

Advancement Rights of Present and Future Officers Under LLC Agreement

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Advancement and indemnification rights are vital in attracting the best and brightest individuals to serve as managers of Delaware entities. Those rights are meant to provide managers of Delaware entities comfort when accepting positions that often lead to being named in litigation. In the limited liability company context, a manager's advancement and indemnification rights are often derived from the entity's operating agreement. And seeing as Delaware courts strive to enforce the express terms of an agreement, advancement and indemnification provisions must be drafted with precision. As discussed below, contractual limitations and qualifications on advancement and indemnification rights will be interpreted in a way that gives meaning to all terms in the agreement.

In *Harrison v. Quivus Systems*, C.A. 12084-VCMR, the Delaware Court of Chancery was confronted with a matter wherein the plaintiff sought advancement of expenses arising from litigation brought against him by Quivus Systems, for actions the plaintiff allegedly took while acting as CEO of Quivus. The Quivus operating agreement required the company, to the fullest extent allowed under Delaware law, to advance and indemnify expenses to its present and future CEO. John Harrison was removed as CEO of Quivus on July 1, 2014. Just over a year later, a derivative action was filed on behalf of Quivus in the Superior Court of the District of Columbia alleging a variety of claims against Harrison in his role as CEO, including that Harrison mismanaged and looted the assets of Quivus. Harrison filed an answer and counterclaim, alleging that Quivus' financial condition was not the result of Harrison's purported mismanagement. Subsequently, Harrison made a demand on the company for advancement of certain expenses incurred in the D.C. action, including his defense of all but one count of the derivative complaint and also the expenses incurred in prosecuting his counterclaims. Following Quivus' rejection of his demand for advancement, Harrison filed a complaint in the Court of Chancery.

The Quivus operating agreement included an advancement provision providing: "Subject to any limitations set forth in the [Delaware LLC] Act, the company shall indemnify and advance expenses to each present and future member or manager of the company (and, in either case, his heirs, estate, personal representatives or administrators) to the full extent allowed by the laws of the state of Delaware, both as now in effect and as hereafter adopted. The company may indemnify and advance expenses to any employee or agent of the company who is not a member or manager (and his heirs, estate, personal representatives or administrators) to the same extent as to a member or manager, if the disinterested members determine that it is in the best interests of the company to do so. The company shall also have the power to contract with individual member, manager, employee, or agent for whatever additional indemnification the members shall deem appropriate." The crux of the defendant's argument was that the advancement provision qualifies the right to advancement and indemnification to present and future members or managers, not past members or managers. As a result, the defendant argued that Harrison was not entitled to advancement because he is neither a present nor a future manager.

The court noted that its task was to give legal effect to the unambiguous, plain language of the advancement provision in the Quivus operating agreement. In so doing, the court stated that while the operating agreement "does not define present or future managers, much less former managers" the operating agreement does define managers as "collectively, the chief executive officer, the secretary, and each other manager elected by the members." It was undisputed that Harrison was the "present" manager when he was CEO of Quivus and it was during his time as CEO that the events giving rise to the D.C. action occurred. Nevertheless, the defendant argued that Harrison was not entitled to advancement as he was not a "present" or "future" manager of Quivus when the advancement action was filed. During oral argument on the parties' cross motions for summary judgment, the defendant took the position that advancement rights vest at the time a claim is made against a present manager. The court found that position untenable, as it essentially eliminates "future" from the operating agreement. The court added color to the conundrum created by defendant's

argument with a clever reference to the timeless Mel Brooks cinema classic, "Spaceballs." With an allusion to Dark Helmet's struggle to comprehend when "then" will be "now," the court interpreted the defendant's argument to suggest that Harrison was a "present" manager in the past, and accordingly not a "present" manager in the present. The court held that defendant's interpretation was unreasonable as it read "present" and "future" out of the operating agreement. Moreover, the defendant's interpretation also rendered the phrase "his heirs, estate, personal representatives or administrators" meaningless.

In granting Harrison's motion for summary judgment, the court stated that "Delaware law is clear that contracts must be read as a whole to give effect to each term, and the court will not adopt an interpretation that produces an unreasonable result." The court held that at the time the Quivus operating agreement was adopted, the company "became bound to provide each then-present member or manager of the company with mandatory indemnification and advancement. Quivus also became bound to provide mandatory indemnification and advancement to anyone who became a member or manager of the company sometime thereafter—that is, in the future. Thus, the class covered by the advancement provision includes anyone who was a member or manager when the parties adopted the LLC agreement a present manager or member—or anyone who later became a manager or member a future member or manager." In addition to granting Harrison's claims for advancement, the court granted Harrison his fees in prosecuting his advancement claim, commonly known as "fees on fees."

This decision illustrates the need for practitioners to advise their clients of the risks associated with advancement litigation, especially where a company is contesting the advancement of expenses. While companies may be leery of advancing thousands, if not millions, of dollars in expenses to managers, losing an advancement fight often leads to the company paying the manager's fees in prosecuting the advancement claim, in addition to actually being required to advance the expenses subject to the dispute.