



















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

### 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,<sup>13</sup> they are nonetheless typically paid handsomely for their board services.<sup>14</sup> 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.<sup>15</sup> This legislation was a reaction to what many perceived to be an unfolding “directors and officers insurance liability crisis”<sup>16</sup> resulting from what some believed to be a newly heightened standard of care for directors.<sup>17</sup>

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,”<sup>18</sup> 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.<sup>19</sup> 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.<sup>20</sup> 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.”<sup>21</sup>

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.<sup>22</sup> 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 equitable<sup>23</sup> or injunctive<sup>24</sup> 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.<sup>25</sup> 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.<sup>26</sup>

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

---

continued from page 5

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.<sup>27</sup>

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.”<sup>28</sup>

For example, where a director takes (or “usurps”) a corporate opportunity,<sup>29</sup> Delaware courts have required the director to return to the corporation any profits made from that opportunity.<sup>30</sup> 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”<sup>31</sup> and “prevent[] an unjust windfall by stripping the profit gained from [the fiduciary’s] disloyal acts.”<sup>32</sup> 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).<sup>33</sup> Moreover, unlike a compensatory damages remedy, which requires a showing of loss or injury to the plaintiff,<sup>34</sup> disgorgement may be ordered “even though no specific injury to [the plaintiff] can be measured.”<sup>35</sup>

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.<sup>36</sup> 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.<sup>37</sup>

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.”<sup>38</sup> 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.”<sup>39</sup>

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.<sup>40</sup>

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

### **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.<sup>42</sup> 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.*,<sup>43</sup> former HealthSouth CEO Richard Scrusby 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”).<sup>44</sup> 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.<sup>45</sup> 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.<sup>46</sup> 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.”<sup>47</sup>

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.<sup>48</sup> 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.”<sup>49</sup>

Similarly, the Court of Chancery in *Valeant Pharmaceuticals International v. Jerney*<sup>50</sup> 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.”<sup>51</sup> 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.”<sup>52</sup> 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.<sup>53</sup> 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).<sup>54</sup> 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.<sup>55</sup> 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.<sup>56</sup>

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,<sup>57</sup> securities fraud,<sup>58</sup> and registration and reporting violations.<sup>59</sup> 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."<sup>60</sup>

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."<sup>61</sup> 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."<sup>62</sup>

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."<sup>63</sup>

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."<sup>64</sup> 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.<sup>65</sup> 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.”<sup>66</sup>

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.<sup>67</sup> 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.<sup>68</sup> 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.”<sup>69</sup> 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.<sup>70</sup>

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.<sup>71</sup>

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.”<sup>72</sup>

The restitutionary theory surfaced in securities law, in particular in actions brought under section 10(b) of the Securities and Exchange Act of 1934.<sup>73</sup> 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.”<sup>74</sup> 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.”<sup>75</sup>

Disgorgement of director compensation does not fall under the restitutionary theory of rescissory damages.<sup>76</sup> Although disgorgement is sometimes ordered to prevent unjust enrichment,<sup>77</sup> 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 (8<sup>th</sup> 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.<sup>78</sup>

The purpose of the trust theory of rescissory damages is to compensate a plaintiff for its actual loss caused by a defendant's conduct.<sup>79</sup> Conversely, an order requiring malfeasant directors to disgorge their director compensation seeks only to deprive the directors of the compensation paid during the period in which the directors were malfeasant — the remedy does not compensate shareholders for their losses caused by the directors' breaches of their duties.<sup>80</sup> 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."<sup>81</sup> 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.”<sup>82</sup> 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.<sup>83</sup>

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.<sup>84</sup> In fact, many corporations have adopted bylaws that *require* the corporation to indemnify its directors.<sup>85</sup>

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.”<sup>86</sup>

---

continued from page 15

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”<sup>87</sup> acted in a manner the director reasonably believed to be in the best interest of the corporation.

The decision in *Carlson v. Hallinan*<sup>88</sup> 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.<sup>89</sup> 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.”<sup>90</sup> 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.<sup>91</sup>

## 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.<sup>92</sup>

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.”<sup>93</sup>

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.<sup>94</sup> 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.”<sup>95</sup>

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.<sup>96</sup>

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.<sup>97</sup>

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.”<sup>98</sup> The insured sought coverage for payments made to settle a class action alleging unfair competition claims.<sup>99</sup> 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.”<sup>100</sup> 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.”<sup>101</sup> 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.<sup>102</sup> 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.<sup>103</sup>

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.<sup>104</sup> Other courts have reinforced this conclusion by holding that disgorgement is not a covered “loss” as that term is used in insurance policies.<sup>105</sup>

## 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.<sup>106</sup>

---

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.<sup>107</sup> 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.<sup>108</sup> 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.<sup>109</sup>

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.

---

continued from page 19

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.*

## FLEXIBILITY UNDER DELAWARE LAW IN DRAFTING ADVANCEMENT PROVISIONS ON A “CLEAR DAY,” AND POTENTIAL SURPRISES FOR THOSE WHO DO NOT TAKE ADVANTAGE OF THAT FLEXIBILITY

William D. Johnston\*

### I. INTRODUCTION

Probably well-known is that Delaware law — both statutory and decisional — provides flexibility in drafting various contract provisions that are intended to control the governance relationships between Delaware-formed business entities, their owners, and their managers. Indeed, Delaware business entity law has been described as “contractarian.”<sup>1</sup>

What may be less well-known is the *extent* of that drafting flexibility. What also may be less well-known is the critical importance of exercising that drafting on a “clear day,” that is, before a dispute arises. Or, to borrow from Latin, “*ex ante*.”

In a day and age of potential statutory, regulatory, and/or common law liability for corporate directors and officers — or for managers of unincorporated business entities — timely and effective drafting of advancement and indemnification provisions has assumed special significance. Appropriate attention to such drafting flexibility can result in advancement and indemnification as narrow or as broad as may be intended. Conversely, disregard of that flexibility can result in a rude awakening for claimants or for the responding business entity, surprised by what may be the unintended scope of advancement and indemnification protection. And, at that juncture, the parties likely will be unable to compel judicially a different outcome.

This article seeks to help the reader avoid traps for the unwary, whether the trap is for the current or former business manager or for the business itself. It does so by highlighting the expansive drafting flexibility that Delaware law affords and then discussing when that drafting must occur in order for it to be effective.

### II. DRAFTING FLEXIBILITY — FROM STATUTORY AND DECISIONAL LAW

#### A. Statutory Scheme

Title 8 of the Delaware Code, the Delaware General Corporation Law or the “DGCL,” is largely enabling in nature. Thus, time and again, the DGCL permits contracting shareholders, directors, or officers to shape their corporate relationships.<sup>2</sup> Delaware statutes addressing unincorporated business entities — such as partnerships, limited partnerships, and limited liability companies — are to the same effect, embracing freedom of contract.<sup>3</sup>

---

\* William D. Johnston is a partner in the Wilmington, Delaware-based law firm of Young Conaway Stargatt & Taylor, LLP. Mr. Johnston gratefully acknowledges the assistance of his colleagues, Kristin Salvatore DePalma and Elisabeth S. Bradley, in the preparation of this article. He also acknowledges the assistance that The Honorable J. Travis Laster, Vice Chancellor of the Delaware Court of Chancery, generously provided in reviewing the article in manuscript form.

1. *E.g.*, David Rosenberg, *Making Sense of Good Faith in Delaware Corporate Fiduciary Law: A Contractarian Approach*, 29 DEL. J. CORP. L. 491, 491 (2004) (“Delaware is the most contractarian jurisdiction [.]”).

2. *Jones Apparel Grp. v. Maxwell Shoe Co.*, 883 A.2d 837, 845 (Del. Ch. 2004) (noting that “Delaware’s corporate statute is widely regarded as the most flexible in the nation because it leaves the parties to the corporate contract (managers and stockholders) with great leeway to structure their relations, subject to relatively loose statutory constraints and to the policing of director misconduct

This theme permeates provisions that address advancement (or advance indemnification) of defense expenses as well as end-of-the-matter indemnification of such expenses. Thus, Section 145(e) of the DGCL permits — but does not require — advancement of defense expenses, and Section 145(a) and (b) of the statute permit — but do not require — indemnification.<sup>4</sup> (Indemnification only is required when, pursuant to Section 145(c) of the DGCL, the claimant has been successful on the merits or otherwise in defending all or a portion of a civil or criminal proceeding.)<sup>5</sup> Other Delaware statutes, addressing unincorporated entities, likewise permit, but do not require advancement or indemnification.<sup>6</sup>

Which brings us to Section 145(f) of the DGCL, the so-called “non exclusivity” provision. That statutory subsection provides in part:

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.<sup>7</sup>

Delaware case law, addressed below, has confirmed that, with very few exceptions, parties are free to expand *or narrow* the corporate advancement and indemnification protections otherwise potentially afforded by Section 145 of the DGCL. Case law addressing “alternative entities” has been to the same effect.

## B. Decisional Law

Delaware courts have made clear that parties may exercise drafting flexibility in expanding or narrowing the scope of advancement and indemnification protection.

Historically, most typical have been provisions in governing documents that have made advancement and/or indemnification “mandatory.”<sup>8</sup> Thus, advancement has been conditioned only upon a claimant tendering an unsecured

---

continued from page 21

through equitable review”); *see also* Edward P. Welch & Robert S. Saunders, *Freedom and its Limits in the Delaware General Corporation Law*, 33 DEL. J. CORP. L. 845, 848-55 (2008) (summarizing DGCL enabling provisions found in Sections 102(b)(1), 141(a), 141(d), 151(a), 212, 102(b)(7), and 122(17)).

3. Delaware Revised Uniform Partnership Act, DEL. CODE ANN. tit. 6, § 15-103(d) (“It is the policy of this chapter to give maximum effect to the principle of freedom of contract . . .”); Delaware Revised Uniform Limited Partnership Act, DEL. CODE ANN. tit. 6, § 17-1101(c) (same); Delaware Limited Liability Company Act, DEL. CODE ANN. tit. 6, § 18-1101(b) (same).

4. DEL. CODE ANN. tit. 8, § 145(e); DEL. CODE ANN. tit. 8, § 145(a), (b).

5. DEL. CODE ANN. tit. 8, § 145(c).

6. DEL. CODE ANN. tit. 6, §§ 15-110, 17-108, 18-108.

7. DEL. CODE ANN. tit. 8, § 145(f).

8. *Homestore, Inc. v. Tafeen*, 888 A.2d 204, 212 (Del. 2005) (“The advancement authority conferred by section 145(e) is permissive. Nevertheless, mandatory advancement provisions are set forth in a great many corporate charters, bylaws and indemnification agreements.”).

“undertaking” (a promise to repay amounts advanced if it later is determined that the claimant is not entitled to indemnification).<sup>9</sup> And indemnification often has been assured “to the fullest extent permitted by law.”<sup>10</sup>

At the other end of the spectrum, Delaware decisions have suggested the possibility of a corporation doing away with advancement altogether or in any event cutting off advancement after a criminal conviction or a finding of civil liability and before appeal.<sup>11</sup> In addition, numerous decisions have embraced conditions on advancement such as (i) providing security or (ii) providing an affirmation that the claimant’s underlying conduct would satisfy the requirements for indemnification under Section 145(a) or (b) of the DGCL.<sup>12</sup>

Likewise, Delaware courts have suggested that a corporation may require a claimant to make a pre-suit “demand” on the corporation’s board as a condition of indemnification.<sup>13</sup>

But *all* decisions underscore the importance of the *timing* of the drafting of such provisions.

