Corporate Indemnification of Directors and Officers – The Expanding Scope of the Statutes

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The extension of corporate directors' and officers' personal liability has recently prompted several states to enact more comprehensive provisions for their indemnification. In an attempt to attract corporations, the legislatures of these states have given corporations greater freedom and their officials greater protection, far more than most statutes had previously provided. This new type of statute represents a real departure from the basic indemnity provision which has been and still is effective, with some variance in language, in many states. These recent developments come at a time when indemnification is being viewed more carefully by corporations and their executives.

The modern corporation demands the very best in manpower throughout its entire corporate structure. This is especially true of top managerial personnel, the directors and officers who must harness and direct the corporation's often far-reaching enterprises. Today many corporate directors serve without compensation other than, perhaps, director's fees, which are usually nominal. Furthermore, they often have only small financial interests in their corporations.

An executive in a corporation assumes certain risks; for instance, the law will not allow a director to treat his position as one of mere honor but will hold him liable when he fails to exercise due care, prudence and diligence.


2. Following an allegation by the Securities and Exchange Commission that Merrill Lynch, Pierce, Fenner & Smith and other security brokers had violated rules on dissemination of inside information, a staff reporter of the Wall Street Journal wrote that: [a] lot of executives are scared stiff these days. . . .

   According to Harold Frederick, a vice-president of Stewart, Smith, a Chicago insurance agency that represents Lloyds of London, sales of executive insurance "were practically nonexistent a few years ago, but recently there has been a tremendous growth." . . .

   Insurance men and executives agree that companies and their top officials are increasingly worried that they may be sued at any time for activities arising out of what seem to be normal business dealings.


4. See, e.g., Briggs v. Spaulding, 141 U.S. 132 (1891); Brown v. Bullock, 294 F.2d 415 (2d Cir. 1961); Helfman v. American Light & Traction Co., 121 N.J. Eq. 1, 187 A. 540 (1936); Hun v. Cary, 82 N.Y. 65 (1880); but see Bishop, Sitting Ducks and Decoy Ducks: New Trends in the Indemnification of Corporate Directors and Officers, 77 Yale L.J. 1078, 1095 (1968), where it is argued that "the cases usually cited as examples of director's liability for negligence fall into a special category not at all typical of modern American corporate life." The author further states that the
A corporate official is vulnerable to stockholder derivative suits and third party actions such as antitrust (criminal or civil), securities fraud, income tax and libel. For example, a private individual can bring a tort action for treble damages under Section 4 of the Clayton Act for pecuniary loss to his business or property resulting from corporate conspiracy, and the corporate executive is personally liable if he has participated in the corporate wrongdoing, whether or not he was acting within the scope of his authority. Furthermore, in a criminal prosecution for conduct contravening the antitrust laws it is no defense that the executive lacked specific intent to violate the statute, or that in good faith he did not believe he was violating the law.

Section 14 of the Clayton Act authorizes the imposition of a fine not exceeding $5000 upon the corporate executive for acts which render his corporation criminally liable.

Since the position of a corporate executive is so prestigious, such risks might at first be discounted by an aspirant to corporate "officialdom"; however, the risks which the corporate director and officer face are increasing. Whether this is due to higher standards of conduct required by federal and state statutes and administrative rulings or to an increase in the number of shareholders resulting in an increase in derivative actions is a question beyond the scope of this Comment. There have recently been some well-publicized suits and threatened suits against corporate officials. To those who must solicit qualified people to serve as directors and officers of a corporation, the substance of indemnification laws has thus become an important factor when choosing a state for incorporation.

In addition to holding corporate officials liable for failure to diligently

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"modern cases which fit into the general category are comparatively few and involve monied corporations other than banks—frequently, investment companies." Id. at 1099. See also Booth v. Dexter Steam Fire-Eng. Co., 118 Ala. 369, 24 So. 405 (1898); Mutual Bldg. Fund & Dollar Sav. Bank v. Bosseaux, 3 F. 817 (E.D. Va. 1880).


10. See Whiting, Antitrust and the Corporate Executive, 47 VA. L. REV. 929, 938 (1961), where it is noted that during the 1930's, the Justice Department indicted 431 corporate officials for alleged violations of the Sherman or Clayton Acts.


12. See, e.g., Sylvia Martin Foundation, Inc. v. Swearingen, 260 F. Supp. 231 (S.D.N.Y. 1966); Smith, The Incredible Electrical Conspiracy, FORTUNE, April 1961, at 132, where it is reported that officials of 44 corporations, adjudged guilty of conspiring to restrain trade, were given jail sentences and, in addition, were fined $100,000.
Corporate Indemnification

perform the duties of their office, courts have long held that a corporate
director or officer is presumed to know everything that he could have learned
by the exercise of reasonable care and diligence and that he is liable for failure
to investigate that which he should have investigated. Perhaps to implement
the policy of these holdings, there also developed a general rule that reim-
bursement for defense expenses incurred would not be allowed to a director or
officer found derelict in the performance of his duties; in the case of a success-
ful defense, there was a split of authority on the right to such reimbursement.
Corporations often attempted to protect their officials through a joint defense
of the corporation and its officials by the corporation's legal counsel, but this
method provided no assistance to directors and officers assessed with fines,
liabilities or settlements. Some corporations provided for directors-officers' 
indemnification in their articles of incorporation or bylaws without state
statutory authorization.

In 1939 the landmark case of New York Dock Company v. McCollum held that a corporation had no power to reimburse corporate officials for the expense of successfully defending a derivative action, absent a showing of benefit to the corporation. This decision triggered a legislative reaction to negate such a holding. The first state to act was New York in 1941, and today 44 states and the District of Columbia have explicit provisions governing the indemnification of directors and officers. Some of these indemnification provisions are permissive, i.e., they allow a corporation to indemnify a director or officer under certain conditions. Others provide for mandatory indemnifica-

14. E.g., Hollander v. Breeze Corp., 131 N.J. Eq. 585, 26 A.2d 507 (1941), aff'd per curiam, 131 N.J. Eq. 613, 26 A.2d 522 (Ct. Err. & App. 1942). A recent case handed down by the Minnesota Supreme Court held that under the Minnesota indemnification statute and the corporation's bylaws, both of which are merely permissive, the directors were not entitled to indemnification as a matter of right and the corporation's refusal to indemnify was justified, particularly since the directors were not vindicated of all the charges brought against them by the Securities and Exchange Commission. Tomash v. Midwest Tech. Dev. Corp., Minn., 160 N.W. 2d 273 (1968).
18. The court required that for reimbursement to be given, the director must clearly demonstrate that "he has conserved some substantial interest of the corporation which otherwise might not have been conserved, or has brought some definite benefit to the corporation which otherwise might have been missed." Id. at 111, 16 N.Y.S.2d at 849. Contra, Solimine v. Hollander, supra note 15.
tion of directors and officers by the corporation where the directors and officers have been successful in their defense, while Wisconsin has both a mandatory and a permissive provision.

