IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

NOAM DANENBERG,	)	
	)	
Petitioner,	)	
	)	
v.	)	C.A. No. 6454-VCL
	)	
FITRACKS, INC.,	)	
	)	
Respondent.	)	

MEMORANDUM OPINION

Date Submitted: December 14, 2011
Date Decided: January 3, 2012

Edmond D. Johnson, Bradley W. Voss, PEPPER HAMILTON LLP, Wilmington, Delaware; *Attorneys for Petitioner.*

William E. Manning, James D. Taylor, Jr., SAUL EWING LLP, Wilmington, Delaware; Michael S. Gugig, SAUL EWING LLP, Newark, New Jersey; *Attorneys for Respondent*.

LASTER, Vice Chancellor.

Petitioner Noam Danenberg formerly served as CEO of Fitracks, Inc., a Delaware corporation. Danenberg seeks advancements from Fitracks for attorneys' fees and expenses incurred defending claims in litigation pending before the United States District Court for the District of Delaware (the "Underlying Action"). Aetrex Worldwide, Inc. sued Danenberg in the Underlying Action. Aetrex is currently the parent corporation of Fitracks, having acquired Fitracks by triangular merger in 2008. Because Aetrex's claims in the Underlying Action arise out of representations made by Danenberg in his capacity as CEO of Fitracks, Danenberg is entitled to advancements for the Underlying Action. Although originally I was inclined to accept Fitracks' representation that Aetrex was not asserting any claims against Danenberg in his covered capacity, upon further reflection I reject that representation as inconsistent with the claims Aetrex has pled and contrary to positions Aetrex has taken in the Underlying Action. Summary judgment is therefore granted in favor of Danenberg and against Fitracks on the issues of liability for advancements in the Underlying Action and indemnification for this proceeding.

I. FACTUAL BACKGROUND

Fitracks owns technology that generates accurate three-dimensional measurements of a person's feet. The measurements facilitate the manufacture and sale of custom orthotic shoes and inserts. Danenberg founded Fitracks and served as its CEO from 2002 until June 16, 2008.

Aetrex manufactures footwear. In 2007, Aetrex began negotiating with Danenberg to acquire Fitracks. The parties' negotiations culminated in an agreement and plan of merger dated May 15, 2008 (the "Merger Agreement"). The merger closed on

June 16, 2008, with Fitracks emerging from the transaction as a wholly owned subsidiary of Aetrex. Danenberg's corporate roles with Fitracks terminated upon closing.

To bridge a disagreement over value during the merger negotiations, the parties agreed that Danenberg and other Fitracks equity holders would receive additional consideration in the form of a continuing interest in Fitracks' technology. To implement this deal term, the Merger Agreement granted Danenberg and fellow Fitracks equity holders the right to form a new company that would receive an exclusive worldwide license to develop "Virtual Stores." This concept envisioned placing booths, stalls, or kiosks in existing brick-and-mortar locations. Using Fitracks' 3-D measurement technology, the "Virtual Store" would measure a customer's feet and facilitate the ordering of custom shoes or inserts.

Section 6.03(a) of the Merger Agreement described the deal term as follows:

> Prior to the Closing Date, all or some of the Equity Holders may form a new legal entity beneficially owned by such Equity Holders ("Newco") which entity shall be created for the express purpose of marketing and selling [Aetrex's] and any [Aetrex] Subsidiary's . . . products through Virtual Stores. . . . Newco shall be granted a worldwide exclusive license (the "Newco License") *pursuant to a license agreement in a form to be agreed upon* by [Aetrex] and Newco *as a result of good faith negotiations prior to the Closing* [of the Aetrex/Fitracks merger]. . . .

Pet'r's Opening Br. App. at A-107 (the "Virtual Store Provision") (emphasis added). The closing of the merger was conditioned on reaching agreement on the form of the Newco License, which I will refer to by its eventual title of "Virtual Store License Agreement." *Id.* at A-112.

