IN THE SUPREME COURT OF THE STATE OF DELAWARE

SHAUN ANDRIKOPOULOS and MICHAEL A. SANTER,

Plaintiffs Below, Appellants,

v.

SILICON VALLEY INNOVATION COMPANY, LLC,

Defendant Below, Appellee.

No. 490, 2015

On Appeal from C.A. No. 9899-VCP in the Court of Chancery of the State of Delaware

Public Version
Filed: October 29, 2015

APPELLANTS' OPENING BRIEF

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Dated: October 26, 2015
(Original Filing Date)

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NATURE OF PROCEEDINGS

This is the appeal of Mr. Shaun Andrikopoulos ("Andrikopoulos") and Mr. Michael A. Santer ("Santer") (plaintiffs below, and together, "Appellants") from the Final Order and Judgment Resolving Priority of Plaintiffs' Advancement Claims, dated August 10, 2015 (the "Final Judgment") (attached hereto as Exhibit A), issued by the Honorable Donald F. Parsons, Jr., Vice Chancellor, in the Court of Chancery of the State of Delaware (the "Trial Court") in Civil Action No. 9899-VCP (the "Advancement Case").

Appellants appealed the Final Judgment on September 9, 2015. *See* Supr. Ct. Dkt. 1 (Notice of Appeal). This is Appellants' Opening Brief in support of their appeal.

SUMMARY OF ARGUMENT

1. The Trial Court erred as a matter of law when, in deciding a matter of first impression, it relegated the advancement claims of Appellants, two former directors, officers, and employees of a Delaware corporation in receivership, both of whom had valid and undisputed claims to advancement in litigation pursued by a receiver against Appellants, to general unsecured creditor status, but granted priority to the claims of the receiver to the limited assets of the corporation (A1308-1317), depriving Appellants of their right to advancement.[1]

[1] All references to "A---" refer to the Appendix to Appellants' Opening Brief which is being filed concurrently herewith. Citations to transcripts will refer to the Appendix page and the line numbers where applicable.

STATEMENT OF FACTS

A. Background of SVIC.

Defendant Below/Appellee Silicon Valley Innovation Company, LLC ("SVIC" or "Appellee") is a Delaware limited liability company which was placed into receivership by the Trial Court on or about January 21, 2013, pursuant to the terms of a Joint Stipulation and Receiver Order (the "Receivership Order") (A1658) in a separate matter captioned *Jagodzinski v. Silicon Valley Innovation Company, LLC*, C.A. No. 7378-VCP (Del. Ch.). Pursuant to the terms of the Receivership Order, the Trial Court appointed Mr. Bram Portnoy as SVIC's receiver (the "Receiver" or "Portnoy"). *Id.* at ¶ 1.

Appellee SVIC had been formed approximately 12 years earlier through a February 28, 2001, merger of Silicon Valley Internet Capital, Inc. ("SVIC, Inc.") with and into Silicon Valley Internet Capital, LLC (A23 at ¶ 4), later changing its name to "Silicon Valley Innovation Company, LLC" in October 2002. *Id.* Appellee SVIC is the successor to SVIC, Inc. with respect to the relevant contractual and other obligations between SVIC, Inc. and Appellants. *Id.*

B. Appellants Enter Into Employment Agreements with SVIC.

Appellant Andrikopoulos joined SVIC, Inc. in February 2000 as a director, officer, and employee serving as the Executive Vice President for Global Strategy. *Id.* at ¶ 5. On February 29, 2000, Andrikopoulos entered into an employment agreement with SVIC, Inc. (the "Andrikopoulos Employment Agreement") (A41), as had other executives joining the company. Andrikopoulos had been recruited from a high-paying job with Deutsche Bank and accepted a major reduction in pay to join SVIC (A1298). Andrikopoulos remained at the company for 11 months, ultimately resigning on January 12, 2001 (A391).

On April 28, 2000, two months after Andrikopoulos had accepted employment at SVIC, Inc., Mr. Santer himself was employed by SVIC, Inc. as the company's Executive Vice President and Secretary (A23 at ¶ 6). Prior to his joining the company as an officer and employee, Santer had served as the Co-Chairman of SVIC, Inc.'s Board of Directors (A1298; A60). Like Andrikopoulos, Santer entered into an employment agreement with SVIC, Inc. (the "Santer Employment Agreement") (A60) and agreed to continue to serve as Co-Chairman of the Board. Santer had joined SVIC from one of its primary competitors (divine interVentures) and, in order to work at SVIC, Inc., had to relinquish stock shortly before divine's IPO valued at over $4.5 million and an approximately $264,000 year salary (A1298; A1331-1332, at Resp. 2). Santer's employment agreement was not renewed upon its expiration on April 28, 2004 (A1352, at Resp. 8).

C. The Advancement and Indemnification Rights Under the Employment Agreements.

Both the Andrikopoulos and Santer Employment Agreements (together, the

"Employment Agreements") provided Appellants with, among other things, indemnification and advancement rights. *See* A1298. Specifically, the Andrikopoulos Employment Agreement provided as follows:

> 19. Indemnification.
>
> a. Subject to limitations imposed by law, the Company shall indemnify and hold harmless the Executive to the fullest extent permitted by law from and against any and all claims, damages, expenses (including attorneys' fees), judgments, penalties, fines, settlements, and all other liabilities incurred or paid by him in connection with the investigation, defense, prosecution, settlement or appeal of any threatened, pending or completed action, suit or proceeding, whether civil, criminal, administrative or investigative and to which the Executive was or is a party or is threatened to be a made a party by reason of the fact that the Executive is or was an officer, employee or agent of the Company, or by reason of anything done or not done by the Executive in any such capacity or capacities. The Company also shall pay any and all expenses (including attorney's fees) incurred by the Executive as a result of the Executive being called as a witness in connection with any matter involving the Company and/or any of its officers or directors.
>
> b. The Company shall pay any expenses (including attorneys' fees), judgments, penalties, fines, settlements, and other liabilities incurred by the Executive in investigating, defending, settling or appealing any action, suit or proceeding described in this Section 19 in advance of the final disposition of such action, suit or proceeding. The Company shall promptly pay the amount of such expenses to the Executive, but in no event later than 10 days following the Executive's delivery to the Company of a written request for an advance pursuant to this Section 19, together with a reasonable accounting of such expenses.
>
> c. The Executive hereby undertakes and agrees to repay to the Company any advances made pursuant to this Section 19 if and to the extent that it shall ultimately be found that the Executive is not entitled to be indemnified by the Company for such amounts.
>
> d. The Company shall make the advances contemplated by

> this Section 19 regardless of the Executive's financial ability to make repayment, and regardless whether indemnification of the Indemnitee by the Company will ultimately be required. Any advances and undertakings to repay pursuant to this Section 19 shall be unsecured and interest-free.
>
> e. The provisions of this Section 19 shall survive the termination of this Agreement.

