CHAPTER 16

Director and Officer Indemnification and Advancement Rights

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§ 16.1 INTRODUCTION

This chapter summarizes significant legislative and case law developments in 2020 concerning the indemnification of directors, officers, employees and agents by the corporations or other entities they serve, as well as the rights of such persons to the advancement of litigation expenses before final resolution of the litigation.[1] This chapter also refers to legislative developments under Delaware law and the Model Business Corporation Act.

§ 16.2 INDEMNIFICATION AND ADVANCEMENT – 8 DEL. C. § 145

The Delaware General Corporation Law ("DGCL"),[2] codified at 8 *Del. C.* § 145, authorizes (and at times requires) a corporation to indemnify its directors, officers, employees, and agents for certain claims brought against them. Section 145 also allows a corporation to advance funds to those persons for expenses incurred while defending such claims. Specifically, Sections 145(a) and (b) broadly authorize a Delaware corporation to indemnify its current and former corporate officials for expenses incurred in legal proceedings to which a person is a party "by reason of the fact that the person is or was a director, officer, employee or agent of the corporation, or is or was serving at the request of the corporation as a director, officer, employee or agent of another corporation, partnership, joint venture, trust or other enterprise." Upon successfully defending against a legal proceeding brought "by reason of the fact" that the person is or was a director or officer of the corporation, § 145(c) requires the corporation to indemnify that person for expenses (including attorneys' fees) reasonably incurred in connection with the defense. "For indemnification with respect to any act or omission occurring after December 31, 2020, references to 'officer' for purposes of" § 145(c) "shall mean only a person who at the time of such act or omission is deemed to have consented to service by the delivery of process to the registered agent of the corporation." With respect to persons "not a present or former director or officer of the corporation," the corporation "may indemnify" them "against expenses (including attorneys' fees) actually and reasonably incurred . . . to the extent he or she has been successful on the merits . . . ."

[1] The views reflected herein are those of the author(s) and may not reflect those of any law firm or its clients.
[2] The DGCL is found in Title 8 of the Delaware Code.

Pursuant to § 145(e) the corporation also may advance "expenses (including attorneys' fees)" incurred by a corporate official to defend against an investigation or lawsuit prior to final disposition.

The Model Business Corporation Act (MBCA) contains similar provisions, as do alternative entity statutes of Delaware and many other jurisdictions. For example, 6 *Del. C.* § 18-108 provides that "[s]ubject to such standards and restrictions, if any, as are set forth in its limited liability company agreement, a limited liability company may, and shall have the power to, indemnify and hold harmless any member or manager or other person from and against any and all claims and demands whatsoever." Similarly, Delaware's Revised Uniform Limited Partnership Act states "[s]ubject to such standards and restrictions, if any, as are set forth in its partnership agreement, a limited partnership may, and shall have the power to indemnify and hold harmless any partner or other person from and against any and all claims and demands whatsoever." 6 *Del. C.* § 17-108. Thus, limited liability companies and partnerships have a "wider freedom of contract to craft their own indemnification" and advancement schemes "than is available to corporations under § 145 of the DGCL." *Weil v. Vereit Operating P'ship, L.P.*, C.A. No. 2017-0613-JTL, 2018 Del. Ch. LEXIS 48, *9-10 (Del. Ch. Feb. 13, 2018) (unpublished). As a result, prospective and current partners, members, and managers of alternative entities should pay close attention to advancement and indemnification rights granted by operating and/or partnership agreements and react accordingly.

Not only are officers and directors often entitled to advancement and indemnification under the codified provisions of Delaware law and the MBCA, but many corporations provide their officers with additional rights to advancement and indemnification. These provisions are often set forth in company charters and bylaws or included in agreements between companies and their officers, directors, and employees. These provisions can, and often do, make indemnification and advancement mandatory under circumstances specifically stated in the agreements.

