Indemnification of Corporate Directors: A Disincentive to Corporate Accountability in Indiana

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NOTES

INDEMNIFICATION OF CORPORATE DIRECTORS:
A DISINCENTIVE TO CORPORATE ACCOUNTABILITY IN INDIANA

INTRODUCTION

During the last half century, the business corporation has become an important force in American society.1 As the number of incorporated businesses has risen and the corporations themselves have grown, government and legislators have sought to control the affairs of these powerful and wealthy enterprises. In recent years, public awareness of the social responsibility of large corporations has become more acute. Increasingly complex regulatory systems govern both the internal and external workings of modern corporations. Thus, the regulatory schemes promulgated by legislatures often serve to establish strict codes of conduct for corporate management and directors whose ultimate responsibility must be to the shareholders and public.2 The corporate director3 who violates the requirements of one of the multitude of regulations risks incurring personal liability from myriad sources unheard of several decades ago.4

As the possibilities for personal liability of corporate directors have expanded, there have been concomitant attempts to insulate those in authority from that liability. Various strategies have been

3. The term "director" shall be used for the sake of simplicity throughout this note. The statutes discussed herein apply to directors, officers, agents and employees. For full discussion of the argument favoring clear distinction between status as director, officer, employee and agent, see infra notes 300-308 and accompanying text.
employed with varying degrees of success. The primary methods used to insulate directors from possible personal liability arising from their actions as director or from their official status have been indemnification clauses and insurance policies.

Indemnification clauses and insurance policies exist in several forms. All states have now enacted indemnification provisions as part of their corporation laws, and many states allow inclusion of indemnification clauses in the corporation's by-laws or charter. In addition, most states also allow for the purchase of Directors' and Officers' Insurance. By employing a combination of indemnification provisions and insurance policies, coupled with the protection afforded under the Business Judgment Rule, corporations are often able to effectuate for their directors a virtually impenetrable shield from personal liability.

5. See Black's Law Dictionary 692 (rev. 5th ed. 1979). Black's Law Dictionary defines the term "indemnification" as denoting compensation given to make the person whole from a loss already sustained. Thus, in the context of corporation law, the corporation seeks to reimburse a director for expenses of defense, fines, judgments, and settlements incurred when he is sued either in a stockholder derivative action or third-party suit. Under many modern indemnification statutes, the indemnification process may enable payment of expenses, etc., for the director immediately without initial payment by the individual and subsequent reimbursement by the corporation.

6. See Black's Law Dictionary 721 (rev. 5th ed. 1979). Insurance policies referred to in the context of this discussion are directors' and officers' liability insurance policies. These policies offer compensation to the director and the corporation for liability of the director arising out of his capacity as director of the corporation.

7. Schaeftler, supra note 2, at 11. Illinois was the last state to adopt indemnification provisions as part of the state corporation law in 1978.

8. See McAdams, A Proposal to Amend the Indemnification Section (§ 5) of the Model Business Corporation Act, 31 Bus. Law 2123, 2126 (1976) [hereinafter cited as McAdams]. State statutes which are non-exclusive allow for inclusion of indemnification provisions other than the statutory rights. Commonly, indemnification provisions are included by in-laws, articles of incorporation or employment contracts.

9. [hereinafter referred to as D & O insurance].

10. See generally Schaeftler, supra note 2, at 93-97; Johnson and Osborne, supra note 1; A. Cohen and R. Loeb, Duties and Responsibilities of Outside Directors, 22-23 (1978). The Business Judgment Rule was stated as follows in Pollitz v. Wabash R.R. Co., 207 N.Y. 113, 124, 100 N.E. 721, 724 (1912):

Questions of policy of management, expediency of contracts of action, adequacy of consideration, lawful appropriation of corporate funds to advance corporate interests, are left solely to [the directors'] honest and unselfish decision, for their powers therein are without limitation and free from restraint and the exercise of them for the common and general interests of the corporation may not be questioned, although the results show what they did was unwise or inexpedient.

Personal liability in the context of the corporate board of directors may be premised upon two philosophical alternatives. If the primary purpose of liability is merely compensation to an individual or group of individuals for harm inflicted by the director's breach of fiduciary duty, then the concept of indemnifying directors through the use of corporate provisions or insurance policies is consistent with the ultimate goal. However, where the primary purpose of liability is viewed as the deterrence policy of precluding future breach, then today's liberal indemnification provisions are repugnant to that goal. Such a view of the underlying rationale for liability necessarily implies a broad public purpose to be served. Liability is imposed upon directors not solely for reasons of recompense, but for reasons of curtailing the abuse of private power exercised to the detriment of society. Hence, corporate accountability is a responsibility to society as a whole, not merely to individuals. The argument against modern indemnification statutes is therefore utilitarian. The ultimate goal of achieving a satisfactory level of public accountability from modern corporations is thwarted by enactment of liberal indemnification statutes which enable directors to evade personal liability for their actions.

12. See Bishop, New Trends, supra note 2, at 1095. These measures generally afford protection from liability from all but the most flagrant abuses of power such as gross negligence, self-dealing or total abdication of corporate responsibility.


14. During the 1971 American Bar Association's National Institute on Officers' and Directors' Responsibilities and Liabilities, Professor Joseph W. Bishop stated that, "...[he] would be happier if in all cases ... indemnification were permitted only with the approval of a court." See KNEPPER, supra note 2, at 408, also at 405-14. See also infra note 57.

In general, the notion expressed by Professor Bishop is indicative of the desired attitude toward indemnification of corporate directors. Where business corporations control such a vast amount of the nation's wealth, it is necessary to keep the public informed of corporate dealings. Directors must maintain the highest integrity in their transactions and must act in accordance with the fiduciary duties owed the corporation. Corporate laws are enacted to ensure that no fraud is perpetrated upon the public. If indemnification of corporate directors is blindly allowed at the corporation's discretion, there is no guarantee of proper conduct. The corporation as a business entity must recognize its responsibility to society and reward only deserving directors with indemnity.

In addition, the public should be informed of important corporate transactions to provide a check upon the conduct of management. As Professor Bishop further comments: "In sum, I think that the practice of protecting corporate executives against litigation and liability has now been carried about as far as it ought to be carried and perhaps a little farther. Corporate directors and officers should eschew efforts
In an age of heightened consciousness of the importance of corporate accountability and fear of the power wielded by corporate America in modern society, the current lack of enforceable liability is regrettable. When the lack of enforceable liability is considered with a recognized need to attract competent people to the corporate board, the core of this complex problem is reached. The difficulty inherent in our system of corporate law is that of striking a delicate balance between the need to punish errant fiduciaries and the need to protect aggressive managers who are willing to take good faith risks within the scope of their fiduciary duty in the search for profits.\textsuperscript{15}

This note examines the legal and ethical issues raised by the use of various forms of indemnification provisions. A historical perspective on the principle of indemnification as it arose from the common law of agency and emerged in case decisions aids in the analysis of the two basic types of modern indemnification statutes. Next, the ambiguities and leniency inherent in each type of statute is investigated. In light of the conclusions drawn from these analyses, the present Indiana statutory provision relating to indemnification of corporate directors is examined and proposals for revision advanced.\textsuperscript{16}

\textbf{HISTORY OF THE PRINCIPLE OF INDEMNIFICATION}

The principle of indemnification of corporate directors has its

\textsuperscript{15} See Johnston, \textit{supra} 2, at 1993.

\textsuperscript{16} The scope of this note will not include extensive discussion of the various liabilities incurred for violation of securities laws or antitrust laws. Rather, the focus of this note will be upon the possibilities for abuse of modern, liberal indemnification statutes as they exist in Delaware, New York and Indiana.
roots in the common law of agency. The nature of the corporate structure and uncertainty as to the status of corporate directors under traditional agency law led early courts confronted with the issue to deny directors a common law right to indemnification. During the evolution of modern corporate law, the director's right to indemnification was gradually defined and is now well recognized. Today, with corporations operating in an increasingly complex web of regulatory systems, the right of indemnification is often a critical factor for the businessman contemplating acceptance of a position on the board of directors. Under the modern, liberal indemnification statutes, protection is guaranteed in numerous circumstances and often granted in a wide range of situations. The liberalized indemnification provisions of modern corporation statutes, charters, and by-laws are barely indentifiable as descendants of the courts' early decisions in this area.

A widely recognized axiom in the common law of agency is that a principal is under a duty to indemnify his agent for any liability for tort or breach of contract the agent might incur to a third party while acting within the scope of his authorized employment. Uncertainty results, however, in the application of this fundamental concept to agents acting within the corporate structure. Third-party actions must be distinguished from shareholder derivative suits instituted on behalf of the corporation. Additionally, the various methods of disposition of a lawsuit must be confronted as they may occur in either a derivative suit or a third-party action. In light of

17. Restatement (Second) of Agency § 439(e) (1958).
18. New York Dock Co., Inc. v. McCollo, 173 Misc. 106, 16 N.Y.S.2d 844 (Sup. Ct. 1939). This case was decided prior to enactment of the New York indemnification statute.
19. McAdams, supra note 8, at 2124.
20. See Bishop, New Trends, supra note 2; Sebring, supra note 4, at 98-99.
22. See Black's Law Dictionary 1327 (rev. 5th ed. 1979). Generally, a third party is one not a party to an agreement or transaction but who may have rights therein. In the context of corporation law, the third party may bring suit against a director for alleged wrongdoing. However, the director does not owe a fiduciary duty to the third party as he does to shareholders.
23. The court in Solimine v. Hollander, 129 N.J. Eq. 264, 265, 19 A.2d 344, 345 (1941), emphasized the true character of the derivative suit: "The stockholders, suing and intervening, do not prosecute the cause in their own right and own benefit but in the right of the corporation and for its benefit. While nominally the company is named as defendant, actually and realistically it is the true complainant, for any avails realized from the litigation belong to it and it alone."
24. The possible methods of disposition of a lawsuit are: adjudication on the merits, settlement, dismissal, and procedural termination.
these many alternatives, early courts were faced with the monumental task of applying fundamental agency law to the corporate structure.

The difficulties of distilling the principles to be applied in indemnification of corporate directors from the common law of agency became apparent in a series of cases litigated during the first half of this century. In 1939, New York Dock., Inc. v. McCollom\(^25\) denied the common law right to indemnity with the proposition that directors who successfully defended themselves in a derivative action were not entitled to indemnification for their legal fees absent a showing that the corporation had benefited from their defense.\(^26\) The benefit contemplated by the court did not consist of the intangible benefits of restitution of the corporation’s good name or, initially, attracting capable managers to the board. The court in McCollom sought a more concrete benefit arising from the corporation’s payment of indemnity. A decade later the standard applied in McCollom was rejected by courts in other jurisdictions\(^27\) which upheld the common law right of a vindicated director to recover the expenses of his defense without any showing of a specific benefit to the corporation.

In reconciling these cases, it is clear that the courts began to recognize a valid benefit to the corporation both through the ability to attract qualified board members and also through the defense and vindication of its directors. Recognition of these valid concerns establishes the foundation for the principles of indemnification. The New Jersey court in Solimine v. Hollander\(^28\) specifically enumerated the policy reasons for allowing a corporation to indemnify its directors: (1) to encourage innocent directors to resist unjust charges and provide them an opportunity to hire competent counsel; (2) to induce responsible businessmen to accept the post as directors; and (3) to discourage “strike” litigation by stockholders.\(^29\) The policies established in Solimine survived and proved to be the primary impetus for adoption of modern indemnification statutes.\(^30\)

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26. Id.
29. Id. “Strike” stockholder suits are usually derivative actions brought with the expectation of winning exorbitant attorney fees or private settlements. These suits are generally brought to harass management with no real intention of benefitting the corporation in whose behalf the suit is theoretically brought. See Shapiro v. Magaziner, 418 Pa. 278, 282, 210 A.2d 890, 894 (1965).
30. See Mooney v. Willys-Overland Motors, Inc., 204 F.2d 888, 898 (3d Cir. 1953); Sebring, supra note 4, at 98; McAdams, supra note 8, at 2124.
In response to the McCollom decision, business-oriented states quickly adopted statutory provisions authorizing corporations to indemnify directors under certain circumstances.\textsuperscript{31} New York was the first state to adopt an indemnification statute in 1941, followed in 1943 by Delaware and then by nearly all the states.\textsuperscript{32} Early attempts at statutory indemnification were vague and consequently ambiguous, evidencing an effort to virtually immunize management from personal liability.\textsuperscript{33} Both courts and corporations encountered difficulties in ascertaining what types of actions against directors were covered and the extent of their coverage.\textsuperscript{34} To further complicate matters, the permissive\textsuperscript{35} nature of the first Delaware statute, which served as the model for many state statutes, did little to establish for directors a clear right to indemnification. The first Delaware statute merely empowered the corporation to indemnify directors at its discretion, but did not create an enforceable right to indemnity for the director. The ambiguities of these early statutes provided the impetus for many states to enact revised, comprehensive forms of their indemnification provisions.

During the 1960's many state legislatures\textsuperscript{36} altered their indemnification statutes in an attempt to confront both the lack of clarity which characterized the initial statutes, and the prodigious problem of director liability with respect to securities law and antitrust law. As the business corporation continued to assume a more important role in the expanding post-war economy,\textsuperscript{37} there were increases in the number of lawsuits and in the size of judgments rendered against corporations and individual directors.\textsuperscript{38} Expansion of substantive regulation as well as development of diverse enforcement mechanisms such as class action suits, derivative suits, and SEC investigative proceedings have generated myriad ways of holding directors liable for

\textsuperscript{31} Knepper, supra note 2, at 405.
\textsuperscript{32} Brook, Directors' Indemnification and Liability Insurance, 21 N.Y.L.F. 1, 3 [hereinafter cited as Brook]. For a thorough discussion of early indemnification provisions, see G. Washington and J. Bishop, Indemnifying the Corporate Executive (1963).
\textsuperscript{33} Bishop, New Trends, supra note 2, at 1079.
\textsuperscript{34} Fenton, Indemnification 4 Del. J. Corp. Law 790, 791 (1979); Johnston, supra note 2, at 1995. The uncomprehensive nature of the early statutes entailed the existence of no distinction between third-party and derivative actions; no statement on whether criminal, administrative and investigative proceedings were covered; and no specific coverage of threatened and settled actions.
\textsuperscript{35} See infra note 47-52 and accompanying text.
\textsuperscript{36} See Brook, supra note 32, at 3.
\textsuperscript{37} See generally Johnston, supra note 2; Schaeftler, supra note 2.
\textsuperscript{38} See supra note 4.

