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Case No. 2362-VCL

IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

RICHARD SCHOON, et al.,	)	
	)	
Plaintiffs,	)	
	)	
v.	)	C.A. No. 2362-VCL
	)	
TROY CORPORATION, a Delaware corporation,	)	
	)	
Defendant.		

DEFENDANT'S SUPPLEMENTAL BRIEF REGARDING APPLICATION OF *LEVY v. HLI OPERATING CO., INC.*

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I. Procedural Background[1]

On November 30, 2007, the Court heard oral argument on Plaintiffs Bohnen's[2] and Schoon's motion for summary judgment and Defendant Troy's cross-motions for judgment on the pleading or for summary judgment. Following oral argument, the Court instructed the parties to submit supplemental briefing regarding the impact of the Court's recent decision in *Levy v. HLI Operating Co., Inc.*, 924 A.2d 210 (Del. Ch. 2007) on the instant action. This is Troy's supplemental brief regarding *Levy*.

II. The Relevant Facts And Holdings From *Levy*

The plaintiffs in *Levy* were six former directors of HLI Operating Company ("Old Hayes"), who were named as defendants in multiple securities lawsuits relating to restatements of Old Hayes' financial results. *Id.* at 214. Old Hayes ultimately filed for Chapter 11 bankruptcy and, pursuant to the plan of reorganization, emerged as an operating subsidiary of the newly created Hayes Lemmerz International, Inc. ("New Hayes"). *Id.*

In 2005, the *Levy* plaintiffs agreed to pay $1.2 million each to settle certain of the securities lawsuits. *Id.* The plaintiffs sought indemnification from both Old Hayes and New Hayes pursuant to their indemnification rights under the Old Hayes bylaws, their personal indemnification agreement with Old Hayes and their rights under the bankruptcy reorganization plan. *Id.* at 214-15. Old Hayes and New Hayes rejected the *Levy* plaintiffs' indemnification

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[1] Unless otherwise noted, the defined terms herein have already been defined in Defendant's opening brief in support of Defendant's motion for judgment on the pleadings or for summary judgment and opposition to Plaintiffs' motion for summary judgment. Citations in the form "DOB _" are to that brief. Citations to "POB _" are to Plaintiffs' opening brief in support of Plaintiffs' motion for summary judgment. Citations to "PAB _" are to Plaintiffs' combined answering brief in opposition to Defendants' motion for judgment on the pleadings or in the alternative for summary judgment and reply brief in support of Plaintiffs' motion for summary judgment. Citations to "DRB _" are to Defendant's reply brief in support of Defendant's motion for judgment on the pleadings or for summary judgment.

[2] Although William Bohnen passed away after initiating this action and has since been substituted by his Estate, for purposes of this brief, his Estate when not referred to as a plaintiff is referred to as "Bohnen."

request, but agreed, pursuant to the indemnification agreements, to advance the *Levy* plaintiffs' attorneys' fees and costs associated with the indemnification suit. *Id.* at 216. In response, the *Levy* plaintiffs filed suit. *Id.* at 216.

During discovery, it was revealed that only two of the *Levy* plaintiffs personally paid their portions of the settlement, while the remaining four plaintiffs (the "JLL Representatives") had their portions of the settlement paid by Joseph Littlejohn & Levy Fund II, L.P. (the "JLL Fund") pursuant to indemnification rights they possessed as representatives of the JLL Fund on the Old Hayes board of directors. *Id.* at 216-17. Old Hayes then stopped advancing litigation expenses and promptly sought summary judgment. *Id.* at 217-18.

Old Hayes argued that the JLL Representatives had no contractual right to indemnification from Old Hayes because the JLL Representatives were only entitled to indemnification for amounts paid from their own pockets (*i.e.*, what the JLL Representatives "actually incurred"). *Id.* In addition, Old Hayes argued that because the JLL Representatives never had a claim for indemnification, they must reimburse the company for the attorneys' fees and expenses advanced to them during the indemnification suit. *Id.* at 218. The Court agreed.

The Court first held that the JLL Representatives lacked standing to pursue their indemnification claims because the JLL Representatives suffered no actual loss as a result of the settlement and were therefore not real parties in interest. *Id.* at 213, 222-23. The Court explained that the JLL Representatives "enjoyed the fullest-extent-of-the-law indemnification rights under two separate contracts — one with the corporation [Old Hayes] and one with the stockholder responsible for [their] election to the board [the JLL Fund]." *Id.* at 221. Accordingly, the Court found that the JLL Representatives were only entitled to indemnification for monies paid out of their own pockets, but they were not entitled to indemnification for

monies paid on their behalf by the JLL Fund. Since their indemnifiable expenses were paid in full by the JLL Fund, the JLL Representatives did not suffer any out-of-pocket loss and, therefore, the Court held that they lacked standing to bring a claim for indemnification. *Id.* at 213, 222-23.