In 1943 Delaware enacted a provision that has served as a model for many states. The Delaware statute authorized the corporation to indemnify its directors and officers, past and present, for actual and necessary expenses incurred in the defense of any action to which they are made parties, except where they are adjudged liable for misconduct or negligence in the performance of their duties. In effect, corporate officials could only be indemnified for expenses of a successful defense. In 1960, the Model Business Corporation Act (hereinafter MBCA) was revised to reflect changes in the Delaware-type provision which were thought to be necessary. The indemnification laws of 21 states and the District of Columbia remain basically patterned after these two statutes, especially in respect to their non-applicability where the director or officer is found guilty of negligence or misconduct in the performance of his corporate duties. The newer, more explicit coverage afforded by recent legislative enactments can only be considered and explained in light of the uncertainty and vagueness which characterized the old Delaware and MBCA (1960 version) provisions.

22. Ch. 125, § 1, [1943] 44 Del. Laws (repealed 1967):
   [A corporation is authorized to indemnify any and all of its directors or officers or former directors or officers or any person who may have served at its request as a director or officer of another corporation in which it owns shares of capital stock or of which it is a creditor against expenses actually and necessarily incurred by them in connection with the defense of any action, suit or proceeding in which they, or any of them, are made parties, or a party, by reason of being or having been directors or officers or a director or officer of the corporation, or of such other corporation, except in relation to matters as to which any such director or officer or former director or officer or person shall be adjudged in such action, suit or proceeding to be liable for negligence or misconduct in the performance of duty. Such indemnification shall not be deemed exclusive of any other rights to which those indemnified may be entitled, under any by-law, agreement, vote of stockholders, or otherwise.
The indemnification laws of Delaware, Iowa, Kansas, Louisiana, Pennsylvania and Virginia enacted within the past two years have, to a large degree, a common pattern. In terms of coverage and statutory language, the newer statutes do not depart radically from those statutes based on the old Delaware provision. Instead, they distill previous provisions allowing greater freedom to the corporation and reject those provisions which tend to restrict corporate discretion. Delaware's new statute will be used as illustrative of the newer enactments.

A. Persons Covered

The new Delaware statute provides for the indemnification of "a director, officer, employee or agent of the corporation."24 Indemnification may also be made to "a person who has ceased to be a director, officer, employee or agent and shall inure to the benefit of the heirs, executors and administrators of such a person."25 The former Delaware statute provided for the indemnification of "directors or officers" but left unclear whether indemnification could be granted for corporate executive personnel who are not "directors or officers" under statute, bylaw or articles of incorporation. Wisconsin's mandatory provision alleviates this problem by specifically providing for coverage of a "director, officer or employe,"26 although its permissive section does not make such an inclusion. Connecticut's statute also includes employees as subjects of indemnification, explicitly defining "employee" to include any person "engaged to perform service for the corporation, whether as independent contractor or otherwise."27 Similarly, Ohio's recently enacted provision28 covers "employees" as well as directors and officers.

This inclusion of corporate personnel who may not technically qualify as directors or officers under statute, certificate of incorporation, or bylaw should prevent the hardship situation where such an individual must face liability because of acts performed pursuant to his corporate duties. Massachusetts' statute allows indemnification of directors and officers elected by the stockholders where such indemnification is provided for in the articles of organization or the bylaws, or by a majority vote of the shareholders. It then authorizes

24. Del. Code Ann., tit. 8, § 145 (a), (b) (CT Corp. ed. 1967). The new Delaware statute also permits indemnification of one who "is or was serving at the request of the corporation as a director, officer, employee or agent of another corporation, partnership, joint venture, trust or other enterprise . . . ." Delaware's former provision was somewhat more restrictive in that it permitted indemnification of "a director or officer of another corporation in which [the indemnifying corporation] owns shares of capital stock or of which it is a creditor." Ch. 125, § 1, [1943] 44 Del. Laws (repealed 1967).
the directors to provide for indemnification of officers "elected by the directors" but who are not directors, as well as "employees and other agents of a corporation." The Massachusetts "agent" provision, together with the new Delaware-type statutes, may extend indemnification to the far corners of the corporate structure.

The earlier Delaware statute was silent as to whether the estate of a deceased director or officer could be reimbursed in situations where the director or officer would have been entitled to indemnification in his lifetime. Other states, in addition to Delaware, have sought to fill this gap. Montana's former enactment, although not providing indemnification for employees other than directors and officers, included the "personal representatives" of directors and officers. South Carolina provides that the "right of indemnity shall inure to the estate, executor, administrator, heirs, legatees, or devisees of any person entitled to indemnification . . ." The newer Delaware-type statutes have followed Montana and South Carolina in obviating any argument that the right to indemnification ceases upon the death of the person entitled to be indemnified.

### B. Types of Actions Covered

Delaware's new statute permits indemnification in "any threatened, pending or completed" third party or derivative action. Indemnification in a third party proceeding covers "civil, criminal, administrative or investigative" actions. This description of types of actions covered is far more detailed than Delaware's former statute, which allowed indemnification for "the defense of any action, suit or proceeding . . ." The uncertainty as to whether the latter provision would apply to criminal actions caused the draftsmen of the MBCA (1960 version) to include "any action, suit or proceeding, civil or criminal."