§ 16.2.1 Legislative Developments

The Delaware General Assembly made several revisions to 8 Del. C. § 145 during 2020, effective July 16, 2020. Providing greater clarity to who qualifies as an "officer" entitled to mandatory indemnification, the General Assembly amended § 145(c) as follows (amendments in italics):

> **(c)**
>
> **(1)** To the extent that a present or former director or officer of a corporation 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, such person shall be indemnified against expenses (including attorneys' fees) actually and reasonably incurred by such person in connection therewith. *For indemnification with respect to any act or omission occurring after December 31, 2020,*

> *references to "officer" for purposes of this paragraphs (c)(1) and (2) of this section shall mean only a person who at the time of such act or omission is deemed to have consented to service by the delivery of process to the registered agent of the corporation pursuant to § 3114(b) of Title 10 (for purposes of this sentence only, treating residents of this State as if they were nonresidents to apply § 3114(b) of Title 10 to this sentence).*
>
> ***(2)** The corporation may indemnify any other person who is not a present or former director or officer of the corporation against expenses (including attorneys' fees) actually and reasonably incurred by such person to the extent he or she 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.*

Additionally, the General Assembly made a small revision to § 145(f). Although § 145(f) previously stated that the right to indemnification could not be eliminated after the fact by an amendment to a certificate of incorporation or bylaw, the revised § 145(f) went further to state that the right to indemnification could not be eliminated after an occurrence by repeal or elimination of the certificate of incorporation or bylaw.

The American Bar Association did not make any changes to the indemnification and advancement provisions of the MBCA during 2020.

§ 16.2.2 Case Law Developments

§ 16.2.2.1 Brick v. Retrofit Source, LLC[3]

Brick v. Retrofit Source, LLC presented an interesting question regarding advancement of legal fees from two related limited liability companies. The requesting party, Nathan Brick, had served as the Chief Operating Officer of The Retro Source, LLC ("Opco"), which was wholly owned by TRS Holdco, LLC ("Holdco"). In addition to serving as COO of Opco, Brick also served as a member of the board of TRS Holdco, LLC ("Holdco"). Both companies were Delaware LLCs (the "Companies"). Holdco owned membership interests in Opco and managed Opco. The question presented was ultimately whether Brick was entitled to advancement and indemnification as a member of the Holdco board when his challenged conduct was on behalf of Opco.

The dispute between Brick and the Companies arose after Opco's Vice President of Finance discovered that Opco had been underpaying Customs duties for years pursuant to a "double-invoicing" scheme. Although certain parties, including Brick, contested who was responsible for the scheme, there was no dispute that Brick played some role in it. Opco voluntarily disclosed to U.S. Customs that Opco suspected it had been underpaying Customs duties, and Opco engaged counsel to conduct an investigation. Counsel conducted an audit of

[3] C.A. No. 2020-0254, 2020 Del. Ch. LEXIS 266 (Del. Ch. Aug. 18, 2020).

Opco's customs policies and issued a report to U.S. Customs and Border Protection. According to Brick, this exposed him and others to civil and criminal liability.

During the course of the dispute, the Holdco Board ultimately decided to terminate Brick's employment, with one Board member claiming that Brick had mislead them. Brick refused to sign a separation agreement, and instead resigned all of his positions with Holdco and Opco. He then retained counsel to represent him against claims made by Opco and in proceedings involving U.S. Customs and Board Protection. When Holdco and Opco rejected Brick's claim to advancement and indemnification, Brick filed suit.

At the outset, the court recognized that "the stated policy of the Delaware LLC Act is 'to give the maximum effect to the principle of freedom of contract and to the enforceability of limited liability company agreements.' 'When interpreting advancement and indemnification provisions in a limited liability company agreement, a Delaware court will follow ordinary contract interpretation principles.'" Thus, where clear and unambiguous, courts honor the intent of the parties. Nevertheless, "the LLC Act is 'less paternalistic' than the corporate code in that it 'defers completely to the contracting parties to create and limit rights and obligations with respect to indemnification and advancement.'"

Based on Delaware law, the court analyzed the Holdco LLC Agreement. Based on the language of the agreement, "indemnification for officers [was] discretionary and indemnification for Holdco Board members [was] mandatory." The Holdco Board had previously decided to deny Brick advancement in his capacity as COO of Opco, that the court determined Brick was not a covered person under the Agreement. Additionally, although Brick was a member of the Holdco Board, the Companies had submitted detailed evidence demonstrating that Brick's relevant conduct occurred in connection with his role as COO of Opco, not in his capacity as a Board member. Brick failed to dispute these material facts on summary judgment, and the court concluded Brick's claim for advancement was solely related to his capacity as COO of Opco. Consequently, the court rejected Brick's claim for advancement as a matter of law.

