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THE LAW OF CLOSELY HELD CORPORATIONS

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oppressive conduct[638]—particularly in circumstances where there is confusion about the capacity in which the defendant committed the oppressive actions.[639]

[7] Contractual Indemnification Rights

Indemnification statutes are typically interpreted as setting the outer limits on a corporation's power to indemnify.[640] Nevertheless, contractual indemnification provisions that are consistent with the substantive

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[638] *See* Section 7.01[D][1][b][i] (noting that some courts define oppression as "a visible departure from the standards of fair dealing and a violation of fair play on which every shareholder who entrusts his money to a [corporation] is entitled to rely"); note 639 and accompanying text; *cf.* Diamond v. Diamond, 120 N.E.2d 819, 820-21 (N.Y. 1954) (denying indemnification to a defendant who was sued as a director and officer of the company, in part because of a belief that it would be an unconscionable result for the corporation to pay the legal expenses of the defendant but not the plaintiff when both parties were shareholders of the company who "were equally guilty of flagrant and continued wrongdoing").

[639] In *Davis v. Sheerin*, 754 S.W.2d 375 (Tex. App. 1988), the court upheld the lower court's finding of oppression based on a number of jury determinations. The determinations included a finding that the 55% controlling shareholder had conspired with his wife to deny the plaintiff his 45% stock ownership in the company (by falsely asserting that the plaintiff had relinquished his stock as a gift), and a separate finding that the 55% controlling shareholder "wasted corporate funds by using them for [his] legal fees, and that this was a willful breach of fiduciary duty." *Id.* at 377, 382-83. The controlling shareholder was also a director and officer of the corporation. *See id.* at 377. The opinion does not indicate (and the court did not question) whether the jury's finding of waste was premised on (1) the ineligibility of the controlling shareholder for expense advancement because of "bad faith"; (2) the ineligibility of the controlling shareholder for expense advancement because he was not sued "by reason of the fact" that he was a director or officer; (3) a belief that the use of corporate monies to fund the defense (and only the defense) was wrongful in and of itself; or (4) some other reason. *Cf.* ARC Mfg. Co. v. Konrad, 467 A.2d 1133, 1135, 1137-38 (Pa. Super. Ct. 1983) (involving two shareholder-directors who were sued by a third shareholder for oppressive conduct and who incurred approximately $134,000 in legal costs and fees: "The Chancellor found that Trustorff and Feuchter [the two shareholder-directors] incurred approximately $134,000 in legal costs and fees but that only [illegible] was expended on activities which the two might [illegible]mpany's] best interests. The balance of the sum w[illegible]uchter's misconduct toward Konrad [the third share[illegible]rustorff and Feuchter, rather than [the company], to[illegible]

[640] *See, e.g.*, Model Bus. [illegible]ing that "the standards for indemnification of directors contained in this [permissive indemnification] subsection

policies underlying the indemnification statutes are permitted. For example, in *Waltuch v. Conticommodity Services, Inc.*,[641] Norton Waltuch argued that he did not have to meet the good faith requirement of the Delaware permissive indemnification statute because a provision of Conticommodity's articles of incorporation provided for indemnification with no good faith restriction.[642] The Second Circuit determined that contractual indemnification provisions "cannot be *inconsistent* with the substantive statutory provisions of the [indemnification statute]," and it concluded that an elimination of the good faith requirement "is inconsistent with [the statute] and thus exceeds the scope of a Delaware corporation's power to indemnify."[643] Significantly, the court also gave

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define the outer limits for which discretionary indemnification is permitted under the Model Act"); *id.* § 8.59 cmt. ("This subchapter is the exclusive source for the power of a corporation to indemnify or advance expenses to a director or an officer."); notes 641-45 and accompanying text.

[641] 88 F.3d 87 (2d Cir. 1996).

[642] *See Waltuch*, 88 F.3d at 89.

