

DISGORGEMENT OF COMPENSATION PAID TO DIRECTORS DURING THE TIME THEY WERE GROSSLY NEGLIGENT: AN AVAILABLE BUT SELDOM USED REMEDY

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I. INTRODUCTION

A bedrock principle of Delaware corporate law is that directors of Delaware corporations are charged with a duty of care, which means that they must consider all material information reasonably available to them and exercise reasonable care and skill in dealing with the affairs of the corporation. Deficiencies in the directors' process are actionable if the directors are grossly negligent.¹

However, over the last thirty-five years, certain corporate practices have resulted in a virtual elimination of directors' personal liability for breaches of their duty of care. Delaware corporations have enacted charter provisions exculpating directors from monetary liability for certain breaches of the duty of care; corporations have further contractually indemnified their directors from liability for malfeasance; and corporations have obtained insurance covering instances where the charter provisions and indemnification agreements are unavailable. As a result, directors essentially bear no responsibility for their acts of gross negligence,² which can cost corporations hundreds of millions of dollars of liability and legal expenses.³ Because the duty of care is unsupported by any credible threat of sanction, it does little to influence directors' actions or deter misconduct. Meanwhile, malfeasant directors retain their compensation for their "service" on corporate boards.

This article proposes a modest way to hold grossly negligent directors at least partially accountable for their actions and to deter future misconduct. Specifically, such directors should be required to disgorge all their director compensation paid for the time period during which they are found to be grossly negligent. While disgorgement is not typically among the remedies sought by shareholders in Delaware litigation, it is nevertheless clearly available to practitioners.

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1. See generally *In re The Walt Disney Co. Deriv. Litig.*, 907 A.2d 693, 745-49 (Del. Ch. 2005).

2. Bernard Black, Brian Cheffins & Michael Klausner, *Outside Director Liability*, 58 STAN. L. REV. 1055, 1060 (Feb. 2006) ("*Outside Director Liability*") (noting that, since 1980, "directors have only once made personal payments after a trial" — in the famous *Van Gorkom* case — and of the additional twelve cases the authors found in which outside directors made out-of-pocket payments for settlement or for their own legal expenses, ten involved claims of oversight failure, two involved duty of loyalty claims, and one involved an allegedly ultra vires transaction involving the directors' compensation; thus, none involved duty of care violations).

3. For example, in the AIG derivative action, the shareholder plaintiffs alleged that AIG's directors breached their fiduciary duties by directing or approving a host of improper activities and transactions that resulted in investigations by the Department of Justice and the SEC and numerous civil lawsuits, costing AIG over a billion dollars in fines, penalties and defense costs. See Third Amended Cons. Stockholders' Deriv. Compl., American International Group, Inc. Cons. Deriv. Action, C.A. No. 769-VCS (Apr. 11, 2008 Del. Ch.). The claims against the directors (as well as certain AIG officers and employees) settled for \$90 million. See *American Int'l Group, Inc.*, Form 8-K, filed with the SEC on Dec. 13, 2010, at 2-3.

Set forth below is a summary of the duties of directors of Delaware corporations and an analysis of the corporate mechanisms that have diluted directors' accountability for their failures to properly discharge their duty of care. First, this article explains how section 102(b)(7) of the Delaware General Corporation Law ("DGCL") provides a means to insulate directors from any personal liability for monetary damages for duty of care violations. As discussed below, this statute authorizes shareholders to enact charter provisions exculpating directors for any personal liability for acts of gross negligence.

Next, this article discusses jurisprudence in Delaware and other jurisdictions showing that disgorgement is not monetary damages such that the remedy would be barred by section 102(b)(7)-based charter provisions. This article also explains why disgorgement is not a form of rescissory damages that could be covered by such charter provisions.

Then discussed is another mechanism diluting directors' accountability — the widespread practice of Delaware corporations, developed under section 145 of the DGCL, to contractually indemnify their directors for damages, amounts paid in settlement, and expenses. However, this article also explains why grossly negligent directors would not be entitled to that indemnification.

Next discussed is another protection from liability available to directors of Delaware corporations — the practice of Delaware corporations, again under section 145 of the DGCL, to obtain directors' and officers' insurance ("D&O insurance") to cover situations where contractual indemnification may be unavailable. However, as discussed below, D&O insurance policies should not prevent enforcement of a disgorgement order against malfeasant directors, as the policies typically contain language that excludes coverage for court-ordered disgorgement of compensation.

This article concludes by recommending that shareholder plaintiffs asserting duty of care claims include in their prayer for relief a request for disgorgement of all compensation paid to the defendant directors during the time they were grossly negligent. While the total amount of such compensation may pale next to the damages caused to the corporation and its shareholders because of acts of gross negligence, disgorgement should be sought, as the remedy would serve the equitable principle of preventing unjust enrichment (as such directors did not earn their pay) and may also deter future misconduct.

II. SETTING THE STAGE: DIRECTORS MANAGE CORPORATE ASSETS AND ARE CHARGED WITH CONCOMMITANT FIDUCIARY DUTIES

Directors of corporations are entrusted with extraordinary power; for the largest corporations, that includes vast financial and capital assets, real estate, and the livelihood of tens of thousands of employees.⁴ Under the laws of Delaware (and most other states), directors are charged with the primary responsibility of managing the business and affairs of the corporation.⁵ In general, the directors' duties and responsibilities include overseeing the financial performance of the company, setting compensation of top executives, and making key decisions regarding payment of dividends, sales of key corporate assets, and mergers and acquisitions.⁶

4. Margaret M. Blair & Lynn A. Stout, *Trust, Trustworthiness, And The Behavioral Foundations Of Corporate Law*, 149 U. PA. L. REV. 1735, 1737 (June 2001) ("Blair & Stout").

5. Section 141(a) of the DGCL states, in pertinent part:

The business and affairs of every corporation organized under this chapter shall be managed by or under the direction of a board of directors except as may be otherwise provided in this chapter or in its certificate of incorporation.

DEL. CODE ANN. tit. 8, § 141(a).

6. See MARGARET BLAIR, OWNERSHIP AND CONTROL: RETHINKING CORPORATE GOVERNANCE FOR THE TWENTY-FIRST CENTURY (The Brookings Institute 1995) (describing the general responsibilities of a board of directors).

In providing these services, directors must discharge “certain fundamental fiduciary obligations to the corporation and its shareholders”⁷ including the duties of care, loyalty, and good faith.⁸ With respect to their duty of care,⁹ directors must “inform themselves of all information reasonably available to them”¹⁰ and exercise reasonable care and skill in dealing with the affairs of the corporation.¹¹ “Shareholders, employees, and creditors all ultimately depend on directors to execute their duties ably and faithfully.”¹²

III. ARE GROSSLY NEGLIGENT DIRECTORS ENTITLED TO THEIR PAY?

While directors may be motivated to serve on boards for intellectual stimulation and exposure to new ideas,¹³ they are nonetheless typically paid handsomely for their board services.¹⁴ But what happens when such directors are found to have been grossly negligent in performing their duties and responsibilities — what is the directors’ liability? Also, are grossly negligent directors entitled to any compensation for the “services” they purportedly rendered to the corporation?

7. *Aronson v. Lewis*, 473 A.2d 805, 811 (Del. 1981). *See also* *TW Servs., Inc. v. SWT Acquisition Corp.*, C.A. No. 10427, 1989 WL 20290, at *8 n.14 (Del. Ch. Mar. 2, 1989) (“directors, not shareholders, have responsibilities to manage the business and affairs of the corporation, subject however to a fiduciary obligation”).

8. *Emerald Partners v. Berlin*, 787 A.2d 85, 90 (Del. 2001) (“The directors of Delaware corporations have a triad of primary fiduciary duties: due care, loyalty and good faith”). Subsequent decisions explain that the duty of good faith may actually be subsumed in the other two fiduciary duties. *See, e.g., Stone v. Ritter*, 911 A.2d 362, 370 (Del. 2006) (“[A]lthough good faith may be described colloquially as part of a ‘triad’ of fiduciary duties that include the duties of care and loyalty, the obligation to act in good faith does not establish an independent fiduciary duty that stands on the same footing as the duties of care and loyalty. Only the latter two duties, where violated, may directly result in liability, whereas a failure to act in good faith may do so, but indirectly.”).

9. This duty is drawn from the law of trusts, *see* RESTATEMENT OF TRUSTS § 174 (1935) (trustees owe a duty “to exercise such care and skill as a man of ordinary prudence would exercise in dealing with his own property”), which in turn was imported to the corporate law setting in *Graham v. Allis-Chalmers Manufacturing Co.*, 188 A.2d 125 (Del. 1963) (“directors of a corporation in managing the corporate affairs are bound to use that amount of care which ordinarily careful and prudent men would use in similar circumstances”).

10. *Smith v. Van Gorkom*, 488 A.2d 838, 893 (Del. 1985).

11. *In re Walt Disney Co. Derivative Litig.*, 906 A.2d 27 (Del. 2006) (stating that gross negligence and actions “without the bounds of reason” violate duty of care); *Benihana of Tokyo, Inc. v. Benihana, Inc.*, 891 A.2d 150, 192 (Del. Ch. 2005); *In re Nat’l Auto Credit, Inc. S’holders Litig.*, C.A. No. 19028, 2003 Del. Ch. LEXIS 5, at *46 (Del. Ch. Jan. 10, 2003) (“The duty of care requires that ‘in making business decisions, directors must consider all material information reasonably available, and the directors’ process is actionable only if grossly negligent.”) (quoting *Brehm v. Eisner*, 746 A.2d 244, 259 (Del. 2000)); *see also* *Benihana of Tokyo, Inc. v. Benihana, Inc.*, 891 A.2d 150, 192 (Del. Ch. 2005) (defining gross negligence as “reckless indifference to or a deliberate disregard of the whole body of stockholders or actions which are without the bounds of reason.”).

