

Client Alert

Financial Markets Developments

Indemnification of Directors and Officers: New Developments in Advancement of Legal Fees to Directors and Officers With Practical Recommendations

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In 2008, there were over ten Delaware cases that addressed a corporation's advancement and indemnification policies relating to advancement of expenses (including attorney's fees) incurred by an officer or director in defending a suit or proceeding.¹ A board of directors of a corporation should be aware that courts tend to treat mandatory advancement provisions in bylaws or charters as contracts that should be interpreted according to their terms and, therefore, a corporation is likely to be held to its promises.

This alert:

- Explains the issues and case law relating to advancement of defense fees,
- Provides practical recommendations on how to avoid the pitfalls of poorly drafted advancement provisions,
- Highlights considerations when drafting a corporation's policies relating to advancement and indemnification, and
- Provides guidance to directors and officers on how to protect themselves under advancement and indemnification policies.

All directors, officers and legal counsel for public and private companies should be aware of the significant new developments in advancement of legal fees and indemnification under Delaware case law.

I. Introduction

Recent Delaware case law illustrates the importance of careful and accurate drafting of directors' and officers' legal fee advancement provisions. Delaware public policy favors advancements. Ambiguous drafting of bylaws or corporate charters granting mandatory advancement to a loosely defined group of directors, officers, employees and agents may impose greater advancement and indemnification obligations than the board of directors of a corporation intended. A board's favorable attitude towards advancements may help to attract capable directors, officers and employees and ensure necessary risk-taking in reaching the corporate objectives. At the same time, a board should ensure that the corporation's advancement policies are drafted fairly in the



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For 20 guidelines and recommendations that corporations, directors and officers should consider with respect to advancement and indemnification of legal fees, see pages 6 – 8.

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¹ See Delaware General Corporation Law Section 145(e).

best interests of the corporation and its shareholders to provide adequate protection against excessive claims.

Section 145 of the Delaware General Corporation Law (the “DGCL”) provides the board of directors broad discretion in determining the corporation’s policies regarding the advancement of expenses to its directors and officers in defending legal actions upon receipt of an undertaking by or on behalf of such director or officer to repay such amount if it is ultimately determined that such person is not entitled to be indemnified.² A corporation further has the power to determine the terms and conditions under which it wishes to advance expenses incurred by former directors and officers or other employees and agents.

The advancement provisions adopted by a board in a corporation’s bylaws, charter or individual contracts are usually either mandatory, leaving no leeway for case by case determination, or permissive, providing for advancement but leaving the board of directors with wide discretion to grant the advancement depending on individual circumstances. Delaware courts have repeatedly upheld mandatory advancement provisions and required corporations to act in accordance with them. Delaware courts consider mandatory advancement provisions in bylaws and charters to be contracts that should be construed according to their terms. What often comes as a surprise to the board of directors is that the right to mandatory advancement also includes those accused (or even proven) of corporate wrongdoing and that the obligations for continual advancements may continue until the final, nonappealable conclusion of the proceeding. Delaware courts have generally upheld a board’s decision with respect to discretionary advancement provisions if the conditions imposed on the advancement have been appropriate and rationally related to a proper corporate interest.

II. Recent Case Law

Bylaw Protection for Former Directors

A recent decision by the Delaware Court of Chancery came as a surprise to many corporate directors by providing corporations the flexibility to eliminate former directors’ advancement rights by a board-approved bylaw amendment. In *Schoon v. Troy Corporation (Del. Ch. 2008)*,³ the corporation amended its bylaw provisions to eliminate former directors’ advancement rights and, soon after the amendment, brought a suit against one of its former directors, Bohnen. The main issue in the case was when the former director’s right to advancement was considered vested. The court concluded that the former director’s right to advancement had not vested at the commencement of his board service or prior to the amendment of the bylaws. Instead, the vesting occurred only upon the triggering of the corporation’s obligations. Therefore, as Bohnen’s right to advancement had not vested prior to the bylaw amendment, he was not entitled to advancement.⁴

