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IN THE SUPREME COURT OF THE STATE OF DELAWARE

SHAUN ANDRIKOPOULOS and MICHAEL A. SANTER,	§	No. 490, 2015
Plaintiffs-Below, Appellants,	§	Court Below – Court of Chancery of the State of Delaware in C.A. No. 9899-VCP
v.	§	
SILICON VALLEY INNOVATION COMPANY, LLC,	§	
Defendant-Below, Appellee.	§	

APPELLEE'S ANSWERING BRIEF

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NATURE OF THE PROCEEDINGS

This appeal arises from the Court of Chancery's determination regarding the priority of payment for the advancement claims of Plaintiffs-Below/Appellants Shaun Andrikopoulos ("Andrikopoulos") and Michael A. Santer ("Santer," together with Andrikopoulos, "Appellants") in the context of the receivership of Defendant-Below/Appellee Silicon Valley Innovation Company, LLC ("SVIC" or the "Company"). On July 30, 2015, the Court of Chancery issued a memorandum opinion, based on a stipulated record, holding 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 pre-petition, unsecured claims without administrative priority" (the "Opinion"). *See Andrikopoulos v. Silicon Valley Innovation Co., LLC*, 120 A.3d 19, 26 (Del. Ch. July 30, 2015). Final judgment was entered on August 10, 2015 (the "Judgment"). Appellants' appeal followed. SVIC files this Answering Brief in response to Appellants' Opening Brief appealing from the Opinion and Judgment.

SUMMARY OF THE ARGUMENT

1. Denied. Appellants contend the Court of Chancery "relegated" their advancement claims "to general unsecured status." *See* Appellants' Opening Brief at 2 (hereinafter "Op. Br."). There was no such "relegation." Appellants are, in fact, general unsecured creditors. They do not claim a security interest in any asset of SVIC.

Appellants confuse Delaware's public policy favoring a director or officer's entitlement to advancement with whether a director or officer's advancement claim should receive favorable treatment over other unsecured claims, over other secured creditors, and even over receivership expenses. The Court of Chancery correctly held that, because SVIC is in a receivership, Appellants' pre-petition and unsecured claims for advancement are not entitled to administrative priority over other creditors and the receivership expenses.

STATEMENT OF THE FACTS

A. The Mismanagement of SVIC and Appointment of a Receiver

In February 2011, Christian Jagodzinski ("Jagodzinski") filed a lawsuit to obtain certain books and records from SVIC. (A138). After the Court of Chancery granted Jagodzinski's request and SVIC failed to produce the documents, the Court of Chancery held SVIC in contempt and appointed a receiver for the purpose of collecting documents. *See generally Jagodzinski v. Silicon Valley Innovation Co., LLC*, 2012 WL 593613 (Del. Ch. Feb. 14, 2012). Bram Portnoy ("Portnoy" or the "Receiver") was appointed as the receiver. *Id.* at *3.

On February 18, 2011, Jagodzinski filed a second lawsuit to obtain a permanent receiver with expanded powers. (A139). On January 21, 2013, this Court entered an Order appointing Portnoy as the Receiver for SVIC with expanded powers and replacing SVIC's prior management (the "Receivership Order"). (A364).

B. The California Litigation

In October 2013, SVIC, through Portnoy, filed a lawsuit in San Luis Obispo, California, asserting claims against Santer for conversion, unjust enrichment, and breach of fiduciary duty (the "San Luis Obispo Action"). (A27-28). In January of 2014, Portnoy filed an action in Los Angeles, California, asserting claims against, *inter alia*, Andrikopoulos and Santer related to mismanagement and other improper

dealings, including claims for breach of fiduciary duty, usurpation of corporate opportunities, and corporate waste (the "Los Angeles Action," together with the San Luis Obispo Action, the "California Litigation"). (A28-29). Portnoy alleged that Appellants wasted SVIC's capital and assets "with their enormously rich employment agreements that drained the company," and he alleged that Appellants were involved in self-dealing and insider transactions. (A109; A140). Portnoy brought claims against Appellants for "specific acts of fraud and self-dealing, that generally arise from the corporate looting." (A112; A140).

C. Appellants' Agreements with SVIC, Inc.

Appellants sought advancement under three separate agreements with a predecessor of SVIC, Silicon Valley Internet Capital, Inc. ("SVIC, Inc."). SVIC, Inc. was a Delaware Corporation. (A79).

In February 2000, Andrikopoulos entered into an employment agreement with SVIC, Inc. (the "Andrikopoulos Employment Agreement"). (A24). Andrikopoulos ceased serving as a director, officer, and employee of SVIC, Inc. in January 2001. (A26).

In April 2000, Santer entered into an employment agreement with SVIC, Inc. (the "Santer Employment Agreement," together with the Andrikopoulos Employment Agreement, the "Employment Agreements"). (A24). Santer also alleges that, sometime in April 2000, he entered into an Indemnification

Agreement with SVIC, Inc. (the "Indemnification Agreement," together with the Employment Agreements, the "Agreements"). (A27).

However, the written consent attached to the Complaint only provided that SVIC, Inc. was "authorized to enter an Indemnification Agreement with the Corporation's current officers and directors and any future executive officers and directors . . . ." (A85). Unlike his Employment Agreement, Santer did not provide an executed copy of any Indemnification Agreement either as an attachment to any of Appellants' filings or in discovery. (A21-128). Santer's employment with SVIC terminated in 2004. (A26). Given a stipulation entered into during the course of the underlying litigation relating to the Employment Agreements, Santer has not pursued any additional relief with respect to the Indemnification Agreement.

