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“Boomerang” Indemnification/Advancement- Gilbert v. Unisys

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Under Delaware law, executives (and former executives) may be entitled to indemnification and advancement from their employer for claims arising in connection with their employment. These rights to indemnification/advancement are generally contractual; they typically arise under the company’s governing documents (*e.g.*, charter, by-laws, or partnership or LLC agreements) or indemnification agreements.

Indemnification may cover a range of expenses and liabilities and advancement may require the employer to advance attorney’s fees incurred in defending a claim at the outset of litigation before final disposition of the action (subject to an undertaking to repay any amounts advanced if it turns out indemnification is not warranted).

The most common indemnity/advancement claims arise when executives are sued by third parties who have claims against the company or firm, and add the executives as defendants. It is important to remember, however, that executives (and former executives) may have a right to indemnification/advancement for attorneys’ fees they incur in defending against claims brought by their employers against them. For example, this could involve lawsuits commenced by the employer for post-separation violations of restrictive covenants and other actionable conduct by the former executives.

To avoid unpleasant surprises, employers considering legal action against executives should assess whether those claims could “boomerang” into indemnification/advancement claims by the targeted executives. As a strategic matter, if an executive prevails on a claim for advancement of his or her legal fees, it can provide critical leverage to settle any action. And to compound the unpleasantness, executives who prevail in these cases may also be entitled, under the by-laws or other operative agreements, to recover the separate attorneys’ fees they incurred in seeking advancement of their attorneys’ fees incurred in the underlying litigation (recovery of “fees on fees”).

Consider the recent decision by the Delaware Court of Chancery in Gilbert v. Unisys (August 13, 2024). In this case, two executives joined Unisys in 2021, when their business unit was acquired from Atos. They left in 2023, to rejoin Atos. Unisys then sued them in federal court alleging that the executives stole confidential and sensitive Unisys information and improperly solicited Unisys employees. The two executives then sued Unisys in Delaware, seeking advancement of their legal fees and expenses incurred to date in defending the Unisys litigation, and future fees. The fee amounts claimed were substantial (roughly $800,000 during the first two months of the litigation). The Court ruled in favor of the former executives and ordered Unisys to advance all outstanding and future fees, as well as "fees on fees" incurred in prosecuting the Delaware proceeding.[1]

In adjudicating the claim for advancement, the Chancery Court in Gilbert carefully reviewed the advancement provisions of the Unisys charter and by laws, to determine whether the plaintiffs were "covered" officers or employees entitled to advancement, and whether the litigation brought by Unisys was "by reason of the fact" that the plaintiffs had served as officers and employees of Unisys and its affiliates.[2]

The Court's review of whether the plaintiffs qualified for indemnification as "officers" of Unisys is very technical but in finding for advancement, the Court noted that (i) the plaintiffs did not have to be elected by the Unisys Board in order to qualify as a covered "officer," and (ii) by-law provisions stating that "officers" shall include "Vice Presidents" (the positions held by the plaintiffs) created an ambiguity that resulted in coverage.

As to the contested issue of whether a claim by a corporation alleging theft of confidential information permitted an executive to invoke indemnification/advancement, the Court held that such a claim was permissible. Under the broadly construed "official capacity" standard applied by Delaware courts to these types of claims, where an action alleges misappropriation or misuse of the corporation's confidential information learned as the result of an officer's pre-departure status, the claim was "by reason of the fact" that the individual had served as an officer or other covered capacity.

The *Gilbert* decision may come as a surprise, but it follows other Delaware cases that have recognized “boomerang” indemnification/advancement claims. Each case stands on its own facts and circumstances, but an employer should take a full inventory of indemnification/advancement provisions in all relevant documents before commencing legal action against executives (current and former). This means reviewing with counsel the company’s (or firm’s or fund’s) governing documents (charter, by-laws, partnership agreements, LLC agreements, etc.) and separate indemnification agreements. For private equity firms, hedge funds and asset managers this means also reviewing with counsel the various agreements that provide for team members to participate in management and/or firm economics, including those covering carry participation and co-investment vehicles.

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[1] Interestingly, Unisys argued that because Atos (the new employer) had already paid a portion of plaintiff’s legal fees, the plaintiffs had no right to advancement from Unisys for those amounts. The Chancery Court held that the plaintiffs’ waived their right to contest this point-hence the Court held they were only entitled to advancement for outstanding and future legal fees.

[2] In these cases, the relevant indemnification language often covers executives in multiple capacities: as “officers” of the parent entity, as appointed officers of subsidiaries or as employees requested to provide services to a joint venture or other enterprise.

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