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their actions while serving on the board of a corporation.\textsuperscript{39} Thus, it was imperative for state legislatures to devise a statutory scheme which dealt specifically with directors’ liability in these many areas and which provided directors with assurance of their coverage.

The second generation of indemnification statutes are much more comprehensive in scope and deal more thoroughly with the various types of potential liability.\textsuperscript{40} The majority of these statutes fall into two categories. The Delaware statute and the Model Business Corporation Act (MBCA) exemplify the non-exclusive\textsuperscript{41} type which provides that the statute is not to preclude any other rights to which a director may be entitled under by-law, contract or other corporate agreement.\textsuperscript{42} The courts generally agree that other provisions may be drafted which afford more extensive protection for the director than specified in the statute, although public policy considerations would undoubtedly place finite limits upon the extensions.\textsuperscript{43}

The second type of indemnification statute, exemplified by the New York law, is specifically drafted to be the sole right to indemnification for a corporate director, establishing a policy from which no material deviation is permitted.\textsuperscript{44} Corporate management may not decide to allow indemnification more readily than the statutory provision permits. Further evidence of legislative intent is a subsequent section of the New York Business Corporation Law\textsuperscript{45} stipulating that no statutory provision shall be valid if in conflict with an explicitly stated by-law, or other corporate action which may limit the statutory right to indemnification. Thus, a corporation is free to draft by-laws containing more stringent indemnification provisions than the statute. Obviously, there are considerations favoring both types of statute. The non-exclusive variety, however, presents far greater opportunity

\textsuperscript{39} See generally Bishop, Indemnification of Corporate Directors, Officers and Employees, 20 Bus. Law. 833 (1965) [hereinafter cited as Bishop, Indemnification]; Bishop, New Cure for an Old Ailment: Insurance Against Directors’ and Officers’ Liability, 22 Bus. Law. 92 (1966) [hereinafter cited as Bishop, Old Ailment]; Johnston, supra note 2, at 2007-09.

\textsuperscript{40} Johnston, supra note 2, at 1995-96.

\textsuperscript{41} MODEL BUSINESS CORP. ACT § 5(f) (1979); DEL. CODE ANN. tit. 8, § 145(f) (1974). These non-exclusivity clauses read, in pertinent part: "[t]he indemnification provided by this section shall not be deemed exclusive of any other rights to which those seeking indemnification may be entitled . . . ."

\textsuperscript{42} MODEL BUSINESS CORP. ACT § 5(f) (1979); DEL. CODE ANN. tit. 8, § 145(f) (1974).

\textsuperscript{43} See Johnston, supra note 2, at 1996.

\textsuperscript{44} N.Y. BUS. CORP. LAW § 721 (McKinney 1963).

\textsuperscript{45} N.Y. BUS. CORP. LAW § 726(b)(2) (McKinney 1963).
for criticism on grounds of being too liberal and not offering sufficient accountability.  

Within the primary categories of exclusive and non-exclusive, indemnification statutes vary widely in scope. Most statutes can be classified as mandatory or permissive. Mandatory indemnification statutes confer upon the director a judicially enforceable right to indemnification, providing the director has met the requisite standards of conduct set forth in the statute. If a director has complied with the required standard of conduct, a court may order an award of indemnity despite the corporation's denial of indemnification to the director. Under permissive indemnification provisions, the corporation is empowered, but not required, to indemnify its directors. If a corporation chooses not to indemnify the director, he has no right to judicial command of the indemnification. The majority of state statutes currently employ a combination of both mandatory and permissive indemnification provisions addressed to specific circumstances of the underlying suit. Generally, where the director is "successful on the merits or otherwise" in a suit, he is entitled to mandatory indemnification as of right. If, however, the director is unsuccessful in his defense, the corporation may choose to indemnify him but has no obligation to do so. These classifications provide the basis for analysis of the various indemnification statutes.

By utilizing the framework of basic categories of indemnification provisions, it is possible to investigate the application of indemnity in different forms of lawsuits. A corporate director may incur liability through either a stockholder derivative suit or third-party action. A stockholder derivative suit is an action by or in the right of the corporation against the director as an individual. Third-party actions occur in two distinct situations. Proceedings may be instituted against a director by a third party for some alleged misconduct in the perfor-

46. See McAdams, supra note 8, at 2140-41.
47. See Note, Court-Ordered Indemnification of Corporate Officers and Directors, 1979 Ariz. St. L.J. 639, 640-41 [hereinafter cited as Court-Ordered Indemnification].
48. Id. An example of a mandatory indemnification provision is N.Y. Bus. Corp. Law § 725 (McKinney 1963); see infra notes 232-39.
49. See Sebring, supra note 4, at 99-100.
50. McAdams, supra note 8, at 2126.
51. See Johnston, supra note 2.
52. Court-Ordered Indemnification, supra note 47, at 642.
53. Id.
54. See generally Johnston, supra note 2, at 1996.
mance of his duty to the corporation. Alternatively, the third party may initiate proceedings against the director merely because of his status as director and not in allegation of any personal misconduct. Due to the nature of the stockholder derivative suit, most modern indemnification statutes grant much broader indemnity protection in third-party suits than in derivative actions. This practice is consistent with the weight of public opinion regarding the fiduciary duty of a director toward the corporation.

The underlying theory of modern indemnification statutes is that a director who acts in good faith in furtherance of the corporation's interests and who incurs liability for violation of some civil or criminal law is entitled to indemnification. However, a director who breaches his fiduciary duty toward the corporation should not be entitled to indemnification. In theory, indemnification statutes would seem to be consistent with the goal of attracting qualified people to serve on the board of a corporation. In practice, the prospect of indemnification may diminish the fear of liability which normally provides one of the major incentives for obedience to the law. Thus, liberal indemnification provisions may serve to decrease accountability to the public and increase the possibilities for abuse of corporate power. A close examination of the specific provisions of the MBCA/Delaware statute and the New York statute reveals the leniency which exists in these modern statutes and which may encourage a lax attitude toward compliance with the law. Indeed, in the words of Justice Brandeis, the race has not been one of diligence, but of laxity.

55. See Brook, supra note 32, at 4; Schaeftler, supra note 2, at 15-34.
56. See Brook, supra note 32, at 6.
57. A director owes three basic duties to the corporation he serves: obedience, diligence and loyalty. The fiduciary relationship of directors to the corporation requires that they act in good faith on all occasions and give to their tasks their conscientious care and best judgment. Because a director owes these various duties to the corporation, a stockholder derivative suit of the shareholders against the director mandates the fulfillment of much more stringent standards of conduct before granting indemnity than a third-party action where the director does not owe such strict duties to the third party. For a more thorough discussion of a director's fiduciary duties, see Knepper, supra note 2, at 1-7.
58. See generally Bishop, Indemnification, supra note 39.
59. Id.; see also supra note 57.
60. The Business Judgment Rule also serves to afford the director with protection from personal liability for mistakes of business judgment arrived at in good faith. The Rule may be applied in both shareholder derivative actions and in third-party actions. See generally Johnson and Osborne, supra note 1; see also supra note 10.
61. See Bishop, New Trends, supra note 2, at 1087.
MODERN STATE INDEMNIFICATION STATUTES

State indemnification statutes differ widely in the latitude given the corporation deciding whether to indemnify the director.63 Currently, the New York64 and California65 statutes exemplify the more limited type of indemnification law. The New York statute, effective in 1963, was an attempt to counteract the recognized overly liberal trend in prior Delaware corporation law.66 The Delaware statute67 and the Model Business Corporation Act,68 containing virtually identical provisions with regard to indemnification, exemplify the more liberal law. The most recent Delaware statute and MBCA were a collaborative effort, both enacted in 1967, and have served as the prototype for a majority of the state indemnification provisions.69 Delaware’s corporation law serves to perpetuate the declared public policy of the state which is “creating a favorable climate” for corporations.70 Although this favorable climate may have a positive effect upon the Delaware state treasury,71 the adverse effect upon corporate accountability to the general public should be of primary concern.

Delaware Statute and Model Business Corporation Act

Since the Delaware statute and MBCA are virtually identical in their provisions, discussion in this section centers on the MBCA with accompanying references to the Delaware statute. The MBCA contains both permissive and mandatory provisions for indemnification.72

63. McAdams, supra note 8, at 2126.
64. N.Y. BUS. CORP. LAW § 721-26 (McKinney 1963).
68. MODEL BUSINESS CORP. ACT § 5 (1979).
69. Presently, at least 26 states have indemnification statutes substantially similar to the MBCA. Only four states currently employ the exclusive type of statute such as used in New York. Furthermore, a substantial and growing percentage of corporations listed on the New York Stock Exchange are incorporated in Delaware: as of 1965, 35% of the 1,250 largest were Delaware corporations; in 1973, 40% were incorporated in Delaware. Cary, supra note 66, at 671.
70. Cary, supra note 66, at 669.
72. The text of the MODEL BUSINESS CORP. ACT § 5 (1979) reads as follows:
   (a) A corporation shall have power to indemnify any person who was or is a party or is threatened to be made a party to any threatened, pending or completed action, suit or proceeding, whether civil, criminal, administrative or investigative (other than an action by or in the right

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A brief outline of the statutory provisions will aid in analysis of the entire scheme. The MBCA permits a corporation to indemnify its directors in third-party actions where the director acted in good faith and

of the corporation) by reason of the fact that he is or was a director, officer, employee or agent of the corporation, or is or was serving at the request of the corporation as a director, officer, employee or agent of another corporation, partnership, joint venture, trust or other enterprise, against expenses (including attorneys’ fees), judgments, fines and amounts paid in settlement actually and reasonably incurred by him in connection with such action, suit or proceeding 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, with respect to any criminal action or proceeding, had no reasonable cause to believe his conduct was unlawful. The termination of any action, suit or proceeding by judgment, order, settlement, conviction, or upon a plea of nolo contendere or its equivalent, shall not, of itself, create a presumption that the person did not act in good faith and in a manner which he reasonably believed to be in or not opposed to the best interests of the corporation, and, with respect to any criminal action or proceeding, had reasonable cause to believe that his conduct was unlawful.

(b) A corporation shall have power to indemnify any person who was or is a party or is threatened to be made a party to any threatened, pending or completed action or suit by or in the right of the corporation to procure a judgment in its favor by reason of the fact that he is or was a director, officer, employee or agent of the corporation, or is or was serving at the request of the corporation as a director, officer, employee or agent of another corporation, partnership, joint venture, trust or other enterprise against expenses (including attorneys’ fees) actually and reasonably incurred by him in connection with the defense or settlement of such action or 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 for negligence of misconduct in the performance of his duty to the corporation unless and only to the extent that the court in which such action or suit was brought shall determine upon application that, despite the adjudication of liability but in view of all circumstances of the case, such person is fairly and reasonably entitled to indemnity for such expenses which such court shall deem proper.

(c) To 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 referred to in subsection (a) or (b), or in defense of any claim, issue or matter therein, he shall be indemnified against expenses (including attorney’s fees) actually and reasonably incurred by him in connection therewith.

(d) Any indemnification under sections (a) or (b) (unless ordered by a court) shall be made by the corporation only as authorized in the specific case upon a determination that indemnification of the director, officer, employee or agent is proper in the circumstances because he has met the applicable standard of conduct set forth in subsections (a) or (b). Such
in a manner he reasonably believed to be "in or not opposed to" the best interests of the corporation. With respect to stockholder derivative actions, the MBCA permits indemnity under slightly more 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 shareholders.

(e) Expenses (including attorneys' fees) incurred 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 may be paid by the corporation in advance of the final disposition of such action, suit or proceeding as authorized in the manner provided in subsection (d) upon receipt of an undertaking by or on behalf of the director, officer, employee or agent 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.

(f) The indemnification provided by this section shall not be deemed exclusive of any other rights to which those indemnified may be entitled under any by-law, agreement, vote of shareholders or disinterested directors or otherwise, both as to action in his official capacity and as to action in another capacity while holding such office, and shall continue as to a person who has ceased to be a director, officer, employee or agent and shall inure to the benefit of the heirs, executors and administrators of such a person.

(g) A corporation shall have power to purchase and maintain insurance on behalf of any person who is or was a director, officer, employee or agent of the corporation, or is or was serving at the request of the corporation as a director, officer, employee or agent of another corporation, partnership, joint venture, trust or other enterprise against any liability asserted against him and incurred by him in any such capacity or arising out of his status as such, whether or not the corporation would have the power to indemnify him against such liability under the provisions of this section.