D. The Related Lawsuit Against Peder Jungck

SVIC, through Portnoy, has filed lawsuits against other former directors, officers, managers and agents of SVIC and/or its predecessors. One such lawsuit was against Peder Jungck ("Jungck"), the former Chief Technology Officer, in the California Superior Court for the County of San Mateo. (A187). That complaint alleges that Jungck, along with other members of the management team, "wrongfully and fraudulently misappropriated, converted, transferred, usurped and/or embezzled" funds for their own benefit during the time period which the

purported agreements at issue here allegedly originated. (A189). The complaint asserted claims for, *inter alia*, conversion and breach of fiduciary duty, related to a payment to Jungck made under the guise that it was a bona fide loan. (A193-94). The purported loan was evidenced by a promissory note, which the complaint alleged was "not a valid contract because it is the instrument of self-dealing amongst SVIC's management team, executed fraudulently and in breach of the fiduciary duties" of Jungck and the other management members of SVIC. (A190). Indeed, approximately seven percent of the total capital raised from investors was funneled into the hands of management through similar "loans." (A191).

Jungck filed Demurrers asserting several grounds for dismissal. (A302). His Demurrers were overruled by another California Superior Court judge. (A315).

Specifically, this California judge held, at least preliminarily, that SVIC

> allege[d] the loan as evidence by the Promissory Note was a sham for which Defendant ***and others*** colluded to keep secret the fact that any payment to Defendant under the Note would never be re-paid. The existence and validity of the loan is challenged in the FAC [First Amended Complaint], and as such the possession and retention of the funds by Defendant is improper.

(A317) (emphasis added). This California judge refused to enforce provisions of an alleged agreement between Jungck and SVIC, Inc. (*e.g.*, a statute of limitations clause) based on the pending allegation of fraud and invalidity of the underlying agreement. This is similar to the position taken (or contemplated) by SVIC in

other lawsuits against prior management based upon conversations with former management of SVIC. (A144).

E. The Delaware Litigation for Advancement

On July 18, 2014, Appellants filed a verified complaint (the "Complaint") seeking advancement of certain fees and expenses incurred in connection with their defense of the California Litigation. (A21). In response, SVIC filed a Motion to Dismiss, or, in the Alternative, for a Stay of this action pending resolution of the California Litigation (the "Motion to Dismiss/Stay") citing the mandatory and binding forum selection provisions in the Employment Agreements which provided for jurisdiction solely in California. (A131). Thereafter, Appellants cross-moved for partial summary judgment (the "Summary Judgment Motion," together with the Motion to Dismiss/Stay, the "Motions"). (A326). The Motions were fully briefed, and the Court of Chancery heard oral argument on November 21, 2014 (the "Hearing"). (A791).

At the Hearing, the Court of Chancery denied Appellants' Motion for Summary Judgment, holding that Defendant's defenses thereto "which relate to whether the Employment Agreements (as defined in the Motions) and related agreements were the product of fraud and therefore invalid – presented genuine disputes of material fact that could not be decided on a motion for summary judgment." (A867). The Court of Chancery also denied the Motion to

Dismiss/Stay, citing a forum selection provision in the Receivership Order, and the Court of Chancery ultimately entered a Scheduling Order providing for a trial in Delaware on April 9, 2015. (*Id.*).

Thereafter, SVIC filed an Answer to the Complaint asserting affirmative defenses primarily based on the two disputes raised in its opposition to the Summary Judgment Motion regarding the validity of the Agreements: (i) whether the Employment Agreements were the product of fraud or waste and, thus, invalid; and (ii) whether the purported Agreements are the operative agreements under which Plaintiffs were employed by SVIC. (A745-746; A916). The Court of Chancery held that these two issues "presented genuine disputes of material fact." (A867).

First, SVIC set forth an affirmative defense that the Agreements were the product of fraud, waste or otherwise invalid. (A916; A1139). In discussions with former management of SVIC, the Receiver learned of the massive fraud and wrongdoing perpetuated by Appellants and others, which encompassed all facets and agreements at SVIC. (A1139). The Employment Agreements called for compensation of hundreds of thousands of dollars per year, but the Receiver was told that work was never performed on behalf of SVIC to justify these salaries. (*Id.*). While employed, Appellants and others also received large loans, sometimes exceeding one million dollars, securitized only by SVIC stock. (*Id.*). Thereafter,

Appellants and others negotiated multi-million dollar severance packages, further depleting SVIC's funds. (*Id.*). After raiding SVIC's corporate treasure chest, Appellants and others "defaulted" on the worthless loans and walked away with millions of dollars of investor money. (*Id.*). SVIC continues to adhere to its claim that massive fraud occurred at SVIC, as evidenced by the settlements with other insiders, the preliminary rulings in the California Litigation, and the wrongdoing uncovered in the course of the Receivership. (A1139). Nonetheless, SVIC recognized that simply because fraudulent activity or wrongdoing occurred, it does not automatically follow that the Agreements would be found to be invalid. (A1139).

SVIC also had concerns regarding whether the Agreements had been subsequently amended in light of the destruction of the Company's documents. Indeed, the Court of Chancery recognized "the fact that the [Company's] documents no longer exist" and that while Appellants "were long gone when it happened, . . . that doesn't mean that . . . that some of those [destroyed] documents were documents that were related to [Appellants]." (A841).

