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CORPORATIONS-INDEMNIFICATION OF MANAGEMENT FOR LITIGATION EXPENSES

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COMMENTS

CORPORATIONS—INDEMNIFICATION OF MANAGEMENT FOR LITIGATION EXPENSES—Two recent decisions concerning the right of a successful director-defendant to seek corporate indemnification for litigation expenses are significant because they interpret not only the relevant statutes of New York¹ and Delaware,² but also language which

¹ 22 N.Y. Consol. Laws (McKinney, 1943, 1953 Cum. Supp.) §§64-68.

² Del. Code Ann. (1953) tit. 8, §122(10).

exists in the statutes of several other states and which as yet has not been construed by the courts of those states. These cases indicate the desirability of a general survey of such indemnification practice at common law and under statutes.³

In *Schwartz v. General Aniline & Film Corp.*⁴ a grand jury had indicted individually the corporation and other defendants, including the petitioner, for alleged violations of section one of the Sherman Antitrust Act.⁵ Petitioner, who was then a vice-president and director of the corporation, pleaded not guilty. The United States subsequently indicated its willingness to permit petitioner to plead *nolo contendere*. On the advice of his attorney that the probable fine would be small and that the savings in litigation expenses would be great, petitioner pleaded *nolo contendere* and was fined \$500 by the court. Petitioner then brought proceedings under article 6-A of the New York General Corporation Law for reimbursement of his expenses by the corporation. The New York Court of Appeals held that the legislature, in enacting article 6-A, did not intend to provide reimbursement to anyone for his attorneys' fees in a criminal cause against him, and that the language "any action, suit or proceeding"⁶ did not include a criminal action.

In *Mooney v. Willys-Overland Motors, Inc.*,⁷ a minority stockholder had commenced an action against the corporation and others, including the plaintiff, who was then the president and a director of the corporation. The complaint had alleged that the president and two others held a controlling interest in the corporation and had conspired with the board of directors to waste the corporation's assets in several specific instances of wrongdoing. The plaintiff was not served with process, but he retained an attorney with the intention of entering an appearance in order to protect his reputation, although he was later dissuaded from entering such an appearance. In the case of all the charges but one, which was later withdrawn, the plaintiff either had

³ On the general subject see WASHINGTON, CORPORATE EXECUTIVES' COMPENSATION, cc. 17-20 (1942); Washington, "Litigation Expenses of Corporate Directors in Stockholders' Suits," 40 COL. L. REV. 431 (1940); STEVENS, CORPORATIONS, 2d ed., §174 (1949); Ballantine, "California's 1943 Statute as to Directors' Litigation Expenses," 31 CALIF. L. REV. 515 (1943); Hornstein, "Directors' Expenses in Stockholders' Suits," 43 COL. L. REV. 301 (1943); Bates and Zuckert, "Directors' Indemnity: Corporate Policy or Public Policy?" 20 HARV. BUS. REV. 244 (1942) (concerning bylaw agreements); Jervis, "Corporate Agreements to Pay Directors' Expenses in Stockholders' Suits," 40 COL. L. REV. 1192 (1940). See also Douglas, "Directors Who Do Not Direct," 47 HARV. L. REV. 1305 (1934).

⁴ 305 N.Y. 395, 113 N.E. (2d) 533 (1953).

⁵ 26 Stat. L. 209 (1890), 15 U.S.C. (1946) §1.

⁶ 22 N.Y. Consol. Laws (McKinney, 1943, 1953 Cum. Supp.) §64.

⁷ (3d Cir. 1953) 204 F. (2d) 888.

not begun his employment with the corporation at the time of the alleged wrong, or had disqualified himself from voting on the question because of his interest in the subject matter of the vote. The stockholder's complaint was dismissed on the merits and the plaintiff instituted an action against the corporation for reimbursement, basing his claim both on a contract for reimbursement between himself and the corporation, and on a corporation bylaw adopted pursuant to the Delaware indemnification statute.⁸ The United States Court of Appeals for the Third Circuit upheld the claim for reimbursement on both grounds in the alternative. As to the cause of action based upon the bylaw and the statute, the court held that by the language of the stockholder's complaint the plaintiff was sued both as a director and as a controlling stockholder, and not merely as the latter;⁹ that indemnification should not be withheld where the director had not in fact taken the action with which he was charged (he had disqualified himself from voting on the act in question because by law he was forbidden to participate in such a vote); and that indemnity should not be limited to those cases where the director actually makes an appearance in the proceedings.¹⁰

I. *Indemnification Prior to Statutes*

Only a handful of cases present squarely the question of a director's right to indemnity from the corporation for litigation expenses in the absence of an indemnification statute, and most of these cases concern stockholders' derivative suits. With respect to the unsuccessful director-defendant the answer is simple: there is neither reason nor authority for requiring a corporation to underwrite the defense of its delinquent fiduciary,¹¹ except possibly where the director's defense,

⁸ Del. Code Ann. (1953) tit. 8, §122(10). This is the first case decided under this statute.

⁹ Both the statute, *ibid.*, and the bylaw, *Mooney v. Willys-Overland Motors, Inc.*, (3d Cir. 1953) 204 F. (2d) 888 at 891, n. 5, required the director or officer to have been made a party to the suit *by reason of* his being or having been a director or officer of the corporation.

¹⁰ The Delaware statute, Del. Code Ann. (1953) tit. 8, §122(10), required the expenses to have been "actually and necessarily incurred . . . in connection with the defense" of the original action; and the bylaw, *Mooney v. Willys-Overland Motors, Inc.*, (3d Cir. 1953) 204 F. (2d) 888 at 891, n. 5, required them to have been "reasonably incurred . . . in connection with or arising out of" the original action.

¹¹ *WASHINGTON, CORPORATE EXECUTIVES' COMPENSATION* 344 (1942), citing *Wickersham v. Crittenden*, 106 Cal. 329, 39 P. 603 (1895); *McConnell v. Combination M. & M. Co.*, 31 Mont. 563, 79 P. 248 (1905); *McCourt v. Singers-Bigger*, (8th Cir. 1906) 145 F. 103; *Chabot & Richard Co. v. Chabot*, 109 Me. 403, 84 A. 892 (1912); *General Mortgage & Loan Corp. v. Guarantee Mortgage & Sec. Corp.*, 264 Mass. 253, 162 N.E. 319 (1928). See also *Hollander v. Breeze Corp.*, 131 N.J. Eq. 585, 26 A. (2d) 507 (1941), *affd. per curiam*, 131 N.J. Eq. 613, 26 A. (2d) 522 (1942).

even though unsuccessful, has substantially benefitted the corporation.¹²

Where a director is successful in his defense and seeks reimbursement, the answer has not been so certain, although the tendency has been to allow reimbursement. The first case directly in point was *Figge v. Bergenthal*,¹³ decided in 1906. There, in a statutory action something like a derivative suit, the directors were charged with fraud and misapplication of funds. The directors were successful in their defense,¹⁴ and the Wisconsin Supreme Court held simply that it was not improper or unjust for the corporation to pay for the defense of the action.¹⁵ In *Jesse v. Four-Wheel Drive Auto Co.*,¹⁶ decided by the same court sixteen years later, a stockholder had sued the directors in an action grounded upon a fraudulent conspiracy to induce stockholders to sell their stock to the directors at a price below its true value. This was not a derivative suit, the corporation was not even a nominal party, and the attack was not on anything done by the director-defendants as directors. In these circumstances the Wisconsin Supreme Court held that the corporation could not reimburse the directors whether or not they were successful.¹⁷ The *Jesse* case could hardly be said to have overruled the *Figge* case because of the substantial difference in facts.¹⁸ An Ohio appellate court, however, assumed the contrary and in partial

¹² See *Godley v. Crandall & Godley Co.*, 181 App. Div. 75, 168 N.Y.S. 251 (1917), *affd.* without opinion 227 N.Y. 656, 126 N.E. 908 (1920). Where the interests of the corporation are involved so as to make defense of the action of special benefit to it, the litigation expenses may be paid by the corporation. *Esposito v. Riverside Sand & Gravel Co.*, 287 Mass. 185, 191 N.E. 363 (1934); *Albrecht, Maguire & Co. v. General Plastics, Inc.*, 256 App. Div. 134, 9 N.Y.S. (2d) 415, *affd.* without opinion 280 N.Y. 840, 21 N.E. (2d) 887 (1939); *Kanneberg v. Evangelical Creed Congregation*, 146 Wis. 610, 131 N.W. 353 (1911). As to the corporation's right to take an active part in the defense of a derivative suit, see WASHINGTON, CORPORATE EXECUTIVES' COMPENSATION, c. 16 (1942). See also *Hornsby v. Lohmeyer*, 364 Pa. 271, 72 A. (2d) 294 (1950); *Blish v. Thompson Automatic Arms Corp.*, 30 Del. Ch. 538, 64 A. (2d) 581 at 607 (1948).

