

Securities
Arbitration in the
Market Meltdown
Era:

Achieving Fairness in
Perception and Reality

Volume Two

Chair
David E. Robbins

Practising Law Institute

CORPORATE LAW AND PRACTICE
Course Handbook Series
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Securities Arbitration in the Market Meltdown Era:

Achieving Fairness in
Perception and Reality

Volume Two

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SELECTED RECENT DEVELOPMENTS IN
INDEMNIFICATION AND ADVANCEMENT
RIGHTS FOR OFFICERS, DIRECTORS,
INVESTMENT MANAGERS OF HEDGE
FUNDS, AND OTHER RELATED PARTIES:
WHO WILL PICK UP THE BILL AND WHEN?

Raymond L. Moss

Gerald B. Kline

Sims Moss Kline & Davis LLP

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I. OVERVIEW¹

With the economy in a deep recession and the stock market continuing to experience significant corrections and weakness, industries are experiencing pressure from market forces, regulators and their investors. The banking and automobile sectors are among the more distressed of industries and the federal government is funding and scrutinizing them in unprecedented ways. Executive compensation and bonuses are under attack as never before, and fraud and other related investor claims are being brought against public and private companies, banks, brokerage firms, investment advisers and hedge funds together with their officers, directors, employees and others with increasingly greater frequency in more significant magnitude.

Within this environment, the SEC recently adopted a new antifraud provision under the Investment Advisers Act of 1940, as amended, 15 U.S.C. § 80(b), that became effective September 10, 2007.

The new rule promulgated thereunder, 17 CFR 275.206(4)-8, prohibits advisers to pooled investment vehicles from making false or misleading statements to or otherwise defrauding investors or prospective investors in pooled investment vehicles. The SEC adopted this rule in response to the decision in *Goldstein v. SEC*, 451 F.3d 873 (D.C. Cir. 2006) wherein the Court of Appeals for the District of Columbia held that the “client” of an investment adviser was the pool itself and not an investor in the pool. New Rule 206(4)-8 makes it clear that the SEC may prohibit conduct of an investment adviser *that impacts the investor in the pool*.

Notably, the rule does not create a private right of action for an individual claimant. Rather, it only vests the SEC with the authority to enforce the rule. The rule applies both to registered and unregistered investment advisers. In other words, it applies to advisers of hedge funds, private equity funds and venture capital funds as well as mutual funds.

The rule prohibits misleading statements and deceptive conduct that may not include statements. The rule also prohibits fraud on potential investors, including even those who do not make an investment. Unlike Rule 10b-5, there is no “in connection with” requirement; the SEC will

1. The authors’ commentary and observations in this chapter are solely designed to promote active and ongoing analysis of the topics discussed herein. Any commentary and observations expressed herein do not constitute legal advice and do not apply to future cases, which by necessity will turn upon their particular facts, circumstances and controlling law.

not have to prove reliance by or harm to any individual in an enforcement action.²

Increasingly in the current corporate environment, officers, directors and employees are having to defend against not only investor-initiated suits, but regulatory investigations initiated by the civil and criminal divisions of the Department of Justice, the SEC, and various state agencies, such as the New York Attorney General's Office. For example, in *SEC v. Cioffi*, E.D.N.Y. 08 Civ. 2457 (June 19, 2008), the SEC charged Ralph Cioffi and Matthew Tannin, former portfolio managers in Bear Stearns asset management division, with deceiving investors and others about the financial condition of two hedge funds that failed due to their overexposure to the subprime securities. At the same time, in a related criminal action, the U.S. Attorney's Office for the Eastern District of New York announced the indictment of Cioffi and Tannin on conspiracy and fraud charges.³ Cases like *Cioffi* and *Tannin*, along with the enactment of New Rule 206(4)-8 and similar legislation, underscore that the potential liability net being cast on those persons is expanding, not shrinking.

On May 5, 2009, the SEC brought its first ever case alleging insider trading against a hedge fund manager involving credit default swaps.⁴ SEC Chair, Mary Shapiro, stated last month that the SEC is pursuing approximately 150 hedge fund investigations, nearly one-third of which involve credit default swaps.⁵

Those who have elected to serve as directors and officers of both public and private companies have historically taken for granted and assumed that the organizations they serve will protect them in the event of a regulatory investigation or proceeding or an investor lawsuit. However, a combination of recent regulatory actions, new legislation, increasing scrutiny of officer and director transactions and investor dissatisfaction with performance of public and private companies, private

