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# Protecting Corporate Directors and Officers: Indemnification

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## I. INTRODUCTION

This Special Project Note on indemnification and the succeeding Special Project Note on insurance are intended to offer practical advice to practitioners with corporate clients. All fifty states have passed indemnification statutes[1] that establish the

*This Special Project Note is cited as "*Indemnification* (Special Project)" throughout the Special Project.

1. ALA. CODE § 10-2A-21 (1980); ALASKA STAT. § 10.05.010 (1985); ARIZ. REV. STAT. ANN. § 10-005 (Supp. 1986); ARK. STAT. ANN. § 64-309 (1980); CAL. CORP. CODE § 317 (West Supp. 1987); COLO. REV. STAT. § 7-3-101.5 (1980); CONN. GEN. STAT. ANN. § 33-320a (West Supp. 1986); DEL. CODE ANN. tit. 8, § 145 (1983) (amended 1986); FLA. STAT. ANN. § 607.014 (West 1977 & Supp. 1986); GA. CODE ANN. § 14-2-156 (1982); HAW. REV. STAT. § 416-35 (1985); IDAHO CODE § 30-1-5 (1980); ILL. ANN. STAT. ch. 32, para. 8.75 (Smith-Hurd 1985); IND. CODE ANN. § § 23-1-37-1 to 23-1-37-15 (BURNS SUPP. 1986); IOWA CODE ANN. § 496A.4A (West Supp. 1986); KAN. STAT. ANN. § 17-6305 (Supp. 1986); KY. REV. STAT. ANN. § 271A.026 (Michie/Bobbs-Merrill Supp. 1987); LA. REV. STAT. ANN. ] N]12.83 (WEST 1969 & SUPP. 1986); ME. REV. STAT. ANN. tit. 13A, § 719 (1981); MD. CORPS. & ASS'NS CODE ANN. § 2-418 (1985); MASS. GEN. LAWS ANN. ch. 156B, § 67 (West Supp. 1986); MICH. COMP. LAWS ANN. § 450.156-1 (West 1973); MINN. STAT. ANN. § 302A.521 (West 1985); MISS. CODE ANN. § 79-3-7(o) (1972); MO. ANN. STAT. § 351.355 (Vernon Supp. 1987); MONT. CODE ANN. § 35-1-414 (1985); NEB. REV. STAT. § 21-2004(15) (1983); NEV. REV. STAT. § 78.751 (Michie 1986); N.H. REV. STAT. ANN. § 293-A:5 (Supp. 1986); N.J. STAT. ANN. § 14A:3-5 (West Supp. 1986); N.M. STAT. ANN. § 53-11-4.1 (1983); N.Y. BUS. CORP. LAW § § 721-725 (McKinney Supp. 1987); N.C. GEN. STAT. § § 55-19 to 55-21 (1982); N.D. CENT. CODE § 10-19.1-91 (1985); OHIO REV. CODE ANN. § 1701.13(e) (Anderson 1985); OKLA. STAT. ANN. tit. 18, § 1031 (West 1986); OR. REV. STAT. §§ 57.255, 57.260 (1984); PA. STAT. ANN. tit. 15, § 1410 (Purdon Supp. 1986); R.I. GEN. LAWS § 7-1.1-4.1 (Supp. 1986); S.C. CODE ANN. § 33-13-180 (Law. Co-op 1977 & Supp. 1985); S.D. CODIFIED LAWS ANN. § § 47-2-58.1 to 47-2-58.6 (Supp. 1986); TENN. CODE ANN. § § 48-8-501 to 48-8-509 (Supp. 1986) (effective Oct. 1, 1987); TEX. BUS. CORP. ACT ANN. art. 2.02-1 (Vernon Supp. 1987); UTAH CODE ANN. § 16-10-4(o) (1953); VT. STAT. ANN. tit. 11, § 1852(15)

scope and terms under which a corporation may, and in some cases must, indemnify its directors and officers. Legal counsel should test the scope of a particular indemnification statute by determining what standards must be met, what procedures must be followed, and what expenses may be indemnified under the relevant state statute. If a particular indemnification statute is not limited to the alternatives specified therein, counsel should determine what additional indemnity is available.

To illustrate the analysis necessary to address these issues, this Special Project Note focuses on four representative indemnification statutes—the Delaware Corporation Act,[2] the California Corporation Act,[3] the New York Corporation Act,[4] and the Revised Model Business Corporation Act (Revised Model Act *or* Revised MBCA)[5]—with an emphasis on the recent amendments to the Delaware and New York statutes.[6] Part II of this Special Project Note examines statutory provisions that make indemnification mandatory. Part III analyzes provisions that authorize permissive indemnification. Finally, Part IV discusses additional methods of providing indemnification protection for corporate directors and officers, such as through charter amendments, by-law provisions, or individual contracts.

## II. MANDATORY INDEMNIFICATION

Indemnification statutes typically contain two distinct parts, a mandatory part and a permissive part. The mandatory part creates an enforceable *right,* requiring the corporation to indemnify its directors and officers upon satisfaction of certain statutory prerequisites. In contrast, the permissive part grants the corporation an *option* to indemnify its directors and officers if an appropriate body, such as the board's disinterested directors, determines that the re-

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(1984); VA. CODE ANN. § § 13.1-696 to 13.1-704 (1985); WASH. REV. CODE ANN. § 23A.08.025 (Supp. 1986); W. VA. CODE § 31-1-9 (1982); WIS. STAT. ANN. § 180.05 (West Supp. 1986); WYO. STAT. § 17-1-105.1 (Supp. 1986).

2. DEL. CODE ANN. tit. 8, § 145 (1983) (amended 1986) [hereinafter DEL. CODE].

3. CAL. CORP. CODE § 317 (West Supp. 1987) [hereinafter CAL. CODE].

4. N.Y. BUS. CORP. LAW §§ 721-725 (McKinney Supp. 1987) [hereinafter N.Y. LAW].

5. REVISED MODEL BUSINESS CORP. ACT §§ 8.50-8.56 (1985) [hereinafter REVISED MBCA *or* REVISED MODEL ACT].

6. Most states have adopted, in whole or in part, legislation similar to either Delaware's statute or the Model Business Corporation Act (Model Act *or* MBCA), which was promulgated in 1980. The Model Act's indemnification section is virtually identical to that of the Revised Model Act. Comparing these statutes to those of California and New York highlights the most salient features of indemnification statutes in general.

quired statutory standard of conduct has been met.[7]

The standards for mandatory indemnification vary among the four representative statutes. The mandatory part of Delaware's indemnification statute requires a corporation to indemnify its directors and officers for "any expenses (including attorneys' fees) actually and reasonably incurred" in defending a lawsuit, "to the extent of" the director's or officer's success "on the merits or otherwise."[8] Mandatory indemnification under the Delaware statute, therefore, requires a showing that the director or officer was successful on the merits or otherwise,[9] not that the director or officer met the standard of conduct required for permissive indemnification.[10] The mandatory part of California's indemnification statute requires indemnification "to the extent" that a director or officer

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7. *See* Pillai & Tractenberg, *Corporate Indemnification of Directors and Officers: Time for a Reappraisal*, 15 U. MICH. J.L. REF. 101, 111 (1981) (noting that unlike the mandatory part, which gives a director or officer the right to indemnification, the permissive part allows the corporation to choose whether to indemnify a director or officer).

8. DEL. CODE § 145(c) (providing that "[t]o the extent that a director, officer, employee or agent of a corporation has been successful on the merits or otherwise in defense of any action, suit or proceeding . . . he shall be indemnified against expenses (including attorneys' fees) actually and reasonably incurred hy him in connection therewith").

Delaware grants "management the broadest possible discretion, subject only to the requirement tbat the expenses have been 'actually and reasonably incurred,' " to define the types and amounts of indemnifiable expenses. J. BISHOP, THE LAW OF CORPORATE OFFICERS AND DIRECTORS: INDEMNIFICATION AND INSURANCE § 6.03[3] (rev. 1985). Delaware's standard for reasonable expenses includes even astronomical counsel fees. The Delaware Superior Court recently upheld attorneys' fees of $500,000, which averaged $190 per hour for the time of each partner and associate. *See* Merritt-Chapman & Scott Corp. v. Wolfson, 321 A.2d 138, 143-44 (Del. Super. Ct. 1974).

Statutes with a "success on the merits or otherwise" standard include: ALA. CODE § 10-2A-21(c) (1980); ALASKA STAT. § 10.05.10(c) (1985); ARIZ. REV. STAT. ANN. § 10-005(c) (Supp. 1986); ARK. STAT. ANN. § 64-309(C) (1980); FLA. STAT. ANN. § 607.014(3) (West 1977); GA. CODE ANN. § 14-2-156(c) (1977); HAW. REV. STAT. § 416-35(d) (1985); IDAHO CODE § 30-1-5(c) (1980); ILL. ANN. STAT. ch. 32, para. 8.75(c) (Smith-Hurd 1985); KAN. STAT. ANN. § 17-6305 (c) (Supp. 1986); LA. REV. STAT. ANN. § 12.83(B) (West 1969); ME. REV. STAT. ANN. tit. 13A, § 719(2) (1981); MD. CORPS. & ASS'NS CODE ANN. § 2-418(d) (1985); MO. ANN. STAT. § 351.355(3) (Vernon Supp. 1986); NEB. REV. STAT. § 21-2004(15)(c) (1983); NEV. REV. STAT. § 78.751(3) (Michie 1986); N.H. REV. STAT. ANN. § 293-A:5(III) (Supp. 1986); N.J. STAT. ANN. § 14A:3-5(4) (West Supp. 1986); OHIO REV. CODE ANN. § 1701.13(e)(3) (Anderson 1985); OKLA. STAT. ANN. tit. 8, § 1031 (C) (West 1986); OR. REV. STAT. § 57.255(3) (1984); PA. STAT. ANN. tit. 15, § 1410(C) (Purdon Supp. 1986); S.D. CODIFIED LAWS ANN. § 47-2-58.3 (Supp. 1986); UTAH CODE ANN. § 16-10-4(o)(3) (1953); W. VA. CODE § 31-1-9(c) (1982); WIS. STAT. ANN. § 180.05(3) (West Supp. 1986); WYO. STAT. § 17-1-105.1(b) (Supp. 1986).

9. *See* Green v. Westcap Corp., 492 A.2d 260 (Del. Super. Ct. 1985) (holding that an officer who had been acquitted of criminal charges was entitled to mandatory indemnification for his legal expenses incurred in defending those charges despite pending civil litigation against the officer concerning the same transactions).

10. *See infra* notcs 32-42 and accompanying text (discussing tbe standard of conduct required for permissive indemnification).

"has been successful on the merits" in defense of an action.[11] Thus, the California statute deletes the "or otherwise" phrase that is used in Delaware's statute. In contrast, the Revised Model Act requires that a director or officer be "wholly successful, on the merits or otherwise," to be indemnified by the corporation.[12] Prior to a recent amendment, New York also employed the "wholly successful" standard;[13] New York now has a "successful on the merits or otherwise" standard.[14]

The mandatory indemnification standards discussed above differ in two important ways. First, a statute may or may not allow partial mandatory indemnification if a defense has been only partially successful.[15] Under each statute, a "successful" defense is a prerequisite to mandatory indemnification.[16] By using the term "wholly successful," the Revised Model Act does not require indemnification for a partial success.[17] Although New York deleted the word "wholly" in its amended indemnification provision, the

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11. CAL. CODE § 317(d) (providing that "[t]o the extent that an agent of a corporation has been successful on the merits in defense of any proceeding . . . the agent shall be indemnified against expenses actually and reasonably incurred by the agent in connection therewith").

12. REVISED MBCA § 8.52 (providing that "[a] corporation shall indemnify a director who was wholly successful, on the merits or otherwise, in the defense of any proceeding to which he was a party because he is or was a director of the corporation").

Statutes with a "wholly successful on the merits or otherwise" standard include: COLO. REV. STAT. § 7-3-101.5(3) (1986); IND. CODE ANN. § 23-1-37-9 (Burns Supp. 1986); IOWA CODE ANN. § 496A.4A(4)(a) (West Supp. 1986); KY. REV. STAT. ANN. § 271A.026(4)(a) (Michie/Bobbs-Merrill Supp. 1986); MONT. CODE ANN. § 35-1-414(4)(1985); N.M. STAT. ANN. § 53-11-4.1(d) (1983); R.I. GEN. LAWS § 7-1.1-4.1(d) (Supp. 1986); S.D. CODIFIED LAWS ANN. § 47-2-58.2 (1983 & Supp. 1986); TENN. CODE ANN. § 48-8-503 (Supp. 1986); TEX. BUS. CORP. ACT. ANN. art. 2.02-1(h) (Vernon Supp. 1986); WASH. REV. CODE ANN. § 23A.08.025(5) (Supp. 1986).