Other questions left unanswered by the former Delaware statute were: whether it granted indemnification in a derivative suit as well as a third party action, and whether it included purely investigatory proceedings, arbitration proceedings and declaratory judgments. North Carolina and Arkansas exclude

30. Ch. 84, § 1, 1943 Mont. Laws (repealed 1967).
35. Folk, Corporation Statutes: 1959-1966, 1966 Duke L.J. 875, 904-05, raises a related problem inherent in such a description of types of action covered as found in the former Delaware provision. A court, when dealing with complicated litigation involving cross-claims and counterclaims, might be bound by the "defense" language and have to allocate legal expenses between the director's dual role as a defendant and a counter or cross-claimant, with only the former amount being indemnifiable.
derivative suits from the reach of their indemnification statutes, although they explicitly provide indemnification in criminal prosecutions and other third party actions. Wisconsin and Rhode Island have chosen to specifically include administrative proceedings within permissible indemnification coverage. However, other statutory provisions on types of actions covered are as vague as Delaware’s former provision; for example, Arizona uses the term “legal action” to describe when indemnification may properly be made.

For those statutes which do not set out with some specificity the type of action covered, the decision must be left to a court in a proper case. Massachusetts is an extreme example in that its statute is completely silent as to the type of proceeding covered by indemnification. It could be construed broadly to cover any conceivable proceeding, or narrowly as did the New York Court of Appeals in interpreting the New York provision allowing indemnification in “any action, suit or proceeding.” In *Schwarz v. General Aniline & Film Corporation*, the court held that statute inapplicable to expenses incurred by an officer or director in a criminal prosecution. The court stated, “[i]t would be a very strange public policy, indeed, which would set up legal machinery whereby one charged with, or convicted of, a crime, of whatever kind, could require the corporation by whom he was employed to pay his legal expenses.” However, the doctrine of *Schwarz* has been repudiated by statute in New York, and in view of the tendency toward more inclusive indemnification statutes, it is doubtful that a court would so narrowly limit Massachusetts’ provision. The description of types of actions covered in the newer statutes will certainly avoid a *Schwarz* result.

**C. Settlements and Expenses—Third Party v. Derivative Suits**

The new Delaware statute allows indemnification in “any threatened, pending or completed” third party or derivative action. In third party suits indemnification can include “amounts paid in settlement actually and reasonably incurred.” In the case of derivative suits, however, indemnification is limited to expenses actually and reasonably incurred in the settlement of such an action. Delaware’s former statute allowed indemnification except in cases of negligence and misconduct but made no mention of settlements in a threatened or pending

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42. Id. at 402, 113 N.E.2d at 536.
43. Del. Code Ann. tit. 8, § 145(a), (b) (CT Corp. ed. 1967).
In 1960, the MBCA revisers desired coverage of settlement payments if, for example, the corporation had been advised by counsel that the suit was without substantial merit and the settlement payment was not in excess of the probable litigation expenses. Thus the MBCA’s provision read “expenses actually and reasonably incurred” in contrast to Delaware’s former requirement that the expenses be actually and necessarily incurred.

Some statutes have specifically included settlements within their indemnification provisions, while others have specifically excluded them. Minnesota, for example, excludes “amounts paid pursuant to a judgment or settlement agreement,” and denies indemnification for expenses where the defendant is “finally” adjudged liable for negligence or misconduct. Michigan allows no indemnification as to “such matters as shall be settled by agreement predicated on the existence of such liability.” In contrast, New Mexico permits indemnification in connection “with the settlement” of any action, and Rhode Island allows indemnification where there is a “reasonable settlement” of legal or administrative proceedings. Florida allows indemnification for expenses in both third party and derivative actions, and expenses can include “judgments, fines, amounts paid in settlement and reasonable expenses, including attorneys’ fees . . .” Possibly from concern that certain expense items of past litigation which seemed reasonable at the time were not at all necessary, as well as from concern for settlement payments, other states have adopted the MBCA (1960 version) approach. Wisconsin apparently has tried to take a middle position by awarding “reasonable expenses, including attorney fees, actually and necessarily incurred . . .”

These statutes failed to recognize, as the new statutes have, that the policy considerations applicable to third party actions differ from those involved in derivative actions. Such recognition would have made it easier to establish when settlements and compromises were properly indemnifiable. It is a well

44. Ch. 125, § 1, [1943] 44 Del. Laws (repealed 1967). In Essential Enterprises Corp. v. Dorsey Corp., 40 Del. Ch. 343, 182 A.2d 647 (1962), the court noted that the statute was ambiguous with respect to compromise settlements. It stated that it was “apparent that were this court concerned only with the statute a question would arise as to whether the statutory limitations on the right to grant indemnification have any application to a settlement because of the use of the word ‘adjudged’ in the statute.” Id. at 350, 182 A.2d at 652. But because of the interpretation and application of the corporation’s bylaw, the court was able to pass over the issue.
established policy of the law to encourage the settlement of threatened actions wherever possible and proper. While a corporation might wish to press for settlement of a claim against one of its officials by an outsider, there is a different policy involved in a derivative suit where, in effect, the corporation itself is the plaintiff seeking to establish the liability of the director or officer. It is in their recognition of this distinction that some statutes have departed markedly from the former Delaware and MBCA (1960 version) provisions.

The various states have handled this problem differently. New Jersey's provision apparently covers settlement payments only in third party actions since it is "exclusive of any amounts paid to the corporation in settlement," and if the action is settled, then the board of directors must determine that the director or officer had not been derelict in his corporate duties. Texas appears to allow indemnification in other than finally adjudicated court proceedings by use of the language "in court or otherwise" but would exclude, like New Jersey, any amount paid in settlement to the corporation.

