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Re: Scharf v. Edgcomb Corporation
C.A. No. 15224-NC
Date Submitted: June 28, 2002

Dear Counsel:

Plaintiff Michael J. Scharf ("Scharf") seeks indemnification by Defendant Edgcomb Corporation ("Edgcomb"), a Delaware corporation, of the attorneys' fees and expenses that he incurred as the target of an investigation conducted by the Securities and Exchange Commission ("SEC") which considered Scharf the source of material, nonpublic information used in the trading of Edgcomb's stock. This is the Court's decision after trial.

I. FINDINGS OF FACT

Scharf, an officer, director and major shareholder of Edgcomb, arranged for its sale in August 1989 to Metals Acquisition Corporation ("MAC").[1] Scharf shared office space with his close personal friend Steven Greenberg ("Greenberg"). The SEC would come to believe that Greenberg and others had engaged in illicit insider trading of Edgcomb securities with the benefit of nonpublic information provided by Scharf. Whether Scharf's disclosures were unintentional (*e.g.*, Greenberg overheard his conversations regarding the transaction between Edgcomb and MAC) or whether Scharf intentionally provided the information to him (*e.g.*, as a *quid pro quo* for information regarding other securities) would become critical.

In February 1990, the SEC subpoenaed Scharf in order to obtain information regarding his trading in the securities of Kidde, Inc. ("Kidde"). Scharf asserted his rights under the Fifth Amendment and refused to testify.

In October 1990, the SEC sent Scharf a Wells notice informing him that the staff was considering recommending that a civil action be filed against him for his 1987 trades in the stock of Kidde and his disclosure of material nonpublic information related to MAC's acquisition of Edgcomb. Shortly thereafter, Scharf and Greenberg, who was also

[1] The Merger Agreement (JX 148) supporting the transaction was executed in May 1989.

being investigated by the SEC on related grounds, jointly retained the law firm of Fried, Frank, Harris, Shriver & Jacobson ("Fried Frank"), a law firm experienced in SEC matters. Several reasons for agreeing to joint representation were identified. Because of the interrelated allegations, joint representation was perceived as more effective and consistent; it would allow for enhanced "management and control;" and it would be more "economical" because it would avoid having multiple law firms engaged in the same activities. Fried Frank billed Greenberg and Scharf jointly. Scharf paid one-half of those fees and expenses through February 1993 when he ceased all payments to Fried Frank.

With the guidance provided by Fried Frank, Scharf gave testimony to the SEC staff in December 1990. The staff focused on the sale of Edgcomb and Scharf's relationship with Greenberg and Edward Downe ("Downe"), another target of its investigation. Fried Frank understood that the staff suspected that Scharf had provided nonpublic information about Edgcomb to Greenberg who, in turn, had given it to Downe as the "*quid pro quo*" for information about Kidde. The staff followed up its questioning of Scharf with a document production request.

Although Scharf's attorneys were frustrated by what they perceived to be the staff's changing theories of the case, Scharf's position was improving while Greenberg's was deteriorating. By February 1991, the SEC's interest in Scharf as a target had been reduced to 1987 trades in Bally Manufacturing Corp. ("Bally"). The SEC's interest in Greenberg, however, was expanding. In early March 1991, an SEC staff attorney advised Fried Frank that the staff had begun viewing Greenberg and Scharf "independently of each other." Indeed, Greenberg was under investigation for not only Edgcomb, Bally and Kidde, but also Supermarkets General.

In early April 1991, the SEC's Associate Regional Administrator informed Fried Frank that the staff would not recommend any action against Scharf. That good news was somewhat tempered by the action of the SEC several days later when it served Greenberg with a subpoena for documents "exculpatory of either Greenberg or Scharf." Scharf's lawyers speculated whether that reflected a decision by the SEC staff to renege on its commitment not to pursue Scharf. That uncertainty was addressed by the SEC staff on May 3, 1991, when it took the unusual step of confirming in writing that it would not recommend prosecution of Scharf. The letter (the "May letter"), as one would expect, was not unqualified. For example, the decision was premised upon information known to the SEC at the time of the letter. Nonetheless, a Fried Frank senior associate assigned to the Greenberg-Scharf team advised Scharf: "you're out."[2]

[2] Scharf's lawyers may not have been positive that Scharf was free from all risk of further action by the SEC. The SEC's theory of Scharf's potential liability had shifted over the course of the investigation, and the SEC's continuing investigation of Greenberg afforded

On June 4, 1992, the SEC filed its complaint against Downe, Greenberg and others.[3] Scharf was not named as a defendant, but he did receive prominent recognition as a key player in the process. The critical allegation, from Scharf's perspective, was that Greenberg had learned material inside information regarding Edgcomb from Scharf and had passed it on to Downe.

During the summer of 1992, a companion criminal investigation resulted in service of a subpoena on Scharf to appear before a grand jury. Scharf retained separate counsel to represent him in that matter. His separate counsel believed that he had negotiated "qualified immunity" for Scharf, but the United States Attorney subsequently withdrew the immunity offer. Scharf never did testify before the grand jury and there is nothing to suggest that he was a target of its investigation.

Also, in the fall of 1992, the SEC noticed Scharf's deposition and requested him to produce more documents. The deposition was continued and, indeed, never took place. Both the SEC and the United States Attorney's Office continued to identify Scharf as a

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it the opportunity to develop new evidence related to Scharf. It may be that Fried Frank viewed the SEC's staff's conclusion not so much as one reflecting its determination that Scharf was innocent of wrongdoing but, instead, as the product of the staff's inability to prove what it believed: that Scharf was deeply involved with Greenberg's trading activities.

[3] *SEC v. Downe*, 92 Civ. 4092 (S.D.N.Y. June 4, 1992).

person connected with the investigation. These references, in one form or another, all involved Scharf as the source of the Edgcomb nonpublic information.

On July 7, 1994, Greenberg settled with the SEC. With Downe's settlement on September 14, 1994, all defendants had resolved the actions against them. No action was ever filed against Scharf.

On September 17, 1996, Scharf filed this action to recover the fees and expenses incurred as the result of the SEC investigation.[4]

II. CONTENTIONS

In a broad sense, three issues are presented for resolution. First, is the question of whether Scharf has proven the elements necessary to support a claim for indemnification. Scharf's efforts to recover the fees that he paid to Fried Frank are premised upon the Delaware General Corporation Law (the "DGCL"), 8 *Del. C.* § 145, Edgcomb's bylaws, and an indemnity agreement negotiated as part of MAC's acquisition of Edgcomb. Edgcomb disputes liability because, it claims, the investigation of Scharf was not "by reason of the fact" of his corporate position.

[4] The foregoing findings of fact do not constitute all of the Court's factual findings. Other facts are found when necessary or appropriate in the context of addressing the various issues framed by this dispute.

Second, if Scharf demonstrates that indemnification is appropriate, the inquiry turns to the reasonableness of Fried Frank's fees. In play here are questions regarding the appropriateness of an equal division of fees between Scharf and Greenberg and the accuracy or reliability of Fried Frank's documentation of its fees. Thus, the Court would be required to ascertain the "reasonable" amount to which Scharf is entitled.