13. N.Y. BUSINESS CORP. LAW § 724(a) (McKinney 1986) [hereinafter FORMER N.Y. LAW] (stating that "[a] person who has been wholly successful, on the merits or otherwise," must be indemnified).

14. N.Y. LAW § 723(a) (providing that "[a] person who has been successful, on the merits or otherwise, . . . shall be entitled to indemnification").

15. For an example of partial success and the right to only limited indemnification, see Green v. Westcap, 492 A.2d 260 (Del. Super. Ct. 1985).

16. *See* Johnston, *Corporate Indemnification and Liability Insurance for Officers and Directors*, 33 BUS. LAW. 1993, 2003 (1978).

17. REVISED MBCA § 8.52 official comment at 250. The official comment advises that the word "wholly" was added to avoid the argument, accepted in Merritt-Chapman & Scott Corp. v. Wolfson, 321 A.2d 138 (Del. 1974), that a defendant may be entitled to partial mandatory indemnification if the defendant succeeds, by plea bargaining or otherwise, in obtaining the dismissal of some, but not all, of the counts in an indictment. The Revised Model Act states that a defendant is "wholly successful" only if the entire proceeding is disposed of on a basis that involves a finding of nonliability. *See* Block, Barton & Radin, *Indemnification and Insurance of Corporate Officials*, 13 SEC. REG. L.J. 239, 241-42 (1985).

amended statute also does not appear to require partial indemnification.[18] In contrast, Delaware and California explicitly require partial indemnification "to the extent" of any partial success.[19]

Only a few cases examine what constitutes a partial success under the Delaware and California statutes. In *Galdi v. Berg*[20] partial success did not include a dismissal without prejudice because the same charge was pending in another forum.[21] The court in *Merritt-Chapman & Scott Corp. v. Wolfson*[22] awarded partial indemnification to two defendants who, pursuant to a plea bargain, were acquitted on one count of criminal conspiracy, but who were unsuccessful on a related count. The *Merritt-Chapman* court held that, in a criminal case, the statutory success standard includes "any result other than conviction."[23]

The second important difference in the representative mandatory indemnification standards concerns defendants who have in fact done something wrong, but who claim indemnification because of success on procedural grounds not related to the merits of the case. For example, a plaintiff may lack standing or the statute of limitations may have expired.[24] California requires indemnification only if the indemnitee prevails on the merits at trial.[25] In contrast, the phrase "on the merits or otherwise" in the Delaware statute, the New York statute, and the Revised Model Act might require indemnification for settlements if there is no payment or

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18. N.Y. LAW § 723(a) (*supra* note 14). A phrase such as "to the extent of any partial success" is conspicuously absent from the amended New York statute. The absence of this or a similar phrase implies that partial indemnification is not required.

19. CAL. CODE § 317(d) (*supra* note 11); DEL. CODE § 145(c) (*supra* note 8).

20. 359 F. Supp. 698 (D. Del. 1973).

21. *Id.* at 701-02. The federal district court held that the directors and officers were entitled to indemnification for expenses stemming from counts that had been dismissed with prejudice. They were not entitled, however, to reimbursement for expenses resulting from a count that had been dismissed without prejudice and without a finding of innocence because that count was being litigated in another forum. *Cf.* American Nat. Bank & Trust Co. v. Scbigur, 83 Cal. App. 3d 790, 148 Cal. Rptr. 116 (1978) (denying indemnification because the case was settled and dismissed with prejudice).

22. 321 A.2d 138 (Del. Super. Ct. 1974).

23. *Id.* at 141 (stating that "[s]uccess is vindication . . . [i]n a criminal action, any result otber than conviction must be considered success . . . [g]oing beyond tbe result . . . is neither authorized by subsection (c) nor consistent with the presumption of innocence").

24. *See, e.g.*, Dornan v. Humphrey, 278 N.Y. App. Div. 1010, 1011, 106 N.Y.S.2d 142, 143-44 (1951) (finding that the defendant-directors were entitled to indemnification even if the court dismissed the complaint only because the statute of limitations had expired).

25. *See* CAL. CODE § 317(d); Comment, *Practical Aspects of Director's and Officer's Liability Insurance—Allocating and Advancing Legal Fees and the Duty to Defend*, 32 UCLA L. REV. 690, 698 (1985).

assumption of liability by the indemnitee.[26] No court has addressed a situation in which a director or officer, as an individual, agrees to make a payment or to assume liability as part of a settlement.[27] The Revised Model Act states that "it is unreasonable to require a defendant with a valid procedural defense to undergo [a trial] to establish eligibility for mandatory indemnification."[28] Presumably, courts interpreting the Delaware and New York statutes would adopt the Revised Model Act's reasoning and allow indemnification for successful defenses based on procedural grounds.[29]

The above discussion illustrates a method for determining the parameters of the mandatory part of a particular state's indemnification statute. First, determine whether the statute uses the "wholly successful" standard. If this phrase is included, partial mandatory indemnification for a partial success is not available. Second, determine whether the statute's success standard includes the phrase "on the merits or otherwise." If so, mandatory indemnification for success on procedural grounds or for settlements is available provided there is no payment or assumption of liability by the indemnitee. Finally, mandatory indemnification is not available in states with entirely permissive statutes.[30]

## III. PERMISSIVE INDEMNIFICATION

The following discussion of permissive indemnification addresses five specific issues. First, Section A will analyze the standards of conduct required for permissive indemnification under the four representative statutes. Second, Section B will discuss the expenses covered by each permissive indemnification statute and the

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26. Two courts have held that settlements of this kind constitute "success on the merits or otherwise." Wisener v. Air Express Int'l Corp., 583 F.2d 579, 583 (2d Cir. 1978) (noting that "[t]he statute . . . refers to success 'on the merits or otherwise,' which surely is broad enough to cover a termination of claims by agreement without any payment or assumption of liability"); B & B Inv. Club v. Kleinert's, Inc., 472 F. Supp. 787, 791 (E.D. Pa. 1979) (applying Pennsylvania law and holding that the defendant was "successful on the merits or otherwise" by negotiating a dismissal with prejudice of the claims against him without making any payment).

27. Barton, *Indemnification of Corporate Officials*, in STRATEGIES FOR RESPONDING TO THE D&O INSURANCE CRISIS 21, 28 (Law & Bus. 1986).

28. REVISED MBCA § 8.52 official comment at 250.

29. *See* Irenas & Moskowitz, *Indemnifications of Corporate Officers, Agents, and Directors: Statutory Mandates and Policy Limitations*, 7 SETON HALL LEGIS. J. 117, 119 (1984) (stating that "the phrase 'or otherwise' includes the disposition of proceedings other than by a judicial determination on the merits").

30. Statutes without a mandatory indemnification part include: MASS. GEN. LAWS ANN. ch. 156B, § 67 (West Supp. 1986); MISS. CODE ANN. § 79-3-7(o) (1972); N.D. CENT. CODE § 10-19.1-91 (1985); VT. STAT. ANN. tit. 11, § 1852(15) (1984).

distinction hetween derivative suits and suits brought by third parties.[31] Third, Section C catalogues the procedures for permissive indemnification and addresses the question of who decides whether to indemnify a director or officer. Fourth, Section D discusses the circumstances in which a court might order indemnification. Finally, Section E examines under what circumstances the corporation may advance litigation expenses.

### *A. Standards for Indemnification*

Assuming indemnification is not mandatory, state corporation laws often provide for permissive indemnification if the statutorily required standard of conduct for directors and officers has been met. Most statutes utilize similar standards for permissive indemnification in third party and derivative actions.[32] These standards of conduct define the boundaries for permissive indemnification;[33] however, a director or officer whose actions fall short of the required conduct still may apply for court-ordered indemnification.[34] Unlike mandatory indemnification, a director or officer whose conduct falls within the bounds of required conduct for permissive indemnification is not necessarily entitled to indemnification.

In third party actions in Delaware, a corporation may indemnify directors and officers if they have acted (1) in "good faith," (2) "in a manner [they] reasonably believed to be in or not opposed to[35] the best interests of the corporation," and (3) in the context of a criminal proceeding, with "no reasonable cause to believe [their] conduct was unlawful."[36] The good faith/reasonable belief stan-

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31. A derivative action is brought by a shareholder to enforce a right properly belonging to the corporation when, for whatever reason, the corporation itself fails to bring the action. Any relief from a derivative suit inures to the benefit of the corporation. In contrast, in a third party suit the plaintiff asserts its own cause of action and any relief is retained by the third party, not passed on to the corporation.

32. *See* Barton, *supra* note 27, at 30-38.

33. *Id.* at 30.

34. *Id.*; *see also infra* notes 69-73 and accompanying text (discussing court-ordered indemnification).

35. The phrase "in or not opposed to" indicates that a director or officer who is sued solely because of insider status, such as under SEC rule 10b-5, may be indemnified if the director or officer meets the other requirements of DEL. CODE § 145. Johnston, *supra* note 16, at 1997-98. Liability based on rule 10b-5 for trading on inside information requires that the defendant possess the status of an insider. The Delaware statute's draftsmen included the phrase "in or not opposed to" because even though an insider may not have been acting in the interests of the corporation, the insider was not acting necessarily in a manner opposed to the interests of the corporation. *Id.*

36. DEL. CODE § 145(a). State statutes with a standard for permissive indemnification similar to Delaware's include: ALA. CODE § 10-2A-21(a) (1980); ALASKA STAT. § 10.05.010(a)

dard of conduct that governs permissive indemnification in third party suits also applies in derivative actions.[37] In a derivative suit, however, the corporation may not indemnify a director or officer who has been adjudged liable to the corporation without court approval.[38]

Formerly, an adjudication of negligence or misconduct precluded indemnification in derivative suits in Delaware.[39] A recent amendment to the Delaware statute, however, changed this standard to allow directors and officers to be eligible for permissive in-

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(1985); ARIZ. REV. STAT. ANN. § 10-005(a) (1977); ARK. STAT. ANN. § 64-309(a) (1980); FLA. STAT. ANN. § 607.014(1) (West 1977); HAW. REV. STAT. § 416-35(b) (1985); IDAHO CODE § 30-1-5(a) (1980); ILL. ANN. STAT. ch. 32, para. 8.75(a) (Smith-Hurd 1985); KAN. STAT. ANN. § 17-6305(a) (1981 & Supp. 1986); LA. REV. STAT. ANN. § 12.83(a) (West Supp. 1986); MO. ANN. STAT. § 351.355(1) (Vernon 1966 & Supp. 1986); NEB. REV. STAT. § 21-2004(15)(a) (1983); NEV. REV. STAT. ANN. § 78.751(1) (Michie 1986); N.H. REV. STAT. ANN. § 293-A:5(I) (1977 & Supp. 1986); OHIO REV. CODE ANN. § 1701.13(E)(1) (Anderson 1985); OKLA. STAT. ANN. tit. 18, § 1031(A) (West 1986); OR. REV. STAT. § 57.255(1) (1984); PA. STAT. ANN. tit. 15, § 1410(a) (Purdon 1967 & Supp. 1986).

37. DEL. CODE § 145(b). Section 145(b) provides that a corporation may indemnify a director or officer in a derivative suit "if he acted in good faith and in a manner he reasonably believed to be in or not opposed to the best interests of the corporation and except that no indemnification shall be made in respect of any claim, issue or matter as to which such person shall have been adjudged to be liable to the corporation unless and only to the extent that the court . . . shall deem proper." *Id.*

38. *Id.* One commentator explains:

> [T]he indemnification against third party claims (section 145(a)) is broader than in the case of derivative actions. The policy reason behind the distinction is that, whereas in the derivative action he has allegedly violated his duty to the corporate principal, the director or officer who is sued by a third party was presumably working in good faith to advance the corporation's interest when he injured the third party and, accordingly, by analogy to the principles of agency law, he should be protected by the corporate principal.

Johnston, *supra* note 16, at 1996.

39. Until 1986 DEL. CODE § 145(b) did not permit indemnification in derivative actions for a director or officer "adjudged to be liable for negligence or misconduct in the performance of his duty to the corporation unless [authorized by the court]."

