DIRECTOR AND OFFICER LIABILITY COMMITTEE NEWSLETTER

April 2018

In This Issue

Important Dates

Business Law Section Spring Meeting
April 12-14, 2018
Orlando, FL

Editorial Board

Message from the Chair

Dear Director & Officer Liability Committee Members,

Next up: the Business Law Section Spring Meeting April 12-14, in Orlando, FL. If you miss the deadline for advanced registration, you will still be able to register in person on site at the Business Law Section Lounge registration desk at the Rosen Shingle Creek Resort.

This promises to be an awesome meeting! Here are some of the highlights:

Our Committee has an interesting agenda planned, including a discussion of the current state of indemnification and advancement case law and reports on new developments impacting director and officer liability. We will be meeting on

> Friday, April 13th, 2018
> 9-10:30 a.m.
> Rosen Shingle Creek
> St. John's 29, Level 2

If you are unable to attend in person, please stay tuned for dial-in information to come.

Be sure to stop by the Diversity Networking Reception on Wednesday evening, April 10th, 6:30-8 p.m., Rosen Shingle Creek, Butler, Level 1.

On Thursday, please attend the first of our two Committee-sponsored **CLE programs** titled:

> ***Talking to Your Board About Cybersecurity: The Evolving Role of In-house Counsel in Managing Cyber Risk***
> Thursday, April 12, 2018
> 2:30-4 p.m.
> Rosen Shingle Creek, Sebastian I-1, Level 1

The complimentary Section Welcome Reception takes place on Thursday, April 12th, 6-7:30 p.m., Quiet Pool, Level 1. It's a great place to join colleagues and friends before one of the many planned committee dinners.

Our second Committee-sponsored **CLE program** takes place on Friday, and is titled:

> ***Navigating Parallel Administrative, Civil, and Criminal***

Proceedings: Challenges, Considerations, and Ethics
Friday, April 13, 2018
10:30 a.m.-12:00 p.m.
Rosen Shingle Creek
Sebastian I-2, Level 1

The Section Dinner will be held at SeaWorld on Friday, April 13, from 7-10 p.m.

There are too many other great CLE programs and activities to list here. The session promises to be a magical event, and I look forward to seeing you in Orlando!

Fran

Featured Articles

The Perils of Being a Bad Egg: DeCoster and the Responsible Corporate Officer Doctrine
By Dolores Garcia â€"Prignitz, Ulmer & Berne LLP

Last year, the Eighth Circuit affirmed a prison sentence for two corporate officers that entered guilty pleas for their company's violations of the Federal Food Drug and Cosmetic Act of 1938 ("FDCA"). In the Northern District of Iowa, Judge Mark Bennett sentenced a father and son executive team to a three-month prison sentence followed by one year of supervised release and a $100,000 fine for each.

Read more...

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By Manju Gupta, Counsel, Ulmer & Berne LLP

The United States Court of Appeals for the Sixth Circuit recently found in favor of an insurer, holding that an insured-versus-insured exclusion in a company's insurance policy precluded coverage of a bankruptcy liquidating trustee's claims against the company's former officers and directors. *Indian Harbor Ins. Co. v. Zucker for Liquidation Tr. of Capitol Bancorp Ltd.,* 860 F.3d 373, 374 (6th Cir. 2017).

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Ninth Circuit Rules Coverage for TPCA Claims Barred Under Invasion of Privacy Exclusion
By Jonathan M. Stemerman, Shareholder, Elliott Greenleaf, P.C.

Recently, the United States Court of Appeals for the Ninth Circuit in *Los Angeles Lakers, Inc. v. Federal Insurance Co.*, C.A. No. 15-55777, 2017 U.S. App. LEXIS 16109 (9th Cir. Aug. 23, 2017) affirmed a district court's finding in favor of an insurer after it denied coverage and declined to defend the Los Angeles Lakers in a lawsuit alleging violations of the Telephone Consumer Protection Act ("TCPA"). The divided panel held that, because a TCPA claim is inherently a violation of privacy claim, the insurer correctly concluded that the claims fell under the insurance policy's broad exclusionary clause.

Read more...

Meyers v Quiz-DIA: The Meaning of "To the Fullest Extent Permitted by Law"
By James D. Wing, Esq.

The June 26, 2017 ruling of Delaware Vice-Chancellor Laster in Meyers v. Quiz-DIA, 2017 WL 2438328 (D. Ch.) is the most recent of a series of Delaware decisions that seek to harmonize the law of advancement and indemnification under section 145 of the Delaware General Corporation Law (DGCL), 8 Del.C., § 145, with indemnification provisions contained in the operating agreements of Delaware LLCs, limited liability partnerships, and other forms of "alternative entities." The decision deserves careful consideration given that the advancement and indemnification law of many states is either derived from that of Delaware or views Delaware law as "instructive."