¹³ 130 Wis. 594, 109 N.W. 581 (1906).

¹⁴ The court found that some of the transactions had been barred by the statute of limitations, others had been authorized by all the stockholders, and the remainder had been carried out in good faith. *Figge v. Bergenthal*, 130 Wis. 594 at 625, 109 N.W. 581 (1906).

¹⁵ The decision on this point occupied only a few lines out of a lengthy opinion, and no cases were cited. *Ibid.* That the defendant-directors had obtained a stockholders' resolution during the course of the trial authorizing corporate indemnification of the directors for their attorneys' fees is a factor which may weaken the case as precedent, although this was not mentioned in the court's opinion. *Id.* at 608.

¹⁶ 177 Wis. 627, 189 N.W. 276 (1922).

¹⁷ This is in accord with the line of authority which holds that an agent, trustee, corporate director or officer may not pay his own debt out of the funds of his principal, cestui or corporation. See *Kenyon Realty Co. v. National Deposit Bank*, 140 Ky. 133, 130 S.W. 965 (1910); *In re George Newman & Co.*, [1895] 1 Ch. 674.

¹⁸ See WASHINGTON, CORPORATE EXECUTIVES' COMPENSATION 337 (1942).

reliance upon this determination held in *Griese v. Lang*¹⁹ that directors who had successfully defended themselves in a stockholders' derivative suit could not be indemnified for their expenses by the corporation. The court also relied upon the fact that there was no allegation of benefit to the corporation, and although the court gave the directors leave to amend their pleadings to show such benefit there is no indication of what kind of benefit to the corporation the court had in mind.²⁰

The leading case denying indemnification to a successful director-defendant is *New York Dock Company, Inc. v. McCollom*,²¹ decided by a lower New York court in 1939. A stockholder had brought a derivative suit against the directors alleging waste, negligence and other wrongful acts, and the suit had been dismissed on the merits. Although the issue of the *permissibility* of corporate indemnification was before the court, there was no indication of corporate willingness to pay and the decision leaned more toward the holding that a corporation could not be *compelled* to reimburse a successful director-defendant. The court stated that there was no strictly legal obligation in the nature of an implied contract requiring reimbursement and no showing of benefit to the corporation arising out of the directors' defense. It added that the proper place in which to apply for indemnity was in the original action. Though the value of this decision as precedent was strongly questioned,²² all such discussion became academic in 1944 when the New York Court of Appeals held that no common law right to reimbursement existed in New York.²³

Two recent cases from other jurisdictions have recognized a common law right to reimbursement. In *Solimine v. Hollander*²⁴ the directors had been vindicated on the merits in a stockholder's derivative action. The New Jersey court, alluding in part to a trustee

¹⁹ 37 Ohio App. 553, 175 N.E. 222 (1931).

²⁰ The court cited *Godley v. Crandall & Godley Co.*, 181 App. Div. 75, 168 N.Y.S. 251 (1917), *affd.*, without opinion, 227 N.Y. 656, 126 N.E. 908 (1920), in support of its requirement of benefit to the corporation. This case, however, concerned the indemnification of *wrongdoing directors*, a type of case in which a showing of benefit is much more appropriate.

²¹ 173 Misc. 106, 16 N.Y.S. (2d) 844 (1939). The case was especially influential because it was decided by Judge Leonard Crouch, a former member of the New York Court of Appeals. The action was brought by the corporation for a declaratory judgment as to the right of the directors to reimbursement for their litigation expenses.

²² See WASHINGTON, CORPORATE EXECUTIVES' COMPENSATION 340-343 (1942).

²³ *Bailey v. Bush Terminal Co.*, 46 N.Y.S. (2d) 877 (1943), *affd.* without opinion 267 App. Div. 899, 48 N.Y.S. (2d) 324 (1944), *affd.* without opinion 293 N.Y. 735, 56 N.E. (2d) 739 (1944). See also *In re Bailey*, 178 Misc. 1045, 37 N.Y.S. (2d) 275 (1942), *revd.* on other grounds 265 App. Div. 758, 40 N.Y.S. (2d) 746 (1943), *affd.* without opinion 291 N.Y. 534, 50 N.E. (2d) 653 (1943).

²⁴ 129 N.J. Eq. 264, 19 A. (2d) 344 (1941), noted 26 MINN. L. REV. 119 (1941).

analogy,²⁵ held that where a director successfully defends his action on the merits he has a right to be indemnified by the corporation. The court rejected the contention that indemnification of a successful director-defendant must be based upon benefit to the corporation, although it found that such benefit did exist in this case.²⁶ In *In re E. C. Warner Co.*²⁷ reimbursement was upheld in the case of director-defendants who were successful on the merits. The court, in a well-considered opinion, expressly rejected two notions which had to a greater or lesser extent pervaded earlier discussions of indemnification. It held that the position of a director is sui generis and that no analogy need be made to the rights of any other fiduciary, such as a trustee, quasi-trustee, or agent.²⁸ And the court held that in the case of a director who is successful on the merits the question of benefit to the corporation has no place in his application for indemnification for litigation expenses.²⁹

It must be recognized that the most persistent concept which courts have considered in accepting or rejecting indemnification of successful director-defendants is that of benefit to the corporation,³⁰ a concept derived from the rules governing the reimbursement of successful stockholder-plaintiffs in derivative actions.³¹ Although the concept has been severely criticized,³² the tenacity of its hold upon the judicial

²⁵ The court cited and discussed *Jessup v. Smith*, 223 N.Y. 203, 119 N.E. 403 (1918), which was a suit by an attorney to recover from trustees under a will expenses incurred by him in defending one of the trustees.

²⁶ The suggested benefit lay in the demonstration by the directors to the investing public of the honesty of the corporate management. *Solimine v. Hollander*, 129 N.J. Eq. 264 at 271, 19 A. (2d) 344 (1941).

²⁷ 232 Minn. 207, 45 N.W. (2d) 388 (1950), noted 26 NOTRE DAME LAWYER 540 (1951), and 29 CHI.-KENT L. REV. 344 (1951).

²⁸ *Accord*, on this point: *New York Dry Dock Co. v. McCollom*, 173 Misc. 106 at 109, 16 N.Y.S. (2d) 844 (1939); WASHINGTON, CORPORATE EXECUTIVES' COMPENSATION 349 (1942). For discussions of the relation of a director to his corporation, see STEVENS, CORPORATIONS, 2d ed., 647 (1949); 3 FLETCHER, CYC. CORP., rev. vol., §§839-852 (1947); 35 MINN. L. REV. 564 (1951).

²⁹ See *Marion v. Wood*, 55 N.M. 367, 233 P. (2d) 1051 (1951) (court ordered corporation to pay litigation fees of both plaintiff and defendant in a suit evolving out of a struggle for control).

³⁰ See *Griese v. Lang*, 37 Ohio App. 553, 175 N.E. 222 (1931); *New York Dry Dock Co. v. McCollom*, 173 Misc. 106, 16 N.Y.S. (2d) 844 (1939); *Solimine v. Hollander*, 129 N.J. Eq. 264, 19 A. (2d) 344 (1941); *In re E. C. Warner Co.*, 232 Minn. 207, 45 N.W. (2d) 388 (1950). Cf. *Drivas v. Lekas*, 182 Misc. 567, 48 N.Y.S. (2d) 785 (1944); *Neuberger v. Barrett*, 180 Misc. 222, 39 N.Y.S. (2d) 575 (1942).

