

IN THE SUPREME COURT OF OHIO

Murray A. Miller, et al.,

Appellees,

v.

Sam M. Miller, et al.,

Appellants.

Case No. 2011-0024

**On Appeal from the
Trumbull County Court of Appeals,
Eleventh Appellate District**

**Court of Appeals
Case No. 2009-T-0061**

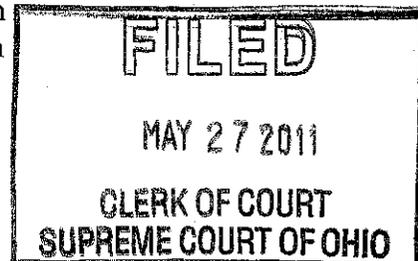
**MERIT BRIEF OF AMICUS CURIAE THE OHIO STATE BAR ASSOCIATION
IN SUPPORT OF APPELLANT SAM M. MILLER**

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INTRODUCTION AND STATEMENT OF INTEREST OF AMICUS CURIAE

Enacted in 1986 by emergency measure to forestall the impending flight of Ohio corporations to states with superior protections for corporate directors, R.C. 1701.13(E)(5)(a) requires a corporation to advance directors' legal expenses whenever they are sued "by reason of the fact" that they serve as directors of Ohio corporations. The advanced fees are subject to later repayment if allegations of misconduct are proven, but the default rule mandating advancement applies unless a corporation elects otherwise in its articles or regulations. This default rule supplies a reliable advancement regime, helping the state attract and retain capable directors.

Amicus curiae the Ohio State Bar Association (the "OSBA") was the driving force behind the emergency adoption of Ohio's mandatory advancement regime. Ohio Passes Law to Curb Lawsuits Against Directors, Corp. Fin. Wk., Dec. 1, 1986, at 4. In the early 1980s, directors of Ohio corporations faced increasing exposure to meritless lawsuits at great personal expense. Many directors were unwilling to serve on the boards of Ohio corporations. Corporations, in turn, began to leave the state, citing laws in other jurisdictions that were more amenable to attracting director talent. At the strong recommendation of the OSBA, and citing "an urgent need to attract qualified individuals to serve as directors of corporations and to assure that corporations remain incorporated in this state," Am.Sub.H.B, No. 902, Section 10, 1986 Ohio Laws 6107, 6153, the General Assembly responded by enacting the mandatory-advancement regime codified in R.C. 1701.13(E)(5)(a). Edward A. Schrag, Jr., Report of the Corporation Law Committee (1986), 59 Ohio St. B. Ass'n Rep. 1694, 1695. Sponsored by, among many others, then-Senators Pfeifer and Cupp, the legislation passed with "overwhelming" support. See Am.Sub.H.B. No. 902; Ohio Passes Law to Curb Lawsuits Against Directors, Corp. Fin. Wk., Dec. 1, 1986, at 4.

The OSBA's interest in this case is the same interest that caused it to propose the 1986 legislation—a powerful interest in ensuring that Ohio's corporations can continue to attract and retain qualified directors. The default rule established by R.C. 1701.13(E)(5)(a) furthers critical policy objectives, helping attract capable directors to the state by supplying a reliable mandatory advancement regime. “[A]dequate legal representation often involves substantial expenses during the course of the proceeding and many individuals are willing to serve as directors only if they have the assurance that the corporation has the power to advance those expenses.” 2 Model Bus. Corp. Act. Ann. § 8.53 cmt. at 8-425 (4th ed. Supp. 2009). “Mandatory advances, like indemnification, serve the salutary purpose of encouraging qualified persons to become or remain” directors “by assuring them, ex ante, that they may resist lawsuits that they consider meritless, free of the burden of financing (at least initially) their own legal defense.” *In re Cent. Banking Sys., Inc.* (Del. Ch. May 11, 1993), No. CA 12497, 1993 WL 183692, at *3.

Many of the OSBA's 23,000 members advise Ohio directors whose service benefits not just corporations, but “the corporation's employees, suppliers, creditors, and customers,” “[t]he economy of the state and nation,” and their “[c]ommunity and societ[y].” R.C. 1701.59(E). Ohio corporations counseled by OSBA members rely on the director protections of the state's corporate laws to attract top-flight directors, without whom Ohio businesses and the Ohio economy would suffer a severe competitive disadvantage. OSBA members and their clients have relied on R.C. 1701.13 in drafting corporate charters and bylaws. In addition to their general civic interests as residents and taxpayers in a statewide economy that relies on sound corporate leadership, OSBA members bear professional responsibilities to promote the accurate and predictable interpretation of Ohio's corporate laws.