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Self-Reporting Under the New FCPA Policy: A Limited Presumption of No Prosecution
By Brett M. Amron, Bast Amron LLP

On November 29, 2017, the United States Department of Justice revealed its revised Corporate Enforcement Policy of the Foreign Corrupt Practices Act ("FCPA"). The new policy expands on the previous policy, which was initiated as a pilot program during the Obama era, and provides key benefits to those companies who self-report violations of the FCPA. These benefits come only with strict compliance with the requirements under the new policy, however, and companies will need to give serious thought to balancing the risks and benefits before deciding to self-report.

Read more...

Receiver's Claims Against Former Officers Not Barred by Insured v. Insured Exclusion
By Lindsey Dean, Tressler LLP

In January 2017, the 9th Circuit U.S. Court of Appeals held that an Insured v. Insured Exclusion barred coverage for claims brought by the FDIC as receiver for a failed financial institution. Shortly following that decision, Judge William E. Smith in the U.S. District Court for Rhode Island took a different view, albeit on slightly different policy language, holding in *Philadelphia Indemnity Ins. Co. v. Providence Community Action Program, Inc., et al.*, no. 15-cv-388, 2017 WL 354279 (D.R.I. Jan. 24, 2017), that an Insured v. Insured Exclusion did not preclude coverage for claims brought by a court-appointed receiver against the insured's directors and officers.

Read more...

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The Perils of Being a Bad Egg: **DeCoster and the Responsible Corporate Officer Doctrine**

Last year, the Eighth Circuit affirmed a prison sentence for two corporate officers that entered guilty pleas for their company's violations of the Federal Food Drug and Cosmetic Act of 1938 ("FDCA"). In the Northern District of Iowa, Judge Mark Bennett sentenced a father and son executive team to a three-month prison sentence followed by one year of supervised release and a $100,000 fine for each.[i]

The district court decision was the final fallout of a summer 2010 incident where more than 50,000 people became ill from eggs carrying the *Salmonella Enteritidis* bacteria.[ii] The U.S. Food and Drug Administration eventually traced the source of the outbreak to the Iowa-based Quality Egg, LLC. Quality Egg owned multiple egg production and processing facilities throughout Iowa.[iii] The FDA urged Quality Egg to issue a voluntary recall, and undertook a regulatory inspection of the plant.[iv] The district court's decision in *United States v. Quality Egg, LLC,* provides great detail from the DeCosters' pre-sentencing reports related to the ensuing investigation and findings in the Quality Egg facilities.[v] Suffice to say, the opinion is not for breakfast reading, and the "egregious unsanitary conditions" are graphically recounted. The district court also describes Quality Egg employees submitting false documents to government officials and bribing a U.S. Department of Agriculture official.[vi]

Following the investigation, Austin DeCoster, the owner of the trust that owned Quality Egg, LLC, and Peter DeCoster, Quality Egg's Chief Operating Officer, faced criminal charges. They entered guilty pleas to 21 U.S.C. § 331(a), a misdemeanor offense for introducing adulterated or misbranded products into interstate commerce.[vii]

The DeCosters pled guilty under the "responsible corporate officer" doctrine, also known as the *Park* doctrine.[viii] Named after the Supreme Court case, The doctrine allows the government to prosecute individual corporate officers for public welfare offenses under the FDCA but only those "responsible" for the offense.[ix] Thus, the individual corporate officer must be in a position of responsibility and authority to prevent or correct the wrongdoing.[x] Since the Supreme Court's decision in *Park*, the responsible corporate officer doctrine has been used infrequently. [xi]

The FDCA provides for a one-year maximum prison sentence for introducing adulterated or misbranded food into interstate commerce.[xii] Following entry of their guilty pleas, the DeCosters filed a motion challenging the constitutionality of a prison sentence for their crimes when they were not aware of the violations, and were therefore only subject to criminal charges through vicarious liability.[xiii] They argued that a prison sentence is unconstitutional for a strict liability offense.[xiv] The district court disagreed. Although not convinced that the DeCosters had no knowledge of the underlying offenses, even if unaware, a maximum prison sentence of one year for a misdemeanor was not a grossly disproportionate punishment invoking Eighth Amendment protections.[xv] Nor did incarceration violate the Fifth[xvi] or Sixth[xvii] Amendment. The district court sentenced each DeCoster to three months in prison.[xviii]

On appeal to the Eighth Circuit, the DeCosters did not find a more sympathetic hearing. The panel of Judges Murphy, Beam, and Gruender, like their lower court colleague, recounted the graphic findings and unsanitary conditions in the Quality Egg facilities.[xix] The opinion in *United States v. DeCoster,* 828 F.3d 626, 630-632 (8th Cir.2016), also expressed doubt that the DeCosters could be unaware of those conditions and their employees' unscrupulous activities.