[643] *Waltuch*, 88 F.3d at 91, 95. In effect, this "consistency" conclusion is a judicial gloss on § 145(f) of the Delaware indemnification statute, *see Waltuch*, 88 F.3d at 91-95, as that section indicates that the statute's indemnification and advancement of expenses provisions "shall not be deemed exclusive of any other rights to which those seeking indemnification or advancement of expenses may be entitled under any bylaw, agreement, vote of stockholders or disinterested directors." DEL. CODE tit. 8, § 145(f); *see, e.g.*, Owens Corning v. Nat'l Union Fire Ins. Co., 257 F.3d 484, 494 (6th Cir. 2001) ("The requirement of good faith on the part of the directors indemnified under [the Delaware permissive indemnification provisions] is statutory . . . and cannot be waived by attempting to extend indemnification even further."); VonFeldt v. Stifel Fin. Corp., No. Civ. A. 15688, 1999 WL 413393, at *2 (Del. Ch. June 11, 1999) ("While § 145(f) permits indemnification on terms other than as set forth in the rest of § 145, such other indemnification must be consistent with the policies expressed in the other parts of § 145. . . . Albeit in dicta, this Court in *Mayer v. Executive Telecard, Ltd.*, [705 A.2d 220, 224 n.6 (Del. Ch. 1997)] expressly approved *Waltuch's* reasoning. It should now be clear that, as far as § 145 is concerned, Delaware corporations lack the power to indemnify a party who did not act in good faith or in the best interests of the corporation."); Mayer v. Executive Telecard, Ltd., 705 A.2d 220, 224 n.6 (Del. Ch. 1997) ("This Court agrees with the Second Circuit's construction of § 145 that a Delaware corporation lacks the power to indemnify a party who did not act in good faith."); *see also* TLC Beatrice Int'l Holdings, Inc. v. Cigna Ins. Co., No. 97-Civ. 8589 (MBM), 1999 WL 33454, at *4-7 (S.D.N.Y. Jan. 27, 1999) (noting that "Delaware law does not empower a corporation to indemnify directors for sums paid in settlement of a derivative suit," and concluding that contractual indemnification provisions authorizing such settlement payments are inconsistent with the statutory framework and invalid); *id.* at *4 (stating that "courts have established that a corporation's indemnification powers cannot be inconsistent with the substantive statutory provisions"); Waskel v. Guaranty

examples of contractual indemnification rights that are beyond those provided by the Delaware indemnification provisions, but that are nevertheless proper due to their consistency with the statute:

> [S]ubsection (f) [of the Delaware indemnification statute] provides general authorization for the adoption of various procedures and presumptions making the process of indemnification more favorable to the indemnitee. For example, indemnification agreements or by-laws could provide for: (i) mandatory indemnification unless prohibited by statute; (ii) mandatory advancement of expenses, which the indemnitee can, in many instances, obtain on demand; (iii) accelerated procedures for the "determination" required by section 145(d) to be made in the "specific case"; (iv) litigation "appeal" rights of the indemnitee in the event of an unfavorable determination; (v) procedures under which a favorable determination will be deemed to have been made under circumstances where the board fails or refuses to act; [and] (vi) reasonable funding mechanisms. . . . Moreover, subsection (f) may reference non-indemnification rights, such as advancement rights or rights to other payments from the corporation that do not qualify as indemnification.[644]

Nat'l Corp., 23 P.3d 1214, 1220 (Colo. Ct. App. 2000) ("While a corporation may grant indemnification rights broader than those provided by statute, such rights may not be inconsistent with the scope of the corporation's power to indemnify, as delineated in the statute's substantive provisions."); note 645 and accompanying text (discussing the Model Business Corporation Act); *cf.* N.Y. Bus. Corp. Law § 721 (allowing corporations to grant contractual indemnification rights, but explicitly stating that "no indemnification may be made . . . if a judgment or other final adjudication adverse to the director or officer establishes that his acts were committed in bad faith or were the result of active and deliberate dishonesty and 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"). *But see* B&B Inv. Club v. Kleinert's, Inc., 472 F. Supp. 787, 792-93 (E.D. Pa. 1979) (suggesting that a bylaw providing indemnification "to the fullest extent now or hereafter permitted by law" eliminated the need to establish that the good faith standard of the indemnification statute had been met); Wilshire-Doheny Assocs., Ltd. v. Shapiro, 100 Cal. Rptr. 2d 478, 490 (Cal. Ct. App. 2000) (suggesting that a showing of good faith was not necessary under a contractual indemnity agreement because the "agreement does not, by its terms, require a showing of good faith or success on the merits for it to be applicable," but not explicitly discussing whether a contractual elimination of the good faith requirement is permissible under the California indemnification statute).

