



1 APPEARANCES:

2 DAVID J. WEIDMAN, ESQ.  
3 Sergovic, Carmean & Weidman, P.A.  
4 for Petitioners

4 RICHARD E. BERL, JR., ESQ.  
5 Berl & Feinberg, LLP  
6 for Respondent Steven J. Kern

6 WILLIAM B. WILGUS, ESQ.  
7 for Respondent David W. Wharton

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1 THE COURT: Good afternoon, counsel.

2 ALL COUNSEL: Good afternoon, Your  
3 Honor.

4 THE COURT: Happy New Year. I'm sorry  
5 this courtroom is not any warmer, but there's not much  
6 I can do about it.

7 Mr. Weidman, would you like to present  
8 your motion.

9 MR. WEIDMAN: Thank you, Your Honor.

10 Dave Weidman for Tom and Georgeann  
11 White. I will not recite the details of my motion for  
12 the Court. I want to make two comments about the  
13 motion itself.

14 And that is, one, it's undisputed that  
15 the current bylaws do not provide for indemnification  
16 for advancement. Number two, it's also undisputed  
17 that the Supreme Court's case of Gentile v.  
18 SinglePoint, in my opinion, controls the disposition  
19 of this case in terms of interpreting the statute.  
20 The Court in that case said that, as I pointed out,  
21 it's a permissive statute, not mandatory.

22 If the issue becomes whether or not  
23 the corporation, through its directors now, can go  
24 back and retroactively provide for advancement by

1 amending the bylaws, there is a case decided by this  
2 Court, which Your Honor is probably familiar with.  
3 It's Underbrink versus Warrior Energy. And in that  
4 case, the Court outlined the analysis that would  
5 apply. In that case, the Court determined, under  
6 those particular facts, that the business judgment  
7 rule would apply.

8           It also weighed, though, whether the  
9 entire fairness review doctrine would apply, and I  
10 submit to the Court that, if the Court permits the  
11 directors in this case to amend the bylaws now to  
12 provide for future advancements, then it would not  
13 pass the entire fairness review test.

14           THE COURT: Would the same be true of  
15 a vote of the directors in the specific instance to  
16 advance fees?

17           MR. WEIDMAN: It would be. Because,  
18 in fact, in the Havens case, the Court had to deal  
19 with the advancement of a particular. This was the  
20 language used, "particular litigation expenses."  
21 Havens found that the advancement of particular  
22 litigation expenses would likely not pass the entire  
23 fairness review test.

24           In this case you already have

1 litigation that's commenced. We have alleged breach  
2 of fiduciary duty. We've alleged self-dealing. And  
3 it's our position that in the event that the directors  
4 now are entitled to prospectively advance themselves  
5 of legal fees in light of those allegations, it would  
6 simply be a continuation of a self-interested  
7 transaction, series of transactions.

8 THE COURT: I'm assuming that your  
9 client is not using corporate funds to pay --

10 MR. WEIDMAN: At all.

11 THE COURT: -- litigation expenses.

12 MR. WEIDMAN: That's correct. All  
13 those funds have been personal, Your Honor.

14 THE COURT: All right. Thank you.

15 MR. WEIDMAN: That's all I have.

16 THE COURT: Thank you, Mr. Weidman.  
17 Are you going to argue, Mr. Berl?

18 MR. BERL: Yes. Thank you, Your  
19 Honor. Richard Berl for the defendants.

20 The issue really isn't the bylaws,  
21 Your Honor. The source of the right to  
22 indemnification and advancement stems from Section 145  
23 of the Code.

24 THE COURT: It's permissive under the

1 Code.

2 MR. BERL: It's permissive. There are  
3 certain --

4 THE COURT: So how is it authorized  
5 here? It's not in the bylaws. There's been no vote,  
6 correct?

7 MR. BERL: Correct.

8 THE COURT: So how is it authorized  
9 here?

10 MR. BERL: Your Honor, that was part  
11 two. We understand that there was never a formal  
12 meeting and formal vote to authorize the advancement.  
13 What we've said is it's a 66 percent to 33 percent.