Statutes that still adhere to the Delaware standard before its amendment deleting the "for negligence or misconduct" language include: ALA. CODE § 10-2A-21(b) (1980); ALASKA STAT. § 10.05.010(b) (1985); ARIZ. REV. STAT. ANN. § 10-005(b) (1977); ARK. STAT. ANN. § 64-309(b) (1980); FLA. STAT. ANN. § 607.014(2) (West 1977); GA. CODE ANN. § 14-2-156(b) (1982); HAW. REV. STAT. § 416-35(c) (1985); IDAHO CODE § 30-1-5(b) (1980); ILL. ANN. STAT. ch. 32, para. 8.75(b) (Smith-Hurd 1985); KAN. STAT. ANN. § 17-6305(b) (1981 & Supp. 1986); LA. REV. STAT. ANN. § 12.83(a) (West Supp. 1986); MO. ANN. STAT. § 351.355(2) (Vernon 1966 & Supp. 1986); NEB. REV. STAT. § 21-2004(15)(b) (1983); NEV. REV. STAT. ANN. § 78.751(2)(Michie 1986); N.H. REV. STAT. ANN. § 293-A:5(II) (1977 & Supp. 1986); N.J. STAT. ANN. § 14A:3-5(3) (West 1969 & Supp. 1986); OHIO REV. CODE ANN. § 1701.13(E)(2) (Anderson 1985); OKLA. STAT. ANN. tit. 18, § 1031(b) (West 1986); OR. REV. STAT. § 57.255(2) (1984); PA. STAT. ANN. tit. 15, § 1410(b) (Purdon 1967 & Supp. 1986); S.D. CODIFIED LAWS ANN. § 47-2-58.2 (1983 & Supp. 1986); UTAH CODE ANN. § 16-10-4(o)(2) (1973); W. VA. CODE § 31-1-9(b) (1982); WIS. STAT. ANN. § 180.05(2) (West Supp. 1986).

demnification unless the director or officer has been adjudged liable to the corporation for gross negligence under the duty of care or for a breach of the duty of loyalty.[40] This amendment conforms Delaware's standard for permissive indemnification to the holdings in *Smith v. Van Gorkom*[41] and *Aronson v. Lewis*.[42]

Under the California statute, the New York statute, and the Revised Model Act, the standards for permissive indemnification in third party and derivative actions are similar to the Delaware good faith/reasonable belief standard.[43] California, however, deletes the phrase "or not opposed to" the best interests of the

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40. *See supra* note 37.

41. 488 A.2d 858 (Del. 1985); *see supra Recent Developments* (Special Project) notes 48-86 and accompanying text.

42. 473 A.2d 805 (Del. 1984); *see supra Recent Developments* (Special Project) notes 36-47 and accompanying text.

43. *See* CAL CORP. CODE § 317(b)-(c). Section 317(b) provides:

> A corporation shall have power to indemnify [any agent in a third party action] if such person acted in good faith and in a manner such person reasonably believed to be in the best interests of the corporation and, in the case of a criminal proceeding, had no reasonable cause to believe the conduct of such person was unlawful.

*Id.* § 317(b). Section 317(c) provides:

> A corporation shall bave power to indemnify [any agent in a derivative suit] if such person acted in good faith, in a manner such person believed to be in the best interests of the corporation and with such care, including reasonable inquiry, as an ordinarily prudent person in a like position would use under similar circumstances.

*Id.* § 317(c).

*See* N.Y. LAW § 722(a) & (c). Section 722(a) provides:

> A corporation may indemnify [a director or officer in a third party action] if such director or officer acted, in good faith, for a purpose which he reasonably believed to be in, or, in the case of service for any other corporation or any partnership, joint venture, trust, employee benefit plan or other enterprise, not opposed to the best interests of the corporation and, in criminal actions or proceedings, in addition, had no reasonable cause to believe that his conduct was unlawful.

*Id.* § 772(a). Section 722(c) provides:

> A corporation may indemnify [a director or officer in a derivative suit] if such director or officer acted, in good faitb, for a purpose which he reasonably believed to be in, or, in the case of service for any other corporation or any partnership, joint venture, trust, employee benefit plan or other enterprise, not opposed to, tbe best interests of the corporation.

*Id.* § 772(c).

*See* REVISED MBCA § 8.51(a). Section 8.51(a) provides:

> [A] corporation may indemnify an individual made party to a proceeding because he is or was a director against liability incurred in the proceeding if: (1) he conducted himself in good faith; and (2) he reasonably believed: (i) in the case of conduct in his official capacity with the corporation, that his conduct was in its best interests; and (ii) in all other cases, that his conduct was at least not opposed to its best interests; and (3) in the case of any criminal proceeding, he had no reasonable cause to believe his conduct was unlawful.

*Id.* § 8.51(a).

corporation.[44] The New York statute and the Revised Model Act require that the indemnitee act in good faith and in the best interests of the corporation, but include the "not opposed to [the best interests of the corporation]" standard for conduct undertaken for an entity other than the corporation.[45] In derivative suits the California statute, the New York statute, and the Revised Model Act all specifically proscribe indemnification for those adjudged liable to the corporation if they have not met the required standard of conduct.[46] Until a recent amendment to the New York statute, a judicial determination that a duty had been breached—not an adjudication of liability—precluded indemnification.[47]

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44. In contrast to Delaware, the more rigorous California standard intentionally deleted the "or not opposed to" phrase in order to require an indemnitee seeking indemnification to have acted in what the indemnitee reasonably believed to be for the good of the shareholders. For example, an officer probably could not claim indemnification for "litigation brought to recover short-swing profit or profits from trading in the stock of his corporation on the basis of inside information" because "[p]ersonal motives, and not the corporate good, would appear predominant in such transactions." Heyler, *Indemnification of Corporate Agents*, 23 UCLA L. REV. 1255, 1258 & n.24 (1976).

Other statutes without the "not opposed to" language include: MASS. GEN. LAWS ANN. ch. 156B, § 67 (West 1970 & Supp. 1986); ME. REV. STAT. ANN. tit. 13A, § 719(1) (1981).

In addition to the good faith/reasonable belief standard, California also requires in derivative suits "such care, including reasonable inquiry, as an ordinarily prudent person in a like position would use under similar circumstances." *See supra* note 43. Although the California courts have not defined "reasonable inquiry," this requirement creates a higher standard of conduct than the Delaware standard.

45. *See* N.Y. LAW § 722(a)&(c) (*supra* note 43); REVISED MBCA § 8.51(a) (*supra* note 43).

Statutes with an "at least not opposed to" standard for all cases other than a director's or officer's fiduciary duty to the corporation include: COLO. REV. STAT. § 7-3-101.5(2) (1986); IND. CODE ANN. § 23-1-37(8) (Burns 1984 & Supp. 1986); IOWA CODE ANN. § 496A.4A(b) (West 1962 & Supp. 1986); KY. REV. STAT. ANN. § 271A.026(2) (Michie/Bobbs-Merrill 1981 & Supp. 1986); MD. CORPS. & ASS'NS CODE ANN. § 2-418(b) (1985); MINN. STAT. ANN. § 302A.521(2) (West 1985); MONT. CODE ANN. § 35-1-414(2) (1985); N.M. STAT. ANN. § 53-11-4.1(b) (1983); N.D. CENT. CODE § 10-19.1-91(2) (1985); R.I. GEN. LAWS § 7-1.1-4.1(b) (1985); S.C. CODE ANN. § 33-13-180(b) (Law. Co-op Supp. 1986); TENN. CODE ANN. § 48-8-502 (Supp. 1986); TEX. BUS. CORP. ACT ANN. art. 2.02-1(b) (Vernon 1980 & Supp. 1986); VA. CODE ANN. § 13.1-697 (1985); WASH. REV. CODE ANN. § 23A.08.025(3) (Supp. 1987).

46. *See* CAL. CODE § 317(c) (prohibiting indemnification if "adjudged to be liable to the corporation in the performance of [one's] duty to the corporation"); N.Y. LAW § 722(c) (prohibiting indemnification if "adjudged to be liable to the corporation"); REVISED MBCA § 8.51(d) (prohibiting indemnification if "adjudged liable to the corporation").

47. *See* FORMER N. Y. LAW § 722(a) (allowing indemnification "except in relation to matters as to which such director is adjudged to have breached his duty to the corporation"). The amended New York statute allows indemnification in more cases because it is possible to have a judicially determined breach of duty without an adjudication of liability. The New York statute now is consistent with the other representative statutes discussed herein concerning what precludes indemnification in a derivative action.

### B. Expenses Covered

The availability of permissive indemnification for various expenses under the above standards depends on the type of litigation—third party or derivative. A Delaware corporation may indemnify its directors and officers for judgments, fines, amounts paid in settlement, and reasonable expenses, including attorneys' fees, incurred in actual or threatened third party actions.[48] In derivative suits Delaware allows indemnification for litigation expenses (including attorneys' fees), but implicitly precludes indemnification for settlements or judgments.[49] The Delaware legislature rejected a proposal to permit indemnification for settlements or judgments in derivative suits. This avoids the circularity that would result if funds received by the corporation in the form of a judgment simply were returned, through indemnification, to the director or officer who paid the judgment.[50] If a director or officer is adjudged liable to the corporation in a derivative suit, the director or officer may not be indemnified, even for expenses, unless permitted by the court.[51]

In third party actions the California statute, the New York statute, and the Revised Model Act each allow broad permissive indemnification, including litigation expenses, judgments, fines, and amounts paid in settlement.[52] In derivative suits the California

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48. DEL. CODE § 145(a) (providing indemnification "against expenses (including attorneys' fees), judgments, fines and amounts paid in settlement actually and reasonably incurred").

In addition to civil and criminal actions, Delaware allows indemnification in connection with administrative and investigative proceedings. Under Delaware law the termination of a third party action by judgment, order, settlement, conviction, or plea of nolo contendere does not preclude indemnification because none of these outcomes creates a presumption that the good faith/reasonable belief standard of conduct has not been met. *See id.*

49. DEL. CODE § 145(b) (providing indemnification "against expenses (including attorneys' fees) actually and reasonably incurred"). Whereas § 145(a) authorizes indemnification against "expenses (including attorneys' fees), judgments, fines and amounts paid in settlement" in third party actions, § 145(b) authorizes indemnification merely against "expenses (including attorneys' fees)" in derivative suits. The omission in § 145(b) of the phrase "judgments, fines and amounts paid in settlement" was intentional. Block, Barton & Radin, *supra* note 17, at 244 & n.20.

50. *See* Barton, *supra* note 27, at 36. Public policy supports a rule prohibiting indemnification for settlements and judgments in derivative suits; otherwise, shareholders would not benefit and the result would be expensive. *See* BUS. LAW., Update (July/August, 1986).

51. *See supra* note 37.

52. In this respect, the California statute, the New York statute, and the Revised Model Act are similar to the Delaware statute. *See* CAL. CODE § 317(b) (providing indemnification "against expenses, judgments, fines, settlements and other amounts actually and reasonably incurred"); N.Y. LAW § 722(a) (providing indemnification "against judgments, fines, amounts paid in settlement and reasonable expenses, including attorneys' fees actually and

statute, the New York statute, and the Revised Model Act each permit indemnification for litigation expenses except when the indemnitee is adjudged liable to the corporation.[53] Whereas California and New York explicitly deny indemnification for amounts paid in settling or otherwise disposing of a derivative action, the Revised Model Act, similar to Delaware, implicitly denies indemnification for settlements.[54] Only seven states do not specifically bar indemnification for settlements in derivative suits.[55]

### C. *Procedures for Indemnification*

The procedures for authorizing permissive indemnification are essentially the same from state to state. Delaware, California, New York, and the Revised Model Act all require case-by-case authorization based on a determination that the potential indemnitee has met the applicable standard of conduct.[56] Many states also require

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necessarily incurred"); REVISED MBCA § 8.50(4) (providing indemnification against "a judgment, settlement, penalty, fine (including an excise tax assessed with respect to an employee benefit plan), or reasonable expenses"). A conviction or plea of nolo contendere, without more, does not prohibit permissive indemnification under any of these statutes. *See* CAL. CODE § 317(b); N.Y. LAW § 722(b); REVISED MBCA § 8.51(c) official comment at 248.

53. *See* CAL. CODE § 317(c) (providing that "[a] corporation shall have power to indemnify [a director or officer in] any . . . action by or in the right of the corporation . . . against expenses actually and reasonably incurred . . . [and that] [n]o indemnification shall be made [to a director or officer] adjudged to be liable to the corporation"); N.Y. LAW § 722(c) (providing that "[a] corporation may indemnify [a director or officer in] an action by or in the right of the corporation . . . against . . . reasonable expenses, including attorneys' fees, actually and necessarily incurred . . . except that no indemnification . . . shall be made [to a director or officer] adjudged to be liable to the corporation"); REVISED MBCA § 8.51(e) (stating that "[i]ndemnification permitted under this section in connection with a proceeding by or in the right of the corporation is limited to reasonable expenses incurred in connection with the proceeding").

54. *See* CAL. CODE § 317(c); N.Y. LAW § 722(c); REVISED MBCA § 8.51(e).

55. IND. CODE ANN. § 23-1-37(8) (Burns 1984 & Supp. 1986); ME. REV. STAT. ANN. § 13A-719(1)(1981); MASS. GEN. LAWS ANN. ch. 156B, § 67 (West 1970 & Supp. 1986); MINN. STAT. ANN. § 302A.521(2) (West 1985); MO. ANN. STAT. § 351.355(2) (Vernon 1966 & Supp. 1986); VT. STAT. ANN. tit. 11, § 1852(15) (1984); WYO. STAT. § 17-1-105.1(a) (1977 & Supp. 1986).

