

IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE
IN AND FOR NEW CASTLE COUNTY

PAUL S. LEVY, JEFFREY LIGHTCAP,)
DAVID Y. YING, ANTHONY GRILLO,)
CLEVELAND CHRISTOPHE, AND RAY)
H. WITT,)

Plaintiffs,)

v.)

C.A. No. 1395-N

HAYES LEMMERZ INTERNATIONAL,)
INC., and HLI OPERATING COMPANY,)
INC.,)

Defendants.)

MEMORANDUM OPINION AND ORDER

Submitted: February 6, 2006

Decided: April 5, 2006

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LAMB, Vice Chancellor.

The plaintiffs in this case, former outside directors of a public company engaged in the automobile supply trade, were sued by both stockholders and bondholders of that company for various statutory violations and breaches of fiduciary duty when the company was forced to reveal that its financial statements for the years 1999-2001 contained materially misleading information. In May 2005, those former directors settled the claims against them for \$27.5 million, paying \$7.2 million of that sum out of their own pockets.

The corporation which the plaintiffs served entered Chapter 11 bankruptcy in 2001, and emerged two years later as the operating subsidiary of a new entity. When the plaintiffs sought indemnification for the settlement amount under the old corporation's bylaws, under their individual indemnification agreements, and under the bankruptcy reorganization plan, both the old company and the new holding company refused. In response, the directors filed this suit on June 3, 2005, seeking an order requiring both the old and new companies to indemnify them for their settlement expenses. The defendants moved to dismiss that action pursuant to Court of Chancery Rule 12(b)(6). After the plaintiffs amended their complaint on September 29, 2005, the defendants renewed their motion to dismiss or alternatively to stay the plaintiffs' indemnification actions until the claimants satisfy various procedural hurdles the companies claim are required. The court heard argument on that motion on February 6, 2006.

In this opinion, the court dismisses the plaintiffs' claims as to the new holding company, which the court finds as a matter of law has no obligation to indemnify its predecessors' former directors and officers. However, the court denies the motion to dismiss as to the old company because the court finds that the directors have a right to proceed with their claim for indemnification at this time.

The amounts sought by these former outside directors are certainly large. But the size of the settlement payments does not lessen the duty of the current directors to make a good faith judgment as to whether the putative indemnitees are entitled to be indemnified by the corporation for the amounts they were required to pay to settle the actions arising out of the company's financial restatement.

I.

A. The Parties

Throughout all relevant periods, Hayes Lemmerz International, Inc., referred to in this opinion as "Old Hayes," was a publicly traded manufacturer of wheels and other auto parts. As described in greater detail below, Old Hayes entered into bankruptcy in December of 2001. After the company emerged from that reorganization on June 3, 2003, the business of Old Hayes, now an operating subsidiary, was carried forward by a successor company also called Hayes Lemmerz International, Inc., referred to in this opinion as "New Hayes." Both Old and New Hayes are defendants in this action.

The plaintiffs in this case, Paul S. Levy, Jeffrey Lightcap, David Y. Ying, Anthony Grillo, Cleveland Christophe, and Ray H. Witt, are all former outside directors of Old Hayes. Christophe and Levy served on the Old Hayes board of directors from 1996 to 2003. Lightcap and Ying served on the board from 1997 to 2003. Witt served on the board from 1999 to June 2001, and Grillo served from 1999 to July 2001.

B. The Facts¹

1. Accounting Irregularities And The Class Actions Against Old Hayes

On August 9, 2001, the chief executive officer of Old Hayes brought certain potentially troublesome accounting issues to the attention of the board of directors,² which quickly authorized a full investigation by the law firm of Skadden, Arps, Slate, Meagher & Flom LLP and the accountants Ernst & Young, LLP. Over the ensuing weeks, the investigating team conducted extensive interviews, reviewed many documents, and reported to the audit committee and to the Old Hayes board.

While this investigation was ongoing, Old Hayes publicly announced its audit committee's conclusion that the company's reported financial results for

¹ The facts recited in this opinion are taken from the well-pleaded allegations of the Amended Complaint ("Compl."), unless otherwise noted, and are presumed to be true for the purposes of this motion.

² Compl. ¶ 21.

fiscal year 2000 and the first quarter of 2001 were incorrect and would have to be restated. The next day, September 6, 2001, Helen Korinsky sued Old Hayes, its executive officers, its outside directors, and certain other defendants, alleging that various of those parties violated Section 10(b), Rule 10b-5, and Section 20(a) of the Securities Exchange Act and the regulations promulgated thereunder. That action and several others filed by Old Hayes stockholders were consolidated into a single case captioned *In re Hayes Lemmerz International, Inc. Equity Securities Litigation*,³ seeking in excess of \$50 million in damages and other relief related to the decline in the price of the company's equity securities following the announced restatement.

On December 13, 2001, Old Hayes issued another press release announcing that the restatement process was substantially complete, and the company had concluded that its financial results for the fiscal year 1999, including the related quarterly periods, would also have to be restated. On May 4, 2002, Pacholder High Yield Fund, Inc. sued Old Hayes's executive officers, its current and former directors (including all the plaintiffs in this case), Hayes's auditors, and the underwriters of Hayes's 1999 through 2001 bond offerings on behalf of itself and others similarly situated, alleging that in connection with the misstated financials

³ No. 01-CV-73433 (E.D. Mich. Sept. 6, 2001).

those parties violated various sections of the securities laws. The plaintiffs in this so-called bondholder action, captioned *Pacholder High Yield Fund, Inc. v. Cucuz*,⁴ sought several hundred million dollars in damages and other relief related to the decline in the price of the company's debt securities after the company announced its restatements. The two class actions, namely the stockholder action first filed by Korinsky and the Pacholder bondholder action, were consolidated for pre-trial purposes on February 19, 2004.