§ 16.2.2.2 Westchester Fire Ins. Co. v. Schorsch[4]

In *Westchester Fire Ins. Co.*, the Supreme Court of New York, Appellate Division, answered a question of first impression: whether a D&O liability policy's bankruptcy exception, which allows claims asserted by the bankruptcy trustee or "comparable authority," applies to claims raised by a Creditor Trust, as a post-confirmation litigation trust, to restore D&O coverage removed by the policy's insured vs. insured exclusion. In concluding that the bankruptcy exception does apply, the court interpreted the broad term "comparable authority," "to encompass a Creditor Trust that functions as a post-confirmation litigation trust, given that such a Creditor Trust is an authority comparable to a 'bankruptcy trustee' or other bankruptcy-related or 'comparable authority' listed in the bankruptcy exception."

This case arose out of RCS Capital Corporation's ("RCAP") chapter 11 bankruptcy proceedings, which created a Creditor Trust. Pursuant to the bankruptcy court's order

[4] 186 A.D.3d 132 (N.Y. App. Div. 2020).

confirming the bankruptcy plan, the Creditor Trust could "enforce, sue on, settle, or compromise … all Claims, rights, Causes of Action, suits, and proceedings … against any Person without the approval of the Bankruptcy Court [and] the Reorganized Debtors." In March of 2017, the Creditor Trust brought suit against the former directors and officers of RCAP ("defendant insureds"), alleging that they had breached their fiduciary duties to RCAP (the "Creditor Trust Action"), which ultimately caused defendants insureds to seek coverage and indemnification under RCAP's D&O liability insurance policy. The policy included an insured vs. insured exclusion, which eliminated coverage for "any Claim made against an Insured Person … by, on behalf of, or at the direction of the Company or Insured Person." The policy also included a bankruptcy exception to the insured vs. insured exclusion, which restored coverage for claims "brough by the Bankruptcy Trustee or Examiner of the Company or any assignee of such Trustee or Examiner, or any Receiver, Conservator, Rehabilitator, or Liquidator or comparable authority of the Company."

Westchester Fire Insurance Co. ("Westchester"), which provided RCAP with an excess liability D&O policy, initiated the instant case, seeking a declaratory judgment, arguing that because the Creditor Trust Action was brought on behalf of RCAP against its own directors and officers, Westchester had no coverage obligations pursuant to the policy's insured vs. insured exclusion, or, alternatively, other policy exclusions. Defendant insureds answered and filed three counterclaims (1) for breach of contract with respect to excess insurers' coverage obligations, (2) alleging bad faith breach, and (3) seeking a declaration of coverage, defense, and attorney's fees, all of which Westchester moved to dismiss. The trial court denied Westchester's motion and granted partial summary judgment to defendant insureds on their counterclaim for breach of contract regarding defense, liability coverage, attorney's fees, and cost of defense.

On appeal, the court held that the language "the Bankruptcy Trustee or … comparable authority" in the bankruptcy exception restored coverage that was otherwise barred by the insured vs. insured exclusion. The court noted that the plain language of the policy did not indicate an intent to bar coverage for D&O claims brought by the Creditor Trust, reasoning that

> [t]o begin, the policy included the crucial language brought by or on behalf of in the insured vs. insured exclusion and the bankruptcy exception. Thus, the exclusion and exception both focused on the identity of the party asserting the claim, not on the nature of the claim being brought. Moreover, the policy included the debtor corporation, or DIP, as an insured under the insured vs. insured exclusion, but did not to include the DIP under the bankruptcy trustee and comparable authorities exception. Thus, when read together, the bankruptcy exception restores coverage for bankruptcy-related constituents, such as the bankruptcy trustees and comparable authorities, and the insured vs. insured exclusion precludes the possibility of a lawsuit by a company as DIP, or by individuals acting as proxies for the board or the company.

Moreover, the court explained that concluding that the bankruptcy exception did not apply to the Creditor Trust would ignore the rationale and purpose for post-confirmation litigation trusts, which allow the reorganized debtor's management to focus on running the business post-bankruptcy and another entity to pursue litigation. Especially in these types of situations, where the litigation often involves claims against directors and officers which management may be reluctant to pursue.

