**IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE**

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| PATRICK HUGHES, MARY MURPHY and ROBERT LAMPIETTI, | : | |
| Plaintiffs, | : | |
| v. | : | **C.A. No. 4814-VCN** |
| JAMES P. KELLY and FUND ADMINISTRATION HOLDINGS, LLC, | : | |
| Defendants. | : | |

**MEMORANDUM OPINION**

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NOBLE, Vice Chancellor

## I. INTRODUCTION

In this action against the managing member of a holding company who failed to distribute deferred payments to members who had assisted in unrelated litigation against him, the managing member brings counterclaims to enforce the indemnification, non-disparagement, and release provisions of the holding company's operating agreement.

## II. FACTUAL BACKGROUND

### A. *The Parties*

Plaintiffs and Counterclaim Defendants Patrick Hughes, Mary Murphy, and Robert Lampietti are members of Defendant and Counterclaim Plaintiff Fund Administration Holdings, LLC ("FAH"), a holding company that previously controlled non-party International Fund Services (N.A.), L.L.C. ("IFS"), a provider of hedge fund administration services, until it was sold to State Street Bank and Trust Company ("State Street") in July 2002. Before its sale to State Street, the Plaintiffs were senior executives of IFS and remain employed by State Street or its affiliates. The Plaintiffs jointly hold 6.015% of the total membership points in FAH.

Defendant and Counterclaim Plaintiff James P. Kelly is the managing member of FAH and was the Chief Executive Officer of IFS until August 24,

2005, after which time he founded Hedgeserv LLC ("Hedgeserv"), a competitor of IFS.

B. *The Sale of FAH to State Street*

On June 1, 2002, Kelly was made Managing Member of FAH; his role was delineated in the Amended and Restated Limited Liability Company Agreement of Fund Administration Holdings, LLC (the "Agreement"), signed that same day. Pursuant to Section 4.1 of the Agreement, Kelly, as Managing Member, was tasked with, inter alia, distributing to FAH's members any net proceeds that FAH realized from the subsequent sale of all or substantially all of its assets.[1]

By way of a purchase agreement signed on July 2, 2002 (the "Purchase Agreement"), FAH sold IFS to State Street for approximately $230 million. Pursuant to the Purchase Agreement, FAH received approximately $60 million at closing, which Kelly caused to be distributed to FAH's members, including the Plaintiffs. At the same time, State Street placed an additional $20 million in escrow for the benefit of FAH.

The balance of the purchase price was to be determined and paid based on IFS's financial performance in the three years following the closing date, in accordance with formulas set forth in the Purchase Agreement. During those three

[1] Although the Agreement is silent as to any imminent transactions and never mentions State Street by name, there is some suggestion that the Agreement was written with the State Street acquisition, which was completed roughly one month later, in mind. *See, e.g.*, Compl. ¶ 11.

years, Kelly was employed by IFS as its Chief Executive Officer, as stipulated in the Purchase Agreement, which provided him the incentive to maximize the deferred payments to FAH members, including himself. Under the Purchase Agreement, Kelly was prohibited from competing with IFS while an IFS employee, and then for two years following his departure from IFS.

In 2003 and 2004, State Street made deferred payments totaling roughly $108 million to FAH, which Kelly distributed to FAH members, including the Plaintiffs. In 2005, State Street made the final deferred payment of approximately $41.7 million to FAH. Kelly set aside roughly $7.85 million of this final payment in order to cover (1) potential tax liabilities, expenses and/or closing costs associated with the transaction, and (2) any costs associated with and potential liability resulting from certain legal claims,[2] while distributing the remaining portion of the payment to FAH members. Kelly subsequently caused $2.3 million of this reserve to be released and distributed in late 2005.

C. *The New York Litigation*

In August 2005, Kelly resigned from IFS. In 2007, apparently after the expiration of the non-competition provisions to which Kelly was bound as an

[2] The Plaintiffs assert that the money was withheld to cover then-outstanding litigation in which a $5,000,000 claim had been asserted, in addition to the tax claims. Compl. ¶ 13. Kelly claims that the litigation set-aside was for "any costs associated with and potential liability resulting from possible claims against Kelly and others." Countercl. ¶ 13.

officer of IFS, he started Hedgeserv, a business operating in the same field of hedge fund administration services as IFS.

