

# Lawyer Insights

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## Guest Post: Do You Know Who Your Corporate Officers Are? An Overlooked Issue That Can Have Serious Consequences

by Steven Haas and Rachel Northup; with introduction by Kevin LaCroix

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*Directors and Officers liability insurance policies of course protect corporate directors and officers. Similarly, advancement and indemnification typically are available to corporate directors and officers. But who is an “officer”? As I have discussed in prior posts on this site this is an important question that can have significant implications. In the following guest post, Rachel W. Northup and Steven M. Haas of the Hunton & Williams law firm take a look at this important question and the significant issues it can involve. I would like to thank Rachel and Steven for their willingness to allow me to publish their article as a guest post on this site. I welcome guest post submissions from responsible authors on topics of interest to this site’s readers. Please contact me directly if you would like to publish a guest post. Here is Rachel and Steven’s guest post.*

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An important but seldom asked question is: do you know who your officers are? You may think you do, but the legal answer to this question might surprise you. Neither corporate statutes nor the courts provide a clear definition of a corporate “officer.” In addition, many corporate charters and bylaws are unclear or even inconsistent in identifying their officers. This can create significant issues for corporations as well as employees who erroneously assume they are officers – especially at large companies that liberally use officer-like titles throughout their ranks.

The lack of certainty about who is an officer could theoretically cause trouble in determining whether a person was authorized to sign a contract on the corporation’s behalf. But a much more significant issue arises in the area of indemnification and advancement of legal expenses. Most corporations obligate themselves through their charters and bylaws to indemnify and advance legal expenses to their “officers” in litigation, but it may not be clear which employees are officers entitled to those benefits. From the corporation’s perspective, being required to advance expenses and ultimately indemnify a mid-level or even junior employee can be expensive. It can also be both frustrating and embarrassing to the company when the employee is accused of serious misconduct, such as insider trading or embezzlement. The rights to indemnification and advancement of expenses can be invoked in shareholder litigation and government proceedings, both criminal and administrative, but they can also apply to claims brought by the company against the former “officer.” In other words, the company may have to fund the employee’s defense against the company.

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This issue is also critical to employees. Litigation in today's world is expensive. It requires experienced lawyers to defend lawsuits and appeals that may last for years. An employee with an officer-like title may assume the corporation will cover the costs of litigation, only to learn after a serious lawsuit is filed that the corporation disputes his or her coverage. Even if the employee ultimately prevails against the company, the employee is likely to incur a significant financial burden in enforcing his or her advancement and indemnification rights.

Delaware courts generally recognize a strong public policy supporting advancement and indemnification to protect persons serving a corporation. When organizational documents are drafted inconsistently or ambiguously, courts are likely to construe the provisions in favor of the employee. Still, both corporations and employees have risk where indemnification and advancement is not addressed with certainty.

*A brief overview of advancement and indemnification*

Advancement refers to the employee's right to have the corporation pay his or her expenses in defending a claim as they are incurred. Though advancement is not mandated by statute, corporations typically obligate themselves in their organizational documents to advance expenses to any officer who is sued by reason of the fact he or she is an officer. The obligation applies as the expenses are incurred, thus requiring the corporation to fund the officer's defense until the proceeding concludes. A mandatory advancement obligation will apply regardless of how guilty the person may appear or how harmful to the corporation his or her behavior may be (e.g., the employee is caught with the proverbial bloody knife!).

Indemnification, in contrast, obligates the corporation to pay judgments, fines, penalties, or settlement amounts on behalf of the officer. In other words, while advancement requires the corporation to pay the officer's legal fees while the officer is defending the suit, indemnification obligates to the corporation to pay fines or settlements imposed on the officer as a result of the proceeding. Unlike advancement, however, state corporation laws require that the officer must have either prevailed in the litigation or met a specified standard of conduct (e.g., acted in good faith and reasonably believed he or she was acting in the best interests of the company). If the officer does not meet the standard for indemnification, the corporation may recover all expenses previously advanced (although the officer may be insolvent by that point). Similar to their provision of mandatory advancement, most corporations obligate themselves to indemnify their officers to the fullest extent permitted by law.

