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**COURT OF CHANCERY
OF THE
STATE OF DELAWARE**

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Submitted: March 28, 2008
Decided: March 28, 2008

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Re: *Reinhard & Kreinberg v. The Dow Chem. Co.*
Civil Action No. 3003-CC

Dear Counsel:

Facially, the motions before me appear to present a relatively simple issue of contract interpretation. Lurking beneath that façade of simplicity, however, are a host of more complex procedural issues. Defendant Dow Chemical Company ("Dow" or the "Company") has filed a series of motions that seek clarification of a joint stipulation governing advancement of legal fees to the plaintiffs, J. Pedro Reinhard and Romeo Kreinberg. Confronting Delaware's law on advancement, a suggestion of collateral estoppel, a conflict of laws issue, and a treatment of what makes a counterclaim "compulsory," I have provided herein a framework for a global resolution to the various motions Dow has filed with respect to the advancement of fees.

First, I conclude that the law requires advancement of legal fees incurred with respect only to *compulsory* counterclaims. Second, neither party is collaterally estopped from litigating the issue of whether plaintiffs' counterclaims are compulsory. Third, I identify the remaining legal issues to be resolved, which include determining what jurisdiction's law will govern the ultimate issue of whether the counterclaims are compulsory under Rule 13(a).

However, I cannot provide the resolution itself without more information about the precise nature of plaintiffs' counterclaims and without briefing on the conflict of laws issue. I hope that the parties will digest what I have written here and negotiate a resolution on their own. If that proves impossible, of course, the parties will have leave to file supplementary briefs on the remaining issues.

I. BACKGROUND

Plaintiffs Reinhard and Kreinberg are former executives of Dow. The Company has filed suit against plaintiffs in Michigan for breach of fiduciary duty, alleging that plaintiffs engaged in unauthorized and undisclosed discussions with third parties relating to a leveraged buyout of Dow. Reinhard filed $75,000,000 counterclaims for libel and breach of contract, and Kreinberg filed a $100,000,000 defamation counterclaim against Dow.

In early June of last year, plaintiffs initiated suit in this Court under 8 *Del. C.* § 145 to compel advancement of attorneys' fees and costs in connection with the action in Michigan. The parties filed cross motions for summary judgment, but before the Court ruled on these motions, the two sides entered a stipulated agreement. This stipulation, granted by the Court on August 24, 2007, governs in detail the advancement of fees and expenses. Pursuant to the stipulation, the Company shall provide advancement of plaintiffs' reasonable fees and expenses "incurred in connection with" plaintiffs' defense against Dow's claims. To receive such advancement, the stipulation requires plaintiffs' counsel to submit to Dow invoices that set forth "(i) the number of hours worked by each attorney or legal assistant on each day, and (ii) a specification of the work performed by each attorney or legal assistant on each day [excluding descriptions that reveal mental impressions]." Finally, the stipulation also provides that Dow may contest these invoices if it provides a basis for so doing, and if the parties cannot resolve such disputes, the Court will resolve them. Pursuant to the Company's bylaws, Dow bears the burden of proving that plaintiffs are not entitled to the advancement of fees.

Perhaps unsurprisingly, the parties have run into one of these disputes. Dow has filed motions with respect to invoices submitted by both plaintiffs. Essentially, Dow complains that plaintiffs' counsel are billing all of their time—including time spent preparing their counterclaims—to Dow, but that the stipulation only provides for advancement of fees and expenses related to defense. Dow proposes a 50% reduction in the fees and expenses, and complains that the invoices submitted lack sufficient detail to understand the nature of the time being billed. Plaintiffs dispute that the stipulation prevents them from receiving advancement of fees incurred in preparing their counterclaims, citing Delaware Supreme Court cases holding that advancement is appropriate in the case of compulsory counterclaims. Plaintiffs also object to giving more detail in their billing invoices lest they betray attorney mental impressions. The Company seems to disagree that plaintiffs' counterclaims are compulsory, and cites precedent for the proposition that the Company need not pay for unrelated legal proceedings.

