

IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE
IN AND FOR NEW CASTLE COUNTY

RADIANCY, INC.,)
)
Plaintiff,)
)
v.) C.A. No. 1547-N
)
ZION AZAR, PINCHAS SHALEV, and)
ITAY PERRY,)
)
Defendants.)

MEMORANDUM OPINION

Submitted: January 5, 2006

Issued: January 23, 2006

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LAMB, Vice Chancellor.

The court held oral argument on the counterclaim plaintiffs' motion for summary judgment with respect to advancement of litigation expenses on December 15, 2005. At that time, the court ruled orally on the record, granting those motions in part, and denying them in part. This opinion summarizes the content of that ruling. In addition, this opinion emphasizes the unambiguous fact that corporations that voluntarily extend to their officers and directors the right to indemnification and advancement under 8 *Del. C.* § 145 have a duty to fulfill their obligations under such provisions with good faith and dispatch. It is no answer to an advancement action, as either a legal or logical matter, to say that the corporation now believes the fiduciary to have been unfaithful. Indeed, it is in those very cases that the right to advancement attaches most strongly.

This case initially arose from a complaint filed on August 5, 2005, by Radiancy, Inc., a Delaware corporation, against Zion Azar, Pinchas Shalev, and Itay Perry, all of whom are former directors and officers of the company. That complaint alleges that the three former directors and officers breached their fiduciary duties to the plaintiff, committed fraud, and committed waste in the course of their duties with Radiancy, Inc. Count IV of the complaint also alleges that Azar and Shalev, but not Perry, breached certain employment agreements entered into with Radiancy. At some point in 2005, the defendants in this action brought a claim against Radiancy Israel, a wholly owned subsidiary of Radiancy,

Inc., in Israel's Labor Court. On or about August 15, 2005, Radiancy Israel responded to that action by filing suit on its own behalf against the present defendants in the same court, asserting claims based on essentially the same set of alleged misdeeds as those that form the basis of the Delaware action.

On August 28, 2005, Azar, Shalev, and Perry sought advancement for litigation expenses in all actions pursuant to a Radiancy, Inc. bylaw provision. When that request was denied, Azar and Shalev filed an answer with affirmative defenses and counterclaims in this court on September 30, 2005, alleging in Counts I and II that Radiancy breached certain employment agreements and violated the implied covenant of good faith and fair dealing in connection with those agreements. In Count III of the counterclaim, Azar and Shalev alleged that they were due advancement for all litigation expenses relating to the Radiancy claims and the defendants' counterclaims. On the same day, Perry filed an answer and counterclaim alleging in Count I that Radiancy violated a stock option agreement, and demanding advancement in Count II.

On October 21, 2005, Azar, Shalev, and Perry moved for summary judgment on their advancement claims. That motion was heard on December 15, 2005. The court's contemporaneous ruling, summarized in this opinion, was delivered orally from the bench. At that hearing, the court also requested supplemental submissions on the issue of Perry's official position with Radiancy, Inc. and

Radiancy Israel at the time of the misconduct alleged by both companies. This opinion incorporates the court's consideration of that matter.

Radiancy justifies its resistance to the advancement claims on a number of fronts. First, it argues that Delaware law recognizes a distinction between claims involving a personal employment agreement and claims brought by "reason of the fact" of the director's position with the corporation. Therefore, it argues, Radiancy's allegations of theft and other "personal" claims in Counts I through IV of this litigation and in Radiancy Israel's action before the Labor Court do not trigger Radiancy's duty to advance litigation expenses as to any of the defendants under the bylaws. At the very least, it argues, advancement is not due for Count IV, which solely references Azar and Shalev's employment agreements.

Further, Radiancy contends that both the Azar and Shalev affirmative claims in Israel's Labor Court, and Counts I and II of their counterclaims in this action, are exempted from advancement because they are affirmative claims related only to employment agreements that are not indemnifiable under the Radiancy bylaws.

Independently, and in addition to the above arguments, Radiancy contends that Section 6.1 of the Radiancy bylaws differentiates between the mandatory right of advancement due to directors and officers, and a discretionary right to advancement due to employees or agents. Therefore, Radiancy maintains that no advancement at all is due to Perry for actions undertaken before June 2004 because

he was neither a director or officer of Radiancy, Inc., nor a director or officer of Radiancy Israel serving at the request of Radiancy, Inc., until that date. Rather, Radiancy argues that Perry served Radiancy Israel as an employee and remained as such for the entirety of his tenure; therefore, Perry is entitled only to discretionary advancement.

I.