12. Rene M. Jones, *Law, Norms and the Breakdown of the Board: Promoting Accountability In Corporate Governance*, 92 IOWA L. REV. 105, 125 (Nov. 2006) (“Jones”).

13. *Id.*

14. *See* Robert C. Pozen, *A New Model For Corporate Boards*, WALL ST. J., Dec. 30, 2010, at A-15 (“The average compensation of directors in S&P 500 companies is currently \$213,000 per year.”); Hewitt Associates, *2010 Analysis of Outside Director Compensation* (Mar. 2010) (study of director compensation based on 708 public companies with revenues between \$14 million and \$425 billion found that the average total director compensation in 2009 was \$161,542, which includes retainer, fees, and equity compensation); Steve Smith, *Board Bonanza*, THE INTELLIGENCER (May 5, 2008), 2008 WLNR 9799053 (noting that “[b]oard pay has been steadily increasing in recent years” and “increases are likely to continue” with half of all directors making between \$52,479 and \$165,401 for “a workload of 200 to 225 hours a year”).

Surprisingly, for most corporations, the answer to the first question is “zero” — malfeasant directors face little or no liability for their breaches of the duty of care. Delaware courts do not appear to have answered the second question directly, but certain principles discussed below counsel against allowing such directors to retain any compensation paid for their time on the board when they failed to act with due care.

A. Directors Face Little Or No Monetary Liability For Breaches Of The Duty Of Care

The Delaware legislature has essentially given directors a free pass on acts of gross negligence or extreme recklessness. In 1985, shortly after the ruling in *Van Gorkom*, the DGCL was amended by the addition of section 102(b)(7). The statute allows shareholders to insulate directors from any personal liability for monetary damages for duty of care violations, but not for duty of loyalty violations, bad faith claims, and certain other conduct.¹⁵ This legislation was a reaction to what many perceived to be an unfolding “directors and officers insurance liability crisis”¹⁶ resulting from what some believed to be a newly heightened standard of care for directors.¹⁷

While section 102(b)(7) was “not intended to be, a panacea for directors” and was not designed to “eliminate the duty of care that is properly imposed upon directors,”¹⁸ its enactment has effectively eviscerated directors’ monetary liability for duty of care violations. Directors of corporations that have adopted section 102(b)(7) charter provisions can obtain dismissal of duty of care claims, or dismissal of entire lawsuits, where the shareholders’ sole allegation is a duty of care violation.¹⁹ These dismissals are not based on the merits of the claims — the directors may indeed have been grossly negligent — rather, the dismissals are required by the section 102(b)(7) charter provisions which immunize the directors from monetary liability for duty of care violations.

Soon after the Delaware legislature’s enactment of section 102(b)(7), nearly every state followed suit with its own counterpart statute. Today, nearly all Delaware public and Fortune 500 companies incorporated in jurisdictions allowing

15. Section 102(b)(7) provides that a certificate of incorporation may include:

A provision eliminating or limiting the personal liability of a director to the corporation or its stockholders for monetary damages for breach of fiduciary duty as a director, provided that such provision shall not eliminate or limit the liability of a director: (i) for any breach of the director’s duty of loyalty to the corporation or its stockholders; (ii) for acts or omissions not in good faith or which involve intentional misconduct or a knowing violation of law; (iii) under § 174 of this title; or (iv) for any transaction from which the director derived an improper personal benefit.

DEL. CODE ANN. tit 8, § 102(b)(7). This statutory protection from liability is not available to corporate officers. *Id.*

16. *Malpiede v. Townson*, 780 A.2d 1075, 1095 (Del. 2001).

17. See Stephen J. Lubben & Alana Darnell, *Delaware’s Duty of Care*, 31 DEL. J. CORP. L. 589, 590 (2006) (noting that the *Van Gorkom* decision “alarmed many and consequently was short-lived” as “the Delaware legislature quickly responded by enacting DGCL section 102(b)(7)”).

18. E. Norman Veasey, Jesse A. Finkelstein & Stephen Bigler, *Delaware Supports Directors with a Three-Legged Stool of Limited Liability, Indemnification and Insurance*, 42 BUS. LAW. 399, 399-404 (1987) (“*Three Legged-Stool*”).

19. *Malpiede*, 780 A.2d at 1095-96 (noting that complaint alleging exclusively duty of care violations is dismissible once directors invoke the corporation’s 102(b)(7) charter provision); *Emerald Partners*, 787 A.2d at 91 (claim is dismissible when it relates only to duty of care violation); see also *McMillan v. Intercargo Corp.*, 768 A.2d 492, 501 n.40 (Del. Ch. 2000) (“The court may take judicial notice of an exculpatory charter provision in resolving a motion addressed to the pleadings”) (citing *In re Wheelabrator Technologies, Inc. S’holders Litig.*, C.A. No. 11495, 1992 WL 212595, at *11 (Del. Ch. Sept. 1, 1992)).

for such exculpatory charter provisions have adopted them.²⁰ As a result of this sweeping immunity given to directors of American corporations, “the damages claim for breach of the duty of care [is] essentially non-existent.”²¹

There must be some accountability imposed upon directors to properly discharge their fiduciary duty of care. Shareholder litigation, the predominant method for holding directors accountable as corporate fiduciaries, ideally serves positively to develop corporate norms, improve director conduct and deter wrongdoing. Accordingly, shareholders who elect to sue directors should have the ability to ask the court to impose a personal and direct penalty on directors who violate their duty of care. At a minimum, such directors should be required to disgorge their director compensation for periods during which the violation(s) occurred. As discussed below, that remedy, though seldom, if ever, requested, is available to shareholder plaintiffs.

B. Disgorgement Is Not “Monetary Damages”

While directors may obtain the dismissal of duty of care claims based on an exculpatory charter provision (rather than on the merits of the claims), Delaware courts have not addressed whether grossly negligent directors should be able to retain compensation paid to them during the period of alleged malfeasance. Nor have the courts addressed whether a claim seeking the disgorgement of director compensation based on a duty of care violation would be barred by a section 102(b)(7) charter provision. Some scholars apparently think such a claim would be barred, as they have called for legislative reform of section 102(b)(7) to allow explicitly for disgorgement of compensation.²² However, as demonstrated below, amending section 102(b)(7) should not be necessary, as the statute does not address, and cannot therefore limit or eliminate, claims for or remedies of disgorgement.

1. Section 102(b)(7) Does Not Address Equitable Remedies

Section 102(b)(7) allows for the exculpation of “monetary damages” claims. It is well-settled that the statute does not address equitable²³ or injunctive²⁴ remedies. Therefore, if disgorgement is a form of equitable relief rather than “monetary damages,” section 102(b)(7) charter provisions would have no effect on claims for disgorgement of director compensation.

20. See Marcel Kahan & Edward B. Rock, *How I Learned to Stop Worrying and Love the Pill: Adaptive Responses to Takeover Law*, 69 U. CHI. L. REV. 871, 889 (2002) (“widespread” adoption of charter amendments implementing § 102(b)(7)); Lawrence A. Hammermesh, *Fiduciary Duty, Limited Liability and the Law of Delaware: Why I Do Not Teach Van Gorkom*, 34 GA. L. REV. 477, 490 (Winter 2000) (“*Fiduciary Duty*”) (98 out of 100 Fortune 500 companies “that incorporated in jurisdictions allowing for exculpatory charter provisions adopted such provisions”).

21. *Fiduciary Duty*, 34 GA. L. REV. at 479. See also Geoffrey P. Miller, *A Modest Proposal for Fixing Delaware’s Broken Duty of Care*, NYU LAW & ECONOMICS PAPERS, Paper 196 (2009), at 4 (“All or virtually all public Delaware companies have opted out of liability, making the possibility of money damages for violations of the duty of care effectively a dead letter for many of the nation’s largest firms”).

22. See, e.g., Elizabeth Nowicki, *Director Inattention and Director Protection Under Delaware General Corporation Law Section 102(b)(7): A Proposal for Legislative Reform*, 33 DEL. J. CORP. L. 695, 712 (2008) (“*Director Inattention*”) (advocating a revision of 102(b)(7) to explicitly provide for disgorgement for duty of care violations); John C. Coffee, Jr. & Donald E. Schwartz, *The Survival of the Derivative Suit: An Evaluation and a Proposal for Legislative Reform*, 81 COLUM. L. REV. 261 (1981) (proposing a director liability cap equal to director compensation); *Speaker Declares Duty of Care to Be “Dead”*; *The Good News is Directors Don’t Know It*, 12 CORP. COUNS. WKLY. (BNA) 7 (Dec. 24, 1997) (“protections for directors should be limited by providing that a director could be held liable for monetary damages equaling the value of one, two, or three years of directors’ fees.”).

23. As explained in *Leslie v. Telephonics Office Technologies, Inc.*, C.A. No. 13045, 1993 WL 547188, at *9 (Del. Ch. Dec. 30, 1993):

2. Disgorgement Is An Equitable Remedy Designed To Prevent One From Profiting From One's Own Wrongdoing

a. Disgorgement Ordered As An Equitable Remedy For Duty of Loyalty Violations

While Delaware courts have not ordered disgorgement for breaches of the duty of care, they have ordered that remedy for breaches of the duty of loyalty.²⁵ In these decisions, disgorgement is described and applied as an equitable, rather than legal, remedy, designed to prevent the wrongdoer from profiting from the wrongdoing, rather than as a way to compensate the plaintiff for any losses.²⁶

Fashioning the disgorgement remedy this way — to deny the wrongdoer of any profits from the wrongdoing — also serves to remove the temptation to engage in similar wrongful acts in the future. As the Delaware Supreme Court explained:

If an officer or director of a corporation, in violation of his duty as such, acquires gain or advantage for himself, the law charges the interest so acquired with a trust for the benefit of the corporation at its election, while it denies to the betrayer all benefit and profit. The rule, inveterate and uncompromising in its rigidity, does not rest upon the narrow ground of injury or damage to the corporation resulting from a betrayal of confidence, but upon a broader foundation of a wise public policy that, for the purpose of

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As a theoretical matter, any claim for compensatory damages stemming from a duty of care violation by the defendants would be barred by the 102(b)(7) provision. However, to the extent plaintiffs seek *equitable* relief for any alleged breaches of the duty of care ... this provision would not bar them.

