03 provides:

The General Partner, each member, officer, employee or affiliate of the General Partner, and any person or persons designated pursuant to Section 9.02 of this Agreement shall not be liable for any loss or cost arising out of, or in connection with, any act or

\(^3\) Compl. Ex. A, the LPA, § 8.05.

\(^4\) LPA § 8.02(c) ("A Partner withdrawing his entire Capital Account pursuant to this Section 8.02 shall be deemed to have retired as of the date of such withdrawal.").
activity undertaken (or omitted to be undertaken) in fulfillment of any obligation or responsibility under this Agreement, including any such loss sustained by reason of any investment or the sale or retention of any security or other asset of the Partnership, except that any person exculpated from liability under this Section shall not be exculpated from any liability arising from losses caused by his, her or its gross negligence, willful misconduct or violation of applicable laws.  

C. Plaintiffs Withdraw from Penfield

Schuss, who was a limited partner of Penfield and Pine Creek and an employee of Witter, acted as chief portfolio manager for Penfield's investments. Starting in 2003, upon the death of Witter's founder and CEO, William D. Witter, Schuss faced internal fighting and mismanagement that decreased Witter's fortunes. These events motivated Schuss's decision to resign from Witter and withdraw from Pine Creek. By letter dated November 15, 2006, Witter informed Penfield's investors that Schuss would withdraw as a limited partner of Pine Creek effective January 3, 2007, but was expected to continue to manage Penfield through the end of 2006. Further, Witter advised the limited partners that they could elect to withdraw some or all of their investment as of December 31, 2006 upon fifteen days notice.

Effective December 31, 2006, Schuss and the other Plaintiffs withdrew from Penfield, instructing the hedge fund to transfer all or a substantial portion of their distribution proceeds to Emerald. Plaintiffs asked that the distribution be in kind and ratable. As of December 31, 2006, the aggregate ending capital of the Plaintiff withdrawing limited partners was $71,103,538. Of that $71,103,538, the limited partners directed Penfield to transfer $63,610,725 to Emerald.  

In addition, other Penfield partners, holding $32,753,986 in capital, also withdrew. Thus, as of December 31, 2006, 93.9% of Penfield's capital withdrew.

The first day the equity markets were open in the United States in 2007 was January 3, 2007. On January 17, 2007, Penfield transferred securities to Emerald on behalf of withdrawing limited partners with an aggregate market value of $58,631,876, or 92.173% of the $63,610,725 aggregate Liquidating Shares of those withdrawing limited partners who requested that their

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5LPA § 3.03(a).
6This amount represented 57.6008% of Penfield's total year-end capital.
distribution be transferred to Emerald. Therefore, the balance due to these limited partners was $4,978,848.

The January 17, 2007 distribution to Plaintiffs was in kind but not ratable. In addition, Plaintiffs received no portion of Penfield's cash balance, which at year end totaled approximately $35 million. A few months later, Witter contacted Schuss concerning the final distribution to the limited partners who withdrew and invested in Emerald, now JES. Witter took the position that it was entitled to make in kind, but not ratable distributions to Plaintiffs and that any in kind distribution would be valued at 2006 year-end prices. On that basis, Witter offered cash and securities with an approximate value of $1.3 million. Schuss rejected Witter's proposal and commenced this lawsuit. After the rejection, Penfield made a partial cash distribution to Plaintiffs.

While the Complaint is not a model of clarity, Plaintiffs ultimately seek the remaining principal obligation, plus interest, less the value of subsequent distributions.

