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## Indemnification of Directors and Officers: The Double Whammy of Mandatory Indemnification under Delaware Law in *Waltuch v. Conticommodity Services, Inc.*

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INDEMNIFICATION OF DIRECTORS AND OFFICERS: THE  
 "DOUBLE WHAMMY" OF MANDATORY  
 INDEMNIFICATION UNDER DELAWARE LAW  
 IN *WALTUCH v. CONTICOMMODITY  
 SERVICES, INC.*

I. INTRODUCTION

Directors and officers have become increasingly concerned with the potential for personal liability arising from their status with the corporation.<sup>1</sup> Consequently, the availability of indemnification and other liability limiting mechanisms for corporate directors and officers has become an important topic in corporate law.<sup>2</sup> States have responded to this concern by enacting statutes intended to limit the exposure of directors and officers to personal liability.<sup>3</sup> Typically, these state efforts include enactment

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1. For a discussion of the director and officer personal liability concern, see *infra* notes 41-50 and accompanying text.

2. For a general discussion of director and officer liability, see PAT K. CHEW, *DIRECTORS' AND OFFICERS' LIABILITY* (1993 & Supp. 1995); MORTIMER FEUER, *PERSONAL LIABILITIES OF CORPORATE OFFICERS AND DIRECTORS* (1961); 2 WILLIAM E. KNEPPER & DAN A. BAILEY, *LIABILITY OF CORPORATE OFFICERS AND DIRECTORS* (5th ed. 1993); MICHAEL A. SCHAEFTLER, *THE LIABILITIES OF OFFICE: INDEMNIFICATION AND INSURANCE OF CORPORATE OFFICERS AND DIRECTORS* (1976); Joseph W. Bishop, Jr., *New Problems in Indemnifying and Insuring Directors: Protection Against Liability Under the Federal Securities Laws*, 72 *DUKE L.J.* 1153 (1972) [hereinafter Bishop, *New Problems*]; Joseph W. Bishop, Jr., *Sitting Ducks and Decoy Ducks: New Trends in the Indemnification of Corporate Directors and Officers*, 77 *YALE L.J.* 1078 (1968) [hereinafter Bishop, *Sitting Ducks*]; Donald E. Pease, *Indemnification Under Section 145 of the Delaware General Corporation Law*, 3 *DEL. J. CORP. L.* 167 (1978); E. Norman Veasey et al., *Delaware Supports Directors with a Three-Legged Stool of Limited Liability, Indemnification, and Insurance*, 42 *BUS. LAW.* 399 (1987).

3. See, e.g., DEL. CODE ANN. tit. 8, § 102(b)(7) (1994) (providing voluntary inclusion of provision in corporation's certificate of incorporation limiting or eliminating liability of directors to corporation and shareholders under certain circumstances); *id.* § 145(a)-(b) (permitting indemnification of directors and officers provided person acted in good faith and in manner individual reasonably believed to be in best interests of corporation); *id.* § 145(c) (requiring indemnification of directors and officers who have been successful on merits or otherwise in defending against action or claim). Delaware has erected a tripartite statutory scheme to provide directors and officers with protection from personal liability. See Veasey et al., *supra* note 2, at 399 (discussing Delaware's "three-legged stool" of protection, including limited liability, indemnification, and director and officer insurance). The first branch of protection is provided by § 102(b)(7), which allows corporations to limit or even eliminate director and officer liability for certain breaches of fiduciary duty in their certificate of incorporation. DEL. CODE ANN. tit. 8, § 102(b)(7). The second branch of protection in Delaware is provided by § 145 which empowers corporations to indemnify directors and officers for legal expenses incurred in a broad range of circumstances and requires such indemnification in other circumstances. *Id.* § 145(a)-(c). The final branch of protection is provided by § 145(g), which allows corporations to purchase and maintain direc-

of indemnification statutes that empower corporations to indemnify their directors and officers for expenses incurred in legal proceedings and, in some instances, requiring such indemnification.<sup>4</sup> In Delaware, the statutory authorization for corporate indemnification is found in § 145 of the Delaware Code.<sup>5</sup> Recently, in *Waltuch v. Conticommodity Services*,

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tor and officer liability insurance policies for their directors and officers. *Id.* § 145(g). For a thorough discussion of Delaware's statutory framework for protecting directors and officers from personal liability, see A. Gilchrist Sparks III et al., *Indemnification, Directors and Officers Liability Insurance and Limitations of Director Liability Pursuant to Statutory Authorization: The Legal Framework Under Delaware Law*, in PROXY CONTESTS, INSTITUTIONAL INVESTOR INITIATIVES, MANAGEMENT RESPONSES 1990, at 941, 948-60 (PLI Corp. Law Practice Course Handbook Series No. 696, 1990) and Veasey et al., *supra* note 2, at 399.

4. See, e.g., ARIZ. REV. STAT. §§ 10-850 to -858 (1996); ARK. CODE ANN. § 4-27-850 (Michie 1995); CAL. CORP. CODE § 317 (West 1996); CONN. GEN. STAT. §§ 33-771 to -778 (1994); FLA. STAT. ch. 607.0850 (1995); GA. CODE ANN. §§ 14-2-850 to -859 (1996); 805 ILL. COMP. STAT. 5/8.75 (West 1996); IND. CODE ANN. §§ 23-1-37-1 to -15 (Michie 1996); IOWA CODE §§ 490.850-858 (1995); N.Y. BUS. CORP. LAW §§ 721-726 (Consol. 1996); N.C. GEN. STAT. §§ 55-8-50 to -58 (1995); 15 PA. CONS. STAT. ANN. §§ 1741-1746 (West 1996); S.C. CODE ANN. §§ 33-8-500 to -580 (Law Cop. 1995); TENN. CODE ANN. §§ 48-18-501 to -509 (1996); TEX. BUS. CORP. ACT ANN. art. 2.02-1 (West 1996); VA. CODE ANN. §§ 13.1-697 to 877 (Michie 1996); WASH. REV. CODE ANN. §§ 23B.08.500-590 (West 1995); W. VA. CODE § 31-1-9 (1996).

Generally, indemnification under these statutes can be categorized as either permissive or mandatory. CHEW, *supra* note 2, at 231 ("The statutes typically distinguish between (1) indemnification that the corporation is required by law to provide, called mandatory indemnification; [and] (2) indemnification that the corporation is authorized but not required to provide, called permissive indemnification . . ."). Permissive indemnification provisions grant corporations the discretionary power to indemnify their directors and officers. *Id.* Mandatory indemnification provisions require corporations to indemnify their directors and officers under certain circumstances. *Id.* For a discussion of permissive and mandatory indemnification, see *infra* notes 61-135 and accompanying text.

5. See DEL. CODE ANN. tit. 8, § 145 (permitting, and in some instances, requiring Delaware corporations to indemnify directors, officers and others for expenses incurred in wide variety of legal proceedings). For a thorough discussion of corporate indemnification, see R. FRANKLIN BALOTTI & JESSE A. FINKELSTEIN, *THE DELAWARE LAW OF CORPORATIONS AND BUSINESS ORGANIZATIONS* § 4.12-4.18, at 180-200.6 (1985 & Supp. 1988); JOSEPH W. BISHOP, *THE LAW OF CORPORATE OFFICERS AND DIRECTORS INDEMNIFICATION AND INSURANCE* (1982 & Supp. 1996) [hereinafter BISHOP, *INDEMNIFICATION AND INSURANCE*]; CHEW, *supra* note 2; RALPH C. FERRARA ET AL., *SHAREHOLDER DERIVATIVE LITIGATION: BESIEGING THE BOARD* § 12 (1995); KNEPPER & BAILEY, *supra* note 2, at 281-333; SCHAEFTLER, *supra* note 2; EDWARD P. WELCH & ANDREW J. TUREZYN, *FOLK ON THE DELAWARE GENERAL CORPORATION LAW: FUNDAMENTALS* 241-52 (1996); S. Samuel Arsht, *Indemnification Under Section 145 of the Delaware General Corporation Law*, 3 DEL. J. CORP. L. 176 (1978); Joseph F. Johnston, Jr., *Corporate Indemnification and Liability Insurance for Directors and Officers*, 33 BUS. LAW. 1993 (1978); Frederic J. Klink et al., *Liabilities Which Can Be Covered Under State Statutes and Corporate By-Laws*, 27 BUS. LAW. 109 (1972); Joseph P. Monteleone & Nicholas J. Conca, *Directors and Officers Indemnification and Liability Insurance: An Overview of Legal and Practical Issues*, 51 BUS. LAW. 573 (1996); Sparks et al., *supra* note 3. For an analysis of corporate indemnification under the New Jersey statute, see Joseph E. Irenas & Ted Moskowitz, *Indemnification of Corporate Officers, Agents, and Directors: Statutory Mandates and Policy Limitations*, 7 SETON HALL LEGIS. J. 117

*Inc.*,<sup>6</sup> the United States Court of Appeals for the Second Circuit defined the parameters of indemnification powers and duties under § 145.<sup>7</sup>

This Note discusses the power and, in some instances, the duty of a corporation to indemnify its directors and officers under § 145 of the Delaware Code.<sup>8</sup> Part II briefly summarizes the relevant facts and legal issues presented to the Second Circuit in *Waltuch*.<sup>9</sup> Part III discusses the development of indemnification under Delaware law and attempts to define the parameters of § 145.<sup>10</sup> Part IV then provides a summary and critical analysis of the Second Circuit's opinion and construction of § 145 in *Waltuch*, finding it to be in accord with § 145 as it has been interpreted by courts and commentators.<sup>11</sup> Finally, Part V discusses the impact of the Second Circuit's opinion, concluding that in the wake of *Waltuch*, corporations entering into settlement agreements on behalf of their directors or officers should carefully consider the principles set forth in *Waltuch* when structuring those agreements in order to avoid the "double whammy" of mandatory indemnification.<sup>12</sup>

## II. *WALTUCH V. CONTICOMMODITY SERVICES, INC.*

Famed silver trader Norton Waltuch served as Chief Metals Trader and Vice-President for Conticommodity Services, Inc. ("Conti"), trading silver for the firm's clients as well as for himself.<sup>13</sup> In late 1979, Waltuch

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(1984). For a further discussion of § 145, see *infra* notes 61-135 and accompanying text.

6. 88 F.3d 87 (2d Cir. 1996).

7. For a discussion of the facts and issues presented in *Waltuch*, see *infra* notes 13-40 and accompanying text. For a discussion and analysis of the decision of the United States Court of Appeals for the Second Circuit in *Waltuch*, see *infra* notes 133-204 and accompanying text.

8. See DEL. CODE ANN. tit. 8, § 145(a)-(b) (providing corporations with broad power to indemnify directors and officers); *id.* § 145(c) (requiring corporations to indemnify directors and officers when they have successfully defended against action or claim). It should be noted that § 145 also applies to claims for indemnification by employees and agents as well as directors and officers. See *id.* § 145(a)-(b) (granting corporation power to indemnify "director, officer, employee or agent of the corporation"); *id.* § 145(c) (requiring corporations to indemnify "a director, officer, employee or agent of the corporation" under some circumstances). Because this Note is primarily concerned with director and officer liability and indemnification, its discussion of § 145 will refer only to directors and officers.

9. For a discussion of the facts and legal issues presented to the Second Circuit in *Waltuch*, see *infra* notes 13-40 and accompanying text.

10. For a general discussion of indemnification under § 145 of the Delaware Code, see *infra* notes 61-135 and accompanying text.

11. For a discussion of the Second Circuit's opinion in *Waltuch*, see *infra* notes 136-97 and accompanying text. For a critical analysis of the Second Circuit's opinion in *Waltuch*, see *infra* notes 180-97 and accompanying text.

12. For a discussion of the impact of the Second Circuit's decision in *Waltuch* and some practical suggestions in light of the opinion, see *infra* notes 198-207 and accompanying text.

13. *Waltuch v. Conticommodity Servs., Inc.*, 88 F.3d 87, 88 (2d Cir. 1996). Waltuch was the account executive in charge of Conticommodity's larger accounts.

heavily invested his domestic and foreign clients in silver and silver futures contracts.<sup>14</sup> During that period, the price of silver rose at a dramatic rate to unprecedented levels.<sup>15</sup> In a manner characteristic of many runaway markets, this all came to an abrupt close in March 1980, on the now infamous "Silver Thursday," when prices plummeted and the silver market collapsed<sup>16</sup> resulting in huge losses for both institutional and individual investors alike.<sup>17</sup> Shortly thereafter, angry investors brought numerous suits against both Waltuch and Conti jointly, alleging fraud, market manip-

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Karen W. Arenson, *Senate Hearing Is Told of Foreign Silver Losses*, N.Y. TIMES, June 27, 1980, at D2. Waltuch frequently made trips to the Commodity Exchange floor's trading ring to purchase vast quantities of silver for his clients. *Id.* In fact, his trips were so frequent and the sums bought were so large that he "earned the reputation for being able to spur the price of silver simply by appearing in the ring." *Id.*

14. *Waltuch*, 88 F.3d at 88. Among Waltuch's more notable clients were the billionaire Hunt brothers. Audrey Duff, *Big Suits*, AM. LAW., June 1989, at 23. Lamar Hunt, Nelson Bunker Hunt and William Herbert Hunt, collectively known as the Hunt brothers bought huge quantities of silver and silver futures. *See id.* at 23-24 (discussing Hunt litigation). In less than seven months, the Hunt brothers bought more than 100 million ounces of silver, an amount equal to one-half the world production of silver in 1979. *See* Laurie Cohen, *Hunts Charged in Silver Scheme 5-Year Probe Says Group Manipulated Market*, CHI. TRIB., Mar. 1, 1985, at C1 (discussing Commodity Futures Trading Commission (CFTC) investigation of Hunt brothers); Michael A. Hiltzik, *Hunt Brothers Accused of Manipulating Silver Futures in '79 and '80*, L.A. TIMES, Mar. 1, 1985, § 4, at 1 (discussing CFTC investigation of Hunt brothers); *see also* Jerry Knight & James Rowe, Jr., *Hunt Brothers' Thrill Ride in Silver Takes U.S. Close to Disaster*, WASH. POST, Apr. 17, 1980, at G1 (discussing CFTC investigation of Hunt brothers); Roy Rowan, *A Talkfest with the Hunts*, FORTUNE, Aug. 11, 1980, at 162 (interviewing Hunt brothers about their actions and silver market crash).

