

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

THOMAS T. S. KAUNG,)
)
 Plaintiff,)
)
 v.) C.A. No. 163-N
)
 COLE NATIONAL CORPORATION,)
 a Delaware Corporation,)
)
 Defendant.)

MEMORANDUM OPINION AND ORDER

Submitted: November 7, 2005

Decided: December 13, 2005

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LAMB, Vice Chancellor.

This case arises from a dispute concerning the advancement of legal fees incurred in connection with an SEC investigation and related litigation. In its August 27, 2004 Memorandum Opinion, this court ruled in favor of the defendant, Cole National Corporation, holding that the plaintiff, Thomas T.S. Kaung, was not entitled to advancement of certain fees. The court further awarded Cole recoupment of fees previously advanced to Kaung. Finally, the court allowed Cole its attorneys' fees and expenses incurred in defending the action.

On July 5, 2005, the Supreme Court of Delaware ruled on appeal, affirming this court's decision in part and reversing it in part. Specifically, although the Supreme Court upheld this court's decisions as to Kaung's lack of entitlement to further advancement and affirmed the award of fees to Cole, the Supreme Court held that this court erred in reaching the recoupment issue prematurely, rather than leaving it for a later proceeding in which Kaung's entitlement to indemnification *vel non* and the scope thereof could be decided.

On September 23, 2005, Kaung filed a motion in this court requesting an award of his attorneys' fees and costs for what he calls his partial success in the prosecution of his advancement action. Having fully considered the issue in a manner consistent with the Supreme Court's instructions, the court now holds that Kaung is not entitled to recover any "fees on fees" in relation to his unsuccessful prosecution of this case.

I.

The facts from which this case arises are fully set out in this court's previous opinion,¹ and in the Supreme Court's opinion of July 5, 2005.² For the present purposes, it suffices to say the following.

Kaung was hired as Cole's Chief Financial Officer in March 2000. He stayed in that position for two years and retired in July 2002. Shortly thereafter, Cole announced that it would restate its financials for the fiscal years 1998 through 2001, as well as for the first two quarters of 2002. In response, certain shareholders of Cole filed a class action against Cole and various corporate officers, including Kaung. Kaung hired Malcolm Kelso, the sole member of Irontree Group, as a non-lawyer consultant. On Kelso's advice, Kaung then hired the O'Rourke & Cundra law firm to represent him in any ensuing litigation.

Cole initially advanced all of Kelso's and Cundra's fees under Kaung's indemnification agreement with Cole, but eventually began to question the magnitude of those charges, as well as Kelso's qualifications to serve as a litigation advisor. On January 7, 2004, Kaung sent Cole a notice of default for its failure to pay the balance of Kelso's bills for the period of mid-May until August 2003. Kaung also noticed a default in paying O'Rourke & Cundra's November and

¹ *Kaung v. Cole Nat'l Corp.*, 2004 Del. Ch. LEXIS 126 (Del. Ch. Aug. 27, 2004).

² *Kaung v. Cole Nat'l Corp.*, 884 A.2d 500 (Del. 2005).

December 2003 bills despite the fact that Cole had consistently made timely payment of that firm's bills. After receiving prompt notice that Cole was investigating the reasonableness of Kaung's expenses, Kaung filed suit in this court on January 12, 2004. The next day, Cole paid O'Rourke & Cundra's outstanding bills. Despite these payments, Kaung persisted in prosecuting this case. Consequently, the court held a one day trial on June 18, 2004, before which Kaung's Delaware counsel withdrew Kaung's request for payment of Kelso's fees, essentially conceding that no part of Kelso's bills were indemnifiable.