(A56-57; Exhibit B). The language in the Santer Employment Agreement's indemnification and advancement provisions is largely similar.[2] The indemnification and advancement provisions of the Employment Agreements were never amended after signing and, as provided for in the agreements, survived the termination of those agreements. *See* A1299; A57 at § 19(e); A76 at § 19(d).[3]

D. Over a Decade Later, SVIC is Placed Into Receivership.

Over 10 years after Andrikopoulos and ***nearly seven years after*** Santer left the company, Mr. Jagodzinski (represented by the same counsel representing SVIC here) initiated a books and records action in the Trial Court in February 2011 against SVIC (A1299). One year later, after repeated misconduct by SVIC and

[2] Paragraph 19(a) of the Santer Employment Agreement includes a clause related to "Executive's prior employment" with various entities. *See* A75. Additionally, the undertaking provision in paragraph 19(c) of the Andrikopoulos Employment Agreement is not included in the Santer Employment Agreement. *See* A75-76. Other than these distinctions, the language in the two versions of the Employment Agreements appears to be largely the same. The complete text of both indemnification and advancement provisions from the two Employment Agreements is contained in Exhibit B, attached hereto.

[3] Additionally, in or about April 2000, Santer entered into an indemnification agreement with SVIC, Inc. that provided advancement rights as well (the "Santer Indemnification Agreement") (A27 at ¶¶ 16-17). While Santer initially proceeded with this litigation under both the Santer Indemnification Agreement and the Santer Employment Agreement, as the Advancement Case proceeded, Santer focused his claims solely on the latter.

SVIC's sole employee, Riverson Leonard, the Trial Court found SVIC in contempt and appointed Mr. Portnoy as a limited receiver to collect documents in response to a books and records demand. *See Jagodzinski v. Silicon Valley Innovation Co., LLC*, 2012 WL 593613, at *2 (Del. Ch. Feb. 14, 2012) (describing contempt ruling). Appellants had no part in this prior proceeding. Instead, SVIC's management in place years after Appellants left the company engaged in the misconduct for which the Trial Court held SVIC in contempt.

Thereafter, in 2012, after purportedly uncovering improprieties at SVIC and based in no small part on the prior contemptuous conduct, Jagodzinski filed a second lawsuit to obtain a permanent receiver with expanded powers. *See* A139. On January 21, 2013, Vice Chancellor Parsons entered the Receivership Order proposed by Jagodzinski and SVIC—***12 years after Andrikopoulos, and nearly 9 years after Santer, had left SVIC*** (A1658). Again, Appellants had no part in this proceeding. Mr. Portnoy in his role as Receiver was granted the power to take possession and control of SVIC and all of its property, rights, and legal interests. *See id*. The Receivership Order gave the Receiver the right to "institute, prosecute, defend [or] compromise … actions or proceedings … for the protection, maintenance and preservation of the Receivership Estate," and further provided that "the Receiver shall pay, from the Receivership Assets, all such costs and expenses as shall be incurred by the Receiver in the ordinary course of business in connection with the operation, maintenance, management, protection and preservation of the Receivership Assets." *Id*. at ¶¶ 2(e), 2(i).

E. The Receiver Pursues the California Action, But Refuses to Pay Advancement.

In late 2013 and early 2014, the Receiver brought two separate actions in California state court against Appellants and more than two dozen other defendants, which were consolidated in the Superior Court for Los Angeles County (the "California Action") (A1300).[4] The California Action asserts, *inter alia*, claims for breach of fiduciary duty, usurpation of corporate opportunities, and corporate waste against Santer and Andrikopoulos pursuant to their employment agreements. SVIC conceded that the California Action fell within the scope of the advancement provisions of Appellants' employment agreements, including that Appellants are parties to the California Action "by reason of the fact" that they took alleged actions while officers, employees, or agents of SVIC. *See* A1390-1392 at Resps. 8-10.

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[4] The two separate actions (referred to as the California Action) were *Portnoy v. Michael A. Santer*, Case No. CV 130493, filed in October 2013 in the California Superior Court for San Luis Obispo County against Santer (the "San Luis Obispo Action"), and *Portnoy v. Estate of Robert W. Shaw,* et al., Case No. BC533571, filed in January 2014 in the California Superior Court for Los Angeles County against Andrikopoulos, Santer, and others (the "Los Angeles Action"). *See* A21-22 at ¶ 1; A28-29 at ¶¶ 19-20. The San Luis Obispo Action has been consolidated with the Los Angeles Action (A1300). In the California Action, the Receiver has attempted again and again to paint the Appellants with the same broad brush as certain SVIC managers who ran the company long after Appellants left. Surprisingly, Riverson Leonard, the SVIC executive whose actions led to the contempt rulings in the Trial Court, and certain other managers who were in control of SVIC long after Appellants left, were not named in the California Action.

On November 26, 2013, Santer, through his counsel, informed Portnoy that SVIC was required to advance and indemnify Santer for the expenses incurred by Santer in defending against the San Luis Obispo Action (A619). In response, the Receiver's counsel asserted that a fully-executed copy of the Santer Employment Agreement did not exist (A623). In response, on December 9, 2013, Santer's counsel provided the Receiver's counsel with a fully-executed copy of the Santer Employment Agreement and again requested that the Receiver acknowledge SVIC's obligation to advance and indemnify Santer's expenses (A626).