The fractured decision below (which prompted three opinions from the three-judge panel) undermines the core guarantees of section (E)(5)(a) and destroys the reliability of Ohio's mandatory advancement regime. *First*, the Court of Appeals inexplicably restricted the availability of indemnification (and therefore advancement) to suits in which directors are *plaintiffs*, when the statute was intended to protect directors as *defendants*. *Second*, the decision below permits a plaintiff's unproven allegations to nullify a director's right to advancement. By holding that advancement under section (E)(5)(a) is mandatory only when the director is alleged to have been acting "on behalf of the corporation"—*i.e.*, in the corporation's interests—rather than whenever the director is sued "by reason of the fact" of his or her position, the Court of Appeals' decision precludes advancement in virtually all cases for which the General Assembly intended to require advancement. *Third*, the Court of Appeals' decision reverses Ohio's mandatory default rule, eliminating R.C. 1701.13(E)(5)(a)'s plain requirement that, unless a corporation opts out of Ohio's mandatory advancement regime in its articles or regulations in advance of litigation, the corporation *must* advance a director's litigation expenses. *Fourth*, the concurring opinion introduces conditions on directors' rights to advancement from irrelevant areas of law which even Appellees concede "would find little support in Ohio case law."

Though this particular case happens to involve a family dispute over the governance of a company wholly owned and directed by two pairs of related brothers, the legal principles announced in the decision below would affect the directors of every Ohio corporation. Consistent with its mission "to promote improvement of the law, our legal system, and the administration of justice," the OSBA respectfully submits this brief in support of Appellant Sam M. Miller.

STATEMENT OF THE CASE AND FACTS

The OSBA adopts the statement of the case and facts presented in the brief of Appellant Sam M. Miller.

ARGUMENT IN SUPPORT OF PROPOSITIONS OF LAW

R.C. 1701.13(E)(5)(a) establishes a clear default rule requiring Ohio corporations to advance a director's litigation expenses. Unless a corporation expressly opts out of section (E)(5)(a) in its articles or regulations, it *must* advance litigation expenses to a director named as a defendant in any case "referred to" in either R.C. 1701.13(E)(1) or R.C. 1701.13(E)(2). These sections refer to "any . . . action" brought against a director "by reason of the fact that he is or was a director." R.C. 1701.13(E)(1)-(2). Whether a director is sued by the corporation itself, or by shareholders in a derivative action, as referred to in R.C. 1701.13(E)(2), or by a third party as contemplated by R.C. 1701.13(E)(1), the mandatory advancement provisions of section (E)(5)(a) require a corporation to advance a director's litigation expenses unless its articles or regulations specifically provide otherwise. The Court of Appeals departed from this regime in four important respects.

Proposition of Law No. 1: A corporation is not excused from its duty under R.C. 1701.13(E)(5) because a director is a defendant.

The appellate court transformed a statute enacted by emergency measure for the benefit of directors as *defendants* into a statute that benefits directors only if they are *plaintiffs*. As the Court of Appeals itself recognized, advancement of a director's litigation expenses is mandatory where the director "ha[s] been sued" in any action "referred to in division (E)(1) or (2)." *Miller v. Miller*, 190 OhioApp.3d 458, 2010-Ohio-5662, 942 N.E.2d 438, at ¶ 49. The Court of Appeals inexplicably held, however, that indemnification under section (E)(2), and therefore advancement under section (E)(5), is limited to litigation where "a director . . . seeks to procure a judgment in favor of the corporation." *Miller* at ¶ 52. In other words, the court found that actions "referred to in" section (E)(2) are those in which the director is the party suing on behalf of the corporation rather than the party *being sued* by or on behalf of the corporation.

That conclusion is obvious error. By its plain language, R.C. 1701.13(E)(2) contemplates suits in which the director seeking indemnification will have been named as a defendant in the underlying litigation. That is why section (E)(2) authorizes indemnification “against expenses . . . incurred . . . in connection with *the defense* or settlement of such action or suit.” R.C. 1701.13(E)(2) (emphasis added); see also *id.* (providing for indemnification where the director “is *threatened to be made a party*” to an action) (emphasis added). The court below never explained (nor could it) how a statute that expressly covers expenses incurred in *the defense* of a suit could be limited to cover only expenses incurred in *the prosecution* of a suit.

Evidently, the Court of Appeals was uncomfortable with the notion that a corporation could be required to advance fees for a director that the corporation itself is suing. Yet that is precisely what the statute requires, if the corporation does not elect to provide otherwise in its articles or regulations. Although section (E)(2) applies to actions prosecuted “to procure a judgment in [the corporation’s] favor,” nowhere does section (E)(2) require that the director seeking advancement be the one who seeks to procure that judgment. Rather, the express language of section (E)(2) provides for indemnification in actions brought “by or in the right of the corporation” in which the director is named as a defendant, explicitly contemplating that a director will be sued by the corporation itself and still be entitled to advancement. Limiting section (E)(2) to lawsuits in which the director acts as the plaintiff “to procure a judgment on behalf of the corporation” is inconsistent with the clear language of the statute.

Moreover, the Court of Appeals’ interpretation is flatly at odds with the legislative history of the statute, which confirms that the General Assembly specifically intended to authorize corporations to indemnify directors against expenses incurred in defending litigation. When section (E)(2) was adopted in 1955, the OSBA Corporation Law Committee explained that

the legislature sought “to indemnify . . . directors and officers *who are sued* by reason of serving the corporation as a director or officer against the expenses incurred by them *in defending themselves*.” Ohio Rev. Code Ann. § 1701.13 cmt. at 62 (West 2009) (emphases added). The comments of the Ohio State Bar Association Committee provide clear guidance on the definitions at issue here. See *Armstrong v. Marathon Oil Co.* (1987), 32 Ohio St.3d 397, 406, 513 N.E.2d 776.