The Delaware indemnification statute, Del. Code Ann. tit. 8, § 145, is identical in substance to the MBCA with the addition of subsection (h), which reads as follows:

(h) For the purposes of this section, references to the "corporation" shall include, in addition to the resulting corporation, any constituent corporation (including any constituent of a constituent) absorbed in a consolidation or merger which, if its separate existence had continued, would have had power and authority to indemnify its directors, officers, and employees or agents, so that any person who is or was a director, officer, employee or agent of such constituent corporation, or is or was serving at the request of such constituent corporation as a director, officer, employee or agent of another corporation, partnership, joint venture, trust or other enterprise, shall stand in the same position under the provisions of this section with respect to the resulting or surviving corporation as he would have with respect to such constituent corporation if its separate existence had continued.

restricted circumstances.\textsuperscript{74} Mandatory indemnification is provided against expenses actually and reasonably incurred by a director to the extent that he has been "successful on the merits or otherwise" in defense of any third-party or derivative suit.\textsuperscript{75} Permissive indemnification may be awarded, however, only after a determination is made that the director has met the requisite standard of conduct.\textsuperscript{76} The determination may be properly made by: (1) a quorum of disinterested directors, or (2) independent legal counsel at the request of a quorum of disinterested directors, or (3) majority vote of the shareholders.\textsuperscript{77} The MBCA allows advancement of expenses upon an "undertaking" by a director to repay the amount in the event he is found not entitled to indemnity.\textsuperscript{78} The MBCA is non-exclusive, meaning that the statutory rights to indemnification are not inclusive of other rights to indemnification which the director may be entitled to under by-law, charter, or contract.\textsuperscript{79} Finally, the MBCA establishes the right of the corporation to purchase insurance on behalf of the director regardless of whether or not the corporation has the power to indemnify him under the statutory scheme.\textsuperscript{80}

Subsection 5(a) of the MBCA governs indemnification in third-party suits. Any threatened, pending or completed action whether civil, criminal, administrative or investigative where the director is being sued may be a situation where indemnity is permitted.\textsuperscript{81} The requisite standard of conduct for allowance of indemnification in civil actions is defined in two parts. First, the director must have acted in good faith.\textsuperscript{82} Good faith requires that the director be bound by traditional notions of fairness, loyalty and honesty when acting in his capacity on the board. Good faith has been interpreted to mean the same care that a reasonably prudent person in a position on the board would exercise.\textsuperscript{83} Alternatively, good faith in some jurisdictions requires the higher standard of care that a reasonable and prudent person would exercise in his own business affairs.\textsuperscript{84} The exact definition is not clear. Second, the director must have acted in a manner he reasonably

\textsuperscript{74} Model Business Corp. Act § 5(b) (1979); Del. Code Ann. tit. 8, § 145(b) (1974).
\textsuperscript{77} Id.
\textsuperscript{80} Model Business Corp. Act § 5(g) (1979); Del. Code Ann. tit. 8, § 145(g) (1974).
\textsuperscript{82} See supra note 81.
\textsuperscript{83} See Knepper, supra note 2, at 79-81.
\textsuperscript{84} Id.
believed to be "in or not opposed to" the best interests of the corporation. Although the best interests of the corporation are sometimes difficult to ascertain, the director must have acted in a manner he reasonably believed to be beneficial or neutral to the corporation. For a criminal proceeding, the applicable standard requires that the director have had no reasonable cause to believe his conduct was unlawful. The language of this section has been the subject of much controversy.

The clause, "in or not opposed to the best interests of the corporation" is ambiguous and has been defined in several ways, some definitions being reasonable, and some unjustifiable. Very few jurisdictions employ this terminology. By using the phrase, the MBCA arguably allows permissive indemnification under a less stringent standard of conduct than required by the vast majority of states. The rationale advanced by drafters of the MBCA for including the phrase was that under early statutes a director's right to indemnity, when sued simply in his status as a director, was unclear. Thus, this statutory construction was employed in an attempt to provide for indemnity when the director's alleged liability rests solely on his status as director. However, alternative interpretations of this phrase have been proposed, rendering the meaning of this section uncertain at best.

The phrase "in or not opposed to the best interests of the corporation" as the requisite standard of conduct for indemnity in civil actions does not accomplish the desired clarification with respect to status claims against directors. The phrase "not opposed to" is subject to a legitimate interpretation which encompasses situations in which the director may be personally involved but reasonably believes that the corporation has no interest in the transaction. An example of this situation would be the director who purchases stock or a business operation for his personal account, reasonably believing that the corporation has no interest in the transaction. If this director is

85. MODEL BUSINESS CORP. ACT § 5(a) (1979); DEL. CODE ANN. tit. 8, § 145(a) (1974).
86. See generally McAdams, supra note 8, at 2132, 2133; Bishop, New Trends, supra note 2; Johnston, supra note 2.
87. By 1980 all states except Delaware (and the MBCA) had omitted the clause permitting indemnification when actions were "not opposed to" the best interests of the corporation.
88. See Sebring, supra note 4, at 102; McAdams, supra note 8, at 2132; Bishop, New Trends, supra note 2, at 1082.
89. See supra note 88.
90. McAdams, supra note 8, at 2132-33; Brook, supra note 32, at 8.
91. See Arsht and Stapleton, Delaware's New General Corporation Law: Substantive Changes, 23 BUS. LAW. 75, 78-79 (1967) [hereinafter cited as Arsht and Stapleton].
sued for alleged diversion to himself of a corporate opportunity, the current wording of this section would permit indemnity upon a finding of his good faith pursuant to the statutory requirements.\textsuperscript{92} Under these circumstances the wording is a desired improvement over previous statutory provisions.\textsuperscript{93} Here, the phrase allows indemnity for a director who meets the required standard of conduct when he is sued merely because of his status as director. However, the phrase has also been interpreted differently to allow indemnity in situations where the director is alleged to have been trading company stock for his own account,\textsuperscript{94} in violation of his fiduciary duty toward the corporation. Such a violation of fiduciary duty is an abuse of power falling outside the intended scope of the statutory phrase. Thus, if this phrase of the statutory provision is allowed to stand, the express purpose for including the phrase is violated.\textsuperscript{95}

In addition to ambiguity in the meaning of the phrase “or not opposed to,” inconsistency also exists between the two parts of the standard of conduct whereby the director must have acted in good faith and in a manner he reasonably believed to be in or not opposed to the corporation’s best interests. It would seem extremely difficult to make an honest determination of the director’s good faith where his belief was no more affirmative than that he reasonably thought his actions to be “not opposed to” the best interests of the corporation.\textsuperscript{97} Thus, this phrase of MBCA § 5(a), because of inherent ambiguity, is detrimental to the standard of conduct required to allow indemnity of a director in civil actions.

The second area of confusion found in subsection 5(a) of the MBCA is the allowance of indemnity for amounts paid in settlement of actions against the director.\textsuperscript{98} Indemnification for amounts an accused director may pay in settlement of an action against him could be viewed as encouraging directors to effectuate settlement rather than risk an adjudication of guilt.\textsuperscript{99} The concern in this context is expressed in terms of the unhealthy consequences which must surely

\textsuperscript{92} Id.
\textsuperscript{93} McAdams, supra note 8, at 2132.
\textsuperscript{94} Sebring, supra note 4, at 102.
\textsuperscript{95} See generally Bishop, New Trends, supra note 2; McAdams, supra note 8, at 2132.
\textsuperscript{96} Johnston, supra note 2, at 1997.
\textsuperscript{97} Brook, supra note 32, at 9.
\textsuperscript{99} See generally Arsh and Stapleton, supra note 91, at 103; Bishop, New Trends, supra note 2, at 1082-83.
result when a director is placed in a position of assured indemnity if he settles prior to judgment but risks paying his own bills if he unsuccessfully resists the action. Payment of indemnity for settlements in stockholder derivative suits has long been forbidden because of the circuity of the payment. Since a stockholder derivative suit is actually a suit by the stockholders on behalf of the corporate entity against the director as an individual, an allowance of indemnity for a settlement would defeat the purpose of the action by reimbursing the director for the amount paid in settlement from corporate funds. Thus, indemnification for amounts paid in settlement of a derivative suit is not allowed because of the desire to avoid encouraging settlement and because of the circuity of payment.

Applying the same rationale advanced to forbid indemnity in settled derivative actions to the situation of third-party suits compels the same conclusion. In the past, indemnification for settlements in third-party actions has been allowed because of the desire to avoid adverse publicity, reduce the total cost actually paid by the corporation, and decrease time spent in litigation. Despite these valid considerations, however, the fact remains that it is no more desirable to encourage compromise settlement through assurance of indemnity in third-party actions than in derivative suits. Since a settlement produces no determination of the propriety of the director's conduct before an award of indemnity is made, there is no apparent justification of indemnification for amounts paid in settling third-party actions. Furthermore, where the MBCA contains no requirement of judicial approval of indemnification in connection with a settlement, the danger to society is clear. The standard of conduct requires merely actions "not opposed to the best interests of the corporation" and indemnity may be granted without court approval of the award.

Under this statutory scheme a director who has breached his fiduciary duty might be granted indemnification by the corporation. Such a result is contrary to the goal of maximizing accountability of corporations to the public. Understandably, a director faced with the choice between an assurance of indemnity for a settlement and risking personal assumption of the costs of litigation would choose to settle the action, if there were any chance of a judicial finding of misconduct. Therefore, statutory allowance of indemnity in settled third-party

100. Bishop, New Trends, supra note 2, at 1083.
101. Arsh and Stapleton, supra note 91, at 103.
102. See Court-Ordered Indemnification, supra note 47, at 645.
103. Id.
104. Bishop, New Trends, supra note 2, at 1083.
actions may encourage termination of suits by settlement where there should be a more thorough determination of the propriety of the directors’ actions to insure proper use of corporate power.

Although subsection 5(b), which pertains to stockholder derivative actions, is drafted more narrowly than subsection 5(a), ambiguity does exist which allows laxity in application of the provision. Section 5(b) contains the same problematic terminology of section 5(a) with regard to the requisite standard of conduct. A director may be entitled to indemnification 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. The stated exception is that no indemnity shall be awarded where the director is adjudged liable for negligence or misconduct in performance of his duty toward the corporation. However, the statute later provides that the court may, upon application by the director, find him entitled to indemnity for expenses in light of all the circumstances of the case, despite an adjudication of liability for negligence or misconduct. Results under this statutory scheme are highly problematic.

The phrase “or not opposed to” the best interests of the corporation arguably becomes even more offensive when applied to stockholder derivative suits under section 5(b). Because of the nature of the derivative suit, the need to avoid indemnification in situations of alleged breach of fiduciary duty to the corporation is particularly acute. Where the director is being sued by a shareholding member of the corporation for alleged misconduct, his actions should be above reproach before enabling a grant of indemnity. An affirmative standard of conduct requiring actions in the corporation’s best interests would achieve this end. A less affirmative “or not opposed to” standard encompasses conduct not readily justifiable as deserving of indemnity. An extension of the rationale in opposition to use of this phrase with regard to third-party actions to include stockholder derivative actions compels the same conclusion.

Although the drafters’ intended purpose for inclusion of the phrase to cover status suits against directors is justifiable, the ambiguity of the phrase renders it open to other interpretations unforeseen by the drafters of the MBCA. There is no indication in the statute

that the lesser standard is not equally applicable to non-status claims.\textsuperscript{110} To allow possible indemnity under this section where there has been a breach of fiduciary duty to the corporation violates the purpose of the derivative suit. It would also appear extremely difficult to fulfill the good faith requirement of the standard of conduct in a derivative suit where the director's belief was merely that his actions were "not opposed to" the corporation's best interests.\textsuperscript{111} The standard of good faith implies more affirmative conduct than actions merely "not opposed to" the best interests of the corporation. Thus, the standard of conduct established in subsection 5(b) for directors being sued in a stockholder derivative suit is ambiguous and too lenient to ensure directors' integrity and adequately protect shareholders and society from abuses of corporate power.

Another area in which MBCA subsection 5(b) proves lenient in providing for indemnification of directors is found in the last clause of the section. In that provision a director may obtain indemnity for expenses notwithstanding an adjudication of liability if the court determines him to be reasonably and fairly entitled to such indemnity.\textsuperscript{112} This statutory provision was reiterated in the case of \textit{Wisener v. Air Express Int'l Corp.},\textsuperscript{113} wherein the court stated "[t]here is little doubt that a corporation may commit itself to indemnify its officers and directors for litigation expenses incurred in defending against liability for actions taken in carrying out corporate responsibilities, even though negligent, if the corporation finds it in the corporate interest to undertake such a commitment."\textsuperscript{114} In \textit{Wisener}, indemnification was allowed\textsuperscript{115} under the Illinois law which is substantially identical to the MBCA with regard to indemnification. It is difficult to imagine many situations in which a court would allow indemnity after a finding of liability. It has been suggested that one such situation might be where the court is newly establishing a stricter standard which the director could not have reasonably anticipated.\textsuperscript{116} However,

\textsuperscript{110} Brook, \textit{supra} note 32, at 9.

\textsuperscript{111} Id.

\textsuperscript{112} Model Business Corp. Act § 5(b) (1979).

\textsuperscript{113} 583 F.2d 579 (2d Cir. 1978).

\textsuperscript{114} Id. at 581.

\textsuperscript{115} In the trial court, relief was denied Wisener on grounds that under the then effective statute and by-laws, negligence was a bar to recovery. Wisener had been found guilty of negligence with regard to accounting figures used in the aborted merger. The appellate court reversed and applied the new Illinois statute retroactively to allow indemnification from the corporation for legal fees and expenses.

\textsuperscript{116} See Johnston, \textit{supra} note 2, at 1997; Arsht and Stapleton, \textit{supra} note 91, at 79.
the existence of this clause creates opportunities for abuse and broad interpretation contrary to the intended purpose, as evidenced in the Wisener decision. In an era demanding greater corporate accountability to society, public policy dictates that indemnification should not be allowed after an adjudication of liability upon the director.

The MBCA provides in subsection 5(c) for absolute indemnification as of right when the director has been “successful on the merits or otherwise”117 in defense of either a stockholder derivative suit or third-party action. What constitutes success under this standard is subject to differing interpretation.118 Meeting the conduct requirement under certain interpretations of the statute does not always render the director worthy of indemnity. The difficulty of ascertaining the proper meaning of this section is aggravated by the use of the clause “to the extent that . . .” a director is successful “in defense of any claim, issue or matter therein” he shall be indemnified against expenses.119 Considered as a whole, this subsection allows for partial indemnification of the director who is partially successful in his defense, with success being defined to include various technical dispositions of the suit. “Success on the merits or otherwise”120 has been clarified and defined in two recent decisions.