---

9. *E.g.*, *Xu Hong Bin v. Heckman Corp.*, C.A. No. 4802-CC, 2010 Del. Ch. LEXIS 3, at \*5 & n.7 (Del. Ch. Jan. 8, 2010) (noting that the following language provided mandatory advancement rights: “The expenses of officers and directors incurred in defending the civil suit or proceeding must be paid by the corporation as incurred and in advance of the final disposition of the actions, suit or proceeding, under receipt of an undertaking by or on behalf of the director or officer to pay the amount if it is ultimately determined by a court of competent jurisdiction that he or she is not entitled to be indemnified by the corporation”).

10. *E.g.*, *Underbrink v. Warrior Energy Servs. Corp.*, C.A. No. 2982-VCP, 2008 Del. Ch. LEXIS 65, at \*25-26 (Del. Ch. May 30, 2008) (“The Corporation shall, to the fullest extent permitted by applicable law in effect on the date of effectiveness of these Bylaws, and to such greater extent as applicable law may thereafter permit, indemnify and hold the Indemnitee harmless from and against any and all losses, liabilities, claims, damages and ... [e]xpenses ... arising out of any event or occurrence related to the fact that the Indemnitee is or was a director or Officer of the Corporation ...”). Governing documents also may require that a trust be established to ensure the funding of the advancement payments in the change-of-control setting or otherwise. *See, e.g.*, JOSEPH WARREN BISHOP, JR., *LAW OF CORPORATE OFFICERS AND DIRECTORS/INDEMNIFICATION AND INSURANCE* 7-190 (Appendix 7C) (West 2010). And those documents may provide that the corporation bears the burden of establishing *non*-entitlement to advancement. *See Schoon v. Troy Corp.*, 948 A.2d 1157, 1169 (Del. Ch. 2008) (quoting a bylaw section providing that the “corporation shall have the burden of proving that the indemnitee was not entitled to the requested ... advancement of expenses”).

11. *Brooks-McCollom v. Emerald Ridge Serv. Corp.*, C.A. No. 147-N, 2004 Del. Ch. LEXIS 105, at \*7 (Del. Ch. July 29, 2004) (“The Delaware General Corporation Law permits a corporation to advance the costs of litigation to a director. This allowance is permissive, not mandatory. Thus, a corporation is free to limit the terms of advancement and even preclude advancement entirely.”); *Sun-Times Media Grp., Inc. v. Black*, 954 A.2d 380, 406 n.104 (Del. Ch. 2008) (“A corporation could grant mandatory advancement but circumscribe that obligation so that it explicitly excludes advancement for costs incurred in connection with any appellate stages of a proceeding.”).

12. *Homestore*, 888 A.2d at 212 (“In addition to an express undertaking requirement, corporations may specify by bylaw or contract the terms and conditions upon which present and former corporate officials may receive advancement, e.g., proof of an ability to repay or the posting of a secured bond.”); *Gentile v. SinglePoint Fin., Inc.*, 787 A.2d 102, 106 (Del. Ch. 2001) (finding plaintiff entitled to advancement under a bylaw provision conditioning advancement upon “receipt by the corporation of [] a written affirmation by such Indemnitee of his good faith belief that he has met the standard of conduct necessary for indemnification by the Corporation”); *see also* *Thompson v. Williams Cos.*, C.A. No. 2716-VCS, 2007 Del. Ch. LEXIS 112, at \*6-8 (Del. Ch. July 31, 2007) (approving bylaw requirement of dollar-for-dollar security); *Paolino v. Mace Security Int’l, Inc.*, 985 A.2d 392, 398 (Del. Ch. 2009) (describing bylaw “variant of a common carve-out eliminating indemnification [and, in turn, advancement] for any proceeding (or part thereof) initiated by an indemnitee without prior Board approval.”); *Connecticut General Life Insurance Co. v. Pinkas*, C.A. No. 5724-VCN, 2010 Del. Ch. LEXIS 228, at \*3 (Del. Ch. Nov. 18, 2010) (“[Limited partnership agreement] tempers the broad right of advancement it provides by requiring that potential indemnitees first seek advancement from other available sources.”).

13. *Stifel Fin. Corp. v. Cochran*, 809 A.2d 555, 560 (Del. 2002) (refusing to read a pre-suit demand requirement into Section 145 but noting that the defendant corporation “was free to write a demand requirement into its bylaws, but did not”).

### III. DRAFTING ON A “CLEAR DAY”

Delaware decisions have emphasized time and again that, while parties are given a wide berth in drafting advancement and indemnification provisions, that drafting must occur on a “clear day,” or *ex ante*, rather than *post hoc*, after a dispute has arisen.

Perhaps most jarring for business entities in recent years has been the phenomenon of being faced with an advancement demand by a current or (more likely) former director or officer or LLC manager, only to find that the documents governing the business entity contain “mandatory” advancement provisions. Under those circumstances, Delaware courts have emphasized, it is too late to attempt to impose limitations on such advancement apart from the unsecured, contingent obligation to repay amounts advanced.<sup>14</sup> Thus, a corporation or other business entity can be left to resist the requested advancement on certain grounds in connection with *entitlement* to advancement (such as lack of a covered proceeding, or lack of requisite capacity on the part of the claimant) and/or *reasonableness* of the attorneys’ fees and other expenses incurred (who did what work, in connection with which matter, at what rates, etc.).<sup>15</sup> But such resistance, if later found by the courts to be unwarranted, can indeed be costly for the defending business entity: with the entity not only paying the advancement amount, but also prejudgment interest (typically at 5% above the Federal Reserve Discount Rate), the claimant’s enforcement attorneys’ fees and other expenses (so-called “fees-on-fees”), and the entity’s own costs.<sup>16</sup> In addition, it has been suggested that business managers could have exposure to a “waste” claim in resisting an advancement demand in the face of mandatory advancement provisions.<sup>17</sup>

---

14. See, e.g., *DeLucca v. KKAT Mgmt.*, C.A. No. 1384-N, 2006 Del. Ch. LEXIS 19, at \*6-7 (Del. Ch. Jan. 23, 2006) (“[T]his is yet another case in which defendants in an advancement case seek to escape the consequences of their own contractual freedom. Regretting the broad grant of mandatory advancement they forged on a clear day, they seek to have the judiciary ignore the plain language of their contracts and generate an after-the-fact judicial contract that reflects their current preference. But it is not the job of a court to relieve sophisticated parties of the burdens of contracts they wish they had drafted differently but in fact did not. Rather, it is the court’s job to enforce the clear terms of contracts.”); *Reddy v. Elec. Data Sys. Corp.*, C.A. No. 19467, 2002 Del. Ch. LEXIS 69, at \*13 (Del. Ch. June 18, 2002) (“Having been accorded the freedom to craft its bylaws as it wished, EDS cannot point to its own drafting failures as a defense to Reddy’s advancement claim, however. If it chose, EDS could have conditioned former employees’ advancement rights on an undertaking, proof of an ability to repay, or even the posting of a secured bond. But it did not do so.”).

15. See, e.g., *Sassano v. CIBC World Mkts. Corp.*, 948 A.2d 453, 463 (Del. Ch. 2008) (“Having found that the Bylaws extend mandatory advancement to nominal officers, the question becomes whether Sassano was a nominal officer of CIBC from 1998 to 2003, the time frame of the allegations for which he seeks advancement.”); *Radiancy, Inc. v. Azar*, C.A. No. 1547-N, 2006 Del. Ch. LEXIS 13, at \*9 (Del. Ch. Jan. 23, 2006) (“Under Section 6.1 of the bylaws, therefore, there is no basis on which to challenge Perry’s right to advancement for those allegations. The only remaining question as to Perry is when and if he became a director or officer ... and whether his status as such (if any) entitles him to mandatory advancement.”); *O’Brien v. IAC/InterActive Corp.*, C.A. No. 3892-VCP, 2010 Del. Ch. LEXIS 189, at \*16 (Del. Ch. Aug. 27, 2010) (“When dealing with a mandatory indemnification provision such as the one here .... The party seeking indemnification ... must prove that the amount of indemnification sought is reasonable.”).

16. *Homestore*, 888 A.2d at 209 (affirming the Court of Chancery’s entry of a “Final Order and Judgment” ordering a corporation to pay to its former corporate officer “96% of the fees and expenses incurred in the liability phase of this advancement action,” “96% of the fees and expenses incurred in the ‘reasonableness’ phase of this action,” and pre-judgment and post-judgment interest); see also *Paolino*, 985 A.2d at 401 (“The broad and mandatory advancement rights that corporations continue to grant or leave in place, despite repeated suggestions by this Court that the rights be more narrowly tailored, already create a disincentive for corporations to pursue remedies when they know that they must also fund the defense.”) (footnote omitted); *Stifel Fin. Corp.*, 809 A.2d at 561-62 (“[Corporations] remain free to tailor their indemnification bylaws to exclude ‘fees on fees,’ if that is a desirable goal.”).

17. *Barrett v. Am. Country Holdings, Inc.*, 951 A.2d 735, 747 (Del. Ch. 2008) (“The accumulation of cases like this, where the stockholders get it coming and going because of the corporation’s refusal to honor mandatory advancement contracts, is regrettable, and at some point, a case of sufficient dollar value will arise such that a board is sued for wasting the corporation’s resources by putting up a clearly frivolous defense.”).

Two Delaware decisions bear special mention.

### A. *Schoon v. Troy*

The first decision is *Schoon v. Troy*.<sup>18</sup> In *Schoon*, plaintiffs included Richard W. Schoon, a current director of Troy Corp., a Delaware corporation, and Linda J. Bohnen, executrix of the estate of former Troy director William J. Bohnen.<sup>19</sup> They sued Troy for advancement of defense expenses in connection with fiduciary duty claims first threatened and then filed by the company.<sup>20</sup> On cross-motions for summary judgment, the Court of Chancery concluded that, under the governing bylaws, William Bohnen was not entitled to advancement but Schoon was.<sup>21</sup>

The Court recounted that Troy had adopted several amendments to its bylaws and that those amendments “establish different advancement rights for Bohnen, as a former director, and Schoon as a current director.”<sup>22</sup> Quoting from the plaintiffs’ brief, the Court observed, for purposes of the cross-motions, that the plaintiffs assumed “that the amendments were validly adopted.”<sup>23</sup>

Troy’s pre-amendment bylaws had provided that “the Corporation shall pay the expenses incurred by any present or former director....”<sup>24</sup> The amended provision read, “[l]osses reasonably incurred by a director or officer in defending any threatened or pending Proceeding ... shall be paid by the Corporation in advance of the final disposition of such Proceeding ....”<sup>25</sup> Troy told the Court that the purpose of the amendment was to “delete former directors from entitlement to advancement.”<sup>26</sup>

Bohnen contended that his advancement rights in the pre-amendment bylaws vested before the adoption of the amendments — at the time he took office as a director.<sup>27</sup> In support of his argument, he relied upon the decision of the Delaware Superior Court in *Salaman v. National Media Corp.*<sup>28</sup> The *Salaman* court had stated that “the right to advancement and indemnification is a vested contract right which cannot be unilaterally terminated.”<sup>29</sup> But the *Schoon* court noted

---

18. *Schoon v. Troy Corp.*, 948 A.2d 1157 (Del. Ch. 2008).

19. *Id.* at 1159-60.

20. *Id.* at 1159.