Although the court determined that the insured vs. insured exclusion did not bar coverage in the Creditor Trust Action, it also determined that factual disputes remained regarding the application of Westchester's other defenses and therefore partial declaratory judgment to defendant insureds' claims for breach of contract on the coverage obligations and declaration of coverage should not have been granted by the trial court. Moreover, the trial court should not have declared that the excess insurers were obligated to pay for all indemnity costs or award defendants insureds attorney's fees incurred in defending the instant action. The court, however, did determine that the defendant insureds were entitled to the advancement of defense costs in defending the Creditor Trust Action, noting that

> the policies issued by the excess insurers provide a broad right to the provision of defense costs subject to repayment in the event and to the extent that the loss "is not covered under this Policy." The policies further provide that the carrier will advance defense costs for any claim "before the disposition." This Court's finding that the Creditor Trust action "may reveal" that defendants insureds' claim is not covered necessarily means that there is a possibility of coverage under the policies for the advancement of defense costs for defendants insureds.

Therefore, the court modified the trial court's order to deny defendant insureds' motion for partial summary judgment on their first counterclaim, to vacate the declaration that excess insurers are obligated to pay for indemnity costs incurred in the Creditor Trust Action, and to vacate the award of attorney's fees incurred by defendant insureds in the instant action, but affirmed the trial court's Order in all other respects.

§ 16.2.2.3 Dolan as Trustee of Charles B. Dolan Revocable Trust v. DiMare[5]

This case arose out of a dispute concerning the business affairs of multiple closely-held, family-run corporations. Dolan brought derivative claims on behalf of the parent company DiMare, Inc., and two of its subsidiaries DiMare Brothers, Inc. and AD Share Capital, Inc. against Paul DiMare. Paul managed the two subsidiaries and was the president and director of all three corporations. Paul contended that Dolan could not properly assert derivative claims. The trial court, however, determined that Dolan could assert the derivative claims, and in doing so, addressed the requirements for shareholders to bring derivative claims under Delaware law.

[5] No. 1984CV03525BLS2, 2020 WL 4347607 (Mass. Super. June 15, 2020).

First, the court noted that Dolan had standing to bring derivative claims as trustee of a trust that owned shares of DiMare, Inc., a Delaware corporation, and that under Delaware law, "a shareholder of a parent corporation may bring suit derivatively to enforce the claim of a wholly owned corporate subsidiary, where the subsidiary and its controller parent wrongfully refuse to enforce the subsidiary's claim directly." Second, the court explained that a corporate shareholder may not bring a derivative action unless he/she made a demand on the corporation to institute such an action or can demonstrate that such a demand would be futile. To demonstrate futility, the allegations must "create a reasonable doubt that … the board of directors could have properly exercised its independent and disinterested business judgment in responding to a demand." The court found that Dolan had met this requirement by alleging that half of the board of directors consisted of Paul, his two sons, and his brother and that Paul caused the business to pay these directors substantial salaries over a long period of time. Last, the court stated that "[a] shareholder may not commence or maintain a derivative proceeding unless the shareholder … fairly and adequately represents the interests of the corporation in enforcing the right of the corporation."

In addition to his derivative claims, Dolan sought to bar any use of the assets of DiMare Brothers, Inc. or AD Share Capital, Inc. for the indemnification or advancement of legal expenses incurred by Paul in defending the derivative claims. The court concluded that this claim failed as a matter of law, recognizing that DiMare, Inc.'s bylaws provide for the indemnification and advancement of legal expenses incurred by its directors and officers. Moreover, DiMare Brothers, Inc. is a wholly-owned subsidiary of DiMare, Inc., and in turn, AD Share Capital, Inc., is a wholly-owned subsidiary of DiMare Brothers, Inc. Therefore, the parent corporation, DiMare, Inc., is "entitled to use the resources of its direct and indirect wholly-owned subsidiaries to carry out any lawful purpose of the parent[.]"—*i.e.*, indemnification and advancement.

