Message from the Chair

I hope you have had a great summer. Our Committee meets next on Friday, September 18, 2015 at 9:00 a.m. at the ABA Business Law Section Annual Meeting. We expect to have presentations on recent federal and state developments affecting director and officer liability as well as a report from Jim Wing, Chair of our Insurance Subcommittee, about D & O insurance updates, including some that have resulted from the Committee's efforts. We will also discuss ideas for future CLE presentations. For those of you who are members but have not attended a meeting, I encourage you to attend in person if you are in Chicago or via teleconference. In-house counsel and new members are welcome.

Finally, this is the last meeting I will chair. I am pleased that Frances Floriano Goins, our Developments Chair for many years, will begin a three-year term as Chair of the Committee once this meeting adjourns. John Mark Zeberkiewicz will serve as Vice-Chair and Brett Amron will serve as Developments Chair. It has been an honor and privilege to serve as Chair and I wish Frances, John Mark and Brett much success in continuing our effort to make this Committee and our website the premier forum not only for keeping abreast of developments affecting director and officer liability and insurance but also for influencing them. I look forward to seeing you in Chicago.

Lewis H. Lazarus
Morris James LLP
Chair, Director and Officer Liability Committee
ABA Business Law Section

Upcoming Meeting

Date: Friday, September 18, 2015
Time: 9:00 a.m. to 10:30 a.m.
Location: Horner, Silver Level, West Tower, Hyatt Regency Chicago
Toll-Free Dial-In (U.S. and Canada): (866) 646-6488
International Dial-In: (707) 287-9583
Conference Code: 6304783957

Featured Articles

A Brief History of the Director and Officer Liability Committee’s Efforts in Addressing the Issue of Criminalization of Director and Officer Legal Risk
By James D. Wing

The Committee has been focusing on the issue of the criminalization of director and officer legal risk since early 2011. In August 2011, the first steps were taken to incorporate the issue of Fifth Amendment privilege protection into the Committee’s draft Annotated Model Indemnification Agreement that was ultimately published by the ABA two years later. At the Committee’s meeting in Washington D.C. in November of that year, in-house counsel from two major
corporations encouraged the committee to draft a checklist that would assist them in supervising the executive protection process.

Accordingly, in March 2012, the Committee introduced a draft "Checklist for Corporate Counsel" to the profession at the Business Section's Las Vegas meeting. It was well received. An ABA-wide webinar followed shortly thereafter. The 2012 Checklist was published in Business Law Today in August 2012. The Checklist attempted to consolidate, in one writing, the various issues that deserved consideration in a comprehensive executive protection program. The Checklist proceeded on a basis consistent with considered professional commentary. It assumed that statutory director exculpation, advancement/indemnity, and D&O insurance should be considered together as a coordinated whole.

Read more...

ROUNDTABLE: Risks facing directors and officers
Moderated by Carolyn Snow, Risk Management Society
Original Publication: Financier Worldwide Magazine, August 2015 Issue

An ever-growing list of mandatory and non-mandatory rules is ramping up the risks faced by directors & officers. The general trend is toward raising the level of care expected of D&Os as they look to steer their organizations through the complexity of today's business challenges. As a consequence, at-risk senior executives are searching for more sophisticated D&O coverage.

Read more...

The SEC's New Proposed Dodd-Frank Clawback Rules: Mechanics and Risk Transfer
By Priya Cherian Huskins, Woodruff Sawyer & Company
Original Publication: D&O Notebook: Directors and Officers Liability Blog, September 2, 2015

Clawbacks of executive incentive compensation roared into the public company conversation with the passage of Section 304 of the Sarbanes-Oxley Act of 2002, which mandates the return of a CEO and CFO's incentive-based compensation when there has been misconduct leading to an accounting restatement.

The Securities and Exchange Commission has been the enforcer of those SOX rules to date. There have been a number of interesting cases where CEOs and CFOs returned big bonuses as a result of the company committing fraud, often despite the fact that these individuals were not personally charged with misconduct.

Read more...

FLASH REPORT: Director & Officer Liability Committee

Two separate advancement opinions issued from the Delaware Court of Chancery on May 28 merit attention: Mooney v. Echo Therapeutics, Inc., C.A. No. 10054-VCP (Del. Ch. May 28, 2015), and Blankenship v Alpha Appalachia Holdings, Inc., C.A. No. 10610-CB (Del. Ch. May 28, 2015). Both opinions continue to enunciate the loud and clear principle of Delaware law that bylaws and certificates of incorporation making contractually mandatory the advancement of defense costs for either civil or criminal proceedings that arise from a covered executive's employment and are phrased as going "to the fullest extent permitted by law" mean what they say - mandatory means mandatory.

Read more...
A Brief History of the Director and Officer Liability Committee’s Efforts in Addressing the Issue of Criminalization of Director and Officer Legal Risk
By: James D. Wing

The Committee has been focusing on the issue of the criminalization of director and officer legal risk since early 2011. In August 2011, the first steps were taken to incorporate the issue of Fifth Amendment privilege protection into the Committee’s draft Annotated Model Indemnification Agreement that was ultimately published by the ABA two years later. At the Committee’s meeting in Washington D.C. in November of that year, in-house counsel from two major corporations encouraged the committee to draft a checklist that would assist them in supervising the executive protection process.

Accordingly, in March 2012, the Committee introduced a draft “Checklist for Corporate Counsel” to the profession at the Business Section’s Las Vegas meeting. It was well received. An ABA-wide webinar followed shortly thereafter. The 2012 Checklist was published in Business Law Today in August 2012. The Checklist attempted to consolidate, in one writing, the various issues that deserved consideration in a comprehensive executive protection program. The Checklist proceeded on a basis consistent with considered professional commentary. It assumed that statutory director exculpation, advancement/indemnity, and D&O insurance should be considered together as a coordinated whole.

The Committee expressed an intention to update the Checklist yearly. In anticipation of this update, a year later (August 2013) in San Francisco, the Committee heard a presentation specifically directed at the revolution in the criminal law known as “cooperation” and the difficult Fifth Amendment issues that affect executives who become involved in its principal manifestation, the “corporate internal investigation.” Aspects of these issues had already been addressed in the Committee’s final Annotated Model Indemnification Agreement published by the ABA the same month. They were then highlighted in greater detail in a 2013 Checklist published in Business Law Today in September 2013.

The criminalization of executive risk then became a centerpiece of a second live presentation by the Committee at the Business Law Section’s meeting in Los Angeles in late March 2014. The Committee’s CLE materials contained a memorandum with an accompanying 52 jurisdiction summary of aspects of the law of advancement. The memorandum contained detailed citations to US Supreme Court precedent relevant to the assertion of the Fifth Amendment privilege in corporate internal investigations. The memorandum highlighted important inconsistencies in state law, two major disagreements between the Model Act and Delaware case law, and the degree to which innocent executives were at risk in internal investigations. With the citations omitted, the memorandum formed the basis of an article in Business Law Today published in September 2014 and a special report to the insurance industry published in January 2015.