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2. Also, unlike Rule 10b-5, new Rule 206(4)-8 contains no scienter requirement. It attacks negligent misrepresentations and conduct that is negligently deceptive. Although negligent conduct is proscribed, the SEC specifically stated in its release (No. IA-2628) that the rule does not create a fiduciary duty not otherwise imposed by law.
 3. SEC Litigation Release No. 20625 (June 19, 2008).
 4. Liz Rappaport, *SEC Opens New Front on Insider Trading*, WALL ST. J., May 6, 2009, at A1. See also SEC Litigation Release No. 21023 (May 5, 2009).
 5. Chairman Mary L. Shapiro, *Speech by SEC Chairman: Address to the Society of American Business Editors and Writers* (April 27, 2009).

investment partnerships and hedge funds have increasingly strained the ability of directors and officers to obtain advancement and indemnification of their defense costs. Additionally and quite ironically, there are many officers of both public and private companies, hedge funds and investment managers who may be entitled to indemnification as a matter of law, yet they may be unaware of their rights and entitlements. This PLI course book chapter will examine it for practitioners.

For example, banks, broker-dealers, and investment advisors regularly appoint mid- to senior-level producers, account managers and other executives as their corporate officers. These persons, while serving as company employees, also perform their services in their capacities as executive officers. Given the current regulatory enforcement environment as well as various legal proceedings, these mid- and senior-level management persons are being drawn into the fray of having to defend their actions. Often, these officers, directors, and others are represented in those proceedings by company counsel without adequate, if any, disclosure and discussion about actual and/or potential conflicts of interest regarding such dual representation. For example, among other things, appropriate written and oral disclosure would clarify to those directors or officers:

- (i) the nature and extent of the company's obligations to provide advancement and indemnification of their costs and expenses in such a proceeding or
- (ii) in fact, the potential or actual limits and conflicts of any such dual representation undertaken by the company's counsel.

If fully informed of these circumstances, many of these directors and officers would likely elect to retain counsel of their own choosing and to obtain advancement and indemnification from their corporate employer for the costs of their separate counsel. What is in the company's best interest may or may not be in the individual director or officer's best interest. This would include the sharing of information, issues relating to any settlement or compromise of a claim or any information or opinions of such executive that may be contrary to the legal position of the company or its other officers and directors. Similarly, many companies and hedge funds procure directors and officers insurance/errors and omissions policies that are designed to fund such indemnification obligations in whole or part.

Defensive costs in complex corporate litigation and regulatory battles can easily run into the hundreds of thousands and even the

millions of dollars. Situations occur where company counsel simply fail to fully inform and advise directors and officers about the terms and provisions of these policies and/or the procedures to follow in order to exercise the advancement and indemnification rights they are entitled to as a matter of law or pursuant to the company's certificate of incorporation, bylaws, employment agreements, or other agreements or internal policies in place. Accordingly, at the inception of and during their tenure, officers and directors should make it their practice to have their independent counsel periodically review their advancement and indemnification entitlements to assure that they are adequately informed of their legal rights to recover their defensive costs.

II. SOURCES OF ADVANCEMENT AND INDEMNIFICATION RIGHTS

Advancement and indemnification entitlements are both statutory and contractual in nature and can be extremely fact and circumstance dependent.

A. Certificate of Incorporation and Bylaws

A company's certificate of incorporation, bylaws and other organic documents, or, for example, in the case of a hedge fund, its limited partnership agreement, LLC operating agreement, or investment management agreement, may provide a basis for advancement and indemnification rights to an officer, director, or employee. These rights may be both "mandatory" and "permissive." Mandatory rights are those that are fully vested through the articles and bylaws and require the company to indemnify and advance defense costs to an officer, director or employee. In contrast, permissive indemnification rights leave the decision on such matters in the hands of a board of directors or other decision-making body.

B. State Law or Law of the Domicile

Various state statutes provide for both mandatory and permissive indemnification and advancement rights. Generally, state statutes leave it to companies whether to grant these rights (and the details thereof) to their executives via their certificates of incorporation, bylaws and other contractual arrangements. In that context, later portions of this chapter will discuss recent developments in Delaware case law and the related recent amendment to the Delaware General

Corporation Law (the “DGCL”), which illustrate the importance of careful review and drafting of directors and officers’ advancement and indemnification rights.

The company laws of offshore jurisdictions, such as Bermuda, the British Virgin Islands, the Cayman Islands, and the Netherland Antilles, also provide for indemnification and advancement rights with respect to offshore hedge funds.