15. *See Waltuch*, 88 F.3d at 88 (noting that "in late 1979 and early 1980 the silver price spiked upward"). The price of silver increased five-fold in the period between late 1979 and early 1980, going from \$11 per ounce to a record high of \$50 per ounce. Cohen, *supra* note 14, at 1; *Hi Ho, Silver Away: International Metals Investment Co. Settles Commodities Futures Trading Commission Case*, INFO. ACCESS CO., June 1991, at 54 [hereinafter, *Hi Ho, Silver Away*].

16. *Waltuch*, 88 F.3d at 88. After peaking at \$50 per ounce, the price dropped back to \$11 per ounce. *Hi Ho, Silver Away*, *supra* note 15, at 54. Prices then plunged further to \$5 per ounce in March 1980. Cohen, *supra* note 14, at 1. The Hunt brothers inability to meet a \$100 million margin call on silver future positions partly caused this catastrophe. *Id.*; *see also* *Minpeco, S.A. v. Hunt*, 693 F. Supp. 58, 60-61 (S.D.N.Y. 1988) (discussing rise and fall of silver prices associated with "Silver Thursday").

17. Arenson, *supra* note 13, at 2. Conticommodity ("Conti") lost \$20 million and the Hunt brothers incurred well over \$1 billion in debts. *Id.* According to one observer, the collapse did benefit at least one group: the lawyers who would represent the parties in the ensuing lawsuits. *See* Steven P. Garmisa, *Silver Trader Escapes Mother Lode of Legal Fees*, CHI. DAILY L. BULL., Sept. 4, 1996, at 5 (labeling Waltuch "[the] silver trader who became a golden client for law firms—racking up legal bills of \$2.2 million after the 'Silver Thursday' collapse"). The market crash was "bad for silver markets but great for legal futures, generating a large number of lawsuits against Waltuch and Conticommodity." *Id.* Ironically, Waltuch, who had been invested in the silver market, not only avoided harm by the crash, but emerged from the crash with profits in excess of \$10 million. Roy Rowan, *Who Guards Whom at the Commodity Exchange?*, FORTUNE, July 28, 1980, at 38.

ulation and antitrust violations.<sup>18</sup> Conti paid over \$35 million in settlement of the civil suits, all of which were dismissed with prejudice as to both Conti and Waltuch.<sup>19</sup> Waltuch assumed no liability to the civil plaintiffs and made no monetary contribution toward the settlement.<sup>20</sup> Waltuch did not escape from the event unscathed, however, he incurred \$1.2 million in unreimbursed legal fees in defending against the civil suits.<sup>21</sup>

In addition to the private civil suits, the Commodity Futures Trading Commission (CFTC) brought an enforcement proceeding against Waltuch, alleging fraud and market manipulation.<sup>22</sup> Waltuch eventually settled with the CFTC by agreeing to a six-month ban on buying or selling futures contracts from any exchange floor and paying a \$100,000 fine.<sup>23</sup> In addition to the fine, Waltuch incurred substantial expenses in defending against the enforcement proceeding totaling \$1 million in attorney fees and costs.<sup>24</sup>

Following settlement of the private and CFTC actions, Waltuch filed an action in the United States District Court for the Southern District of New York against Conti claiming indemnification for the legal expenses he incurred defending both the civil suits and the CFTC enforcement proceeding.<sup>25</sup> Waltuch's action set forth two claims for indemnification.<sup>26</sup> First, Waltuch claimed that "Article Ninth" of Conti's certificate of incorporation required Conti to indemnify him for the expenses incurred in both the civil and CFTC actions.<sup>27</sup> Article Ninth afforded indemnification

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18. *Waltuch*, 88 F.3d at 88. See, e.g., *Minpeco, S.A. v. Hunt*, 718 F. Supp. 168 (S.D.N.Y. 1989) (alleging "fraud and violations of Commodities Exchange Act, federal anti-trust statutes, and federal racketeering statute"); *Minpeco, S.A. v. Conticommodity Servs., Inc.*, 673 F. Supp. 684 (S.D.N.Y. 1987) (suing for conspiracy to manipulate market prices); *Strax v. Commodity Exch., Inc.*, 524 F. Supp. 936 (S.D.N.Y. 1981) (suing for conspiracy to manipulate silver prices and monopolize silver industry in violation of various federal and state antitrust laws).

19. *Waltuch*, 88 F.3d at 88; see Duff, *supra* note 14, at 23 (discussing settlements in class action suits filed by investors after silver market crash).

20. *Waltuch*, 88 F.3d at 88.

21. *Id.*

22. *Id.* For a discussion of the various CFTC proceedings brought in the wake of "Silver Thursday," see Cohen, *supra* note 14, at 1; Hiltzik, *supra* note 14, at 1.

23. *Waltuch*, 88 F.3d at 88; see also *CFTC Settles with Figure in Hunt Case*, CHI. TRIB., July 12, 1990, at C5 ("Without admitting or denying the allegations, Waltuch agreed to pay a civil penalty of \$100,000 and agreed to cease and desist from violating the anti-fraud provisions of the commodities laws.").

24. *Waltuch*, 88 F.3d at 88 & n.1.

25. *Waltuch v. Conticommodity Servs., Inc.*, 833 F. Supp. 302, 304-05 (S.D.N.Y. 1993), *aff'd in part, rev'd in part* by 88 F.3d 87 (2d Cir. 1996).

26. *Id.* at 304. The district court disposed of both claims on summary judgment. *Id.*

27. *Id.* at 306. "Article Ninth" of Conticommodity's certificate of incorporation specifically addressed the issue of indemnification, providing:

The Corporation shall indemnify and hold harmless each of its incumbent or former directors, officers, employees and agents . . . against expenses actually and necessarily incurred by him in connection with the defense of any action, suit or proceeding threatened, pending or com-

to Conti's directors and officers for expenses incurred in the defense of any legal action so long as the individual claiming indemnification had not been found liable for negligence or misconduct in that action.<sup>28</sup> Waltuch argued that he had clearly not been "adjudged liable for negligence or misconduct" and as such was entitled to indemnity under Article Ninth.<sup>29</sup> Moreover, Waltuch argued that he was entitled to indemnification under Article Ninth even in the absence of good faith pursuant to § 145(f) of the Delaware Code.<sup>30</sup>

Conti countered by arguing that, in addition to satisfying Article Ninth's internal standard of conduct, Waltuch was required to prove that he had acted in "good faith" pursuant to § 145(a) of the Delaware Code.<sup>31</sup> The District Court agreed and denied Waltuch's motion for summary judgment on his claim for indemnification under Article Ninth.<sup>32</sup>

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pleted, in which he is made a party, by reason of his serving in or having held such position or capacity, except in relation to matters as to which he shall be adjudged in such action, suit or proceeding to be liable for negligence or misconduct in the performance of his duty.

*Id.*

28. *Id.* The district court agreed that "Article Ninth . . . [was] facially satisfied since Waltuch has not been 'adjudged . . . liable for negligence or misconduct in the performance of duty.'" *Id.* (citation omitted). Nonetheless, the court denied Waltuch's claim because it found Article Ninth to exceed the scope of Conti's power to indemnify as granted by § 145 of the Delaware Code. *Id.* at 309. For a discussion of the district court's decision, see *supra* notes 25-27, *infra* notes 29-40 and accompanying text.

29. *Waltuch*, 833 F. Supp. at 306 (noting "that [Waltuch] has satisfied the literal terms of Article Ninth and argues that this should 'end the matter'").

30. *Id.* at 306-07. Waltuch claimed that § 145(f), the nonexclusivity provision of the statute, allows a corporation to provide indemnification rights in addition to those contained in the statute. *Id.* For a discussion of § 145(f), see *infra* notes 96-112 and accompanying text. For a discussion and critical analysis of the Second Circuit's construction of subsection (f), see *infra* notes 136-62, and 180-97 and accompanying text.

31. *Waltuch*, 833 F. Supp. at 306-07. Section 145(a) grants corporations the power to indemnify directors, officer and others provided that the person seeking indemnification "acted in good faith and in a manner he reasonably believed to be in or not opposed to the best interests of the corporation." DEL. CODE ANN. tit. 8, § 145(a) (1994). For a further discussion of § 145(a), see *infra* notes 73-83 and accompanying text. Conti contended that Waltuch was unable to meet this burden and was therefore not entitled to indemnification under the statute. *Waltuch*, 833 F. Supp. at 306. Waltuch countered that Article Ninth was an example of the additional rights to indemnification that a corporation could provide under § 145(f), and because it contained no good faith requirement he was entitled to indemnification even in the absence of good faith on his part. *Id.* at 306-07. Neither the district court nor the Second Circuit fully considered whether Waltuch had acted in good faith. See *Waltuch v. Conticommodity Servs., Inc.*, 88 F.3d 87, 89 (2d Cir. 1996) (explaining that on appeal issue before court was "how to interpret . . . 145(a) and 145(f) assuming Waltuch acted with less than 'good faith'").

32. *Waltuch*, 833 F. Supp. at 306-09. As a procedural note, Waltuch eventually agreed to forgo trial on the issue of his good faith. *Waltuch*, 88 F.3d at 89. A final judgment was entered against him on his claim based upon Article Ninth, and the district court certified the issues for appeal. *Waltuch v. Conticommodity Servs., Inc.*, No. 92 Civ. 0383, 1994 U.S. Dist. LEXIS 1392, at \*1-6 (S.D.N.Y. Feb. 10, 1994).

In the alternative, Waltuch claimed that even if he was not to be indemnified under Article Ninth, he was entitled to indemnification as a matter of right under § 145(c) of the Delaware Code because he was "successful on the merits or otherwise" in defending the civil suits.<sup>33</sup> Waltuch made this argument because the civil actions against him had been dismissed with prejudice without his assuming any liability.<sup>34</sup>

Conti, on the other hand, reasoned that the payments it made in settlement were directly attributable to Waltuch's conduct and that, as a result, its payments were made on Waltuch's behalf.<sup>35</sup> Consequently, Waltuch's dismissals with prejudice were not truly achieved without payment and could not be considered "successful" under the statute.<sup>36</sup> Again, the district court agreed with Conti and granted its motion for summary judgment with respect to Waltuch's claim for indemnification under § 145(c).<sup>37</sup>

Waltuch appealed the district court's decision regarding his indemnification claims to the United States Court of Appeals for the Second Circuit.<sup>38</sup> The Second Circuit affirmed the district court's decision that Waltuch could not receive indemnification under Article Ninth of Conti's certificate of incorporation in the absence of good faith.<sup>39</sup> The court of appeals, however, reversed the district court's decision to deny Waltuch's claim for mandatory indemnification under § 145(c).<sup>40</sup>

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33. *Waltuch*, 88 F.3d at 89; see DEL. CODE ANN. tit. 8, § 145(c) (providing for mandatory indemnification of expenses incurred when individual has been "successful on the merits or otherwise" in defending action). For a further discussion of mandatory indemnification under § 145(c), see *infra* notes 113-38 and accompanying text.

34. *Waltuch*, 833 F. Supp. at 310.

35. *Id.* at 309-10.

36. *Id.*

37. *Id.* at 309-12. The court granted Conti's motion for summary judgment, denying Waltuch's claims under § 145(c) as to all of the civil plaintiffs with the exception of one. *Id.* at 311. The court granted Waltuch's claim for the indemnification of expenses incurred in connection with the Michelson suit because he had been successful on the merits or otherwise in asserting a technical defense of insufficient service of process. *Id.* at 310-11. With respect to the other claims, the district court agreed with Conti that Waltuch had not been truly "successful" in defending the remaining private suits because he was only dismissed from the case as a result of Conti making payments on his behalf in settlement. *Id.* at 311. Specifically, the court stated: "Being bailed out is not the same as being vindicated." *Id.* The court later certified the issue for appeal. *Waltuch*, 1994 U.S. Dist. LEXIS 1392, at \*1-6.

38. *Waltuch*, 88 F.3d at 87.

39. *Id.* at 89. For a discussion of the Second Circuit's analysis of the issue on appeal, see *infra* notes 139-62 and accompanying text.

40. *Waltuch*, 88 F.3d at 89. The district court denied indemnification under § 145(c) for Waltuch's legal expenses in both the private civil actions and the CFTC proceeding. *Waltuch*, 833 F. Supp. at 311. Waltuch appealed the ruling only with respect to the expenses incurred in the civil actions. *Waltuch*, 88 F.3d at 89 n.4. For a discussion of the Second Circuit's analysis of § 145(c), see *infra* notes 163-79 and accompanying text. For a critical analysis of the Second Circuit's construction of § 145(c), see *infra* notes 190-97 and accompanying text.