On May 9, 2008, State Street and IFS filed suit against Kelly and other former employees of IFS in New York for breach of non-competition, non-solicitation and non-disparagement agreements, misappropriation of IFS proprietary information, and breach of fiduciary duty regarding employment contracts that IFS had entered into with some of its employees. Although neither FAH nor the Plaintiffs had any direct role in the lawsuit, Kelly asserts that the Plaintiffs induced State Street to bring the suit, "an intentional course of action to damage Kelly's reputation and ability to succeed in this new endeavor [Hedgeserv]," despite "knowing such claims were without merit."[3] Kelly also alleges that some of the Plaintiffs were the individuals actually responsible for the claims brought against him by State Street.[4]

Kelly and State Street settled the matter in late June 2009, with

[REDACTED]

[3] Countercl. ¶ 2.

[4] For example, State Street alleged that Kelly caused IFS to enter into commercially unreasonable employment agreements with senior IFS managers, yet Kelly asserts that Murphy was responsible for drafting and executing the contracts in question and had entered into a similar employment agreement with IFS, herself. Countercl. ¶ 19.

[5] [REDACTED]

[REDACTED]

After the parties settled, all other FAH members received a significant portion of the deferred payments owed to them, while the Plaintiffs received no additional monies. Kelly asserts that he is entitled to the deferred payment amounts currently withheld from the Plaintiffs because of the indemnification provisions in the Agreement, which he claims apply to the New York litigation, and that he can choose from which Members to seek indemnification.

D. *The Parties' Contentions*

In 2009, upon learning of the [REDACTED] outcome of the litigation for which the Plaintiffs understood the undistributed deferred payments had been set aside, they contacted Kelly seeking distribution of the balance of the funds due them. After being told that the money would not be paid to them, the Plaintiffs commenced this action.

Defendants counterclaimed. Kelly insists that he incurred significant legal fees in his efforts to defend himself against State Street's claims and now seeks a judicial declaration that the Plaintiffs are responsible for FAH's indemnification obligations to him for both the New York litigation and this action. Kelly also

asserts a claim for breach of the non-disparagement provision in the Agreement because of the Plaintiffs' alleged role in inducing State Street to bring litigation against him.[6] Finally, Kelly seeks a judicial declaration that the Plaintiffs' claims fall within the scope of the release contained in the Agreement (the "Release"), or, alternatively, specific performance of the terms of the Release.

This memorandum opinion addresses Plaintiffs' motion under Court of Chancery Rule 12(b)(6) to dismiss these counterclaims.

## III. DISCUSSION

A. *Rule 12(b)(6) Standard of Review*

On a motion to dismiss under Court of Chancery Rule 12(b)(6) for failure to state a claim upon which relief can be granted, the Court must accept all well-pleaded factual allegations in the complaint—or, as in this instance, the counterclaim—as true and draw all reasonable inferences from those facts in the non-moving party's favor.[7] Conclusory allegations, however, without supporting factual allegations, will not be accepted as true.[8] Further, the Court may also consider the unambiguous terms of documents that are integral to or are

[6] While the nature of the Plaintiffs' involvement in the New York litigation is unclear, their counsel acknowledged at oral argument that the Plaintiffs had made statements to State Street as part of the initiation of the lawsuit regarding actions taken by Kelly that they believed had injured State Street. Tr. 8-9.
[7] *Malpiede v. Townson*, 780 A.2d 1075, 1083 (Del. 2001).
[8] *In re Santa Fe Pac. Corp. S'holder Litig.*, 669 A.2d 59, 65-66 (Del. 1995).

incorporated by reference into the complaint.[9] Where the unambiguous language of the documents contradicts the allegations of the complaint, the Court may disregard those contrary allegations in favor of the express terms of the document.[10] Under the motion to dismiss standard, if the defendants assert in their counterclaim any set of facts that would entitle them to relief, the plaintiffs' motion to dismiss must fail.[11]

