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UNPUBLISHED OPINION. CHECK COURT RULES BEFORE CITING.

Court of Chancery of Delaware.
Michael T. REDDY, Plaintiff,
v.
ELECTRONIC DATA SYSTEMS
CORPORATION, a Delaware corporation,
Defendant.
No. CIV.A. 19467.

Submitted: June 12, 2002.

Decided: June 18, 2002.

[David S. Eagle](#), Esquire, of Klehr, Harrison, Harvey, Branzburg & Ellers, Wilmington, Delaware; [Bryan C. Skarlatos](#) and [Caroline Rule](#), Esquires, of Kostelanetz & Fink, New York, New York, Attorneys for Plaintiff.

[Michael Hanrahan](#) and [Bruce E. Jameson](#), Esquires, of Prickett, Jones & Elliott, Wilmington, Delaware, Attorneys for Defendant.

MEMORANDUM OPINION
[STRINE](#), Vice Chancellor.

*1 In this case, plaintiff Michael T. Reddy seeks advancement of his litigation expenses for two lawsuits pending against him. He contends that both suits were brought by reason of his service as an employee at defendant Electronic Data Systems Corporation ("EDS"). Stated more concretely, Reddy argues that both the suits he must defend accuse him of on-the-job misconduct he allegedly committed as an executive employee of EDS. Because he faces liability based on his acts as an employee, Reddy submits that the mandatory advancement provisions of the EDS bylaws are implicated and require EDS to advance him his reasonable litigation costs.

In this opinion, I resolve EDS's motion to dismiss Reddy's claim, and Reddy's motion for summary judgment. Based on the undisputed facts in the record, I conclude that Reddy is entitled to advancement under EDS's bylaws. Therefore, he is entitled to summary judgment, and I deny EDS's

motion to dismiss.

I.

The origins of this dispute can be traced to the purchase of FACS Incorporated ("FCI") by EDS in 1995. At the time of purchase, FCI was headed by Reddy. Among its business activities, FCI performed asset recovery services involving the identification of funds that had been erroneously escheated as abandoned property. In seeking to recover assets, FCI would examine the records of its clients (e.g., custodial banks) to find bookkeeping mistakes that resulted in the mistaken identification of property as having no known owner. Similarly, FCI also reviewed funds that had been earmarked by clients for escheatment, but not yet escheated. In either circumstance, FCI would be paid a percentage of any funds it identified that were not subject to escheatment.

EDS bought FCI under the terms of a stock purchase agreement calling for an initial payment of \$9 million to FCI stockholders, the largest of whom was Reddy. An additional \$3 million was escrowed and placed in an account held by FCI's attorney. Two million dollars of these funds could be earned by the former FCI stockholders, subject to FCI's performance during the remainder of 1995. The other \$1 million could be earned if certain performance targets were achieved and certain outstanding receivables of FCI were collected.

FCI's post-purchase performance was to occur under the rubric of Global Financial Markets Group ("GFMG"), [\[FN1\]](#) the new EDS business division created to operate the purchased FCI operations. After the sale, Reddy became division vice-president of the larger EDS strategic business unit of which GFMG was a part. Despite his title, Reddy was not an officer of EDS under its bylaws, but simply an employee. In connection with his new position, Reddy entered into both an employment agreement and an incentive compensation agreement with EDS. Under the incentive compensation agreement, Reddy and other former FCI stockholders could receive up to \$14 million in incentive compensation payments over a three-year period beginning in 1996. [\[FN2\]](#) These payments were tied to the earnings of GFMG.

[FN1.](#) GFMG had a prior name. For the sake

of clarity, however, I will refer only to GFMG.

[FN2](#). There were later amendments to these contracts, the substance of which are not relevant.

*2 In 2001, two actions were filed against Reddy arising out of his conduct as an employee of EDS. Both allege that Reddy engaged in financial fraud against EDS during the performance of his official duties as GFMG's manager.

