

IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

KAI HANKINSON,

Plaintiff,

v

PIKE HOLDINGS INC., a Delaware corporation,

Defendant.

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: Civil Action
: No. 12730-CB
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Chancery Court Chambers
Leonard L. Williams Justice Center
500 North King Street
Wilmington, Delaware
Tuesday, November 15, 2016
12:49 p.m.

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BEFORE: HON. ANDRE G. BOUCHARD, Chancellor

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TELEPHONIC RULINGS OF THE COURT ON PLAINTIFF'S MOTION
FOR SUMMARY JUDGMENT

CHANCERY COURT REPORTERS
Leonard L. Williams Justice Center
500 North King Street - Suite 11400
Wilmington, Delaware 19801
(302) 255-0523

1 APPEARANCES: (Via teleconference)

2 K. TYLER O'CONNELL, ESQ.
3 DANIEL B. RATH, ESQ.
4 TRAVIS J. FERGUSON, ESQ.
Landis, Rath & Cobb LLP
for Plaintiff

5 RICHARD LI, ESQ.
6 Morris, Nichols, Arsht & Tunnell LLP
-and-

7 JASON de BRETTEVILLE, ESQ.
of the California Bar
8 Stradling, Yocca, Carlson & Rauth, P.C.
for Defendant

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1 THE COURT: Good afternoon, Counsel.
2 This is the Chancellor on the line. Could I have
3 appearances for the record, starting with counsel for
4 the plaintiff.

5 MR. O'CONNELL: Yes, Your Honor. On
6 behalf of the plaintiff, Kai Hankinson, you have Tyler
7 O'Connell, Dan Rath, and Travis Ferguson, from Landis,
8 Rath & Cobb.

9 THE COURT: And who do we have on the
10 line for the defendant?

11 MR. LI: Good afternoon, Your Honor.
12 On behalf of defendant, Pike Holdings, you have
13 Richard Li from Morris Nichols, and Jason de
14 Bretteville from Stradling Yocca.

15 THE COURT: All right. Thank you,
16 Counsel. This is a follow-up to the hearing that we
17 had last week, where I want to give you a ruling on
18 the motion that was briefed up.

19 Before the Court is the motion of
20 plaintiff, Kai Hankinson, for summary judgment on
21 Counts I, III, and IV of his verified complaint for
22 advancement. For reasons I will explain, it is my
23 opinion that Mr. Hankinson has rights to advancement
24 under the bylaws at issue here. Thus, I'm going to

1 resolve today the legal issues concerning the scope of
2 Mr. Hankinson's advancement rights. But as I
3 discussed during last week's hearing, the payment of
4 any advancement and the final resolution of this case
5 will have to await further proceedings for the purpose
6 of resolving the issues arising from certain
7 recordings that Pike has brought to the Court's
8 attention.

9 Let me start with some background.
10 Defendant Pike Holdings is a Delaware corporation
11 headquartered in California. The plaintiff,
12 Mr. Hankinson, was a director of Pike from October
13 2010 to February 2015 and the CEO of Pike from April
14 2012 to February 2015.

15 On November 23, 2015, Pike filed an
16 action in the Superior Court of the State of
17 California for the County of San Diego against
18 Hankinson, Hankinson's partner Heather Conine, Pike's
19 former CFO and secretary Brad Miller, and Miller's
20 partner Jenny Ferrera. The California action arises
21 from actions Hankinson and Miller allegedly took
22 relating to the sale of Pike's main operating
23 subsidiary sterkly Holdings, in February 2015.

24 According to the complaint in the

1 California action, Hankinson and Miller each entered
2 into agreements with Pike in 2014 pursuant to which
3 they agreed to forego their salaries for a period of
4 time in exchange for additional shares of Pike stock.
5 The California complaint alleges that Hankinson and
6 Miller improperly compensated themselves for the
7 salaries they agreed to give up by reimbursing
8 themselves from the company for certain personal
9 expenses and that they concealed this conduct from the
10 company and its stockholders during the negotiation of
11 the sterkly sale. Conine and Ferrera, the other two
12 defendants in the California action, allegedly aided
13 and abetted Hankinson and Miller.

14 Pike's bylaws contain an advancement
15 provision that requires Pike to advance legal fees and
16 expenses to its directors and officers under certain
17 circumstances. Before this advancement action was
18 filed, Hankinson submitted multiple requests to Pike
19 for advancement of fees and expenses he incurred in
20 defending the California action, all of which Pike has
21 rejected.