Questions of contract interpretation are generally questions of law that are appropriate for a motion to dismiss.[12] However, the proper application of ambiguous contract provisions is a question of fact that can rarely be determined at the motion to dismiss stage.[13] Ambiguity exists "when the provisions in controversy are reasonably or fairly susceptible of different interpretations."[14] There, the Court cannot choose between reasonable interpretations of ambiguous contract provisions,[15] even where one interpretation is, perhaps, "more reasonable."[16] As such, the Plaintiffs would only be entitled to dismissal if "the

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[9] *In re Lukens Inc. S'holders Litig.*, 757 A.2d 720, 727 (Del. Ch. 1999).
[10] *Steinman v. Levine*, 2002 WL 31761252, at *8 (Del. Ch. Nov. 27, 2002), *aff'd*, 822 A.2d 397 (Del. 2003) (TABLE).
[11] *Diamond State Tel. Co. v. Univ. of Del.*, 269 A.2d 52, 58 (Del. 1970).
[12] *Allied Capital Corp. v. GC-Sun Holdings, L.P.*, 910 A.2d 1020, 1030 (Del. Ch. 2006).
[13] *Vanderbilt Income and Growth Assocs., L.L.C. v. Arvida/JMB Managers, Inc.*, 691 A.2d 609, 613 (Del. 1996).
[14] *Kaiser Aluminum Corp. v. Matheson*, 681 A.2d 392, 395 (Del. 1996).
[15] *VLIW Tech., LLC v. Hewlett-Packard Co.*, 840 A.2d 606, 615 (Del. 2003).
[16] *Appriva S'holder Litig. Co., LLC v. EV3, Inc.*, 937 A.2d 1275, 1292 (Del. 2007). To resolve the ambiguity, the Court would then look to extrinsic evidence to ascertain the parties' intent, which necessarily requires the finding of fact. *Id.*

interpretation of the contract on which their theory of the case rests is the '*only* reasonable construction as a matter of law.'"[17] Because, for reasons set forth below, the Court concludes that the Plaintiffs' narrow interpretation of the scope of the Agreement is not the only reasonable one, it must interpret any ambiguous provisions in the light most favorable to the Defendants.[18]

B. *The Indemnification Claims*

Kelly claims entitlement to indemnification from the Plaintiffs, as FAH members, for the costs associated with any litigation arising from activities undertaken in connection with either IFS or FAH, which, he argues, includes both the New York litigation and the current case. The Plaintiffs counter that Kelly's interpretation of the provision is overly expansive and that he is not entitled to any indemnification for the New York litigation because there is no nexus between the New York litigation claims, on the one hand, and FAH, any actions taken by Kelly in his capacity as Managing Member of FAH, or the Agreement, on the other. Similarly, they argue that he not be entitled to indemnification for costs related to this action because his withholding of the Plaintiffs' funds in order to pay for the costs of the New York litigation constitutes per se bad faith, rendering him not indemnifiable.

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[17] *Kahn v. Portnoy*, 2008 WL 5197164, at *3 (Del. Ch. Dec. 11, 2008) (quoting *VLIW Tech.*, 840 A.2d at 615) (emphasis in original).

[18] *VLIW Tech.*, 840 A.2d at 615 ("Because the provisions at issue in the Agreement are susceptible to more than one reasonable interpretation, for purposes of deciding a motion to dismiss, their meaning must be construed in the light most favorable to the non-moving party.").