2. The Old Hayes Bankruptcy

On December 15, 2001, Old Hayes filed a petition in the United States Bankruptcy Court for the District of Delaware for protection pursuant to Chapter 11 of the United States bankruptcy code. As part of this process, Old Hayes negotiated with its stakeholders to fashion its reorganization plan, which was approved by the bankruptcy court on May 12, 2003.

In part, the reorganization plan excluded the former directors of Old Hayes from any release of Old Hayes's indemnification obligations in the bankruptcy, but capped those potential obligations at \$10 million beyond the amount paid pursuant to Old Hayes's directors and officers ("D&O") insurance policies. Section 11.7 of the reorganization plan stated, in relevant part:

⁴ No. 02-CV-71778 (E.D. Mich. May 4, 2002).

(a) Except as specifically provided in Section 6.7 of the Plan, in satisfaction and compromise of the Indemnitee's Indemnification Rights, all Indemnification Rights except those held by (i) Persons included in either the definition of "Directors and Officers" or the "Insureds" in either of the policies providing the Debtors' D&O Insurance as of December 15, 2002 . . . shall be released and discharged on and as of the Effective Date.

(b) On and after the Effective Date, the Indemnification Rights excepted from the release and discharge (i) shall remain in full force and effect . . . and shall not be modified in any way by the Chapter 11 Cases . . . (ii) shall be limited to the coverage provided in the Debtors' D&O Insurance as of December 15, 2002 and any additional Insurance Coverage purchased pursuant to Section 11.7 plus an additional \$10 million in the aggregate with respect to the directors of [Old Hayes] who serve on the executive committee of [Old Hayes's] board of directors serving in such capacity . . . and the Reorganized Debtors shall not be liable to make any payments beyond the additional \$10 million in excess of any such coverage actually paid by the D&O Insurance or the Insurance Coverage to or for the benefit of any such Indemnitee⁵

The plain language of the reorganization plan mandates that "Reorganized Debtors" under this provision includes Old Hayes as well as what would become the new holding company for the Hayes auto parts business, New Hayes. The complaint alleges that this provision extends liability for indemnification to both Old and New Hayes.

Old Hayes emerged from bankruptcy on June 3, 2003 and began operating as a wholly owned subsidiary of New Hayes. On or before February 27, 2002,

⁵ Compl. ¶ 36.

however, the Securities and Exchange Commission began an investigation into the misstated financials, which is still pending. In June 2005, the company and certain former officers of Old Hayes received Wells Notices from the SEC indicating that the SEC intended to recommend enforcement action against them. None of the plaintiffs in this case, however, has ever received a Wells Notice or any other indication that he is a target of that SEC investigation.

3. The Class Action Settlement

On May 2, 2005, Old Hayes's D&O insurance carriers, the outside directors, and the class action plaintiffs, agreed to settle all outstanding claims against the outside directors for \$27.5 million. Old Hayes's insurers, Gulf Insurance Company and Continental Casualty Company, agreed to fund \$20.3 million of this sum, apparently exhausting the Gulf D&O policy, but expressly leaving certain amounts of the Continental policy untapped.⁶ The outside directors personally funded the remaining \$7.2 million, which was deposited into an escrow account controlled by counsel for the class action plaintiffs on June 1, 2005.

⁶ This information was provided by the defendants as an exhibit to their opening brief to dismiss or stay the amended complaint, and is therefore outside the strict bounds of what the court may consider in a 12(b)(6) motion. Defs.' Opening Br. Ex. B. The court does not rely on this information for any of its conclusions, but nonetheless includes it for the sake of completeness.

4. The Plaintiffs' Demand For Indemnification

In connection with that payment, the outside directors sought indemnification from both Old Hayes and New Hayes pursuant to their indemnification rights under the Old Hayes bylaws,⁷ their indemnification agreements with Old Hayes, and what they believe to be their rights under Section 11.7 of the reorganization plan. The New Hayes board of directors met on or about April 29, 2005 allegedly to consider the outside directors' demand for indemnification. Also in attendance at this meeting was the one remaining director of Old Hayes. During the evening of May 26, 2005, the outside directors were allegedly informed by representatives of both New and Old Hayes that the companies would not indemnify any of the outside directors for the cost of settling the bondholder and stockholder class actions.⁸ In response to that refusal, the outside directors filed their initial complaint in this case on June 3, 2005, without making any written demand on the boards of either Old or New Hayes.

⁷ The relevant Old Hayes bylaw provides that "the Corporation shall indemnify 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, whether civil, criminal, administrative, or investigative . . . by reason of the fact that he is or was a director or officer of the Corporation . . . against expenses . . . actually and reasonably incurred by him in connection with such action, suit, or proceeding if he acted in good faith and in a manner he reasonably believed to be in or not opposed to the best interests of the Corporation" Pls.' Opposition to Defs.' Mot. To Dismiss Ex. A.

⁸ Compl. at ¶ 48.

On September 13, 2005, however, the outside directors sent a letter to the defendants reiterating their demand for indemnification.⁹ Old Hayes responded to this letter on September 26, 2005, “urg[ing] plaintiffs to abandon [their] improper litigation strategy” and refusing to indemnify the plaintiffs until they agreed “to follow the procedures set forth in the Indemnification Agreements.”¹⁰ The letter went on to request a wide range of information from the plaintiffs, purportedly to allow Old Hayes to make what the letter called an “informed decision” regarding the plaintiffs’ demand.¹¹ In response to these communications, the plaintiffs filed the amended complaint on September 29, 2005.