[644] *Waltuch*, 88 F.3d at 94 (internal quotation omitted); *see* note 643 and accompanying text (discussing § 145(f) of the Delaware General Corporation Law and the "consistency" principle); *see also* Owens Corning v. Nat'l Union Fire Ins. Co., 257 F.3d 484, 495-96 (6th Cir. 2001) (concluding that "[i]t is not impermissible for a Delaware corporation to accord

The approach of the Model Business Corporation Act is similar. Although the commentary indicates that the subchapter "is the exclusive source for the power of a corporation to indemnify or advance expenses to a director or an officer," it also states that it "does not preclude provisions in articles of incorporation, bylaws, resolutions, or contracts designed to provide procedural machinery in addition to (but not inconsistent with) that provided by this subchapter."[645]

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a director seeking indemnification a rebuttable presumption of good faith," and stating that "when a corporation has extended indemnification to the maximum permissible extent . . . such a presumption may be applied"); *id.* at 496 (concluding that "good faith may be presumed under the expansive by-laws of [the corporation], even if the relevant determination [that the person meets the substantive requirements for indemnification] is not specifically made"); Homestore, Inc. v. Tafeen, 888 A.2d 204, 212 (Del. 2005) ("In addition to an express undertaking requirement, corporations may specify by bylaw or contract the terms and conditions upon which present and former corporate officials may receive advancement, *e.g.*, proof of an ability to repay or the posting of a secured bond."); *cf.* Chamison v. HealthTrust, Inc.—The Hospital Co., 735 A.2d 912, 919-20 & n.26 (Del. Ch. 1999) (involving a contractual indemnification provision that obligated the indemnitor to pay counsel fees, but only for counsel selected by the indemnitor: "[I]t is *not* clear to the Court that such a restriction would be necessarily consistent with the mandate of [the Delaware mandatory indemnification statute]. [There are] cases suggest[ing] that a counsel selection provision would be antithetical to the mandatory indemnification imposed by [the Delaware statute]. I need not reach this issue in this case, however." (citations omitted)).

[645] MODEL BUS. CORP. ACT § 8.59 cmt. As examples, the comment notes that "a corporation may properly obligate the board of directors to consider and act expeditiously on an application for indemnification or advance for expenses or to cooperate in the procedural steps required to obtain a judicial determination." *Id.*

Interestingly, the Model Business Corporation Act does allow a corporation to avoid the good faith and other substantive requirements of the permissive indemnification statute through a provision in the articles of incorporation. *See id.* § 8.51(a)(2). Under such a provision, a corporation is prohibited from indemnifying only the following liabilities: (1) liability for receipt of a financial benefit to which the indemnitee is not entitled; (2) liability for an intentional infliction of harm on the corporation or the shareholders; (3) liability for unlawful distributions; and (4) liability for an intentional violation of criminal law. *See id.* §§ 2.02(b)(5), 8.51(a)(2). If particular bad faith conduct does not fall within one of these categories, it would be eligible for indemnification under § 8.51(a)(2). Given the breadth of these categories, however, this point is likely more theoretically interesting than practically significant.

Similarly, with respect to an officer (or a director who is sued solely in his capacity as an officer), the good faith and other substantive requirements of the permissive indemnification statute can be avoided by a provision in the articles of incorporation, the bylaws, a board resolution, or a contract. *See id.* § 8.56(a)(2), (b). Under such a provision, a corporation is prohibited from indemnifying only the following liabilities: (1) liability in

A contractual indemnification provision that is often encountered is a corporation obligating itself in advance to provide indemnification through a provision in its articles or bylaws.[646] For example, language similar to "the corporation shall, to the full extent permitted by applicable law, indemnify any incumbent or former director or officer" is relatively commonplace.[647] The Model Business Corporation Act makes clear that

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connection with a proceeding by or in the right of the corporation (other than for reasonable expenses incurred in connection with the proceeding); (2) liability for the officer's receipt of a financial benefit to which he is not entitled; (3) liability for an intentional infliction of harm on the corporation or the shareholders; and (4) liability for an intentional violation of criminal law. *See id.*

For examples of other statutes that authorize contractual indemnification provisions, see, e.g., CAL. CORP. CODE § 317(g); N.Y. BUS. CORP. LAW § 721; TEX. BUS. ORGS. CODE § 8.004 (explicitly requiring consistency with the indemnification statutes).

[646] *See, e.g.*, DEL. CODE tit. 8, § 145(f); MODEL BUS. CORP. ACT § 8.58 ("A corporation may, by a provision in its articles of incorporation or bylaws or in a resolution adopted or a contract approved by its board of directors or shareholders, obligate itself in advance of the act or omission giving rise to a proceeding to provide indemnification in accordance with section 8.51 [permissive indemnification] or advance funds to pay for or reimburse expenses in accordance with section 8.53."); *see also* note 645 (discussing the ability, under the Model Business Corporation Act, to provide broader indemnification rights through a provision in the articles of incorporation).