Extensive litigation between Merritt-Chapman & Scott Corporation (MCS)121 and Louis Wolfson122 during the late 1960’s and early 1970’s is illustrative of the tendency toward more liberal interpretation of indemnification provisions in recent years. The substantive issue involved in these cases was alleged criminal violation of federal securities laws. In 1966 a federal grand jury in the Southern District of New York returned a five-count indictment against defendants Wolfson, Gerbert, Kosow and Staub; all prominent figures in the management of MCS and its subsidiary.123 The claimants were charged with various violations of federal securities laws.124 At the conclusion of the criminal trial in 1968, the defendants were convicted on all five

118. Arsh and Stapleton, supra note 91, at 79.
See generally Arsh and Stapleton, supra note 91, at 80.
121. [hereinafter cited as MCS].
counts of the indictment. These convictions were later reversed, and in each of two retrials, the jury was unable to reach a verdict. Subsequently, the charges were settled as follows: Wolfson entered a plea of nolo contendere to count five, and the other charges against him were dropped. He was fined $10,000 and issued a suspended sentence of eighteen months. Gerbert agreed not to appeal his conviction on count three, and the other charges against him were dropped. He was fined $2,000 and received an eighteen month suspended sentence. The prosecution also dropped all charges against Kosow and Staub.

Wolfson and Gerbert then sought indemnification under section 145(c) of the Delaware Act, for the expenses they incurred in defending the counts which were eventually dropped. The court in Merritt-Chapman & Scott v. Wolfson held that the defendants had not achieved "success on the merits or otherwise" under the meaning of the statute and were therefore not entitled to indemnification for their expenses. The initial finding of guilt on all counts against the defendants was never fully rebutted. Despite reversal of the convictions, lack of consensus among subsequent jury members and eventual partial settlement on the charges led the Delaware court to deny the right of indemnification to Wolfson and Gerbert.

A denial of indemnity in the Wolfson case was undoubtedly the proper result. However, four years later the Superior Court of Delaware reversed the lower court's decision and granted partial indemnity. The reversal was a departure from the definition of success as established in previous cases. In granting the partial indemnity, the Delaware court observed that success in a criminal action

125. See U.S. v. Wolfson, 437 F.2d 862 (2d Cir. 1970).
126. Although a plea of nolo contendere may not be used as an admission in another action, upon acceptance by the court and imposition of a sentence, there is a judgment of conviction against the defendant. See Fed. R. Crim. P. 11, 32(b).
129. Id.
130. The court's opinion denying indemnification to Wolfson and Gerbert was concluded by these guiding words: "It would be anomalous, indeed, and diametrically opposed to the spirit and purpose of the statute and sound public policy to extend the benefits of indemnification to these defendants under the facts and circumstances of this case." Merritt-Chapman & Scott Corp. v. Wolfson, 264 A.2d 358, 360 (Del. Super. Ct. 1970). See also Galdi v. Berg, 359 F. Supp. 698, 701 (D. Del. 1973).
132. McAdams, supra note 8, at 2135.
must be considered as anything other than conviction.\textsuperscript{133} By allowing indemnification under these circumstances, the court was establishing a broad interpretation of the statutory language, in abuse of the public trust.

In deciding to award indemnity in this situation, the court enabled future awards of indemnification where a suit is terminated for merely technical reasons, such as the running of time limitations. The Delaware court failed to recognize that, although a “successful” defendant may avoid conviction for a variety of reasons, he may not be deserving of indemnification in light of the policies underlying the practice.\textsuperscript{134} Because subsection 5(c) provides for mandatory indemnification, unlike subsections 5(a) and 5(b) which are permissive, there is no requirement for an impartial entity to ascertain whether minimum standards of conduct have been met. The sole criterion for an award of mandatory indemnification is the success standard defined so liberally in the statute. By implication, the MBCA provides that the director need not satisfy a requisite standard of conduct so long as he meets the success standard.\textsuperscript{135} The provision for mandatory indemnification as set forth in MBCA subsection 5(c), allowing partial indemnity under a loosely construed definition of success, is too liberal and violates the corporation’s duty to society by awarding indemnity to undeserving directors. Furthermore, allowing for broad latitude in judicial discretion permits the possibility of increasingly liberal interpretations of the “success” criterion until there may exist no real standard at all.

The increasingly liberal interpretation of “success” is further evidenced in a more recent decision\textsuperscript{136} under the Illinois indemnification statute which is patterned after the MBCA.\textsuperscript{137} In 1978, the Sec-

\textsuperscript{133} In granting partial indemnity to Wolfson and Gerbert, the Delaware court observed:

The statute requires indemnification to the extent that the claimant has been “successful on the merits or otherwise.” Success is vindication. In a criminal action, any result other than conviction must be considered success. . . . The statute does not require complete success. It provides for indemnification to the extent of success “in defense of any claim, issue or matter” in an action. Claimants are therefore entitled to partial indemnification if successful on a count of an indictment, which is an independent criminal charge, even if unsuccessful on another, related count.


\textsuperscript{134} McAdams, \textit{supra} note 8, at 2135.


\textsuperscript{136} Wisener v. Air Express International Corp., 583 F.2d 579 (2d Cir. 1979).

ond Circuit\textsuperscript{138} followed the lead of the Delaware Superior Court by holding in \textit{Wisener v. Air Express Int'l Corp.} that a settlement for no liability and no payment on a third-party claim constituted "success on the merits or otherwise."\textsuperscript{139} Wisener had been president, director, and chairman of the board of Air Express International Corporation (AEI) during an aborted merger with the Novo Corporation. The merger negotiations ended abruptly when Novo discovered huge discrepancies between the unaudited income figures supplied to them by AEI and the actual figures.\textsuperscript{140} A number of claims and cross-claims ensued alleging fraud and violation of securities law, some charging Wisener personally.\textsuperscript{141} More specifically, Wisener was charged with negligence for permitting Novo to rely on the figures during merger negotiations when he knew or should have known of severe deficiencies in the accounting system of AEI.\textsuperscript{142} Before trial began, all the actions were settled and withdrawn except for Wisener's claim for indemnity. The court awarded indemnity under the mandatory provision of the Illinois statute and held that a settlement for no liability fit the statutory requirement for "success on the merits or otherwise."\textsuperscript{143} From examination of both \textit{Wolfson} and \textit{Wisener},\textsuperscript{144} it is apparent that courts are now opting to allow indemnification of directors without a showing of meeting high standards of conduct which the public demands from these corporate leaders. Because of the tendency toward extremely liberal interpretation of loosely constructed statutory provisions, there must be revision of the statutes and a more conservative approach taken to the mandatory indemnification provisions of the MBCA and its progeny.

\textsuperscript{138} The case was brought in the United States District Court for the Southern District of New York and decided under Illinois law because Air Express International Corp. is an Illinois corporation.

\textsuperscript{139} Wisener v. Air Express International Corp., 583 F.2d 579, 583 (2d Cir. 1979).

\textsuperscript{140} \textit{Id.} at 581.

\textsuperscript{141} \textit{Id.}

\textsuperscript{142} \textit{Id.} Wisener had received reports along with audits from the Arthur Anderson Company noting the discrepancies and had been warned by AEI employees that variances were surfacing.

\textsuperscript{143} \textit{Id.} at 583. The court awarded indemnity by retroactively applying the liberal statute and by-law to Wisener's actions which occurred prior to enactment of either provision but which had come into effect during the pendency of his suit for indemnity.

\textsuperscript{144} For court decisions achieving the same result, see \textit{B & B Investment Club v. Kleinert's, Inc.}, 472 F. Supp. 787 (E.D. Pa. 1979). An individual defendant who negotiated a dismissal with prejudice for alleged violation of federal securities laws in connection with an offering of stock without making any payment to plaintiff class, was "successful on the merits or otherwise" within the meaning of the Pennsylvania statute and was therefore entitled to indemnity. \textit{See also Goldstein v. Alodex Corp.}, 409 F. Supp. 1201 (E.D. Pa. 1976).
The inadequacies so apparent in the initial sections of the MBCA are compounded in subsection 5(d). In subsection 5(d) of the MBCA, procedures are established which must be followed before granting permissive indemnification under subsections 5(a) and 5(b). Authorization for indemnity under the permissive sections of the statute is given after a determination has been made that indemnification is proper because the applicable standard of conduct has been met by the director. This determination must 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 shareholders." The requirement of an impartial entity to determine the propriety of permissive indemnification in a given situation is commendable. However, the entities designated by the statute cannot be guaranteed impartial to the extent necessary for the administration of justice.

Considering the realities of the corporate world, those appointed in the statute to determine a proper allowance of indemnification are not sufficiently impartial to equitably render a decision. Most derivative suits name all directors as parties to the suit, which places the determination in the hands of "independent legal counsel." However, some question remains as to what constitutes "independent" for these purposes. The Ohio statute explicitly provides that "an attorney, or a firm having associated with it an attorney, who has been retained by or who has performed services for the corporation, or any person to be indemnified within the past five years" is not independent. Ohio's statute further specifies that any determination made by either the disinterested directors or independent legal counsel "shall be promptly communicated to the person who threatened or brought the action or suit . . . and within ten days after receipt of such notification, such person shall have the right to petition a court to review the reasonableness of such determination." These limitations seem

147. Bishop, New Trends, supra note 2, at 1083. Because of the nature of a derivative suit, the shareholders certainly could not make the determination under such circumstances.
149. Pages Ohio Revised Code § 1701.13(E)(4) (1976 Supp.).
desirable in the interest of ensuring an equitable and impartial determination of the propriety of indemnification.

As the MBCA subsection 5(d) now stands, there are no limitations expressed. The present definition of "independent legal counsel" is so vague that the disinterested directors might hire the regular outside counsel of the corporation to make the indemnity determination.\(^\text{150}\) Regular corporate counsel could easily be friends and associates of defendants in the case.\(^\text{151}\) Obviously, close associates or even legal counsel indebted to the corporation for its retainer\(^\text{152}\) will not be the impartial entity required to make the determination for or against granting indemnity. In the event that the deciding entity is comprised of colleagues of the accused director, there is little doubt that one of two situations will more than likely occur. Either the directors not named as parties to the suit will be lenient in judging the actions of their peers seeking indemnity,\(^\text{153}\) or, when a quorum of unaccused directors face an agent who has been acquitted, indemnity may be denied to the innocent director because of a change in membership on the board.\(^\text{154}\) In either case, the resulting decision may not be proper under the circumstances.

By revising the statutes to preclude such unwanted actions as using the corporation's usual outside counsel or "disinterested" directors to opine on permissive indemnity, it may be possible to achieve a more impartial determination on the issue of indemnification.\(^\text{155}\) Provisions such as those employed by the Ohio legislature would properly define the requisite limitations which should exist under the MBCA subsection 5(d).

Despite vague and ambiguous draftsmanship which results in lenient application of the foregoing sections to permissive and mandatory indemnification of directors, the alleged intent of the draftsmen of the MBCA was to restrain management's power to protect itself from personal liability.\(^\text{156}\) However, the entire foundation for the indemnification provisions is subverted when subsections (f) and (g) are introduced

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\(^{150}\) McAdams, supra note 8, at 2139.

\(^{151}\) Id. See also Johnston, supra note 2, at 1998.

\(^{152}\) Bishop, New Problems in Indemnifying and Insuring Directors: Protection Against Liability Under the Federal Securities Law, 1972 DUKE L.J. 1153, 1158 [hereinafter cited as Bishop, Protection].

\(^{153}\) Sebring, supra note 4, at 100.

\(^{154}\) Bishop, New Trends, supra note 2.

\(^{155}\) Id. at 1084, 1085.

\(^{156}\) Id.
into the statutory scheme. These subsections suggest, instead, a legislative desire to permit indemnification either directly or through the use of insurance, in virtually all circumstances.\textsuperscript{157}

Subsection 5(f), which provides that the indemnity possible under the statutory scheme is not exclusive of any other right to indemnification, embodies the very core of the difficulties inherent in the MBCA’s indemnification provisions. Under the nonexclusivity clause, the corporation is empowered with the freedom to draft provisions in the articles of incorporation, by-laws, or even a contract, providing for broader indemnification than allowable under the statute.\textsuperscript{158} The intent of the draftsmen of the MBCA is that “other rights to indemnification may still exist . . . within such limits of public policy as the courts may establish.”\textsuperscript{159} Further, courts will be guided by “public policy considerations, possibly in light of the substantive provisions of the statute” in construing and considering enforcement of a corporate action which extends coverage beyond the statute’s scope.\textsuperscript{160}

Traditionally, this construction has been the case. Courts in the past have been reluctant to validate a by-law allowing indemnity for a director who acted in dereliction of his fiduciary duty toward the corporation,\textsuperscript{161} or whose innocence was doubtful. However, in recent years courts have been more willing to allow indemnification under broadly constructed by-laws, charter provisions and contracts.\textsuperscript{162} Frequently, the policy rationale advanced by MBCA drafters and the early courts which undergirds the indemnification statute has not been met. For example, a corporate by-law providing indemnity to a director who is required to act only in a manner not absolutely contrary to

\textsuperscript{157} Although the extent of such other indemnity provisions may be limited by public policy, a broader remedy has been found allowable. Mooney v. Willys-Overland Motors, Inc., 204 F.2d 888 (3d Cir. 1953).

\textsuperscript{158} Sebring, supra note 4, at 107-09.

\textsuperscript{159} Id.

\textsuperscript{160} See, e.g., Teren v. Howard, 322 F.2d 949 (9th Cir. 1963); Essential Enterprises Corp. v. Dorsey Corp., 40 Del. Ch. 343, 182 A.2d 647 (Del. Ch. 1962).