⁹ This letter explained that the plaintiffs did not believe that they were required to make written demand, but that they had done so nonetheless: “Under these circumstances, we do not believe that any further action, including providing Old or New Hayes with a written demand for indemnification, is required of the Directors prior to filing a complaint against Old Hayes and/or New Hayes. Quite simply, it is our position that if any further demand was necessary prior to the filing of a complaint, such an act was excused by Old Hayes’ and/or New Hayes’ anticipatory breach of their obligation to indemnify the Directors Nevertheless, and without waiver of any of the Directors’ rights and their arguments, we hereby demand on behalf of the Directors of Old Hayes that Old Hayes and/or New Hayes indemnify the Directors for the cost of the Settlement, plus interest from the date that payment was made, plus costs and attorneys fees incurred in connection with their enforcement of their rights to indemnification.” Compl. Ex. 8.

¹⁰ *Id.*

¹¹ The defendants’ information demand, attached to the September 26, 2005 letter, includes 25 categories of documents, some of which seem quite broad on their face. Category 8, for example, requests “all documents that reflect, evidence, constitute, or refer to the actual or potential liability of any of Plaintiffs for actions taken in his capacity as a director of Old-Hayes.” Compl. Ex. 8. Clearly, this request could potentially require an enormous amount of document production.

II.

A. The Plaintiffs' Allegations

Count I of the amended complaint seeks monetary damages resulting from the company's refusal to honor its agreements to indemnify the plaintiffs with respect to the settlement of the class action suits. The plaintiffs allege that they are due these expenses, which comprise not only the \$7.2 million paid in connection with the settlement, but also interest, expenses, and attorneys' fees, including the costs and expenses incurred in connection with the current action, from both Old and New Hayes pursuant to the Old Hayes bylaws, the plaintiffs' indemnification agreements, and the bankruptcy reorganization plan.

Count II seeks a declaration that the plaintiffs are entitled to be indemnified by the companies in an amount up to \$10 million beyond any amount actually paid under the D&O policies for the benefit of the outside directors in connection with the May 2, 2005 settlement and related costs. In other words, this count seeks to assure the plaintiffs that they will be indemnified not only for the \$7.2 million plus costs already incurred, but also for any additional liability up to the full \$10 million cap provided for by the reorganization agreement.

B. The Defendants' Motion To Dismiss

The defendants have moved to dismiss both counts of the plaintiffs' complaint on a number of grounds. First, the defendants argue that all counts

against New Hayes should be dismissed because the plaintiffs were never directors of New Hayes, and because New Hayes has no obligation, by contract or otherwise, to indemnify the plaintiffs. Particularly, the defendants argue that Section 11.7 of the reorganization plan, which limits New Hayes's liability for indemnification over D&O insurance to \$10 million, does not, as the plaintiffs claim, implicitly extend Old Hayes's indemnification obligations to New Hayes.

Second, the defendants move to dismiss the complaint against both Old and New Hayes because, they argue, the plaintiffs have breached their indemnification agreements. In short, the defendants claim that the indemnification agreements contain certain procedural requirements that are prerequisites to any legitimate claim for indemnification. Because the plaintiffs have failed to overcome these procedural hurdles, and most importantly have failed to allow the defendants 30 days after the first written demand to respond, the defendants claim that the amended complaint is premature.

Finally, the defendants argue that their statutorily required determination of whether the plaintiffs have met the "good faith" and "best interests" tests of Section 145 cannot be made until after the conclusion of the pending SEC investigation. Therefore, they argue, the complaint betrays a rush to judgment on the part of the plaintiffs, and should be stayed until all the relevant facts have been

collected, and until the defendants can be sure that no SEC investigation is forthcoming against any of the plaintiffs.

III.

This case has come before the court on a motion to dismiss under Court of Chancery Rule 12(b)(6). Generally speaking, a court may only grant such a motion if it can “determine with reasonable certainty that, under any set of facts that could be proven to support the claims asserted, the plaintiffs would not be entitled to relief.”¹² Currently, this case primarily concerns the interpretation of written agreements. Thus, the court will only grant the motion to dismiss in favor of the defendants if those written agreements may only be reasonably read in the manner advanced by New and Old Hayes. If, however, those agreements can reasonably be read in more than one way, the motion to dismiss must be denied.¹³

IV.

A. The Indemnification Liability Of New Hayes To The Outside Directors

The defendants argue that all counts against New Hayes should be dismissed because the plaintiffs were never directors of New Hayes, and because no provision of any agreement, and particularly not Section 11.7 of the reorganization

¹² *Grobow v. Perot*, 539 A.2d 180, 187 n.6 (Del. 1988).

¹³ *See VLIW Tech., LLC v. Hewlett-Packard Co.*, 840 A.2d 606, 614-615 (Del. 2003) (“In deciding a motion to dismiss, the trial court cannot choose between two differing reasonable interpretations of ambiguous provisions. Dismissal, pursuant to Rule 12(b)(6), is proper only if the defendants’ interpretation is the only reasonable construction as a matter of law.”).

plan, requires New Hayes to extend indemnification to Old Hayes's directors. The plaintiffs' response is simple. Because Section 11.7 limits both Old Hayes's and New Hayes's liabilities, it necessarily implies that New Hayes is also bound by Old Hayes's obligation to indemnify its directors.

First, as the plaintiffs implicitly concede, the outside directors have no direct basis to claim that they are indemnified by New Hayes. That is to say, they never were directors of New Hayes, and never signed indemnification agreements with that entity. Their argument depends, therefore, on their reading of Section 11.7 of the reorganization agreements, under which the plaintiffs believe New Hayes assumed the indemnification obligations in question.

