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IN THE SUPREME COURT OF THE STATE OF DELAWARE

SHAWN EVANS, Plaintiff Below-Appellant/Cross-Appellee, v. AVANDE, INC., Defendant Below-Appellee/Cross-Appellant.	No. 208, 2023 APPEAL FROM THE COURT OF CHANCERY OF THE STATE OF DELAWARE, C.A. NO. 2018-0454-LWW

APPELLEE/CROSS-APPELLANT'S REPLY BRIEF ON CROSS-APPEAL

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I. UNDER THE CIRCUMSTANCES OF THIS ACTION, DELAWARE LAW DOES NOT REQUIRE AVANDE TO INDEMNIFY EVANS FOR EXPENSES PAID BY DC RISK.

In his Answering Brief on Cross-Appeal (cited as "Ans. Br."), Shawn Evans ("Evans") argues that the Court of Chancery correctly ordered Avande, Inc. ("Avande" or the "Company") to indemnify Evans for attorneys' fees and costs paid to counsel representing him in the action captioned *Avande, Inc. v. Evans, et al.*, C.A. No. 2018-0203-AGB (the "Plenary Action"), notwithstanding the fact that Evans did not fund a single cent of his defense. Instead, Evans' expenses were paid entirely by DC Risk Solutions, Inc. ("DC Risk"), another corporation owned by Evans which was found in the Plenary Action to have been the beneficiary (and aider and abettor) of Evans' breaches of loyalty while he was a director and officer of Avande. While the Plenary Action was pending, Evans willingly chose ***not*** to pursue advancement from Avande to fund his defense. At the same time, however, Evans did not self-fund his defense; instead, DC Risk paid his personal counsel's bills.

When the Plenary Action concluded, Evans had paid nothing out of his own pocket for his counsel's defense. There also was (and still is) no possibility that Evans will ***ever*** bear financial responsibility for his defense because DC Risk paid his counsel's fees and expenses without any promise or agreement that Evans would repay them. Nonetheless, Evans pursued this action demanding that Avande, under

the guise of his indemnification rights as a former director and officer of the Company, "reimburse" him for defense costs that he did not pay himself. While indemnification is intended to protect an indemnitee from "loss," it is undeniable that Evans' defense in the Plenary Action caused him to suffer no such losses.

Ultimately, the Court of Chancery denied Evans' claim for indemnification in large part, holding that Evans successfully defended only two causes of action for which Delaware law and Avande's Bylaws mandated the Company to indemnify him. However, the court below then ordered Avande to pay indemnification to Evans for 20% of the sum paid by DC Risk to Evans' counsel for defending the Plenary Action.

In support of this ruling, Evans offers two arguments. First, Evans suggests that, because he is the sole stockholder of DC Risk, the Court should disregard decades of bedrock Delaware law upholding the separate identities of corporations and their owners and treat DC Risk's loss as Evans' personal (and thus indemnifiable) loss. Second, Evans – like the Court of Chancery in its ruling below – attempts to analyze issues of ***indemnification*** under principles of ***advancement*** that are legally and factually distinguishable. As explained below, neither argument justifies affirming the Court of Chancery's holding.

A. Evans Did Not Personally Suffer An Indemnifiable Out-Of-Pocket Loss.

As a preliminary matter, Evans' Answering Brief misconstrues Avande's argument. Avande does not dispute and has never disputed that Evans owns 100% of DC Risk's stock – this is a fact of record in both the Plenary Action and this action. *See, e.g.*, B0935; B1192. At the same time, however, Avande has never sought to pierce the corporate veil between Evans and DC Risk or claimed that DC Risk is not "separate and distinct" from Evans. Ans. Br. at 25. Rather, Avande alleged in the Plenary Action – and the Court of Chancery held after trial in that action – that transactions between Avande and DC Risk were self-interested and subject to entire fairness review due to Evans' ownership of DC Risk. *See* B1208-B1209. Avande also alleged in the Plenary Action – and the Court of Chancery also held after trial in that action– that DC Risk, as the beneficiary of the self-interested transactions, aided and abetted Evans' breaches of fiduciary duty. *See* B1210. Therefore, Avande's argument that DC Risk's payments to Evans' counsel did not result in an indemnifiable out-of-pocket loss to Evans is entirely consistent with, and is not contrary to, Avande's "own theory of the case." Ans. Br. at 25.[1]

[1] Even if Evans' position had any merit, he never argued in the proceeding below that Avande should be estopped from claiming that DC Risk is "separate and distinct" from Evans and, accordingly, the issue is not properly before the Court on appeal. *See* Supr. Ct. R. 8.