C. Employment Agreements

Executives should review and discuss the critical topics of mandatory advancement and indemnification rights in their employment agreements with their independent counsel. They should not agree to grant discretion to a board of directors or other decision-making body to determine if and when advancement or indemnification will be allowed. In fact, if left to the discretion of a decision-making body, that body could decide to negate retroactively, the advancement and indemnification rights of an executive.

This result was illustrated in the Delaware Chancery Court’s decision in *Schoon v. Troy Corp.*, 948 A.2d 1157 (Del. Ch. 2008). In *Schoon*, a former director sought advancement of expenses under the company’s bylaw provision in place while he was on the board and existing at the time of the alleged wrongdoing asserted in the litigation. However, the company’s board of directors amended that bylaw provision before the commencement of the legal action against the former director and then maintained that former directors were no longer entitled to advancement of their expenses. In a very surprising decision, the Delaware Chancery Court found that the advancement rights claimed by the former director only vested upon the commencement of the lawsuit against him. Therefore, whether or not he was entitled to indemnification and advancement of his defense costs would depend upon those corporate documents in effect at the time the lawsuit was filed. The court then decided that the later bylaw amendment negating his earlier indemnification rights was in fact valid and, therefore, that the director was not entitled to the advancement of his litigation costs.

The *Schoon* decision has shocked many practitioners who believe that these indemnification and advancement rights for a former director or officer are in fact vested and cannot be divested. As a result of and in response to *Schoon*, Delaware amended DGCL § 145(f), effective August 1, 2009, to add the following new default rule regarding indemnification and advancement right:

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, 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.

The amendment may create a quasi default rule regarding indemnification advancement rights by prohibiting the elimination or impairment of any indemnification or advancement right in a corporation's charter and bylaws, once the act in question has occurred. However, it does *not* prevent such elimination or impairment where a bylaw or charter provision existing at the time of the alleged act or omission expressly authorizes such elimination or impairment. Consequently, it is critical for counsel representing the executive to carefully check the language in the charter and bylaws. Whether for existing directors and officers or for entrepreneurs starting new companies where other investors may join as private equity participants or through public offerings, to prevent retroactive gutting of advancement and indemnity provisions, the company's certificate of incorporation should state that those provisions cannot be amended by the board of directors without shareholder approval.

D. Indemnity Agreements

Schoon also underscores the importance of specifically addressing the nature and extent of any indemnification and advancement rights stipulated in an officer's or director's employment agreement or in a separate renegotiated indemnity agreement for such officer or director. We strongly urge that management also obtain individual indemnity agreements that deal with the advancement of defense costs and indemnification. Additionally, in the context of any departure or termination from employment, it would be appropriate for any "termination or separation agreement" likewise include those critical covenants.

It is also noteworthy that § 145 of the DGCL provides that the right to indemnification is subject to a person having acted in good faith in a manner reasonably believed to be in or not opposed to the best interest of the corporation. In any criminal action or proceeding, the DGCL requires that the person had no reasonable cause to believe his or her conduct was unlawful. The DGCL also states 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 to the extent a court determines that, despite the adjudication of liability, the person is fairly and reasonably entitled to indemnification for expenses deemed proper by the court).”

It is important to note that in the case of advancement, without the ability of an officer, director or employee to compel his employer to advance the costs of his individual defense, said the officer, director or employee may not have the financial means to retain his own counsel and continue to fund the ongoing and likely substantial legal fees of counsel.

E. Directors and Officers Insurance/Errors and Omissions Insurance

Many business entities secure “directors and officers” and “errors and omissions” policy insurance to fund the defense costs of the company and its officers and directors. These policies vary in scope, coverage, and deductibility, but generally provide coverage in the case of lawsuits, investigations and the like. However, they routinely contain a laundry list of *exclusions* that bar coverage and defense costs for fraud, theft, embezzlement, certain types of transactions, certain services performed, and a variety of other matters. In fact, insurers’ denials of coverage based on available policy exclusions often prompt substantial “coverage dispute” litigation asserted by entities and their executives. It is recommended that executives obtain periodic copies and renewals of these policies to review and understand their entitlement to and the scope of their coverage long before an action or proceeding triggers that review.

In many circumstances, former directors as to whom advancement and indemnification have been withheld would still be entitled to seek defense expense protection and indemnity under their entities’ D&O liability policies. For directors who have left board service and are concerned that future events might divest of their benefits and leave them unprotected (e.g., through certificate of incorporation and bylaw amendments; termination or exhaustion of existing D&O policy limits; etc.), other insurance solutions are available. For example, coverage under so-called former director and officer liability insurance policies exists. That type of policy is buyer-specific and belongs exclusively to the individual director or officer. It may not be subject to termination or discontinuance through the action or inaction of the company or others. In certain cases, this form of coverage may

provide for up to six years of additional coverage after the director or officer resigns, retires, is fired or suffers some other termination event.