## III. BACKGROUND—CORPORATE POWER TO INDEMNIFY

A. *The Liability Problem Confronting Corporations*

Corporate directors and officers have become increasingly concerned with the personal liabilities that may occasion their offices.<sup>41</sup> Individuals considering whether to become a director or officer are bitterly aware of the large judgments rendered against corporate directors and officers in recent years.<sup>42</sup> In addition to the substantial judgment and settlement amounts, directors and officers also face the specter of the enormous attorney fees associated with defending against these claims.<sup>43</sup> In fact, one court has even gone so far as to state that "[l]itigation is an occupational hazard for corporate directors."<sup>44</sup>

The problem of director and officer liability has become exacerbated in recent years because there has been a dramatic increase in the potential threats of personal liability accompanied by an erosion of the traditional protection against such threats.<sup>45</sup> On one side of the problem, there has been a significant increase in the volume of lawsuits launched against corporate directors and officers seeking to impose personal liability upon them.<sup>46</sup> State and federal governments have added fuel to the fire by en-

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41. For a general discussion of director and officer personal liability, see authorities cited *supra* note 2.

42. See, e.g., *Clarkson Co. v. Shaheen*, 660 F.2d 506, 515 (2d Cir. 1981) (affirming judgment finding directors jointly and severally liable for \$53 million in damages); *Smith v. Van Gorkom*, 488 A.2d 858 (Del. 1985) (resulting in \$23 million settlement in suit against directors); see also *Sparks et al.*, *supra* note 3, at 943-44 (noting "the potential for enormous money judgments and settlements in derivative and stockholder class action suits" as cause of director and officer liability crisis); *Veasey et al.*, *supra* note 2, at 400-01 (noting that "every director of a public company is painfully aware of the celebrated damages case of *Smith v. Van Gorkom*, where directors were found personally liable in damages for gross negligence in hastily approving a merger transaction").

43. See *CHew*, *supra* note 2, at 230 (noting that "[m]ounting a defense can cost hundreds of thousands of dollars," and that during late eighties, "the average defense costs of a major litigation were \$476,000" (citation omitted)). *Waltuch* incurred over \$2.2 million in attorney fees in defending both the civil and CFTC actions, illustrating the huge expense involved in director and officer defenses. *Waltuch*, 88 F.3d at 88.

44. *Heffernan v. Pacific Dunlop GNB Corp.*, 965 F.2d 369, 369 (7th Cir. 1992). Despite this potential hazard, the court observed that litigation expenses "may often be shifted to the corporation through indemnification." *Id.*; see also *SCHAEFTLER*, *supra* note 2, at 1 (noting that "[t]he liabilities of office of a corporate executive have increased substantially with the growth of business and the important role played by the publicly held corporations in modern society"); *Bishop*, *New Problems*, *supra* note 2, at 1153 (noting that "the Damocles' sword of personal liability is as much a part of the furniture of the executive suite as the Bigelow on the floor").

45. For a discussion of the increase in the personal liability of directors and officers, see *infra* notes 46-47 and accompanying text. For a discussion of the erosion of the traditional protections against director and officer personal liability, see *infra* notes 48-50 and accompanying text.

46. See *CHew*, *supra* note 2, at 2 (noting "[t]he increasing number and types of lawsuits are sensitizing directors and officers to the personal risks inherent in their

acting and promulgating new statutory and regulatory mandates.<sup>47</sup> At the same time, the principal protection against these new threats of liability, director and officer liability insurance, has deteriorated in recent years.<sup>48</sup> Faced with the proliferation of potential liability, some individuals have determined that the risks of office outweigh the benefits and have decided not to serve as directors and officers.<sup>49</sup> Consequently, in order to attract and retain qualified individuals to serve as directors and officers, corporations have been forced to provide an efficient and comprehensive shield against personal liability.<sup>50</sup> Indemnification has proven to be an indispensable component of this shield.

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fiduciary roles"). The number of lawsuits filed against directors and officers is increasing rapidly at an annual rate of between 15% and 20%. *Id.* Surveys of directors and officers in 1990 and 1991 revealed that 25% had been the object of a lawsuit. *Id.*

47. See Johnston, *supra* note 5, at 1993-94 (noting modern expansion of state and federal consumer-oriented statutes has created new causes of action which have "added a new impetus to the remarkable litigiousness of American society").

48. See Sparks et al., *supra* note 3, at 943-44 (discussing erosion of liability insurance coverage for directors and officers). Historically, director and officer (D&O) liability was not a problem. Beginning in 1984, however, the director and officer liability environment became very different. *Id.* At that time, concern for director and officer liability was sparked by "i) increased premiums . . . for D&O insurance[;] . . . ii) decreased availability of D&O insurance; . . . and iii) proliferat[ion] of exclusions to D&O . . . policies." *Id.* In 1986 alone, insurance premiums for directors and officers increased by 500% and deductibles doubled. CHEW, *supra* note 2, at 242. For a general discussion of directors' and officers' insurance, see BISHOP, INDEMNIFICATION AND INSURANCE, *supra* note 5, § 8, at 8-1 to 8-47; CHEW, *supra* note 2, at 242-62; KNEPPER & BAILEY, *supra* note 2, at 335-488; Monteleone & Conca, *supra* note 5, at 584-619; Sparks et al., *supra* note 3, at 961-97; Karen Leigh Chapman, Note, *Statutory Responses to Boardroom Fears*, 1987 COLUM. BUS. L. REV. 749, 752-56.

49. See SCHAEFTLER, *supra* note 2, at 2 (noting "the growing reluctance of competent people to join the board"); Pease, *supra* note 2, at 167 (noting that nominees for directorships are concerned about growing number of cases imposing liability upon directors for negligence); Sparks et al., *supra* note 3, at 945 ("Qualified persons . . . [are] reluctant to serve as directors if they perceive [ ] that the insurance and indemnification available to them . . . [are] inadequate because of the possible . . . risks involved in such service."); Laura Baum & John A. Byrne, *The Job Nobody Wants*, BUS. WEEK, Sept. 8, 1986, at 56 (noting that only two out of five individuals offered executive positions at major corporation accepted as opposed to four out of five who accepted five years earlier); Tamar Lewin, *Directors Insurance Drying Up*, N.Y. TIMES, Mar. 7, 1986, at D1 (noting that directors of five major corporations all resigned when their insurance policies ended).

50. Dennis J. Block et al., *Indemnification and Insurance of Corporate Officials*, 13 SEC. REG. L.J. 239, 239 (1985). Discussing the director and officer liability crisis, the authors state:

To get the best individuals to fill the slots of officers and directors, it often is not enough to offer attractive remuneration. It is also necessary to provide for a shield against the threat of lawsuits through the promise of indemnification and directors and officers liability insurance.

*Id.*; see also Pease, *supra* note 2, at 167-68 (noting "one of the first questions asked by a new nominee to a board of directors is whether the company has an indemnification provision in its bylaws" because nominees are concerned about increase in director liability); Veasey et al., *supra* note 2, at 400 ("In view of the substantial

### B. *The Development of Indemnification Protection*

A corporation's power to indemnify officers and directors for legal expenses was not firmly established at common law.<sup>51</sup> Many courts held that a corporation did not have the power to indemnify their directors and officers for expenses incurred in defending lawsuits.<sup>52</sup> In the mid-twentieth century, however, some courts began to recognize the need for corporate indemnification.<sup>53</sup> More importantly, the uncertainty at common law prompted many corporations and their executives to petition their legislatures to enact explicit statutory authorization for indemnification.<sup>54</sup> State

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judgments rendered against directors by the courts in recent years . . . directors are demanding increased protection from personal liability.”).

51. See CHEW, *supra* note 2, at 231 (noting that “the common law on indemnification was . . . confusing and unpredictable”); Arsh, *supra* note 5, at 176 (noting “there had been divergent holdings by the courts in New York and New Jersey on the question of whether the common law provided a right of indemnification”); Norwood P. Beveridge, *Does the Corporate Director Have a Duty to Always Obey the Law?*, 45 DEPAUL L. REV. 729, 748 (1996) (noting existence of “questions present at corporate common law about the corporation’s authority to indemnify”); Monteleone & Conca, *supra* note 5, at 574 (“In years past, corporate employers were not permitted to protect their corporate officials in the form of indemnification.”).

For a general discussion of the common law on corporate indemnification, see BISHOP, INDEMNIFICATION AND INSURANCE, *supra* note 5, § 6.01, at 6-3 to 6-4; KNEPPER & BAILEY, *supra* note 2, at 281-83; Klink et al., *supra* note 5, at 109-11.

52. See, e.g., *New York Dock Co. v. McCollom*, 16 N.Y.S.2d 844 (Sup. Ct. 1939) (holding there was no common law basis allowing corporations to indemnify corporate directors that successfully defend derivative suits); *Griess v. Lang*, 175 N.E. 222 (Ohio Ct. App. 1931) (holding corporations have no power to indemnify officers who successfully defend against shareholder actions); see also Klink et al., *supra* note 5, at 109 (noting that many cases and commentators have stated that “at common law there was no right of indemnification”); Monteleone & Conca, *supra* note 5, at 574 (noting that historically corporations could not protect officials through indemnification). Most courts reasoned that corporations should be precluded from indemnifying their directors and officers because such payments were not viewed as benefitting the corporation or the shareholders. *Id.* at 573. Furthermore, these courts found it difficult to uphold indemnification because many suits against directors and officers did not fit neatly into traditional common law principles of agency. Johnston, *supra* note 5, at 1994-95.

53. See, e.g., *In re Dissolution of E.C. Warner Co.*, 45 N.W.2d 388, 391-93 (Minn. 1950) (upholding corporation’s power to indemnify); *Solimine v. Hollander*, 19 A.2d 344, 348 (N.J. Ch. 1941) (upholding corporation’s power to indemnify); see also Monteleone & Conca, *supra* note 5, at 573-74 (noting “[in] the 1940s and 1950s . . . courts began to realize that a key ingredient to effective corporate management was the protection of corporate officials from personal liability”). Some courts allowed for indemnification even earlier but only under certain circumstances. For example, some courts would only uphold indemnification if the director or officer had been successful in defending a suit. See, e.g., *Wickersham v. Crittenden*, 39 P. 603 (Cal. 1895); *Hollander v. Breeze Corp.*, 26 A.2d 507 (N.J. Ch. 1942). Still other courts would only allow for indemnification if the director or officer could prove that the underlying litigation had been beneficial to the corporation. See, e.g., *Jesse v. Four-Wheel Drive Auto Co.*, 189 N.W. 276 (Wis. 1922).

54. See BISHOP, INDEMNIFICATION AND INSURANCE, *supra* note 5, § 6.02, at 6-4 to 6-5 (noting that *McCollom* decision disturbed business community leading to reform of indemnification laws); Monteleone & Conca, *supra* note 5, at 573-74

legislatures responded positively by enacting enabling legislation conveying broad indemnification powers upon corporations.<sup>55</sup>

Consistent with this trend, Delaware enacted § 145 of the Delaware Code to provide Delaware corporations with generous indemnification powers.<sup>56</sup> Courts have liberally construed this section giving it an expansive application.<sup>57</sup> Section 145 is intended to promote two significant policy objectives.<sup>58</sup> First, § 145 is intended to encourage capable individuals to serve as corporate directors and officers by allaying their concerns over potential personal liability through the vehicle of indemnification.<sup>59</sup> Sec-

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("[C]orporate officials vigorously began to pursue the protection of corporate indemnification and corporations responded by seeking the power [from legislatures] to indemnify their directors and officers.").

55. See CHEW, *supra* note 2, at 231 ("[B]ecause the common law on indemnification was so confusing and unpredictable, states have adopted statutes specifying when the corporation may indemnify its officers and directors."); Bishop, *Sitting Ducks*, *supra* note 2, at 1078-79 (noting concern of personal liability held by corporate directors and officers "stimulated . . . the legislatures of most states of incorporation to devise . . . statutes authorizing indemnification of corporate executives under certain circumstances"); Johnston, *supra* note 5, at 1995 (noting that after *McCullom* "[t]he legislatures in the business-oriented states quickly responded by adopting statutes authorizing corporations to indemnify directors and officers"); Monteleone & Conca, *supra* note 5, at 573-74 (noting that not long after corporations sought empowering legislation, "legislatures began to enact statutory schemes permitting corporate indemnification").

It appears that the first indemnification statute was the British Clauses and Consolidation Act of 1845. Klink et al., *supra* note 5, at 110. The Act provided that a director carrying out an activity within his powers with the corporation is entitled to indemnification from the corporation for any liability incurred in executing his powers. *Id.* In modern times, all 50 states have enacted statutes authorizing corporations to indemnify their directors and officers. KNEPPER & BAILEY, *supra* note 2, at 283. For examples of state indemnification statutes, see authorities cited *supra* note 4. The Revised Model Business Corporation Act also contains a provision conveying broad indemnification powers upon corporations. REV. MODEL BUS. CORP. ACT §§ 8.50-59 (1994).

56. See WELCH & TUREZYN, *supra* note 5, § 145.1, at 245 ("Section 145 addresses the power of a Delaware corporation to indemnify its directors [and] officers . . . [it] confers broad, flexible indemnification powers."); Veasey et al., *supra* note 2, at 404 ("Section 145 of the Delaware General Corporation Law is the statutory authority for indemnification."). For a thorough analysis of § 145, see BALOTTI & FINKELSTEIN, *supra* note 5, §§ 4.12-18, at 180-200.6; WELCH & TUREZYN, *supra* note 5, § 145.1-7, at 245-52; Arsht, *supra* note 5, at 176-81; S. Samuel Arsht & Walter K. Stapleton, *Delaware's New General Corporation Law: Substantive Changes*, 23 BUS. LAW. 75, 77-80 (1967); Klink et al., *supra* note 5, at 109-30; Pease, *supra* note 2, at 167-75; Sparks et al., *supra* note 3, at 948-61.

