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Schlossberg v Schwartz
2014 NY Slip Op 50760(U)
Decided on May 14, 2014
Supreme Court, Nassau County
DeStefano, J.
Published by New York State Law Reporting Bureau pursuant to Judiciary Law § 431.
This opinion is uncorrected and will not be published in the printed Official Reports.

Decided on May 14, 2014

Supreme Court, Nassau County

Kenneth Schlossberg, Individually and Derivatively on Behalf and in the Right of STEUBEN FOODS, INC., Plaintiff,

against

Henry Schwartz, STEUBEN SALES, INC., ELMHURST DAIRY, INC., DORA'S NATURALS, INC., WORCHESTER CREAMERIES CORP. and EMPACT AMERICA, INC., , Defendants, STEUBEN FOODS, INC., Nominal Defendant.

014491-11

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Vito M. DeStefano, J.

The following papers and the attachments and exhibits thereto have been read on this motion:

[*2]

Notice of Motion1

Affirmation in Opposition2

Reply Affirmation3

It is hereby ordered that the motion by the plaintiff for an order pursuant to, *inter alia*, Business Corporation Law § 724(c), directing Steuben Foods Inc. ("Steuben") to advance payment of expenses, including reasonable attorneys' fees incurred by Plaintiff in defending counterclaims asserted against him, in the amount of $54,477.72, is granted.

Background

The Plaintiff, a shareholder, director and former officer of Steuben, suing in an individual and derivative capacity, seeks an award of expenses *pendente lite* in connection with the defense

of counterclaims made by Steuben. The verified answer to the second amended complaint contains

ten counterclaims, nine of which seek damages and sound in misappropriation of confidential information, replevin with respect to such information and property, unfair competition, unjust enrichment, conversion, breach of fiduciary duty, breach of the duty of loyalty, violation of Business Corporation Law §720 and corporate waste. The tenth counterclaim seeks injunctive relief.

According to the Plaintiff, "Steuben's By-Laws are consistent with, and essentially duplicate, the relevant language of BCL § 722 which provides for indemnification to corporate officers and directors. Because Steuben has provided for mandatory indmenification * * * in its By-Laws, it is contractually required to provide such indemnification to Plaintiff, as a matter of law". Plaintiff claims to have incurred $54,477.72 in legal fees and costs attributable to the counterclaims.

In response, Steuben argues that: its bylaws do not provide for the indemnification of Plaintiff given that the indemnification obligations described in the bylaws do not apply to actions and claims brought by Steuben against officers and directors; this is demonstrated by reference to the language of the indemnification provision itself and by comparison to the relevant language of section 722 of the Business Corporation Law. Moreover, to hold that the bylaws require indemnification under the circumstances presented is without any basis in law and would contravene the Business Corporation Law. Steuben adds that even assuming some basis for indemnification was established, in no event could Plaintiff recover with respect to counterclaims that were unrelated to his mere status as director or officer. In addition, Steuben argues that because there is a substantial overlap of facts relevant to Steuben's defense of Plaintiff's claims and Plaintiff's defense of Steuben's counterclaims, there is no basis to distinguish between expenses which might be recoverable and those which are not.

The Court's Determination

Initially, the court will review the relevant provisions of the Business Corporation Law and bylaws of Steuben.

Business Corporation Law § 724(c) provides:

> Where indemnification is sought by judicial action, the court may allow a person such

> reasonable expenses, including attorneys' fees, during the pendency of the litigation as are necessary in connection with his defense therein, if the court shall find that the defendant has by his pleadings or during the course of the litigation raised genuine issues of fact or law.

Business Corporation Law § 725 [Other provisions affecting indemnification of directors and officers], provides:

(a) All expenses incurred in defending a civil or criminal action or proceeding which are advanced by the corporation under paragraph (c) of section 723 (Payment of indemnification other than by court award) or allowed by a court under paragraph (c) of section 724 (Indemnification of directors and officers by a court) shall be repaid in case the person receiving such advancement or allowance is ultimately found, under the procedure set forth in this article, not to be entitled to indemnification or, where indemnification is granted, to the extent the expenses so advanced by the corporation or allowed by the court exceed the indemnification to which he is entitled.

