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IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

IN AND FOR NEW CASTLE COUNTY

FGC HOLDINGS LIMITED and PETER FRIEDMANN,	)	
Plaintiffs,	)	
v.	)	Civil Action No. 883-N
TELTRONICS, INC.,	)	
Defendant.	)	

MEMORANDUM OPINION

Submitted: September 27, 2006
Decided: January 22, 2007

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PARSONS, Vice Chancellor.

Pending before the Court is Plaintiffs' motion for attorneys' fees and costs stemming from a putative director's successful bid to be placed on the board of directors of the Defendant. Plaintiff FGC Holdings Limited ("FGC") is an Ontario-based Canadian holding corporation owned by Peter Friedmann, the sole shareholder and director of FGC. Defendant, Teltronics, Inc. ("Teltronics"), is a publicly traded telecommunications company. The underlying dispute stems from FGC's purchase of preferred stock in Teltronics. FGC purchased all 12,625 shares of Teltronics' Series B Preferred Convertible Stock (the "Series B") from a third party and presented the stock to Teltronics for registration on October 5, 2004. Teltronics refused to register the transfer. On November 24, 2004, FGC filed suit to compel Teltronics, among other things, to (i) register the transfer of stock to FGC; (ii) issue stock certificates in FGC's name; and (iii) recognize FGC's election of Friedmann as a Series B director.[1]

On the scheduled trial date, February 2, 2005, Teltronics and FGC entered into a Consent to Judgment, whereby Teltronics agreed to register FGC's shares. The Court then tried the sole remaining issue: whether FGC's Series B director designee had an immediate right to sit on Teltronics' board of directors. In a memorandum opinion issued September 14, 2005 (the "Memorandum Opinion"),[2] I concluded that FGC was entitled to a declaratory judgment that its Series B director had an immediate right to sit on Teltronics' board. FGC has now moved for its reasonable attorneys' fees and costs under

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[1] On August 24, 2006, the Court granted FGC's motion to amend the Complaint to add Friedmann as an additional Plaintiff, among other things.

[2] 2005 Del. Ch. LEXIS 140.

two alternative theories. First, FGC seeks reimbursement based on the bad faith exception to the American Rule. Second, FGC seeks reimbursement pursuant to Section 145 of the Delaware General Corporation Law ("DGCL")[3] and Teltronics' bylaws regarding indemnification. As this litigation developed, it involved two distinct parts: (1) the proceedings from the commencement of the action until the eve of trial, which concentrated on FGC's claim to register the transfer of the Series B stock to it; and (2) the proceedings from the end of January 2005 until the present, which focused on Plaintiffs' efforts to establish Friedmann's right to an immediate seat on Teltronics board and recover their expenses in vindicating that right.

For the reasons stated, I conclude that Plaintiffs failed to prove an entitlement to attorneys' fees incurred in the registration portion of the case under either an exception to the American Rule or an indemnification theory. I also am not persuaded that FGC or Friedmann has a right to indemnification for their efforts to establish Friedmann's right to an immediate seat on the Teltronics board. I do find, however, that much of Teltronics' conduct in the latter part of the litigation constituted an improper attempt to delay or render more burdensome than necessary Plaintiffs' efforts to secure their clear and established right to a Series B director. Accordingly, I have determined to award Plaintiffs 50 percent of the attorneys' fees they incurred in connection with the portion of the case from late January 2005 to the present. In addition, because Plaintiffs were the

[3] 8 *Del. C.* § 145.

prevailing party in the litigation overall, they are entitled to recover their costs under Court of Chancery Rule 54(d).

I. BACKGROUND AND FACTS

A. The Series B Stock and Teltronics' Board of Directors

When FGC filed its Complaint, Teltronics had, issued and outstanding, 7,861,539 shares of common stock in addition to several types of preferred, including 12,625 shares of Series B Preferred Convertible stock.[4] Teltronics first issued 25,000 Series B shares to Sirrom Capital Corporation ("Sirrom") to raise capital to repurchase a portion of its debt. The Series B stock gave its holder the right, among others, to elect a Series B director.[5] Specifically, Section 4(b) of the Certificate of Designations for the Series B (the "CD") provides in pertinent part that:

> The holders of the Series B Preferred Stock, voting separately as one class, shall have the exclusive and special right at all times to elect one (1) director to the Board of Directors of the Corporation provided, however, that so long as any shares of Series B Preferred Stock are outstanding, the Board of Directors shall not consist of more than five (5) members …. The right of holders of the Series B Preferred Stock contained in this Section 4(b) may be exercised either at a special meeting of the holders of Series B Preferred Stock or at any annual or special meeting of the stockholders of the Corporation, or by written consent of such holders in lieu of a meeting.

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[4] Unless otherwise noted, the facts are drawn from the Memorandum Opinion, *FGC Holdings, Ltd. v. Teltronics, Inc.*, 2005 Del. Ch. LEXIS 140 (Sept. 14, 2005).

[5] For simplicity, I will refer to the holders of common stock and Series A Preferred Stock as the "common stockholders," those directors elected by the "common stockholders" as the "common directors," and the director elected by the Series B stockholders as the "Series B director."

In 1998, Sirrom elected Craig Macnab as the Series B director.[6]

In April 1999, FINOVA Mezzanine Capital, Inc. ("FINOVA"), acquired Sirrom along with the Series B stock and certain Teltronics debt. After the acquisition, Macnab resigned as the Series B director. The remainder of Teltronics' board consisted of two inside common directors and one outside common director. FINOVA chose not to replace Macnab and never appointed a Series B director, believing that its position as a creditor of Teltronics would create a conflict of interest. Over time, FINOVA converted all but 12,625 Series B shares into common stock.

At the 1999 and 2000 annual meetings, the common stockholders elected four common directors to the board — Ewen Cameron, Norman Dobiesz, Carl Levine and Gregory Barr. At the 2001 annual meeting, the common stockholders elected five common directors — adding Richard Stevens. The same five common directors were re-elected in 2002 and 2003.

In August 2004, the board mailed a proxy to the company's stockholders (the "Proxy"). The Proxy nominated five common directors — Cameron, Dobiesz, Levine, Barr and Stevens — for a vote by the common stockholders. It did not mention the potential for the election of a Series B director or indicate that the Series B stockholders, although they could elect a Series B director, had no right to vote for the common directors. The Proxy, however, did state that:

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[6] Tr. at 50 (Cameron). Citations in this form are to the trial transcript ("Tr.") and indicate the page and, where applicable, the witness testifying.

> The holders of the Preferred Convertible Stock have the right to elect a majority of the Board of Directors of the Company if and whenever four quarterly dividends (whether or not consecutive) payable on the Preferred Convertible Series B Stock shall be in arrears.[7]

In September 2004, the five nominated common directors were elected.

B. The Transfer

FGC purchased the Series B stock from FINOVA on September 21, 2004. Before FGC informed Teltronics about the purchase, Teltronics held its 2004 annual meeting on September 28, 2004. The record date was August 6, 2004. As of that date, FINOVA held the Series B stock, entitling it to attend and vote at the annual meeting. Although the FINOVA-FGC purchase agreement permitted FGC to direct FINOVA to act on FGC's behalf at the annual meeting, FGC did not direct FINOVA to take any action regarding the meeting.

On October 5, 2004, FGC presented the Series B stock certificate to Teltronics and requested that it be transferred from FINOVA to FGC. For several months Teltronics rebuffed FGC's request, raising various objections to the transfer. In its capacity as the Series B stockholder, FGC executed a written consent in early November 2004 electing Friedmann as a Series B director.[8] In a letter to the Teltronics board, dated November 10, 2004, Friedmann complained about Teltronics continuing refusal to register the transfer of the Series B stock from FINOVA to FGC. The letter states in relevant part:

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[7] JX 16 at 4742.