Even though it is likely that former directors would be entitled to indemnification under a corporation’s directors’ and officers’ insurance, which usually covers former directors, the above problems can be easily avoided with more carefully tailored bylaws that accurately reflect the corporation’s intention with respect to advancement and indemnification. A corporation can, for example, address the vesting of advancement rights in its bylaws or add wording that prohibits retroactive adverse amendments to the bylaws affecting the directors’ and officers’ right to advancement. Another, perhaps less practical alternative is to include the right to advancement in the corporation’s charter (the amendment of which requires shareholder approval). A corporation, director or officer may also enter into an individual advancement and indemnification

² Pursuant to Section 145 of the DGCL, the right to indemnification is subject to the person having acted in good faith and in a manner reasonably believed to be in or not opposed to the best interests of the corporation. With respect to any criminal action or proceeding, the DGCL requires that the person had no reasonable cause to believe his or her conduct was unlawful. The DGCL further requires that no indemnification shall be made in respect of any claim, issue or matter as to which such person shall have been adjudged to be liable to the corporation (unless and to the extent a court determines that despite the adjudication of liability, the person is fairly and reasonably entitled to indemnification for expenses deemed proper by the court). Although Delaware law requires the recipient to repay the corporation the advanced fees if it is later determined that he/she is not entitled to indemnification, this may not always be a viable option after a lengthy proceeding.

³ *Schoon v. Troy Corporation*, 948 A.2d 1157 (Del. Ch. March 28, 2008).

⁴ See also *Underbrink v. Warrior Energy Services Corporation*, No. 2982-VCP, 2008 Del. Ch. LEXIS 65 (Del. Ch. May 30, 2008), a litigation over the former directors’ right to retroactive advancement under Warrior’s bylaws adopted shortly before the directors resigned from the board service upon the conclusion of a secondary public offering. Warrior denied advancement and argued the bylaws adopted by the interested directors were invalid. The court found the plaintiffs were entitled to advancement.

agreement, although the divisiveness that may result amongst board members, officers and a corporation may outweigh the benefits of individual agreements.

Distinction Between Advancement and Indemnification

In *Schoon v. Troy Corporation*, the court emphasized that “even though related, indemnification and advancement are distinct types of legal rights”. This serves as a reminder that if a corporation wishes to draw a distinction between the two, the bylaws and corporate charters should be drafted accordingly. The importance of this was also illustrated in *Sodano v. American Stock Exchange (Del. Ch. 2008)*,⁵ in which the court held the term “indemnification” in the Chief Executive Officer’s separation agreement included advancement due to the broad use of the term in the corporation’s charter.

What Constitutes “Final Disposition” of a Proceeding?

Delaware case law has demonstrated that broadly drafted, mandatory advancement policies can extend a corporation’s obligation to pay directors’ or officers’ legal expenses for a long period even after a court has initially determined the defendant’s wrongdoing.

In *Bergonzi v. Rite Aid Corporation (Del. Ch. 2003)*,⁶ the court was faced with the question of whether the defendant’s guilty plea constituted “final disposition” of the proceeding and thereby terminated the defendant’s right to advancement or indemnification under Rite Aid’s charter. The court concluded that Rite Aid’s “Certificate of Incorporation provided the defendant a contract right to advancement before a final disposition of the criminal proceedings” and, while the defendant awaited sentencing, the proceedings had not yet reached their final disposition, entitling Bergonzi to advancement of his legal fees. In reaching its decision, the court emphasized that “Rite Aid could have easily drafted the provisions differently but it did not and must now maintain its bargain with its former officer”.