(emphasis added). *See also* Chaffin v. GNI Group, Inc., C.A. No. 16211, 1999 WL 721569, at *6 (Del. Ch. Sept. 3, 1999) (“GNI’s exculpatory clause would bar the plaintiffs from recovering money damages for the plaintiffs’ duty of care claims, but it would not bar any equitable remedies that would flow if those claims were to prevail.”).

24. *See Malpiede*, 780 A.2d at 1095 (“Such a [102(b)(7)] charter provision, when adopted, would not affect injunctive proceedings based on gross negligence”); *Arnold v. Society for Savings Bancorp, Inc.*, 678 A.2d 533, 542 (Del. 1996) (“While section 102(b)(7) and charter provisions adopted thereunder will leave stockholders without a monetary remedy in some instances, they remain protected by the availability of injunctive relief. Stockholders are not discouraged from pursuing such remedies when warranted.”).

25. The duty of loyalty prohibits fiduciaries from placing their personal interests before those of the corporation. As the Delaware Supreme Court explained over seventy years ago:

Corporate officers and directors are not permitted to use their position of trust and confidence to further their private interests. While technically not trustees, they stand in a fiduciary relation to the corporation and its stockholders. A public policy, existing through the years, and derived from a profound knowledge of human characteristics and motives, has established a rule that demands of a corporate officer or director, peremptorily and inexorably, the most scrupulous observance of his duty, not only affirmatively to protect the interests of the corporation committed to his charge, but also to refrain from doing anything that would work injury to the corporation, or to deprive it of profit or advantage which his skill and ability might properly bring to it, or to enable it to make in the reasonable and lawful exercise of its powers.

Guth v. Loft, Inc., 5 A.2d 503, 510 (Del. 1939). *See also* *Gottlieb v. McKee*, 107 A.2d 240, 243 (Del. Ch. 1954) (quoting and applying *Guth*).

26. As explained above, section 102(b)(7) charter provisions do not insulate directors from monetary damage liability from duty of loyalty violations. Thus, courts are free to order disgorgement against directors who have breached their duty of loyalty.

removing all temptation, extinguishes all possibility of profit flowing from a breach of the confidence imposed by the fiduciary relation.²⁷

Likewise, the Court of Chancery held that “[t]he prophylactic policy underlying these principles is that acts of conscious wrongdoing and breaches of a fiduciary’s duty of loyalty will best be deterred by requiring the wrongdoer to disgorge any profit made as a result of such wrongful conduct.”²⁸

For example, where a director takes (or “usurps”) a corporate opportunity,²⁹ Delaware courts have required the director to return to the corporation any profits made from that opportunity.³⁰ This remedy is not imposed in order to compensate the corporation for the profits it lost on the usurped opportunity, but instead is “designed to discourage disloyalty”³¹ and “prevent[] an unjust windfall by stripping the profit gained from [the fiduciary’s] disloyal acts.”³² To further

27. *Guth*, 5 A.2d at 510.

28. *Pike v. Commodore Motel Corp.*, C.A. No. 940, 1986 WL 13007, at * 3 (Del. Ch. Nov. 14, 1986).

29. The doctrine of corporate opportunity, set forth in *Guth*, 5 A.2d at 511, was later explained in more detail in *Brown v. Fenimore* as follows:

[W]hen there is presented to a corporate officer a business opportunity which the corporation is financially able to undertake, and which, by its nature, falls into the line of the corporation’s business and would be of practical advantage to the corporation, such corporate officer is prohibited from permitting his self-interest to be exercised in conflict with the corporation’s interest and may not take the opportunity for himself.... A similar rule applies to corporate officers and directors who engage in competition with the corporation at the expense of the corporation.

Brown v. Fenimore, C.A. No. 4097, 1977 WL 2566, at *5 (Del. Ch. Jan. 11, 1977) (where defendant operated a towing service in competition with the corporation where he served as an officer and director, the court “require[d] the imposition of a constructive trust upon all profits derived from the competing towing service”) (citations omitted).

30. See, e.g., *Thorpe v. Cerbco, Inc.*, 676 A.2d 436, 445 (Del. 1996) (court found controlling shareholders liable to the corporation for the \$75,000 they received from a third party in connection with that party’s execution of a letter of intent to purchase the shareholders’ controlling interest in the corporation — the shareholders usurped the opportunity for the corporation to sell itself to the third party); *Stephanis v. Yiannatsis*, C.A. No. 1508, 1993 WL 437487, at *7-8 (Del. Ch. Oct. 4, 1993) (finding that as director usurped a corporate opportunity by purchasing stock in a third party, the director “cannot be deemed to have validly purchased these shares” and the court imposed “a constructive trust on the [improperly purchased] stock currently held by [defendant] in favor of [the corporation]”); *Theodora Holding Corp. v. Henderson*, 257 A.2d 398, 404 (Del. Ch. 1969) (where controlling shareholder improperly caused corporation to acquire rights on the NYSE for the defendant shareholder’s personal use, which seat was later sold for a profit retained by the shareholder, the court held that the shareholder “must account to the corporate defendant for any profits made by him in the sale of the Stock Exchange seat ... as well as for the receipt of any brokerage commissions not already remitted by him to the corporation”); see also *Lingo v. Lingo*, 3 A.3d 241, 243-246 (Del. Ch. 2010) (“equitable remedy” of “restitution and disgorgement” required defendant to pay back to the estate the funds acquired from decedent, prior to death, by defendant taking advantage of decedent’s reduced mental capacity); *Borden v. Sinsky*, 530 F.2d 478, 497 (3d Cir. 1976) (applying Delaware law, court found that director had usurped corporate opportunity through acquisitions and related transactions, and thus plaintiff corporation was entitled to all the salaries the director had received as a director and/or officer of the banks that he, rather than the company, had acquired).

31. *Thorpe*, 676 A.3d at 445.

32. *Triton Construction Co., Inc. v. Eastern Shore Electrical Services, Inc.*, C.A. No. 3290-VCP, 2009 WL 1387115, at *28 (Del. Ch. May 18, 2009). See also *Jackson National Life Ins. Co. v. Kennedy*, 741 A.2d 377, 394 (Del. Ch. 1999) (complaint sufficiently pled claim for unjust enrichment and imposition of a constructive trust to prevent defendants from retaining any improvidently gained benefits from false and misleading communications forming the basis of the alleged duty of loyalty violation).

prevent an unjust windfall, the fiduciary will not be entitled to compensation from the corporation during the period in which the fiduciary was improperly taking the corporate opportunity (*e.g.*, operating a competing enterprise).³³ Moreover, unlike a compensatory damages remedy, which requires a showing of loss or injury to the plaintiff,³⁴ disgorgement may be ordered “even though no specific injury to [the plaintiff] can be measured.”³⁵

Courts in other jurisdictions have similarly ruled that disloyal fiduciaries and employees must disgorge the profits they earned from competing enterprises, as well as any compensation earned from their employer during the period of their disloyalty.³⁶ While courts in Delaware have not explicitly ruled that disgorgement ordered under these circumstances is an equitable remedy, courts in other states have done so.³⁷

Delaware courts have also ordered disgorgement in order to prevent one from profiting from improper insider trading. As the Court of Chancery recently noted: “Delaware law has long held ... that directors who misuse company

33. *Craig v. Graphic Arts Studio, Inc.*, 166 A.2d 444, 447 (Del. Ch. 1960) (denying the plaintiff-officer’s claim for compensation, holding that “absent some special circumstance, which does not here appear, the plaintiff should not be permitted ... to recover compensation from his employer for the period when he was violating his fiduciary duty”).

34. *See Strassburger v. Earley*, 752 A.2d 557, 579 (Del. Ch. 2000) (“The traditional measure of damages is that which is utilized in connection with an award of compensatory damages, whose purpose is to compensate a plaintiff for its proven, actual loss caused by the defendant’s wrongful conduct.”).

35. *Triton Construction*, 2009 WL 1387115, at *28 (ordering disgorgement of all compensation an employee received from moonlighting in direct competition with his employer, even though employer was not damaged by the moonlighting).

36. *See, e.g.*, *Soam Corp v. Trane Co.*, 608 N.Y.S.2d 177 (N.Y. App. Div. 1994) (applying “New York’s strict application of the forfeiture doctrine which mandates the forfeiture of all compensation, whether commissions or salary, where ... one who owed a duty of fidelity to a principal is faithless in the performance of his services”); *Royal Carbo Corp. v. Flameguard, Inc.*, 645 N.Y.S.2d 18, 19 (N.Y. App. Div. 1996) (“It is well settled that one who owes a duty of fidelity to a principal and who is faithless in the performance of his or her services is generally not entitled to recover compensation, whether commissions or salary”); *Bon Temps Agency Ltd. v. Greenfield*, 584 N.Y.S.2d 824, 825-26 (N.Y. App. Div. 1992) (“Not only must [a disloyal employee or agent] account to his principal for secret profits but he also forfeits his right to compensation for services rendered by him if he proves disloyal”); *Murray v. Beard*, 102 N.Y. 505, 508, 7 N.E. 553 (N.Y. 1886); *Lamdin v. Broadway Surface Advertising Corp.*, 272 N.Y. 133, 138, 5 N.E.2d 66 (N.Y. 1936) (employee or agent “forfeits his right to compensation for services rendered by him if he proves disloyal”); *Edwards v. Allied Home Mortgage Capital Corp.*, 962 So.2d 194 (Ala. 2007) (“The faithless-servant doctrine precludes an employee from receiving compensation for conduct that is disloyal to the employer or in violation of the employee’s employment contract.”); *Henderson v. Hassur*, 594 P.2d 650, 659 (Kan. 1979) (“An unfaithful servant forfeits the compensation he would otherwise have earned but for his unfaithfulness.”); *Bessman v. Bessman*, 520 P.2d 1210, 1211 (Kan. 1974) (“dishonesty and disloyalty on the part of an employee which permeates his service to his employer will deprive him of his entire agreed compensation”); *Burrow v. Arce*, 997 S.W.2d 229, 237 (Tex. 1999) (“person who renders service to another in a relationship of trust may be denied compensation for his service if he breaches that trust”; attorney who breached fiduciary duty ordered to disgorge compensation); *Rockerfeller v. Grabow*, 39 P.3d 577 (Idaho 2001) (holding that remedy can include malfeasant fiduciary’s forfeiture of compensation as well as requirement to repay compensation already paid); *Futch v. McAllister Towing of Georgetown, Inc.*, 518 S.E.2d 591, 596 (S. Car. 1999) (“The general rule is that an employee is not entitled to any compensation for services performed during the period he engaged in activities constituting a breach of his duty of loyalty even though part of those services may have been properly performed”); RESTATEMENT (SECOND) OF THE LAW OF AGENCY § 469 (1958) (“An agent is entitled to no compensation for conduct which is disobedient or which is a breach of his duty of loyalty; if such conduct constitutes a willful and deliberate breach of his contract of service, he is not entitled to compensation even for properly performed services for which no compensation is apportioned.”).