[8] JX 46; JX 21.

> I am writing this letter to the Board of Directors of the Company to make certain that each of you are personally aware of the waste of corporate assets that has occurred in the connection with this matter and of [Mr. Cameron's] apparent breach of his fiduciary duty to all of the stakeholders of the Company. Obviously, if the Preferred Stock is not transferred immediately, FGC will have to pursue other alternatives to cause the Company to transfer the Preferred Stock to FGC. . . .
>
> In addition, attached is a written consent in lieu of a special meeting, dated November 10, 2004, executed by FGC, which elects me as a director of the Company, pursuant to the provisions of Section 4(b) of the Certificate of Designations Establishing the Series of Shares and Articles of Amendment of Teltronics, Inc., dated February 23, 1998. Please take all actions necessary or desirable in connection with my election to the board of directors of the Company. I look forward to the opportunity to work with each of you in an effort to enhance the value of the Company for the benefit of all of its stakeholders.[9]

Despite Friedmann's letter, Teltronics continued to refuse to register the stock transfer.

C. Procedural History

On November 24, 2004, FGC filed this suit to compel Teltronics to issue a stock certificate in FGC's name for its Series B stock, register the transfer of that stock from FINOVA to FGC and recognize Friedmann as a proper Series B director. In the context of a motion to expedite by FGC, the Court set an early trial date of February 2, 2005.

Teltronics' Answer raised ten affirmative defenses.[10] After discovery and on the eve of trial, though, Teltronics abandoned all of these defenses. Teltronics continued to maintain, however, that FGC's ability to elect a Series B director depended upon the

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[9] JX 46.

[10] Ans. at 6-9, ¶¶ 1–20.

availability of a director position. Because five common directors already had been elected, Teltronics contended that the CD precluded recognition of a Series B director until the next annual meeting. Consequently, the trial went forward on that specific issue.

The Court heard post-trial arguments on May 10, 2005. Relying upon the language of Section 4(b) that the Series B holder "shall have the exclusive and special right at all times to elect one (1) director," FGC argued that the CD vests FGC with the right to elect a Series B director at any time, and sought to have its designee appointed immediately to the board of directors. Teltronics, focusing on the provision in Section 4(b) "that so long as any shares of Series B Preferred Stock are outstanding, the Board of Directors shall not consist of more than five (5) members," countered that FGC could not immediately elect a Series B director because the board already had the maximum number of directors.

On March 27, 2005, the parties stipulated to an order preserving aspects of the status quo pending the final judgment of the Court. That order required Teltronics to provide Friedmann written notice of any meeting of the board of directors and a list of topics expected to be acted or voted on at such meeting. In late June 2005, a dispute arose regarding Teltronics' compliance with the interim order. Roughly contemporaneously, I concluded that FGC had demonstrated a high probability of success on the merits of its claim to elect a Series B director to the board immediately. Accordingly, I caused a further order to be entered on August 16, 2005, directing Teltronics to allow Friedmann to participate in board meetings to the same extent as its five common directors.

In the Memorandum Opinion issued on September 14, 2005, I held that FGC was entitled to a declaratory judgment that it "had the right to elect Friedmann to the board in November 2004 and to have him promptly seated on the board" and that, in that circumstance, the common stockholders of Teltronics would have had the right to no more than four common directors on the board.[11] In the exercise of my discretion to fashion an appropriate equitable remedy, however, I declined to order Teltronics to immediately make FGC's Friedmann a director. In making that decision I had no reservations about FGC's right to elect a director, by written consent, at any time. Instead, I based my decision on several other factors. For example, the DGCL required Teltronics to have its next annual meeting soon (by October 28, 2005, at the latest). Among other things, I also was apprehensive that an order compelling the immediate addition of Friedmann to Teltronic's board would create a number of questions in terms of its corporate governance that would serve only to expose the company to unnecessary uncertainty, risk and expense during the brief period left before the 2005 annual meeting. Based on all the circumstances, I determined not to order Teltronics to immediately make Friedmann a director. Rather, I continued the August 16, 2005 preliminary injunction,[12] and ordered that FGC's designee officially take his place on the Teltronics board immediately following Teltronics' next annual meeting, at which the common stockholders could elect no more than four directors.

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[11] 2005 Del. Ch. LEXIS 140, at *33.

[12] The Order of August 16, 2005 effectively expired when the Series B director formally took his position on the Teltronics board.

After the Memorandum Opinion, FGC moved for attorneys' fees, or alternatively, indemnification. During argument on this motion, an issue arose as to whether the Complaint needed to be amended to cause the pleadings to conform to the issues and evidence presented at trial. Shortly thereafter, on April 21, 2006, FGC filed a motion to amend under Court of Chancery Rule 15(b) to add Friedmann as a plaintiff, assert a claim under 8 *Del. C.* § 225 to determine the validity of his election as a director and assert a claim for indemnification on behalf of Friedmann, as well as FGC. Teltronics opposed the motion. After briefing and argument, the Court granted the motion to amend in an oral ruling on August 24, 2006. FGC and Friedmann promptly filed their amended complaint and renewed the request for attorneys' fees and indemnification. The parties then filed supplemental memoranda on the amended request.

II. ANALYSIS

A. Reimbursement of Fees Based on Exceptions to the American Rule

Plaintiffs seek attorneys fees based on Teltronics' conduct before and during this litigation. As a general principle, Delaware follows the American Rule, under which each party must bear its own litigation expenses, including attorneys' fees.[13] The Court of Chancery, however, has recognized limited equitable exceptions to the rule under 10 *Del. C.* § 5106.[14] In fact, it is well established that this Court, in its discretion, may

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13 *Abex, Inc. v. Koll Real Estate Group, Inc.*, 1994 Del. Ch. LEXIS 213, at *61 (Dec. 22, 1994).

14 *See, e.g., Judge v. City of Rehoboth Beach*, 1994 Del. Ch. LEXIS 55 (Apr. 29, 1994); *see generally* DONALD J. WOLFE, JR. AND MICHAEL A. PITTENGER, CORPORATE AND COMMERCIAL PRACTICE IN THE DELAWARE COURT OF

award attorneys fees where equity so provides.[15] As the Court stated in *Judge v. City of Rehoboth Beach*, attorneys fees generally "can be awarded only when the party against whom the fees are assessed acted in bad faith, fraudulently, negligently, frivolously, vexatiously, wantonly or oppressively."[16] The Court in *Judge* further observed that to constitute bad faith, for example, "the defendants' action must rise to a high level of egregiousness."[17] Thus, determination of bad faith necessarily requires a fact-intensive inquiry[18] to determine whether or not a litigant's actions extend beyond the realm of zealous advocacy.[19]

Of relevance here, courts have found that where a defendant's actions force a plaintiff to file suit to "secure a clearly defined and established right," that can evidence bad faith.[20] For example, in *Judge*, the Court awarded fees to plaintiffs because even

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CHANCERY, § 13-3(b) (providing overview of the bad faith exception to the American Rule).

15 10 *Del. C.* § 5106 ("The Court of Chancery shall make such order concerning costs in every case as is agreeable to equity."); *Wilmington. Med. Ctr. v. Severns*, 433 A.2d 1047, 1049 (Del. 1981).

16 1994 Del. Ch. LEXIS 55, at *5 (citations omitted).