One of the principal issues where state law differed involved a provision in the Model Business Corporation Act that required executives to make a written and cross-examinable assertion of innocence as a condition to receiving advancement of defense costs in criminal cases. On its face, this provision imposed a Fifth Amendment waiver as a condition to advancement. The Committee worked to amend the Model Act to delete the requirement; its formal deletion occurred in late 2014.

Then, partly in response to the Committee’s efforts, in July of this year the market saw the introduction of the Marsh Alpha Side A D&O difference-in-conditions policy, underwritten by Lloyd’s. This is the first policy that provides insured executives coverage for “pure” internal investigations (i.e. it covers
investigations precipitated by whistleblowers and other sources unrelated to a derivative suit investigation or one precipitated by an enforcement authority). Among other features, it provides a mechanism guarding against waiver of Fifth Amendment privileges arising from interactions between the insured executive and the insurer, guarantees advancement if the corporation is unable to advance defense costs or refuses to advance for any reason after 45 days, covers adverse attorney's fee awards, covers costs incurred by insured executives to access corporate documents necessary for their defense, locates venue over disputes in the jurisdiction of the underlying primary insurance policy, and to the extent the law permits, waives the insurer’s right to recoup defense costs previously advanced even if the executive is found guilty in the underlying criminal or civil case of conduct that triggers the policy’s “willful and deliberate act” exclusion.

At the moment, this policy comes closest to any on the market to meeting the objectives set forth in the Committee’s 2012 and 2013 Checklists, which may be found at the Committee’s website. It represents a major move in the insurance markets and an advance for executive protection worldwide.

Having worked to bring the movement this far, what is next for the Committee?

The central purpose of a Side A-only difference-in-conditions policy is to give covered executives access to insurance limits that cannot be invaded by the corporation itself or non-covered executives. The central idea is that Side A-only policies are excess over the corporation’s underlying “tower” of combined ABC cover and the corporation’s often substantial retention. Side B ABC cover already insures the corporation for defense costs that it advances to executives. Side A-only policies (and the premiums charged for them) are designed only to cover loss that the corporation and the underlying ABC cover does not pay and are written on the assumption that the corporation will in fact advance and indemnify to the fullest extent permitted or required by law. The Marsh Alpha policy, like other Side A-only policies, specifically so provides.

Thus, to maximize their separate Side A-only cover, it is in the covered executives’ interest to expand and strengthen their rights to statutory or common law advancement. Their objective is to throw onto the corporation’s retention and the Side B cover as much loss as possible. By doing so, the insured executives will best preserve their Side A-only limits. On the other hand, how far should that intention be respected if it may later be in the corporation’s interest to oppose advancement to one or more insured executives? It is the job of boards on the “clear day” to balance the desire to protect executives, on the one hand, against the cost of that protection and the potential interest of the corporation to deny advancement on the later "stormy day." These issues have become even more critical in light of the recent issuance of new guidelines for prosecutors by the United States Department of Justice, which may be found here.

During the week of September 21, 2015, The Business Lawyer will publish a comprehensive article on the “cooperation revolution” in criminal law and the issues that arise from its increasing use as they relate to executive protection. The article will emphasize the need for corporate boards to resolve the tension between the “clear day” and “stormy day” scenarios and will catalog in detail the issues where the tension is most acute. The article suggests that boards can best find a balance and insulate themselves from later criticism if the process is guided by counsel who represent only boards or duly authorized board committees, not executives personally or the corporation. Such counsel will necessarily have a cross-disciplinary focus given that the end product must combine expertise from four separate practice areas -- corporate law, insurance law, civil litigation, and white collar criminal defense.
Board counsel tasked with drafting these protections to harmonize with the new insurance cover will be challenged. A potentially worthwhile project for the Committee might be to create short-form model bylaws under both the Model Act and Delaware law that deal with the various points of tension outlined in the article. The exercise alone may serve to at least commence discussion that could lead ultimately to professional best practices and safe harbors. The energy and enthusiasm of younger lawyers would be most welcome in any such endeavor.
ROUNDTABLE

Risks facing directors and officers

REPRINTED FROM
AUGUST 2015 ISSUE

© 2015 Financier Worldwide Limited. Permission to use this reprint has been granted by the publisher.
An ever-growing list of mandatory and non-mandatory rules is ramping up the risks faced by directors & officers. The general trend is toward raising the level of care expected of D&Os and expanding their existing duties. These higher standards increase the personal risks and liabilities for D&Os as they look to steer their organisations through the complexity of today’s business challenges. As a consequence, at-risk senior executives are searching for more sophisticated D&O coverage.
THE MODERATOR

Carolyn Snow
Immediate Past President, Risk Management Society (RIMS)
T: +1 (602) 580 3861
E: csnw@humana.com
www.humana.com

Carolyn Snow is immediate past president of the Risk Management Society (RIMS) and director of Risk Management at Humana Inc. On the RIMS board she has served as liaison to Conference Planning, Marketing and Communications, Quality, and Technology. As director of operational and clinical risks at Humana, Ms Snow manages the corporate insurance program, including Humana’s captive and RMIS systems.

THE PANELLISTS

Jeremy Scott-Mackenzie
Commercial Institutions Manager, AIG Australia
T: +61 2 9240 1712
E: jeremy.scott.mackenzie@aig.com
www.aig.com

Jeremy Scott-Mackenzie is the regional commercial institutions manager – Financial Lines, at AIG Australia. He is a leading authority in his field and is responsible for the strategic development of AIG’s Commercial Crime and Directors & Officers Liability insurance portfolio across Australasia, having been with AIG for over 10 years in a variety of roles across the Asia Pacific region. He is a member of the Australian Institute of Company Directors and the President of the Australian Professional Indemnity Group, Inc.

Beverly Bell Godbey
Partner, Gardere Wynne Sewell LLP
T: +1 (214) 999 4855
E: bgodbey@gardere.com
www.gardere.com

Beverly Bell Godbey is a trial partner in the Dallas, Texas office of Gardere Wynne Sewell LLP. Her practice over more than 10 years emphasizes commercial litigation and insurance coverage. She routinely performs coverage reviews, analyses and comparisons for both corporate and insurer clients in all commercial lines. A frequent speaker on D&O insurance, Ms Godbey also consults in bid faith and extra-contractual issues.

