SETH W. HAMOT, et al. **Plaintiffs/Counter-Defendants**	*	**IN THE**
	*	**CIRCUIT COURT**
v.	*	**FOR BALTIMORE CITY**
TELOS CORPORATION **Defendant/Counterclaimant**	*	**CASE NO.: 24-C-07-005603**

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ORDER DENYING MOTION FOR RECONSIDERATION

Plaintiffs/counter-defendants are directors of defendant/counterclaimant Telos Corporation. Plaintiffs filed a motion seeking an order requiring Telos to advance to them reimbursement of legal fees and expenses that they incurred in connection with their defense against the counterclaim filed by Telos in this case. On November 3, 2011, the court denied the motion and filed a Memorandum setting forth the reasons for the denial. Thereafter, plaintiffs filed a Motion for Reconsideration of the Court's Order Denying Plaintiffs/Counter-Defendants' Motion for Advancement of Legal Fees and Expenses. Defendant filed an Opposition and plaintiffs filed a Reply. A hearing was held on March 2, 2012.

In the decision that is the subject of the request for reconsideration, the court concluded that plaintiffs were not entitled to an order for advancement because they could not affirm in good faith that the standard of conduct necessary for indemnification of legal expenses by the corporation had been met, as required by Md. Ann. Code, Corporations & Associations Article § 2-418(f). This reasoning was based upon the fact that the expenses for which plaintiffs sought advancement were expenses incurred in connection with the proceedings upon Telos' motion for preliminary injunction, proceedings which resulted in an order by Judge Albert Matricciani that was contrary to plaintiffs' position and which determined that plaintiffs' conduct warranted the issuance of a preliminary injunction against them. The request for advancement was not made until after the issuance of that order.

Plaintiffs make two arguments in their Motion for Reconsideration. The first is that in denying the request for advancement the court erroneously relied upon the conclusions reached by Judge Matricciani in connection with Telos' request for a preliminary injunction. The second is that the court failed to give proper deference to the plaintiffs' affirmations that they met the relevant standard of conduct for advancement. The court will consider these contentions in inverse order.

Plaintiffs argue that the court could not disregard their affirmation of good faith. As the court previously stated in the Memorandum, an interpretation of the statute that precluded a challenge to a director's profession of good faith under any and all circumstances would be an unreasonable construction because it would render the requirement of a good faith affirmation meaningless. Plaintiffs seek to invert this logic, stating that if "the Court is correct that Maryland law requires that a party seeking advancement prove that the allegations contained in a complaint are false rather than simply provide a good faith affirmation, the requirement of a written undertaking to repay the amount of any indemnification would be unnecessary." This statement sets up a false dichotomy in which the two alternatives are an impermeable good faith affirmation, on the one hand, and a requirement that the directors prove that the allegations in the complaint are false, on the other. Holding that an affirmation of good faith may be impeached does not require that directors "prove" that the allegations of a complaint are false. The court explicitly cautioned against an overly rigorous scrutiny of the basis for the directors' affirmation, and made clear that the finding of lack of good faith was based on the unique procedural setting of this motion.

The court also notes that, as Telos points out, its holding is supported by additional authority, not cited in the previous Memorandum, that supports the conclusion that an affirmation of good faith is open to examination by a court.[1] *See* Official Comment to Model Business Corporation Act § 8.54: "If the corporation has contracted to indemnify a director to the fullest extent permitted by law, a court may, nevertheless, deny an advance for expenses if it determines that the director did not have, at the time he delivered the affirmation required by section 8.53(a)(1), a good faith belief that he met the relevant standard of conduct." Model Business Corporation Act, Official Comment to § 8.54 (8-116).

Plaintiffs rely heavily upon *Miller v. United States Foodservice, Inc.*, 405 F. Supp. 2d 607 (D. Md. 2005), and particularly on a passage in a footnote in which that court stated:

> Thus, the requirement in § 2-418(e)(1) for a determination that the director "has met the standard of conduct set forth in subsection (b)" is initially satisfied simply by a determination that it has not yet been "proved" that the director's conduct fell within any of the three exceptions. *See* James J. Hanks, Jr. & Larry P. Scriggins, *Let Stockholders Decide: The Origins of the Maryland Director and Officer Liability Statute of 1988*, 18 U. Balt. L. Rev, 235, 249 (1989). In this case, Royal Ahold and USF have countersued, claiming that Miller violated the fiduciary duties of due care, good faith, and loyalty and, as a result, USF should not be required to reimburse Miller's legal fees. However, because these claims have not yet been "established" -- they are merely allegations -- the statute does not foreclose USF's obligation to reimburse Miller for his legal fees.

