

Supreme Court of Delaware.

**HOMESTORE, INC.**, Defendant Below, Appellant,  
v.

Peter TAFEEN, Plaintiff Below, Appellee.  
No. 233,2005.

Submitted: Oct. 12, 2005.

Decided: Nov. 17, 2005.

HOLLAND, Justice.

Homestore is a Delaware corporation that has a mandatory advancement provision in its bylaws. A few years ago, Homestore discovered some accounting irregularities that resulted in an overstatement of the company's revenues. In March 2002, it announced those findings and restated its financial statements for several periods. Thereafter, Homestore and its officers and directors were named as defendants in numerous civil actions. They also became the subjects of an administrative investigation by the Securities and Exchange Commission ("SEC") and a criminal investigation by the Department of Justice ("DOJ").

Tafeen is a former officer of Homestore. He was employed by Homestore from September 1997 through November 30, 2001, first as Vice President of Business Development and later as Executive Vice President of Business Development, Ads and Sales. Since Homestore's announcement and reinstatement of its financial statements, Tafeen has incurred and continues to incur substantial legal fees related to several investigations, civil actions, and a criminal indictment.

Section 6.1 of Homestore's bylaws provides for, among other things, indemnification of present or former officers and directors "to the fullest extent permitted by the" Delaware General Corporation Law. In addition, Section 6.2 of Homestore's bylaws contains a mandatory advancement provision: "[t]he Corporation *shall pay* all expenses (including attorney's fees) incurred by such a director or officer in defending any such Proceeding as they are incurred in advance of its final disposition."

Tafeen sought advancement for expenses in connection with investigations by Homestore's Audit Committee, the SEC, and the DOJ, and numerous civil actions that named Tafeen as a defendant (collectively, the "Proceedings"). Tafeen also sought advancement in connection with another action filed after this litigation was commenced--captioned *Myers v. Homestore, Inc.* There is no dispute that all of the Proceedings are a covered "Proceeding" under Homestore's bylaws.

The Proceedings allege a scheme involving a series of transactions by Homestore that supposedly allowed Homestore's Finance Department to overstate

Homestore's revenues. Tafeen was the head of the business development department and the challenged transactions were implemented by Tafeen's department. According to Tafeen, any role he had in implementing or overseeing the challenged transactions was in his official capacity as an officer of the corporation. Therefore, Tafeen asserts that he is a party to the Proceedings "by reason of the fact" that he was a former officer of Homestore. This assertion was challenged by Homestore. According to Homestore, Tafeen cannot satisfy the "by reason of the fact" requirements because his actions were motivated by personal greed that resulted in his receipt of \$15 million.

The DOJ investigation led to an indictment of Tafeen and Homestore's former CEO in April 2005, with trial scheduled for January 2006. The securities class action and the SEC civil action have been stayed pending the outcome of the criminal trial. Three of the civil actions have been dismissed with prejudice as to Tafeen and no money was paid by Tafeen in connection with the resolution of those law suits.

In early 2002, Tafeen requested advancement of legal fees and costs incurred in defending all of the Proceedings. Homestore notified Tafeen that it would reimburse him for expenses accrued through February 2002 related to Homestore's internal investigation. Homestore initially refused to advance any expenses related to the other aspects of the Proceedings.

On April 30, 2002, Homestore sent a letter to Tafeen's counsel advising him that Homestore would advance expenses in connection with the SEC investigation and the then-pending civil litigation in which Tafeen had been named as a defendant. That advancement agreement by Homestore was contingent, however, upon Tafeen's agreement with an April 30 memorandum containing a bullet point list of conditions. None of the requirements in the April 30 memorandum were set forth in Homestore's bylaws. On the advice of his counsel, Tafeen did not return Homestore's proffered advancement documents.

On July 11, 2003, Tafeen's counsel wrote to Homestore's attorney demanding advancement once again. Enclosed with this letter was an undertaking signed by Tafeen, even though Homestore's mandatory advancement bylaw does not require an undertaking from a former officer. Homestore denied Tafeen's request for advancement.

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*Advancement and Indemnification*

Indemnification encourages corporate service by capable individuals by protecting their personal financial resources from depletion by the expenses they

incur during an investigation or litigation that results by reason of that service. Section 145(a) and (b) of the Delaware General Corporation Law gives corporations the power to indemnify their current and former corporate officials from expenses incurred in legal proceedings "*by reason of the fact* that the person is or was a director, officer, employee or agent of the corporation." Section 145(c) allows corporate officials to defend themselves in legal proceedings "secure in the knowledge that, if vindicated, the corporation will bear the expense of litigation." The right to indemnification cannot be established, however, until after the defense to legal proceedings has been "successful on the merits or otherwise."