Connecticut allows indemnification for expenses of "any judgment, money decree, fine, penalty or settlement" which the board of directors deems "reasonable." In the case of derivative actions, that state withholds indemnification unless the defendant is successful in his defense on the merits or the court "finds such payment not unreasonable or inequitable ... ." If a court were to award indemnification in a derivative suit where the defendant was not even partially successful on the merits, the very purpose of the derivative action would seem to be defeated. If a director or officer loses a derivative suit, he will have to pay damages to the corporation in whose behalf the suit was brought. Obviously this payment of damages would be meaningless if the corporation were then permitted to put this money back into the director's or officer's pocket. It is thus unlikely that any court under a statute such as Connecticut's would grant an indemnification award in very many settlements of derivative actions. This provision may, however, be utilized when a court, for the first time in its jurisdiction, labels certain conduct as constituting a breach of the director's or officer's duty. Then it would be inequitable to deny indemnification to a director or officer following conservative advice on a course of conduct never before held a breach of duty. The British Companies Act recognized that such instances may occur where, in fairness, the corporation should bear the risk of loss. The newer statutes, typified by Delaware, also provide that in derivative suits a person shall not be indemnified where adjudged

57. See Folk, supra note 35, at 911.
58. 11 & 12 Geo. 6, ch. 38, § 448(1) (1948).
liable for negligence or misconduct "unless and only to the extent that the [court] shall determine . . . that, despite the adjudication of liability but in view of all the circumstances of the case, such person is fairly and reasonably entitled to indemnity for such expenses which the [court] shall deem proper." 59 Of the recent statutes, Iowa is the only one which apparently has decided to proscribe its courts from giving this type of equitable relief. 60

Other states have given boards of directors discretion to indemnify for settlement of derivative suits. Kentucky's provision apparently applies to compromise settlements in both situations since it requires that the board of directors "shall have first approved such proposed compromise settlement and determined that the director or officer involved was not guilty of actual negligence or misconduct . . . ." 61 This latter standard of conduct has been expressly made applicable to derivative suits in many statutes for purposes of determining if indemnification shall be granted. Ohio also makes indemnification for amounts paid in settlement of any threatened or pending action dependent upon adjudication or determination by the board that the director or officer was not guilty of negligence or misconduct. 62 Missouri and Georgia similarly grant indemnification for third party or derivative action settlements upon the board's determination. 63 This type of provision gives a corporation great latitude in dealing with settlements in view of the fact that there is no judicial supervision of the settlement or the indemnification award.

South Carolina permits indemnification for court-approved settlements where a court finds that the defendant director or officer equitably merits such indemnity. 64 No distinction is made in the South Carolina statute between derivative and third party actions. Other states, however, have drawn such a distinction in regard to settlements with court approval. With respect to third party actions, North Carolina allows a director or officer, even if wholly unsuccessful in his defense, to be indemnified for defense expenses and the amount of the judgment, money decree, fine, penalty or settlement, if the shareholders approve of such a plan. However, indemnification in a derivative suit is permitted only if the director or officer is successful in at least part of the suit and the court finds he equitably merits such indemnity. 65 California gives the court discretion to award indemnification in third party and derivative suits if the action itself is settled with court approval, but the board of directors

59. DEL. CODE ANN. tit. 8, § 145(b) (CT Corp. ed. 1967).
60. IOWA CODE ANN. § 496A.146 (Supp. 1968).
61. KY. REV. STAT. § 271.375(2) (1963).
64. S.C. CODE ANN. § 12-18.18(b) (1) (B) (Supp. 1966).
may make the award under certain circumstances in a third party action.\textsuperscript{66} New York's statute pertaining to derivative actions does not provide indemnification for amounts paid in settling or disposing of a threatened action whether or not there is court approval, but there must be court approval of a settlement before other defense expenses of a derivative suit can be indemnified.\textsuperscript{67} New York does, however, allow indemnification for amounts paid in settlement of a third party action.\textsuperscript{68} Tennessee's new indemnification law follows New York very closely in this respect.\textsuperscript{69}

Massachusetts leaves open the question of whether it allows indemnification for amounts paid in settlement or compromise or whether there has to be a "final" adjudication other than to the extent "authorized by (i) the articles of organization or (ii) a by-law adopted by the stockholders or (iii) a vote adopted by the holders of a majority of the shares of stock entitled to vote on the election of directors or such officers."\textsuperscript{70} At once it would appear that the Massachusetts statute opens the floodgates to virtually unlimited indemnification, for, by its terms, only broad limits are imposed on the corporation in one respect and on the directors in another as far as determining just how much and in what instances indemnification will be proper. Again, the Massachusetts courts may narrowly construe the provision and eliminate amounts paid in settlement (at least with regard to derivative actions) on the ground that to do otherwise would violate public policy or be harmful to the corporation or its shareholders.

\textbf{D. Standards for Denying Indemnification—Third Party v. Derivative Suits}

In those statutes patterned after the former Delaware statute, indemnification is denied where the director or officer is found liable for negligence or misconduct in the performance of his corporate duty. This standard is appropriate enough for judging the official's action as it relates to his corporate duty to shareholders and should be the one utilized in a derivative action. But the standard seems overly strict in its application to the official's conduct toward outsiders or third parties. Some statutes depart from the old Delaware-type statute by recognizing policy differences between the standards to be employed in derivative and third party actions. Accordingly, the new Delaware statute provides for indemnification in civil actions where the director or officer had acted in good faith and in the reasonable belief he was acting

\begin{itemize}
\item \textsuperscript{66} \textit{CAL. CORP. CODE ANN.} § 830(a), (f) (Supp. 1967).
\item \textsuperscript{67} \textit{N.Y. BUS. CORP. LAW} § 722(1) (McKinney 1963).
\item \textsuperscript{68} \textit{Id.} at § 723(a).
\item \textsuperscript{69} \textit{Tenn. Reg. Sess. H.B. 551, § 3.08(1) [1968] (CCH TENN. ADVANCE SESS. L. REP. 430)} (effective July 1, 1969).
\item \textsuperscript{70} \textit{MASS. GEN. LAWS ANN.} ch. 156B, § 67 (Supp. 1968).
\end{itemize}
in the interests of his corporation, and in criminal actions where he had no reason to believe his conduct was unlawful. Indemnification is denied, however, in derivative actions when the director or officer is found negligent or guilty of misconduct in the performance of his corporate duties.

Arizona has not made an explicit distinction between third party and derivative actions and leaves in doubt whether derivative actions come within its provisions at all, since the language merely allows indemnification to the director or officer for any actions or omissions while acting "within the scope of his employment as a director or officer . . ." The standard of conduct it employs is of no help in resolving the question. It provides for indemnification where the director or officer "did not act, fail[s] to act, or refuse[s] to act wilfully or with gross negligence or with fraudulent or criminal intent . . ."71 Similarly, the standard expressed in Massachusetts' statute raises one more unresolved question as to the scope of that statute's coverage. In Massachusetts no indemnification is provided if the director or officer did not act "in good faith in the reasonable belief that his action was in the best interests of the corporation."72 The application of this provision in a derivative suit would relieve a director or officer of the stricter standard of conduct, i.e., reasonable care. This conclusion, of course, assumes that the Massachusetts provision covers both derivative and third party suits.