For a discussion of whether a covered person is entitled to indemnification for his fees incurred in bringing an action to enforce his contractual indemnification rights (so-called "fees on fees"), see notes 623-26 and accompanying text.

[647] *See, e.g.*, *In re* Miller, 290 F.3d 263, 267 (5th Cir. 2002); Waltuch v. Conticommodity Services, Inc., 88 F.3d 87, 88-89, 92 (2d Cir. 1996); Ridder v. CityFed Fin. Corp., 47 F.3d 85, 86-87 (3d Cir. 1995); Heffernan v. Pac. Dunlop GNB Corp., 965 F.2d 369, 371-72 (7th Cir. 1992); First Chicago Int'l v. United Exch. Co., 125 F.R.D. 55, 59 (S.D.N.Y. 1989); Waskel v. Guaranty Nat'l Corp., 23 P.3d 1214, 1217-18 (Colo. Ct. App. 2000); Homestore, Inc. v. Tafeen, 888 A.2d 204, 206-07, 212 (Del. 2005); Stifel Fin. Corp. v. Cochran, 809 A.2d 555, 557 (Del. 2002); VonFeldt v. Stifel Fin. Corp., 714 A.2d 79, 81 & n.4 (Del. 1998); Hibbert v. Hollywood Park, Inc., 457 A.2d 339, 341 n.1 (Del. 1983); Fasciana v. Elec. Data Sys. Corp., 829 A.2d 178, 182 (Del. Ch. 2003); Mayer v. Executive Telecard, Ltd., 705 A.2d 220, 223-24 (Del. Ch. 1997); Biondi v. Beekman Hill House Apartment Corp., 731 N.E.2d 577, 580 n.2 (N.Y. 2000); Neal v. Neumann Med. Ctr., 667 A.2d 479, 480 (Pa. Commw. Ct. 1995); note 649 and accompanying text; *cf.* Mitrano v. Total Pharm. Care, Inc., 75 F.3d 72, 73, 75 (1st Cir. 1996) (awarding prejudgment interest to an officer who was entitled to indemnification (via a bylaw) for his attorney's fees, and concluding that the interest accrued from when the officer actually paid the fees).

A corporation obligating itself in advance to provide expense advancement is also relatively common. *See, e.g.*, DEL. CODE tit. 8, § 145(e), (f); Ridder v. CityFed Fin. Corp., 47 F.3d 85, 86-87 (3d Cir. 1995); Heffernan v. Pac. Dunlop GNB Corp., 965 F.2d 369, 371 n.2 (7th Cir. 1992); Homestore, Inc. v. Tafeen, 888 A.2d 204, 206-07, 212 (Del. 2005);

this obligatory language satisfies the "authorization" requirement of the permissive indemnification statute, but the "determination" requirement of the statute (i.e., ensuring that the person is eligible for indemnification) must still be met.[648] In effect, such language makes indemnification mandatory in circumstances where it would otherwise be permissible

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Fasciana v. Elec. Data Sys. Corp., 829 A.2d 178, 182 (Del. Ch. 2003); Neal v. Neumann Med. Ctr., 667 A.2d 479, 480-81 (Pa. Commw. Ct. 1995); MODEL BUS. CORP. ACT § 8.58 & cmt.; *id.* § 8.53 & cmt. ("[M]any corporations enter into contractual obligations . . . to advance funds for directors' expenses. . . . However, any such obligatory arrangement must comply with the requirements . . . regarding furnishing of an affirmation and undertaking."); note 649 and accompanying text; *see also Ridder*, 47 F.3d at 86-88 (concluding that appellants were entitled to have their costs of defense advanced to them as a matter of law when a bylaw obligating the corporation to advance expenses was present); Neal v. Neumann Med. Ctr., 667 A.2d 479, 481-82 (Pa. Commw. Ct. 1995) (concluding that a contractual provision making advancement of expenses mandatory does not conflict with the directors' duty to act in a corporation's best interests, and disagreeing with authority to the contrary (citing Fidelity Fed. Sav. & Loan Ass'n v. Felicetti, 830 F. Supp. 262 (E.D. Pa. 1993))); *cf. Homestore, Inc.*, 888 A.2d at 217-18 ("[A]ll contracts providing for the advancement of expenses are implicitly limited to those that are reasonably incurred.").