14 THE COURT: Right.

15 MR. BERL: If we go back and do it --

16 THE COURT: Go ahead.

17 MR. BERL: Okay. If we go back and  
18 have that meeting, the two existing -- the two  
19 defendant shareholders approve it, we are right back  
20 where we are today.

21 THE COURT: So it's your contention --  
22 I think as you put it -- it would be a speed bump.

23 MR. BERL: I think that's what I  
24 called it.

1           THE COURT:  But isn't it a speed bump  
2 on the road to looting the corporation?  Your clients  
3 can't in a nonconflicted manner authorize payment of  
4 their own legal fees from corporate funds, can they?  
5 They would be precluded from that vote.

6           MR. BERL:  As interested directors  
7 they would be, but as shareholders --

8           THE COURT:  As controlling  
9 shareholders?

10          MR. BERL:  As controlling  
11 shareholders.

12          THE COURT:  They have the same  
13 fiduciary duty; do they not?

14          MR. BERL:  They might.  But  
15 advancement is one of those decisions, Your Honor,  
16 made at the outset of the litigation.  It's not like  
17 indemnification where we have to come back and say,  
18 "Okay.  We prevailed.  We get to keep the money."  The  
19 advancement can be authorized by the corporation  
20 without an analysis of the reasons for the  
21 advancement, the pros and cons.

22          THE COURT:  That's not what Vice  
23 Chancellor Chandler says in a case that has just been  
24 cited by Mr. Weidman, is it?  He said that business

1 judgment rule would apply, but that upon a showing  
2 that there hadn't been consideration of the good of  
3 the corporation or the ability to repay or any one of  
4 a number of factors, if the business judgment rule  
5 applied, that, as in that case, the decision of the  
6 corporate board would not be considered valid, would  
7 not be entitled to business judgment rule.

8 Here, if your clients had voted at the  
9 outset, they were already interested. So I can't see  
10 how their vote -- it would be an entire fairness  
11 review. How would your client prove entire fairness?

12 MR. BERL: Your Honor, I don't think  
13 that analysis takes place at the outset with respect  
14 to advancement.

15 THE COURT: Sure it does. They're  
16 giving themselves a benefit from the corporation, and  
17 they're doing it in a conflicted manner. There would  
18 be no independent director voting in favor of this, if  
19 I assume that the vote would come out two to one, as  
20 you've suggested. So I don't see how there can be --  
21 you're saying I should retroactively apply a vote that  
22 presumably would have taken place, but it would have  
23 been a conflicted vote.

24 MR. BERL: Well, I don't think 145



1 precludes the shareholders from making that decision,  
2 Your Honor. It specifically gives you four choices,  
3 and we understand all three directors are essentially  
4 conflicted. I think that's why they work down that  
5 hierarchy.

6 THE COURT: But these stockholders are  
7 controlling stockholders. They have the same  
8 fiduciary obligation and they would be under the same  
9 constraint. And those four possibilities -- it's not  
10 even clear that the independent counsel one would  
11 apply here. But in any event, there is no independent  
12 counsel that is advocating for this, correct?

13 MR. BERL: That's right.

14 THE COURT: You're under conflict.  
15 Mr. Wilgus is under conflict.

16 MR. BERL: Your Honor, I think it  
17 follows what Justice Holland said in that Homestore  
18 case that we relied on. Advancement is one animal,  
19 and indemnification is the other. At the end of the  
20 day, if those receiving the advancements don't prevail  
21 in some sense, they have to give the money back.

22 THE COURT: If there had been a  
23 two-to-one vote to provide advancement to all  
24 directors that was independent of the lawsuit filed

1 here, then I would agree with you. If there had been  
2 a vote to amend the bylaws to create such a right,  
3 independent of this lawsuit, I would agree with you.  
4 But I am -- frankly, I see no way at all that the  
5 controlling stockholders/majority of the board of  
6 directors can vote for themselves a benefit that's not  
7 in the corporate bylaws to shift money from the  
8 corporation to them for purposes of this litigation.  
9 I just don't understand it.