17 *Id.*, at *6. *See also In re Smith Trust*, 1999 Del. Ch. LEXIS 152 (July 23, 1999) (quoting *Arbitrium (Cayman Is.) Handels AG v. Johnston*, 1994 Del. Ch. LEXIS 213 (Dec. 22, 1994)).

18 *Abex*, 1994 Del. Ch. LEXIS 213, at *61-62.

19 *Credit Lyonnaise Bank Nederland, N.V. v. Pathe Commc'n Corp.*, 1996 Del. Ch. LEXIS 157, at *13-14 (Dec. 20, 1996).

20 *McGowan v. Empress Entm't, Inc.*, 791 A.2d 1, 4 (Del. Ch. 2000); *Abex*, 1994 Del. Ch. LEXIS 213, at *61; *see Barrows v. Bowen*, 1994 Del. Ch. LEXIS 164, at

though "the record show[ed] that defendants were faced with a mountain of evidence, including legal opinions, legal authority and judicial declarations" that demonstrated the weakness of their position, they still persisted and forced plaintiffs to take legal action to vindicate their legal rights.[21]

Similarly, this Court found bad faith in *Carlson v. Hallinan*,[22] in which a director of a corporation, Carlson, requested inspection of the company's books and records to research a potential breach of fiduciary duty. The defendants denied the request, despite knowing of Carlson's status as a director and his concomitant right to inspect when he made his request. In those circumstances, the Court found that the defendants' actions in forcing Carlson to file suit to vindicate that right evidenced bad faith.

Based on the briefing and argument, FGC's claim for attorneys' fees centers on two distinct sets of actions by Teltronics. The first involves Teltronics' refusal to register the transfer of the Series B stock from FINOVA to FGC. That refusal began in early October 2004, continued after FGC commenced this action on November 24, 2004 to

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*3-4 (Sept. 7, 1994) (describing the situation where the cost of litigation was increased due to the bad faith conduct of the losing party).

Other states have adopted the same reasoning. The Rhode Island Supreme Court has opined that bad faith can be demonstrated when a defendant's obstinate refusal to grant a plaintiff her clear legal rights forces the plaintiff into a judicial forum to vindicate those rights. *Quill Co. v. A.T. Cross Co.*, 477 A.2d 939, 944 (R.I. 1984). Likewise, in New Hampshire, action by a defendant that necessitated judicial intervention to secure a clearly defined and established right was held to evidence bad faith. *Indian Head Nat'l Bank v. Corey*, 523 A.2d 70, 72 (N.H. 1986).

[21] 1994 Del. Ch. LEXIS 55, at *6-7.

[22] 2006 Del. Ch. LEXIS 58, at *104 (Mar. 21, 2006)

compel such registration and did not end until approximately January 27, 2005, when Teltronics agreed to consent to a judgment requiring it to register the transfer. Teltronics did not agree to such a judgment until just before the trial in this case on February 2, 2005. The second set of actions pertains to Teltronics' vigorous efforts since at least January 27, 2005 to prevent FGC's principal, Friedmann, from assuming a seat on Teltronics board before its next annual meeting in late 2005. The Court will follow that same logical division in addressing FGC's arguments in favor of an award of attorneys' fees or indemnification against Teltronics.

B. Does Teltronics' Resistance to FGC's Efforts to Register the Transfer Warrant Making an Exception to the American Rule?

FGC alleges that several actions taken by Teltronics to avoid registering FGC's ownership of the Series B stock caused FGC to incur substantial and needless costs and evidence bad faith. Among other things, FGC points to the fact that Teltronics raised ten affirmative defenses to FGC's requests to register the transfer of 12,625 Series B shares, but dropped all of those defenses on the eve of trial. In particular, FGC complains of Teltronics' ongoing refusal to accept a written opinion by FGC's counsel that the transfer satisfied all applicable state securities laws on the ground that it was too conclusory. FGC contends that Teltronics raised those defenses merely to delay (or avoid) registration of the Series B stock and Friedmann's election to the Teltronics' board.

FGC also contends that Teltronics' filing of an action in the United States Bankruptcy Court for the District of Delaware reflects bad faith. Specifically, FGC argues that by filing an adversary complaint in FINOVA's post-confirmation bankruptcy

action on November 23, 2004, eighteen minutes before FGC filed this case, Teltronics improperly sought to interfere with FGC's purchase of the Series B stock and its attendant right to place Friedmann on the board. According to FGC, Teltronics' later motion on December 20, 2004 to stay this action in the Court of Chancery pending the outcome of the bankruptcy action further demonstrates its bad faith purpose of delay. In that regard, FGC notes that within a few days after it filed its opposition to the motion to stay, Teltronics withdrew that motion and dropped the bankruptcy action. Finally, FGC argues that the factual and legal deficiencies of the bankruptcy action render it a "sham," "meritless and baseless."[23]

In addition, in January 2005, Teltronics moved to amend their Answer in the Chancery action to add a counterclaim for relief under the federal securities laws. FGC asserts that even cursory legal research would have revealed that the proposed counterclaim fell exclusively within federal jurisdiction. Indeed, when FGC raised this contention in a draft of the pretrial order, Teltronics promptly withdrew its motion to amend. Teltronics' actions, according to FGC, again resulted in unnecessary delay and expense.

Having carefully considered the parties' arguments, I find that FGC has not shown by clear evidence that Teltronics acted in bad faith in opposing registration of the transfer of the Series B stock until late January 2005. The actions FGC complains of do raise doubts about the propriety of Teltronics' intentions. Nevertheless, the relatively short

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[23] *See* Pl.'s Mot. for Attorneys' Fees, and/or, Alternatively, Indemnification ("Pls.' Mot. for Fees") at 12 and 16.

period of time in which Teltronics' objections to registration were resolved and FGC's refusal to cooperate in voluntarily providing much of the additional information Teltronics sought to alleviate its professed concerns convince me that the circumstances are not so egregious as to warrant an award of attorneys' fees.

Although FGC complains that Teltronics asserted, but later dropped, ten affirmative defenses to registration,[24] the record does not clearly show that those defenses were frivolous. Several of the defenses, for example, relate to FGC's alleged failure to comply with federal and state securities laws. An important aspect of them was Teltronics' contention that a restrictive legend on the Series B stock required an opinion of counsel that the transfer complied with any applicable state securities law before the transfer could be effectuated. When FGC's attorney, Philip Kushner, presented the certificate representing the 12,625 shares of Series B stock to Teltronics for registration on or about October 5, 2004, he enclosed a legal opinion stating that the transfer did not require registration with the government and complied with any applicable state securities law.[25] Noting the conclusory nature of the opinion, Teltronics requested that FGC's counsel be more specific and identify the applicable state securities laws and the facts and legal reasoning underlying his conclusion. According to Teltronics, FGC never provided a revised opinion addressing the state securities questions, as requested. Through discovery in this action, however, Teltronics obtained additional information

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[24] *Id.* at 9.

[25] *See* JX 22.

from which it allegedly reached its own determination that the transfer did not present a problem under state securities law.[26] Thus, Teltronics abandoned its various affirmative defenses to registration relating to FGC's opinion and state securities law issues within approximately two months of the commencement of this action. In these circumstances, I cannot say that Teltronics acted in bad faith.[27]

Based on the limited record before me, the same is true as to Teltronics' pursuit of a separate adversary proceeding in Bankruptcy Court, filed minutes before this action, and its short-lived attempt to stay this case pending resolution of the bankruptcy action. The complaint in the adversary proceeding, which named FGC and FINOVA as defendants, asserted that FINOVA'S confirmed plan of reorganization required it to maximize the value of its assets, including its securities portfolio, through an orderly liquidation. The complaint further alleged that Teltronics made an offer to purchase the Series B stock from FINOVA for more than FGC paid, and that FINOVA's effective rejection of that offer in favor of FGC violated the plan of reorganization.[28] Teltronics voluntarily dismissed the adversary proceeding in bankruptcy on January 27, 2005. FGC

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[26] Teltronics contends that when it answered the original complaint, FGC had not provided Teltronics with material documents, such as the Purchase and Sale Agreement, which would have allowed Teltronics to conduct their own research immediately.