37. *See, e.g.*, *ERI Consulting Engineers, Inc. v. Swinnea*, 318 S.W.3d 867, 874 (Tex. 2010) (“courts may fashion equitable remedies such as profit disgorgement and fee forfeiture to remedy a breach of fiduciary duty”); *Wenzel v. Hopper & Galliher P.C.*, 830 N.E.2d 996, 1001 (Ind. Ct. App. 2005) (“Disgorging an agent of all compensation received during a period of employment in which the agent was also breaching a fiduciary duty to the principal, without a requirement for the principal to demonstrate financial loss, is an equitable, not legal remedy”; ordering disgorgement of three months salary for breach of fiduciary duty).

information to profit at the expense of innocent buyers of their stock should disgorge their profits.”³⁸ In the seminal *Brophy* case, then-Vice Chancellor Berger held that Delaware’s common law insider trading claim is rooted in trust principles providing that if a person “in a confidential or fiduciary position, in breach of his duty, uses his knowledge to make a profit for himself, he is accountable for such profit.”³⁹

As with remedies for usurping corporate opportunities, the courts aim to prevent an unjust windfall rather than to compensate those injured by the insider trading. Emphasizing this goal, the Delaware Supreme Court has explained that it would not permit insiders to profit from trading on confidential information even if the corporation was not harmed:

It is an act of disloyalty for a fiduciary to profit personally from the use of information secured in a confidential relationship, even if such profit or advantage is not gained at the expense of the fiduciary. The result is nonetheless one of unjust enrichment which will not be countenanced by a Court of Equity.⁴⁰

The Delaware Supreme Court and the Chancery Court have both noted that disgorgement of insider trading profits is an equitable remedy.⁴¹

b. Disgorgement Or “Restitution” As An Equitable Remedy To Prevent Unjust Enrichment

In addition to ordering disgorgement to prevent a defendant from profiting from wrongdoing (such as usurping corporate opportunities and insider trading), Delaware courts have also ordered disgorgement or “restitution” simply to prevent unjust enrichment.⁴² In these cases, disgorgement is not designed to remedy or prevent wrongdoing or to compensate a damaged plaintiff. Rather, disgorgement is an equitable remedy designed to prevent an unjust windfall to the defendant.

For example, in *HealthSouth Corp. Shareholders Litig.*,⁴³ former HealthSouth CEO Richard Scrushy had repaid a \$25 million loan granted to him by HealthSouth by transferring to HealthSouth a block of company shares held by

38. *Guttman v. Huang*, 823 A.2d 492, 505 (Del. Ch. 2003) (citing *Brophy v. Cities Service, Inc.*, 70 A.2d 5 (Del. Ch. 1949)).

39. *Brophy*, 70 A.2d at 8. *See also* *American Int’l Group, Inc. v. Greenberg*, 965 A.2d 763, 800-01 (Del. Ch. 2009) (upholding claim against directors seeking disgorgement of profits they earned from improperly trading on insider knowledge).

40. *Oberly v. Kirby*, 592 A.2d 445, 463 (Del. 1991).

41. *Id.*; *Citron v. Merritt-Chapman & Scott Corp.*, C.A. No. 3130, 1977 WL 2580, at *5 (Del. Ch. May 4, 1977) (recognizing “the fundamental equitable principle that one in a fiduciary position cannot be permitted to profit personally from information obtained in that capacity”). *See also* *Lingo*, 3 A.3d at 243 (Delaware Supreme Court affirmed the Court of Chancery’s finding that the defendant, the attorney-in-fact of her family estate, behaved like a “faithless fiduciary” by engaging in transactions to enrich herself at the expense of the estate, and ordered disgorgement for the full amount she had converted through her power of attorney).

42. Delaware courts define unjust enrichment as “the unjust retention of a benefit to the loss of another, or the retention of money or property of another against the fundamental principles of justice or equity and good conscience.” *Schock v. Nash*, 732 A.2d 217, 232 (Del. 1999); *Fleer Corp. v. Topps Chewing Gum, Inc.*, 539 A.2d 1060, 1062 (Del. 1988). The Court of Chancery has in some cases identified the following “factors” to consider in evaluating an unjust enrichment claim: “(1) an enrichment, (2) an impoverishment, (3) a relation between the enrichment and impoverishment, (4) the absence of any justification and (5) the absence of a remedy provided by law.” *Metcap Securities LLC v. Pearl Senior Care, Inc.*, C.A. No. 2129-VCN, 2009 WL 513756, at *5 (Del. Ch. Feb. 27, 2009); *Jackson National Life Ins. Co. v. Kennedy*, 741 A.2d 377, 393 (Del. Ch. 1999); *Cantor Fitzgerald, L.P. v. Cantor*, C.A. No. 16297, 1998 WL 326686, at *6 (Del. Ch. June 16, 1998). However, as explained in *Metcap*, “[t]his formulation of the test for unjust enrichment (restitution) has been criticized” because “[t]he lack of an adequate remedy at law is not critical to an unjust enrichment claim” and “the emphasis on ‘impoverishment’ is not entirely warranted because restitution may be awarded based solely on the benefit conferred upon the defendant, even in the absence of an impoverishment suffered by the plaintiff.” *Metcap*, 2009 WL 513756, at *5 n.26.

43. *In re HealthSouth Corp. S’holders Litig.*, 845 A.2d 1096 (Del. Ch. 2003).

Scrushy (the “Buyback”).⁴⁴ Shortly after the Buyback, HealthSouth’s stock price plunged dramatically, and the NYSE subsequently suspended trading in the stock, following a series of disclosures of write-downs and the SEC’s commencement of a federal securities fraud action against HealthSouth and Scrushy.⁴⁵ HealthSouth shareholders sued, alleging that Scrushy was unjustly enriched because he had satisfied his indebtedness to HealthSouth using HealthSouth shares worth far less than the value of the loan Scrushy was retiring.⁴⁶ For purposes of their motion for summary judgment on their unjust enrichment claim, plaintiffs “accepted the notion that Scrushy, although responsible for ensuring the preparation of accurate financial information, was not aware that the company’s financial statements and public releases were materially inaccurate.”⁴⁷

The court rescinded the Buyback, so that Scrushy received his shares back and the loan to HealthSouth was reinstated, with Scrushy obligated to pay the full amount of principal and interest.⁴⁸ The court held that even if Scrushy was guilty only of an “innocent failure to catch the misdeeds or inaccuracies of his underlings,” and whether or not he “breached any cognizable duty in signing those [HealthSouth financial] statements, he was undoubtedly enriched when the company of which he was a fiduciary bought back shares from him at a price inflated by false financial statements he had signed.”⁴⁹

Similarly, the Court of Chancery in *Valeant Pharmaceuticals International v. Jerney*⁵⁰ ordered disgorgement to prevent the defendant from retaining certain funds (a bonus paid to him) rather than to compensate the plaintiff for any harm from an alleged breach of fiduciary duty. The Court of Chancery found that it would be inequitable for the defendant to retain a \$3 million bonus he received while he was the president and director of the company because the decision to award that bonus was “ill-advised and was not entirely fair to the company.”⁵¹ While the court found that the defendant (along with others) approved the bonus, the court held that the defendant’s “disgorgement obligation stems from his receipt of the company’s money, not from his participation in the decision to authorize the payment.”⁵² Disgorgement was required in order to prevent an unjust windfall to the defendant, rather than to compensate the company for any damages it suffered or to penalize the defendant for his participation in the unfair transaction.

One of the defendants in *Schock v. Nash* was ordered to pay back certain funds even though she was not found to have engaged in any wrongdoing.⁵³ A defendant improperly transferred funds from an estate to an account she held jointly with her mother, who did not know of the wrongdoing (or even that funds had been transferred to the joint account).⁵⁴ The

44. *Id.* at 1100.

45. *Id.* at 1101.

46. *Id.* at 1099.

47. *Id.*

48. *Id.* at 1109.

49. *Id.* at 1106.

50. *Valeant Pharmaceuticals Int’l v. Jerney*, 921 A.2d 732 (Del. Ch. 2007).

51. *Id.* at 736.

52. *Id.* at 753.

53. *Schock v. Nash*, 732 A.2d 217, 232 (Del. 1999).