§ 16.2.2.4 Ironwood Capital Partners, LLC et al. v. Jones[6]

This case illustrates the impact that an automatic stay in a bankruptcy proceeding can have on a director's or officer's indemnification rights. In *Ironwood*, Timbervest, LLC and its four officers, Jones, Shapiro, Boden, and Zell entered into a settlement agreement with AT&T to resolve various claims of fraud and misuse of assets pursuant to ERISA. Thereafter, Jones sought, *inter alia*, a declaratory judgment stating that he was entitled to indemnification for the portion of the settlement for which he might be liable. Timbervest, the three other officers, and other related corporations counterclaimed, seeking to have Jones pay his pro rata share of the settlement. The trial court granted Jones's motion for declaratory judgment regarding indemnification and dismissed most of the counterclaims. While the appeal was pending, Shapiro petitioned for chapter 7 bankruptcy.

Because of Shapiro's bankruptcy petition, the court found that Jones's claim for declaratory relief against all defendants seeking indemnification constituted a judicial action against the debtor, which was subject to the automatic stay. The court explained that the "filing of a bankruptcy petition automatically operates as a stay of 'the commencement or continuation … of a judicial … action or proceeding against the debtor." Moreover, "[a]ny

[6] 844 S.E.2d 245 (Ga. Ct. App. 2020).

orders or judgments entered in violation of an automatic bankruptcy stay are void; they are deemed without effect and are rendered an absolute nullity." The court also found that while automatic stay provisions generally do not extend to third parties, "any action for declaratory relief against Shapiro is inextricably intertwined with action for declaratory relief against the other co-defendants such that we cannot resolve any of the numerations of error regarding the declaratory judgment with the automatic stay in place." Therefore, the court remanded the case with instructions for the trial court to enter a stay pending the resolution of Shapiro's bankruptcy proceedings. The court noted, however, that once Shapiro's bankruptcy proceedings were resolved or the bankruptcy court lifted the automatic stay, the defendants could reinstitute the appeal.

§ 16.2.2.5 LZ v. Cardiovascular Research[7]

In *LZ v. Cardiovascular Research*, the California Court of Appeal illustrated the importance of specificity when drafting director and officer indemnification language, in order to prevent the drafting of a clause that provides indemnification well beyond the intended scope. In *LZ*, employees of Cardiovascular Research Foundation ("CRF") were staying at a Marriot Hotel while attending a nearby conference. While cleaning the room of a CRF executive, housekeeper L.Z. was sexually assaulted and battered by another CRF employee who happened to walk by the room. L.Z. brought a breach of contract action against CRF, alleging that CRF was liable for the harm caused by its employee pursuant to an indemnification clause contained in a contract between CRF and the Marriot. The indemnification clause at issue stated:

> Each party to this Agreement shall, to the extent not covered by the indemnified party's insurance, indemnify, defend, and hold harmless the other party and its officers, directors, agents, employees, and owners from and against any and all demands, claims, damages to persons or property, losses, and liabilities, including reasonable attorneys' fees (collectively, 'Claims'), arising solely out of or solely caused by the indemnifying party's negligence or willful misconduct in connection with the provisions and use of [the Marriott] as contemplated by [the CRF-Marriot Contract].

CRF moved for summary judgment, arguing that the indemnification clause did not cover an employee's conduct that fell outside the scope of employment. The trial court granted the motion.

On appeal, the court affirmed the judgment of the trial court, concluding that because CRF and the Marriott intended the word "party" to mean CRF or the Marriott, the express language of the indemnification clause limited coverage to the negligence or willful misconduct attributable to only CRF or the Marriott. Therefore, the court noted that throughout the contract and specifically in the indemnification clause, the use of the word "party" referred only to CRF and the Marriot, not their employees. "In fact, CRF and the

[7] No. A155721, 2020 WL 2520114 (Cal. Ct. App. May 18, 2020) (unpublished).

Marriott's use of the phrase 'party and its officers, directors, agents, employees, and owners' in one part of the indemnification clause supports a determination that they intended to distinguish between 'party' on the one hand and 'officers, directors, agents, employees, and owners' on the other." Therefore, CRF was not liable for its employee's misconduct, which fell outside the scope of his employment.