³¹ For a discussion of the benefit rule as applied to successful complainants in stockholders' derivative suits, see Hornstein, "The Counsel Fee in Stockholder's Derivative Suits," 39 COL. L. REV. 784 at 798-804 (1939).

³² See WASHINGTON, CORPORATE EXECUTIVES' COMPENSATION 345 (1942); N.Y. LAW REV. COMM. REP., Leg. Doc. No. 65(E), p. 31 (1945); *In re E. C. Warner Co.*, 232 Minn. 207, 45 N.W. (2d) 388 (1950); *Solimine v. Hollander*, 129 N.J. Eq. 264, 19 A. (2d) 344 (1941). Although upholding the requirement of benefit as a prerequisite to

mind is indicated by the awkward reading of the requirement into the early New York statute concerning indemnification,³³ and it is doubtful that we have heard the last of the benefit doctrine.

The *McCullom* case is easily the most significant of the cases just discussed in terms of the reaction it inspired among legislators and corporate managers. In its wake came the first New York statutes providing for indemnification of successful director-defendants,³⁴ and it likely influenced many of the statutes presently in existence in fifteen other states. In addition, a large number of corporations, their managers alarmed by the implications of the *McCullom* decision, adopted bylaws providing for the indemnification of their officers for litigation expenses.³⁵ Although litigation concerning such bylaw agreements is sparse, writers have criticized their wholesale and ungoverned use because of the extremes to which such bylaws may go in allowing indemnification.³⁶ Such extremes not only permit an unwarranted imposition upon stockholders who accept the bylaws blindly or who are forced to accept them,³⁷ but they also invite extensive litigation concerning the validity of the provisions of each such bylaw. In an

the reimbursement of a successful director-defendant, Judge Crouch, in *New York Dock Co. v. McCullom*, 173 Misc. 106 at 111, 16 N.Y.S. (2d) 844 (1939), suggested: "Just how such a state of facts [benefit to the corporation] can come about, however, is not very clear to the referee."

³³ The benefit rule was read into 22 N.Y. Consol. Laws (McKinney, 1943) §61-a, where the director was successful only in part or settled the suit. See *Drivas v. Lekas*, 182 Misc. 567, 48 N.Y.S. (2d) 785 (1944). Cf. *Neuberger v. Barrett*, 180 Misc. 222, 39 N.Y.S. (2d) 575 (1942). This confusion led to the exclusion from the present law of any mention of reimbursement of successful plaintiffs. See N.Y. LAW REV. COMM. REP., Leg. Doc. No. 65(E), p. 31 (1945).

³⁴ WASHINGTON, CORPORATE EXECUTIVES' COMPENSATION 340 (1942). The statutes referred to were 22 N.Y. Consol. Laws (McKinney, 1943) §§27-a, 61-a.

³⁵ "In 1938 stockholders had not heard of agreements for general indemnification of directors and officers for expenses incurred by them in connection with litigation to which they might become subject by virtue of their corporate positions." Bates and Zuckert, "Directors' Indemnity: Corporate Policy or Public Policy?" 20 HARV. BUS. REV. 244 at 244 (1942). "The direct motivation for the wholesale adoption of indemnity agreements was apparently a New York decision in the case of *New York Dock Co. v. McCullom*. . . ." Id. at 246.

³⁶ See Bates and Zuckert, "Directors' Indemnity: Corporate Policy or Public Policy?" 20 HARV. BUS. REV. 244 (1942) (including an analysis of 169 bylaw indemnity provisions); WASHINGTON, CORPORATE EXECUTIVES' COMPENSATION, c. 19 (1942) (discussing the validity of indemnity provisions and problems of adoption, disclosure and form); BALLANTINE AND STERLING, CALIFORNIA CORPORATION LAWS, 1949 ed., 122. Examples of some such bylaw provisions are contained in N.Y. LAW REV. COMM. REP., Leg. Doc. No. 65(E), pp. 40-44 (1945).

³⁷ "There must be a frank recognition of the inherent advantage a compact management group holds over its scattered security holders, and there must be a willingness to dilute the measure of protection that might be obtained as well as to provide safeguards against the misuse of management's power." Bates and Zuckert, "Directors' Indemnity: Corporate Policy or Public Policy?" 20 HARV. BUS. REV. 244 at 259 (1942).

effort to clarify some of the questions concerning these bylaws, several states have adopted statutes expressly authorizing indemnification by bylaw in certain specified instances,³⁸ and one state has by statute expressly deprived such agreements of any effect.³⁹

II. Statutory Provisions Regarding Indemnifications

Moved by the idea that innocent director-defendants "ought" to be indemnified against litigation expenses⁴⁰ or by the conviction that such indemnification is necessary in order to induce the most qualified individuals to accept the responsibilities of corporate management,⁴¹ the legislatures of sixteen states have enacted indemnification statutes.⁴²

The New York⁴³ and California⁴⁴ statutes, though dissimilar in many respects, are the most complete. There are two general types of statutes: (1) those which provide that the corporation has power to indemnify specified personnel for litigation expenses in certain situations,⁴⁵ or that it may provide for such indemnification in its bylaws,⁴⁶

³⁸ Conn. Gen. Stat. (1949) §5129; Me. Rev. Stat. (1944) c. 49, §23; 22 N.Y. Consol. Laws (McKinney, 1943) §63; R.I. Acts (1948) c. 2154.

³⁹ Cal. Corp. Code Ann. (Deering, 1953) §830(e).

⁴⁰ Cf. Hornstein, "The Counsel Fee in Stockholder's Derivative Suits," 39 Col. L. Rev. 784 at 816 (1939): "The same reasons which justify an allowance out of the fund in favor of the complainant stockholder for expenses incurred in recovering it require the disallowance of compensation for expenses incurred by directors or other individual defendants defending suits against them for waste of corporate funds, whether they be successful or unsuccessful."

⁴¹ See Douglas, "Directors Who Do Not Direct," 47 HARV. L. REV. 1305 (1934).

⁴² *California*: Cal. Corp. Code Ann. (Deering, 1953) §830; *Connecticut*: Conn. Gen. Stat. (1949) §5129; *Delaware*: Del. Code Ann. (1953) tit. 8, §122(10); *Kentucky*: Ky. Rev. Stat. (1953) §271.375; *Maine*: Me. Rev. Stat. (1944) c. 49, §23; *Maryland*: Md. Code Ann. (1951) art. 23, §60; *Michigan*: Mich. Comp. Laws (1948) §450.10(1); *Minnesota*: Minn. Stat. Ann. (1947, 1953 Cum. Supp.) §301.09(7); *Missouri*: Mo. Stat. Ann. (Vernon, 1952) §351.355; *Montana*: Mont. Rev. Code Ann. (1947) §15-412; *Nevada*: Nev. Comp. Laws (1950 Supp.) §1608(6); *New Jersey*: N.J. Rev. Stat. (1944 Cum. Supp.) §14:3-14; *New York*: 22 N.Y. Consol. Laws (McKinney, 1943, 1953 Cum. Supp.) §63-68; *Pennsylvania*: Pa. Stat. Ann. (Purdon, 1953) tit. 12, §1323; Pa. Stat. Ann. (Purdon, 1938, 1953 Cum. Supp.) tit. 15, §2852-410; *Rhode Island*: R.I. Acts (1948) c. 2154; *Wisconsin*: Wis. Stat. (1951) §§180.04(14), 182.034.

⁴³ 22 N.Y. Consol. Laws (McKinney, 1943, 1953 Cum. Supp.) §§63-68. For the background of the present New York indemnification statutes, see N.Y. LAW REV. COMM. REP., Leg. Doc. No. 65(E) (1945).

⁴⁴ Cal. Corp. Code Ann. (Deering, 1953) §830. See Ballantine, "California's 1943 Statute as to Directors' Litigation Expenses," 31 CALIF. L. REV. 515 (1943); BALLANTINE AND STERLING, CALIFORNIA CORPORATION LAWS, 1949 ed., §95.