21. *Id.*

22. *Id.* at 1165.

23. *Id.* at 1161 n.7.

24. *Id.* at 1165.

25. *Id.* at 1169.

26. *Id.* at 1165.

27. *Id.* at 1166.

28. *Id.* at 1165-66 (citing *Salaman v. Nat’l Media Corp.*, C.A. No. 92C-01-161, 1992 Del. Super. LEXIS 564 (Del. Super. Oct. 8, 1992)).

29. *Id.* at 1166 (quoting *Salaman*, 1992 Del. Super. LEXIS 564, at \*17-18).

that the plaintiff in *Salaman* had been named as a defendant before the bylaw at issue was amended.<sup>30</sup> In contrast, the court found, Bohnen's rights under the pre-amendment bylaws had not been triggered prior to the amendments because he had not been named in certain affirmative defenses and was not a party to the lawsuit at issue.<sup>31</sup>

The Court of Chancery likewise rejected Bohnen's argument that, even if the amendments to the bylaws were effective, they failed to terminate his right to advancement because of other language in the bylaws.<sup>32</sup> In particular, Bohnen relied on language that read, "The rights conferred by this Article shall continue as to a person who has ceased to be a director or officer and shall inure to the benefit of such person and the heirs, executors, administrators and other comparable legal representatives of such person."<sup>33</sup> The court found that the quoted language did not aid Bohnen's cause because he had resigned before Troy initiated its fiduciary duty claims against him: "Rather, it is better understood as providing that a director, whose right to advancement is triggered while in office, does not lose that right by ceasing to serve as a director."<sup>34</sup> In addition, the court found that the bylaws as amended would still provide for *indemnification* of former directors.<sup>35</sup> The court concluded, "In short, the language of the bylaws deliberately and unambiguously provides for unequal treatment of current and former directors in receiving advancement."<sup>36</sup>

The *Schoon* decision was criticized by some commentators as sanctioning a corporation's unilateral and retroactive extinguishment of advancement and indemnification rights.<sup>37</sup> But it would seem that that conclusion is overbroad.

Undeniably, the *Schoon* court, on the facts presented, did find that the claimant former director was not entitled to further advancement. But, doctrinally, what the court concluded was that the right to advancement never "vested" in the first place because it had not been triggered during the time Bohnen was in office as a director. In addition, the distinction that the court endorsed between former and current officers or directors is supported by the language of Section 145(e) of the Delaware General Corporation Law: "Such expenses (including attorneys' fees) incurred by former directors and officers or other employees and agents may be so paid upon such terms and conditions, if any, as the corporation deems appropriate."<sup>38</sup> The *Schoon* court accordingly referred to "the flexibility inherent in section 145."<sup>39</sup>

---

30. *Id.* at 1166.

31. *Id.*

32. *Id.* at 1166-67.

33. *Id.* at 1166.

34. *Id.* at 1167.

35. *Id.*

36. *Id.* at 1168.

37. See, e.g., Sheppard Mullin Richter & Hampton LLP, *Delaware Chancery Court Denies Advancement Claim Brought by Former Director Where Subsequent By-Law Amendment Retroactively Limited Advancement Rights of Former Directors*, CORP. & SEC. L. BLOG, (Sept. 2, 2008), <http://www.corporatesecuritieslawblog.com/148291-print.html> ("Before *Schoon*, it was commonly understood that rights to advancement and indemnification could not be unilaterally terminated by a director's corporation. Now, however, directors can be held liable for all expenses relating to their official actions if litigation arises after they resign from the board."); Steven H. Goldberg & Michael B. Jacobson, Keeping Current: Director Indemnification, 18 Bus. L. Today, no. 2, Nov.-Dec. 2008, available at <http://www.abanet.org/buslaw/blt/2008-11-12/keepingcurrent-1.shtml> ("A recent Delaware Chancery Court decision has arguably significantly eroded the protection of fee advancement and indemnification rights provided to directors in company bylaws. The decision in *Schoon v. Troy Corp.*, 948 A.2d 1157 (2008), opens the door for companies to terminate unilaterally such rights afforded to corporate directors.").

38. DEL. CODE ANN. tit. 8, § 145(e).

39. *Schoon*, 948 A.2d at 1165.



Subsequently, the Delaware General Assembly amended Section 145(f) to provide:

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 expenses 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.<sup>40</sup>

Thus, the statute, as amended, preserves drafting flexibility that can accomplish “elimination or impairment” of advancement and indemnification rights after the occurrence of the challenged act or omission. But, in the absence of such a contractual provision, such an attempt to abrogate or narrow advancement and indemnification rights will be a legal nullity. In addition, presumably the “vesting” of those rights need not await the assertion of a claim in the underlying proceeding but instead will occur when the position is assumed.

### ***B. Xu Hong Bin v. Heckmann Corp.***

The second decision of note is *Xu Hong Bin v. Heckmann Corp.*<sup>41</sup> There, in a “letter” decision, the form of which may understate the significance of the ruling, the Court of Chancery held that the defendant corporation may place reasonable terms and conditions on the plaintiff former director of the corporation.<sup>42</sup> The court concluded that the corporation was entitled to impose the terms and conditions on advancement where, notwithstanding an unqualified right in the corporate charter to receive advancement, simultaneously-executed bylaws provided, “Such expenses (including attorneys’ fees) incurred by former directors and officers or other employees and agents may be so paid upon such terms and conditions, if any, as the Corporation deems appropriate.”<sup>43</sup>

The court found that there was “nothing inherently contradictory” between the charter provisions and the bylaw provisions, at least where the provisions had been drafted at the same time and the drafters could be assumed not to “intend for these two documents to conflict.”<sup>44</sup> Accordingly, the court concluded that the bylaw provision was not invalid under Section 109(b) of the DGCL (which provides that a bylaw provision “may contain any provision, not inconsistent with law or with the certificate of incorporation.”)<sup>45</sup> Relatedly, the court rejected the plaintiff’s argument that “the preservation of a right to place conditions on advancement must be made in the same instrument that creates the advancement rights.”<sup>46</sup> By footnote, the court added:

---

40. AN ACT TO AMEND TITLE 8 OF THE DELAWARE CODE RELATING TO THE GENERAL CORPORATION LAW, 77 DEL. LAWS, c. 14 § 3 (2009) (amending DEL. CODE ANN. tit. 8, § 145(f) by adding the above-quoted sentence to the end of the subsection).

41. *Xu Hong Bin v. Heckmann Corp.*, C.A. No. 4802-CC, 2010 Del. Ch. LEXIS 3 (Del. Ch. Jan. 8, 2010).

42. *Id.* at \*1.

43. *Id.* at \*11.

44. *Id.* at \*14.

45. *Id.* at \*11-12 & n.15 (quoting DEL. CODE ANN. tit. 8, § 109(b)).

46. *Id.* at \*11-12.

Had Section 6 of the bylaws been enacted at some point subsequent to the execution of the articles my opinion on this matter might have been different. I decline a foray into that question today because it involves a different circumstance than the one at issue. Today I focus only on circumstances such as this where the articles and bylaws were executed simultaneously.<sup>47</sup>

While the court acknowledged “the articles would have been better drafted if they included some language in Article Ninth [of the charter] that pointed the reader to the bylaws for further information that advancement and indemnification rights,” it declined to adopt a cross-referencing rule.<sup>48</sup> The court also seemed to suggest that the plaintiff had the opportunity either to have declined the directorship or to have negotiated for greater advancement protection before he agreed to become a director:

Second, both the articles and the bylaws were in effect when Xu began his directorship. Thus, Xu had every opportunity to read the articles and bylaws and become fully informed regarding the scope of his indemnification and advancement rights before agreeing to serve as a director. I must proceed on the assumption that directors of Delaware corporations read the articles and bylaws before joining the board, particularly those provisions that relate to indemnification and advancement rights.<sup>49</sup>

The court left for another day “the reasonableness of the terms and conditions that have already been demanded by Heckmann.”<sup>50</sup>

#### IV. TWO IMPORTANT COROLLARIES

There are two important corollaries to keep in mind as drafting considerations in the advancement context. The first is that ambiguities in advancement provisions generally will be construed against the business entity that drafted the provisions.<sup>51</sup> The practical impact is that parol evidence may not be considered; instead, the court may well look only to the words of the governing document to determine the reasonable expectations of the advancement claimant.<sup>52</sup> The second corollary is that the advancement *claimant* also should be clear in making a demand for advancement, ensuring that the demand refers to advancement rather than indemnification, refers to a specific amount, provides support for the amount

---

47. *Id.* at \*14 n.21.

48. *Id.* at \*14-15.

49. *Id.* at \*15-16.

50. *Id.* at \*1.

51. *Paolino*, 985 A.2d at 402 (citing *Thompson v. Williams Cos.*, C.A. No. 2716-VCS, 2007 WL 2215953, at \*3 (Del. Ch. July 31, 2007); *Greco v. Columbia HCA Healthcare Corp.*, C.A. No. 16801, 1999 WL 1261446, at \*13 (Del. Ch. Feb. 12, 1999)); *see also* *Stockman v. Heartland Indus. Partners, L.P.*, C.A. No. 4427-VCS, 2009 Del. Ch. LEXIS 131, at \*3 (Del. Ch. July 14, 2009) (“Moreover, to the extent there is any ambiguity in the Partnership Agreement regarding advancement, that ambiguity must be resolved against [the limited partnership].”).

52. *Stockman*, 2009 Del. Ch. LEXIS, at \*18-19.

requested, and includes an undertaking if required.<sup>53</sup> Such attention to careful drafting not only will demonstrate the adequacy and ripeness of the advancement claim, it also will lay the groundwork for a later award of prejudgment interest.<sup>54</sup>

## V. CONCLUSION

Business entities and their managers have an opportunity under Delaware law to exercise drafting flexibility in connection with advancement and indemnification so long as they do so before a dispute arises. Failure to avail themselves of this opportunity can result in costly remorse.

---

53. *Paolino*, 985 A.2d at 395.

54. *Citadel Holding Corp. v. Roven*, 603 A.2d 818, 826 n.9 (Del. 1992) (awarding “interest computed from the date of demand,” meaning “the date when Roven specified the amount of reimbursement demanded and produced his written promise to pay”); *Katzman v. Comprehensive Care Corp.*, C.A. No. 5892-VCL (Del. Ch. Dec. 28, 2010) (Transcript) at 22, 29 (prejudgment interest on advancement amounts to run from date of submission of invoices certified to include “expenses reasonably incurred for purposes of advancements”).



## CRIMINAL LAW: 2010 DELAWARE SUPREME COURT DECISIONS

Michael F. McTaggart\*

This article reviews and summarizes some of the forty-three criminal law opinions issued by the Delaware Supreme Court in 2010. This article addresses the court's search and seizure decisions, trial evidentiary decisions, and decisions of significance or issues of first impression.

### I. TRIAL EVIDENCE DECISIONS

#### A. Section 3507 Statements—*Blake v. State, Stevens v. State, Woodlin v. State*

In a trilogy of cases that were consolidated for *en banc* oral argument and decided on the same day, the Court addressed “recurring problems with regard to the admission of evidence under 11 *Del. C.* § 3507 (“Section 3507”).