II. ANALYSIS

A. Delaware Law on Indemnification and Advancement of Attorneys' Fees

Section 145 of the Delaware General Corporation Law endows corporations with the power to indemnify and provide advancement of attorneys' fees to officers, directors, employees, or agents of the corporation.[1] This provision is permissive, but its effect is purportedly made mandatory in Dow's bylaws. Section 6.1 of those bylaws states, "The Company shall indemnify, to the fullest extent permitted by Delaware law, any person who was or is a defendant or is threatened to be made a defendant to threatened, pending or completed action, suit or proceeding, whether civil, criminal, administrative or investigative, by reason of the fact that such person: (1) is or was a director, officer or employee of the Company." Similarly, section 6.3 of the bylaws provides that expenses, including attorneys' fees, shall be paid by the company in advance.

A company's bylaws are contractual in nature.[2] Thus, "indemnification is a right conferred by contract, under statutory auspice."[3] Although courts use the tools of contractual interpretation when construing bylaw provisions relating to

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[1] 8 *Del. C.* § 145; *Sassano v. CIBC World Markets Corp.*, C.A. No. 3066-VCL, 2008 WL 152582, at *4 (Del. Ch. Jan. 17, 2008).

[2] *Centaur Partners, IV v. Nat'l Intergroup, Inc.*, 582 A.2d 923, 928 (Del. 1990) ("Corporate charters and by-laws are contracts among the shareholders of a corporation."); *Jana Master Fund, Ltd. v. CNET Networks, Inc.*, C.A. No.3447-CC, 2008 WL 660556, at *3 (Del. Ch. Mar. 13, 2008).

[3] *Stifel Fin. Corp. v. Cochran*, 809 A.2d 555, 559 (Del. 2002).

indemnification and advancement,[4] they simultaneously apply the patina of section 145's policy.[5] Thus, I will do the same when interpreting the contract that governs advancement in this dispute: the August 24 stipulation. The Delaware Supreme Court has consistently emphasized "that the indemnification statute should be broadly interpreted to further the goals it was enacted to achieve."[6] Moreover, the Supreme Court has noted that the state's "invariant policy . . . on indemnification 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.'"[7]

With this expansive policy in mind, I turn to the August 24 stipulation between the parties. That agreement provides that Dow will pay reasonable fees and expenses incurred in connection with plaintiffs' defense of claims brought against them by Dow. Plaintiffs contend that the term "defense" as used in the stipulation includes their claims against Dow. Dow disputes that contention and argues that the parties, in using that term in the stipulation, specifically intended to preclude fee advancement with respect to work on the plaintiffs' claims against the Company.

Thus, the dispute here centers on the definition of the word "defense." Delaware law, of course, "adheres to an objective theory of contracts"[8] and interprets words according to their common meaning[9] as they would be understood by a reasonable, third-party observer.[10] Such a reasonable, third-party observer understands that sophisticated parties who are represented by counsel—like those in this dispute—bargain for and draft their agreements under the shadow of established law. With respect to the definition of the word "defense" in the context of advancement, parties have the benefit of Supreme Court precedent that is perfectly on point. In *Citadel Holding Corp. v. Roven*, Justice Walsh explained

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[4] *See Hibbert v. Hollywood Park, Inc.*, 457 A.2d 339, 342–43 (Del. 1983); *Sassano*, 2008 WL 152582, at *4.

[5] *See, e.g.*, *VonFeldt v. Stifel Fin. Corp.*, 714 A.2d 79, 83–84 (Del. 1998).

[6] *Cochran*, 809 A.2d at 561.

[7] *Id.* (quoting RODMAN WARD, JR., EDWARD P. WELCH, ANDREW J. TUREZYN, FOLK ON THE DELAWARE GENERAL CORPORATION LAW § 145 (4th ed. 2001)).

[8] *United Rentals, Inc. v. RAM Holdings, Inc.*, 937 A.2d 810, 835 (Del. Ch. 2007); *Seidensticker v. Gasparilla Inn, Inc.*, C.A. No. 2555-CC, 2007 WL 4054473, at *2 (Del. Ch. Nov. 8, 2007).

[9] *Pharmathene, Inc. v. Siga Techs., Inc.*, C.A. No. 2627-VCP, 2008 WL 151855, at *11 (Del. Ch. Jan. 16, 2008).