> (b) No indemnification, advancement or allowance shall be made under this article in any circumstance where it
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> appears:
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> * * *
>
> (2) That the indemnification would be inconsistent with a provision of the certificate of incorporation, a by-law, a resolution of the board or of the shareholders, an agreement or other proper corporate action, in effect at the time of the accrual of the alleged cause of action asserted in the threatened or pending action or proceeding in which the expenses were incurred or other amounts were paid, which prohibits or otherwise limits indemnification.

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Business Corporation Law § 721 [Nonexclusivity of statutory provisions for indemnification of directors and officers] requires:

The indemnification and advancement of expenses granted pursuant to, or provided by, this article shall not be deemed exclusive of any other rights to which a director or officer seeking indemnification or advancement of expenses may be entitled, whether contained in the certificate of incorporation or the by-laws or, when authorized by such certificate of incorporation or by-laws, [I]

a resolution of shareholders, [ii] a resolution of directors, or [iii] an agreement providing for such indemnification, provided that no indemnification may be made to or on behalf of any director or officer if a judgment or other final adjudication adverse to the director or officer establishes that his acts were committed in bad faith or were the result of active and deliberate dishonesty and were material to the cause of action so adjudicated, or that he personally gained in fact a financial profit or other advantage to which he was not legally entitled. Nothing contained in this article shall affect any rights to indemnification to which corporate personnel other than directors and officers may be entitled by contract or otherwise under law.

Business Corporation Law § 722[c] requires:

> A corporation may indemnify any person made, or threatened to be made, a party to an action by or in the right of the corporation to procure a judgment in its favor by reason of the fact that he, his testator or intestate, is or was a director or officer of the corporation, or is or was serving at the request of the corporation as a director or officer of any other corporation of any type or kind, domestic or foreign, of any partnership, joint venture, trust, employee benefit plan or other enterprise, against amounts paid in settlement and reasonable expenses, including attorneys' fees, actually and necessarily incurred by him in connection with the defense or settlement of such action, or in connection with an appeal therein, if such director or officer acted, in good faith, for a purpose which he reasonably believed to be in, or, in the case of service for any other corporation or any partnership, joint venture, trust, employee benefit plan *or* other enterprise, not opposed to, the best interests of the corporation, except that no indemnification under this paragraph shall be made in respect of (1) a threatened action, or a pending action which is settled or otherwise disposed of, or (2) any claim, issue or matter as to which such person shall have been adjudged to be liable to the corporation, unless and only to the extent that the court in which the action was brought, or, if no action was brought, any court of competent jurisdiction, determines upon application that, in view of all the circumstances of the case, the person is fairly and reasonably entitled to indemnity for such portion of the [*4]settlement amount and expenses as the court deems proper.

Section 8.1 of Steuben's bylaws [Indemnification of Officers and Directors], reads as follows:

Indemnification of Officers and Directors. The Corporation shall indemnify any person made, or threatened to be made, a party to any action, suit or proceeding by reason of the fact that he, . . . is or was a director or officer of the Corporation, . . . against all judgments, fines, amounts paid in settlement and reasonable expenses, including attorneys' fees, actually and necessarily incurred by him in connection with the defense of such action, . . . to the fullest extent and in the manner set

forth in and permitted by the Business Corporation Law and any other applicable law, as from time to time in effect. Such right of indemnification shall not be deemed exclusive of any other rights to which such director or officer may be entitled apart from the foregoing provisions. The forgoing provisions of this Section 8.1 shall be deemed to be a contract between the Corporation and each director and officer * * *

In *Ficus Invs., Inc. v Private Capital Mgt.* (61 AD3d 1 [1st Dept 2009]), the First Department stated that:

> Delaware courts have had ample opportunity to address these issues of indemnification for and advancement of expenses and, although not binding as to * * * New York law, their holdings can be instructive. Under Delaware law, a clear distinction is drawn between the two provisions: whether an officer is entitled to advancement is determined in a summary proceeding, while the right to indemnification is delayed until the conclusion of the matter (see Kaung v Cole Natl. Corp., 884 A2d 500, 509 [Del 2005]). The rights are recognized as independent of one another, in that "an advancement proceeding is summary in nature and not appropriate for litigating indemnification or recoupment. The detailed analysis required of such claims is both premature and inconsistent with the purpose of a summary proceeding" (id. at 510).
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> * * *
>
> Given the separate purposes of indemnification and advancement, Supreme Court properly determined that the Operating Agreement distinguishes between the relief available to a corporate officer at the conclusion of the proceedings and that which is available while the proceedings are ongoing.