The first action filed against Reddy is a criminal action brought by the United States Attorney for the Southern District of New York (the "Criminal Action"). The Criminal Action involves charges of conspiracy, mail fraud, and wire fraud arising out of three basic allegations of wrongdoing:

- First, the indictment alleges that Reddy and others improperly caused GFMG to record as 1995 income certain monies obtained from fees from pre-escheatment work performed for two large clients. Reddy supposedly recorded this income despite knowing that GFMG had no basis to conclude that the client funds out of which GFMG was to be paid a percentage as its fee were not subject to escheatment. The motive for this misbehavior, it is alleged, was to help GFMG meet a contractual performance target, thus increasing payments to Reddy and other former FCI stockholders from the escrowed funds.
- Second, the indictment alleges that Reddy and others falsely recorded income in 1997 based on claims that GFMG had supposedly made to state escheators for return of erroneously escheated client funds, although such claims had not in fact been filed. Later, these non-existent 1997 claims were replaced by claims made in 1998. The nefarious purpose for these acts, it is said, was to increase the incentive compensation payments made to Reddy and others.
- Third, the indictment charges that Reddy and others falsely recorded revenue as having resulted from what in fact remained uncollectable receivables. Reddy and others also caused payments for work done by GFMG after EDS purchased FCI to be recorded as if it was performed by FCI before the purchase. The purpose of these actions, the allegation goes, was to make it appear that the former FCI stockholders were entitled to the escrowed funds.

In sum, the Criminal Action alleges that Reddy purposely manipulated the financial records of EDS to increase the payments he would receive from the escrowed funds and the incentive compensation agreement. In accomplishing his ends, Reddy is alleged to have conspired with the attorney holding the escrowed funds, who helped by falsifying and mislabeling financial entries and payments in order to create the false impression that the pre-requisites for release of those funds to the former FCI stockholders had been met.

The second action was filed against Reddy by EDS itself (the "EDS Action") and is based on the same conduct alleged in the Criminal Action. That is, the EDS Action contends that Reddy manipulated and falsified the financial records of GFMG to inflate improperly the incentive compensation and escrowed funds payments to him and other former FCI stockholders, and to conceal his wrongdoing.

The complaint in the EDS Action avers that this misconduct is actionable as: i) negligence; ii) gross negligence; iii) common law fraud; and iv) breaches of Reddy's employment agreement and the incentive compensation agreement. Among other relief, the complaint seeks tens of millions of dollars in damages to remedy the overpayments supposedly harvested by Reddy and former FCI stockholders, and liabilities incurred by EDS to clients and state escheators because of Reddy's conduct in falsely identifying client funds as not subject to escheatment.

II.

*3 Reddy demanded advancement for both the Criminal and the EDS Action. EDS refused to provide it. Reddy then brought this lawsuit, alleging that he was due advancement under the EDS bylaws.

The parties then agreed that the case could be most efficiently decided if each side filed a dispositive motion. For its part, EDS has filed a motion to dismiss for failure to state a claim, and a motion to dismiss or stay in favor of the EDS Action. Meanwhile, Reddy has filed a motion for summary judgment.

The procedural standards for each motion are well-settled and need not be repeated. In deciding these motions, both sides agree that I may consider the plain terms of two key documents, the indictment in the Criminal Action and the amended complaint in the EDS Action. [FN3](#) The words of those

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instruments, when considered in light of the requirements of EDS's bylaws, [§ Del. C. § 145](#), and prior cases, form the foundation for my ruling. The only factual dispute raised in the briefs is whether Reddy engaged in the wrongdoing that is alleged in the two actions for which he seeks advancement. That dispute of fact is not a material one, however, in this action for advancement, and does not preclude the entry of a dispositive order.

[FN3](#). EDS contends that the documents were incorporated by reference in Reddy's complaint.

With this procedural context in mind, I turn to the parties' contending arguments.

III.

A.