In *Sun-Times Media Group, Inc. (f/k/a Hollinger International Inc.) v. Black (Del. Ch. 2008)*,⁷ the main issue was the interpretation of the words “the final disposition of such action, suit or proceeding” in the Sun-Times’ bylaws, which parallels the use of those terms in Section 145 of the DGCL. The Sun-Times charter also stated that advancement and indemnification were available “to the fullest extent permitted by applicable law”. Therefore, the case also involved a dispute over the meaning of “final disposition” in the DGCL. The defendants, who were former officers of Sun-Times, had already been convicted and sentenced on criminal charges and the matter was on appeal to the US Court of Appeals for the Seventh Circuit when Sun-Times applied for a declaratory judgment from the Delaware Court of Chancery to stop continuing to advance costs. Sun-Times argued it had no obligation to advance to the former officers appellate costs and costs incurred after they were sentenced, as sentencing constituted final disposition of the proceeding and required repayment or setoff of the previously advanced amounts. The court held that the final disposition of the proceeding was the final, nonappealable conclusion to the proceeding and that the right to advancement continues until the dispute is finally resolved. Final resolution may extend through an extended period until the actual sentencing occurs, even if a conviction has occurred but sentencing is delayed while the defendant cooperates with the prosecution or for other reasons.

Scope of Advancement Provision

A corporation often drafts its bylaw and charter provisions broadly to include not only directors and officers but also employees and agents. This may expose the corporation to unexpected advancement claims, particularly in today’s corporate climate where at times the granting of titles is relatively broad. In addition, recent Delaware case law illustrates the importance of careful business judgment when including agents in a corporation’s mandatory advancement policies.

⁵ *Sodano v. American Stock Exchange LLC and Financial Industry Regulatory Authority, Inc.*, No. 3418-VCS, 2008 Del. Ch. LEXIS 92 (Del. Ch. July 15, 2008).

⁶ *Bergonzi v. Rite Aid Corporation*, No. 20453-NC, 2003 Del. Ch. LEXIS 117 (Del. Ch. Nov. 3, 2003).

⁷ *Sun-Times Media Group, Inc. (f/k/a Hollinger International Inc.) v. Conrad M. Black*, 954 A.2d 380 (Del. Ch. July 30, 2008).

In *Sassano v. CIBC World Markets Corp. (Del. Ch. 2008)*,⁸ a former employee claimed that as an officer with management supervisory functions the corporation's bylaws entitled him to mandatory advancement for costs incurred in certain administrative and investigative proceedings. The court found the employee to be a nominal officer at the time of the allegations for which the bylaws extended mandatory advancement and, as the underlying actions for which the employee sought advancement were brought by reason of his service as an officer, the employee was entitled to advancement.

In *Jackson Walker LLP v. Spira Footwear, Inc. (Del. Ch. 2008)*,⁹ the court was faced with the question of whether the plaintiff, Jackson Walker, a former outside litigation counsel for the corporation, constituted an "agent" eligible for advancement under Section 145 of the DGCL and Spira's bylaws. Mr. Walker had acted as counsel for Spira in a dispute among the major shareholders of Spira for control of the corporation (the "El Paso Action") and was later, after a change of control of Spira, sued by the new board for breach of fiduciary duty and of negligence in connection with the El Paso Action. Walker sought summary judgment against Spira for advancement of his legal expenses based on the mandatory advancement provision in Spira's bylaws that provided advancement for directors, officers, employees and agents.

Both parties relied on *Fasciana v. Electronic Data Systems Corporation (Del. Ch. 2003)*¹⁰ in support of their arguments as to why Walker did or did not qualify as Spira's agent. In *Fasciana*, the court held that "an agent under Section 145 of the DGCL does not include a lawyer who acts as a legal advisor to a corporate client, but does not act on the client's behalf in relation to third parties". In the case the court found *Fasciana*, a lawyer who engaged in corporate advisory work, generally not to be an agent under Section 145 of the DGCL. Unlike in *Fasciana*, Vice Chancellor Parsons found in *Walker* that "the alleged wrongs for which Spira has sued Walker all represent instances where Walker acted on behalf of Spira in relations with third parties. As outside litigation counsel Walker was Spira's agent because it had the power to act

on behalf of the principal with third persons." Walker therefore qualified for advancement of legal fees and expenses under Spira's bylaws. Vice Chancellor Parsons did note that when Delaware courts grant advancements to agents they proceed with more caution. The DGLC, however, does provide Delaware corporations the possibility to include agents in their advancement policies and Spira could have tailored its bylaws narrower had it wished to do so.