In light of the financial problems currently experienced by some of the largest national and international insurance companies, such as American International Group (AIG), it is incumbent upon all owners and insureds under D&O and E&O policies – be they entities or individuals – to fully review and evaluate their policy coverage terms and limits as well as the creditworthiness and historical claims settlement practices of the issuing companies.

F. Distinction between Advancement of Defense Costs and Indemnification

Advancement of defense costs is not the same as indemnification of defense costs. The right to indemnification generally may not necessarily evidence a right to “advancement” of defense costs. This distinction is very important in the review of a director/officer’s entitlement to coverage. In *Schoon, supra*, the court made it clear that “even though related, indemnification and advancement are distinct types of legal rights.” This point was also illustrated in *Sodano v. Am. Stock Exch.* (Del. Ch. 2008),⁶ where the court stated: “indemnification in a CEO’s separation agreement also included advancement as a result of a broad use of the term in the corporation’s charter.”

G. Person and Entities other than Directors and Officers may also be Entitled to Advancement and Indemnification

A corporation may provide in its certificate of incorporation and bylaws that its employees and agents (in addition to directors and officers) may be entitled to advancement of defense costs and indemnification. This circumstance may require a corporation to provide indemnification and advancement even to employees and agents. In *Jackson Walker LLP v. Spira Footware, Inc.*, (Del. Ch.

6. *Sodano v. Am. Stock Exch. LLC and Fin. Indus. Reg. Auth., Inc.*, No. 3418-VCS, 2008 Del. Ch. LEXIS 92 (Del. Ch. July 15, 2008).

2008),⁷ plaintiff Jackson Walker, former outside litigation counsel for the company, sought summary judgment against the corporation for advancement of legal expenses. In *Fasciana v. Elecs. Data Sys. Corp.*, (Del. Ch. 2003),⁸ the court held that an agent under § 145 of the DGCL does not include a lawyer who acts as a legal advisor to a corporate client. It does not act on the client's behalf in relation to third parties. In that case, the court held Fasciana, a lawyer, who engaged in corporate advisory work, not to be an agent under § 145 of the DGCL. However, in *Sassano v. CIBC World Mkts. Corp.*, (Del. Ch. 2008),⁹ a former employee contended that he functioned as an officer with management supervisory functions and, therefore, that the corporation's bylaws required him to receive mandatory advancement of his costs incurred in certain legal proceedings. The court determined that the employee was a nominal officer at the time of the allegations for which the bylaws provided for mandatory advancement; the court held that the employee was entitled to advancement.

In *United States v. Stein*, (2nd Cir. 2008),¹⁰ the Second Circuit held that corporations under government investigation should continue making voluntary advancements of legal expenses where there has been a prior pattern and practice of doing so. Interestingly, on August 28, 2008, the same date as the *Stein* decision, the Department of Justice changed its Principles of Federal Prosecution of Business Organizations to advise federal prosecutors that they may not make charging decisions based upon the advancement of legal fees to current or former employees.¹¹

H. Respondeat Superior

One might also assert that if, at the time of an alleged wrongdoing, an employee or officer was acting within the scope of his employment with regard to the challenged conduct, his employer entity ought to indemnify his defensive fees and costs because the employee was working at the behest of his employer, thereby

7. *Jackson Walker LLP v. Spira Footwear, Inc.*, No. 3150-VCP, 2008 Del. Ch. LEXIS 82 (Del. Ch. June 23, 2008).

8. *Fasciana v. Elec. Data Sys. Corp.*, 829 A.2d 178 (Del. Ch. July 1, 2003).

9. *Sassano v. CIBC World Mkts. Corp.*, 948 A.2d 453 (Del. Ch. January 17, 2008).

10. *United States of America v. Stein*, 541 F.3d 130 (2nd Cir. August 28, 2008).

11. See <http://www.usdoj.gov/>.

creating the employer's vicarious liability under the doctrine of *respondeat superior*. For example, in Georgia, the doctrine of *respondeat superior* is codified as follows: "Every person shall be liable for torts committed by his wife, his child, or his servant by his command or in the prosecution and within the scope of his business, whether the same are committed by negligence or voluntarily." O.C.G.A. § 51-2-2.