Thereafter, SVIC filed the Los Angeles Action against Santer and others on January 17, 2014 (A417). On June 3, 2014, Santer's counsel renewed the request for advancement with respect to San Luis Obispo Action, and demanded advancement as to the Los Angeles Action (A646). Santer's counsel confirmed Santer's undertaking and agreement to repay SVIC such fees and other expenses advanced to Santer by SVIC with respect to the California Action if it was ultimately determined that Santer was not entitled to be indemnified by SVIC. *Id.* Santer's counsel further informed the Receiver that Santer had incurred more than $100,000 in fees and costs to date in defense of the California Action. *Id.*

Andrikopoulos likewise requested advancement. On April 25, 2014, Andrikopoulos, through his counsel, requested advancement of his legal fees and costs in defending the Los Angeles Action and informed Portnoy that he had incurred over $33,000 in legal fees and expense in connection with the defense of the Los Angeles Action (A391). Despite the repeated requests for advancement by Appellants, the Receiver refused to honor these requests.

F. Appellants File the Advancement Case, and the Receiver Entrenches in His Refusal to Pay Advancement.

On July 18, 2014, Appellants filed the Advancement Case in the Trial Court (A1). The Verified Complaint for Advancement (the "Verified Complaint") contained three counts: (1) Count I sought advancement for Andrikopoulos pursuant to the Andrikopoulos Employment Agreement; (2) Count II sought advancement for Santer pursuant to the Santer Employment Agreement; and (3) Count III sought advancement for Santer pursuant to the Santer Indemnification Agreement. *See* A11-15. The Verified Complaint sought declarations that SVIC had breached Appellants' rights under the various agreement, advancement of the expenses including attorneys' fees in the California Action, attorneys' fees and expenses incurred in connection with the Advancement Case, and such other and further relief as the Court deemed appropriate. *See id.*

Instead of answering, on or about September 4, 2014, SVIC filed a motion to dismiss, or in the alternative, to stay the Advancement Case (A129). In SVIC's motion to dismiss, SVIC argued, *inter alia*, that the case should dismissed or stayed in favor of the pending California Action and additionally threw in a number of challenges to the Employment Agreements (A136-138). Appellants responded by answering the motion to dismiss—pointing out SVIC's inconsistent positions taken between the California Action and the Advancement Case—and simultaneously filing a motion for partial summary judgment on their entitlement to advancement on October 3, 2014 (A331-335).

When faced with Appellants' motion for partial summary judgment, SVIC argued (via Rule 56 affidavit) that it needed additional discovery regarding (i) whether Appellants' Employment Agreements were the product of fraud and invalid and (ii) whether there were any amended employment agreements (A774-777). Based on these defenses, the Court entered the Case Scheduling Order on January 20, 2015, denying summary judgment "because SVIC's defenses . . . presented genuine disputes of material fact that could not be decided on a motion for summary judgment" (A867). Trial was set for April 9, 2015. *Id*.

Following the filing of SVIC's Answer (A891), which included conclusory affirmative defenses of fraud (A916), the parties engaged in discovery on SVIC's defenses ***for three months***, costing Appellants ***tens of thousands of additional dollars*** in litigation costs. Costs were further driven up by Appellants need to file a motion to compel to which SVIC ultimately consented (A1302). During that time, SVIC did not produce any evidence that Appellants' Employment Agreements were the product of fraud or that their advancement rights were amended. *Id.*[5] Indeed, the only "evidence" of fraud that SVIC provided in its interrogatory responses was SVIC's generic assertion that Appellants' Employment Agreements provided them with generous compensation packages that were negotiated by insiders and were not disclosed to investors. *See* A1381 at Resp. 2. SVIC provided no evidence of fraud that would invalidate the Employment Agreements, and its claims were belied by the uncontroverted record that the agreements were in fact negotiated at arms' length, were in fact disclosed to investors, and that Appellants in fact fulfilled their duties to SVIC pursuant to the agreements. *See* A1327 at Resp. 2; A1367 at Resp. 2.

G. As the Parties Approach Trial, SVIC Drops Its Baseless Fraud Defense and Other Challenges to Advancement.

In late February 2015, at the end of the document discovery period and *before taking a single deposition*, SVIC indicated its intention to abandon most of its defenses and proposed that the parties enter into a stipulation conceding Appellants' entitlement to advancement (A1303; A922 at ¶ 7). Despite his willingness to concede Appellants' right to advancement, SVIC refused to completely drop the fraud defense. In essence, what SVIC offered was a "tabling"

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[5] To the contrary, SVIC's interrogatory responses admitted a number of points establishing Appellants' right to advancement, including that (i) Appellants served as officers and/or employees of SVIC pursuant to their employment agreements; (ii) the California action is an "action, suit or proceeding" covered by Appellants' advancement provisions; and (iii) Appellants are parties to the California Action "by reason of the fact" that they served as officers, employees or agents of SVIC (A1386-1392 at Resps. 4-9).

of the fraud defense for purposes of advancement, but the right to contest this issue again in California (A1303; A922 at ¶ 7). Despite the lack of evidence of fraud, SVIC refused to acknowledge that Appellants were entitled to judgment in their favor on SVIC's defenses and insisted instead that it should have the right to re-litigate those same defenses again in California (A1303-1304). SVIC further argued that Appellants' claims did not have priority over the Receiver's claims on SVIC's limited assets. *Id*.

At that time, Appellants' counsel requested to see information regarding the present financial condition of SVIC (A922 at ¶¶ 8-9), and SVIC agreed (A922-923 at ¶¶ 10-11). It was then, one month before trial, that Appellants learned that despite the fact that SVIC had obtained ***over $800,000*** in capital contributions and litigation settlements in the past two years (*see* A1399-1400, Resp. 15), SVIC had ***less than $5,000 in the bank*** as of March 6, 2015. *See* A922-923 at ¶ 10. SVIC had not paid a cent of advancement to Appellants. Instead, the Receiver had burned through ***99.4 percent*** of the over $800,000 he had raised. Included in this cash burn was a hefty monthly fee going to the Receiver, as well as payments presumably made to other counsel—all of which were being made at the expense of Appellants' advancement rights.