More importantly, Evans' claim that payments made by DC Risk should be attributed to him personally flies in the face of foundational Delaware corporate law. Evans suggests that when ***DC Risk*** paid his counsel for fees and expenses incurred to defend Evans as a defendant in the Plenary Action, he "suffered the loss" ***individually*** based on nothing more than Evans' status as DC Risk's 100% stockholder. Ans. Br. at 26. However, as Avande noted in its Opening Brief – and Evans cannot refute – it is a "fundamental principle of Delaware law that a corporation is an entity … with an identity ***separate*** from its stockholders." *Manti Holdings, LLC v. Authentix Acquisition Co., Inc.*, 261 A.3d 1199, 1213 (Del. 2021) (emphasis in original). *See also Orzeck v. Englehart*, 195 A.2d 375, 377 (Del. 1963) (holding that acquirer of corporation's shares "has the status of a stockholder of the corporation whose shares it has purchased and nothing more" and rejecting argument that "corporate identities merge by reason solely of the purchase by one of all of the other's stock"); *Bird v. Wilmington Soc. of Fine Arts*, 43 A.2d 476, 483 (Del. 1945) ("Few principles of corporation law are clearer than that, as a general rule, a corporation is an entity distinct from its stockholders.").

While he does not label his argument as such, Evans essentially is seeking to pierce the corporate veil between himself and DC Risk in reverse by claiming that DC Risk's payments satisfied his personal debt. *See Manichaean Capital, LLC v. Exela Techs., Inc.*, 251 A.3d 694, 710 (Del. Ch. 2021) ("At its most basic level,

reverse veil-piercing involves the imposition of liability on a business organization for the liabilities of its owners."). Reverse veil-piercing is an exception to the general rule "that a corporation's assets are owned by the corporation, which is considered by state law to be a legal entity distinct from its shareholders." *Spring Real Estate, LLC v. Echo/RT Holdings, LLC*, 2016 WL 769586, at *3 (Del. Ch. Feb. 18, 2016). Under this theory, "the Court may treat the assets of the subsidiary as those of the parent" when "the subsidiary is a mere alter ego of the parent." *Id.* Taken to its logical conclusion, Evans' argument would permit his counsel to enforce his personal debt against DC Risk, as Evans' alter ego, if Evans failed to pay it – in such a circumstance, however, Evans surely would claim that he is legally separate and distinct from his wholly owned corporation.

Ultimately, any attempt by Evans to pierce the corporate veil fails because there is no record evidence suggesting, let alone proving, that Evans and DC Risk "operate[] as a single economic entity such that it would be inequitable … to uphold a legal distinction between them." *Manichaean Capital*, 251 A.2d at 707 (internal quotations omitted). "The natural starting place when reviewing a claim for reverse veil-piercing are the traditional factors Delaware courts consider when reviewing a traditional veil-piercing claim – the so-called 'alter ego' factors that include insolvency, undercapitalization, commingling of corporate and personal funds, the absence of corporate formalities, and whether the subsidiary is simply a facade for

the owner." *Id.* at 714. The Court of Chancery never considered these factors in granting Evans indemnification for payments made by DC Risk, and Evans never asked the court below to do so. Accordingly, Evans' argument that he "expressly did ***not*** have his expenses paid by another, because he owns DC Risk," Ans. Br. at 31 (emphasis in original), has no basis under Delaware law.