\textsuperscript{162} Although technically the corporation purchases the insurance, sometimes the corporation pays 90% and the individual director must pay 10% of the premiums. Arguably, this procedure renders the idea of indemnity insurance more palatable. For further discussion of this area, see generally, Bishop, Old Ailment, supra note 39. Also, the scope of this note necessarily limits discussion of this topic to a cursory examination of the primary concepts involved as they relate to indemnification provisions in corporation statutes.
the best interests of the corporation may, conceivably, be found valid. This would enable a grant of indemnity to one who has not acted in a manner worthy of indemnification from a policy standpoint. This problem of subversion of the public policy of the MBCA is further complicated by the use of D & O insurance.

Subsection 5(g) empowers the corporation to purchase directors' and officers' liability insurance against any liability asserted against a director "whether or not the corporation would have the power to indemnify him against such liability under the provisions of this section." D & O insurance policies have been heavily criticized. MBCA subsection 5(g) appears to allow the directors of a corporation to "relieve themselves at the company's expense of any legal obligation to manage the corporation's affairs with either honesty (provided that they steer clear of the penal code) or diligence." Commentators holding this view often argue that insurance for deliberate misconduct, which is not violative of criminal statutes, undermines the essential deterrent function of the imposition of civil liability. Thus, they object to the principle of allowing the purchase of broad coverage insurance. This viewpoint is aptly summarized by a leading commentator when he states, "[s]o long as the law imposes on directors duties of good faith and due care, it should not permit them to evade those duties through the device of insurance purchased by the corporation."

Proponents of the converse argument would seem to tolerate broad D & O insurance on the grounds that the criminal law serves the essential deterrent function and insurance for civil liability serves primarily to ensure full compensation for the victim. Once the distinction has been made between coverage for compensatory civil damages versus punitive criminal damages, the propriety of D & O insurance can be maintained. D & O indemnification insurance is not intended to extend to coverage of punitive damages. Rather, the insurance provides for payment of compensatory damages and the costs of defense, subject to explicitly stated exclusion clauses which bring D

163. MODEL BUSINESS CORP. ACT § 5(g) (1979); DEL. CODE ANN. tit. 8, § 145(g) (1974).
164. See Bishop, New Trends, supra note 2, at 1086-1088, quoting the MODEL BUSINESS CORP. ACT § 5(g) (1979).
165. Id. at 1086.
166. Id. at 1087.
167. Id. at 1091.
168. Id.
170. Id. at 25.
& O insurance well within the limits of public policy.\textsuperscript{171} Also, the nature of insurance allows for dispersion of the costs over a large number of people, and, ultimately, only a few directors will avail themselves of the coverage. Further, to the extent that insurance lessens and liquidates what could be an expensive and uncertain claim, it permits better financial planning by the corporation and guarantees recovery to the plaintiff.\textsuperscript{172} Thus, the debate over the propriety of D & O liability insurance continues, with no definitive argument for either side.

Although an improvement over the early type of indemnification statutes, comprehensive indemnification provisions as found in the MBCA and its progeny are in many ways vague and ambiguous. Lack of clarity, coupled with a certain ideological leniency inherent in the statutes, has led to increasingly liberal interpretations and application of the provisions in recent years, as evidenced in the \textit{Wolfson} and \textit{Wisener} decisions. The effect of this type of statute has been to decrease corporate accountability to the public in an era when society seems to demand more stringent, rather than more lenient, controls over powerful corporations. Thus, there is a recognized need to alter the statutory scheme to re-align it with values apparent in today's society. In furtherance of this objective, several states, such as New York, are attempting to utilize more conservative indemnification statutes. A comparative analysis of the New York statute in terms of the MBCA confirms that the New York-type statute is preferable in many respects.

\textit{New York Statute}

The revised New York Business Corporation Law's (BCL) indemnification statute,\textsuperscript{173} which places strict limitations on the freedom of

\begin{itemize}
\item \textsuperscript{171} Johnston, supra note 2, at 2000.
\item \textsuperscript{172} Heyler, \textit{Indemnification of Corporate Agents}, 23 U.C.L.A. L. \textit{Rev.} 1255, 1265 (1976).
\item \textsuperscript{173} The pertinent part of N.Y. \textit{Bus. Corp. Law} §§ 721-27 (McKinney 1963 and Supp. 1981) reads as follows:
\begin{itemize}
\item \textbf{§ 721. Exclusivity of statutory provisions for indemnification of directors and officers.} No provisions made to indemnify directors or officers for the defense of any civil or criminal action or proceeding, whether contained in the certificate of incorporation, the by-laws, a resolution of shareholders or directors, an agreement or otherwise, nor any award of indemnification by a court, shall be valid unless consistent with this article. Nothing contained in this article shall affect any rights to indemnification to which corporate personnel other than directors and officers may be entitled by contract or otherwise under law. L.1961, c. 855, eff. Sept. 1, 1963.
\item \textbf{§ 722. Authorization for indemnification of directors and officers in

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management to indemnify itself, is much less prevalent among state

actions by or in the right of a corporation to procure a judgment in its favor.
(a) A corporation may indemnify any person, made a party to an action
by or in the right of the corporation to procure a judgment in its favor
by reason of the fact that he, his testator or intestate, is or was a direc-
tor or officer of the corporation, against the reasonable expenses, including
attorneys' fees, actually and necessarily incurred by him in connection
with the defense of such action, or in connection with an appeal therein,
except in relation to matters as to which such director or officer is ad-
judged to have breached his duty to the corporation under § 717. (Duty
of directors) or under (b) of § 715 (Officers). As amended L.1977, c. 432, § 6.
(b) The indemnification authorized under paragraph (a) shall in no case
include: (1) Amounts paid in settling or otherwise disposing of a threatened
action, or a pending action with or without court approval, or (2) Expenses
incurred in defending a threatened action, or a pending action which is
settled or otherwise disposed of without court approval. L.1961, c.855; as amended L.1962, c.819, § 2, both eff. Sept. 1, 1963.

§ 723. Authorization for indemnification of directors and officers in
actions or proceedings other than by or in the right of a corporation to
procure a judgment in its favor.
(a) A corporation may indemnify any person, made, or threatened to be
made, a party to an action or proceeding other than one by or in the
right of the corporation to procure a judgment in its favor, whether civil
or criminal, including an action by or in the right of any other corpo-
tion of any type or kind, domestic or foreign, or any partnership, joint
venture, trust, employee benefit plan or other enterprise, which any direc-
tor or officer of the corporation served in any capacity at the request
of the corporation, by reason of the fact that he, his testator or intestate,
was a director or officer of the corporation, or served such other corpo-
tion, partnership, joint venture, trust, employee benefit plan or other enter-
prise in any capacity, against judgments, fines, amounts paid in settle-
ment and reasonable expenses, including attorneys' fees actually and
necessarily incurred as a result of such action or proceeding, or any ap-
peal therein, if such director or officer acted, in good faith, for a purpose
which he reasonably believe to be in, or for, in the case of service for
any other corporation of any partnership, joint venture, trust, employee
benefit plan or other enterprise, not opposed to, the best interest of the
 corporation and, in criminal actions or proceedings, in addition, have no
reasonable cause to believe that his conduct was unlawful.
(b) The termination of any such civil or criminal action or proceeding by
judgment, settlement, conviction or upon a plea of nolo contendere, or
its equivalent, shall not in itself create a presumption that any such director
or officer did not act, 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 enter-
prise, not opposed to, the best interest of the corporation or that he had
reasonable cause to believe that his conduct was unlawful.
(c) For the purpose of this section, a corporation shall be deemed to have
requested a person to serve an employee benefit plan where the perfo-
mance by such person of his duties to the corporation also imposes duties
on, or otherwise involves services by, such person to the plan or par-
participants or beneficiaries of the plan; excise taxes assessed on a person with respect to the employee benefit plan pursuant to applicable laws shall be considered fines; and action taken or omitted by a person with respect to an employee benefit plan in the performance of such person's duties for a purpose reasonably believed by such person to be in the interest of the participants and beneficiaries of a plan shall be deemed to be for a purpose which is not opposed to the best interest of the corporation. As amended L.1977, c.299, § 1.

§ 724. Payment of indemnification other than by court award.
(a) A person who has been wholly successful, on the merits or otherwise, in the defense of a civil or criminal action or proceedings of the character described in § 722 . . . or § 723 . . . shall be entitled to indemnification as authorized in such sections.
(b) Except as provided in paragraph (a), any indemnification under sections 722 and 723, unless ordered by a court under section 725 . . . shall be made by the corporation, only if authorized in a specific case: (1) By the board acting as a quorum consisting of directors who are not parties to such action or proceedings upon a finding that the director or officer has met the standard of conduct set forth in section 722 or 723, as the case may be, or (2) If a quorum under subparagraph (1) is not obtainable with due diligence; (A) By the board upon the opinion in writing of independent legal counsel that indemnification is proper in the circumstances because the applicable standard of conduct set forth in such section has been met by such director or officer, or (B) By the shareholders upon a finding that director or officer has met the applicable standard of conduct set forth in such section.
(c) Expenses incurred in defending a civil or criminal action of proceeding may be paid by the corporation in advance of the final disposition of such action or proceeding if authorized under paragraph (b).

§ 725. Indemnification of directors and officers by a court.
(a) Notwithstanding the failure of a corporation to provide indemnification, and despite any contrary resolution of the board or of the shareholders in the specific case under section 724 . . . indemnification shall be awarded by a court to the extent authorized under section 722 . . . , 723 . . . , and paragraph (a) of section 724. Application therefore may be made, in every case, either: (1) In the civil action or proceeding in which the expenses were incurred or other amounts were paid, or (2) to the Supreme Court in a separate proceeding, in which case the application shall set forth the disposition of any previous application made to any court for the same or similar relief and also reasonable costs for the failure to make application for such relief in the action or proceeding in which the expenses were incurred or other amounts were paid.
(b) The application shall be made in such manner and form as may be required by the applicable rules of court or, in the absence thereof, by direction of a court to which it is made. Such application shall be upon notice to the corporation. The court may also direct that notice be given at the expense of the corporation to the shareholders and such other persons as it may designate in such manner as it may require.
(c) Where indemnification is sought by judicial action, the court may allow a person such reasonable expenses, including attorneys' fees, during a pendency of the litigation as are necessary in connection with his defense.
therein, if the court shall find that the defendant has by his pleadings or during the course of the litigation raised genuine issues of fact or law.

§ 726. Other provisions affecting indemnification of directors and officers.

(a) All expenses incurred in defending a civil or criminal action or proceeding which are advanced by the corporation under paragraph (c) of section 724 . . . or allowed by a court under paragraph (c) of section 725 . . . shall be repaid in case the person receiving such advancement or allowance is ultimately found, under the procedures set forth in this article, not to be entitled to indemnification or, where indemnification is granted, to the extent the expenses so advanced by the corporation or allowed by the court exceed the indemnification to which he is entitled.

(b) No indemnification, advancement or allowance shall be made under this article in any circumstance where it appears: (1) That the indemnification would be inconsistent with the law of the jurisdiction of incorporation of a foreign corporation which prohibits or otherwise limits such indemnification; (2) That the indemnification would be inconsistent with a provision of the certificate of incorporation, a by-law, a resolution of the board or of the shareholders, an agreement or other corporate action, in effect at the time of the accrual of the alleged cause of action asserted in the threatened or pending action or proceeding in which the expenses were incurred or other amounts were paid, which prohibits or otherwise limits indemnification; or (3) If there has been a settlement approved by the court, that the indemnification would be inconsistent with any condition with respect to indemnification expressly imposed by the court in approving the settlement.

(c) If, under this article, any expenses or other amounts are paid by way of indemnification, otherwise than by court order or action by the shareholders, the corporation shall not later than the next annual meeting of shareholders unless such meeting is held within three months from the date of such payment, and, in any event, within fifteen months from the date of such payment, mail to its shareholders of record at the time entitled to vote for the election of directors a statement specifying the persons paid, the amounts paid, and the nature and status at the time of such payment of the litigation or threatened litigation.

(d) The provisions of this article relating to indemnification of directors or officers and insurance therefore shall apply to domestic corporations and foreign corporations doing business in this state, except as provided in section 1320 . . .

§ 727. Insurance for indemnification of directors and officers.

(a) Subject to paragraph (b), a corporation shall have power to purchase and maintain insurance: (1) To indemnify the corporation for any obligation which it incurs as a result of the indemnification of directors and officers under the provisions of this article, and (2) to indemnify directors and officers in instances which they may be indemnified by the corporation under the provisions of this article, and (3) to indemnify directors and officers in instances which they may not otherwise be indemnified by the corporation under the provisions of this article provided the contract of insurance covering such directors and officers provides, in a manner acceptable to the superintendent of the insurance, for retention amount and for co-insurance.
statutes than the more liberal MBCA type. Although there are certain advantages to both statutes, the New York BCL enables closer control over corporate actions while allowing greater public accountability and less opportunity for abuse of corporate power. Comparison of the New York BCL indemnification provisions with the Delaware/MBCA provisions compels the inevitable conclusion that the New York-type statute is preferable from a policy standpoint.

Perhaps the single most important restriction placed upon management by the New York BCL is the exclusivity provision, whereby any by-law or other corporate action is invalid to the extent that it is inconsistent with the statute. This represents a fundamental ideological departure from the more common and traditional non-exclusive statute such as the MBCA. By structuring the New York BCL as the exclusive right to indemnification, the drafters express their intent to provide strict guidelines within which corporate directors must function and from which no material deviation will be permitted. Indeed, the legislative history of this section suggests it was included because of the need to clarify the extent to which statutory indemnification provisions place limits upon corporate freedom to indemnify in various other forms. The exclusivity provi-

(b) No insurance under paragraph (a) may provide for any payment, other than cost of defense, to or on behalf of any director or officer. (1) If a judgment or other final adjudication adverse to the insured director or officer establishes that his acts of active and deliberate dishonesty were material to the cause of action so adjudicated, or that he personally gained in fact a financial profit or other advantage to which he was not legally entitled, or (2) in relation to any risk the insurance of which is prohibited under the insurance law of this state.

c) Insurance under any or all subparagraphs of paragraph (a) may be included in a single contract or supplement thereto. Retrospective rated contracts are prohibited.

d) The corporation shall, within the time and to the persons provided in paragraph (c) of section 726 . . . mail a statement in respect to any insurance it has purchased or renewed under this section, specifying the insurance carrier, date of the contract, cost of the insurance, corporate positions of the insured, and a statement explaining all sums, not previously recorded in a statement to shareholders, paid under any indemnification insurance contract.

e) This section is a public policy of this state to spread the risk of corporate management, notwithstanding any other general or special law of this state or of any other jurisdiction including the federal government.