Florida employs different standards for derivative and third party actions similar to those of the new Delaware statute.73 The other recent enactments follow the Delaware provision, except that Virginia omits the standard with respect to criminal actions.74 The limitation upon the power to indemnify in criminal actions found in Delaware and other recent statutes attempts to avoid undermining the deterrent effect of the criminal law.75 In view of the myriad federal and state statutes and regulations with which a director or officer must comply in conducting the affairs of a corporation, it is not unreasonable to indemnify a director or officer who has unwittingly broken a law or regulation. Ohio, which does not explicitly distinguish between derivative and third party actions, nevertheless employs the three types of standards found in Florida and the newer provisions.76 Georgia also utilizes the same standards and adds that indemnification will be provided where the director or officer in a third party suit had acted in a manner which he believed was "not opposed to the best interests of the corporation."77 It has been suggested that this kind

75. See Arsh & Stapleton, Delaware's New General Corporation Law: Substantive Changes, 23 BUS. LAw. 75, 78 (1967).
of language was intended to cover situations in which the director or officer
did not realize that his corporation had any interest whatever in the particular
course of action he had taken.78

E. Provisions Guarding Against Unfavorable Presumptions

Another means by which the newer enactments give corporate officials greater
protection is through specific provisions guarding against unfavorable presump-
tions. The new Delaware-type provision stipulates that in third party suits
the "termination of any action, suit or proceeding by judgment, order, settle-
ment, 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 which he reasonably believed to be in or not opposed to the best
interests of the corporation, and, with respect to any criminal action or pro-
ceeding, had reasonable cause to believe that his conduct was unlawful."79
This clause, of course, has no application to derivative actions where, absent
a judicial equitable award, indemnification is denied if the director or officer
is found negligent or guilty of misconduct.

In addition to the newer enactments modeled after Delaware's provision,
Florida, South Carolina, and Tennessee similarly provide against unfavor-
able presumptions arising from an adverse final adjudication.80 The recent
Virginia statute81 omits the provision against an unfavorable presumption
in a criminal proceeding and thus exposes the corporate executive to the
probable deleterious effect of a conviction or nolo contendere plea on indemni-
fication. Iowa's new statute makes a real departure in providing that the
"termination of any action . . . by judgment or order against such person
on the merits, conviction, or upon a plea of nolo contendere . . . shall, of itself,
create a presumption that the person did not act in good faith . . . ."82
(Emphasis added.) While the language excludes settlements from the presump-
tion, nonetheless such a presumption places an unnecessary burden upon the
director or officer who, although adjudged liable to third parties, must now
convincingly show that he was acting in good faith, in the best interests of the
corporation and, with respect to criminal actions, had no reasonable cause to
believe his conduct was unlawful.

78. Araht and Stapleton, supra note 75, at 78.
79. DEL. CODE ANN. tit. 8, § 145(a) (CT Corp. ed. 1967).
80. FLA. STAT. ANN. § 608.13(15) (Supp. 1966); Tenn. Reg. Sess. H.B. 551,
§ 3.08(2) [1968] (CCH TENN. ADVANCE SESS. L. REP. 450-31) (effective July 1, 1969).
82. IOWA CODE ANN. § 496A.146(1) (Supp. 1968).
F. Non-Exclusivity of the Statutes

The newer statutes are also non-exclusive in their operation. For example, Delaware provides that indemnification "shall not be deemed exclusive of any other rights to which those indemnified may be entitled under any by-law, agreement, vote of stockholders or disinterested directors or otherwise . . . ."83 Both Delaware's former provision and the MBCA (1960 version) contained similar language, although the MBCA omitted the "or otherwise" clause.84 These provisions afford to corporations a maximum amount of discretion and could conceivably defeat the purpose of an indemnification statute, i.e., to enumerate some guidelines for permissible indemnification. To what extent a court will allow a corporation to go beyond the statutory indemnification provision is not at all clear. Essential Enterprises Corporation v. Dorsey Corporation,85 decided under Delaware's former non-exclusive provision, may have raised a warning flag to corporations concerning the extent of permissiveness. The court specified, "[a] corporation is free to invoke less than all the indemnification power granted it under this particular statute,"86 and left to implication that the contrary would not necessarily be true when the corporation went beyond the statutory grant. Most of the statutes patterned after Delaware's former provision or the MBCA (1960 version) have similar non-exclusivity provisions. However, Nevada explicitly permits only a narrowing of the state's permissive grant, stating specifically that indemnification is only "[s]ubject to such limitations, if any, as may be contained in its certificate or articles of incorporation, or any amendment thereof . . . ."87

The language of these non-exclusivity provisions may require the corporation to act at its peril in guessing at the outer limit of the statutes' permissiveness and to risk being held to have abused its discretion by providing indemnification without some supervision. As some statutes became more comprehensive, such discretion was generally removed from the corporation. For instance, South Carolina renders invalid any provision which purports to "extend or limit" the rights and remedies under the statute.88 Arkansas also has an exclusive provision to the extent that "[n]o provision of the articles of incorporation or by-laws for the indemnification of officers [and directors?] in respect to costs incurred . . . shall be valid unless consistent with the provisions of this

85. Supra note 44.
Section . . . .” Similarly California, New York and Tennessee incorporate exclusivity provisions within their statutes. Although these exclusive statutes seek to limit the corporation to the indemnification provisions enacted by the legislatures, still it is possible that a court may find other theories upon which to indemnify directors or officers. In *Cohn v. Lionel Corporation* the New York Court of Appeals held that an officer-director, who was liable for over $630,000 as a result of his personal guarantee that 30,500 shares exchanged by his corporation would be worth at least $800,000, had stated a cause of action for indemnification. Although New York has an exclusive indemnification provision, the court ruled that indemnification could result from his agency because he “unequivocally assert[ed] that he executed the guarantee agreement as a agent for Lionel.”