Hans-Ulrich Brunner
Partner, Prager Dreifuss Ltd
T: +41 44 254 5555
E: hans-ulrich.brunner@prager-dreifuss.com
www.prager-dreifuss.com

Hans-Ulrich Brunner advises and represents individual and corporate clients in corporate and commercial matters. He has a special focus on, and longstanding experience with, real estate transactions and construction business operations. In addition, he regularly acts as defence counsel in liability and insurance cases. He is a member of the practice groups ‘Insurance & Reinsurance’ and ‘Corporate and M&A’.

Frances Floriano Goins
Partner, Ulmer & Berne LLP
T: +1 (216) 583 7202
E: fgoins@ulmer.com
www.ulmer.com

Frances Floriano Goins is incoming chair of the ABA Director & Officer Liability Committee and is involved in firm leadership. Her practice focuses on resolving complex business disputes for public and private companies, primarily securities, corporate governance and control, shareholder rights, cyber security and financial services. Ms Goins also conducts internal corporate investigations and counsels businesses on compliance issues.

Rob Yellen
Executive Vice President, Willis FINEX North America
T: +1 (212) 915 7919
E: roboticyellen@willis.com
www.willis.com

Rob Yellen is an executive vice president with Willis FINEX NA serving as its directors and officers and fiduciary liability thought and product leader. With over 24 years of Financial Lines industry experience, and a legacy of legacy of innovative, market-leading products and industry firsts, Mr Yellen is a respected leader in the management and professional liability space.
Activist investors, regulatory uncertainty, cyber insecurity and veritable mountains of compliance add pressure and unprecedented complexity to today’s challenges.

ROB YELLEN

Shareholder emphasis on short-term profits and increased outsourcing are some of the factors that put pressure on D&Os to meet higher standards and increase their personal risks. D&Os are responding to these pressures through increased attention to risk management, including the appointment of dedicated senior-level chief risk and chief compliance officers, better interdisciplinary corporate planning for risk contingencies, and increased training on issues such as ethics, fraud and cyber risk for both directors and employees. Boards are also attempting to plug expertise gaps in the director mix through better succession planning and more focused talent searches, and are reviewing D&O liability coverage.

Godbey: In the US, the drop in oil prices which caused a downturn in the energy sector, coupled with slow growth in employment and consumer confidence, has sent some companies scrambling to avoid financial insolvency. Any threat of bankruptcy, debt restructuring, stock drops or financial re-statements tends to increase risks for D&Os because investors have become much more aggressive about pursuing decision makers on the board, even when natural market fluctuations are responsible for the changes. Many D&Os, particularly independent directors, are demanding more comprehensive D&O insurance with larger policy limits, including Side A DIC and Independent Director Liability (IDL) coverage, to help mitigate this risk. Even the broadest indemnity agreement is virtually worthless if the company is unable or unwilling to reimburse the directors and officers, so good insurance is imperative.

Yellen: Keeping investors and other stakeholders happy in an environment with slow or no, economic growth, cascading economic crises such as Greece and China, and intense pressure to live up to high expectations commonly reflected in near record share prices is no small task. Activist investors, regulatory uncertainty, cyber insecurity and veritable mountains of compliance add pressure and unprecedented complexi-
ity to today’s challenges. For many of the risks they face, there is not much D&Os can do to avoid the suits. Stock drops – especially large drops – attract class action claims and today’s relatively high valuations give stock prices more room to fall. Nearly 95 percent of US M&A transactions over $100m in 2014 with public targets experienced litigation while activist shareholders have never been more effective in pushing for change – leaving today’s leaders caught in a classic Catch 22, finding themselves damned if they do or don’t. Also, today’s connectivity puts high-profile, highly-compensated directors and officers in the crosshairs of thieves and others who seek to profit from their private information, identity theft or personal brand.

Snow: What themes have underpinned recent claims filed against D&Os? What factors are driving these claims?

Godfrey: The single most pervasive theme appears to be measuring the conduct of D&Os by an ‘overall fairness’ standard rather than strict adherence to corporate rules and regulations, which tend to exculpate D&Os. This trend in American law manifests itself in legal decisions that remove or reduce barriers to shareholder derivative actions, emasculate the business judgment rule, and shift the burden of establishing good faith and fairness from the claimant to D&Os. Although no one factor drives these decisions, some commentators postulate that D&Os should no longer be able to hide behind the opinions of their investment bankers or financial advisers, because these experts always declare a transaction ‘fair’. After all, these experts have an incentive to close a transaction – they want to be paid.

Yellen: Reside from the 2008 financial crisis and a Main Street public sentiment have fuelled an unprecedented focus on business leaders’ conduct and compensation. Fuelled, in part, by ‘Fair Share’ politics which pits ‘haves’ against the ‘have nots’, public outrage and mistrust of busi-ness leaders has never been higher. Disappointed, disenfranchised stakeholders lament sometimes tragic losses from fraud schemes laid bare during the crisis. Workforce rationalisation, a product of companies struggling to hit profitability targets in a slow-growth economy, has left many angry and frustrated over their disrupted lives and looking to blame the leaders forced to make tough calls.

Goins: In the wake of enhanced pleading requirements for securities claims in US federal courts – such as the Private Securities Litigation Enforcement Act – the plaintiffs’ bar is focusing on state law claims against directors and officers. Unfortunately, many state court judges do not have the expertise or the experience to deal with complex issues of corporate governance. Allegations of breach of directors’ ‘duty of oversight’ have become the response to any and all negative events that may impact the company – including not only the more traditional financial issues, but also data breaches, fraud and anti-bribery violations, and failure to comply with regulatory requirements. Factors such as the dependence of even smaller businesses on international trade and foreign markets and increased anti-corruption prosecutions not only domestically, but also in countries as diverse as the UK, China and Brazil, create fertile ground for follow-on litigation in the US.

Brunner: While earlier D&O claims largely focused on companies that had become insolvent and as a consequence were put into liquidation, we have seen a growing number of liability claims against directors where the company was far from being bankrupt and fully operational. One broader theme relates to shareholder disputes spilling over on the directors’ level. In addition, some recent claims targeted intercompany loans that had been granted within the same group of companies, at favourable terms and without any security. One can discern from recent jurisprudence that corporate groups affected by financial distress must be careful when managing group liquidity on a consolidated level to avoid violating statutory laws in different jurisdictions applicable to the various group subsidiaries. A recent judgment of the Swiss Federal Supreme Court confirmed that cash-pooling schemes pose a considerable risk for D&Os in connection with capital protection rules, such as prohibition to repay stock capital and to grant hidden distributions to shareholders.