[648] *See, e.g.*, MODEL BUS. CORP. ACT § 8.58(a) & cmt. ("[This section] authorizes a corporation to make obligatory permissive provisions of [the indemnification statutes] in advance of the conduct giving rise to the request for assistance. Many corporations have adopted such provisions. . . . An obligatory provision satisfies the requirements for authorization . . . but compliance would still be required with [the determination provisions] of these sections."); *id.* § 8.55 cmt. ("A pre-existing obligation . . . to indemnify if the director is eligible for indemnification dispenses with the second-step decision to 'authorize' indemnification."); *see also* DEL. CODE tit. 8, § 145(d), (f) (providing "authorization" and "determination" requirements for permissive indemnification, but also allowing contractual indemnification rights to be enforced); Advanced Mining Sys., Inc. v. Fricke, 623 A.2d 82, 83 (Del. Ch. 1992) (implying that an obligatory indemnification provision satisfies the statutory "authorization" requirement but does not eliminate the need to determine that the person has met the substantive requirements for indemnification: "While the permissive authority to indemnify its directors, officers, etc., may be exercised by a corporation's board of directors on a case-by-case basis, in fact most corporations and virtually all public corporations have by bylaw exercised the authority recognized by Section 145 so as to mandate the extension of indemnification rights *in circumstances in which indemnification would be permissible under Section 145.*" (emphasis added)); Section 6.09[A][4][b] (discussing the procedural "authorization" and "determination" requirements for permissive indemnification). *But see* B&B Inv. Club v. Kleinert's, Inc., 472 F. Supp. 787, 792-93 (E.D. Pa. 1979) (suggesting that a bylaw providing indemnification "to the fullest extent now or hereafter permitted by law" obviated the need to meet the statutory "authorization" and "determination" requirements).

under the statute.[649] In addition, the Model Act provides that language obligating the corporation to provide indemnification to the fullest extent permitted by law also obligates the corporation to advance expenses to the

[649] *See, e.g.*, Owens Corning v. Nat'l Union Fire Ins. Co., 257 F.3d 484, 494 (6th Cir. 2001) ("It is common for corporations to adopt through their by-laws a requirement that they must (as opposed to may) reimburse directors for their costs."); Homestore, Inc. v. Tafeen, 888 A.2d 204, 212 (Del. 2005) (noting that "mandatory advancement provisions are set forth in a great many corporate charters, bylaws and indemnification agreements"); Advanced Mining Sys., Inc. v. Fricke, 623 A.2d 82, 83 (Del. Ch. 1992) ("While the permissive authority to indemnify its directors, officers, etc., may be exercised by a corporation's board of directors on a case-by-case basis, in fact most corporations and virtually all public corporations have by by-law exercised the authority recognized by [the indemnification statute] so as to mandate the extension of indemnification rights in circumstances in which indemnification would be permissible under [the indemnification statute]"); Merritt-Chapman & Scott Corp. v. Wolfson, 321 A.2d 138, 142 (Del. Super. Ct. 1974) (noting that "a corporation may pass a by-law making mandatory the provision for permissive indemnification"); *see also* VonFeldt v. Stifel Fin. Corp., 714 A.2d 79, 81 n.5 (Del. 1998) (noting that "'[v]irtually all' public corporations have extended indemnification guarantees via bylaw to cases where indemnification is typically only permissive"); *cf. id.* at 85-86 ("Stifel Financial is liable in this case only because it voluntarily extended its indemnification duties to cover circumstances where indemnification is permissive by default. [The permissive indemnification provision] does not oblige Delaware corporations to indemnify those who serve other enterprises at their request. If a corporation wishes not to extend indemnification rights to those who serve elsewhere at its request, it can say so in its bylaws, or it can say nothing at all, thereby achieving the same result.").

In *Chamison v. HealthTrust, Inc.—The Hospital Co.*, 735 A.2d 912 (Del. Ch. 1999), a contractual indemnification provision obligated HealthTrust to indemnify Chamison for his attorney's fees, provided that Chamison used counsel selected by HealthTrust. *See id.* at 920. Chamison ultimately used counsel that HealthTrust did not select, and he sued to recover his attorney's fees. The court determined that HealthTrust acted unreasonably in attempting to compel Chamison to use attorneys that were raising "markedly inferior" defenses, and in suggesting alternative counsel too late in the proceedings. *See id.* at 922-23; *id.* ("HealthTrust's right to select Chamison's defense counsel cannot be construed so broadly as to permit it to force clearly inferior representation upon Chamison."). As a result, the court concluded that the use of "unapproved" counsel did not excuse HealthTrust from its contractual obligation to pay Chamison's attorney's fees. *See id.* at 923.