Two elements must be present to hold an employer liable under *respondeat superior*: "... first, the servant must be in furtherance of the master's business; and second, he must be acting within the scope of his master's business." *Piedmont Hosp., Inc. v. Palladino*, 276 Ga. 612, 613, 580 S.E.2d 215, 217 (2003) (citations omitted). An employer may be held liable even if the act was expressly forbidden by the employer. *Cummings v. Wash Constr. Co.*, 561 F. Supp. 872, 879 (S.D. Ga. 1983) (citation omitted). It is not necessary that the employee's conduct provide the employer with any benefit, so long as the employee intended to benefit the employer. *Id.* (citation omitted).

Where it is undisputed that the employee was "acting within the scope of the actual transaction of [employer's] business for accomplishing the ends of his employment," the employer will be held liable. *Rent to Own, Inc. v. Bragg*, 248 Ga. App. 130, 131, 546 S.E.2d 9, 11 (2001) (manager of store authorized to swear out an arrest warrant was acting within the scope and summary judgment for plaintiff was upheld).

I. Indemnification Under § 145 of the Delaware General Corporation Law

In 1986, the Delaware legislature provided protection to directors and strengthened a company's ability to provide indemnification to its directors and officers for litigation expenses and other legal exposure.¹²

Section 145 of the DGCL is both permissive and mandatory in its application to corporations. The statute allows corporations to indemnify both past and present officers, directors, employees, agents, and other persons serving in such capacities and in other

12. See generally Del. J. Corp. L., Vol. 29, 143-189.

entities. Subsections (a) and (b) describe the nature and extent of indemnification as well as its scope.

Subsection (a) is the most commonly asserted clause for indemnification. It relates to claims that arise out of “any threatened, pending or completed action, suit or proceeding, where there is civil, criminal, administrative or investigative... ‘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.’” This subsection goes on to state that “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 in which 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 a reasonable cause to believe that the person’s conduct was unlawful.”

Subsection (b) applies to indemnification claims arising out of claims brought by the corporation, by its receivers, trustees, or custodians or by stockholders in stockholder derivative suits, for example.

J. Indemnification Rights may also Apply to Directors and Officers and others of a Subsidiary

The Delaware courts have taken the position that directors of a wholly-owned subsidiary of a parent that had strong indemnification language in its bylaws shall also be entitled to indemnification. See *VonFeldt v. Stifel Corp.*, 714 A.2d 79 (Del. 1998).

K. Fees on Fees

Company liability for the additional legal fees and expenses that an eligible indemnitee, himself, incurs in seeking reimbursement of his underlying costs and expenses has been found to be authorized by § 145 of the DGCL.¹³ However, the “reasonableness” of such fees and expenses can be subject to interpretation. In one case, the

13. See *Stifel Fin. Corp. v. R. Cochran*, 809 A.2d 555 (S.C. Del. June 2002). *Stifel Fin. Corp.*, 809 A.2d at 561.

Superior Court of Delaware permitted indemnification of very significant fees by a prominent defense lawyer.¹⁴ It should also be noted that in *Schoon, supra*, the defendants argued that under *Fasciana v. Electronic Data Sys.*,¹⁵ indemnification in a fees-on-fees situation must be proportionate to the indemnitee plaintiff's success notwithstanding the terms and the bylaws. The bylaw language provided for indemnification "if successful in whole or in part," which distinguished *Fasciana* and required full indemnification. The court noted that the plaintiff in *Fasciana* had advanced a substantially similar argument as the *Schoon* and *Bohnan* plaintiffs had, namely, that they were entitled to all fees incurred in the advancement provision regardless of success. Citing *Fasciana*, the Superior Court observed that the award must adhere to the recognized principle in *Fasciana* that courts "should only award that amount of fees that is reasonable in relation to the results obtained."

L. Mandatory Indemnification Under Section 145(c) of the Delaware General Corporation Law

Section 145(c) of the DGCL provides mandatory indemnification of a former director or officer who has been successful on the merits or otherwise in defense of any action, suit, or proceeding referred to in subsections 145(a) and (b) or in the defense of any claim, issue, or matter therein. Surprisingly, in seeking indemnification for a successful criminal defense under this subsection, the indemnitee claimant is not required to show that he acted in good faith or actually committed no actual wrong. *See, e.g., Green v. Westcap Corp. of Delaware*, 492 A.2d 260 (Del. Super. Ct. 1985). Obtaining the dismissal of counts of a criminal conviction may also create eligibility for mandatory indemnification. *See Merritt-Chapman & Scott Corp. v. Wolfson, supra*, at 141.

