209

COURT OF CHANCERY
OF THE
STATE OF DELAWARE

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Re: In Re Carver Bancorp, Inc.
C.A. No. 17743-NC

Submitted: May 26, 2000
Decided: August 28, 2000

Dear Counsel:

BBC Capital Market, Inc. has asked me to order Blaylock & Partners, L.P. to pay attorneys' fees incurred by BBC Capital in opposing Blaylock's application to count its shares in the recent Carver Bancorp, Inc.'s election of directors. Because: the facts on record do not support application of the bad-faith exception to the American Rule that each party pay its own fees, I deny BBC Capital's request.

Carver held its annual stockholders meeting on February 24, 2000. Two director positions were to be filled in a hotly contested election with

two slates of competing candidates running in an apparent "dead heat." Carver management supported one slate, while BBC Capital, a 7.4% Carver shareholder, supported another. The vote promised to be very close.

Blaylock beneficially owned a large number of Carver shares. Blaylock representatives personally attended the Meeting and hoped to vote their shares after listening to each side's presentation. Blaylock's representatives, however, learned at the Meeting that they could not vote their shares because they were not shareholders of record, and they did not have the necessary documentation to vote despite their status as beneficial owners. As a result, Blaylock could not vote in person or by proxy. No one now disputes (nor could anyone on this record ever contend otherwise) that Blaylock's representatives could not vote Blaylock's shares at the meeting because they failed to read materials sent to them by Carver explaining in plain English what steps needed to be taken by beneficial owners in order to be able to vote by proxy or in person at the annual meeting.

Hoping it had a viable argument for equity to intervene notwithstanding the fact that Carver representatives would not count Blaylock's shares as a result of Blaylock's own careless disregard of clear written instructions, Blaylock filed an application in this Court, pursuant to 8 Del. C. § 23 l(c), seeking an order directing the Inspector of Election to

accept and count Blaylock's votes. Blaylock maintained that it did submit a proxy form to a third party, which was to forward the completed form to the Carver proxy solicitor. The polls closed before the third party delivered the form to Carver's proxy solicitor. Nonetheless, Blaylock argued it should be permitted to vote its shares pursuant to Section 231(c), which states, in pertinent part, "[n]o **ballot,** proxies or votes, nor any revocations thereof or changes thereto, shall be accepted by the inspectors after closing of the polls *unless the Court of (Chancery upon application by a stockholder shall determine otherwise."* Presumably, the italicized portion of the above sentence gave Blaylock some hope that equity would intervene and allow it to vote its shares despite Blaylock's demonstrable incompetence.

In support of its effort, Blaylock submitted an affidavit from its General Counsel, Nathaniel Christian, who attended the Meeting on Blaylock's behalf: In his affidavit, Christian claims to have been unsophisticated about voting shares of equities and misled by Carver regarding the precise steps necessary in order for shareholders to vote their shares in person or by proxy. BBC Capital, which was in litigation with Carver for control of Carver's Board, charges that Christian's affidavit was materially false and that Blaylock engaged in bad faith litigation designed to avoid discovery of the "true facts." Further, BBC Capital alleges Blaylock

opposed BBC Capital's motion to consolidate the Section 23 1 (c) action with the Carver-BBC Capital action because Blaylock had reason to believe its application might be unopposed standing alone but knew if combined with the ongoing Section 231(c) its claim would be dismissed when subjected to active adversarial scrutiny.

Initially, despite its knowledge that its 100,000 shares would affect the outcome of the **election,** Blaylock refused to reveal that Blaylock had voted for the slate backed by Carver's incumbent directors. Blaylock named no party defendant in its action and appeared content to receive Carver's response purporting not to oppose as the only necessary responsive pleading. Blaylock knew or should have known that consolidation of its application with the Carver election of directors contest would have exposed the circumstances surrounding Blaylock's attempt to vote its shares as well as reveal the slate for which it had voted. Blaylock vigorously opposed both consolidation and any attempt to be subject to discovery either as a party to a consolidated action or as a mere source of facts which may have led to the discovery of relevant evidence in the Carver governance dispute. Notably, BBC Capital and Carver have since settled the action over control of the Board. BBC Capital contends that Blaylock should pay BBC Capital's attorneys' fees and costs because Blaylock's filing was legally groundless,

brought in bad faith, and ostensibly supported by a knowingly false affidavit. Blaylock has since dismissed its Section 23 l(c) application but opposes BBC Capital's application for fees and costs.