[*5]

Accordingly, the Business Corporation Law draws a distinction (though somewhat inconsistently) between "indemnification" and "advancement" (*see Crossroads ABL LLC v Canares Capital Mgmt., LLC*, 105 AD3d 645 [1st Dept 2013]). Nevertheless, that the "detailed analysis" required for an indemnification determination is not required for an advancement determination, does not alter the fact that the concepts are related, and, more specifically, that the right to retain (or, rather, to avoid repaying) monies advanced for defense costs, is dependent upon whether the person receiving such advancement is ultimately found to be entitled to indemnification (Business Corporation Law §725).

At bar, therefore, a director or officer's right of indemnification, and "retention" of funds advanced for indemnification, will necessarily require that:

there be an action, suit or proceeding;

against a person who is or was a director or officer;

by reason of the fact that the person was a director or officer;

for attorneys' fees actually and necessarily incurred by the person in connection with the defense;

except that there will be no indemnification and no right of "retention" of advanced monies: if a judgment or other final adjudication adverse to the director or officer establishes that his acts were committed in bad faith or were the result of active and deliberate dishonesty and were material to the cause of action so adjudicated, or that he personally gained a financial profit or other advantage to which he was not legally entitled; and, unless the director or officer acted in good faith and for a purpose he reasonable believed to be in the best interests of the corporation. If the action is settled, or if the director or officer was adjudged to have been liable to the corporation, there will be no indemnification except to the extent the court deems proper.

Concomitantly, there must be genuine issues of law or fact as to indemnifiable claims to warrant an order by the court directing the advancement of expenses.[FN1]

Contrary to Steuben's contention, section 8.1 of the bylaws of Steuben contemplates the indemnification of directors and officers not only in defense of suits by third parties but also in intra-company actions such as the instant one, where the corporation is asserting direct [*6]counterclaims against the Plaintiff. Steuben's erroneous argument that the bylaws affirmatively preclude indemnification for intra-company disputes (and, by extension, that they preclude the advancement of such expenses) is contrary to the plain language of section 8.1, which, by its terms, is to be deemed a contract. Moreover, Steuben's comparison of section 8.1 to Business Corporation Law § 722(c), and its assertion that the omission of certain language from the former ("by or in the right of the corporation to procure a judgment in its favor"), and its inclusion in the latter, is both incorrect and misleading. In this regard, the court notes that Business Corporation Law §722(c) must be understood in the context of the entirety of the section and the history of the Business Corporation Law. Significantly, section 722(c) applies only to intra-company disputes—to wit, derivative claims or direct claims brought by the corporation against directors and officers (or against other "persons" as defined therein). Business Corporation Law § 722(a), in contrast, applies only to third-party actions or proceedings brought against officers and directors (or against other "persons" as defined therein). The court notes the relevant language of both sections:

Business Corporation Law §722 (a):

> A corporation may indemnify any person made, or threatened to be made, a party to an action or proceeding (other than one by or in the right of the corporation to procure a judgment in its favor), whether civil or criminal, including an action by or in the right of any other corporation of any type or kind * * *

Business Corporation Law §722(c):

> A corporation may indemnify any person made, or threatened to be made, a party to an action by or in the right of the corporation to procure a judgment in its favor by reason of the fact that he, his testator or intestate, is or was a director or officer of the corporation* * *

Thus, a comparison of the two sections reveals that inclusion of the language, "by or in the right of the corporation", in Business Corporation Law §722(c), addressed what was specifically excluded—parenthetically, from section 722(a). Interestingly, Steuben inaptly and misleadingly fails to note that section 8.1 of the bylaws actually more closely mirrors Business Corporation Law 722(a) than section 722(c). The reason for Steuben's failure to note the similarity in this regard, no doubt, is the language contained in the parenthetical of section 722(a), the omission of which from section 8.1 of the bylaws would lead to the very opposite inference which Steuben seeks the court to draw in connection with its comparison to section 722(c).