Section 145(c) of the DGCL is particularly noteworthy to management members and employees of broker-dealers, investment bankers, and hedge funds. Someone who has successfully defended an investor lawsuit or arbitration through their own counsel may, under certain conditions, effectively assert this statutory provision to

14. *See Merritt-Chapman & Scott Corp. v. Wolfson*, 321 A.2d 138 (Del. Super. Ct. 1974).

15. 829 A.2d 178 (Del. Ch. July 1, 2003).

claim eligibility for reimbursement of his actually and reasonably incurred defensive fees and expenses in the underlying case.

In that regard, our law firm was successful in obtaining indemnification and reimbursement of certain defense costs that a registered representative had incurred in connection with his equally successful defense of an investor arbitration claim brought by a customer against him and A.G. Edwards.¹⁶ In that case, A.G. Edwards' (later acquired by Wachovia Securities) provided for permissive indemnification in its bylaws, but its practice and policy was to indemnify big producers. The claimant, Michael Sean Cain, was an A.G. Edwards officer and branch manager at the time a customer initially complained and prior to the time the customer initiated her subsequent arbitration action. After winning a motion to dismiss the customer's arbitration action, then winning denial of the customer's state court vacatur application and obtaining a judgment for frivolous litigation damages against the customer, Mr. Cain then sought indemnification against his former broker-dealer for his defensive costs in all of the foregoing proceedings plus the costs of pursuing his indemnification claim the broker-dealer. A.G. Edwards/Wachovia stated in its defense to the claim, among other things, that the fees were not reasonable.¹⁷ The arbitration panel thereafter entered a sizable indemnification award in Mr. Cain's favor.

III. CONCLUSION

It can be seen that, while advancement and indemnification of officers, directors, and employees is an established right with ever changing

16. See *Cain v. Wachovia Sec. LLC*, FINRA Arbitration Resolution, Case No. 06-05187 (Award decided May 2008) (attached).

17. Based on research provided by the Securities Arbitration Commentator ("SAC") (www.sacarbitration.com) from its extensive database of reported FINRA arbitration decisions (for which the authors gratefully acknowledge its assistance), covering the period of June 5, 1986 to the present, there appears to be only 21 reported arbitration decisions involving claims for indemnification by officers, directors, branch managers, registered representatives and employees of FINRA member firms in the SAC database. In addition, of the 76 awards found based on a word search that included the words "indemnification," "officer," "director," "branch manager, and "manager," 36 of those arbitration decisions involved claims by a broker-dealer for indemnification against the employee or registered representative.

permutations and developments, one paramount conclusion stands out. *Management must periodically and carefully review its individual independent right to the protections afforded as a matter of law and by contract; that review must involve independent counsel not affiliated with the corporate employers.*

What may be most surprising is that, in the last several decades, banks, brokerage firms, registered representatives, other FINRA registered persons and entities, and similar parties involved in the investment industry have not invoked these advancement and indemnification provisions in greater numbers. The moral of the story is that it is imperative for management to take a proactive approach in protecting their advancement and indemnification rights to avoid indigestion, heartburn, or worse before the bill comes. This vigilance should begin at the initial stage of employment or at the time of becoming an officer or director. It should continue throughout one's term of service and be reviewed again at the termination of one's service in those capacities.

The cost of an adverse ruling, judgment, or settlement, together with the very significant costs of a legal defense, potentially poses a career-ending and financially ruinous result.

Award
FINRA Dispute Resolution

In the Matter of the Arbitration Between:

Name of the Claimant Case Number: 06-05187
Michael Sean Cain

Name of the Respondent Hearing Site: Atlanta, Georgia
Wachovia Securities, LLC, as Surviving Entity
by Merger with A. G. Edwards & Sons, Inc.

Nature of the Dispute: Associated Person vs. Member.

REPRESENTATION OF PARTIES

For Michael Sean Cain, hereinafter referred to as "Claimant": Raymond L. Moss, Esq.,
Sims, Moss, Kline & Davis, LLP, Atlanta, Georgia.

For Wachovia Securities, LLC, as Surviving Entity by Merger with A.G. Edwards &
Sons, Inc., hereinafter referred to as "Respondent": James C. Browning, Jr., Litigation
Counsel, A. G. Edwards & Sons, Inc., St. Louis, Missouri.