The plaintiffs' proposed reading of that unambiguous provision, however, is plainly unreasonable. First, the reorganization plan makes clear that the court is not to assign liabilities to New Hayes by implication. Specifically, the reorganization plan provides that New Hayes would assume only those obligations of Old Hayes that it *expressly* assumed. Section 4.14 states:

Except to the extent a Reorganized Debtor expressly assumes an obligation or liability of a Debtor, or another Reorganized Debtor, the Plan will not operate to impose liability on any Reorganized Debtor for the claims against any other Debtor or the debts and obligations of any Debtor or Reorganized Debtor¹⁴

¹⁴ Compl. Ex. 1 at A-47.

In similar cases, and faced with similar language, our courts have required plaintiffs seeking indemnification to point to specific contractual language that actively assigns liability to the new, successor, defendant.¹⁵

Section 11.7, however, provides no such clear mandate. Indeed, at its most basic, the question of New Hayes's liability is determined by the fact that the provision in question says nothing affirmatively about its obligations. Rather, it provides only that any liability for indemnification, to the extent it exists, is capped at \$10 million above Old Hayes's D&O policies. Significantly, the sophisticated bankruptcy parties knew quite well how to negotiate for a provision that expressly assigned liability to New Hayes, as evidenced by other, unambiguous, provisions of the reorganization agreement. Section 6.7, for example, requires both New and Old Hayes to continue the company's pension plans:

Upon the occurrence of the Effective Date, the Reorganized Debtors shall continue the Pension Plan, meet the minimum funding standards under ERISA and the Internal Revenue Code, . . . and administer and operate the Pension Plan in accordance with its terms and ERISA.¹⁶

¹⁵ In discussing the responsibilities of a successor corporation to indemnify a former director, for example, this court has held that liability for indemnification was assumed by the successor as a contractual matter when the merger agreement in question expressly mandated that both parties "shall indemnify to the fullest extent permitted under [Delaware law] the former directors and officers" of the selling party. *Chamison v. Healthtrust, Inc.*, 735 A.2d 912, 919-20 (Del. Ch. 1999).

¹⁶ Compl. Ex. 1 at A-53.

Similarly, Section 6.8 imposes the same duties in terms of the company's workers' compensation plan:

Upon confirmation and substantial consummation of the Plan, the Reorganizing Debtors shall continue the Worker's Compensation Programs in accordance with applicable state laws The Reorganized Debtors shall be responsible for all valid claims for benefits and liabilities under the Workers' Compensation Programs regardless of when the applicable injuries were incurred.¹⁷

The distinction between these provisions and Section 11.7, which pointedly includes no "shall" clause as to New Hayes other than providing that whatever its liabilities they are not to exceed \$10 million above the insurance, is striking. If the reorganization plan was meant to ensure that New Hayes would be responsible for indemnification, the drafters could easily have used the template provided by the rest of the reorganization agreement to reach that result. They did not do so. Thus, there is no reason to believe that Section 11.7 acts as anything other than a limitation on the Reorganized Debtors' liability, as dictated by its plain contractual language.¹⁸ Counts I and II against New Hayes must be dismissed.

¹⁷ *Id.* at A-55.

¹⁸ The court recognizes that this reading of the reorganization plan means that the directors' indemnification agreements are now guaranteed not by a publicly traded corporation, but by its wholly owned subsidiary. This is significant, in the plaintiffs' view, because Section 11.7(b)(i) of the reorganization plan provides that those rights "shall not be modified, reduced, discharged, or otherwise affected" by the reorganization other than as provided for in the rest of Section 11.7. Because the shift of Old Hayes from a public company to a subsidiary would modify the plaintiffs' expectations, the outside directors believe that the agreement should be read to preserve the plaintiffs' rights to payment from a public corporation, and thus to extend liability to New Hayes. This, simply, is not a reasonable reading of Section 11.7(b)(i). The plaintiffs' rights to indemnification are exactly as they were before the reorganization plan. Far from

B. The Procedural Structure Of The Outside Directors' Indemnification Rights

The only remaining claims for indemnification, therefore, are against Old Hayes, by virtue of the plaintiffs' indemnification agreements with that company, as authorized by the Old Hayes bylaws. In connection with those claims, the defendants argue that, whatever the plaintiffs' eventual right to indemnification, their case to compel payment is premature because they have failed to satisfy certain threshold contractual provisions of the indemnification agreements. This argument is in part dependent on the way that the defendants interpret the following language in Section 2(a) of the indemnification agreements:

In the event Indemnitee was, or becomes a party to . . . a Claim by reason of (or arising in part out of) an Indemnifiable Event, the Company shall indemnify Indemnitee to the fullest extent permitted by law as soon as practicable, but in any event no later than thirty days after written demand is presented to the Company.

In the defendants' view, this provision only makes sense if read to extend "the thought . . . beyond the word 'practicable' to include the phrase 'after written demand is presented to the Company.'"¹⁹ Read in that way, the defendants argue

implying that liability is imposed on New Hayes, the only reasonable reading of Section 11.7(b)(i) is that it exists to address exactly the concern that the plaintiffs raise; under that provision, the plaintiffs can be secure in their belief that the only change to their rights is that they are capped at \$10 million beyond the D&O insurance. If the parties meant to impose liability on New Hayes, they were required to do so expressly. This court will not look to extrinsic evidence when the reorganization agreement's meaning is otherwise so evident. *James River-Pennington Inc. v. CRSS Capital Inc.*, 1995 Del. Ch. LEXIS 22, *14 (Del. Ch. Mar. 6, 1995) ("a trial court may not consider parol evidence when interpreting a clear and unambiguous contract").