As contemplated by the Virtual Store Provision, the parties worked before closing on the Virtual Store License Agreement. The final pre-closing draft defined a Virtual Store as:

> a non-shoe store environment (such as a booth, stall or kiosk) at a fixed site, situated in a location other than at a shopping mall or shopping center in North America containing an existing iStep customer (unless Aetrex agrees otherwise in writing), which contains single or multiple foot-measuring devices and is intended to function as a promoter and direct seller of customized footwear products, including, without limitation, insoles and shoes, but which shall carry no inventory of shoes and which shall occupy a space of not more than 150 square feet.

Id. at A-351. By mutual agreement, the parties continued to negotiate the terms of the Virtual Store License Agreement after closing. Also by mutual agreement, Danenberg formed Just4Fit, Inc., a Delaware corporation, after closing on September 2, 2008. Just4Fit is the "Newco" referenced in the Virtual Store Provision, a party to the Virtual Store License Agreement, and the entity through which Danenberg pursued the Virtual Store concept.

In March 2009, Aetrex and Just4Fit executed the Virtual Store License Agreement. The final agreement remained substantially the same as the pre-closing document. Most importantly, the operative definition of a Virtual Store remained functionally unchanged. The only post-closing change was to delete "but which shall carry no inventory of shoes" and to add a final sentence: "Additionally, the Virtual Stores shall be permitted to carry a limited fitting inventory in amounts as mutually agreed upon between the Parties in writing from time to time." *Id.* at A-379.

The Virtual Store License Agreement required that Just4Fit establish certain numbers of Virtual Stores by certain dates to retain its license. The first benchmark called for twenty-five Virtual Stores by July 1, 2010. Just4Fit claimed to have met the benchmark. Aetrex asserted that Just4Fit missed the first benchmark because the stores it established did not conform to Danenberg's representations. Aetrex consequently refused to extend Just4Fit's license.

In September 2010, Just4Fit filed a complaint in this Court alleging that Aetrex breached the Virtual Store License Agreement by refusing to extend its license. Aetrex removed the action to the District Court. Rather than merely counterclaiming for breach of contract, Aetrex adopted the shock-and-awe strategy of suing Danenberg personally. In a third-party complaint naming Danenberg, Aetrex asserted counts for fraud, civil conspiracy, unjust enrichment, and civil violations of the Racketeer Influenced and Corrupt Organizations Act ("RICO"). Aetrex also sought injunctive relief and to pierce Just4Fit's corporate veil. Aetrex would later dismiss its RICO claim voluntarily after Danenberg's counsel provided precedent showing that the claim was not colorable.

In support of Aetrex's various claims against Danenberg, the third-party complaint alleged as follows:

> At various times, Danenberg solicited Aetrex with an idea to develop a "Virtual Store" concept. This concept was described by Danenberg to be an elaborate, visibly beautiful, free-standing, self-sufficient retail setup . . . . Danenberg provided Aetrex with detailed documents, illustrations, videos, promotional materials and representations of the "Virtual Store" he claimed to be developing. (Attached hereto as Exhibit B are several examples of the many

> representations made to Aetrex and provided by Danenberg as to the intended appearance . . . of Virtual Stores).

Id. ¶29. The third-party complaint attached artistic renderings of the Virtual Stores dating from August 2005, nearly *three years before* the closing of the merger. *Id.*, Ex. B. The third-party complaint alleged that "[i]n reliance on Danenberg's representations regarding (among other things) the intended purpose and appearance of Virtual Stores, Aetrex agreed to grant Danenberg a limited license to open Virtual Stores in the form that Danenberg had represented to Aetrex prior to signing the V[irtual] S[tores] License Agreement." *Id.* ¶41. As discussed above, Aetrex "agreed to grant Danenberg a limited license" during pre-merger negotiations and memorialized the agreement in the Merger Agreement itself.