22 Pike justifies its rejection of
23 Hankinson's request for advancement based in part on a
24 decision its board of directors made on April 22,

1 2016, where it found that Hankinson had acted in bad
2 faith with respect to the conduct challenged in the
3 California action and thus was not entitled to
4 advancement under Pike's bylaws.

5 On September 8, 2016, Hankinson filed
6 the complaint in this action, which contains four
7 counts. Count I asserts a claim for advancement of
8 fees and expenses Hankinson incurred and will incur in
9 defense of the California action; Count II asserts a
10 claim for declaratory judgment that the Pike board's
11 determination that Hankinson acted in bad faith was
12 invalid; Count III seeks an injunction enjoining Pike
13 from pursuing the California action until Pike
14 complies with its advancement obligations; Count IV
15 seeks reimbursement for attorneys' fees and expenses
16 that Hankinson incurred in connection with prosecuting
17 this advancement action.

18 On November 4, 2016, Pike submitted a
19 letter requesting that the Court review in camera
20 recordings of certain telephone conversations that
21 purportedly evidence a scheme to overstate the amount
22 of fees Hankinson had incurred and will incur in the
23 California action for which he seeks advancement.
24 According to Pike, such a scheme would constitute a

1 fraud and deprive Hankinson of any right to
2 advancement. On November 7, 2016, Hankinson submitted
3 a response objecting to Pike's intended use of the
4 recordings.

5 Now let me turn to the legal analysis
6 that's the basis of my ruling today. To resolve
7 Hankinson's motion for summary judgment, I have to
8 consider two major issues; namely, whether Hankinson
9 is entitled to advancement under the bylaws and the
10 implication of the recordings on Hankinson's
11 advancement rights.

12 I will address Hankinson's advancement
13 rights under the bylaws first, because if Hankinson is
14 not entitled to advancement under Pike's bylaws, then
15 the issue of the recordings would be moot for the
16 purpose of this advancement action.

17 Section 44(c) of Pike's bylaws
18 contains two provisions particularly relevant to
19 Hankinson's advancement rights. The first sentence of
20 Section 44(c), which I will refer to as "the
21 advancement provision," provides in relevant part,
22 "The corporation shall advance to any person who was
23 or is a party or is threatened to be made a party to
24 any ... proceeding ... by reason of the fact that he

1 is or was a director or officer, of the Corporation,
2 ... all expenses incurred by any director or officer
3 in connection with such proceeding." That was a
4 partial quote. Some words were excised from the
5 quotation, but that's the gravamen of the provision.

6 The second part of Section 44(c),
7 which I will refer to as "the determination provision"
8 provides in relevant part as follows:

9 "Notwithstanding the foregoing ... no advance shall be
10 made by the Corporation to an officer of the
11 Corporation (except by reason of the fact that such
12 officer is or was a director of the Corporation, in
13 which event this paragraph shall not apply) in any
14 action, suit or proceeding ... if a determination is
15 reasonably and promptly made ... that the facts ...
16 demonstrate clearly and convincingly that such person
17 acted in bad faith or in a manner that such person did
18 not believe to be in or not opposed to the best
19 interests of the Corporation."

20 It is undisputed that the advancement
21 provision in Section 44(c), standing alone, requires
22 Pike to advance fees and expenses to its directors and
23 officers who are sued in a corporate capacity.
24 Hankinson and Pike disagree, however, as to the proper

1 interpretation of the determination provision.

2 According to Hankinson, as long as the
3 person seeking advancement is or was a director of
4 Pike, the determination provision would not apply,
5 irrespective of whether that person was sued in his
6 capacity as a director. Pike, on the other hand,
7 contends that the determination provision would not
8 apply only if that person was sued in his capacity as
9 a director.

10 Key to the interpretation of the
11 determination provision is the parenthetical language
12 in Section 44(c) that reads, "except by reason of the
13 fact that such officer is or was a director of the
14 Corporation, in which event this paragraph shall not
15 apply."

16 Numerous Delaware cases have held that
17 "by reason of the fact," when used in an advancement
18 provision, means the advancement right is contingent
19 upon the official capacity in which the party seeking
20 advancement is sued, not the mere status of the
21 individual as a director or officer.

22 Hankinson agrees that this is the
23 proper interpretation of the phrase "by reason of the
24 fact" as used in the advancement provision. Hankinson

1 argues, however, that "by reason of the fact" has a
2 different meaning when used in the determination
3 provision. According to Hankinson, by reason of the
4 fact," as used in the determination provision, does
5 not concern the capacity in which the claimant is
6 sued, but only relates to the status of the claimant
7 as a current or former director of Pike.