CASE INFORMATION

Statement of Claim filed on or about: December 1, 2006.
Claimant signed the Uniform Submission Agreement [reflecting A. G. Edwards, Inc. as
Respondent]: December 1, 2006.
Claimant signed the Uniform Submission Agreement [reflecting Wachovia Securities,
LLC as Surviving Entity by Merger with A.G. Edwards & Sons, Inc. as Respondent]:
April 28, 2008.
Motion to Dismiss and Answer filed by Respondent on or about: January 29, 2007.
Respondent signed the Uniform Submission Agreement [reflecting A. G. Edwards, Inc.
as Respondent]: January 29, 2007.
Respondent signed the Uniform Submission Agreement [reflecting Wachovia Securities,
LLC, as Surviving Entity by Merger with A.G. Edwards & Sons, Inc. as Respondent]:
April 24, 2008.
Motion for Leave to Amend Statement of Answer and Amended Statement of Answer
filed by Respondent on or about: November 27, 2007.
Response to Respondent's Motion for Leave to Amend Statement of Answer filed by
Claimant on or about: November 27, 2007.
Motion for Leave to File Amended Statement of Claim, Amended Statement of Claim
and Memorandum in Support thereof filed by Claimant on or about: November 27, 2007.
Objection to Claimant's Motion for Leave to File Amended Statement of Claim filed by

FINRA Dispute Resolution
Arbitration No. 06-05187
Award Page 2

Respondent on or about: November 29, 2007.
Motion to Amend Name of Party and Memorandum in Support thereof filed by Claimant on or about: April 18, 2008.
Response to Motion to Amend Name of Party filed by Respondent on or about: April 21, 2008.

CASE SUMMARY

Claimant asserted the following causes of action: 1) contractual and statutory indemnification, 2) breach of fiduciary duty; 3) negligence; and, 4) violation of controlling state bar and related ethics rules. The causes of action relate to attorneys' fees incurred by Claimant in connection with a separate arbitration proceeding (the "Proceeding") stemming from a customer dispute that arose when Claimant was employed by Respondent.

Unless specifically admitted in its Answer, Respondent denied the allegations made in the Statement of Claim and asserted various defenses.

RELIEF REQUESTED

Claimant requested: 1) compensatory damages in an amount in excess of \$300,000.00, representing attorneys' fees and expenses incurred in the Proceeding; 2) pre-judgment interest at the rate of seven percent (7%) pursuant to O.C.G.A. § 7-4-2; 3) post-judgment interest at the rate of twelve percent (12%) pursuant to, among other things, O.C.G.A. § 7-4-12; 4) attorneys' fees and expenses; and, 5) punitive damages pursuant to, among other things, O.C.G.A. § 51-12-5.1 (c) in an amount deemed just and proper by the Panel.

Respondent requested: 1) a dismissal with prejudice of the Statement of Claim, as amended, in its entirety; 2) costs; and, 3) any other relief the Panel deemed appropriate.

OTHER ISSUES CONSIDERED AND DECIDED

Respondent's Statement of Answer contained a Motion to Dismiss in which Respondent requested that the Panel dismiss the claim on the pleadings. Therein, Respondent asserted, among other things, that Claimant has pleaded no basis upon which he can recover attorneys' fees. The Panel determined to conduct an evidentiary hearing and proceeded to schedule hearing dates with the parties during the initial pre-hearing conference conducted on April 10, 2007.

On or about November 30, 2007, the Panel issued Orders which, among other things, deferred ruling on the parties' respective motions to amend their pleadings until the outset of the evidentiary hearing. Following an executive session, the Panel determined at the outset of the evidentiary hearing on December 4, 2007, to grant the parties' respective motions to amend their pleadings.

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Claimant filed an unopposed motion to modify the style of the case to reflect Respondent as "Wachovia Securities, LLC, as Surviving Entity by Merger with A.G. Edwards & Sons, Inc." instead of "A.G. Edwards & Sons, Inc." On or about April 23, 2008, the Panel issued an Order which granted Claimant's motion and directed the parties to file new Uniform Submission Agreements reflecting the change.

The parties have agreed that the Award in this matter may be entered in counterpart copies or that a handwritten, signed Award may be entered.

After considering the pleadings, the testimony and evidence presented at the hearing, and the post-hearing submissions (if any), the Panel has decided in full and final resolution of the issues submitted for determination as follows:

Respondent is liable for partial contractual indemnification under the By-Laws of A. G. Edwards, Inc. in connection with the Proceeding, as well as a portion of the attorneys' fees incurred in this arbitration proceeding pursuant to O.C.G.A. § 13-6-11. Accordingly, Respondent shall reimburse Claimant the sum of \$160,000.00, pre-judgment interest specifically excluded.