57. See *Heffernan v. Pacific Dunlop GNB Corp.*, 965 F.2d 369, 375 (7th Cir. 1992) ("Both the language and the purpose of Delaware's indemnification statute support interpreting its scope expansively.").

58. See Veasey et al., *supra* note 2, at 404 ("The two-fold policy of section 145 is: (i) to encourage corporate officials to resist what they consider unjustified suits and claims 'secure in the knowledge that their reasonable expenses will be borne by the corporation they have served if they are vindicated,' and (ii) to encourage capable persons to serve as corporate directors." (citation omitted)).

59. See *Mooney v. Willys-Overland Motors*, 204 F.2d 888, 898 (3d Cir. 1953) (construing § 145's predecessor and stating "[i]t seems clear that the purpose of

ond, § 145 is intended to encourage directors and officers to actively resist unjustified suits with the assurance that the corporation will pay for the expenses associated with such defense.<sup>60</sup>

C. *The Statutory Framework of Indemnification Under § 145 of the Delaware Code*

Indemnification under § 145 is divided into two categories.<sup>61</sup> The first category is permissive indemnification, which finds its statutory basis

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statutes such as Delaware's is to encourage capable men to serve as corporate directors"); *Merritt-Chapman & Scott Corp. v. Wolfson*, 321 A.2d 138, 141 (Del. Super. Ct. 1974) (noting larger purpose of § 145 is "to encourage capable men to serve as corporate directors"); *see also* WELCH & TUREZYN, *supra* note 5, § 145.2, at 246 (stating that § 145's "larger purpose" is to encourage capable persons to serve as corporate directors and officers); *Monteleone & Conca*, *supra* note 5, at 574 (noting that indemnification statutes "were intended to encourage capable individuals to serve as directors and officers"). Those courts upholding the validity of indemnification at common law also recognized this public policy objective. *See In re Dissolution of E.C. Warner Co.*, 45 N.W.2d 388, 393 (Minn. 1950) (holding indemnification is "a sound policy favorable to the development of sound corporate management as a prerequisite for responsible corporate action"); *Solimine v. Hollander*, 19 A.2d 344, 348 (N.J. Ch. 1941) (stating indemnification should be allowed to encourage "responsible business men to accept the post of directors"). Two commentators suggest that:

The overriding goal of [statutory provisions such as § 145] was to protect directors and officers from personal liability resulting from business decisions. The statutes were intended to encourage capable individuals to serve as directors and officers secure in the knowledge that they would be insulated from personal liability if corporate actions, taken in good faith, were brought under attack by way of a legal proceeding.

*Monteleone & Conca*, *supra* note 5, at 573-74. For a discussion of the threats of personal liability to corporate directors and officers, *see supra* notes 41-50 and accompanying text.

60. *See McLean v. International Harvester Co.*, 902 F.2d 372, 375 (5th Cir. 1990) ("Indemnification under the Delaware statute is provided to assure corporate officials that they will not be hampered by financial constraints in mounting a full defense against unjustified suits."); *Mooney*, 204 F.2d at 898 (stating that indemnification statutes allow directors to resist claims "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"); *Essential Enters. Corp. v. Automatic Steel Prods.*, 164 A.2d 437, 441-42 (Del. Ch. 1960) (interpreting policy behind earlier Delaware indemnification statute as "promot[ing] the desirable end that corporate officials will resist what they consider to be [unjustified claims] . . . secure in the knowledge that their reasonable expenses will be borne by the corporation they have served if they are vindicated").

61. *See Wolfson*, 321 A.2d at 140 (noting that § 145 is divided into two categories: (i) "subsection (a) which permits indemnification" and (ii) "subsection (c) which requires indemnification"); CHEW, *supra* note 2, at 231 ("The statutes typically distinguish between (1) indemnification that the corporation is required by law to provide, called mandatory indemnification [and] (2) indemnification that the corporation is authorized but not required to provide, called permissive indemnification."); FERRARA ET AL., *supra* note 5, § 12.04 (noting that § 145 "distinguish[es] between situations in which the corporation must indemnify its directors and officers (i.e., mandatory indemnification) and those in which a corporation may indemnify its officers and directors (i.e., permissive indemnification)"); Bever-

in § 145(a) and (b).<sup>62</sup> Permissive indemnification under subsections (a) and (b) may, in some circumstances, be supplemented by § 145(f), which is also known as the nonexclusivity clause.<sup>63</sup> The second category is mandatory indemnification, which is provided in § 145(c).<sup>64</sup>

### 1. *Permissive Indemnification*

Generally, indemnification under § 145(a) and (b) is permissive in nature.<sup>65</sup> These subsections clearly establish corporate authority to indemnify directors and officers and effectively remove all questions regarding the existence of such authority at common law.<sup>66</sup> While these subsections convey the power to indemnify upon a corporation, they in no

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edge, *supra* note 51, at 748 ("These state statutes generally divide indemnification into two categories, permissive and mandatory."); Monteleone & Conca, *supra* note 5, at 574-75 (noting that "indemnification can be broadly categorized as 'mandatory' or 'permissive'").

62. DEL. CODE ANN. tit. 8, § 145(a)-(b) (1994) (granting corporations power to indemnify as long as indemnitee has acted in good faith and in manner consistent with corporation's best interests). For a further discussion of permissive indemnification under subsections (a) and (b), see *infra* notes 65-95 and accompanying text.

63. DEL. CODE ANN. tit. 8, § 145(f) (declaring § 145 not exclusive of other rights to indemnification possessed by individual). For a discussion of supplemental indemnification under § 145(f), see *infra* notes 96-112 and accompanying text. For a discussion of the Second Circuit's construction of subsection (f), see *infra* notes 139-62 and accompanying text.

64. DEL. CODE ANN. tit. 8, § 145(c) (requiring corporations to indemnify individuals who succeed in defending actions). For a further discussion of mandatory indemnification under subsection (c), see *infra* notes 113-35 and accompanying text. For a discussion of the Second Circuit's construction of subsection (c), see *infra* notes 163-79 and accompanying text. For a critical analysis of the Second Circuit's construction of subsection (c), see *infra* notes 190-97 and accompanying text.

65. See Klink et al., *supra* note 5, at 115 (noting "the permissive nature" of subsections (a) and (b) "with respect to third party as well as derivative actions"). For a general discussion of permissive indemnification, see CHEW, *supra* note 2, at 234.1-236; FERRARA ET AL., *supra* note 5, § 12.03; KNEPPER & BAILEY, *supra* note 2, at 295-99; Monteleone & Conca, *supra* note 5, at 576-80; Sparks et al., *supra* note 3, at 948-57.

66. See Beveridge, *supra* note 51, at 748 ("Permissive indemnification authorizes . . . the corporation to indemnify the director against certain liability, thereby removing questions present at common law about the corporation's authority to indemnify."). For examples of other state statutes authorizing permissive indemnification, see ARIZ. REV. STAT. § 10-005(A) to (B) (1996); ARK. CODE ANN. § 4-27-850(A) to (B) (Michie 1995); CAL. CORP. CODE § 317(b)-(c) (West 1996); CONN. GEN. STAT. § 33-771; DEL. CODE ANN. tit. 8, § 145 (1994); FLA. STAT. ch. 607.0850(1)-(2) (1995); GA. CODE ANN. § 14-2-851 (1996); 805 ILL. COMP. STAT. 5/8.75(a)-(b) (West 1996); IND. CODE ANN. § 23-1-37-8 (Michie 1996); IOWA CODE § 490.851 (1995); N.Y. BUS. CORP. LAW § 722(a)-(c) (Consol. 1996); N.C. GEN. STAT. § 55-8-51(a) (1995); 15 PA. CONS. STAT. ANN. §§ 1741-1742 (West 1996); S.C. CODE ANN. § 33-8-510 (Law Co-op. 1995); TENN. CODE ANN. § 48-18-502 (1996); TEX. BUS. CORP. ACT ANN. art. 2.02-1(B) (West 1996); VA. CODE ANN. § 13.1-697 (Michie 1996); WASH. REV. CODE ANN. § 23B.08.510 (West 1995); W. VA. CODE § 31-1-9(a) to (b) (1996).

way require the exercise of that power.<sup>67</sup> Rather, exercise of the power to indemnify directors and officers is wholly discretionary, and a director or officer is not entitled to indemnification unless the corporation provides for such protection in its by-laws or certificate of incorporation.<sup>68</sup>

Permissive indemnification under § 145 is further divided into two categories: suits brought by third parties; and suits brought by or in the right of the corporation.<sup>69</sup> Section 145(a) generally addresses the power

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67. See CHEW, *supra* note 2, at 234.1 (noting that permissive indemnification applies "where the corporation is authorized but not required to indemnify"); Pease, *supra* note 2, at 172 ("[Section 145(a) and (b)] of the Delaware corporation law only permits the corporation to, but does not require it, to make payments in indemnification of a director or officer.").

68. See *Waltuch v. Conticommodity Servs., Inc.*, 88 F.3d 87, 92-93 (2d Cir. 1996) (noting that subsections (a) and (b) are "permissive in the sense that a corporation may exercise less than its full power to grant the indemnification rights set out in these provisions"); *Bergstein v. Texas Int'l Co.*, 453 A.2d 467, 471 (Del. Ch. 1982) (noting that under § 145(b), it is not "assured that the corporation will necessarily choose to indemnify" its directors or officers); *KNEPPER & BAILEY, supra* note 2, at 285 ("Indemnification statutes merely permit indemnification . . . [t]hey do not confer any right to indemnification except when the statute or appropriate corporate action calls for mandatory indemnification."); *Veasey et al., supra* note 2, at 406 ("[Subsections (a) and (b)] are permissive. Implementation of the authority granted requires action by the corporation."). Most corporations do provide indemnity protection for their directors and officers in their certificate of incorporation or by-laws. Pease, *supra* note 2, at 171. Subsections (a) and (b) also empower a corporation to provide similar indemnity to their employees and agents. *Id.* The by-laws and certificates of incorporation of many corporations do not extend, however, the protection of indemnification to employees and agents. Instead, they restrict such protection to directors and officers. *Id.* This illustrates that even though the statute includes "employees" and "agents," it is only an enabling act, and therefore, it provides indemnification only where the corporation so chooses. Nonetheless, employees and agents are commonly entitled to indemnification through traditional agency principles. *Id.*; see also *WELCH & TUREZYN, supra* note 5, § 145.3, at 248 n.12 ("[I]ndemnification under subsections (a) and (b) is never guaranteed [because] . . . [i]t is the corporation's option, assuming it is financially feasible, to choose whether or not to indemnify its directors, officers, employees or agents."); *Beveridge, supra* note 51, at 748 ("Permissive indemnification authorizes, but does not require, the corporation to indemnify the director against certain liability, thereby removing questions present at corporate common law about the corporation's authority to indemnify."); *Monteleone & Conca, supra* note 5, at 574-75 (noting under permissive indemnification "corporations are afforded the power, but not necessarily the duty, to provide indemnification"); *Sparks et al., supra* note 3, at 952 (noting that § 145(a) has been interpreted to allow for indemnification of expenses of individuals as plaintiffs as well but that corporation can avoid having to pay such expenses by limiting its indemnification provision in its certificate or by-laws).

69. See CHEW, *supra* note 2, at 235 (noting that "statutes treat permissive indemnification differently, depending on whether the plaintiff is a third party [or the corporation]"); *WELCH & TUREZYN, supra* note 5, § 145.3, at 246-47 ("The statute distinguishes (1) suits by or in the right of the corporation and (2) any other type of suits or proceedings (third party actions), and declares the standards applicable to each category."); *Beveridge, supra* note 51, at 748 ("Typically, permissive indemnification provisions are further divided into two categories: (1) suits brought by or on the behalf of the corporation . . . and (2) suits brought by third parties, public or private."); *Klink et al., supra* note 5, at 111 (noting that Delaware

of a corporation to indemnify its directors, officers and others for expenses incurred in connection with litigation or other proceeding initiated by third parties.<sup>70</sup> Section 145(b), on the other hand, deals exclusively with corporate authority to indemnify directors, officers and others for expenses incurred in actions brought by or in the right of the corporation (i.e., derivative suits).<sup>71</sup> While both subsections are permissive in nature, the scope of their indemnification coverage differs significantly.<sup>72</sup>

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"draw[s] a distinction between the indemnification in third party and derivative actions"; Sparks et al., *supra* note 3, at 948 ("Section 145 . . . distinguishes between suits brought by a corporation itself and suits brought by stockholders in the right of the corporation . . . and other actions.").

70. DEL. CODE ANN. tit. 8, § 145(a). For a discussion of indemnification for expenses incurred in third party actions under § 145(a), see *infra* notes 73-83 and accompanying text.

71. DEL. CODE ANN. tit. 8, § 145(b). For a discussion of indemnification for expenses incurred in suits brought by or on behalf of the corporation under § 145(b), see *infra* notes 84-95 and accompanying text.

72. See Monteleone & Conca, *supra* note 5, at 579 (noting significant differences in scope of indemnification between third party suits and those brought by or on behalf of corporation). For a discussion of the scope of indemnification under § 145(a) and (b), see *infra* notes 73-94 and accompanying text.