¹⁹ Defs.' Reply Br. 15.

that Section 2(a) establishes a strict demand regime for any indemnification claim. First, any potential indemnitee must make a written demand on the company. That written demand, and nothing else, triggers a thirty-day period in which the company can consider the indemnitee's request.

Under that reasoning, the plaintiffs officially initiated indemnification proceedings by presenting written demand on September 13, and not by their informal request on May 26. By filing their amended complaint only 16 days afterwards, the plaintiffs therefore deprived the company of its contractually mandated thirty-day consideration period, violated the procedural requirements of the indemnification agreements, and thus repudiated their rights to indemnification.²⁰

The defendants' arguments as to the procedural structure of Section 2(a) clearly find their foundation in the Supreme Court's decision in *Stifel Financial Corp. v. Cochran*.²¹ There, a corporation resisting an indemnification claim argued

²⁰ The defendants also apparently believe that Section 2(b) provides a second, independent, limitation on an indemnitee's right to sue before the company has issued a formal rejection of the directors' claims, based on language which requires that "if there has been no determination by the Reviewing Party or if the Reviewing Party determines that Indemnatee substantively would not be permitted to be indemnified . . . Indemnatee shall have the right to commence litigation" Compl. Ex. 2 at § 2(b). Because the defendants maintain on the basis of their equivocal September 26 letter that they have not actually refused to indemnify the plaintiffs, but have only made procedural objections to the plaintiffs' strategy in pursuing their rights, they claim that Section 2(b) strengthens their position on this motion to dismiss because the plaintiffs' right to commence litigation has not yet ripened. Like Old Hayes's principal argument, this subsidiary claim is unsupported by an unambiguous reading of the contract language.

²¹ 809 A.2d 555 (Del. 2002).

that the directors' authority to decide an indemnitee's rights to payment under 8 *Del. C.* § 145 meant that any indemnitee must make demand on the corporation before pressing his claim. The court rejected that analogy to the board of directors' power over derivative litigation or books and records actions under 8 *Del. C.* § 220, noting that the statutory nature of indemnification precluded the court from implying procedural safeguards that the legislature could itself have expressly included:

The General Assembly has spoken on the issue, and in the absence of a specific legislative restriction, we cannot engraft a requirement that creates a further bar to a statutorily created remedy.²²

The court then went on to note, however, that there was no impediment in Delaware law if a corporation itself contracted for expanded procedures:

“[F]inally, we note that Stifel was free to write a demand requirement into its bylaws, but did not.”²³

The defendants' claim, therefore, is that Section 2(a) of the indemnification agreements represents exactly the kind of expanded procedural structure, for the benefit of the indemnifying company, approved in *Stifel*. While the court stands ready to enforce such demand requirements when presented, the plain language of

²² *Id.* at 560.

²³ *Id.*

these indemnification agreements does not appear to support the defendants' proposed interpretation.²⁴

There is no indication that the indemnification provision requires the plaintiffs in this case to issue a written demand on Old Hayes.²⁵ The most likely interpretation of the disputed provision, in fact, is precisely the one the plaintiffs have presented, that Section 2(a) of the indemnification provision protects the potential indemnitee by requiring Old Hayes to respond to a request for

²⁴ In reaching this conclusion, however, the court rejects the plaintiffs' argument that the Old Hayes bylaws and the indemnification agreements provide two entirely independent sources of indemnification, and that therefore any procedural requirements for indemnification under the agreements are irrelevant to indemnification under the bylaws. Not only does such a construction of the two documents make nonsense of the indemnification agreements, but it is plainly contradicted by our cases. Most obviously, the Supreme Court was confronted with a similar situation in *Citadel Holding Corp. v. Roven*, 603 A.2d 818 (Del. 1992), where a bylaw provided indemnitees with the full range of indemnification rights available under Delaware law, and the accompanying indemnification agreement contained certain other rights. The court there assumed that the two documents would be read together, and firmly rejected the defendant's position that the indemnification agreement somehow left the advancement provision, at issue in that case, entirely unchanged. The court sees no reason to read the plainly conjunctive documents in this case any differently than the Supreme Court construed them in *Citadel*.

²⁵ The defendants rely, in part, on the authority of R. FRANKLIN BALOTTI & JESSE A. FINKELSTEIN, *THE DELAWARE LAW OF CORPORATIONS & BUSINESS ORGANIZATIONS*, §§ 4.24, 4.26 (3d ed. Supp. 2006) for their argument that corporations commonly contract to limit the rights of directors to demand indemnification. The sections of that treatise selectively excerpted in their papers, however, prove exactly the opposite point. Section 4.24, for example, explains that "the determination procedure may be critical in many indemnification cases, particularly where there has been a change of control or insolvency. To provide *an additional measure of protection to directors*, many corporations are entering into definitive and comprehensive agreements providing clear indemnification rights, procedures, and presumptions" *Id.* at § 4.24 (emphasis added). Similarly, Section 4.26 notes that "Section 145(f) may authorize the adoption of various procedures . . . to make the process of indemnification *more favorable* to the indemnitee without violating the statute. For example, such agreements or bylaws could provide for . . . (iii) *accelerated proceedings for the 'determination'* required by Section 145(d) to be made in the specific case." *Id.* at § 4.26 (emphasis added).

indemnification “as soon as practicable,” and also by allowing the plaintiffs to put Old Hayes on the clock by issuing a written demand.