Reddy contends that he is due advancement under the advancement provision in the EDS bylaws, which he asserts imposes a mandatory obligation on EDS to advance funds to former employees facing charges of official misconduct in their capacities as employees of EDS. By contrast, EDS argues that its bylaws simply give its board the discretion to advance funds to Reddy if they choose to do so, which they do not.

The bylaw provision in question reads:

Each person who at any time shall serve or shall have served as a Director, officer, employee or agent of the Corporation ... shall be entitled to (a) indemnification and (b) the advancement of expenses incurred by such person from the Corporation as, and to the fullest extent, permitted by [Section 145](#) of the DGCL or any successor statutory provision, as from time to time amended. [\[FN4\]](#)

[FN4](#). EDS Bylaws, Art. 6.1 (emphasis added).

Although EDS contends otherwise, the plain import of this provision is to require EDS to advance funds to former employees like Reddy if [§ 145](#) of the DGCL would permit it to do so. By its own scrivener's hand, EDS has bound itself to advance funds to Reddy so long as the DGCL allows it to do so.

The pertinent parts of [§ 145](#) of the DGCL state:

(e) 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.

*4 (f) The indemnification and advancement of expenses provided by, or granted pursuant to, the other subsections of this section shall not be deemed exclusive of any other rights to which those seeking indemnification or advancement of expenses may be entitled under any bylaw, agreement ... or otherwise, both as to action in such person's official capacity and as to action in another capacity while holding such office. [\[FN5\]](#)

[FN5. § Del. C. § 145\(e\), \(f\).](#)

These capacious provisions of our law clearly provide corporations with the flexibility to advance litigation expenses to former employees like Reddy. Indeed, EDS fails to dispute this point, recognizing the implausibility that the DGCL would prevent corporations from granting the protection of advancement to former employees.

Instead, EDS falls back on the argument that its own bylaws do not mean what they plainly say, which is that former employees are entitled to advancement if the corporation is statutorily authorized to accord it to them. This argument rests on the supposed linguistic distinction between the words "shall be entitled to ... the advancement [if the DGCL permits]" in the EDS bylaws and the words "shall advance if the DGCL permits." The former are argued to simply express the idea that EDS could--if it so chose in its discretion--advance expenses to former employees. The latter, by contrast, would impose a binding obligation on EDS to advance funds.

I fail to discern the logic behind this supposed distinction, however. The wordier language of the EDS bylaws granting Reddy an entitlement has the same meaning as the simpler language EDS claims would be mandatory.

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EDS makes another argument that also seeks to shift the burden of the company's drafting decisions to Reddy. That argument rests on the absence of any language in the EDS bylaws dealing with the conditions the company may impose on former employees who invoke their right to advancement--in particular, the failure of the bylaws to require former employees to execute an undertaking to repay the advanced funds.

Because directors and officers who seek advancement must--by statute--execute an undertaking, [FN6] EDS argues that its bylaws cannot reasonably be read as providing mandatory advancement to former employees. Otherwise, former employees would have greater rights than current directors and officers, a result that EDS considers anomalous.

[FN6. See 8 Del. C. § 145\(e\).](#)

The anomaly to which EDS points, however, is one authorized by [§ 145\(e\)](#) itself. The General Assembly specifically amended that statutory subsection to give corporations the flexibility to advance funds to employees and agents without an undertaking. [FN7] In lieu of this required undertaking, corporations may specify by bylaw or contract the terms and conditions upon which employees and agents may receive advancement, which could include an undertaking and more onerous pre-requisites to advancement. Having been accorded the freedom to craft its bylaws as it wished, EDS cannot point to its own drafting failures as a defense to Reddy's advancement claim, however. If it chose, EDS could have conditioned former employees' advancement rights on an undertaking, proof of an ability to repay, or even the posting of a secured bond. But it did not do so.

[FN7.](#) The evolution of [§ 145\(e\)](#) suggests that the General Assembly intended to mandate that an undertaking be received only from directors and officers, and not from other possible indemnitees, such as former employees. In 1983, the requirement that employees or agents execute an undertaking was dropped from the statute, leaving corporations free to set the conditions on which advancement to them would take place. See 64 Del. Laws. Ch. 112, § 7 & commentary (1983).