Consequently, the Court next held that because the JLL Representatives "suffered no actual loss as a result of the settlement and are therefore not real parties-in-interest, the appropriate cause of action . . . is a claim for contribution against the corporation [Old Hayes] by the entity [the JLL Fund] which paid more than its equitable share of the amounts subject to indemnification." *Id.* at 213. The Court explained that "[a]n equitable right of contribution arises when one of several obligors are liable on a common debt discharges all, or greater than its share, of the joint obligation for the benefit of all the obligors." *Id.* at 220. The Court's analysis was guided, in part, by this Court's decision in *Chamison v. HealthTrust, Inc.*, 735 A.2d 912 (Del. Ch. 1999). There the Court consulted insurance law principles and noted that a co-indemnitor, who fully-satisfies a joint indemnification obligation shares with a co-indemnitor covering the same indemnitee, has a cause of action for equitable contribution against the co-indemnitor. *Id.* at 925-26.

The Court in *Levy* finally addressed the ability of a corporation to obligate itself to advance fees in a "fees-on-fees" case. The Court invalidated a provision in the plaintiffs' indemnification agreement that purported to require Old Hayes "to indemnify the plaintiffs for fees and expenses incurred in [an indemnification] action regardless of their success on the merits . . . ." *Levy*, 924 A.2d at 227. The Court reasoned that "[a] contractual agreement for indemnification of fees on fees . . . cannot overstep [the] bright-line legal boundary" set forth in *Fasciana v. Elec. Data Sys. Corp.*, 829 A.2d 178 (Del. Ch. 2003), which instructed "that a

litigant's partial success in an indemnification action leads to partial indemnification of the litigant's fees commensurate with the extent of the victory." *Levy*, 924 A.2d at 225 (internal quotations and citation omitted). This Court also reasoned that Section 145(e) of the DGCL "requires the same result," and that "[t]he legislature could not have enacted such a provision and simultaneously intended that a corporation could contractually provide final reimbursement for such expenses regardless of the director's ultimate right to indemnification." *Id.* at 226. This Court concluded that as a matter of public policy "[t]he law should not encourage directors and officers to bring non-meritorious indemnification claims against the corporation, and the provision at issue here clearly creates a perverse incentive to do so." *Id.* at 226. Accordingly, the Court held that Old Hayes is entitled to recover the *pro rata* portion of the fees and expenses it advanced the JLL Representatives (4 of the 6 plaintiffs) because the JLL Representatives achieved no success in their underlying indemnification claims. *Id.* at 227.

III. Plaintiffs Lack Standing To Pursue This Action

Plaintiffs lack standing to pursue this action for advancement and indemnification. Under Troy's Bylaws, Certificate of Information and under Section 145 of the DGCL, Troy is only empowered to advance or indemnify expenses "actually incurred." *See generally* DEL. CODE ANN. tit. 8, § 145 (2007) (repeatedly referring to expenses actually incurred); POB Exh. B (same). Indemnitees, like Plaintiffs, who have actually incurred no fees lack standing to seek indemnification and advancement. *Levy*, 924 A.2d at 213, 222-23 (explaining that indemnitees lack standing to pursue indemnification claims where they incur no actual expenses (*i.e.*, they were not out-of-pocket any expenses)). Because Plaintiffs concede that Steel has paid their litigation expenses, they have not actually incurred any of the fees they seek to have indemnified

and, therefore, their suit should be dismissed and the fees advanced to date should be returned to Troy. *See* DOB at 26; DRB at 18; Rostocki Aff., Exh. Q; POB Exh. JJ (Schoon Dep. Tr. at 4-5, 41).

IV. Steel Has No Equitable Right Of Contribution Against Troy

Troy respectfully submits that there exists no equitable right of contribution in this case, because Troy had no obligation to advance or indemnify the fees at issue here, which were largely incurred in the 220 Action in which Schoon was unsuccessful on the merits and in which the Court determined that both Schoon and Bohnen had an undisclosed conflict of interest. The 220 Action is final and indemnification is disallowed under Section 145 of the DGCL and Troy's Certificate of Incorporation and Bylaws under such circumstances.