Scott-Mackenzie: We are seeing the last gasp of GFC related litigation. These include a number of Australian class actions that had been dormant up until recently. A number of these cases involve litigation against directors that may have retired from the board some years ago, only to be drawn back into the fray recently. We have also seen a significant increase in the number of newer entrant litigation funders, who are seeking class actions and other forms of litigation. Since IMF Bentham was listed in Australia in 2001, another dozen or so litigation funders have arrived. In addition, we have seen a number of attempts by law firms or their related entities to fund class actions. Where previously we were seeing it take many months for class actions lawyers and litigation funders to undertake due diligence on whether to pursue an action, we are now seeing a ‘rush to file’ as class action lawyers and funders want to be the first to lodge class actions. In many cases, this means that there are a number of Australian class actions and other claims against managers that are, in our opinion, poorly framed.

FRANCES FLORIANO GOINS
and that have been brought without sufficient understanding of how to run litigation.

Snow: How have the personal risks to D&Os changed over the past few years? What major new risks have emerged?

Goin: The major personal risk to D&Os is litigation itself, which has increased in severity over time. Even when terminated in its earliest stages, litigation causes personal reputational risk, expense, distraction and business disruption. In private civil litigation, the actual risk of a personal damage award against a director or officer has not changed significantly in recent years. However, to take full advantage of the business judgment rule, directors must be fully informed and act in good faith. Adequate indemnification and advancement provisions in corporate charters and bylaws and appropriate insurance coverage can also mitigate the degree of personal risk. In the wake of the Dodd-Frank Act and heightened attention by the SEC and other regulators to enforcement actions against individuals as corporate ‘gatekeepers’, regulatory penalties and criminal-side risks are increasing.

Scott-Mackenzie: The biggest emerging risk for directors is managing cyber and data related risks. Only a few years ago, cyber and data were seen as the domain of the IT team. Nowadays, most companies have recognised that data, including customer data, process maps or employee information, is one of their most valuable assets. With this insight, it is clear that the protection of this asset is important, and the loss of this data can be devastating to an organisation. Most boards have considered the impact of the mega data breaches in the US, such as the data breaches at Target and JP Morgan. However, many Australian directors continue to feel overwhelmed by the complexity required for an effective risk management framework for data protection and privacy. For example, is the ownership of a risk management strategy to protect employee data the domain of the HR or IT functions? The insurance industry has been quick to respond to the risks faced by directors arising from the loss of data and other cyber exposures. Specialised cyber insurance policies will provide a response team drawn from across the gamut of required professionals, including IT, accountants, public relations consultants and lawyers. In addition, the best such policies will meet the cost of business interruption as well as the defence and settlement of any regulatory or civil litigation against the directors and the company that may ensue.

Godfrey: New personal risks for D&Os can be found in some unusual places. For example, several states, including California, Illinois, Michigan and Oklahoma, have enacted statutes that make D&Os individually liable for the payment of sales, use, franchise and other business taxes if the company does not or cannot pay. In addition to paying the taxes, the states threaten liens on property and garnishment actions. Receipt of this type of tax notice can be terrifying because the amounts are huge, the company may be insolvent and unable to provide indemnification, and most D&O policies exclude taxes from the definition of ‘loss’. A few D&O insurers now offer some coverage for tax liability in the event of insolvency, so prudent directors and officers should insist on this coverage. There are good defences to these tax actions, but coverage for defence costs to avoid this personal liability is essential.

Generally, we expect proceedings to become more and more complex and entail significant defence and procedural costs.

Hans-Ulrich Brunner

Yellen: The biggest, most impactful change has to be in the rise of US derivative claims. Once largely seen as throwaway claims, derivative settlements have reached new multi-hundred million dollar heights. With massive, non-indemnifiable losses a real threat, derivative claim exposure could be materially personal, if not insured. How bad is that risk now? Consider the top five derivative settlements: $275m for Activision Blizzard in 2014, $139m for News Corp. in 2013, $137.5m for Freeport-McMoRan in 2015, $122m for Oracle in 2005 and $18m for Broadcom Corp. in 2009. Not all of those settlements were fully funded by D&Os, or their insurers, but those amounts do set the bar for plaintiffs’ expectations. Also, nothing is secret or sacred any longer. Social media has empowered anyone with a gripe to make a public spectacle of virtually any slight, real or perceived. Connectivity and cyber insecurity not only empowers crooks, competitors and others to steal personal information, money, intellectual property and other secrets, but hackers can interrupt service, hijack business process and cause real damage, too. Unlike litigation loss, reputation damage can be profound and immediate – with consequences exponentially worse.

Brunner: The regulatory environment has changed dramatically in recent years. Also, public opinion has changed significantly with respect to compliance issues and it has even led some politicians to express the opinion that managers should be held accountable for a company’s bankruptcy. Moreover, recent actions have seen some banks – not only Swiss banks – forced to admit wrongdoing to achieve non-prosecution agreements or deferred prosecution agreements. These actions will no doubt have an impact on personal risks incurred by D&Os. Generally, we expect proceedings to become more and more complex and entail significant defence and procedural costs. These proceedings include not only civil and criminal litigation, but also defences in a variety of administrative proceedings, such as proceedings led by the Swiss Financial Market Supervisory Authority or by the Swiss Competition Commis-
D&Os would be well-advised to make sure admissions are removed from the final adjudication language to preserve their D&O coverage.
both their company’s value and their own reputation? Are D&Os as aware of the risks they face as they should be?

Scott-Mackenzie: Many directors continue to join boards without necessarily undertaking the requisite due diligence. Prospective directors need to recognise that, whilst there may be prestige associated with taking a board position, it should inherently be a ‘two way’ street. Not only should the company be comfortable with the director, but the director must be comfortable with the company after due enquiry. As an extension, I advocate that such due diligence should be an ongoing process. Directors should take time each year to review what the corporate foundations were that they initially drew comfort from to join the board, and whether those foundations are still present. We have had occasion where a director drew comfort because there was a particularly strong executive team with a focus on a structured risk management framework. However, when there were changes in that team, the directors did not necessarily reflect on whether that should occasion a change to their continued directorship. If a director’s view is that they would not join the board at this time, then this should be a ‘red flag’ that either they should be working for change, or, in the absence of change, consider resigning their directorship.

Brunner: There is not a single, unified appropriate risk management system. Each company faces its own particular risks, whether operating internationally or domestically, or depending on the regulatory environment that applies to its particular business. Hence, a permanent objective is to ensure that D&Os are not only aware of their legal obligations under company law, but also under any other regulations that might apply. Abiding by a certain formalism and the simple, but basic requirements for applying the business judgment rule is actually an important starting point. In addition, proper records should be maintained to avoid potential evidentiary difficulties in the event a dispute arises. Last but not least, internal processes should be reviewed periodically and amended if necessary to reflect the current regulatory environment. Also, as D&Os may become personally liable for taxes and social security contributions, they have a self-interest to know the risks as well as also regularly supervise and actively avoid such debts remaining unpaid.