56. DEL. CODE § 145(d) provides:

> Any indemnification . . . (unless ordered by a court) shall be made by the corporation only as authorized in the specific case upon a determination that indemnification . . . is proper in the circumstances because [a director or officer] has met the applicable standard of conduct . . . . Such determination shall be made (1) 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 (2) 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 (3) by the stockholders.

CAL. CODE § 317(e) provides:

> [A]ny indemnification under this section shall be made by the corporation only if au-

notice to the shareholders of the indemnification.[57] In Delaware and New York the determination of whether the statutorily required standard of conduct has been met must be made either (1) by the board of directors by a majority vote of a quorum of directors who were not parties to the proceeding, (2) by independent legal counsel, or (3) by the stockholders.[58] In contrast, California

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thorized in the specific case, upon a determination that indemnification of the [director or officer] is proper in the circumstances because [that person] has met the applicable standard of conduct . . . by (1) a majority vote of a quorum consisting of directors who are not parties to such proceeding; [or] (2) approval of the shareholders . . . with the shares owned by the person to be indemnified not being entitled to vote thereon . . . .

N.Y. LAW § 723(b) provides:

[A]ny indemnification . . . (unless ordered by the court) . . . shall be made by the corporation, only if authorized in the specific case: (1) [b]y the board acting by a quorum consisting of directors who are not parties to such action or proceeding upon a finding that the director or officer has met the standard of conduct . . . or (2) [i]f a quorum . . . is not obtainable or, even if obtainable, a quorum of disinterested directors so directs; (A) [b]y the board upon the opinion in writing of independent legal counsel that indemnification is proper in the circumstances because the applicable standard of conduct . . . has been met . . . or (B) [b]y the shareholders upon a finding that the director or officer has met the applicable standard of conduct . . . .

REVISED MBCA § 8.55(a)-(b) provides:

A corporation may not indemnify a director under section 8.51 unless authorized in the specific case after a determination has been made that indemnification of the director is permissible in the circumstances hecause he has met the standard of conduct set forth in section 8.51. The determination shall be made: (1) by the board of directors by majority vote of a quorum consisting of directors not at the time parties to the proceeding; (2) if a quorum cannot be obtained under subdivision (1), by majority vote of a committee [designed for that purpose]; (3) by special legal counsel . . . or (4) by the shareholders, but shares owned by or voted under the control of directors who are at the time parties to the proceeding may not be voted on the determination.

57. *See, e.g.*, N.Y. LAW § 725(c). The New York statute provides:

If any expenses or other amounts are paid by way of indemnification, otherwise than by court order or action by the shareholders, the corporation shall . . . mail to its shareholders . . . a statement specifying the persons paid, the amounts paid, and the nature and status at the time of such payment of the litigation.

*Id.* Such a statement of notice gives shareholders an opportunity to challenge permissive indemnification if they believe that the requisite standards have not been met. *See* McAdams, *A Proposal to Amend the Indemnification Section (§ 5) of the Model Business Corporation Act*, 31 BUS. LAW. 2123, 2138 (1976).

Statutes with notice requirements include: COLO. REV. STAT. § 7-3-101.5(10) (1986); FLA. STAT. ANN. § 607.014(9) (West 1977); GA. CODE ANN. § 14-2-156(h) (1982); ILL. ANN. STAT. ch. 32, para. 8.75(h) (Smith-Hurd 1985); IOWA CODE ANN. § 496A.4A(11) (West Supp. 1986); KY. REV. STAT. ANN. § 271A.026(11) (Michie/Bobbs-Merrill 1981 & Supp. 1986); MD. CORPS. & ASS'NS CODE ANN. § 2-418(I) (1985); MINN. STAT. ANN. § 302A.521(8) (West 1985); MONT. CODE ANN. § 35-1-414(11) (1985); NEB. REV. STAT. § 21-2004(15)(j) (1983); N.M. STAT. ANN. § 53-11-4.1(k) (1983); N.D. CENT. CODE § 10-19.1-91(10) (1985); R.I. GEN. LAWS § 7-1.1-4.1(k) (1985); TEX. BUS. CORP. ACT ANN. art. 2.02-1(s) (Vernon 1980 & Supp. 1986); WASH. REV. CODE ANN. § 23A.08.025(12) (1969 & Supp. 1986).

58. *See* DEL. CODE § 145(d) (*supra* note 56); N.Y. LAW § 723(b) (*supra* note 56). Presumably, in a shareholder vote a director or officer with an interest in the proceeding could

authorizes permissive indemnification only if it is approved by a quorum of disinterested directors or by the shareholders, with the shares owned by the potential indemnitee not entitled to vote.[59] California does not authorize indemnification based on a determination by independent counsel.[60] The Revised Model Act combines the above approaches and allows a determination by disinterested directors, special counsel, or shareholders not party to the proceeding.[61]

The use of independent legal counsel under the Delaware statute, the New York statute, and the Revised Model Act raises the question of which counsel qualifies as "independent." Very few states allowing this type of authorization for permissive indemnification define "independent legal counsel."[62] Consequently, the safest course is to seek the opinion of special counsel appointed solely for this purpose.[63] In *Schmidt v. Magnetic Head Corp.*[64] a New York state court defined "independent legal counsel" as "an attorney who is free from past connections with the corporation or the person to be indemnified."[65] According to the Revised Model Act, a corporation should choose neither inside counsel nor regular outside counsel to authorize permissive indemnification.[66] If, how-

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vote his shares in favor of indemnification.

59. *See* CAL. CODE § 317(e)(2) (*supra* note 56). Under most statutes, including Delaware's and New York's, a shareholder decision is based on the votes of all shareholders. *See* Block, Barton & Radin, *supra* note 17, at 246. The California approach, which is not followed by any other state, prohibits participation in the shareholder vote by interested shareholders. Thus, in California an indemnitee who owns a controlling block of stock could not gain indemnification simply by voting personal shares.

60. CAL. CODE § 317(e) (*supra* note 56). The option of having independent legal counsel decide whether the applicable standard of conduct has been met is not specifically mentioned in California's statute.

61. REVISED MBCA § 8.55(b) (*supra* note 56).

62. The only statutes defining the term "independent legal counsel" are OHIO REV. CODE ANN. § 1701.13(e)(4) (Anderson 1985) (requiring the passage of five years from counsel's previous association with either the corporation or the person seeking indemnification) and WASH. REV. CODE ANN. § 23A.08.025(6) (1969 & Supp. 1986) (requiring the passage of three years from any association between counsel and the corporation or the indemnitee).

63. *See* Johnston, *supra* note 16, at 1999.

64. 97 A.D.2d 151, 468 N.Y.S.2d 649 (1983).

65. *Id.* at 161, 468 N.Y.S.2d at 656. The court held that an attorney who owned no company stock, had not previously represented the company, and had no past relationship with the company's directors or officers constituted independent legal counsel despite the fact that he had been retained by a partner in the law firm that represented the corporation and the defendant-directors.

66. REVISED MBCA § 8.55 official comment at 256. A prior relationship might cause a court to doubt the genuine independence of counsel for several reasons, including: (1) longstanding ties with management; (2) possible involvement in the transactions being attacked; and (3) dependence on management for future fees. *See* Johnston, *supra* note 16, at 1998.

ever, a corporation selects independent legal counsel to authorize permissive indemnification, counsel's required opinion may be inadequate or ill-suited for indemnification of expenses advanced during the trial because counsel may not be able to analyze adequately a director's or officer's conduct until after pre-trial discovery has been completed.[67] One commentator, therefore, recommends that disinterested board members, whose actions would be protected by the business judgment rule, authorize any permissive indemnification.[68]

### *D. Court-Ordered Indemnification*

A court may order indemnification not only in situations in which a director or officer is entitled to mandatory indemnification,[69] but also in the permissive context. Delaware courts have the authority to order indemnification notwithstanding a director's or officer's ineligibility for permissive indemnification under the applicable standard.[70] Despite an adjudication of liability, Delaware allows indemnification, if the court deems it proper, for fair and reasonable litigation expenses.[71] The Revised Model Act also permits court-ordered indemnification for fair and reasonable expenses, even if the indemnitee has not met the requirements for permissive indemnification. The Revised Model Act, however, limits a court's authority to order indemnification in derivative suits.[72]

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67. *See* Johnston, *supra* note 16, at 1999. The extent of counsel's investigation certainly will affect the value of the opinion. An opinion on the propriety of an executive's conduct issued before discovery proceedings undoubtedly will be filled with qualifications that cast doubt on its overall value. An unqualified opinion issued after discovery probably is too late to assist in the decision on advancements. *Id.*

68. *Id.* at 1999 & n.20 (stating that "[w]here practicable, the option of having the indemnification approved by a neutral quorum of the board may be preferable, even if this requires expanding the size of the board by the appointment of additional, neutral directors").

"The alternative of seeking shareholder approval will usually be both unpalatable to the defendants and cumbersome, particularly in publicly-held corporations." *Id.* at 1998.

69. *See, e.g.*, Green v. Westcap Corp., 492 A.2d 260, 265-66 (Del. Super. Ct. 1985); REVISED MBCA § 8.54(1) (stating that a court "may order indemnification if it determines the director is entitled to mandatory indemnification").

70. *See* DEL. CODE § 145(b) (stating 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 of Chancery or such other court shall deem proper").

71. *Id.*

72. REVISED MODEL ACT § 8.54(2) provides that "[t]he director is fairly and reasonably entitled to indemnification in view of all the relevant circumstances, whether or not he met the standard of conduct set forth in section 8.51 or was adjudged liable as described in section 8.51(d), but if he was adjudged so liable his indemnification is limited to reasonable

In contrast, California and New York authorize court-ordered indemnification only if a director or officer has met the required standard of conduct for permissive indemnification.[73]

### *E. Advancement of Litigation Expenses*

The various aspects of permissive indemnification discussed thus far — the applicable standards, the expenses covered in third party and derivative suits, the procedures for indemnification, and court-ordered indemnification — all are part of the crucial issue of whether to advance litigation expenses to directors and officers. Even though a majority of indemnification statutes allow advances,[74] each of these statutes is entirely permissive; no state grants directors and officers a right to funds in advance.

Recent amendments to the Delaware indemnification statute do not make advancements mandatory, but permit them in more cases. Delaware deleted language that required authorization of advance litigation expenses to be "by the board of directors in the specific case."[75] Before this amendment, directors were forced to evaluate each request for an advancement on an individual basis. This requirement rendered invalid charter or by-law provisions and indemnification contracts that obligated the corporation to make advances.[76] A provision that required the corporation to

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expenses incurred." *Id.* The "idemnification with respect to derivative suits or improper benefit is always limited to expenses by the last clause of section 8.54(2)." REVISED MBCA § 8.54 official comment at 253.

73. *See* CAL. CODE § 317(e)(3) (stating that "any indemnification under this section shall be made by the corporation . . . upon a determination [by the court] that . . . the agent has met the applicable standard of conduct"); N.Y. LAW § 724(a) (noting that "indemnification shall be awarded by a court to the extent authorized under section 722 [which requires the applicable standard of conduct for permissive indemnification be met]").

74. The only statutes that do not explicitly allow advancements are MASS. GEN. LAWS ANN. ch. 156B, § 67 (West 1970 & Supp. 1986); MISS. CODE ANN. § 79-3-7(o) (1972); VT. STAT. ANN. tit. 11, § 1852(15) (1984).

75. DEL. CODE § 145(e) provides:

> Expenses incurred by an officer or director in defending a civil or criminal action, suit or proceeding may be paid by the corporation in advance of the final disposition of such action, suit or proceeding upon receipt of an undertaking by or on behalf of such director or officer to repay such amount if it shall ultimately be determined that he is not entitled to be indemnified by the corporation as authorized in this section.

Before its amendment, § 145(e) read in pertinent part:

> [I]n advance of the final disposition of such action, suit or proceeding as authorized by the board of directors in the specific case upon receipt of an undertaking hy or on behalf of such director or officer to repay such amount unless it shall ultimately be determined that he is entitled to be indemnified by the corporation as authorized in this section.