With SVIC not willing to forego the affirmative defenses and Appellants having spent resources gathering discovery regarding the baseless fraud defense, Appellants determined that they would to continue forward towards trial. Unable to get the deal it wanted, SVIC filed a new motion to dismiss on March 26, 2015, seeking to argue that the litigation was moot except for the questions of the reasonableness and priority of payment (A920). Three days before trial, on April 6, 2015, the parties entered into a Stipulation and [Proposed] Order Governing Resolution of Plaintiffs' Claims (the "Pretrial Order") (granted by the Court on April 8) by which SVIC dropped its fraud challenge to the Employment Agreement (A1694 at ¶ 1). The Pretrial Order specified that Appellants "are entitled to advancement under the Employment Agreements for their defense of the California Action and their prosecution of this Action." *Id.*

Thus, seventeen months after Santer first demanded advancement, a year after Andrikopoulos' demand, and more than eight months after Appellants filed the Advancement Case, SVIC finally conceded what the Receiver should never have contested: that Appellants were entitled to advancement under their Employment Agreements, and that Appellants were entitled to "fees for fees" in bringing this action. With the fraud and other challenges to Appellants' advancement claims withdrawn, the only question faced by the Trial Court was "to what extent, if any, [Appellants'] advancement claims are entitled to priority as against the other claims asserted against SVIC in the receivership" (A1758).

H. The April 9 Hearing on Advancement Priority.

With the evidentiary issues having been eliminated on the eve of trial, the April 9 hearing (the "April 9 Hearing") was little more than an oral argument on the issue of priority of claims.[6] In short, with the Appellants having learned one month earlier that the Receiver had burned through all but approximately $5,000 of SVIC's funds, the main focus of the April 9 Hearing was on who would have "priority" to SVIC's limited assets. *See* A1702-1703.

During oral argument, Appellants' counsel addressed whether Appellants' "advancement rights should be treated as a priority [administrative] payment or relegated to an after-the-fact unsecured claim …" (A1706 at 17-19). Appellants' counsel acknowledged that the question whether advancement claims would be treated in a receivership as administrative claims or general creditor claims—which would not be paid out until the end of litigation—was an issue of first impression in Delaware (A1706-1707). The one case squarely on point was a case decided by the U.S. District Court for the District of Connecticut, *SEC v. Illarramendi*, 2014 WL 545720 (D. Conn. Feb. 10, 2014), a case which the Trial

[6] While there had been one other issue related to the reasonableness of fees, the parties resolved that issue before the April 9 hearing. *See* A1703 at 4-20. The amount of the reasonable fees that the parties agreed on was $502,006.37. *Id.* at 13-16. This amount has since increased substantially in light of the ongoing litigation.

Court noted "had it dead on …" (A1724 at 12-13).[7] SVIC's counsel instead attempted to draw upon precedent from the Bankruptcy Code's priority scheme. The Trial Court rejected this precedent, stating, "I don't find them persuasive" (A1724 at 8-9).

Instead, the Trial Court noted that the concept of placing advancement on a lower level of priority to the claims of the Receiver was contrary to Delaware's strong public policy. Vice Chancellor Parsons stated:

> [I]f we start going around and saying that the receiver sits there and thinks they've got a million-dollar claim, and I want to make this million-dollar claim against these two former directors, I'll probably have to spend \$100,000, \$200,000, somewhere in that range, of my own attorneys' fees. But is it worth it to spend that to recover a million dollars?
>
> Well, that's not the right calculus. The right calculus is do I have to spend twice that? Because I have already committed to the officers and directors – that's how I got them to join in – and it makes perfect sense to me that if we start going around and saying to everybody who is going to be an officer and director of a corporation that, yes, you get advancement rights, and so on, but by the way, we could go into receivership at any time. And all of a sudden, we can keep suing you, because we're going to bring in some third party who is going to look around, at no cost to themselves, and say, oh, we can bring these claims against all these past persons. And you're stuck; that you've got, number one, to pay up front and, number two, when you win, I'm sorry, there's not going to be any money to pay you.
>
> I don't think that adds up. I think that the much better reasoning is that it would undermine the strong public policy of Delaware if this Court,

[7] While the *Illarramendi* case was decided by the Connecticut court under Delaware law, *Illarramendi* cited precedent from other states including Virginia, Ohio, and Kansas, as well as the 3rd Circuit supporting Appellants' position. 2014 WL 545720, at *5-7.

> in the context of receivership, which is not governed by all the priority regulations and specifications of the bankruptcy law, would be to relegate our officers and directors to the same status as some preexisting or pre-receivership debt. It doesn't add up, to me.

(A1724 at 13-A1725 at 21).

Much of the oral argument focused on fashioning a remedy in light of the fact that SVIC had been on notice of the advancement obligations, but had continued to pay out to other claimants despite the advancement obligations (A1713 at 6-22). SVIC's counsel, Mr. Rostocki, attempted to distinguish *Illarramendi* during oral argument claiming, "Part of that case was the reasoning that the receiver there knew of the advancement rights, decided – made a cost benefit decision, and decided to file suit. ***Here, there's no record evidence that the receiver had knowledge of the advancement obligations***" (A1726 at 16-22) (emphasis added). This was simply not true. The Private Placement Memo—which the Receiver attached to his complaint in the California Action—stated:

> We have, or intend to, enter into indemnification agreements with each of our officers and directors containing provisions that may require us, among other things, to indemnify our officers and directors against certain liabilities that may arise by reason of their status or service as our officers or directors (other than liabilities arising from willful misconduct of a culpable nature) ***and to advance their expenses incurred as a result of any proceeding against them as to which they could be indemnified***.

A260 (emphasis added). Further as noted above (pp. 9-10), Santer notified the Receiver's counsel—specifically Mr. Rostocki—as early as November 26, 2013, of the obligation to advance expenses, and provided a copy of the Santer Employment Agreement in December 2013. Andrikopoulos notified the Receiver of these obligations in April 2014.[8]

The Trial Court was reluctant to adopt a remedy which required all future payments to be made until the full amount of the $500,000+ advancement obligation was paid out. *See* A1712 at 16-A1713 at 5; A1714 at 13-A1715 at 10. However, the Trial Court did "hold the receiver at fault, to some extent, for that extra money getting pushed out …" and discussed fashioning a remedy to that effect (A1718 at 17-18). As the Trial Court noted, "I don't think I have too much problem with docking the receiver for the fact that it acted somewhat irresponsibly, in your view …" (A1713 at 13-15).