##### 1. *Stevens v. State*

In *Stevens v. State*,<sup>1</sup> the defendant argued that the State improperly admitted irrelevant evidence from the testifying detective regarding his opinion that Stevens was involved in other robberies and his opinion about the credibility of the State's key witnesses. The DVD evidence was presented as part of a Section 3507 statement of the police interrogation of the juvenile co-defendant, Boyd.<sup>2</sup>

Stevens and his co-defendant were arrested for a robbery at the China King restaurant in Dover on August 14, 2008. Boyd was arrested on August 22, 2008, and he gave a statement to the Dover Police. In the recorded statement, he told the police where he and Stevens had left a cash register drawer from the restaurant. At trial, the statement was admitted as Section 3507 evidence. The recorded Section 3507 statement contained police questioning of Boyd, during which the police officer stated his belief that the two suspects were involved in other crimes.<sup>3</sup> When this part of the statement was played at trial, Stevens' defense counsel objected on the ground of relevance. After a sidebar at which the prosecutor represented that a later reference to a gun and drugs in the suspects' vehicle had been redacted, defense counsel withdrew his objection and indicated that a curative jury instruction would not be necessary.<sup>4</sup>

The court first noted that, under Section 3507, it is only “the voluntary out-of-court statement of a witness who is present and subject to cross-examination” that is admissible.<sup>5</sup> The portions of the Section 3507 statements that contain

---

\* Mr. McTaggart is a Deputy Attorney General in the Delaware Department of Justice.

1. 3 A.3d 1070 (Del. 2010).

2. *Id.* at 1071.

3. *Id.* at 1071-72, 1075.

4. *Id.* at 1075.

5. *Id.* at 1072 (quoting *Morgan v. State*, 922 A.2d 395, 399 (Del. 2007) (quoting 11 *Del. C.* § 3507)).

both witness statements and inadmissible third party statements are required to be redacted.<sup>6</sup> The court further noted that the best practice for admission of a Section 3507 statement is to present the statement in writing or by audio recording.<sup>7</sup>

The court declared that “at some reasonable time before trial, the State must provide defense counsel with the entire recorded exchange between a witness and a third party, together with a copy of its proposed redacted version of that recording that it intends to introduce under section 3507.”<sup>8</sup> In the event that parties cannot reach an agreement regarding redactions, the court stated that the issue should be presented to the trial court in a motion *in limine*.<sup>9</sup> The court held that “any substantive comments of a third party embedded in a section 3507 statement are inadmissible under section 3507 because they are not prior statements of the witness.”<sup>10</sup>

The court noted that Stevens’ trial counsel had decided not to move for a mistrial when the portion of the Section 3507 statement referring to other crimes was played and had declined the trial court’s offer of a curative jury instruction.<sup>11</sup> The court held that the decisions of Stevens’ counsel precluded plain error review. The court found that the police officer’s reference to other crimes was inadmissible and should have been redacted *sua sponte* by the State.<sup>12</sup> The court affirmed the judgment of the Superior Court.

## 2. Woodlin v. State

In *Woodlin v. State*,<sup>13</sup> the defendant was convicted of rape in the first degree and related charges for crimes committed against his seven year old daughter. The defendant and his wife were also charged with engaging in sex acts in front of their daughter. The daughter had disclosed the crimes while living with her aunt during a temporary stay. The aunt took the victim to the Child Advocacy Center (“CAC”) in Kent County, and she gave a recorded statement. At her father’s trial, the defendant’s daughter was called as a witness. She admitted to speaking to the CAC forensic interviewer about her father “[b]ecause he did something wrong to me.” She refused to describe what her father did “[b]ecause it’s nasty.” The taped statement was played at the conclusion of the daughter’s testimony. There was no cross-examination.<sup>14</sup>

Prior to trial, defense counsel had moved *in limine* for the exclusion of the taped statement on the ground that the statement was involuntary due to impermissible questioning by the forensic interviewer. The trial court ruled that the

---

6. *Id.* at 1073.

7. *Id.* at 1073 (citing *Morgan*, 922 A.2d at 399).

8. *Id.* at 1073-74.

9. *Id.* at 1074.

10. *Id.* The court also noted that “any alleged technical or contextual difficulties for the State in redacting inadmissible third-party comments are not relevant factors to be considered.” *Id.* (citing *Miles v. State*, No. 257, 2009, 2009 WL 4114385 (Del. Nov. 23, 2009)).

11. *Id.* at 1077.

12. *Id.* The court cited to *Miller v. State*, 893 A.2d 937, 951 (Del. 2006), in which the prosecutor’s failure to redact a police reference to prior criminal acts was not made an issue until the videotape was played at trial. The court in *Miller* held that the admission of such evidence “created the risk that the defendant’s conviction would be overturned and, since its admissibility was so clear, result[] in an unnecessary expenditure of judicial, prosecutorial and defense resources.” *Id.* (citing *Miller*, 893 A.2d at 951-52). The court concluded the opinion by stating that “[n]evertheless, the same impropriety was repeated in Stevens’ case. With guidance provided by this opinion, it should not happen again.” *Id.*

13. 3 A.3d 1084 (Del. 2010).

14. *Id.* at 1084-85.

statement was voluntary, and that the witness testified that the events perceived were true. On appeal, Woodlin argued for the first time that the daughter's testimony did not touch upon the events described in the CAC interview, and that she did not affirm the truthfulness of the prior recorded statement. As this was a new argument raised on appeal, the court reviewed the issue for plain error.<sup>15</sup>

The court reviewed the procedure for admission of a Section 3507 statement set forth in *Keys v. State*,<sup>16</sup> decided five years after enactment of Section 3507. The *Keys* court held that “[i]n order to offer the out-of-court statement of a witness, the Statute requires the direct examination of the declarant by the party offering the statement, as to both the events perceived or heard and the out-of-court statement itself.”<sup>17</sup> The Section 3507 foundation requirements were expanded three weeks later, when the court, in *Hatcher v. State*,<sup>18</sup> ruled that the State must establish that the witness' statement was voluntary. Also, in *Johnson v. State*,<sup>19</sup> the court held that “a witness' statement may be introduced [under Section 3507] only if the two-part foundation [identified in *Keys*] is first established: [by having] the witness testif[y] about both events and whether or not they are true.”<sup>20</sup>

The court ratified and reaffirmed its earlier rulings in *Keys*, *Hatcher*, and *Johnson*.<sup>21</sup> Applying these principles in *Woodlin*, the court ruled that the victim did testify to remembering the interview with the CAC interviewer, and that she spoke about her father.<sup>22</sup> She also testified that she spoke to the interviewer because her father “did something wrong to me.” She also stated that no one forced her to talk to the CAC interviewer.<sup>23</sup> The court found no error in the trial court's ruling that the witness at least “implicitly” affirmed that her CAC statements were true and touched upon the events described in the CAC interview.<sup>24</sup> The court found that there was no plain error in the admission of the Section 3507 statement and affirmed the convictions.<sup>25</sup>

### 3. Blake v. State

In *Blake v. State*,<sup>26</sup> the court held that the trial court committed reversible error in admitting the prior statements of five witnesses under Section 3507 due to the lack of a proper foundation.<sup>27</sup>

---

15. *Id.* at 1085-87.

16. 337 A.2d 18 (Del. 1975).

17. *Id.* at 20 n.1.

18. 337 A.2d 30, 32 (Del. 1975).

19. 338 A.2d 124 (Del. 1975).

20. *Woodlin*, 3 A.3d at 1088.

21. *Id.* (citing *Smith v. State*, 669 A.2d 1, 7 (Del. 1995) (Section 3507 “requires not just the opportunity to cross-examine the declarant, but the opportunity to cross-examine the declarant about the out-of-court statement”).

22. *Id.* at 1088.

23. *Id.*

24. *Id.* at 1089.

25. *Id.*

26. 3 A.3d 1077 (Del. 2010).

27. *Id.* at 1079.

Blake was tried and convicted of murder in the first degree, attempted murder in the first degree, and related charges. He was convicted after a ten day jury trial and was sentenced to life on the murder charge and to various terms of incarceration on the other charges. The charges arose out of an early morning shooting in Dover on September 1, 2007. There had been a series of fights between a number of female residents around North New Street. At approximately 12:45 a.m., a police officer observed four cars that appeared to be headed to the New Street area. When one of the cars stopped, there was a series of gunshots from a vacant lot. One of the passengers in one car, Kenneth Riddick, was shot and killed. The police later found four spent shell casings in the vacant lot and a 9mm Ruger semi-automatic pistol. The bullet recovered from the victim was determined to have been fired from the Ruger pistol, as were all four shell casings. The police obtained statements from five occupants of the various vehicles, each of whom implicated the defendant as the shooter. There was no physical evidence tying the defendant to the shooting.<sup>28</sup>

The court considered the sufficiency of the foundation for the admission of the Section 3507 statements in light of its ruling in *Woodlin*. Again relying on *Keys v. State*,<sup>29</sup> the court stated that a Section 3507 statement may only be admitted “if the two-part foundation is first established: the witness testifies about both the events and whether or not they are true.”<sup>30</sup> The court also stated that the Sixth Amendment requires that the witness be subject to cross-examination regarding the content of the statement and its truthfulness.<sup>31</sup>

At Blake’s trial, the court found that the direct examination of the five Section 3507 witnesses was inadequate.<sup>32</sup> With respect to three of the witnesses, the State conceded that the Section 3507 foundation was insufficient.<sup>33</sup> Regarding the other two witnesses, the State asserted that there was confusion as to whether a witness must testify to the truthfulness of a Section 3507 statement. The court found that it was clear, under both *Johnson v. State*<sup>34</sup> and *Ray v. State*,<sup>35</sup> that the witness must testify “whether or not” the prior statement is true.<sup>36</sup> The court’s decision in *Moore v. State*<sup>37</sup> similarly held that, under *Ray*, the witness must testify about the events of the incident and “whether or not they are true.”<sup>38</sup> The court also stated that the foundational requirements of Section 3507 must be met in order to comply with the Sixth Amendment’s requirements for the admission of the statement as substantive evidence.<sup>39</sup> In Blake’s trial, the court concluded that none of the Section 3507 witnesses was asked if his prior statement was true, and the statements were, therefore, improperly

---

28. *Id.* at 1079-80.

29. 337 A.2d 18 (Del. 1975).

30. *Id.* at 20 n.1 (emphasis added).

31. *Blake*, 3 A.3d at 1081 (quoting *Keys*, 337 A.2d at 20 n.1).

32. *Id.*

33. *Id.*

34. 338 A.2d 124 (Del. 1975).

35. 587 A.2d 439 (Del. 1991).

36. *Blake*, 3 A.3d at 1082 (quoting *Johnson*, 338 A.2d at 127).

37. No. 63, 1994, 1995 WL 67104 (Del. Feb. 17, 1995).

38. *Id.* at \*2.