Yellen: In addition to the basics of staying informed, setting the tone at the top and seeking independent advice, savvy D&Os buy D&O liability insurance and they make sure their ‘Side-A’ coverage will respond when there is a failure or refusal to advance or indemnify loss. D&O coverage really pays, and it may be the only buffer between a robust litigation industry and personal assets. D&Os should also make sure their coverage is up to date. D&O insurance quality and features vary, and with a competitive market driving innovation, your D&O policy may not be keeping up with new opportunities to transfer today’s new or heightened risks. New features, like enhanced investigation coverage, express advancement, reputation protection and claims cooperation severability are essential in today’s heightened enforcement world. Also, D&Os should make sure to share their troubles directly or via their company’s risk manager, with their broker and legal advisers who can help assess the situation and how insurance may factor in. To illustrate, with activist investors demanding reform now more than ever, a broker can help you assess whether D&O insurance may respond, and, perhaps more importantly, whether a demand for reform may trigger a policy’s duties to notify provisions. For most D&O insurance, a mere written demand for monetary or non-monetary relief will likely trigger that duty and potentially trigger coverage, too.

Godby: Recent opinions from the Delaware Chancery Court shed light on actions D&Os should take to avoid potential risks and liabilities. In one case, minority shareholders sued to challenge a recapitalisation by majority shareholders and investors. Although the court ultimately found that the recapitalisation was fair, it found a breach of fiduciary duty because the ‘process’ was not fair. The court criticised the board for failing to hire an independent financial adviser, relying on a ‘back of the envelope’ company valuation, and failing to consult with the one independent director for advice and input. In another case, the court criticised the board for approving credit agreements entitling lenders to accelerate the debt in the event of a change of control. This action can be a breach of fiduciary duty when a proxy fight is foreseeable. D&Os should evaluate the process for transactions, demand transparency and stop rubber-stamping.

Goins: D&Os are generally aware of the need for broad-based enterprise risk management. In recent surveys, directors mentioned cyber security, for instance, as among their top concerns. Most large public companies are at least considering appropriate programs to manage risks, but smaller entities may not view such risks as vendor management or international fraud enforcement as significant enough to justify the investment of time and corporate resources necessary to identify and manage them, although issues such as these can create devastating corporate losses. Directors may not simply abdicate risk management because they deem the problem to be beyond the resources of the entity. Traditional lower-level risk management departments are not generally equipped to assess the cost-to-benefit impact of current risks. Effective risk management requires an interdisciplinary approach, drawing on
the collective expertise of the enterprise to identify, quantify and control risk. Education, advance planning, oversight and tracking are crucial.

Snow: With mergers and acquisitions presenting a wide array of potential pitfalls, what advice can you give to D&Os undertaking M&A in terms of protecting themselves from the personal liabilities associated with a transaction?

Godbey: By far, conflicts of interest remain the predominant risk factor in M&A transactions. In many cases, the courts focus on whether the director or officer has or will obtain a benefit from the transaction — even a subtle benefit. For example, directors who also serve as investors or consultants to the company need to evaluate the potential for a conflict between the two entities. Similarly, directors who may receive bonuses or compensation in the event of a change of control face increased risk of a conflict. Even current officers or directors who want to serve on the board of the new entity may have a conflict in supporting the transaction. Use of special committees of independent directors to objectively evaluate the transaction can help reduce the risk of a conflict, as can a vote of the minority shareholders if there is a potential conflict between majority and minority interests.

Scott-Mackenzie: Many directors, and their advisers, continue to get caught in the hype of the deal and fail to consider not only the risk to the business, but the personal risk. The personal risk directors’ face in M&A transactions continues to grow. Of late, plaintiffs are naming directors and officers in civil litigation as a tactic to press for early settlement. In essence, the directors face the specter of personal litigation if the company does not settle. Often, the pleading against the D&Os will use the Australian Competition and Consumer Act 2010 (Cth) as an alternate pleading to draw in the individuals, and may also be used to bypass contractual limits that are in place from the sale and purchase agreement.

Yellen: M&A is a critical insurance juncture. In addition to risks from that transaction, there are also risks that the transaction will result in coverage traps, like gaps in coverage for future claims that may relate to both pre-close and post-close acts, errors or omissions. Most M&A objection litigation is addressed before the deal becomes effective through adjustments to consideration and deal terms. Typically, the costs of those adjustments, while not covered under D&O insurance, would be borne by the acquiring entity rather than personally by directors or officers. However, if those claims are not resolved before the deal closes or if the deal fails, personal risks increase substantially as the character of loss potentially shifts from mere additional consideration to potential damages for breach of fiduciary duty by the directors.

Goin: Recent reports say 94 to 97 percent of M&A transactions generate shareholder lawsuits. This is more than twice the number calculated in 2005. While most suits are resolved prior to the deal closing and some are withdrawn or dismissed, such claims remain an issue for D&Os. The Delaware Supreme Court recently upheld exculpatory charter provisions that eliminate an outside director’s personal liability to shareholders for monetary damages for breach of fiduciary duty where the director has acted in good faith and is not conflicted. That opinion, In re Cornerstone Therapeutics, Inc., may have broader application in other contexts to protect at least independent directors by requiring individualised allegations of non-exculpated misconduct to survive a director’s motion to dismiss. Most state corporate laws also protect directors who reasonably rely on good faith on reports of corporate management or certain outside experts.

Brunner: We have not yet seen — and would not expect to see — a flood of US style M&A litigation of disgruntled shareholders of a company in Switzerland, that either has been or is about to be acquired, based on the allegation that the board of directors breached its fiduciary duties by conducting a sales process that did not maximize shareholder value. Accordingly, our advice would be simple: do whatever is necessary to obtain the protection of the business judgment rule. In the M&A context, this means, for example, undertaking thorough and proper due diligence, using independent external advice and, eventually, fairness opinions, to obtain all information necessary to understand what risks are associated with the transaction and the pricing, then act accordingly to minimize such risks. With regard to D&O insurance, the acquirer should ensure that there is coverage for the kind of deal contemplated, and from the perspective of the acquired, the D&O should be aware that coverage might expire upon completion of the transaction.

Snow: What has been the impact of increased regulations, penalties and settlement figures on the costs associated with defending claims filed against D&Os?

Scott-Mackenzie: The cost of settlements in securities actions continue to skyrocket, with the high water mark in Australia of the Centro securities class action a few years ago. Whilst the increasing costs of settlements and increased regulation makes headlines, some directors are surprised at the cost of defending such proceedings, and that, even if successful, these costs are seldom fully recoverable. In many cases, we are seeing the legal defence costs of complex D&O litigation exceeding $10m, and on occasion in excess of $25m. Quite simply, without the benefit of D&O insurance, many directors would not get their day in court. Given the rising cost and complexity of D&O litigation, the need for both capable legal expertise and an experienced claims manager is needed now more than ever.

