Delaware Chancery Court Offers a Partial Solution to Recent Decisions that Adversely Affect Private Equity Fund Indemnification

A recent Delaware decision provides guidance to private equity organizations seeking to avoid co-indemnification obligations with the sponsor's portfolio company for an investment professional who is serving as a director or officer of the portfolio company.

In *Sodona v. American Stock Exchange LLC*, the Chancery Court provided a partial roadmap to address an earlier Delaware decision that disrupted settled expectations concerning the respective obligations of a private equity fund and its portfolio company to pay advancement and indemnification to, or on behalf of, a principal of the private equity fund serving as a director or officer of the portfolio company. This decision offers some relief from the Chancery Court's decision in *Levy v. HLI Operating Co.*, which raised the very real prospect that, in the absence of appropriate contractual provisions at the private equity organization and/or portfolio company levels, a portfolio company could successfully take the position that the private equity fund, or its affiliates, is a "co-indemnitor" (along with the portfolio company) and, as such, is obligated to indemnify each of the private equity fund's board designees at the portfolio company on a "co-equal," or *pro rata*, basis with the portfolio company.

In particular, in *Sodona*, the Chancery Court enforced a contractual prioritization term providing that a parent corporation's obligations to indemnify directors serving at a subsidiary, at the request of the parent, would only take effect if the subsidiary were financially or legally unable to make an advancement or indemnification payment. Otherwise, the subsidiary is obligated to indemnify on a primary basis. The Court held that this provision was sufficient to permit the parent to avoid co-indemnitor status with its subsidiary.

Takeaways from *Levy* and *Sodona*

Certain takeaways from the recent Delaware decisions include the following:

- Absent clear contractual provisions, the Delaware courts will not presume that a private equity organization's obligation to indemnify its director designees is secondary to the portfolio company's obligation to indemnify the directors.
- Absent such contractual clarity, a private equity organization is at risk of being required to pay indemnification to its director designees despite a portfolio company's indemnification obligation to the designees.
- There are several reasonably efficient alternative solutions to the problem raised by *Levy v. HLI Op. Co.*, which, as a practical matter, do not require extensive review and amendment of each portfolio company-level or fund-level agreement.
- To effectively address the issue raised by these cases, it is important to carefully consider a private equity organization's particular circumstances and the options available to the firm.

Private equity funds and other companies should take notice of the *Sodona* decision. The articles "Director and Officer Liability: Delaware Reinforces the Limits on Indemnification Claims" and "Advancement and Indemnification Update: *Sodona v. American Stock Exchange*," by Ropes & Gray partners Randall Bodner and Peter Welsh, further describe each of the above cases and potential solutions to the issues that can arise from this developing area of the law.

Contact Information

If you would like to learn more about these recent Delaware decisions, please contact your legal advisor at Ropes & Gray or a member of our Private Investment Funds team.