§ 16.2.2.6 Xtreme Limo, LLC v. Antill[8]

The takeaway from the *Xxtreme Limo* decision is that, at least under Ohio law, a corporation's By-Laws may provide discretion for the Board to advance litigation expenses to employees who are not directors or officers, but unless that discretion is explicit, an employee has no advancement rights. In *Xtreme Limo*, Antill was an employee of US Tank Alliance, Inc., managing one of its affiliates, Xtreme Limo, LLC. At some point, Antill left US Tank and began working for an alleged competitor of Xtreme Limo. A month later, US Tank and Xtreme Limo sued Antill for breach of fiduciary duty, breach of contract, unjust enrichment, tortious interference with business relationships, conversion, and misappropriation of trade secrets. Antill moved to require US Tank to advance him litigation expenses, pursuant to his employer's By-Laws. The trial court denied that motion.

On interlocutory appeal, Antill argued not that he was entitled to the mandatory advancement of litigation expenses as a director or officer of US Tank under Ohio law, but, rather, that he was entitled to advancement contractually, based on US Tank's By-Laws. The court affirmed the trial court's decision, concluding that neither the law nor US Tank's By-Laws required the advancement of litigation expenses to Antill. Section 5.04 of US Tank's By-Laws stated that US Tank shall make the advancement of litigation expenses "incurred by a director or officer in defending a lawsuit upon receipt of an undertaking by … the director to repay such amount if it shall ultimately be determined that he is not entitled to be indemnified by the corporation as authorized in Article V." The court explained that the "[By-Law] entitlement to advance payments therefore is limited to directors or officers, as Section 5.04 further underscores by providing that 'other employees and agents may be so paid upon such terms and conditions, if any, as the Board of Directors deems appropriate.'" Although Antill's title was President of Xtreme Limo, the court found that he was not a director or officer of US Tank and, therefore, was not entitled to the advancement of litigation expenses under US Tank's By-Laws.

Xtreme Limo demonstrates that a corporation's By-Laws may provide discretion for the Board to advance litigation expenses to employees, even if the employee is not an officer or director. It is important when drafting By-Laws to use specific language outlining the boundaries for the advancement of litigation expenses and indemnification, such that only intended categories of corporate membership are included within that scope.

[8] 2020 WL 5250390 (Ohio Ct. App. Apr. 9, 2020).

§ 16.2.2.7 VBenx Corporation v. Finnegan[9]

In *VBenx Corp. v. Finnegan*, the Massachusetts Superior Court illustrated that an officer or director who was advanced litigation expenses pursuant to the corporation's By-Laws may have to repay part of that advancement if he or she is only partially successful in defending the claims asserted against him or her.

VBenx arose after myriad litigation, including two trials and two appeals. As a result of that litigation, the jury returned verdicts in favor of VBenx on its claims against Finnegan for breach of fiduciary duty, aiding and assisting that breach, and malicious prosecution. Finnegan did, however, successfully defend himself against a conspiracy claim and other counterclaims related to him and other defendants. In *VBenx*, VBenx moved for the repayment of funds, in the amount of $618,044 plus interest, that it had *advanced* to Finnegan for the defense of certain counterclaims asserted against him, based on his position as a former director and officer of VBenx. VBenx's motion was opposed by Finnegan, who argued that he was successful in the dismissal of the conspiracy claim and the exclusion of VBenx's damages expert's $21 million lost profit analysis.

In reviewing VBenx's motion, the court noted that under Delaware law:

> [F]unds are advanced if a corporate official is called upon to defend himself in a civil or criminal proceeding in which the claims asserted against him are " 'by reason of the fact' that [he] was a corporate officer, without regard to [his] motivation for engaging in that conduct." *Tafeen,* 888 A.2d at 214. Whether the officer/director can, however, retain advanced funds, as relevant to this case, depends upon whether he was "successful on the merits or otherwise in defense of any ... suit, or in defense of any claim, issue or matter therein." 8 Del. Corp. § 145(c). In a case in which a defense is partially, but not wholly, successful: "the burden is on the [former officer] to submit a good faith estimate of expenses incurred relating to the indemnifiable claim." *May v. Bigmar, Inc.,* 838 A.2d 285, 290 (Del. Ch. 2003). It is therefore necessary to separate the "winning issues from the losing ones." *Id.* at 291. Whether a corporate officer may have won "a battle" in the course of a litigation, but "lost the war," i.e., was generally unsuccessful in the litigation, is an important consideration in apportioning fees. *Id.*