SVIC's counsel attempted to redirect much of the oral argument to whether the Receiver and his agents would have a "super[-]priority" claim (A1730 at 17-21). To the degree that the Trial Court ultimately determined that the advancement claims had priority as "administrative" claims, SVIC wanted to make sure that the Receiver had the first cut at any monies coming into the receivership estate. The Trial Court tended to agree, but pushed back when the SVIC's counsel attempted

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8 The misrepresentation by SVIC's counsel regarding the Receiver's lack of notice regarding the advancement obligation is disconcerting. To the degree that the Trial Court operated under an assumption that the Receiver had no notice of the advancement obligations when he continued with the San Luis Obispo Action and then filed the Los Angeles Action, then this was clearly an error on the part of the Trial Court.

to include the "Receiver's agents" in those entitled to super-priority:

> [A]ttorneys such as yourself or the attorneys for the company are agents as well. And I don't want those agents treated any differently than the plaintiffs' attorneys, if the plaintiffs' attorneys have a legitimate advancement claim. …
>
> So at this point, all I know is [the Receiver] is approved to get a set amount of money each month, and that gets priority. After that, all the rest of the agents are all -- you know, it makes sense that they get administrative priority, but they're all in essentially the same level.

(A1731 at 21-A1732 at 12). The Trial Court ultimately decided that it would reserve final decision, but advised that a final order would be forthcoming that would "recognize the priority" (A1745 at 5-6).

Despite the Trial Court's guidance at the April 9 Hearing, SVIC continued to "push out" funds it received. Following the April 9 Hearing, Appellants were advised by SVIC that additional money in excess of $10,000 was received by SVIC (A1748). SVIC indicated that the funds would be used to pay for undisclosed "fees incurred during and for the purposes of the receivership." *Id.* Again, no efforts were made to pay the advancement obligations.

I. The July 30 Opinion.

The Trial Court, however, did not enter a final order shortly after the April 9 Hearing; instead, the Trial Court issued an opinion on July 30, 2015 (the "July 30 Opinion"), which, much to Appellants' surprise, reached the exact opposite result that the Trial Court had previewed at the April 9 Hearing. Instead of granting administrative priority to the advancement claims, the Trial Court, acknowledging that the issue was a matter of first impression in Delaware (A1760; A1767), determined that Appellants' "advancement claims should be treated the same as the claims of other unsecured creditors" (A1768).

The Trial Court's decision turned on four separate points. ***First***, it noted that "while advancement is important, so is the successful winding up of a corporation or other business entity." *Id.* The Trial Court stated that because "the focus [of a receivership] is on the winding up the entity's affairs" "the relevant importance of the policy justification of advancement as an inducement to attract qualified individuals to manage the company is diminished." *Id.* The Trial Court concluded that "granting administrative priority to advancement claims, such as [Appellants'] claims here, seriously could undermine, if not entirely eliminate, the ability of companies in receivership to pursue claims against former management." *Id.*

Second, while the Trial Court noted that the analogy to the priority scheme under the Bankruptcy Code was not binding on the Trial Court, the Trial Court borrowed from bankruptcy court precedent in determining that "there is substantial force to the idea that the pre-receivership entity and the receivership entity are meaningfully different: they are managed by different individuals for different purposes and are governed by different rules" (A1768). Thus, the Trial Court determined that "[a]dvancement obligations are contractual in nature and generally arise from pre-receivership transactions. In that respect, they are no different from other creditors' claims" (A1768-1769).

Third, while the Trial Court acknowledged that its decision would "frustrate[] the expectations of advancement legitimately held by former corporate officers and directors" (A1769), citing an article by three Delaware practitioners, the Trial Court concluded, "Market-based solutions already may exist for ameliorating the challenges that may arise in this area." *Id.*

Fourth and finally, the Trial Court concluded that it decided against granting "super-priority" status to the Receiver's fees, the trouble would be what other expenses would necessarily be entitled to the same status. The Trial Court wrote, "[I]f the Receiver's own fees are so important, what of other 'necessities,' such as a bookkeeper, office space, a rental car, etc.? Once the line drawing among those items begins, courts face the danger of becoming embroiled in time-consuming, line-item accounting disputes." *Id*.

The Trial Court concluded:

> SVIC is entitled to entry of an order declaring that: (1) [Appellants'] claims for advancement are not entitled to administrative priority or otherwise to receive priority treatment as administrative expenses of the receivership; and (2) [Appellants'] request for advancement of legal fees and expenses should be treated as a pre-petition, unsecured claim without administrative priority.

(A1770). The Court entered the Final Judgment on August 10, 2015 (A1771 and Ex. A). This appeal followed.

ARGUMENT

The Trial Court Erred as a Matter of Law When It Relegated the Advancement Claims of Former Directors, Officers, and Employees of a Delaware Corporation to the Same Status as Those of General Unsecured Creditors.

Question Presented

Whether the Trial Court erred as a matter of law when, as a matter of first impression, it relegated the advancement claims of Appellants, two former directors, officers, and employees of a Delaware corporation in receivership, both of whom had valid and undisputed claims to advancement in litigation pursued by a receiver against Appellants, to general unsecured creditor status, but granted priority to the claims of the receiver to the limited assets of the corporation, depriving Appellants of their right to advancement (A1308-1317).

Standard and Scope of Review

The standard and scope of review is *de novo* where this Court is asked to review a question of law and where the facts material to the claims are uncontroverted. *See Airgas, Inc. v. Air Prods. & Chems., Inc.*, 8 A.3d 1182, 1188 (Del. 2010) (quoting *B.F. Rich & Co., Inc. v. Gray*, 933 A.2d 1231, 1241 (Del. 2007)).

Merits of the Argument

Despite the fact that SVIC proceeded with litigation in the face of advancement obligations and ultimately conceded to Appellants' rights to well over $500,000 in advancement after dropping a baseless fraud defense on the eve of trial, the Trial Court's determination that Appellants' advancement claims would be classified as general unsecured claims has carved a massive hole in Delaware's advancement jurisprudence. The Final Judgment has made clear that Appellants' advancement claims will only be paid pro rata with other general unsecured creditors ***when and if*** the Receiver makes a distribution at the conclusion of the litigation claims SVIC is pursing. To date, ***not one penny of advancement has been paid*** while Appellants are forced to continue to fight what they maintain is a baseless action in the California state courts.