39. *Blake*, 3 A.3d at 1082-83 (citing *Ray*, 587 A.2d 443; *Johnson*, 338 A.2d at 127, 128).



admitted into evidence.<sup>40</sup> The court further ruled that the error was not harmless because there was no physical evidence presented at trial and because the five witness statements were the only evidence linking the defendant to the crimes.<sup>41</sup> The court reversed the judgments and remanded the case to the Superior Court.<sup>42</sup>

### B. Excited Utterances Hearsay Exception—*Dixon v. State*

In *Dixon v. State*,<sup>43</sup> the court held that a witness' 911 call about the defendant's crimes was admissible as an excited utterance, and that the admission of the evidence did not violate the Confrontation Clause of the Sixth Amendment.<sup>44</sup>

Dixon was charged with a shooting that occurred at 24th and Lamotte Streets, in Wilmington, at 2:00 a.m. on March 28, 2008. Dixon shot the victim in the leg; the victim staggered home and was transported to Wilmington Hospital. The 911 center received a call shortly after the shooting, but the individual hung up before speaking. The 911 dispatcher was able to return the call after two unsuccessful attempts, whereupon the witness described the shooting and identified the shooter by his first name. At trial, the State admitted the 911 call into evidence as an excited utterance. The 911 caller did not appear as a witness at trial. Dixon challenged the ruling on appeal.<sup>45</sup>

The court first reviewed the three foundation requirements for the admission of an excited utterance under Rule 803(b)(2):

- (1) the excitement of the declarant must have been precipitated by an event; (2) the statement being offered as evidence must have been made during the time period while the excitement of the event was continuing; and (3) the statement must be related to the startling event.<sup>46</sup>

The court explained that the amount of time between the event and the statement is not determinative; it is a factor.<sup>47</sup> The court stated that, in order to admit a statement as an excited utterance, the declarant need only be "under the 'stress of excitement' caused by the startling event or condition at the time of the statement's making."<sup>48</sup> Dixon's 911 call was made only fifteen minutes after the shooting. The trial court found that the caller sounded excited and upset during the 911 call. The court therefore found that all of the elements of an excited utterance were present, and that the statement was properly admitted under Rule 803(2).<sup>49</sup>

---

40. *Id.* at 1083.

41. *Id.*

42. *Id.*

43. 996 A.2d 1271 (Del. 2010).

44. *Id.* at 1273.

45. *Id.* at 1273-75.

46. *Id.* at 1276 (citing D.R.E. 803(2)).

47. *Id.* at 1276 (citing *Warren v. State*, 774 A.2d 246, 253 (Del. 2001); D.R.E. 803(1)).

48. *Id.* (quoting *Culp v. State*, 766 A.2d 486, 490 (Del. 2001)).

49. *Id.* at 1276-77.

The court also found that the admission of the 911 call as an excited utterance did not violate the Sixth Amendment Confrontation Clause.<sup>50</sup> The court noted that *Crawford v. Washington*<sup>51</sup> barred the admission of testimonial statements of witnesses who do not appear for trial and are not subject to cross-examination by the defense.<sup>52</sup> In considering the Sixth Amendment question, the *Dixon* court relied on *Davis v. Washington*,<sup>53</sup> which also considered the admissibility of a reverse 911 call that identified the perpetrator of an alleged crime. The *Davis* Court held that a 911 call was not testimonial in nature and was “ordinarily not designed primarily to ‘establis[h] or prov[e]’ some past fact, but to describe current circumstances requiring police assistance.”<sup>54</sup> The court found the facts in *Dixon* to resemble closely the facts in *Davis*: the 911 callers were describing an event actually happening; the callers were asking for help against a legitimate physical threat; and the callers were describing a present emergency while in an unsafe setting.<sup>55</sup> The court concluded that “the circumstances of the 911 caller’s interrogation ‘objectively indicate[d] its primary purpose was to enable police assistance to meet an ongoing emergency. [The 911 caller] simply was not acting as a *witness*; she was not *testifying*. What she said was not ‘a weaker substitute for live testimony’ at trial.”<sup>56</sup>

### C. Admission of Police Photographs—*McNair v. State*

In *McNair v. State*,<sup>57</sup> the court held that the admission of a prior photo of the defendant that was displayed in the office of a business was admissible and did not constitute evidence of prior bad acts.<sup>58</sup>

Defendant McNair was observed going through the passenger side of a car in a Wilmington parking garage. A garage security officer saw McNair move from the front to the back of the car, and he recognized McNair from a photo posted in the garage office. The security officer observed broken glass and items that were scattered around the car and the garage floor. McNair claimed someone had broken into his car, but he refused to file a report. McNair fled before ad-

---

50. *Id.* at 1279.

51. 541 U.S. 36 (2004).

52. *Id.* at 53-54.

53. 547 U.S. 813 (2006).

54. *Id.* at 827. The *Davis* Court also drew a precise determination of which police interrogations produce testimony in ruling:

Statements are nontestimonial when made in the course of police interrogation under circumstances objectively indicating that the primary purpose of the interrogation is to enable police assistance to meet an ongoing emergency. They are testimonial when the circumstances objectively indicate that there is no such ongoing emergency, and that the primary purpose of the interrogation is to establish or prove past events potentially relevant to later criminal prosecutions.

*Id.* at 822.

55. *Dixon*, 996 A.2d at 1278-79 (citing *Davis*, 547 U.S. at 827).

56. *Id.* at 1279 (quoting *Davis*, 547 U.S. at 828 (quoting *United States v. Inadi*, 475 U.S. 387 (1986))).

57. 990 A.2d 398 (Del. 2010).

58. *Id.* at 402.

ditional security could arrive. A police officer who responded to the scene obtained the garage surveillance tape, but the tape was of poor quality and did not show the crime.<sup>59</sup>

McNair was arrested and tried on charges of third degree burglary, theft, offensive touching, and criminal mischief. At trial, McNair was convicted on all charges, and he appealed the evidentiary rulings by the trial court.<sup>60</sup>

On appeal, McNair first argued that the photo and testimony about the photo should have been excluded from the trial. The trial court had ruled that the photo was admissible but had ordered that the photo be cropped to remove any writing that suggested prior criminal acts by McNair. The trial court also ruled that the security officer could testify that he had seen the photo several times, but the court precluded the officer from testifying as to where he had seen it.<sup>61</sup> During the trial, the security officer had testified that he saw McNair's photo every day at work. The trial court gave a curative instruction in response to this testimony.

The Supreme Court rejected McNair's argument that admission of the photograph required a full *Getz* analysis. The court reasoned that McNair's picture did not implicate D.R.E. 404(b) or *Getz* because the evidence did not relate to prior bad acts.<sup>62</sup> The State did not offer evidence as to why McNair's photo was posted in the garage, nor did it offer any testimony suggesting prior misconduct by McNair. The court also found that the trial judge had taken several steps, in an abundance of caution, to prevent the jury from inferring from the photo that McNair had committed prior crimes.<sup>63</sup>

The court ruled that the admission of a police photograph is subject to three prerequisites: "(1) the prosecution must show a demonstrable need to introduce the photographs; and (2) the photographs, if shown to the jury, must not imply that the defendant has a prior criminal record; and (3) the introduction at trial [must] not draw particular attention to the source or implications of the photographs."<sup>64</sup> The court found that the State had met all three requirements, as the photo touched on a central issue; the trial court had ordered the photo cropped; and the trial court had placed limitations on the testimony about the photo. The court also ruled that any error in the testimony of the security officer about viewing the photo on a daily basis was cured by the trial court's prompt instruction.<sup>65</sup>

McNair also argued that the trial court erred in declining to give a *Lolly* instruction regarding the surveillance tape. The Supreme Court disagreed and held that a *Lolly* instruction was not required because there was no basis to conclude that the State had failed to gather or preserve material evidence.<sup>66</sup> Instead, the court explained, the trial court correctly found that the surveillance tape had no evidentiary value because the State's witnesses testified that the tape was blurry.

---

59. *Id.* at 399-400.

60. *Id.* at 400.

61. *Id.*

62. *Id.* at 402 (citing *Howard v. State*, 704 A.2d 278, 281 (Del. 1998)).

63. *Id.* at 402.

64. *Id.* (quoting *Brookins v. State*, 354 A.2d 422, 422-23 (Del. 1976) (citing *United States v. Harrington*, 490 F.2d 487 (2d Cir. 1973)).

65. *Id.* at 402-03.

66. *Id.* at 403 (citing *Lolly v. State*, 611 A.2d 956, 961 (Del. 1992)).

## II. SEARCH AND SEIZURE DECISIONS

### A. Community Caretaker Doctrine—*Moore v. State*

In *Moore v. State*,<sup>67</sup> the court held that a police officer's stop of two persons walking away from an area where gunshots and a stabbing had been reported, and where one of the individuals appeared to be holding his side as if he had been stabbed, was reasonable under the community caretaker doctrine.<sup>68</sup>

On June 18, 2008, at 11:15 p.m., the police received reports about a large group of disorderly black males near a townhouse development. At 11:25 p.m., RECOM<sup>69</sup> received a report that one person in the group had been stabbed and had fled the area. One minute later, there was a police broadcast of shots fired near the location. A number of police officers responded to the area. Upon approach, one officer observed two black males walking 1,000 feet away from the intersection where the shots had been reported. One of the men had his hands at his waist and appeared to be possibly protecting his abdomen. This individual was also observed fidgeting around his waist. The other man had his hands in his pockets. The officer believed the first individual may have been the stabbing victim who was leaving the area of the disorderly crowd. The officer first drove past the two men; then she activated her lights and drove up to them. The police officer conducted a pedestrian stop. The officer asked both men to show their hands and then patted them down. During the pat down of defendant Moore, the police officer felt an object that was discovered to be an ammunition magazine to a .380 caliber pistol. Moore was handcuffed. As he sat on the roadway, a .380 caliber pistol fell out of Moore's pants.<sup>70</sup>

Moore appealed from the trial court's denial of his suppression motion and conviction after a bench trial. The Supreme Court first considered the question of when the stop occurred.<sup>71</sup> The court found that the actions of the police officer in driving her car around in the middle of the street, flashing her lights, pulling up in front of Moore and his companion and asking them to show their hands constituted a seizure.<sup>72</sup> Relying on *Quarles v. State*,<sup>73</sup> the court ruled that a reasonable person in Moore's position would not have believed he could ignore the police presence.<sup>74</sup>

The court next declared that the police officer's stop was reasonable under the community caretaker doctrine.<sup>75</sup> The police officer observed the defendant and his companion walking from the area at which gunshots and a stabbing had

---

67. 997 A.2d 656 (Del. 2010).

68. *Id.* at 655.

69. RECOM is the New Castle County Police Regional Communication Center. *Id.* at 659.

70. *Id.* at 658-63.

71. *Id.* at 664.

72. *Id.*

73. 696 A.2d 1334 (Del. 1997).

74. *Moore*, 997 A.2d at 664.

75. *Id.* at 664-65 (citing *Williams v. State*, 962 A.2d 210 (Del. 2008)). The court noted the three elements of the community caretaker doctrine:

First, if there are objective, specific and articulable facts from which an experienced officer would suspect that a citizen is in apparent peril, distress or need of assistance, *the police officer may stop and investigate* for the purpose

been reported. The officer saw one person put his hands near his abdomen, and the officer believed this person was possibly the stabbing victim. The court concluded that police had a sufficient basis to determine that Moore was in apparent peril, distress, or need of assistance and could stop Moore for that reason.<sup>76</sup> The court held that the initial stop was proper under the community caretaker doctrine and that the stop did not have to be supported by reasonable articulable suspicion.<sup>77</sup>

The court found that the community caretaker function concluded, however, once the officer illuminated the defendant with her car's headlights and saw that the defendant had his hands in his waistband and was not a stabbing victim.<sup>78</sup> The court held that the continued seizure of the defendant and his companion was supported, in part, by the fact that the police observed one person concealing his hands and the other fidgeting at his mid-section.<sup>79</sup> Thus, the court concluded, the officer had sufficient reason to pat down the defendant under the totality of the circumstances.<sup>80</sup> Once the officer found the ammunition magazine on Moore, she was entitled to seize the pistol that fell out of Moore's pocket and was in plain view.<sup>81</sup> The court therefore affirmed the judgments of the Superior Court.<sup>82</sup>

---

continued from page 38

of assisting the person. Second, if the citizen is in need of aid, then the officer may take appropriate action to render assistance or mitigate the peril. Third, once, however, the officer is assured that the citizen is not in peril or is no longer in need of assistance or that the peril has been mitigated, the caretaking function is over and any further detention constitutes an unreasonable seizure unless the officer has a warrant, or some exception to the warrant requirement applies, such as a reasonable, articulable suspicion of criminal activity.