Advancement is an especially important corollary to indemnification as an inducement for attracting capable individuals into corporate service. 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. [FN7] Section 145(e) allows a corporation to advance corporate officials the costs of defending an investigation or lawsuit. Section 145(e) provides, in pertinent part:

[e]xpenses (including attorneys' fees) incurred by an officer or director in defending any civil, criminal, administrative or investigative action, suit or proceeding may be paid by the corporation in advance of the final disposition of such action, suit or proceeding upon receipt of an undertaking by or on behalf of such director or officer to repay such amount if it shall ultimately be determined that *such person* is not entitled to be indemnified by the corporation as authorized in this section. Such expenses (including attorneys' fees) incurred by *former directors and officers* or other employees and agents may be so paid upon such terms and conditions, if any, as the *corporation* deems appropriate.

Section 145(e) provides corporations with the flexibility to advance funds to *former* corporate officials, such as Tafeen, without an express undertaking. Nevertheless, when corporations, like Homestore, do not have advancement provisions that expressly require an undertaking, the ultimate right to keep payments characterized as an "advancement" depends upon whether the former corporate official is entitled to indemnification. In addition to an express undertaking requirement, corporations may specify by bylaw or contract the terms and conditions upon which present and former corporate officials may receive advancement, *e.g.*, proof of an ability to repay or the posting of a secured bond.

The advancement authority conferred by section 145(e) is permissive. Nevertheless, mandatory advancement

provisions are set forth in a great many corporate charters, bylaws and indemnification agreements. Homestore's bylaws provide corporate officials with a mandatory right of indemnification and an unconditional mandatory right to advancement.

Section 6.1 of Homestore's bylaws provides for mandatory indemnification of present or former officers and directors "to the fullest extent permitted by the" Delaware General Corporation Law:

Each person who was or is ... involved in any action, suit or proceeding, whether civil, criminal, administrative or investigative (the "Proceeding"), *by reason of the fact* that such person ... is or was a director or officer of the Corporation ... shall be indemnified and held harmless by the Corporation to the fullest extent permitted by the Delaware General Corporation Law .... (emphasis added).

Section 6.2 of Homestore's bylaws contains a *mandatory* and *unconditional* advancement provision:

The Corporation *shall* pay all expenses (including attorney's fees) incurred by such a director or officer in defending any such Proceeding as they are incurred in advance of its final disposition; provided, however, that if the Delaware General Corporation Law then so requires, the payment of such expenses ... shall be made only upon delivery to the Corporation of an undertaking, by or on behalf of such director or officer, to repay all amounts so advanced if it should be determined ultimately that such director or officer is not entitled to be indemnified .... (emphasis added).

Although the right to indemnification and advancement are correlative, they are separate and distinct legal actions. The right to advancement is not dependent on the right to indemnification. The right to indemnification requires "success on the merits or otherwise" in defending proceedings brought under section 145(a) or (b). Section 145(e), however, expressly contemplates that corporations may confer a right to advancement that is *greater* than the right to indemnification and recognizes that advances must be repaid if it is ultimately determined that the corporate official is not entitled to be indemnified.

The scope of an advancement proceeding is usually summary in nature and limited to determining the issue of entitlement in accordance with the corporation's own uniquely crafted advancement provisions. Homestore's advancement provision is mandatory and unconditional. Thus, the Court of Chancery was called upon to determine Tafeen's broad unconditional right to mandatory advancement in the context of a narrow proceeding.

#### *Official Capacity Established*

Homestore contends that Tafeen personally received \$15 million dollars as a result of the irregularities that

resulted in the reinstatement of its financial records. Therefore, Homestore argues that Tafeen cannot satisfy the "official capacity" ("by reason of the fact") requirement of section 145(a) and the Homestore's section 145(e) advancement bylaw. According to Homestore, Tafeen's purported actions were outside the scope of his official duties because they were allegedly motivated by personal greed.

The Court of Chancery dismissed Homestore's "official capacity" defense to Tafeen's claim for *advancement* as a matter of law. In addressing Homestore's official capacity "by reason of the fact" argument, the Court of Chancery applied the analysis set forth in *Perconti*. According to the holding in *Perconti*, in order for one to be deemed a party to a proceeding "by reason of the fact" of one's corporate position, there must be a "causal connection or nexus" between the underlying proceeding and "the corporate function or 'official [corporate] capacity.'" In this case, the Court of Chancery noted that the motivation of the corporate official is not a part of the *Perconti* analysis.

In *Perconti*, the court expressly rejected the argument that the officer was not entitled to indemnification "because his conduct was motivated exclusively by personal greed." In relying upon *Perconti*, the Court of Chancery was cognizant that the *Perconti* "by reason of the fact" analysis had been applied in *Reddy v. Electronic Data Systems Corp. (EDS)*, another *advancement* proceeding, that was affirmed by this Court on appeal. The Court of Chancery also recognized the striking similarity between *Reddy* and this case.

In *Reddy*, a former director claimed a right to advancement for defending himself in civil and criminal proceedings. The advancement provisions required EDS to advance expenses "to the fullest extent, permitted by Section 145." EDS argued that the former director was not entitled to advancement because the proceedings accused him of misappropriating funds for personal benefit. The *Reddy* court rejected that argument by applying the *Perconti* "by reason of the fact" analysis. The *Reddy* court distinguished our decision in *Cochran v. Stifel Financial Corp.* and noted that "*Perconti* is not an isolated decision, but instead reflects a consistent line of authority upholding the contractual and statutory advancement and indemnification rights of corporate officials charged with serious misconduct allegedly inspired by personal greed."