*5 As a practical matter, moreover, I fail to see the

great danger to the corporate republic posed by the lack of a formal undertaking. As the Supreme Court has noted, all contracts for advancement and indemnification are subject to an implied reasonableness term. [FN8] When that implied term is utilized in concert with the actual language of the EDS bylaw in question, no horrific scenario arises. Rather, by accepting payments expressly termed an "advancement," Reddy necessarily acknowledges that his ultimate right to keep those payments depends on whether his underlying conduct is indemnifiable. If his conduct is not the proper subject of indemnification by EDS, Reddy must repay the funds advanced to him by the corporation. His counsel readily conceded this principle in the argument of these motions, and Reddy is bound by that representation.

[FN8. Citadel Holding Corp. v. Roven, 603 A.2d 818, 823 \(Del.1992\).](#)

B.

EDS's next argument is that Reddy is not entitled to any advancement payments because he is a party to neither the Criminal Action nor the EDS Action "by reason of the fact that" he was an "employee" of EDS. [FN9] The foundation for this argument rests in the proposition that Reddy's motivation for the allegedly wrongful actions he took as an EDS employee was personal--*i.e.*, the desire to increase the amount of escrowed funds and incentive compensation payments he and other former FCI stockholders would receive. As a result of this personal motivation, EDS claims that the conduct for which Reddy is being prosecuted civilly and criminally does not implicate the policy concerns addressed by [§ 145](#), which broadly empowers corporations to provide advancement and indemnification to corporate employees.

[FN9. 8 Del. C. § 145\(a\), \(b\).](#)

The problem with EDS's argument is that it has no logical stopping point. It is not uncommon for corporate directors, officers, and employees to be sued for breach of the fiduciary duty of loyalty, and to have to defend claims that they took official action for the primary purpose of diverting corporate resources to their own pocketbooks--in the form of contractual compensation benefits (*e.g.*, severance payments or stock options) or an unfair return on a self-dealing transaction. Therefore, it is highly problematic to make the advancement right of such

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officials dependent on the motivation ascribed to their conduct by the suing parties. To do so would be to largely vitiate the protections afforded by [§ 145](#) and contractual advancement rights.

Corporate advancement practice has an admittedly maddening aspect. At the time that an advancement dispute ripens, it is often the case that the corporate board has drawn harsh conclusions about the integrity and fidelity of the corporate official seeking advancement. The board may well have a firm basis to believe that the official intentionally injured the corporation. It therefore is reluctant to advance funds for his defense, fearing that the funds will never be paid back and resisting the idea of seeing further depletion of corporate resources at the instance of someone perceived to be a faithless fiduciary. [\[FN10\]](#)

[FN10](#). Cf. [Greco v. Columbia/HCA Healthcare Corp.](#), 1999 WL 1261446, at *11 (Del. Ch.) ("An indemnification dispute between a corporation and a former officer is in many respects akin to a corporate divorce proceeding. Emotions run high, feelings are frayed, and former friends and colleagues find themselves at odds.").

*6 But, to give effect to this natural human reaction as public policy would be unwise. Imagine what EDS believes to be unthinkable: that the United States government and EDS are in fact wrong about Reddy. What if he in fact did not falsify records? What if he in fact did not do anything that was even grossly negligent? In that circumstance, it would be difficult to conceive of an argument that would properly leave him holding the bag for all of his legal fees and expenses resulting from two cases centering on his conduct as an employee of EDS. That result would make the promise made to Reddy in the EDS bylaws an illusory one.