**G. The Board’s Role in Awarding Indemnification**

Allowing indemnification for settlement payments necessitates some procedure for determining whether a director or officer is entitled to indemnification. The new Delaware provision requires that such a determination be made “by the board of directors by a majority vote of a quorum consisting of directors who were not parties to such action, suit or proceeding” or “if such a quorum is not obtainable, or, even if obtainable a quorum of disinterested directors so directs, by independent legal counsel in a written opinion” or “by the stockholders.”

New Jersey also allows indemnification in settlement situations only when the board of directors has determined that the director or officer had not been derelict in his duties. But both the New Jersey and new Delaware provisions raise an interesting problem; they impose no legal standard such as “good faith” upon the board, although it is likely a court would imply this or else it could be supplied in the certificate of incorporation or bylaws. Arizona imposes by statute such a standard upon boards of directors. New Jersey further requires merely that the defendant director or officer had not been derelict in any “substantial” way. Since it may be too much to expect that a board of directors can act in the same manner as an adjudicative court, the lack of rigid standards on the board of directors may cause an abuse of in-

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92. *Id.* at 562, 236 N.E.2d at 636-37, 289 N.Y.S.2d at 408.
demnification awards unless the corporation itself provides stricter standards. New Jersey, in contrast with Delaware, does not specify who on the board is to make the determination; conceivably, the very director or directors who are parties defendant may be able to make or assist in making the determination of their own liability. This is certainly not the most impartial forum, and even if the certificate of incorporation or bylaws did not exclude the defendant director(s) from taking part in the determination, a court would probably do so on public policy grounds. Although New Jersey has excluded indemnification for amounts paid when a derivative action has been settled, amounts paid in settlement of third party actions are included, and there is a possibility that a director interested in the outcome might be able to make the determination of liability and defeat the policy behind the statute where his dealings with outsiders had been wanton, reckless, and in no sense in good faith or in the reasonable belief that he was furthering the corporation's interest. Arizona's statute shares the same infirmity of New Jersey's provision in this regard.

Massachusetts' statute, which is a model of ambiguity, allows indemnification for directors and officers elected by the stockholders where such indemnification is provided for in the articles of organization, bylaws or by a majority vote of the shareholders. Concerning officers who are elected by the directors but who are not directors, as well as employees and other agents, the board of directors is authorized to grant indemnification except where the defendant had not acted in good faith and in a reasonable belief that his actions were in the best interests of the corporation. It would appear that the board of directors has a maximum amount of discretion under this statute and is accountable to neither court nor shareholders.

Kentucky and Missouri allow indemnification for amounts paid in settlement provided that the board of directors "shall have first approved such proposed compromise settlement and determined that the director or officer involved was not guilty of actual negligence or misconduct . . ." Both statutes share the deficiency of those of New Jersey and Arizona by failing to expressly limit to disinterested directors the composition of the board of directors making the determination. But Missouri's provision goes a step further and allows the board of directors to rely conclusively upon an opinion of independent legal counsel selected by such board and any such compromise settlement is not "effective until submitted to and approved by a court of competent jurisdiction." Missouri at least furnishes a guide for the board of directors to follow in making its determination, although in reality it may be difficult for counsel to be truly "independent" when selected by the board.

This is especially so if the counsel is a regular associate or friend of the defendant director or officer since he is probably sympathetic to the problems of the corporation and its management, and perhaps hesitant to impose stringent standards on people who are responsible for his retainer. The same problem of "independent" counsel is present in the new Delaware statute. Yet the Missouri provision makes the indemnification award contingent upon court approval, which should keep the directors and independent counsel within the bounds anticipated by the statute.

North Carolina's provision, pertaining only to third party actions, allows indemnification "as the board of directors in good faith shall deem reasonable" where the director or officer is successful otherwise than solely on the merits. If the director or officer is not wholly successful or is unsuccessful in his defense, he may still be indemnified, in whole or in part, for the expense of defense and "the amount of any judgment, money decree, fine, penalty or settlement . . . if a plan for such payment is sent to the holders of all shares entitled to vote, with notice of shareholders' meeting . . . to be held to take action thereon . . . exclusive of the shares held directly or indirectly by any directors or officers to be benefited by the plan if approved."99 North Carolina thus provides machinery, however cumbersome it may prove to be in other than closely held corporations, to notify shareholders, exclusive of the "interested" or "benefited" parties, and have them approve an indemnification plan. Ohio allows a determination of negligence or misconduct to be made by a quorum of the board of directors excluding any director defendants, but if such a quorum is not obtainable, then a determination can be made in accordance with "a method established by the articles, the regulations, such agreement, or such resolution [of the shareholders]."100 This provision is obviously quite liberal with respect to the alternatives available when a quorum of disinterested directors is unavailable, and the end result in such a situation would be to relegate the decision making machinery to the whims of the corporation without any direct judicial supervision.

Georgia permits indemnification by a majority vote of the disinterested directors constituting a quorum, by independent counsel, or by a majority vote of the stockholders where the director or officer is not successful on the merits or otherwise.101 Montana formerly provided that a quorum of the board of directors, excluding interested directors, must first approve any compromise settlement and make a determination of the defendant's negligence or misconduct. If such a quorum is not obtainable, then the determination is made by a majority of disinterested board members or by three disinterested stockholders appointed

by the stockholders at a meeting. The Montana provision also allowed the board of directors to “conclusively” rely upon the opinion of independent legal counsel. New York permits a corporation to make indemnification upon a finding by the board of directors that the director or officer has met the statutory standards or upon the opinion “in writing” of independent legal counsel that indemnification is proper, or by the shareholders. Tennessee allows indemnification by a quorum of disinterested directors to an official not wholly successful on the merits, or, if such a quorum is not obtainable “with due diligence,” then by the board upon the opinion in writing of independent legal counsel or by the shareholders.

### H. The Court’s Role in Awarding Indemnification

Another way statutes have provided indemnification, especially in a settlement situation, is through use of the courts. As explained above, the new Delaware statute allows a court to indemnify a director or officer for expenses incurred in a derivative suit, although he may have been found liable for negligence or misconduct, if the court feels he equitably merits such indemnification. There was no provision for such a judicial award in the former Delaware statute. Connecticut and Georgia have similar equitable provisions in their statutes. Such a provision, as indicated above, will probably allow a director or officer to be indemnified in a situation where his conduct is held to constitute a breach of duty for the first time in a particular jurisdiction.