This interpretation, if supported at trial, would be logically consistent with the way our courts have interpreted similar indemnification agreements in the past. In *Citadel Holding Corp. v. Roven*,²⁶ the Supreme Court was asked to decide whether an indemnification agreement provided greater rights to advancement than did the corporation’s bylaws. Relying on preliminary recitals in the indemnification agreement which explained that the indemnitee “does not regard the indemnities available under the Corporation’s Certificate of Incorporation and Bylaws and available insurance, if any, as adequate to protect him against the risks associated with his service to the Corporation[.]”²⁷ the Supreme Court held that the purpose of the agreement was to provide the director with “greater protection than he already enjoyed under the Certificate of Incorporation, Bylaws, and insurance provided by [the corporation].”²⁸ The court therefore interpreted the agreement consistently with that purpose.

The recitals in the indemnification agreements *sub judice* similarly avow their intent to protect the plaintiffs:

²⁶ 603 A.2d at 818.

²⁷ *Id.* at 819.

²⁸ *Id.* at 823.

Whereas, in recognition of Indemnatee's need for substantial protection against personal liability in order to enhance Indemnatee's service to the Company in an effective manner, the increasing difficulty in obtaining satisfactory director liability insurance coverage and Indemnatee's reliance on the aforesaid Charter and By-Laws . . . the Company wishes to provide in this Agreement for the indemnification of and the advancing of expenses to Indemnatee to the fullest extent permitted by law.²⁹

Section 2(a) can thus most reasonably be read in the same way—in favor of indemnitees—as the agreement in *Citadel*. In contrast, nothing in the indemnification agreements suggests any countervailing intent, or that the agreements were drafted with the intention to create procedural protections for Old Hayes.

Further, unlike the plaintiffs' proposed reading, which is consistent with the indemnification agreements and with Delaware law, Old Hayes's rewriting of Section 2(a) to include a purportedly dropped comma introduces a complexity for which there is no obvious justification. Contrary to the defendants' assertion, for example, our courts have had no trouble interpreting the phrase "as soon as practicable," even without an accompanying temporal limitation.³⁰ Nor do the

²⁹ Compl. Ex. 2.

³⁰ *Oberly v. Kirby*, 592 A.2d 445, 464 (Del. 1991) ("The Certificate clearly requires that there be at least three members at all times and that vacancies be filled 'as soon as practicable.' We find no merit in Fred's contention that he could not decide who was best qualified to serve the Foundation and therefore did not find it 'practicable' to appoint new members. Given the mandatory language of the Certificate, eleven years was clearly too long to delay in performing his duty as the sole member."); *AGR Halifax Fund v. Fiscina*, 743 A.2d 1188, 1197 (Del. Ch. 1999) (holding that a delay of one month in producing certain documents did not constitute a contractual failure to produce documents "as soon as practicable.").

agreements, on their face, evidence the kind of “sloppiness” that our law has suggested requires the court to redraft a contract in accordance with the manifest intent of the parties.³¹ If anything, the contract as drafted exactly follows the parties’ intent, to the extent it is evident from the complaint. In that context, it would be quite extraordinary for this court to determine on a motion to dismiss that a contract intended on its face to favor the plaintiffs included a demand requirement that would operate to hamper their rights to indemnification. Taking all facts pleaded by the plaintiffs as true, therefore, the court finds that Section 2(a) of the indemnification agreements is clear that no prior written demand for indemnification is required.

C. The Duty Of Good Faith And Fair Dealing

Independently, the defendants maintain that the plaintiffs violated their implied duties to perform the indemnification agreements with good faith and fair dealing when they refused to respond to Old Hayes’s September 26 document requests. Thus, the defendants argue, the plaintiffs are owed no performance under those agreements at this time.

³¹ *Interim Healthcare v. Spherion Corp.*, 884 A.2d 513, 555 (Del. Super. 2005). Even if the contractual language is in error, this is clearly not an issue suited for disposition under Rule 12(b)(6). In *Interim Healthcare*, for example, the court reached its conclusion to clarify contractual language *after trial*. *Id.* at 555.

Certainly, the omnipresent responsibilities of good faith and fair dealing underlie the indemnification agreements,³² as they underlie all Delaware contracts.³³ As the Supreme Court summarized the relevant law,

[T]he implied covenant requires “a party in a contractual relationship to refrain from arbitrary or unreasonable conduct which has the effect of preventing the other party to the contract from receiving the fruits of the bargain.” Thus, parties are liable for breaching the covenant when their conduct frustrates the “overarching purpose” of the contract by taking advantage of their position to control implementation of the covenant’s terms.³⁴

Thus, the court assumes that a contracting party can indeed violate the covenant of good faith and fair dealing in an indemnification agreement by withholding information. Of course, an implied covenant would be an extremely curious way for sophisticated parties to structure the exchange of key documents, but a

³² This court has, on several occasions, recognized that the implied covenant of good faith and fair dealing is an implicit part of an indemnification agreement, and has left questions of those implied duties for determination at trial. *Chamison*, 735 A.2d at 921-22 (holding that an indemnitee’s refusal of a defendant’s choice of counsel under an indemnification agreement was justified by the evidence adduced at trial because the defendant violated the implied duties of good faith and fair dealing by insisting on inadequate counsel); *Tafeen v. Homestore Inc.*, 2004 Del. Ch. LEXIS 156, *8-9 (Del. Ch. Oct. 27, 2004), *aff’d*, 888 A.2d 204 (Del. 2005) (holding, after trial, that a director who was granted advancement, but maintained an extravagant personal lifestyle, did not violate any duty under the implied covenant of good faith and fair dealing to maintain and demonstrate a financial ability to repay that advancement if unsuccessful at the indemnification stage); *Greco v. Columbia/HCA Healthcare Corp.*, 1999 Del. Ch. LEXIS 24, *22-23 (Del. Ch. Feb. 11, 1999) (holding that an indemnitee did not violate his implied duties of good faith and fair dealing by failing to inform the defendants that he was seeking advice from a third party attorney who was acting adversely to the defendants in another action).