A number of states have adopted statutory schemes similar to Delaware. These states set forth two independent permissive indemnification subsections, one dealing with third party actions and another dealing with actions brought by or on behalf of the corporation. See, e.g., ARIZ. REV. STAT. § 10-005(A) to (B) (1996); ARK. CODE ANN. § 4-27-850(A) to (B) (Michie 1995); CAL. CORP. CODE § 317(b)-(c) (West 1996); FLA. STAT. ch. 607.0850(1)-(2) (1995); 805 ILL. COMP. STAT. 5/8.75(a)-(b) (West 1996); N.Y. BUS. CORP. LAW § 722(a)-(c) (Consol. 1996); 15 PA. CONS. STAT. ANN. §§ 1741-1742 (West 1996); W. VA. CODE § 31-1-9(a) to (b) (1996). Other states have adopted a different statutory framework. These states set forth a broad grant of power to indemnify directors and officers against expenses or liability incurred and then carve out an exception to that power where the director or officer has been found liable to the corporation. See, e.g., CONN. GEN. STAT. § 33-771 (1994); GA. CODE ANN. § 14-2-851 (1996); IOWA CODE § 490.851 (1995); N.C. GEN. STAT. § 55-8-51(a), (d) (1995); S.C. CODE ANN. § 33-8-510 (Law Co-op. 1995); TENN. CODE ANN. § 48-18-502 (1996); TEX. BUS. CORP. ACT ANN. art. 2.02-1(B) (West 1996); VA. CODE ANN. § 13.1-697 (Michie 1996); WASH. REV. CODE ANN. § 23B.08.510 (West 1995). The result under most of these statutes is the same as that under the Delaware model: under both statutory schemes a director may not be indemnified for damages or settlement expenses incurred in the event he or she is adjudged liable to the corporation. Sparks et al., *supra* note 3, at 951-52. For a discussion of the consequences of being adjudged liable to the corporation, see *infra* notes 88-95 and accompanying text.

In contrast, Indiana's statute does not distinguish between third party suits and those brought by or on behalf of the corporation. IND. CODE ANN. § 23-1-37-8 (Michie 1996). The Indiana statute provides in pertinent part:

(a) A corporation may indemnify an individual made a party to a proceeding because the individual is or was a director against liability incurred in the proceeding if:

- (1) The individual's conduct was in good faith; and
- (2) The individual reasonably believed:

(A) In the case of conduct in the individual's official capacity with the corporation, that the individual's conduct was in its best interests; and

### a. Third Party Actions

Section 145(a) conveys broad indemnification powers for actions brought against a corporate director or officer by third parties.<sup>73</sup> Generally, this section applies to any action brought against a director or officer so long as such action is not brought by or in the right of the corporation.<sup>74</sup> The scope of § 145(a) covers all such actions regardless of whether the litigant is a public or private person, or entity.<sup>75</sup> In addition, the section does not restrict the indemnification to expenses for commenced liti-

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(B) In all other cases, that the individual's conduct was at least not opposed to its best interests . . . .

*Id.* The Indiana statute simply provides corporations with the power to indemnify directors and officers irrespective of the character of the plaintiff. *Id.* Thus, the same rules apply even if the director or officer is adjudged liable to the corporation. *Id.*

73. See CHEW, *supra* note 2, at 232 (noting that under § 145 “[d]irectors and officers may receive indemnification in virtually any type of litigation or proceeding”); Monteleone & Conca, *supra* note 5, at 579 (noting third party actions “carr[y] relatively few limitations regarding the scope of indemnification that may be afforded”). Section 145(a) provides:

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

DEL. CODE ANN. tit. 8, § 145(a).

74. See Pease, *supra* note 2, at 168 (“A third party suit is one other than an action brought by or in the right of the corporation.”); Veasey et al., *supra* note 2, at 404 (noting that § 145(a) “applies only to third party actions, not to actions brought by or in the right of the corporation”). Section 145(b) deals specifically with suits brought by or in the right of the corporation. DEL. CODE ANN. tit. 8, § 145(b). For a discussion of § 145(b), see *infra* notes 84-95 and accompanying text.

75. See DEL. CODE ANN. tit. 8, § 145(a) (authorizing indemnification of expenses for “any threatened, pending or completed action, suit or proceeding, whether civil, criminal, administrative or investigative”); see also Monteleone & Conca, *supra* note 5, at 578 (noting that statute “is broad enough to encompass almost any legal proceeding, including those brought by private litigants or governmental agencies”); Pease, *supra* note 2, at 169 (noting § 145(a) authorizes cor-

gation; instead, it encompasses a broad range of legal proceedings including threatened, pending and completed actions.<sup>76</sup> Further, § 145(a) indemnifies directors, officers and others for expenses incurred in such actions both as plaintiffs and as defendants.<sup>77</sup> The scope of indemnifiable expenses under § 145(a) is extremely generous, authorizing corporations to indemnify directors and officers against expenses incurred, including attorney fees, judgments, fines and amounts paid in settlement.<sup>78</sup> This broad spectrum of expenses is limited only by a vague reasonableness standard.<sup>79</sup>

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porations to indemnify directors and officers for expenses incurred in defending criminal actions).

76. See DEL. CODE ANN. tit. 8, § 145(a) (granting power to indemnify for expenses of "any person who was or is a party or is threatened to be made a party to any threatened, pending or completed action, suit or proceeding, whether civil, criminal, administrative or investigative"); see also WELCH & TUREZYN, *supra* note 5, § 145.3, at 247 (noting that subsection (a) "applies to a broad variety of third party proceedings, whether threatened, pending or completed"). While it is clear that § 145 covers expenses incurred in traditional legal proceedings such as lawsuits, it is also broad enough to cover nontraditional proceedings as well. CHEW, *supra* note 2, at 232. Thus, § 145 can be used to provide indemnification for expenses incurred in alternative dispute resolution forums such as arbitration and mediation. *Id.*

77. See *Hibbert v. Hollywood Park, Inc.*, 457 A.2d 339 (Del. 1983) (holding former corporate directors entitled to indemnification for expenses incurred in connection with suits filed by them in unsuccessful bid for re-election); *Monteleone & Conca*, *supra* note 5, at 579 ("[T]here is no requirement under the statute that the action, suit or proceeding be brought *against* the director or officer." (emphasis added)). Typically, indemnification is sought by directors and officers when they have been forced to defend themselves in a lawsuit or other legal proceeding. *Id.* Nonetheless, the statute speaks of the director being made a "party" to a legal proceeding; not a "defendant." *Id.* Because both defendants and plaintiffs are "parties" to a legal proceeding, it follows that a director or officer who brings an action, suit or proceeding as a plaintiff is a "party" to such proceeding and thus may be entitled to indemnification. *Id.*; see also CHEW, *supra* note 2, at 232-33 (noting that corporations may indemnify directors and officers when they act as parties suing as opposed to being sued because § 145 "indicates that the corporation may indemnify a director or an officer who is a 'party' to a proceeding"). In contrast, some states have expressly restricted the application of their indemnification statutes exclusively to directors and officers who were defendants in legal proceedings. See, e.g., TEX. BUS. CORP. ACT ANN. art. 2.02-1(B) (West Supp. 1996) (limiting indemnification of directors and officers to expenses incurred as defendants).

78. DEL. CODE ANN. tit. 8, § 145(a); see Veasey et al., *supra* note 2, at 404-05 ("Section 145(a) permits indemnification of officers, directors, employees and agents for attorneys' fees and other expenses as well as judgments or amounts paid in settlement of civil cases.").

79. See DEL. CODE ANN. tit. 8, § 145(a) (providing indemnification "against expenses (including attorneys' fees), judgments, fines and amounts paid in settlement actually and reasonably incurred by [indemnitee] in connection with such action"); see also *Monteleone & Conca*, *supra* note 5, at 579 (noting that "indemnification of a director or officer may be objectionable if the amounts indemnified are unreasonably excessive"). The standards used to determine the reasonableness of expenses incurred are similar to those typically used by courts in determining

While § 145(a) gives corporations broad indemnification power, that power is not unlimited.<sup>80</sup> Section 145(a) contains two significant public policy limitations upon the power to indemnify.<sup>81</sup> First, the section explicitly sets forth a good faith requirement that must be satisfied.<sup>82</sup> Second, in

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whether to award fees. *Merritt-Chapman & Scott Corp. v. Wolfson*, 321 A.2d 138, 143 (Del. Super. Ct. 1974).

Some states impose a stricter standard requiring that expenses be "actually and necessarily" incurred. *See, e.g.*, N.Y. BUS. CORP. LAW § 722(a) (Consol. 1995). The scope of indemnifiable expenses under such a statute would be narrower than under a statute requiring only that expenses be reasonable. *See* KNEPPER & BAILEY, *supra* note 2, at 295 ("Anything necessary would presumably be reasonable, but an expenditure might be reasonable although not necessary."); *see also* Tillman v. Wheaton-Haven Recreation Ass'n, 580 F.2d 1222, 1227 (4th Cir. 1978) (noting that by-law requirement that expenses be actually and necessarily incurred was stricter requirement than Maryland statute requiring expenses be actually and reasonably incurred).

80. *See* DEL. CODE ANN. tit. 8, § 145(a) (allowing indemnification in third party suits only if indemnitee acted in good faith and in manner reasonably believed consistent with best interests of corporation).

81. *See id.* (providing that corporations may indemnify directors, officers and others provided that they "acted in good faith and in a manner he reasonably believed to be in or not opposed to the best interests of the corporation"); *see also* CHEW, *supra* note 2, at 235 ("Corporations are permitted to indemnify directors for their expenses and liability from a civil case brought by a third party if they (1) acted in 'good faith' and (2) reasonably believed that their conduct was in the corporation's best interests."). Section 145(a) includes a third policy limitation applicable to expenses incurred in connection with a criminal proceeding. DEL. CODE ANN. tit. 8, § 145(a). In such a case, indemnification is available as long as the individual "had no reasonable cause to believe his conduct was unlawful." *Id.* For a further discussion of indemnification for criminal actions, *see* Pamela H. Bucy, *Indemnification of Corporate Executives Who Have Been Convicted of Crimes: An Assessment and Proposal*, 24 IND. L. REV. 279 (1991).

82. *See* DEL. CODE ANN. tit. 8, § 145(a) (providing corporations with power to indemnify individuals for expenses incurred in third party actions "if [the individuals] acted in good faith"); Pease, *supra* note 2, at 168 (noting that in third party actions, indemnification is available "provided it is found that he acted in good faith"); *see also* Arsht & Stapleton, *supra* note 56, at 78 (discussing good faith standard under § 145).

Most commentators agree that both the good faith and reasonable belief standards are premised upon the principle of a "duty of loyalty" and not the "duty of care." *See* KNEPPER & BAILEY, *supra* note 2, at 298 (noting commentators agree good faith requirement is based on duty of loyalty concept, not duty of care); Sparks et al., *supra* note 3, at 949-50 ("The legislative history of Section 145 indicates that both the 'good faith' and 'reasonable belief' standards were premised upon 'duty of loyalty' and not 'duty of care' concepts."). Indeed the principal drafter of the 1967 revisions that added the good faith and best interests requirement has stated that the amendments were intended to prevent the statute from undermining the duty of loyalty. Arsht & Stapleton, *supra* note 56, at 78. This distinction is significant because it means that a director or officer who has been found liable to the corporation for breach of the duty of care owed to the corporation may still be eligible for indemnification as long as the director or officer has not breached his or her duty of loyalty. KNEPPER & BAILEY, *supra* note 2, at 298. For example, in the celebrated case of *Smith v. Van Gorkom*, 488 A.2d 858 (Del. 1985), the directors were adjudged liable for gross negligence, but there was no evidence that they had not acted in good faith or violated their duty of loyalty. *Id.* Consequently, they might still be eligible for indemnification if all other condi-

addition to establishing good faith, indemnification requires that a director or officer seeking indemnification demonstrate that he or she acted in a manner reasonably believed to be consistent with the best interests of the corporation.<sup>83</sup>

b. Actions by or in the Right of the Corporation—Derivative Suits

Section 145(b) specifically addresses the power of a corporation to indemnify its directors and officers for expenses incurred in connection with an action brought "by or in the right of the corporation."<sup>84</sup> Typically, these actions occur when a director or officer breaches one of the duties

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tions were met. *KNEPPER & BAILEY*, *supra* note 2, at 298; *see also* Sparks et al., *supra* note 3, at 949-50 (noting that in *Van Gorkom*, indemnification would be permissible because, the "Delaware Supreme Court emphasized that the 'grossly negligent' violation of the duty of care . . . did not involve lack of good faith on the part of the directors and, arguably, therefore, no duty of loyalty violation of the type the 'good faith' and 'reasonable belief' tests were meant to implicate").

The Official Comment to the Revised Model Business and Corporations Act section expressly states that the good faith and reasonable belief requirements are applicable to the duty of loyalty and not to the duty of care. *See* REV. MODEL BUS. CORP. ACT § 8.51(a) cmt. 1 (1994) (stating that "section 8.51(a) authorizes indemnification at the corporation's option even though section 8.30's due care requirement is not met"); Sparks et al., *supra* note 3, at 950 (noting that under § 8.51 "a director or officer who has not acted with the care an ordinarily prudent person in a like position would exercise under similar circumstances, required by section 8.30, could nevertheless be indemnified if the standard of section 8.51 (the indemnification provision) were met").

83. *See* DEL. CODE ANN. tit. 8, § 145(a) (providing corporations may indemnify individuals if such individual acted "in a manner he reasonably believed to be in or not opposed to the best interests of the corporation"); Pease, *supra* note 2, at 168-69 (noting that in third party actions indemnification is available "provided it is found that he acted in . . . a manner he reasonably believed to be in or not opposed to the best interests of the corporation"). Virtually every state indemnification statute contains an identical code of conduct. For examples of such statutes, *see* authorities cited *supra* note 66.