Levy stated that "[a]n equitable right of contribution arises when one of several obligors ***liable on a common debt*** discharges all, or greater than its share, of the ***joint obligations*** for the benefit of all the obligors. To succeed on a contribution claim, a party must show ***concurrent obligations*** existed to the same entities, and that the obligors essentially incurred the same interests and the same risks." 924 A.2d at 220 (emphasis added). Here, there was no joint or concurrent obligation between Steel and Troy to either advance or indemnify the disputed expenses at issue.

Steel's Bylaw provisions regarding indemnification state:

> Section 1. No person shall be liable to the company for any loss or damage suffered by it on account of any action taken or omitted to be taken by him as a director or officer of the company, in good faith, if such person (a) exercised or used the same degree of care and skill as a prudent man would have exercised or used under the same circumstances in the conduct of his own affairs, or (b) took or omitted to take such action upon the advice of counsel, or upon statements made or information furnished by officers or employees of the company which he had reasonable grounds to believe.
>
> Section 2. Each director or officer of the company, whether or not then in office, shall be held harmless and indemnified by the company against all claims and liabilities and all expenses reasonably incurred or imposed upon him in

> connection with or resulting from any action, suit or proceeding, or the settlement or compromise thereof, and against all expenses reasonably incurred by him in connection with or resulting from the preparation for defense of any action, suit or proceeding which may be threatened, through which he is or may be made a party by reason of any action taken or omitted to be taken by him as a director or officer of the company, in good faith, if such person (a) exercised and used the same degree of care and skill that a prudent man would have exercised or used under the same circumstances in the conduct of his own affairs, or (b) took or omitted to take such action in reliance upon advice of counsel or upon statements made or information furnished by officers or employees of the company which he had reasonable grounds to believe.
>
> Section 3. The right of indemnification as provided for in this Article shall not be exclusive of other rights to which any director or officer may be entitled as a matter of law.

See Rostocki Aff., Exh. R. Steel's Bylaws do not explicitly address advancements, other than to state that Sections 1 and 2 of Article V are not "exclusive of other rights to which any director or officer may be entitled as a matter of law." *Id.* Steel's Certificate of Incorporation states: [Steel] shall to the fullest extent permitted by Section 145 of the Delaware General Corporation Law, as amended from time to time, indemnify all person whom it may indemnify pursuant thereto." *Id.*

Plaintiffs' advancement rights under Troy's Bylaws are as follows:

> Section 9: Expenses Payable in Advance. Losses reasonably incurred by a director or officer in defending any threatened or pending Proceeding (or as provided in Section 7 of this Article) shall be paid by the Corporation in advance of the final disposition of such 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 Article. Losses incurred by other employees may be so paid upon such terms and conditions, if any, as the Board of Directors deems appropriate.

POB, Exh. B at 4.[3] Under Article VIII, Section 1 of the Troy's Bylaws, the term "Proceeding" is defined as "any threatened, pending or completed action, suit or proceeding, whether civil,

[3] *See also* Paragraph EIGHTH, Section 9 of Troy's Certificate of Incorporation. POB, Exh. B at 8-9. Article VIII of Troy's Bylaws and Paragraph EIGHTH of Troy's Certificate of Incorporation contain corresponding, nearly identically-worded provisions.

criminal, administrative or investigative," and the term "Losses" is defined as "all expense, liability and loss (including, without limitation, attorneys' and other professionals' fees and expenses, claims, judgments, fines, ERISA excise taxes or penalties and amounts paid in settlement) reasonably incurred or suffered" in connection with a Proceeding. POB, Exh. B at 1.[4] Plaintiffs' advancement and indemnification rights are further limited by Article VIII, Section 7 of the Troy Bylaws, which state:

> Section 7. Proceedings Initiated by Indemnified Persons. Notwithstanding any provisions of this Article to the contrary, the Corporation shall not indemnify any person or make advance payments in respect of Losses to any person pursuant to this Article in connection with any Proceeding (or portion thereof) initiated against the Corporation by such person unless such Proceeding (or portion thereof) is authorized by the Board of Directors or its designee; provided, however, that this prohibition shall not apply to a counterclaim, cross-claim or third-party claim brought in any Proceeding or to any claims provided for in Section 8 of this Article.

POB, Exh. B at 3.[5] The right to indemnification is provided under Article VIII, Section 1 of the Troy Bylaws to a person who "is made a party or is threatened to be made a party to or is otherwise involved in" a Proceeding "by reason of the fact . . . that he or she is or was a director or officer of the Corporation." POB, Exh. B at 1.[6]

Thus, under Troy's Certificate of Incorporation and Bylaws, advancement shall be paid for losses (i) incurred by a Troy director or officer, (ii) in defending a proceeding, (iii) brought against him, (iv) by reason of fact that he is or was a Troy director or officer. However, advancement shall not be paid and indemnification is not required (and in fact prohibited) for

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[4] *See also* POB, Exh. B at 5-6.