405 F. Supp.2d at 618 n. 8. The passage that plaintiffs cite does not refer to section 2-418(f), the section of the statute that specifically governs advancement, although the *Miller* court did go on to cite the requirement of a good faith affirmation. It does not appear that the court was ever asked to

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[1] In the Memorandum, the court cited J. Hanks, Maryland Corporation Law § 6.21[h] as authority for its construction of the statute.

consider the issue of whether an affirmation of good faith may be challenged; indeed, the court's holding was primarily concerned with whether the parties' agreement authorizing advancement, which had no conditions, was inconsistent with Delaware law. In any event, to the extent that *Miller* could be read to suggest that an affirmation of good faith may never be questioned, this court disagrees, for the reasons discussed in the previous Memorandum and in this order.

In short, the court is convinced that it correctly held that the mere fact that directors provide a good faith affirmation that they met the relevant standard of conduct does not insulate that affirmation from all inquiry into whether their belief is actually held in good faith. There remains the question of whether the court properly relied on the preliminary injunction findings in holding that plaintiffs' affirmations of good faith belief were ineffective in this case.

The primary argument advanced by plaintiffs is that the court erroneously relied upon the preliminary injunction order because those proceedings were limited in scope to the "distinct issues" involved in the preliminary injunction, which were "entirely different from the issues presented in the Motion for Advancement." Plaintiffs note that a preliminary injunction is not a final adjudication. They state that the preliminary injunction proceedings should not be relied on because they were "outdated and moot." They quote language from the opinion of the Court of Special Appeals, in which it dismissed plaintiffs' appeal from the preliminary injunction due to mootness, to the effect that the proceedings before this court bear the marks of haste characteristic of a request for preliminary injunction, and suggest that this language reflects a weakness in Judge Matricciani's findings that should prevent their use to support this court's conclusions on the motion for advancement.

Plaintiffs' arguments miss the mark because they fail to take into account the unique procedural setting of this case. The conceptual basis for advancement contemplates that it will precede a decision on the claims that are the subject of the request for advancement. *See, e.g.*, Official Comment to Model Business Corporation Act § 8.53. "Section 8.53 recognizes an important difference between indemnification and an advance for expenses: *indemnification is retrospective and, therefore, enables the persons determining whether to indemnify to do so on the basis of known facts, including the outcome of the proceeding. Advance for expenses is necessarily prospective* and the individuals making the decision whether to advance expenses generally have fewer known facts on which to base their decision." Model Business Corporation Act, Official Comment to § 8.53. (8-110 to 8-111)(emphasis added).

In this case, the subject of the request for advancement was the preliminary injunction proceeding. The outcome of that proceeding was known at the time that plaintiffs made their request for advancement and at the time that they made their affirmations of good faith. Plaintiffs, however, want the court to pretend that the outcome of the proceeding is not known and to assess their good faith wholly without reference to that outcome. Moreover, plaintiffs want the court to disregard specific factual findings on the very conduct that is the subject of the affirmations of good faith, in favor of their *post hoc* conclusory allegations of good faith.

In the particular and unusual procedural setting of this motion for advancement, the court believes that it is appropriate to assess the affirmation of good faith against the known outcome of the proceeding. While Judge Matricciani's ruling was not a decision on the merits of the entire litigation, it did resolve the merits of the preliminary injunction, which is the proceeding for which plaintiffs seek fees. The issues that he resolved were not "distinct" from the issues posed by the motion for advancement, because the adjudication of those issues is the very proceeding for which plaintiffs seek fees. If plaintiffs' good faith is to be tested by any standard external to their own profession of their belief, it seems logical to employ that adjudication as the standard.

Judge Matricciani's findings, quoted at length in the previous Memorandum, are inconsistent with a good faith belief on the part of plaintiffs in the legality of their conduct. Plaintiffs do not point to any fact that would relevant to the determination of advancement that contradicts his conclusions, despite their repeated characterization of the preliminary injunction proceedings as limited in scope. Plaintiffs have not cited any fact that the court should consider as bearing upon good faith that was not before Judge Matricciani at the time he made his decision on the preliminary injunction.

The fact that the preliminary injunction has ceased to have any continuing effect due to mootness does not affect the reasons for this court's conclusions on advancement; the decision has not been overturned. Plaintiffs also quote the statement in the opinion of the Court of Special Appeals to the effect that the proceedings in this court before Judge Matricciani bear "marks of haste" that made it inappropriate to decide the merits of the appeal notwithstanding the fact that the case was moot. *Hamot v. Telos Corp.*, 185 Md. App. 352, 362 (2009). Without some indication of how this haste undermines Judge Matricciani's determination, there is no apparent reason to disregard that determination in order to require the "advancement" of fees for the litigation that led to it.

For these reasons, it is this 21st day of May, 2012,

ORDERED that the Motion for Reconsideration of the Court's Order Denying Plaintiffs/Counter-Defendants' Motion for Advancement of Legal Fees and Expenses (No. 101) be and hereby is DENIED.

Judge W. Michel Pierson