

# Advancement Rights in Delaware Limited Partnerships

## Delaware Law Update

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In *Weil v. VEREIT Operating Partnership, L.P.*, C.A. No. 2017-0613-JTL (Del. Ch. Feb. 13, 2018), the Delaware Court of Chancery dealt with the issue of advancement of fees and expenses to certain directors and officers (the “Plaintiffs”) of a Delaware limited partnership (the “Partnership”). This case also involved the sole general partner of the Partnership (the “General Partner”) and an entity controlled by, and affiliated with, some of the Plaintiffs (the “Other Entity”).

Section 17–108 of the Delaware Revised Uniform Limited Partnership Act (the “LP Act”) states that “[s]ubject to such standards and restrictions, if any, as are set forth in its partnership agreement, a limited partnership may, and shall have the power to, indemnify and hold harmless any partner or other person from and against any and all claims and demands whatsoever.”

As the court points out, the statute “is broadly empowering and deferential to the contracting parties’ wishes regarding indemnification and advancement.” “In fact, Section 17–108 defers completely to the contracting parties to create and delimit rights and obligations with respect to indemnification and advancement of expenses.” “Section § 17–108 of the [LP Act] gives limited partnerships wider freedom of contract to craft their own indemnification scheme for a partnership’s indemnitees than is available to corporations under § 145 of the DGCL, which creates mandatory indemnification rights for corporate indemnitees in some circumstances and also bars indemnification in others.”

In this case, the partnership agreement of the Partnership (the “Partnership Agreement”) granted mandatory advancement rights to an “Indemnitee,” which was defined as any person “made a party to a proceeding by reason its status as . . . a director, manager or member of the [General Partner] or an officer or employee of the Partnership or the [General Partner].” In this case, the Delaware Court of Chancery agreed that the definition of Indemnitee excluded the Other Entity. The court relied on precedent from the Delaware Supreme Court, which has explained that to meet the “by reason of” test, there must be “a nexus or causal connection” between the underlying proceeding and the function or capacity that the individual performed on behalf of the entity. In other words, the court held that “if there is a nexus or causal connection between any of the underlying proceedings . . . and one’s official corporate capacity, those proceedings are ‘by reason of the fact’ that one was a corporate officer, without regard to one’s motivation for engaging in that conduct.” In this case, the Partnership conceded that the Plaintiffs

were named to the underlying proceedings by reason of their status as directors and officers of the General Partner. However, the Partnership argued that the underlying proceedings for which they seek advancement also involve claims against the Plaintiffs in non-covered roles, i.e., in their roles with the Other Entity. The question in this case turned on whether the Partnership was required to advance fees and expenses on matters that involved non-covered claims. The court relied on the following precedent in ruling that the Partnership should make an advancement on certain non-covered claims:

*[In] actions where only certain claims are advanceable, the Court generally will not determine at the advancement stage whether fee requests relate to covered claims or excluded claims, unless such discerning review can be done realistically without significant burden on the Court . . . . If fees cannot be apportioned with rough precision between advanceable claims and non-advanceable claims or the work was useful for both sets of claims, then the fees will be advanced in whole.*

As the court noted, advancement cases are summary proceedings where the only question involves the extension of credit. “If it is subsequently determined that a corporate official is not entitled to indemnification, he or she will have to repay the funds advanced.” Moreover, the court noted that a good faith effort must be made to allocate fees between covered and non-covered claims.

Another important takeaway from this case involves “unilateral imposition of terms” on an Indemnitee’s advancement rights. As stated earlier, advancement is a contractual right and as such, when a company has provided a covered person with a mandatory advancement right that is conditioned only on specific contractual requirements, such as an undertaking to repay, the company “does not have the right to impose any terms or conditions on . . . advancement other than an undertaking to repay.” As the court pointed out, an entity cannot, for example, later demand that the covered person show “proof of an ability to repay, or even the posting of a secured bond.”

In this case, the Partnership sought to require compliance with a set of billing guidelines, including an obligation to create and adhere to a litigation budget. However, as the court pointed out, the Partnership Agreement in question did not mention billing guidelines or litigation budgets. As stated by the court, the Partnership cannot now impose different obligations on the plaintiffs unilaterally.

This opinion is noteworthy in that limited partnership agreements should consider what conditions the partnership would like to impose on advancement rights.