Danenberg moved to dismiss the third-party complaint for lack of personal jurisdiction. In its March 2011 brief in opposition to the motion to dismiss, Aetrex made clear that it was relying on Danenberg's pre-merger representations. According to Aetrex, the Underlying Action involved

> a protracted web of deceit perpetrated upon Aetrex by Just4Fit and its co-conspirators, the Third-Party Defendants, in an attempt to force Aetrex to grant Just4Fit an exclusive worldwide license to market the Virtual Store concept. The deceit started with Danenberg's pre-contract fraudulent misrepresentations to Aetrex regarding what constituted a Virtual Store.

Pet'r's Answering Br. Ex. A at 1. Aetrex then described its allegations in the third-party complaint as follows:

> Aetrex has alleged that for years Danenberg made false written and oral representations to Aetrex that were intended

> to, and did, induce Aetrex to enter into the V[irtual] S[tores] License Agreement . . . . [I]t appears likely that the Aetrex/Fitracks Delaware merger would not have been consummated absent Danenberg's blatant misrepresentations of what Virtual Stores were intended to be.

Id. at 9-10. Aetrex thus represented to the District Court that Danenberg had made the representations on which it was suing "for years" prior to the execution of the Virtual Store License Agreement in March 2009, which necessarily meant that at least some of the representations pre-dated the closing of the merger in June 2008. Confirming this inference, Aetrex represented to the District Court that it relied on Danenberg's representations when entering into the Merger Agreement, such that "it appears likely that the Aetrex/Fitracks Delaware merger would not have been consummated absent Danenberg's blatant misrepresentations of what Virtual Stores were intended to be." *Id.*

In May 2011, Danenberg filed his petition for advancement. The same lawyers who represented Aetrex in the Underlying Action, who had signed the third-party complaint, and who had made the representations to the District Court in Aetrex's briefs appeared for Fitracks in the advancement proceeding. In September, the parties cross-moved for summary judgment on liability for advancements in the Underlying Action and indemnification in this proceeding.

Faced with the reality that their shock-and-awe strategy of suing Danenberg personally could require Fitracks to advance Danenberg's legal fees, the Aetrex/Fitracks lawyers heroically backpedaled. In briefing on the cross-motions, the Aetrex/Fitracks lawyers represented to this Court, contrary to their representations to the District Court, that they were not suing Danenberg for any pre-merger conduct. During the hearing on

the cross-motions, the Aetrex/Fitracks lawyers repeatedly confirmed this representation. They further stipulated that Aetrex would not rely on any pre-September 2, 2008 representations in the Underlying Action and that, to the extent that there was any such reliance, Aetrex would dismiss any claims based on pre-September 2, 2008 representations. These undertakings had obvious implications for the personal jurisdiction motion, where Aetrex relied on Danenberg's pre-merger and merger-related representations to obtain jurisdiction.

In reliance on counsel's representations, I concluded that Danenberg's claim for advancements was moot. I held that Danenberg was entitled to indemnification for the fees and expenses incurred in seeking advancements because, although he had not obtained the advancements themselves, he had succeeded on the merits in eliminating the litigation threat otherwise giving rise to advancements. I also indicated that once Danenberg obtained the resulting dismissal of pre-merger claims in the Underlying Action (and potentially a dismissal of all claims for lack of personal jurisdiction), he would have succeeded on the merits with respect to those aspects of the Underlying Action and could seek indemnification. I asked the parties to agree on a form of implementing order.

Despite counsel's representations, Aetrex took no action to amend the third-party complaint. When Danenberg brought the representations made in this proceeding to the attention of the District Court, Aetrex contended that the representations had no effect on the Underlying Action or on the motion to dismiss for lack of personal jurisdiction. The parties also proved unable to agree on a form of implementing order, and they returned

for a further hearing on December 14, 2011. At the conclusion of that hearing, I determined that Aetrex's conduct had muddied the waters sufficiently that I would need to issue this written ruling. To the extent this ruling conflicts in any respect with my earlier oral ruling, I have reconsidered those aspects of the prior ruling *sua sponte*.