This analysis is confirmed by reference to the legislative history of the Business Corporation Law in general, and to the history of the relevant sections of the Business [*7]Corporation Law, specifically. In this regard, when adopted in 1961, sections 722 and 723, respectively, addressed authorization for indemnification of directors and officers in actions by or in the right of a corporation to procure a judgment in its favor, and, authorization for indemnification of directors and officers in actions or proceedings *other than by or in the right of a corporation* to procure a judgment in its favor (*see* 39 Fordham Law Review 4, The Right of Directors to Indemnification in Actions Brought Directly by the Corporation: A Study of BCL Sections 722 and 723, at p. 752; *Baker v Health Mgmt. Sys*., 98 NY2d 80 [2002]).

The history of the indemnification provisions contained in the Business Corporation Law and the confusion engendered by the failure on the part of legislators and scholarly commentators to properly distinguish between direct and derivative actions was described at length in a 1971 law review article appearing in the Fordham Law Review. That article pre-dated amendments to the Business Corporation Law, which include the statutes at issue herein:

If a director has a right of indemnification for the defense of an action brought directly by the corporation, it must be found in either section 722 or section 723. Were it not for the Legislative Comments this right would seem to fall naturally into section 722 *[which today would be Section 722 (c)]* which authorizes indemnification "in actions by or in the right of a corporation . . . . However, the Legislative Comment to section 722, despite the plain language of the statute, states that the section is to apply to "derivative actions only." Section 723 *[which today would be 722 (a)]*, on the other hand, authorizes the indemnification of directors for actions "other than [those brought] by or in the right of the corporation . . . . The Comment to section 723, however, indicates it is to apply to "non-derivative" actions. The Comments thus speak of a distinction between "derivative" and "non-derivative" actions as being the key to the distinction between the sections. Derivative actions have variously been referred to as "actions in the right of the corporation', secondary actions by shareholders', or actions to enforce a secondary right on the part of the shareholders.'" Consequently, the usual definitions of the word "derivative" do not encompass the direct action by the corporation. The question then arises as to which, if either, of these two sections is applicable when a director is sued, not derivatively, but directly by the corporation.

(Bracketed italicized words have been added by the court)

* * *

[I]n *Griesse v. Lang*, payment was denied by the Ohio Court of Appeals after the successful defense of a stockholder's derivative action because the corporation had received no benefit from the legal services. New York has followed the strict benefit theory as applied in *Griesse*. In *New York Dock Co. v. McCollum*, it was held that a successful director was not entitled to reimbursement unless "he has conserved some substantial interest of the corporation which otherwise might [*8]have been conserved, or had brought some definite benefit to the corporation which otherwise might have been missed . . . . In *McCollum*, the corporation had brought the action seeking a declaratory judgment that it was not legally obligated to pay or reimburse legal expenses incurred by the directors in the successful defense of a stockholder's derivative action. The court reasoned that although the rule of indemnity might be a rule of law in a principal-agent relationship, it was only a rule of guidance in the corporation-director relationship because "a director of a corporation is not an agent either of the corporation or of its stockholders, except in a convenient rhetorical sense . . . . Thus the matter rested on whether the corporation itself benefitted from this defense. Defendant-directors in *McCollum* argued that a benefit did accrue since the corporation was attacked as well as the directors. But the court stated that "[t]he sins alleged were the sins of the directors against the corporation . . . ." and therefore found this argument to be insubstantial.

Thus, prior to the enactment of corrective legislation in 1941, New York, as evidenced by

McCollum, strictly followed the benefit theory, preventing a director from receiving indemnification it is was determined that, regardless of the outcome of the action, the corporation had received no benefit from the defense. It would be difficult to conceive of a case in which the defense of an action brought directly by a corporation against a director would inure to the corporation's benefit. Therefore, prior to the enactment of legislation, it would seem that there was no right of indemnification in New York in an action brought directly by the corporation.