10 MR. BERL: There's no bylaw at issue,  
11 Your Honor.

12 THE COURT: Sure. That's right.  
13 There's no bylaw.

14 MR. BERL: But the authority stems  
15 from the Corporate Code. I don't think it requires  
16 that there be a bylaw.

17 THE COURT: It requires there be a  
18 bylaw or a decision of the corporation through the  
19 shareholders or a decision of the corporation through  
20 the directors. Both the stockholders -- the  
21 shareholders and the directors here are conflicted.  
22 So it's -- you can't do it.

23 MR. BERL: Your Honor, our reading of  
24 145 would -- again, focuses on the shareholders

1 knowing -- and there are some cases that I did review  
2 that focused on the interested director situation.  
3 But it's our feeling that the stockholders --

4 THE COURT: Cite me a case, if you  
5 would. Cite me a case where the majority  
6 stockholders, who are the same as the majority of the  
7 board of directors, voted themselves a benefit, and  
8 the ratification of those interested stockholders was  
9 sufficient to confer business judgment protection or  
10 any other protection on that decision.

11 MR. BERL: I couldn't do that.

12 THE COURT: I couldn't either because  
13 I don't think there are any, frankly.

14 You know, the situation is your  
15 clients' control the board. They control the board  
16 because they are the majority of the board. They  
17 control the board because they're majority  
18 shareholders. They're being sued, and they have voted  
19 for themselves -- well, they haven't even done that.  
20 But even if I considered them to have in some sense  
21 made a determination on behalf of the corporation that  
22 it's in the corporation's interest that there be  
23 advancement here, they're conflicted, both as majority  
24 stockholders and as directors.

1           So if it were in the -- if it had been  
2 done in an independent way, for instance if it were in  
3 the bylaws, then they would be entitled to  
4 advancement. But nobody did that. You didn't create  
5 that. Your clients didn't create that.

6           What they created was a regime in  
7 which there was no advancement unless it is provided  
8 for by director action or shareholder vote, and those  
9 are precluded here because of the conflict, because of  
10 the self-interest.

11           MR. BERL: Well is Your  
12 Honor indicating -- I won't use that word. If the  
13 corporation enacted a bylaw that provided, for  
14 example, for mandatory advancement in the event of a  
15 lawsuit under 145, that would carry the day.

16           THE COURT: If they had done it before  
17 this lawsuit arose, and if they did it to cover  
18 situations that didn't include this lawsuit, then they  
19 could do that. But you can't go back now and say,  
20 "Well, we're really independent directors making an  
21 independent decision that we would like advancement  
22 rights to apply generally," and have them apply to  
23 this case, because they are obviously conflicted.  
24 They're fiduciaries for a corporation. I know they're

1 only three of them, but they're fiduciaries for a  
2 corporation. They have fiduciary obligations to the  
3 minority. And they can't take a decision that is in  
4 their self-interest in a way that is separate from the  
5 interest of the stockholders and transfer a benefit to  
6 themselves. That, to me, is basic corporate fiduciary  
7 duty.

8 MR. BERL: But the Court would have  
9 the ability under 145 to reverse an advancement in the  
10 event the defendants did not prevail, for example.

11 THE COURT: Right. But what if they  
12 don't have the money? Then the corporation is out.  
13 So it's not really in the interest of Mr. White's  
14 shares that there be this advancement. It's only in  
15 the interest of your clients. So unless I'm missing  
16 something -- and it wouldn't be the first time -- I  
17 don't understand how they can do this.

18 MR. BERL: Well, again, Your Honor, it  
19 was our contention as shareholders that they would  
20 have the right to do that. I can't offer you anything  
21 other than what was in the application.

22 THE COURT: All right. Thank you,  
23 Mr. Berl. I appreciate the argument.

24 Mr. Wilgus, do you want to add

1 anything?

2 MR WILGUS: The only thing I would  
3 like to add, Your Honor, is that -- and I looked at  
4 the case cited by Mr. Weidman -- I don't see anything  
5 that prevents the corporation itself from hiring  
6 independent counsel to represent the corporation and  
7 make a recommendation to provide advancements for the  
8 two respondents.