For these reasons, this court has often been required to uphold the indemnification and advancement rights of corporate officials accused of serious misconduct, because to do otherwise would undermine the salutary public policies served by [§ 145](#). In the recent case of *Perconti v. Thornton Oil Co.*, for example, this court made clear that a suit is brought "by reason of a" defendant's corporate function when the "conduct resulting in the prosecution was done in his capacity as a corporate officer." [\[FN11\]](#) That case involved a corporate

officer whose criminal trial ended in a mistrial after the jury could not reach a unanimous verdict. The government decided not to seek another trial. The former officer then sought indemnification under [8 Del. C. § 145\(c\)](#), which provides for indemnification whenever a director or officer prevails in an official capacity suit "on the merits or otherwise." On a motion for summary judgment, the court concluded that the officer was owed indemnification. In so ruling, the court expressly rejected the argument that the officer was not entitled to indemnification "because his conduct was motivated exclusively by personal greed." [\[FN12\]](#) The court did so because a contrary ruling would have limited "the rights clearly conferred by [Section 145\(c\)](#) in a manner that was not (but could have been) included in the legislative standard." [\[FN13\]](#)

[FN11](#). 2002 WL 982419, at *4 (Del. Ch.).

[FN12](#). *Id.*

[FN13](#). *Id.*

Perconti is not an isolated decision, but instead reflects a consistent line of authority upholding the contractual and statutory advancement and indemnification rights of corporate officials charged with serious misconduct allegedly inspired by personal greed. [\[FN14\]](#) That line of authority counsels in favor of rejecting EDS's argument that the Criminal Action and the EDS Action were not brought against Reddy "by reason of" his service as an EDS employee. Because both suits seek to hold Reddy liable for wrongdoing that he committed in his official capacity as an EDS executive, they are within the scope of coverage of the advancement provision of EDS's bylaws.

[FN14](#). Cases of this type include: [Greco](#), 1999 WL 1261446; [MCI Telecommunications Corp. v. Wanzer](#), 1990 WL 91100 (Del.Super.); and [Merritt-Chapman & Scott Corp. v. Wolfson](#), 321 A.2d 138 (Del.Super.1974).

By so holding, I also reject EDS's alternative argument, which rests largely on pleading formalism. Because EDS did not specifically allege that Reddy had committed a breach of fiduciary duty, it claims that the EDS Action is not a proper subject of advancement. But, the negligence, gross negligence, common law fraud, and contract claims brought

against Reddy all could be seen as fiduciary allegations, involving as they do the charge that a senior managerial employee failed to live up to his duties of loyalty and care to the corporation. Most critically, all of the misconduct alleged by EDS involves actions Reddy took on the job in the course of performing his day-to-day managerial duties. Likewise, the Criminal Action also involves conduct solely involving Reddy's actions in his official capacity; indeed, the indictment specifically alleges that Reddy's criminal acts were taken in a fiduciary capacity and that he defrauded EDS by depriving it of his honest services. [\[FN15\]](#).

[FN15](#). EDS argues that a recent decision requires a ruling in its favor on this broad argument. I conclude otherwise.

That case is the unpublished bench ruling by this court in the case of *Stengel v. Sales Online Direct, Inc.*, C.A. No. 18448, Tr. , (Jan. 2, 2002), *aff'd*, [783 A.2d 124 \(Del.2001\)](#) (Table). EDS argues that the decision was one in which this court refused advancement to a plaintiff accused of wrongdoing *as a* corporate officer and director because the suing company sought only to hold the plaintiff liable under his contractual obligations in those capacities, having redrafted its complaint to drop earlier claims for breach of fiduciary duty. As a result, EDS contends that this court concluded that the plaintiff was not being sued "by reason" of his official status. Candidly, I have difficulty determining exactly what legal principle can be derived from the *Stengel* decision. Most of the claims actually pled against the plaintiff in that case sought to rescind the very contract that brought the plaintiff into his fiduciary capacities. Another was for breach of his employment contract. The transcript ruling does not clearly say that an accusation of official wrongdoing is only subject to advancement rights if the accusation is pled as a breach of fiduciary duty, and I am disinclined to read it that way. Rather, the ruling refused advancement because the court was "satisfied" that the claims pled against the plaintiff did not "accuse" him of "wrongdoing arising out of his status as an officer or director." *Id.* at 8. In this case, both the EDS Action and the Criminal Action do accuse Reddy of wrongdoing in

his capacity as an employee. The labeling of the counts against him in the EDS Action does not obscure this reality.

