

## Commercial Litigation

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# Advancement of Attorney Fees Is Alive and Well In the Commercial Division

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The cost of litigating complex commercial cases can quickly become very significant for the parties involved in the process. Under most circumstances, each party will have to bear its own attorney fees and costs absent a contractual right (an attorney fees provision in a contract) or a statutory provision (anti-discrimination laws) that provides otherwise. However, in some cases, a party may not have to bear its own attorney fees and costs of litigation.

Statutory provisions of the New York Business Corporation Law (BCL) (§§722, 723, and 724) govern the advancement of attorney fees and costs to one party from another party under the right circumstances. In addition, a relatively recent decision in the New York Supreme Court, Nassau County Commercial Division, *Schlossberg v. Schwartz*, 43 Misc.3d 1224(A), 992 N.Y.S.2d 161 (Sup. Ct., Nassau Co., 2014) (J. DeStefano), ultimately granted a party's motion for advancement of legal fees and costs.

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### Advancement, Indemnification

Before delving into advancement rights, it is imperative to distinguish between advancement and a closely-related concept—indemnification. Indemnification for attorney fees and damages under the BCL is addressed at the conclusion of the case and necessarily involves the ultimate determination of whether a corporate officer and/or director “acted in good faith for a purpose

which he reasonably believed to be in, or ... not opposed to, the best interests of the corporation ...” BCL §§722, 723, and 724. As a result, the right to indemnification must await the outcome of the case.

Advancement, on the other hand, refers to payment of legal fees and expenses during the pendency of the action and does not depend on any ultimate determination of liability. See *Kliger v. Drucker*, No. 003304/11, 2011 N.Y. Misc. LEXIS 6704, \*20, (Sup. Ct., Nassau Co. 2011). The right to advancement is not dependent on the ultimate outcome of an action. *Id.* The overall purpose of advancement is to “provide[] corporate officials with immediate interim relief from the personal out-of-pocket financial burden of paying the significant on-going expenses inevitably involved with investigations and legal proceedings.” *SEC v. FTC Capital Mkts.*, 09 Civ. 4755, 2010 U.S. Dist. LEXIS 65417, \*14 (S.D.N.Y. June 29, 2010) (citing *Homestore v. Tafeen*, 888 A.2d 204, 213 (Del. 2005)).

### BCL §§721-724

BCL §721 addresses the non-exclusivity of statutory provisions for indemnification and advancement of directors and/or officers. BCL §721

provides, in relevant part:

The indemnification and advancement of expenses granted ... shall not be deemed exclusive of any other rights to which a director or officer seeking indemnification or advancement of expenses may be entitled, whether contained in the certificate of incorporation or the by-laws ... .

Indemnification of officers and directors of a corporation is addressed in BCL §722(a) and (c). Section 722(a) deals with indemnification of a party to an action, other than a derivative action in the name or right of the indemnifying corporation, “by reason of the fact that [such party] was a director or officer of the corporation ... if such director or officer acted, in good faith [or], for a purpose which he reasonably believed to be in ... the best interest of the corporation.” Section 722(c) contains identical provisions for indemnification of officers and directors in derivative actions when the lawsuit has been brought against such persons “by or in the right of the corporation to procure a judgment in its favor.” In both §722(a) and §722(c), indemnification includes “reasonable expenses [and] attorney fees actually and necessarily incurred” in defense, settlement or on appeal.

BCL §723 also incorporates by reference the bases for indemnification under §722, but unlike §722, no distinction is made between individual and derivative actions. Section 723(a) states:

A person who has been successful on the merits or otherwise, in the defense of a civil or criminal action or proceeding of the character described in Section 722 shall be entitled to indemnification as authorized in such section.

As succinctly stated by Judge Tim-

othy Driscoll in *Kliger v. Drucker*, “if a corporation provides for indemnification to its directors and officers consistent with BCL §722, BCL §723 binds the corporation to its promises to indemnify.” 2011 N.Y. Misc. LEXIS at \*20. Section 723(c) provides:

Expenses incurred in defending a civil ... action or proceeding may be paid by the corporation in advance of the final disposition of such action or proceeding by or on behalf of such director or officer to repay such amount as, and to the extent, required by paragraph (a) of section 725.

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Statutory provisions of the New York Business Corporation Law (§§722, 723 and 724) **govern the advancement of attorney fees and costs** to one party from another party under the right circumstances.

Unlike §§722 and 723(c), which depend on a certificate of incorporation, corporate by-laws or some other corporate act to provide indemnification and/or advancement, a party to an action or proceeding may seek indemnification and/or advancement rights pursuant to BCL §724. Section 724(a) of the BCL provides that when indemnification of directors and officers would otherwise be permitted under §§722 and 723 of the BCL, a party seeking indemnification or advancement may make application therefore either in the action or in a separate proceeding. With regard to advancement, §724(c) states:

Where indemnification is sought by judicial action, the court may

allow a person such reasonable expenses including attorney fees, during the pendency of the litigation as are necessary in connection with his defense therein, if the court shall find that the defendant has by his pleadings or during the course of the litigation raised genuine issues of fact or law.