The decision below ignores not only the plain text of the statute and its legislative history, but also basic principles of corporation law. After all, a director is generally *unable* to bring derivative suits in the first instance. Only shareholders have that power. See, e.g., Civ.R. 23.1 (describing a derivative action as an action “brought by one or more *legal or equitable owners of shares* to enforce a right of a corporation,” and requiring that the complaint allege “that *the plaintiff was a shareholder* at the time of the transaction of which he complains”) (emphases added); *Crosby v. Beam* (1989), 47 Ohio St.3d 105, 107, 548 N.E.2d 217 (“A shareholder’s derivative action is brought by a shareholder in the name of the corporation to enforce a corporate claim.”). A director might conceivably sue in an alternative capacity as a shareholder, if he or she owns shares. But a director cannot bring a derivative suit solely in his or her capacity as director. Accordingly, under the decision below, a director would never be entitled to indemnification (or advancement) as a defendant in a suit by the corporation or the shareholders derivatively, because the Court of Appeals’ interpretation of section (E)(2) requires the director to be the plaintiff “seek[ing] to procure a judgment in favor of the corporation.” By rendering indemnification (and advancement) unavailable in precisely the circumstances a director would properly seek to enforce his or her rights, the court below clearly erred.

Proposition of Law No. 2: Under Ohio’s mandatory advancement regime, a corporation must advance litigation expenses to a director, regardless of the unproven allegations of claimants.

By permitting a plaintiff’s allegations to thwart Ohio’s mandatory advancement regime, the Court of Appeals created a different but equally novel condition which would moot R.C.1701.13(E)(5)(a) in the precise circumstances it was enacted to govern. According to the court below, if a plaintiff alleges that a director acted against the interests of the corporation, section (E)(5)(a) does not require advancement of the director’s litigation expenses because the director was not acting “on behalf of the corporation.” *Miller* at ¶ 49-50 (ruling that for R.C. 1701.13(E)(5)(a) to apply, “the director must have been sued as a result of an ‘act or omission’ on behalf of the corporation.”). This unprecedented “on behalf of the corporation” condition, which has no basis in law, effectively nullifies Ohio’s mandatory advancement statute, which was designed to ensure advancement where the director is alleged (as is routinely alleged in this line of litigation) to have acted against the corporation’s interests.

A. The Court of Appeals’ novel “on behalf of the corporation” condition has no basis in any authority.

The supposed requirement that a director must have been acting “on behalf of the corporation” to receive advancement of litigation expenses is a whole-cloth creation of the court below. The phrase “on behalf of the corporation” does not appear anywhere in section (E)(5)(a). And nowhere does the statute require, as a condition of advancement, that the underlying litigation involve a director’s act or omission “on behalf of the corporation.” Instead, section (E)(5)(a) broadly requires advancement in *all* actions arising “by reason of the fact” of the director’s corporate service. The statute covers any lawsuit filed against a director in connection with his or her corporate capacity.

To the limited extent that Ohio law restricts mandatory advancement for directors, it does so based only on the *types of actions*—those “referred to in” either R.C. 1701.13(E)(1) or R.C. 1701.13(E)(2)—in which advancement is sought. And section (E)(2) expressly contemplates that a director will be sued by the corporation itself, or by shareholders derivatively in the right of the corporation. In those suits, the only conceivable allegations will be that the director was acting against the interests of the corporation, not “on behalf of the corporation,” as the Court of Appeals used that phrase.

Contrary to the decision below, unproven allegations made against a director in no way limit a corporation’s duty to advance a director’s litigation expenses in any lawsuit related to the director’s official capacity. The statute clearly provides that a corporation must advance expenses to a director who is named “by reason of the fact that he is or was a director” as a party in any action either “by or in the right of the corporation,” as well as in actions by a third party “other than by or in the right of a corporation.” Consistent with this understanding, Delaware courts have addressed when a suit arises “by reason of the fact” that a defendant is a director and is therefore entitled to advancement. “[I]f there is a nexus or causal connection between any of the underlying proceedings [for which advancement is sought] and one’s official corporate capacity, those proceedings are ‘by reason of the fact’ that one was a corporate [official].” *Homestore, Inc. v. Tafeen* (Del. 2005), 888 A.2d 204, 214. In determining whether a director is sued “by reason of the fact” that he is a director, “the key inquiry is whether the claim depends on a showing that the [director] breached duties, quintessentially fiduciary duties, he owed to the corporation in that capacity or faces liability from a third party due to actions taken in his official capacity.” *Zaman v. Amedeo Holdings, Inc.* (Del. Ch. May 23, 2008), C.A. No. 3115-VCS, 2008 WL 2168397, at *17. As these decisions emphasize, allegations of misconduct—which are

inevitable in any lawsuit against a director—do not restrict a director’s right to advancement under section (E)(5)(a). There is no basis in the statute for the Court of Appeals’ conclusion that section (E)(5)(a) applies only where the director is sued for an act or omission “on behalf of the corporation.” Rather, the statute *requires* advancement in suits “by or in the right of the corporation” or “other than an action by or in the right of the corporation” in which a director is named “*by reason of the fact*” of his or her corporate service.