In the Complaint, Appellants alleged that "[t]he Santer Employment Agreement was amended at least three times between its effective date and 2004 by Santer and SVIC, LLC (as successor by merger to SVIC, Inc.), with effective dates of April 2001, September 2001, and January 2002." (A26). Yet, Appellants

did not attach those amendments to the Complaint. (A21-128). Accordingly, at the Hearing on the Motions, SVIC argued that it is "entitled to some limited discovery to determine whether or not these are the operative agreements which purportedly provide those advancement rights." (A811). SVIC sought discovery into the existence and terms of these amendments, as well as into whether there was an executed version of the Indemnification Agreement. (B8).

On February 20, 2015, Santer produced documents responsive to Defendant's request for production. (A1138). In that production, Appellants produced, for the first time, the amendments to the Employment Agreements which enabled SVIC to evaluate whether those were the purportedly operative agreements. (*Id.*). On February 25, 2015, Andrikopoulos produced documents responding to Defendant's request for production. (*Id.*).

Within a week of receiving Santer's document production, and two days after receiving Andrikopoulos' document production, counsel for SVIC contacted counsel for Appellants, on February 27, 2015, to propose that the parties enter into a stipulation of the nature previously contemplated by Appellants' counsel at the Hearing. (A1120-1122) (detailing the numerous exchanges between counsel); (A843) (Appellants' counsel suggesting the possibility "mak[ing] a representation filed with the Court [of Chancery] that a decision to grant advancement in this case will not be *res judicata* that precludes SVIC from challenging the validity and

enforceability of the agreement itself. Then I think we can avoid the necessity of all of this, what may be potentially broad discovery….").

Appellants, however, were unwilling to agree to such a compromise and instead sought to use this litigation as an offensive weapon in defense of the claims against them in the California Litigation. (A1121). Rather, in response to the draft stipulation circulated by SVIC (which mirrored the stipulation contemplated by Appellants' counsel at the Hearing), Appellants' counsel circulated comments which deleted relevant provisions and sought more than the relief sought in the original Complaint (or what a plaintiff would typically get in an advancement proceeding). (*Id.*). Numerous drafts of a stipulation were circulated between counsel leading up to the April 9, 2015 trial date set by the Court of Chancery. (A1121-22).

On April 8, 2015, in an effort to conserve SVIC's *de minimis* funds, and to serve the interests of judicial economy, SVIC entered into the Stipulation and Order Governing Resolution of Plaintiffs' Claims which limited the remaining issue to whether Appellants' advancement claim should receive administrative priority. (A1692).

F. The Oral Argument Before the Court of Chancery and the Opinion

On April 9, 2015, the Court of Chancery heard oral argument on the "priority issue" regarding whether Appellants' advancement claims were entitled

to administrative priority (the "April 9 Oral Argument"). (A1700). Appellants spend numerous pages recanting the Oral Argument and citing the Court of Chancery's questions and commentary, none of which constitute the Court of Chancery's Opinion which is the subject of this appeal. *See* Op. Br., at 15-19. Appellants then state their "surprise" that the Opinion held that Appellants' advancement claims should not be provided administrative priority. *Id.* at 19.

This result, however, should not have been surprising. As the Court is well-aware, colloquy between a court and counsel is not binding or even a ruling. Moreover, on April 10, 2015, the morning after the Oral Argument, the Vice Chancellor arranged a second telephonic hearing and stated:

> The reason for my call was that after we had the argument yesterday and we had our various discussions, it's caused me to want to rethink this matter further. And therefore, number one, I will not be issuing an oral or a letter opinion ruling within the next few days in this matter.
>
> In particular, I want to give further consideration to the overall question of how we handle the advancement in the context of a receivership. So having reached that decision, I did not want counsel to be spinning their wheels in terms of trying to come up with language that would implement the kind of superpriority that I was discussing. ***That may survive, or may not, after I've gone through, looking at this more closely.***
>
> So we should just treat it that at this point the matter is under submission, and then we'll just go from there. At some point you'll receive an opinion from me relating to it.

(B22-23) (emphasis added). This subsequent telephonic conference was omitted from Appellants' Opening Brief and Appendix.

On July 30, 2015, the Court of Chancery issued its Opinion holding that Appellants' advancement claims should not be given administrative priority. (A1756). The Judgment was entered on August 10, 2015. (A1771).

ARGUMENT

THE COURT OF CHACNERY DID NOT ERR IN HOLDING THAT, BECAUSE SVIC IS IN RECEIVERSHIP, FORMER OFFICERS' ADVANCEMENT CLAIMS ARE PRE-PETITION UNSECURED CLAIMS NOT ENTITLED TO ADMINISTRATIVE PRIORITY

Question Presented

Whether the Court of Chancery erred when it held that, because SVIC is in a receivership, Appellants' pre-petition and unsecured claims for advancement are not entitled to administrative priority?