⁴⁵ Del. Code Ann. (1953) tit. 8, §122(10); Md. Code Ann. (1951) art. 23, §60; Mich. Comp. Laws (1948) §450.10(1); Minn. Stat. Ann. (1947, 1953 Cum. Supp.) §301.09(7); Nev. Comp. Laws (1950 Supp.) §1608(6); Pa. Stat. Ann. (Purdon, 1938, 1953 Cum. Supp.) tit. 15, §2852-410; Wis. Stat. (1951) §180.04(14). Most of these are quite like the Delaware statute, which reads in part as follows: "Every corporation created under the provisions of this chapter shall have the power to: . . . 10. indemnify any and all of its directors or officers. . . ."

⁴⁶ Conn. Gen. Stat. (1949) §5129; Me. Rev. Stat. (1944) c. 49, §23; N.J. Rev. Stat. (1944 Cum. Supp.) §14:3-14; R.I. Acts (1948) c. 2154; 22 N.Y. Consol. Laws (McKin-

and (2) those which give the specified personnel a statutory right to indemnification in certain situations.⁴⁷ New York, Pennsylvania, and Wisconsin⁴⁸ have both types of statutes. Kentucky, Missouri, and Montana⁴⁹ have statutes of the latter type, but they alone, of all the sixteen states having indemnification statutes, give directors and officers the right to indemnification not only for litigation expenses, but also for sums paid in settlement of actions against them in certain prescribed circumstances.⁵⁰

The true character of these statutes, however, can be discerned only through a careful comparison of their specific provisions. The more important issues arising under these statutes will therefore be discussed in some detail.⁵¹

A. *Exclusiveness of the Statutory Provisions.* California alone makes the statutory remedy the sole method by which indemnification for litigation expenses may be obtained.⁵² Under the California scheme, indemnity may be assessed against the corporation only if (1) the person sued is successful in whole or in part, or the proceeding against him is settled with the approval of the court; and (2) the court finds that his conduct fairly and equitably merits such indemnity.⁵³

Ten of the twelve statutes which merely permit corporate indemnification,⁵⁴ including that of Delaware, provide expressly that the power

ney, 1943, 1953 Cum. Supp.) §63. The statutes of New York, New Jersey and Maine refer also to other corporate documents, such as the certificate of incorporation, or other certificate filed pursuant to law, or a resolution in a specific case, or an amendment to any of these.

⁴⁷ Cal. Corp. Code Ann. (Deering, 1953) §830; Ky. Rev. Stat. (1953) §271.375; Mo. Stat. Ann. (Vernon, 1952) §351.355; Mont. Rev. Code Ann. (1947) §15-412; N.Y. Consol. Laws (McKinney, 1943, 1953 Cum. Supp.) §64; Pa. Stat. Ann. (Purdon, 1953) tit. 12, §1323; Wis. Stat. (1951) §182.034.

⁴⁸ 22 N.Y. Consol. Laws (McKinney, 1943, 1953 Cum. Supp.) §§63-68; Pa. Stat. Ann. (Purdon, 1953) tit. 12, §1323; Pa. Stat. Ann. (Purdon, 1938, 1953 Cum. Supp.) tit. 15, §2852-410; Wis. Stat. (1951) §§180.04(14), 182.034. For a discussion and history of §182.034, see 1950 WIS. L. REV. 157.

⁴⁹ Ky. Rev. Stat. (1953) §271.375; Mo. Stat. Ann. (Vernon, 1952) §351.355; Mont. Rev. Code Ann. (1947) §15-412.

⁵⁰ See note 115 *infra* and accompanying text.

⁵¹ All of the statutes apparently refer only to defendants, and not to plaintiffs. The early New York statute, 22 N.Y. Consol. Laws (McKinney, 1943) §61-a, included plaintiffs, but this provision was abandoned intentionally in the 1945 revision of the New York indemnification statutes. See N.Y. LAW REV. COMM. REP., Leg. Doc. No. 65(E), p. 31 (1945). N.Y. Laws (1945) c. 869, §5, effective April 18, 1945, provided that the repeal of §61-a should not be construed to limit the power of the court in actions brought in behalf of a corporation to grant allowances to parties plaintiff for their reasonable expenses including attorneys' fees.

⁵² Cal. Corp. Code Ann. (Deering, 1953) §830(e). See Ballantine, "California's 1943 Statute as to Directors' Litigation Expenses," 31 CALIF. L. REV. 515 (1943).

⁵³ Cal. Corp. Code Ann. (Deering, 1953) §830(a).

⁵⁴ See statutes cited in notes 45 and 46 *supra*.

conferred by the statute shall not affect any other right to indemnification to which a person may be entitled under any bylaw, agreement, vote of stockholders, or other provision.⁵⁵ Michigan's statute does not mention the existence or applicability of any rights outside the statute.⁵⁶ Pennsylvania gives the corporation the power to grant indemnification "unless the articles provide otherwise," but no mention is made of any rights outside of the statute.⁵⁷ Under all twelve of these statutes, therefore, there may still remain a doubtful area of corporate indemnification by means of bylaw or other such provision that is not authorized by the statute.

Of the six states having statutes which provide that certain persons *shall* be indemnified in accordance with the statute, Missouri and Wisconsin⁵⁸ provide that this right to indemnification shall not be exclusive of any other rights. Pennsylvania, Montana, and Kentucky⁵⁹ make no mention of exclusiveness. New York provides that no award of indemnity shall be made where it shall appear "that the award would be inconsistent with any action of the stockholders or members of the corporation taken prior to and in effect at the time of the accrual of the alleged cause of action."⁶⁰

B. *Corporate Personnel Covered.* All statutes provide for reimbursement of directors and officers.⁶¹ Six statutes, including those of New York and California, extend this relief to employees,⁶² and two statutes mention trustees.⁶³ Sixteen statutes make express provision for persons who formerly served in the requisite capacity,⁶⁴ but although

⁵⁵ Del. Code Ann. (1953) tit. 8, §122(10); Conn. Gen. Stat. (1949) §5129; Me. Rev. Stat. (1944) c. 49, §23; Md. Code Ann. (1951) art. 23, §60; Minn. Stat. Ann. (1947, 1953 Cum. Supp.) §301.09(7); Nev. Comp. Laws (1950 Supp.) §1608(6); N.J. Rev. Stat. (1944 Cum. Supp.) §14:3-14; R.I. Acts (1948) c. 2154; Wis. Stat. (1951) §180.04(14); 22 N.Y. Consol. Laws (McKinney, 1943, 1953 Cum. Supp.) §63. See the criticism of such a non-exclusive statutory treatment of indemnification in Ballantine, "California's 1943 Statute as to Directors' Litigation Expenses," 31 CALIF. L. REV. 515 at 515 (1943).

⁵⁶ Mich. Comp. Laws (1948) §450.10(1).

⁵⁷ Pa. Stat. Ann. (Purdon, 1938, 1953 Cum. Supp.) tit. 15, §2852-410.

⁵⁸ Mo. Stat. Ann. (Vernon, 1952) §351.355; Wis. Stat. (1951) §182.034.

⁵⁹ Pa. Stat. Ann. (Purdon, 1953) tit. 12, §1323 (applies only to derivative suits); Mont. Rev. Code Ann. (1947) §15-412; Ky. Rev. Stat. (1953) §271.375.

⁶⁰ 22 N.Y. Consol. Laws (McKinney, 1943, 1953 Cum. Supp.) §67.

⁶¹ See REP. N.Y. ARMY. GEN. 296 (1943) for an opinion that since the earlier New York statute, 22 N.Y. Consol. Laws (McKinney, 1943) §27-a, referred only to directors, this could not be construed so as to include officers, etc.

⁶² 22 N.Y. Consol. Laws (McKinney, 1943, 1953 Cum. Supp.) §§63-64; Cal. Corp. Code Ann. (Deering, 1953) §§830(a); Conn. Gen. Stat. (1949) §5129; R.I. Acts (1948) c. 2154; Wis. Stat. (1951) §182.034.

⁶³ Conn. Gen. Stat. (1949) §5129; N.J. Rev. Stat. (1944 Cum. Supp.) §14:3-14.