Third, Edgcomb contends that Scharf's claim is time-barred. This obligates the Court to engage in a fact-intensive inquiry to determine when Scharf could have been "confident" that the SEC's investigation of him had been "resolved with certainty," a standard prescribed in an earlier memorandum opinion in these proceedings.[5]

III. ANALYSIS

A. *Scharf's Entitlement to Indemnification*

Scharf tenders a three-pronged claim for indemnification: (1) under § 145(c) of the DGCL; (2) under Edgcomb's bylaws; and (3) under the Merger Agreement between MAC and Edgcomb. Substantially the same analysis governs each.

1. Indemnification Conferred by Statute

A Delaware corporation, by 8 *Del. C.* § 145(a), is empowered to indemnify

[5] *Scharf v. Edgcomb Corp.*, 1997 WL 762656, at *4 (Del. Ch. Dec. 4, 1997), *appeal refused*, 705 A.2d 243 (Del. 1998) [hereinafter "*Scharf I*"].

> [A]ny person who was or is a party or is threatened to be made a party to any threatened, pending or completed action, suit or proceeding, whether civil, criminal, administrative or investigative (other than by or in the right of the corporation) by reason of the fact that the person is or was a director, officer, employee or agent of the corporation . . . .

By 8 *Del. C.* § 145(c), the directors and officers of a Delaware corporation "shall be indemnified against expenses (including attorneys' fees) actually and reasonably incurred" to the extent that the director or officer "has been successful on the merits or otherwise in defense of any action, suit or proceeding referred to in subsections (a) and (b) of this section, or in defense of any claim, issue or matter therein . . . ."

Edgcomb concedes that Scharf was a director and an officer of Edgcomb; that the SEC investigative proceeding was neither "by [n]or in the right of Edgcomb;" and that Scharf was "successful on the merits or otherwise" in his defense against the SEC investigation. The parties, however, diverge on whether Scharf was the target of the SEC investigation "by reason of the fact" that he was an officer or director of Edgcomb.

Claims for the indemnification of directors and officers of Delaware corporations must be evaluated in light of the admonition

> that the indemnification statute should be broadly interpreted to further the goals it was enacted to achieve. . . . The invariant policy of Delaware legislation on indemnification is to "promote the desirable end that corporate officials will resist what they consider unjustified suits and

> claims, secure in the knowledge that their reasonable expenses will be borne by the corporation they have served if they are vindicated."[6]

The inquiry necessarily focuses on whether the conduct that resulted in the litigation involving the officer or director or, as in this case, the investigation, was "done in his capacity" as a corporate officer or director.[7] Edgcomb asserts that the SEC investigation resulted from Scharf's personal involvement in an insider trading scheme for his personal financial benefit. The SEC did investigate Scharf because it suspected that he had used Edgcomb's material, nonpublic information as his ticket to the multi-party insider trading scheme. An essential component to Scharf's potential insider trading liability was his access to Edgcomb's nonpublic information, and he acquired that information "by reason of the fact" that he was a corporate officer and director. Indeed, one possible explanation for Greenberg's access to Edgcomb's nonpublic information was that Greenberg overheard Scharf's conversations while Scharf, as an officer and director of Edgcomb, was discussing the potential merger with MAC. Although Scharf's trading in the securities of other corporations may have been part of the SEC

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[6] *Stifel Fin. Corp. v. Cochran*, 809 A.2d 555, 561 (Del. 2002) (quoting RODMAN WARD, JR., ET AL., FOLK ON THE DELAWARE GENERAL CORPORATION LAW § 145 (2001)).

[7] *Perconti v. Thornton Oil Corp.*, 2002 WL 982419, at *4 (Del Ch. May 3, 2002); *see also Reddy v. Elec. Data Sys. Corp.*, 2002 WL 1358761, at *6 (Del. Ch. June 18, 2002), *aff'd*, 820 A.2d 371 (Del. 2003) (mem.); *Weaver v. ZeniMax Media, Inc.*, 2004 WL 243163, at *3-*5 (Del Ch. Jan. 30, 2004).

investigation, Scharf's involvement, if any, was always tied to his having been the source of the information regarding Edgcomb's anticipated merger. Thus, Scharf was a target of the SEC investigation "by reason of the fact" that he was a director and officer of Edgcomb.

Accordingly, Scharf has satisfied each of the elements necessary to demonstrate an entitlement to indemnification under 8 *Del. C.* § 145(c).

2. Indemnification Under Edgcomb's Bylaws

Edgcomb's bylaws track the requirements of 8 *Del. C.* § 145(c). By Article VIII, § 1 of the bylaws, Edgcomb

> shall indemnify any person who was or is a party or is threatened to be made a party to any threatened, pending or completed action, suit or proceeding, whether civil, criminal, administrative or investigative (other than an action by or in the right of the corporation) by reason of the fact that he is or was a director, officer, employee or agent of the corporation . . . against expenses (including attorneys' fees) . . . actually and reasonably incurred by him in connection with such action, suit or proceeding. . . .[8]

Furthermore, under Article VIII, § 3 of Edgcomb's bylaws, a director or officer who has been "successful on the merits or otherwise" in the defense of a proceeding described in Article VIII, § 1 of the bylaws "shall be indemnified against expenses (including attorneys' fees) actually and reasonably incurred by him in connection therewith . . . ."

[8] JX 149.

For the same reasons which entitle Scharf to indemnification under 8 *Del. C.* § 145(c), Scharf is entitled to indemnification under Edgcomb's bylaws.

3. Indemnification Under the Merger Agreement

The Merger Agreement, at Section 6.09, provides:

> For six years after the Effective Time, Purchaser [MAC] shall, and shall cause the Surviving Corporation [Edgcomb] to, indemnify, defend and hold harmless each person who as of the date hereof serves as a director or officer of the Company . . . against any . . . expenses . . . in connection with any claim arising from actions taken or omissions to act as directors or officers of the Company . . . (i) to the fullest extent permitted under Delaware or other applicable law or (ii) as provided in the Company's charter or bylaws. . . .[9]

Scharf incurred the cost of defending against the SEC investigation because of a potential claim "arising from actions taken" as an officer and director of Edgcomb. The claim arose from his actions in communicating and disclosing, whether intentionally or unintentionally, Edgcomb's confidential information. Thus, for reasons similar to those establishing Scharf's entitlement to indemnification under both statute and bylaws, he is entitled to indemnification under the Merger Agreement, provided that he avoids the

[9] JX 148.

contractual time bar established by the initial clause "[f]or six years after the Effective Time."[10]

Accordingly, Scharf holds the right to recover the fees and expenses he incurred in successfully resisting the SEC investigation.

B. *The Amount of Indemnification*

When Scharf and Greenberg jointly retained Fried Frank, they agreed to divide its charges evenly between them, a course that they followed until February 1993 when Scharf stopped paying.[11] Two questions are presented: (1) whether the amount billed to Scharf and Greenberg by Fried Frank was reasonable;[12] and (2) how should Scharf's share be determined.