Standard and Scope of Review

The Court of Chancery is provided broad discretion in the receivership context and in the application of the Court of Chancery Rules with respect to creditor claims. *See Andrikopoulos*, 120 A.3d at 25 ("I am mindful that this Court has broad discretion in the receivership context.") (citing CT. CH. R. 148 ("Rules 149 to 168 shall apply to all cases in which receivers are appointed . . . provided, however, that the Court [of Chancery] may relieve the receivers or trustees from complying with all or any of the duties and procedures set forth in Rules 149 to 168 and may impose such other duties or prescribe such other procedures as the Court [of Chancery] may deem appropriate.")); *see also* CT. CH. R. 167 ("Upon settling the final account with the receiver, the Court [of Chancery] may make final allowances to the receiver for the receiver's services and expenses and for the services of the receiver's attorneys and order the distribution by the receiver

among the creditors or stockholders of the company of the moneys remaining for distribution to which they are entitled; and thereupon the receiver shall make report to the Court [of Chancery] of the receiver's proceedings under the order of distribution, submitting vouchers for all payments so made."). This Court should review the Opinion and Judgment under the abuse of discretion standard.[1]

Merits of Argument

"One of the problems with [Appellants'] argument is that it ignores the difference between a corporate entity in the ordinary course and one in receivership." *Andrikopoulos*, 120 A.3d at 21. This fatal error continues in Appellants' Opening Brief. Appellants focus solely on the policy behind one's entitlement to advancement without acknowledging the reality of SVIC and how other similarly situated (or potentially secured) creditors should be treated.

Entitlement to advancement and the ability to get paid are separate and distinct in the context of an insolvent company in receivership or even bankruptcy. It is in these dire situations when an entity's focus is justifiably on marshalling its assets, remedying any misconduct, and winding up its affairs.

In the receivership context, claims for advancement are pre-petition, unsecured claims when they arise from pre-receivership conduct, and these claims should be treated the same as other pre-receivership, unsecured creditors. It is

[1] In any event, the Court of Chancery did not err, as a matter of law, in the Opinion and Judgment, and each should be affirmed even under a *de novo* standard of review.

undisputed that Andrikopoulos and Santer were sued relating to their conduct while employed by SVIC's predecessors which conduct occurred prior to SVIC being placed into receivership by the Court of Chancery, thus creating a pre-petition obligation of advancement. (A26-28, at ¶¶ 14-15, 18-20). Appellants do not contend their advancement rights are securitized, because the Agreements did not provide them with any such right. Thus, Appellants have no basis to assert priority over any other common creditor in the division of SVIC's limited funds.

As explained below, Appellants' argument improperly discredits the numerous federal and state court decisions which have already opined on the priority of payment for advancement claims. These decisions are particularly apt here. Absent any other precedent on this particular issue, drawing a parallel to these well-reasoned decisions is appropriate in the receivership context. Those decisions counsel that advancement claims are akin to executive compensation and, accordingly, are unsecured and pre-petition claims that should not be afforded administrative priority.

The Court of Chancery Rules, as incorporated in the Receivership Order, provide the procedure Appellants should follow in order to resolve their outstanding claim for compensation in the form of advancement of their legal fees and expenses. (A364, at ¶ 2(q)); *see also* DEL. CH. CT. R. 151, 153-54, 167. In this case, the Receivership Order clearly and explicitly provides that ***only*** the

Receiver's fees and receivership expenses (including Receivers' attorneys' fees) are entitled to administrative priority. (A364, at ¶¶ 2(j), (h)).

Appellants' advancement claims should have equal priority with other unsecured creditors who hold a pro-rata interest in SVIC's limited funds. *See* Henry Jaffe, Esq., *Strategic Alternatives for and Against Distressed Business: State-by-State Guide to Receiverships: Delaware*, at § 43.2 (January 2015) ("In Delaware, … costs and expenses of a receivership, including compensation for the receiver, counsel fees, and obligations incurred by [her] in the discharge of [her] duties, constitute a first charge against the property or funds of the receivership …."), attached hereto as Exhibit A; *see also Ferry v. Kehnast*, 2008 WL 2154861, at *5 (Del. Ch. May 6, 2008) (holding that, where claims of equal priority against an entity in receivership exceed the funds available, payment of these claims should be made "pro-rata" out of available funds). Immediate payment of Appellants' advancement claims out of SVIC's limited liquid assets would not comply with the Receivership Order, Court of Chancery Rules, or the fundamental priority of creditors entitled to payment when an entity is winding down.

In sum, the Court of Chancery's well-reasoned Opinion properly balances the competing policies of advancement and receiverships, and it properly held that Appellants' pre-petition and unsecured claims for advancement are not entitled to administrative priority. The Opinion should be affirmed.

A. Appellants Misconstrue the Relevant Public Policies

"[T]he appointment of a receiver is an extraordinary, a drastic and . . . an 'heroic' remedy. It is not to be resorted to if milder measures will give the plaintiff, whether creditor or shareholder, adequate protection for his rights." *Ross Holding and Mgmt. Co. v. Advance Realty Group, LLC*, 2010 WL 3448227, at *6 (Del. Ch. Sept. 2, 2010) (quoting *Maxwell v. Enterprise Wall Paper Mfg. Co.*, 131 F.2d 400, 403 (3d Cir. 1942)). When the mismanagement by corporate officers causes a real imminent danger of great loss, the Court of Chancery has the authority to place the entity into receivership and install a fiduciary to manage the entity's affairs. *Id.* at *6 (quoting *Drob v. Nat'l Mem'l Park*, 41 A.2d 589, 597 (Del. Ch. 1945)).