⁶⁴ Cal. Corp. Code Ann. (Deering, 1953) §830; Del. Code Ann. (1953) tit. 8, §122(10); Me. Rev. Stat. (1944) c. 49, §23; Md. Code Ann. (1951) art. 23, §60; Mich.

the three other statutes include no such provision it appears that the same result would obtain under their language.⁶⁵

A different matter is the provision in the statutes of ten states, including Delaware, New York and Michigan, for certain personnel serving with subsidiaries.⁶⁶ Typically, indemnification is extended to specified personnel of the corporation, and to the same classification of persons "who may have served at its request as a director or officer [or other] of another corporation in which it owns shares of capital stock or of which it is a creditor. . . ."⁶⁷ In these cases, indemnification apparently is to be provided by the stockholding or creditor corporation, except under the New York statute where the language indicates that the indemnification may be assessed against either corporation.⁶⁸ Under statutes not making reference to subsidiaries, it is apparently the subsidiary corporation that is referred to in the statute.⁶⁹

C. *Type of Action Covered.* California has given the most exten-

Comp. Laws (1948) §§450.10(1); Minn. Stat. Ann. (1947, 1953 Cum. Supp.) §301.09(7); Mo. Stat. Ann. (Vernon, 1952) §351.355; Mont. Rev. Code Ann. (1947) §15-412; Nev. Comp. Laws (1950 Supp.) §1608(6); 22 N.Y. Consol. Laws (McKinney, 1943, 1953 Cum. Supp.) §§63, 64; Pa. Stat. Ann. (Purdon, 1953) tit. 12, §1323; Pa. Stat. Ann. (Purdon, 1938, 1953 Cum. Supp.) tit. 15, §2852-410; R.I. Acts (1948) c. 2154; Wis. Stat. (1951) §§180.04(14), 182.034.

⁶⁵ Conn. Gen. Stat. (1949) §5129; Ky. Rev. Stat. (1953) §271.375; N.J. Rev. Stat. (1944 Cum. Supp.) §14:3-14. All three expressly make their acts applicable to the personal representative of a former director or officer, so that these legislatures apparently contemplated the possibility of a suit against a director at a time when he was no longer a director. Besides these three statutes, those of Missouri, Montana, New York, Rhode Island, and Wisconsin make express provision for the inclusion under the statute of the personal representatives of a former director or officer. Mo. Stat. Ann. (Vernon, 1952) §351.355; Mont. Rev. Code Ann. (1947) §15-412; 22 N.Y. Consol. Laws (McKinney, 1943, 1953 Cum. Supp.) §§63, 64; R.I. Acts (1948) c. 2154; Wis. Stat. (1951) §182.034. This, however, would seem to be superfluous.

⁶⁶ Del. Code Ann. (1953) tit. 8, §122(10); Md. Code Ann. (1951) art. 23, §60; Mich. Comp. Laws (1948) §450.10(1); Mo. Stat. Ann. (Vernon, 1950) §351.355; Mont. Rev. Code Ann. (1947) §15-412; Nev. Comp. Laws (1950 Supp.) §1608(6); 22 N.Y. Consol. Laws (McKinney, 1943, 1953 Cum. Supp.) §§63, 64; Pa. Stat. Ann. (Purdon, 1938, 1953 Cum. Supp.) tit. 15, §2852-410; R.I. Acts (1948) c. 2154; Wis. Stat. (1951) §182.034.

⁶⁷ Del. Code Ann. (1953) tit. 8, §122(10). Montana requires that the parent corporation own at least fifty percent of the voting stock of the subsidiary, while Rhode Island specifies that the parent must own a majority of the subsidiary's shares. New Jersey requires only that the officer or director of one corporation have been requested to serve the second corporation because of the "interest" of the first in the second.

⁶⁸ The New York statutory remedy states that reimbursement may be "assessed against the corporation or against another corporation at the request of which he served as such director, officer or employee. . . ." 22 N.Y. Consol. Laws (McKinney, 1943, 1954 Cum. Supp.) §64.

⁶⁹ For a criticism of statutes providing for indemnification of a subsidiary's officer by the parent corporation, see Ballantine, "California's 1943 Statute as to Directors' Litigation Expenses," 31 CALIF. L. REV. 515 at 522-523 (1943). Cf. Bates and Zuckert, "Directors' Indemnity: Corporate Policy or Public Policy," 20 HARV. BUS. REV. 244 at 253 (1942).

sive attention to defining the types of actions covered by its indemnification statute. Its remedy applies where a person is sued, either alone or with others, because he is or was a director, officer, or employee of a corporation, in "any proceeding arising out of his alleged misfeasance or nonfeasance in the performance of his duties or out of any alleged wrongful acts against the corporation or by the corporation";⁷⁰ and it covers all such proceedings "whether brought by the corporation, its receiver, its trustee, one or more of its shareholders or creditors, any governmental body, any public official, or any private person or corporation, domestic or foreign."⁷¹ This is more explicit and possibly more inclusive than any other statute.⁷² Of the remaining statutes, only two⁷³ vary in any significant particular from the following formula of coverage: any such person made a party to any action, suit or proceeding by reason of the fact that he was a director or officer (or whatever personnel is covered) of a corporation.⁷⁴ Both of the recent cases described at the beginning of this comment bear on the interpretation of such terminology.

In the *Schwarz* case⁷⁵ the New York Court of Appeals held that the expenses incurred by a director in defending himself against a criminal action brought under section one of the Sherman Antitrust Act⁷⁶ did not come within the provisions of the New York indemnification statute because the language "action, suit or proceeding" referred only to a civil action.⁷⁷ The opinion of the court, accepted by four of the seven judges, including one who wrote a separate concurring

⁷⁰ Cal. Corp. Code Ann. (Deering, 1953) §830(a).

⁷¹ *Id.*, §830(d).

⁷² "This [the California statute] means that there is no limitation upon the class of complaints or the kind of proceedings to which indemnity applies. There seems no reason or principle why indemnity should be confined to one type of proceeding." BALLANTINE AND STERLING, CALIFORNIA CORPORATION LAWS, 1949 ed., 119.

⁷³ The Rhode Island statute extends to the "defense or reasonable settlement of any legal or administrative proceedings," R.I. Acts (1948) c. 2154, while Pennsylvania's statutory remedy is limited to stockholder's derivative actions. Pa. Stat. Ann. (Purdon, 1953) tit. 12, §1323.

⁷⁴ The Kentucky statute refers only to "any action," Ky. Rev. Stat. (1953) §271.375, while the Missouri statute applies to "any action, suit, proceeding or claim." Emphasis added. Mo. Stat. Ann. (Vernon, 1952) §351.355.

⁷⁵ *Schwarz v. General Aniline & Film Corp.*, 305 N.Y. 395, 113 N.E. (2d) 533 (1953).

⁷⁶ 26 Stat. L. 209 (1890), 15 U.S.C. (1946) §1.

⁷⁷ Cf. *DuPuy v. Crucible Steel Co. of America*, (D.C. Pa. 1923) 288 F. 583; *Hoch v. Duluth Brewing & Malting Co.*, 173 Minn. 374, 217 N.W. 503 (1928), where reimbursement was denied corporate officials who had successfully defended themselves after being indicted for acts committed in their official capacity. In both cases relief was sought on an agency theory. Relief was denied in the *DuPuy* case because of the criminal prosecution was not a direct and natural result of the agency, and in the *Hoch* case because the expenses had been necessitated by the independent and unexpected wrongful act of an independent third party, the United States, which had brought the action.

opinion,⁷⁸ concluded that neither the legislature nor the New York Law Revision Commission, which sponsored the present statutory scheme, had ever intended that indemnification should extend to criminal actions.⁷⁹ This decision was based primarily on the fact that the court could find no evidence that such a possibility had ever been suggested.⁸⁰ Indemnification for expenses incurred in a criminal action was also thought to be poor public policy.⁸¹ Though the dissenting opinion spoke to some extent of criminal actions generally, it actually seemed to be limiting its break with the majority to the issue of whether criminal actions instituted under the antitrust laws came within the indemnification statute.⁸² The dissenters believed that the legislative history and the wording of the statute indicated that such actions were intended to be covered.⁸³

Since all statutes, except that of California and one in Pennsylvania,⁸⁴ are as ambiguous (or as unambiguous) as New York's, the problem of criminal actions is likely to arise under each of them. In the absence of a clearly expressed legislative intent to the contrary, it would seem that the dissenters in the *Schwarz* case were correct in their conclusion that a criminal prosecution under the antitrust laws is

⁷⁸ The concurrence was based chiefly upon a close interpretation of the statutory language, the statute being found to be in derogation not only of the common law, but also of the contract rights or engagements of the parties. This opinion was joined in by the other majority members of the court. *Schwarz v. General Aniline & Film Corp.*, 305 N.Y. 395, 113 N.E. (2d) 533 (1953).