76. *See* Morris, Nichols, Arsht & Tunnell, memorandum of May 7, 1986, in THE COR-

make advancements would have no effect if each specific request, by statute, had to be approved by the board.[77] The new Delaware law appears to allow the general authorization of advancements, through charter and by-law provisions and through individual contracts for additional indemnity, without an *ad hoc* determination that the applicable standard of conduct has been met.[78]

Another amendment to the Delaware statute changes a director's or officer's obligatory promise to repay advancements[79] if indemnification ultimately is unavailable. Whereas a director's or officer's commitment to repay was formerly a binding obligation "unless it shall ultimately be determined that he is entitled to be indemnified," the amended Delaware statute makes a promise to repay binding "if it shall ultimately be determined that he is not entitled to be indemnified."[80] Delaware's amendment shifts the burden of going forward to obtain the required finding concerning entitlement from the claimant to the corporation.[81]

Like Delaware, the three other representative statutes permit advances if the corporation receives a promise from each director or officer to repay funds not ultimately subject to indemnification.[82] California's statute is similar to the amended Delaware law

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PORATE COUNSEL (July 8, 1986); *see also infra* notes 89-157 and accompanying text (discussing charter or by-law provisions and indemnification contracts providing additional indemnity).

77. *See* Morris, Nichols, Arsht & Tunnell, *supra* note 76.

78. Olson, Bogen & Magill, *Responding to the D&O Insurance Crisis: Negotiated Indemnification Contracts and Other Alternatives for Director and Officer Protection* in STRATEGIES FOR RESPONDING TO D&O INSURANCE CRISIS 216, 224-25 (Law & Bus. 1986). These authors argue that, under § 145(d), authorization by the board "in the specific case" only governs the procedure for awarding indemnification; it does not affect extra-statutory indemnity through charter or by-law provisions or indemnification contracts. For example, advancements pursuant to a by-law provision would not require authorization by the board in each case. *Contra* Block, Barton & Garfield, *Advising Directors on the D&O Insurance Crisis*, 14 SEC. REG. L. J. 130, 141-42 (1986). These commentators argue that advancements under a by-law provision would have to be pursuant to a prior determination that the standard of conduct for permissive indemnification has been met because Delaware's § 145(d) requires authorization "in the specific case."

79. *See* DEL. CODE § 145(e) (*supra* note 75) (providing that "expenses . . . may be paid by the corporation in advance . . . upon receipt of an undertaking by or on behalf of such director or officer to repay such amount").

80. *Id.*

81. "[B]y-laws may seek to shift the burden of proof as to entitlement to indemnification by providing that the corporation must make indemnification on demand, unless, within a specified time, the board of directors affirmatively determines that the agent has *not* met the required standard." Olson, Bogen & Magill, *supra* note 78, at 224 (emphasis in original).

82. *See* CAL. CODE § 317(f) (providing that "[e]xpenses incurred in defending any proceeding may be advanced by the corporation prior to the final disposition of such proceed-

because authorization for funds advanced for litigation expenses does not have to proceed on a case-by-case basis.[83] In California, however, the burden of obtaining a determination as to entitlement still is on the director or officer.[84] Likewise, New York does not have a "specific case" requirement and the burden of establishing entitlement is on the director or officer.[85] In contrast, the Revised Model Act still requires that authorization for advancements be made "in the specific case" and in the same manner that a corporation authorizes permissive indemnification.[86] A number of states have adopted the former Delaware statute, but, like the Revised Model Act, have not deleted the language requiring authorization on a case-by-case basis.[87] A "specific case" requirement does not necessarily mean fewer advancements; instead, it means that advancements cannot be made obligatory by a corporation's charter, by-laws, or indemnification contracts.

The foregoing analysis of the Delaware, California, and New York statutes and the Revised Model Act provides some insights into the scope of permissive statutory indemnification. In third

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ing upon receipt of an undertaking by or on behalf of the [director or officer] to repay such amount unless it shall be determined ultimately that [he] is entitled to be indemnified as authorized in this section"); N.Y. LAW § 723(c) (stating that "[e]xpenses incurrred in defending a civil or criminal action or proceeding may be paid by the corporation in advance of the final disposition of such action or proceeding upon receipt of an undertaking by or on behalf of such director or officer [that such amounts] shall be repaid in case the person receiving such advancement or allowance is ultimately found . . . not to be entitled to indemnification"); REVISED MBCA § 8.53(a) (noting that "[a] corporation may pay for or reimburse the reasonable expenses incurred by a director who is a party to a proceeding in advance of final disposition of the proceeding if the director furnishes the corporation a written undertaking, executed personally or on his behalf, to repay the advance if it is ultimately determined that he did not meet the standard of conduct").

83. CAL. CODE § 317(f) (*supra* note 82).

84. *Id.*; *see also* Barton, *supra* note 27, at 43-44.

85. N.Y. LAW § 723(c) (*supra* note 82).

86. REVISED MBCA § 8.53(c) (noting that "[d]eterminations and authorizations of payments [for advances] shall be made in the manner specified in section 8.55"); *see* REVISED MBCA § 8.55 (*supra* note 56).

87. Statutes with a "specific case" requirement include: ALA. CODE § 10-2A-21(e) (1980); ALASKA STAT. § 10.05.010(e) (1985); ARIZ. REV. STAT. ANN. § 10-005(e) (1977); ARK. STAT. ANN. § 64-309(e) (1980); FLA. STAT. ANN. § 607.014(5) (West 1977 & Supp. 1986); HAW. REV. STAT. § 416-35(f) (1985); IDAHO CODE § 30-1-5(e) (1980); ILL. ANN. STAT. ch. 32, para. 8.75(e) (Smith-Hurd 1985); KAN. STAT. ANN. § 17-6305(e) (1981 & Supp. 1986); LA. REV. STAT. ANN. § 12.83(d) (West 1969 & Supp. 1986); ME. REV. STAT. ANN. tit. 13A, § 719(4) (1981); MO. ANN. STAT. § 351.355(5) (Vernon 1966 & Supp. 1986); NEV. REV. STAT. ANN. § 78.751(5) (Michie 1986); N.H. REV. STAT. § 293-A:5(V) (1977 & Supp. 1986); OHIO REV. CODE ANN. § 1701.13(e)(5) (Anderson 1985); OKLA. STAT. ANN. tit. 18, § 1031(e) (West 1986); OR. REV. STAT. § 57.260(4) (1984); PA. STAT. ANN. tit. 15, § 1410(e) (Purdon 1967 & Supp. 1986); W. VA. CODE § 31-1-9(e) (1982); WIS. STAT. ANN. § 180.05(5) (West 1957 & Supp. 1986); WYO. STAT. § 17-1-105.1(d) (1977 & Supp. 1986).

party actions, a corporation can indemnify its directors and officers for all expenses, fees, settlements, and judgments if the applicable statutory standard of conduct has been met. In contrast, indemnification for settlements or judgments against directors and officers in derivative suits is contrary to the public policy of most states because the corporation would be indemnifying the defendants for a judgment or settlement paid to the corporation by the defendant-indemnitee. Depending on the circumstances, court-ordered indemnification does not necessarily require that the statutory standard of conduct for permissive indemnification be met. Advances for litigation expenses merely require a director's or officer's unsecured, written promise to repay the funds if indemnification ultimately is unavailable.[88] In most states, however, the burden of showing entitlement to ultimate indemnification is on the claimant, not the corporation. In addition, advancements cannot be made obligatory under a charter or by-law provision or indemnification contract if the state statute requires a case-by-case determination. Thus, except for egregious breaches of the duty of care, breaches of the duty of loyalty, and payment of settlements or judgments in derivative suits, the corporation, if it elects to do so, may reimburse directors and officers for liabilities under its power to grant permissive indemnification.

## IV. Additional Indemnity

Because of the uncertainty of reimbursement for directors and officers whose conduct falls within the boundaries of permissive indemnification, many corporations offer additional protection through charter amendments, by-laws, and individual indemnification contracts. In fact, some state statutes require that a corporation's authority to indemnify or to advance expenses be embodied in a charter or by-law provision or in a resolution approved by a majority of the stockholders.[89] In contrast, other states have "ex-

88. *See* Oesterle, *Limits on a Corporation's Protection of its Directors and Officers from Personal Liability*, 1983 WIS. L. REV. 513, 545-46. Because promises to repay generally are unsecured, any director or officer may obtain the resources necessary to defend a lawsuit. A security requirement would favor wealthy directors and officers who are able to post security. *See* Johnston, *supra* note 16, at 1999.

Some statutes expressly provide that the promise need not be secured or conditioned on one's financial ability to repay. *See, e.g.*, MD. CORPS. & ASS'NS CODE ANN. § 2-418(f) (1985); N.M. STAT. ANN. § 53-11-4.1(f) (1983); N.D. CENT. CODE § 10-19.1-91(4) (1985); TEX. BUS. CORP. ACT ANN. art. 2.02-1(1) (Vernon 1980 & Supp. 1987); WASH. REV. CODE ANN. § 23A.08.025(7) (1969 & Supp. 1986).

89. *See, e.g.*, IND. CODE ANN. § 23-1-37-15 (Burns Supp. 1986); IOWA CODE ANN.

clusive" statutes that nullify any by-law or other corporate action not "consistent" with the statute.[90] The threshold question, therefore, is whether a particular state's indemnification statute has a nonexclusivity clause that permits additional indemnity.

Delaware's nonexclusivity clause, section 145(f),[91] is typical of nonexclusivity clauses in other states.[92] Amended section 145(f) states that the specific indemnification rights and procedures, which stem from the other subsections of section 145, are not exclusive and do not bar any other rights to indemnification or the advancement of expenses established through "by-law, agreement, vote of stockholders or disinterested directors or otherwise."[93] Notwithstanding the breadth of Delaware's nonexclusivity clause, courts usually read provisions of this type restrictively.[94] The pur-

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§ 496A.44 (West 1962 & Supp. 1986); MASS. GEN. LAWS ANN. ch. 156B, § 67 (West 1970 & Supp. 1986).

90. Exclusive indemnification statues include: COLO. REV. STAT. § 7-3-101.5(7)(a) (1986); CONN. GEN. STAT. ANN. § 33-320a(g) (1960 & Supp. 1986); MD. CORPS. & ASS'NS CODE ANN. § 2-418(g) (1985); MICH. COMP. LAWS ANN. § 450.156-5 (West 1973 & Supp. 1986); MONT. CODE ANN. § 35-1-414(7) (1985); NEB. REV. STAT. § 21-2004(15)(f) (1983); N.M. STAT. ANN. § 53-11-4.1(G) (1983); N.C. GEN. STAT. § 55-19(a) (1982); R.I. GEN. LAWS § 7-1.1-4.1(g) (1985); TENN. CODE ANN. § 48-8-509 (1984 & Supp. 1986); TEX. BUS. CORP. ACT ANN. art. 2.02-1(M) (Vernon Supp. 1986); WASH. REV. CODE ANN. § 23A.08.025(8) (Supp. 1987).

91. DEL. CODE § 145(f) provides:

> The indemnification and advancement of expenses provided by . . . this section shall not be deemed exclusive of any other rights to which those seeking indemnification or advancement of expenses may be entitled under any bylaw, agreement, vote of stockholders or disinterested directors or otherwise, both as to action in his official capacity and as to action in another capacity while holding such office.

92. Nonexclusive statutes include: ALA. CODE § 10-2A-21(f) (1980); ALASKA STAT. § 10.05.010(f) (1985); ARIZ. REV. STAT. ANN. § 10-005(F) (1977); ARK. STAT. ANN. § 64-309(F) (1980); FLA. STAT. ANN. § 607.014(6) (West 1977); GA. CODE ANN. § 14-2-156(f) (1982); HAW. REV. STAT. § 416-35(g) (1985); IDAHO CODE § 30-1-5(f) (1980); ILL. ANN. STAT. ch. 32, para. 8.75(f) (Smith-Hurd 1985); KAN. STAT. ANN. § 17-6305(f) (1981 & Supp. 1986); KY. REV. STAT. ANN. § 271A.026(12) (Michie/Bobbs-Merrill Supp. 1986); LA. REV. STAT. ANN. § 12.83(e) (West 1969 & Supp. 1986); MD. REV. STAT. ANN. tit. 13A, § 719(5) (1981); MO. ANN. STAT. § 351.355(6) (Vernon Supp. 1987); NEV. REV. STAT. ANN. § 78.751(6) (Michie 1986); N.H. REV. STAT. ANN. § 293-A:5(VI) (Supp. 1986); N.J. STAT. ANN. § 14A:3-5(8) (West 1969 & Supp. 1986); OHIO REV. CODE ANN. § 1701.13(e)(6) (Anderson 1985); OKLA. STAT. ANN. tit. 18, § 1031(F) (West 1986); OR. REV. STAT. § 57.260(3) (1984); PA. STAT. ANN. tit. 15, § 1410(f) (Purdon Supp. 1986); S.D. CODIFIED LAWS ANN. § 47-2-58.6 (Supp. 1986); UTAH CODE ANN. § 16-10-4(o)(6) (1973); W. VA. CODE § 31-1-9(f) (1982); WIS. STAT. ANN. § 180.05(6) (West Supp. 1986); WYO. STAT. § 17-1-105.1(e) (Supp. 1986).