The receiver's focus in such situations, to marshal the entity's assets for the benefit of creditors and equity-holders, reflects Delaware's public policy decision of preserving and distributing an entity's assets. *See Henson v. Sousa*, 2015 WL 4640415, at *1 (Del. Ch. Aug. 4, 2015) (appointing a receiver to "marshal[] the company's assets for the benefit of creditors and for distribution."); *see also Williams v. Calypso Wireless, Inc.*, 2012 WL 424880, at *8 (Del. Ch. Feb. 8, 2012) (appointing a receiver for the purpose of "deliver[ing] the present value of the [company's assets] for the benefit of its creditors and ultimately its equity holders."). Delaware's public policy supports the payment of the receiver and

receivership expenses above all other creditors (even secured creditors) to incentivize talented persons to serve in such roles:

> As a general rule, costs and expenses of a receivership, including compensation for the receiver, counsel fees, and obligations incurred by [her] in the discharge of [her] duties, constitute a first charge against the property or funds of the receivership . . . . Indeed, Delaware's statutory scheme governing corporate receiverships and allowing for compensation of the receiver appears to track the general rule. There are, of course, strong policy reasons supporting such a rule-chief among those is that a receiver who administers the affairs of an insolvent corporation is an appointed officer of the court and performs a great service to the court in executing the often difficult and complicated task of winding up the affairs of a corporation or otherwise discharging the purposes of the receivership. Thus, it is only fair and equitable that the receiver should be compensated first for his expenses and services in that regard; similarly, it is only fair and equitable that the corporation's stockholders and creditors-the beneficiaries of the receivership-should bear the burden of compensating the receiver for his efforts.

Ferry v. Kehnast, 2008 WL 2154861, at *4 (Del. Ch. May 6, 2008) (internal footnotes, quotations and citations omitted).

While Delaware also has a strong public policy in favor of advancement, a director or officer's entitlement to advancement and the ability to get paid are different, especially in the context of an insolvent company in receivership or bankruptcy. In the context of receiverships, "there is no long-term horizon; the focus is on winding up the entity's affairs" and "the relevant importance of the policy justification of advancement as an inducement to attract qualified individuals to manage the company is diminished . . . ." *See Andrikopoulos*, 120

A.3d at 25. It is in these situations when an entity's focus shifts.

The Receiver of SVIC sued Andrikopoulos and Santer relating to their conduct while employed by SVIC's predecessors which conduct occurred prior to SVIC being placed into receivership by the Court of Chancery. (A26-28, at ¶¶ 14-15, 18-20). The advancement obligation was established at the time of Appellants' alleged misconduct, not when the lawsuit against them was filed, rendering their claims pre-petition. Appellants cannot contend their claims are securitized by any of SVIC's assets or receivables. Thus, Appellants are the same as other pre-petition, unsecured creditors.

Appellants contend such an outcome ignores the public policy behind advancement. Appellants cite the Court's authorization for "fees on fees" in *Stifel Fin. Corp. v. Cochran*, 809 A.2d 555 (Del. 2002), which was intended to preclude a corporation from "using its 'deep pockets' to wear down a former director, with a valid claim to indemnification, through expensive litigation." *See* Op. Br. at 27 (citing *Stifel*, 809 A.2d at 561). The public policy identified in *Stifel*, however, cuts the exact opposite way here. It is Appellants, who have lined their pockets at the expense of SVIC investors, who seek to wear down the cash-strapped and insolvent entity through expensive litigation. As the Court of Chancery held, granting administrative priority in instances such as this "seriously could undermine, if not entirely eliminate, the ability of companies in receivership to

pursue claims against former management." *See Andrikopoulos*, 120 A.3d at 25.

Furthermore, Appellants argue the Opinion will result in the end of the corporate world, with prophesies of directors and officers ceasing to serve Delaware entities. *See* Op. Br. at 25-28. Appellants' argument, however, ignores the fact that *In re Baldwin-United Corp.*, 43 B.R. 443 (S.D. Ohio 1984) held more than three decades ago that, in the context of a bankruptcy, directors and officer's advancement and indemnification claims are not entitled to administrative priority. *Id.* at 445. Entities formed under the laws of Delaware are commonly placed into bankruptcy, and claims are commonly pursued against the former directors and officers in the bankruptcy context (*e.g.,* by a court-appointed Chapter 7 trustee or a creditors committee). In light of this widely-adopted precedent from nearly thirty years ago, those officers and directors of bankrupt entities are without advancement and indemnification rights for pre-petition claims when facing litigation. Despite this fact, Delaware entities still continue to attract qualified candidates to serve as directors and officers implicitly because (like a receivership) bankruptcy is an extreme result where the rules of the game must change.

In addition, Appellants should not be given priority over other pre-receivership unsecured creditors, such as two Delaware law firms that represented SVIC prior to the receivership who have outstanding unsecured claims. Appellants are in no different position. They are all pre-receivership, unsecured creditors.

Finally, if Appellants are given administrative priority over the Receiver and his agents, the receivership (and the pending litigation against Appellants) is not likely able to be continued (which SVIC believes is Appellants' motivation). SVIC's source of funding in receivership has come, primarily, through funds contributed by SVIC investors who lost their money and who wish to fund the lawsuits filed by the Receiver. (A1129). If the advancement claims filed by Appellants are given administrative priority, investor funding is likely to cease. (*Id.*). This funding arrangement in receivership is analogous to debtor-in-possession financing in bankruptcy, and, in that situation, advancement and indemnification claims are not given administrative priority and access to the financing. *See In re Overland Park Fin. Corp.*, 1999 WL 958628 (Bank. D. Kan. June 17, 1999). Similarly, Appellants should not be afforded administrative priority.

