

## Goldman Ordered to Advance Defense Fees for Former Employee Accused of Stealing Computer Codes

On October 16, 2013, the U.S. District Court for the District of New Jersey, in *Aleynikov v. The Goldman Sachs Group, Inc.*, found that a former vice president and computer programmer was an “officer” of Goldman Sachs & Co., Inc. (GSCo), and therefore eligible for advancement of legal fees and expenses for his ongoing defense in a New York state criminal case, **even though the criminal action concerned the theft of confidential GSCo property**. The decision provides an interesting lesson in the differences between indemnification and advancement and who may be considered an officer for purposes of awarding indemnity and advancement.

### Background

For two years, Sergey Aleynikov was an employee of GSCo and part of a team of computer programmers responsible for developing source code for GSCo’s high frequency trading system. During his time at GSCo, Aleynikov held the title of “vice president.”

After accepting an offer of employment with a startup company, Aleynikov allegedly copied and transmitted thousands of lines of confidential source code to his home computer. He was eventually arrested by the FBI and charged for his actions.

The U.S. District Court for the Southern District of New York convicted Aleynikov on two federal counts and sentenced him to 97 months in prison. On appeal, the U.S. Court of Appeals for the 2d Circuit reversed the district court’s decision, finding that Aleynikov’s behavior did not fall within the scope of the federal crimes. Shortly thereafter, Aleynikov was rearrested and indicted by a Manhattan grand jury on similar state charges.

GSCo is a limited liability partnership organized under New York law and a non-corporate subsidiary of Goldman Sachs Group, Inc. (Goldman), a Delaware corporation. One section of Goldman’s bylaws provided for indemnification and advancement to directors and officers of Goldman’s subsidiaries.

Aleynikov subsequently sought indemnification for the legal fees and expenses he incurred in the federal case from his former employer, GSCo. He also sought an advancement of legal fees and expenses for his ongoing defense in the New York state criminal case.

### Indemnity, Advancement and Officer Status

According to the district court, the main issue in deciding Aleynikov’s motion for summary judgment was whether Aleynikov was entitled to advancement or indemnity as an officer of GSCo within the terms of Goldman’s bylaws.

### Delaware Law Authorizes Indemnity and Advancement

The court started by looking to Delaware General Corporate law, which authorizes indemnity of legal expenses when a current or former corporate official has been successful on the merits or otherwise in his legal defense. Delaware also authorizes the advancement of expenses being incurred in pending proceedings. The court recognized that the right to indemnification and the right to advancement are separate and distinct. Specifically, the court noted that indemnification depends on whether the officer’s defense in the litigation was successful. Conversely, advancement depends on the pendency of the claims asserted against the corporate official in that its purpose is to offer “immediate relief from the personal out-of-pocket financial burden” of paying significant legal fees.



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## Definition of Officer Construed Broadly Based on Strong Delaware Public Policy Concerns

The court noted that, under Goldman's bylaws, indemnification and advancement are mandatory provided certain conditions are met. Specifically, the bylaws restrict indemnification and advancement to particular persons, including officers, a term defined therein as "any officer of such entity, [and] any person serving in a similar capacity or as the manager of such entity." Aleynikov did not claim that he served "in a similar capacity" to an officer or that he served as a "manager." Instead, Aleynikov claimed that his title of vice president made him an officer and therefore, he was entitled to advancement and indemnification of his legal fees.

The court found the question of whether Aleynikov was an officer to be close. Ultimately, the court found that Aleynikov was entitled to the advancement of legal fees and expenses, noting the urgency to fund the defense while it was still pending. The court withheld judgment on the indemnification issue until discovery was more developed and related issues regarding Goldman's counterclaims, which could provide an offset to the indemnity claim, were ripe for determination.

In determining that Aleynikov was entitled to the advancement of legal fees as an officer of GSCo, the court looked to Goldman's bylaws and Delaware's strong statutory policy in favor of advancement and indemnification. According to the court, the public policy served by authorizing advancement of litigation expenses was well-settled, and allowed corporations to retain high-quality directors and officers willing to make "socially useful decisions" involving economic risk. Moreover, the court noted that Delaware law prioritized speed over accuracy in advancement. As such, the court held that Delaware's strong statutory policy favoring immediate advancement dictated a liberal reading of Goldman's bylaws in favor of advancement.