Based on the above, a board should avoid unnecessary expansion of the scope of coverage but, at the same time, it should consider the risks of scrutiny faced by certain officers and employees. If the corporate climate supports broad mandatory advancement and titles are granted broadly, it may be sensible to define the officers and employees entitled to advancement.

Voluntary Advancement

A recent decision by the United States Court of Appeals for the Second Circuit, *United States v. Stein (2nd Circuit 2008)*,¹¹ requires corporations under government investigation to continue making voluntary advancements when there has been a pattern for doing so.

In *Stein*, KPMG was being investigated for possible involvement in creating and marketing fraudulent tax shelters. When KPMG found out that the United States Attorney's office was investigating its top partners and employees, it announced, in accordance with the firm's past practice, that any present or former members of the firm asked to appear would be represented by competent counsel at the firm's expense. In the course of the investigation KPMG, under the prosecutors' overwhelming influence and fearing that it would be considered noncooperative with the government's investigation, copped and placed conditions on the advancement of legal fees and ultimately ended them. The District Court for the Southern District of New York found that the government deprived the defendants of their constitutional right to counsel and substantive due process and, as a result, dismissed the indictment of the defendants.

8 *Sassano v. CIBC World Markets Corp.*, 948 A.2d 453 (Del. Ch. January 17, 2008).

9 *Jackson Walker LLP v. Spira Footwear, Inc.*, No. 3150-VCP, 2008 Del. Ch. LEXIS 82 (Del. Ch. June 23, 2008).

10 *Fasciana v. Electronic Data Systems Corporation*, 829 A.2d 178 (Del. Ch. July 1, 2003).

11 *United States of America v. Stein*, 541 F.3d 130 (2nd Circ. August 28, 2008).

On appeal, the Second Circuit affirmed the District Court's decision. The Second Circuit confirmed that the change in the firm's advancement policy was a direct consequence of the government's overwhelming influence, and the firm's conduct therefore amounted to state action. The government unjustifiably interfered with the defendants' relationship with counsel and their ability to mount a defense, in violation of the Sixth Amendment, and the government did not cure the violation.

On August 28, 2008, the same day the Second Circuit issued its decision in *Stein*, the Department of Justice amended its charging guidelines for prosecuting corporate fraud¹² to instruct prosecutors, among others, not to consider a corporation's advancement of attorneys' fees to employees when evaluating cooperativeness. On October 6, 2008, the Securities and Exchange Commission published its Enforcement Manual,¹³ used in the investigation of potential violations of the securities laws. The manual encourages and rewards cooperation with the staff investigations. It does not address advancement of legal fees as a factor in evaluating a corporation's cooperation.

In light of the above, any voluntary advancement should be subject to carefully defined criteria for advancement to commence and continue, criteria for termination of the advancement obligation and criteria that triggers the repayment obligation. A formal, explicit advancement scheme may, however, be preferable.

Broad Interpretation of "Defense"

In *Reinhard & Kreinberg v. The Dow Chem. Co. (Del. Ch. 2008)*,¹⁴ the court interpreted the meaning of the word "defense", which

is commonly used by corporations in their bylaws, charters and indemnification agreements. In *Reinhard*, the parties had entered into an agreement where Dow had agreed to advance "the plaintiffs' reasonable fees and expenses incurred in connection with the plaintiffs' defense against Dow's claims". Dow argued that the plaintiffs were not entitled to advancement for costs relating to the time spent preparing their counterclaims. The court concluded, relying on the Supreme Court precedent *Citadel Holding Corp. v. Roven (Del. Supreme Court 1992)*,¹⁵ that "in litigation context the term 'defense' has a broad meaning and under this broad understanding, directors are entitled to advancement for legal work on their affirmative defenses and compulsory counterclaims."¹⁶