B. Bankruptcy Precedent is Persuasive and Should Guide the Court's Determination on the Priority of Advancement Payments

1. Under the Bankruptcy Law, Advancement does not Qualify for Administrative Priority

If SVIC were in bankruptcy and Appellants requested "administrative priority status for their advancement claims—which [Appellants] essentially seek here—the relevant bankruptcy case law overwhelmingly supports the denial of such a request." *See Andrikopoulos*, at 22. In bankruptcy, for a claim to qualify

for administrative priority, two elements are required: "(1) a post-petition obligation (2) as a result of the actions that benefitted the estate." *See In re Hackney*, 351 B.R. 179, 185-195 (Bankr. N.D. Ala. 2006) (citing 115 cases over the past two decades).

As to the first prong, Appellants' claim for advancement is a pre-petition claim because the advancement obligation arose prior to the Court of Chancery's decision to place SVIC in receivership. *See In re Mid-Am. Waste Sys., Inc.*, 228 B.R. 816, 821 (Bankr. D. Del. 1999) ("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."); *In re Heck's Props., Inc.*, 151 B.R. 739, 767 (S.D. W.Va. 1992) ("Numerous courts have denied administrative expense priority . . . to corporate officials seeking indemnification under the provisions of corporate by-laws when it is determined that the acts or services which gave rise to the claims occurred before rather than after the filing of the petition for relief in bankruptcy.").

Appellants argue "the claims of those seeking advancement were triggered by the fact that the receiver brought actions against those entitled to advancement."

See Op. Br. at 32. Although the filing of the California Litigation may have resulted in Appellants retaining lawyers and incurring fees warranting advancement, the "trigger" was pulled on their advancement rights when Appellants committed the wrongdoing alleged in the California Litigation; namely, in 2000-2004 during their employment at SVIC. (A26-28, at ¶¶ 14-15, 18-20). Appellants sought advancement under the Agreements with SVIC, Inc., a former Delaware Corporation (A79), and the Delaware General Corporation Law provides the right to indemnification or advancement vests at the "occurrence of the act or omission that is the subject of the civil . . . suit . . . unless the [contractual] provision in effect at the time of such act or omission explicitly authorizes such elimination or impairment [of advancement and indemnification rights] after such act or omission occurred." *See* 8 *Del. C.* § 145(f). Thus, Appellants' advancement rights were established at the time of their alleged breaches of fiduciary duty and other wrongdoing, not when the lawsuit against them was filed. (A26-28, at ¶¶ 14-15, 18-20).

Finally, the result of the Court of Chancery's Opinion is supported by the U.S. Bankruptcy Court for the District of Delaware which has held that an indemnification claim of a former officer of the debtor (or its predecessor) was not entitled to administrative status because it was a pre-petition claim. *See In re Summit Metals, Inc.*, 379 B.R. 40, 55 (Bankr. D. Del. 2007). There, the court

reasoned the indemnification claim arose from a fiduciary duty proceeding stemming from the officer's pre-petition conduct as an officer of the debtor company/predecessor. *Id.* at 56. The court, citing an array of authority, concluded the officer's indemnification claim "is a form of prepetition compensation for services that is not entitled to administrative expense priority." *Id.* As such, the reasoning in *Summit Metals* and the numerous other cases supporting the same rationale are persuasive and should apply here.

Regarding the second prong—substantially benefitting the estate—providing advancement to Appellants will result in no benefit to SVIC.

> SVIC has minimal assets and any assets dissipated to finance the defense of those former officers and directors that SVIC is suing almost certainly would harm the estate; it would make prosecution of SVIC's claims more difficult, if not practically impossible, given Defendant's financial constraints, and could create additional credit risk, even if SVIC succeeds.

Andrikopoulos, 120 A.3d at 23. Because Appellants cannot meet the second prong for establishing administrative priority, they are not entitled to administrative priority. *See Wojcik v. Hudson Funding LLC*, 2013 WL 2085959, at *4 (Bankr. N.D. Ohio May 13, 2013) ("Defendants cannot claim that the contractual obligation to advance fees and indemnify arose from a transaction with the bankruptcy estate nor did these obligations provide a benefit to the bankruptcy estate."); *State of Conn. Comm'r of Social Services v. 3030 Park Fairfield Health Center, Inc.*, 2006 WL 3360589, at *4 (Conn. Super. Ct. Nov. 2, 2006) (holding

that "indemnification requests … are not entitled to administrative priority" in determining whether a state court appointed "receivership is responsible for pre-receivership claims.").

2. Bankruptcy Precedent is Analogous to a Receivership in Material Respects.

Appellants resort to citing the transcript of the Oral Argument held in the Court of Chancery (not the Opinion) to support their proposition that the parallels to bankruptcy precedent are "not compelling." *See* Op. Br. at 32. Unfortunately for Appellants, the Oral Argument transcript is not the decision on appeal. The Opinion is, and there the Court of Chancery held, upon further reflection, that there is "a strong analogy between receiverships and bankruptcy . . . ." *See Andrikopoulos*, 120 A.3d at 25; *see also Jaffe*, *supra*, at § 43.2. The Court of Chancery did not err in reaching this conclusion, and this Court should look to the policies supporting bankruptcy in determining whether advancement claims receive administrative priority.