Judicial supervision of indemnification assures, to some degree, that awards will not be arbitrarily allowed, for an impartial court is not likely to stray from the statutory standards. In recognition of this fact, a number of states have indemnification provisions utilizing, in varying degrees, their courts. Texas allows a court to assess indemnity against a corporation which has not fully indemnified a director or officer for the amount that the court “shall deem reasonable and equitable . . . only if the court finds that the person indemnified was not guilty of negligence or misconduct . . . .” The Texas provision thus prevents the director or officer from being short-changed by the corporation’s insufficient award, but only to the extent the court feels is proper under the particular facts. Missouri requires that a compromise settlement first approved by the board of directors be submitted to a court of competent jurisdiction

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102. Ch. 84, § 1, 1943 Mont. Laws (repealed 1967).
and approved by it before such settlement is effective.\(^{107}\) Maryland provides that "a claim of right to or grant of indemnification . . . may, but need not, be asserted or submitted for adjudication by the corporation or by the person claiming indemnification" in a court which shall "[a]fter notice and, if requested, a hearing . . . pass a decree either dismissing the proceeding or fixing the amount to which the person is entitled."\(^{108}\) South Carolina specifies that the amount of indemnity be "fixed by order of court."\(^{109}\) The court may permit or direct reimbursement for expenses, including attorney's fees, if the director or officer is successful in whole or in part or if the action is settled with court approval and the court finds the defendant not guilty of negligence or misconduct. The court can also permit or direct indemnification if it finds that the person "fairly and equitably" merits it, and for any amount paid in discharge of a judgment or settlement approved by the court if it is deemed fair and equitable. Perhaps in fear that such corporate discretion would be abused, South Carolina has given discretion to its courts rather than to the corporations themselves, as is the trend of the newer statutes. While New York's statute does not permit indemnification for amounts paid in disposing of or settling a threatened or pending derivative action, it does require court approval of such settlement in order to indemnify for defense expenses.\(^{110}\)

A few states require some degree of successful defense for judicial award of indemnification. For example, North Carolina requires some degree of success in a derivative suit, and then a judge can award indemnification for expenses of defense which he finds to be reasonable if the director or officer merits the relief.\(^{111}\) California permits a court to determine whether indemnification shall be made and what amount is reasonable if the director or officer has had some degree of success in the action and if the court finds that his conduct merits such indemnity.\(^{112}\) However, another subdivision of the California statute allows the board of directors in a third party suit to pay expenses, judgments or fines upon a determination that the director or officer was acting in good faith and under the reasonable belief that the act was within the scope of his employment.\(^{113}\)

I. Effect of Indemnification Provisions in Foreign Actions

Some states have anticipated that a corporate director or officer might have an action brought against him in another state, and although he would be

112. Id. at (f).
entitled to indemnification in the state of incorporation, the laws of the foreign state do not provide such relief. North Carolina provides that in such a situation the director or officer may make a motion for indemnification as though the action had been brought in North Carolina, with notice to the plaintiff in the prior action as the court approves.\textsuperscript{114} Arkansas has a similar provision.\textsuperscript{115} Only six states—Alabama, Idaho, Illinois, New Hampshire, Oklahoma, and Vermont—have no explicit indemnification provisions, but this does not mean that relief will necessarily be denied.\textsuperscript{116} It is not clear, however, whether the North Carolina and Arkansas provisions would be utilized to supplement the award of a foreign state explicitly providing for indemnification but only in more restrictive circumstances. Although the new Delaware statute makes no explicit provision for such a situation, its non-exclusivity provision would appear to give the corporation discretion to make just such an award.

\textbf{J. Notice}

Some states have also provided that notice be given to the corporate shareholders or other interested parties after an assertion of a claim for indemnity. No such provision is present in Delaware's new statute. Tennessee allows a court to award indemnification where the corporation has failed to do so, requiring, however, that the application for indemnification be upon "notice to the corporation." The court may also require that "notice be given at the expense of the corporation to the shareholders or members and such other persons as it may designate . . . ."\textsuperscript{117} In Maryland, where a court can award indemnification, the statute specifies that after assertion of a claim but before the court awards indemnity, notice must be given to the parties in interest and a hearing held, if requested.\textsuperscript{118} Notice further assures that indemnification will not be indiscriminately awarded after a corporation has refused or failed to do so, or, as in the case of Maryland, where indemnification may be sought through the courts.

\textbf{K. Advance Indemnification}

To alleviate any financial hardship upon the director or officer who must initially pay the defense expenses, the new Delaware-type statute allows an advance of indemnification in civil and criminal actions for expenses incurred in preparation for defense of the suit. Virginia, however, disallows advance in-

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  \item \textsuperscript{114} N.C. GEN. STAT. § 55-21(b) (1965).
  \item \textsuperscript{115} Ark. STAT. ANN. § 64-309(c) (1966).
  \item \textsuperscript{116} See, e.g., Solimine v. Hollander, 129 N.J. Eq. 264, 19 A.2d 344 (1941).
  \item \textsuperscript{118} Md. ANN. CODE art. 23, § 64(b) (Supp. 1967).
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demnification in criminal actions, but allows the corporation to make other or "further" indemnification even in criminal proceedings, except where the defendant has been grossly negligent or guilty of wilful misconduct. In the absence of the corporation's further indemnification of such person either through the articles or bylaws, the director or officer will have to bear the burden of litigation expenses until he is exonerated.

New York and Tennessee also allow an advance of indemnification for defense expenses in civil and criminal actions. These provisions seem wise and practical in that they not only place the costs of litigation upon the corporation, which is better able to bear them, but also relieve the director or officer of financial worry during the pendency of the litigation. In the event that such director or officer is ultimately found not entitled to indemnification, Delaware, New York and Tennessee require that such advance indemnification be repaid.