[5] *See also* POB, Exh. B at 8. Section 8 of Article VIII of Troy's Bylaws (and Section 8 of Paragraph EIGHTH of Troy's Certificate of Incorporation) concerns application to a court for indemnification.

[6] *See also* POB, Exh. B at 5.

losses incurred in connection with a Proceeding initiated by that person against Troy, other than for counterclaims, cross-claims, or third-party claims brought by Troy in such a Proceeding.

For the reasons previously set forth, with respect to the expenses at issue, Troy has no obligation to advance or indemnify Plaintiffs in connection these expenses. *See* DOB at 22-41; DRB at 12-30.[7] Thus, Troy owed no joint or concurrent obligation with Steel with respect to the disputed expenses purportedly incurred by Plaintiffs, and for the reasons already set forth, Troy's motion for judgment on the pleadings or for summary judgment should be granted.

Even if the Court were to find that Steel and Troy were jointly obligated with respect to these disputed expenses, only then would this case turn into one for equitable contribution. It is undisputed that Steel has already paid Plaintiffs the disputed expenses. *See* DOB at 26; DRB at 18; Rostocki Aff., Exh. Q; POB Exh. JJ (Schoon Dep. Tr. at 4-5, 41). *Levy* makes clear that because the disputed expenses did not come out of Plaintiffs' pockets, but rather from Steel, Plaintiffs are not entitled to advancement or indemnification of the monies already paid by Steel. Thus, Plaintiffs would lack standing to bring this advancement and indemnification action and Steel would be the proper party for an equitable contribution claim.

V. Plaintiffs Are Not Entitled To "Fees On Fees"

In *Levy*, the court also held that the provision in the JLL Representatives' indemnification agreements that permitted them to retain fees advanced to them to prosecute an ultimately unsuccessful indemnification claim was void as contrary to Delaware law and public policy. 924 A.2d at 226-27. The Supreme Court held in *Stifel Fin. Corp. v. Cochran*, 809 A.2d 555 (Del. 2002) that Section 145(a) of the DGCL permits indemnification for expenses incurred in successfully prosecuting an indemnification suit. *Id.* at 565. This Court has interpreted

[7] Arguably, Steel was not obligated to advance Plaintiffs the disputed expenses and arguably was not obligated to indemnify Steel with respect to the disputed expenses.

entitlement to fees on fees under *Cochran* as hinging on success in the underlying indemnification action. *See, e.g., Fasciana*, 829 A.2d at 184 (holding that partial success in an indemnification suit yields only partial indemnification of that suit's fees). *Levy* carried this logic a step further, holding that an indemnification provision mandating fees on fees must be conditioned on the indemnitee's success in the underlying indemnification action, or declared void. This result is consistent with Section 145(e) of the DGCL, which, according to *Levy*, "is best read as limiting a corporation's power to indemnify fees on fees to those situations where success is achieved on the underlying claim." 924 A.2d at 226. The holding also furthers sound public policy by discouraging frivolous indemnification claims. *Id.* Consequently, Old Hayes was entitled to recover the *pro rata* portion of fees and expenses it advanced on behalf of the directors who unsuccessfully pursued indemnification claims (*i.e.*, 4 of the 6 plaintiffs — the JLL Representatives).

Based on this holding in *Levy*, Plaintiffs are only entitled to fees on fees incurred in this advancement action in proportion to the level of Plaintiffs' success in this action. Plaintiffs, just like the JLL Representatives in *Levy*, are not entitled to indemnification of their fees in pursuing this action because they were ultimately unsuccessful since they lacked standing. And even if the Court finds that Plaintiffs have standing notwithstanding the holding in *Levy*, Plaintiffs are still not entitled to any fees on fees in pursuing this action because, as already set forth by Troy, Plaintiffs are not entitled to the advancements and indemnification they pursue in this action. *See* DOB at 22-41, DRB at 12-30.

VI. Conclusion

Based on the foregoing analysis, Troy respectfully submits that this action should be dismissed because Plaintiffs lack standing and Plaintiffs should be required to return to Troy the fees advanced to date.

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Dated: December 31, 2007

CERTIFICATE OF SERVICE

I hereby certify that copies of **Defendant's Supplemental Brief Regarding Application Of *Levy v. HLI Operating Co., Inc.*** and **Transmittal Affidavit Of Brian M. Rostocki** with **Exhibit R** were caused to be served via e-Service on December 31, 2007 on the following counsel:

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