* * *

In order to overcome the effects of the *McCollum* decision, the New York legislature found it necessary to enact sections 27-a and 61-a of the General Corporation Law (GCL). Section 27-a was essentially a permissive provision which allowed a corporation to grant its directors the right of indemnification through the certificate of incorporation, by-laws, or a shareholder resolution. Thus a corporation could assure itself of not losing potential directors because of possible liability by providing for their complete indemnification. The facts of the *McCollum* case, however, came more precisely within in the scope of section 61-a. Where a corporation chose not to indemnify a director, this section provided for mandatory assessment of expenses for a successful defense made by a director of an action brought "by the corporation, or brought in its behalf by . . . one or more stockholders . . . ." The "benefit to the corporation" doctrine was eliminated, and even the defense of an action brought directly by the corporation had to be indemnified if the defense proved to be successful. Thus the 1941 amendments clearly recognized the difference between a "derivative" action and a "direct" action by the corporation and made it clear that if no contractual [*9]indemnification was available, the successful defense of a suit would assure the director of reimbursement in both types of actions.

In 1945 the legislature set out to correct some inconsistencies in the sections. The major inconsistency was that section 61-a was "mandatory" in providing that the court was to assess a corporation the reasonable expenses of a successful defense despite any previous adoption by the shareholders of a more limited provision under the "permissive" section 27-a. The Law Revision Commission thought that otherwise the sections were not basically inconsistent but did differ in important respects. The difference in the type of action covered was that section 27-a applied to "any action, suit or proceeding" to which the defendant was a party "by reason of his being or having been a director" and section 61-a applied to "any action, suit or proceeding . . . brought by the corporation, or brought in its behalf by . . . one or more stockholders. . . . The Commission noted that the language in section 27-a was broader and suggested it might potentially cover certain situations not covered by section 61-a. It is clear, therefore, that the language "any action, suit or proceeding" encompassed the language "any action brought by the corporation."

The result of the Commission's labors was the modification of section 27-a and its

renumbering as section 63 and the incorporation of the provisions of section 61-a into sections 64 through 67.

Section 27-a of the General Corporation Law read as follows: "The certificate of incorporation of a corporation or other certificate filed pursuant to law or the by-laws of a corporation or a resolution in a specific case or an amendment to any of the foregoing, adopted by the vote of the holders of record of a majority of the outstanding shares at the time entitled to vote for the election of directors . . . may provide that each director of the corporation shall be indemnified by the corporation against expenses actually and necessarily incurred by him in connection with the defense of any action, suit or proceeding in which he is made a party by reason of his being or having been a director of the corporation, except in relation to matters as to which he shall be adjudged in such action, suit or proceeding to be liable for negligence or misconduct in the performance of his duties as such director. . . ."

Section 61-a of the General Corporation Law read as follows: "In any action, suit or proceeding against one or more officers or directors, or former officers or directors, of a corporation, domestic or foreign, brought by the corporation or brought in its behalf by . . . one or more stockholders . . . and whether brought under the provisions of this article or otherwise, the reasonable expenses, including attorneys [sic] fees, of any party plaintiff or party defendant incurred in connection with the successful prosecution or defense of such action, suit or proceeding shall be assessed upon the corporation . . . ." [*10]

The Fordham Law Review article continues as follows:

> In the 1945 amendments to the GCL the legislature had emphasized the application of the indemnification statutes to derivative actions. On the other hand, the Joint Committee which did much of the research for the Business Corporation Law was primarily concerned with the possibility that sections 63 and 64 were not applicable to an action brought by an outside third party against a director. For this reason it was recommended that a new section be added which authorized indemnification for actions brought by third persons.
>
> The Working Draft of the BCL prepared by the Joint committee empowered the corporation, in the section which eventually became section 722, to provide for indemnification in "any action, suit or proceeding." As such, it was identical to section 63 of the GCL and consequently failed to solve the problem of whether indemnification was proper in actions brought by third parties. Therefore, a new section was created which solved this problem by providing for such indemnification. This new section became section 723. Thus, the Joint Committee's aim of providing for indemnification in actions

by third parties was realized early in the preliminary drafts. However, the confusion engendered in the 1945 amendments was continued by the use of the term "derivative action" in the Reviser's Notes referring to the applicability of section 722.