The Court of Chancery did, however, consider the representation from Evans' counsel that DC Risk was "a pass-through entity for tax purposes" in concluding that DC Risk's payments resulted in an indemnifiable loss to Evans. *See* Appellee/Cross-Appellant's Combined Ans. Br. on Appeal & Op. Br. on Cross-Appeal, Ex. B, at 14. However, the record contains no evidence from which the Court of Chancery could find that DC Risk was, indeed, a pass-through entity whose income and expenses should be attributed to Evans. Contrary to Evans' suggestion, his 100% ownership of DC Risk's stock does not by itself make DC Risk a pass-through entity; under federal law, a corporation with fewer than 100 individual shareholders must elect for S corporation treatment to be taxed as a pass-through entity. *See* 26 U.S.C. §§ 1361, 1363. There is nothing in the record, however, indicating whether DC Risk has been designated as an S corporation or for which years. This is because Evans ***never*** asserted that DC Risk is a pass-through entity until the final post-trial damages argument in this action – even though Avande has always denied its obligation to indemnify Evans for funds paid by third parties (*see, e.g.*, B0353; B0642-B0643) –

and thereby prevented Avande from seeking discovery on DC Risk's tax treatment. *See* B2272. Evans does not and cannot claim that there is any record evidence proving that Evans claimed DC Risk as an S corporation on his personal tax returns.

This is not merely an academic issue. If DC Risk paid dividends or distributions to Evans as its sole stockholder, and Evans used those funds to pay his counsel's fees and expenses, then Evans personally would have suffered an out-of-pocket loss (and would have paid personal income tax on the distributions). The evidence, however, shows that every dollar paid to Evans' counsel came directly from DC Risk. If DC Risk is a C corporation, then it would have deducted these payments as expenses and paid corporate taxes on the remaining income. Any dividends then paid to Evans from DC Risk would be taxed again as Evans' personal income. If DC Risk is an S corporation as Evans claims, then Evans potentially would recognize DC Risk's net income (less expenses paid to his counsel) as personal income. *See* 26 U.S.C. § 1366. This, however, does not mean that counsel fees paid by DC Risk result in an equal dollar-for-dollar "loss" to Evans, since the actual income passed through to an S corporation's stockholder is subject to various qualifications and adjustments. *See id.*

In short, whether DC Risk was a pass-through entity, and the possible implications of that status on Evans' entitlement to indemnification from Avande, presents fact-intensive inquiries that required discovery into, at a minimum, tax

returns filed by Evans and DC Risk. The Court of Chancery, however, could not consider any evidence pertinent to this issue because Evans did not raise it until the eleventh hour, after discovery had concluded and trial was heard. Since the Court of Chancery's finding that DC Risk was a pass-through entity was not "supported by the record and logically derived," *Norton v. Norton*, 672 A.2d 53, 55 (Del. 1996), the attendant holding that funds paid by DC Risk to Evans' counsel resulted in an indemnifiable loss to Evans was reversible error.

B. Principles Favoring Advancement Do Not Justify Indemnification In This Case.

The General Corporation Law and Avande's Bylaws both make clear, by using identical language, that Evans, to the extent he successfully defended covered claims in the Plenary Action, is entitled to mandatory indemnification only for "expenses (including attorneys' fees) ***actually*** and reasonably incurred by ***such person*** in connection therewith." 8 *Del. C.* § 145(c)(1) (emphasis added); B0920 (emphasis added). Additionally, the Bylaws provide unequivocally that "the Company shall not be obligated to indemnify any person … in connection with any Proceeding (or any part of any Proceeding) … ***for which payment has actually been made to or on behalf of such person under any statute, insurance policy, indemnity provision, vote or otherwise***." B0920 (emphasis added).

It is equally clear from the record evidence that Evans – the covered "person" referenced in Section 145(c) and the Bylaws – did not "actually" pay a single dime

to his counsel who represented him in the Plenary Action, and Evans does not claim otherwise. Despite this, Evans sought (and the Court of Chancery granted) an indemnification award from Avande paying ***him*** for funds paid to his counsel by ***DC Risk***. The Court of Chancery's ruling, however, expands Avande's indemnification obligations beyond the limits set by statute and the Company's Bylaws.