The Final Judgment and the underlying rationale in the July 30 Opinion is completely contrary to Delaware's "invariant policy" in favor of advancement and long-standing precedent supporting this public policy. *Reinhard & Kreinberg v. Dow Chem. Co.*, 2008 WL 868108, at *3 (Del. Ch. Mar. 28, 2008) (noting "Delaware's 'invariant policy' in favor of advancement"). As this Opening Brief will show, Delaware precedent in favor of advancement (*see Pontone v. Milso Indus. Corp*., 2014 WL 2439973, at *6 (Del. Ch. May 29, 2014)) colors nearly every aspect of why the case was brought by the Appellants, why the case was prosecuted the way it was, and, thus, why the result reached by the Trial Court is, in a word, erroneous. While the Trial Court outlined four points why it was varying from precedent (*see supra* at pp. 20-21), none of these points withstands scrutiny. The Final Judgment should be reversed.

A. Delaware's Strong Public Policy in Favor of, and Appellants' Reasonable Expectation of, Prompt and Complete Advancement.

Delaware courts and the General Assembly have long recognized the need for prompt and complete advancement as critical in attracting qualified persons to serve as directors and officers of Delaware entities. *See Miller v. Palladium Indus., Inc.*, 2012 WL 6740254, at *3 (Del. Ch. Sept. 14, 2012) ("Delaware policy favors indemnification and advancement as a means of attracting qualified individuals to serve in important corporate capacities."); *Underbrink v. Warrior Energy Services Corp.*, 2008 WL 2262316, at *10, n.89 (Del. Ch. May 30, 2008) ("Advancement policies have been found to be valuable because they 'encourage[] corporate service by capable individuals by protecting their personal financial resources from depletion by the expenses they incur during an investigation or litigation that results by reason of that service.'") (quoting *Homestore, Inc. v. Tafeen*, 888 A.2d 204, 211 (Del. 2005)).

Given this long-standing policy of upholding liberal advancement provisions, the Appellants had clear expectations that their rights to advancement would be upheld. *See Stockman v. Heartland Indus. Partners, L.P.*, 2009 WL 2096213, at *5 (Del. Ch. July 14, 2009) (noting that ambiguities in contract "should be resolved in favor of the reasonable expectations of [indemnitees] regarding their indemnification and advancement rights"). In fact, it was in no small part this public policy in favor of advancement that led the Connecticut court in *SEC v. Illarramendi*, 2014 WL 545720 (D. Conn. Feb. 10, 2014), to reach the result ordering advancement despite the company being in receivership. *See* 2015 WL 545270 at *4-5. *See also Ridder v. CityFed Fin. Corp.*, 47 F.3d 85 (3d Cir. 1995) (ordering advancement in receivership context).

This Court has time and again enforced promises of advancement in recognition that without such provisions, Delaware corporations would not be able to attract those willing to take on the risks associated with service on a board or in management. In *Tafeen*, this Court summarized:

> No Delaware corporation is required to provide for advancement of expenses. Nevertheless, most Delaware corporations do adopt advancement provisions as an inducement which promotes the same salutary public policy that is served by indemnification: attracting the most capable people into corporate service. Although advancement provides an individual benefit to corporate officials, it is actually "a desirable underwriting of risk by the corporation in anticipation of greater corporate-wide rewards" for its shareholders.

888 A.2d at 218 (citations omitted).

Here, the record clearly showed that SVIC received the benefit of attracting two highly qualified individuals away from highly-paid positions at other companies to serve in executive capacities for SVIC. *See* A1298. Without the potential availability of a meaningful hedge against the risk, the risk to reward ratio may have ultimately been too great for a start-up entity such as SVIC to attract either of the Appellants to serve. The Court of Chancery recognized in *Scharf v. Edgcomb Corp.*, 1997 WL 762656, at *4 (Del. Ch. Dec. 4, 1997), that "[a]nalyzing director and officer indemnification provisions as if they were salary, company cars or other personal corporate prerequisites simply makes no sense. More simply put, director and officer indemnification benefits the corporation more than the director or the officer covered." *See also id.* (describing the "chilling effect of potential personal liability").

Moreover, because the General Assembly has provided statutory authority for permitting Delaware corporate entities to indemnify directors, officers, and employees in their service to Delaware corporate entities and to advance expenses to those same persons facing litigation (*see* 8 *Del. C.* § 145), this Court and other Delaware courts have been chary of efforts—whatever form they may take—to deprive parties of these rights when granted. For example, the *Tafeen* Court specifically recognized the value associated with prompt advancement: "Advancement provides corporate officials with 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." 888 A.2d at 211. Thus, in the context of what it viewed in *Tafeen* as "protracted" litigation related to the contractual claims for advancement, the Court's subtle admonishment that such a "non-summary" proceeding was "an aberration that, fortunately, is rarely necessary" speaks volumes. 888 A.2d at 219.[9]

Here, the Appellants had an expectation of prompt and complete advancement where the Employment Agreements were clear and unambiguous, and they prosecuted this matter with this in mind. Section 19(b) provided that "The Company ***shall pay*** any expenses (including attorneys' fees), judgments, penalties, fines, settlements, and other liabilities incurred by the Executive in investigating, defending, settling or appealing any action, suit or proceeding described in this Section 19 ***in advance of the final disposition of such action, suit or proceeding***" (A56; A75) (emphasis added).[10] Given these reasonable expectations that advancement would be honored and that they would receive

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[9] Moreover, the Court's case law providing for a grant of "fees on fees" in such litigation also underscores the high public policy value that the Court places on meaningful indemnification and advancement rights. *See Stifel Fin. Corp. v. Cochran*, 809 A.2d 555 (Del. 2002). As was noted in *Stifel*, such policies were implemented to prevent a corporation from "using its 'deep pockets' to wear down a former director, with a valid claim to indemnification, through expensive litigation." *Id.* at 561. *See also* Donald J. Wolfe, Jr. & Michael A. Pittenger, *Corporate & Commercial Practice in the Delaware Court of Chancery* § 8.02 (Matthew Bender & Co. 2015) ("The Court's analysis appeared to apply with equal force to actions to enforce advancement obligations initiated pursuant to Section 145(k), and, indeed, the Court of Chancery has since so held.") (citing authority).