⁷⁹ "Our own conclusion is that the draftsman who was responsible for the statutory language: 'any action, suit or proceeding' was being overcautious in making sure that the law would apply in an 'action' at law, a 'suit' in equity, or a special 'proceeding'." *Id.* at 403.

⁸⁰ In N.Y. LAW REV. COMM. REP., Leg. Doc. No. 65(E), p. 31, n. 36 (1945) it is suggested that the language "any action, suit or proceeding" might be urged to include a criminal proceeding against the corporation and its officers or directors for violation of the antitrust laws. The majority of the court dismissed this comment, saying: "But that was a mere comment by the writer of the study made for the commission, referring to a contention made, or which might be made, by somebody else. . . ." *Schwarz v. General Aniline & Film Corp.*, 305 N.Y. 395 at 402, 113 N.E. (2d) 533 (1953).

⁸¹ "It would be a very strange public policy, indeed, which would set up legal machinery whereby one charged with, or convicted of, a crime, of whatever kind, could require the corporation by whom he was employed to pay his legal expenses." *Id.* at 402.

⁸² "The basic flaw in the majority's reasoning, it seems to me, stems from a faulty assumption of an essential difference between the criminal and the civil in the area of antitrust regulation." *Id.* at 410.

⁸³ The dissenting opinion relied primarily on (1) the footnote in the Report of the Law Revision Commission discussed in note 80 supra; (2) the lack of any such limitation in the language of the statute; and (3) the fact that a limitation requiring that the action, suit or proceeding be "brought by the corporation, or brought in its behalf," was dropped from 22 N.Y. Consol. Laws (McKinney, 1943) §61-a in the 1945 revision when that section was altered and renumbered as the present §64 in 22 N.Y. Consol. Laws (McKinney, 1943, 1953 Cum. Supp.) §64. *Id.* at 408.

⁸⁴ Cal. Corp. Code Ann. (Deering, 1953) §830; Pa. Stat. Ann. (Purdon, 1953) tit. 12, §1323 (limited to derivative suits).

more like a civil action than like the ordinary criminal action,⁸⁵ and that the policy reasons for reimbursement are just as strong in the case of an antitrust prosecution as in the case of a civil action.⁸⁶

The *Mooney* case⁸⁷ deals with that part of the Delaware statute which limits its indemnification provisions to one who was made a defendant *by reason of his having been an officer or director of the corporation*.⁸⁸ Such a proviso is contained in some form, and usually in almost identical terms, in all but one indemnification statute,⁸⁹ and the *Mooney* case is the first interpretation of this language in any jurisdiction. The plaintiff, a director, sued the corporation for reimbursement of litigation expenses incurred by him in the successful defense of a stockholder's derivative suit.⁹⁰ One of the primary contentions of the corporation was based on the fact that indemnity under the statute and bylaw is limited to expenses incurred in the justification of actions actually taken by the officer or director in the administration of corporate affairs. The proof showed that the plaintiff had not committed as an officer or director any of the acts charged in the complaint—he had either not been with the corporation at the time of the alleged wrongful act, or had disqualified himself in accordance with the law from voting on the acts.⁹¹ The court rejected this contention, stating that unless it was clear from the stockholder's complaint that there was no ground for holding the plaintiff liable as a director or officer, the fact that the plaintiff was named in the complaint as such should determine whether or not he was sued by reason of his having been an officer or director of the corporation, and therefore the direc-

⁸⁵ See Cahill, "Must We Brand American Business by Indictment as Criminal?" A.B.A. SECTION ON ANTI-TRUST LAW (1952).

⁸⁶ Cf. WASHINGTON, CORPORATE EXECUTIVES' COMPENSATION 349, n. 52 (1942): "It may plausibly be argued that the risk of criminal prosecution is a personal one, and that it would be against public policy to reimburse defendants in such cases even though they have been acquitted. At any rate, stockholders' actions clearly seem to be in a different category."

⁸⁷ *Mooney v. Willys-Overland Motors, Inc.*, (3d Cir. 1953) 204 F. (2d) 888.

⁸⁸ Del. Code Ann. (1953) §122(10).

⁸⁹ The Pennsylvania statutory remedy refers only to defendants in stockholders' derivative suits. Pa. Stat. Ann. (Purdon, 1953) tit. 12, §1323.

⁹⁰ The director's claim was based upon both the Delaware statute and a corporation bylaw adopted thereunder, but the language as to the point in question was identical. The bylaw is set out in *Mooney v. Willys-Overland Motors, Inc.*, (3d Cir. 1953) 204 F. (2d) 888 at 891, n. 5.

⁹¹ The corporation contended also that the stockholder's complaint charged the plaintiff with wrongful actions, not as an officer or director, but as a controlling stockholder. The allegation was based on the facts recited in the text and on the fact that the stockholder's complaint spoke in terms of a conspiracy between the plaintiff and two others, as controlling stockholders, and the board of directors of the corporation. The court decided that the plaintiff had been sued both as a controlling stockholder and as an officer and director of the corporation. *Id.* at 896.

tor's ultimate defense should not deprive him of indemnification.⁹² This result seems to be easily justified as being within the letter and spirit of the statute, although as pointed out by the court the situation apparently is a novel one in American law.

D. *Expenses Reimbursed.* Indemnification is usually extended to expenses actually and necessarily incurred in the defense of the action. Only Kentucky, Missouri, and Montana⁹³ provide in addition for the reimbursement of sums paid in compromise of claims, although Rhode Island permits indemnification through bylaws for "any and all claims and liabilities" to which the person may be or become subject by reason of his service with the corporation.⁹⁴

The *Mooney* case⁹⁵ dealt with the significance of the phrase "expenses actually and necessarily incurred . . . in connection with the defense of any action. . . ." ⁹⁶ Although the plaintiff was named as a defendant in the stockholder's derivative suit, he was never served with process. He hired his attorney with the intention of entering a voluntary appearance in order to defend his professional reputation, but was later dissuaded by the corporation's attorneys from making such an appearance. In holding that a director or officer need not actually appear in an action in order to be indemnified for his litigation expenses, the court said that plaintiff's attorney prepared to join in the defense of the action in case the corporation's motion to dismiss failed and that therefore the effort was performed "in connection with the defense" of the stockholder's suit. The court suggested that the purpose of indemnification statutes is "to encourage capable men to serve as corporate directors, secure in the knowledge that expenses incurred by them in upholding their honesty and integrity as directors will be borne by the corporation they serve."⁹⁷

⁹² The court here distinguished a Scottish case, *Tomlinson v. Liquidators of Scottish Amalgamated Silks, Ltd.*, [1935] Sess. Cas. (H.L.) 1, on the ground that indemnity in that case was based upon language in the corporation's articles of association which was more restricted than the language in question in the *Mooney* case: "Every Director . . . of the Company shall be indemnified by the Company against . . . all costs, losses, and expenses which any such Director . . . may incur or become liable to by reason of any contract entered into, or act or deed done, by him as such Director . . . in any way, in the discharge of his duties. . . ." *Id.* at 5.

⁹³ Ky. Rev. Stat. (1953) §271.375(2); Mo. Stat. Ann. (Vernon, 1952) §351.355; Mont. Rev. Code Ann. (1947) §15-412(2).

⁹⁴ R.I. Acts (1948) c. 2154.

⁹⁵ *Mooney v. Willys-Overland Motors, Inc.*, (3d Cir. 1953) 204 F. (2d) 888.