Like the Court of Chancery did in its holding below, Evans posits that this award – even if it does not comport with the plain meaning of the words used in Section 145(c) and Avande's Bylaws – is consistent with the principles upon which Delaware's statutory indemnification is based and the case law applying those principles. None of the case law cited by Evans and the court below, however, compels the relief granted to Evans here – an award of indemnification to an individual who secured representation by counsel to defend him in a proceeding through that proceeding's conclusion, but did so at no cost to himself. Rather, this result advances none of the policy goals Delaware's corporate indemnification law is designed to promote.

As this Court has recognized, "[t]he 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." *Stifel Fin. Corp. v. Cochran*, 809 A.2d 555, 561 (Del. 2002) (internal

quotations omitted). *See also Homestore, Inc. v. Tafeen*, 888 A.2d 204, 211 (Del. 2005) ("Indemnification encourages corporate service by capable individuals by protecting their personal financial resources from depletion by the expenses they incur during an investigation or litigation that results by reason of that service."). "The right to indemnification cannot be established, however, until after the defense to legal proceedings has been 'successful on the merits or otherwise.'" *Id.* (quoting 8 *Del. C.* § 145(c)).

By contrast, advancement is intended to "provide[] corporate officials with ***immediate*** interim relief from the personal out-of-pocket financial burden of paying the significant on-going expenses inevitably involved with investigations and legal proceedings." *Id.* (emphasis added). Thus, when covered proceedings are brought against directors and officers, advancement serves to encourage them "to defend suits they consider unjustified without the worry of how to fund their defense." *Weaver v. ZeniMax Media Inc.*, 2004 WL 243163, at *7 (Del. Ch. Jan. 30, 2004). To promote this goal, Section 145(e) allows officers and directors to bring summary proceedings to secure advancement expeditiously, so that their ability to defend themselves against a covered proceeding will not suffer from a lack of available funds to pay counsel. *See Tafeen v. Homestore, Inc.*, 2005 WL 1314782, at *3 (Del. Ch. May 26, 2005) ("The Court of Chancery has been empowered to treat advancement rights as summary in nature because the immediate advancement of

fees fulfills a real and legitimate need of those who serve as directors and officers of Delaware corporations when faced with the significant costs of defending legal actions against them."), *aff'd*, 886 A.2d 502 (Del. 2005); *DeLucca v. KKAT Mgmt., L.L.C.*, 2006 WL 224058, at *9 (Del. Ch. Jan. 23, 2006) (warning against "encourag[ing] indemnitors to use the leverage of denial of advancement to deprive indemnitees of appropriate legal advice, putting them under pressure to settle disputes not because of the merits, but because of doubts whether they could obtain competent defense counsel"). Indeed, "to be of any value to the executive or director, advancement must be made promptly" during the pendency of a covered proceeding, "otherwise its benefit is forever lost because the failure to advance fees affects the counsel the director may choose and litigation strategy that the executive or director will be able to afford." *Tafeen*, 2005 WL 1314782, at *3.

Thus, "[a]lthough the right to indemnification and advancement are correlative, they are separate and distinct legal actions," each designed to address a different concern. *Homestore*, 888 A.2d at 212. While advancement is intended to ensure that a covered person can obtain and pay for counsel to defend against a covered proceeding while it is pending, indemnification allows covered persons (after the proceeding has concluded) to recoup personal funds they spent to defend themselves. This distinction can be seen in the case law examined by the Court of Chancery in its ruling below and cited by Evans in his Answering Brief.

For example, the Court of Chancery's holding in *Levy v. HLI Operating Co., Inc.*, 924 A.2d 210 (Del. Ch. 2007), is not as narrow as Evans suggests. Applying Section 145(c)'s limitation of mandatory indemnification to expenses "actually incurred" by a covered person, the *Levy* court recognized that "[w]hen a purported indemnitee has all of his indemnifiable expenses paid in full and cannot show an out-of-pocket loss, he has no claim for indemnification under section 145." *Id.* at 222. The court then denied directors' claim for indemnification against the corporation on whose board they sat because a third party had funded their liability for a settlement pursuant to a separate indemnification contract. *See id.* at 223-24. The ruling in *Levy* turned not on whether a third party was obligated by contract to indemnify the directors, but on whether the directors suffered an out-of-pocket loss as Section 145(c) requires. Put differently, if the third-party co-indemnitor in *Levy* had breached its contract and the directors had self-funded the settlement, the directors would have suffered a loss and could have pursued indemnification claims against the corporation and the co-indemnitor, each of whom would have contribution rights against the other. *See id.*