[27] *See Amer v. NVF Co.*, 1995 WL 54411, at *3 (Del. Ch. Feb. 2, 1995) (even though certain asserted defenses were either abandoned or held to be without merit, the court found no bad faith).

[28] When Teltronics took the challenged actions, it had not yet been provided with a copy of the purchase agreement between FGC and FINOVA.

argues that Teltronics' claim in the adversary proceeding had serious defects, such as a lack of standing. There appears to be at least a colorable basis for the claim, however, and the Bankruptcy Court was never called upon to assess its merits. Thus, I am not confident that Teltronics' claim was so lacking in merit as to constitute bad faith.

Teltronics did act carelessly in moving to amend its answer to add a counterclaim for a securities law violation seeking relief under the federal securities laws. FGC recognized this and noted in a draft pretrial order provided to Teltronics that the asserted claim was exclusively within the jurisdiction of the federal courts. Because Teltronics then promptly withdrew its motion to amend, however, this mistake was not sufficiently egregious or prejudicial as to warrant an award of attorneys' fees.

Accordingly, I do not find that the incidents FGC complains of regarding its claim for registration individually show bad faith. I also do not believe that those actions collectively rise to the high standard of the bad faith exception. The issues raised by FGC's original complaint and Teltronics' numerous defenses to it did not become tightly focused until after discovery and other pretrial activity. By then, the trial was imminent. The only issues remaining for trial involved the parties' competing interpretations of the Certificate of Designations and how it should be applied. Although Teltronics' pretrial actions do not justify making an exception to the American Rule, they do raise doubts about the good faith of Teltronics' continuing resistance to FGC's representative Friedmann's effort to take his seat on the Teltronics board.

The issue of the proper interpretation of the Certificate of Designations provision regarding the Series B director and Teltronics' related waiver argument did not become

the focus of this action until Teltronics dropped its affirmative defenses and counterclaim.[29] Consequently, the proceedings pertaining to the Friedmann directorship are fairly segregable from the registration litigation. Thus, I will address separately whether Teltronics' conduct in the post-January 27, 2005 period merits an award of attorneys fees. Before doing so, however, I consider it useful to discuss FGC's and Friedmann's claim for indemnification.[30]

C. Indemnification under 8 *Del. C.* § 145

In their Amended Complaint, both FGC and Friedmann claim they are entitled to indemnification for their litigation expenses under Section 145 of the DGCL and Teltronics' bylaws. Article IV, paragraph 1 of Teltronics' bylaws provides for indemnification to

> [e]very person now or hereafter serving as a director or officer of the corporation . . . in accordance with and to the fullest extent permitted by law for the defense of, or in connection with, any threatened, pending or completed action, suit or proceeding, whether civil, criminal, administrative, or investigative.[31]

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29 Indeed, the parties disputed whether FGC received adequate notice of those defenses before trial. *See, e.g.*, Pls.' Feb. 1, 2005 Mot. in Limine, at 1-2 (alleging that Teltronics did not identify its waiver defenses until January 24, 2005 for a February trial date). The Court ultimately allowed Teltronics to present its waiver defense, despite the relatively short notice. *FGC v. Teltronics*, 2005 Del. Ch. LEXIS 140, at *27.

30 FGC does not argue for indemnification as it pertains to the registration of the Series B stock independently of the directorship issue. Rather, its arguments appear to be subsumed in the arguments as to Friedmann in his capacity as a constructive director pursuant to the Memorandum Opinion. These issues are addressed below.

31 JX 2 at 64-65, Art. IV, 1.

The bylaws track the statutory predicate for, and do not further expand, the right to indemnification. No party contends that the bylaws enlarge or modify the indemnification rights authorized by Section 145. Therefore, the Court need not analyze the bylaws separately, since they extend as far as Section 145 reaches.

1. Indemnification under 8 *Del. C.* § 145

a. Brief overview of Section 145

Plaintiffs contend that they are entitled to indemnification under subsections 145(a) - (c) of the DGCL. In pertinent part, these subsections provide:

> (a) A corporation may indemnify any person who was or is a party or is threatened to be made a party to any threatened, pending or completed action, suit or proceeding, whether civil, criminal, administrative or investigative (other than an action by or in the right of the corporation) by reason of the fact that he is or was a director, officer, employee or agent of the corporation . . . against expenses (including attorneys' fees), judgments, fines and amounts paid in settlement actually and reasonably incurred by him in connection with such action, suit or proceeding if he acted in good faith and in a manner he reasonably believed to be in or not opposed to the best interests of the corporation . . . .
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> (b) A corporation may indemnify any person who was or is a party or is threatened to be made a party to any threatened, pending or completed action or suit by or in the right of the corporation to procure a judgment in its favor by reason of the fact that he is or was a director, officer, employee or agent of the corporation . . . against expenses (including attorneys' fees) actually and reasonably incurred by him in connection with the defense or settlement of such action or suit if he acted in good faith and in a manner he reasonably believed to be in or not opposed to the best interests of the corporation . . . .
>
> (c) To the extent that a director, officer, employee or agent of a corporation has been successful on the merits or otherwise in defense of any action, suit or proceeding referred to in

> subsections (a) and (b) of this section, or in defense of any claim, issue or matter therein, he shall be indemnified against expenses (including attorneys' fees) actually and reasonably incurred by him in connection therewith.[32]

In layman's terms, Section 145 provides a two-part test that gives "vindicated directors and others involved in corporate affairs a judicially enforceable right to indemnification."[33] First, the proceeding must fall under subsection (a) or (b). Subsection (a) applies to third party proceedings other than those by or in the right of the corporation that exist "by reason of the fact" that the party seeking indemnification is or was a director, officer, employee or agent of the corporation.[34] Subsection (b) permits statutory indemnification if the action is "by or in the right of the corporation to procure a judgment in its favor by reason of the fact" that the indemnitee holds or held one of the enumerated positions.[35] In both subsections 145(a) and 145(b), the movant must have acted in good faith and reasonably believed that her actions would be in or not opposed to the best interests of the corporation. For a proceeding referred to in either subsection (a) or (b), subsection (c)

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32 DEL. CODE ANN. tit. 8, § 145(a), (b), (c) (2001). S*ee also Green v. Westcap Corp. of Delaware*, 492 A.2d 260, 264-65 (Del. Super. 1985) (summarizing each of these provisions).

33 *Merritt-Chapman & Scott Corp. v. Wolfson*, 264 A.2d 358 (Del. Super. 1970).

34 DEL. CODE ANN. tit. 8, § 145(a) (2001). Subsection (a) also permits indemnification of a party who is serving at the request of the corporation as a director, officer, employee or agent of another corporation. *See id.; VonFeldt v. Stifel Fin. Corp.*, 714 A.2d 79, 84 (Del. 1998).