[10] *Sassano v. CIBC World Markets Corp.*, C.A. No. 3066-VCL, 2008 WL 152582, at *5 (Del. Ch. Jan. 17, 2008).

that "[i]n a litigation context the term 'defense' has a broad meaning . . . ."[11] Specifically, the court held that, under this broad understanding of the term "defense," directors were entitled to advancement for legal work on their affirmative defenses and compulsory counterclaims.[12] With respect to the latter, the court reasoned that an agreement to advance fees for defense of a claim naturally includes legal fees for compulsory counterclaims because such counterclaims "are necessarily part of the same dispute."[13]

Legal fees incurred in pursuit of merely permissive counterclaims, which do "not "aris[e] out of the transaction or occurrence that is the subject matter of the opposing party's claim,"[14] however, cannot justifiably be construed as part of a director's "defense" of claims brought against her by a corporation. The Supreme Court has broadly interpreted the meaning of "defense" in these advancement actions, but not even Delaware's "invariant policy" in favor of advancement can expand the boundaries of the word's meaning to include permissive counterclaims. In *Citadel*, the Supreme Court acknowledged that including even compulsory counterclaims within the definition of defense "present[ed] a . . . difficult problem" because such counterclaims "represent separate causes of action."[15] This concern was assuaged because compulsory counterclaims "must be asserted or be thereafter barred;"[16] permissive counterclaims do not face the same fate.[17]

Consequently, if plaintiffs' claims are in fact compulsory counterclaims, the fees incurred in pursuing such claims are subject to advancement. The next question becomes how to determine whether plaintiffs' counterclaims are compulsory.

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[11] 603 A.2d 818, 824 (Del. 1992).
[12] *See id.*
[13] *Id.*; *accord Pearson v. Excide Corp.*, 157 F. Supp. 2d 429, 439 (E.D. Pa. 2001) (noting that the *Citadel* court broadly interpreted the meaning of "defense" in the context of advancement to include compulsory counterclaims and, following *Citadel*, requiring advancement for legal fees incurred prosecuting such a compulsory counterclaim).
[14] Ct. Ch. R. 13(b).
[15] 603 A.2d at 824.
[16] *Id.*
[17] 6 CHARLES ALAN WRIGHT, ARTHUR R. MILLER & MARY KAY KANE, FEDERAL PRACTICE AND PROCEDURE § 1420 (supp. 2008) ("unlike Rule 13(a) counterclaims, permissive counterclaims are not waived, or estopped, or barred when omitted from the original action and a party will not be precluded from bringing his claim in a subsequent action because of a failure to present it as a counterclaim under Rule 13(b)"); *see also Kaye v. Pantone, Inc.*, 395 A.2d 369, 371 n.2 (Del. Ch. 1978) (noting that Delaware's Rule 13 is similar to the federal rule).

B. The preclusive effect of the federal court's consolidation order

Plaintiffs seemingly argue that the United States District Court for the Eastern District of Michigan has already determined that their counterclaims are compulsory.[18] In support of this contention, plaintiffs cite that court's November 13 order setting a hearing on the court's own motion on consolidation. There, Judge Ludington scheduled a hearing to consolidate the various claims and counterclaims between Reinhard, Kreinberg, and Dow, because the cases "involve like claims, overlapping parties, and overlapping discovery," and because "common questions of law and fact are at issue."[19] If the Michigan court has in fact ruled that the counterclaims are compulsory, the doctrine of collateral estoppel would make such a determination binding on this Court.[20] In Delaware, "[a] claim will be collaterally estopped only if the same issue was presented in both cases, the issue was litigated and decided in the first suit, and the determination was essential to the prior judgment."[21] However, because the "other case" here involves a decision issued by the federal court in Michigan, its "preclusive effect . . . is measured by standards of the rendering forum."[22] Thus, I must determine what preclusive effect, if any, the district court in Michigan would give the judgment.

Like everything else in this dispute, even that inquiry proves far more complicated than it initially seems. In *Columbia Casualty Company v. Playtex FP, Inc.*,[23] the Supreme Court upheld on an interlocutory appeal a decision by the Superior Court refusing to give preclusive effect to a decision by a federal district court in Kansas. There, a tampon manufacturer brought an action in the Superior Court for reimbursement against its insurer.[24] The insurer sought to use a finding that Playtex had at least constructive knowledge of the risks of its products against Playtex as a defense. That finding was made in a case brought against Playtex by a customer who died of toxic shock syndrome in the Federal District Court for the

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[18] *See* Reinhard's Dec. 28, 2007 Answering Br. at 1; Kreinberg's Jan. 14, 2008 Answering Br. at 1–2.