Following trial, the court ruled for Cole, as previously described. In its final order and judgment, the court ordered Kaung to pay Cole \$150,606.85 for the amount already advanced for Kelso's fees. The court also determined that \$81,760 of O'Rourke & Cundra's bills related to its interactions with Kelso, and, therefore, (i) Cole had no obligation to pay O'Rourke & Cundra's then unpaid \$65,226.86 bill, and ordered (ii) that Kaung repay Cole the balance of \$16,533.14, and (iii) pay Cole \$300,000 for attorneys' fees and expenses due to the bad faith conduct of this lawsuit.

On appeal, the Delaware Supreme Court upheld this court's conclusions as to Cole's attorneys' fees and expenses, noting that the record "fully support[ed]"

the award in this case.³ The Supreme Court also agreed with this court in holding that O'Rourke & Cundra was not entitled to advancement of its unpaid legal fees, as "the time billed by [the firm] relating to its dealings with Kelso was not reasonably incurred in connection with its representation of Kaung pursuant to the indemnification agreement."⁴ The Supreme Court held, however, that this court's determination as to Kaung's liability to repay sums voluntarily advanced by Cole in the past was premature, basing its decision on the fact that an "advancement proceeding is summary in nature," and is inappropriate for "litigating indemnification or recoupment."⁵ As the Supreme Court further explained, "the detailed analysis required of such claims is . . . inconsistent with the purpose of a summary proceeding."⁶ Following the Supreme Court's partial reversal of this court's decision, Kaung brought the instant motion seeking attorneys' fees and costs for complete or partial success in the prosecution of this action.

II.

Kaung's argument regarding his request for "fees on fees" is simple. According to Kaung, his indemnification agreement with Cole requires indemnification for all expenses "reasonably incurred" *regardless* of the outcome

³ *Kaung*, 884 A.2d at *15.

⁴ *Id.* at *27.

⁵ *Id.*

⁶ *Id.*

of the underlying litigation. This, Kaung argues, means that the indemnification agreement requires “fees on fees” in this case. Second, Kaung maintains that he was successful in the previous litigation, winning reversal of a portion of this court’s decision from the Delaware Supreme Court. Therefore, even if the indemnification agreement is read less broadly than he argues, Kaung should still be entitled to attorneys’ fees on the basis of Delaware precedent that requires the payment of “fees on fees” if a corporate officer or director is successful in his or her advancement claims.

Cole argues that Kaung fundamentally misunderstands the indemnification agreement. Rather than guaranteeing recovery to Kaung, Cole notes, the agreement only requires recovery if Cole breaches the agreement, and thus forces Kaung to pay for his own counsel in the underlying litigation. Therefore, “if Cole did not breach the Agreement . . . Cole is not responsible for Kaung’s expenses.” Second, Cole argues that Kaung should be denied “fees on fees” because he was not successful in his underlying claims. Indeed, according to Cole, Kaung was completely unsuccessful because he was awarded no additional advancements and the court held that Kaung’s expenditures were not reasonably incurred. Further, Cole argues, the Supreme Court’s limited, procedural, reversal of this court’s decision cannot justify “fees on fees.” In fact, the \$167,000 put at issue by the Supreme Court’s decision has already been advanced. Thus, a ruling that this court

was premature in granting recoupment to Cole is insufficient to establish that Kaung has in any way been successful in his claims.

III.

“Fees on fees” refers to an award of litigation expenses (including attorneys’ fees) incurred in the process of obtaining another award of litigation expenses pursuant to some statutory or contractual authority.⁷ In *Stifel Financial Corp. v. Cochran*,⁸ the Delaware Supreme Court definitively ruled that such fees are required when a corporate officer or director is successful in an indemnification action against a corporation. Naturally, this court has since followed the Supreme Court’s teaching on the subject.⁹ In those cases, this court has determined that a litigant’s partial success in an advancement or indemnification action leads to partial indemnification, commensurate with the extent of the victory.¹⁰

In this case, the court necessarily begins its analysis with the indemnification agreement. If Kaung is correct that the agreement envisions advancement regardless of the merits of the case, the court is left only to answer the question of whether these particular expenses were “reasonably incurred.”