54. *Id.* at 232.

court upheld the judgment, jointly and severally, against both the mother and daughter, finding that the plaintiffs could seek satisfaction from the mother without first attempting to have the judgment satisfied by the daughter.⁵⁵ The court held:

For a court to order restitution it must first find the defendant was unjustly enriched at the expense of the plaintiff. . . . To obtain restitution, the plaintiffs were required to show that the defendants were unjustly enriched, that the defendants secured a benefit, and that it would be unconscionable to allow them to retain that benefit. Restitution is permitted even when the defendant retaining the benefit is not a wrongdoer. Restitution serves to deprive the defendant of benefits that in equity and good conscience he ought not to keep, even though he may have received those benefits honestly in the first instance, and even though the plaintiff may have suffered no demonstrable losses.⁵⁶

Thus, the disgorgement remedy was imposed to prevent the defendants, including the innocent mother, from retaining the funds transferred from the estate, rather than to compensate the estate for any resulting harm.

c. Disgorgement As An Equitable Remedy For Violations Of Federal Statutes

Where federal courts have ordered disgorgement, like the Delaware courts, they have done so in order to deprive a wrongdoer of the benefits of the wrongdoing. However, more explicitly than the Delaware courts (which merely characterize disgorgement as an equitable remedy), federal courts have actually distinguished the equitable remedy of disgorgement from a legal award of “damages.”

For example, disgorgement is a common form of ancillary relief granted in SEC enforcement actions. It has been ordered as an equitable remedy in a wide variety of cases, including insider trading,⁵⁷ securities fraud,⁵⁸ and registration and reporting violations.⁵⁹ In these cases, the courts emphasize that disgorgement is distinct from damages as it is not meant

55. *Id.* at 233.

56. *Id.* at 232-33 (quotations and citations omitted) (imposing “equitable remedy” of constructive trust on the account and requiring restitution). *See also* Highlands Ins. Group, Inc. v. Halliburton Co., 852 A.2d 1, 8 (Del. Ch. 2003) (quoting *Schock* and finding that “[r]estitution is appropriate even when the party retaining the benefit is not a wrongdoer”; ordering parent corporation to pay back to captive liability insurer all of the payments the insurer had mistakenly made to the parent following the insurer’s spin-off from parent); *Fleer Corp.*, 539 A.2d at 1063 (defendant could recover profits made by antitrust plaintiff during time an improperly-issued injunction was in effect; “[r]estitution has been recognized as a legitimate remedy when a court finds that a wrongfully issued injunction allowed the defendant to be unjustly enriched”).

57. *See, e.g.*, SEC v. Tome, 833 F.2d 1086, 1096 (2d Cir. 1987) (“ordering disgorgement . . . to make sure that wrongdoers will not profit from their wrongdoing”; defendants ordered to “disgorge a sum of money equal to all the illegal payments [they] received”); SEC v. Materia, 745 F.2d 197, 200 (2d Cir. 1984) (affirming order requiring defendant to “disgorge his illegally obtained profits”); SEC v. Texas Gulf Sulfur Co., 446 F.2d 1301, 1307-08 (2d Cir. 1971) (defendants’ “restitution” of profits earned on insider trading “deprives [defendants] of the gains of their wrongful conduct” and was not “punitive” simply because the remedy did not contain an “element of compensation to those who ha[d] been damaged”).

58. SEC v. Lorin, 76 F.3d 458, 462 (2d Cir. 1996) (“we reject the challenge to the district court’s order that appellants disgorge all of the profits they received from trading in Haas securities during the several-month period in question”); SEC v. Bilzerian, 814 F. Supp. 116, 121 (D.D.C. 1993) (requiring defendants to disgorge the profits gained from failures to timely disclose stock accumulations and making false statements about source of funds used to purchase stock); SEC v. General Refractories Co., 400 F. Supp. 1248, 1260 (D.D.C. 1975); SEC v. First City Financial Corp., Ltd., 890 F.2d 1215, 1230-31 (D.C. Cir. 1989) (for section 13(d) violation court ordered disgorgement pursuant to its “equitable power” to “prevent unjust enrichment” and deprive the wrongdoer of “profits causally connected to the violation”).

59. SEC v. Blavin, 760 F.2d 706, 712-13 (6th Cir. 1985); SEC v. Manor Nursing Centers, Inc., 458 F.2d 1082, 1103-04 (2d Cir. 1972) (affirming order requiring defendants to disgorge all the proceeds received in connection with a fraudulent stock offering); *General Refractories*, 400 F. Supp. at 1260.

to compensate the victim, nor is it measured by the victim's losses. As explained by the Second Circuit in a case involving federal securities law violations, "the primary purpose of disgorgement is not to compensate investors. Unlike damages, it is a method of forcing a defendant to give up the amount by which he was unjustly enriched."⁶⁰

The Second Circuit has emphasized that: "[d]isgorgement is an *equitable* remedy designed to deprive a wrongdoer of his unjust enrichment and to deter others from violating the securities laws."⁶¹ In another case involving federal securities law violations, the D.C. Circuit Court of Appeals stated that "[s]ince disgorgement is a method of forcing a defendant to give up the amount by which he was unjustly enriched, it is unlike an award of damages."⁶²

Moreover, federal courts have noted that they may, pursuant to their equitable powers, grant disgorgement even where there is no injury from securities law violations. As the Sixth Circuit held, "[o]nce the Commission has established that a defendant has violated the securities laws, the district court possesses the equitable power to grant disgorgement without inquiring whether, or to what extent, identifiable private parties have been damaged by [the] fraud."⁶³

Also demonstrating that disgorgement is not an award of damages are federal court decisions granting disgorgement remedies for claims where damages could not be awarded. For instance, although section 13(b) of the Federal Trade Commission Act does not expressly authorize courts to grant monetary relief, courts have held that "section 13(b) carries with it the full range of equitable remedies, including the power . . . to compel disgorgement of profits."⁶⁴ The Federal Trade Commission has explicitly stated that "[d]isgorgement is an equitable monetary remedy" when imposed for violations of the Hart-Scott-Rodino Act, FTC Act and the Clayton Act.⁶⁵ Similarly, in ordering disgorgement to prevent a defendant

60. SEC v. Commonwealth Chemical Securities, Inc., 574 F.2d 90, 97-98 (2d Cir. 1978) (finding defendants liable for violations of the Securities Act, Exchange Act, Investment Company Act and Investment Advisers Act). See also *First City*, 890 F.2d at 1232 n.24 (same) (citing L. LOSS, FUNDAMENTALS OF SECURITIES REGULATION 531 (2d ed. 1988)); *Tome*, 833 F.2d at 1096 (quoting *Commonwealth Chemical*).

61. *First City*, 890 F.2d at 1230 (emphasis added). See also SEC v. Patel, 61 F.3d 137, 139 (2d Cir. 1995) ("In the exercise of its equity powers, a district court may order the disgorgement of profits acquired through securities fraud"); *Tome*, 833 F.2d at 1096 ("disgorgement is an equitable remedy designed to deprive a wrongdoer of his unjust enrichment"); *Manor Nursing*, 458 F.2d at 1104 ("Clearly the provision requiring the disgorging of proceeds received in connection with the [fraudulent] offering was a proper exercise of the district court's equity powers"); *General Refractories*, 400 F. Supp. at 1260 ("It has long been recognized that courts, pursuant to their general equity powers, may order ancillary relief, including disgorgement of monies or other benefits received, in SEC injunctive actions brought pursuant to Section 21(e) of the Securities Exchange Act of 1934 so as to prevent defendants from profiting from their illegal conduct.").

62. SEC v. First Jersey Securities, Inc., 101 F.3d 1450, 1475 (2d Cir. 1996).

63. *Blavin*, 760 F.2d at 713. See also *Bilzerian*, 29 F.3d at 697 ("Whether or not Bilzerian's securities violations injured others is irrelevant to the question whether disgorgement is appropriate"); *Tome*, 833 F.2d at 1096 ("Whether or not any investors may be entitled to money damages is immaterial. The paramount purpose of enforcing the prohibition against insider trading by ordering disgorgement is to make sure that wrongdoers will not profit from their wrongdoing"); *Commodity Futures Trading Commission v. Hunt*, 591 F.2d 1211-1222 (7th Cir. 1979) ("disgorgement does not penalize, but merely deprives wrongdoers of ill-gotten gains"); SEC v. Drexel Burnham Lambert, Inc., 956 F. Supp. 503, 505-06 (S.D.N.Y. 1997) (ordering the defendants to disgorge compensation earned at a corporation as a result of Exchange Act violations enabling defendants to gain control and place themselves in highly paid positions at the corporation; "the salary paid to the defendants . . . represented illegal profits from the Exchange Act violations, and the Court ordered these profits disgorged under its broad equitable power").

64. FTC v. Gem Merchandising Corp., 87 F.3d 466, 468 (11th Cir. 1996); FTC v. Pantron I Corp., 33 F.3d 1088, 1103 n.34 (9th Cir. 1994) (court may order defendant who violated FTC Act "to disgorge its unjust enrichment").

65. See Policy Statement On Monetary Equitable Remedies In Competition Cases (July 25, 2003), <http://www.ftc.gov/os/2003/07/disgorgementfrn.htm>.

from retaining the profits of its false advertising obtained in violation of the Lanham Act, a court explained, “[h]ere, only profits are sought. Profits and damages are categorically distinct. Disgorgement of profits focuses on the prevention of unjust enrichment. Compensatory damages, on the other hand, redress an injury.”⁶⁶

These federal court decisions, along with the Delaware court decisions discussed above, show that disgorgement is an equitable remedy, designed to prevent a wrongdoer from profiting from wrongdoing, deter future misconduct, and prevent unjust enrichment, rather than to compensate the plaintiff for any harm or loss suffered from wrongdoing. Accordingly, similarly crafted disgorgement remedies designed to prevent a fiduciary from profiting from his or her breaches of the duty of care should not be considered awards of “monetary damages” and would therefore not appear to be barred by section 102(b)(7) charter provisions (which insulate directors from liability for monetary damages).