B. By importing irrelevant limiting conditions from Ohio’s indemnification statutes, the Court of Appeals eliminated the independent advancement guarantees for which section (E)(5)(a) was enacted.

The Court of Appeals derived its new “on behalf of the corporation” limitation on *advancement* under section (E)(5)(a) from the unrelated conditions that limit a corporation’s authority to *indemnify* corporate officials after the conclusion of an action. In doing so, the Court of Appeals eliminated the additional, independent advancement guarantees specifically extended by the General Assembly to directors of Ohio corporations. The General Assembly enacted current section (E)(5)(a) in 1986 to supplement the existing indemnification and permissive advancement regimes, creating a mandatory default rule for directors to ensure that Ohio directors would reliably be guaranteed, at the outset of litigation, the resources necessary to defend themselves against suits related to their corporate service, subject to possible later repayment. Yet the Court of Appeals’ decision eliminates that guarantee for all practical purposes.

Before the 1986 amendments, section 1701.13(E) provided that corporations could indemnify directors after the conclusion of an action, and *permitted* corporations to advance directors’ litigation expenses. See Am.Sub.H.B. No. 902, 1986 Ohio Laws 6107, 6116. By 1986, however, derivative litigation was fast becoming a cottage industry, and directors of Ohio corporations faced exposure to increasingly routine and often meritless litigation arising simply

by reason of the fact of their corporate service. See Edward A. Schrag, Jr., Report of the Corporation Law Committee (1986), 59 Ohio St. B. Ass'n Rep. 1694, 1695; Richard A. Myers, Jr., Where Have All The Directors Gone? Corporate Director and Officer Liability and Coping with the Insurance Crisis (1988), 36 Clev. St. L. Rev. 575, 575.

Facing the flight of Ohio corporations to jurisdictions that provided superior protections for directors, and at the urging of the OSBA, the General Assembly responded to the impending crisis with an emergency measure that established a default rule requiring corporations to advance directors' litigation expenses. Am.Sub.H.B. No. 902, 1986 Ohio Laws 6107, 6153. As amended, the statute ensures that directors either have a reliable guarantee that the corporation they serve will supply the resources necessary to defend claims brought against them in their capacity as directors. Or, where the corporation has opted out of the mandatory advancement regime in its charter or regulations, the directors are fully on notice before any dispute arises that the corporation makes no such guarantee.

By requiring that a corporation advance a director's litigation expenses "as they are incurred, in advance of the final disposition of the action," R.C. 1701.13(E)(5)(a), the General Assembly recognized that advancement is extremely time-sensitive, and with any delay "its benefit is forever lost because the failure to advance fees affects the counsel the director may choose and litigation strategy that the executive or director will be able to afford." *Homestore, Inc. v. Tafeen* (Del. 2005), 886 A.2d 502, 505. To have any meaning, advancement guarantees must be enforced *before* any allegations have been proven or disproven.

Critically, unlike a corporation's authority to provide for indemnification, a corporation's duty to advance a director's litigation expenses under section (E)(5)(a) does not depend on whether the director prevails on the merits. Nor is advancement conditioned on a finding that the

director “acted in good faith and in a manner he reasonably believed to be in or not opposed to” the corporation’s best interests. To be sure, *after* the claims have been resolved, a corporation may require a director to repay the advanced expenses “if it is proved by clear and convincing evidence in a court of competent jurisdiction that his action or failure to act involved an act or omission undertaken with deliberate intent to cause injury to the corporation or undertaken with reckless disregard for the best interests of the corporation.” R.C. 1701.13(E)(5)(a)(i). But nothing in section (E)(5)(a) limits a corporation’s duty to advance litigation expenses *before* the underlying claims have been resolved in court.

The statute draws a clear distinction between a director’s unconditional *ex ante* right to advancement and the conditional *ex post* right to indemnification. The Court of Appeals’ novel “on behalf of the corporation” standard, however, conflates the two by importing into the advancement regime inapplicable conditions from the indemnification provisions of sections (E)(1) and (E)(2). Apparently relying on the fact that a corporation’s authority to indemnify a corporate official is conditioned on the official having “acted in good faith and in a manner he reasonably believed to be in or not opposed to the best interests of the corporation,” *Miller* at ¶ 51, the court concluded that, where a director is sued for acts “allegedly in contravention of his fiduciary duties as a director,” *id.* at ¶ 50, or acts that caused “harm to the corporation as a result of a violation of his duties *to* the corporation,” *id.* at ¶ 53, advancement under section (E)(5)(a) does not apply. A director alleged to have acted *against* the best interests of the corporation, the court below reasoned, cannot have been sued “as a result of an ‘act or omission’ on behalf of the corporation,” *id.* at ¶ 49-50.