A receivership, which is established to wind down a company and maximize any recovery, is analogous to the liquidation by a trustee in a bankruptcy proceeding. *Compare* 11 U.S.C. § 704(a) (describing the duties of a bankruptcy trustee) *with* DEL. CH. CT. R. 151 (describing the duties of a receiver which was incorporated into the Receivership Order in this case). Although differences exist, the policies underlying the bankruptcy decisions are applicable in the receivership

context, and the appointment of a receiver, like a bankruptcy, "materially affect[s] the remedies of such creditors, at least while the receivership proceedings are pending." *See Hannigan v. Italo Petroleum Corp. of Am.*, 181 A. 660, 662-663 (Del. Super. Ct. 1935) (citations omitted).

Appellants cite three non-Delaware cases, *Weingarten v. Gross*, 563 S.E.2d 771, 774 (Va. 2002), *Ridder v. CityFed Fin. Corp.*, 47 F.3d 85 (3d Cir. 1995), and *SEC v. Illarramendi*, 2014 WL 545720 (D. Conn. Feb. 10, 2014), for the proposition that bankruptcy precedent should not be followed to deny advancement claims administrative priority in the receivership context. *See* Op. Br. at 25, 32 n.11. At the outset, *Weingarten* is a Virginia case interpreting Virginia law on receiverships. 563 S.E.2d at 774. Appellants offer no explanation as to why Virginia law should have any impact on this Court's interpretation of Delaware law. Indeed, *Weingarten* applied Virginia law in holding the claim for mandatory indemnification (not advancement) accrued not when the underlying conduct occurred (pre-receivership) but rather after the commencement of the receivership when the director defendants prevailed in the action against them brought by the receiver. *Id.* at 774-75. However, as stated above, Delaware law provides that claims for advancement and indemnification vest at the occurrence of the conduct that is the subject of the civil suit. *See supra* at 23.

Further, and contrary to Appellants' suggestion, *Ridder* did not "order[] advancement in receivership context." *See* Op. Br. at 25. In *Ridder*, employees filed a lawsuit to compel CityFed Financial Corporation ("CityFed"), then in receivership, to advance their attorneys' fees incurred in litigation. 47 F.3d at 86. The district court acknowledged their right to advancement, but, because CityFed was in receivership, and "the rights of other creditors [were] implicated," held "the harm to appellants from denial of the injunction was outweighed by the public interest in assuring equal treatment to all of CityFed's creditors, and that appellants' claim should not be accorded priority by the issuance of a preliminary injunction." *Ridder*, 47 F.3d at 87.

On appeal, however, the Third Circuit held the district court erred because the only issue was "whether appellants were entitled to advance payment of the cost of defense of the [litigation]. The insolvency proceeding itself was not before the district court, and the impact, if any, of a grant of injunctive relief was not only a matter for other tribunals to decide, but, on this record, purely speculative." *Id.* at 87-88. On remand, the district court entered the injunction requiring the payment of attorneys' fees.

After the employees' litigation was remanded, the Office of Thrift Supervision issued a cease-and-desist order preventing CityFed from paying advancement while in receivership, which was affirmed by the United States Court

of Appeals for the District of Columbia Circuit. *See Ridder v. Office of Thrift Supervision*, 146 F.3d 1035, 1037-38 (D.C. Cir. 1998) (recounting this history). After this cease-and-desist order was issued and affirmed on appeal, the employee's litigation was appealed again to the Third Circuit who ultimately vacated the district court injunction ordering the payment of advancement. *Id*. Contrary to this convoluted procedural history in *Ridder*, the issue and impact of SVIC's status in receivership was before the Court of Chancery and warranted consideration.

Finally, *Illarramendi* should not determine whether this Court should be guided by the analogous bankruptcy precedent. *Illarramendi* is from the District of Connecticut and is not binding on this Court. Rather, the Court should look to the bankruptcy courts in the District of Delaware who are far more versed in interpreting and applying Delaware law and analogous situations.

Although *Illarramendi* purports to rely upon Delaware law, it does not cite any relevant Delaware cases. *Illarramendi* mentions the "Delaware policy of indemnification and advancement of attorney's fees," *see* 2014 WL 545720, at *7, but that policy and the Delaware cases cited in *Illarramendi* only speak to a director and officer's entitlement to advancement, not the payment therefore. Further, none of the cases cited in *Illarramendi* were issued in the context of a

Delaware receivership or held that advancement should receive administrative priority.

Illarramendi also misinterprets Delaware law by citing the Second Circuit's warning that receiverships are not akin to bankruptcy. *Id.* at *8. Quite the contrary, a member of the Court of Chancery has authored an article which detailed several similarities between bankruptcy and Delaware receiverships. *See* Honorable J. Travis Laster, *The Chancery Receivership: Alive and Well,* 28 FALL Del. Law 12, 1-2 (2010) (noting that, similar to a bankruptcy, "[a] receivership is the court-supervised winding-up of an entity's operations and existence" that can be instituted by a creditor or the corporation itself). Both a receivership and a bankruptcy proceeding provide for the resolution of creditor's claims in an orderly process, the only difference is a bankruptcy judge's scope and explicit statutory guidance extends farther. *Id.*

C. Market-Based Solutions Offer a Resolution

The Court of Chancery properly recognized that an equitable resolution of this issue is a "market-based solution," which would preserve the receivership estate's assets and provide the directors and officers with payment from insurance policies. *See Andrikopoulos*, 120 A.3d at 26. The Court of Chancery did not err in including the existence of such insurance policies in the balancing of the "existence of advancement rights against the realities of insolvent entities." *Id.*

Indeed, this ensures defenses costs are paid while upholding the policy behind receiverships and preserving the Company's limited assets.