93. DEL. CODE § 145(f) (*supra* note 91).

94. *See, e.g.*, SEC v. Continental Growth Fund, Inc., [1964-1966 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 91,437, at 94,719 (S.D.N.Y. 1964). In *Continental Growth Fund* a charter provision authorized the indemnification of a director guilty of ordinary negligence in managing the corporation's affairs. The court, however, denied indemnification because the Maryland statute's nonexclusivity clause permitted additional rights to be granted "under any by-law, agreement, vote of stockholders, or otherwise," but did not mention

pose of Delaware's nonexclusivity clause, and others like it, is to legitimize the power of management to guarantee reimbursement to directors and officers through additional indemnification provisions.[95] The effect of section 145(f), however, is to allow the courts, based on "public policy" considerations, to set the outer boundaries of indemnification.[96] A by-law or contract could be drafted that would provide more extensive protection for directors and officers than normally allowed under the other clauses of the Delaware statute, but public policy will limit the effectiveness of this by-law or contract.[97]

*Mooney v. Willys-Overland Motors, Inc.*,[98] the leading case interpreting Delaware's nonexclusivity clause, approved the indemnification of a former director and officer based on a corporate by-law providing for mandatory indemnification and a severance contract.[99] The court concluded that any additional indemnity must satisfy public policy and have some independent legal basis.[100] The *Mooney* court distinguished permissive indemnification from additional indemnity under a nonexclusivity clause by defining additional indemnity as an independent, extra-statutory right of directors and officers.[101]

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charter provisions.

95. *See* Oesterle, *supra* note 88, at 538.

96. *Id.* at 538-39 (stating that the Delaware statute "establish[es] a minimum permissible level of indemnification and allow[s] courts to expand that level if . . . so inclined 'and that' [Delaware] draftsmen thus attempted to cut off budding restrictive judicial precedent while saving whatever liberal treatments could be coaxed out of the courts"); *see also* Arsht & Stapleton, *Delaware's New General Corporation Law: Substantive Changes*, 23 BUS. LAW. 75, 80 (1967).

97. *See* Johnston, *supra* note 16, at 1996; Bishop, *supra* note 8, at § 6.03[1][a]. Although the boundaries within which an indemnification by-law or contract must be drafted are unclear, public policy in many states precludes indemnification for settlements by or judgments against those adjudged liable to the corporation in derivative suits. *See supra* note 50 and accompanying text.

98. 204 F.2d 888 (3d Cir. 1953).

99. *Id.* at 891-92, 896. *Mooney* was decided under the old Delaware statute, which had no explicit provision granting indemnification for a settlement, but which had a nonexclusivity clause similar to the current § 145(f). Mr. Mooney sued to compel indemnification for attorney fees paid by him for the defense of a derivative suit. A contract between Mr. Mooney and the corporation provided that the corporation would indemnify him in accordance with a by-law whose terms were broader than the Delaware statute. In alternative holdings, the court found that either the contract right was supported by independent consideration or that the corporation's by-law was an independent basis for indemnification.

100. *Id.* at 896. The independent legal basis in the *Mooney* case was either the by-law or the contract right. *Id.*

101. *Id.* (stating that "[w]here there exists, as there does here, an independent ground for payment of litigation expenses, we see no reason to make an overriding reference to the statute").

An examination of the other representative statutes reveals that the former New York law was an exclusive statute.[102] Recent amendments to New York's indemnification statute, however, include a nonexclusivity clause similar to Delaware's section 145(f).[103] New York now expressly permits additional indemnity through a corporation's charter, its by-laws, or individual contracts.[104] In contrast, the California statute and the Revised Model Act contain exclusivity provisions that invalidate any agreement to indemnify a director or officer not "consistent" with the statutes.[105] Under these exclusivity statutes, directors' and officers' indemnification rights cannot be enlarged by a charter or by-law provision, or by an individual indemnification contract.[106]

Whereas the California statute and the Revised Model Act restrict additional indemnity, a recent addition to the Delaware corporation statute (section 102(b)(7)) encourages additional indemnity by permitting a corporation to include in its charter a provision that would limit a director's monetary damages liability for breaches of the duty of care.[107] Such a provision, however, can-

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102. *See* FORMER N.Y. LAW § 721 (providing that "[n]o provision made to indemnify directors or officers . . . shall be valid unless consistent with this article").

103. *See* N.Y. LAW § 721. This law provides:

> The indemnification and advancement of expenses granted pursuant to, or provided by, this article shall not be deemed exclusive of any other rights to which a director or officer seeking indemnification or advancement of expenses may be entitled, whether contained in the certificate of incorporation or tbe hy-laws or, when authorized by such certificate of incorporation or by-laws, (i) a resolution of shareholders, (ii) a resolution of directors, or (iii) an agreement providing for such indemnification.

*Id.*

104. *Id.*

105. *See* CAL. CODE § 317(g) (providing that "[n]o provision made by a corporation to indemnify its or its subsidiary's directors or officers for the defense of any proceeding, whether contained in the articles, bylaws, a resolution of shareholders or directors, an agreement or otherwise, shall be valid unless consistent with this section"); REVISED MBCA § 8.58(a) (stating that "[a] provision treating a corporation's indemnification of or advance for expenses to directors that is contained in its articles of incorporation, bylaws, a resolution of its shareholders or board of directors, or in a contract or otherwise, is valid only if and to the extent the provision is consistent with this subchapter").

106. The California statute and the Revised Model Act do not define "consistent" as used in their statutes. Nevertheless, the term "consistent" is clearly a major limitation on counsel's options for recommending additional indemnity.

107. DEL. CODE § 102(b)(7) provides:

> (b) In addition to the matters required to be set forth in the certificate of incorporation by subsection (a) of this section, the certificate of incorporation may also contain any of the following matters:
>
> (7) A provision eliminating or limiting the personal liability of a director to the corporation or its stockholders for monetary damages for breach of fiduciary duty as a director, provided that such provision shall not eliminate or limit the liability of a director: (i) [f]or any breach of the director's duty of loyalty to the

not limit a director's liability for (1) breaches of the duty of loyalty, (2) acts or omissions not in good faith, involving intentional misconduct, or involving a knowing violation of law, (3) the payment of unlawful dividends, unlawful stock repurchases, or redemptions, or (4) transactions in which the director received an improper personal benefit.[108] Charter provisions that include this amendment can absolve a director of liability for gross negligence in observing the duty of care.[109] Even though this amendment provides a director with relief from damages for a breach of the duty of care, it does not abolish the duty itself because equitable remedies such as an injunction or rescission still are available.[110] Likewise, this amendment only limits directors' monetary liability for their actions as directors, not for their actions as officers.[111] In addition, a charter provision adopted pursuant to this amendment

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corporation or its stockholders, (ii) for acts or omissions not in good faith or which involve intentional misconduct or a knowing violation of law, (iii) under [section] 174 of this title, or (iv) for any transaction from which the director derived an improper personal benefit. No such provision shall eliminate or limit the liability of a director for any act or omission occurring prior to the date when such provision becomes effective.

This amendment is the most significant change to the Delaware corporation law concerning indemnification of directors and officers. *See* Morris, Nichols, Arsht & Tunnell, *supra* note 76.

108. DEL. CODE § 102(b)(7) (*supra* note 107).

109. The official commentary to amended § 102(b)(7) explains as follows: "This provision enables a corporation in its original certificate of incorporation or an amendment thereto validly approved by stockholders to eliminato or limit personal liability of members of its board of directors or governing body for violations of a director's . . . duty of care." Memorandum to ABA Committee on Corporate Laws, at 3, May 28, 1986 [hereinafter official commentary].

110. *See* Veasey, *Non-Insurance Alternatives: Charter Amendments* in STRATEGIES FOR RESPONDING TO THE D&O INSURANCE CRISIS 161, 168 (Law & Bus. 1986). Mr. Veasey, an attorney with Richards, Layton & Finger in Wilmington, Delaware, argues that "[t]he duty of care continues to have vitality in remedial contexts other than personal monetary damages against directors as individuals. For example, it will continue to be vitally important in injunction and rescission cases and may well be relevant in elections, proxy contests, resignations and removal contests."

111. *See* Veasey, Finkelstein & Bigler, *Delaware Supports Directors with a Three-Legged Stool of Limited Liability, Indemnification, and Insurance*, 42 BUS. LAW. 399, 403 (1987). As amended, § 102(b)(7) only applies to directors because of Delaware's concern for effective corporate governance. Liability insurance has become a relatively standard condition of employment demanded by directors. "[T]he unavailability of traditional policies . . . [has] threatened the quality and stability of the governance of Delaware corporations because directors have become unwilling, in many instances, to serve without the protection which such insurance provides and, in other instances, may be deterred by the unavailability of insurance from making entrepreneurial decisions." DEL. CODE § 102(b)(7) official commentary (*supra* note 109) at 3.

would apply only prospectively.[112] Whereas newly formed Delaware corporations may include an exculpatory provision in their charter, existing corporations will be forced to seek shareholder approval for a charter amendment.[113]

Corporations have considerable flexibility in drafting charter provisions that limit director liability. First, a corporation could draft a charter provision under section 102(b)(7) that imposes a cap or ceiling on liability for due care violations.[114] This cap or ceiling would establish a maximum dollar amount for which directors would be liable, either individually or collectively.[115] Second, if a corporation desires to eliminate director liability to the fullest extent authorized, it could draft a provision that either incorporates section 102(b)(7) by reference[116] or tracks the statutory language.[117] Even without a provision comparable to Delaware's section 102(b)(7), corporations in nonexclusive states might want to adopt charter provisions that limit a director's liability for duty of care violations because the provision might be within the outer boundaries of their state's public policy or their state eventually might follow Delaware's lead.

Another method of providing additional indemnity in a nonexclusive state is through a by-law provision. By-law provisions can authorize various procedures and presumptions to make the indemnification process more favorable to directors and officers.[118]

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112. *See* Veasey, Finkelstein & Bigler, *supra* note 111, at 402 (arguing that an exculpatory charter provision passed pursuant to § 102(b)(7) will not cover acts or omissions that occurred before the provision was enacted).

113. Morris, Nichols, Arsht & Tunnell, *supra* note 76.

114. Veasey, Finkelstein & Bigler, *supra* note 111, at 402.

115. Morris, Nichols, Arsht & Tunnell, *supra* note 76.

116. A provision incorporating the Delaware statute by reference would read as follows:

> To the fullest extent permitted by the Delaware General Corporation Law as the same exists or may hereafter be amended, a director of this corporation shall not be liable to the corporation or its stockholders for monetary damages for breach of fiduciary duty as a director.

117. A provision tracking the current Delaware statute would read as follows:

> A director of this corporation shall not be personally liable to the corporation or its stockholders for monetary damages for breach of fiduciary duty as a director, except for liability (i) for any breach of the director's duty of loyalty to the corporation or its stockholders, (ii) for acts or omissions not in good faith or which involve intentional misconduct or a knowing violation of Law, (iii) under Section 174 of the Delaware General Corporation Law, or (iv) for any transaction from which the director derived an improper personal benefit.

118. *See* Veasey, Finkelstein & Bigler, *supra* note 111, at 415. These authors assert that by-law provisions for the protection of directors and officers might include: (i) mandatory indemnification unless prohibited by statute; (ii) mandatory advancement of liti-

For example, a by-law could provide the indemnitee with the right to "appeal" an unfavorable determination by the board, independent counsel, or shareholders.[119] A by-law also could provide that the corporation must indemnify upon demand unless, within a specified time, the board affirmatively determines that the director or officer has not met the required standard of conduct, thus effectively shifting the burden of proof for entitlement.[120] More importantly, a guarantee to advance litigation expenses could, and should, appear in the corporation's by-laws.[121] A by-law provision that mandates indemnification in circumstances in which the state statute is permissive is a highly advantageous right for directors and officers.[122]

When drafting an indemnification by-law, commentators generally recommend the following language: "The corporation shall indemnify . . . to the full extent permitted by applicable law."[123]

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gation expenses, which the indemnitee can obtain on demand; (iii) accelerated procedures for determining whether the appropriate standard of conduct has been met; (iv) procedures under which a favorable determination will be deemed to have been made if the board fails or refuses to act; and (v) reasonable funding mechanisms. *Id.*

119. *Id.*

120. *See* Olson, Bogen & Magill, *supra* note 78, at 224.

121. *See* Oesterle, *supra* note 88, at 565 (arguing that "[b]ecause the standards for providing advances are very lenient and it is often of critical importance for officials to secure a source of funds before an indemnifiable liability is actually incurred, the guarantee of advances has much value"); Olson & Morgan, *D&O Exclusions Extend to Takeover Context*, Legal Times, Mar. 10, 1986, at 23, 34. Olson and Morgan assert that:

> Of critical importance is a provision stating that officers and directors have an absolute right to receive an advance of litigation expenses and costs from the corporation in return for an undertaking to repay any amounts advanced if it is subsequently determined that the officer or director is not entitled to indemnification. Without such a provision, [in the hostile takeover context] the decision to advance litigation-related costs may be left to the discretion of the board of directors of the corporation who are in office at the time the request for the advance is made.