35 DEL. CODE ANN. tit. 8, § 145(b) (2001).

grants an absolute right of indemnification to the movant, provided that he has been successful on the merits or otherwise.[36]

Teltronics argues that Friedmann did not succeed on his claim under 8 *Del. C.* § 225 for a determination that he was a properly elected director of Teltronics. It contends that "there was no finding in this case who, among competing claimants, properly held the directorship."[37] In my opinion, Teltronics' position demonstrates an obstinate failure to heed the Court's rulings and a willingness to seize upon the most hypertechnical arguments to thwart FGC and Friedmann's efforts to enforce their rights. A fair reading of the Memorandum Opinion shows that Friedmann did succeed "on the merits or otherwise" in proving the validity of his election or appointment to the board. Additionally, the Court later granted, over Teltronics' objection, Plaintiffs' motion to amend the Complaint to conform to the evidence presented at trial by adding Friedmann as a party and claims for relief under Section 225 and the indemnification statute. In fact, as I noted on more than one occasion during the course of this litigation, Friedmann most likely had the clearest right to hold office among those who Teltronics calls the

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[36] *Green*, 492 A.2d at 265 (quoting S. Samuel Arsht & Walter K. Stapleton, *Delaware's New General Corporation Law: Substantive Changes*, 23 BUS. LAW. 75, 80 (1967)); *Cochran v. Stifel Fin. Corp.*, 2000 WL 1847676, at *9 (Del. Ch. Dec. 13, 2000), *aff'd in part, rev'd in part on other grounds*, 809 A.2d 555 (Del. 2002). *See also Perconti v. Thornton Oil Corp.*, 2002 Del. Ch. LEXIS 51, at *10 (Del. Ch. May 3, 2002) ("Under 8 *Del. C.* § 145(c), an officer or director who meets the requirements of the statutory provision has an absolute right to indemnification."); *accord Shearin v. E.F. Hutton Group, Inc.*, 652 A.2d 578, 593 (Del. Ch. 1994).

[37] *See* Def.'s Br. in Opp. to Pls.' Am. Mot. for Att'ys' Fees, and/or, Alternatively, Indemnification ("Def.'s Br.") at 45-46.

"competing claimants" to directorships. As explained in the Memorandum Opinion,[38] I did not order Teltronics to make Friedmann a director immediately only in the exercise of my equitable discretion to fashion an appropriate remedy for Teltronics' misconstruction of the Certificate of Designations. In particular, I deferred making Friedmann a *de jure* director as an accommodation to Teltronics based on a concern that doing so might create significant uncertainty, risk and expense in terms of the legitimacy of the other directors' positions. Thus, I reject as frivolous Teltronics' argument that Plaintiffs did not meet the success on the merits requirement of § 145(c), and turn to whether this case satisfies either § 145(a) or (b).

b. The case law interpretation of Section 145

Most of the case law on indemnification focuses on the extent of statutory indemnification of actions by current or former directors. There does not appear to be any case that explicitly addresses whether the current or former director requirements can be met by a party who has not previously been a director and successfully obtains a determination of the validity of his election as a director in a § 225 proceeding. Nevertheless, FGC contends that the case law supports the proposition that corporations must pay the litigation expenses of those who successfully defend their right to hold office. Specifically, Plaintiffs rely on the following cases: *Essential Enterprises Corp. v.*

[38] 2005 Del. Ch. LEXIS 140, at *34.

Automatic Steel Products, Inc.,[39] *Hibbert v. Hollywood Park, Inc.*,[40] and *May v. Bigmar, Inc.*[41]

Before examining the cases cited by FGC, I first consider the language of the statute. Both subsections 145(a) and (b) require that the person seeking indemnification be or have been a party to a pending action "by reason of the fact that he is or was a director, officer, employee or agent of the corporation." Teltronics contends that neither FGC nor Friedmann was a director, officer, employee or agent of Teltronics during the time period relevant to this case.[42] In other words, Friedmann was not a present or former director of Teltronics when his claims were litigated. In addition, Teltronics argues that, even if Friedmann were deemed to have been a director as of November 2004, when FGC first executed a written consent, this action was not brought "by reason of" his position as a director of the company.

Unlike this case, the party seeking indemnification in each of the cases cited by Friedmann for the broad proposition that "individuals that are successful in a contested election of directors action under Section 225 are required to be indemnified under Section 145(c) of the DGCL"[43] was already a director or officer at the time of the

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39 164 A.2d 437 (Del. Ch. 1960).

40 457 A.2d 339 (Del. Ch. 1983).

41 838 A.2d 285 (Del. Ch. 2003).

42 Friedmann did not formally become a director until the time of the 2005 annual meeting.

43 *See* Pls.' Reply Br. in Support of Their Amended Mot. for Att'ys' Fees or Indemnification ("Pls.' Reply Br.") at 5.

contested election. The *Essential Enterprises* case involved a precursor of the current indemnification statute, but the relevant language is similar. There, a majority stockholder had sought to remove three individual defendants from office, but they successfully defended against that action. In granting those defendants indemnification, the court stated: "When the statute is read literally the defendants come within its four corners because they defended an action in which they were made parties defendant by reason of the offices which they held in the corporation."[44]

In *Hibbert*, the plaintiffs who sought indemnification were former directors who lost a reelection campaign to a competing faction of the old board. The reelection campaign stemmed from differences of opinion on corporate policy.[45] While they were directors, the *Hibbert* plaintiffs had filed a suit in California against some of the competing directors seeking to postpone the shareholders' meeting, prevent the defendant directors from interfering with the audit committee and compel them to attend board meetings. They later sued the same defendants in federal court in California, for using false and misleading proxy material. Both suits were unsuccessful. Thereafter, the *Hibbert* plaintiffs filed an action for indemnification in Delaware claiming that the corporations' bylaws mandated payment of their expenses in the California litigation. The directors elected to the new board challenged this claim, contending that the word

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[44] 164 A.2d at 440.

[45] 457 A.2d at 344.

"party" and the phrase "by reason of the fact" limited indemnification to defendants only.[46]

The Delaware Supreme Court rejected such a narrow interpretation of indemnification, instead focusing on whether the plaintiffs acted out of a duty they had because of their roles with the corporation. The court framed the issue as whether "a director who is a plaintiff in a suit initiated by him because of his position as a director should be indemnified."[47] In granting indemnification to these directors in *Hibbert*, the court stated:

> Plaintiffs, through the California litigation, sought to compel the defendant directors to attend board meetings and to protect the independence of the board's internal auditing procedures. We can not say that such litigation was entirely initiated without regard to any duty the plaintiffs might have had as directors. In short, those lawsuits served, as we see it, to uphold the plaintiffs' "honesty and integrity as directors."[48]

Thus, the Supreme Court held that the term "party" in the bylaws refers to the plaintiff or the defendant in a lawsuit, and that the entire phrase "is broad enough to include an individual who acts as an intervenor or *amicus curiae* in any particular case."[49]

As noted by this Court in a subsequent case, the Supreme Court in *Hibbert* "gave considerable weight to the fact that the plaintiff-directors brought suit, at least in part, to

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46 *Id*. at 342. The language of the *Hibbert* opinion focuses on the wording of the bylaw; for all purposes relevant to this case, however, the bylaw tracks the statute.

47 *Id.* at 343.

48 *Id.* at 344.

