

## Chancery Allows Advancement Claims to Proceed in Del. Despite Illinois Action

By Michael M. Farhang

Plaintiffs bringing claims for advancement under Section 145 of the Delaware General Corporation Law have traditionally benefited from a judicial preference for having such claims resolved by Delaware courts. Section 145(k) provides that the Delaware Court of Chancery has exclusive jurisdiction to hear advancement and indemnification claims arising under Delaware law or the bylaws or agreements of Delaware corporations, and that litigants have a right to summary determination of the question of whether advancement is required.

A recent Court of Chancery decision, *In re Tulum Management USA LLC v. Casten*, C.A. No. 11321-VCN, reinforces that Delaware courts will draw exceptions even to established rules of judicial comity in order to protect litigants' rights under Section 145 to have such advancement claims resolved by Delaware courts first. The preference for adjudicating advancement claims in Delaware may govern even where a related first-filed action in another forum might otherwise justify a stay of the Delaware action

under the standard articulated in *McWane Cast Iron Pipe v. McDowell-Wellman Engineering*, 263 A.2d 281 (Del. 1970). In *Tulum*, the court held that where such an advancement claim is at issue in a later-filed Delaware action, *McWane's* comity-based analysis—favoring a stay of Delaware actions where there exists a pending first-filed action involving the same parties and issues in another court capable of doing prompt and complete justice—does not control. In *Tulum*, the court instead applied a presumption in favor of allowing Delaware advancement claims to proceed in the Chancery Court absent “exceptional circumstances” justifying a stay, a much higher standard.

In *Tulum*, Vice Chancellor John W. Noble evaluated a motion to stay a derivative action brought by plaintiffs Tulum Management USA LLC and its controlling stockholder, George Polk, claiming alleged financial manipulation and mismanagement by the management of RED Parent LLC, an energy development company that held an operating subsidiary managing energy development projects



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called Recycled Energy Development LLC. RED Parent's management had earlier filed an action in Illinois against Tulum and Polk, who collectively held approximately 39 percent of RED Parent's total ownership, in order to prevent them from exercising a provision in RED Parent's operating agreement that would permit plaintiffs to gain control of RED Parent assuming a significant decline in the value of the company's asset holdings.

Under the disputed operating agreement provision, the plaintiffs had the right to demand a valuation by an independent accounting firm of RED Parent's asset holdings under certain enumerated circumstances and, in the event of a decline in the value of RED Parent's assets below the value of outstanding preferred interest shares (including those held by the plaintiffs), the provision would permit the plaintiffs to take over control of RED Parent's holding subsidiary. The defendants' Illinois suit sought to prevent this result. The plaintiffs subsequently filed a suit against the defendants in the Chancery Court for breach of fiduciary duty, breach of contract, and advancement and indemnification under the operating agreement for fees and expenses incurred in both actions.

The *Tulum* court began by noting that the *McWane* standard generally favors resolution of all related claims in the court in which an action is first filed. But in *Tulum*, this principle was at odds with Delaware's recognized interest in summarily adjudicating advancement claims brought under Delaware law. The court noted its earlier opinion in *Fuisz v. Biovail Technologies* (Del. Ch. 2000), in which it stated that "Section 145(k) represents a determination by the General Assembly that persons claiming a right to the advancement of expenses (including attorneys' fees) under Delaware law should be entitled to have their claims adjudicated by the court in a summary fashion." In *Tulum*, while the first-filed Illinois action did relate

to a common nucleus of operative facts shared by the Delaware action in part, i.e., interpretation of the operating agreement, the question of advancement was separate and independent from those issues. Further, only the Delaware action involved an advancement claim, which would otherwise be stayed indefinitely if *McWane* were found to justify a stay.

In addressing the defendants' motion to stay, Noble limited the court's determination to the advancement claim and denied the stay as to that claim alone, expressing no position regarding the propriety of a stay of the other claims in the plaintiffs' Delaware action. The court held that *McWane's* doctrine of comity did not apply where defendants could not present a "particularly compelling explanation" of why the advancement claim should be stayed, and the court held that defendants had failed to present such a compelling justification despite their arguments about the overlapping common issues in the two actions. Critically, the court concluded that even though the advancement claim involved a common set of facts with the other claims asserted in Delaware and Illinois, it could be resolved independently of those other claims and therefore comity and Delaware policy favoring resolution of related claims "in the same court and at the same time" did not provide a compelling justification for a stay. In addition, the court was unmoved by the fact that the operating agreement did not require such claims to be litigated

in Delaware, holding that the mere fact that such claims could be litigated there was sufficient to invoke "longstanding Delaware policy" in favor of allowing such claims to proceed in Delaware courts.

*Tulum* highlights the strong deference of the Court of Chancery to Section 145(k)'s policy of permitting Delaware advancement claims to be litigated promptly in Delaware courts even where a first-filed action involving related issues might justify a stay under *McWane*. Like other recent decisions that have limited *McWane's* holding, *Tulum* clarifies that when there is a strong basis to confer primacy on other important rights of litigants, deference to principles of comity will give way.

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