*Id.*

122. J. BISHOP, *supra* note 8, at § 7.01, 7-2.

123. *See* Olson, *The D&O Insurance Gap: Strategies for Coping*, Legal Times, Mar. 3, 1986, at 25, 32; Johnston, *supra* note 16, at 2011; J. BISHOP, *supra* note 8, at § 7.03[2], 7-20. Professor Bishop, asserts that the best by-law for the average corporation seeking the fullest indemnification coverage possible under a nonexclusive statute would read as follows:

> The corporation shall indemnify every person who was or is a party or is or was threatened to be made a party to any action, suit, or proceeding, whether civil, criminal, administrative or investigative, by reason of the fact that he is or was a director, officer, employee, agent, or controlling stockholder of the corporation, or is or was serving at the request of the corporation as a director, officer, employee, agent, or trustee of another corporation, partnership, joint venture, trust, employee benefit plan, or other enterprise, against expenses (including counsel fees), judgments, fines and amounts paid in settlement actually and reasonably incurred by him in connection with such action, suit or proceeding, to the full extent permitted by applicable law. Such indem-

One court has indicated that this language would require a corporation to indemnify directors and officers in all situations in which indemnification does not violate the law.[124] Although a general provision of this type maximizes protection for corporate officials, it is inadequate to clarify the rights of a director or officer who contests a corporation's refusal to indemnify.[125] A by-law, therefore, should combine specific procedures for indemnification, like those mentioned above, with broad language obligating the corporation to indemnify to the fullest extent possible.

The following are suggestions for drafting a by-law or charter provision that may expand an indemnitee's rights: (1) expressly provide coverage for investigations (including internal corporate investigations — for example, a special litigation committee's inquiry into derivative claims), administrative proceedings, appeals, and other matters not covered by statute;[126] (2) specifically address claims against directors and officers representing the corporation as ERISA fiduciaries;[127] (3) if not covered by statute, specifically discuss fines, excise taxes and other penalties, and attorney's fees;[128] (4) include a provision stating that the indemnification rights established in the charter or by-law are to be deemed a contract between the individual and the corporation and that any subsequent repeal or modification does not diminish the individual's

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nification may, in the discretion of the board of directors, include advances of his expenses in advance of final disposition of such action, suit or proceeding, subject to the provision of any applicable statute.

J. BISHOP, *supra* note 8, at § 7.03[2], 7-20.

124. B & B Inv. Club v. Kleinert's, Inc., 472 F. Supp. 787, 793 (E.D. Pa. 1979) (finding that the use of the "mandatory word 'shall' " in the corporation's by-laws gave the directors and officers a contractual right to indemnification).

125. *See* Oesterle, *supra* note 88, at 565. Professor Oesterle points out the provision's shortcomings as follows:

> For example, an official settles a third-party action but the board decides that he did not act in good faith. Can the official seek a de novo review of the good faith decision in court? Or does the board decision receive deference under a facsimile of the business judgment rule? Can the officer argue that he has a right to a separate determination of his good faith by independent legal counsel or the stockholders? Whose decision controls if there is a conflict on the matter? Thus, the drafters of the general contract provision see and accomodate only one side of the indemnification problem: the provision legitimizes and maximizes corporate desires to protect its controlling officials, but it is woefully inadequate in clarifying the rights of an official who contests a corporation's refusal to indemnify.

*Id.* (footnote omitted).

126. *See* Olson, *supra* note 123, at 32.

127. *Id.*

128. *Id.*

rights;[129] (5) include a provision stating that a determination by the board that indemnification is not available — *e.g.*, pursuant to Delaware Code section 145(d) — will not be binding on a court when deciding whether indemnification is mandatory or permissive;[130] (6) extend coverage to heirs, personal representatives, and the estates of the directors and officers;[131] and (7) provide for indemnification and advancement of expenses in suits brought by a director or officer.[132] Exhibit 1 in the Appendix contains an example of a possible by-law or charter provision that incorporates the above ideas.[133]

Depending on the situation, a corporation may choose to restrict statutorily authorized indemnification through a by-law provision. One reason for imposing a restriction would be to improve relations with shareholders.[134] In addition, because the applicable law may permit indemnification for a director or officer who is suing fellow board members, the corporation might decide to limit indemnification provisions to claims *against* directors and officers; otherwise, the corporation might be forced to fund a dissident's lawsuit against other directors.[135]

Another means of providing additional indemnification in a nonexclusive state is by the execution of a contract between the corporation and its directors. A contract for indemnification has the same advantages as a by-law that sets forth the specific process and procedures for indemnification.[136] Unlike a by-law, however,

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129. *Id.* Absent this provision, a director or officer would have to rely on equitable doctrines, such as estoppel, to avoid being disadvantaged by a change in control. *Id.* A contract right would negate any requirement that the indemnitee prove reliance on the previous by-law or charter provision. *See* Sparks, Johnston & Conan, *Indemnification and Directors and Officers Liability Insurance: The Legal Framework Under Delaware Law*, in THE CRISIS IN DIRECTORS' AND OFFICERS' LIABILITY INSURANCE 3, 11 (Law & Bus. 1986).

130. *See* Olson & Morgan, *supra* note 121, at 34.

131. *See* Olson, *supra* note 123, at 32.

132. *See* Sparks, Johnston & Conan, *supra* note 129, at 11; *see, e.g.*, Hibbert v. Hollywood Park, Inc., 457 A.2d 339 (Del. Super. Ct. 1983). In *Hibbert* former directors sought indemnification for proxy contest expenses and legal fees incurred in suits filed by the former directors in their unsuccessful bid for reelection.

133. The proposed charter or by-law provision in the Appendix is reprinted from THE CORPORATE COUNSEL (July/August, 1986). Excepting § 1, it is virtually identical to the model proposal set forth in Sparks, Johnston & Conan, *supra* note 129, at 27-28.

The proposed provision does not distinguish between third party and derivative claims because it is possible that a state's public policy does not bar indemnification in derivative suits.

134. J. BISHOP, *supra* note 8, at § 7.01, 7-3.

135. Barton, *supra* note 27, at 52.

136. *See supra* notes 118-19 and accompanying text. A contract for indemnification must be supported by independent consideration of some benefit to the corporation. Mere

an indemnification contract cannot be repealed or amended by a new board of directors.[137] The greatest advantage of an indemnification contract is the security and certainty it offers. This security will induce qualified individuals to serve on boards and will help persuade sitting members not to resign.[138] Although in *Mooney v. Willys-Overland Motors, Inc.*[139] the court held that an indemnification contract was enforceable,[140] the outer limits of contractual indemnification have not been established firmly.

In drafting an indemnification contract, counsel may adopt one of the two basic approaches currently in use. The first approach virtually duplicates the proposed by-law or charter provision found in Exhibit 1. These contracts evince individual, bargained-for consideration and are not subject to unilateral amendment or rescission by the corporation.[141] The second approach is intended to supplement or replace cancelled or reduced directors' and officers' liability insurance.[142] This type of indemnification contract is written in essentially the same terms as a D&O insurance policy, but without all the exclusions and without a dollar limit on liability.[143] These quasi-insurance contracts,[144] however, are not insurance. Therefore, they are subject to public policy limitations on indemnification[145] and their value is limited to the assets of the corporation.[146] Exhibit 2 in the Appendix is an example of an indemnification contract modeled after the second approach.[147]

In addition to charter or by-law provisions or indemnification contracts, several commentators recommend that corporations es-

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approval by the board of directors is not sufficient. *See* Sparks, Johnston & Conan, *supra* note 129, at 20.

137. *See* Royner, *D&O Indemnity*, Legal Times, Nov. 25, 1985, at 1, 2; Olson & Morgan, *supra* note 121, at 34.

138. *See* Royner, *supra* note 137, at 2.

139. 204 F.2d 888 (3rd Cir. 1953).

140. *See supra* notes 98-101 and accompanying text.

141. *See* Olson, *supra* note 123, at 33.

142. *Id.*

143. *Id.*; *see infra Insurance* (Special Project) notes 41-67 and accompanying text.

144. Olson, Bogen & Magill, *Non-insurance Alternatives for Director and Officer Protection*, in THE CRISIS IN DIRECTORS' & OFFICERS' LIABILITY INSURANCE 313, 321 (Law & Bus. 1986).

145. *Id; see supra* note 97 and accompanying text.

146. *See* Olson, Bogen & Magill, *supra* note 144, at 321-22 (noting that directors and officers relying on indemnification contracts are subject to the same collection and insolvency risks as other creditors).

147. The proposed contract is reprinted from Olson, Bogen & Magill, *supra* note 144, at 344-50.

tablish one of two outside funding mechanisms to segregate funds and release these funds automatically when certain procedures have been followed.[148] These funding mechanisms represent practical ways to obtain prompt indemnification if the corporation refuses to pay because of bankruptcy or a change in control.[149] First, the corporation could set up an irrevocable trust to release assets upon a determination by an independent trustee that the claimant is entitled to indemnification.[150] In *Security America Corp. v. Walsh, Case, Coale, Brown & Burke*[151] the court upheld an irrevocable trust that was established in the face of an imminent change of management and that provided for the continued advancement of expenses to the outgoing directors.[152] Second, the corporation could obtain an irrevocable letter of credit from a bank or third party in favor of its directors and officers.[153] This letter of credit would be payable directly to directors and officers entitled to indemnification under the corporation's by-laws if a request to the corporation did not result in prompt indemnification.[154]

Contracts and by-laws relating to indemnification might be adopted by the board of directors independently or as part of a "package" for shareholder approval. In the case of a Delaware corporation, this package might include a new charter provision au-

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148. *See* Barton, *supra* note 27, at 53; Olson & Morgan, *supra* note 121, at 34.

149. *See* Olson & Morgan, *supra* note 121, at 34.

150. *See* Barton, *supra* note 27, at 53; Olson, *supra* note 123, at 25.

151. No. 82-C-2953 (N.D. Ill. Jan. 11, 1985) (applying Delaware law).

152. *Id.* at 9. The court found that an irrevocable trust authorized by the outgoing board pursuant to DEL. CODE § 145(e) was a legitimate technique for funding advances. The thrust of the decision was that a court would not question the mechanism employed by the corporation to ensure that an indemnitee received the proper funds if there was an underlying right to indemnification.

153. *See* Barton, *supra* note 27, at 53.

154. *See* Zirinsky & Mrazek, *Effects of Insolvency on Indemnification and Insurance of Directors and Officers* in STRATEGIES FOR RESPONDING TO THE D&O INSURANCE CRISIS 121, 136-37 (Law & Bus. 1986). The authors note that:

> While there is little precedent in the area, there appears to be a substantial basis for enforcing an arrangement whereby a third-party would make the required indemnification payments to directors or officers subject to a reimbursement obligation by the corporation, secured by corporate assets, which would ultimately be satisfied in accordance with a Cbapter 11 plan . . . . [The purpose of this type of letter of credit would be to cover] the deductible amounts and self-retention portion not covered by the D&O insurance and, where D&O insurance is not available, any litigation expenses or other expenses that might be incurred in defending an action during the period in which the corporation could not fund such payments . . . . In all cases, the scope of this assured funding arrangement would be no broader tban the corporation's indemnification obligations under its by-laws.

*Id.*

thorized by section 102(b)(7).[155] If these agreements were adopted by a vote of disinterested directors or were deemed to be fair, they most likely would be given effect even in the absence of shareholder approval.[156] If practical, however, shareholder approval is highly desirable to avoid possible challenges for self-dealing.[157]

Thus, in nonexclusive jurisdictions, additional indemnity through charter or by-law provisions or individual contracts can augment the protection afforded directors and officers. As with permissive indemnification, the boundaries of additional indemnity are circumscribed by public policy. In Delaware, a charter provision effectively can eliminate damages for a director's breach of the duty of care. Other provisions in either the charter or by-laws can clarify gray areas concerning advanced expenses, actions covered, and procedural issues. Indemnification contracts are yet another option to clarify obligations and to establish enforceable contract rights between a director or officer and a corporation.

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155. *See supra* notes 107-17 and accompanying text.

156. Veasey, Finkelstein & Bigler, *supra* note 111, at 416-17. Delaware law does not appear to require shareholder approval of indemnification contracts.

157. *See* Olson, *supra* note 123, at 32. Shareholder approval might have the effect of shifting the hurden of proving "fairness" away from the interested directors and onto the party objecting to the indemnification agreement. *See* Olson, Bogen & Magill, *supra* note 78, at 228.