II. PROCEDURAL HISTORY

On July 31, 2007, Plaintiffs filed a verified complaint in this action, which they amended on August 17, 2007 (the "Complaint"). The Complaint asserts three causes of action. Count one is against Penfield and seeks damages for breach of the Partnership Agreement. It alleges Penfield breached the LPA by failing to make a full and timely final distribution to Plaintiffs and by failing to make ratable, in kind distributions to Plaintiffs. Count two is against Pine Creek and Witter and seeks damages for breach of fiduciary duty. It alleges that Pine Creek, at the direction of Witter, breached its fiduciary duties to Plaintiffs and acted in bad faith, or at a minimum was grossly negligent in causing Penfield to: (a) distribute securities to Plaintiffs on a non-ratable basis in violation of Delaware law; (b) attempt to distribute depreciated securities at inflated year-end prices to satisfy Penfield's distribution obligation to Plaintiffs; and (c) unreasonably delay the final distribution to Plaintiffs in order to leverage them to accept less than their full Liquidating Shares. Count three seeks an order for an accounting against Penfield. The Complaint also seeks costs, interest, and attorneys' fees.

On October 8, 2007, Defendants moved to dismiss the Complaint pursuant to Court of Chancery Rule 12(b)(6) for failure to state a claim upon which relief can be granted. The Court heard argument on Defendants' motion on January 10, 2008. This is the Court's ruling on that motion.
III. ANALYSIS

A. Standard for Dismissal under Rule 12(b)(6)

The standard for dismissal pursuant to Rule 12(b)(6) for failure to state a claim is well settled. A court will grant the motion only if it concludes, after accepting all well-pled factual allegations of the complaint and drawing all reasonable inferences in favor of the nonmoving party, that the "plaintiff would not be entitled to recover under any reasonably conceived set of circumstances susceptible of proof." A court need not accept every interpretation of the allegations proposed by the plaintiff; instead, a court will accept those "reasonable inferences that logically flow from the face of the complaint."

While the court may not consider matters outside the pleadings when assessing a motion to dismiss for failure to state a claim, the court may consider documents that are integral to a plaintiff's claim and incorporated into the complaint as well as facts subject to judicial notice. Here, I have considered the LPA because the agreement is integral to Plaintiffs' claims, referred to throughout the Complaint, and attached to the Complaint as an exhibit.

B. Did Penfield Breach the LPA?

The first claim in the Complaint is for breach of the Partnership Agreement against Penfield. Specifically, Plaintiffs allege Penfield breached the LPA by failing to make a full and timely final distribution to Plaintiffs and by failing to make ratable, in kind distributions to Plaintiffs. As a preliminary matter, Defendants argue that because Penfield is not a party to the LPA and is not alleged to have caused a breach of the LPA, it cannot be liable for breach of that contract. Delaware law, however, dictates otherwise. In particular, 6 Del. C. § 17-606(a) of the Delaware Revised Uniform Partnership Act ("DRULPA" or the "Limited Partnership Act") provides:

Subject to §§ 17-607 and 17-804 of this title, and unless otherwise provided in the partnership agreement, at the time a partner

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7In re Gen. Motors (Hughes) S'holder Litig., 897 A.2d 162, 168 (Del. 2006) (quoting Savor, Inc. v. FMR Corp., 812 A.2d 894, 896-97 (Del. 2002)).
8Malpiede v. Townson, 780 A.2d 1075, 1083 (Del. 2001).
9See In re Gen. Motors, 897 A.2d at 170.
becomes entitled to receive a distribution, he or she has the status of, and is entitled to all remedies available to, a creditor of the limited partnership with respect to the distribution.

Under the statute, once a partner withdraws, the partner becomes "simply a contract claimant holding fixed rights," and can sue in contract for failure to pay the value of its share as of the withdrawal date. As Plaintiffs note, logically and consistent with the plain meaning of DRULPA § 17-606(a), it is the partnership that owes the distribution to the creditor (i.e., the withdrawn limited partner). Therefore, Penfield is a proper defendant.

Defendants also argue Penfield could not have breached the LPA because it vests the General Partner with discretion regarding distributions to withdrawing limited partners. The parties' dispute concerns two main issues: (1) was the General Partner required to make ratable, in kind distributions; and (2) are the withdrawing partners entitled to receive distribution of specific securities selected by the General Partner at or around the time of retirement or of assets whose aggregated value equals the value of their Liquidating Shares at the time of retirement?