1. Does the Indemnification Clause in the Agreement Cover IFS?

Section 7.1 of the Agreement, entitled "Indemnification of Covered Persons," states:

> (a) General. The Company shall and hereby does, to the fullest extent permitted by applicable law, indemnify, hold harmless and release (and each Member does hereby release) each Covered Person from and against any and all claims, demands, liabilities, costs, expenses, damages, losses, suits, proceedings and actions, whether judicial, administrative, investigative or otherwise, of whatever nature, known or unknown, liquidated or unliquidated . . . that may accrue to or be incurred by any Covered Person, or in which any Covered Person may become involved, as a party or otherwise, or with which any Covered Person may be threatened, relating to or arising out of the activities of the Company, or activities undertaken in connection with the Company, or otherwise relating to or arising out of this Agreement . . . except to the extent that it shall have been determined ultimately by a court of competent jurisdiction by a non-appealable judgment that such Damages arose primarily from Disabling Conduct of such Covered Person. The termination of any Proceeding by settlement shall not, of itself, create a presumption that any Damages relating to such settlement or otherwise relating to such Proceeding arose primarily from Disabling Conduct of any Covered Person.

The term "Covered Person" is defined in the Agreement to include Kelly as the Managing Member.[19] "Disabling Conduct" is defined, with respect to Kelly, as "bad faith."[20]

[19] Defs.' Answering Br. in Opp'n to Pls.' Mot. to Dismiss Defs.' Verified Am. Countercl. Ex. A (the "Agreement") § 6.5 ("[T]he Managing Member, the Majority Member or an officer of the Company, or any of their respective officers, directors, partners, members, trustees and stockholders (collectively, "Covered Persons"). . . .").
[20] Agreement § 12.

The Plaintiffs argue that the Agreement provides indemnification for Kelly only as Managing Member of FAH, which was ostensibly created as a transactional vehicle to facilitate the sale of IFS to State Street. Specifically, Plaintiffs point to the language granting Kelly indemnification only for conduct, "arising out of the activities of the Company, or activities undertaken in connection with the Company, or otherwise relating to or arising out of this Agreement." The Agreement defines "the Company" as "Fund Administration Holdings, LLC," and is completely silent with respect to IFS. Nowhere in the Agreement are Kelly's duties as the Chief Executive Officer of IFS mentioned or referenced. According to the Plaintiffs, Kelly's role as Managing Member of FAH is limited to (1) distributing the proceeds of the IFS sale to the other Members; (2) managing certain tax liabilities of FAH; and (3) managing a lawsuit against IFS that predated its sale to State Street, and the Agreement only agrees to indemnify him in the context of those duties. Yet the conduct at issue in the New York litigation for which Kelly asserts he is entitled to indemnification dealt only with Kelly's allegedly wrongful actions as the Chief Executive Officer of IFS in the period following its sale to State Street and as the Chief Executive Officer of Hedgeserv, an unrelated competitor.

Nevertheless, Kelly argues that there is a sufficient nexus between the New York action and his role as Managing Member of FAH for indemnification

purposes. Specifically, he notes that, through the Purchase Agreement, he was contractually obligated to serve as IFS's Chief Executive Officer during the three years following the sale of IFS to State Street and that, because the amount of the deferred payments was "determined and paid based on IFS's financial performance" during that time, his executive role at IFS gave him the opportunity to maximize these payments, consistent with the fiduciary duties he owed in his capacity as Managing Member of FAH to the other Members. Thus, reasons Kelly, the actions that he took while serving at IFS in the years following its sale to State Street were "inextricably intertwined" with FAH and his role as Managing Member. Furthermore, he suggests that "but for [his] obligation to maximize the amounts of the Deferred Payments that State Street was required to pay under the Purchase Agreement, and State Street's insistence that [he] remain at the helm of IFS as a condition of the IFS Sale—a transaction that [he] believed was beneficial to FAH's members—[he] would not have taken the position as IFS's CEO."[21]

The Plaintiffs push back against Kelly's reading of the Agreement, asserting that Kelly's two roles, Chief Executive Officer of IFS and Managing Member of FAH, were distinct and unrelated positions. Thus, the provisions of the Agreement, which are facially restricted to the operations of FAH, may not be read to include Kelly's role as Chief Executive Officer of IFS, regardless of whether or

[21] Defs.' Answering Br. in Opp'n to Pls.' Mot. to Dismiss Defs.' Verified Am. Countercl. at 20.

not his actions in that capacity somehow implicated his duties as Managing Member of FAH. As the Plaintiffs point out, Kelly's agreement to continue serving at IFS was a condition of the sale to State Street and was known at the time of the Agreement. As such, it would have been easy at the time the Agreement was drafted to have broadened the provision's scope to include duties at IFS within those roles of Covered Persons under the Agreement. Indeed, the Agreement's non-disparagement provision was written to cover the "Company, the Managing Members, any officer of the Company or any of their respective Affiliates. . . ."[22] Consequently, the Plaintiffs argue, the plain and unambiguous language of the Agreement, absent such hypothetical inclusion, limits indemnification to FAH matters alone.