Nothing in section (E)(5)(a), however, links a director’s right to advancement to the conditions for indemnification set forth in sections (E)(1) and (E)(2)—and it would make no

sense to link the two. Section (E)(5)(a) requires advancement regardless of the ultimate availability of indemnification. See *Ridder v. CityFed Financial Corp.* (C.A.3 1995), 47 F.3d 85, 87 (noting that directors' "right to receive the costs of defense in advance does not depend upon the merits of the claims asserted against them, and is separate and distinct from any right of indemnification they may later be able to establish"). Although section (E)(5)(a) refers to the indemnification provisions, it does so only to describe the types of actions—those "referred to in" the indemnification provisions of sections (E)(1) and (E)(2)—in which a director's expenses must be advanced. Indeed, section (E)(8) explicitly states that "[t]he authority of a corporation to indemnify persons pursuant to division (E)(1) or (2) of this section does not limit the payment of expenses as they are incurred." R.C. 1701.13(E)(8). The Court of Appeals therefore erred in relying on the indemnification provisions of sections (E)(1) and (E)(2) to restrict a corporation's obligation to advance a director's litigation expenses.

C. By permitting a claimant's unproven allegations to vitiate a corporation's duty to advance litigation expenses, the Court of Appeals has rendered Ohio's advancement statute a "nullity."

The Court of Appeals' "on behalf of the corporation" condition destroys Ohio's mandatory advancement statute. The General Assembly sought to mandate advancement for directors regardless of a director's ultimate right to indemnification, and regardless of the allegations made in the complaint.¹ Under the Court of Appeals' interpretation of section (E)(5)(a), however, a director's right to mandatory advancement will be eliminated in virtually every action "referred to" in section (E)(2), despite the plain language *requiring* advancement in

¹ If "the only liability asserted against a director in an action, suit, or proceeding referred to in division (E)(1) or (2) of this section is pursuant to section 1701.95 of the Revised Code," which authorizes joint and several liability of directors who vote for or assent to various self-dealing transactions, such as "[t]he payment of a dividend or distribution . . . contrary . . . to law or the articles," section (E)(5)(a) does not apply. R.C. 1701.13(E)(5)(a); R.C. 1701.95(A)(1).

precisely those lawsuits. A director sued “by or in the right of the corporation” is never sued for having acted *in* the corporation’s interests—in this type of litigation, a director is always alleged to have acted *against* the corporation’s interests.

Directors named as defendants in suits by the corporation itself or shareholders derivatively are sued for actions that allegedly harmed the corporation, such as breaches of fiduciary duty. Where a director breaches his or her fiduciary duties by, for example, usurping a corporate opportunity, “[t]he right of redress is in the corporation itself because the injury or loss is to the corporation[.]” 12 Ohio Jurisprudence 3d (2006), Business Relationships, Section 914. The corporation can pursue the claim itself through its board of directors.² Alternatively, the corporation’s shareholders may bring a “derivative action.” *Id.* Because “[a] prerequisite to any shareholder’s derivative suit” (and a suit by the corporation itself) “is that the corporation sustain damage as a consequence of the alleged wrong,” *id.* Section 919, actions “by or in the right of the corporation” necessarily will allege that the director acted in a manner that harmed the corporation, not that the director acted “on behalf of the corporation.” Conditioning a director’s right to mandatory advancement on the absence of any allegations of wrongdoing to the corporation, as the Court of Appeals has done, moots Ohio’s advancement guarantee in the very cases to which it was intended to apply.

Limiting the application of section (E)(5)(a) to cases involving allegations that the director acted “on behalf of the corporation” also invites abuse on a vast scale. Simply by alleging that a director usurped a corporate opportunity or otherwise breached a fiduciary duty—as is claimed in virtually all cases “by or in the right of the corporation”—the corporation or

² In Ohio, “the ‘board of directors has the primary authority to file a lawsuit on behalf of the corporation.’” *In re Ferro Corp. Derivative Litig.* (C.A.6 2008), 511 F.3d 611, 618 (quoting *Drage v. Proctor & Gamble* (1997), 119 Ohio App.3d 19).

shareholders could readily sever a defendant director from his or her right to advancement. Section (E)(5)(a), however, was intended to *require* advancement of a director's litigation expenses in "nearly all situations." Deborah Cahalane, 1986 Ohio Corporation Amendments: Expanding the Scope of Director Immunity (1987), 56 U. Cin. L. Rev. 663, 675. As the Chairman of the OSBA Corporation Law Committee that proposed the amendment explained, "an Ohio corporation in most cases is *required* by statute to advance expenses to a *director* that are incurred in defending any action." Edward A. Schrag, Jr., et al., Director and Officer Liability and Indemnification: The Ohio Approach (1988), 20 U. Tol. L. Rev. 1, 47. Neither a corporation, nor its shareholders derivatively, may void its guarantee of mandatory advancement by claiming that "the corporation now believes the fiduciary to have been unfaithful. Indeed, it is in those very cases that the right to advancement attaches most strongly." *Radiancy, Inc. v. Azar* (Del. Ch. Jan. 23, 2006), No. Civ.A. 1547-N, 2006 WL 224059, at *1. Accordingly, a director is never required "to prove that his or her conduct met an applicable standard, or that the allegations in the underlying legal proceeding are untrue" in order to obtain advancement. Richard A. Rossman, et al., A Primer on Advancement of Defense Costs: The Rights and Duties of Officers and Corporations (2007), 85 U. Det. Mercy L. Rev. 29, 33.