1. Was the General Partner required to make ratable, in kind distributions?

Defendants assert that under §§ 8.05 and 10.01 of the LPA the General Partner has the sole discretion to return capital of a withdrawing partner in cash, in securities selected by the General Partner, or partly in cash and partly in securities selected by the General Partner. Thus, according to Defendants, the LPA overrides any statutory default limiting the scope of in kind distributions. Additionally, Defendants challenge as incorrect Plaintiffs' position that withdrawing partners can only be forced to accept their pro rata share of any security. Defendants aver that if a distribution is solely in kind, which the LPA authorizes, a withdrawing partner necessarily will receive more than her pro rata share of some security if the partnership holds at least one dollar of cash, as Penfield did. Therefore, say Defendants, the General Partner in the exercise of its sole discretion was entitled to make payment to a withdrawing partner in selected securities in excess of the withdrawing partner's pro rata share of such securities.

Plaintiffs, citing § 17-605 of the Limited Partnership Act, assert Penfield could not compel them, as withdrawing partners, to accept securities

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in an amount exceeding their pro rata share in the capital of the partnership. Plaintiffs concede the statutory limitation on in kind distributions may be overridden by a partnership agreement, but contend that the LPA does not contain explicit language trumping the statute. Plaintiffs also challenge Defendants' assertion that if a distribution is solely in kind and the partnership holds any cash a withdrawing partner necessarily will receive more than her pro rata share of some security. Although Plaintiffs acknowledge the validity of Defendants' argument if the value of each and every security held by the partnership remains static between the retirement date and the date of payment, Plaintiffs contend it breaks down otherwise. Logically, they argue, certain securities will increase in value and the General Partner, acting in his discretion, could allocate units of the more valuable security to fully satisfy the credit balance without the need to make a comprehensive pro rata distribution of all the shares in the partnership's portfolio. Plaintiffs therefore urge the Court to reject Defendants' argument as an unworkable syllogism.  

Section 17-605 of DRULPA provides that a partnership may compel a partner to accept an in kind asset distribution, but as to each asset, not in an amount exceeding the partner's pro rata share in the capital of the partnership. Section 17-605, however, is a default rule that applies where the partnership agreement does not provide otherwise. Here, under Article VIII of the LPA, a limited partner who withdraws part or all of its capital account or who retires is entitled to a distribution. Section 8.05 governs whether the distribution can be in cash or in kind:

All distributions to a Partner by reason of the Partner's partial or complete withdrawal or retirement from the Partnership shall be made in cash or in the sole discretion of the General Partner, in securities selected by the General Partner or partly in cash and partly in securities selected by the General Partner.

Further, LPA § 10.01 prescribes terms and conditions for a distribution upon a withdrawing partner's retirement:

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12 Plaintiffs' argument necessarily relies on the assumption that the value of the withdrawing partner's credit balance becomes fixed on the retirement date and that the withdrawing partner is entitled to a percentage of that fixed value, not of the securities selected by the General Partner, on the initial distribution date. I address this dispute infra Part III.B.2, and conclude Plaintiffs conceivably could prove their point in this regard.

13 6 Del. C. § 17-605 ("Except as provided in the partnership agreement, a partner may not be compelled to accept a distribution of any asset in kind from a limited partnership to the extent that the percentage of the asset distributed exceeds a percentage of that asset which is equal to the percentage in which the partner shares in distributions from the limited partnership.").
Within 30 days after the date of retirement of a Partner . . . there shall be paid or distributed to such Partner or to the legal representative of such Partner, an amount in cash or, as determined by the General Partner, in securities selected by the General Partner or in cash and securities selected by the General Partner, equal in value to not less than 90% of the estimated amount of the Liquidating Share (as hereinafter defined) of such Partner . . . .