8 It is a general rule of construction
9 that where the same word or phrase is used on more
10 than one occasion in the same instrument, and in one
11 instance its meaning is definite and clear and in
12 another instance it is susceptible of two meanings,
13 there is a presumption that the same meaning was
14 intended throughout such instrument.

15 "By reason of the fact" is used twice
16 in Section 44(c) of Pike's bylaws. In the first
17 instance, it's undisputed that the phrase refers to
18 the capacity in which the advancement claimant is
19 sued. Thus, applying the rule of construction I have
20 explained, and finding nothing in the bylaws that
21 clearly supports a different interpretation, I hold
22 that in both the advancement provision and the
23 determination provision, the phrase "by reason of the
24 fact" refers to the capacity in which the person

1 seeking advancement is sued.

2 In other words, under Section 44(c) of
3 Pike's bylaws, Pike's current or former directors and
4 officers shall be entitled to advancement of legal
5 fees and expenses if they are sued in their corporate
6 capacity, but if the potential claimant is an officer,
7 then he is not entitled to advancement if a valid
8 determination is made that he acted in bad faith
9 unless that person also was sued in his capacity as a
10 director.

11 This leads to the next issue, which is
12 whether Hankinson was sued in the California action in
13 his capacity as a director, an officer, or in a
14 personal capacity. The complaint in the California
15 action alleges five causes of action. Count I asserts
16 a claim for rescission of the two stock award
17 agreements that Hankinson and Miller each entered into
18 with Pike in 2014; Count II asserts a claim for breach
19 of fiduciary duty; Count III asserts a claim for
20 fraud; Count IV asserts a claim for concealment; and
21 Count V asserts what is called a common count for
22 "money had and received."

23 Before delving into an analysis of the
24 nature of each of these causes of action, it is

1 important to first put that analysis in context. In
2 Vonfeldt v. Stifel Financial Corporation, our Supreme
3 Court articulated the long-recognized dual policies of
4 Section 145 to, "(a) allow[] corporate officials to
5 resist unjustified lawsuits, secure in the knowledge
6 that, if vindicated, the corporation will bear the
7 expense of litigation; and (b) encourag[e] capable
8 women and men to serve as corporate directors and
9 officers, secure in the knowledge that the corporation
10 will absorb the costs of defending their honesty and
11 integrity."

12 Cases from this Court have followed
13 this public policy when discerning the scope of
14 advancement and indemnification rights afforded by a
15 company's bylaws. For example, just last year, in
16 Mooney v. Echo Therapeutics, this Court observed that
17 "Delaware courts generally have eschewed attempting to
18 resolve disputes over whether claims relate to a
19 potential indemnitee's personal or official capacity
20 at the advancement stage unless the answer can be
21 discerned swiftly, accurately, and consistent with the
22 summary nature of an advancement proceeding.
23 Deferring resolution of less clear-cut disputes to the
24 indemnification stage helps avoid excessive litigation

1 over advancement[, which] threaten[s] to undermine ...
2 the policy of providing prompt reimbursement to
3 present and former directors and officers who have had
4 to incur attorneys' fees and related expenses."

5 Repeating what I preliminarily
6 addressed during last week's hearing, I find that
7 Counts II and IV of the California action clearly
8 implicate Hankinson's capacity as a director or
9 officer of Pike.

10 The core allegation for both of these
11 claims is found in paragraphs 27 and 41, respectively,
12 of the California complaint. There -- and I'm now
13 going to quote from paragraph 27 -- which is
14 substantively identical to paragraph 41 -- Pike and
15 its subsidiaries allege as follows: "Hankinson and
16 Miller controlled Plaintiffs' books and records while
17 the sterkly entities were owned by Plaintiffs and
18 through the due diligence period of the sale of
19 sterkly, expressly for the benefit of the Plaintiffs
20 and the Pike stockholders. As such, Miller and
21 Hankinson had a fiduciary obligation to accurately
22 report to the Pike stockholders and its accounting
23 department their own personal compensation, their
24 substantial inappropriate reimbursements of personal

1 expenses, and their failures to live up to their
2 commitments to reduce their compensation in return for
3 the additional stock awards under the April 21, 2014
4 and June 16, 2014 Agreements."

5 In my opinion, this language
6 implicates Hankinson's capacity both as a director and
7 as an officer, since he had access to Pike's books and
8 records and, under Delaware law, owed the same
9 fiduciary duties to Pike's stockholders in both
10 capacities.

