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Re: *Smith v. Demeter Energy Corporation*
C.A. No. 6937-VCN
Date Submitted: February 16, 2012

Dear Counsel:

This is an advancement action. The Plaintiff has moved for summary judgment. The parties disagree about the corporation's bylaws. It is not a disagreement about their meaning; it is a disagreement about: what are the bylaws? The corporation takes the perplexing position of claiming that the Plaintiff does not have the right set of bylaws, but it is more complicated than that. The corporation does not know what its bylaws are.[1]

[1] At oral argument, the corporation, for the first time, claimed to posses what it believes to be the "true" bylaws. Pl.'s Mot. for Partial Summ. J. Hr'g Tr. ("Hr'g Tr.") 15. As this argument was not raised timely and a copy of these bylaws was not entered into the record, the Court will not consider this argument now. Indeed, at oral argument, counsel for the corporation disclaimed

Plaintiff Scott Smith ("Smith"), one of the founders of Defendant Demeter Energy Corporation ("Demeter"), served as its Chief Executive Officer and was a board member. Demeter has sued Smith for breach of fiduciary duty in California (the "California Action"); that, and other claims, arose out of his status as an officer and director of Demeter.

He seeks advancement from Demeter for the costs of defending that action and has presented two sets of bylaws that he claims were validly adopted. Both sets of bylaws call for advancement of legal expenses to the fullest extent permitted by law if those expenses are attributable to the fact that he was an officer and director of Demeter. The first set of bylaws, Smith alleges, was adopted by Demeter's sole incorporator, Robb Scott ("Scott") (the "Sole Incorporator Bylaws");[2] these bylaws provide for advancement in article 7.1. In his affidavit, Smith declares that the Action of Sole Incorporator of Demeter Energy Corporation (the "Action of Sole Incorporator") attached to the affidavit as Exhibit F and purporting to adopt the Sole Incorporator Bylaws is a "true and

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reliance on the newly found bylaws for purposes of the pending application. *Id.* at 16. No explanation was offered for why this "newly discovered" evidence—presumably within the corporation's control throughout—had not surfaced earlier.

[2] Smith Aff., Ex. F (Action of Sole Incorporator of Demeter Energy).

correct copy" of this document.[3] Furthermore, Scott testified in a deposition for the California Action that he adopted the Sole Incorporator Bylaws in the Action of Sole Incorporator.[4] Next, Smith alleges that Demeter's board of directors (the "Board") ratified the Sole Incorporator Bylaws in a unanimous written consent dated January 31, 2008 (the "Unanimous Written Consent") and that the bylaws ratified by and attached to the Unanimous Written Consent (the "Written Consent Bylaws") provide for advancement in article 7.1. In his affidavit, Smith declares that the Written Consent Bylaws attached to the affidavit as Exhibit A were adopted by the unanimous written consent of the Board.[5]

Demeter contends that the bylaws upon which Smith relies are not its bylaws. In his affidavit, Wendell Brown, a founding shareholder of Demeter and its Chairman at the time the Unanimous Written Consent was purportedly adopted, declares that, during his tenure as Chairman, the Board never approved the Written Consent Bylaws.[6] He also testifies that he did not sign, and did not authorize

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[3] Smith Aff. ¶ 7.
[4] Pl.'s Reply Br. in Supp. of His Mot. for Partial Summ. J., Ex. A 10-15.
[5] Smith Aff. ¶ 2. Smith also provides what he declares to be a "true and correct copy" of the Unanimous Written Consent in Exhibit H of his affidavit.
[6] Brown Aff. ¶ 5.

anyone else to sign, the Unanimous Written Consent; he states that his purported signature on that document appears to be a forgery.[7] Therefore, while Smith claims that the Written Consent Bylaws are valid bylaws adopted by the Board through the Unanimous Written Consent, Demeter presents testimony that the Written Consent Bylaws were not adopted by the Board and that the Unanimous Written Consent includes a forged signature. These conflicting assertions raise an issue of material fact regarding whether the Written Consent Bylaws were properly adopted by Demeter.

In contrast, Demeter does not raise an issue of material fact regarding the Sole Incorporator Bylaws. In the face of testimony from the sole incorporator and Smith attesting to the validity of the Sole Incorporator Bylaws, Demeter's only argument against their validity is that they are inconsistent with the Unanimous Written Consent.[8] Although article 2.2 of the Sole Incorporator Bylaws states that the number of directors shall initially be set at three, the Unanimous Written Consent states that the number of directors was initially set at one and it purports to

[7] *Id.* at ¶ 4.
[8] Hr'g Tr. 9-11.

change the number of directors from one to three.[9] Demeter's argument is largely undercut by the fact that it argued *against* the validity of the Unanimous Written Consent when making its argument that there is a material issue of fact with regard to the Written Consent Bylaws.[10] The Court concludes that Demeter does not raise an issue of material fact with regard to the Sole Incorporator Bylaws. Therefore, even if the Written Consent Bylaws were found to be invalid, article 7.1 of the Sole Incorporator Bylaws would still provide for advancement.

Smith has moved for summary judgment. The question to be resolved is whether, as a matter of undisputed material fact, the advancement provision of the Smith-sponsored bylaws is that of Demeter. If Smith is correct about the bylaws, it would appear that he would be entitled to summary judgment and to advancement of his defense costs.

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[9] Smith Aff., Ex. H (Unanimous Written Consent) 5. A possible explanation for this discrepancy is that a mistake or typographical error was made in the Unanimous Written Consent.

[10] Demeter Energy Corp.'s Answering Br. in Opp'n to Pl.'s Mot. for Partial Summ. J. 3; *see also* Hr'g Tr. 11-13 (arguing that the purported forged signature "casts doubt" on the Unanimous Written Consent). At oral argument, counsel for Demeter acknowledged this uncomfortable position, stating: "[F]rankly, from my point of view . . . I'd just as soon have [the Unanimous Written Consent] be valid . . . ." Hr'g Tr. 12-13.

Demeter is in the peculiar position of arguing that Smith has the wrong bylaws but Demeter has not produced its own bylaws. Why it has not done so, especially since it is supposedly in compliance with 8 *Del. C.* § 108, is curious. Although the background of the dispute does suggest some uncertainty, there is no dispute of material fact regarding the Sole Incorporator Bylaws. Nothing but the Unanimous Written Consent has been offered to support a repeal of the Sole Incorporator Bylaws, but, because both contain substantially the same indemnification rights, it does not matter which set of bylaws is applicable. Under either set, Smith is entitled to advancement. One may speculate about how this unusual set of circumstances evolved, but there is no factual dispute that materially casts doubt upon whether Demeter has in force a relatively standard indemnification provision.

For the foregoing reasons, Smith's motion for summary judgment as to his entitlement to advancement is granted.[11]

[11] Counsel are requested to confer in an effort to reach agreement on the amount of the litigation expenses which should be advanced to Smith. If agreement cannot be reached, counsel should discuss the appointment of a special master to resolve any such disputes.

IT IS SO ORDERED.

Very truly yours,

/s/ John W. Noble

JWN/cap
cc: Register in Chancery-K

Also, it should be emphasized that this matter is at the advancement stage. If it progresses to the indemnification stage, Demeter may choose to revisit the question of what set of bylaws controls.