Statutory Section 17-605 provides a default rule, but defers to the parties' limited partnership agreement when the agreement specifies how in kind distributions are to be made and that procedure conflicts with the default rule. Penfield's LPA expressly authorizes the General Partner to make in kind distributions upon retirement of each withdrawing limited partner. Defendants contend the LPA authorizes non-ratable, in kind distributions and, therefore, overrides § 17-605. Plaintiffs argue the default rule controls, suggesting the LPA, in fact, does not authorize non-ratable, in kind distributions. To resolve this dispute, I must determine the meaning of the relevant provisions of the Partnership Agreement.

Under Delaware law, the interpretation of a contract is a question of law, and a motion to dismiss is a proper vehicle to determine the meaning of contract language.14 Limited partnership agreements are contracts the courts construe like any other contract.15 When interpreting a contract, the court strives to determine the parties' shared intent, "looking first at the relevant document, read as a whole, in order to divine that intent."16 As part of that review, the court interprets the words "using their common or ordinary meaning, unless the contract clearly shows that the parties' intent was otherwise."17 If the contractual language is plain and unambiguous, the Court should give binding effect to its evident meaning.18 Additionally, when

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14 OSI Sys., Inc. v. Instrumentarium Corp., 892 A.2d 1086, 1090 (Del. Ch. 2006).

15 See Arbor Place, 2002 WL 205681, at *3. The court in Arbor Place cited Elf Atochem N. Am., Inc. v. Jaffari, 727 A.2d 286, 290-91 (Del. 1999), for the proposition that: "The policy of freedom to contract underlies both the [LLC] Act and the LP Act . . . . The basic approach of the [LLC] Act is to provide members with broad discretion in drafting the Agreement and to furnish default provisions when the members' agreement is silent." Id.


18 Rhone-Poulenc Basic Chems. Co. v. Amer. Motorists Ins. Co., 616 A.2d 1192, 1195
interpreting a contractual provision, a court attempts to reconcile all of the agreement's provisions when read as a whole, giving effect to each and every term. 19 In doing so, courts apply the well settled principle that "contracts must be interpreted in a manner that does not render any provision 'illusory or meaningless.' "20

Here, the LPA expressly gives the General Partner discretionary rights and authority in making payments to withdrawing limited partners. LPA § 8.05 provides that the General Partner shall exercise its sole discretion and make a distribution in cash, securities, or a combination, as determined and selected by the General Partner. It thus authorized Pine Creek, the General Partner of Penfield, to make the type of in kind distributions challenged by Plaintiffs. The LPA does not require such distributions to be ratable. To the contrary, the LPA specifically vests the General Partner with the discretion to determine which, if any, securities to distribute in kind, and whether to make a distribution entirely in kind, even if the partnership also has cash assets. Plaintiffs' interpretation of the LPA as requiring the General Partner to make only ratable, in kind distributions would render meaningless the language in §§ 8.05 and 10.01. 21 Therefore, I conclude as a matter of law that the General Partner was not required to make the in kind distributions to Plaintiffs ratably. Thus, Plaintiffs could not conceivably succeed in proving that Penfield or Pine Creek breached the LPA because it made non-ratable in kind distributions, and their claims to that effect will be dismissed.

2. The manner in which Defendants made the in kind distributions to Plaintiffs

Defendants argue the withdrawing partners are entitled to the securities the General Partner specified for distribution at the time of retirement, which should have an aggregate value equal to the withdrawing partners' Liquidating Shares at that time. Defendants explain that under the LPA, the General

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19See, e.g., Council of the Dorset Condo. Apartments v. Gordon, 801 A.2d 1, 7 (Del. 2002); W. Willow-Bay Court, LLC v. Robino-Bay Court Plaza, LLC, 2007 WL 3317551, at *11 (Del. Ch. Nov. 2, 2007) ("Delaware courts do prefer to interpret contracts to give effect to each term rather than to construe them in a way that renders some terms repetitive or mere surplusage.").


21Because the language of the LPA is clear, I need not address the parties' alternative arguments in resolving this issue.