

Aleynikov v. Goldman Sachs Group, Inc.:

U.S. District Court Finds Broad Scope of Advancement of Legal Fees under Delaware Law

Often corporate bylaws relating to indemnification and advancement of legal fees to directors and officers are drafted broadly to provide assurances that these corporate officials will not be required to expend personal funds in defending a suit or proceeding. The ramifications of this breadth generally go unrealized until matters run awry, after litigation ensues and the issue of legal costs is thrust to the forefront. A recent decision of the U.S. District Court for the District of New Jersey, *Aleynikov v. Goldman Sachs Group, Inc.*,¹ gives Delaware corporations good reason to conduct a thorough review of these policies on a regular basis.

I. Factual Background and Procedural History²

Beginning in May 2007, Aleynikov was employed as a computer programmer with Goldman, Sachs & Co., a non-corporate subsidiary of the parent company, Goldman Sachs Group, Inc., a Delaware corporation (the “Company”). In this position he was responsible for developing source code for the high frequency trading system. Throughout his tenure, Aleynikov held the title of “vice president” in the firm’s Equities Division.

In April 2009, Aleynikov accepted a position with a Chicago-based start-up company where, as executive vice president of the Platform Engineering group, he would develop and administer its own high-frequency trading business to compete with the Company. Prior to his formal departure from the Company in June, Aleynikov encrypted and extracted hundreds of thousands of lines of proprietary source code for the Company’s high frequency trading system, including complex trading algorithms that value stock options, and downloaded this confidential data to his personal computer. The FBI later arrested Aleynikov, who was charged in the U.S. District Court for the Southern District of New York with violating federal trade secrecy laws.

Following an eight day jury trial, Aleynikov was convicted and sentenced to 97 months of imprisonment. On appeal, the U.S. Court of Appeals for the Second Circuit reversed this decision, holding that Aleynikov’s alleged theft of intangible property fell outside the scope of the charged federal offenses.³ Soon thereafter, Aleynikov was re-arrested and indicted in Manhattan state court on criminal charges arising from the same alleged theft of the Company’s highly valuable computer code.

Aleynikov, rendered “impecunious” after paying out-of-pocket for a portion of the legal fees incurred in his defense of the federal charges, filed a motion for summary judgment seeking (1) indemnification for legal costs and fees stemming from his successful defense in federal court, (2) advancement of legal costs and fees for his ongoing defense of the state criminal charges and (3) advancement of attorneys’ fees and expenses incurred in the present action pursuing indemnification and advancement.

II. Distinguishing Indemnification and Advancement

As a threshold matter, the Court stressed that indemnification and advancement are separate and distinct remedies. Indemnification is a claim for expenses incurred in a proceeding that has already been resolved in the

¹ *Aleynikov v. Goldman Sachs Group, Inc.*, Civ. No. 12-5994 (KM) (D.N.J. Oct. 16, 2013), available at <http://docs.justia.com/cases/federal/district-courts/new-jersey/njdce/2:2012cv05994/279916/174/0.pdf> (the “Opinion”).

² Unless otherwise indicated, the factual background and procedural posture is summarized from the background set forth in the Opinion.

³ *United States v. Aleynikov*, 676 F.3d 71 (2d Cir. 2012).

corporate official's favor. It is not appropriate "until *after* the defense to legal proceedings has been successful on the merits or otherwise."⁴ In contrast, the principle of advancement serves to provide "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."⁵ This remedy is distinct from indemnification in that a corporate official's eligibility for advancement is wholly disconnected from the merits of the pending proceedings; although, if unsuccessful, the recipient must repay the funds to the corporation.⁶

III. Indemnity and Advancement Under the Company's By-Laws

Section 145 of the Delaware General Corporation Law ("DGCL") governs indemnification and advancement of directors and officers. That provision authorizes—and in certain circumstances, requires—a corporation to indemnify a present or former director or officer for expenses (including attorneys' fees) incurred in connection with the defense of an action or proceeding.⁷ A corporation is granted full discretion in setting its policy on advancement:

Expenses (including attorneys' fees) incurred by an officer or director of the corporation in defending any civil, criminal, administrative or investigative action, suit or proceeding *may* be paid by the corporation in advance of the final disposition of such action, suit or proceeding upon receipt of an undertaking by or on behalf of such director or officer to repay such amount if it shall ultimately be determined that such person is not entitled to be indemnified by the corporation as authorized in this section. Such expenses (including attorneys' fees) . . . may be so paid upon such terms and conditions, if any, as the corporation deems appropriate.⁸