The court's determination of whether Perry is due advancement requires consideration of several subsidiary points. First, the court must determine whether Radiancy, Inc.'s bylaws make any differentiation between the advancement due to directors and officers on one hand, and agents and employees "serving at the request" of Radiancy, Inc. on the other. If so, and if agents and employees are due only discretionary advancement, as the plaintiff alleges, then, in order to be due mandatory advancement, Perry must show either that (1) he became a director or officer of Radiancy, Inc. or (2) that he became a director or officer of Radiancy Israel at the request of Radiancy, Inc., and that such directors or officers are due mandatory advancement to the same extent as directors or officers of the parent.

As to the first issue, the court concludes on the basis of the plain language of Section 6.1 of the Radiancy, Inc. bylaws that mere employees or agents of Radiancy, Inc., even those serving another corporation "at the request" of the

parent, are due only discretionary advancement.¹ The parties knew, as demonstrated by the more inclusive indemnification provision, how to draft language that provides mandatory advancement for directors, officers, *and* employees or agents serving at the request of Radiancy, Inc. They chose not to do so. Rather, the advancement bylaw provides that litigation expenses *may* be advanced to such parties as “the Board of Directors deems appropriate.”² Such language, as this court has repeatedly held, does not establish mandatory advancement or indemnification.³

Second, the record is clear that Perry was not a director or officer of Radiancy, Inc. at any time prior to June 1, 2004. Delaware corporate law requires that officers are either named in the certificate of incorporation, or designated by a vote of the board of directors.⁴ In the absence of any facts on the record indicating

¹ Section 6.1 of the bylaw provides that “[e]ach person who was . . . a party . . . in any threatened, pending, or completed action, suit or proceeding . . . by reason of the fact that he or she . . . is or was a director or officer of the Corporation or is and was serving at the request of the Corporation as a director, officer, employee, partner (limited or general) or agent of another corporation . . . shall be . . . indemnified and held harmless by the Corporation . . . to the fullest extent authorized by the Delaware General Corporation Law” The bylaw also provides for advancement, which “shall include the right to be paid by the Corporation . . . the expenses (including attorney’s fees) incurred in the defense of or other involvement in any such proceeding in advance of its final disposition; . . . and provided further, that, such expenses incurred by other employees and agents may be so paid in advance upon such terms and conditions, if any, as the Board of Directors deems appropriate.” McGrath Aff. Ex.1 § 6.1.

² *Id.*

³ *See e.g., Havens v. Attar*, 1997 Del. Ch. LEXIS 12, *40 (Del. Ch. Jan. 30, 1997).

⁴ RODMAN WARD, EDWARD P. WELCH, & ANDREW TUREZYN, *FOLK ON THE DELAWARE GENERAL CORPORATION LAW*, § 141.2 (2005 ed.).

that Perry was appointed as a director or officer of Radiancy, Inc. before June 2004, he is not entitled to any earlier advancement.

It is equally clear that Perry is due advancement as a director and officer of Radiancy, Inc., to the same extent as Azar and Shalev, for any actions after June 2004 . Indeed, the plaintiff concedes that Perry became an officer and director of Radiancy on that date. Under Section 6.1 of the bylaws, therefore, there is no basis on which to challenge Perry's right to advancement for those allegations.

The only remaining question as to Perry is when and if he became a director or officer of Radiancy Israel at the request of Radiancy, Inc., and whether his status as such (if any) entitles him to mandatory advancement. The latter question can be answered as a matter of law by reading Section 6.1. As the court has already concluded, the bylaws differentiate between directors/officers and employees/agents of Radiancy, Inc. for the purposes of mandatory advancement. This includes directors and officers serving another corporation "at the request" of Radiancy, who are unambiguously entitled to mandatory advancement.

The court cannot decide on this record, however, whether Perry himself was a director or officer of Radiancy Israel serving at the request of Radiancy, Inc. at any time prior to June 2004. Simply put, no facts presented either in the parties' initial papers, or in the supplemental submissions, suggest in any way that Perry was appointed to his position at Radiancy Israel by Radiancy, Inc. It may be that

such evidence exists, and can be produced by Perry. If so, and if Perry was serving as a director or officer of Radiancy Israel,⁵ then he would be due advancement to the same extent as Azar and Shalev from the date when he was so appointed. At this stage, however, the court cannot conclude Perry is due advancement for allegations that predate June 2004.