(“The district court accordingly concluded that this was not a case involving a mere unaware corporate executive.”).[xx] In so doing, the Eighth Circuit rejected the notion that the DeCosters, and FDCA responsible corporate officers generally, are subject to a prison sentence based on vicarious liability.[xxi] Rather, under the FDCA, a responsible corporate officer “is held accountable not for the acts or omissions of others, but rather for his own failure to prevent or remedy “the conditions which gave rise to the charges against him.”[xxii] Reviewing the district court’s findings, the Eighth Circuit concluded that neither of the DeCosters claimed to have been powerless to prevent Quality Egg from violating FDCA, and despite their familiarity with the conditions of the Iowa facility, the DeCosters failed to take sufficient measures to improve them.[xxiii] It thus agreed that Eighth Amendment protections were not implicated, and likewise, concluded that the sentences were not procedurally or substantively unreasonable.[xxiv]

So what has changed in the wake of *DeCoster*? Is it a portent of a turning tide or just a particularly egregious situation that warranted individual accountability? The answer is not yet clear. The Eighth Circuit denied rehearing, and the Supreme Court denied cert.[xxv] In the short term, the ruling stands as just another application of the Responsible Corporate Officer doctrine, albeit at a time when federal prosecutors have come under increased scrutiny for not pursuing individuals on the basis of corporate wrongdoing.[xxvi] Indeed, in such an environment, a three-month prison sentence does not strike many other than the DeCosters as a more than a slap on the wrist.[xxvii] In the wake of *DeCoster*, the advice to directors and officers of food and drug companies has not changed since the dawn of the *Park* doctrine forty years ago: be aware or be at risk.

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[i] *United States v. Quality Egg, LLC*, 99 F.Supp.3d 920, 922 (N.D.Iowa 2015).
[ii] *Id.* at 926 n.7.

[iii] *Id.* at 923.
[iv] *Id.* at 926.
[v] *Id.* at 927-935.
[vi] *Id.*
[vii] *Id.* at 324.
[viii] *United States v. Park*, 421 U.S. 658, 673–74, 95 S.Ct. 1903, 44 L.Ed.2d 489 (1975).
[ix] *Id.*
[x] *Id.*
[xi] Trends In Responsible Corporate Officer Doctrine Under FDCA - Law360, December 14, 2015, 1:11 PM EST - https://www.law360.com/articles/737403/trends-in-responsible-corporate-officer-doctrine-under-fdca (last accessed Aug. 28, 2017).
[xii] 21 U.S.C. § 331(a) ("Any person who violates a provision of section 331 of this title shall be imprisoned for not more than one year or fined not more than $1,000, or both.")
[xiii] *Quality Egg*, 99 F.Supp.3d at 924-925.
[xiv] *Id.* at 934.
[xv] *Id.* at 942-947.
[xvi] *Id.* at 951-958.
[xvii] *Id.* at 936-939
[xviii] *Id.* at 958.
[xix] *United States v. DeCoster*, 828 F.3d 626, 630-632 (8th Cir.2016)
[xx] *Id.* at 632 (internal citations and quotations omitted).
[xxi] *Id.*
[xxii] *Id.* (internal citations and quotations omitted).
[xxiii] *Id.* at 634-635.
[xxiv] *Id.* at 635-636.
[xxv] *DeCoster v. United States*, 137 S. Ct. 2160, 198 L. Ed. 2d 232 (2017) (petition for writ of certiorari denied).
[xxvi] *See e.g.* Jesse Eisinger, The Chickenshit Club: The Justice Department and Its Failure to Prosecute White Collar Criminals, Simon & Schuster – 2017.
[xxvii] Peter J. Henning, Why It Is Getting Harder to Prosecute Executives for Corporate Misconduct, 41 Vt. L. Rev. 503, 518-519 (2017).

Insured-Versus-Insured Exclusion Applies to Liquidating Trustee
By Manju Gupta, Counsel, Ulmer & Berne LLP

The United States Court of Appeals for the Sixth Circuit recently found in favor of an insurer, holding that an insured-versus-insured exclusion in a company's insurance policy precluded coverage of a bankruptcy liquidating trustee's claims against the company's former officers and directors. *Indian Harbor Ins. Co. v. Zucker for Liquidation Tr. of Capitol Bancorp Ltd.*, 860 F.3d 373, 374 (6th Cir. 2017).

Capitol Bancorp Ltd. owned community banks in 17 states. Joseph Reid was its chairman and chief executive officer; his daughter served as president, and her husband as general counsel (the Reids). In 2012, after the financial crisis, Capitol filed for relief under chapter 11 of the Bankruptcy Code. At the time of Capitol's filing, Capitol's assets became property of the bankruptcy estate, and Capitol became the debtor in possession.

After several years of negotiations with the creditors' committee, Capitol agreed to assign all of the company's causes of action to a Liquidating Trust, which could then pursue those claims on behalf of creditors. The liquidating plan stipulated that the Reids would have no liability for any conduct after the bankruptcy was commenced and limited any recovery of prepetition liability amounts to Capitol's liability insurance policy. The Reids were also required to sue Indian Harbor Insurance Company, the company's insurer, if the insurer denied coverage under the management liability policy.