As with many corporations, the Company exercised the option afforded by this section. Specifically, section 6.4 of its by-laws provide:

The Corporation shall indemnify to the full extent permitted by law any person made or threatened to be made a party to any action, suit or proceeding, whether civil, criminal, administrative or investigative, by reason of the fact that such person . . . is or was a director or officer of the Corporation, [or] is or was a director, officer, trustee, member, stockholder, partner, incorporator or liquidator of a Subsidiary of the Corporation . . . Expenses, including attorneys' fees, incurred by any such person in defending any such action, suit or proceeding shall be paid or reimbursed by the Corporation promptly upon demand by such person and, if any such demand is made in advance of the final disposition of any action, suit or proceeding, promptly upon receipt by the Corporation of an undertaking of such person to repay such expenses if it shall ultimately be determined that such person is not entitled to be indemnified by the Corporation.⁹

⁴ *Homestore, Inc. v. Tafien*, 888 A.2d 204, 211 (Del. 2005) (emphasis added) (internal quotation omitted).

⁵ *Id.*; see Opinion at 8 ("Advancement . . . depends on the pendency, not the merits, of the claims asserted against the corporate official.").

⁶ Opinion at 2, but see note 14.

⁷ 8 Del. C. § 145(a)-(c).

⁸ 8 Del. C. § 145(e) (emphasis added); see Opinion at 13 (Section 145(e) "grants a corporation the option to advance fees and expenses; it does not require the corporation to do so.").

⁹ Opinion at 8.

The term “officer” is defined to include, in pertinent part, “any officer of such entity, [and] any person serving in a similar capacity or as the manager of such entity.”¹⁰

IV. The Decision of the Court

Central to the availability of indemnity or advancement under the above by-law was Aleynikov’s employment status: was he, as a vice president of the Company, an “officer” for purposes of section 6.4 of its by-laws?

As an interpretive matter, the Court’s analysis was guided by “Delaware’s strong statutory policy favoring advancement of fees and expenses.”¹¹ This policy extends from the “emergent and provisional nature” of the advancement remedy.¹² Promptness is critical to provide meaningful assistance with the ongoing expenses of a pending action.¹³ Further, the funds are awarded subject to an undertaking to repay that amount in the event the corporate official does not prevail in the underlying litigation.¹⁴ Given these considerations, the remedy of advancement “almost explicitly prioritizes speed over accuracy.”¹⁵ The Court observed that, to further this policy, advancement provisions should be construed “liberally and expansively.”¹⁶

Reading the by-laws “as broadly as [it] reasonably can,” the Court looked to three forms of parol evidence bearing on the meaning of the term “officer” in determining whether there existed a genuine issue of material fact on indemnification and advancement.¹⁷ First, the Company asserted that the title of “officer” for these purposes only includes individuals who have been appointed by formal, written resolution of the general partner. Merely holding the title of vice president without formal designation, as was the case with Aleynikov, is insufficient. The Company, however, was unable to present any evidence memorializing this procedure or corroborating the contention that designation by written consent is the sole means of achieving “officer” status. Unpersuaded, the Court found this bare assertion shed little light on the interpretive issue at hand and failed to create a triable issue of material fact.

Second, Aleynikov pointed to the Company’s track record of indemnification and advancement to demonstrate that a vice president qualifies as an officer. Over a six-year time frame, the Company paid the legal fees of 51 out of 53 employees who were considered for indemnification and advancement. Of these, 15 were vice presidents. Although the Company had previously declined to indemnify or advance the legal fees of another

¹⁰ *Id.* at 9.

¹¹ *Id.* at 12. The substantive law of Delaware state law governed this dispute because the federal district court sat in diversity. *See Erie R. Co. v. Tompkins*, 304 U.S. 64 (1938).

¹² *Id.* at 13.

¹³ *See id.* at 14 (“The lesson to be drawn is that advancement is urgent; the applicant’s defense is to be funded now, while the action is pending. Otherwise, the parties might just as well await the outcome and seek indemnification. An award of advancement, if not expeditious, may be valueless.”).

¹⁴ *Id.* at 12. Despite its reliance on the provisional nature of this remedy, the Court understood that the utility of this undertaking is limited: “Of course, the advancement remedy has a backstop. It is provisional to the extent that a person who receives advancement of fees must furnish an ‘undertaking’ to pay them back if he or she is unsuccessful in the underlying litigation. But an ‘undertaking,’ the parties agree, is nothing more than a promise; no further security is required.” *Id.* at 14.