*Id.* (quoting *Williams*, 962 A.2d at 219) (emphasis added).

76. *Id.* at 665.

77. *Id.* (citing *Williams*, 962 A.2d at 219).

78. *Id.*

79. *Id.* at 666 (citing *Terry v. Ohio*, 392 U.S. 1, 30 (1968)).

80. *Id.* at 667. The court detailed a number of factors that provided justification for the *Terry* patdown:

- (1) [the police officer] was in a high crime area that was the source of numerous complaints involving guns and drugs;
- (2) she was responding to citizen complaints about a large group of disorderly men;
- (3) within a few minutes of her first contact with [Moore] a person allegedly was stabbed and fled the scene;
- (4) within a few minutes of her first contact with [Moore] another police officer reported hearing multiple gun shots;
- (5) [Moore] and his companion were the first pedestrians she observed near the scene of the reported gunfire;
- (6) [the police officer] observed [Moore] and his companion approximately 1000 feet away from Cathy Court only a few minutes after the report of shots fired;
- (7) she saw that one of the men had his hands in his pockets and the other [Moore] was fidgeting with something in his waistband; and
- (8) [the police officer's] training and experience alerted her that the waistband area is a common place to conceal weapons.

*Id.*

81. *Id.* at 668.

82. *Id.*

### B. Reverse *Franks* Claim—*Rivera v. State*

In *Rivera v. State*,<sup>83</sup> the court held that exculpatory facts that police failed to insert into a search warrant application were immaterial under a reverse-*Franks* analysis and affirmed the trial court's denial of the defendant's suppression motion.<sup>84</sup>

Defendant Rivera was convicted at trial on the charge of murder first degree for the killing of Christine Pate. Pate's body had been found in the Leipsic River on October 8, 2007. The victim's mud-covered body was located about ten miles from her home in Pinewood Acres in Dover. She was living with her friend Deanna Hall, who had previously lived in the house with the defendant, then Hall's husband. The medical examiner determined that the cause of death was asphyxiation due to drowning, complicated by multiple blunt force trauma to the head. The medical examiner's report identified significant bruising on the victim's right side of her face, a number of damaged teeth, and a hemorrhage covering the right side of her head.<sup>85</sup>

During the police investigation, Pate's boyfriend stated that he had last seen Pate on the night before her body was discovered, after the two had returned from a weekend at the beach. He also advised that the defendant had made sexual advances toward the victim. One of Pate's neighbors told the police that he awoke on October 7<sup>th</sup>, around 1:00 a.m., to the sound of loud banging and saw a man carrying a small woman in a bear hug out of Hall's trailer. This neighbor could not identify Rivera from a photo lineup, but he stated that he believed the man he saw was Rivera.<sup>86</sup>

The police interviewed the defendant at his home. Rivera had a 1997 Grand Am at the residence, which he insisted was his car. The police confirmed that the car was registered to Hall. The police also observed several fresh lacerations on the defendant's left hand. A search of the victim's trailer uncovered blood spots, part of a tooth, and hair clumps on the trailer steps. A DNA analysis matched the blood spots to the victim. Police believed that the victim struggled with the assailant and did not die from her head wounds.

The police obtained a warrant to search Rivera's car on October 11, 2007. The search revealed dirt and mud on the passenger side of the vehicle, along with blood samples matching the victim's DNA profile. Rivera was arrested on the charge of murder first degree.<sup>87</sup>

At trial, the defendant sought to introduce expert testimony that he suffered from parasomnias at the time of the killing. The defense expert, Dr. Mark, reviewed a Christiana Hospital sleep study of the defendant that did not reveal any sleep terror episodes. Nevertheless, Dr. Mark formed an opinion that the defendant was suffering from sleep terrors based on statements from witnesses who lived near Rivera, Rivera's cellmate and Rivera's ex-wife, and from Rivera's own statement. The trial court ruled that Dr. Mark, who had never examined the defendant, could not testify about whether the defendant was suffering a sleep terror at the time of the killing.<sup>88</sup>

On appeal, the Supreme Court first reviewed the trial court's denial of the motion to suppress the fruits of the search warrant. Rivera claimed, under *Franks v. Delaware*,<sup>89</sup> that the police recklessly omitted several exculpatory facts

---

83. 7 A.3d 961 (Del. 2010).

84. *Id.* at 969-71.

85. *Id.* at 964.

86. *Id.*

87. *Id.* at 965.

88. *Id.* at 966.

89. 438 U.S. 154 (1978).

from the affidavit in the search warrant for the vehicle. Specifically, the defendant asserted that the police should have included the following facts: (1) the neighbor saw two men drag the female body out of the trailer; (2) the neighbor was unable to identify Rivera in a photo lineup; (3) the statement from the victim's boyfriend about Rivera's sexual advances toward the victim referred to conduct that had occurred months prior; and (4) the victim's boyfriend was the last person seen with the victim mere hours before her death.<sup>90</sup> The court described the claim as a "reverse-*Franks* situation," which required the defendant to show by a preponderance of the evidence that the police knowingly and intentionally, or with reckless disregard for the truth, omitted material information from the search warrant affidavit.<sup>91</sup> The court adopted a Third Circuit, two-part test for the analysis: first, whether the omissions were made with reckless disregard, and second, whether the omissions were material or necessary to establish probable cause.<sup>92</sup> Rather than employ the sequential two-step approach of the Third Circuit, however, the court declared that there was no meaningful difference between the information that a magistrate would want to know under the first prong and information that would be material under the second prong.<sup>93</sup>

The court did not find that the omitted facts cited by the defendant undermined the finding of probable cause.<sup>94</sup> The police did not rely solely on the neighbor's statement to procure the warrant and, instead, swore to multiple independent facts to support the probable cause finding.<sup>95</sup> The court did find that the case presented a "close call" and warned that "a police officer cannot make unilateral decisions about the materiality of information, or, after satisfying him or herself that probable cause exists, merely inform the magistrate or judge of inculpatory evidence."<sup>96</sup>

The court also ruled that the trial judge did not err in restricting the testimony of the defense expert at trial. The trial court allowed the expert to testify about the defendant's history of sleep terrors but not on the issue of whether the defendant suffered from a sleep terror on the night of the killing. The medical evidence was that the defendant did not suffer any sleep terrors during a sleep study, and the defendant was never examined by the expert. Dr. Mark based

90. *Rivera*, 7 A.3d at 968.

91. *Id.* (citing *Sisson v. State*, 903 A.2d 288, 300 (Del. 2006) (quoting *Smith v. State*, 887 A.2d 470, 472 (Del. 2005)); *Blount v. State*, 511 A.2d 1030, 1034 (Del. 1986) ("Although the *Franks* decision dealt with misstatements included in probable cause affidavits, the Superior Court ... and several other courts have concluded that the *Franks* rationale is also to be applied to omissions of facts which are material to a finding of probable cause.")).

92. *Id.* at 969 (citing *Reddy v. Evanson*, 615 F.3d 197, 213 (3d Cir. 2010); *Wilson v. Russo*, 212 F.3d 781, 783, 787-88 (3d Cir. 2000)).

93. *Id.* (citing *United States v. Eberle*, 266 Fed. App'x 200, 204-06 (3d Cir. 2008); *Reddy*, 615 F.2d 213; *Wilson*, 212 F.3d at 789).

94. *Id.* at 970.

95. *Id.* The court noted the following "multiple independent facts" contained in the search warrant affidavit:

Rivera being left-handed and the injuries to his left hand, Pate's injuries to her right side that were consistent with an attack by a left-handed person, evidence of a struggle at Pinewood Acres, the distance from Pate's Pinewood Acres trailer to where her body was recovered, and Rivera's possession of Hall's car ... [were] facts ... sufficient to establish a fair probability that police would recover evidence of the crime during a search of the Grand Am, because Pate's attacker most likely used a vehicle to move her body from Pinewood Acres to the river.

*Id.* at 969.

96. *Id.* at 970 (citing *Illinois v. Gates*, 462 U.S. 213, 285 n.6 (1983) (Brennan, J., dissenting); *Franks v. Delaware*, 438 U.S. 154, 163-64 (1978)).

his opinion solely on the statements of lay witnesses, including the defendant, none of whom were medical experts.<sup>97</sup> The methodology was not of the type “reasonably relied upon by experts in the field.”<sup>98</sup> Dr. Mark was also permitted to testify as to the defendant’s version of events, namely, that he woke from a sleep terror episode believing that the victim was already dead, panicked when he realized that he had attacked the victim, and then dumped her body to conceal his actions.<sup>99</sup> The court found no error in the rulings of the Superior Court and affirmed the judgment.

### C. Probable Cause To Arrest For DUI—*Miller v. State*

In *Miller v. State*,<sup>100</sup> the court held that a police officer possessed probable cause to arrest a suspect for DUI based on the defendant’s odor of alcohol, her failed performance tests, her glassy watery eyes, and her admission of drinking two beers within two hours of her accident with another vehicle stopped at a red light.<sup>101</sup>

Miller was arrested by police for DUI and following too closely after she collided with the rear of a vehicle that was stopped at a red light. The investigating officer detected a strong odor of alcohol from Miller, who had glassy, watery eyes. Miller admitted to drinking two beers approximately two hours earlier. Miller subsequently failed a series of field tests, as well as the horizontal gaze nystagmus (“HGN”) test and a portable breath test (“PBT”). After failing the field tests, Miller began to cry to the officer and stated that she had multiple previous DUI convictions. Miller was arrested and later failed a blood alcohol test. The trial court denied the defendant’s motion to suppress the arrest or the results of the blood alcohol test. Miller was convicted at trial and appealed the suppression ruling.<sup>102</sup>

The Supreme Court first ruled that the trial court should not have considered the results of the PBT in assessing probable cause. The State failed at trial to prove that the PBT was properly calibrated or that the officer was trained to administer the test.<sup>103</sup> The court also found that the police officer should not have been permitted to testify at trial about the results of the HGN test because the State did not establish a foundation that the officer was an expert in HGN testing and in its underlying principles.<sup>104</sup> Nevertheless, the court found that even absent the PBT and HGN tests, the police officer possessed probable cause based on the odor of alcohol from the defendant, her glassy, watery eyes, her failed walk-and-turn and one-legged standing tests, and her admission of consuming two beers within two hours of the stop.<sup>105</sup> The court affirmed the judgment of the Superior Court.

---

97. *Id.* at 971 (citing D.R.E. 702).

98. *Id.* at 972 (citing *Santiago v. State*, 510 A.2d 488, 490 (Del. 1986); D.R.E. 703).

99. *Id.* at 973.

100. 4 A.3d 371 (Del. 2010).

101. *Id.* at 374-75.

102. *Id.* at 372-73.

103. *Id.* at 374 (citing *State v. Clay*, No. IK01-10-0010, 2002 WL 1162300, at \*3 (Del. Super. May 28, 2002); *State v. Caputo*, Cr. A. Nos. 99-01-1310, 99-01-1311, 99-02-1312, 1999 WL 1847363, at \*2 (Del. Com. Pl. June 10, 1999)).