[19] *Dow Chem. Co. v. Reinhard*, No. 07-12012-BC, 2007 WL 3379688, at *3 (E.D. Mich. Nov. 13, 2007).

[20] *See Territory of U.S. Virgin Islands v. Goldman, Sachs & Co.*, 937 A.2d 760, 785 (Del. Ch. 2007); *One Va. Ave. Condo. Ass'n of Owners v. Reed*, C.A. No. 18726-NC, 2005 WL 1924195, at *10 (Del. Ch. Aug. 8, 2005).

[21] *Sanders v. Malik*, 711 A.2d 32, 33–34 (Del. 1998).

[22] *Columbia Cas. Co. v. Playtex FP, Inc.*, 584 A.2d 1214, 1217 (Del. 1991) (determining the preclusive effect of a judgment rendered by a federal district court in Kansas).

[23] *Id.*

[24] *Id.* at 1215.

District of Kansas.[25] The federal court, of course, heard the tort case under its diversity jurisdiction. Columbia Casualty Company was not a party to the federal case in Kansas, but nevertheless sought to use the finding against Playtex in the Delaware action. Although Delaware recognizes and permits nonmutual offensive collateral estoppel, the Supreme Court affirmed the determination that it was not Delaware's law that governed the doctrine's applicability.[26] Noting that the federal district court was applying Kansas state law and that the Tenth Circuit directs its district courts sitting in diversity to look to state law, the Supreme Court cited Kansas state law decisions, which require mutuality of estoppel.[27] Thus, the Supreme Court affirmed the Superior Court's refusal to give the federal court's finding any preclusive effect because Columbia was not a party to the federal action.

However, the United States Court of Appeals for the Sixth Circuit, whose decisions bind the District Court for the Eastern District of Michigan, has held that "[a] federal court sitting in diversity looks to *federal law* on collateral estoppel to determine any preclusive effect of a prior federal judgment in a diversity action."[28] Thus, unlike the court in *Columbia Casualty*, I must look to federal law. In the Sixth Circuit, courts only apply the doctrine of collateral estoppel where the following four conditions are met: "(1) the precise issue raised in the present case must have been raised and actually litigated in the prior proceeding; (2) determination of the issue must have been necessary to the outcome of the prior proceeding; (3) the prior proceeding must have resulted in a final judgment on the merits; and (4) the party against whom estoppel is sought must have had a full and fair opportunity to litigate the issue in the prior proceeding."[29]

Based on that standard, Judge Ludington's consolidation order has no preclusive effect on this Court's determination of whether plaintiffs' counterclaims are compulsory. I can reach this conclusion relying solely on the first factor, because at no time did Judge Ludington rule on the "precise issue" of whether

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[25] *Id.* at 1216; *see also O'Gilvie v. Int'l Playtex, Inc.*, 609 F. Supp. 817 (D. Kan. 1985), *aff'd in part and rev'd in part*, 821 F.2d 1438 (10th Cir. 1987).
[26] *Columbia Cas.*, 584 A.2d at 1217.
[27] *Id.* The federal courts, on the other hand, have abandoned the mutuality requirement. *See, e.g.*, *Parklane Hosiery Co., Inc. v. Shore*, 439 U.S. 322, 331–32 (1979) (allowing use of nonmutual offensive collateral estoppel).
[28] *Tri-Med Fin. Co. v. Nat'l Century Fin. Enters., Inc.*, 208 F.3d 215 (TABLE), 2000 WL 282445, at *10 (6th Cir. 2000) (emphasis added).
[29] *Bies v. Bagley*, ___ F.3d ___, No. 06-3471, 2008 WL 507818, at *6 (6th Cir. Feb. 27, 2008) (quoting *N.A.A.C.P., Detroit Branch v. Detroit Police Officers Ass'n*, 821 F.2d 328, 330 (6th Cir. 1987)).

plaintiffs' counterclaims were compulsory or part of the same transaction as Dow's claims against them. Judge Ludington commented that there were "common questions of law and fact" and that the cases he was consolidating involved "like claims," but he never concluded or considered whether the claims all stemmed from the same transaction. It is entirely possible to have two claims that could satisfy the standard for consolidation under Rule 42(a) because they involve common questions of law or fact but fail to be compulsory counterclaims under Rule 13(a).[30] Thus, I conclude that neither party is collaterally estopped from litigating the issue of whether plaintiffs' counterclaims are compulsory.