*7 EDS makes another narrower argument, however, that potentially has more logical force. Recognizing that it might not be able to deny Reddy advancement for the Criminal Action or for his defense of the tort claims in the EDS Action, EDS has alternatively argued that Reddy must denied advancement for the expenses he incurs in defending EDS's claims for breach of his employment agreement and the incentive compensation agreement. [\[FN16\]](#) Because EDS's contract claims are based solely on specific agreements between Reddy and EDS, it asserts, those claims do not arise "by reason of" Reddy's service as an EDS employee and therefore are not covered by the advancement provision in EDS's bylaws. Otherwise, EDS says, employees could simply rewrite the risk and benefit allocations contained in their employment agreements, by seeking to escape personal responsibility through invocation of their general right to advancement and indemnification to cover any obligations they owe to their companies under those more specific personal agreements.

[FN16](#). It is not clear whether the amended complaint in the EDS Action alleges a breach of the stock purchase agreement. Even if it did, my analysis would not be different.

In large measure, EDS bases this argument on a decision of this court, *Cochran v. Stifel Fin. Corp.*, which was recently affirmed in relevant part by the Supreme Court. [\[FN17\]](#) That case involved very unusual circumstances, which are not present here. In *Cochran*, the party seeking indemnification--*not advancement*--was serving as an officer of a wholly-owned subsidiary "at the request" of the parent corporation. In an arbitration with the subsidiary, he was held to have breached his employment contract by receiving more than his contractually due compensation, and a promissory note agreement by failing to repay the note on the terms required. In the same arbitration, he prevailed on the subsidiary's claims that he had breached his fiduciary duties. In the later indemnification case in this court, the corporation admitted that its fiduciary duty claim was brought by reason of the officer's service at the corporation, but contended that the employment contract and promissory notes claims were not.

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[FN17, 2000 WL 1847676 \(Del. Ch.\)](#), *aff'd in relevant part, and aff'd. and rev'd in other parts, Stifel Fin. Corp. v. Cochran*, Nos. 548 and 549 Cons., slip. op., ___ A.2d. ___ (Del. June 13, 2002).

This court agreed, but for highly fact-specific reasons. To wit, the court found that the officer could not have reasonably believed that the parent corporation would indemnify him if he received contractually excessive compensation from its wholly-owned subsidiary or failed to repay a promissory note to that subsidiary. [FN18](#) The court found it inconceivable that the parent asked the officer to serve the subsidiary on the understanding that the parent would--through indemnification--allow the officer to breach his obligations under his employment agreements at no risk to himself. [FN19](#) Instead, the court held that the parent was an implied beneficiary of those agreements, and as a result did not have to indemnify the officer. [FN20](#)

[FN18, 2000 WL 1847676 at *6.](#)

[FN19, Id.](#)

[FN20, Id.](#)

Critically, the *Cochran* case did not involve any claim for advancement, nor did it involve a situation in which the officer's alleged breach of his employment agreements was argued to be the identical conduct that was also averred to be a breach of fiduciary duty. Rather, that case involved an unusual situation in which the officer would have received a windfall if indemnification was permitted, which would have been contrary to the expectations of rational contracting parties. Indeed, on appeal, the Supreme Court expressly noted that the arbitrators had found that the plaintiff's conduct as a corporate official was "irrelevant" to the contract dispute before them. [FN21](#)

[FN21, Cochran, ___ A.2d. ___, slip. op. at 19 \(Del. June 13, 2002\).](#)

*8 *Cochran* therefore grappled with the issue of which contract is paramount in a situation in which a corporate official's claim for indemnification collides with the corporation's right to hold an employee to his duties under an employment contract--most specifically, to ensure that the employee receives only such payments as are due him under his

employment contract and repays any loans he owes to the corporation. In that precise situation, *Cochran* treated the employment contracts as the more specific and controlling agreements between the parties, thereby preventing an inequitable and unintended boon for the employee.