Goin: The cost associated with defending claims against D&Os have been spiralling upward steadily over the last few years. Although many observers believe the raw number of suits filed has declined of late, their severity is at record levels, and there have been more jumbo settlements across the board, with fewer cases disposed of through initial motion practice. State courts, where much of the recent activity has occurred, are particularly reluctant to grant early dismissals without a factual record. When an initial motion fails and litigation enters the discovery phase, costs skyrocket. Increased regulation in industries such as financial services and healthcare also drives up costs, since the revelation of a regulatory investigation usually triggers tag-along shareholder litigation. Regulatory enforcement actions and attendant penalties only exacerbate the problem.

Yellen: Naturally when more is at stake, settlement values increase, and defence costs are likely to be higher, too. No matter how well written new rules or regulations may be, uncertainty...
board service if top quality D&O insurance is not in place in sufficient amounts to cover a catastrophic loss. Potential board members, particularly independent directors, frequently demand to read the policies and have them evaluated by coverage counsel or personal brokers. They want Side A DIC layers, as well as IDL policies, to make sure coverage is available to protect their interests apart from the company’s interests and those of senior executives. A well-crafted and structured D&O program benefits the company, protects individual D&O’s and offers an incentive for the company to attract the most well-qualified new board members – all good reasons to spend the time and money to get the best coverage.

Scott-Mackenzie: The role of D&O insurance goes beyond that of mitigating the risk. It allows directors to focus upon the business without compromising their decisions for fear of personal liability. In the absence of D&O insurance, many directors could simply not meet the cost of this complex litigation, and would likely have to settle civil litigation, or accept banning orders and other sanctions imposed by ASIC and other regulators.

Goin: D&O liability insurance is critical to mitigate exposure to personal risk for board members and senior executives. D&O need to take steps to be sure that their companies provide them with adequate indemnification for such expenses, as well as appropriate provision for advancement of defence costs, which are frequently the most expensive element of such claims. Often the actual costs of advancement and indemnification must be funded through liability insurance. While such insurance limits cover fraud or intentional actions by the insured D&O’s and it is unlikely to cover a liability verdict, D&O need to know that they will be funded in mounting the best possible defence to avoid such a result. Moreover, an aggressive and well-constructed defence is the best leverage in settlement negotiations.

Yellen: Because there are circumstances when even well-funded companies cannot or will not protect their D&O’s, effective D&O liability coverage is a must have proposition. D&O policies may provide protection long after the company no longer can. While D&O insurance can provide critical resources to ensure directors and officers can defend themselves, some D&O carriers also bring expertise and influence that can help get tough situations resolved. Having the right carrier and broker can make a world of difference in outcome.

Snow: With the scope and nature of D&O risks having increased exponentially in recent years, how have D&O insurance policies evolved to satisfy today’s needs?

Scott-Mackenzie: D&O policies continue to evolve to address a range of exposures, such as the impact of multinational risk and the imposition of fines and penalties. In addition, modern D&O litigation requires more than a good lawyer, but also requires a litigation management team, including an experienced claims manager that can call upon accountants, public relations and their overseas counterparts. As an addition, leading D&O policies should provide access to claims managers prior to any such litigation. These claims managers have a wealth of experience in litigation management and are able to provide feedback on common pitfalls when dealing with regulators or in other complex D&O litigation, which the board can then use.
to review and bolster their risk management framework.

Brunner: Some 20 years ago, D&O policies in Switzerland were a matter of a few publicly traded large companies, and it was a specialty business carried out by only a small number of insurance companies. This has changed considerably. Nowadays, even small and medium-size enterprises are purchasing D&O policies and such policies are no longer a specialty business, but are sold by many, which led to a market environment that has become more competitive and fast-paced. Improved insurance parameters now comprise a larger and more diversified risk pool in combination with a larger premium volume, more competition and high insurance capacities due to a difficult investment environment with negative interest rates. This has effectively resulted in lower premiums and more flexibility. Accordingly, these aspects have neutralized, to a certain extent, any contrary effect from more regulation, at least for the moment. Following a public vote on executive salaries, new rules have been implemented entailing criminal liability in case of breach. Executives will likely be under scrutiny, which may also lead to more D&O cases in Switzerland. Overall, we would not be surprised if heightened scrutiny of executive action, potential obstacles in international business through a veritable regulatory boom and a more litigious shareholder society in Switzerland could result in an increased demand for more sophisticated D&O insurance products. As we have seen in the past, such circumstances have resulted in a significant increase of insurance premiums and reduced individual risk coverage.

Yellow: The good news is D&O insurance solutions have never been better suited to mitigate the risks associated with serving on a board or as an executive. Coverage is available not just for traditional claims-based loss, including defence costs, but also to loss from informal investigations and inquiries - even if no claim has been made and no wrongful act has been alleged. Side-A coverage, which largely responds to non-identified exposures of board members and executives, has never been broader and may include multiple reinstatements of limits. Global risks call for global solutions, and today’s D&O coverage addresses global better than ever before. More traditional D&O coverage can now benefit from ‘Side-A Liberalisation’ that not only upgrades traditional D&O to match the exceptionally broad terms of Side-A excess, but can enhance the entire program to improve mitigation of counterparty and contract risk. A critical enhancement not uniformly offered is protection that will not dissipate when one or more insureds cooperate with authorities, rather than the insurer, in the context of an investigation.

Goins: D&O insurers have paid attention to the increasing and evolving risks to D&Os, and have created new products to address the increased risks. For instance, there are currently available in the US a number of different cyber security coverage policies, most of which did not exist three years ago. It is important for companies and their D&Os to stay ahead of the curve with respect to insurance risk coverage, since once claims begin to accumulate under a particular policy, insurers may be more reluctant to issue similar coverage at cost effective rates to new insureds. Insurers have likewise responded to the market for expanded Side A coverage and the market for such policies is now quite competitive. To the extent coverage needs to evolve, the industry will continue to develop new products to respond to those needs.

Godhey: Luckily for corporate D&Os, D&O insurers have listened and responded with expanded and novel coverages, like coverage to defend against subpoenas and document requests received before a claim arises. This coverage for pre-claim inquiry costs is just one of many changes to the definition of ‘loss’ or ‘damages’, which now can include derivative investigation costs, liberty protection costs, SOX 304 costs, extra-dition costs, UK Corporate Manslaughter Act defence costs, personal reputation expenses, asset protection costs and Dodd-Frank 954 costs. Newer D&O policies also offer coverage for certain civil penalties assessed pursuant to the Foreign Corrupt Practices Act, some HIPAA liabilities and even cyber liability. Unfortunately, the insurers have not yet addressed coverage for, or at least a defence against, the proliferation of aiding and abetting claims arising out of ‘merger and acquisition objection’ cases, but D&Os look forward to the day this coverage is available, as well.