The *Chamison* court also determined that, because HealthTrust and Tenet had both contractually obligated themselves to indemnify Chamison for his attorney's fees, they were "equally responsible" for the fees. *Id.* at 925. The court concluded that "a right of contribution among §145 co-indemnitors exists under Delaware law and ought to be recognized, especially in this instance where one co-indemnitor acted inequitably," and it ordered HealthTrust to reimburse Tenet for half the costs Tenet paid in defending Chamison. *Id.* at 926, 930.

fullest extent permitted by law, unless the provision specifically provides otherwise.[650] The Delaware courts have reached the opposite conclusion.[651]

Most corporations seek to provide the broadest possible indemnification to encourage persons to serve as directors and officers. Some corporations, however, may wish to restrict indemnification rights due to concerns over the financial position of the corporation or other factors. Such restrictions would seem to be permissible, and some indemnification statutes expressly authorize them.[652]

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[650] *See* MODEL BUS. CORP. ACT § 8.58(a); *accord* CONN. GEN. STAT. § 33-778(a).

[651] *See, e.g.*, Advanced Mining Sys., Inc. v. Fricke, 623 A.2d 82, 84-85 (Del. Ch. 1992) (concluding that a general obligatory provision requiring indemnification to the extent permitted by law does not include the obligation to advance expenses unless that obligation is specifically mentioned).

[652] *See, e.g.*, MODEL BUS. CORP. ACT § 8.58(c) ("A corporation may, by a provision in its articles of incorporation, limit any of the rights to indemnification or advance for expenses created by or pursuant to this subchapter."); *see also* CAL. CORP. CODE § 317(h)(1) (stating that no permissive indemnification or advance shall be made "where it appears . . . [t]hat it would be inconsistent with a provision of the articles, bylaws, a resolution of the shareholders, or an agreement . . . which prohibits or otherwise limits indemnification"); CONN. GEN. STAT. § 33-778(c) ("A corporation may, by a provision in its certificate of incorporation, limit any of the rights to indemnification or advance for expenses created by or pursuant to [the indemnification statutes]."); N.Y. BUS. CORP. LAW § 725(b)(2) (stating that "[n]o indemnification, advancement or allowance shall be made under [any of the indemnification statutes] in any circumstance where it appears . . . [t]hat 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 proper corporate action . . . which prohibits or otherwise limits indemnification"); TEX. BUS. ORGS. CODE § 8.003(a) (stating that "[t]he certificate of formation of an enterprise may restrict the circumstances under which the enterprise must or may indemnify or may advance expenses to a person under this chapter"). *But cf.* Chamison v. HealthTrust, Inc.—The Hospital Co., 735 A.2d 912, 919-20 & n.26 (Del. Ch. 1999) (involving a contractual indemnification provision that obligated the indemnitor to pay counsel fees, but only for counsel selected by the indemnitor: "[I]t is *not* clear to the Court that such a restriction would be necessarily consistent with the mandate of [the Delaware mandatory indemnification statute]. [There are] cases suggest[ing] that a counsel selection provision would be antithetical to the mandatory indemnification imposed by [the Delaware statute]. I need not reach this issue in this case, however." (citations omitted)).

[B] Insurance for Directors and Officers

Corporation statutes often expressly authorize a corporation's purchase of liability insurance for its directors, officers, employees, and other agents (often called "D&O insurance").[653] The statutes also commonly provide that the insurance may cover acts that the corporation would not have the power to indemnify,[654] although most policies exclude coverage for the same type of conduct that renders a person ineligible for indemnification.[655]

One fairly standard D&O insurance policy covers any loss arising from "any actual or alleged breach of duty, neglect or error by or accountability of" the directors or officers or "any actual or alleged misstatement, misleading statement or other act or omission" by the directors or officers "in their respective capacities as" directors or officers.[656] The insurance policy covers direct losses on the part of directors and officers, as well as losses to the corporation for indemnifying the directors and officers.[657]

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[653] *See, e.g.*, CAL. CORP. CODE § 317(i); CONN. GEN. STAT. § 33-777; DEL. CODE tit. 8, § 145(g) (authorizing a corporation's purchase of 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"); MASS. GEN. LAWS ch. 156B, § 67; N.Y. BUS. CORP. LAW § 726; TEX. BUS. ORGS. CODE § 8.151; WYO. STAT. § 17-16-857; MODEL BUS. CORP. ACT § 8.57 (authorizing a corporation's purchase of insurance "on behalf of an individual who is a director or officer of the corporation, or who, while a director or officer of the corporation, serves at the corporation's request as a director, officer, partner, trustee, employee, or agent of another domestic or foreign corporation, partnership, joint venture, trust, employee benefit plan, or other entity").