"Case law quite clearly demonstrates that a corporation may be required to advance fees in the face of allegations of extreme misconduct . . . , even when such allegations against the [director] are made by the corporation itself." Rossman, et al., at 31. Even where directors allegedly acted "on behalf of" themselves by, for example, "diverting corporate resources to their own pocketbooks," directors are entitled to advancement. *Reddy v. Electronic Data Sys. Corp.* (Del. Ch. June 18, 2002), No. CIV.A. 19467, 2002 WL 1358761, at *5. Advancement is not "dependent on the motivation ascribed to [directors'] conduct by the suing parties." *Id.* The

Court of Appeals therefore erred in requiring as a condition of advancement that a director be sued as a result of an act or omission “on behalf of the corporation.”

Proposition of Law No. 3: A corporation may “opt out” of the mandatory duty imposed by R.C. 1701.13(E)(5), through a statement in its articles or regulations, but it may not wait until litigation commences and seek to escape its obligation.

Lastly, the Court of Appeals erred by transforming the “opt-out” rule set forth in R.C. 1701.13(E)(5)(a) into an “opt-in” rule. According to the Court of Appeals, there can be no advancement if the corporation’s articles and regulations are silent on advancement. See *Miller* at ¶ 57. But by its plain language, section (E)(5)(a) mandates advancement of a director’s litigation expenses “[u]nless at the time of a director’s act or omission that is the subject of [the underlying litigation] the articles or the regulations of the corporation state, by specific reference to [R.C. 1701.13(E)(5)(a)], that the provisions of this division do not apply to the corporation.” R.C. 1701.13(E)(5)(a); see Cahalane, at 672-73 (noting that the mandatory advancement provision will apply “[u]nless a corporation specifically opts out”).

Not surprisingly, courts applying statutes similar to R.C. 1701.13(E)(5)(a) recognize that advancement is mandatory unless a corporation opts out of the default advancement provision in its organizational documents. E.g., *Barry v. Barry* (C.A.8 1994), 28 F.3d 848, 851 (concluding that, under Minnesota’s nearly identical advancement provision, “advances are mandatory unless the corporation chooses to alter this scheme”); *Asian Women United of Minn. v. Leindecker* (Minn. Ct. App. 2010), 789 N.W.2d 688, 692 (“[U]nless otherwise specified in a corporation’s articles of incorporation or bylaws, . . . advancement [is] mandatory.”).

Even if the statute were the least bit unclear (which it is not), the legislative history of section (E)(5)(a) would remove any doubt. In summarizing an early version of section (E)(5)(a), the Chairman of the OSBA Corporation Law Committee stated that advancement for directors would be mandatory, but that “shareholders [could] amend the corporation’s articles or

regulations to make the proposal inapplicable.” Schrag, 59 Ohio St. B. Ass’n Rep. at 1694. The OSBA Corporation Law Committee’s official comment to R.C. 1701.13(E)(5)(a) further confirms that, “[u]nless the corporation’s articles or regulations specify that division (E)(5)(a) does not apply to the corporation,” section (E)(5)(a) “requires the advancement of a director’s expenses.” Ohio Rev. Code Ann. § 1701.13 cmt. at 61 (West 2009).

The legislative history further shows that section (E)(5)(a) was enacted to *supplement* the *permissive* advancement statute that was already in place. Current section (E)(5)(b), which existed prior to the 1986 enactment of section (E)(5)(a), provides that “[e]xpenses, including attorney’s fees, incurred by a director, trustee, officer, employee, member, manager, or agent in defending any action, suit, or proceeding referred to in division (E)(1) or (2) of this section, *may* be paid by the corporation as they are incurred, in advance of the final disposition of the action, suit, or proceeding.” R.C. 1701.13(E)(5)(b) (emphasis added). Thus, even without section (E)(5)(a), a corporation has the authority to advance litigation expenses under section (E)(5)(b). In enacting section (E)(5)(a), the legislature thus sought to provide *additional* protection to directors by requiring corporations to advance directors’ litigation expenses entirely independent of the permissive advancement provision set forth in section (E)(5)(b). See Schrag, 59 Ohio St. B. Ass’n Rep. at 1697 (setting forth an earlier draft of section (E)(5)(a) that required advancement of litigation expenses “[i]n the case of directors only, unless otherwise provided in the articles or the regulations”) (emphasis added). The Court of Appeals’ decision eliminates the statute’s clear “opt-out” requirement, thus rendering the 1986 “emergency measure” meaningless.

The only explanation offered by the Court of Appeals to justify its erroneous conclusion was that applying the statute as written “ha[d] been considered and rejected by the Eastern

District of Virginia” in *James River Management Co. v. Kehoe* (E.D. Va. 2009), 674 F.Supp.2d 745. *Miller* at ¶ 57. The Court of Appeals’ reliance on *Kehoe* is misplaced, however, because *Kehoe* itself profoundly misunderstands Ohio’s indemnification and advancement provisions.³ *Kehoe* held that, reading section 1701.13(E) “as a whole, its plain language supports the construction that advancement is mandated [under section (E)(5)(a)] only when the corporation has exercised the underlying right to make indemnification available.” *Kehoe*, 674 F.Supp.2d at 753. Adopting the reasoning of *Kehoe*, the Court of Appeals agreed that “it would be incongruous to require corporations to ‘opt in’ to indemnification,” but require them to “‘opt out’ of the corollary advancement remedy.” *Miller* at ¶ 57 (quoting *Kehoe*, 674 F. Supp. 2d at 753).