## Goldman's Loose Procedures for Appointing Officers Prevents Goldman from Denying that Status to Aleynikov

The court next considered three categories of parol evidence produced in discovery: (a) GSCo's procedure for appointing officers; (b) Goldman's and GSCo's track record of indemnifying personnel; and (c) the effect of title inflation on the meaning of vice president. In looking to GSCo's appointment procedure, the court found that the company allowed itself a "broad range of discretion, parallel and unrelated" to the procedure in the bylaws, which did not specify any appointment procedure. Goldman, however, contended that GSCo's practice was to appoint officers only by formal resolutions of the general partner, which were confidential. Because GSCo's appointment process was highly flexible, it shed little light on interpreting who was an officer for purposes of the bylaw provision and did not create a material, triable issue of material fact.

When looking to Goldman's track record of indemnification and advancement of officers, the court found that over a six-year period 53 people were considered for advancement or indemnification and Goldman paid the legal fees of 51 of them, including 15 vice presidents. Although one of the persons denied was a vice president, Goldman never cited the person's title as reason for denying legal fees. Moreover, Goldman's claims that decisions to provide indemnification or advancements were discretionary did not offer the court insight into the ambiguities of the term officer used in the bylaws. In addition, Goldman contended that, in the financial services industry, the title of vice president is very common and is intended to distinguish someone who is senior to an associate but distinct from an officer within the meaning of the bylaw. Goldman's evidence of title inflation, however, did not bar summary judgment, in particular because the burden of uncertainty fell on Goldman. Although Goldman may have been generous in providing the title to numerous employees, the court found the company "must bear the consequences of that profligacy."

Finally, the court considered the record under Delaware law and resolved potential ambiguities in the bylaws under the ordinary rules of contract construction. The court found that the usual and ordinary meaning of the term vice president, and case law, provided that the bylaws were unambiguous. According to the court, the parol evidence offered by Goldman was not sufficient to raise a material issue of fact in light of Delaware's liberal interpretation principles favoring advancement. Moreover, Delaware's doctrine of *contra proferentem* when applied to Goldman's corporate bylaws required that they be interpreted against Goldman, as the corporate drafter. Whether Aleynikov read or relied on the bylaws was irrelevant, under Delaware law, he was entitled

to rely on the rights set forth in them.

The court awarded Aleynikov advancement for fees incurred to date in the state action, reasonable fees going forward, and the fees and expenses incurred in establishing his right to advancement.

With respect to indemnification, however, although there was no dispute that Aleynikov had been successful in the federal action, the court believed that the issues regarding potential offsets that might derive from Goldman's counterclaims may not have been fleshed out by limited discovery focused mainly on the advancement dispute. Thus, the court denied this part of Aleynikov's motion pending further discovery.

## Conclusion

The issue of whether to pay the legal expenses and fees of an employee accused of wrongdoing is an ever more important concern due to the recent wave of white collar prosecutions. In *Aleynikov*, Goldman faces advancing defense fees for someone it has accused of misappropriating its trade secrets. The *Aleynikov* case demonstrates the liberality with which courts may interpret advancement provisions in corporate bylaws governed by Delaware law. The decision also illustrates the pitfalls companies may face when they fail to define precisely who is an officer for purposes of entitlement to advancement or indemnification – a not uncommon situation in corporate bylaws. Finally, *Aleynikov* also shows that indemnification may not be automatic even when the indemnitee has been successful in the underlying litigation and the bylaw provides for mandatory indemnity. The *Aleynikov* Court's analysis of who constitutes an officer and of the differences between advancement and indemnification provides valuable insight for corporations and their D&O insurers on these issues.

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To discuss any questions you may have regarding the issues discussed in this Alert, or how they may apply to your particular circumstances, please contact **Angelo Savino** at 212.908.1248 or [asavino@cozen.com](mailto:asavino@cozen.com) or **Kristie Able** at 215.665.2715 or [kabel@cozen.com](mailto:kabel@cozen.com).