Any and all relief not specifically addressed herein, including Claimant's request for punitive damages, is denied,

FEES

Pursuant to the Code of Arbitration Procedure (the "Code"), the following fees are assessed:

Filing Fees

FINRA Dispute Resolution will retain or collect the non-refundable filing fees for each claim:

Initial claim filing fee	= \$ 300.00
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Member Fees

Member fees are assessed to each member firm that is a party in these proceedings or to the member firm that employed the associated person at the time of the events giving rise to the dispute. Respondent is a party to this dispute and is a member firm. Accordingly, the following fees were assessed:

Member surcharge	= \$1,700.00
Pre-hearing process fee	= \$ 750.00
Hearing Process fee	= \$2,750.00
Total Member Fees	= \$5,200.00

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Adjournment Fees

Adjournments granted during these proceedings for which fees were assessed:

No adjournment fees were incurred during this proceeding.

Three-Day Cancellation Fees

Fees apply when a hearing on the merits is postponed or settled within three business days before the start of a scheduled hearing session:

No three-day cancellation fees were incurred during this proceeding.

Injunctive Relief Fees

Injunctive relief fees are assessed to each member or associated person who files for a temporary injunction in court. Parties in these cases are also assessed arbitrator travel expenses and costs when an arbitrator is required to travel outside his or her hearing location and additional arbitrator honoraria for the hearing for permanent injunction. These fees, except the injunctive relief surcharge, are assessed equally against each party unless otherwise directed by the Panel.

No injunctive relief fees were incurred during this proceeding.

Forum Fees and Assessments

The Panel has assessed forum fees for each session conducted or each decision rendered on a discovery related motion on the papers or a contested motion for the issuance of subpoenas. A session is any meeting between the parties and the arbitrators, including a pre-hearing conference with the arbitrators that lasts four (4) hours or less. Fees associated with these proceedings are:

One (1) Pre-hearing session with a single arbitrator @ \$450.00/session	= \$ 450.00
Pre-hearing conference: October 2, 2007 1 session	
Two (2) Pre-hearing sessions with the Panel @ \$1,125.00/session	= \$ 2,250.00
Pre-hearing conferences: April 10, 2007 1 session	
August 30, 2007 1 session	
Sixteen (16) Hearing sessions with the Panel @ \$1,125.00/session	= \$18,000.00
Hearing Dates: December 4, 2007 3 sessions	
December 5 2007 3 sessions	
December 6, 2007 3 sessions	
December 7, 2007 2 sessions	
April 29, 2008 2 sessions	
April 30, 2008 3 sessions	
Total Forum Fees	= \$20,700.00

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The Panel has assessed \$10,350.00 of the forum fees to Claimant. The Panel has assessed \$10,350.00 of the forum fees to Respondent.

Administrative Costs

Administrative costs are expenses incurred due to a request by a party for special services beyond the normal administrative services. These include, but not limited to, additional copies of arbitrator awards, copies of audio transcripts, retrieval of documents from archives, interpreters, and security.

No administrative costs were incurred during this proceeding.

Fee Summary

Claimant is solely liable for:

Initial Filing Fee	= \$ 300.00
Forum Fees	= \$ 10,350.00
Total Fees	= \$ 10,650.00
Less payments	= \$ 1,425.00
Balance Due FINRA Dispute Resolution	= \$ 9,225.00

Respondent is solely liable for:

Member Fees	= \$ 5,200.00
Forum Fees	= \$ 10,350.00
Total Fees	= \$ 15,550.00
Less payments	= \$ 5,200.00
Balance Due FINRA Dispute Resolution	= \$ 10,350.00

All balances are payable to FINRA Dispute Resolution and are due upon receipt.

ARBITRATION PANEL

<i>Richard V. McGalliard</i>	-	<i>Non-Public Arbitrator, Presiding Chairperson</i>
<i>Marian Cover Dockery</i>	-	<i>Non-Public Arbitrator</i>
<i>Alfred Lee Dingier</i>	-	<i>Non-Public Arbitrator</i>

May 16, 2008 4:50PM

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Concurring Arbitrators' Signatures

/s/

5/16/08

Richard V. McGalliard
Non-Public Arbitrator, Presiding Chairperson

Signature Date

/s/

5/15/08

Marian Cover Dockery
Non-Public Arbitrator

Signature Date

/s/

5/16/08

Alfred Lee Dingier Non-
Public Arbitrator

Signature Date

May 16, 2008

Date of Service (For FINRA Dispute Resolution use only)