C. Remaining Legal Issues

Having determined that the federal court has not already decided the issue, what remains, of course, is the issue itself. Before the Court can decide whether the counterclaims are compulsory, however, the Court must determine what law should be applied. Because this case involves an advancement agreement entered under Delaware law that governs advancement of legal fees incurred in a federal action in Michigan under the district court's diversity jurisdiction, there is a potential conflict of laws. The parties have not briefed this issue and without more information I cannot rule on it. I hope that the parties can confer and agree on what law governs and, then, what that law requires with respect to compulsory counterclaims. If no agreement can be reached, the parties should promptly brief these remaining legal issues and submit them to the Court.

III. CONCLUSION

Advancement agreements require a hefty dose of good faith on the part of both sides in order to work. Given the context in which advancement often arises (i.e., a dispute between the company and its former directors/officers), good faith cooperation is undoubtedly difficult to muster. Nevertheless, this Court does not

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[30] *See Harris v. Steinem*, 571 A.2d 119, 124 (2d Cir. 1978) (finding that a counterclaim for defamation based on the filing of the initial complaint is *not* a compulsory counterclaim despite common issues of law and fact); *see also Greater New Orleans Fair Housing Action Ctr. v. Brister*, C.A. No. 02-3797, 2005 WL 517338, at *1 (5th Cir. Mar. 1, 2005) (noting that defamation counterclaims based on allegations of initial complaint are not compulsory); *Hickory Pine Assocs. Ltd. P'ship v. Purchase Envtl. Prot. Ass'n. Inc.*, 92 CIV. 1414 (TPG), 1995 WL 231311, at *3–4 (S.D.N.Y. Apr. 19, 1995) (noting that defamation counterclaims based partially on statements made even before filing of complaint are still not necessarily compulsory even where there are some common questions of law or fact); *Howell v. Town of Fairchild*, 123 F.R.D. 429, 430–31 (D. Conn. 1988) (holding similarly that defamation counterclaims in civil rights suits are not compulsory despite "common questions of truth and falsity").

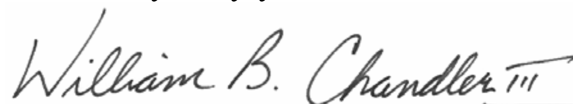
relish and will not perform the task of playground monitor, refereeing needless and inefficient skirmishes in the sandbox.[31] As this Court has stated before, "a balance of fairness and efficiency concerns would seem to counsel deferring fights about details until a final indemnification proceeding."[32]

Dow cannot simply continue to arbitrarily pay only half of the amount listed on invoices submitted by plaintiffs. At the same time, plaintiffs need to give Dow invoices with greater detail. To the extent the parties agree or this Court subsequently determines that the counterclaims are not compulsory, plaintiffs will need to carefully review their invoices to remove time billed for work on the counterclaims. Even if, however, the counterclaims are compulsory, plaintiffs should submit invoices with greater detail.

Perhaps I am overly optimistic, but I do not believe this case has reached a point where there is "no reasonable hope of light at the end of this tunnel,"[33] and, therefore, I decline to follow Dow's suggestion of appointing a special master to oversee advancement disputes. I trust that this decision will render clear the rules of the game and that once it is determined or agreed whether the plaintiffs' counterclaims are compulsory, the advancement agreement will operate efficiently.

IT IS SO ORDERED.

Very truly yours,



William B. Chandler III

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[31] *Cf. Fasciana v. Electronic Data Sys. Corp.*, 829 A.2d 160, 177 (Del. Ch. 2003) ("[T]he function of a § 145(k) advancement case is not to inject this court as a monthly monitor of the precision and integrity of advancement requests.").
[32] *Id.*
[33] *Homestore, Inc. v. Tafeen*, 888 A.2d 204, 209 (Del. 2005) (approving Court of Chancery's decision to appoint special master).