This advancement case does not present the same issue. If EDS has to advance funds to Reddy for his defense, that does not mean that it will ultimately have to indemnify Reddy for any judgment against him on its contract claims. In particular, it does not mean that Reddy will be indemnified if EDS proves that Reddy received overpayments under his employment agreement or the incentive compensation agreement. At that stage, the reasoning of *Cochran* would be implicated directly. If that eventuality comes to pass and Reddy is not entitled to indemnification, he will have the obligation to pay back any funds advanced for EDS's contract claims because, otherwise, he would reap an unfair windfall by escaping the duties he accepted under his more specific agreements with EDS.

Because these limitations on Reddy's ultimate right to indemnification provide sufficient protection to EDS, it is not necessary or advisable to apply the reasoning of *Cochran* to his advancement case, especially because such an extension would undermine the policy objectives of [§ 145](#). As the Supreme Court noted in its *Cochran* decision, the "invariant policy" behind [§ 145](#) "is 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.'" [FN22](#) If EDS's argument were adopted here, that policy objective would be frustrated.

[FN22, Cochran, ___ A.2d. ___, slip. op. at 15 \(Del. June 13, 2002\) \(quoting ERNEST L. FOLK, ET AL., FOLK ON THE DELAWARE GENERAL CORPORATION LAW, § 145.2 \(3d ed.1996\)\).](#)

The reason why is that the actions that Reddy supposedly took in breach of his contractual obligations--falsifying and manipulating the books and records of EDS--are identical to the tort claims the company has asserted. Put another way, EDS admits that Reddy's alleged contractual breaches consist of his failing to have lived up to the implied covenant in his contracts that he would not engage in

official misconduct to generate false financials, thereby generating improper payments under the contracts. [\[FN23\]](#) To permit EDS to escape its advancement duties on this hyper-technical ground would invite abuse. [\[FN24\]](#) Under this rubric, a corporation could sue a faithless officer or employee only under her employment contract. In defending an advancement suit, a corporation would then argue that the employee's improper on-the-job acts were simply breaches of an implied covenant to serve the corporation faithfully and honestly, and that the contractual claims against her did not implicate her right to advancement. I am reluctant to issue a decision creating this incentive, because it seems contrary to the legislative intent behind [§ 145](#), as recognized by our Supreme Court. Rather, because EDS has premised its contractual claims entirely on allegedly improper actions taken by Reddy in his official capacity, I conclude that EDS has implicated the protections promised in its own bylaws. Therefore, it must advance funds to Reddy. [\[FN25\]](#)

[FN23.](#) Perhaps for this reason, EDS has not shown how it would be practicable to cleave the breach of contract aspects of the EDS Action off from the other parts, for purposes of determining what funds should be advanced to Reddy. As a practical matter, most of the time Reddy's lawyers will devote to defending EDS's contract claims will be also be equally useful to defending EDS's tort claims. Nonetheless, Reddy's lawyers shall, for use in future proceedings, endeavor in good faith to record separately the time and expenses attributable solely to EDS's contract claims.

[FN24.](#) Cf. [VonFeldt v. Stifel Fin. Corp.](#), 714 A.2d 79, 84-85 (Del.1998) (eschewing undue formalism and hyper-technical readings of [§ 145](#), which would contradict the statute's policy objectives).

[FN25.](#) Nothing in this decision prevents corporations from crafting specific employment agreements that clearly relieve the corporation of any duty to provide advancement in a breach of contract action between the corporation and the employee. No specific provision of this kind is contained in the agreements between Reddy and EDS.

C.