9 THE COURT: Has it done that?

10 MR WILGUS: It has not done that. But  
11 if it does, we get right back to the point that  
12 Mr. Berl made in his written statement, which is that  
13 it's a speed bump.

14 THE COURT: It's hardly a speed bump  
15 because you are going to have to get independent  
16 counsel to opine that it is in the interest of this  
17 corporation that advancement be given to two directors  
18 being sued by a third and that that is a fair result  
19 to the minority stockholder. So it's hardly a speed  
20 bump.

21 MR WILGUS: Or the independent counsel  
22 could also opine, possibly, that attorneys' fees could  
23 be advanced to all three shareholders in this  
24 instance. And I would suggest --

1                   THE COURT: There could be any kind of  
2 opinion. We can't speculate as to what there are.  
3 But it's not a speed bump. It will require an  
4 evaluation of fiduciary duty. It seems to me that it  
5 is unlikely in this instance, because it would have to  
6 be in the best interest of the corporation. How that  
7 would be in the best interest -- usually the interests  
8 that are represented by advancement contracts or  
9 advancement bylaw provisions are in the corporation  
10 being able to acquire for itself fiduciaries who are  
11 willing to work for the good of the corporation.  
12 That's the interest, not the individual interests of  
13 the directors who are suing one another.

14                   In this situation, it seems to me  
15 extremely unlikely that you could get such an opinion.  
16 I'm not precluding it. If that's what you want to do,  
17 you can try it. But it seems unlikely to me that that  
18 is going to be the result you are going to get from  
19 independent counsel. But at any rate, it's not been  
20 done. So it's not in front of me.

21                   MR WILGUS: I understand that.

22                   THE COURT: So I'm not going to make  
23 an advisory opinion on whether that would be effective  
24 or not effective.

1                   MR WILGUS: As long as we are not  
2 precluded from it. And frankly, I thought the Court's  
3 prior comments precluded such action.

4                   THE COURT: No; you can take whatever  
5 action you like. We are going to be back here. Once  
6 it's in front of me and I see what the decision of  
7 counsel is, can evaluate the independence of counsel  
8 and the adequacy of the decision, if there is such a  
9 decision, then I will be happy to look at it. But I'm  
10 not precluding you from doing anything, but I'm not  
11 making an advisory ruling either.

12                   MR WILGUS: That's appreciated, Your  
13 Honor. Thank you.

14                   THE COURT: All right. Anything else?

15                   MR WILGUS: Not from me.

16                   THE COURT: All right. Mr. Weidman, I  
17 have determined that there was no unconflicted  
18 director vote, either effective or actual, and that  
19 the bylaws did not confer the right to advancement and  
20 that therefore the taking of funds under the guise of  
21 advancement by the defendants in this case was ultra  
22 vires.

23                   What application are you making at  
24 this point?



1                   MR. WEIDMAN: The application I would  
2 make, Your Honor, is for the Court to enter an  
3 order -- and if you wish, I can prepare a form of  
4 order -- that all funds advanced to the two defendants  
5 in this case be repaid by them within 30 days from the  
6 date of the Court's order.

7                   Based upon the Court's comments  
8 moments ago, I'm not sure if the Court would entertain  
9 an order that also provided that there shall be no  
10 further advancements pending further order of the  
11 Court or application by the defendants. But I am  
12 concerned based upon counsel's comments that I'm going  
13 to be in the position of having to police whether or  
14 not additional funds will be written out of the  
15 corporate account to benefit counsel.

16                   THE COURT: All right. Let me hear  
17 from Mr. Berl and Mr. Wilgus their reaction to that  
18 proposal.

19                   MR. BERL: I would assume that the  
20 Court would order the funds to be reimbursed. And I  
21 don't know why -- I don't know why any more would be  
22 required after today.

23                   THE COURT: All right.

24                   MR. BERL: I'm not quite sure what

1 Mr. Weidman really was asking for.

2 THE COURT: Mr. Weidman was asking me  
3 to enter an order that would enjoin the defendants  
4 from transferring funds from the corporation  
5 themselves for purposes of advancement without further  
6 notice to the Court. He's concerned that you will get  
7 an -- that you will hire counsel to provide an opinion  
8 which would allow advancement and then would take  
9 funds from the corporation without any further review  
10 by the Court.