104. *Id.* (citing *Zimmerman v. State*, 693 A.2d 311, 314 (Del. 1997) (citing *State v. Ruthardt*, 680 A.2d 349, 351-52 (Del. Super. 1996)). The officer did testify about the principles of the HGN testing but did not testify about the NHSTA training manual or whether his testing complied with NHSTA standards.

105. *Id.* at 374-75 (citing *Bease v. State*, 884 A.2d 495 (Del. 2005); *State v. Maxwell*, 624 A.2d 926 (Del. 1993)).



### D. Probation Officers' Administrative Searches—*Pendleton v. State*

In *Pendleton v. State*,<sup>106</sup> the court upheld the admissibility of evidence obtained during an administrative search conducted by probation officers who substantially complied with departmental guidelines.<sup>107</sup>

On October 7, 2008, Probation Officer McClure and the Governor's Task Force conducted curfew checks in the Milford area. Defendant Pendleton was on probation, and the probation records showed that he had (i) tested positive for marijuana and cocaine on four prior screens, (ii) was a career criminal and (iii) missed a curfew on August 21, 2008. Officer McClure believed that Pendleton was a consistent drug user based on the positive drug tests and sought approval from his supervisor for an administrative search. Neither McClure nor his supervisor completed a pre-search checklist but, instead, analyzed the information available to probation officers. After obtaining approval, probation and police officers conducted the administrative search and seized crack cocaine.<sup>108</sup>

Pendleton's appeal challenged the probation officers' failure to comply with their departmental rules. The Supreme Court noted that, under 11 *Del. C.* § 4321(d), probation officers have authority to conduct warrantless searches, but that authority is predicated upon a showing of reasonable suspicion.<sup>109</sup> The court also stated that probation officers must substantially comply with their departmental regulations in order for any administrative search to be reasonable.<sup>110</sup> Pendleton claimed that the probation officers violated Delaware Department of Corrections Bureau of Community Corrections Probation and Parole Procedure No. 7.19, sections VI.A.6, VI.E. This regulation requires probation officers to conduct a case conference and complete a pre-search checklist.<sup>111</sup> The court found that the probation officers held a telephone conference and analyzed each of the five factors on the pre-search checklist. The court characterized Pendleton's argument, that the probation officers violated the regulation because they did not fill out the paper form, as an attempt to "elevate form over substance."<sup>112</sup> The court ruled that the search would not be invalidated based on a technical deficiency.<sup>113</sup> As a final note, the court stated:

All probation officers [are reminded] to pursue the rehabilitation of their probationers as fervently as they pursue compliance, curfew checks, spontaneous searches, and deterrence. Delaware law places the responsibility upon probation officers of reintegrating probationers into society by creating treatment plans to "alleviate [the] conditions which brought about the criminal behavior," "securing employment", and "us[ing] all suitable methods to aid and encourage them to bring about improvement in their conduct and conditions and to meet their probation or parole obligations." Any neglect of these important responsibilities only denigrates society's trust and confidence in the corrections system.<sup>114</sup>

---

106. 990 A.2d 417 (Del. 2010).

107. *Id.* at 418-19.

108. *Id.* at 419.

109. *Id.* at 419-20.

110. *Id.* (citing *Griffin v. Wisconsin*, 483 U.S. 868 (1987); *Fuller v. State*, 844 A.2d 290 (Del. 2004)).

111. *Id.* at 420.

112. *Id.*

113. *Id.* (citing *King v. State*, 984 A.2d 1205 (Del. 2009); *Culver v. State*, 956 A.2d 5 (Del. 2008); *Fuller*, 844 A.2d at 292).

114. *Id.* at 421 (quoting 11 *Del. C.* § 4321(b)(2)(3)).

### III. OTHER SIGNIFICANT CASES

#### A. Decision In *Allen v. State* Not Applied Retroactively—*Richardson v. State*

In *Richardson v. State*,<sup>115</sup> the court held that its prior decision in *Allen v. State*,<sup>116</sup> regarding accomplice liability under 11 Del. C. § 274, did not constitute a “new rule,” was “not implicit in the concept of ordered liberty” and would not be retroactively applied.<sup>117</sup>

Defendant Richardson was convicted in the Superior Court on charges of attempted murder first degree, robbery first degree, burglary first degree, conspiracy second degree, and four counts of possession of a firearm during the commission of a felony. The defendant appealed the Superior Court’s denial of his motion for postconviction relief. On appeal, Richardson sought a new trial on the ground that the trial court did not instruct the jury on the issue of Section 274 liability pursuant to the decision in *Allen*.<sup>118</sup>

Richardson and Steven Norwood burglarized a home in Elsmere in 2005, and located a set of keys to enter the house. Once inside the house, the two burglars stole the victim’s checkbook from the kitchen. Richardson went upstairs, which woke the resident of the house, who grabbed a loaded gun and shot and injured both intruders. Norwood and the homeowner exchanged gunfire in the dining room. The suspects then fled and were located a short distance from the house. Norwood died from his bullet wounds. The police found Richardson’s blood on the victim’s checkbook in the dining room of the house, along with a flashlight. In Richardson’s pants, the police found two sets of keys to the house, one set taken from the garage and one taken from the kitchen.<sup>119</sup>

Relying on *Allen*, Richardson claimed that he was entitled to a jury instruction that would require the jury to make an “individualized determination of the defendant’s mental state and culpability for any aggravating factor or circumstance.”<sup>120</sup> Richardson asserted that *Allen* set forth a new substantive rule regarding the applicability of Section 274 and must be applied retroactively.

115. 3 A.3d 233 (Del. 2010).

116. 970 A.2d 203 (Del. 2009).

117. *Richardson*, 3 A.3d at 240.

118. *Id.* at 235. At Richardson’s trial, the court instructed the jury as follows on state of mind:

If the only element of robbery first degree about which you have a reasonable doubt is whether it was reasonably foreseeable that Norwood would display a deadly weapon during the robbery, then you should find defendant guilty of the lesser included offense of robbery second degree.

In order to find defendant guilty of possession of a firearm during the commission of a felony, you must find that all the following elements have been established:

And three, defendant acted knowingly. Defendant acted knowingly if he was aware that he was committing a burglary with Steven Norwood and it was reasonably foreseeable that Norwood possessed a firearm or that Norwood, defendant, or both of them would possess a firearm during the felony.

*Id.* at 236.

119. *Id.*

120. *Id.* at 237 (citing *Allen*, 970 A.2d at 213; 11 Del. C. § 274).

The Supreme Court considered Richardson's argument in light of *Teague v. Lane*,<sup>121</sup> which "adopt[ed] a general rule of non-retroactivity for cases on collateral review."<sup>122</sup> The *Richardson* court noted the two exceptions to the *Teague* rule: first, "a new rule should be applied retroactively if it places 'certain kinds of primary, private individual conduct beyond the power of the criminal lawmaking authority to proscribe,'" and second, "a rule may apply retroactively if 'it requires the observance of those procedures that are implicit in the concept of ordered liberty.'"<sup>123</sup>

In regards to the first *Teague* exception, the *Richardson* court found that the decision in *Allen* did not declare a "new rule."<sup>124</sup> In *Allen*, the court agreed with the defendant's argument that under *Johnson v. State*,<sup>125</sup> "the jury is required to make an individualized determination regarding both his mental state and his culpability for any aggravating fact or circumstance."<sup>126</sup> The court concluded that *Allen* did not create a new rule but rather relied on the earlier decision in *Johnson*, and, therefore, the first *Teague* exception was inapplicable.<sup>127</sup>

To satisfy the second *Teague* exception, the court noted that the rule "must be necessary to prevent 'an impermissibly large risk' of an inaccurate conviction" and "the rule must 'alter our understanding of the bedrock procedural elements essential to the fairness of a proceeding.'"<sup>128</sup> The court noted that the United States Supreme Court has only retroactively applied one decision, namely, *Gideon v. Wainwright*.<sup>129</sup> The *Richardson* court determined that the retroactive application of *Allen* was not needed to prevent a large risk of inaccurate convictions, and the decision did not rise to the level of *Gideon*'s bedrock- altering nature.<sup>130</sup>

The court also stated that, under *Chao v. State*,<sup>131</sup> a new substantive decision will be given retroactive effect when the decision determines that the defendant was convicted of acts which are not criminal.<sup>132</sup> The decision in *Allen* did not alter the fact that Richardson's actions constituted crimes under the Delaware Code, and the court found the *Chao* ruling

---

121. 489 U.S. 288 (1989).

122. *Richardson*, 3 A.3d at 238 (citing *Flamer v. State*, 585 A.2d 736, 749 (Del. 1990)).

123. *Id.* (citing *Flamer*, 585 A.2d at 749 (quoting *Teague*, 489 U.S. at 311, 313)).

124. *Id.* at 238-39.

125. 711 A.2d 18 (Del. 1998).

126. 970 A.2d at 213.

127. 3 A.3d 238-39 (citing *Younger v. State*, 547 A.2d 948 (Del. 1988)).

128. *Id.* (citing *Whorton v. Bockting*, 549 U.S. 406 (2007) (quoting *Schriro v. Summerlin*, 542 U.S. 348 (2004))).

129. 372 U.S. 335 (1963). The *Richardson* court also noted that the United States Supreme Court held that the decision in *Crawford v. Washington*, 541 U.S. 36 (2004), on the Confrontation Clause was not a "watershed rule." *Richardson*, 3 A.3d at 239 (citing *Whorton*, 549 U.S. at 416).

130. *Richardson*, 3 A.3d at 239.

131. 931 A.2d 1000 (Del. 2007).

132. *Richardson*, 3 A.3d at 239-40.

inapplicable.<sup>133</sup> The court concluded that neither of the *Teague* exceptions applied and that the *Allen* decision would not be applied retroactively.<sup>134</sup>

### **B. Mandatory Sentencing Provision In Possession Of A Firearm By A Person Prohibited Statute—*Ross v. State***

In *Ross v. State*,<sup>135</sup> the court ruled that under the Possession of a Firearm During the Commission of a Felony statute, 11 *Del. C.* § 1448(e)(1)c, an offender is subject to the enhanced sentencing provision if convicted of two or more prior violent felonies, even if the convictions would not satisfy the definition of a predicate offense under the habitual offender statute.<sup>136</sup>

In 2008, Defendant Ross was present in a Dover townhouse at the time the police executed a search warrant. The police saw Ross holding a handgun and took Ross into custody. Ross had been convicted in 1993 for Possession with Intent to Deliver Cocaine. He was arrested for that offense on December 10, 1993, and he pled guilty on March 8, 1994. While awaiting sentencing, Ross was arrested, on April 25, 1994, on new drug charges. On May 13, 1994, Ross was sentenced on the 1993 drug charge. He received a sentence of thirty months at Level V suspended for one year at Level IV halfway house, and Level III supervision. Ross later pled guilty, on July 26, 1994, to the charge of Possession with Intent to Deliver Cocaine. He was sentenced on September 23, 1994. On the second drug charge, Ross received a sentence of five years incarceration, suspended after three years for eighteen months Level IV halfway house, followed by Level III probation.<sup>137</sup>

As a result of the 2008 arrest, Ross pled guilty to the charge of Possession of a Firearm by a Person Prohibited (“PFBPP”), Possession of Ammunition by a Person Prohibited and other drug offenses. With regard to the defendant’s sentence, the parties agreed that Ross was subject to the penalty provisions of 11 *Del. C.* § 1448(e)(1) because of his prior drug convictions. The State contended that Ross had “been convicted on 2 or more separate occasions of a violent felony” and was subject to the minimum five year sentence of incarceration under 11 *Del. C.* § 1448(e)(1)c. The defense contended that the sequencing of the convictions for the PFBPP statute was the same as required under the habitual offender statute, 11 *Del. C.* § 4214. The trial court adopted the position advanced by the State and sentenced Ross to the minimum five year sentence for a defendant with two or more violent felony convictions.<sup>138</sup>

Ross appealed the sentence to the Supreme Court. In reviewing the PFBPP statute, the court noted that Section 1448(e)(1)c requires a five year minimum prison term if the defendant “has been convicted on 2 or more separate occasions of a violent felony.”<sup>139</sup> The court found, under 11 *Del. C.* § 222(3), the word “conviction” is defined as “a verdict of

---

133. *Id.* at 240.