The court in *VBenx* also noted that the successful defense of any claims that resulted from Finnegan's conduct occurring after he was no longer an officer or director would be uncovered claims, and would not included in offsetting the advancement that he was ordered to repay. Ultimately, the court held that VBenx was entitled to the repayment of advancement funds in the amount of $583,044.22, plus interest, which was offset by Finnegan's successful defense of three counterclaims. The court determined that Finnegan, however, was not entitled

[9] 2020 WL 2521297 (Mass. Super. Apr. 9, 2020).

to an offset for the defense of the conspiracy claim nor the exclusion of the expert witness's lost-profit analysis, because both of those claims pertained to Finnegan's conduct that occurred after he was no longer an officer or director for VBenx.

In finding Finnegan liable for the repayment of the advancement amounts, the court in *VBenx* explained that pursuant to VBenx's By-Laws, Finnegan executed an "Undertaking of Repay Advanced Funds," if it was determined that he was not entitled to indemnification. The court further explained:

> [I]f the prosecution of the plaintiff in the underlying proceeding established that the indemnitee acted in bad faith, particularly through a showing that the indemnitee knew that his actions were damaging to the company or that his conduct was unlawful, "that would be conclusive evidence that the [indemnitee] is not entitled to indemnification."

The court found that Finnegan had a non-indemnifiable state of mind based on the jury's finding that he breached his fiduciary duty to VBenx and that he attempted to gain control of VBenx from its majority shareholders while he was still chairman of the company.

§ 16.2.2.8 Clarkwestern Dietrich Building Systems, LLC v. Certified Steel Stud Association, Inc.[10]

This Ohio Court of Appeals decision addresses the *priority* of a company's duty to indemnify directors and/or officers over that of general creditors, after a lawsuit settlement.

In *Clarkwestern Dietrich Building Systems, LLC v. Certified Steel Stud Ass'n, Inc*., Clarkwestern Dietrich Building Systems ("ClarkDietrich") previously brought multiple claims against Certified Steel Stud Association, Inc. ("the Association"). After an eleven-week jury trial, on the eve of closing arguments, ClarkDietrich offered to dismiss with prejudice the claims against the Association, which the Association rejected. The jury returned a verdict in favor of ClarkDietrich, awarding it $43 million. The Association stipulated that it had insufficient tangible assets to satisfy the judgment. Thereafter, the trial court appointed a receiver (the "Receiver"), on ClarkDietrich's motion, to investigate and pursue any claims against the Association's officers and directors arising from their decision to reject ClarkDietrich's dismissal offer. Upon his appointment, the Receiver filed a complaint against the Association's four directors. At some point during litigation, the Receiver and Director Jung reached a settlement agreement, requiring Jung to pay $550,000 in exchange for the dismissal of the claims against him. The trial court subsequently granted ClarkDietrich's motion to distribute the settlement funds in order to pay the outstanding $43-million-dollar judgment owed by the Association, which the Association opposed, arguing that its duty to indemnify its directors took priority over repayments to creditors such as ClarkDietrich.

On appeal, the court affirmed the trial court's decision to release the settlement funds to ClarkDietrich for multiple reasons. First, the court concluded that because the Association

[10] 2020 WL 1847478 (Ohio Ct. App. Apr. 13, 2020).

failed to seek a stay before the settlement funds were distributed, its appeal was moot. The court explained that

> [w]here the trial court rendering judgment has jurisdiction of the subject matter of the action and of the parties, and where fraud has not intervened, and the judgment is voluntarily paid and satisfied, payment puts an end to the controversy and takes away from the defendant the right to appeal or prosecute error or even to move for vacation of judgment.