176. Id.
177. A study published in the Harv. Bus. Rev. provides concrete evidence in

https://scholar.valpo.edu/vulr/vol17/iss2/3
sion of section 721 establishes a foundation for subsequent comprehensive sections allowing indemnification under strictly guarded circumstances.

Section 722 governs authorization for indemnification of directors in derivative actions. The indemnity offered in this section is permissive in nature. Section 722(a) stipulates that indemnity for a director may be authorized in payment of reasonable expenses actually and necessarily incurred by him in the defense or appeal of a derivative action against him, except in relation to a matter in which the director is adjudged to have breached his duty to the corporation.

This section constitutes an improvement over the comparable MBCA subsection 5(b). The two-prong standard of conduct established in the MBCA subsection 5(b) where the director must have acted in "... good faith and in a manner he reasonably believed to be in or not opposed to the best interests of the corporation ...", is a much less stringent standard than that advanced in the New York BCL. By establishing an affirmative duty to the corporation as the requisite standard of conduct in derivative actions, the New York legislature has made the director accountable to a higher degree for his actions. Considering the nature of a derivative suit and the requirements which the fiduciary duty toward the corporation place on a director, there is clearly a need for close scrutiny of a director's activity when sued in this fashion.

Subsection 722(b) of the New York BCL enumerates further

support of this more conservative approach to corporation law. The report, based upon a study of resolutions and amendments to by-laws and charter provisions proposed to shareholders of 100 large corporations during the period 1938 to 1941, underscored the danger of perpetuating the non-exclusive system of indemnification. It revealed an excessive amount of irresponsibility in corporate management and a consequent need to tighten the strictures on the freedom of directors to indemnify. After examination of the indemnification proposals, the authors commented: "Extensions of the scope of these agreements removes much of the ring of truth from the original cry that managements seek only protection from 'unfounded suits.' It must be inferred that managements are attempting to escape responsibilities attaching to their offices. . . ." In response to such evidence of irresponsible corporate directors abusing the power inherent in non-exclusive statutes, New York adopted their exclusivity provision. Bates and Zuckert, Directors' Indemnity: Corporate Policy or Public Policy, 20 HARV. BUS. REV. 244 (1942).

179. This duty is enumerated in § 717 of the statute.
180. MODEL BUSINESS CORP. ACT § 5(b) (1979); DEL. CODE ANN. tit. 8, § 145(b) (1974).
181. See supra note 23.
182. See supra note 57.
restrictions on the corporate power of permissive indemnification in stockholder derivative suits. The corporation may only indemnify the director against expenses, never judgments. Nor may the corporation indemnify against amounts paid in settling or otherwise disposing of an action, whether pending or merely threatened; or expenses incurred in defending a threatened or pending action which is settled or otherwise disposed of without court approval. The purpose of this provision is primarily to protect against secret or collusive settlements. By requiring court approval before granting an award of indemnity for expenses incurred in settling a derivative action, the statute guarantees that the required standard of conduct has been met.

Furthermore, the New York BCL, unlike the MBCA, does not contain a provision permitting the court to award indemnification notwithstanding an adjudication of liability. Thus, the New York BCL succeeds in allowing indemnification of a director sued in a stockholder derivative action only for expenses incurred in defense of appeal where the director has been found not to have breached his duty to the corporation. Under the exclusivity provision, this minimum right to indemnification is not necessarily guaranteed. The exclusivity clause provides that statutory rights to indemnification may not be broadened, but they could be restricted by proper corporate action. A corporation is therefore free to adopt narrow indemnification provisions at its discretion. Indemnification under these circumstances is justifiable and consistent with the goals of sound public policy.

Section 723 of the New York BCL empowers a corporation to indemnify directors in third-party actions. As in the case of the MBCA, in third-party actions the allowable extent of indemnification is broader than in derivative actions. Indemnification in third-party suits is permissive in nature. Under this section a director may be indemnified for his litigation expenses, judgments, amounts paid in settling civil suits, and fines in criminal cases. A director may be indemnified

184. Id.
185. Id.
187. MODEL BUSINESS CORP. ACT § 5(b) (1979); DEL. CODE ANN. tit. 8, § 145(b) (1974).
189. See Johnston, supra note 2.
191. Id.
192. Id. at § 723(a) (McKinney 1963).
either for suits actually instituted against him or suits merely threatened.\textsuperscript{193}

Unlike the MBCA-type statute, the New York BCL makes no specific provision for indemnification in administrative and investigative proceedings. In simply making reference to civil and criminal suits, the BCL might preclude indemnity in many of the now commonplace SEC or other agency investigative proceedings.\textsuperscript{194} Like the MBCA, however, the BCL does provide a director with indemnity for actions brought by or in the right of another corporation which he has served at the request of his corporation.\textsuperscript{195} The right of indemnification also extends to actions by or in the right of a partnership, joint venture, trust, employee benefit plan\textsuperscript{196} or other enterprise which he has served at the request of the corporation.\textsuperscript{197} The rights of indemnification provided in third-party actions under this section are available subject to meeting the applicable standards of conduct as established in the section.

The New York BCL subsection 723(a) differentiates between the standards of conduct required to allow indemnification in criminal actions, civil proceedings by any independent third-party entity, and civil proceedings by another corporation or entity which the director served by request.\textsuperscript{198} In criminal proceedings, the director must have acted in good faith, for a purpose which he reasonably believed to be in the best interests of the corporation and had no reasonable cause to believe that his conduct was unlawful.\textsuperscript{199} For a civil proceeding by an independent third-party entity, a grant of indemnification requires that the director have acted in good faith, for a purpose which he reasonably believed to be in the best interest of his corporation.\textsuperscript{200} For civil proceedings against the director by another business entity which he served at the request of his corporation, the director must have acted in good faith and in a manner he reasonably believed to be in or not opposed to the best interests of his corporation\textsuperscript{201} to be entitled to indemnification.

\textsuperscript{193} Id.
\textsuperscript{194} See generally, KNEPPER, supra note 2.
\textsuperscript{195} N.Y. BUS. CORP. LAW § 723(a) (McKinney 1963).
\textsuperscript{196} Extended indemnification coverage under this section is of particular importance in view of the 1974 Employee Retirement Insurance Security Act (ERISA) which creates another avenue for potential liability of a director.
\textsuperscript{197} N.Y. BUS. CORP. LAW § 723(a) (McKinney 1963).
\textsuperscript{198} Id.
\textsuperscript{199} Id.
\textsuperscript{200} Id.
\textsuperscript{201} Id.
The standards of conduct established in the New York BCL are more stringent than the standards required under the MBCA. The MBCA-type statute provides indemnification upon a finding that the director acted in a manner "in or not opposed to the best interests of the corporation" with regard to all third-party actions.\textsuperscript{202} The New York BCL requires an affirmative type of conduct, wherein the director must have acted for a purpose he reasonably believed to be in the corporation's best interests.\textsuperscript{203} The negative "or not opposed to" standard established in the MBCA allows for leniency and ambiguity in application of the provisions to actual situations.\textsuperscript{204} The distinctions made between various types of proceedings under the New York BCL render clarity as to the extent of protection available. For the majority of cases falling under general third-party suits, the standard of conduct advanced is stringent enough to insure adequate accountability of the corporate directors to society as a whole.

One issue remaining unclear under the New York BCL is whether directors are entitled to indemnity in suits arising merely because of their "insider" status and the requisite standard of conduct.\textsuperscript{205} If a director trading in the corporation's stock is sued for violation of the 1934 Securities Exchange Act, and is successful on the merits, should he be entitled to indemnification?\textsuperscript{206} Arguably, he could be deemed entitled to indemnification because the only reason he was sued was due to his "insider" status.\textsuperscript{207} However, if he was actually acting only for his own personal benefit, rather than in the best interests of the corporation,\textsuperscript{208} he has therefore not met the statutory requirement for indemnification. The MBCA purports to solve this problem by the use of the phrase "in or not opposed to" the best interests of the corporation as part of the standard of conduct.\textsuperscript{209}

It might be argued that although the "or not opposed to" phrase does compel indemnity under certain justifiable circumstances, applying the broad standard to all third-party actions against a director would permit indemnification of directors in violation of the ultimate goal of deterring such conduct in society.\textsuperscript{210} Thus, New York's limited

\textsuperscript{203} N.Y. Bus. Corp. Law § 723(a) (McKinney 1963).
\textsuperscript{204} See supra notes 97-104 and accompanying text.
\textsuperscript{205} Johnston, supra note 2, at 2001-2002.
\textsuperscript{206} Id.
\textsuperscript{207} Id.
\textsuperscript{208} Id.
\textsuperscript{210} See generally Bishop, New Trends, supra note 2.
use of the broad standard is preferable. Limited use of the broad standard of conduct is also desirable when indemnity may be granted for amounts paid in settlement.

The MBCA\textsuperscript{211} and New York BCL\textsuperscript{212} are similar in their allowance of indemnification for amounts paid in settling third-party actions. As noted earlier,\textsuperscript{213} a guarantee of indemnification for settlement of actions may encourage directors to settle rather than risk a potential determination of misconduct if the case is heard on the merits. However, the impropriety of indemnification under these circumstances is greater with the MBCA provisions than the New York BCL. Both statutes allow indemnification for amounts paid in settling third-party actions only after a determination is made that the director met the stated standard of conduct. The MBCA requires the director to have acted "in good faith and in a manner he reasonably believed to be in or not opposed to the best interests of the corporation."\textsuperscript{214} This standard is less stringent than the New York standard governing third-party suits by a disinterested third party. The standard of conduct required by the New York BCL is that the director have acted "in good faith and in a manner he reasonably believed to be in the best interests of the corporation."\textsuperscript{215} Thus, although the possibility may still exist for abuse of power by allowing indemnification of a director for amounts paid in settlement, the danger is lessened by requiring compliance with strict standards of conduct under the New York BCL.\textsuperscript{216}

Subsection 724(a) of the New York BCL establishes that a director who is "wholly successful on the merits or otherwise" in defense of a derivative action or third-party suit against him is entitled to indemnification as of right.\textsuperscript{217} This right is mandatory, provided that

\begin{itemize}
\item 212. N.Y. Bus. Corp. Law § 723(a) (McKinney 1963).
\item 213. See generally supra notes 97-104 and accompanying text.
\item 215. N.Y. Bus. Corp. Law § 723(a) (McKinney 1963).
\item 216. The remainder of N.Y. Bus. Corp. Law § 723 establishes the procedural presumptions underlying the substantive provisions of subsection (a). Subsection (b) stipulates that termination of a civil or criminal action in various ways shall not create a presumption that the director acted in a manner not in compliance with the requisite standard of conduct. This section, like the Model Business Corp. Act § 5(a) (1979) provides assurance that indemnity will not be denied a director without an appropriate determination that he has not met the standard of conduct. Subsection (c) expands the details of indemnification awarded for violation of ERISA requirements, and clarifies the fact that indemnity may be awarded for these violations, provided that the director otherwise satisfied the statutory standards.
\item 217. N.Y. Bus. Corp. Law § 724(a) (McKinney 1963).
\end{itemize}
the director is in compliance with the standards of conduct set forth in sections 722 and 723. 218 If the corporate management refuses to indemnify the director in such a case, the court will enforce his right. 219 A guarantee of indemnity for the director, who is vindicated on the merits of the case, is desirable 220 as consistent with the goals of sound public policy and the need to attract qualified people to the board of directors. 221 The requirement of complete success before mandating indemnification under the New York BCL serves to alleviate a portion of the leniency inherent in the clause "on the merits or otherwise." For example, a director could not be granted mandatory indemnification for a portion of a suit against him terminated on technical grounds where he is found guilty of misconduct for another portion. Conceivably, given these same facts, under an MBCA-type statute, partial indemnity could be granted, provided the director had acted in a manner "in or not opposed to" the best interests of the corporation. 222 Such a result would clearly be inconsistent with the goal of maximizing public accountability of the corporation and upholding the directors' duty of integrity to both the corporation and to society as a whole.

The second paragraph of section 724 establishes the procedure to be followed before making a grant of indemnity where the action against a director has been settled or the director has not been wholly successful in his defense. 223 Under these circumstances, no indemnification may be allowed except upon a post hoc determination in the specific case by an impartial entity that the director is entitled to indemnity. 224 The New York BCL provides for authorization of indemnification upon determination by the board, acting by a quorum consisting of directors who are not parties to the action, that the director has met the standard of conduct as stated in section 722 225 or 723. 226 If a qualified quorum of directors is not obtainable, the determination may be made by either independent legal counsel in a written opi-

218. Id.
220. One prominent proponent of this idea, Joseph W. Bishop, is a professor of law at Yale University and is a noted scholar in this area.
221. Bishop, Indemnification, supra note 39, at 843.
222. MODEL BUSINESS CORP. ACT § 5(a) (1979); DEL. CODE ANN. tit. 8, § 145(a) (1974).
223. N.Y. BUS. CORP. LAW § 724(b) (McKinney 1963).
224. Id.
225. See supra notes 178-89 and accompanying text.
226. See supra notes 190-216 and accompanying text.
nion or by the shareholders. 227 The various entities authorized to make a determination of the propriety of the director's actions under the New York BCL are the same under the MBCA. 228

The problems inherent in the use of various tribunals as impartial judges under the MBCA also exist under the New York BCL. Colleagues of the accused director cannot render an unbiased opinion with regard to his indemnification. 229 Neither may the regular outside corporate counsel be considered sufficiently impartial to insure an equitable grant of indemnity. 230 Also, if a defendant director holds shares of stock, there remains some doubt under either statute whether he would be able to exercise his vote as a shareholder in making the indemnification determination. 231 Clearly, revision is necessary to remedy such conflicts.