The conflict between the words of section 722 and the Reviser's Notes first arose in the Tentative Staff Draft. There the words "by or in the right of the corporation" were substituted for "any action, suit or proceeding." On the other hand, the Reviser's Notes stated: "This section is a substantial re-enactment of the G.C.L. § 63, modified, however, to the extent that it has been made applicable in terms only to *derivative actions*." At this point it can be seen that the application of the statute has run the gamut from the clear distinction between direct action and derivative action in section 61-a of the GCL to the unclear applicability of "any action, suit or proceeding" in sections 63 and 64 of the GCL to the conflicting language of the Tentative Staff Draft and its Reviser's Notes.

The applicability of section 723 solely to third party actions was further emphasized in the Reviser's Comments on the Study Bill introduced into the Senate in 1960. The Comments to the section which became section 722 remained essentially the same as they were in the Tentative Staff Draft. But in the Comment to the section which became section 723 it was noted that the section's "purpose is to codify the common law principle that corporate agents . . . should be reimbursed by the corporate principal for costs and expenses incurred when they are sued, *not by the corporation, directly or indirectly . . . but by a third party*. . . . Thus it is apparent that section 722 was to cover everything which had [*11]been covered by GCL section 63 with the sole exception of third party actions.

When the BCL became the law of New York on April 24, 1961, the contradiction became complete. The plain words of section 722 made it applicable to actions "by or in the right of a corporation" while the Legislative Comment continued to refer to its application to "derivative actions only." The final Comment to section 723 referred to its application to "actions or proceedings, other than derivative actions. Senator Warren M. Anderson, who introduced the bill, referred to the sections as making "a clear distinction between indemnification in derivative actions (§ 722) and in non-derivative actions (§ 723). Nowhere was mention made of the fact that a derivative action does not necessarily include direct corporate action. With this state of affairs the New York courts were left to decipher the meanings of sections 722 and 723.

* * *

The contradiction between section 722 and its Comment arises from the fact that the Comment was itself a product of legislative assumption and oversight. Perhaps it was the fact that "it is not usual for such actions to be instituted by corporations" which caused this laxity in the legislature's drafting of the Comment. This laxity seems to have confused some of the commentators in their interpretations of sections 722 and 723.

* * *

[T]he amendments to the GCL in 1941 . . . encompassed both the direct and derivative actions. However, in the 1945 changes the derivative action seems to have been of paramount concern to the legislature in its restructuring of section 61-a into section 64, although the actual language of section 64 was apparently broad enough to include both types of actions. It was here that the confusion began. Because the direct action was rare, it was assumed that the statute would be applicable to the direct action. Thus the legislature apparently confined its emphasis to the section's applicability to the derivative action. In drafting the BCL, this thinking was naturally carried forward because the emphasis was no longer on the applicability of the statute to "derivative" actions but to "third-party" actions. The resultant aim of the BCL was to separate what was surely applicable before - the "derivative" action - from what was more doubtful in its application - the third-party action. That the term "derivative" action included, in the minds of the New York legislature, the direct action by the corporation is indicated by the plain words of applicability of section 722 - an action "brought by or in the right of the corporation."

Proper statutory interpretation dictates that one first look to the [*12]language in the statuteitself "[f]or it must be presumed that the

means employed by the legislature to express its will are adequate to the purpose and do express that will correctly. Instead, however, the Supreme Court of New York, persuaded perhaps unwittingly by the Legislative Comment, reached the correct result, albeit relying on an incorrect section of the statute.