¹⁵ *Id.*

¹⁶ *Id.*

¹⁷ *Id.* at 15.

vice president, that individual's status as vice president was never cited as the basis for its decision. This practice suggested that a vice president is in fact an officer, and the Court found that no material conflict that would preclude summary judgment on this point.

Finally, Aleynikov argued that "vice president" could be understood as an officer of a corporation under the "plain and commonly-understood meaning" of the term.¹⁸ The Company countered that this title simply reflects "title inflation" that is commonplace in the financial services industry. Indeed, it continued, there are "thousands at the firm and across the financial services industry" that are designated a vice president, and the indemnification and advancement provisions of the by-laws "could not have been intended to cover so many."¹⁹ Without disputing the incidence of title inflation, the Court remained unsympathetic:

It may be the case that [the Company] (or the industry of which it is a part) has been profligate in conferring the title of vice president. If so, [the Company] must bear the consequences of that profligacy. [The Company] might easily have chosen to be more sparing with job titles, or to confer them in some other way. It might easily have drafted its By-Laws to restrict indemnification to a well-defined class. It did not.²⁰

For these reasons and others,²¹ the Court granted summary judgment as to advancement. Per its bylaws, the Company was obligated to pay (1) the reasonable fees and expenses incurred to date in defending the state criminal charges, (2) the reasonable fees and expenses that Aleynikov will incur in his ongoing defense of the state criminal charges until a final judgment is rendered and (3) "fees on fees," meaning those fees and expenses incurred in the present action seeking indemnification and advancement.

While there was no dispute that Aleynikov prevailed in the federal case, the Court assumed a more reserved stance with respect to indemnification. Unlike advancement, the remedy of indemnification is neither time-sensitive (the funds are designed to reimburse past expenditures, rather than to fund the ongoing defense of a pending legal proceeding) nor provisional (the disbursement is final as the official has already prevailed in the underlying litigation).²² Thus, the policy considerations calling for a truncated resolution are absent, and the Court denied summary judgment as to indemnification to allow further discovery on the Company's potential offsets.

V. Significance of the Decision

Delaware public policy favors advancement of legal fees. The *Aleynikov* Court's analysis of who constitutes an officer underscores the importance of careful and precise drafting of advancement policies in corporate by-laws and organizational documents. Given that courts applying Delaware law will construe these provisions broadly, an inexact description of which employees qualify as officers entitled to advancement (and under which circumstances) may lead to enforcement of those policies in a manner contrary to the corporation's

¹⁸ *Id.* at 22.

¹⁹ *Id.*

²⁰ *Id.* at 23.

²¹ The Court also supported its interpretation of the by-laws with the principle of *contra proferentem*, requiring that "ambiguous terms be construed against their drafter." *Id.* at 28 (quoting *Stockman v. Heartland Indus. Partners, L.P.*, 2009 WL 2096213, at *5 (Del. Ch. July 14, 2009)).

²² *Id.* at 32 ("[T]he indemnification claim—an ordinary claim for damages based on events already concluded—is not marked by the same urgency that infuses the advancement claim.").

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intention. That is the case, as this decision demonstrates, even if the individual seeking advancement has been accused of wrongful conduct against the corporation and even if the prospects for success in the underlying proceeding are slight.

This case brings into focus competing concepts which in many instances may not be deemed to warrant much attention when drafting corporate indemnification and related advancement provisions.

On the one hand, companies, when drafting or revisiting their advancement policies, might consider the scope of these provisions and ensure that enforcement under Delaware law is consistent with corporate expectations. Depending on how a particular company's corporate chart is organized, some companies might wish to consider who may be eligible for advancement and whether any groups of employees are to be excluded for one reason or another. If part of a company's culture is to bestow titles such as vice president broadly, the company may wish to limit the availability of expense advancement provisions by tailoring the definition of "officer" to include only a "well-defined class."

On the other hand, the advantages of expansive advancement provisions are compelling. Broad coverage of employees who carry out important corporate functions encourages capable, high-quality individuals to take on responsible positions "by eliminating the chilling effect of potential personal liability on the part of officers and directors."²³ In assessing advancement policies, the need to attract well-qualified individuals to serve as officers may often outweigh the desire to reduce corporate expenses by limiting such policies.

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If you have any questions about the issues addressed in this memorandum or if you would like a copy of any of the materials mentioned, please do not hesitate to call or email Charles A. Gilman at 212.701.3403 or cgilman@cahill.com; Jon Mark at 212.701.3100 or jmark@cahill.com; John Schuster at 212.701.3323 or jschuster@cahill.com.

²³ *Scharf v. Edgcomb Corp.*, 1997 WL 762656, at *4 (Del. Ch. Dec. 4, 1997).