⁷ *Fasciana v. Elec. Data Sys.*, 829 A.2d 178, 182 n.13 (Del. Ch. 2003).

⁸ 809 A.2d 555 (Del. 2002).

⁹ DONALD J. WOLFE, JR. & MICHAEL A. PITTENGER, CORPORATE AND COMMERCIAL PRACTICE IN THE DELAWARE COURT OF CHANCERY, § 8.2 (2005); *Fasciana*, 829 A.2d at 178; *Reddy v. Elec. Data Sys. Corp.*, 2002 Del. Ch. LEXIS 69 (Del. Ch. June 18, 2002), *aff’d*, 820 A.2d 371 (Del. 2003).

¹⁰ *Fasciana*, 829 A.2d at 178.

The court concludes, however, that Kaung’s reading of the indemnification agreement is far too broad. Section 2, Article VIII of Cole’s bylaws states that advancement of fees is governed by the indemnification agreement between the parties. Paragraph 6(c) of the agreement, which is operative here, explains what happens if Cole violates the agreement and refuses to provide Kaung with counsel, or to pay for Kaung’s choice of counsel. Simply put, the agreement ensures that if Cole violates Kaung’s rights by failing to perform the agreement, Cole is bound to pay for all reasonably incurred expenses regardless of the outcome of the litigation. The important point, of course, is that this backstop provision only goes into effect if Cole fails to perform the indemnification agreement, or if Cole contests the validity or enforceability of the agreement. Otherwise, Kaung’s right to recover “fees on fees” is limited to that authorized by Delaware law.

In this case, there are no facts evidencing that Cole violated the agreement, thus triggering the “regardless of the outcome thereof” language on which Kaung relies. Rather, as this court has already decided, Cole has fulfilled its duties to advance attorneys’ fees under the indemnification agreement by paying the vast majority of bills forwarded by Kaung’s representatives, and has only withheld monies when its reasonable requests for further information about Kaung’s expenditures were ignored. This case, therefore, does not implicate the guarantees in paragraph 6(c) of the agreement.

Kaung argues, in the alternative, that the court should rule in his favor because he was partially successful in prosecuting this claim against Cole. The fact that the Supreme Court overturned this court's recoupment judgment of \$167,139.99 in favor of Cole, Kaung argues, means that he was "awarded a subset of his advancement claim."¹¹ Cole, however, is ultimately right to note that Kaung's procedural victory in the Supreme Court cannot form the basis of a "fees on fees" award. Fundamentally, Kaung has cited no case that establishes such a right, and the court has not been able to independently find any precedent where a Delaware court has awarded "fees on fees" for a partial, procedural, reversal of the kind at issue here.¹²

¹¹ In his reply brief, Kaung argues more specifically that he is due "fees on fees" because the only reason the court denied advancement to Kaung on \$65,226.86 of fees owed to O'Rourke & Cundra is that the recoupment award exceeded the fees owed, resulting in a judgment in Cole's favor of \$16,533.14. Since the recoupment award has been reversed, says Kaung, O'Rourke & Cundra should receive their unpaid fees. This is an inaccurate reading of both this court's previous decision and the decision of the Supreme Court. As the Supreme Court concluded, "O'Rourke & Cundra was not entitled to advancement of its unpaid legal fees." That is the \$65,228.86 now claimed, in full. As an independent matter, the Supreme Court reversed the recoupment award. But that reversal does nothing to disturb both courts' conclusions that Kaung was not entitled to further advancement as an offset of amounts earlier advanced with respect to O'Rourke & Cundra's dealings with Kelso.