In any case, it seems clear that the BCL applies to *any* action

brought against adirector of a corporation in connection with his

duties as a director. However, it would be desirable to have the Legislative Comments to sections 722 and 723 changed to both achieve the legislative purpose and conform to the usual definition of a derivative action. Otherwise, the doors will remain open to the

possibility of a higher court determining that a director sued directly by

a corporation will have to bear the expense of his own defense,

regardless of liability.[FN2]

In view of the foregoing, the court concludes that the Plaintiff is not prohibited by Steuben's

bylaws or by the Business Corporation Law from seeking indemnification for the defense of direct counterclaims brought by Steuben against him "by reason of the fact that he * * * is or was a director or officer of the Corporation." Moreover, although ultimate resolution of the indemnification issue must await the conclusion of the action, it is sufficient to note that an advancement of fees pursuant to Business Corporation Law 724(c) may also properly be sought (*see also Crossroads ABL LLC v Canares Capital Mgt*., LLC, 105 AD3d, supra at 645-46 ["Nor does the indemnification provision at issue preclude intra-party claims. To the contrary, the indemnification provision does not include an exhaustive list of actions for which indemnification is required* * *."]). [*13]

The next question to be addressed is whether there exist "genuine issues of fact or law" that the counterclaims against Plaintiff are made "by reason of the fact that * * * he is or was a director or officer of the corporation." Not surprisingly, there is little case law or commentary on the subject, although the Delaware courts have addressed it on occasion. The Delaware case law (including as it has been interpreted by the First Department), indicates that a broad interpretation of that phrase, which would include a wide array of claims that might be asserted against a director or officer, is warranted. "Courts have shown some latitude in interpreting this language such that if there is a nexus or causal connection between any of the underlying proceedings ... and one's official corporate capacity, those proceedings are 'by reason of the fact' that one was'" an officer or director (1-5 Corporate Governance: Law and Practice § 5.03; *see Homestore, Inc. v Tafeen*, 888 A2d 204, 214 [Del Ch 2005]).[FN3] "Under this test, a claim against a director or officer for matters relating to the corporation will typically fall within * * * [the statutory section of the Delaware Code authorizing advancement], even if the individual was a party to an employment agreement" (*Paolino v Mace Sec. Int'l, Inc*., 985 A2d 392 [Del Ch 2009]. And, as the First Department noted in *Ficus Invs., Inc. v Private Capital Mgt*. (*supra* at 15), "one of the beneficial purposes behind * * * advancement is to help attract capable individuals into corporate service by easing the burden of litigation-related expenses. In particular, advancement provides corporate officials with immediate interim relief from the personal out-of-pocket financial burden of paying the significant on-going expenses inevitably involved with investigations and legal proceedings."

At bar, considering the nature of the counterclaims asserted against Plaintiff, all of which involve conduct alleged to have been based on Plaintiff's status as an officer or director of Steuben, the court concludes that the counterclaims, *as pleaded*, involve issues and claims made by reason of the fact that Plaintiff was an officer or director of Steuben. That some of the counterclaims might have been asserted differently—and more specifically, in a manner that did not invoke the

Plaintiff's status as director or officer, or, that evidence could have been presented in opposition to the motion conclusively establishing the absence of any nexus between the counterclaims and the Plaintiff's "official corporate capacity", is speculative and cannot defeat the instant application (*see Lemle v Lemle*, 92 AD3d 494 [1st Dept 2012]; *cf. Tilden of New Jersey v Regency Leasing Sys*., 237 AD2d 431 [2d Dept 1997]). As such, Plaintiff may be entitled to indemnification for the defense of such counterclaims and may seek an advancement in connection with them. That the advancement is sought in connection with the defense of counterclaims (as opposed to the defense of claims asserted by a plaintiff) is relevant only insofar as the proper apportionment of expenses is concerned (*see generally Mercado v Coes FX, Inc*., 12 Misc 3d 766 [Supreme Court Nassau County 2006] [motion for counsel fees and expenses for defense of counterclaims is denied but only on basis that matter was settled not because they [*14]were otherwise not recoverable]; *Weaver v ZeniMax Media, Inc*., __ A2d__, 2004 WL 243163 [Del Ch 2004] [awarding advancement for defense of counterclaims]; *see also Reinhard & Kreinberg v. Dow Chemical Co.*, __A2d__, 2008 Del. Ch. LEXIS 39 [Del Ch 2008] ["[I]f plaintiffs' claims are in fact compulsory counterclaims, the fees incurred in pursuing such claims are subject to advancement."]). Moreover, the fact that there may be some overlap between the claims being prosecuted by the Plaintiff and the defense of counterclaims being asserted against him does not warrant a different result (*TMR Bayhead Sec., LLC v Aegis Tex. Venture Fund II, LP*, 111 AD3d 508 [1st Dept 2013] ["Pursuant to the applicable laws governing the agreements regarding advancement of legal fees, Roberts was entitled to advancement of costs to cover his counterclaims, which largely arise from the same facts as the fund entities' claims against him in the companion action."]; *Schoon v Troy Corp*., 948 A2d 1157, 1171, fn.66a [Del Ch 2008] ["[A] plaintiff seeking advancement is only entitled to the portion of the case against him that is entitled to advancement."]; *Radiancy, Inc. v Azar*, __A2d__, 2006 WL 4762868 [Del Ch 2006]).