[654] *See, e.g.*, CAL. CORP. CODE § 317(i); CONN. GEN. STAT. § 33-777; DEL. CODE tit. 8, § 145(g) (authorizing a corporation's purchase of insurance for a person "whether or not the corporation would have the power to indemnify such person against such liability"); MASS. GEN. LAWS ch. 156B, § 67; N.Y. BUS. CORP. LAW § 726(a); TEX. BUS. ORGS. CODE § 8.151; WYO. STAT. § 17-16-857; MODEL BUS. CORP. ACT § 8.57 (authorizing a corporation's purchase of insurance for a person "whether or not the corporation would have power to indemnify or advance expenses to him against the same liability").

[655] *See* note 658 and accompanying text (discussing exclusions in D&O policies); *see also* Section 6.09[A][4][c] (discussing impermissible indemnification).

[656] Joseph Hinsey, *The New Lloyd's Policy Form For Directors and Officers Liability Insurance—An Analysis*, 33 BUS. LAW. 1961, 1967 (1978).

[657] *See* Hinsey, *supra* note 656, at 1962-63; *see also* Owens Corning v. Nat'l Union Fire Ins. Co., 257 F.3d 484, 489 (6th Cir. 2001) (noting that the policy insured Owens Corning for "expenses incurred when Owens Corning indemnified its directors and

Although such a coverage clause is extremely broad, it is usually subject to substantial exclusions. Typical exclusions include the following: (a) losses that are reimbursed under other insurance policies; (b) violations of environmental pollution regulations; (c) violations of the Employee Retirement Income Security Act; (d) libel or slander; (e) losses resulting from a failure to procure or maintain insurance; (f) acts involving an illegal personal profit; (g) acts committed with dishonesty or in bad faith; and (h) losses arising from any claim against a director or officer for the return of remuneration that is determined to have been paid illegally, or that must be repaid to the company under a settlement agreement.[658] Given these exclusions, D&O insurance is most useful in

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officers against certain liabilities"); TLC Beatrice Int'l Holdings, Inc. v. Cigna Ins. Co., No. 97-Civ. 8589 (MBM), 1999 WL 33454, at *3 (S.D.N.Y. Jan. 27, 1999) (describing the insurance policy at issue and noting that it provided coverage for "direct claims by the insured directors and officers, or . . . claims by the company seeking reimbursement for indemnification it provided to its directors").

[658] *See* Hinsey, *supra* note 656, at 1968-72; Int'l Ins. Co. v. Johns, 874 F.2d 1447, 1452, 1455 (11th Cir. 1989) (discussing "illegal remuneration" and "illegal personal gain" exclusions); *see also* Joseph P. Monteleone & John F. McCarrick, *Directors' and Officers' Liability: A D&O Policy Road Map: The Coverage Exclusions*, 7 No. 7 Insights 8, 9-11 (1993) (stating that some of the more common exclusions in D&O policies include the following: (1) exclusion for personal profit or advantage to which the person was not legally entitled; (2) dishonesty exclusion; (3) bodily injury/property damage exclusion; (4) ERISA exclusion; (5) section 16(b) ("short-swing profit") exclusion; (6) return of illegal remuneration exclusion; (7) pollution exclusion; (8) insured v. insured exclusion; and (9) claims which may be covered under other insurance policies exclusion); MODEL BUS. CORP. ACT § 8.57 cmt. (noting that "policies typically do not cover uninsurable matters, such as actions involving dishonesty, self-dealing, bad faith, knowing violations of the securities acts, or other willful misconduct"). For further detail, consider the following:

> There are generally three categories of exclusions in D&O policies. "Conduct" exclusions seek to eliminate coverage for certain conduct which is deemed to be sufficiently selfserving or egregious that insurance protection is considered inappropriate. The personal profit and advantage, dishonesty, remuneration, and §16(b) exclusions are examples. The "other insurance" category of exclusions implements the concept that the D&O policy is the ultimate "backstop" protection for directors and officers. If a corporation can purchase another type of insurance to cover a specific D&O risk, the D&O insurer expects that other insurance to be purchased and

protecting directors and officers from the financial consequences of violating the duty or care or other negligence or strict liability standards (so long as the directors or officers do not make an illegal profit).

therefore the D&O policy will not cover that risk. Examples of exclusions in this category include the exclusions for bodily injury/property damage, ERISA, libel and slander, notice under a prior policy and (at least historically) pollution. Finally, the "laser" exclusions are intended to address specific risks unique to the insured corporation which the insurer has identified as inconsistent with its underwriting principles.