II. LEGAL ANALYSIS

Summary judgment is appropriate when the record shows that "there is no genuine issue as to any material fact and that the moving party is entitled to a judgment as a matter of law." Ct. Ch. R. 56(c). Danenberg's entitlement to advancements for the Underlying Action turns on whether the allegations of the third-party complaint fall within the scope of the advancement right conferred on Danenberg under the Fitracks bylaws in effect while he served as CEO (the "Bylaws"). *See* 8 *Del. C.* § 145(f) & (j).

A. Danenberg Is Entitled To Advancements For The Underlying Action.

The Bylaws provided Fitracks' officers with the right to mandatory indemnification and advancements. Section 43(a) of the Bylaws provided that Fitracks "shall indemnify its directors and executive officers . . . to the fullest extent not prohibited by the Delaware General Corporation Law or any other applicable law . . . ." Pet'r's Opening Br. App. at A-318. Section 43(a) of the Bylaws further required that Fitracks

> advance to any person who was or is a party . . . to any . . . proceeding . . . by reason of the fact that he is or was a director or executive officer[] of the corporation . . . prior to the final disposition of the proceeding, promptly following request therefor, all expenses incurred by any director or executive officer in connection with such proceeding upon receipt of an undertaking by or on behalf of such person to

> repay said amounts if it should be determined ultimately that such person is not entitled to be indemnified under this Bylaw or otherwise.

Id. at A-319.

Under the Bylaws, the right to advancements turns on whether the individual was named as a defendant "by reason of the fact" that he was a Fitracks' officer. "[I]f there is a nexus or causal connection between any of the underlying proceedings . . . and one's official corporate capacity, those proceedings are 'by reason of the fact' that one was a corporate officer, without regard to one's motivation for engaging in that conduct." *Homestore, Inc. v. Tafeen*, 888 A.2d 204, 214 (Del. 2005). The requisite causal "'connection is established if the corporate powers were used or necessary for the commission of the alleged misconduct.'" *Zaman v. Amedeo Holdings, Inc.*, 2008 WL 2168397, at *17 (Del. Ch. May 23, 2008) (quoting *Bernstein v. Tractmanager, Inc.*, 2007 WL 4179088, at *5 (Del. Ch. Nov. 20, 2007)).

After the merger closed on June 16, 2008, Danenberg no longer held any corporate position at Fitracks. Danenberg's entitlement to advancements therefore depends on whether the third-party complaint sufficiently implicates his pre-closing conduct during the negotiations of the merger, when he was acting in a covered corporate capacity as Fitracks' CEO.

After initially reviewing the third-party complaint and Aetrex's representations to the District Court, I concluded preliminarily that Aetrex's claims related in significant part to representations made by Danenberg in his corporate capacity during the pre-merger negotiations. Although the Virtual Store License Agreement ultimately was

signed post-closing, and although there were some post-closing negotiations over its terms, I regarded these events as consequences of the core agreement to provide additional consideration to Danenberg and other Fitracks equity holders in the form of the Virtual Store Provision. The third-party complaint and Aetrex's related representations to the District Court appeared to recognize that the pivotal event for Aetrex's claims was the execution of the Merger Agreement containing the Virtual Store Provision. But for that agreement, there would have been no merger, no Virtual Store License Agreement, and no dispute.

In response to this powerful case for advancements, however, counsel to Fitracks and Aetrex represented that Aetrex would confine its claims in the Underlying Action to post-closing representations. Counsel went further and undertook that Aetrex would not rely on any events pre-dating September 2, 2008, when Just4Fit was formed. Counsel relied heavily on *Xu Hong Bin v. Heckmann Corp.*, in which this Court accepted a defendant's representation that its claims in an underlying proceeding related only to the plaintiff's post-merger conduct, which was not be covered by the plaintiff's advancement right, and deemed the representation sufficient to moot the plaintiff's advancement claim. *See Xu Hong Bin v. Heckmann Corp.*, 2010 WL 187018, at *2 (Del. Ch. Jan. 8, 2010).