C. Disgorgement Is Not “Rescissory Damages”

One could argue that although disgorgement is not a traditional form of damages, it is a form of rescissory damages, because it seeks to rescind or undo the malfeasant director’s receipt of compensation. Such a characterization would present two potential barriers to obtaining disgorgement remedies for breaches of the duty of care. First, an award of rescissory damages might be a form of damages barred by section 102(b)(7) charter provisions. Second, rescissory damages are properly awarded only for violations of the duty of loyalty.⁶⁷ In fact, however, neither of these imagined barriers exists.

First, Delaware courts have held that both rescission and awards of rescissory damages are forms of equitable relief.⁶⁸ Thus, even if disgorgement could be considered to be a form of rescissory damages, it would nevertheless be an equitable remedy that is not covered by section 102(b)(7) charter provisions.

Second, a thorough analysis of the jurisprudence explaining the rescissory damages award shows that disgorgement of director compensation is not a form of rescissory damages. Unlike disgorgement, the remedies of rescission and rescissory damages both seek to undo the effects of a challenged transaction. As the Court of Chancery has held, “[r]escission requires that all parties to [a] transaction be restored to the *status quo ante*, *i.e.*, to the position they occupied before the challenged transaction.”⁶⁹ Similarly, rescissory damages seek to restore the parties to their respective positions before the transaction and are awarded when actual rescission is not available:

66. *Castrol, Inc. v. Pennzoil Quaker State Co.*, 169 F. Supp. 2d 332, 344 (D.N.J. 2001). *See also* *Balance Dynamics Corp. v. Schmitt Indus., Inc.*, 204 F.3d 683, 688, 695 (6th Cir. 2002) (“the principles of equity” warrant a grant of disgorgement if there is “some proof” that defendant earned profits from its false advertising); *American Cyanamid Co. v. Sterling Drug, Inc.*, 649 F. Supp. 784, 788-89 (D.N.M. 1986) (court held that even though plaintiff abandoned its claim for damages it could still seek disgorgement, reasoning that “claims for both damages and unjust profits cannot be interpreted as blurring the two claims and rendering legal an otherwise purely equitable claim for profits”).

67. Rescissory damages may be awarded only “where a breach of the directors [sic – directors’] duty of loyalty has been found.” *Cinerama, Inc. v. Technicolor*, 663 A.2d 1134, 1144 (Del. Ch. 1994); *Strassburger*, 752 A.2d at 581 (Del. Ch. 2000) (“In order to be equitably appropriate, rescissory damages must redress an adjudicated breach of the duty of loyalty, specifically, cases that involve self dealing or where the board puts its conflicting personal interests ahead of the interests of the shareholders.”); *Ryan v. Tad’s Enterprises, Inc.*, 709 A.2d 682, 698 (Del. Ch. 1996) (“An award of rescissory damages ... is grounded upon restitutionary principles ... [and] would be most appropriate where it is shown that the defendant fiduciaries unjustly enriched themselves by exercising their fiduciary authority deliberately to extract a personal financial benefit at the expense of the corporation’s shareholders.”).

68. *See* *Schultz v. Ginsburg*, 965 A.2d 661, 669 (Del. 2009) (“Ordering rescission or awarding rescissory damages are forms of equitable relief.”); *In re Philadelphia Stock Exchange, Inc.*, 945 A.2d 1123, 1137 (Del. 2008) (“the primary relief sought in the initial and amended complaints was equitable, specifically, the rescission of the Strategic Investor Transactions or, alternatively, rescissory damages.”).

69. *Strassburger*, 752 A.2d at 578. *See also* *Norton v. Paplos*, 443 A.2d 1, 4 (Del. 1982); *In re MAXXAM, Inc.*, 659 A.2d 760, 775 (Del. Ch. 1995).

In a mechanical way, rescissory damages function to put a party in the same financial position it would have occupied prior to the initiation of a transaction which is found to be invalid or voidable. This remedy is applied when equitable rescission of a transaction would be appropriate, but is not feasible.⁷⁰

Disgorgement to remedy a violation of the duty of care is completely different. It is not directed to a particular transaction, but instead to depriving directors of compensation earned during a period in which they breached their fiduciary duties. The money returned to the corporation constitutes *all* the director's compensation paid during the period of his or her malfeasance — it is not defined by or limited to moneys improperly earned by the director *from* a particular improper transaction. Nor does disgorgement seek to restore the corporation to the financial position it maintained before the breaches of fiduciary duty.⁷¹

Additionally, disgorgement does not fall under either of the two theoretical foundations for awards of rescissory damages. In *Cinerama*, the Court of Chancery identified “two prevailing ‘strains’ of the remedy of rescissory damages” — one which grew out of principles of restitution, and the second of which “employs a liberal application of the compensatory theory of damages against trustees who commit egregious breaches of the express terms of a trust or who self-deal.”⁷²

The restitutionary theory surfaced in securities law, in particular in actions brought under section 10(b) of the Securities and Exchange Act of 1934.⁷³ As the *Cinerama* court explained, “[t]he general rule is that a defrauded seller of securities will be entitled to her out-of-pocket damages, measured by the value of the security at a time period reasonably close to the point at which the seller received notice of the fraud.”⁷⁴ Under the restitutionary theory, rescissory damages “may be awarded against a fiduciary who becomes unjustly enriched as a result of his wrongdoing,” and the measure of damages “is the amount of the unjust enrichment.”⁷⁵

Disgorgement of director compensation does not fall under the restitutionary theory of rescissory damages.⁷⁶ Although disgorgement is sometimes ordered to prevent unjust enrichment,⁷⁷ directors who breach their duty of care do not receive a financial benefit as a result of their breaches of fiduciary duties. Unlike situations where a director obtains personal benefits through violations of the duty of loyalty, a director does not earn compensation derived from acts of gross negligence, nor is there any cause and effect relationship between a director's breaches and his or her director compensation.

70. *Cinerama*, 663 A.2d at 1144. *See also* *Schultz v. Ginsburg*, 965 A.2d 661, 669 (Del. 2009) (“Rescissory damages ‘restore a plaintiff to the position occupied before the defendant’s wrongful acts.’”) (quoting BLACK’S LAW DICTIONARY 419 (8th ed. 2004)).

71. Indeed, the damages a corporation sustains from a director’s breach of fiduciary duties may far exceed the compensation earned by the malfeasant directors. *See supra* note 3.

72. *Cinerama*, 663 A.2d at 1144-45.

73. 15 U.S.C.A. § 78 j(b).

74. *Cinerama*, 663 A.2d at 1145.

75. *Strassburger*, 752 A.2d at 581. *See, e.g.*, *Lynch v. Vickers Energy Corp.*, 429 A.2d 497 (Del. 1981).

76. While disgorgement of the personal benefits obtained by a director through breaches of the duty of loyalty (*e.g.*, from usurping corporate opportunities or engaging in insider trading) do appear to fall under this theory of rescissory damages, that would not prevent an order of disgorgement because, as explained above, *supra* at notes 6-8, disgorgement may be awarded for breaches of the duty of loyalty.

77. *See supra* at notes 8-11.

Nor does disgorgement fall under the second theoretical foundation for rescissory damages, which grew out of trust law. As explained in *Cinerama*:

Trustees have been surcharged for the appreciated value (at the time of judgment) of property they sold (1) in violation of their obligations under the trust instrument or (2) in a transaction in which they labored under a material conflict of interest. In both of these situations, courts have justified this surcharge as an attempt to render the beneficiary whole for all of the damages he has suffered as a result of the breach of trust.⁷⁸

The purpose of the trust theory of rescissory damages is to compensate a plaintiff for its actual loss caused by a defendant's conduct.⁷⁹ Conversely, an order requiring malfasant directors to disgorge their director compensation seeks only to deprive the directors of the compensation paid during the period in which the directors were malfasant — the remedy does not compensate shareholders for their losses caused by the directors' breaches of their duties.⁸⁰ In short, disgorgement is not a form of rescissory damages.

IV. DIRECTORS WHO VIOLATE THEIR DUTY OF CARE ARE NOT ENTITLED TO INDEMNIFICATION UNDER SECTION 145

In addition to enacting exculpatory charter provisions pursuant to DGCL section 102(b)(7), many Delaware corporations use another mechanism to dilute directors' personal liability for breaches of the duty of care. Corporations typically enter into indemnification agreements with their directors that serve to protect the directors from having to satisfy personally judgments against them for most breaches of fiduciary duties.

Section 145 permits a corporation to indemnify a director for damages, fines, amounts paid in settlement, and expenses (including attorneys' fees) so long as the director acted "in good faith and in a manner the person reasonably believed to be in or not opposed to the best interests of the corporation."⁸¹ The Court of Chancery, in construing an

78. *Cinerama*, 663 A.2d at 1146.

79. *Cinerama*, 663 A.2d at 1146-47; *Strassburger*, 752 A.2d at 581.

80. The federal courts have in one line of cases explicitly distinguished disgorgement from rescission or rescissory damages. The United States Supreme Court, in construing the Investment Advisors Act of 1940, held that there is a limited private remedy under that statute to void an investment advisers contract. *See Transamerica Mortgage Advisors, Inc. v. Lewis*, 444 U.S. 11, 24 (1979). Following that decision, courts have denied claims for disgorgement for violations of the Investment Advisers Act, holding that the only available remedy is rescission. *See, e.g., Welch v. TD Ameritrade Holding Corp.*, No. 07 Civ. 6904-RJS, 2009 WL 2356131, at *30-31 (S.D.N.Y. July 27, 2009); *Kassover v. UBS AG*, 619 F. Supp. 2d 28, 34 (S.D.N.Y. 2008).