84. DEL. CODE ANN. tit. 8, § 145(b). Section 145(b) provides:

A corporation shall have power to indemnify any person who was or is a party or is threatened to be made a party to any threatened, pending or completed action or suit by or in the right of the corporation to procure a judgment in its favor by reason of the fact that he is or was a director, officer, employee or agent of the corporation, or is or was serving at the request of the corporation as a director, officer, employee or agent of another corporation, partnership, joint venture, trust or other enterprise against expenses (including attorneys' fees) actually and reasonably incurred by him in connection with the defense or settlement of such action or suit if he acted in good faith and in a manner he reasonably believed to be in or not opposed to the best interests of the corporation and except that no indemnification shall be made in respect of any claim, issue or matter as to which such person shall have been adjudged to be liable to the corporation unless and only to the extent that the Court of Chancery or the court in which such action or suit was brought shall determine upon application, that, despite the adjudication of liability but in view of all the circumstances of the case, such person is fairly and reasonably entitled to indemnity for such expenses which the Court of Chancery or such court shall deem proper.

he or she owes to the corporation.<sup>85</sup> The corporation then maintains an action against such director or officer for damages suffered by the corporation as a result of the breach.<sup>86</sup> Actions brought by or in the right of the corporation are either maintained directly by the corporation itself or, alternatively, by a shareholder or shareholders in a "derivative suit" on behalf of the corporation to recover losses suffered by the corporation.<sup>87</sup>

The most significant difference between subsections (b) and (a) is that the scope of expenses that a corporation is authorized to indemnify is narrower under subsection (b).<sup>88</sup> While the scope of expenses under subsection (a) allows for indemnification of amounts paid in settlement or under judgments, subsection (b) does not permit indemnification of such amounts in actions brought by or in the right of the corporation.<sup>89</sup> Sub-

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*Id.* For examples of similar statutory sections dealing exclusively with actions brought by or in the right of the corporation, see ARIZ. REV. STAT. § 10-005(B) (1996); ARK. CODE ANN. § 4-27-850(B) (Michie 1995); CAL. CORP. CODE § 317(c) (West 1996); FLA. STAT. ch. 607.0850(2) (1995); 805 ILL. COMP. STAT. 5/8.75(b) (West 1996); N.Y. BUS. CORP. LAW § 722(c) (Consol. 1996); 15 PA. CONS. STAT. ANN. § 1742 (West 1996); W. VA. CODE § 31-1-9(b) (1996).

85. See Monteleone & Conca, *supra* note 5, at 579-80 (explaining that an "action by or in the right of the corporation" takes place "in the event a director or officer breaches his or her duties to the corporation," and in such case, "the corporation may pursue a legal action to collect the losses incurred as a result of such wrongful conduct").

86. See *id.* at 580 (noting that when director or officer violates duty owed "the corporation assumes the capacity of plaintiff asserting claims against its director or officer").

87. See CHEW, *supra* note 2, at 235 ("The corporation may be the plaintiff in a suit against its directors or officers in two circumstances: (1) when the corporation sues its directors or officers on its own behalf (direct corporate actions) and (2) when shareholders sue the directors or officers on the corporation's behalf (derivative actions)."); see also MCI Telecomms. v. Wanzer, C.A., Nos. 89C-MR-216, 89C-SE-26, 1990 Del. Super. LEXIS 222, at \*9-18 (Del. Super. Ct. June 19, 1990) (holding that actions "by or in the right of the corporation" under subsection (b) include direct actions brought by corporation); Monteleone & Conca, *supra* note 5, at 579-80 (noting that in event of breach of fiduciary duty, corporation may bring action on its own directly against director or officer, or that "a shareholder may assert the claim on behalf of (or 'in the right of') the corporation—a so-called derivative action"). An action brought by a shareholder or shareholders on behalf of the corporation is known as a derivative suit and is the most common type of action falling under § 145(b). See Pease, *supra* note 2, at 168 (citing actions brought by shareholders against directors for damages corporation had to pay for violation of antitrust laws as example of derivative suit); Veasey et al., *supra* note 2, at 405 (noting § 145(b) most frequently applies to derivative suits). For a discussion of derivative suits and indemnification, see SCHAEFTLER, *supra* note 2, at 15-34.

88. See CHEW, *supra* note 2, at 235-36 (noting that "[i]ndemnification is more restricted" in actions brought "by or in the right of the corporation" as opposed to third party actions); Monteleone & Conca, *supra* note 5, at 579 (noting that § 145(b) "imposes certain limitations on the indemnification afforded in connection with" actions brought "by or in the right of the corporation" which are not imposed upon third party actions under § 145(a)).

89. DEL. CODE ANN. tit. 8, § 145(a)-(b). The policy behind the limitation upon indemnifiable expenses in derivative actions is quite straightforward. See Arshst & Stapleton, *supra* note 56, at 79-80 (discussing drafting committee's ration-

section (b) restricts indemnification exclusively to attorney fees and other expenses and does not permit indemnification for judgments or amounts paid in settlement of an action.<sup>90</sup> Thus, when a director or officer is ad-

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ale behind excluding amounts paid in settlement and judgment under § 145(b)). In a derivative action, the corporation is in fact the plaintiff, and the director or officer is the defendant. *See* Monteleone & Conca, *supra* note 5, at 580 ("Whether the legal action is asserted directly by the corporation or derivatively by a shareholder, the corporation assumes the capacity of plaintiff asserting claims against its director or officer. Consequently, certain restrictions are placed on [the] director's or officer's right to indemnification from the corporation."); Veasey et al., *supra* note 2, at 405-06 (noting that "in a derivative action the ultimate plaintiff is the corporation on whose behalf the suit is brought"). Judgments and settlement payments flow from the defendant director to the plaintiff corporation as compensation for the losses caused by the director's misconduct. Veasey et al., *supra* note 2, at 405-06 ("[A]ny resulting money judgments against, or settlement funds provided by, the defendant is paid to the corporation in order to make it whole."). If the corporation was required to reimburse the defendant for judgments or amounts paid in settlement, a circular and self-defeating process would result. *See* CHEW, *supra* note 2, at 236 (noting it "would be meaningless if the corporation received funds from them as damages and then turned around and returned the funds to them as indemnification"); KNEPPER & BAILEY, *supra* note 2, at 296 ("The theory of this restriction is that it will avoid circularity: namely, for the corporation to recover funds . . . and then pay them over to the director who had paid them would constitute a meaningless exercise."); SCHAEFTLER, *supra* note 2, at 3 (noting that if corporation is indemnified for judgments or settlements in derivative suits "[t]he result is circuity of payments: the officer or director pays money into the corporation, and the corporation turns right around and puts the money back into the director's or officer's pocket"); Monteleone & Conca, *supra* note 5, at 580 (noting that "[t]he theory is that the corporation would be indemnifying the director or officer for a settlement ultimately paid to the corporation itself as plaintiff" and that Delaware has "determined that such circularity of payment is unacceptable"). In effect, the corporation would never be made whole in a derivative suit because it would always have to payback all amounts received in judgment or settlement to the defendant through indemnification. *See* Sparks et al., *supra* note 3, at 952 (noting that if indemnification of judgment or settlement expenses were permitted "the efficiency of the derivative suit would be undermined"); Veasey et al., *supra* note 2, at 405-06 ("The corporation would not receive [the benefit of compensation] if it were to reimburse a defendant for the amount of the judgment or settlement funds that the defendant is required to pay the corporation.").

Some states, such as New York, tolerate circularity of payment but only with court approval. *See, e.g.*, IND. CODE ANN. § 23-1-37-8 & cmt. (a) (Michie 1996); N.Y. BUS. CORP. LAW § 722(c) (Consol. 1996). These states allow indemnification of amounts paid in settlement or in satisfaction of a judgment if, upon application, a court deems the defendant "fairly and reasonably entitled to indemnity." N.Y. BUS. CORP. LAW § 722(a). Furthermore, Indiana has rejected the circularity argument and allows indemnification even where a director has been adjudged liable to the corporation, as long as that individual meets the standard of conduct under the statute. IND. CODE ANN. § 23-1-37-8 & cmt. (a) (noting that "the Commission concluded that indemnification should not be prohibited so long as a person can in fact meet [the section's] indemnification standards—notwithstanding formalistic concerns about 'circularity'").

90. *See* WELCH & TUREZYN, *supra* note 5, § 145.4, at 249-50 (comparing subsections (a) and (b) and noting in contrast to subsection (a) "nothing is said about indemnifying the amounts paid in settlement, although the corporation may indemnify 'against expenses' actually and reasonably incurred"); Sparks et al., *supra* note 3, at 952 (noting that under subsection (b) "indemnification is limited to the

judged liable to the corporation in suits brought by or in the right of the corporation, any rights to indemnification are significantly curtailed.<sup>91</sup>

director's litigation expenses and does not include amounts paid in settlement or in satisfaction of a judgment"); Veasey et al., *supra* note 2, at 405 (noting § 145(b) "permits indemnification only for attorneys' fees and other expenses" and "does not permit indemnification of judgments or amounts paid in settlement").

The argument can be made that the term "expenses" used in § 145(b) is broad enough to include amounts paid by the defendant to the corporation in satisfaction of a judgment or settlement. Bishop, *Sitting Ducks*, *supra* note 2, at 1083-84. The better interpretation, however, is that such amounts are not included in the scope of § 145(b). *Id.* This conclusion is warranted by the fact that subsection (a) explicitly includes judgments and amounts paid in settlement within its scope and subsection (b) omits them. DEL. CODE ANN. tit. 8, § 145(a)-(b). The express inclusion in one section and the exclusion in the other demonstrates a legislative intent to prohibit indemnification of such amounts in derivative suits. Veasey et al., *supra* note 2, at 405-06. Commentators have illustrated this argument, stating:

It can be argued that since section 145(b) does not expressly prohibit indemnification of judgments or amounts paid in settlement in derivative suits, such indemnification may be provided under the "non-exclusive" provision of section 145(f). It would seem that since subsection (a) and (b) should be read in *pari materia*, the express inclusion of the broader indemnification power in (a) and its exclusion in (b) demonstrates a legislative intent to prohibit indemnification of judgment or amount paid in settlement of derivative suits.

*Id.*; see also Bishop, *Sitting Ducks*, *supra* note 2, at 1084 (noting that "the draftsmen of [§ 145(b)] . . . unequivocally disclaim" any intention that "expenses" be construed to include amounts paid to corporation in derivative suits).

Other states have determined to allow for recovery of amounts paid in settlement or judgment in actions brought by or in the right of the corporation. See, e.g., ARIZ. REV. STAT. § 10-005(B) (1995); ARK. CODE ANN. § 4-27-850(B) (Michie 1995); 805 ILL. COMP. STAT. 5/8.75(b) (West 1996); N.Y. BUS. CORP. LAW § 722(c); 15 PA. CONS. STAT. ANN. § 1742 (West 1996). Typically, these statutes only allow for such recovery when, upon application, the appropriate court determines in view of all the circumstances that the director or officer is "fairly and reasonably entitled to indemnity" for such amounts. N.Y. BUS. CORP. LAW § 722(c). Still other states have taken a more liberal approach, permitting indemnification of amounts paid in settlement or in satisfaction of a judgment in derivative suits even in the absence of court approval. See, e.g., IND. CODE ANN. § 23-1-37-8. For example, Indiana allows for indemnification in any action, whether by a third party or derivative in nature, as long as the applicable standard of conduct is satisfied. *Id.* Thus, in Indiana, a corporation has the power to indemnify its directors and officers for liabilities incurred, including judgments and settlements, in any suit as long as "the individual's conduct was in good faith" and "the individual reasonably believed" his or her conduct was in or not opposed to the best interests of the corporation. *Id.* In contrast, other states have dramatically circumscribed a corporation's power to indemnify directors and officers who have been found liable to the corporation. Some states have gone so far as to extinguish indemnification powers completely when a director has been adjudged liable to the corporation. See, e.g., CONN. GEN. STAT. § 33-771(d) (1994); IOWA CODE § 490.851(4) (1995); N.C. GEN. STAT. § 55-8-51(d) (1995); S.C. CODE ANN. § 33-8-510(d) (Law Co-op. 1995); TENN. CODE ANN. § 48-18-502(d) (1996); VA. CODE ANN. § 13.1-697(D) (Michie 1996); WASH. REV. CODE ANN. § 23B.08.510(4) (West 1995).

91. See DEL. CODE ANN. tit. 8, § 145(b) (limiting availability of directors and officers found liable to corporation). It is worth noting that a director or officer may still be protected from the potential liability of actions brought by or in the

In addition to narrowing the scope of expenses a corporation may agree to indemnify in derivative suits, subsection (b) also restricts the circumstances in which such indemnification is available.<sup>92</sup> Similar to subsection (a), indemnification under subsection (b) requires that a director or officer seeking indemnification must have acted in good faith and in a manner he or she reasonably believed to be consistent with the best interests of the corporation.<sup>93</sup> Additionally, the subsection imposes a further constraint in the event that a director or officer is found liable to the corporation in a derivative suit.<sup>94</sup> In such a case, subsection (b) prohibits indemnification of any expenses unless, upon application, the appropriate court determines that the defendant is fairly and reasonably entitled to indemnity.<sup>95</sup>

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right of the corporation because there are other liability limiting mechanisms available in Delaware. See *id.* § 102(b)(7) (allowing corporations to limit director liability to corporation for certain breaches of fiduciary duty); *id.* § 145(g) (granting corporations power to provide insurance to directors and officers); see also Sparks et al., *supra* note 3, at 978-97 (discussing § 102(b)(7) as limitation upon director liability for duty of care violations). Most importantly, a corporation has the power to provide liability insurance to directors and officers. See DEL. CODE ANN. tit. 8, § 145(g) (providing that corporations have power to provide insurance for directors and officers to cover liabilities whether or not corporation could indemnify for such liabilities under § 145). While the insurance policies themselves have limitations and exclusions, they could potentially cover amounts paid in the form of judgments and settlements in a derivative action. See Sparks et al., *supra* note 3, at 969 (noting that insurance policies can cover amounts paid in settlement and judgments in derivative suits). For a general discussion of directors' and officers' insurance, see BISHOP, INDEMNIFICATION AND INSURANCE, *supra* note 5, § 8, at 8-1 to 8-47; CHEW, *supra* note 2, at 242-62; KNEPPER & BAILEY, *supra* note 2, at 335-488; Monteleone & Conca, *supra* note 5, at 584-619; Sparks et al., *supra* note 3, at 961-97.