Appellants contend the only coverage that could have been available in this context would be under a "tail" which only covers a period of 6 years and would not have provided coverage in this case. *See* Op. Br. at 34. Appellants provide no support for their conclusory statement that "no market for such [ten to thirteen year tail] policies is known to exist." *Id.* It is hard to fathom that an insurance provider would be willing to provide such a "tail" policy for the first six years (which would have the highest risk of loss) but not for the following four to seven years (during which most claims would be time-barred). *See Atlantis Plastics Corp. v. Sammons*, 558 A.2 1062, 1064 (Del. Ch. 1989) (holding that claims filed in the Delaware Court of Chancery seeking money damages are generally subject to the three-year limitations period of 10 *Del. C.* § 8106).

Appellants also ignore the reason the California Litigation was only recently filed was due to Appellants' own affirmative and fraudulent acts of concealment.[2] Thus, Appellants should not be afforded any sympathy for the detriment caused by their own actions to conceal their systemic mismanagement of SVIC. Indeed, in

[2] Indeed, in the California Litigation, that court recently denied Santer and Andrikopolous' demurrer on the basis of a statute of limitations defense, finding that the statute of limitations on the claims against Santer and Andrikopolous was tolled because of their fraudulent concealment. *See Portnoy v. Estate of Robert W. Shaw, et al.*, C.A. No. BC533571 (Ca. Sup. Ct. Sept. 25, 2015), attached as Exhibit B (decision denying Defendants' demurrers) (of which the Court can take judicial notice).

most instances six years should provide more than sufficient coverage for directors and officers in light of the statute of limitations applicable to most claims that could be asserted.[3]

D. Administrative "Headaches" Weigh Against Priority Treatment

The Court of Chancery did not err in recognizing "the reality of practical administration weighs in favor of treating advancement claims the same as claims of other unsecured creditors." *See Andrikopoulos*, 120 A.3d at 26. The Court of Chancery exercised its discretion and determined the policy of "incentivizing talented individuals to serve as receivers of troubled entities" supported the granting of administrative priority to the receivership expenses. (A364, at ¶ 2(j)). Absent some "super-priority" system, the Receivers' own fees could be treated on par with Appellants' advancement rights, in violation of the Court of Chancery's Receivership Order.

To the extent the Court of Chancery sought to recruit and incentivize talented individuals to serve as Receivers, handcuffing their ability to hire counsel, accountants or even rent office space would certainly undercut that goal. *See*

[3] Appellants cite Vice Chancellor Glasscock's opinion in *Henson*, arguing that "persons expecting advancement may have similar prospects as to what occurred in *Henson*" when counsel for the managers withdrew. *See* Op. Br. at 34 n.13. In *Henson*, however, the former managers seeking advancement argued that the LLC Agreement submitted by Appellants was "forged" and could not point to an LLC Agreement governing the company which provided their purported advancement rights. 2015 WL 4640415, at *1. Thus, it was the managers' failure to prove their entitlement to advancement, not the priority of payment, which ultimately resulted in their counsel's withdrawal.

Ferry, 2008 WL 2154861, at *4; *see also In re S&Y Enterprises, LLC*, 480 B.R. 452, 455 (Bankr. E.D. N.Y. 2012) ("Every bankruptcy case benefits from the services of bankruptcy professionals . . . [who are] compensated with special administrative priority from the assets of the debtor's estate. This administrative priority encourages professionals, including counsel, to take on the responsibility of representing a company in financial difficulties and steering it through the Chapter 11 process to a successful reorganization."). Indeed, it is for that reason that the Receivership Order specifically states that

> [w]ithout further order of Court, the Receiver is authorized to employ and pay from the Receivership Assets such contractors, property managers, brokers, accountants, attorneys and other persons and professionals as the Receiver may deem necessary or appropriate to the performance of his duties hereunder, and such expense shall be deemed a normal, ordinary, and necessary operating expense of the Receivership Estate.

(A368 ¶ 2(h)).

The Court of Chancery was within its discretion in deciding to avoid "time-consuming, line-item accounting disputes" which would invariably arise in seeking to determine where each of the Receiver's expenses fell on the priority scale. *See Andrikopoulos*, 120 A.3d at 26. The Court of Chancery's time and judicial resources, as well as SVIC's limited funds, are better served avoiding such battles.

E. Appellants' Interjection of Irrelevant "Facts"

Likely realizing the well-reasoned nature of the Opinion, Appellants resort to injecting so-called "facts" challenging the Receivers' conduct on other matters involving the receivership. *See* Op. Br. at 11, 13, 19. All of this is irrelevant to the "[o]ne issue for decision: to what extent, if any, [Appellants'] advancement claims are entitled to priority as against the claims asserted SVIC in the receivership." *Andrikopoulos*, 120 A.3d at 20. In any event, the Court of Chancery already resolved such challenges in the underlying receivership action (C.A. No. 7378-VCP) after a full evidentiary hearing with live witnesses, keeping Portnoy as the Receiver and holding: "[b]ased on the evidence of record, Portnoy appears to be doing a good job in his role as Receiver." *Jagodzinski v. Silicon Valley Innovation Co., LLC*, 2015 WL 4694095, at *3 (Del. Ch. Aug. 7, 2015).

CONCLUSION

For all the reasons stated herein, SVIC respectfully requests that this Court affirm the Court of Chancery's Opinion and Judgment.

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Respectfully submitted,

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