As to Azar and Shalev, it is clear that virtually all amounts spent by them in defending the action before this court are fully and properly subject to the advancement bylaw provision. Certainly, it is true that Delaware law recognizes the same distinction between entirely personal claims and claims brought “by reason of” the director’s duties. But the plaintiff’s allegations in this case, possibly other than those in Count IV, are centered around actions taken by directors and officers in their capacities as such. These are paradigmatically the kinds of claims

⁵ A subsidiary issue is whether Perry was ever an officer of Radiancy Israel at any time prior to June 2004. Under Delaware law, it seems clear that he was not, because he was only formally appointed as an officer at that later date. But Radiancy Israel is not a Delaware corporation, and may be subject to some rule by which Perry would indeed be considered an officer by virtue of his position as comptroller, or because he was acting as CFO. The facts on the record permit that result. Azar and Perry’s declarations suggest that Perry was merely an employee of Radiancy Israel, serving as comptroller, with augmented responsibilities that might have replicated that of a CFO. But Radiancy, Inc.’s May 18, 2004 board minutes characterize Perry as CFO of Radiancy Israel, in the course of discussions leading to his appointment as an officer and director of Radiancy, Inc. The court cannot say, without further factual development, whether that characterization was merely a flawed description of Perry’s functional role with Radiancy Israel, or whether it reflected a decision by the Radiancy Israel board to employ Perry as CFO in a more formal capacity, or whether Radiancy Israel felt that no such formalities were needed. As explained above, however, this issue is moot unless the defendants can show that Perry was serving Radiancy Israel at the request of Radiancy, Inc.

that are subject to advancement. Indeed, to hold otherwise would be to allow companies to convert fiduciary duty claims subject to advancement into personal claims for which no payment is due simply by clever labeling. The court rejects such efforts.

Count IV of the complaint alleges that Azar and Shalev breached employment agreements with Radiancy. As a practical matter, there may be some legal or factual issues relating to this count that are not otherwise encompassed within the rest of the complaint. To that extent, these issues may overlap with those parts of the counterclaims, also relating to employment agreements, that are not properly subject to advancement. But the fact that there may be some overlap between the counts subject to advancement in the Radiancy Israel action or in the instant case, and the defendants' counterclaims, is not a basis for the company to object to the amount of advancement sought in this case. Although issues will inevitably arise as to the allocation of expenses between claims due advancement and those that are not, the retainers in question here are so modest that they clearly are due to the defendants.

Radiancy Israel's action in Israel is also subject to advancement. It may well be true, as the plaintiff belatedly urged at oral argument, that the Labor Court in Israel generally hears cases that are similar in nature to the personal claims set out

as exceptions to advancement in *Cochran v. Stifel Financial Corp.*⁶ Whatever the result of that court's view of its jurisdiction, however, under Delaware law, Radiancy Israel's allegations are plainly based in the defendants' roles as directors and officers, and are not of the type identified as personal in *Stifel*. The defendants are therefore also due advancement as to the Radiancy Israel action.

Finally, the court agrees in part with Radiancy that neither the action brought by the defendants in Israel nor parts of Counts I and II of their counterclaim in this court are subject to advancement. The court need not decide the advancement claim as to the defendants' Israel action because the defendants have forthrightly conceded that issue. As to the latter counterclaims, the court finds that they refer in part to matters of contractual interpretation that fall outside the defendants' roles as officers or directors. Specifically, the factual and legal issues involved in determining whether the defendants validly entered into employment agreements with Radiancy are clearly separable from the questions raised by the complaint and are therefore not subject to advancement. Of course, to the extent that the issues involved in Counts I and II of the counterclaim mirror the allegations in the plaintiff's complaint, those issues are subject to advancement. The court hopes that issues of allocation can be resolved by the parties without further court intervention.

⁶ 2000 Del. Ch. LEXIS 179 (Del. Ch. Dec. 13, 2000).

In sum, the court finds that the plaintiff wrongly denied the defendants advancement in connection with both the Delaware and Radiancy Israel actions. The court finds this particularly striking because the defendants' requested advancement, at this point, is a modest retainer in order to secure the services of counsel. As the court observed at oral argument, it would be surprising if any lawyer would agree to represent foreigners in litigation here, or in litigation in a foreign country, without first receiving a retainer. Far from demanding a blank check, in other words, the defendants have requested the very least they could have expected to receive under the Radiancy advancement bylaw.

The court therefore also awards the defendants "fees on fees" in connection with having filed Count III of the counterclaim, having moved for summary judgment, and having brought this matter to a decision today. Moreover, that award will include interest at the legal rate from August 28, 2005, when the demand was made. To decide otherwise when the plaintiff has so clearly violated its contractual duty to provide advancement would be to weaken Section 145 of the Delaware corporate law, and to encourage the very kind of reflexive challenges to advancement claims that have proliferated in such number before this court recently. The court firmly refuses to reach a result that would have either one of those undesirable effects.

II.

For the foregoing reasons, Azar and Shalev's motion for summary judgment is GRANTED IN PART and DENIED IN PART. Perry's motion for summary judgment is DENIED. The attorneys for the movants shall submit a form of order in compliance with this opinion, on notice, within ten days of the date of this opinion.