Indemnification of directors by court order is the subject of section 724 of the New York BCL. The BCL makes specific provision in this section for alternative methods of obtaining indemnification after a denial of indemnity by the corporation. The statute stipulates that a court may award indemnification "notwithstanding the failure of a corporation to grant indemnity, and despite any contrary resolution of the board or of the shareholders." 232 Indemnification under these circumstances shall be awarded to the extent authorized under substantive sections 722, 723 and 724(a), 233 after application by the director in one of two ways. First, he may apply in the civil action or proceeding in which the expenses were incurred or other amounts paid. 234 Second, he may apply for indemnification to the state supreme court in a separate proceeding. 235 Thus, a director justly deserving of indemnification according to established guidelines is guaranteed the award of indemnity.

The legislative history of the New York BCL indicates a desire to ensure authorization of indemnification by judicial action to the maximum extent allowed. 236 However, such indemnification must be within the same constraints established for voluntary indemnification

228. MODEL BUSINESS CORP. ACT § 5(d) (1979); DEL. CODE ANN. tit. 8, § 145(d) (1974).
229. See supra notes 146-55 and accompanying text.
230. See supra notes 146-55 and accompanying text.
231. See supra notes 146-55 and accompanying text.
233. Id.
234. Id. at (1).
235. Id. at (2).
236. N.Y. Bus. Corp. Law § 725, Legislative Studies and Reports, Comment 947.
by the corporation. The New York BCL clearly creates the right to resort to judicial remedy where the corporation has failed to grant indemnity to a deserving director. The alternative remedy exists subject to one caveat. No indemnification may be awarded by the court if the corporation’s denial of indemnity was pursuant to a valid corporate action limiting the director’s right to indemnification. This section of the New York BCL thus renders much needed clarity to the concept of court-ordered indemnification: a director of high integrity worthy of the grant of indemnity is ensured its receipt.

Although the right to court-ordered indemnification exists under the MBCA, it has not been clearly delineated in the same exacting fashion as in the New York BCL. Clarity, such as exists in New York’s indemnification law, renders application of the statute to actual situations less problematic and more consistent. Thus, the right to court-ordered indemnification to the fullest extent allowable under required standards of conduct is a principle which should be clearly established in all indemnification statutes.

The New York BCL is unusual because it requires notice to shareholders of any amounts paid in indemnification of a director by the corporation. Under section 726, notice to shareholders is required of any indemnification other than by court order or shareholder action. The BCL specifies what information must be furnished and stipulates time limitations for dissemination of the information to shareholders. Requiring notification of shareholders whenever indemnity is awarded is essential to the attainment of an adequate measure of public accountability.

237. Id.
238. Id.
239. Id.
240. Id.
242. N.Y. BUS. CORP. LAW § 726(c) (McKinney 1963).
243. Id.
244. Id.
245. Section 726 also contains conflict of laws provisions explaining that the indemnification sections of New York law pertain both to domestic corporations and to foreign corporations doing business in New York. The one exception to this provision is contained in section 1320 of the BCL which states that a foreign corporation will be exempt from the New York indemnification provisions if, at the time indemnity would be considered, either (1) its shares were listed on a national securities exchange or (2) less than one-half of its business income for the preceding three fiscal years was allocable to New York state for franchise tax purposes. This provision was enacted to preclude businesses from incorporating in the state of Delaware in order to benefit from that state’s more liberal indemnification provisions when the bulk of the business’ income is generated in New York.
The final section of the New York BCL which addresses the problem of indemnification of corporate directors pertains to the purchase of insurance for directors and officers.\textsuperscript{246} The BCL allows the purchase of D \& O insurance for much more restrictive coverage than allowed under the MBCA.\textsuperscript{247} Section 727 of the New York BCL establishes that the corporation has the power (subject to certain restrictions) to purchase D \& O insurance: (1) to indemnify the corporation for its obligation to indemnify the directors and officers,\textsuperscript{248} (2) to indemnify directors and officers in instances in which they may be indemnified by the corporation under the BCL,\textsuperscript{249} and (3) to indemnify directors and officers in instances in which they may not be indemnified by the corporation.\textsuperscript{250} The subsection (1) grant of power to buy insurance to indemnify the corporation for its obligation to indemnify the directors and officers is a reflection of the standard procedure for D \& O insurance. Generally, D \& O insurance is purchased as a two-part package, with one part covering the corporation's obligation to indemnify and a second part offering coverage of the directors and officers in situations where the corporation may not indemnify.\textsuperscript{251} In most circumstances, the scope of insurance provided under subsection (3) would be of primary concern to the director.

Restrictions on the right to purchase indemnification insurance which exist in New York are more stringent than those in most other states.\textsuperscript{252} In particular, the restricted right to insurance afforded under the New York BCL is markedly different from the broad right to insure the director "whether or not the corporation would have the power to indemnify him against such liability under other provisions,"\textsuperscript{253} as stated in the MBCA. The strictures placed upon D \& O insurance in this section of the New York BCL are twofold. First, if the insurance is desired to offer protection where the director may not otherwise be indemnified by the corporation, the policy must provide for a retention (a type of deductible) and co-insurance\textsuperscript{254} amount "in a manner acceptable to the superintendent of insurance."\textsuperscript{255}

\begin{itemize}
\item \textsuperscript{246} N.Y. BUS. CORP. LAW § 727 (McKinney 1963).
\item \textsuperscript{247} Id.
\item \textsuperscript{248} Id. at (a)(1).
\item \textsuperscript{249} Id. at (a)(2) [emphasis supplied].
\item \textsuperscript{250} Id. at (a)(3) [emphasis supplied].
\item \textsuperscript{251} See Johnston, supra note 2, at 2013.
\item \textsuperscript{252} Id. at 2004.
\item \textsuperscript{253} MODEL BUSINESS CORP. ACT § 5(g) (1979); DEL. CODE ANN. tit. 8, § 145(g) (1974).
\item \textsuperscript{254} For a more thorough discussion of these requirements, see Johnston, supra note 2, at 2014.
\item \textsuperscript{255} N.Y. BUS. CORP. LAW § 727(a)(3) (McKinney 1963).
\end{itemize}
ondly, the insurance policy may not provide for any payment other than expenses of defense: "(1) if a judgment or other final adjudication adverse to the insured director establishes that his acts of active and deliberate dishonesty were material to the cause of action so adjudicated, or that he personally gained in fact a financial profit or other advantage to which he was not legally entitled; or (2) in relation to any risk the insurance of which is prohibited under the insurance law of this state." The restrictions in this last section of the New York BCL are included pursuant to public policy considerations precluding insurance against certain types of misconduct, including gross negligence, self-dealing and total abdication of fiduciary responsibility.

The final subsections of section 727 of the BCL further stipulate that retrospective-rated contracts are prohibited, and that notice to stockholders is required upon purchase of D & O insurance. The New York BCL also provides that, "[t]his section is the public policy of this state to spread the risk of corporate management, notwithstanding any other general or special law of this state or of any other jurisdiction including the federal government." The reason for this provision is apparently to state for the courts' benefit an intent to liberally interpret statutory provisions in favor of director indemnification, despite federal laws or prior policies which might be deemed to disfavor indemnification of directors. Thus, the legislators appear to favor awards of indemnity to the maximum extent allowed within the specifically enumerated restrictions in the BCL.

As previously explained, D & O insurance policies were highly controversial when they first appeared. The debate as to the propriety of insuring against certain types of misconduct continues. However, the prevalence today of D & O policies in various forms indicates their general acceptance as another type of compensation for executives and a way of attracting capable managers. D & O insurance policies, as allowed under the New York BCL indemnification section subject to explicitly stated restraints, would be acceptable to all but the most

256. Id. at (b).
258. N.Y. BUS. CORP. LAW § 727(c) (McKinney 1963).
259. Id. at (d). Notice is required pursuant to the stipulations indicated in § 726(c).
260. Id. at (e).
261. See Johnston, supra note 2, at 2005.
262. See supra notes 162-171 and accompanying text.
critical opponents of the practice. The more offensive type of D & O insurance, enabling the purchase of coverage for virtually anything deemed appropriate by the corporation, is the primary target of their criticism. Where the statutory scheme provides guidelines within which the corporation must operate when purchasing insurance coverage, there is assurance of at least a minimum amount of corporate accountability to society, and the possibilities for abuse of power are narrowed.

The more conservative approach to corporate law, demonstrated in the New York BCL indemnification provisions, reveals an intent to hold corporate directors to a higher degree of responsibility for the consequences of their actions than required under the MBCA. New York's exclusivity provision, coupled with more stringent standards of conduct required to allow an award of indemnity, serves to preclude indemnification of corporate directors in situations violative of traditional notions of good faith and fiduciary responsibility. Given the existence of a perceived "corporate crime wave" in America, the restrictive approach to indemnification taken by New York is the preferred approach. Accordingly, many state statutes which either resemble the MBCA or are not comprehensive in scope should be reformed to meet the societal attitudes of today. Among those statutes in need of reform is the State of Indiana's which consists of provisions rendering illusory any attempt at encouraging corporate responsibility toward society.

INDIANA'S INDEMNIFICATION PROVISION: A FAILURE AT CORPORATE ACCOUNTABILITY

The Indiana corporate indemnification provision is deficient in many respects. Unlike most modern indemnification provisions, including the MBCA and New York BCL, the Indiana Act is not

263. N.Y. BUS. CORP. LAW § 721 (McKinney 1963).
264. N.Y. BUS. CORP. LAW § 722(a), § 723(a) (McKinney 1963).
265. See supra note 57.
267. IND. CODE § 23-1-2-2(b)(9). The text of the Indiana provision reads as follows: (9) to indemnify any person who is or was a director, officer, employee or agent of the corporation, or is or was serving at the request of the corporation as a director, officer, employee or agent of another corporation, partnership, joint venture, trust or other enterprise, against expenses reasonably incurred by him in connection with the defense of any action, suit or proceeding, civil or criminal, in which he is made or
comprehensive. Although the Act is permissive in nature, allowing a corporation to indemnify its directors under certain circumstances, the criteria upon which a decision to award indemnity must be based are not defined adequately. Standards of conduct which must be met and situations in which indemnification is permitted are not enumerated with sufficient clarity to afford necessary guidelines for corporate policy-makers. Lack of specificity necessarily renders the Act ambiguous and subject to differing interpretations. Further, the non-exclusivity of the Act and the unrestricted right to purchase D & O insurance, when coupled with the vague substantive provisions, reveal a denial of even minimal public accountability. Therefore, the Indiana Act should be reformed.

Statutory Framework

At the outset, the Indiana Act purports to provide indemnity for a director against expenses reasonably incurred in the defense of any action, suit or proceeding whether civil or criminal, in which threatened to be made, a party by reason of being or having been in any such capacity, or arising out of his status as such, except in relation to matters as to which he is adjudged in such action, suit or proceeding, civil or criminal, to be liable for negligence or misconduct in the performance of duty to the corporation: Provided, however, That such indemnification shall not be deemed exclusive of any other rights to which those indemnified may be entitled under any provision of the articles of incorporation, by-laws, resolution or other authorization heretofore or hereafter adopted, after notice, by a majority vote of all the voting shares then issued and outstanding; and provided further that expenses incurred in defending any action, suit, or proceeding, civil or criminal, may be paid by the corporation in advance of the final disposition of such action, suit, or proceeding notwithstanding any provisions of this article to the contrary upon receipt of an undertaking by or on behalf of the director, officer, employee, or agent to repay the amount paid by the corporation if it shall ultimately be determined that the director, officer, employee, or agent is not entitled to indemnification as provided in this section;

(10) to purchase and maintain insurance on behalf of any person who is or was a director, officer, employee or agent of the corporation, or is or was serving at the request of the corporation as a director, officer, employee or agent of another corporation, partnership, joint venture, trust or other enterprise against any liability asserted against him and incurred by him in any such capacity, or arising out of his status as such, whether or not the corporation would have the power to indemnify him against such liability under the provisions of this section.

268. Originally enacted in 1959, the Act was subsequently amended in 1969 and 1973.

269. See supra notes 47-53 and accompanying text.

270. See supra notes 41-46 and accompanying text.

he is made or threatened to be made a party.\textsuperscript{272} This broad grant of authority is problematic in several ways. Granting the power to indemnify against "expenses reasonably incurred" places no definitional limitation upon what constitutes "expenses." The possibility of indemnifying against judgments, fines and settlements is neither confirmed nor denied. Considering the non-exclusive nature of the Indiana Act, indemnity could presumably be awarded for any amount paid, regardless of the classification of payment. However, the lack of specific reference to these possibilities creates ambiguity in interpretation of the statute.

Unlike most modern indemnification statutes, the Indiana Act makes no distinction between stockholder derivative suits and third-party actions. Indemnity may be granted in connection with the defense of any action, whether civil or criminal\textsuperscript{273} and whether threatened or pending. Furthermore, a director is entitled to indemnity either in suits arising merely out of his status or where he is being sued personally for alleged wrongdoing in his capacity as director.