Moreover, the court concluded that even if the appeal was not moot, the Receiver was not authorized to pay indemnification claims. The court noted that the trial court's receivership order clearly stated that the Receiver was appointed for the limited purpose of investigating claims against the Association's directors and officers and to bring, prosecute, and manage those claims. This limited authority never authorized the Receiver to pay indemnification claims to directors. The court explained that "[a]ny decision otherwise would have been contrary to the trial court's intended purpose in creating the receivership and inconsistent with the plain language of the receivership order." Finally, the court found that the remaining directors' claims were pending before the Ohio Supreme Court, making any right to indemnification merely speculative. The court reasoned that even if the remaining directors were successful in their indemnification claims against the Association, the Association was still operating and could indemnify the directors with alternate funds.

As shown by this case, courts strictly interpret receivership orders. In situations such as this, directors and officers must address ambiguities in receivership orders early, especially where indemnity claims have been made or are anticipated.

§ 16.2.2.9 Revolutionar, Inc. v. Gravity Jack, Inc.[11]

The court in *Revolutionar, Inc. v. Gravity Jack, Inc.*, essentially ruled that indemnity may apply to a claim brought by a company against its own directors and officers—*i.e.*, indemnity rights are not limited to third-party claims, unless the language of the indemnification clause is clear and unambiguous.

The *Revolutionar* case arose out of a business dispute between RevolutionAR and its CEO, Joshua Roe, and Gravity Jack and its President, Luke Richey. RevolutionAR was formed to develop and market "custom interacting learning, process, training, and maintenance applications using augmented reality technology." Roe was named the CEO and Richey a member of the board of directors. RevolutionAR executed three contracts with Gravity Jack which covered "Gravity Jack's development of software for RevolutionAR's interactive augmented reality applications for learning and training." Years later, RevolutionAR and Roe sued Gravity Jack and Richey, alleging that "Gravity Jack used the content the company developed for RevolutionAR's prototype application when Gravity Jack marketed and sold augmented reality software content to its other clients." RevolutionAR and Roe also alleged that Gravity Jack stole business from RevolutionAR. Moreover,

[11] 13 Wash.App.2d 1044 (Wash. Ct. App. 2020) (unpublished).

RevolutionAR and Roe alleged that Richey, through Gravity Jack, "breach representations, utter false and misleading statements about RevolutionAR, dissuaded investors from backing RevolutionAR, and discouraged customers from conducting business with RevolutionAR."

Gravity Jack and Richey moved for summary judgment, contending that the contract language released them from any liability, and neither RevolutionAR nor Roe had a legally protected interest in the augmented-reality prototype prepared by Gravity Jack. The trial court granted summary judgment, dismissed all claims, and awarded Gravity Jack and Richey reasonable attorney's fees and costs.

On appeal, in relevant part, Richey contended that the indemnification clause in RevolutionAR's articles of incorporation, benefiting RevolutionAR's board of directors, shielded Richey from liability, because he was a director. RevolutionAR argued that the indemnification clause applied only to third-party claims brought against members of its board of directors. The court in *Revolutionar* concluded that RCW 23B.08.510 permitted corporations to indemnify the members of its board of directors in limited circumstances, and RevolutionAR's articles of incorporation indemnified its directors "from 'all liability, damage, or expense resulting from the fact that such person … was a director, to the maximum extent and under all circumstances permitted by law,' except when grossly negligent." Explaining that the indemnification clause did not solely apply to third-party claims against directors, the court in *RevolutionAR* reasoned that

> [t]he broad language of the indemnification provision does not limit its import to third party claims, but instead extends to the maximum protection allowed by law. Indemnification may be sought in many types of proceedings, whether third-party actions or actions by or in the right of the corporation. 18B AM. JUR. 2D *Corporations* § 1628 (2020). Accordingly, a corporation may be required to indemnify an officer for expenses incurred in successfully defending against an action by the company. *Truck Components Inc. v. Beatrice Co*., 143 F.3d 1057, 1061 (7th Cir. 1998).

The court, however, agreed with RevolutionAR that indemnification did not extend to claims brought by the corporation against Richey for breaches of his duties to the corporation, because as a director and advisor of RevolutionAR, Richey had a duty of good faith and to act in the best interest of the company.

The *RevolutionAR* decision illustrates the importance of crafting an indemnification clause to specifically limit indemnification of third-party claims against members of the corporation's board of directors, if that is the intended purpose. If the indemnification clause lacks specificity, courts may interpret the broad language to require corporations to indemnify members of its board of directors against claims brought by third-parties and even the corporation itself.