*9 EDS's next argument to defeat Reddy's advancement claim involves a bold proposition. Because Reddy seeks advancement to defend accusations that he engaged in serious financial fraud intended to benefit himself at the expense of EDS, EDS contends that the equitable doctrine of unclean hands is implicated. If Reddy in fact purportedly harmed EDS, he should be estopped from demanding advancement under EDS's bylaws. To do so would, EDS argues, be to permit a thief to steal twice.

If adopted, EDS's rule would turn every advancement case into a trial on the merits of the underlying claims of official misconduct. [\[FN26\]](#) [Section 145](#) of the DGCL is an explicit rejection of this approach, because the clear authorization of advancement rights presupposes that the corporation will front expenses before any determination is made of the corporate official's ultimate right to indemnification. [\[FN27\]](#)

[FN26.](#) So would EDS's companion argument that it should be able to try the merits in order to assert a set-off or recomponent as an advancement defense. I reject this argument as well.

[FN27.](#) See [Greco](#), 1999 WL 1261446 at *12 (rejecting an argument with a logical premise similar to EDS's); [Ridder v. Cityfed Fin. Corp.](#), 47 F.3d 85, 87 (3d Cir.1995) ("Under Delaware law, [the defendants'] right to receive the costs of defense in advance does not depend upon the merits of the claims asserted against them ...").

For similar reasons, I reject another related argument made by EDS. *After this lawsuit was filed*, EDS amended its complaint in the EDS Action to seek a declaratory judgment that Reddy was not entitled to advancement or indemnification. Because the EDS Action will necessarily involve discovery into Reddy's allegedly improper acts and because those acts are supposedly relevant to whether Reddy can obtain advancement, EDS claims I should defer to that other pending case.

But, acceding to EDS's argument would upset settled principles of law, and undermine the purposes of [§ 145\(k\)](#), which "represents a determination by the General Assembly that persons claiming a right to the advancement of expenses (including attorneys' fees) under Delaware law should be entitled to have their

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claims adjudicated by this court in a summary fashion." [FN28] EDS has failed to identify any "exceptional circumstances" that would justify departure from the ordinary rule that advancement cases "should not be stayed or dismissed in favor of the prior pending foreign litigation that [gave] rise to them." [FN29] Instead, EDS simply suggests that it is more efficient to try claims for advancement simultaneous with the trial of the same lawsuits for which the corporate official is seeking provisional payment of his litigation expenses. This type of efficiency, however, results in an unacceptable cost: the effective elimination of the separate right of advancement.

[FN28. *Fuisz v. Biovail Techs., Ltd.*, 2000 WL 1277369, at *1 (Del. Ch.).

[FN29. *Id.* at *1. EDS does assert that the specificity of the accusations against Reddy in the EDS Action is exceptional. I do not find it to be, and believe it imprudent and inefficient to have the forum in which advancement cases are decided turn on whether the complaint in the underlying action is pled with particularity or generally.

IV.

For the foregoing reasons, EDS's motion to dismiss is denied. Reddy's motion for summary judgment is granted and EDS shall advance him his reasonable expenses in the Criminal Action and the EDS Action promptly. The parties have quibbled about whether Reddy has adequately documented his advancement requests to date, but not in any manner that aids the court in setting a specific dollar figure. [FN30] Therefore, the parties shall collaborate on that issue, and report back within ten days on the status of their discussions. In that time, I expect that the parties will maturely consider the matter, in light of prior precedent, and substantially narrow or, even better, eliminate their differences. Furthermore, the parties should confer and work out an appropriate award of "fees for fees" pursuant to the Supreme Court's holding in *Cochran* that such an award is required, absent a specific contract to contrary. [FN31] At the same time as they report on those matters, the parties shall submit a conforming final order.

[FN30. Reddy recently provided detailed attorney time and expense records to EDS. EDS is bound to advance these costs, if they appear reasonable.

[FN31. *Cochran*, ___ A.2d ___, slip op. at 16-17 (Del. June 13, 2002).

Not Reported in A.2d, 2002 WL 1358761 (Del.Ch.)

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