L. Insurance

Perhaps the most controversial area of indemnification involves insurance. The recent statutes give the corporation "power to purchase and maintain insurance . . . whether or not the corporation would have the power to indemnify him against such liability." California recently amended its statute and now allows a corporation to carry indemnity insurance and pay the premium "in whole or part." Ohio specifies that statutorily allowable recovery is not exclusive of any other rights under "any insurance purchased by the corporation." Georgia also allows a corporation to purchase and maintain insurance.

The recent trend toward allowing corporations to carry insurance and pay the premiums raises some serious questions, although this practice has met with corporate approval. A leading company in the field of such insurance

122. E.g., Del. Code Ann. tit. 8, § 145(g) (CT Corp. ed. 1967).
127. Carley, Insuring Executives, The Wall Street Journal, Aug. 29, 1968, at 1, col. 1. [M]any giant companies and their executives are hustling to take out insurance. General Motors Corp. and its executives recently purchased $25 million in coverage in what is said to be the biggest executive insurance deal on record.
is Stewart, Smith & Co., whose coverage plan is composed of two separate policies. One such policy pays, on behalf of the corporation, amounts which the corporation may be required to pay or permitted to pay to its directors or officers. The other policy permits a director or officer to recover directly from the insurer in situations where the director or officer cannot be indemnified by the corporation, but such recovery from the insurance company is denied the director or officer where, for example, there is intentional dishonesty or the director or officer has personally profited illegally.

Two basic questions arise as to the propriety of allowing indemnification insurance. One concerns the negation by such insurance of the deterrent effect of civil or criminal liability upon the actions of corporate officials. Where the director or officer is guilty of misfeasance, civil liability in the form of a judgment should be imposed to deter such actions. If the director or officer can then avoid the financial consequence of such acts through insurance, corporate officials can embark with impunity upon a course of self-enriching acts. California's statute, which requires a judicial determination of whether indemnification shall be made, appears to be rendered meaningless by a new provision which states that "[n]othing in this section shall prohibit a corporation . . . from paying, in whole or part, the premium or other charge for any type of indemnity insurance . . . against liability or loss arising out of his actual or asserted misfeasance or nonfeasance in the performance of his duties or out of any actual or asserted wrongful act against, or by, any of such corporations including, but not limited to, judgments, fines, settlements, and expenses . . . ."128

The other question raised by the insurance provisions concerns the burden of premium costs. California specifically allows the corporation to pay in whole or in part. If a statute prohibits indemnification of a director or officer under certain circumstances, a corporation which pays premiums for insurance of its officials can still indirectly indemnify the officials and thus defeat the policy of any indemnification provision. The generally accepted division of premium costs is ninety percent paid by the corporation and ten percent paid by the directors and officers as a group. Some corporations, however, take the view that such insurance is not only a business expense but also too novel.

The coverage costs about $450,000 for a three-year period, and GM says its executives pick up part of the tab. . . . [T]he companies that have the most trouble buying policies are in industries that are prime targets for antitrust proceedings, such as steel. . . . Other companies that sometimes have trouble buying policies include firms whose sales are tied closely to Government contracts. . . . Firms having trouble with their creditors or facing big proxy fights are often turned down, insurance men say.

for an accurate allocation; these corporations thus bear the entire cost on their own.

It is possible that indemnity by insurance will be denied in a situation where the director or officer collects under a policy wholly paid for by the corporation for acts which could not be indemnified by the corporation. When the director or officer is guilty of misfeasance which in no way benefited the corporation and he did not pay for any part of the insurance premium, it is conceivable that a derivative action could be instituted to have the director or officer contribute his fair share to the premium payment. There is also the possibility in the situation posited that an insurance company would refuse to pay, if faced with a sizable loss, on the ground that such insurance contravenes public policy. It is also arguable on public policy grounds that even the director or officer himself should not be allowed to buy insurance against liability arising from breach of duty for which the corporation could not indemnify him under the state statute. However, experience with such insurance is still minimal, and such questions will have to be answered when these specific controversies arise.

Conclusion

Delaware's new statute and the one patterned thereafter have come a long way from the previous Delaware statute. From a basic statute with broad language has emerged a form of statute which tries to anticipate troublespots, and, at the same time, gives the corporation maximum discretion in the award of indemnification. It has clearly distinguished between third party and derivative actions and has acknowledged that different standards are applicable in those two situations. Employees and agents are included within its coverage, in addition to directors and officers, and it explicitly applies to civil, criminal, administrative and investigative proceedings. It also affords the corporate officer an opportunity to settle third party suits or enter a plea of nolo contendere in a criminal action without risking an unfavorable presumption, by either act alone, which might defeat his chance for indemnification.

The new statutes also empower a corporation to indemnify for expenses in connection with settlements of threatened or pending derivative actions, and it is here that an area of abuse may have been opened up. A defendant-director or officer will likely settle with the corporation, taking a chance that the board of directors will determine him to be not guilty of negligence or misconduct in the performance of his duties. It is difficult to see how fellow directors can form a truly impartial forum even with the opinion of "independent" legal counsel. Just how broadly the non-exclusivity provision will be interpreted by courts is yet to be seen, but courts may be willing to set limits. The problems that the insurance provision presents have not surfaced at this time, but some of the obvious difficulties should be anticipated.
Because of its liberality and attractiveness to corporations and because of Delaware's influence in the area of corporation law, the new Delaware-type provision is likely to be adopted by many states. However, the states should consider the possibility of further improvement. One improvement might be to exclude explicitly from indemnification certain persons whom judicial interpretation may bring within the coverage of the new Delaware statute. While it may be desirable to retain within the statutory language corporate personnel who do not qualify de jure as directors or officers under statute, certificates of incorporation or bylaw, but who are in fact corporate officials by virtue of their powers and responsibilities, the inclusion of minor employees and independent contractors is questionable.

Judicial supervision of the indemnification award, especially in the settlement of a threatened or pending action, is another area needing improvement. Providing for judicial review of a board of directors' determination to insure that the public policy behind an indemnification statute is not violated is neither unprecedented nor unreasonable. In addition, the statute should require that notice of a claim for indemnification be given, at least to shareholders, so that they may be apprised of possible disposition of corporate assets. Finally, future statutes should make indemnification obtainable for suits brought in states not having indemnification provisions or not providing for such awards in all situations covered by the new Delaware-type statute. This would be more desirable than relying upon the catch-all non-exclusivity provision.

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