11 Turning to Counts I, III, and V, those
12 claims are less clear-cut than Counts II and IV
13 because they are not expressly predicated on duties
14 owed by a fiduciary. But this Court has rejected in
15 the past arguments based on "pleading formalism" and
16 found that claims have the requisite causal connection
17 to one's corporate capacity if the corporate powers
18 were used or necessary for the commission of the
19 alleged misconduct.

20 In the Reddy case, for example,
21 then-Vice Chancellor Strine found that the
22 corporation's claims of negligence, gross negligence,
23 common law fraud, and contract claims against its
24 former employee "all could be seen as fiduciary

1 allegations, involving as they do the charge that a
2 senior managerial employee failed to live up to his
3 duties of loyalty and care to the corporation," even
4 though the underlying complaint did not contain a
5 formal fiduciary duty claim.

6 Here, the same conduct that underlies
7 the fiduciary-duty-based claims against Hankinson also
8 underlies the claims against him for rescission,
9 fraud, and the common count.

10 With respect to Count I, which seeks
11 rescission of the stock award agreements, the core
12 allegations involve Hankinson's alleged "huge
13 reimbursements to [himself] out of company funds" and
14 concealment of such conduct, "knowing that the Pike
15 stockholders were relying on them to transmit accurate
16 records of the companies' assets and liabilities under
17 the purchase formula for the sale of sterkly."

18 Count III contains similar
19 allegations. There, Pike alleges that Hankinson
20 committed fraud at the time of entering into the two
21 stock award agreements because he "had no intention of
22 honoring [his] commitments to take salary reductions,"
23 but "planned to secretly compensate [himself] for the
24 salary reductions by aggressively running [his]

1 personal expenses through the company as though they
2 were business expenses." The complaint further
3 alleges that Hankinson "knew the Pike stockholders
4 were relying on [him] to carry out [his] promises of
5 taking salary reductions in consideration of the 2014
6 stock awards."

7 Finally, Count V is "based upon an
8 implied promise which the law creates to restore money
9 which the defendant in equity and in good conscience
10 should not retain." The conduct underlying that claim
11 also concerns Hankinson's alleged improper
12 reimbursement and concealment.

13 The allegations here, in my view, are
14 analogous to those made in the Mooney case last year,
15 where the defendant corporation argued that the
16 plaintiff was not entitled to advancement for claims
17 related to, among other things, improper expense
18 reimbursements, because that issue was governed by the
19 plaintiff's employment agreement and solely implicated
20 his personal capacity. The Court rejected that
21 argument, reasoning that "it is unlikely that such
22 extensive, and expensive, reimbursements could have
23 been obtained other than by reason of the fact that
24 Dr. Mooney was CEO." The Court also found it

1 significant that Dr. Mooney allegedly "effected his
2 improper reimbursement scheme through a campaign of
3 concealment that undoubtedly involved the exercise of
4 corporate power."

5 That reasoning applies here. Given
6 the nature and the magnitude of the amounts for which
7 Hankinson secured reimbursement for himself, it is
8 reasonable to infer that some manipulation of Pike's
9 corporate records occurred to obtain and conceal these
10 allegedly improper payments. Those actions logically
11 would have occurred through the use of corporate
12 powers by a person serving in the capacity as a
13 director or as an officer of the company. In that
14 regard, Hankinson's alleged conduct, as Pike pleaded
15 in Counts I, III, and V, evidenced a failure to live
16 up to his duties of loyalty and care to the
17 corporation and therefore implicates his capacity as a
18 director and officer of Pike.

19 Pike contends that any reference in
20 the California complaint to Hankinson's fiduciary duty
21 only refers to Hankinson's duty as an officer, but not
22 as a director. I cannot, however, discern such a
23 clear line between the fiduciary duty Hankinson owed
24 in those capacities, and I am reluctant to attempt to

1 engage in such a line-drawing exercise at this stage,
2 given the summary nature of the advancement proceeding
3 and Delaware's public policy protective of
4 contractually conferred advancement rights.

5 For these reasons, I conclude that all
6 five of the causes of action in the California
7 complaint implicate Hankinson's capacity as both a
8 director and an officer of Pike. As I explained
9 before, under its plain language, the determination
10 provision does not apply when a claim relates to a
11 person's capacity both as a director and as an
12 officer. Therefore, under Pike's bylaws, Hankinson is
13 entitled to advancement for fees and expenses he
14 incurred in defense of all of the claims asserted
15 against him in the California action.

16 I'm now going to turn to a second
17 issue that's implicated by Hankinson's motion.
18 Another allocation issue Pike raises concerns the
19 presence of three other defendants in the California
20 action who share the same counsel with Hankinson.