⁹⁶ This is the language of the Delaware statute. Del. Code Ann. (1953) §122(10). The action was based both on this statute and on a corporation bylaw adopted thereunder, the language of the bylaw at this point being: "any expenses reasonably incurred by him in connection with or arising out of any action, suit or proceeding. . . ." *Mooney v. Willys-Overland Motors, Inc.*, (3d Cir. 1953) 304 F. (2d) 888 at 891, n. 5.

⁹⁷ *Id.* at 898.

E. *Degree of Success Required for Recovery.* All statutes cover in some manner the degree to which a person must be successful in the litigation in order to recover expenses, though usually with little consideration for the various ways in which an action may be terminated. Except for the statutory remedies of California⁹⁸ and Pennsylvania,⁹⁹ the usual statute, whether it is in mandatory or permissive terms, excludes indemnification where a person has been, to use a typical formula, "adjudged in such action, suit or proceeding to be liable for negligence or misconduct in the performance of his duty."¹⁰⁰ Three New York decisions have interpreted this language to mean that *only* such an adjudication of liability will bar indemnification,¹⁰¹ and it is quite likely that other courts will adopt this approach in the interpretation of similar statutes.¹⁰² That the Wisconsin statutory

⁹⁸ California's statute permits indemnification "if both of the following conditions exist: (1) The person sued is successful in whole or in part, or the proceeding against him is settled with the approval of the court. (2) The court finds that his conduct fairly and equitably merits such indemnity." Cal. Corp. Code Ann. (Deering, 1953) §830(a).

⁹⁹ Under Pennsylvania's statutory remedy, which is limited to derivative suits, reimbursement is "in such amount as the court shall determine and find to be reasonable in the circumstances," and may be awarded where the defendant was successful in whole or in part or the action was settled with court approval. Pa. Stat. Ann. (Purdon, 1953) tit. 12, §1323.

¹⁰⁰ Del. Code Ann. (1953) tit. 8, §122(10). The Kentucky and Missouri statutes speak of *actual* negligence or misconduct. Ky. Rev. Stat. (1953) §271.375(1); Mo. Stat. Ann. (Vernon, 1952) §351.355(1). New Jersey instead requires that the officer or director not have been "derelict" in the performance of his duties. N.J. Rev. Stat. (1944 Cum. Supp.) §14:3-14. In addition to the general formula cited in the text, Michigan denies indemnification "to such matters as shall be settled by agreement predicated on the existence of such liability." Mich. Comp. Laws (1948) §450.10(1).

¹⁰¹ *Tichner v. Andrews*, 193 Misc. 1050, 85 N.Y.S. (2d) 760 (1949), *affd.* without opinion 275 App. Div. 749, 90 N.Y.S. (2d) 920 (1949) (suit dismissed on plaintiffs' failure to give security for costs); *Diamond v. Diamond*, 200 Misc. 1055, 108 N.Y.S. (2d) 864 (1951) (dismissed on merits because plaintiff had participated in the alleged wrong); *Dornan v. Humphrey*, 100 N.Y.S. (2d) 684 (1950), *revd. per curiam* 278 App. Div. 1010, 106 N.Y.S. (2d) 142 (1951), *affd. per curiam* 279 App. Div. 1040, 112 N.Y.S. (2d) 585 (1952), noted 37 *CORN. L.Q.* 78 (1951) (most of complaint dismissed under statute of limitations, and rest by consent). Cf. *Neuberger v. Barrett*, 180 Misc. 222, 39 N.Y.S. (2d) 575 (1942).

¹⁰² The problem of whether a plea of *nolo contendere* in a criminal action brought under the Sherman Act, 26 Stat. L. 209 (1890), 15 U.S.C. (1946) §1, constitutes an adjudication of misconduct under New York's statutory remedy, 22 N.Y. Consol. Laws (McKinney, 1943, 1953 Cum. Supp.) §64, was discussed by all three courts which ruled on the Schwarz case. The supreme court held that a fine based upon such a plea constituted a conviction for the crime charged, and thus an adjudication of misconduct. *Schwarz v. General Aniline & Film Corp.*, 198 Misc. 1046, 102 N.Y.S. (2d) 325 (1951). The appellate division affirmed in a *per curiam* opinion, one judge dissenting strongly on this point. 279 App. Div. 996, 112 N.Y.S. (2d) 146 (1952). The majority in the court of appeals ignored the point, although the minority returned to the question and thought it no bar to recovery. 305 N.Y. 395, 113 N.E. (2d) 533 (1953). See the Clayton Act, 38 Stat. L. 730 (1914), 15 U.S.C. (1946) §16, which distinguishes between the consequences of a final judgment or decree and a consent judgment or decree entered before any testimony has been taken. See also *Twin Ports Oil Co. v. Pure Oil Co.*, (D.C. Minn.

remedy refers only to misconduct, and not to negligence or misconduct, may prove to be significant.¹⁰³ This departure from the usual formula appears to be more than inadvertent in the light of the fact that this is one of the most recent of the indemnification statutes.

Three statutes provide expressly for the situation in which the defendant is adjudged successful in part and unsuccessful in part, and all three allow recovery. In two cases the amount is that which the court finds to be reasonable,¹⁰⁴ and in the third it is what the court finds to be fairly and equitably merited.¹⁰⁵

Where the suit is dismissed as to the defendant seeking reimbursement without an adjudication on the merits,¹⁰⁶ indemnity is permitted in California by implication.¹⁰⁷ New Jersey grants indemnification where the suit is "settled or otherwise terminated" and it is found that the defendant "had not in any substantial way been derelict in the performance of his duties."¹⁰⁸ Under the general requirement that the indemnitee must not have been adjudged liable for negligence or misconduct, a New York court has allowed indemnification where the dismissal of the suit was based on the plaintiff's failure to post security for costs¹⁰⁹ and where it was based on the statute of limitations.¹¹⁰

1939) 26 F. Supp. 366, *affd.* (8th Cir. 1941) 119 F. (2d) 747, cert. den. 314 U.S. 644, 62 S.Ct. 84 (1941); *Barnsdall Refining Corp. v. Birmamwood Oil Co.*, (D.C. Wis. 1940) 32 F. Supp. 308, both of which held that a conviction upon a plea of *nolo contendere* in an antitrust suit was a consent judgment within the meaning of the Clayton Act. Cf. *State v. LaRose*, 71 N.H. 435, 52 A. 943 (1902).

¹⁰³ Wis. Stat. (1951) §182.034.

¹⁰⁴ 22 N.Y. Consol. Laws (McKinney, 1943, 1953 Cum. Supp.) §67; Pa. Stat. Ann. (Purdon, 1953) tit. 12, §1323.

¹⁰⁵ Cal. Corp. Code Ann. (Deering, 1953) §830(a).

¹⁰⁶ See WASHINGTON, CORPORATE EXECUTIVES' COMPENSATION 351 (1942), where it is suggested that when the case is dismissed by motion on some technical ground, such as the statute of limitations, there is little need (since the expenses will be small) or justification for indemnification. It would seem, however, that only in the most obvious case would the defendant rely upon such a defense alone, without also making preparation for a trial on the merits. Cf. Bates and Zuckert, "Directors' Indemnity: Corporate Policy or Public Policy?" 20 HARV. BUS. REV. 244 at 260 (1942); Hornstein, "Directors' Expenses in Stockholders' Suits," 43 COL. L. REV. 301 at 314 (1943).

¹⁰⁷ The language relied upon here is in the section concerning the exclusiveness of the statutory remedy: "The awarding of indemnity for expenses, including attorneys' fees, to parties to such proceedings, whether terminated by trial on the merits or by settlement or dismissal, shall be made only upon order of court. . . ." Cal. Corp. Code Ann. (Deering, 1953) §830(e). As usual, indemnification is subject in California to a finding by the court that the defendant's conduct "fairly and equitably merits such indemnity." *Id.*, §830(a).

¹⁰⁸ N.J. Rev. Stat. (1944 Cum. Supp.) §14:3-14.

¹⁰⁹ *Tichner v. Andrews*, 193 Misc. 1050, 85 N.Y.S. (2d) 760 (1949), *affd.* without opinion 275 App. Div. 749, 90 N.Y.S. (2d) 920 (1949).