Monteleone & McCarrick, *supra*, at 8.

Figure 6.1

CONFLICT OF INTEREST TRANSACTIONS: DIRECTOR AUTHORIZATION

State	Statutory Provisions	Language Concerning Director Authorization
Alabama	ALA. CODE §§ 10-2B-8.60 to 8.63	Conflict transaction approved if it "received the affirmative vote of a majority (but no fewer than two) of those qualified directors on the board of directors or on a duly empowered committee of the board . . . provided that action by a committee is to be effective only if (1) all its members are qualified directors, and (2) its members are either all the qualified directors on the board or are appointed by the affirmative vote of a majority of the qualified directors on the board." "A majority (but no fewer than two) of all the qualified directors on the board of directors, or on the committee, constitutes a quorum. . . ."
Alaska	ALASKA STAT. § 10.06.478	Conflict transaction approved if the "board authorizes, approves, or ratifies the contract or transaction in good faith by a sufficient vote without counting the vote of the interested director or directors. . . ." "Interested or common directors may be counted in determining the presence of a quorum at a meeting of the board that authorizes, approves, or ratifies a contract or transaction."
Arizona	ARIZ. REV. STAT. §§ 10-860 to 863	Conflict transaction approved "if the transaction received the affirmative vote of a majority, but at least two, of those qualified directors on the board of directors or on a duly empowered committee of the board. . . . Action by a committee is effective under this section only if both: (1) [a]ll of its members are qualified directors [and] (2) [m]embers are either all of the qualified directors on the board or are appointed by the affirmative vote of a majority of the qualified directors on the board."

Figure 6.1 *(Cont.)*

State	Statutory Provisions	Language Concerning Director Authorization
		"A majority, but at least two, of all of the qualified directors on the board of directors or on the committee is a quorum. . . ."
Arkansas	ARK. CODE § 4-27-831	"[A] conflict of interest transaction is authorized, approved, or ratified if it receives the affirmative vote of a majority of the directors on the board of directors (or on the committee) who have no direct or indirect interest in the transaction, but a transaction may not be authorized, approved, or ratified under this section by a single director. If a majority of the directors who have no direct or indirect interest in the transaction vote to authorize, approve, or ratify the transaction, a quorum is present for the purpose of taking action under this section."
California	CAL. CORP. CODE § 310	Conflict transaction approved if "the board or committee authorizes, approves or ratifies the contract or transaction in good faith by a vote sufficient without counting the vote of the interested director or directors. . . ." "Interested or common directors may be counted in determining the presence of a quorum at a meeting of the board or a committee thereof which authorizes, approves or ratifies a contract or transaction." Special provision for board approval of loans and guarantees for directors, officers, and employees. CAL. CORP. CODE § 315.
Colorado	COLO. REV. STAT. § 7-108-501	Conflict transaction approved if "the board of directors or committee in good faith authorizes, approves, or ratifies the conflicting interest transaction by the affirmative vote of a majority of the disinterested directors, even though the disinterested directors are less than a quorum. . . ."

Figure 6.1 *(Cont.)*

State	Statutory Provisions	Language Concerning Director Authorization
		"Common or interested directors may be counted in determining the presence of a quorum at a meeting of the board of directors or of a committee which authorizes, approves, or ratifies the conflicting interest transaction."
Connecticut	CONN. GEN. STAT. § 33-781 to 784	Conflict transaction is approved "if the transaction has been authorized by the affirmative vote of a majority, but no fewer than two, of the qualified directors . . . provided that where the action has been taken by a committee, all members of the committee were qualified directors, and either (1) the committee was composed of all the qualified directors on the board of directors, or (2) the members of the committee were appointed by the affirmative vote of a majority of the qualified directors on the board." "A majority, but no fewer than two, of all the qualified directors on the board of directors, or on the committee, constitutes a quorum. . . ."
Delaware	DEL. CODE tit. 8, § 144	Conflict transaction approved if "the board or committee in good faith authorizes the contract or transaction by the affirmative votes of a majority of the disinterested directors, even though the disinterested directors be less than a quorum. . . ." "Common or interested directors may be counted in determining the presence of a quorum at a meeting of the board of directors or of a committee which authorizes the contract or transaction."
Florida	FLA. STAT. § 607.0832	Conflict transaction approved if the "board of directors or committee . . . authorizes, approves, or ratifies the contract or transaction by a vote or consent sufficient for the purpose without counting the votes or consents of such interested directors. . . ."