[10] The Court of Chancery has held that "the existence of ambiguity in the advancement context usually has a different consequence than in a situation when the court is trying to interpret a bilaterally negotiated commercial contract." *DeLucca v. KKAT Mgmt., L.L.C.*, 2006 WL 224058, at *6 (Del. Ch. Jan. 23, 2006). While SVIC did not argue that the provisions were ambiguous or unclear, even if SVIC had, Delaware courts would have construed such provisions against SVIC. *See Miller v. Palladium Indus., Inc.*, 2012 WL 6740254, at *3 (Del. Ch. Sept. 14, 2012) (noting that Delaware's public policy "supports the approach of resolving ambiguity in favor of indemnification and advancement"). *See also Stockman*, 2009 WL 2096213, at *5 (resolving ambiguity in favor of indemnitee).

prompt and complete advancement, Appellants pursued their claims for advancement for over a year. Throughout this period, Appellants were forced to go through discovery, a motion to compel, prepare for a trial, two motions to dismiss, briefing on a motion for summary judgment, all to have SVIC drop its defense and announce that SVIC did not have any resources to pay advancement.

Without a single penny of advancement being paid, SVIC's actions in this context have completely undercut the strong public policy and this Court's prior admonishments related to prompt and complete advancement. Bearing in mind that the Appellants' need for advancement arose only because of SVIC's pursuit of the California Action against the Appellants a decade after Santer, and 13 years after Andrikopoulos, had left service, the equities of the Receiver being able to ignore SVIC's obligations weigh decidedly in favor of Appellants.

B. The July 30 Opinion's Faulty Four Point Analysis.

Despite this Court's precedent, the overwhelming public policy interest, and the legitimate expectation that Appellants had, the Trial Court erroneously ruled in the July 30 Opinion that the advancement obligations would be relegated to the same status as other general unsecured creditors (A1758). The July 30 Opinion turned on four points, none of which withstands scrutiny.

1. Should Receivership Trump Advancement?

In the July 30 Opinion, Vice Chancellor Parsons noted that "while advancement is important, so is the successful winding up of a corporation or other entity," and that the "inducement to attract qualified individuals is diminished" given the fact that the company is winding down (A1768). The Trial Court's decision, however, ignores the fact that any Delaware corporation facing an "end-game" scenario similar to SVIC would be in jeopardy of being placed in receivership. While the Court is correct that the current focus of SVIC should be "on winding up the entity's affairs" (*id.*), when SVIC sought to attract Appellants to serve, it did so through, among other things, offering advancement and indemnification. *DeLucca v. KKAT Mgmt., LLC*, 2006 WL 224058 (Del. Ch. Jan. 23, 2006), is particularly pertinent. There, facing an objection to the payment of advance, the Court of Chancery poignantly summarized the company's position:

> In other words, this is yet another case in which defendants in an advancement case seek to escape the consequences of their own contractual freedom. Regretting the broad grant of mandatory advancement they forged on a clear day, they seek to have the judiciary ignore the plain language of their contracts and generate an after-the-fact judicial contract that reflects their current preference. But it is not the job of a court to relieve sophisticated parties of the burdens of contracts they wish they had drafted differently but in fact did not. Rather, it is the court's job to enforce the clear terms of contracts.

DeLucca, 2006 WL 224058, at *2. The promises made and inducements offered at a time when the prospect of receivership was far outside of the horizon for SVIC should not be trumped by the unfortunate turn of fortunes. Now, more than ever—

when the company is in the throes of receivership—is when the need for advancement is paramount.

The July 30 Opinion further states that "granting administrative priority to advancement claims … seriously could undermine, if not entirely eliminate, the ability of companies in receivership to pursue claims against former management" (A1768). However, the Trial Court's rationale here could extend with equal weight to an argument against advancement and indemnification generally. Advancement is almost always a disincentive to a board or management in bringing claims against indemnified persons, whether such claims are brought directly or derivatively. The General Assembly—and this Court in particular—have already weighed in on the value of permitting advancement. *See Tafeen*, 888 A.2d at 218 (describing advancement as a "actually a desirable underwriting risk by the corporation in anticipation of greater corporate-wide rewards for its shareholders") (citation and internal quotation omitted). The fact that a receiver would need to calculate whether to pursue claims against parties that have advancement rights is simply the public policy that the Delaware courts have already adopted. Receivership should not trump advancement. *See also Lawson v. Young*, 486 N.E.2d 1177 (Ohio Ct. App. 1984) (noting "serious adverse implications in treating former directors as "general creditors").

2. Should Bankruptcy Precedent Be Borrowed?

In his briefing to the Trial Court before the April 9 Hearing, SVIC relied heavily on bankruptcy court precedent that advancement claims should be treated as "pre-petition" claims (A1124). One case cited by SVIC, *In re Mid-American Waste Systems, Inc.*, 228 B.R. 816 (Bankr. D. Del. 1999), is particularly telling of the distinctions between bankruptcy and Delaware precedent, and why such precedent is inapposite in this case. In *In re Mid-American Waste*, the Bankruptcy Court reviewed as part of the claims objection process whether a claim for indemnification was an "administrative expense" under 11 U.S.C. § 503(b)(1)(A). *Id.* The Bankruptcy Court ruled:

> An indemnification claim by an officer or director based on that officer's or director's prepetition services is not a claim on account of 'services rendered after the commencement of a case' that is entitled to administrative expense priority. Instead, the O & D Claimants' indemnification claims are merely claims for prepetition compensation for services rendered, not unlike salary or other benefits.