¹¹⁰ *Dorman v. Humphrey*, 100 N.Y.S. (2d) 684 (1950), *revd. per curiam* 278 App. Div. 1010, 106 N.Y.S. (2d) 142 (1951), *affd. per curiam* 279 App. Div. 1040, 112 N.Y.S. (2d) 585 (1952). Cf. the following cases where there was an adjudication on the merits and indemnification was permitted: *Hayman v. Morris*, 37 N.Y.S. (2d) 884 (1942),

Most states have foreseen the case of settlement or compromise of the action, but the treatment has not been uniform. In New York, if the statutory remedy is relied upon, court approval of the settlement is necessary and the award of expenses must not be inconsistent with any condition imposed by the court in approving the settlement.¹¹¹ California allows indemnification if the settlement is approved by the court and the court finds that the defendant's conduct fairly and equitably merits the award.¹¹² Michigan's statute does not include indemnity where the settlement was predicated on the existence of a liability,¹¹³ and New Jersey allows indemnification for settlement expenses subject to the corporation's finding that the defendant was not derelict in the performance of his duties.¹¹⁴ Kentucky, Missouri, and Montana are alone in permitting indemnification for sums paid in settlement of the action. The only limitation in all three states is that the corporation must have approved the settlement and determined that the defendant was not guilty of negligence or misconduct, though Missouri also requires the settlement or compromise to be approved by a court.¹¹⁵

F. *Procedure for Obtaining Indemnity.* Only New York, California, and Maryland have provisions concerning the procedure which

settled 179 Misc. 265, 38 N.Y.S. (2d) 782 (1942); *Isensee v. Long Island Motion Picture Co.*, 184 Misc. 625, 54 N.Y.S. (2d) 556 (1945); *Marony v. Applegate*, 266 App. Div. 412, 42 N.Y.S. (2d) 768 (1943).

¹¹¹ 22 N.Y. Consol. Laws (McKinney, 1943, 1953 Cum. Supp.) §67. See *Bysheim v. Miranda*, 45 N.Y.S. (2d) 473 (1943); *Neuberger v. Barrett*, 180 Misc. 222, 39 N.Y.S. (2d) 575 (1942), which respectively allowed and denied reimbursement under §61-a of the previous New York statute, and used corporate benefit as the criterion. See also *REP. N.Y. ATTY. GEN.* 296 (1944) for an opinion that reference in §27-a of the earlier statute to the "successful defense" of an action did not include indemnification for the expense of settling an action. For decisions under the present statute, see *Montro Corp. v. Moncrief*, 127 N.Y.L.J., Jan. 10, 1953, p. 126:5; *Cohn v. Columbia Pictures Corp.*, 117 N.Y.S. (2d) 809 (1952) (dictum).

¹¹² Cal. Corp. Code Ann. (Deering, 1953) §830(a). "Only when the court in which the suit is brought . . . has approved a settlement and assessed expenses against the corporation, can a payment by the corporation be unequivocally upheld." *Bates and Zuckert, "Directors' Indemnity: Corporate Policy or Public Policy?"* 20 *HARV. BUS. REV.* 244 at 260 (1942).

¹¹³ Mich. Comp. Laws (1948) §450.10(1).

¹¹⁴ N.J. Rev. Stat. (1944 Cum. Supp.) §14:3-14. Connecticut and Rhode Island permit reimbursement of expenses incurred in the "reasonable settlement" of a suit, provided the person is not finally adjudged liable for negligence or misconduct in the performance of his duties. Conn. Gen. Stat. (1949) §5129; R.I. Acts (1948) c. 2154. The Pennsylvania judicial remedy permits reimbursement of expenses where the settlement was approved by the court. Pa. Stat. Ann. (Purdon, 1953) tit. 12, §1323.

¹¹⁵ Ky. Rev. Stat. (1953) §271.375(3); Mo. Stat. Ann. (Vernon, 1952) §351.355; Mont. Rev. Code Ann. (1947) §15-412. This aspect of the Kentucky statute is criticized in *BALLANTINE AND STERLING, CALIFORNIA CORPORATION LAWS*, 1949 ed., §95, p. 123.

must be followed in order to obtain indemnification.¹¹⁶ Where indemnification is secured under a bylaw¹¹⁷ in New York, the amount must be determined and paid either in accordance with the procedure provided under the statutory remedy, or in such other manner as the corporation may determine not inconsistent with any applicable provisions of a bylaw or other instrument. But if reimbursement is made otherwise than pursuant to court order or action by the stockholders or members, the corporation must inform its stockholders of the circumstances¹¹⁸ within eighteen months. Where indemnification is sought under the statutory remedy in New York, the application may be made either in the action in which the expenses were incurred or in the supreme court in a separate proceeding.¹¹⁹ Notice of the application must be given to the corporation and to such other persons as the court may designate.

Under the California statute, indemnification for the expenses of litigation may be assessed against the corporation by the court in the same or in a separate proceeding.¹²⁰ Notice must be given to the corporation, the plaintiff, other parties to the proceeding and, in the discretion of the court, to the shareholders.¹²¹ California alone permits application for indemnity to be made not only by the party sued but also by the attorney or other person rendering services to the defendant in connection with the defense of the action; and the court may order fees and expenses to be paid directly to such persons even though they are not a party to the proceedings.¹²² Maryland provides that the right

¹¹⁶ Pennsylvania's statutory remedy provides: "The amount of all such expenses so assessed shall be awarded as costs of the suit and be recoverable in the same manner as statutory taxable costs." Pa. Stat. Ann. (Purdon, 1953) tit. 12, §1323.

¹¹⁷ Or under the certificate of incorporation or an amendment thereto, or other certificate filed pursuant to law, or a resolution in a specific case. 22 N.Y. Consol. Laws (McKinney, 1943, 1953 Cum. Supp.) §63.

¹¹⁸ The notice must specify "the persons paid, the amounts of the payments and the final disposition of the litigation." *Ibid.*

¹¹⁹ *Id.*, §65. Reasonable cause must be shown for not making application in the action in which the expenses were incurred. See *Petition of Schwarz*, (D.C. N.Y. 1950) 94 F. Supp. 129, where a petition for indemnification was made under the New York statute and it was held that a federal court had no power to enter a civil judgment against a co-defendant in a criminal proceeding on the petition of another co-defendant. Cf. *In re Bailey*, 178 Misc. 1045, 37 N.Y.S. (2d) 275 (1942), *revd. on other grounds* 265 App. Div. 758, 40 N.Y.S. (2d) 746 (1943), *affd. without opinion* 291 N.Y. 534, 50 N.E. (2d) 653 (1943), where application for reimbursement in a separate proceeding was upheld in spite of the fact that this procedure was not mentioned in the earlier New York statute, 22 N.Y. Consol. Laws (McKinney, 1943) §61-a, on the theory that the legislature did not intend a right without a remedy.

¹²⁰ Cal. Corp. Code Ann. (Deering, 1953) §830(a).

¹²¹ *Id.*, §830(c).

¹²² *Id.*, §830(b). Cf. *Solimine v. Hollander*, 129 N.J. Eq. 264, 19 A. (2d) 344 (1941), where the court in permitting indemnification without statutory authorization held that the more roundabout procedure of reimbursement was not necessary and that the corporation could pay the attorneys directly if it wished.

to indemnity may be asserted in the proceeding against the officer or director, or in a subsequent proceeding in equity. Notice is mentioned, but nothing is said as to whom it should be given.¹²³

III. *Conclusion*

The question of corporate indemnification of management is not one that is beclouded by theoretical analyses or problems. It is a practical problem involving primarily the answer to clear-cut though sometimes difficult questions of justice, the legal interpretation of statutory language, and thoughtful and skillful legislative draftsmanship. In an economic atmosphere more conducive to managerial mistakes than that of the last decade, the problem of corporate indemnification may become a very important one for many attorneys, and developments in the area, especially at the legislative level, deserve continued attention.

Chester F. Relyea, S.Ed.

¹²³ Md. Code Ann. (1951) art. 23, §60(b).