In reliance on the repeated representations and undertakings made by counsel, I initially followed *Xu Hong Bin* and treated the advancement claim as moot. Upon further reflection, and after taking into account what occurred after the hearing, I can no longer accept those representations. Aetrex declined to amend the third-party complaint in the Underlying Action to remove any allegations based on pre-merger representations, and

Aetrex continued to rely on pre-merger conduct to establish jurisdiction over Danenberg in the Underlying Action. Most importantly, I no longer believe that it is possible at the advancement stage to parse finely between Danenberg's pre- and post-merger conduct.

Consistent with my preliminary inclinations, the claims in Aetrex's third-party complaint necessarily relate in significant part to representations made by Danenberg in his covered corporate capacity during the pre-merger negotiations. For purposes of advancements, the limited post-closing negotiations over the Virtual Store License Agreement represent a continuation of the pre-merger negotiations. Those discussions flowed out of the Virtual Store Provision, which was the critical agreement between Danenberg and Aetrex. Danenberg negotiated and obtained that provision in a covered corporate capacity as CEO of Fitracks. Aetrex confirmed the natural inferences from the third-party complaint by representing to the District Court that Danenberg made representations to Aetrex concerning the Virtual Stores "for years" and that Aetrex relied upon them in entering into the Merger Agreement. Aetrex cannot disavow its representations for the limited purpose of avoiding the advancement obligations it triggered by choosing to sue Danenberg personally.

Danenberg is therefore entitled to advancements for defending against the third-party complaint. The allegations regarding Danenberg's pre-merger conduct and their necessary implications underpin the third-party complaint to such a degree that Danenberg is entitled to advancements for 100% of his fees and expenses for defending against the Underlying Action. It is not possible at this stage to parse between pre- and post-merger representations or among causes of action such that a lesser allocation would

be appropriate. This ruling addresses advancements only. In any eventual dispute over ultimate indemnification, Fitracks is free to argue for an allocation and consequent recovery of advancements from Danenberg. *See Kaung v. Cole Nat'l Corp.*, 884 A.2d 500, 509 (Del. 2005) ("Whether a corporate officer has a right to indemnification is a decision that must necessarily await the outcome of the investigation or litigation.").

The granting of full advancements to Danenberg does not mean that all of counsel's fees and expenses must be paid by Fitracks. The same law firm represents other defendants who were named in the third-party complaint. Fitracks only must advance those fees and expenses that Danenberg's counsel would have incurred if Danenberg were the sole third-party defendant. If a particular defense or litigation activity benefits multiple third-party defendants, but Danenberg would have raised or undertaken it himself if he were the sole third-party defendant, then Fitracks must advance 100% of the related fees and expenses. By contrast, if a particular defense or litigation activity only partially benefits Danenberg, then counsel must make a good faith allocation of the amount of fees and expenses that Danenberg would have incurred if he were the sole third-party defendant. If a defense or litigation activity only benefits third-party defendants other than Danenberg, then obviously Fitracks need not advance the related fees and expenses.

B. Danenberg Is Entitled To Indemnification For This Action.

Danenberg has been successful on the merits in seeking advancements in this action. He therefore is entitled to indemnification for the fees and expenses incurred in this proceeding. *See* 8 *Del. C.* § 145(c).

C. Further Proceedings

This ruling addresses only liability for advancements and indemnification. It does not address the amounts. The parties shall confer regarding the fees and expenses that Danenberg has incurred to date and present any dispute promptly for the Court to resolve. The parties also shall confer about how to handle future advancement requests, including (i) time periods for submitting, reviewing, and responding to requests, (ii) a mechanism for paying undisputed amounts or providing for full payment subject to an escrow or claw-back, and (iii) procedures for periodically submitting disputes to the Court.

III. CONCLUSION

Summary judgment is granted for Danenberg for advancement of fees and expenses incurred in the Underlying Action and for indemnification of fees and expenses incurred in this proceeding. **IT IS SO ORDERED.**