What the *Kehoe* court and the Court of Appeals failed to appreciate, however, was that advancement and indemnification are separate and independent concepts. While “indemnification is a decision that must necessarily await the outcome of the investigation or litigation,” a director’s right to advancement must be determined before the merits of any allegations against a director are evaluated. *Kaung v. Cole Natl. Corp.* (Del. 2005), 884 A.2d 500, 509. Thus, while mandatory advancement is “an important corollary” to indemnification provisions, *Homestore*, 888 A.2d at 211, it is “a distinct remedy” in its own right, separate from

³ The *Kehoe* court should not have applied section (E)(5)(a) in the first place. The issue to which the court applied Ohio law was whether an Ohio corporation was required to advance litigation expenses to three of its former *officers*. *Kehoe*, 674 F.Supp.2d at 747, 755. Section (E)(5)(a), however, applies only to advancement of *directors’* litigation expenses. The concerns motivating the court’s error in *Kehoe* are therefore themselves misplaced.

Moreover, it is simply not the case that mandating advancement in the absence of indemnification would, as the court in *Kehoe* believed, “result in legal fees being advanced in cases where the party seeking advancement has absolutely no prospect of ultimate indemnification from the corporation.” *Id.* at 755. *Kehoe* failed to recognize that a corporation “shall” indemnify a director “[t]o the extent that a director . . . has been successful on the merits or otherwise.” R.C. 1701.13(E)(3). Thus, even when the corporation does not provide for indemnification pursuant to sections (E)(1) or (E)(2), there is a “prospect of ultimate indemnification” because a director could be “successful on the merits or otherwise,” and therefore entitled to indemnification under section (E)(3).

indemnification, *MD Acquisition, LLC v. Myers*, 173 Ohio App.3d 247, 2007-Ohio-3521, 878 N.E.2d 37, at ¶ 6. It serves the entirely different function of providing reliable assurances “*ex ante*, that [directors] may resist lawsuits that they consider meritless, free of the burden of financing (at least initially) their own legal defense.” *In re Cent. Banking Sys., Inc.*, 1993 WL 183692, at *3. Thus, under certain circumstances, a director will be entitled to advancement under section (E)(5)(a) even where the director ultimately is not entitled to indemnification. But the ultimate availability of indemnification after the action’s conclusion is entirely independent of a corporation’s *ex ante* duty to advance a director’s litigation expenses whenever he is sued “by reason of the fact” that he is a director.

In any event, the “incongruity” to which the *Kehoe* court took exception was specifically *required* by Ohio law. Far from being impermissibly “incongruous” to require opt-in provisions for advancement and opt-out provisions for indemnification, the General Assembly took a statute which was “congruous”—providing for both indemnification and advancement on an “opt-in” basis—and specifically determined that the default rule for advancement of directors’ litigation expenses should be reversed such that corporations would have to “opt out.” In short, the General Assembly specifically *created* incongruity, transforming advancement for directors into a mandatory opt-out regime, to provide heightened protections to directors. Thus, unlike the permissive advancement provision now set forth in section (E)(5)(b), which *permits* the corporation to advance litigation expenses where the corporate official agrees to repay the advanced fees “*if it is ultimately determined that he is not entitled to be indemnified by the corporation,*” section (E)(5)(a) *mandates* advancement to directors, and does not condition repayment on the director’s ultimate right to indemnification. R.C. 1701.13(E)(5)(a)(i)

(requiring repayment only if a court finds the director acted “with deliberate intent to cause injury to the corporation” or “with reckless disregard for the best interests of the corporation”).

By establishing a default rule mandating advancement of directors’ litigation expenses, the General Assembly explicitly provided that a corporation could choose to opt-out of the statute’s requirements by stating in its articles or regulations that section (E)(5)(a) would not apply. This is yet another area in which the *Kehoe* court profoundly misunderstood Ohio’s statute. *Kehoe* concluded that the “policy considerations [of attracting talented directors]. . . carry no weight” in the interpretation of Ohio’s advancement provision because “advancement is not a corporate decision, but is mandated [by statute].” *Kehoe*, 674 F.Supp.2d at 753. That reasoning is plainly without merit. Advancement remains a “corporate decision” in Ohio—the fact that an Ohio corporation chooses *not* to opt-out of mandatory advancement is no less of a “decision” than the decision of a Delaware corporation to provide for mandatory advancement in its organizational documents. Cf. Rossman, et al., at 33 (“Each jurisdiction may accomplish [the strong public policy in support of advancing fees to officers] differently. Depending on the statutory framework . . . , an unconditional obligation to advance could . . . be required or presumed by statute . . . [or] granted by organizational documents.”). An Ohio corporation *must*, however, decide in advance whether it will accede to Ohio’s mandatory advancement regime, or whether it will create another arrangement for its directors. It cannot accept the statutory default rule, electing not to make alternative arrangements, and then at the very moment a director seeks advancement, attempt to escape its obligations.