In August 2014, the liquidating trustee, Clifford Zucker, sued the Reids for $18.8 million, alleging they had breached their fiduciary duties to Capitol through a number of improper actions. Indian Harbor responded by seeking a declaratory judgment that it had no obligation to cover damages because the insured-versus-insured exception applied. The district court agreed. The Reids and Zucker appealed and a divided panel of the Sixth Circuit affirmed.

The insurance policy provided that the carrier agreed to pay for any "Loss resulting from a Claim first made against Insured Persons" – a group that included Capitol's directors, officers, and employees. But the policy excluded from coverage "any claim made against an Insured Person… by, on behalf of, or in the name or right of, the Company or any Insured Person," except for derivative suits by independent shareholders and employment claims.

The Sixth Circuit held that the exclusion applied because, as a voluntary assignee, the liquidating trustee stands in Capitol's shoes, possessing the same rights and defenses as Capitol. Likewise, just as the exclusion covers a lawsuit "by" Capitol it covers a lawsuit by the trust "in the…right" of Capitol. Conversely, the Reids and Zucker had argued that by commencing a bankruptcy, Capitol underwent a transformation and a debtor in possession is legally distinct from a pre-bankruptcy company, making the insured-versus-insured exception inapplicable to Capitol or its assignee.

The Sixth Circuit reasoned that the new-entity argument doesn't work because Capitol could not have dodged the exclusion by transferring a mismanagement claim to a new company. In addition, it reviewed the policy as a whole and found that the policy supported a finding that coverage existed after a bankruptcy filing. For instance, the "Change in Control" clause contemplated that coverage would continue uninterrupted during bankruptcy, even after the company became a debtor in possession. Further, the fact that after filing for bankruptcy, Capitol renewed its coverage twice did not support the Reids' and Zuckers' interpretation. The Court noted that if the policy were to cover only claims arising from prepetition conduct, there would be no purpose in renewing the policy. The two renewals, along with the policy being read as a whole, supported a finding that the exclusion applied to Zucker.

The Bankruptcy Code does not alter this conclusion. Section 1101(1) defines a chapter 11 "debtor in possession" as the debtor. Section 101(13) defines "debtor" as the "person or municipality concerning which a case under this title has been commenced." In *Biltmore Assocs., LLC v. Twin City Fire Ins. Co.,* 572 F.3d 663, 671 (9th Cir. 2009), the Ninth Circuit noted that "[T]he debtor in possession is the debtor, and the debtor is the person that filed for bankruptcy." Similarly, in *NLRB v. Bildisco & Bildisco,* 465 U.S. 513, 528 (1984), the United States Supreme Court viewed the debtor in possession as the same entity that existed before the filing of the bankruptcy petition.

The Sixth Circuit notably distinguished between court-appointed trustees and assigned trustees, remarking that rather than a court having to appoint a trustee, chapter 11 gives the debtor in possession all the statutory powers and duties of a trustee to enable the company to continue operations during the bankruptcy. 11 U.S.C. § 1107(a). The one exception is that the debtor in possession does not need to investigate the debtor's financial condition or improper conduct because the "debtor cannot be expected to inform on itself." *See* Norton § 93:2; 11 U.S.C. § 1107(a). This is an important distinction because many courts have held that an insured-versus-insured exclusion does not apply to court-appointed trustees because there is no risk of collusion. *See Alstrin v. St. Paul Mercury Ins. Co.,* 179 Supp. 2d 376 (D. Del. 2002); *In re Molten Metal Tech.,* 271 B.R. 711 (Bankr. D. Mass. 2002); *Zurich Am. Ins. Co. v. Boyes,* 2001 U.S. Dist. Lexis 15123 (ND. Tex. 2001).

The dissent disagreed, stating that there is no functional difference between the appointed and assigned trustees and that they should be treated the same for purposes of applying the insured-versus-insured exclusion. The majority, however, reasoned that a voluntary assignee such as the trust brings the lawsuit by, on behalf of, or in the name or right of the debtor in possession and as such the insured-versus-insured exception applies.

The Sixth Circuit concluded that the bankruptcy estate is a nominal entity that cannot act on its own and it needs a debtor in possession or trustee to sue on its behalf. Accordingly, a lawsuit by Capitol as a debtor in possession on behalf of the bankruptcy estate remains a lawsuit by Capitol and fits within the insured-versus-insured policy exception.