The Plaintiffs rightly note that the cases upon which Kelly relies for support that an indemnity clause ought to be read expansively are unhelpful, as they do not resolve the question before this Court: whether an indemnification clause that facially limits itself to one role of many held by an executive can be expanded to include actions taken in other roles that have some relation to that role subject to indemnification.[23]

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[22] Agreement § 5.3(a)(ii).
[23] *See, e.g.*, *Homestore, Inc. v. Tafeen*, 888 A.2d 204, 213 (Del. 2005); *Perconti v. Thornton Oil Corp.*, 2002 WL 982419, at *6 (Del. Ch. May 3, 2002).

Admittedly, the Court is skeptical of the expansive reading of the Agreement that Kelly suggests. Nevertheless, the Court is constrained by the plaintiff-friendly standard applied to a motion to dismiss where all reasonable inferences must be drawn in favor of the non-moving party. Because the indemnity provisions are susceptible to two opposing, yet reasonable, interpretations as to their proper scope, dismissal on a motion to dismiss would be improper. Furthermore, there also are necessary questions of fact precluding dismissal at this stage, particularly the relationship, if any, between Kelly's roles at IFS and at FAH.[24] Consequently, Plaintiffs' motion to dismiss Count I of the counterclaim is denied.

2. May Kelly's Alleged Bad Faith be Determined through a Motion to Dismiss?

The Plaintiffs argue that Count II of the counterclaim, Kelly's indemnification claim with respect to this action, should be dismissed because Kelly's conduct constituted bad faith and, thus, he is ineligible for indemnification under the Agreement. Kelly counters that the question of whether he acted in bad faith is a factual conclusion currently subject to dispute, thus inappropriate for resolution at the motion to dismiss stage.[25] Specifically, under Section 7.1(a) of

[24] Certain facts, such as the timing of the deferred payments closely coinciding with the term of Kelly's employment, would seem to favor Kelly's reading of the indemnity clause, while other facts, such as the fact that Kelly continued to hold his position as Managing Member of FAH even after departing IFS and founding a competing company, would seem to favor the Plaintiffs' description of the two roles as distinct.

[25] *Desert Equities, Inc. v. Morgan Stanley Leveraged Equity Fund, II, L.P.*, 624 A.2d 1199, 1208 (Del. 1993) ("[G]ood faith/bad faith raises essentially a question of fact which generally cannot

the Agreement, an action "relating to or arising out of the activities of the Company, or activities undertaken in connection with the Company, or otherwise relating to or arising out of this Agreement" is subject to indemnification "except to the extent that it shall have been determined ultimately by a court of competent jurisdiction by a non-appealable judgment that such Damages arose primarily from Disabling Conduct." Kelly contends that, because no factual finding has taken place in this case, much less one determining that Kelly's actions as alleged by the Plaintiffs constituted Disabling Conduct, his indemnification claim cannot be dismissed.[26]

The Plaintiffs argue that the Court may now determine that Kelly's conduct is not indemnifiable because it has all of the facts necessary to make such a determination. They contend that discovery will not reveal any additional relevant information because there are no facts that remain in dispute. The Plaintiffs assert that even after taking the facts presented by Kelly on their face and making all inferences in his favor, Kelly's actions constituted bad faith. More particularly, because Kelly concedes in his pleadings that his withholding of funds was

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be resolved on the pleadings or without first granting an adequate opportunity for discovery."); *Weiss v. Swanson*, 948 A.2d 433, 447 (Del. Ch. 2008) (questions of fact are "unsuitable for determination on a motion to dismiss").