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[10] "Effective Time," a defined term in the Merger Agreement, was on August 24, 1989, when the certificate of merger was filed with the Delaware Secretary of State. (JX 150). Scharf was both an officer and director of Edgcomb as of "Effective Time." Scharf, however, did not pursue his claim under the Merger Agreement in his post-trial briefing. Thus, that aspect of his claim is treated as abandoned. It also should be noted that this action was filed more than seven years after "Effective Time."

[11] Scharf's final payment in February 1993 appears to have been in response to the December 1992 invoice.

[12] This Court has interpreted

> the requirement of reasonableness to incorporate the following three inquiries: were the expenses actually paid or incurred; were the services that were rendered thought prudent and appropriate in the good faith professional judgment of competent counsel; and were charges for those services made at rates, or on a basis, charged to others for the same or comparable services under comparable circumstances.

Scharf paid $1,655,130.86 in fees and expenses to Fried Frank with regard to this matter. He carefully reviewed the bills and, on several occasions, challenged them and obtained a reduction in the amount charged. Over the years, he negotiated reductions of approximately $170,000.

Fried Frank's billing practices were reasonable. One of its attorneys reviewed a pre-bill monthly.[13] The reasonableness of the hourly rate has not been questioned. Fried Frank's defense of Scharf and Greenberg took several years, was a difficult undertaking, and achieved, for Scharf, remarkable success. In sum, the amount billed by Fried Frank was reasonable for the services that it provided to Scharf and Greenberg through December 1992.[14]

Delphi Easter Partners v. Spectacular Partners, Inc., 1993 WL 328079, at *9 (Del. Ch. Aug. 6, 1993).

[13] Several of Fried Frank's time entries contain no description of the work performed. I am satisfied that the time was spent on the Scharf-Greenberg matter. I am also satisfied that it was spent productively and reasonably on the Scharf-Greenberg matter. I note that these entries now date back well over a decade and it is with hindsight that I reach this conclusion. Whether a lawyer's time entries without explanation in 2004 would be viewed as charitably is, of course, a question not addressed here.

[14] For purposes of determining the indemnification amount, I am assuming that it was necessary and appropriate for Scharf to continue with Fried Frank's services through the end of 1992, an assumption that may not be valid in light of the evaluation of Edgcomb's statute of limitations defense, *infra*.

Although the total fees and expenses billed by Fried Frank may have been reasonable, the question of how to allocate those fees and expenses between Scharf and Greenberg, even with the benefit of hindsight, is a significantly greater challenge.

Scharf and Greenberg agreed to split their fees equally. At the outset, this was a reasonable approach and remained reasonable until the May letter. In retrospect, it may well be that a few months before the May letter the separation in perceived culpability between Scharf and Greenberg should have been accounted for, but, in light of the events at the time, I cannot conclude that some minor delay in recognition of their then-imminent change of status was unreasonable.

Thus, fees and expenses incurred through April 1991 are reasonably allocated between Greenberg and Scharf on an equal basis. With the May letter, however, the reasonableness of an equal sharing of fees dissipated. Scharf was no longer an acknowledged target and the investigation into Greenberg had expanded significantly. In an effort to facilitate an appropriate allocation, one of Scharf's lawyers reviewed Fried Frank's time records and attempted to create a set of bills as if Scharf had been Fried Frank's only client. In substance, the goal was to exclude time allocable only to Greenberg and to identify the work necessary to protect Scharf's interests. Admittedly, this involved a great deal of discretion, required application of several assumptions, and was far from a precise or scientific effort. I find that effort, however, credible and reasonable under the circumstances. Allocation of attorney time and effort is best done by the attorney involved in the matter, whose good faith and reasonableness can be tested by cross-examination.[15]

As a general matter, Scharf's reimbursement for fees and expenses incurred after April 1991 should be in accordance with the efforts of his counsel to create, on a retrospective basis, his otherwise comparable personal billing statements. I differ, however, with the billing allocation reconstruction effort in one material aspect. For this post-April 1991 period, the estimates should be adjusted so that Scharf never receives credit for more than 50% of the sums billed by Fried Frank during the particular monthly billing period. This equal share concept was at the core of the billing arrangement from the beginning and there is no reason why Scharf should, after the fact, achieve a more favorable allocation than the one under which he both paid the bills and sought indemnification. During nine out of twenty months following the April 1991 billing period, the estimates of the amount that Scharf would have paid are in excess of one-half

[15] *See May v. Bigmar, Inc.*, 838 A.2d 285, 290-91 (Del. Ch. 2003).

of the total bill to Scharf and Greenberg. In these instances, the estimates shall be reduced to one-half of the total amount billed that month.[16]

With these adjustments, Scharf is entitled to recover $1,116,389.38 in legal fees. Scharf is also entitled to reimbursement of expenses incurred in the amount of $192,986.49.[17]

C. *Edgcomb's Statute of Limitations Defense*

Scharf's right to indemnification is the target of Edgcomb's assertion of a three-year statute of limitations defense.[18] A cause of action for indemnification accrues when

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[16] Edgcomb has persuaded me that to do otherwise would be unreasonable. I also note that Edgcomb has pointed to correspondence (DX 7) exchanged with Scharf's attorneys during the unsuccessful negotiation of his indemnification claim as support for its contention that certain expenses incurred with respect to Bally and Kidde should be excluded because they were of minimal value to Scharf. I do not consider this argument because it is premised upon communications regarding a possible compromise of Scharf's claim and none of the exceptions to Rule 408 of the Delaware Rules of Evidence would allow for its consideration.

[17] I discern no practicable means for a precise allocation of expenses between Scharf and Greenberg. I am satisfied that an allocation in the same proportion as all of the fees have been allocated is the fairest approach. Thus, of the $243,977.86 paid by Scharf of the $487,955.72, *see* PX 27, at 2, which Fried Frank billed through the end of 1992 for expenses, Scharf is entitled to recoupment of $192,986.49 or 79.1% of the total.

[18] *Stifel Fin. Corp. v. Cochran*, 809 A.2d at 558-59, designates 10 *Del. C.* § 8106 ("no action based on a promise [or] on a statute . . . shall be brought after the expiration of 3 years from the accruing of the cause of such action") as the applicable time bar statute because "indemnification is essentially a contract right." *Id*. at 559. The holding of *Stifel Fin. Corp.* that indemnification claims are subject to a statute of limitations defense

the officer or director entitled to indemnification can "be confident any claim against him has been resolved with certainty."[19] Edgcomb, of course, bears the burdens of proof and persuasion with respect to its affirmative defense.[20] The matter on which the claim for indemnification is premised may be said to have been resolved with certainty "when the underlying investigation or litigation [is] definitely resolved."[21] For example, a successful result in the trial court does not cause the statute of limitations to begin running if an appeal is taken. Until the appeal is withstood, there is no "definitive resolution." "The implicit rationale for this conclusion is that the person seeking indemnity should not have to rush in at the first possible moment but rather should be able to wait until the outcome of the underlying matter is certain."[22]

Statutes of limitations are most fairly and predictably applied with reference to a single, well-defined moment in time. In some instances, particularly those involving

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effectively forecloses Scharf's argument that his delay in filing this action should be judged instead under the more flexible doctrine of laches.