The Court of Chancery has broad discretion when asked to award attorneys' fees.[1] Usually, the Court defers to the "American Rule," which holds each litigant responsible for paying their own costs and fees.[2] Delaware courts are very reluctant to grant exceptions to the American Rule." Several generally recognized exceptions do exist, however.

The Court may award attorneys' fees if recovery is provided by statute or court rule, if there is a contractual right to attorneys' fees, if the action results in the creation of common fund or corporate benefit, and most applicable here, if the opposing party has acted in bad faith.[4] In order for a party's conduct to constitute bad faith, that conduct must be "egregious."[5] More specifically this "quite narrow exception is applied in only the most

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[1] 10 *Del.* C. § 5106 ("[t]he Court of Chancery shall make such order concerning costs in every case as is agreeable to equity").

[2] See ***Goodrich*** v. ***E.F. Hutton Group, Inc.,*** Del. Supr., 681 A.2d 1039, 1044 (1996); ***Tandycrafts, Inc. v. Znitio Partners,*** Del. Supr., 562 A.2d 1162, 1164 (1989); ***Weinberger v. UOP Inc.***, Del. Ch., 517 A.2d 653 (1986).

[3] DONALD J. WOLFE, JR. AND MICHAEL A. PITTENGER, CORPORATE AND **COMMERCIAL PRACTICE IN THE** DELAWARE **COURT OF CHANCERY,** § 13-3(a), at 868 (1998) (citing ***Weinberger, 5 17*** A.2d at 654.)

[4] WOLFE **AND** PITTENGER, *supra*, §13-3(b), at 868-69.

[5] ***Arbitrium (Cayman Islands) Handels AG v. Johnston,*** Del. Ch., 705 A.2d 225, 231 (1997), *aff'd*, Del. Supr., 720 A.2d 542 (1998) ("[t]his Court has suggested that in certain

egregious instances of fraud or overreaching."[6] The bad-faith exception extends not just to actions brought in bad faith, but also to circumstances in which the "litigation process itself is conducted in bad faith."[7]

Importantly, in order for the Court to award fees, the responding party must be found to have acted in *subjective* bad faith.[8] And, a finding of bad faith involves a more stringent "clear evidence" standard of proof." These requirements combine to set quite a high bar for any party seeking payment of its fees.

Notwithstanding this daunting threshold, some parties have managed to leap in Olympian-like fashion into the netherworld of bad faith. In ***Abex, Inc. v. Koll Real Estate Group, Inc.***,[10] Vice Chancellor Jacobs found that the defendant acted vexatiously and in bad faith when it refused to contribute to a settlement despite having no reasonable defense to liability. As a result of defendant's actions, plaintiffs were required "to prosecute

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egregious circumstances, a party's fraudulent behavior that underlies and forms the basis of the action may justify an award of attorneys' fees against that party").
[6] *Id.*
[7] *Id.*
[8] *Id.* at 232.
[9] *Id.* (citing, *inter alia*, ***Chambers v. NASCO,*** 501 U.S. 32, 44 (1991)).
"Del. Ch., C.A. No. 13462, 1994 WL 728827, Jacobs, V.C. (Dec. 22, 1994).

[the] action and litigate defenses that had no factual or legal merit."" Vice Chancellor Jacobs awarded fees to the plaintiff

Likewise, Chancellor Chandler found the bad-faith exception applicable in ***Judge v. City of Rehoboth Beach***.[12] Plaintiffs were involved in a dispute with the City of Rehoboth and sought the right to access Rehoboth's streets. "[T]he record show[ed] that defendants were faced with a mountain of evidence, including legal opinions, legal authority and judicial declarations, demonstrating the City's obligation to grant plaintiffs access."[13] Nonetheless, the City refused to take notice of this evidence, and forced the plaintiffs into litigation to vindicate their rights.[14] The Chancellor found that the City "acted in bad faith and vexatiously," justifying an award of attorneys' fees. [15]

In the present case, I find the record to be too incomplete for me to reach a similar finding. This should not be read to say that I, or any reasonable person could agree with or accept Blaylock's tactics in this litigation. In fact, I consider Christian's affidavit to be replete with half-truths and misleading statements. BBC Capital argues that Christian should