[26] *Levy v. Hayes Lemmerz Int'l, Inc.*, 2006 WL 985361, at *9 (Del. Ch. Apr. 5, 2006) ("At this early stage in the litigation, . . . the court can only take into account the facts as pleaded in the complaint. . . . To infer . . . that the plaintiffs in this case have violated their duties of good faith and fair dealing [in an indemnification agreement] as a matter of law would be to stray far beyond the boundaries of a motion to dismiss and into the realm of speculation.").

intentional, should the Court determine that Kelly's reliance on the Agreement as grounds for withholding funds from the Plaintiffs is unfounded, the Court may determine that Kelly acted in bad faith.

It would seem, however, that those ambiguities as to the scope of the indemnity clause would also preclude any determination of bad faith on the pleadings, and that the Court's determination to reject Plaintiff's motion to dismiss Count I necessarily precludes dismissal of Count II on bad faith grounds. Moreover, even if the Court ultimately finds that the New York litigation may not be indemnified under the Agreement, it is not convinced that there would not still be questions of fact in dispute as to whether or not Kelly's reliance on a broad interpretation of the Agreement's indemnity clause in withholding funds from the Plaintiffs in order to satisfy that right amounted to bad faith. Among those material questions of fact which the Court anticipates a likelihood of further clarification following discovery are questions relating to Kelly's intent in seeking indemnification (assuming, arguendo, that the Court finds that the indemnity provision does not include suits relating to Kelly's actions as Chief Executive Officer of IFS),[27] the good faith of Plaintiffs in helping to bring the New York

[27] There is also the perhaps thornier question of whether Kelly's interpreting the Agreement, which provides that the Company will indemnify him for any claims against him, to allow him to select individual Members from whom to seek indemnification constituted bad faith; even if a general reliance on the Agreement to indemnify his costs in the New York action did not.

litigation, and the extent of their involvement in such litigation. As such, the Court also may not dismiss Count II of the counterclaim at this stage.

C. *The Non-Disparagement Claim*

In Count III, Kelly seeks damages for the Plaintiffs' alleged breach of a non-disparagement clause in the Agreement. Section 5.3 of the Agreement states:

> [Each] Member agrees that he, she or it shall not, directly or indirectly, during the term of such Member's employment by the Company or an Affiliate thereof, and, in the case of any Member who receives a distribution pursuant to [the Agreement], for the one year period following such Member's Effective Termination Date,
> . . .
> (ii) engage in any conduct or make any statement disparaging or criticizing, or that could reasonably be expected to impair the reputation or goodwill of, the Company, the Managing Member, any officer of the Company or any of their respective Affiliates, or any products or services of any of these, in each case except to the extent required by law or legal process, after consultation with the Managing Member to the extent possible.

The Plaintiffs argue that Kelly does not state an actionable claim against them under Section 5.3 for a number of reasons, including that: (1) any criticism of Kelly as Chief Executive Officer of IFS falls outside of the scope of the non-disparagement provision, which, they claim, only prohibits statements regarding Kelly's conduct as Managing Member of FAH; (2) the non-disparagement clause had expired by the time of the New York litigation; and (3) their disclosures were made in the course of "legal process" and, thus, exempt from the provision.

1. Is the Non-Disparagement Provision Unambiguously Limited to FAH?

As with the indemnification provision, there remains the open question of whether the Agreement is restricted to Kelly as Managing Member of FAH and allows for criticism of Kelly in his role at IFS, or whether the provision precludes disparagement on a broader scale. The language prohibits criticism of "the Managing Member," which the Agreement defines as "James P. Kelly," and the Agreement does not facially restrict the non-disparagement provision to Kelly's actions in his role as Managing Member of FAH. Nevertheless, should the Agreement be narrowly read as Plaintiffs assert, such a restriction on the language would seem necessary. Regardless, as with the indemnification provision, the Agreement is not unambiguous as to the proper scope of this provision. Consequently, the Court must look to extrinsic evidence to ascertain the parties' intent with respect to this provision. The Plaintiffs' motion to dismiss fails on this ground.