81. Section 145, subsections (a) and (b), provide:

- (a) A corporation shall have power to indemnify any person who was or is a party or is threatened to be made a party to any threatened, pending or completed action, suit or proceeding, whether civil, criminal, administrative or investigative (other than an action by or in the right of the corporation) by reason of the fact that the person is or was a director, officer, employee or agent of the corporation, or is or was serving at the request of the corporation as a director, officer, employee or agent of another corporation, partnership, joint venture, trust or other enterprise, against expenses (including attorneys' fees), judgments, fines and amounts paid in settlement actually and reasonably incurred by the person in connection with such action, suit or proceeding if the person acted in good faith and in a manner the person reasonably believed to be in or not opposed to the best interests of the corporation, and, with respect to any criminal action or proceeding, had no reasonable cause to believe the person's conduct was unlawful. The termination of any action, suit or proceeding by judgment, order, settlement, conviction, or upon a plea of nolo contendere or its equivalent, shall not, of itself, create a presumption that the person did not act in good faith and in a manner which the person reasonably believed to be to be in or not opposed to the best interests of the corporation, and, with respect to any criminal action or proceeding, had reasonable cause to believe that the person's conduct was unlawful.
- (b) A corporation shall have power to indemnify any person who was or is a party or is threatened to be made a party to any threatened, pending or completed action or suit by or in the right of the corporation to procure

earlier version of section 145, explained that it was enacted “primarily to permit corporate executives to be indemnified in situations where the propriety of their actions as corporate officials is brought under attack.”⁸² More recently, the Court of Chancery stated:

[T]he purpose of § 145 is not to encourage litigation or to deter the losing party in the underlying action from prescribed categories of conduct. Rather, its purpose is to encourage capable persons to serve as officers, directors, employees or agents of Delaware corporations, by assuring that their reasonable legal expenses will be paid.⁸³

In addition to section 102(b)(7) charter provisions, almost all public companies have adopted indemnification agreements providing a second layer of protection insulating directors from mismanagement liability.⁸⁴ In fact, many corporations have adopted bylaws that *require* the corporation to indemnify its directors.⁸⁵

However, directors ordered to disgorge compensation for breaching their duty of care should not be entitled to indemnity for such compensation under section 145 because, by engaging in grossly negligent behavior, the director was no longer acting “in a manner [he] reasonably believed to be in or not opposed to the best interest of the corporation.”⁸⁶

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a judgment in its favor by reason of the fact that the person is or was a director, officer, employee or agent of the corporation, or is or was serving at the request of the corporation as a director, officer, employee or agent of another corporation, partnership, joint venture, trust or other enterprise against expenses (including attorneys’ fees) actually and reasonably incurred by the person in connection with the defense or settlement of such action or suit if the person acted in good faith and in a manner the person reasonably believed to be in or not opposed to the best interests of the corporation and except that no indemnification shall be made in respect of any claim, issue or matter as to which such person shall have been adjudged to be liable to the corporation unless and only to the extent that the Court of Chancery or the court in which such action or suit was brought shall determine upon application that, despite the adjudication of liability but in view of all the circumstances of the case, such person is fairly and reasonably entitled to indemnity for such expenses which the Court of Chancery or such other court shall deem proper.

DEL. CODE ANN. tit. 8, §§ 145(a), (b). As these provisions make clear, the corporation may indemnify its officers, employees and corporate agents as well as directors. *Id.*

82. *Essential Enterprises Corp. v. Automatic Steel Prods, Inc.*, 164 A.2d 437, 441 (Del. Ch. 1960).

83. *Mayer v. Executive Telecard, Ltd.*, 705 A.2d 220, 223 (Del. Ch. 1997).

84. *Outside Director Liability*, 58 STAN. L. REV. at 1083. See also Edward Tsai, *Success by Another Name: Recognizing a Limited Exception Under Delaware Law to the Indemnification of Derivative Action Settlements*, 64 N.Y.U. ANN. SURV. AM. L. 879 (2009) (“Delaware’s approach to permissive indemnification leaves corporations broad discretion in the degree of liability protection they decide to confer.”).

85. Such bylaws are expressly permitted by 8 *Del. C.* §145(f), which provides:

(f) The indemnification and advancement of expenses provided by, or granted pursuant to, the other subsections of this section shall not be deemed exclusive of any other rights to which those seeking indemnification or advancement of expenses may be entitled under any bylaw, agreement, vote of stockholders or disinterested directors or otherwise, both as to action in such person’s official capacity and as to action in another capacity while holding such office. A right to indemnification or to advancement of expenses arising under a provision of the certificate of incorporation or a bylaw shall not be eliminated or impaired by an amendment to such provision after the occurrence of the act or omission that is the subject of the civil, criminal, administrative or investigative action, suit or proceeding for which indemnification or advancement of expense is sought, unless the provision in effect at the time of such act or omission explicitly authorizes such elimination or impairment after such action or omission has occurred.

86. DEL. CODE ANN. tit. 8, § 145(a).

It would be anomalous for a court to find that a grossly negligent director whose “actions [were] without the bounds of reason”⁸⁷ acted in a manner the director reasonably believed to be in the best interest of the corporation.

The decision in *Carlson v. Hallinan*⁸⁸ is instructive. There, the court found that two individual defendants — one the CEO, Chairman, and controlling stockholder of a corporation, and the other the corporation’s vice president and a director — breached their fiduciary duties by paying themselves an excessive amount of executive compensation, authorizing the corporation to pay certain management fees and bear expenses of other entities, usurping a corporate opportunity and causing the corporation to pay for their defenses to those claims.⁸⁹ The court held that the individual defendants did not act in good faith, and thus were not entitled to indemnification, and had to repay to the corporation “all funds it expended in defense of [the] action.”⁹⁰ Similarly, section 145 and bylaws adopted pursuant to that statute should be no impediment to requiring grossly negligent directors to disgorge their director compensation, nor should there be any coverage for such directors under any indemnification agreement.⁹¹

V. DISGORGEMENT IS NOT AN INSURABLE FORM OF DAMAGES

Even if a corporation may not indemnify its directors for grossly negligent or bad faith behavior, it can indirectly provide similar protection through D&O insurance. Section 145(g) provides that a corporation may obtain D&O insurance regardless of whether it has the power to indemnify the covered individual:

87. *Benihana*, 891 A.2d at 192 (definition of gross negligence).

88. *Carlson v. Hallinan*, 925 A.2d 506 (Del. Ch. 2006).

89. *Id.* at 529-42.

90. *Carlson*, 928 A.2d at 542. *See also* *VonFeldt v. Stifel Fin. Corp.*, C.A. No. 15688, 1999 WL 413393, at *2 (Del. Ch. June 11, 1999) (confirming good faith requirement for indemnification and holding that “as a matter of public policy it simply would not make sense for a corporation to have the power to indemnify agents who do not act in its best interests”).

91. *See Three-Legged Stool*, 42 BUS. LAW. at 405 (“it seems that indemnification may not be made (absent court relief provided in the statute) if the director has been adjudged liable to the corporation on any recognized basis of personal liability such as self-dealing, statutory violations, or gross negligence”). *See also* *Choate, Hall & Stewart v. ACS Services, Inc.*, 495 N.E.2d 562, 565-67 (Mass. App. Ct. 1986) (enforcing a provision of a settlement agreement obligating a corporation to indemnify a director for his legal expenses, over objection that indemnification was improper because the director behaved improperly, holding that such agreements were enforceable in the absence of specific findings that the director had violated a fiduciary duty to the corporation). However, this remains an open question. For example, the SEC has in many cases obtained disgorgement orders against corporate directors and officers for violations of federal securities laws. The SEC has taken the position that it is against public policy for a company to have an indemnification agreement with its officers and directors for misstatements in offering documents that are part of a sale of securities under the Securities Act of 1933 (17 C.F.R. §229.510). Similarly, the Foreign Corrupt Practices Act provides: “Whenever a fine is imposed . . . upon any officer, director, employee, agent, or stockholder of an issuer, such fine may not be paid, directly or indirectly, by such issuer.” 15 U.S.C. § 78ff(c)(3). The Investment Company Act, which regulates mutual funds, states that a company cannot have any provision:

which protects or purports to protect any director or officer of a company against liability to the company or to its security holders to which he would otherwise be subject by reason of willful malfeasance, bad faith, gross negligence or reckless disregard of the duties involved in the conduct of his office.

15 U.S.C. § 80a-17(h).

(g) A corporation shall have power to purchase and maintain insurance on behalf of any person who is or was a director, officer, employee or agent of the corporation, or is or was serving at the request of the corporation as a director, officer, employee or agent of another corporation, partnership, joint venture, trust or other enterprise against any liability asserted against such person and incurred by such person in any such capacity, or arising out of such person's status as such, whether or not the corporation would have the power to indemnify such person against such liability under this section.⁹²

As some commentators have explained, this “final ‘leg’ of support afforded directors under the Delaware statutory scheme ... is largely intended to fill the gap in situations where indemnification is legally unavailable, as in the case of liability for derivative actions.”⁹³

Thus, section 145(g) allows a corporation to obtain insurance coverage for judgments and amounts paid in settlement in derivative suits and against expenses incurred even where a director is found to have acted in bad faith or with gross negligence or otherwise has been adjudged liable in some respects.⁹⁴ As explained in one treatise, “[t]he rationale of Section 145(g) would appear to be based on the theory that the corporation is only paying a premium, which ordinarily would not constitute 100 percent of any payments in settlement or in expenses.”⁹⁵

On the surface, it appears that even if a plaintiff obtains an order requiring malfeasant directors to disgorge their compensation, the directors may actually keep the money, because the D&O insurer would satisfy the judgment (or perhaps repay the directors if they satisfied the judgment in the first instance). However, most D&O policies now have provisions excluding coverage for disgorgement claims, deliberate wrongdoing or other willful misconduct, as well as for liability arising from certain specified types of transactions, such as those from which the director reaped a personal pecuniary benefit.⁹⁶

Cases construing the extent of coverage under insurance policies have also examined whether disgorgement remedies are awards of “damages.” Liability insurance policies for directors, officers or other professionals typically contain provisions providing coverage for “damages” the insured must pay for various types of injuries or losses suffered from certain enumerated acts. Almost all courts addressing whether disgorgement is a form of “damages” as that term is used in such insurance policies have ruled that disgorgement is not damages. The courts reason that because the remedy requires

92. DEL. CODE ANN. tit. 8, § 145(g). Almost all public corporations purchase such insurance. See Geoffrey P. Miller, *A Modest Proposal for Fixing Delaware's Broken Duty of Care*, 2010 COLUM. BUS. L. REV. 319, 323 (2010) (citing Sean J. Griffith, *Uncovering a Gatekeeper: Why the SEC Should Mandate Disclosure of Details Concerning Directors' and Officers' Liability Insurance Policies*, 154 U. PA. L. REV. 1147, 1168 (2006) (99% of surveyed companies had purchased D&O policies in 2004)).