Ninth Circuit Rules Coverage for TPCA Claims Barred Under Invasion of Privacy Exclusion
By: Jonathan M. Stemerman, Shareholder, Elliott Greenleaf, P.C., Wilmington, DE

Recently, the United States Court of Appeals for the Ninth Circuit in *Los Angeles Lakers, Inc. v. Federal Insurance Co.*, C.A. No. 15-55777, 2017 U.S. App. LEXIS 16109 (9th Cir. Aug. 23, 2017) affirmed a district court's finding in favor of an insurer after it denied coverage and declined to defend the Los Angeles Lakers in a lawsuit alleging violations of the Telephone Consumer Protection Act ("TCPA"). The divided panel held that, because a TCPA claim is inherently a violation of privacy claim, the insurer correctly concluded that the claims fell under the insurance policy's broad exclusionary clause.

In 2012, David Emanauel attended a Los Angeles Lakers basketball game at the Lakers' home arena. While at the game, he observed a message on the scoreboard inviting attendees to send a text message to a specific number. He sent a text message to the number, hoping the Lakers would display the message on the scoreboard. In response to his text, he received an automated text message. Subsequently he filed suit against the Lakers alleging both negligently and knowingly and/or willfully violations of the TCPA.

The Lakers promptly notified their insurance carrier, Federal Insurance Company of the action and asked federal to defend them against the lawsuit. The Lakers argued that the TCPA claims were covered by its "ForeFront Portfolio" insurance policy's "Directors & Officers Liability Coverage Section." Specifically, the section required Federal to pay for losses suffered by the Lakers "resulting from any Insured Organization Claim … for Wrongful Acts." An "Insured Organization Claim" included a civil proceeding commenced by service of a complaint … against [the Lakers] for a Wrongful Act." The policy, however, also contained a number of exclusions, including that "[n]o coverage would be available" for a claim "based upon, arising from, or in consequence of … invasion of privacy …."

Federal denied coverage and declined to defend the Lakers, concluding that the TCPA claims constituted invasion of privacy claims. The Lakers filed an action against Federal for breach of contract and breach of the implied covenant of good faith and fair dealing in state court. The action was removed to federal court. The district court, looking to California law, dismissed the action, finding that the TCPA claims are "implicit invasion-of-privacy claims" that fell squarely within the policy's broad exclusionary clause.

The Ninth Circuit affirmed the district court's finding. Analyzing California law, the Ninth Circuit noted that California courts (as well as the Ninth Circuit itself) have consistently given broad interpretation to the clause "arising from" in an insurance contract. The Ninth Circuit also noted that California courts have recognized four different forms of tortious invasion of privacy, including "intrusion upon the plaintiff's seclusion or solitude" otherwise known as "the right to be left alone." Unwanted calls, received at inconvenient times, generally invade an individual's privacy and right to be left alone under California law.

Examining the TCPA, the Ninth Circuit found that it is explicitly intended to protect privacy rights. The Ninth Circuit further found that violations of the TCPA were an implicit invasion of privacy and that, “in pleading the elements of a TCPA claim, a plaintiff pleads an invasion of privacy claim.” Thus, the Ninth Circuit determined that the complaint against the Lakers, in asserting two TCPA claims, asserted two invasion of privacy claims.

Recognizing that exclusionary clauses are to be construed against the insurer, the Ninth Circuit nevertheless found that the plain language of Federal’s contract was intended to exclude all invasion of privacy claims. The court therefore found that Federal had properly denied coverage based on the policy’s exclusionary clause language.

The Lakers also argued that, even if the policy did not require Federal to indemnify costs incurred from the action, it still had a duty to defend the action. Under California law, insurers must defend its insured against claims that create even a potential for indemnity under the policy, including where, under the facts alleged, reasonable inferable, or otherwise known, the complaint could fairly be amended to state a covered liability. The Laker’s asserted that, although only containing counts for violations of the TCPA, the plaintiff asserted that he had suffered multiple harms. The Ninth Circuit found that, because the Lakers did not identify what other claims the plaintiff could bring, there was no potential for the complaint to be amended to assert a claim for relief triggering a duty to defend.

Concurring in the result, a member of the panel argued that the case should have been decided on narrower grounds. Noting that the plaintiff alleged several times in the complaint that the message he received was an invasion of policy, the concurrence stated that those allegations were sufficient to find that the plaintiff had alleged an invasion of privacy and that there was no need to hold more broadly that a TCPA claim is inherently an invasion of privacy claim.

The dissent argued that the plaintiff’s claims did not fall under the invasion of privacy exclusion. Examining the elements of a TCPA claim, the dissent noted that they say nothing about invasion of privacy and that the court should adhere to the text of the statute. The dissent also argued that Federal had a duty to defend the Lakers because, contrary to the majority’s conclusion, TCPA claims are not privacy claims.

Meyers v Quiz-DIA: the meaning of "to the fullest extent permitted by law"

The June 26, 2017 ruling of Delaware Vice-Chancellor Laster in *Meyers v. Quiz-DIA*, 2017 WL 2438328 (D. Ch.) is the most recent of a series of Delaware decisions that seek to harmonize the law of advancement and indemnification under section 145 of the Delaware General Corporation Law (DGCL), 8 *Del.C.*, § 145, with indemnification provisions contained in the operating agreements of Delaware LLCs, limited liability partnerships, and other forms of "alternative entities." The decision deserves careful consideration given that the advancement and indemnification law of many states is either derived from that of Delaware or views Delaware law as "instructive."