2. Determining the Effective Termination Date

The Plaintiffs additionally argue that the time limit under which Section 5.3 applies—one year following a Member's Effective Termination Date—expired in July 2003, on the one-year anniversary of FAH's sale to State Street. As such, they contend, they cannot be subject to the non-disparagement provision for their involvement with the New York litigation, brought in May 2008. Kelly, however,

is correct that, as the Plaintiffs remain Members of FAH and employees of IFS, their Effective Termination Date has not yet occurred; thus, Section 5.3 still applies to them.

3. Are Plaintiffs' Statements to State Street Exempt as Required by Legal Process?

Finally, the Plaintiffs seek dismissal of Kelly's non-disparagement claim on the grounds that their involvement with the New York litigation fell within the exception for statements made "to the extent required by law or legal process." The Plaintiffs assert that (1) principles of agency law required the disclosure of known facts to their employer, State Street; (2) the mere filing of a civil complaint constitutes "legal process" for purpose of the provision; and (3) regardless of the non-disparagement clause, they should be afforded an absolute privilege as witnesses to a court proceeding as a matter of public policy and under Delaware law. Kelly reads the "law or legal process" exception narrowly, arguing that it only applies to conduct that is compelled by state or federal law or by a court order, such as a subpoena.

Relying on agency law, the Plaintiffs argue that they are fiduciaries of State Street and, thus, obligated under fundamental principles of agency law to disclose relevant information that they know may affect the decisions of their principals.[28]

[28] *See, e.g.*, *Sci. Accessories Corp. v Summagraphics Corp.*, 425 A.2d 957, 962 (Del. 1980) ("[U]nder elemental principles of agency law, an agent owes his principal a duty of good faith,

The Plaintiffs rightly point out that none of the litany of cases that Kelly cites[29] for his narrow reading of the legal process provision directly addresses the issue of whether information provided in conjunction with the commencement of civil litigation qualifies as legal process—which Plaintiffs assert does.[30] Nevertheless, on a motion to dismiss, the burden rests on the Plaintiffs to establish that the term "legal process" can be read as expansively as they would have it be. This, Plaintiffs have not done. Moreover, focusing on the definition of "legal process," Plaintiffs have ignored the operative language in the non-disparagement provision: that "disparagement" is forbidden "except to the extent required" by law or legal process. The inclusion of the word "required" suggests mandated disclosure and that the limits to the legal process exception are closer to those suggested by Kelly.

The Plaintiffs also contend that they should be protected by the absolute privilege afforded to witnesses in judicial proceedings. Such a privilege is

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loyalty, and fair dealing. Encompassed within such general duties of an agent is a duty to disclose information that is relevant to the affairs of that agency entrusted to him.") (citation omitted); Restatement 2d of Agency § 387; Restatement 3d of Agency § 8.06, 8.11.

[29] *La. Mun. Police Employees' Ret. Sys. v. Fertitta*, 2009 WL 2263406, at *5 n.17 (Del. Ch. July 28, 2009) (finding a confidentiality clause exception for disclosure to a securities regulator); *County of Santa Clara v. Astra USA, Inc.*, 588 F.3d 1237, 1249 (9th Cir. 2009) (holding that a district court's discovery order compelling the production of documents would be a disclosure "required by law"). *Cf. MapQuest, Inc. v. CIVIX-DDI, LLC*, 2009 WL 383476, at *7 (N.D. Ill. 2009) (allowing breach of confidentiality claim premised on plaintiff's decision to attach documents to a complaint where such documents must be kept confidential unless disclosure was "required by law or pursuant to a subpoena or court order").

