



For Convicted CEO, Legal Fee Payment Depends on the Agreement

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When is a company obliged to pay the legal fees of a wayward employee? The answer generally depends on the precise wording of the employee agreement, if an agreement exists.

A good case in point is the recent one of Frances Flood, the CEO of ClearOne Communications, who left the company in 2004 while under SEC investigation. Things didn't turn out well for her: She was indicted in 2007 and convicted in 2009 of nine felony counts and sentenced to four years in prison for falsifying revenue of one of the company's subsidiaries.

Through all this, Flood continued to pursue a case against her former company, trying to get them to pay her for the legal fees she had incurred. She claimed that the indemnification provision of her Employment Separation Agreement required the company to advance her legal fees.

On August 30, 2010, the U.S. Court of Appeals for the 10th Circuit ruled against her and found that as long as the company had acted in good faith in denying her fees, she wasn't entitled to any money. So now it seems very likely that ClearOne will not be paying the CEO-turned-convict's legal fees.

The appellate court noted that in the separation agreement, signed in 2003, ClearOne agreed to indemnify Flood for all reasonable attorneys' fees and costs, subject to the company's articles of incorporation and bylaws. The bylaws, in turn, provided for indemnification of directors if the company





determined that the director met a defined standard of conduct and payment was authorized. Payment was to be authorized, in turn, if the company determined that the legal fees were reasonable, that the corporation had the ability to pay, and that the money should be devoted to that purpose.

ClearOne advanced Flood's legal fees up to the spring of 2008 and then stopped. The company's board ultimately adopted a resolution reaffirming the company's refusal to advance any more funds.

After Flood sued to enforce the agreement, the district judge determined that ClearOne had likely breached its obligations. It ordered the company to advance Flood's legal expenses at least through the conclusion of her criminal trial. In the judge's view, ClearOne's promise to indemnify Flood if it later decided the expenditure was appropriate was empty and illusory. The court fixed the problem by making the indemnification provision absolute.

The 10th Circuit reversed. It noted that, if the indemnification provision were truly illusory, the contract would be unenforceable and Flood would be entitled to nothing. Disagreeing with the district judge, the appeals court said it was not the courts' role to impose an obligation the parties had not agreed to. But, the court explained, the provision was actually not illusory because, under the law of Utah, where the contract was signed, parties to a contract are obligated to perform in good faith.

Although the agreement conditioned ClearOne's obligation on its future decision to devote resources to that purpose, ClearOne could not exercise its discretion arbitrarily or in bad faith. ClearOne was obligated to honestly assess the company's financial interest before invoking the condition. Thus, the circuit remanded so the district court could determine whether ClearOne had acted in good faith.



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Notably, the agreement was hammered out roughly a year after the SEC began investigating Flood. ClearOne's attorneys were prescient in giving the company an out if things went badly for her. Whether or not the appeals court's ruling will set off a rash of contract negotiations remains to be seen. Corporate executives would do well to check their contracts, though—especially in Utah.

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The commentary and cases included in this blog are contributed by Jeff Ifrah and firm associates Rachel Hirsch, Jeff Hamlin, Steven Eichorn and Sarah Coffey. These posts are edited by Jeff Ifrah and Jonathan Groner, the former managing editor of the Legal Times. We look forward to hearing your thoughts and comments!