Nor can an Ohio corporation, having elected to initiate a lawsuit against one of its directors, attempt to escape its advancement obligations by waving a director’s undertaking to “reasonably cooperate” with the corporation in litigation as a talisman to avoid the application of

section (E)(5)(a). By mandating advancement in all actions “referred to in” section (E)(2), section (E)(5)(a) requires a corporation to advance a director’s litigation expenses when a corporation brings suit against the director. Despite that clear requirement, the concurrence concluded that a director is not entitled to advancement when sued by a corporation or its shareholders derivatively, reasoning that in such a suit, it would be “impossible for the director to reasonably cooperate with the corporation concerning the action inasmuch as the corporation’s and the director’s interests [would be] opposed,” and therefore the director could not fulfill one of the two undertakings required by section (E)(5)(a). Miller at ¶ 64 (Grendell, J., concurring).

Permitting a director’s undertaking to thwart the express language and clear function of the statute makes little sense. Where a director is sued by a corporation or derivatively by the shareholders in the right of the corporation—a situation section (E)(5)(a) clearly contemplated by its reference to section (E)(2)—it would hardly be “reasonable” to require the director to cooperate with the *opposing* party, and the undertaking to cooperate with the corporation would neither apply nor bar advancement under its own terms. Moreover, if, as the concurrence’s reasoning suggests, a director never can “reasonably cooperate” with the corporation when the corporation is on the other side of the litigation, then advancement of a director’s litigation expenses *never* would be mandatory in the types of actions “referred to in” section (E)(2). But that could not have been the intent of the General Assembly. After all, section (E)(5)(a) *explicitly provides* that advancement is mandatory when a director is involved in litigation of the type described in section (E)(2). What is more, eliminating an entire category of suits in which a corporation must advance a director’s litigation expenses is contrary to the clear purpose and legislative history of the statute—to provide additional protection to directors. Schrag, et al., 20 U. Tol. L. Rev. at 47 (noting that section (E)(5)(a) was added “[i]n an effort to protect directors”).

Notably, the concurrence relied on a case which is irrelevant to the statutory provisions here, referring to a statement in *Westbrook v. Swiatek* that “a corporation may be reluctant to advance funds to an *officer* who is perceived by the corporation as being unfaithful, for fear the funds will never be paid back.” *Miller* at ¶ 64 (emphasis added) (quoting *Westbrook v. Swiatek*, 5th Dist. No. 2009 CAE 05 0048, 2010-Ohio-2868, at ¶ 24). The case involved “advancement of litigation expenses to corporate *officers* for legal claims brought against them in that capacity.” *Westbrook* at ¶ 2 (emphasis added). *Westbrook*, however, has nothing to do with section (E)(5)(a), which mandates advancement only for *directors*. Advancement for officers is governed solely by section (E)(5)(b), which unlike (E)(5)(a) is a *permissive, optional* advancement statute with no bearing on mandatory advancement for directors. If a corporation has not elected to provide otherwise in its articles or regulations, advancement for directors is mandatory, regardless of a corporation’s construction of a director’s undertaking to “reasonably cooperate” in the litigation, or any concerns it may have about a director’s ability to repay the advanced expenses. Any such conditions, limitations, or alterations to the statutory default rule must be made by the corporation in its articles or regulations well in advance of litigation.

Countless directors of Ohio corporations rely upon the guarantees supplied by Ohio’s default rule that advancement will be available when sued “by reason of the fact” of their corporate service—whether by third parties, by shareholders, or by the corporation itself. If courts do not consistently enforce the responsibility of corporations to opt out of the mandatory advancement regime before the moment of litigation, Ohio’s advancement statute will “be rendered a nullity.” *United States v. Weissman* (S.D.N.Y. June 16, 1997), No. S2 94 CR. 760 (CSH), 1997 WL 334966, at *16.

Proposition of Law No. 4. Allegations that a director's conduct would not be protected by the business-judgment rule are irrelevant to a corporation's duty to advance fees.

As appellees concede, the concurrence below wrongly concluded that there can be no advancement if a plaintiff merely alleges that a director's conduct is unprotected by the business-judgment rule. Whether a director is protected by the business-judgment rule has no bearing on a director's entitlement to advancement under section (E)(5)(a), because the business-judgment rule is merely "a tool of judicial review, not a standard of conduct." *Gries Sports Ent., Inc. v. Cleveland Browns Football Co., Inc.* (1986), 26 Ohio St.3d 15, 21, 496 N.E.2d 959; see *id.* at 22 (noting that even where the business-judgment rule does not apply, "the director's decision is [not] necessarily wrong; it only removes the protection provided by the business judgment presumption," permitting a court to examine the director's actions more closely). Moreover, for reasons explained above, a corporation must advance expenses to a director even where the director is accused of actions that (if proven) would place the director outside of the business-judgment rule's protection—disloyal actions, for example. E.g., *Zaman*, 2008 WL 2168397, at *26. Nothing in the business-judgment rule, or the standards applied in considering the availability of the business-judgment presumption, provides any basis for limiting or conditioning Ohio's clear default rule requiring mandatory advancement of expenses to directors in lawsuits arising "by reason of the fact" of their corporate service.

CONCLUSION

For the foregoing reasons, this Court should reverse the judgment of the Court of Appeals and reaffirm Ohio's mandatory regime for advancement of fees to directors of Ohio corporations.

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Respectfully submitted,



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