Snow: What advice would you give to companies and their D&Os when they are assessing the merits of a D&O policy? Which elements should be considered of paramount importance?

Goins: Companies and their D&Os should consult experienced coverage counsel when assessing the merits of D&O insurance. Too frequently, companies rely upon internal risk management employees or insurance brokers to interpret policies for them and to tell them what coverage they need. But internal risk management may not be sophisticated enough and brokers may not be entirely independent. Moreover, the interpretation of policy provisions is constantly evolving in case law, and experienced coverage counsel may be better positioned to correctly match up the particularised risks faced by the entity and its D&Os with available products, and to interpret and assess the insurance products under consideration.

Brunner: As D&O policies are on a claims-made basis, the most important aspects are related to time – D&Os should be covered beyond functus officio and beyond the ‘life’ of the entity; hence, there should be a run-off period of five years at least. In addition, we would recommend including the possibility of triggering coverage by notifying circumstances, and there should be an extended reporting period after termination of the policy. With regard to coverage, defence costs for criminal prosecution and proceedings become more and more important. Finally, coverage for D&Os’ personal liability for tax claims and social security contributions should be sought.

Godhey: D&O policies vary greatly from insurer to insurer, so it is wise to read and compare the actual language to find the broadest and most comprehensive coverage. Brokers and coverage attorneys regularly provide these evaluations and comparisons. Depending on the size of the policyholder, D&O policies can be highly negotiable. If shopping the market is an option, ask the broker to obtain two or three quotes, along with policy specimen forms and all proposed endorsements. Use competing quotes as leverage to negotiate not only the lowest premium, but also superior coverage. Brokers also can provide ‘peer reviews’ to compare potential policies with those issued to other insureds in the same industry or insureds of approximately the same size. Analyse specific company risks.
then employ all of these negotiations and tools to purchase the coverage that best protects the company and the D&Os from these potential risks.

**Yellen:** At the end of the day, selecting the right partners and building relationships is critical to getting protection that can be relied upon. Also, while cost always matters, in today’s competitive market, broad coverage should be first priority since it is available for reasonable cost. Start by finding a broker you can trust with multinational reach and influence. Brokers can not only get best-in-class features tailored to your situation, but they have information and relationships that often make the difference between resolution and litigation. When claims happen, a strong broker will serve a critical function pulling potentially diverse stakeholders, like primary and excess carriers and defense and coverage counsel, together.

**Scott-Mackenzie:** While obtaining a broad coverage and sufficient limits are often focused upon, we would suggest that if a director really wants to see the quality of their D&O insurance, they should meet with the insurer’s claims manager. Whilst the insurer’s and the broker’s sales team are important to the placement of the D&O, it is the insurer’s claims manager that will assist them should they face litigation or an investigation. In addition, consider whether you want your D&O insurance to cover just the D&Os, or whether you want the policy, including its limit, to be shared with the company. Some policies continue to provide cover to the company in the event of securities class actions or employment practices disputes. These may lead to the policy being depleted by claims against the company, and the directors being left without the protection they thought they had purchased.

**Snow:** What risk management measures can directors adopt to mitigate against potential legal battles and costly settlements?

**Yellen:** D&O coverage is not a commodity. Likewise, D&O risk is dynamic, shifting with myriad factors like stock price, enforcement trends, M&A and IPO trends, and the fluid priorities of the plaintiffs bar. Enterprise risk management has become a more significant agenda item for boards lately – not just for D&O exposures, but those D&O exposures can fall within and be impacted by the larger risk management efforts. To stay ahead of the curve, companies and their D&Os should keep a sharp eye on the SEC, its rulemaking and enforcement. In particular, watch how regulators look at cyber security and related disclosures, and track how enforcement authorities use evolving analytical tools to increase its efficiency and effectiveness. On the civil litigation front, while cyber security breaches have made headlines, and they have, thus far, not resulted in a successful securities class action or derivative claim, it is just a matter of time. When that first successful suit becomes the template for success, we could see a torrent of similar litigation follow.

**Scott-Mackenzie:** First and foremost, good risk management for the company is often good risk management for the directors. Directors are often investigated by regulators, or lawyers look to litigate against directors, where the company has had perceived difficulties – whether a worksite death causing an investigation under Work Health & Safety legislation, or a securities action arising from the company’s failure to meet its continuous disclosure obligations. Secondly, when faced by an investigation or civil litigation, obtaining good legal advice as quickly as possible is essential. With early intervention, the matter may be dealt with at a preliminary stage which is obviously advantageous. Our experience is that once a regulator has a head of steam up, they can often be difficult to stop. This often requires that the company’s risk management framework include not only the preventative measures to reduce the likelihood of a breach that may cause a litigation or investigation, but developing and testing processes to effectively respond should a regulator like ASIC call upon them.

**Godley:** The most effective way to avoid D&O litigation is to prepare, implement and enforce specific written corporate governance, compliance and ethics programs. Within these programs, companies should strengthen internal controls, including financial and reporting procedures, engage in comprehensive risk assessment, create employee handbooks and conduct regular inside and outside audits. Companies need to make sure these programs are adequately staffed and funded, and with board oversight, they should periodically review and update the programs to make sure they remain viable and relevant. In addition, companies need specific policies and training on how to prevent, detect and remediate misconduct, should it occur. Some companies have implemented bonuses and rewards for managers and employees who diligently follow compliance policies. All of these measures tend to reduce litigation and prevent negative regulatory scrutiny and activity.

**Gowin:** The best defense for directors to potential legal battles and costly settlements is to be proactive. This means demand full analysis of potential risks from management, putting in place effective and thorough accountability and reporting systems, effectively monitoring the implementation of such systems through regular reporting and review, promptly rectifying any deviations or violations, and adjusting the systems as needed. The protections of the business judgment rule only apply when directors make informed decisions in good faith, based on adequate investigation, and applying a well thought-out and well executed strategy. Simply ‘doing nothing’ nullifies the business judgment rule, increases the risk of litigation, and potentially exposes directors to liability for damages. Directors should also consider new strategies, such as forum selection bylaws, recently approved in Delaware, and some form of fee-shifting, which can, if properly implemented, reduce risk of personal liability.