The limited and narrow focus of an advancement proceeding precludes litigation of the merits of entitlement to indemnification for defending one self in the underlying proceedings. If it is subsequently determined that a corporate official is not entitled to indemnification, he or she will have to repay the funds advanced. Accordingly, we hold that if there is a nexus or causal connection between any of the underlying

proceedings contemplated by section 145(e) and one's official corporate capacity, those proceedings are "by reason of the fact" that one was a corporate officer, without regard to one's motivation for engaging in that conduct.

In this case, the Court of Chancery determined there can be no doubt that "Tafeen is a party to the underlying Proceedings because of his alleged role in a scheme to inflate Homestore's financial results while serving as an officer of Homestore." Therefore, it concluded that, because Tafeen's expenses were incurred *by reason of the fact* that he was a former officer of Homestore, those costs were within the scope of coverage provided by Homestore's mandatory and unconditional advancement bylaw. We agree. The Court of Chancery properly dismissed Homestore's "official capacity" defense as a matter of law in its summary judgment decision.

#### *Discovery Limitations Appropriate*

In denying Tafeen's motion for summary judgment, the Court of Chancery concluded that Homestore had raised "questions of fact as to whether Tafeen has acted in a way to avoid a potential obligation to repay advanced funds." According to Homestore, Tafeen went to the Court of Chancery "with unclean hands and should be prohibited from receiving advancement." As a basis for asserting its unclean hands defense, Homestore cited the fact that Tafeen purchased an expensive house in Florida, a state with expansive homestead protections.

Nevertheless, prior to trial, Homestore also sought discovery regarding Tafeen's efforts to shelter money in a variety of ways, such as via domestic and foreign bank accounts in his name or the names of his wife, children, relatives, and friends, or via real estate held in his name or the names of others. In an effort not to undermine the narrow focus of advancement claims, the Court of Chancery ruled that Homestore's "discovery requests shall be limited to its allegation that Tafeen *purchased his home in Florida* with the intent to shelter assets from Homestore."

According to Homestore, the Court of Chancery effectively precluded Homestore from exploring in discovery any and all other aspects of Tafeen's financial dealings that could support its claim that Tafeen engaged in a scheme to shelter assets from Homestore and other potential creditors. Homestore also asserts that the Court of Chancery compounded this error by limiting the scope of discovery to: "what did Tafeen *know* about the investigation into allegedly improper accounting at Homestore and his right to advancement on or around the time he purchased his Florida home?" In limiting Homestore's discovery request, the Court of Chancery stated:

its unclean hands defense was tied specifically to Tafeen's purchase of a home in Florida .... Having tied

its unclean hands defense to the purchase of the home, and having only presented affidavits related to that purchase, the Court will not permit Homestore to undertake a fishing expedition regarding its recently raised allegations about Tafeen's purported disposition of other assets. Defendant's discovery requests shall be limited to its allegation that Tafeen *purchased his home in Florida* with the intent to shelter assets from Homestore.

The record reflects that, in response to Tafeen's motion for summary judgment, the only evidence Homestore offered in support of its unclean hands defense was the allegation of its general counsel, Michael Douglas: "Upon information and belief, either while still an employee at Homestore or after leaving the Company, Tafeen purchased an expensive home in Florida, a state that has extremely protective homestead laws against creditor claims." Homestore did not offer affidavits for any other specific acts of sheltering by Tafeen other than the Florida home purchase.

Homestore does not point to any allegations in the record prior to the Court of Chancery's summary judgment decision to provide any other specific factual basis for its unclean hands defense. Thus, Tafeen's purchase of his Florida home was the only specific factual basis Homestore offered in support of its unclean hands defense and that was the only ground upon which the Court of Chancery denied summary judgment for Tafeen. Accordingly, we hold that limiting discovery to that subject was a proper exercise of discretion by the Court of Chancery.

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#### *Conclusion*

No Delaware corporation is required to provide for advancement of expenses. Nevertheless, most Delaware corporations do adopt advancement provisions as an inducement which promotes the same salutary public policy that is served by indemnification: attracting the most capable people into corporate service. Although advancement provides an individual benefit to corporate officials, it is actually "a desirable underwriting of risk by the corporation in anticipation of greater corporate-wide rewards" for its shareholders. The broader salient benefits that the public policy behind section 145 seeks to accomplish for Delaware corporations will only be achieved if the promissory terms of advancement contracts are enforced by courts even when corporate officials, such as Tafeen, are accused of serious misconduct.

The unconditional and mandatory advancement rights adopted by Homestore provided its corporate officials with the maximum possible protection against personal liability for the interim costs of involvement in any legal proceeding. The expanded record supports the Court of Chancery's conclusions that Tafeen is entitled to

advancement under Homestore's bylaw provisions and that the expenses he submitted are reasonable. The protracted and non-summary nature of this proceeding is an aberration that, fortunately, is rarely necessary for an adjudication of contractual claims for advancement.

The judgment of the Court of Chancery is affirmed.