Cooley

August 15, 2022

Whether they are new executive leaders or longtime members of a corporate board, directors and officers should be considering two prongs of protection – a robust insurance program and a tailored indemnification agreement.

Directors and officers can face significant personal exposure whenever their company is involved in a dispute or investigation. For example, for the past 10+ years, stockholder litigation has accompanied 80% to 90% of public M&A deals, in which stockholders assert breach of fiduciary duty claims or disclosure claims. Ongoing market volatility and increased regulatory efforts add to the potential for exposure. Prudent directors and officers – and any funds that place them on boards or in leadership positions – should avail themselves of all available legal protections in charter provisions, D&O insurance **and** indemnification agreements individualized to their needs.

In fact, looking to the company for indemnification vis-à-vis its charter provisions and indemnification agreements is generally the first line of defense. As an initial point, individualized indemnification agreements offer several advantages over any indemnification provisions in organizational documents, as outlined below.

Easier enforcement

Indemnification agreements may be more easily enforced by directors and officers because they are bilateral contracts reflecting bargained-for consideration in the form of an individual's agreement to accept or continue service with the company – and cannot be amended without the directors' and officers' consent.

Broader, more thorough protection

Indemnification agreements also typically provide broader and more thorough protection of directors' and officers' indemnity rights than statutes and organizational documents. A well-written indemnification agreement should include, for example:

- **Definitions of key terms** – Pay attention to terms that define the scope of indemnification, such as "claims," "proceedings," "expenses" and "losses."
- **Outside directors and venture funds** – If applicable, include language that extends the indemnification and advancement rights provided to a venture fund's designee (an outside director) to the venture capital fund appointing the director.
- **Advancement of defense costs** – Advancement is not automatically mandatory, so a good agreement should specify that the company "shall" provide advancement. The advancement language also should cover expenses incurred by the individual both as a current and a former director or officer.
- **Fees-on-fees** – The agreement also may specifically provide for, or preclude, expenses incurred in successfully asserting a claim for indemnification or advancement under the agreement or the company's governing documents. While it is routine for directors to be indemnified in suits brought by third parties, they are not necessarily entitled to indemnification for attorneys' fees and costs should they need to sue the corporation to enforce their indemnification rights under an agreement, organizational document or applicable law. An indemnification agreement can expressly provide the right to be indemnified in such "fees-on-fees" disputes.
- **Procedure for determination of entitlement and time frames** – The agreement should set forth a time frame for the determination of whether indemnity is owed and establish a means by which the indemnitee may appeal or contest the

determination, as well as include procedures and deadlines. This can be critical in moving the claim forward and providing clarity to the person seeking indemnification.

- **Priority** – Often, a director or officer may have indemnification rights separate from those offered by the company, including from a private equity fund or other sponsor. In this case, it is important for both parties to specify the relative priority of each indemnitor source in the event multiple parties are liable to the director or officer for indemnification.
- **Insurance** – The indemnification agreement typically will require that the company provide D&O liability insurance that protects the indemnitee to the same extent as the most favorably insured of the company's and its affiliates' current directors and officers.

D&O insurance filling in the gaps

The next line of defense – D&O insurance – has terms that incorporate by reference the company's indemnification obligations and then serves to fill gaps where indemnification is not otherwise available to directors and officers (i.e., bankruptcy or derivative suits). For those becoming a director or officer, the scope of the D&O policy's protections should undergo an evaluation, in conjunction with an indemnification agreement. In the event of a claim against a director and officer, the availability of relief and reimbursement should be evaluated under both the policy and the indemnification agreement to pursue all possible sources of recovery.

If you have questions about indemnification agreements, please reach out to Rachel Katz, Jacquelyn Burke or other members of the Cooley insurance group.

Key Contacts

Jacquelyn Burke Boston	jburke@cooley.com +1 617 937 2398
Rachel F. Katz New York	rkatz@cooley.com +1 212 479 6546