**Brunner:** There are – in essence – two sets of risk mitigating measures a director should adopt. On the one hand, they should ensure proper decision-making processes and take decisions on the basis of appropriate and timely information after due discussion of the pros and cons, by considering alternatives and their respective risks, by consulting experts in areas where they lack sufficient expertise as well as acting solely in the interest of the company. Also, they should maintain an orderly file of all relevant decisions and acts that may give rise to potential claims. On the other hand, they should follow best industry practices as these may likely be regarded as certain minimum standards and could be used by courts to determine whether a breach of duty occurred.
FLASH REPORT: Director & Officer Liability Committee

Two separate advancement opinions issued from the Delaware Court of Chancery on May 28 merit attention: Mooney v. Echo Therapeutics, Inc., C.A. No. 10054-VCP (Del. Ch. May 28, 2015), and Blankenship v Alpha Appalachia Holdings, Inc., C.A. No. 10610-CB (Del. Ch. May 28, 2015). Both opinions continue to enunciate the loud and clear principle of Delaware law that bylaws and certificates of incorporation making contractually mandatory the advancement of defense costs for either civil or criminal proceedings that arise from a covered executive’s employment and are phrased as going “to the fullest extent permitted by law” mean what they say – mandatory means mandatory.

Mooney v. Echo Therapeutics, Inc.

Mooney arose out of litigation between a corporation’s terminated principal and the corporation itself and either permitted or denied advancement on seven separate types of claims: a FINRA proceeding, an internal investigation, two sets of counterclaims lodged in a civil lawsuit brought by Mooney, a second civil lawsuit by Mooney allegedly brought to vindicate rights damaged by the first set of counterclaims in the earlier civil suit, and a claim for “fees on fees.” The issues involved in resolving the various claims were acutely factual, yet the issue of advancements was resolved summarily on paper following DeLucca v KKAT Mgmt., L.L.C., 2006 WL 224058, at *6 (Del. Ch. Sept. 14, 2007): “Advancement cases are particularly appropriate for resolution on a paper record, as they principally involve the question of whether claims pled in a complaint against a party...trigger a right to advancement under the terms of a corporate instrument.”

The Court also deferred until the ultimate indemnification stage of the case “line item review” of counsel’s invoices to determine reasonableness of fees sought and a detailed inquiry into whether the fee claimant’s conduct was or was not “by reason of” his status as an indemnified director or officer. As to the latter issue, Echo pled counterclaims seeking the recovery from Mooney of alleged unauthorized and fraudulent expense reimbursements which the corporation could recover even if Mooney had not been CEO. Finding that both the power to make the disbursements and the power to cover them up by (allegedly) intimidating corporate personnel from reporting them involved exercise of his powers as CEO, the Court required advancement, relegating the recovery of the advanced fees to the indemnity stage of the case. Mooney, however, was denied advancement of fees he incurred in his affirmative case on the familiar principle that generally only costs of defense are recoverable, not costs of prosecution. The Court noted that Mooney’s attempt to justify his affirmative case as being limited to seeking vindication of reputation destroyed by Echo’s initial counterclaims against him in the first suit that Echo withdrew was stretching Delaware counterclaim advancement law too far.

Blankenship v. Alpha Appalachia Holdings, Inc.

On the same day, Chancellor Bouchard issued an opinion in Blankenship. Mr. Blankenship is the former Chairman and CEO of Massey Energy Company, which owned and operated the coal mine in West Virginia that suffered an explosion in 2010 resulting in the death of 29 miners. Massey’s entire safety culture came under intense review. In 2011, Blankenship retired (“not entirely voluntarily,” as the Court noted), and Massey was acquired by Alpha Natural Resources. For a time, Alpha continued advancing Blankenship’s legal expenses arising out of the explosion. In late 2014, Blankenship was indicted, and Alpha stopped advancing his defense costs. On the eve of the criminal trial, Blankenship’s counsel, Zuckerman Spaeder LLP, was owed $5.8 million in unpaid legal fees and costs.
What makes Blankenship unique was the existence of an advancement undertaking not required by Delaware law that was apparently signed inadvertently after the merger agreement was signed and before Blankenship was indicted. Although characterized by the company’s lawyer as merely “clarifying” the company’s preexisting duty to advance fees and costs, the undertaking, if applied literally, would have gutted Blankenship’s advancement rights. In the undertaking, Blankenship made the same cross-examinable assertion of good faith and reasonable belief in the legality of his conduct that is required by most states that follow the Model Business Corporation Act.

(This committee was in the forefront of the successful effort to abolish this requirement in the Model Act. In practice, it forces executives seeking advancement of criminal defense costs to waive their Fifth Amendment rights by submitting to the cross examination of their conduct in a civil forum before the criminal case is tried. If they do not so submit and insist on their Fifth Amendment protections, they risk losing their right to advancement. The Model Act was revised to eliminate this requirement last year, although no state has yet adopted the amendment.)

Despite having no legal or contractual obligation to do so, Blankenship signed a document making the former Model Act representation, in derogation of his existing rights. All ended well, however. The Court distinguished between the clause in which Blankenship made his representation of good faith and reasonable belief, on the one hand, and a second clause that granted Alpha and Massey the right to terminate advancement, on the other. It found that Alpha/Massey had elected not to proceed under the termination provision but had limited their case to a breach of the representation provision. The Court interpreted the representation provision as relating only to the commencement of advancement as distinct from its continuation, as granting no grounds to terminate advancement, and as being overly broad and unreasonable.

To one familiar with how the provision operates in Model Act states, the opinion might appear strained. Indeed, in footnote 135 of the opinion, the Court came close to noting that the representation clause may have been inspired by the law of West Virginia, a Model Act state, the jurisdiction in which Massey conducted significant operations, and the domicile of a different Alpha subsidiary that was a co-obligor. One could reasonably infer that the principal factor underlying the decision is the strength of Delaware’s strong public policy in favor of advancement:

“Finally,...Delaware’s salutary statutory public policy of ‘attracting the most capable people into corporate service through broad indemnification and advancement protections supports resolving ambiguity in an instrument governing advancement rights in favor of advancement. The Supreme Court has described advancement as ‘provid[ing] 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.’ Against this public policy backdrop, I find the present circumstances – where Massey exclusively drafted the Undertaking and never gave Blankenship fair notice that it intended for the Undertaking to fundamentally alter his right to advancement—support interpreting any ambiguity in the Undertaking in favor of Blankenship’s advancement rights. Thus, if the Contingency Provision were ambiguous, I would construe the provision against Massey and adopt Blankenship’s interpretation on this alternative ground.”
Perhaps of nearly equal force is the burden that corporations’ refusal to honor their mandatory obligations to advance expenses are putting on the Delaware courts. Francis Pileggi’s recent blog and Kevin LaCroix’s comments on the case address this point in greater detail.

While Delaware public policy in favor of advancement served as a key basis for avoiding the adverse consequences of the former Model Act’s good faith and reasonable belief undertaking provision, counsel to parties seeking advancement should not rely on it to rescue those parties when the provision is expressly set forth in the certificate of incorporation, bylaws, or agreement providing rights to advancement. Many of these provisions exist in corporate documents. They should be revisited whenever found.