¹² The plaintiff cites several cases which he says support his position. The facts of those cases, and the facts present here, however, are plainly different. Fundamentally, in all those cases the defendants refused to advance funds, and were compelled by judicial order to pay at least some advancement claim. In this case, as explained above, the defendant has manifestly fulfilled all its advancement obligations. *Tafeen v. Homestore, Inc.*, 2005 Del. Ch. LEXIS 41 (Del. Ch. Mar. 29, 2005) (granting "fees on fees" where the plaintiff requested advancement, and the defendant did not provide the funds because Tafeen neglected to tender the defendants' desired undertaking); *Weaver v. Zenimax Media*, 2004 Del. Ch. LEXIS 10 (Del. Ch. Jan. 30, 2004) (awarding "fees on fees" where the plaintiff demanded that the defendant advance fees, and the defendant argued that the plaintiff was not entitled to advancement because he had not met the

Some language in *Fasciana v. Electronic Data Systems*¹³ superficially appears to provide support for Kaung’s position. In that case, this court held that even if the plaintiff seeking advancement eventually lost at the indemnification stage, his partial victory at the advancement stage brought him what the court called a “real benefit.” Namely, this was the “interest-free use of [the defendant’s] money until his entitlement to indemnification . . . is finally determined.”¹⁴ It might be said in this case, therefore, that Kaung benefitted from the Supreme Court’s ruling by being left to potentially reimburse Cole later.

The context presented in *Fasciana*, however, was much different than that found here. In *Fasciana*, the plaintiff had been denied advancement by the company, brought an action to compel payment, and won a limited but clear victory on parts of that claim. As a result of the Section 145 action at the heart of *Fasciana*, the plaintiff successfully invoked the court’s power to compel the defendant to offer what was effectively “an extension of credit.” *Fasciana* explains, in other words, why “fees on fees” should be awarded if a plaintiff wins his advancement case, even if all those funds are returned in indemnification/

applicable standard); *Morgan v. Grace*, 2003 Del. Ch. LEXIS 113 (Del. Ch. Oct. 29, 2003) (granting “fees on fees” where the defendant argued that the plaintiffs were entitled to neither advancement nor indemnification); *Reddy*, 2002 Del. Ch. LEXIS 69, *7 (ordering a meet and confer session to discuss an appropriate award of “fees on fees” where “Reddy demanded advancement for both the Criminal and the EDS Action,” but “EDS refused to provide it.”).

¹³ 829 A.2d 178.

¹⁴ *Id* at 183.

recoupment. The logic in *Fasciana* is inapplicable to this case, therefore, because Cole never denied Kaung's right to advancement of these funds. Rather, the money at issue here had already been advanced to Kaung under the indemnification agreement, and the court determined that Cole had no obligation to extend further advancement. The claim on which Kaung received relief from the Supreme Court, thus, was no advancement claim at all. Rather, Kaung prevailed in persuading the Supreme Court that a recoupment action was premature.

"Fees on fees," in sum, are inappropriate in this case because Kaung has thus far been entirely unsuccessful in his advancement claims. The court has ruled against him on fee shifting and against him on the question of whether further advancement for fees submitted by O'Rourke & Cundra was required. The Supreme Court upheld both those decisions.

The goal of awarding "fees on fees," the Supreme Court explained,¹⁵ is to "promote the desirable end that corporate officials will resist what they consider unjustified suits and claims, secure in the knowledge that their reasonable expenses will be borne by the corporation they have served if they are vindicated."¹⁶ To give Kaung "fees on fees" when he has neither been vindicated nor has confined

¹⁵ In *Stifel*, the Delaware Supreme Court effected a notable change in Delaware precedent, which had theretofore disfavored such awards. See, e.g., *Mayer v. Executive Telecard, Ltd.*, 705 A.2d 220 (Del. Ch. 1997).

¹⁶ *Stifel*, 809 A.2d at 561, quoting RODMAN WARD, EDWARD P. WELCH, & ANDREW TUREZYN, *FOLK ON THE DELAWARE GENERAL CORPORATION LAW*, § 141.2.11 (2005).

himself to reasonable expenses would be to directly undermine that important policy.

IV.

For the foregoing reasons, the plaintiff's petition for "fees on fees" is DENIED. IT IS SO ORDERED.