49 *Hibbert*, 457 A.2d at 344.

fulfill their own fiduciary obligation to the corporation."[50] In *Shearin v. E.F. Hutton Group*,[51] a plaintiff employee claimed various contractual breaches by her employer in connection with her termination. The employee sought to add a claim of indemnification under the company's bylaws and Section 145 on the ground that she was a "party" to the litigation "by reason of the fact" of her position as an employee.[52]

The court rejected a broad-brush application of indemnification to individuals based solely on their holding a title or position enumerated in the statute. Rather, the court inquired first whether the expenses in question had been incurred in connection with a covered proceeding as described in subsection (a) or (b) of Section 145. Chancellor Allen further held that when the claimant was a plaintiff the proceeding would be covered by § 145(a) or (b) only when the proceeding was brought as part of the claimant's duties to the corporation. In that regard, the court stated: "Thus, I take *Hibbert* to recognize that permissible indemnification claims will include those deriving from lawsuits brought by directors, officers, agents, etc., *only insofar as the suit was brought as part of the employee's duties to the corporation and its shareholders*."[53] The plaintiff in *Shearin* initiated the suits for which she sought indemnification when "she was no longer an employee, and thus had no authority to act for Hutton Trust [her

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50 *See Shearin v. E.F. Hutton Group, Inc.*, 652 A.2d 578, 594 (Del. Ch. 1994) (analyzing *Hibbert*).

51 652 A.2d 578 (Del. Ch. 1994).

52 *Id*. at 593.

53 *Id.* at 594 (emphasis in original).

employer] and no ongoing responsibilities to it."[54] Based on this fact and its conclusion that the employee's claims involved "purely the assertion of [her] personal rights (i.e., defamation, breach of contract) and thus advance[d] no interest of, or duty to Hutton,"[55] the court held that plaintiff's demand for indemnification was without merit.

The only other case Plaintiffs cite for their argument that "a corporation must pay the litigation expenses of directors who successfully litigate their right to hold office"[56] is *May v. Bigmar, Inc.*[57] As in this case, the party seeking indemnification in *May* was a plaintiff in the underlying proceeding. May had participated in three Section 225 cases involving actions taken when she was a director and officer. She initiated at least one of those cases. In an earlier ruling, the court had held that May was entitled to indemnification in that action, despite having been a plaintiff, and that remained the law of the case.[58] Unlike this case, however, May was an officer and director of the corporation at the time of all of the actions challenged in the underlying lawsuits.

In sum, the parties have not cited and the Court has not found any case in which a court has addressed whether a non-director party who prevails in an action to establish his or her right to hold the position of a director is entitled to indemnification under Section

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54 *Id.* at n.21.

55 *Id.* at 594.

56 Pls.' Reply Br. at 3-4.

57 838 A.2d 285, 287-88 (Del. Ch. 2003).

58 *Id.* at 288 n.8.

145. Thus, the Court must determine whether Section 145(c) applies in the specific circumstances of this case.

Indemnification under Delaware law serves two important policies:

> (a) allowing corporate officials to resist unjustified lawsuits, secure in the knowledge that, if vindicated, the corporation will bear the expense of litigation; and (b) encouraging capable women and men to serve as corporate directors and officers, secure in the knowledge that the corporation will absorb the costs of defending their honesty and integrity.[59]

The Delaware Supreme Court also has stated that it "eschew[s] narrow construction of the [indemnification] statute where an overliteral reading would disserve these policies."[60]

Turning to this case, FGC argues that but for Teltronics' bad faith, Friedmann would have held a seat on its board in November 2004, when FGC sent its written consent to the Teltronics board.[61] Teltronics' actions in refusing registration until January 2005, however, have not been shown to have been in bad faith. Moreover, although I concluded that Plaintiffs had a right to have Friedmann serve as a Teltronics director in late 2004 or early 2005, he did not actually become a director until late 2005, after the Court's decision on the merits. In these circumstances, I find that Friedmann

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59 *VonFeldt v. Stifel Fin. Corp.*, 714 A.2d 79, 84 (Del. 1998) (holding that where a 100 percent stockholder elects a director to a subsidiary's board, that director thereafter serves the subsidiary "at the request of" the stockholder within the meaning of Section 145).

60 *Id.* at 84.

61 Pls.' Reply Br. at 10. Presumably due to the continued dispute over registration of the transfer of the Series B stock, FGC executed a second written consent with FINOVA and sent it to Teltronics on or about January 13, 2005. JX 54.

was not literally a "present or former director" of Teltronics during the relevant time period.[62]

Applying the principles discussed above to the requirement in subsections (a) and (b) of Section 145 that a covered action must be one "by reason of the fact that [the claimant] is or was a director, officer, employee or agent of the corporation," I conclude that neither FGC nor Friedmann meet that requirement. In the specific context of this case, I do not believe that construing the statute to exclude a person, like Friedmann, who was not a director but claimed entitlement to hold that position based on a contractual right granted to a preferred stockholder by the corporation would disserve the policies motivating indemnification.[63] No action of Friedmann taken in the capacity of a Teltronics director is at issue in this case. Nor is the second policy rationale significantly involved here. Friedmann is the president and sole stockholder of FGC, the owner of the Series B stock. That ownership interest most likely provides ample encouragement for him to serve on Teltronics' board. Moreover, Friedmann undoubtedly took the action that is the focus of this litigation at the request of FGC and, therefore, would qualify for indemnification from FGC. Consistent with that inference, the record suggests that FGC has paid Friedmann's litigation expenses in this action.

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62 I also do not find any ambiguity in the requirement of Section 145(c) for a "present or former director or officer."

63 FGC argues, for example, that because it "brought an action to recognize its Series B Preferred Stock in Teltronics and its resulting *contractual right* to elect a director to the Teltronics board—and it was successful—Teltronics is mandated by statute and Teltronics' bylaws to indemnify FGC for its costs to define its right to hold a d[irectorship]." Pls.' Mot. for Fees at 20 (emphasis added).

That FGC and Friedmann initiated this litigation further complicates their claim for indemnification. As this Court observed in *Shearin*, *Hibbert* establishes "the proposition, in Delaware, that a plaintiff may in proper circumstances be entitled to indemnification."[64] To qualify for such indemnification, however, the litigation must encompass or have "sought to achieve . . . a corporate benefit that it was plaintiff's duty to seek to achieve."[65]

In this case, the Series B stockholder, FGC, initiated the suit before this Court. FGC, however, does not fall within any of the named categories specified as eligible for indemnification in Section 145. Moreover, even assuming that Friedmann, as a putative director, would meet the requirements for a present director within the meaning of Section 145, he had no contractual or other relationship or duty to Teltronics in November 2004 that required him to file this lawsuit to obtain his directorship. Friedmann may have owed a duty to FGC to take that action, but not to Teltronics. Thus, the fact that FGC and Friedmann brought this action constitutes a further impediment to this Court's mandating that Teltronics indemnify either Plaintiff for its litigation expenses. Therefore, for the reasons stated, I hold that FGC and Friedmann are not entitled to indemnification by Teltronics.[66]

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64 *Shearin*, 652 A.2d at 594.

