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Corporate Governance Advisory: Delaware Court Ruling May Impact Charter-Provided Advancement Rights to Officers and Directors

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A recent Delaware Chancery Court ruling, *Schoon v. Troy Corporation*,[1] calls into question the manner in which advancement rights are provided to officers and directors of Delaware corporations and compels the examination of the basis, if any, of rights to advancement of legal fees and expenses when a lawsuit is brought against officers and directors for company-related matters.

Corporations may advance legal fees and expenses on behalf of officers and directors who are sued for actions taken on the corporation's behalf. While advancement pursuant to § 145(e) of the Delaware General Corporation Law is discretionary, not mandatory, many corporations include such provisions in their charters as an equitable measure to prevent officers and directors from being forced to pay significant fees in advance of an ultimate indemnity determination. Advancement claims often arise after an officer or director ceases service to the corporation. One might assume that advancement rights—at least those provided by charter—vest upon an officer or director's assumption of their corporate duties, but the Delaware Chancery Court reached a contrary conclusion in *Schoon*.

The individual seeking advancement in *Schoon* resigned as a director of Troy Corporation for health reasons. After his resignation, Troy amended its charter to provide advancement rights only to active, not former, officers and directors. After the charter amendment, the former director was sued for actions relating to his directorship. Troy denied his request for advancement on the basis that the charter amendment had nullified his advancement rights.

In upholding Troy's right to amend its charter to deny advancement to former officers and directors, the Delaware Chancery Court reasoned that charter-provided advancement rights do not vest until advancement-related claims are either threatened or asserted. In reaching this conclusion, the court relied on a prior advancement case, *Salaman v. National Media Corp.*,[2] which rejected a charter amendment nullifying advancement because the rights under the charter became contractual upon the assertion of a claim. Unlike *Salaman*, however, the claims asserted in *Schoon* were asserted after Troy amended its charter to remove advancement protection for former directors. Because the advancement claim did not vest prior to the amendment, the court reasoned, the former director in *Schoon* was not entitled to advancement, even though the events giving rise to the claim occurred prior to the amendment.

Mintz Levin's Recommendation

Salaman and *Schoon* should cause directors and officers to examine the manner in which advancement rights are provided, and they should have an explicit understanding as to when their rights to advancement vest. Charter-provided advancement rights may not vest upon the assumption of corporate office, and events triggering the vesting of those rights may not occur until well after a director or officer resigns. It appears, therefore, that officers and directors who rely solely upon charter-provided advancement rights may be at risk, as *Schoon* suggests that a Delaware corporation may freely alter those rights unless appropriate language in the charter compels otherwise. Mintz Levin suggests that corporations consider memorializing advancement rights, if any, through charter language that provides for mandatory advancement and which clarifies the contractual nature of such rights, which include the vesting of such rights at the commencement of service, or through an employment, advancement or indemnification agreement, the consideration for which is the officer or director's agreement to serve on the corporation's behalf. If advancement rights clearly vest upon the delivery of consideration, such as an officer or director's commencement or continuation of service to the corporation, it would be difficult for a corporation unilaterally to alter those rights even after a director or officer ceases to serve. In addition, directors and officers may take some comfort in knowing that they are covered under directors and officers insurance policies, which typically afford coverage to present and former officers and directors. Thus, although there may be a dispute over the applicable retention, the *Schoon* decision should not impact the availability of insurance coverage for an officer or director.

Endnotes

[1] CA No. 2362-VCL, 2008 WL 821666. An appeal of this decision was filed on June 4, 2008.

[2] 1992 EL 808095 (Del. Super. Oct. 8, 1992).

If you have any questions about the topics covered in this Advisory, or you need assistance in a review of your corporate charter provisions, your directors and officers' insurance coverage, or applicable employment and indemnification and advancement agreements, please contact the Mintz Levin lawyer who usually handles these matters for you, or any of the following individuals.

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