[19] *Scharf I*, 1997 WL 762656, at *4.

[20] *See, e.g.*, *In re IBP, Inc. S'holders Litig.*, 789 A.2d 14, 53 n.94 (Del. Ch. 2001); *Common Cause of De. v. Red Clay Consol. Sch. Dist. Bd. of Educ.*, 1995 WL 733401, at *1 (Del. Ch. Dec. 5, 1995).

[21] *Simon v. Navellier Series Fund*, 2000 WL 1597890, at *9 (Del Ch. Oct. 19, 2000).

[22] *Id*. *See also Cochran v. Stifel Fin. Corp.*, 2000 WL 286722, at *3 (Del. Ch. Mar. 8, 2000, *aff'd in part*, 809 A.2d 555 (Del. 2002) (statute of limitations did not begin to run until the government's time to petition for review of the Court of Appeal's dispositive order had expired).

investigations where the investigative interest eventually wanes into nothingness, that exact moment may be very difficult to divine. Imposing upon the director or officer the obligation to ascertain when his or her claim accrues in light of a unique set of facts is not ideal. Ultimately, however, in this case the question is not precisely when could Scharf have been "confident" that the SEC investigation of him had "been resolved with certainty." Instead, the question is whether as of September 17, 1993, three years before he filed his complaint in this action, Scharf could have been "confident" that the SEC investigation against him had been "resolved with certainty." The inquiry, thus, necessarily and perhaps unfortunately, is fact-intensive.

Scharf first learned of the SEC's interest in his trading activities during February 1990, when he received a subpoena seeking information about his trades of securities of Kidde. His response was to assert his privilege under the Fifth Amendment. The SEC staff's interest in Scharf eventually grew to a level where it was considering a recommendation that a civil action be filed against him both for his 1987 trades in Kidde and his communication of Edgcomb's nonpublic information to others in breach of his duty of confidentiality. Following receipt of the Wells notice in October 1990, Scharf and Greenberg, who had been represented by the same firm, sought out Fried Frank. Thereafter, the joint representation continued, but by Fried Frank. Initially, Greenberg and Scharf thought that the SEC investigation was limited to trading in Kidde stock, which they had traded together.

By December 1990, with the benefit of Fried Frank's investigation, analysis and guidance, Scharf had agreed to testify before the SEC staff. After giving that testimony, he was required to produce documents pertaining not only to his trading in Kidde and his disclosures of Edgcomb's nonpublic information but also to a transaction involving Bally.

The SEC's interest in Scharf started to diminish while its attention to Greenberg increased. By February 1991, the SEC's remaining investigative interest in Scharf appeared to be limited to the Bally transaction, but the SEC continued to pursue Greenberg for Edgcomb, Bally and Kidde trades and even added trades in another company – Supermarkets General – to the list.[23]

Importantly, the SEC staff communicated its evolving assessment of Scharf to his lawyers. In early March 1991, his attorneys were informed that the SEC staff viewed Scharf and Greenberg "independently of each other."[24] A month later, on April 9, the SEC's Associate Regional Administrator informed Scharf's attorneys that the SEC staff

[23] JX 24.
[24] JX 111, at MS 004310.

would not recommend any action against Scharf.[25] Scharf's happiness about this development was dampened by a continuing concern about the status of his friend, Greenberg, and by an SEC request seeking documents "exculpatory or either Greenberg or Scharf." While that request made Scharf and his counsel wonder about the reliability of the news that the SEC staff would not seek to pursue Scharf, their fears were addressed by the May letter, an extraordinary letter transmitted by the staff on May 3, 1991, which confirmed for them "the staff's determination[ ] . . . [**a**]**t this time** not to recommend an enforcement action against Michael Scharf."[26]

In order to understand the significance of the May letter, correspondence between the SEC and Scharf's attorneys, both before and after, is instructive. After receiving a verbal representation from the SEC that Scharf was no longer a target and after the SEC took certain steps which Scharf's counsel perceived to be inconsistent with that representation, Scharf's attorneys sent a letter to the SEC on April 22, 1991, which provided in part:

> We agreed last week with [the SEC staff] that the concept of further testimony by Mr. Greenberg was not objectionable, in the context of numerous other agreements, . . . that the staff had determined (i) not to recommend action against Michael Scharf. . . .

[25] JX 115.
[26] JX 29.

> . . . [O]ur conversation . . . occurred . . . before I learned that Mr. Scharf's name and the name of Bally Manufacturing Corporation were included in [certain] subpoenas [issued by the SEC]. . . . [T]his latter development had undermined our client's confidence in the representations that had been made to us . . . .
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> . . . Your document request only further confounds the already confused situation: for example, you suggest that Mr. Greenberg should produce (among other things) documents 'exculpatory of * * * Mr. Scharf,' when the Staff has told us it has concluded its investigation with respect to him and has determined that enforcement action against Mr. Scharf is not warranted. . . .[27]

In reply, the SEC sent to Scharf's attorneys the May letter which read in part:

> [T]he staff's determinations as it relates to your clients, Messrs. Greenberg and Scharf, were and still are as follows;
>
> 1) **__At this time__**, not to recommend an enforcement action against Michael Scharf; . . .
>
> As you should be well aware and as the staff has made clear, the communication not to recommend an enforcement action with respect to Mr. Scharf or trading in Bally securities "at the most, can mean that **__as of its date__**, the staff of the Commission does not regard enforcement action as called for based upon whatever information **__it then has__**." Securities Act Release No. 5310 (emphasis added). Moreover, "if such advice is given, however, it must in no way be construed as indicating that the party has been exonerated or that no action may ultimately result from the staff's investigation of that particular matter." **__Id__**.
>
> You have been advised that we have determined to conduct additional investigation. Some of the subpoenaed individuals appear to have relationships or affiliations with Mr. Greenberg and Mr. Scharf and/or

[27] JX 28.

> may have knowledge regarding Bally or trading in its securities. It would be incomprehensible if, in questioning these individuals, questions regarding Mr. Scharf and/or Bally (which would undoubtedly have been asked at any earlier stage of the investigation) must now be avoided because the staff has determined not to recommend an action based on information **now in its possession**. We never agreed to consciously avoid seeking information which, irrespective of whether it may support or contradict our present views of this matter, would clearly be relevant.[28]

The May letter, of course, was not without qualification. It was premised on information known to the SEC at that time. However, the assessment by Scharf's team was evidenced by the contemporaneous comment by one of Scharf's attorneys who told him expressly: "Yes, you're out."[29]

Their contemporaneous understanding of the SEC's position was preserved by a letter written by Scharf's attorneys, in response, on May 7, 1991:

> *First*, we appreciate your written confirmation of the advice previously given to us with respect to Mr. Scharf – namely, that this investigation, *at the present time* has not produced evidence warranting further enforcement interest in Mr. Scharf and that, *based on the information presently available to the Staff*, no enforcement proceeding is contemplated, or will be recommended, against Mr. Scharf. As you know, that is a result we think is dictated by the facts and circumstances here, and we are gratified that the Staff has concurred in our conclusion to that effect. . . .
>
> *Second*, my letter was not intended to suggest, nor do I think it does, that the Commission's Staff is not entitled to conduct additional

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[28] JX 29 (emphasis in original).
[29] JX 128, at MS 004432.

