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Director Liability Gets Personal

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Settlement in Just for Feet Case May Fan Board Fears

Directors' Payment Of $41.5 Million Shows The Risk of Liability

Five former outside directors of a defunct shoe retailer have paid $41.5 million to settle a lawsuit, in a case likely to fan fears among directors about personal liability for corporate misdeeds.

The settlement, finalized last month, is believed to be among the largest out-of-pocket payments by outside directors following corporate-fraud allegations. It ends a lawsuit brought by the trustee in the bankruptcy of **Just for Feet** Inc., once the second-largest athletic-shoe retailer in the U.S.

The personal payments by the Just for Feet former directors top those in two better-known cases. In 2005, former **WorldCom** Inc. outside directors paid roughly $24.8 million of their own money to settle a shareholders' suit with aggrieved investors. Also that year, former outside directors of **Enron** Corp. paid about $13 million to settle shareholders' claims. A recent survey by consulting firm Towers Perrin found that potential directors are increasingly concerned about personal liability if something goes wrong.

Such payments are still rare. Courts in Delaware, where many big companies in the U.S. are incorporated, generally protect directors from liability for mistakes as long as they acted in good faith, under the business-judgment rule. When directors are found liable, or agree to settle, the company's directors' and officers' insurance typically covers most of the cost. In the case of Just for Feet, court filings show that only $100,000 of liability insurance remained available for the trustee's lawsuit; most of it was exhausted by the company's officers in settling a shareholders' lawsuit.

Deep Pockets

Though it is rare, outside directors have paid to settle shareholders' claims, as in these notable cases:

- **Enron Corp.:** In 2005, 10 directors paid $13 million.
- **WorldCom Inc.:** In 2005, 12 directors paid $24.8 million.
- **Trans Union Corp.:** In 1985, 10 directors paid $1.35 million. The case, known as Van Gorkom, spawned legislation limiting director liability.

Bloomberg News/Landov

In an article last year in the Stanford Law Review, Stanford professor Michael Klausner and two co-authors identified only 13 cases in 25 years in which outside directors of public companies had made out-of-pocket payments. Directors may have to pay personally "when a company's insolvent, insurance is inadequate, the directors have access to considerable wealth, and the merits of the case are reasonable," Mr. Klausner said in an interview.

Just for Feet collapsed in 1999 amid an accounting fraud. Three former executives pleaded guilty to crimes related to a scheme to overstate earnings by $8 million between 1996 and 1998. The Birmingham, Ala., company filed for bankruptcy protection and its assets were auctioned off in 2000.

The bankruptcy judge appointed a trustee to recover money for the company's creditors. The trustee, **Charles Goldstein** of financial-consulting firm **Protiviti** Inc., filed suit in 2001 in Alabama state court against former directors and officers of the company, as well as its former auditor, Deloitte & Touche LLP.

The lawsuit charged the former directors with, among other things, conflicts of interest and misrepresentations. The lawsuit, for example, notes that one former outside director, Randall Haines, was president of Compass Bank in Birmingham, which was one of the company's primary lenders. The suit also accused former directors of breaching their fiduciary duty and acting in bad faith in delaying the bankruptcy filing despite the advice of experts.

In September 2006, four former outside directors paid a combined $40 million to settle the trustee's case against them. They are Michael Lazarus, a managing partner at Weston Presidio Capital Management, a venture-capital firm in San Francisco; John Berg, managing partner at Dorset Capital Management LLC, a private-equity firm in San Francisco; Warren Smith, a managing director at TH Lee Putnam Ventures, a Boston private-equity firm; and Edward Croft, a founder of Croft & Bender LLC, an investment-banking firm in Atlanta. Last month, Mr. Haines, the last remaining former outside director, paid $1.5 million to settle the trustee's claims.

The former directors neither admitted nor denied liability. It is unclear whether any of the former outside directors' employers, former employers or any other person or institution helped cover their portion of the settlement. The former directors didn't return repeated phone calls. Their attorneys declined to comment or didn't return calls.

"This case demonstrates that the law doesn't protect directors who fly blindly or fail to do the homework necessary to make informed decisions on behalf of a company," said **William Ryan** of **Whiteford Taylor Preston** LLP in Baltimore, the lawyer for the trustee.

Separately from the outside directors, the estate of Harold Ruttenberg, Just for Feet's founder and former chief executive, agreed in August to pay $15 million along with son Don-Allen Ruttenberg to settle the trustee's lawsuit. The elder Mr. Ruttenberg died in December 2005 at 63. His son pleaded guilty to criminal charges and was sentenced to a 20-month prison term.

As part of the trustee's lawsuit, Deloitte & Touche agreed to pay $24 million to settle the trustee's allegations. In all, the trustee recovered roughly $80 million for the company's creditors.