228 B.R. at 821.

Despite the Bankruptcy Court's description of indemnification as "not unlike salary," Delaware courts have determined that indemnification and advancement are not the same as salary or other benefits. *Id.* Instead, in *Scharf v. Edgcomb Corp.*, 1997 WL 762656, at *4 (Del. Ch. Dec. 4, 1997), the Court of Chancery specifically held: "Analyzing director and officer indemnification provisions as if they were salary, company cars or other personal corporate prerequisites simply makes no sense." Given the Bankruptcy Code's rigid statutory priority scheme, as the Trial Court itself noted, parallels to bankruptcy precedent cited by SVIC are not compelling (A1724 at 6-12).[11]

Despite the differences between receivership under Delaware law and bankruptcy under the Bankruptcy Code, the Trial Court, with at least nod toward bankruptcy precedent (A1768), wrote in the July 30 Opinion that "[a]dvancement obligations are contractual in nature and generally arise from pre-receivership transactions. In that respect, they are no different from other creditors' claims" (A1768-1769). The Trial Court's reasoning here is erroneous. There is a vast distinction between the claims of those seeking advancement and the claims of general creditors. Here, the claims of those seeking advancement were triggered by the fact that the Receiver brought actions against those entitled to advancement. Unlike the general creditors, here the Receiver's action itself gave rise to the claim.

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[11] *See* Honorable J. Travis Laster, *The Chancery Receivership: Alive and Well*, 28 DELAWARE LAWYER 12, Fall 2010 (describing receivership proceedings as a "viable alternative" to bankruptcy); id. (noting the extensive differences between the power and jurisdiction held by a state court and a federal bankruptcy court); id. at 15 (quoting Delaware practitioner, "in a receivership, the Court of Chancery is not bound by the elaborate scheme of priorities among creditors imposed by the Bankruptcy Code, but rather is 'free to impose rules of distribution that are appropriate under the particular circumstances of the case'") (emphasis added)). *See also Illarramendi*¸ 2014 WL 545720, at *7-8 ("[I]mplementing [this] policy of advancement should supplant any contradictory analysis drawn from bankruptcy law."); *Weingarten v. Gross*, 563 S.E.2d 771, 774 (Va. 2002) (refusing to read bankruptcy precedent into Virginia receivership provision's classification of mandatory indemnification).

The Vice Chancellor recognized this at the April 9 Hearing when he stated with respect to a receiver's weighing the value of pursuing a claim, "The right calculus is do I have to spend twice that?" (A1724 at 22). When a receiver is charged with marshalling the limited assets of an entity in receivership, the Vice Chancellor correctly noted that sometimes the right decision is that it "may be [that] it's time to just shut off the lights and call it a day" (A1742 at 5-6). Because the Receiver's actions gave rise to the need to additional claims, the Trial Court's rationale that advancement claims are not dissimilar from other receivership claims is erroneous.

Even if the Court were to view the advancement obligations as "just another contract," the fact remains that had SVIC wanted to draft an exception to its obligation to pay advancement in the context of a receivership, it could have done so. The Employment Agreements contain no such exception. *See DeLucca*, 2006 WL 224058, at *2.

3. Are There Market-Based Solutions?

The Trial Court, while noting that failing to grant priority status could "frustrate[] the expectations of advancement," countered that "[m]arket-based solutions already may exist for ameliorating the challenges that may arise in this area" (A1769). The Trial Court's only authority for this was an article which noted the value of having a D&O policy with "Side A" coverage. *Id.* (citing William D. Johnston et al., *Bankruptcy: The Game-Changer for Directors & Officers Who*

May Face Claims by Shareholders or Others, SEC. LITIG. REPORT, Dec.-Jan. 2010, at 3-4). The issue of whether a "market-based" solution existed was not briefed by the parties. Had the issue been briefed, Appellants would have been able to present evidence that no market for such policies is known to exist. In fact, D&O coverage in this context would have only been available under a "tail"—which usually "runs off" after ***6 years***,[12] nowhere near the ***10 to 13 years*** which would have been necessary in this case. The suggestion of a market-based solution—where Appellants had an expectation of advancement under Delaware's public policy of upholding these obligations—provides no relief to Appellants.[13]

4. Do Administrative Headaches Outweigh the Benefit?

Finally, the Trial Court acknowledged that one of its main problems with granting priority to advancement claims was the trouble that it faced in drawing

[12] *See* Dan Bailey, *Director Liability Loss Prevention in Mergers and Acquisitions*, http://www.chubb.com/businesses/csi/chubb16452.pdf (last visited Oct. 17, 2015) ("Frequently, the term of such a run-off policy is six (6) years."); Priya Cherian Huskins, *Protecting Ds and Os against Post-Acquisition Claims: D&O Tail Policies*, http://www.wsandco.com/about-us/news-and-events/blogs/do-blog/do-tail (last visited Oct. 17, 2015) ("In the United States, six years is the standard."); Thomas H. Bentz, Jr. and Shannon A. Graving, *A Buyer's Guide to Obtaining Comprehensive D&O Insurance Coverage* (Holland & Knight LLP 2009), http://www.agentsofamerica.org/newsletters/chap3_ebook.pdf (last visited Oct. 17, 2015) ("The typical duration of run-off policies today is six years, for which the premium is likely to be 150 to 250 percent of the expiring policy's annual premium.").

[13] The Trial Court's decision in this matter was also adopted by Vice Chancellor Glasscock in *Henson v. Sousa*, 2015 WL 4640415, at *2 (Del. Ch. Aug. 4, 2015). A review of the docket in this matter (of which the Court can take judicial notice) shows that counsel for *Henson*—whose request for priority on advancement was initially granted by the receiver, but then reversed by the Court—has been forced to withdraw from the matter for lack of payment. Whatever the prospect for a market-based solution, until one appears, persons expecting advancement may face similar prospects as to what occurred in *Henson*.

lines between what was and what was not administrative in nature. However, the problem faced by the Trial Court was one that was solely the making of the Receiver. Because of SVIC's limited assets, SVIC should not have put the Trial Court in the position of making a determination between whether the Receiver's attorneys or the Appellants' attorneys were to be paid. Here, the more prudent decision was the one which appropriately weighed the cost of bringing claims where advancement would need to be paid, not one that allowed SVIC to ignore the obligations and proceed anyway.

CONCLUSION

For all the reasons stated herein, Appellants respectfully request that this Honorable Court reverse the Final Judgment in accordance with the arguments outlined in this appeal and remand this case to the Trial Court for further proceedings consistent with the ruling of this Court.

Respectfully submitted,

Dated: October 29, 2015

Public Version

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