93. *Three-Legged Stool*, 42 BUS. LAW. at 417.

94. *Id.* See also *Waltuch v. Conticommodity Services, Inc.*, 88 F.3d 87, 93 (2d Cir. 1996) (“subsection (g) explicitly allows a corporation to circumvent the ‘good faith’ clause of subsection (a) by purchasing a directors and officers liability insurance policy”); *TLC Beatrice Int'l Holdings, Inc. v. Cigna Ins. Co.*, No. 97 Civ 8589-MBM, 1999 WL 33454, at *6 (S.D.N.Y. Jan. 27, 1999) (following *Waltuch*, noting that section 145(g) is meaningful only because the corporation lacks the power in some circumstances to directly indemnify its officers and directors); *Outside Director Liability*, 58 STAN. L. REV. at 1085 (“In contrast to indemnification, neither corporate law nor securities law places limitations on the permissible scope of D&O coverage”).

95. R. FRANKLIN BALOTTI & JESSE A. FINKELSTEIN, *THE DELAWARE LAW OF CORPORATIONS AND BUSINESS ORGANIZATIONS*, § 4.13[A] (Vol. 1 2010).

96. *Three-Legged Stool*, 42 BUS. LAW. at 418. See also *Redar, LLC v. Rush*, 51 So.3d 859, 871-72 (La. Ct. App. 2010) (noting that the policy “specifically excluded from coverage disgorgement claims”).

a return of money or property that has been wrongfully acquired, and is not designed to compensate a plaintiff for losses, disgorgement is not “damages” covered under policies using that term.⁹⁷

The insurance policy construed in a case often cited with approval on this issue provided for coverage from “damages” the insured was required to pay for injuries arising out of “unfair competition” in the course of “advertising injuries.”⁹⁸ The insured sought coverage for payments made to settle a class action alleging unfair competition claims.⁹⁹ The court found that the plaintiff could not recover damages; the only non-punitive monetary relief available under the governing statute was “the disgorgement of money that has been wrongfully obtained.”¹⁰⁰ Moreover, the court reasoned that payments pursuant to disgorgement orders cannot be insurable damages because “one may not insure against the risk of being ordered to return money or property that has been wrongfully acquired.”¹⁰¹ The court noted that any remedy for violations of the governing statute must seek to deter future violations and foreclose retention of the ill-gotten gains.¹⁰² Further, public policy supported the court’s holding:

When the law requires a wrongdoer to disgorge money or property acquired through a violation of the law, to permit the wrongdoer to transfer the cost of disgorgement to an insurer would eliminate the incentive for obeying the law. Otherwise, the wrongdoer would retain the proceeds of his illegal acts, merely shifting his loss to an insurer.¹⁰³

Numerous other courts have adopted the same reasoning and ruled that disgorgement is not an award of damages for purposes of construing the limits of insurance coverage.¹⁰⁴ Other courts have reinforced this conclusion by holding that disgorgement is not a covered “loss” as that term is used in insurance policies.¹⁰⁵

VI. CONCLUSION

As made clear above, directors of Delaware corporations essentially bear only a reputational risk for violations of their duty of care. However, the mere fear of social sanction provides a “weak constraint” on director misbehavior.¹⁰⁶

97. See cases cited *infra* at notes 105-06.

98. Bank of the West v. Superior Court, 2 Cal. 4th 1254, 1265 (Cal. 1992).

99. *Id.* at 1260.

100. *Id.* at 1266.

101. *Id.*

102. *Id.*

103. *Id.* at 1269.

104. See, e.g., Republic Western Ins. Co. v. Spieren, Woodward, Willens, Denis & Furstman, 68 F.3d 347, 351-52 (9th Cir. 1995) (attorney’s required disgorgement to the court of fees not properly earned due to disabling conflict of interest was not “damages” for which the insurance policy required coverage); Haines v. St. Paul Fire & Marine Ins. Co., 428 F. Supp. 435, 439-41 (D. Md. 1977) (law firm’s professional liability insurance did not cover SEC action seeking judgment requiring firm to disgorge attorneys’ fees); Burlington Ins. Co. v. Deudhara, No. C09-00421-SBA, 2010 WL 3749301, at *11 (N.D. Cal. Sept. 23, 2010) (claims for injunctive relief and disgorgement of unlawfully collected rent sought “equitable relief [and] not ... ‘damages’ that can be covered by a liability policy”); Jaffe v. Cranford Ins. Co., 168 Cal. App. 3d 930, 935 (Cal. Ct. App. 1985) (“The defendant is asked to return something he

To promote greater accountability in corporate governance and deter future malfeasance, some commentators have recommended new laws requiring negligent directors to make personal payments toward settlements and damage awards.¹⁰⁷ One proposal for revision of the ALI's Principles of Corporate Governance (the most widely recognized statement of best practice standards) included a requirement that defendants disgorge any compensation received from the corporation during the year the violation occurred.¹⁰⁸ Instead, the final version of the ALI's Principles endorsed voluntary charter-based limits on director liability such as that permitted by section 102(b)(7) of the DGCL.¹⁰⁹

And, as made clear in this article, Delaware's corporate code does permit practitioners to seek greater director accountability. They simply need to request a new remedy — disgorgement of compensation for the period during which the director violated his or her duty of care. In addition to driving home the importance of that fiduciary duty, a disgorgement remedy would provide some sanction for director misconduct and perhaps serve as a deterrent against future violations. Additionally, and importantly, directors would not profit from fees paid by the corporations they serve during their period of malfeasance. In short, the now-empty duty of care will have some of its vitality and force restored.

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wrongfully received; he is not asked to compensate the plaintiff for injury suffered as a result of his conduct. At least absent demonstrably unusual circumstances, we have doubts whether an insurance policy which purported to insure a party against payments of a restitutionary nature would comport with public policy.”); *O'Neill Investigations, Inc. v. Illinois Employers Ins. of Wausau*, 636 P.2d 1170, 1174-75 (Ala. 1981) (debt collector's professional liability insurance did not cover unfair trade practice claim for “restoration of monies to injured individuals”); *Seaboard Surety Co. v. Ralph Williams' Northwest Chrysler Plymouth, Inc.*, 504 P.2d 1139, 1140 (Wash. 1973) (concluding that state's complaint for injunctive relief, civil penalties and “such additional orders or judgments as may be necessary to restore to any person in interest any monies or property” acquired by violations of the statute was not a suit “seeking damages” within the coverage of the insurance policy); *see also* *Porter v. Warner Holding Co.*, 328 U.S. 395, 398-99 (1946) (“a decree compelling one to disgorge profits, rents, or property acquired in violation of the Emergency Price Control Act may properly be entered by a District Court once its equity jurisdiction has been invoked under § 205(a)”).

105. *See, e.g.*, *Level 3 Communications, Inc. v. Federal Ins. Co.*, 272 F.3d 908, 910-11 (7th Cir. 2001) (“[A] ‘loss’ within the meaning of an insurance contract does not include the restoration of an ill-gotten gain.... An insured incurs no loss within the meaning of the insurance contract by being compelled to return property that it had stolen, even if a more polite word than ‘stolen’ is used to characterize the claim for the property's return.”); *CNL Hotels & Resorts, Inc. v. Houston Casualty Co.*, 505 F. Supp. 2d 1317, 1322-23 (M.D. Fl. 2007) (payment to settlement fund of amounts wrongfully appropriated did not constitute a “loss” under insurance policy since payment was in nature of disgorgement); *Vigilant Ins. Co. v. Credit Suisse First Boston Corp.*, 782 N.Y.S.2d 19, 20 (N.Y. App. Div. 2004) (disgorgement of funds obtained through violations of securities laws constituted “restitution” and not insurable “damages” or “loss”); *Conseco, Inc. v. National Union Fire Ins. Co. of Pittsburgh, No. 49D130202CP000348*, 2002 WL 31961447, at *6-9 (Ind. Cir. Ct. Dec. 31, 2002) (finding that Conseco's liability to return funds it wrongfully took from investors when securities were sold in violation of Section 11 of the Securities Act was not a covered “loss” under insurance policies); *Central Dauphin School Dist. v. American Casualty Co.*, 426 A.2d 94, 96 (Pa. 1981) (return of tax money to taxpayers collected as result of unlawful tax was not an insurable “loss”); *but see In re Corriea*, 719 A.2d 1234, 1240-41 (D.C. App. 1998) (disgorgement of profits gained by attorney in transaction was damages under liability policy).

106. Blair & Stout, *supra* note 4, at 1796.

107. *See, e.g.*, Jones, *supra* note 12, at 145-56 (recommending calibrating directors' monetary liability based on their ability to pay); John C. Coffee, Jr. & Donald E. Schwartz, *The Survival of the Derivative Suit: An Evaluation and a Proposal for Legislative Reform*, 81 COLUM. L. REV. 261, 317, 335 (1981) (suggesting penalties keyed to the financial circumstances of the defendant, but proposing that damages in cases exclusively involving the breach of the duty of care be capped at the greater of an individual's highest annual gross income during the preceding five years or the aggregate director's fees received by such defendant).

108. Jones, *supra* note 12, at 153.

109. *Id.*