### Before Advancement

Prior to the advancement of a corporate director and/or officer’s attorney fees and costs for the defense of an action or proceeding, that person must provide the corporation with an undertaking. BCL §723(c). However, unlike such an “undertaking” as covered within the CPLR, an “undertaking” within the provisions of the BCL is simply an unconditional, unsecured promise by the officer or director to repay the advancement to the corporation. No cash deposit, bond or surety is required as the officer or director making the undertaking acts as his own surety. See *Spitzer v. Soundview Health Ctr.*, No. 401432/04, 2005 N.Y. Misc. LEXIS 3249, at \*9 (Sup. Ct., New York Co. Jan. 27, 2005).

### Advancement Rights

On May 14, 2014, Judge Vito M. DeStefano of Supreme Court Commercial Division issued a decision granting a party’s request for advancement of legal fees in a case entitled *Schlossberg v. Schwartz*, 43 Misc.3d 1224(A), 992 N.Y.S.2d 161 (Sup. Ct., Nassau Co. 2014). In *Schlossberg*, the plaintiff-counterclaim defendant, a shareholder, director and former officer of Steuben Sales, commenced an action in both his individual capacity and derivatively on behalf of the corporation. The defendants-counterclaim plaintiffs interposed

a litany of counterclaims, including counterclaims based upon allegations that the plaintiff-counterclaim defendant misappropriated corporate confidential information, converted corporate assets, breached his fiduciary duty and wasted corporate assets. The plaintiff-counterclaim defendant then moved for an award of expenses, including reasonable legal fees, pendent lite, in connection with the defense of counterclaims made by Steuben.

In his detailed and well-reasoned decision, DeStefano first conducted an analysis of §§721-724, tracing their roots to before the 1941 and 1945 amendments to the General Corporation Law (GCL) and before the BCL was enacted. In that discussion, the court noted that prior to 1941 there was no right of indemnification to a corporate official in New York in a direct suit brought against him by the corporation. *Id.* at \*17.

However, in 1941, the New York legislature enacted §§27-a and 61-a of the GCL to permit a corporation to grant corporate officials the right of indemnification through the certificate of incorporation, by-laws, or a shareholder resolution and provide mandatory indemnification to a corporate official that is successful in his defense of a direct or derivative suit brought by or on behalf of the corporation. *Id.* at \*17-18. In 1961, the BCL was enacted, and then amended in 1986, to further enlarge indemnification rights to directors and officers sued by third parties. *Id.* at \*23-24.

Based upon the court's review of the history of indemnification and Steuben's by-laws, DeStefano concluded that the plaintiff-counterclaim defendant was "not prohibited" from seeking indemnification for the defense of direct counterclaims brought by Steuben against him "by reason of the fact

that he is or was a director or officer of the Corporation" and that "although ultimate resolution of the indemnification issue must await the conclusion of the action, it is sufficient to note that an advancement of fees pursuant to BCL §724(c) may also properly be sought." *Schlossberg*, at \*28.

The court followed this by directly addressing whether there exist "genuine issues of fact or law" that the counterclaims against the plaintiff-counterclaim defendant were made "by reason of the fact ... that he is or was a director or officer of the corporation." *Id.* The court then stated that, not surprisingly, there is little case law or commentary on the subject, although the Delaware courts have addressed it on occasion and found the Delaware cases to be instructive. The Delaware case law indicates that a "broad interpretation of that phrase [genuine issues of fact or law], which would include a wide array of claims that might be asserted against a director or officer, is warranted." Finding Delaware case persuasive, the court held:

Considering the nature of the counterclaims asserted against Plaintiff, all of which involve conduct alleged to have been based on Plaintiff's status as an officer or director of Steuben, the court concludes that the counterclaims, *as pleaded*, involve issues and claims made by reason of the fact that Plaintiff was an officer or director of Steuben. That some of the counterclaims might have been asserted differently—and more specifically, in a manner that did not invoke the Plaintiff's status as director or officer, or, that evidence could have been presented in opposition to the motion conclusively establishing the absence of any

nexus between the counterclaims and the Plaintiff's 'official corporate capacity', is speculative and cannot defeat the instant application." *Id.* at \*30.

Accordingly, the court granted the plaintiff-counterclaim defendant's application for advancement of legal fees and expenses relating to the defense of the counterclaims asserted against him.

## Conclusion

Overall, advancement is an important concept that counsel should always contemplate before setting forth claims against an officer and/or director of a corporation. Without proper thought and contemplation, unintended adverse consequences may occur, which could be detrimental to the prosecution of claims, as demonstrated in *Schlossberg*. From the perspective of the defense, advancement can be a very significant factor when developing a litigation strategy to effectively defend claims brought against an officer and/or director of a corporation.

Forethought and an understanding of advancement are strongly suggested before commencing an action against a corporate officer and/or director as well as when defending an action on behalf of a corporate officer and/or director. With the proper understanding of advancement under the BCL, counsel may be able to successfully mitigate against the risk of an unfavorable decision granting an adversary's motion for an advancement award or utilize advancement as a weapon in defense of claims.