Furthermore, a Delaware corporation may include a provision in its certificate of incorporation limiting, or even eliminating altogether, the liability of a director or officer to the corporation for some breaches of fiduciary duty. See DEL. CODE ANN. tit. 8, § 102(b)(7) (authorizing corporations to limit or eliminate personal liability of director to corporation for breaches of fiduciary duty). For a discussion of § 102(b)(7), see R. Franklin Balotti & Mark J. Gentile, *Commentary from the Bar: Elimination or Limitation of Director Liability for Delaware Corporations*, 12 DEL. J. CORP. L. 5 (1987); Ronald E. Mallen & David W. Evans, *Surviving the Directors' and Officers' Liability Crisis: Insurance and the Alternatives*, 12 DEL. J. CORP. L. 439 (1988); Sparks et al., *supra* note 3, at 978-97; Thomas C. Lee, Comment, *Limiting Corporate Directors' Liability: Delaware's Section 102(B)(7) and the Erosion of the Directors' Duty of Care*, 136 U. PA. L. REV. 239 (1987).

92. DEL. CODE ANN. tit. 8, § 145(b).

93. *Id.*; see WELCH & TUREZYN, *supra* note 5, § 145.3, at 248 ("Indemnification under subsection (b), like subsection (a), is dependent on the individual's having acted in good faith and in a manner he reasonably believed to be in or not opposed to the best interests of the corporation.").

94. KNEPPER & BAILEY, *supra* note 2, at 297 (noting in addition to good faith and "best interests," "[t]here is an additional requirement when a person has been adjudged liable for negligence or misconduct in the performance of his duty to the corporation").

95. *Id.* The relevant part of § 145(b) provides:

### c. Supplemental Indemnification and the Nonexclusivity Provision

In addition to defining the types of cases that fall under the umbrella of permissive and mandatory indemnification, § 145 also recognizes that supplemental rights to indemnification may be created by declaring the section nonexclusive.<sup>96</sup> Subsection (f) states that § 145 "shall not be deemed exclusive of any other right to which those seeking indemnifica-

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[N]o indemnification shall be made in respect of any claim, issue or matter as to which such person shall have been adjudged to be liable to the corporation unless and only to the extent that the Court of Chancery or the court in which such action or suit was brought shall determine upon application, that, despite the adjudication of liability but in view of all the circumstances of the case, such person is fairly and reasonably entitled to indemnity for such expenses which the Court of Chancery or such other court shall deem proper.

DEL. CODE ANN. tit. 8, § 145(b); see WELCH & TUREZYN, *supra* note 5, § 145.3, at 248 ("[W]here a person has been adjudged liable to the corporation . . . there must be a finding by the . . . court that the person is fairly and reasonably entitled to indemnification."); Veasey et al., *supra* note 2, at 405 (noting that § 145(b) "does not permit any indemnification" if individual is found liable, except upon application to court). It should be noted that while this provision is of significance, it will likely only be applied to a relatively narrow set of cases. See Johnston, *supra* note 5, at 1997 (discussing § 145(b)'s allowance for expenses upon court approval). This is primarily because it is hard to imagine many cases in which a court will find both that a director or officer has violated a fiduciary duty to the corporation and is concurrently "fairly and reasonably" entitled to reimbursement for expenses incurred. *Id.* The most probable situation would be in a case where the court has imposed liability on the corporation according to a new and higher standard which the director or officer could not have reasonably anticipated. *Id.*

Some statutes prohibit any indemnification in the event that a director or officer is found liable to the corporation in a suit brought by or in the right of the corporation. See, e.g., CONN. GEN. STAT. § 33-771(d) ("A corporation may not indemnify a director under this section: (1) In connection with a proceeding by or in the right of the corporation in which the director was adjudged liable to the corporation . . ."); IOWA CODE § 490.851(4)(a) ("A corporation shall not indemnify a director under this section . . . [i]n connection with a proceeding by or in the right of the corporation in which the director [is] adjudged liable to the corporation. . ."); N.C. GEN. STAT. § 55-8-51(d)(1) ("A corporation may not indemnify a director under this section: (1) In connection with a proceeding by or in the right of the corporation in which the director was adjudged liable to the corporation. . ."); S.C. CODE ANN. § 33-8-510(d)(1) (same); TENN. CODE ANN. § 48-18-502(d) (1996); VA. CODE ANN. § 13.1-697(D) (same); WASH. REV. CODE ANN. § 23B.08.510(4) (same). In such a state, a director or officer found liable to the corporation may not even recover the costs of attorney fees and other expenses.

96. DEL. CODE ANN. tit. 8, § 145(f). Subsection (f) provides:

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

*Id.* For a discussion of nonexclusivity provisions in indemnification statutes, see BALOTTI & FINKELSTEIN, *supra* note 5, § 4.16, at 196-200.1; BISHOP, INDEMNIFICATION AND INSURANCE, *supra* note 5, §§ 6.11-12, at 6-20 to 6-27; CHEW, *supra* note 2,

tion . . . may be entitled under any by-law, agreement or vote of stockholders or disinterested directors or otherwise."<sup>97</sup> On its face, this provision appears to expand the permissive authority to indemnify found in subsections (a) and (b), conveying upon corporations expansive powers of indemnification.<sup>98</sup> Indeed, the case law interpreting subsection (f) has been generous in its construction of the nonexclusivity provision.<sup>99</sup>

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at 238-42; KNEPPER & BAILEY, *supra* note 2, at 304-12; Johnston, *supra* note 5, at 2009-11; Monteleone & Conca, *supra* note 5, at 582-84.

97. DEL. CODE ANN. tit. 8, § 145(f). Forty-four states have nonexclusivity provisions in their indemnification statutes. KNEPPER & BAILEY, *supra* note 2, at 304. For examples of nonexclusivity provisions in other state statutes, see ARIZ. REV. STAT. § 10-005(F) (1995); ARK. CODE ANN. § 4-27-850(F) (Michie 1995); CAL. CORP. CODE § 317(g) (West 1996); FLA. STAT. ch. 607.0850(7) (1995); 805 ILL. COMP. STAT. 5/8.75(f) (West 1996); IND. CODE ANN. § 23-1-37-15 (Michie 1996); IOWA CODE § 490.858; N.Y. BUS. CORP. LAW § 721 (Consol. 1995); N.C. GEN. STAT. § 55-8-57; 15 PA. CONS. STAT. ANN. § 1746 (West 1996); TENN. CODE ANN. § 48-18-509(a); VA. CODE ANN. § 13.1-704(B); W. VA. CODE § 31-1-9(f) (1996); *see also* Beveridge, *supra* note 51, at 748 ("[M]ost statutes provide that the statutory provisions are nonexclusive of other rights which the director may have to indemnification by contract or otherwise.").

In contrast, the old Model Business Corporation Act was exclusive because it required that any agreement to indemnify in a corporation's articles, in the by-laws or by contract is "valid only if and to the extent the provision is consistent" with the other provisions of the indemnification statute. MODEL BUS. CORP. ACT § 8.58(a) (1967); *see* Report of Committee on Corporate Laws, *Changes in the Model Business Corporation Act Affecting Indemnification of Corporate Personnel*, 36 BUS. LAW. 99, 115 (1980) (discussing modifications to Model Business Act and noting that it specifically changed to require that "every provision for indemnification of directors by corporations must be consistent with the statute in order to be valid" as opposed to merely declaring statute nonexclusive). One commentator has summarized the effect of an exclusive statute as follows:

This presumably means that the statutes define the minimum and maximum limits for indemnification. At a minimum, corporations must provide directors and officers indemnification provided for under the mandatory indemnification statutes. At the other extreme, corporate indemnification may not exceed that provided for under permissive indemnification and court-ordered indemnification. In other words, indemnification provided for under the statutes is exclusive.

CHEW, *supra* note 2, at 238; *see also* FERRARA ET AL., *supra* note 5, § 12.07 ("Under the Model Business Corporation Act provision, it is relatively clear that no substantive protection can be afforded by the corporation in excess of what is specifically permitted by the relevant indemnification statute."). For examples of states with similar consistency provisions in their indemnification statutes, see CONN. GEN. STAT. § 33-772; S.C. CODE ANN. § 33-8-580(a); TENN. CODE ANN. § 48-18-509(3); TEX. BUS. CORP. ACT ANN. art. 2.02-1(M) (West 1996); WASH. REV. CODE ANN. § 23B.08.590(1).

98. *See* CHEW, *supra* note 2, at 239 (noting that nonexclusive provisions are unclear, but that current "trend appears to be to interpret them to maximize corporate discretion"); Veasey et al., *supra* note 2, at 415 ("[S]ection 145(f) does provide support for wide-ranging agreements or by-laws that broaden indemnification rights granted in other subsections of 145 . . ."). For a discussion of cases interpreting § 145(f) as expanding a corporation's permissive indemnification power, *see infra* note 104.

99. *See, e.g.,* Mooney v. Willys-Overland Motors, Inc., 204 F.2d 888, 896 (3d Cir. 1953) (upholding corporation's power to provide independent ground for

Notwithstanding the trend toward a broad interpretation, the power to indemnify under subsection (f) is not unlimited.<sup>100</sup> Most commentators generally agree that subsection (f) was not meant as a plenary grant of authority to indemnify and is clearly limited by public policy con-

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indemnification pursuant to statutory predecessor of § 145(f)); *PepsiCo, Inc. v. Continental Cas. Co.*, 640 F. Supp. 656, 661 (S.D.N.Y. 1986) (construing § 145(f) to give corporations broad power to indemnify and characterizing other provisions of statute as mere "fall back" provisions); *Hibbert v. Hollywood Park, Inc.*, 457 A.2d 339, 344 (Del. 1983) (discussing § 145(f) and stating that it gives corporations power to "grant indemnification rights beyond those provided by the statute"); *Choate, Hall & Stewart v. SCA Servs., Inc.*, 495 N.E.2d 562, 565 (Mass. App. Ct. 1986) (characterizing § 145(f) as "the 'nonexclusion' provision which says that there may be an agreement to indemnify for legal expenses which is not founded in, or limited by, the other provisions of the statute"); *see also B & B Inv. Club v. Kleinert's, Inc.*, 472 F. Supp. 787, 793 (E.D. Pa. 1979) (construing Pennsylvania nonexclusivity clause to allow corporations to provide rights not expressly in statute). Both the United States District Court for the Southern District of New York and the Second Circuit recognized the expansive effect of subsection (f), but they also felt there were limitations upon that power. For a discussion of limitations upon § 145(f)'s broad power as identified by these two courts, *see infra* notes 139-62 and accompanying text. For a critical analysis of the Second Circuit's construction of subsection (f), *see infra* notes 180-89 and accompanying text.

100. *See Sparks et al., supra* note 3, at 975 ("[P]ublic policy limits the power to indemnify under Section 145(f)."). Samuel S. Arsht was the chairman of the committee that drafted Delaware's General Corporation Law in 1967. Arsht, *supra* note 5, at 176 n.\*. In a 1978 article, Arsht noted that the nonexclusivity of § 145(c) was unquestionably limited by public policy, stating:

The question which subsection (f) invariably raises is whether a corporation can adopt a by-law or make a contract with its directors providing that they will be indemnified for whatever they may have to pay if they are sued and lose or settle. The answer to this question is "no." . . . The statutory language is circumscribed by limits of public policy, . . .

*Id.* at 176-77 & n.2.

straints.<sup>101</sup> Needless to say, defining the public policy limitations upon the scope of § 145(f) is a difficult and unpredictable task.<sup>102</sup>

Most commentators agree that the other substantive provisions of § 145 are an authoritative statement of Delaware public policy regarding corporate indemnification.<sup>103</sup> While no Delaware court has specifically

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101. See BALOTTI & FINKELSTEIN, *supra* note 5, § 4.16, at 197-98 ("Although there is no case law on point, it is probable that a Delaware court would not allow indemnification under a by-law or pursuant to a contract when the proposed indemnification is prohibited by law or public policy."); Arsht, *supra* note 5, at 176-77 ("Subsection (f), the non-exclusive clause, permits additional rights to be created, but it is not a blanket authorization to indemnify directors against all expenses, fines, or settlements of whatever nature and regardless of the director's conduct. The statutory language is circumscribed by limits of public policy."); Bishop, *Sitting Ducks*, *supra* note 2, at 1085 ("The Delaware draftsmen remark cryptically that [§ 145(f)] was inserted 'so that other rights to indemnification may still exist by contract, by-law or charter within such limits of public policy as the courts may establish.'") (quoting Arsht & Stapleton, *supra* note 56, at 80)); Johnston, *supra* note 5, at 1996 (noting that § 145(f) appears to contemplate "that a by-law or agreement could be drafted which would provide more extensive protection to the directors and officers than specified in the other provisions of the statute, although there are undoubtedly public policy limitations on how far such a by-law or agreement could go beyond the statutory formulation"); Klink et al., *supra* note 5, at 116 (noting that while it is unclear "[t]o what extent [the statute] provides or permits additional rights of indemnification" it is most likely that such additional rights would be "subject to whatever the applicable Delaware public policy" concerning indemnification); John B. McAdams, *A Proposal to Amend the Indemnification Section (§ 5) of the Model Business Corporation Act*, 31 BUS. LAW. 2123, 2126 n.23 (1976) ("Nonexclusive statutes are generally considered to be limited by public policy."); Veasey et al., *supra* note 2, at 414 ("[I]t is probable that a Delaware court would not allow indemnification under a by-law or pursuant to a contract when the proposed indemnification is prohibited by law or public policy. . . . [A] by-law or agreement purporting to expand these limits would likely be void as violative of public policy."); see also *Mooney*, 204 F.2d at 896 (noting that by-law must "have met the requirements of public policy by the realistic limits they set upon the right of indemnification" under statutory predecessor to § 145(f)).