> investigatory procedures *with respect to Mr. Greenberg*, or that, should information come to the Staff's attention that might warrant review of its prior conclusions *regarding Mr. Scharf*, the Staff would be disabled somehow from pursuing those issues with respect to Mr. Scharf. . . .
>
> *Third*, what is particularly troublesome is the notion that, simply because the Staff wishes to adduce further information *with respect to Mr. Greenberg*, that fact alone is sufficient cause for the Staff affirmatively to name *Mr. Scharf* in its recent subpoenas. . . .
>
> . . . .
>
> *Fifth*, we do not question the Staff's right to investigate any matter within the SEC's jurisdictional purview. What we do question is how the Staff, in one breath, can tell us there is no longer any basis to believe its *current and previous* theories involving Mr. Scharf or Bally are tenable, and yet assert that the Staff intends to question individuals with no direct connection either to Bally or to Mr. Scharf about these matters. We wonder what it is that the Staff intends to review with these witnesses – is this an effort to devise yet another theory in a series of thus far discredited theories of possible liability, or is this simply an effort to see whether a now-discredited theory of possible liability can somehow be resurrected? . . .[30]

During the next year, Scharf's lawyers' activities directly representing Scharf's interests were limited. At most, they consisted of information collection and transmittal. The focus of their efforts was on Greenberg. For example, a memorandum summarizing a January 31, 1992, meeting with the SEC reflected that they were "[a]ttending on behalf of Steven Greenberg."[31] A memorandum following that meeting set forth the

[30] JX 30.
[31] JX 141, at MS 004492.

understanding of Scharf's lawyers that they represented only one individual accused by the SEC of culpability in the insider trading scheme – Greenberg.[32] Interestingly, that memorandum contains the continuing understanding of Scharf's lawyers that the SEC viewed Scharf as the source of the material, nonpublic information which Greenberg passed on to his compatriots in the scheme. Nothing suggests any ongoing concern by Scharf's lawyers about Scharf's status as a potential target.

On June 4, 1992, the SEC filed a civil complaint against Greenberg and six others. Scharf was not a defendant, but, as had been anticipated by Scharf and his attorneys, the SEC alleged that Greenberg had acquired Edgcomb's nonpublic information through Scharf and then had shared it with other defendants. Accordingly, Scharf was named as the source of the nonpublic information but there was no allegation that he had violated any securities laws. This, of course, was consistent with the SEC's position in May 1991 and in January 1992.

The SEC issued a subpoena to depose Scharf in the latter part of 1992, but the deposition was never taken. Similarly, he was subpoenaed to appear before a grand jury investigating potential criminal liability associated with the trading activities, but he never testified and he never received any indication that he was a target of the grand jury.

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[32] JX 142.

A tentative agreement regarding immunity was never consummated, and that gave counsel some concern.[33]

Scharf stopped paying any of Fried Frank's legal bills as of February 1993, thus ending his fee-sharing arrangement with Greenberg.

Greenberg settled with the SEC in July 1994. He was one of the last of the defendants to resolve the claims asserted in the June 1992 complaint. The SEC never filed any action against Scharf.

Edgcomb first relies upon the May letter to define the moment when the investigation as to Scharf had been "definitely resolved." The May letter is said to demonstrate that Scharf was no longer being investigated, at that time, by the SEC. If that date fails, then Edgcomb would move to June 1992 when the SEC enforcement action, without a defendant named Scharf, was filed. Here, Edgcomb argues that Scharf, because he was not named as a defendant while aware that the SEC considered – indeed, identified – him as the source of the Edgcomb information, could have, indeed, should have, been confident that he was no longer at risk. I first return to the May letter.

[33] Scharf was represented by counsel other than by Fried Frank in the criminal investigation and no claim for indemnification has been asserted for costs incurred as the result of the criminal investigation.

The parties vigorously dispute the import of the May letter. All agree, however, that it was unusual, if not extraordinary, for the agency to issue such a letter at that time. Scharf emphasizes that the SEC qualified its position with reference to the facts as then known. Moreover, Scharf points out several events which, he contends, undercut the expectations resulting from the May letter and caused him to doubt that the SEC's investigation of him had, in fact, been resolved. For example, during a September 13, 1991, meeting, an SEC representative observed to Scharf's counsel, "Greenberg and Scharf had gone into Edgcomb together; their offices were one knock on the wall away from each other. The view that they did not talk until the press release [announcing the acquisition] is hard to accept."[34] On more than one occasion, the SEC expressed doubts about Scharf's veracity.[35] In addition, in the months after May 1991, the SEC issued subpoenas to individuals who worked in the offices shared by Scharf and Greenberg; those subpoenas sought documents about both Scharf and Greenberg.

It is understandable that Scharf and his attorneys experienced concerns about his status despite the May letter. There is, however, no evidence to support an inference that the SEC staff had acted in bad faith or with devious motivations when the May letter was

[34] JX 137, at MS 004463.
[35] *Id.*; JX 144; *see* note 2 *supra*.

issued. The better inferences are that the SEC staff considered Scharf culpable; that the staff could not compile sufficient credible evidence against Scharf to support an enforcement effort against him; and that the SEC staff would have welcomed the receipt of evidence supporting its view. On the other hand, it is also likely that the SEC staff held the same view of Scharf before the May letter and, yet, the May letter was sent. Thus, when the May letter was authored, the SEC staff had a perception of Scharf's role that was not likely to change, but, importantly, a perception that did not support prosecution. Although Scharf and his attorneys refer to the "shifting sands" of the SEC's position with respect to him, Scharf, as of May 1991, was no longer the object of the investigation.[36]

Edgcomb supported its statute of limitations defense with the expert testimony of Jay Dubow ("Dubow"), a recognized expert in SEC enforcement matters.[37] According to Dubow, the May letter was "an extremely strong indication that the SEC did not further

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[36] Scharf makes much of the discovery efforts of the SEC following the May letter. These efforts included not only Greenberg but also Scharf. However, because of their closeness – both as friends and in terms of office space, any inquiry into Greenberg's activities would prudently also have included Scharf's activities.

[37] Dubow is the chair of the securities litigation and enforcement practice group at a prominent law firm headquartered in Philadelphia, Pennsylvania. Before joining that firm in 1989, he had worked in the SEC's Division of Enforcement, where he conducted numerous investigations and brought actions alleging violations of the federal securities laws.

view Mr. Scharf as someone that they were going to be looking at to bring an enforcement action against."[38] He based this opinion on (i) his experience; (ii) his knowledge that it was "unusual" at that time and in the context of an ongoing investigation of others for the SEC to issue such a letter; and (iii) Scharf's prior assertion of his privilege against self-incrimination which may have been perceived as a refusal to cooperate with the agency. In addition, he expressed his view that the SEC staff would not have issued the May letter "if they had any intention of pursuing or recommending an enforcement action against Mr. Scharf."[39]

Dubow, moreover, concluded that "[t]o the extent that there was any doubt, remaining doubt, such doubt was removed" when the SEC's complaint was filed in June 1992.[40] He noted that not only had the SEC not named Scharf as a defendant but also it had specifically outlined his nexus to the conduct of the defendants in the action. As Dubow observed, merely being the source of the nonpublic information does not equate with liability under the securities laws.