The public policy behind advancement and indemnification is to encourage capable individuals to serve as corporate officials by assuring them that, if they are sued by reason of the fact that they were serving the corporation, the corporation will bear the risks resulting from the performance of their duties. Otherwise, directors and officers might be reluctant to make important decisions out of the fear of being personally liable. The costs of mounting a complex legal defense against shareholder derivative suits, governmental investigations, criminal prosecutions and similar cases are often too great for an individual to bear alone.

Mandatory indemnification and advancement of expenses for corporate directors and officers is nearly universal in the United States. Moreover, some companies go further and obligate themselves to advance and indemnify employees. Other companies take a permissive approach in dealing with employees that allows the company to make case-by-case decisions based on the circumstances. Whether to take a mandatory or permissive approach to protecting employees is a decision for each

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company to make. But, as described below, problems can arise when a company is not clear on its position.

*So, who is an “officer”?*

There is no statutorily prescribed definition of “officers.” Indemnification and advancement provisions in organizational documents often refer to coverage for “officers” generically. In that case, the analysis often turns on the corporate bylaws governing officer appointments. Bylaws often simply provide for a president and/or chief executive officer, secretary and treasurer, and other officers appointed by the board or by other officers to whom the board delegates appointment powers, including vice presidents.

In some cases, it will be clear that the only officers are persons whose titles are specifically authorized in the bylaws or who are elected by the board. In other cases, it may not be clear whether a person who was not appointed by the board is nevertheless an “officer.” This latter scenario seems to occur most often at companies that use officer-like titles liberally, such as banks and other financial institutions where it sometimes seems like anyone from middle-management has the title of “vice president.”

Court decisions interpreting who is an officer do not add much clarity. One of the most publicized cases in this area involved a former computer programmer and vice president of a large financial institution who was criminally prosecuted for stealing valuable computer code before leaving his job. The computer programmer was one of many vice presidents within the financial institution, was given the title of vice president in his offer letter signed by another vice president, and had no management or supervisory functions. A federal appeals court found the corporation’s bylaws to be ambiguous in defining officers, but it refused to resolve the ambiguity in favor of the employee’s eligibility for advancement of expenses. In a separate but related proceeding, the Delaware Court of Chancery held that because of the federal court’s ruling on the issue, the state court could not allow the employee to re-litigate whether he was an officer. However, the Delaware judge did offer his rationale for why he would have ruled for the employee, including the following:

- the corporation drafted its bylaws unilaterally and was in the best position to remove ambiguities;
- a slate of officers including a vice president is common;
- a person with the title of “vice president” could normally assume he or she was an officer entitled to advancement;
- the corporation’s bylaws included vice presidents in its set of officers and also allowed officers who were elected by the board to appoint other officers;
- the corporation was responsible for the ambiguity by liberally designating its employees as “vice presidents”;
- a vice president does not need to have supervisory or managerial functions to be an officer; and
- public policy favors advancement and indemnification.

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Other Delaware court decisions analyzing officer status involving alleged serious misconduct by employees have likewise emphasized the corporation's unilateral control over drafting organizational documents and its ability to ensure its officers are defined clearly and consistently.

### *Conclusion*

The question of who, exactly, is a corporate officer is rarely asked, but it could have significant consequences. A corporation may unexpectedly find itself obligated to cover a present or former employee's hefty litigation expenses arising from serious misconduct. Conversely, an employee who thought he or she had protection in litigation may be surprised to be left footing the bill – which, for an individual, could result in bankruptcy. Many corporations would benefit from a closer review of their bylaws and use of officer titles. Revising the bylaws with greater specificity can set expectations now and avoid protracted litigation later. Moreover, there is nothing that prohibits the company from voluntarily covering its employees' legal expenses on a case-by-case basis.

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