65 *Id.*

66 If Friedmann had been a present or former director of Teltronics at the relevant time, his status as a plaintiff here might not have precluded indemnification. In some respects, FGC and Friedmann's case did promote important corporate policy interests of Teltronics. Broadly, the case determined the meaning of the

D. Do Teltronics' Actions Since January 2005 Warrant Making an Exception to the American Rule?

Plaintiffs also seek reimbursement of their attorneys' fees in establishing Friedmann's immediate right to a seat on the Teltronics board on the ground that this case falls within an equitable exception to the American Rule that each party to litigation normally bears its own expenses. As discussed in Part II.A *supra*, courts generally award attorneys' fees only when the party against whom the fees are assessed acted in bad faith, fraudulently, negligently, frivolously, wantonly or oppressively. Thus, for example, a plaintiff who demonstrates by clear evidence that a defendant's actions forced her to file suit to "secure a clearly defined and established right" can recover her attorneys' fees.[67]

Considering all aspects of this litigation since late January 2005, when Teltronics abandoned its defenses to registration but continued to challenge Friedmann's right to an immediate seat on its board, I find that during this period Teltronics has acted, at least in part, negligently, frivolously, vexatiously and oppressively to deny Plaintiffs their clear right to elect a Series B director at any time, as established in the Certificate of Designations. Teltronics' actions, coupled with its dubious resistance to registration in

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Certificate of Designations as it relates to the makeup of the board of directors, which reflects a fundamental corporate policy. Importantly, Friedmann's actions also clarified the CD in several ways that affects all of Teltronics' stockholders. For example, the resulting decision confirmed that the Series B stock can elect a director at any time and determined that, in some circumstances, Teltronics common stockholders can elect five common directors, subject to certain conditions. These facts would make it difficult conceptually to reject Friedmann's indemnification claim solely because he initiated the underlying litigation, rather than waiting until he was sued, if ever.

67 *See* n.23 *supra*.

the first part of this case, convince me that it pursued aspects of the Section 225 portion of the litigation to advance an improper intent to delay as long as possible Friedmann's ability to assume his position as a director or otherwise thwart Plaintiffs' efforts to pursue their legitimate rights, or both. Thus, for the reasons explained below, I conclude that Teltronics must reimburse Plaintiffs for 50 percent of the attorneys' fees they incurred in the latter part of this action.

At the trial on February 2, 2005, the primary issue was whether FGC's Series B director designee, Friedmann, had an immediate right to sit on Teltronics' board. FGC argued that the CD gave them, as the holder of the Series B stock, the right to elect a Series B director at any time. Teltronics raised only two defenses to that proposition: (1) that the proviso in Section 4(b) of the CD limiting the total number of directors to five, precluded Friedmann from becoming a director, because the board already had five members; and (2) that, in any event, FGC waived any right to appoint a director by not doing so in connection with the 2004 annual meeting. I ultimately held that neither defense had merit.

Once Teltronics dropped all of its defenses to registration in late January or early February 2005, the CD established a clear right on the part of FGC to have Friedmann appointed immediately to the board. I found Teltronics' attempt to deny that right based on the CD's five director limit weak and incongruous, because that limit was intended to benefit the Series B stockholders by ensuring that they always could elect at least twenty percent of the directors. The more interesting issue concerned the resulting status of Teltronics' five, apparently undifferentiated, common directors, if Friedmann assumed

his position on the board before the next annual meeting. Teltronics claimed the right to elect all five directors at the 2004 annual meeting, because the Series B stockholders had not elected a director at that time. In contrast, FGC contended that the CD precluded Teltronics from electing more than four common directors, even if the Series B directorship was vacant.

Against this backdrop and in the context of an incipient dispute over the meaning of a stipulated status quo order, I determined that Friedmann's right to be a director was quite clear. Therefore, on July 22, 2005, I *sua sponte* directed the entry of an order requiring Teltronics to allow Friedmann to participate in board meetings to the same extent as its common directors. I stated my reasons for that ruling in some detail. In particular, I advised the parties that FGC had a very strong probability of success on its argument that it had the right to elect Friedmann a director in November 2004 or "at any time" under the CD.[68] In that regard, I preliminarily concluded that "the five-director maximum does not affect FGC's right to elect a preferred director at all times."[69] To the extent that created uncertainty regarding the status of the five common directors, the uncertainty was of Teltronics' own making in that "they went ahead and elected five directors as though they had the right to do that without being subject to any

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[68] July 22, 2005 Tr. at 4, 6, 10-11, 12.

[69] *Id.* at 12.

contingency."[70] Teltronics' counsel then asked whether the Court was ruling that the five-member limit was unenforceable. I responded as follows:

> I think the five-member limit is enforceable. I could go completely in a hypertechnical way and say the one thing I'm sure about is that Mr. Friedmann is a director. The other five are all suspect. I don't want to go down that road for obvious reasons. But it's a big problem for Teltronics, and it needs to get dealt with immediately. . . . But I am—I am most definitely not saying that the five limit is not enforceable. What I'm saying is the five limit is Teltronics' problem, not FGC's problem.[71]

In my view, the Teltronics' board could have taken some action voluntarily at that point or thereafter to alleviate the uncertainty regarding the makeup of its board. It chose not to, however, and the litigation continued.

I issued the post-trial opinion on September 14, 2005. Among other things, I held that there is nothing in the CD that suggests that the five-member limit was intended to curtail in any way the Series B holders' "exclusive and special right at all times to elect" a Series B director. In addition, I held that Teltronics could elect as many as five common directors in certain limited circumstances. Even then, however, the common stockholders could elect only a *provisional* fifth director, whose term would end if, at any time, the Series B stockholders elected a Series B director.

On the eve of trial, Teltronics raised its only other defense to Friedmann's right to assume a directorship immediately. Teltronics contended that Friedmann and FGC

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70 *Id.* at 13.

71 *Id.* at 16-17.

waived that right by not electing a Series B director at the 2004 meeting. As with a number of Teltronics' other positions, its waiver defense could not withstand even a modicum of scrutiny. A "[w]aiver is the voluntary and intentional relinquishment of a known right,"[72] and must be shown by unequivocal facts. The facts in this case plainly demonstrate that Teltronics' waiver defense was frivolous. The Series B stockholders had no right to vote on any common directors; yet, the proxy for the 2004 annual meeting listed only common directors. Nor do the proxy materials even mention that the Series B stockholders could vote for a Series B director at the meeting, the only vote they could have cast. Furthermore, Teltronics made no showing that the Series B stockholders understood or had any notice whatsoever that Teltronics took the position, contrary to the plain and unambiguous language of the CD, that if they failed to object to the election of five common directors, they would be waiving their right to elect a Series B director until the next annual meeting. For these reasons, the Memorandum Opinion rejected Teltronics' waiver defense on the merits.

Teltronics also has taken frivolous and vexatious positions in the post-opinion proceedings relating to Plaintiffs' claim for attorneys' fees or, alternatively, indemnification. During the initial briefing and argument on that claim, the only named plaintiff was FGC, which Teltronics argued had no right to indemnification. At the oral argument, the Court granted FGC leave to move to amend under Court of Chancery Rule 15(b) to add Friedmann as a party and a claimant for indemnification. FGC promptly

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[72] *FGC Holdings, Ltd. v. Teltronics, Inc.*, 2005 Del. Ch. LEXIS 140, at *28 (Sept. 14, 2005).

made such a motion, and Teltronics opposed it. Teltronics argued, among other things, that the proposed amendment did not conform to the evidence. I consider that argument frivolous, because as I stated in ruling on the motion to amend, "Teltronics ignores the fact that, 'the only question before the Court [at trial] [wa]s whether Friedmann, FGC's designee, ha[d] an immediate right to sit as a Series B director. And I so stated … in the [Memorandum Opinion] on September 14th.'"[73] Moreover, Teltronics bears most of the responsibility for any deficiencies in the pleadings at the time of trial, because it did not abandon its ten affirmative defenses until just before trial.[74]

I also consider specious Teltronics' argument that Plaintiffs' claim for a determination of Friedmann's right to be seated immediately as a director did not constitute a proper claim under 8 *Del. C.* § 225. In that regard, Teltronics emphasized that "there was no finding in this case who, among competing claimants, properly held the directorship."[75] Teltronics first made this argument in opposition to FGC's motion to amend and repeated it in its supplemental brief in opposition to the motion for fees, despite the Court's previous rejection of it. Regrettably, the argument again ignores the Court's ruling that if it were forced to decide the issue, it would hold that Friedmann properly held his directorship and the propriety of the other directors' positions was in

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[73] Aug. 24, 2006 Tr. at 8.