Scharf, in his challenge of Dubow's opinion, points out that Dubow conceded that Scharf's lawyers are widely recognized as experts in SEC enforcement matters and that

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[38] Tr. 346.
[39] Tr. 350.
[40] Tr. 346.

they reached a different conclusion as to whether the investigation had been resolved with certainty before 1994. At trial, Scharf's trial counsel and Dubow had the following exchange:

> Q: Is this an area where reasonable minds differ?
>
> A: Could reasonable minds differ? I don't know. I know what my view is based on being on the staff. . . .
>
> Q: In your view, does that make [Scharf's counsel's] judgment unreasonable or uninformed?
>
> A: No; just different.[41]

Despite Scharf's efforts to undermine Dubow's opinion based on this exchange, all that it shows is that he did not consider the views of Scharf's attorneys as unreasonable. That experts come to different opinions does not necessarily lead to the conclusion that one opinion must be unreasonable.[42]

This exchange draws attention to perhaps the most difficult aspect of this case. Scharf's attorneys, experienced lawyers of unquestioned integrity, testified that they did not consider Scharf's exposure to have been resolved with certainty until Greenberg settled in the summer of 1994. For example, while acknowledging that "the more time

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[41] Tr. 367.
[42] Thus, I find Dubow's expert testimony persuasive.

[that] went by that nothing happened directly concerning Mr. Scharf the better it was for him," one of his attorneys testified:

> It was plain from what the SEC alleged and from what the U.S. Attorney was doing and from the course [the] investigation had taken for quite a long time that it was prudent to consider that Mr. Scharf was still under jeopardy[.] . . . [H]e thought he was still under threat, and we were certainly unable to tell him, based on what we knew, that there wasn't a rational basis for thinking so."[43]

Scharf's lawyers who testified were truthful and extremely competent. It is one of the several ironies in this action that the pending dispute might not have arisen but for the extraordinary work performed by his counsel. To obtain the no further action letter from the SEC was a substantial accomplishment. Ultimately, however, the testimony of Scharf's lawyers cannot carry the day. First, good lawyers know that very little is absolute and, thus, tend to suffer (or perhaps benefit from) a degree of skepticism. Second, bureaucracies are generally regarded by lawyers as, at least on occasion, prone to take strange and unpredictable steps, thus provoking even more skepticism. In short, a healthy apprehension – I shun the use of "paranoia" – is an inevitable part of a lawyer's assessment of a given set of facts. However, an undifferentiated apprehension that something "bad" (*e.g.*, the SEC's bringing of an action against Scharf) might happen

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[43] Tr. 36.

cannot be the standard here because if it were (or is) the standard, the only reasonable time for commencing the limitations period for an indemnification claim based solely upon one's status as a target of an investigation would be when the statute of limitations governing the underlying substantive offense has run.

It is also fairly clear that, at least in the judgment of some SEC enforcement lawyers, the decision not to prosecute Scharf was not driven by their conviction that he had not done anything improper but, instead, by their perception that they could not prove improper conduct. What the Court does not, should not, and cannot know is whether Scharf's lawyers' assessment of the possibility that an action would be brought against Scharf (or the investigation revived) was influenced by their understanding, most likely drawn primarily from privileged communications, of Scharf's involvement (or non-involvement) in the wrongful conduct which was the subject of the SEC investigation. In short, the question before the Court cannot be resolved solely based upon the honest testimony of skilled counsel regarding their individual thought processes. Instead, it must be based on a broader and detached assessment of the known facts, and the reasonable inferences which may be drawn from those facts.

It may be helpful to return to the indemnification statute. Scharf is entitled to indemnification of expenses related to "any threatened, pending or completed action, suit or proceeding, whether civil, criminal, administrative or investigative."[44] The May letter demonstrates that, as of that time, the SEC was not threatening to take any action against him or to continue its investigation of him. Because he was the source of Edgcomb's nonpublic information, he was, of course, a fact witness, and thus, the SEC's discovery of him,[45] as a person with knowledge, does not support an argument that, despite the May letter, it was continuing to seek a basis for filing charges against Scharf.[46] Although the possibility existed that the SEC could "stumble" upon information incriminating Scharf or that others, such as Greenberg, could implicate him, that possibility, however remote, always exists for someone who, at one time, was the target of an investigation. Indemnification, however, is only available when there is an "action, suit or proceeding," that is "threatened, pending of completed" in which the officer or director is "a party or threatened to be made a party." After May 3, 1991, Scharf was, in terms of the indemnification statute, neither a party nor a person threatened to be made a party to any

[44] 8 *Del. C.* § 145(a).

[45] In its responses to interrogatories propounded by another defendant in the *Downe* proceedings, the SEC identified Scharf as someone with knowledge of Greenberg's providing Downe with inside information regarding Bally. JX 214, at 17-20; JX 147 ¶ 96-97. Thus, from the SEC's perspective, Scharf's knowledge of the insider trading scheme was not strictly limited to Edgcomb matters.

[46] Merely testifying as a fact witness does not entitle a corporate officer or director to indemnification. *Chamison v. Healthtrust, Inc. – Hospital Co.*, 735 A.2d 912, 928 (Del. Ch. 1999).

"action, suit or proceeding." Before then, he was a party to the SEC's investigative proceeding and, in light of the SEC's views of his actions at the time, a person threatened to be made a party to an enforcement action. With the May letter, neither status continued.

To the extent that doubt about Scharf's status may have lingered after May 1991, that doubt was removed in June 1992 when the SEC filed its complaint. The complaint fully describes Scharf's role as the source of Edgcomb nonpublic information but he was not named as a defendant. If the SEC had intended to pursue Scharf, it would have been simple to have added him as another defendant. As of June 1992, there was no ongoing SEC investigation of Scharf (as contrasted with discovery of Scharf as an obvious witness) and the litigation which had been commenced did not include him as a party. Moreover, there is no indication that the SEC had any intention to add him as a party or to renew its investigation of him.