³³ *Dunlap v. State Farm Fire and Cas. Co.*, 878 A.2d 434 (Del. 2005).

³⁴ *Id.* at 442.

contract's inelegance does not make it implausible.³⁵ Nor does the fact that Old Hayes itself seems best situated to possess the key documents completely preclude liability under this theory.

At this early stage in the litigation, however, the court can only take into account the facts as pleaded in the complaint. The complaint and the accompanying documents show only that certain, unspecified, documents were requested by Old Hayes, that some of them may already be in Old Hayes's possession, and that Old Hayes had in any case already decided not to indemnify the plaintiffs when the request was made.³⁶ Nothing in, or attached to, the complaint explains which of the requested documents is publicly available, which Old Hayes already has in its possession, or even why Old Hayes needs the entirety of the wide ranging document production set out in its September 26, 2005 letter, in addition to the documents it should already have from its own internal investigations. To highlight only two examples of these factual ambiguities, the parties appear to dispute even whether Old Hayes can be sure that the plaintiffs

³⁵ *E.g., Bonham v. HBW Holdings*, 2005 Del. Ch. LEXIS 210, *33-34 (Del. Ch. Dec. 23, 2005) (“[T]he implied duty of good faith cannot be used to create a ‘free-floating duty . . . unattached to the underlying legal document.”); *Tafeen*, 2004 Del. Ch. LEXIS at *8 (noting, in the context of an indemnification agreement that “it would be odd for the court to interpret Homestore’s bylaws as impliedly obligating Tafeen to maintain and demonstrate financial ability to repay when the express terms of Homestore’s bylaws do not require a secured undertaking or any showing of financial ability to repay”).

³⁶ Compl. ¶ 53; Compl. Ex. 8.

have actually paid their portion of the settlement for which they seek indemnification,³⁷ or whether the plaintiffs' refusal to produce the voluminous information requested might have been justified in view of Old Hayes's alleged refusal to consider any indemnification. To infer, on that undeveloped basis, that the plaintiffs in this case have violated their duties of good faith and fair dealing as a matter of law would be to stray far beyond the boundaries of a motion to dismiss and into the realm of speculation. To the extent such a claim exists, it will have to await further factual development.

D. The SEC Investigation And Ripeness

The defendants claim the court should stay the plaintiffs' indemnification action because the determination of whether the plaintiffs acted in "good faith" and in the "best interests" of Old Hayes, as required by Sections 145(a) and (d) of the Delaware General Corporation Law, cannot responsibly be made until the SEC concludes its investigation of the underlying accounting irregularities and financial restatements that gave rise to the class action. Although no Wells Notices have been issued against the plaintiffs, and no litigation is ongoing against the plaintiffs,

³⁷ Defs.' Opening Br. 25 ("Plaintiffs, however, have refused to provide Old Hayes with any documentation whatsoever regarding the bases of the settlement payment for which they seek indemnification. Not even so much as a canceled check has been offered to show that any of Plaintiffs (as opposed to some other person or persons) 'actually and reasonably incurred' the settlement amount."); Defs.' Reply Br. 20 ("Plaintiffs have also declined, despite Defendants' prompting, to explain their continued refusal to provide any evidence of even so straightforward a matter as the alleged fact that they themselves paid the \$7.2 million settlement amount . . .").

Old Hayes claims that it must wait to indemnify until the statute of limitations for action by the SEC against the plaintiffs has run in 2007, or otherwise risk violating its statutory and fiduciary duties.

The defendants' reading of the indemnification agreements and bylaws runs contrary to the plain language of the indemnification agreements, as well as to well established Delaware law. As to the former point, the bylaws are quite clear in promising indemnification for any action, "whether civil, criminal, administrative, or investigative." This standard indemnification language, by enumerating the various kinds of actions for which an indemnified party might seek remedy, clearly implies that indemnification is to be treated on a case-by-case basis: a party may be indemnified for a civil action, and may also seek indemnification for a later criminal action, if it arises.³⁸ To read this language to mean that in any case where multiple causes of action could be raised the indemnified party must wait for all relevant statutes of limitations to run, or for all other possible causes of action to be disposed of, is to eviscerate the important right of indemnification on which Delaware corporations rely to secure qualified people to serve on their boards.

³⁸ See, e.g., *Witco Corp. v. Beekhuis*, 1993 U.S. Dist. LEXIS 17289, *10 (Del. Ch. Oct. 22, 1993) (in deciding not to stay an indemnification action under 8 *Del. C.* § 145 while awaiting appeal of the underlying case, the court considered the plaintiff's entitlement to indemnification separately on three different "matters").

The defendants primarily rely on *Scharf v. Edgcomb*,³⁹ where a corporation resisting a director's indemnification claim raised the statute of limitations as a defense. The defendant in that case argued that the three-year statute of limitations for bringing an indemnification claim had begun to run when the SEC informed the plaintiff that he was unlikely to be prosecuted. More than three years later, in the corporation's view, the plaintiff was estopped from pursuing his claim. The Delaware Supreme Court rejected the defendant's argument. Holding that the statute of limitations for indemnification claims only begins to run when the indemnitee can be "confident that any claim against him . . . has been resolved with certainty,"⁴⁰ the Supreme Court ruled that the qualified nature of the SEC's assurances failed to establish that the claim against the director had been resolved, and thus the plaintiff could still timely bring his indemnification claims. Therefore, Old Hayes argues, the plaintiffs' rights to indemnification for their class action claims have also not yet accrued, because they potentially still face related SEC action on the same underlying facts.