11 MR. BERL: Just going one step further  
12 from your discussion with Mr. Wilgus -- I'm sorry. If  
13 the defendants were to retain counsel and obtain that  
14 sort of opinion --

15 THE COURT: The defendants couldn't  
16 retain counsel. The corporation.

17 MR. BERL: That's right. If the  
18 corporation retained counsel, got the opinion that  
19 Mr. Wilgus was referring to, I don't know that that  
20 would necessarily automatically bring this matter back  
21 to court, would it?

22 THE COURT: That's the concern that's  
23 just been expressed that I put something in the order  
24 so that it would require court review before payments

1 were resumed, if that comes to pass.

2 Do you have any objection to that?

3 MR. BERL: I don't think so, Your  
4 Honor.

5 THE COURT: All right.

6 Mr. Wilgus.

7 MR WILGUS: Well, I do. I think it's  
8 putting the cart before the horse. Let's see if the  
9 corporation chooses to hire independent counsel. And  
10 if it does so and an opinion is rendered so as to  
11 allow the advancements, then it's corporate action and  
12 not the action of the parties before the Court.

13 THE COURT: Got it.

14 All right. What I need then is a form  
15 of order, please, ordering --

16 30 days is what you are suggesting?

17 MR. WEIDMAN: Yes, sir.

18 THE COURT: I haven't heard any  
19 suggestion to the contrary. So ordering that the  
20 money be disgorged within 30 days and that no further  
21 advancement is to be made without an order of the  
22 Court.

23 I don't think it's putting the cart  
24 before the horse. I think what your clients have done

1 is clearly, clearly a violation of their fiduciary  
2 duties. It's ultra vires. They didn't have the right  
3 to do it. They ought not to have done it. I don't  
4 have any confidence that they won't do it again.

5           So to suggest that it's putting the  
6 cart before the horse to have this reviewed by the  
7 Court rather than have them simply transfer money to  
8 themselves again from the corporate treasury doesn't  
9 impress me, Mr. Wilgus, as appropriate. So I would  
10 like that in the opinion as well -- I mean, in the  
11 order as well.

12           MR. WEIDMAN: I will put that in the  
13 form of order.

14           Your Honor, when I initially filed the  
15 motion I also had a provision in there for attorneys'  
16 fees for having to bring this motion. I can leave it  
17 in there and let counsel respond to it or submit an  
18 affidavit. But I have been requested by my client to  
19 seek attorneys' fees for having to bring this motion.

20           THE COURT: Because they didn't  
21 respond directly to that, what I will do is --

22           Counsel, discuss that with your  
23 clients. If you wish to oppose it, then I will give  
24 you two weeks from today to file a memo opposing the

1 fees requested for \$750 each; is that right? \$1500?

2 MR. WEIDMAN: I asked for -- yes, each  
3 respondent.

4 THE COURT: That would include the  
5 presentation today?

6 MR. WEIDMAN: Yes, it would.

7 THE COURT: All right. I will give  
8 you two weeks to respond to that, unless you can work  
9 it out.

10 Anything else we can do here?

11 MR. WEIDMAN: No. Thank you, Your  
12 Honor.

13 THE COURT: Thank you, all.

14 (Court adjourned at 1:16 p.m.)

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CERTIFICATE

I, CHRISTINE L. QUINN, Official Court Reporter for the Court of Chancery of the State of Delaware, do hereby certify that the foregoing pages numbered 3 through 21 contain a true and correct transcription of the proceedings as stenographically reported by me at the hearing in the above cause before the Vice Chancellor of the State of Delaware, on the date therein indicated, except for the rulings at pages 16 through 21, which were revised by the Vice Chancellor.

IN WITNESS WHEREOF I have hereunto set my hand in Georgetown, Delaware this 27th day of January, 2014.

/s/ Christine L. Quinn  
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Official Court Reporter  
of the Chancery Court  
State of Delaware