The court also interpreted the meaning of "defending" in *Sun-Times v. Black*.¹⁷ Sun-Times' use of the term "defending" parallels the use of the term in Section 145 of the DGCL. Sun-Times argued that an appeal initiates a new proceeding and the defendant can no longer be considered to be "defending" on appeal. The court held that although defending in Section 145 of the DGCL has not explicitly been determined to encompass appeal, it was interpreted broadly in *Citadel Holding Corp. v. Roven*¹⁸ and, as a result, *Roven* suggests that an appeal of a conviction is defending. The court held that "appeals are clearly designed to defeat or offset the prosecutor's claims against the defendant and are necessarily part of the same dispute" and that "in fact, an appeal of a criminal conviction is even more closely tied to the concept of defending than a compulsory counterclaim".¹⁹

Although a corporation may be reluctant to have broad obligations to advance defense costs, it may be both fair and needed because

¹² See <http://www.usdoj.gov/>.

¹³ See <http://www.sec.gov/divisions/enforce/enforcementmanual.pdf>. See also http://www.whitecase.com/alert_whitecollar_doj_090808/.

¹⁴ *Reinhard & Kreinberg v. The Dow Chem. Co.*, No. 3003-CC, 2008 Del. Ch. LEXIS 39 (Del. Ch. March 28, 2008).

¹⁵ *Citadel Holding Corp. v. Roven*, 603 A.2d 818 (Del. Supreme Court February 18, 1992).

¹⁶ See also *Zaman v. Amedeo Holdings, Inc.*, 2008 WL 2168397 (Del. Ch. May 23, 2008), in which the court considered the applicability of *Citadel Holding Corp. v. Roven* in jurisdictions in which all counterclaims are permissive. The court concluded that "the counterclaim fits within the term "in defending" and "the costs of prosecuting a counterclaim should be subject to advancement if the counterclaim would qualify as a compulsory counterclaim under the traditional counterclaim test used by both Delaware and federal civil procedure and when that counterclaim so directly relates to a claim against a corporate official such that success of the counterclaim would operate to defeat the affirmative claims against the corporate official".

¹⁷ *Sun-Times Media Group, Inc. (f/k/a Hollinger International Inc.) v. Conrad M. Black*, 954 A.2d 380 (Del. Ch. July 30, 2008).

¹⁸ *Citadel Holding Corp. v. Roven*, 603 A.2d 818 (Del. Supreme Court February 18, 1992).

¹⁹ See also *Donohue v. Corning*, 949 A.2d 574 (Del. Ch. June 20, 2008), in which the court denied the plaintiff's right to advancement because the Limited Liability Company Agreement only provided for advancement in a defensive posture and here, the plaintiff had brought the claim for which advancement was sought against the defendant. In *Duthie v. CorSolutions Medical Inc.*, No. 3048-VCN, 2008 Del. Ch. LEXIS 128 (Del. Ch. September 10, 2008), the court concluded the plaintiffs were entitled to advancement of fees for affirmative defamation claims asserted as part of a defensive strategy involving the same dispute. The court also held that in this particular case it was justified to hold another counsel available if the first would be held to be in disqualifying conflict and that, therefore, the fees were subject to advancement.

new and existing directors and officers will expect this broad type of coverage. A corporation may also consider the possibility of limiting advancement to conviction in the first instance and then ultimately determine whether the director or officer is entitled to indemnification for appellate costs.

Delaware Court of Chancery Upheld Defendants' Right to Refuse to Settle

In *Barrett v. American Country Holdings, Inc. (Del. Ch. 2008)*²⁰ (since acquired by Kingsway Financial Services, Inc., "Kingsway"), Kingsway had sued the former directors for intentional fraud and the former directors sought advancement of their legal fees from the Delaware Court of Chancery as the limits of the directors' and officers' insurance policy that had covered the fees until then were almost exhausted. Kingsway made settlement proposals in the underlying fraud litigation which the former directors were not authorized to accept under the insurance policy without the insurer's consent. Kingsway asserted that the former directors forfeited their advancement rights by unreasonably refusing settlement. The court held that the former directors had an unconditional right to advancement and were not required to accept the settlement that would have exposed them to liability.