[74] Indeed, the parties disputed the adequacy of Teltronics own pleadings on the two remaining issues, whether the five-director proviso in the CD prevented Friedmann's election as a director and waiver. See Mem. Op. at *27 n.46.

[75] Def.'s Br. at 45.

doubt. For equitable reasons and to avoid unnecessary uncertainty, risk and expense to the shareholders of Teltronics, a public company, I did not order Friedmann to be made a *de jure* director immediately.[76] Because I made that ruling to accommodate the interests of Teltronics despite the missteps of its directors and managers, it comes with ill grace for Teltronics to twist the result around and deny that FGC and Friedmann even succeeded on the merits of this action.

Taken together, these actions and the questionable conduct of Teltronics during the earlier proceedings regarding registration, lead me to infer that Teltronics' behavior in the Section 225 portion of this litigation was either the result of subjective bad faith or a negligent, frivolous and oppressive disregard of the rights of its Series B stockholder. I therefore conclude that FGC and Friedmann are entitled to reimbursement of at least some of their attorneys' fees in connection with the prosecution of that portion of the case.

In determining the extent to which Plaintiffs can recover their attorneys' fees, I am mindful that Teltronics' problematic conduct did not extend to all aspects of the litigation

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[76] Another factor I mentioned in the Memorandum Opinion in support of the relief I ordered was that, "although I have concluded that the CD language is unambiguous, I do not believe that Teltronics' contrary argument was made in bad faith." Mem. Op. at *34. That comment refers to the balancing required to determine whether Teltronics' mistaken judgment that it had the right to elect five common directors unconditionally at the 2004 annual meeting and its insistence that it had no way to determine which of those five directors needed to be displaced if Friedmann became a director, warranted an order that might have the draconian effect of invalidating the election of all five common directors. I did not make any finding as to Teltronics' bona fides as relates to the propriety of an award of attorneys' fees in the context of the Memorandum Opinion. I, of course, also did not consider any of the actions that have occurred since that Opinion.

since January 2005 and that Teltronics succeeded on certain of its other arguments. The main activities during the relevant period were the trial, post-trial briefing and argument and matters relating to Plaintiffs' motion for fees or indemnification. In terms of the trial and later proceedings directed to the merits, the actions supporting the award of fees related to Teltronics' denial of FGC's clear right to elect a Series B director "at any time" and its meritless waiver defense. Regarding Plaintiffs' motion for fees, the bad faith or vexatious conduct included portions of its opposition to FGC's motion to amend the pleadings to conform to the evidence and certain arguments against an award of fees. Examples of that conduct include Teltronics' continued, but baseless, insistence that the trial did not involve a Section 225 claim and that Plaintiffs did not prevail on the merits of their claim for a declaratory judgment that FGC had the right to elect Friedmann as a director at any time and to have him promptly seated on the board. Taking these matters and all the relevant circumstances into consideration, I conclude that Teltronics should be required to reimburse Plaintiffs for 50% of (1) all the attorneys' fees they incurred in this matter for services or consultation performed on or after January 28, 2005, [77] and (2) for one attorney's attendance at and preparation for the depositions of Friedmann and Ewen Cameron, (who appeared at trial), Joseph Agnetta and John Blair. Testimony of all these

[77] Teltronics agreed to drop its ten affirmative defenses to registration on January 27, 2005. *See* Def.'s Br. at 29. The parties actually filed a Consent to Judgment to similar effect on February 2, 2005, which the Court entered on that date. In any event, the January 28, 2005 starting date for fees appears reasonable because, with the possible exception of the argument relating to the impact of the five director limit on FGC and Friedmann's ability to seat a Series B director on the board immediately, the issues that actually were tried did not become the focus of the litigation until just a short time before trial.

witnesses was referred to in a potentially material way in either or both the parties' post-trial briefing on the merits and the Memorandum Opinion.

E. Costs

Under Court of Chancery Rule 54(d), costs "shall be allowed as of course to the prevailing party unless the Court otherwise directs." For purposes of Rule 54(d), the "prevailing party" is the party who successfully prevails on the merits of the main issue.[78] Courts have understood this to mean that a party need not be successful on all claims, but successful on a general majority of the claims.[79]

Under case law, "costs" are not identical to "expenses"; our courts have defined costs as those "expenses necessarily incurred in the assertion of [a] right in court,"[80] such as court filing fees, fees associated with service of process or costs covered by statute.[81] Thus, items such as computerized legal research, transcripts, or photocopying are not recoverable.[82]

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78 *See, e.g.*, *Brandin v. Gottlieb*, 2000 Del. Ch. LEXIS 97, at *87 (July 13, 2000); *Nucar v. Doyle*, 2006 Del. Ch. LEXIS 74, at *11-12 (Apr. 17, 2006).

79 *Id.*

80 *See Comrie v. Enterasys Networks, Inc.*, 2004 Del. Ch. LEXIS 53, at *16-17 (Apr. 27, 2004).

81 *Dewey Beach Lions Club v. Longacre*, 2006 Del. Ch. LEXIS 181, at *2-3 (Oct. 11, 2006).

82 *Gaffin v. Teledyne, Inc.*, 1993 Del. Ch. LEXIS 117, at *6-7 (July 15, 1993). Additionally, Court of Chancery Rule 54(d) explicitly excludes from recoverable costs "any charge for the Court's copy of the transcript of the testimony or any depositions."

In this case, I find that FGC and Friedmann are the prevailing parties for purposes of Rule 54(d). As identified earlier, FGC prevailed as to registration because Teltronics entered into the Consent to Judgment. Plaintiffs also prevailed in obtaining a preliminary injunction order on August 16, 2005 and, for the reasons discussed above, on the ultimate issue tried before me, as reflected in the Memorandum Opinion.

III. CONCLUSION

For the reasons stated, Plaintiffs' Motion for Attorneys' Fees, and/or, Alternatively, Indemnification is granted in part and denied in part. In particular, I deny Plaintiffs' request, under an exception to the American Rule, for fees incurred before and during the first part of this litigation regarding registration of the transfer of the Series B stock. I also deny in all respects the claims of each of the Plaintiffs for indemnification under 8 *Del. C.* § 145 and Teltronics' bylaws. As to the Section 225 portion of the litigation, I find that Teltronics' conduct does warrant making an exception to the American Rule. Accordingly, I grant in part and deny in part Plaintiffs' motion for attorneys' fees as it relates to the Section 225 part of this action as follows. Teltronics shall reimburse Plaintiffs for 50% of all the attorneys' fees they incurred in this matter for services or consultation performed on or after January 28, 2005 and of the fees for one attorney's attendance at and preparation for the depositions of Friedmann, Cameron, Agnetta and Ifergan. Plaintiffs also are entitled to recover their costs in this litigation under Court of Chancery Rule 54(d).

Plaintiffs shall submit documentation supporting the amount of the attorneys' fees they claim in accordance with these rulings and an itemized list of the costs they claim

under Rule 54(d) within 20 days of the date of this opinion. In addition, Plaintiffs shall provide to Teltronics within the same time period a proposed form of final judgment and order. Within 20 days after receipt of those papers from Plaintiffs, Teltronics shall file any opposition it may have to the amount of Plaintiffs' claimed attorneys' fees and costs. The parties also shall file within the latter time period an agreed upon form of final judgment and order or, if no agreement is reached, separate proposed forms together with concise letters setting forth their positions on the disputed items.