Scharf points out that the fact that he was not designated as a defendant does not conclusively demonstrate that the SEC would not amend its complaint to add him as a defendant.[47] New information from Greenberg or Downe, one of Greenberg's co-defendants who was listed in an SEC discovery response as a person having knowledge of Scharf's role,[48] might have been obtained. Scharf is, of course, correct to recognize the possibility, as noted above, that someone might have come forward with new information and that the SEC might have proceeded against him. The mere possibility that someone might come forward with new and adverse information that would implicate a director or officer in illegal conduct is not the standard for indemnification.[49] The question, in this context, is what was the SEC doing or going to do? As of June

[47] The allegations of the SEC's complaint were at odds with testimony given by Scharf. Scharf had provided an affidavit for Fried Frank to use in its Wells submission on behalf of Greenberg. Certain allegations of the SEC's complaint were at odds with that affidavit and with the deposition that Scharf had given to the SEC. For instance, the affidavit states that, "on March 4, [1988] . . . I [Scharf] regarded the sale of Edgcomb as being virtually impossible," JX 143 ¶ 3, and that it "was only during the summer months of 1988 . . . that [he] began to think an attempt to sell Edgcomb would be forthcoming." *Id.* at ¶ 5. However, the SEC's complaint alleges "on or before March 6, 1988, Scharf informed Greenberg . . . of . . . his intention to sell Edgcomb" and detailed Scharf's efforts to sell the company between March 7 and August 19, 1988. JX 147 ¶ 141-42. Thus, from this and other information available to it, Fried Frank concluded that the SEC staff doubted Scharf's credibility.

[48] JX 214, at 19; JX 147 ¶ 141.

[49] Even Greenberg's settlement with the SEC and resolution of the SEC's action in the summer of 1994 did not preclude the possibility that someone might even then have brought forth new factual allegations adverse to Scharf. In this light, one could argue closure would come only when the statute of limitations for the underlying insider trading activities expired.

1992, it was not investigating Scharf and it was not litigating with Scharf. More importantly, the evidence in this case and the inferences readily drawn from the evidence support the conclusion that it had no intention to do either. On these grounds, Scharf, as of June 1992, could be "confident" with "certainty" that the SEC was not pursuing him.[50]

This conclusion is buttressed by the events which occurred after June 1992. In order for Scharf's complaint to have been timely filed, the statute of limitations must have started running no earlier than September 1993, roughly 15 months after the filing of the SEC complaint in June 1992. What occurred during that 15-month period is consistent with Scharf's status as not being a target of the investigation and, of course, not being a party to any litigation. That Scharf received inquiries from various federal entities regarding his activities does not change his status because, given his acknowledged proximity to the conduct in question, he was a necessary witness, but not necessarily a target of an investigation.

[50] Edgcomb delights in pointing out that Scharf's counsel, in correspondence to Edgcomb's counsel, regarding settlement of the indemnification claim asserted that "Mr. Scharf remained at risk until the filing of the SEC's complaint in *SEC v. Downe* in early June 1992." DX 7, at 5-6. That position, of course, has changed, but that correspondence occurred in the context of settlement negotiations and, thus, must be excluded under Rule 408 of the Delaware Rules of Evidence. Accordingly, I do not consider it in my decision.

Finally, the test that must be applied here, *i.e.*, could Scharf have been confident that his status had been resolved with certainty, is an objective one. Scharf's personal "feelings" (as contrasted with the facts known to him which may support those "feelings" or may assist in the application of an objective standard) are of little, if any, moment. Two facts in this context, however, bear mentioning. First, although he subsequently came to testify differently at trial, Scharf, at his deposition on November 17, 2000, testified that he had stopped paying his attorneys when "it was absolutely certain that I was not going to be sued by the SEC."[51] Second, by February 1993, Scharf had stopped paying his lawyers. That may well be the best evidence that Scharf was no longer personally concerned about his potential exposure from the SEC's activities.[52]

In conclusion, I find that Scharf could have been confident before September 1993 that the SEC's investigation of him had been resolved with certainty.[53] Although May

[51] JX 168, at 46-47. Scharf, at trial, explained his decision to cease payment of his attorneys' bills in February 1993 by stating that he "felt the focus of the case had shifted, to some degree, to [Greenberg]." Tr. 178. No explanation was offered as to why a "shifting" of the focus would excuse all payments as opposed to a reallocation of some of those costs to Greenberg.

[52] That Scharf's lawyers also ceased billing him well before September 1993 evidences a lack of ongoing apprehension on their part as well.

[53] I note that this conclusion is also consistent with the following allegation of Scharf's complaint in this action: "Scharf was targeted from 1990-92 in an investigation by the Enforcement Division of the [SEC]." Compl. ¶ 1.

1991 could reasonably be viewed as the time when Scharf could have had the necessary confidence that he was no longer a target of the investigation, it may have been prudent for Scharf and his attorneys to acknowledge a modicum of lingering risk derived from the investigation that was otherwise continuing. In June 1992, shortly after the filing of the SEC's complaint and Scharf's opportunity to assess it, Scharf was no longer at risk and the reasonable person in his position both would have and could have concluded with both certainty and confidence that the SEC's investigation of him had been definitely resolved. Because Scharf did not file this action until September 1996, his claim for indemnification is barred by Delaware's three-year statute of limitations.[54]

[54] Another policy consideration militates against reflexively adopting the essence of Scharf's argument. Under 8 *Del. C.* § 145(c), an indemnification claim does not ripen until the officer or director has been "successful" in his or her defense. Thus, an officer or director who has incurred substantial defense costs may not pursue an indemnification claim until success has been achieved. It is difficult, for example, to see how Edgcomb could have denied, as not yet ripe, an indemnification claim from Scharf in, say, the summer of 1992, after he had received the May letter and after the SEC had filed an enforcement action against seven defendants but not against him. In short, when a cause of action "accrues" carries consequences not only for time bar purposes but also for purposes of establishing when the initial opportunity to pursue an indemnification claim comes into existence. Of course, in the interim, however long that may be, the officer or director may have rights to advancement of his defense costs.

D. *Scharf's Arguments Against Application of the Statute of Limitations*

1. His Contention that Edgcomb's Bylaws Preclude Such a Defense.

Scharf seeks to preclude consideration of Edgcomb's statute of limitations defense by pointing out that Edgcomb's bylaws authorize indemnification payments to "the fullest extent permitted by law." That language, according to Scharf, precludes the assertion of the statute of limitations because Edgcomb could choose not to raise that defense to avoid its obligations.

I note at the outset that *Stifel Financial Corp.* and *Simon* both evaluated assertions of the statute of limitations defense in the context of indemnification clauses which allowed indemnification to the fullest extent of the law.[55] If provisions such as that deprive the corporation of the right to assert a statute of limitations defense, then significant judicial energy was unnecessarily expended. The precise question of whether the bylaws' liberal language authorizing indemnification operated to preclude the limitations defense, however, was not raised in those cases.

Although an indemnification bylaw could be drafted to allow directors or officers an indefinite period in which to enforce judicially their indemnification right, Edgcomb's bylaws do not require such a result. There is no express mention of the statute of

[55] *See also Tafeen v. Homestore, Inc.*, 2004 WL 516559 (Del. Ch. Mar. 16, 2004).

limitations, and, as a general matter, a waiver of the statute of limitations must be express because of the

> strong policy considerations underlying the enactment of statutes of limitations. Limitations periods are intended to put defendants on notice of adverse claims and to prevent plaintiffs from sleeping on their rights. Statutes of limitations "represent a pervasive legislative judgment that it is unjust to fail to put the adversary on notice to defend within a specified period of time." The Supreme Court has recognized that statutes of limitations are not "simply technicalities," but rather, "fundamental to a well-ordered judicial system." These policies have led commentators to generalize that "[t]he promise of the defendant not to raise the defense of the expiration of the limitations period must either be express or couched in words clearly conveying the defendant's intention not to plead the statutory bar."[56]

There is, however, more to Scharf's argument than waiver. He correctly contends that (i) Delaware law does not require Edgcomb to assert a statute of limitations defense and, thus, (ii) nothing prevents Edgcomb from indemnifying Scharf.[57] It follows, according to Scharf, particularly in light of the premise that bylaws are construed against their corporate drafters,[58] that Edgcomb must indemnify Scharf simply because it is permissible to do so under the DGCL. Ultimately, from the premise that the corporation

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[56] *United States v. Richardson*, 889 F.2d 37, 40 (3d Cir. 1989) (citations omitted).