Although arguably the Act encompasses both proper third-party suits\textsuperscript{274} and derivative suits, there are no requisite standards of conduct established and no procedures for determination of the propriety of indemnification in each case. The only caveat explicitly stated in the Indiana Act consists of a denial of indemnity where the director is adjudged liable for negligence or misconduct in the performance of duty to the corporation.\textsuperscript{275} Apparently, any termination of the suit for procedural reasons, or by settlement, would be proper grounds for an award of indemnity for expenses.\textsuperscript{276} Contrary to widely accepted notions of equity, the Indiana statutory scheme might permit indemnification for expenses incurred in settling a derivative suit without any determination as to the propriety of the director's activity or the propriety of the settlement. Such lenient application of this vague statute is violative of the public trust and downgrades the importance of corporate accountability.\textsuperscript{277}

\textsuperscript{272} Id. at (9).
\textsuperscript{273} No provision has been made to clarify whether protection is intended to extend to administrative and investigative proceedings. See supra notes 194-97 and accompanying text.
\textsuperscript{275} Ind. Code. 23-1-2-2(b)(9).
\textsuperscript{276} The reader will be reminded that "expenses" has no specific definitional limits. Thus, are amounts paid in settlement "expenses?"
\textsuperscript{277} Despite the clear reference in the Indiana statute, one commentator argues that in practice, the standards of conduct proposed in the MBCA should be employed
Difficulties created by the ambiguity of the Indiana indemnification statute are compounded by the problems inherent in a coupling of a non-exclusive statute with unrestricted rights to purchase D & O insurance.\(^2\) When a corporation is allowed to draft by-laws affording indemnification to directors at its discretion, the by-laws will undoubtedly provide indemnity for all but the most flagrant misdeeds.\(^3\) Similarly, an unrestricted right to purchase D & O insurance will generally imply the purchase of broad coverage by many corporations. Consequently, the issue is again raised whether the corporation may purchase insurance which effectively frees directors from the fear of civil liability for breaching their duty of good faith toward the corporation. In the final analysis, an indemnification statute such as the Indiana Act which establishes virtually no restraint upon the corporation's discretionary right to indemnify its directors, is illusory in its attempt to provide an adequate measure of corporate accountability.

Proposals for Reform

Analysis of Indiana's indemnification statute illuminates several possibilities for reform. Of primary concern is the non-exclusivity provision of the statute. Any statutory scheme regulating indemnification, regardless of the extent of restrictions it embodies, is essentially without value when complemented by a blanket non-exclusivity provision. Despite clear delineation in the statute of restrictions upon corporate indemnification, these restraints must be considered only as comment upon the state's public policy, if the corporation is free to draft additional protection at its discretion. The preferable method of ensuring adequate protection from liability for the director, in addition to offering a necessary measure of public responsibility, is the use of a comprehensively drafted statute addressed to specific situations with an accompanying exclusivity provision. The New York BCL\(^4\) is exemplary in this regard, providing extensive indemnification protection for directors under the restricted scope of an exclusive statute. The specific provisions of the New York BCL are worthy of use as a model in many respects. In particular, the New York BCL embodies protection to varying degrees for directors sued in third-party actions as well as stockholder derivative suits.

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in conjunction with the Indiana Act. If this usage is intended, the Indiana legislature should enact appropriate provisions requiring these standards of conduct to be used in all cases in order to avoid inconsistency.

278. See supra notes 162-71 and accompanying text.

279. Generally, where gross negligence, negligence, self-dealing or total abdication of corporate responsibility is found, indemnity will be denied.

The distinction in both substance and procedure between stockholder derivative suits and third-party actions is of paramount importance in any reformation scheme for the Indiana statute. The standards of conduct required and procedures for determining the propriety of an indemnification award must differ because of the distinct nature of each type of suit. Due to the special fiduciary relationship between the director and his corporation, he must be held to the highest standards of conduct with respect to his dealings. It is the fiduciary duty of a director to act in his corporation's best interests. However, a director may be acting in furtherance of what he reasonably believes to be the corporation's best interests and still act wrongfully as to a third party. Where the director is acting in this fashion, an award of indemnification may be considered more justifiable than in the stockholder derivative action where the director's fellow shareholders are suing and where the expectation of his fiduciary duty is greater.

This scheme of corporate relationship has perhaps best been analyzed in terms of concentric circles. The inner circle deals with the relationship among shareholders themselves and between shareholders and the corporate management. The outer circle depicts the relationship between the corporation as a whole and outside third parties. A higher standard of integrity is demanded with regard to transactions in the inner circle, where shareholders are of closer relationship, than in the outer circle. This reasoning, however, is not intended to imply justification of a lenient attitude toward the standard of care required in dealing with third parties. Instead, the rationale is intended to reinforce the necessity of distinguishing between third-party actions and stockholder derivative suits.

The Indiana indemnification Act does not acknowledge the vital distinction between stockholder derivative actions and third-party suits. The Act applies in the same manner to both types of action. The New York BCL, however, is true to the goal of securing the highest degree of fiduciary care of directors to the shareholders and corporation. The BCL allows indemnification of directors in derivative actions within a restrictive scope. By allowing the corporation to indemnify its directors only for expenses, never judgments, in derivative actions, the New York BCL precludes the undesirable

281. See supra note 57.
282. Schaeftler, supra note 2, at 6-7.
circuity of payment sometimes possible under the MBCA and its non-exclusivity clause. Under the New York statutory standard of conduct required for a grant of indemnity in stockholder derivative actions, where the director is adjudged to have breached his duty to the corporation, he will be denied indemnity. This standard is preferable to that of the MBCA and should be employed in Indiana's revised statute. Under this standard, the director's good faith belief that he was acting in furtherance of the corporation's best interests will be irrelevant if he actually breached his fiduciary duty.

Moreover, integrity of corporate management is further encouraged under the New York BCL both by complete denial of indemnification for amounts paid in settlement and prohibition against an award of indemnity for even expenses in out-of-court settlement of derivative actions. The absence in the New York BCL of a clause permitting the court to award indemnification for expenses notwithstanding an adjudication of liability affords greater protection to shareholders and the public by enforcing a finding of misconduct. When these provisions are considered concurrently, their effect is to compel the utmost integrity from directors when acting within the scope of their fiduciary duty toward the shareholders and to award indemnification only to those directors entitled to protection.

The New York BCL is exemplary in the maintenance of a necessary distinction between third-party actions and derivative suits. The permissible extent of indemnification in third-party actions is defined as requiring the director to act in good faith and in a manner he reasonably believed to be in the best interests of the corporation. Requirement of the affirmative type of "good faith and reasonable belief" standard enumerated in the New York BCL should be employed by the Indiana legislators to preserve the necessary distinction between third-party actions and derivative suits while still providing the degree of integrity required for upholding the public trust.

Under the New York BCL, because investigative and administrative proceedings are not specifically covered, indemnity may not be awarded for directors involved in these types of actions. Given

286. Id. at (2).
287. MODEL BUSINESS CORP. ACT § 5(b) (1979); DEL. CODE ANN. tit. 8, § 145(b) (1974).
289. Id.
290. See supra notes 194-97 and accompanying text.
the frequency of SEC and various other investigative and administrative proceedings, indemnification protection is certainly indicated. In the Indiana statute, provision should be made for indemnification upon fulfillment of a pertinent standard of conduct in both administrative and investigative proceedings, in addition to the coverage of civil and criminal actions now afforded. The MBCA subsection 5(a) contains this provision, enabling indemnity for the worthy director in both.

The Indiana statute should be patterned after the New York BCL in another respect. New York's requirement of complete success for a finding of mandatory indemnification enforceable by court action is preferable to the MBCA allowance of mandatory partial indemnity for partial success. Presently, the Indiana statute does not address the possibility of partial success and consequent indemnification. Neither does the Indiana statute establish distinct procedures or guidelines for granting mandatory and permissive indemnity. In contrast to the desirable BCL mandatory indemnification provision, the procedural mechanism for determining the propriety of permissive indemnification is not worthy of imitation by Indiana in its effort to devise a fully comprehensive indemnification statute.

Both the New York BCL and the MBCA require that a director not wholly successful in his defense must obtain authorization by an impartial tribunal before receiving an award of indemnity. However, the entities designated in the statute cannot be fully impartial to the necessary degree. Therefore, to insure the impartiality of at least the outside independent counsel, guidelines should be utilized. By stating at least that legal counsel or a law firm engaged within the last five years by either an accused director or the corporation are not considered independent, some degree of impartiality is guaranteed. This statutory construction is therefore superior to the unrestrained ratification of regular outside counsel as "independent," which is possible under the MBCA and BCL.

Finally, New York's shareholder notice provision is yet another means of ensuring high standards of corporate integrity in its dealings with the public. In addition, New York's restrictive grant of the

293. Id. at (b).
295. Currently, Ohio uses an exemplary provision in this regard. See supra notes 147-49 and accompanying text.
297. N.Y. Bus. Corp. Law § 726(c) (McKinney).
power to purchase D & O insurance is essential to a fully effective statutory scheme creating maximum corporate accountability. Indiana currently utilizes an insurance provision identical to the MBCA in its unrestrained grant of power to purchase insurance. Revision of the Indiana Act to ensure some measure of integrity and corporate accountability would necessarily include enactment of provisions similar to the New York BCL in this regard. In order to effectuate the necessary reformation of Indiana’s indemnification statute, the substantive proposals advanced herein should be adopted. Such proposals, however, to achieve greatest impact, contemplate a new accountability scheme, one which recognizes the differing roles and responsibilities of corporate agents.

Virtually all contemporary indemnification statutes are applicable to “any person who is or was a director, officer, employee or agent” of the corporation. Even comprehensive statutory provisions, however, make no distinction between these agents of the corporation in terms of the scope of their agency. Modern corporations are comprised of assorted agents acting in diverse roles with varying degrees of responsibility. Cognizant of this reality, indemnification provisions should embody degrees of protection in accordance with the differing degrees of responsibility. Design of a statutory scheme establishing prerequisites for indemnification of agents according to the scope of their agency would be beneficial to all concerns. Such an accountability scheme would afford both optimal protection of the agent and protection of society from abuse of corporate power.

Pursuant to the dual goal of protection, and considering the realities of corporate governance, the agent’s function and access to information become important criteria in devising requisite standards of conduct. The primary decision-making unit of the corporation will, logically, be privy to vital information which is easily misused. Agents whose scope of responsibility entails much less access to information and reduced decision-making capacity are less able to misuse their limited power. Consequently, in contemplating a grant of indemnification for a corporate agent, the scope of his responsibility should be considered in ascertaining the requisite standard of conduct for indemnification.

298. IND. CODE § 23-1-2-2(b)(9).
299. MODEL BUSINESS CORP. ACT § 5(g) (1979).
300. See, e.g., MODEL BUSINESS CORP. ACT § 5(a) (1979); DEL. CODE ANN. tit. 8, § 145(a) (1974); IND. CODE § 23-1-2-2(b)(9).
301. See generally SCHAEFFLER, supra note 2, at 73.
Given these assumptions, it is necessary to establish finite limits within which the diverse corporate agents may function. In the majority of corporate governance structures, officers are the management entity responsible for the core decisions regarding corporate activity. They are given vast power and, concurrently, a wide scope of responsibility. The standard of conduct for officers should be stringent and accordingly reflect their greater responsibilities.

The role of corporate directors has, in recent years, been redefined as corporations engage more outside directors. In general, a director owes the duty of fiduciary care to the corporation. However, outside directors often serve the corporation in a more limited capacity than inside directors. Inside directors are involved in the day-to-day workings of the corporation and, consequently, have far greater access to more information. Outside directors are engaged primarily for their business expertise and impartial objectivity. They serve the corporation on a limited basis, often only attending board meetings several times per year, and are not possessed of a working knowledge of the corporation's daily affairs. Thus, it is imperative to acknowledge the disparity between potential for abuse of power by outside versus inside directors. Outside directors should be held to a lesser standard of conduct in ascertaining the propriety of indemnification.

In addition, distinction must be made in accordance with the scope of authority and possibilities for abuse of power inherent in the positions of employee/agent. An employee of lesser status who performs a limited function within the corporate structure and has minimal access to information does not present the threat to corporate accountability posed by high-ranking “insiders.” Thus, indemnification provisions must be made for such employees in terms of their limited sphere of control.

Ultimately, the responsibility for ensuring corporate accountability must exist in each director, officer and employee's explicit duty to the corporation. Fiduciary duties of loyalty, obedience and honesty

302. Id. at 75.
303. Id.
304. See generally COHEN AND LOEB, supra note 10. In a recent survey of over 1,000 major corporations, more than 60% had boards of directors in which outside directors constituted a majority. Id. at 13.
305. Outside directors often serve as “idea men,” specialists in their field, contributing their expertise to benefit the corporation.
306. SCHAFFTLE, supra note 2, at 74.
307. Id. at 8.
must be upheld by directors and officers.\textsuperscript{308} Employees must perform their duties with integrity and good faith. In recognizing the diversity which exists among corporate personnel and establishing requisite standards of conduct for a grant of indemnification protection in accordance with recognized diversity, the greatest benefit will emerge for individuals, the corporation, and society.

Indiana, now cognizant of the problems inherent in the construction of its indemnification statute, must initiate reforms to comply with current public policy which demands corporate accountability. To ensure fully comprehensive indemnification coverage for deserving directors and officers, distinction must be made between the various agents in the scope of their responsibilities. Within such a revised statutory scheme, corporate accountability to the degree demanded by society can be maintained.

**CONCLUSION**

Indemnification provisions of modern corporation laws were initially enacted amid rising fear of the great potential for personal liability often incurred by corporate directors. Protection for these invaluable overseers of the wealth of the nation’s corporations is a justifiable goal. In an effort to effectuate adequate protection for corporate directors, however, the majority of states have exceeded the limitation of traditional fiduciary notions. These states often allow indemnification in circumstances strongly indicative of director misconduct. The non-exclusive statute, coupled with a broad grant of authority to purchase indemnification insurance, affords virtually no assurance of corporate accountability to society. The Indiana statute is rendered essentially without value by the concurrent problem of its uncomprehensive scope and lack of clarity. Thus, reformation of the Indiana indemnification provision is imperative. Utilizing a framework distinguishing among agents of the corporation would provide the structure necessary for optimal protection of directors performing vital functions in modern corporations, as well as ensuring the necessary level of accountability to society.

*Heidi L. Ulrich*

\textsuperscript{308} See supra note 57.