134. *Id.* The court also rejected the defendant’s claim of ineffective assistance of counsel based on trial counsel’s failure to present an alleged plea offer. *Id.* at 240-41. The court noted that the alleged failure of counsel to present a plea offer to the defendant does not constitute prejudice under *Strickland v. Washington*, 466 U.S. 668 (1984). *Richardson*, 3 A.3d at 241 (citing *Hill v. Lockhart*, 474 U.S. 52, 58 (1985)). The court also cited to the Superior Court’s findings that the defendant never claimed that he would have accepted a plea offer or that any such plea was ever actually made. *Id.*

135. 990 A.2d 424 (Del. 2010).

136. *Id.* at 431.

137. *Id.* at 426.

138. *Id.* at 425-27.

139. *Id.* at 429.

guilty by the trier of fact, whether judge or jury, or a plea of guilty or a plea of nolo contendere accepted by the court.”<sup>140</sup> The court declared that the definition of “conviction” in Section 222(3) contains the word “means” which limits the term to the definition contained in the statute.<sup>141</sup> The court therefore found that Section 1448(e)(1) was unambiguous.<sup>142</sup> In Ross’ case, the court ruled that he had two prior violent felony convictions and fell within the unambiguous terms of the minimum sentence provision in Section 1448(e)(1)c.

The defendant had argued that the habitual offender statute required “some period of time . . . between sentencing on the earlier conviction and the commission of the offense resulting in the later felony conviction.”<sup>143</sup> In *Hall v. State*,<sup>144</sup> the court had ruled that the habitual offender statute was unambiguous regarding the phrase “2 times convicted.” The *Hall* court had interpreted Section 4214(b) as “applying only to those offenders who have been twice convicted of the specified felonies in prior proceedings where the second conviction took place on account of an offense which occurred after sentencing had been imposed for the first offense.”<sup>145</sup> Similarly in *Buckingham v. State*,<sup>146</sup> in interpreting the phrase “3 times convicted” in Section 4214(a) the court held that “three separate convictions are required, each successive to the other, with some chance for rehabilitation after each sentencing. . . .”<sup>147</sup> The *Ross* court noted that a literal interpretation of “2 times convicted” or “3 times convicted” under the habitual offender statute would have led to an unreasonable result contrary to the purpose of the statute, namely, that “a defendant who was convicted for multiple felonies at one time [would receive] a life sentence without having distinct opportunities to reform. . . .”<sup>148</sup>

The court ruled that no such considerations applied to Ross’ sentence under the PFBPP statute. The PFBPP statute requires imposition of the enhanced sentence for a defendant with a prior felony, without mention of any opportunity for rehabilitation of the offender. The court also noted that, when the statute was amended in 1994, the synopsis of the bill provided that the legislature’s intent was to:

[H]elp protect society from armed crime committed by drug dealers and previously-convicted violent felons by increasing the punishment for their illegal possession of a firearm. . . . By making it a certainty

---

140. *Id.* (quoting 11 *Del. C.* § 222(3)).

141. *Id.* The court noted that in the Delaware Criminal Code, “when the word ‘means’ is employed in defining a word or term, the definition is limited to the meaning given.” *Id.* at n.15 (quoting 11 *Del. C.* § 221(a)).

142. The court cited prior precedent, which applied the definition of “conviction” in Section 222(3) “in its general and popular sense, that is, the establishment of guilt independent of judgment and sentence.” *Id.* at n.14 (citing *Lis v. State*, 327 A.2d 746, 748 (Del. 1974); *Pryor v. State*, 453 A.2d 98, 100 (Del. 1982)).

143. *Id.* at 427 (citing *Johnson v. Butler*, No. 423, 1994, 1995 WL 48368, at \*1 (Del. Jan. 30, 1995)).

144. 473 A.2d 352 (Del. 1984).

145. *Id.* at 356-57.

146. 482 A.2d 327 (Del. 1984).

147. *Id.* at 330.

148. *Ross*, 990 A.2d at 430-31 (citing *State v. Cooper*, 575 A.2d 1074, 1075 (Del. 1990) (“Literal or perceived interpretations, which yield illogical or absurd results, should be avoided in favor of interpretations which are consistent with the intent of the legislature.”)).

that they will be incarcerated if found to be in possession of a gun, the amendment seeks to deter violent criminals and drug dealers from carrying or possessing firearms.<sup>149</sup>

The court indicated that its literal interpretation of Section 1448(e)(1)c did not yield an unreasonable result and held that Ross was properly sentenced to the five year minimum sentence.<sup>150</sup>

### **C. Party Autonomy Rule Applies To Bench Trials; Party Must Make A Specific Request For Consideration Of Lesser-Included Offense — *Ramsey v. State***

In *Ramsey v. State*,<sup>151</sup> the court held that the “party autonomy” rule, which requires a party to request that a lesser-included offense be considered in a jury trial, also applies to bench trials.<sup>152</sup>

In 2008, Defendant Ramsey and three co-conspirators robbed a New Castle pizza shop. Ramsey and another robber, Harry Bodine, who was armed, entered the store and demanded money. The restaurant owner and one of the employees were present near the register. The owner opened the register and handed over the store’s money while the employee stood frozen with his hands in the air. Ramsey grabbed the money from the owner, and the suspects fled. Ramsey was charged with multiple offenses, including the robbery at the pizza shop. At his bench trial, Ramsey moved for judgment of acquittal on the first degree robbery charge that named the pizza store employee as a robbery victim. The Superior Court denied the motion. In closing arguments, the trial judge suggested that Ramsey should be convicted of attempted first degree robbery for the robbery of the store employee. During closing, neither party argued for conviction of attempted robbery. At the conclusion of the evidence, the court convicted Ramsey on the lesser-included charge of attempted first degree robbery for the robbery charge against the store employee.<sup>153</sup>

On appeal, Ramsey contended that the trial court erred by *sua sponte* convicting him of an uncharged offense. The court noted that, while 11 *Del. C.* § 206(c) allows a trial court to instruct the jury on a lesser-included offense, Delaware follows the “party autonomy” rule, which places the initial burden on a party to request an instruction on a lesser-included offense.<sup>154</sup> The court declared that the rationale of the “party autonomy” rule applies to bench trials and held that a trial judge in a bench trial should not consider uncharged lesser-included offenses unless there is a specific request by a party.<sup>155</sup>

149. *Id.* at 431 (citing H.B. No. 524, 137th Gen. Assem. (1994) (Synopsis)).

150. *Id.* (quoting *State v. Robinson*, 251 A.2d 552 (Del. 1969)). In a dissenting opinion, Justice Ridgely stated that the decisions in *Hall* and *Buckingham* were consistent with the express intent of the General Assembly in amending the Mandatory Sentencing Act in 1980 to “require that an offender has an opportunity to mend his ways after an initial confrontation with the courts before he is sentenced as a second offender.” *Id.* at 432 (quoting 62 Del. Laws 331 (emphasis added)).

151. 996 A.2d 782 (Del. 2010).

152. *Id.* at 783.

153. *Id.* at 783-84.

154. *Id.* at 784-85 (citing *State v. Brower*, 971 A.2d 102, 107 (Del. 2009)).

155. *Id.* at 785 (citing *Chao v. State*, 604 A.2d 1351, 1358 (Del. 1992) (trial counsel “determine trial tactics and presumably act in accordance with a formulated strategy”)).

In Ramsey's trial, the Supreme Court found that neither side explicitly requested that the Superior Court actually consider conviction on the lesser-included offense of attempted robbery.<sup>156</sup> Therefore, the court vacated Ramsey's conviction on that charge. The court indicated that in future bench trials, the judge should hold a conference with counsel prior to closing arguments to allow each side to make specific requests for any lesser-included offenses. A failure by a party to request a lesser-included offense will be deemed a knowing and intentional decision.<sup>157</sup>

---

156. *Id.* at 785 (citing *Perkins v. State*, 920 A.2d 391, 399 (Del. 2007) ("The burden falls on defense counsel to request the instruction; otherwise, the trial court cannot 'discount the possibility that such a position [to decline the instruction] is a tactical decision by defense counsel.'" (citing *Keyser v. State*, 893 A.2d 956, 961 (Del. 2006))).

157. *Id.* at 785-86.

## APPENDIX

### DELAWARE SUPREME COURT CRIMINAL LAW OPINIONS — 2010

*Black v. State*, 3 A.3d 218, 219 (Del. 2010) (defendant was denied his right to a fair trial where juror had discussed facts of drug case with his son (a recovering drug addict) and other jurors).

*Blake v. State*, 3 A.3d 1077, 1079 (Del. 2010) (trial court erred in admitting five prior statements of witnesses under Section 3507 because the State did not establish the proper foundational requirements).

*Bohan v. State*, 990 A.2d 421, 423 (Del. 2010) (trial judge did not commit error in declining to order a mistrial after a defense witness invoked his Fifth Amendment privilege; court issued three curative instructions).

*Burroughs v. State*, 988 A.2d 445, 451 (Del. 2010) (prosecutor's remarks in closing were invited by defense arguments and did not constitute prosecutorial misconduct).

*Cruz v. State*, 990 A.2d 409, 415-16 (Del. 2010) (defendant could be found to be in violation of probation based on evidence presented at trial that resulted in his acquittal).

*Dickinson v. State*, 8 A.3d 1166, 1168 (Del. 2010) (under the "party autonomy" rule, the trial court is not required to give an accomplice liability instruction unless requested by a party).

*Dixon v. State*, 996 A.2d 1271, 1276, 1279 (Del. 2010) (witness' 911 call describing shooting and identity of suspect was admissible as excited utterance; call was nontestimonial and admission of out-of-court statement did not violate the Confrontation Clause).

*Erskine v. State*, 4 A.3d 391, 392 (Del. 2010) (the accomplice "level of liability" jury instruction should only be given if there is a rational basis in the record to support the instruction).

*Forehand v. State*, 997 A.2d 673, 674-75 (Del. 2010) (statute constitutionally classified all escapes as violent felonies).

*Guy v. State*, 999 A.2d 863, 865 (Del. 2010) (defendant's post-conviction claims were procedurally barred and lacked substantive merit).

*Hall v. State*, 12 A.3d 1123, 1125 (Del. 2010) (trial court committed plain error in failing to remove juror who was correctional officer in same institution as the defendant).

*Harris v. State*, 991 A.2d 1135, 1140, 1144 (Del. 2010) (defendant could not be convicted of tampering with physical evidence when he momentarily attempted to hide a baggie in his mouth; police observed the attempt to hide and retrieved the evidence; LIDAR device was sufficiently reliable to calculate defendant's distance from church).