Directors and officers may wish to consider who controls settlement decisions and the impact of that on the availability of advancement and indemnification. For example, either, on the one hand, a director or officer seeking indemnification may make settlement decisions or, on the other hand, the board or a committee or an officer, such as the general counsel, may make decisions on when and under what circumstances to settle.

III. Pros and Cons of Granting Greater Advancement Rights for Audit Committee Members

Audit committees have broad responsibilities in overseeing a corporation's financial reporting, internal controls and internal auditing, as well as in appointing the corporation's external auditor. Recent corporate scandals have placed a corporation's

audit committee under increased scrutiny and some fear this will expose audit committee members to greater risk of investigation and litigation expenses. This might suggest that granting audit committee members broader advancement rights than other board members is appropriate, particularly if the corporation has adopted a permissive advancement scheme. Having a separate agreement might, however, also suggest that such person has greater liability than the other board members, which may not be the case, or advantageous to that individual. On balance, it may be a better approach to treat all board members as having the same advancement and indemnification rights, in part to foster unity amongst board members.

IV. Pros and Cons of Separate Agreements for Each Director and Officer

The Delaware Court of Chancery's decision in *Schoon v. Troy Corporation*²¹ may encourage directors to enter into individual advancement and indemnification agreements that cannot be unilaterally amended or rescinded by the corporation. If there is one agreement and the corporation or its director and officer insurer has capped the advancement policy and one director ends up using the entire amount, the other directors may be left without adequate coverage. Individual agreements providing greater rights for some corporate directors may, however, cause tension between the directors and, instead of working towards common goals, they may end up working against each other and, on balance, the better approach may be to have one agreement or policy covering all directors and officers, not individual agreements.

V. Guidelines and Recommendations

Corporate Policies

Boards should spend time becoming educated on the implications of advancement provisions in order to make sure policies reflect how companies want their provisions to work. When deciding on a corporation's advancement and indemnification policies, a board should balance the need to attract high-quality individuals to serve

²⁰ *Barrett v. American Country Holdings, Inc.*, 951 A.2d 735 (Del. Ch. June 20, 2008).

²¹ *Schoon v. Troy Corporation*, 948 A.2d 1157 (Del. Ch. March 28, 2008).

as directors and officers against the need to protect the corporation from excessive expenses and possible criticism for advancement after it may appear any such individual is culpable. The guidelines below should be considered when drafting or revising the corporation's advancement and indemnification policies:

■ **Inform the Board and Provide Details of Alternative Provisions:**

Provide a detailed presentation to the board of the advantages and disadvantages of advancement and indemnification policies in bylaws, charter and individual contracts with respect to directors, officers, employees and agents.

■ **Mandatory or Permissive Advancement Scheme:**

Consider whether a mandatory advancement scheme is too broad for the corporation and whether a permissive advancement policy for more lower level officers that allows the board to take into account individual circumstances would better serve the corporation's purposes.

■ **The Scope of Advancement:** Consider carefully who is entitled to advancement and to what extent. If the corporate climate supports broad mandatory advancement and titles are granted broadly, it may be sensible to define the officers and employees entitled to advancement. Consider the advantages and disadvantages of granting agents the right to advancement. Avoid unnecessary expansion of the scope of coverage.

■ **Inclusion of Lower Level Officers and Employees:**

Consider whether certain lower level officers and employees (for example, compliance officers and employees in reporting functions) should be covered under the policy. Again, avoid unnecessary expansion of the scope of coverage while, at the same time, being sensitive to the potentially higher risks for certain types of employees.

■ **Retirement from Board:** Amend bylaws to cover retirement from the board. A corporation may, for example, state in its bylaws that the right to advancement vests at the commencement of board service or add wording that prohibits retroactive adverse amendments to the bylaws affecting directors' and officers' right to advancement.