The facts of *Quiz-DIA* presented one primary question: May indemnified officers of an LLC recover payment of their legal costs incurred in securing the dismissal of a federal securities law claim against them when the dismissal was based exclusively on jurisdictional grounds, was without prejudice, and a new state court case was filed almost immediately thereafter seeking the same relief on state law grounds? That is not an easy question when one considers that the LLC's indemnification provision did not contain the equivalent of section 145(c) of the DGCL that makes indemnification mandatory when an indemnified executive successfully defends a case against him "on the merits, or otherwise."

<u>Facts:</u> In 2014 the chief executive and chief financial officers of the Quizno's restaurant chain were sued in Colorado federal district court after Quizno's lenders forced it into bankruptcy and assumed ownership of its parent LLC and a series of direct and indirect subsidiary LLCs. The bankruptcy was filed after a 2006 leveraged recapitalization had failed. The recapitalization was allegedly premised on false and fraudulent financial projections made by the officers. The officers successfully defended the case on jurisdictional grounds. The lenders appealed to the Tenth Circuit, which affirmed, and the lenders did not seek certiorari relief to the Supreme Court. Instead, they filed an equivalent suit in state court under state law theories of recovery seeking the same relief.

Shortly before the district court's ruling in the officers' favor holding that the lenders had no cognizable federal securities act claim, the officers amended an existing Delaware suit in which they sought advancement and indemnification for that litigation. The amendment added to the suit claims for indemnification for their costs of investigating and defending the Colorado federal court claims based on identical indemnification clauses contained in the member agreements of three of the Quizno LLCs. The clauses provided:

"*To the full extent permitted by applicable law*, a Member or Officer shall be entitled to indemnification from the Company for any loss, damage or claim incurred by such Member or Officer *by reason of* any act or omission performed or committed by such Member or Officer *in good faith* on behalf of the Company and in a manner reasonably believed to be within the scope of the authority conferred on such Member or Officer by this Agreement, *except that no*

Member or Officer shall be entitled to be indemnified in respect of any loss, damage or claim incurred by such Member or Officer by reason of willful misconduct with respect to such acts or omissions...." (emphasis added).

The lenders moved for summary judgment dismissing the claims for indemnification. Vice-Chancellor Laster obliged, citing the familiar principle that no claim for indemnification is ripe until the underlying litigation is finally concluded. Because the matter was then on appeal to the Tenth Circuit, however, the court dismissed the indemnification claims without prejudice, but with the proviso that should the district court be affirmed and the lenders seek certiorari review in the Supreme Court, he would consider the officers' advancement claims. Shortly thereafter, the Tenth Circuit affirmed, the lenders did not seek certiorari review, the court granted the officers' motion to set aside the earlier dismissal of the indemnification claims on grounds of judicial efficiency, and proceeded to rule on the merits. Vice-Chancellor Laster held:

- Because the officers were not in fact members or officers of one of the LLCs (Quiz-DIA), they were not entitled to indemnification under the plain language of its member agreement's indemnification provision.
- The lenders' claims against the officers for making allegedly false financial projections incident to the 2006 restructuring fell within the "by reason of" clause of the indemnity. The officers' "involvement in negotiating the Restructuring and preparing the financial statements and projections that provided the basis for the Restructuring...was intended to save the entire Quiznos family of companies from financial failure.... [They] were therefore taken on behalf of the entire Quiznos family of companies, including [the two indemnifying subsidiaries]. Given this fact, [the two officers] acted 'by reason of' their status as CEO and CFO of [the two indemnifying subsidiaries]. Any losses that they suffered in the Colorado Action were incurred by reason of acts they performed on behalf of the Quiznos family of Companies.... The Indemnification Provision therefore covers expenses that [they] incurred in the Colorado Action."
- The officers were entitled to their costs of investigating the Funds' claims *before* they ripened into a suit: "In the indemnification context, the concept of loses generally includes not only fines or judgments, but also the costs of investigation and defense". He held that he would have so ruled even if the indemnification clause had stated that they could only recover "costs of defense."
- The indemnification provision's requirement that only "good faith" conduct would be indemnified did not impose on the officers a duty to plead and prove their good faith before they could obtain indemnification. Logically, that holding extended as well to the language excluding from indemnification recovery for any "willful misconduct." Vice-Chancellor Laster held that the grant of indemnification "[t]o the full extent permitted by applicable law" was an expression of an intention to grant indemnity as broad as public policy permits. He cited the "by reason of" language to reflect the intention to rely on "corporate concepts" of indemnification as a guide to the extent of that policy.