The question presented in this case, however, is quite different than that faced by the court in *Scharf*. Here, the issue is not whether the plaintiffs' indemnification claim for any SEC investigation has begun to accrue, but whether

³⁹ 864 A.2d 909 (Del. 2004).

⁴⁰ *Id.* at 919.

the plaintiffs are due indemnification for the class action settlement, which the complaint alleges they have already paid. This court treated that separate subject in the case *Certainfeed Corp. v. Celotex Corp.*,⁴¹ where the parties disputed a contractual indemnification provision in a merger agreement, under which the seller had promised the buyer indemnification if certain losses eventuated after the merger's closing. In resisting the buyer's contractual claims, the seller argued that those claims had become barred by laches on the third anniversary of the closing date, rather than the third anniversary of when all the losses at issue had been incurred. The buyer answered by arguing that the general rule, as cited in *Scharf*, was that indemnification claims only accrue when they have been resolved with certainty. Because that could not be until all losses had actually been paid, and because that had not yet occurred, the buyer believed that his action was still timely.

The court ruled in favor of the seller, holding that the indemnification claim accrued on the date of closing. Crucially, the court reached that conclusion by differentiating the contractual indemnification claim at issue from what it termed "common law indemnification," which it defined as "a general right of reimbursement for debts owed to third parties by the [indemnifier] as a

⁴¹ 2005 Del. Ch. LEXIS 11 (Del. Ch. Jan. 24, 2005).

secondarily-liable party.”⁴² The “indemnification” at issue in *Certainfeed*, the court held, was a term of art designed to describe a particular contractual remedy between two parties. Common law indemnification, in contrast, involves the responsibility of a third party to pay for another’s liability. In those cases, “a cause of action [for indemnification] accrues after the party seeking indemnification has made payment to the third party and the dispute with that party is finally concluded.”⁴³ In other words, a claim for indemnification in the common law sense is defined by reference to a particular action, and becomes legally cognizable when payment is made to a third party on that action specifically.⁴⁴

The indemnification provision in this case, of course, is a paradigmatic example of third-party indemnification. Indeed, it is precisely the kind of indemnification that was at issue in *Scharf*, on which the *Certainfeed* decision relies.⁴⁵ The plaintiffs here wish to be indemnified by Old Hayes for liability to a third party. Further, the complaint alleges that the plaintiffs have paid \$7.2 million to certain claimants as part of a \$27.5 million class action settlement. The outside directors therefore settled a particular claim for which a sum certain was due and

⁴² *Id.* at *10.

⁴³ *Id.* at *8.

⁴⁴ Numerous other state and federal courts have recognized that this understanding of indemnification is a blackletter rule of common law. *See, e.g., McDermott v. New York*, 50 N.E.2d 460, 461-62 (N.Y. 1980).

⁴⁵ *Certainfeed*, 2005 Del. Ch. LEXIS, at *8.

allegedly paid on June 1, 2005. In other words, the plaintiffs have suffered an indemnifiable injury, separate from any injury they may suffer as a result of the pending SEC investigation.⁴⁶ That the SEC action concerns, in part, the same facts does not preclude a current indemnification demand. Under the language of the indemnification agreements, the plaintiffs may pursue indemnification for the class action claims now, and may also seek indemnification for the SEC action if and when it is brought.

The defendants are right to note that Section 145 requires the board of an indemnifying company to make a full determination of whether the plaintiffs are due indemnification, including an investigation as to whether the indemnitee has acted in good faith, and in a manner reasonably believed to be in or not opposed to the best interests of the corporation.⁴⁷ This duty could be made easier if the SEC

⁴⁶ In *Simon v. Navellier Series Fund*, 2000 Del. Ch. LEXIS 150 (Del. Ch. Oct. 19, 2000), this court noted it maintained the right, as a matter of “litigative efficiency,” to stay indemnification claims where an appeal of the underlying case was pending. As the court observed, in a case where the reason that the plaintiff had a right to indemnification was that the trial court had found in his favor, the court should be wary of granting indemnification when “any prior decision on [the claim] for indemnification might be undone depending on the basis of the [appeal court’s] ruling.” *Id.* at *33. The defendants rely on *Simon* for their belief that this court should stay the current proceeding until the SEC investigation is concluded. In contrast to *Simon*, however, the only effect of the SEC investigation here would be to unearth additional information about the plaintiffs’ behavior. If the SEC pursues a claim, and if that claim is ever brought to trial, it can have no legal effect whatsoever on the settlement reached by the outside directors and their insurers with the class action plaintiffs. This case presents none of the concerns about judicial efficiency, therefore, which were behind the court’s observations in *Simon*.

⁴⁷ DONALD J. WOLFE, JR. & MICHAEL A. PITTENGER, CORPORATE AND COMMERCIAL PRACTICE IN THE DELAWARE COURT OF CHANCERY § 8.2(a) (2005).

investigation produces additional information. Further, waiting to make a decision about indemnification could relieve the Old Hayes board from the uncomfortable position of voluntarily indemnifying the plaintiffs, and then later discovering that the SEC believes them liable on the basis of facts that suggest a lack of good faith. With \$7.2 million at stake, the defendants reasonably believe that such a mistake would expose them to suit from their own stockholders.

As reasonable as those concerns are, however, they cannot abrogate Old Hayes's responsibility to make a decision about the plaintiffs' indemnification rights with regard to the class actions, which, under our law, have definitively been concluded, and as a result of which the plaintiffs have paid a substantial amount of money from their own pockets.

V.

For the foregoing reasons, the defendants' motion to dismiss is DENIED IN PART and GRANTED IN PART. IT IS SO ORDERED.