The court has considered the expenses sought to be advanced and concludes that they are reasonable and supported by substantial documentation (*see TMR Bayhead Sec., LLC v Aegis Tex. Venture Fund II, LP*, *supra*). Payment shall be made to the Plaintiff within 20 days of the date hereof.

Regarding future advancement requests, Plaintiff's attorney shall submit a sworn statement to Steuben's attorney indicating that the expenses for which advancement are sought have been incurred reasonably as a matter of sound professional judgment; thereafter, Steuben's attorney will identify, also by sworn statement, the expenses that are disputed. The expenses that are not disputed will be paid within 15 days of submission. Disputes concerning the reasonableness of the expenses

sought to be advanced shall be referred to a special referee for determination (see *Fasciana v Electronic Data Systems Corp.*, 829 A2d 160 [Del. Ch.2003]; *Duthie v CorSolutons Medical, Inc*., 2008 Del Ch LEXIS 128 [Del Ch 2008] *mod other grounds* 2009 Del Ch 112 [Del Ch 2009]).[FN4] In addition, Plaintiff's attorney shall separately allocate time and expense entries attributable to the defense of each counterclaim.

This constitutes the decision and order of the court.

DATE: May 14, 2014 [*15]

Hon. Vito M. DeStefano, J.S.C.

Footnotes

Footnote 1: The "[l]imited relief of litigation expenses, including attorney fees, is also available during the pendency of the action upon the movant's demonstration that such fees and expenses are reasonable and necessary in connection with the defense, and that the movant has raised a genuine issue of fact or law" (New York Commercial Litigation Guide § 2.15).

Footnote 2: Interestingly, and consistent with several of the observations made in the Fordham Law Review article, the Court of Appeals in *Baker v Health Management Systems, Inc*. (98 NY2d 80 [2002]) stated that:

In the context of derivative actions, section 722 (c) provides that a corporation may indemnify officers and directors who acted in good faith and in the best interests of the corporation "against amounts paid in settlement and reasonable expenses, including attorneys' fees, actually and necessarily incurred by [them] in *connection with the defense or settlement of such action."* (Emphasis in original).

Footnote 3:"Put simply, regardless of the label of the claim, the requisite connection between official capacity and underlying suit is established if the official's corporate powers were used or necessary for the commission of the alleged misconduct for which indemnification is sought" (Directors' and Officers' Liability: Determining Indemnifiable Conduct, New York Law Journal, October 14, 2010). "A corollary to this official capacity doctrine is that advancement and indemnification are not available if the alleged wrongdoing did not implicate the official's use of corporate powers entrusted to him or her." (*Id.*)

Footnote 4: In *Fasciana v Electronic Data Systems Corp*. (*supra* at 177), the court stated: "To implement this ruling [granting advancement], Fasciana shall submit a good faith estimate of expenses incurred to date to address the precise allegations that trigger Fasciana's advancement right * * * [I]n order to ensure the integrity of this process, Fasciana's attorneys shall provide a sworn affidavit certifying their good faith, informed belief that the identified litigation expenses relate solely to defense activity to address those allegations for which Fasciana is owed advancement. On a going-forward basis, Fasciana's advancement requests shall all be submitted [i]n this format."

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