He then ruled that Delaware law permits indemnification of any indemnified corporate officer "who has been successful on the merits *or otherwise* in defense of any action, suit or proceeding...." He held that the phrase "or otherwise" includes a successful defense that is only "technical"… "such as a defense based upon a statute of limitations", and "includes the dismissal without prejudice of a federal action, even if the same claims are re-alleged in state court at a later date."

- Vice-Chancellor Laster cited in support of these rulings former Vice-Chancellor (now Chief Justice) Strine's 2009 decision in *Stockman v. Heartland Indus. P'rs. L.P.*, 2009 WL 2096213 (Del. Ch. July 14, 2009). Vice-Chancellor Laster characterized *Stockman* as holding that "when an alternative entity's operating agreement grants mandatory indemnification to "the fullest extent permitted by law," the grant includes a right to mandatory indemnification when an individual has been successful "on the merits or otherwise," without having to show good faith.

So would the result be different if the indemnification provisions in *Stockman* and *Quiz-DIA* did not contain the words "to the fullest extent permitted by law"? So it appears. The stated rationale of *Quiz-DIA* would support the conclusion that without the "full extent" language, the right to indemnification might not extend to a non-merits, "or otherwise" success. After all, the officers had only won a jurisdictional skirmish and must still face the substantively identical claims in a state forum. A New York case is in accord, see *546-552 W. 146th St. LLC v Arfa*, 70 A.D.3d 512, 894 N.Y.S.2d 427 (1st Sept. 2010).

The term "full[est] extent permitted by law" may have meaning after all.

<u>Take Away</u>. We have repeatedly emphasized that the field of executive protection is not for amateurs or tourists. It is full of technical pitfalls. The consequences of drafting errors to innocent executives charged with wrongdoing are frequently personally severe. The creation and renewal of executive protection programs remains a "three-legged stool" of director exculpation, advancement/ indemnification, and insurance that should be coordinated, with no individual element treated in isolation. Complicating the matter is that drafting and enforcement issues cut across at least four separate legal silos.

Because these programs are for the direct personal benefit of individual executives, ethical issues arise in the initial drafting and insurance renewal process because corporate counsel is creating a protection program for the direct benefit of non-client individual executives who in fact may be relying on corporate counsel for personal advice. Modern ethics codes call these executives "corporate constituents", and they are arguably entitled to separate disclosures that are rarely given. This may be an accident waiting to happen.

Self-Reporting Under the New FCPA Policy: A Limited Presumption of No Prosecution
By Brett M. Amron, Esq., Bast Amron LLP

On November 29, 2017, the United States Department of Justice revealed its revised Corporate Enforcement Policy of the Foreign Corrupt Practices Act ("FCPA"). The new policy expands on the previous policy, which was initiated as a pilot program during the Obama era, and provides key benefits to those companies who self-report violations of the FCPA. These benefits come only with strict compliance with the requirements under the new policy, however, and companies will need to give serious thought to balancing the risks and benefits before deciding to self-report.

The primary benefit of the new policy is the presumption of no prosecution if a company self-reports violations of the FCPA. The new policy states that "[w]hen a company has voluntarily self-disclosed misconduct in an FCPA matter, fully cooperated, and timely and appropriately remediated [in accordance with standards set forth in the policy], there will be a presumption that the company will receive a declination absent aggravating circumstances involving the seriousness of the offense or the nature of the offender." In addition, the company is required to pay all disgorgement, forfeiture, and/or restitution resulting from the misconduct at issue.

Voluntary self-disclosure, as defined under the new policy, must occur "prior to an imminent threat of disclosure or government investigation" and "within a reasonably prompt time after becoming aware of the offense." The burden to demonstrate timeliness rests with the company, and the company must "disclose all relevant facts known to it, including all relevant facts about all individuals involved in the violation of law." The policy does not provide more specific guidance as to what is a "reasonable" amount of time, what constitute "relevant facts," and who determines what is relevant. As a result, companies are faced with significant uncertainty in determining whether to self-report, as non-compliance with these requirements may put their declination in jeopardy.

Moreover, in an effort to comply with the timeliness requirement, a complete investigation of the alleged FCPA violation likely will not be completed by the company and potentially aggravating circumstances may not be brought to the company's attention prior to self-disclosure. A non-exhaustive list of aggravating circumstances mentioned in the policy includes (1) involvement of the company's executive management in the misconduct; (2) a significant profit to the company from the misconduct; (3) pervasiveness of the misconduct within the company; and (4) criminal recidivism. An analysis of these circumstances adds another complex layer to the analysis of deciding whether to self-report.

Nevertheless, the new policy attempts to protect those companies that self-report but are subject to aggravating circumstances by providing a 50 percent reduction off the low end of the applicable sentencing guidelines fine range. Additionally, these companies will not be required to appoint an independent monitor if they have implemented an effective compliance program, which is required under the new policy for all companies that self-report to receive full credit for timely and appropriate remediation.