21 In *Danenberg v. Fittracks*, this Court
22 held that when the same law firm represents several
23 defendants named in a complaint, the corporation:
24 "only must advance those fees and expenses that [the

1 advancement plaintiff's] counsel would have incurred
2 if [he] were the sole ... defendant. If a particular
3 defense or litigation activity benefits multiple ...
4 defendants, but [the advancement plaintiff] would have
5 raised or undertaken it himself if he were the sole
6 ... defendant, then [the defendant corporation] must
7 advance 100% of the related fees and expenses."

8 Thus, Hankinson could obtain
9 advancement for fees and expenses that he would have
10 incurred if he were the sole defendant, whether or not
11 the work also would benefit his codefendants. When
12 submitting a demand for advancement, counsel for
13 Hankinson will be required to make a good-faith
14 representation as to whether the work would have been
15 done if Hankinson were the only client and to deduct
16 from the demand fees solely related to work for
17 Hankinson's codefendants.

18 Let me address the issue of the
19 recordings. Even though I have concluded that
20 Hankinson would be entitled to advancement under
21 Pike's bylaws for his defense of all the claims
22 asserted against him in the California action, the
23 recordings that were brought to my attention on
24 November 4 raise some other rather troubling issues.

1 First, as I explained during the
2 hearing on November 7, it is not clear at this stage
3 whether the Court can even properly consider the
4 recordings. Hankinson asserts that the recordings
5 were obtained by Pike's counsel through improper means
6 and that they are subject to the attorney-client
7 privilege. These allegations necessitate some inquiry
8 into the underlying facts, which are vigorously
9 disputed.

10 Second, assuming the recordings are
11 admissible, there would need to be further proceedings
12 to determine whether Hankinson engaged in conduct that
13 could sustain a defense for fraud or unclean hands
14 that could provide a basis to deny advancement
15 altogether.

16 I am now going to address a final
17 issue concerning the request for injunctive relief
18 that has been made by Hankinson. As I explained
19 during the oral argument on November 7, I will not
20 enjoin the California action simply based on a letter
21 from Pike's counsel where he asserted that any success
22 Hankinson might have in pursuing advancement would be
23 a "Pyrrhic victory."

24 Although Hankinson views this letter

1 as an unequivocal threat by Pike to ignore its
2 advancement obligations, I agree with Pike that it
3 would be premature to grant the requested injunction.
4 Hankinson's entitlement to advancement has not yet
5 been fully adjudicated, and if the Court enters an
6 order in this case requiring Pike to advance his
7 expenses, Pike would be at risk of being held in
8 contempt of a court order if it fails to comply with
9 that order.

10 Accordingly, I am going to deny
11 Hankinson's request for an injunction without
12 prejudice to his ability to renew such an application
13 in the future if it is warranted.

14 To sum up, as I've indicated, I'm
15 giving you my opinion that Mr. Hankinson is entitled
16 to advancement for all the claims that have been
17 asserted against him in the California action.
18 However, we need to have a trial to resolve the issues
19 surrounding the recordings. I want counsel to confer
20 and to plan to have that trial within a 60- to 90-day
21 period, and you should contact my chambers to get a
22 date to schedule that.

23 I think two other things flow from
24 what I am saying today. One is I don't believe, but I

1 guess Hankinson will have to decide for himself, that
2 Count II is relevant to this case any further, given
3 the rulings I've made, but you'll have to make that
4 judgment for yourself as to whether or not there's
5 anything further to litigate in that regard. And
6 second, I am reserving and will address the issue of
7 fees on fees depending on the outcome of the trial.

8 That constitutes my ruling. Does
9 anybody have any questions for me?

10 MR. O'CONNELL: Your Honor, on behalf
11 of the plaintiff, no questions.

12 MR. LI: No questions on behalf of the
13 defendants.

14 THE COURT: All right. Good day,
15 Counsel. Thank you very much.

16 (Hearing concluded at 1:13 p.m.)

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CERTIFICATE

I, JULIANNE LABADIA, Official Court Reporter for the Court of Chancery for the State of Delaware, Registered Diplomate Reporter, Certified Realtime Reporter, and Delaware Notary Public, do hereby certify that the foregoing pages numbered 3 through 22 contain a true and correct transcription of the rulings as stenographically reported by me at the hearing in the above cause before the Chancellor of the State of Delaware, on the date therein indicated.

IN WITNESS WHEREOF I hereunto set my hand at Wilmington, this 15th day of November, 2016.

/s/ Julianne LaBadia

Julianne LaBadia
Official Court Reporter
Registered Diplomate Reporter
Certified Realtime Reporter
Delaware Notary Public