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[11] *Id.* at *20.
"Del. Ch., C.A. No. 1613, 1994 WL 198700, Chandler, V.C. (April 29, 1994).
[13] *Id.* at *2
[14] *Id.*
[15] *Id.* at *2, *7.

have explained in his affidavit that he only "scanned" the notice of the meeting, that he ignored proxy material in his possession, and **that** he did not check how Blaylock held its shares even though there was ample time to do so. Anything less, BBC Capital argues, was less than the truth. The facts that BBC Capital contends should have been included are uncontroverted, and were well known to Christian or if he had acted as any reasonably prudent attorney would have done, should have been known to him before he reviewed and signed. his affidavit.

For example, Christian, a corporate General Counsel for a mortgage-backed securities firm, claims that he did not know the difference between a record owner and a beneficial owner of stock. The litigation settled before Christian's actual knowledge or credibility in that regard could be attacked in open court. Therefore, I must take Christian at his word no matter how suspiciously callous that word would appear to be on its face.

BBC Capital did not **move** for Rule 11 sanctions in this case. Had they done so, I would have been presented with a very difficult question as to whether the introduction and continued use of Christian's affidavit, despite overwhelming evidence indicating its incompleteness or outright

disingenuousness, constituted a representation to the Court warranting sanction.[16]

Accordingly, I need only decide whether Blaylock acted "egregiously" in initiating and pursuing their position in this litigation.

Blaylock's initial Section 23 l(c) application and the argument, supporting it had no case law support. No cases currently explain what factual circumstances would justify the Court of Chancery's intervention at a time after election results have been announced and certified by inspectors. Certainly no case exists which suggests that Chancery would intervene on behalf of a beneficial owner who admitted that its general counsel neither read applicable voting instructions received by the beneficial owner nor understood the distinction in law between owning shares as a stockholder of record as opposed to beneficially through street name. No case speaks to the alleged inequity of closing the polls at an annual meeting when all persons present to vote who have established their right to do so, have voted, whether the polls are open five minutes or five hours. No case holds that polls, in all fairness, should remain open until persons present to vote, but who are not on the stock list, can take the necessary steps to qualify. Carver made its stock list available for inspection ten days before the annual

[16] See Ct. of Ch. Rule 11 (b).

meeting and Blaylock had notice of that fact. Had they bothered to read it, it is unlikely that equity would have salvaged the wreck caused by Blaylock's failure to determine well before the annual meeting that they did not appear on the stock list and that they were not, therefore, stockholders of record. This "most inconvenient fact"[17] could only be remedied by a proxy from the actual stockholder of record should Blaylock wish to appear at the annual meeting, listen to the position of the opposing factions and vote their 100,000 shares. Unarmed by the facts, lacking in legal knowledge, and leaving a careless trail of bread crumbs through the forest, Blaylock could do no more than whine for equity's intervention. Only the most charitable of Chancellors could recognize that the ambiguity of the Court's role as described in the statute left an opening for a colorable claim.

The manner in which Blaylock went about gathering "facts" to support that argument is much more dubious than the argument they purported to bolster, however. The earlier-discussed Christian affidavit is only the most glaring example. There were other actions taken by Blaylock suggesting obfuscation. Blaylock refused to cooperate with discovery even though with 100,000 shares in the balance, Blaylock had possession of important facts. Blaylock opposed consolidation ostensibly to void the

[17] A marvelous phrase of understatement found in BBC's opening brief at 213.

associated costs and risks. One might speculate about the real tactical reasons for Blaylock's actions.

When deciding whether to apply the bad-faith exception, this Court must examine the "totality of circumstances."[13] After examining the totality of circumstances in this case, I cannot find the bad-faith exception applicable. Blaylock "pushed the envelope" here, and indeed flirted with a finding of bad faith and Rule 11 sanctions. However, given the fact that Blaylock advanced at least a colorable legal argument, and that the record is -incomplete on credibility issues crucial to the determination of the bad faith -issue, I must, without any genuine enthusiasm, deny BBC Capital's motion for attorneys' fees.

IT IS SO ORDERED.

Vice Chancellor (by designation)

[13] ***Judge v. City of Rehoboth,*** Del. Ch., C.A. No. 1613, 1994 WL 198700, at *2, Chandler, V.C. (April 29, 1994).