[30] Plaintiffs suggest that Black's Law Dictionary defines legal process as "the proceeding in any civil lawsuit or criminal prosecution." Yet, it is also defined therein as "[a] summons or writ, [especially] to appear or respond in court." Black's Law Dictionary 1242 (8th ed. 2004).

designed to ensure that witnesses are not intimidated or coerced into withholding information relevant to a judicial proceeding.[31] The privilege typically operates to bar any cause of action against a witness for defamation or disparagement for statements made in a judicial proceeding, upon a showing that: (1) the statements issued were part of a judicial proceeding; and (2) that the statements were relevant to a matter at issue in the case.[32] However, it is not clear that Plaintiffs' statements to State Street in the buildup to the New York litigation, absent any direct involvement in the litigation, would necessarily fall within this privilege. Moreover, factual questions, including Plaintiffs' good faith in making such statements to State Street, would seem relevant to the application of any absolute privilege they assert. As such, Count III also survives motion to dismiss.

D. *The Release*

In Count IV, Kelly seeks a declaratory judgment that his decision to withhold a portion of the deferred payment in order to cover Plaintiffs' indemnification obligations was undertaken in good faith such that, under the

[31] *Barker v. Huang*, 610 A.2d 1341, 1345 (Del. 1992) ("The purpose served by the absolute privilege is to facilitate the flow of communication . . . in judicial proceedings and, thus, to aid in the complete and full disclosure of facts necessary to a fair adjudication"). *See also Nix v. Sawyer*, 466 A.2d 407, 411 (Del. Super. 1983) ("[T]he interest in encouraging a litigant's unqualified candor as it facilitates the search for truth is deemed so compelling that the privilege attaches even where the statements are offered maliciously or with knowledge of their falsity."); *Short v. News-Journal Co.*, 212 A.2d 718, 719-20 (Del. 1965); *Tatro v. Esham*, 335 A.2d 623, 626-27 (Del. Super. 1975).

[32] *Nix*, 466 A.2d at 410.

Release in Section 7.1 of the Agreement, Plaintiffs have released Kelly from the claims alleged in their Complaint. In Count V, Kelly seeks specific performance of the Release.

The Release states that "each Member does hereby release" each Covered Person from any and all claims "relating to or arising out of the activities of the Company, or activities undertaken in connection with the Company, or otherwise relating to or arising out of this Agreement." Kelly reads this language as necessarily precluding all of Plaintiffs' claims in this litigation, absent a "final, non-appealable order" determining that he engaged in Disabling Conduct. Plaintiffs, for their part, argue that Kelly has clearly demonstrated bad faith and that his reading of the Release would leave them, or any other FAH member for that matter, with no recourse if Kelly were to simply withhold funds for no reason at all.[33] Kelly points out that Plaintiffs would merely need first to bring suit seeking a declaratory judgment that Kelly had engaged in Disabling Conduct and, upon winning such a judgment, would then have a predicate to claim that the Release did not apply to that conduct.

One, perhaps, could take a hypertechnical approach to the Release language and conclude that Plaintiffs are ineligible to bring any claims against Kelly in his

[33] Plaintiffs also argue that the Release does not apply to the conduct at issue in this litigation because the Release predated the claims (and the facts giving rise to the claims) in the Complaint by several years. Because it dismisses these counts on other grounds, the Court need not consider this argument.

role as Managing Member in the absence of demonstrable bad faith, as determined first in a non-appealable judicial order. However, considering the Agreement as a whole, which apparently was written for the express purpose of providing a means whereby funds from the IFS sale would be evenly and efficiently distributed to the FAH Members, the Court cannot accept that the parties intended (or agreed) to employ a two-stage litigation process in order to induce Kelly to carry out his primary obligations under the Agreement, or that, in the absence of bad faith, Kelly has no such obligations. To conclude otherwise would defeat the very purpose of the Agreement. Accordingly, Counts IV and V are dismissed.

E. *Attorneys' Fees*

As some of the counts in Kelly's counterclaims survive the motion to dismiss, the Court cannot conclude that the counterclaim was brought in bad faith. Thus, Plaintiffs' request for attorneys' fees incurred for responding to Kelly's counterclaim is denied.

## IV. CONCLUSION

For the foregoing reasons, Plaintiffs' motion to dismiss Defendants' counterclaim Counts IV and V is granted; otherwise, it is denied. An implementing order will be entered.