



Client Alert

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Important New Delaware Case Re Advancement of Directors' Legal Expenses

A Delaware Chancery Court ruling on May 28, 2008 suggests that corporate directors may want to immediately revisit their corporation's bylaws and other contractual rights regarding advancement of legal expenses to directors and officers. The ruling, in *Schoon v. Troy Corporation*, held that the rights of former directors to advancement of legal expenses *can* be eliminated by the corporation *even after* the occurrence of the events or circumstances that give rise to the claim.

Schoon involved the resignation of William J. Bohnen, a director of Troy Corporation. Following Mr. Bohnen's resignation as a director, the board of directors of Troy approved amendments to Troy's bylaws that eliminated the rights of former directors to advancement of legal expenses. Shortly thereafter, Troy itself filed an action against Mr. Bohnen, claiming breach of fiduciary duty for his actions while he served as a Troy director. After Troy refused his request for advancement of his legal fees, Mr. Bohnen filed his own action against Troy seeking to enforce his rights to advancement under Troy's bylaws.

Mr. Bohnen argued that the bylaws amendments adopted after he resigned as a director could not eliminate his rights to advancement, because these rights had vested when he took office as a director when the original bylaws were in place and could not be unilaterally terminated by the corporation. The court rejected Mr. Bohnen's argument, holding that the language of Troy's original bylaws did not preserve his right to advancement in these circumstances, because his right "vested" only when he was sued by his former corporation, which was after the bylaws were amended.

The Troy bylaws contained customary "saving" language to the effect that the rights conferred by the bylaws would continue as to former directors. According to the court, however, this language should be read to mean that a director whose rights to advancement have been triggered while in office does not lose these rights if he thereafter ceases to be a director. This language was inapplicable to Mr. Bohnen, therefore, since he resigned prior to the vesting of his advancement rights.

The *Schoon* decision makes clear that a director's rights to advancement of expenses under corporate bylaws can be eliminated by subsequent amendments to the bylaws that occur prior to the assertion of the claim against the director. This decision does not alter rights of a director under a written indemnification agreement that specifically provides for advancement of expenses that cannot be amended without the director's consent. The result in this decision also can be avoided by properly worded bylaw provisions that make clear that the right of directors to advancement of expenses arises, or becomes vested, when they join the board, irrespective of when a claim accrues or is initiated against the directors. In light of this decision, directors might wish to review their corporation's bylaws and indemnification scheme.