Lastly, companies must be cognizant of the fact that this policy protects the company, and not individuals. Corporate directors, officers, executives, employees, agents, *etc.*, will not enjoy the same leniency offered to the company for their past or future misconduct. Accordingly, those companies that decide not to self-report but that do take appropriate remedial steps will receive a 25 percent reduction of the applicable sentencing guidelines.

In sum, companies are left with a difficult decision. Although the new policy provides numerous benefits to self-reporting and strives to reward self-reporting, there remains significant ambiguity and risk. As Deputy Attorney General Rod Rosenstein stated, “the new policy does not provide a guarantee. We cannot eliminate all uncertainty. Preserving a measure of prosecutorial discretion is central to ensuring the exercise of justice. But with this new policy, we strike the balance in favor of greater clarity about our decision-making process.”

Also, companies must remember that the considerations impacting a decision to self-report necessarily extend beyond white collar concerns. To what extent will the amounts required to be paid by the company be covered by insurance? Are the company's executives whose identities will be disclosed as being implicated even to a minor extent in reportable conduct appropriately insured for the costs of proving their innocence? Will this initiative come to set the standard in all areas of corporate compliance?

Receiver's Claims Against Former Officers Not Barred by Insured v. Insured Exclusion
By Lindsey Dean, Esq., Tressler LLP

In January 2017, the 9th Circuit U.S. Court of Appeals held that an Insured v. Insured Exclusion barred coverage for claims brought by the FDIC as receiver for a failed financial institution. Shortly following that decision, Judge William E. Smith in the U.S. District Court for Rhode Island took a different view, albeit on slightly different policy language, holding in *Philadelphia Indemnity Ins. Co. v. Providence Community Action Program, Inc., et al.*, no. 15-cv-388, 2017 WL 354279 (D.R.I. Jan. 24, 2017), that an Insured v. Insured Exclusion did not preclude coverage for claims brought by a court-appointed receiver against the insured's directors and officers.

Philadelphia Indemnity Insurance Company (Philadelphia) insured Providence Community Action Program, Inc. (ProCAP) under a directors and officers liability insurance policy. ProCAP began experiencing financial difficulty after it purchased the Policy from Philadelphia and was forced into receivership. The receiver appointed by the court brought a claim against two former ProCAP officers for breach of fiduciary duty and sent a demand to Philadelphia for payment under the Policy. Philadelphia denied coverage for the claim pursuant to the Insured v. Insured Exclusion in the Policy.

The Policy generally provided coverage for Claims first made against ProCAP during the Policy Period for a D&O Wrongful Act. The Policy's Insured v. Insured Exclusion barred coverage for "Claims made against the Insured brought or maintained by, at the behest, or on behalf of the Organization." After ProCAP went into receivership, the Policy was amended to include the receiver as an "Independent Contractor" that qualified as an "individual insured" under the Policy. The amendment to the Policy defined "Independent Contractor" as "an individual who is contracted to perform services for the Organization…"

The District Court held that the Insured v. Insured Exclusion did not preclude coverage for the receiver's demand. The court first analyzed whether the receiver was taking action on behalf of ProCAP, or on his own behalf as an agent of the court that appointed him. Looking to Rhode Island law analyzing the role of a court-appointed receiver, the court noted that when the Rhode Island Superior Court orders a company into receivership, the court and its receiver take legal title of the company and its property, leaving the company with only a contingent right in the property. Accordingly, the court found that a receiver is "better understood" as an agent of the court and as working for the potential benefit of various parties, rather than as working on behalf of the company. The court therefore held that the receiver's claim was not brought on behalf of ProCAP, and the Insured v. Insured Exclusion did not apply.

The court next rejected Philadelphia's argument that the Insured v. Insured Exclusion should apply regardless of the legal status of the receiver because the Policy was amended to add the receiver as an "Independent Contractor" who was contracted to perform services for ProCAP. The court reasoned that Philadelphia could not alter the relationship between the receiver and the court through an amendment to the Policy. The court also differentiated between the language used in the Insured v. Insured Exclusion, which applied to claims brought *on behalf of* ProCAP, and the amendment, which defined "Independent Contractor" as someone who is contracted to perform services *for* the Organization. The court also noted that the Exclusion did not reference "Independent Contractors" and vice versa.

In its opinion, the District Court correctly noted that the question of whether a successor in interest, such as a receiver, bankruptcy trustee or the FDIC, acts on behalf of an insured "has been the subject of much debate and disagreement." Courts take varying stances as to whether an Insured v. Insured Exclusion will bar coverage for claims brought against an insured by a receiver or similar successor. Oftentimes, courts will find that an insured v. insured exclusion does not apply because it is ambiguous in the context of claims brought by a receiver. Interestingly, the District Court here did not reach the issue of ambiguity. Instead, the court took a slightly different approach, focusing predominately on the legal role of the receiver under Rhode Island law.