[57] For present purposes, I need not consider whether there may be circumstances in which a board of directors would be required, through the faithful exercise of fiduciary duties or to avoid the wasting of corporate assets, to assert an affirmative defense.

[58] *See, e.g., Hibbert v. Hollywood Park, Inc.*, 457 A.2d 339, 343-44 (Del. 1983).

is not required to assert affirmative defenses comes the conclusion that the corporation, therefore, is barred from asserting affirmative defenses.[59] Although the policy of Delaware is to favor indemnification, it does not render a corporation defenseless.

The purpose of the "to the fullest extent of the law" language is to confirm that the scope of the indemnification right is to be construed broadly, an approach that is fully consistent with Delaware law. As a matter of policy, it is difficult to perceive any benefit that would result from allowing a director or officer with an indemnification claim to wait decades before bringing an action to enforce that right. As with virtually all claims of whatever nature, some limitation is necessary to their orderly processing. Delaware has chosen three years as the appropriate time limit for indemnification matters. In the absence of something more explicit than the words chosen by the drafter of Edgcomb's bylaws, the statute of limitations defense remains available to it.

[59] Indeed, Scharf's approach would preclude a defendant in an indemnification action, governed by officer and director – friendly bylaws, from asserting not only the defense of statute of limitations but also other defenses otherwise authorized by Court of Chancery Rule 8(c).

2. <u>His Contention that Edgcomb's Inequitable Conduct</u> <u>Precludes a Time Bar Defense</u>.

Scharf also argues that Edgcomb should be prohibited from asserting a time bar defense because of its inequitable conduct.[60] Scharf first presented his claim for indemnification to Edgcomb in January 1995.[61] Edgcomb, which recognized early on that Scharf's claims might be time barred, engaged in negotiations during the ensuing 17 months. Edgcomb tendered several requests for additional information, but it never indicated any concern about the timeliness of Scharf's application until June 11, 1996,[62] when it advised Scharf's lawyers that it considered his claims time barred. In essence, Scharf argues that because Edgcomb engaged in a merits-based discussion regarding his claim, it would be inequitable to charge him with the consequences of the passage of time that was induced by Edgcomb.[63] Under certain circumstances, a putative defendant's

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[60] Scharf must carry the burden of proving the facts necessary to support a claim for tolling the statute of limitations. *In re ML/EQ Real Est. P'ship Litig.*, 1999 WL 1271885, at *2 (Del. Ch. Dec. 21, 1999).

[61] If the May letter and the events surrounding it resulted in the commencement of the limitations period, Scharf was then already too late with his claim. On the other hand, if the filing of the SEC complaint established the critical date, then Scharf still had an opportunity to file his indemnification action timely.

[62] JX 165.

[63] *See, e.g.*, *McMeekin v. Prudential Ins. Co. of Am.*, 36 A.2d 430, 431 (Pa. 1944) (statute of limitations tolled where insurance agent told the insured that "there certainly must be some mistake or misunderstanding because you are entitled to [disability benefits]").

efforts to lull its plaintiff into inactivity or a defendant's acquiescence in the validity of a plaintiff's claim may estop the defendant from asserting a statute of limitations defense.[64] However, "participation in settlement negotiations with a claimant ordinarily does not create an estoppel where the purpose has been to determine whether there is any basis for the claim asserted."[65]

I am satisfied that Scharf has not demonstrated that the statute of limitations should be tolled in this instance. First, because of various transactions after the merger, Edgcomb, which received Scharf's request for indemnification in 1995, was not directly familiar with Scharf's role and may not have possessed the relevant records. Given the length of time between the Edgcomb-MAC merger, which occurred in 1989, and the Scharf claim first asserted in 1995, a perception that a time bar defense might be appropriate should have been anticipated. Although Edgcomb discussed that view with its counsel, no formal conclusion was reached.[66] Second, while Edgcomb engaged Scharf's counsel in negotiations focused on documentation of the amount of Scharf's claim, it is not accurate to assert that Edgcomb had recognized the validity of Scharf's

[64] *Lecates v. Hertrich Pontiac Buick Co.*, 515 A.2d 163, 177 (Del. Super. 1986).
[65] *Id. See also Mergenthaler v. Asbestos Corp. of Am.*, 500 A.2d 1357, 1365 n.13 (Del. Super. 1985).
[66] JX 175, at 21.

claim. Edgcomb was careful to recite that it had not agreed that Scharf was entitled to indemnification.[67] Third, the length of the negotiations is, at least to some significant extent, attributable to Scharf's counsel who, for example, in one instance, took seven months to respond to an Edgcomb request for information.[68] Finally, Scharf, in his negotiations with Edgcomb was represented by sophisticated counsel. In short, Scharf has provided no persuasive basis for treating his claim outside the general rule that negotiations do not routinely toll the applicable statute of limitations. Edgcomb's negotiating strategy may have an unsavory taste about it, but to adopt Scharf's position would defeat the very purpose of the statute of limitations – certainty – in too many conceivable scenarios. Thus, Edgcomb's conduct does not bar it from asserting a limitations defense.

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[67] A letter dated September 22, 1995, from Edgcomb's secretary to Scharf's lawyers noted "the mere fact of our receipt of [the indemnification request] in no way signifies any recognition of the validity of Mr. Scharf's claim against Edgcomb Corporation." JX 155. A December 7, 1995, letter from counsel for Edgcomb asserted that "the documentation [Scharf's lawyers] have provided gives no basis to determine how much, if any, of the total fee sought is legitimately owed pursuant to Edgcomb Corporation's indemnity obligations." JX 159. Correspondence, such as this, cannot fairly be expected to "lull" experienced counsel into inactivity and, perhaps more importantly, by then, it had already more than three and one-half years since the filing of the SEC complaint in June 1992.

[68] Tr. 403-04. On January 16, 1995, Edgcomb requested documents from Scharf. It did not receive a response to this request until August 18, 1995. JX 154.

IV. CONCLUSION

For the reasons set forth, Scharf's claim for indemnification is barred by 10 *Del. C.* § 8106.[69] Judgment, accordingly, will be entered in favor of Edgcomb.

Very truly yours,

/s/ John W. Noble

JWN/cap
cc: Register in Chancery-NC

[69] As the result of this determination, it is not necessary to address Scharf's claims for interest or for his attorneys' fees and expenses incurred in pursuing this action.