■ **Final Disposition:** Amend bylaws to include the definition of "final disposition". Pursuant to *Sun-Times v. Black*, Delaware courts are likely to interpret "final disposition" as the final, nonappealable conclusion to the proceeding. If the corporation's intent is to limit the advancement obligation to either sentencing (i.e., it does not want to be liable for appellate costs) or a guilty plea (i.e., it does not want to be liable for costs between a guilty plea and sentencing), the bylaws should be drafted accordingly.

■ **Ambiguous Words:** Be careful with the use of ambiguous words such as "defense" that are likely to be construed broadly by the courts. If the corporation's intent is to exclude mandatory counterclaims from the scope of advancement, this should be specifically addressed in the bylaws in light of *Reinhard v. The Dow Chem. Co.*

■ **Distinction Between Advancement and Indemnification:**

Draw a clear distinction between the advancement and indemnification provisions if the corporation's intent is to treat them differently. Address them preferably in separate articles of the bylaws or charter.

■ **Distinction Between Indemnification by Statute, by Contract and through Director and Officer Insurance:**

Make sure that the corporation's advancement and indemnification policies are drafted in accordance with applicable statutes and that any policies adopted by a board in the corporation's contracts, bylaws or charters are consistent with each other and with the corporation's director and officer insurance.

■ **Mergers and Acquisitions:** Ensure that former directors and officers are not deprived of their rights to advancement as a result of a change in the composition of the board of directors after a proxy fight or if the corporation is acquired.

■ **Repayment Obligation in Mandatory Advancement Schemes:**

When adopting a mandatory advancement bylaw or charter provision, consider adding a provision requiring repayment of the advanced fees if the person to whom the advancement is granted is eventually found guilty of wrongdoing or for other reasons. Consider what the other reasons should be, such as liability in a civil matter as opposed to a criminal matter.

■ **Direct Suits and Derivative Suits in Mandatory**

Advancement Schemes: When adopting a mandatory advancement bylaw or charter provision, consider making a distinction between direct suits by the corporation and derivative suits (otherwise a corporation could be required to fund the defense of a defendant director even when the board has already concluded that he has engaged in significant wrongdoing).

■ **Voluntary Advancement Scheme:** If the corporation voluntarily agrees to advancement in a particular case without a written advancement policy, make sure this is communicated as a one-time exception. Any such advancement should be subject to carefully defined criteria for advancement to commence and continue, criteria for termination of the advancement obligation and criteria that triggers the repayment obligation. A formal, explicit advancement scheme may, however, be preferable.

■ **Capping the Advancement Policy:** Consider the need for having a cap on the advancement policy. This may, however, lead to one “rogue” director or officer using the entire amount which, in turn, may leave the other directors and officers without adequate coverage. Therefore, it may be preferable not to have a cap on the advancement or to have a cap that can be exceeded upon board approval.

■ **Evaluation by an Independent Entity:** Consider establishing a committee of independent directors or specialists to evaluate the limitations imposed by the board on advancement in each individual case. The considerations for the reasonableness of the limitations may include, among others, the liability or culpability of the individual.

■ **Revisit Advancement Policies on a Regular Basis:** Revisit the advancement policies on a regular basis to ensure that they reflect the best interests of the corporation and its shareholders.

Directors and Officers

In addition to the items mentioned above, directors and officers should consider the following to protect themselves under advancement and indemnification policies:

- Advancement and indemnification policies should probably cover all directors and officers to foster a unified board and defense. Nevertheless, directors and officers may have better protection with a separate agreement if there is a likelihood that one “rogue” director or officer could somehow use up all of the available coverage. In that case, separate policies should be considered.
- Directors and officers should make sure language is included in the advancement and indemnification provisions that specify that the corporation cannot unilaterally amend or rescind.
- Directors and officers should consider the creditworthiness and responsiveness of the director and officer liability insurer.
- Directors and officers should determine whether they have the right to settle or reject settlements without such decisions impacting their advancement and indemnification coverage.

As always, White & Case would be pleased to assist you in determining whether your advancement and indemnification policies need to be updated and in revising them to reflect the board’s and directors’ and officers’ intents.

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