## Appendix

### Exhibit 1

PROPOSED AMENDMENT OF CERTIFICATE OF INCORPORATION

Section 1. *Elimination of Certain Liability of Directors.* A director of the Corporation shall not be personally liable to the Corporation or its stockholders for monetary damages for breach of fiduciary duty as a director, except for liability (i) for any breach of the director's duty of loyalty to the Corporation or its stockholders, (ii) for acts or omissions not in good faith or which involve intentional misconduct or a knowing violation of law, (iii) under Section 174 of the Delaware General Corporation Law, or (iv) for any transaction from which the director derived an improper personal benefit.

Section 2. *Indemnification and Insurance.*

(a) *Right to Indemnification.* Each person who was or is made a party or is threatened to be made a party to or is involved in any action, suit or proceeding, whether civil, criminal, administrative or investigative (hereinafter a "proceeding"), by reason of the fact that he or she, or a person of whom he or she is the legal representative, is or was a director or officer, of the Corporation or is or was serving at the request of the Corporation as a director, officer, employee or agent of another corporation or of a partnership, joint venture, trust or other enterprise, including service with respect to employee benefit plans, whether the basis of such proceeding is alleged action in an official capacity as a director, officer, employee or agent or in any other capacity while serving as a director, officer, employee or agent, shall be indemnified and held harmless by the Corporation to the fullest extent authorized by the Delaware General Corporation Law, as the same exists or may hereafter be amended (but, in the case of any such amendment, only to the extent that such amendment permits the Corporation to provide broader indemnification rights than said law permitted the Corporation to provide prior to such amendment), against all expense, liability and loss (including attorneys' fees, judgments, fines, ERISA excise taxes or penalties and amounts paid or to be paid in settlement) reasonably incurred or suffered by such person in connection therewith and such indemnification shall continue as to a person who has ceased to be a director, officer, employee or agent and shall inure to the benefit of his or her heirs, executors and administrators; *provided, however*, that, except as provided in paragraph (b) hereof, the Corporation shall indemnify any such per-

son seeking indemnification in connection with a proceeding (or part thereof) initiated by such person only if such proceeding (or part thereof) was authorized by the board of directors of the Corporation. The right to indemnification conferred in this Section shall be a contract right and shall include the right to be paid by the Corporation the expenses incurred in defending any such proceeding in advance of its final disposition; *provided, however,* that, if the Delaware General Corporation Law requires, the payment of such expenses incurred by a director or officer in his or her capacity as a director or officer (and not in any other capacity in which service was or is rendered by such person while a director or officer, including, without limitation, service to an employee benefit plan) in advance of the final disposition of a proceeding, shall be made only upon delivery to the Corporation of an undertaking, by or on behalf of such director or officer, to repay all amounts so advanced if it shall ultimately be determined that such director or officer is not entitled to be indemnified under this Section or otherwise. The Corporation may, by action of its Board of Directors, provide indemnification to employees and agents of the Corporation with the same scope and effect as the foregoing indemnification of directors and officers.

*(b) Right of Claimant to Bring Suit.* If a claim under paragraph (a) of this Section is not paid in full by the Corporation within thirty days after a written claim has been received by the Corporation, the claimant may at any time thereafter bring suit against the Corporation to recover the unpaid amount of the claim and, if successful in whole or in part, the claimant shall be entitled to be paid also the expense of prosecuting such claim. It shall be a defense to any such action (other than an action brought to enforce a claim for expenses incurred in defending any proceeding in advance of its final disposition where the required undertaking, if any is required, has been tendered to the Corporation) that the claimant has not met the standards of conduct which make it permissible under the Delaware General Corporation Law for the Corporation to indemnify the claimant for the amount claimed, but the burden of proving such defense shall be on the Corporation. Neither the failure of the Corporation (including its Board of Directors, independent legal counsel, or its stockholders) to have made a determination prior to the commencement of such action that indemnification of the claimant is proper in the circumstances because he or she has met the applicable standard of conduct set forth in the Delaware General Corporation Law, nor an actual de-

termination by the Corporation (including its Board of Directors, independent legal counsel, or its stockholders) that the claimant has not met such applicable standard or conduct, shall be a defense to the action or create a presumption that the claimant has not met the applicable standard of conduct.

*(c) Non-Exclusivity of Rights.* The right to indemnification and the payment of expenses incurred in defending a proceeding in advance of its final disposition conferred in this Section shall not be exclusive of any other right which any person may have or hereafter acquire under any statute, provision of the Certificate of Incorporation, by-law, agreement, vote of stockholders or disinterested directors or otherwise.

*(d) Insurance.* The Corporation may maintain insurance, at its expense, to protect itself and any director, officer, employee or agent of the Corporation, or another corporation, partnership, joint venture, trust or other enterprise against any such expense, liability or loss, whether or not the Corporation would have the power to indemnify such person against such expense, liability or loss under the Delaware General Corporation Law.

## Exhibit 2

### INDEMNITY AGREEMENT

This Agreement is made as of the _____ day of _____, 1986, by and among _____ Corporation, a Delaware corporation (the "Corporation"), and the undersigned ("Agent") [of _____, a Delaware corporation (the "Company"),] with reference to the following facts:

The Agent is currently serving as a (Director) (Officer) [of the Company at the request] of the Corporation and the Corporation wishes the Agent to continue in such capacity. The Agent is willing, under certain circumstances, to continue in such capacity.

In addition to the indemnification to which the Agent is entitled pursuant to the by-laws of [the Company and] the Corporation, and as additional consideration for the Agent's service, the Corporation has, in the past, furnished at its expense directors and officers liability insurance protecting the Agent in connection with such service. Effective _____, 1985, such insurance was cancelled or severely limited with respect to coverage of _____. The Corporation has not been able to replace such insurance at a reasonable cost.

The Agent has indicated that he does not regard the indemni-

ties available under [the Company's and] the Corporation's by-laws and the insurance remaining in effect as adequate to protect him against the risks associated with his service to [the Company] the Corporation. The Agent may not be willing to continue in office in the absence of obtaining insurance such as that he has heretofore enjoyed.

In order to induce the Agent to continue to serve as (Director) (Officer) for [the Company] the Corporation and in consideration for his continued service, the Corporation hereby agrees to indemnify the Agent as follows:

1. The Corporation will pay on behalf of the Agent, and his executors, administrators or assigns, any amount which he is or becomes legally obligated to pay because of any claim or claims made against him because of any act or omission or neglect or breach of duty, including any actual or alleged error or misstatement or misleading statement, which he commits or suffers while acting in his capacity as a Director and/or Officer of [the Company] the Corporation and solely because of his being a Director and/or Officer. The payments which the Corporation will be obligated to make hereunder shall include, *inter alia*, damages, judgments, settlements and costs, cost of investigation (excluding salaries of officers or employees of [the Company or] the Corporation) and costs of defense of legal actions, claims or proceedings and appeals therefrom, and costs of attachment or similar bonds; provided, however, that the Corporation shall not be obligated to pay fines or other obligations or fees imposed by law or otherwise which it is prohibited by applicable law from paying as indemnity or for any other reason.

2. If a claim under this Agreement is not paid by the Corporation, or on its behalf, within ninety days after a written claim has been received by the Corporation, the claimant may at any time thereafter bring suit against the Corporation to recover the unpaid amount of the claim and if successful in whole or in part, the claimant shall be entitled to be paid also the expense of prosecuting such claim.

3. In the event of payment under this Agreement, the Corporation shall be subrogated to the extent of such payment to all of the rights of recovery of the Agent, who shall execute all papers required and shall do everything that may be necessary to secure such rights, including the execution of such documents necessary to enable the Corporation effectively to bring suit to enforce such rights.

4. The Corporation shall not be liable under this Agreement to make any payment in connection with any claim made against the Agent:

(a) for which payment is actually made to the Agent under a valid and collectible insurance policy, except in respect of any excess beyond the amount of payment under such insurance;

(b) for which the Agent is entitled to indemnity and/or payment by reason of having given notice of any circumstance which might give rise to a claim under any policy of insurance, the terms of which have expired prior to the effective date of this Agreement;

(c) for which the Agent is indemnified by [the Company or] the Corporation otherwise than pursuant to this Agreement;

(d) based upon or attributable to the Agent gaining in fact any personal profit or advantage to which he was not legally entitled;

(e) for an accounting of profits made from the purchase or sale by the Agent of securities of [the Company or] the Corporation within the meaning of Section 16(b) of the Securities Exchange Act of 1934 and amendments thereto or similar provisions of any state statutory law or common law; or

(f) brought about or contributed to by the dishonesty of the Agent seeking payment hereunder; however, notwithstanding the foregoing, the Agent shall be protected under this Agreement as to any claims upon which suit may be brought against him by reason of any alleged dishonesty on his part, unless a judgment or other final adjudication thereof adverse to the Agent shall establish that he committed (i) acts of active and deliberate dishonesty (ii) with actual dishonest purpose and intent, which acts were material to the cause of action so adjudicated.

5. The maximum aggregate amount of indemnity payable by the Corporation hereunder to the Agent is $ _____.

6. No costs, charges or expenses for which indemnity shall be sought hereunder shall be incurred without the Corporation's consent, which consent shall not be unreasonably withheld.

7. The Agent, as a condition precedent to his right to be indemnified under this Agreement, shall give to the Corporation notice in writing as soon as practicable of any claim made against him for which indemnity will or could be sought under this Agreement. Notice to the Corporation shall be directed to _____, attention: Corporate Secretary (or such other address as to the Corporation shall designate in writing to the Agent); notice shall be deemed received if sent by prepaid mail properly addressed, the date of such notice being the date post-

marked. In addition, the Agent shall give the Corporation such information and cooperation as it may reasonably require and as shall be within the Agent's power.

8. Costs and expenses (including attorneys' fees) incurred by the Agent in defending or investigating any action, suit, proceeding or investigation shall be paid by the Corporation in advance of the final disposition of such matter, upon receipt of a written undertaking by or on behalf of the Agent to repay any such amounts unless it is ultimately determined that the Agent is entitled to indemnification under the terms of this Agreement. Notwithstanding the foregoing or any other provision of this Agreement, no advance shall be made by the Corporation if a determination is reasonably and promptly made by the Board of Directors by a majority vote of a quorum of disinterested directors, or (if such a quorum is not obtainable or, even if obtainable, a quorum of disinterested directors so directs) by independent legal counsel, that, based upon the facts known to the Board or counsel at the time such determination is made, (a) the Agent acted in bad faith or in a manner that he or she did not believe to be in or not opposed to the best interest of [the Company and/or] the Corporation, or (b) with respect to any criminal proceeding, the Agent believed or had reasonable cause to believe his conduct was unlawful, or (c) the Agent deliberately breached his duty to [the Company and/or] the Corporation or its [their] stockholders.

9. In order to provide for just and equitable contribution in circumstances in which the indemnification provided for herein is held by a court of competent jurisdiction to be unavailable to the Agent in whole or part, the parties agree that, in such event, the Corporation shall contribute to the payment of the Agent's losses in an amount that is just and equitable in the circumstances, taking into account, among other things, contributions by other directors and officers of the [Company or] Corporation pursuant to Indemnification Agreements or otherwise. The Corporation and the Agent agree that, in the absence of personal enrichment, acts of intentional fraud or dishonesty or criminal conduct on the part of the Agent, it would not be just and equitable for the Agent to contribute to the payment of Losses arising out of any action, suit, proceeding or investigation in an amount greater than: (i) in a case where the Agent is a director of [the Company or] the Corporation or any subsidiaries of [the Company or] the Corporation, but not an officer of [the Company or] the Corporation or any such subsidiary, the amount of fees paid to the Agent for serving as a director

during the 12 months preceding the commencement of such action, suit, proceeding or investigation; or (ii) in a case where the Agent is a director of [the Company or] the Corporation or any subsidiaries of [the Company or] the Corporation and is an officer of [the Company or] the Corporation or any such subsidiary, the amount set forth in clause (i) plus 5% of the aggregate cash compensation paid to the Agent for service in such office(s) during the 12 months preceding the commencement of such action, suit, proceeding or investigation; or (iii) in a case where the Agent is only an officer of [the Company or] the Corporation or any subsidiaries of [the Company or] the Corporation, 5% of the aggregate cash compensation paid to the Agent for service in such office(s) during the 12 months preceding the commencement of such action, suit, proceeding or investigation. The Corporation shall contribute to the payment of losses covered hereby to the extent not payable by the Agent pursuant to the contribution provisions set forth in the preceding sentence.

10. This Agreement may be executed in any number of counterparts, all of which taken together shall constitute one document.

11. Nothing herein shall be deemed to diminish or otherwise restrict the Agent's right to indemnification under any provision of the certificate of incorporation or by-laws of [the Company or] the Corporation or under Delaware law.

12. This Agreement shall be governed by and construed in accordance with Delaware law.