Sodano v. Am. Stock Exchange LLC, 2008 WL 2738583 (Del. Ch. July 15, 2008), was an advancement ruling that did not consider the question posed here – *i.e.*, whether a director or officer suffered an indemnifiable out-of-pocket loss. The language from *Sodano* quoted by the Court of Chancery in its ruling – "[o]ther cases

… indicate that a company's advancement or ultimate indemnification obligation is not reduced merely because a volunteer advances or indemnifies the relevant expenses," *id.* at *16 – is *dicta*. The *Sodano* court did not address whether corporations must indemnify expenses that were paid by a third party, but rather whether corporations, as "primary indemnitors," could avoid advancement obligations "by refusing to pay … and thereby shifting liability to [a] secondary indemnitor." *Id.* Unlike Evans, the plaintiff in *Sodano* was not seeking reimbursement of expenses that already had been paid by a third party.

Schoon v. Troy Corp., 948 A.2d 1157 (Del. Ch. 2008), is another advancement opinion which distinguished *Levy* on facts that are not present here. The *Schoon* court found that, "this is not a case, as in *Levy*, in which [plaintiff] 'has not and will not sustain any actual out-of-pocket loss.'" *Id.* at 1175 (quoting *Levy*, 924 A.2d at 222). This was because the plaintiff in *Schoon* "has no assurance that [the third party] will continue advancing his costs and is obligated to repay those amounts to the extent he recovers them from [the corporation]." *Id.* In this action, however, Evans admits that there is no contract with DC Risk requiring him to repay the funds DC Risk paid to his personal counsel to defend the Plenary Action. Therefore, unlike the plaintiff in *Schoon*, Evans faces no threat of suffering an out-of-pocket loss.

In its ruling below, the Court of Chancery found *Creel v. Ecolab, Inc.*, 2018 WL 5733382 (Del. Ch. Oct. 31, 2018), particularly persuasive. However, while the

defendant in that case "[did] not provide any justification why Delaware policy should not prevent a corporation from shirking its indemnification obligation when a third party advances payment without a pre-existing obligation, when that same policy prevents corporations from shirking their advancement obligations," the *Creel* court ultimately had no occasion to decide the issue. *Id.* at *8. Additionally, even if *Creel* was not *dicta*, the plaintiff there – as in *Schoon* – was "obligated to repay" the third party volunteer. *See id.*

That is not true here, where DC Risk did, in fact, pay Evans' expenses through the conclusion of the Plenary Action and Evans admittedly has no obligation to repay DC Risk. Additionally, since DC Risk fully funded Evans' defense in the Plenary Action, the policy concerns cited in case law upholding advancement when expenses are fronted by a third party are not implicated. Rather, when 8 *Del. C.* § 145(c) expressly limits mandatory indemnification to expenses actually incurred by the indemnitee, and Evans personally has not suffered (and will not suffer) an out-of-pocket loss from defending the Plenary Action, affirming the Court of Chancery's ruling will result in an unjustified windfall to Evans.

CONCLUSION

For the foregoing reasons, and for the reasons stated in its Opening Brief on Cross-Appeal, Avande respectfully requests that this Court: (i) reverse the Court of Chancery's holding that Avande is obligated to indemnify expenses paid by DC Risk, rather than by Evans; and (ii) vacate the Court of Chancery's Final Order and Judgment awarding Evans payment of indemnification, pre-judgment interest, and "fees-on-fees" from Avande.

Dated: October 9, 2023

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CERTIFICATE OF SERVICE

The undersigned hereby certifies that on October 9, 2023, true and correct copies of the foregoing were served upon the following counsel of record via File & ServeXpress:

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