102. See SCHAEFTLER, *supra* note 2, at 12 (noting that use of § 145(f) "result[s] in difficult problems involving public policy and interpretation"); see also *Waltuch v. Conticommodity Servs. Inc.*, 833 F. Supp. 302, 308 (S.D.N.Y. 1993) (stating that it is "difficult . . . to define precisely what limitations on indemnification public policy imposes"), *aff'd in part, rev'd in part* by 88 F.3d 87 (2d Cir. 1996).

The divergent holdings of the District Court for the Southern District of New York in *PepsiCo* and *Waltuch* are illustrative of the unpredictability involved in interpreting the nonexclusivity clause. At one end of the spectrum, the court in *PepsiCo* interpreted subsection (f) as a plenary grant of power which, in effect, trumped the other provisions of the statute which the court deemed merely "fall back" provisions. *PepsiCo*, 640 F. Supp. at 661. Seven years later, in *Waltuch*, the same court held that subsection (f) did not trump the other provisions of the statute, but instead, was directly limited by those provisions. *Waltuch*, 833 F. Supp. at 308-09. To make matters even more unstable, no Delaware court has explicitly dealt with the issue of the interplay between subsection (f) and public policy. See *Waltuch*, 88 F.3d at 91 ("No Delaware Court has decided the very issue presented here.").

103. Klink et al., *supra* note 5, at 128. One commentator has noted how the rest of § 145 limits the exercise of subsection (f)'s grant of additional discretion: The first five subsections of Section 145 represent an attempt to clarify and expand the permissible scope of indemnification under Delaware

addressed this issue, the applicable cases appear to support the idea that

law. They are an affirmative statement of the public policy of the State of Delaware and should be so construed should the occasion arise. . . . However, Section 145 does not attempt to define with precision the full scope of permissible indemnification, and therefore, the bounds of public policy. . . . [T]here may be instances apart from those contemplated in Subsections (a) to (e) of Section 145 where a Delaware corporation could indemnify, and public policy, as developed in the course of time on a case by case basis, would come into play in those instances as the determinant of their validity.

*Id.* at 127-28; see also BALOTTI & FINKELSTEIN, *supra* note 5, § 4.13, at 187 (noting that corporations can make items permissive under subsections (a) through (e) mandatory through the use of subsection (f) but that such provision would not be enforceable if it is "barred by other provisions of Section 145, other laws or public policy" (emphasis added)); FERRARA ET AL., *supra* note 5, § 12.07 (noting that subsection (f) "allows a corporation to provide procedural mechanics so long as they are not inconsistent with the statutory indemnification provisions" (emphasis added)). Indeed, the principal drafters of the original Model Business Corporation Act, upon which the Delaware statute was based, believed that "courts will be guided by 'public policy considerations, possibly in light of the substantive provisions of the statute' in deciding whether to enforce, for example, a by-law which goes beyond the statute's scope." Bishop, *Sitting Ducks*, *supra* note 2, at 1085 (quoting Sebring, *Recent Legislative Changes in the Law of Indemnification of Directors, Officers and Others*, 23 BUS. LAW. 95, 107-09 (1967)) (emphasis added). Both the Southern District of New York and the Second Circuit held that any agreement to indemnify pursuant to subsection (f) had to be consistent with the other substantive provisions of § 145. See *Waltruch*, 88 F.3d at 90-94 (arguing that there is "a consistency rule" to § 145 requiring that use of subsection (f) be consistent with other provisions of statute); *Waltruch*, 833 F. Supp. at 309 (arguing § 145(f) "does not permit indemnification without regard to the limitations set forth in the other subsections of Section 145"). For further discussion of the Second Circuit's reasoning in formulating this "rule of consistency," see *infra* notes 136-62 and accompanying text. For a critical analysis of the Second Circuit's construction of subsection (f), see *infra* notes 180-89 and accompanying text.

Some state statutes have taken a different approach: expressly limiting their nonexclusivity clauses in certain circumstances. See, e.g., CAL. CORP. CODE §§ 204(a)(10)-(11), 317(g) (West 1996) (declaring statute nonexclusive but subject to list of limitations in § 204(a)(11)); FLA. STAT. ch. 607.0850(7) (1995) (providing statute not exclusive of other indemnification rights but limited where director acted unlawfully, for improper personal benefit, willful misconduct or conscious disregard for best interests of corporation); IOWA CODE § 490.858 (1995) (providing statute not exclusive but subject to limitations similar to Florida statute). New York for example, declares its indemnification statute nonexclusive but specifically prohibits a corporation from indemnifying an individual from expenses incurred if the final adjudication "establishes that [the individual's] acts were committed in bad faith." N.Y. BUS. CORP. LAW § 721 (Consol. 1995).

At the other end of the spectrum, Pennsylvania's nonexclusivity provision appears to convey virtually unlimited authority upon corporations to indemnify. CHEW, *supra* note 2, at 239 (citing 15 PA. CONS. STAT. ANN. § 1746(c) (West 1996)). Section 1746(c) of the Pennsylvania code provides that a corporation may agree to indemnify its officers or directors "whether or not the corporation would have the power to indemnify the person under any other provision of law except as provided in this section." 15 PA. CONS. STAT. ANN. § 1746(c). Further, § 1746(c) declares that such indemnification is "consistent with the public policy" of the Commonwealth. *Id.* The "except as provided in this section" limitation simply precludes a corporation from agreeing to indemnify for "willful misconduct or recklessness." *Id.* § 1746(b).

the other substantive provisions of § 145 limit the scope of subsection (f).<sup>104</sup> Thus, any agreement purportedly authorized by subsection (f) will

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104. See *Citadel Holding Corp. v. Roven*, 603 A.2d 818, 823 (Del. 1992) (denying corporation's claim that indemnification agreement could be inconsistent with § 145); *Hibbert*, 475 A.2d at 344 (upholding interpretation of corporate by-law to indemnify officers for expenses as plaintiffs, in part because it was "consistent" with subsection (a)). But see *PepsiCo*, 640 F. Supp. at 661 (characterizing subsections (a) and (b) as mere "backstop" provisions).

In *Hibbert*, a number of directors sought indemnification under a by-law for expenses incurred in an action they brought as plaintiffs against the corporation. *Hibbert*, 475 A.2d at 340. The by-law read in relevant part:

Every person who is or was a director . . . shall be indemnified by the Corporation against any and all liability and reasonable expense that may be incurred by him in connection with or resulting from any claim, action, suit or proceeding . . . in which he may be involved, as a party or otherwise, by reason of his being or having been a director, officer or employee of the Corporation . . . provided such person acted, in good faith, in a manner he reasonably believed to be in or not opposed to the best interests of the Corporation.

*Id.* at 341 n.1. The corporation claimed the proper interpretation of the by-law was that it applied only to defense expenses. *Id.* at 341-42. The court, however, disagreed, construing the term "party" to include plaintiffs as well as defendants. *Id.* at 343. More importantly, the court noted that the corporation could "grant indemnification rights beyond those provided by the statute" and that the by-law was consistent with § 145(a) which also uses the term "party" to legal proceeding. *Id.* at 344.

In *Citadel*, the corporation had provided for indemnification "to the full extent permitted by the General Corporation Law of Delaware" in its by-laws and had entered into a separate indemnification agreement with a director providing for mandatory advancement of expenses. *Citadel*, 603 A.2d at 823. Section 145(e) of the Delaware Code specifically allows corporations to agree to advance expenses to directors and officers. DEL. CODE ANN. tit. 8, § 145(e) (1994). The corporation argued that the agreement to indemnify was an example of the "other rights to indemnification" that § 145(f) explicitly protects and preserves, and that even if the Delaware Legislature repealed § 145(e) authorizing advancement of expenses, the director would still be entitled to such indemnification through the non-exclusivity provision. *Citadel*, 603 A.2d at 823. The Delaware Supreme Court rejected this line of reasoning stating that: "Private parties may not circumvent the legislative will simply by agreeing to do so." *Id.* Notably, the Delaware Supreme Court did not challenge the proposition that the contract between the corporation and the director to provide for mandatory advancement of expenses was a valid exercise of subsection (f). *Id.* Rather, the court simply disagreed with the corporation's hypothetical argument that the contract would remain enforceable if the legislature repealed subsection (e). *Id.*

The lone dissenting voice on this issue appears in dicta in the Southern District of New York's decision in *PepsiCo*. *PepsiCo*, 640 F. Supp. at 661. There, the court characterized subsections (a) and (b) as mere "fall back" provisions that a corporation may or may not adopt through the use of subsection (f). *Id.* On the whole, however, *PepsiCo* is not considered very persuasive as to the scope of § 145(f). But see *Waltuch*, 88 F.3d at 92 n.8 (disagreeing explicitly with holding in *PepsiCo*). Most commentators have frowned upon the court's loose language. See, e.g., BALOTTI & FINKELSTEIN, *supra* note 5, § 4.16, at 198 ("It is doubtful that a Delaware court would be quite this sweeping in its language in a case properly presented to it involving the outer limits of the authority provided in section 145(f)."). Moreover, it is arguable that the court's statement is not opposed to the proposition that subsection (f) is limited. The court said that subsections (a) and

only be valid in so far as it is consistent with the other provisions of the section.<sup>105</sup>

In addition to the express provisions of the statute, there are other sources of public policy that operate to preclude a corporation from indemnifying directors and officers under certain circumstances.<sup>106</sup> For instance, subsection (f) would not authorize a corporation to indemnify its directors and officers who have been found liable for violations of federal securities laws.<sup>107</sup> Furthermore, public policy prohibits a corporation

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(b) could be adopted at the discretion of the corporation and this is completely consistent with the concept of permissive indemnification. For a discussion of permissive indemnification under subsections (a) and (b), see *supra* notes 65-95 and accompanying text. Moreover, this is precisely what most corporations, including the one in *PepsiCo*, achieve by providing that indemnification shall be provided to the "full extent permissible by law." For a discussion of such clauses, see authorities cited *infra* note 112.

105. See BALOTTI & FINKELSTEIN, *supra* note 5, § 4.13, at 187 (noting that subsection (f) is limited by other subsections of § 145); Klink et al., *supra* note 5, at 127 (noting that first five subsections of § 145 limit exercise of subsection (f)). The Delaware Code specifically limits the subject matter of the provisions that a corporation may include in its certificate of incorporation and by-laws. See, e.g., DEL. CODE ANN. tit. 8, § 102(b)(1) (limiting content of certificate of incorporation); *id.* § 109(b) (limiting content of by-laws). Section 102(b)(1) states that "a certificate of incorporation may also contain . . . any provision creating, defining, limiting and regulating the powers of the corporation . . . if such provisions are not contrary to the laws of this State." *Id.* § 102(b)(1). Section 109(b) places a similar limitation upon the content of corporate by-laws stating that they may contain "any provision not inconsistent with law or the certificate of incorporation." *Id.* § 109(b). The first five subsections of § 145 are "the laws" of Delaware. *Id.* § 109(a)-(e). Thus, any attempt to use subsection (f)'s nonexclusivity proclamation to support a by-law or certificate provision would be "inconsistent" with the law of Delaware and invalid. See *Waltuch*, 833 F. Supp. at 306 (arguing similarly). The accuracy of this position is demonstrated by the fact that if subsection (f) were deemed a plenary grant of permissive power to corporations to indemnify their officers and directors in any circumstance, there would be no need for subsections (a) and (b). *Waltuch*, 88 F.3d at 91; see *Waltuch*, 833 F. Supp. at 309 ("[T]here would be no point to the carefully crafted provisions of Section 145 spelling out the permissible scope of indemnification under Delaware law if subsection (f) allowed indemnification in additional circumstances without regard to these limits. *The exception would swallow the rule.*" (emphasis added)). By way of example, if a corporation could use subsection (f) to provide for indemnification of amounts paid in satisfaction of judgments or settlements in derivative suits, then there would be no conceivable purpose for having subsection (b) at all. See Sparks et al., *supra* note 3, at 976 ("[I]ndemnification which is unconditionally prohibited under subsections (a) and (b) such as amounts paid in judgment or settlement of derivative actions . . . are contrary to public policy and hence cannot be the subject of subsection (f) indemnification.").

106. For a discussion of other sources of public policy limiting the use of subsection (f), see *infra* notes 107-09 and accompanying text.

107. See BISHOP, INDEMNIFICATION AND INSURANCE, *supra* note 5, § 6.16, at 6-30 (noting that because Securities Act of 1933 does not provide for indemnification "courts have held that there is no federal right to indemnification" in such actions); CHEW, *supra* note 2, at 230-31 ("[I]ndemnification for any liability arising under the Securities Act of 1933 is contrary to public policy."). See, e.g., *King v. Gibbs*, 876 F.2d 1275 (7th Cir. 1989) (holding no right to indemnification under

from indemnifying its directors and officers for intentional illegal conduct.<sup>108</sup> Given these public policy limitations, it is clear that subsection (f) is not a plenary grant of authority to Delaware corporations to indemnify their directors and officers however they see fit, but instead allows for an expansion of the statutory power to indemnify only where to do so would be consistent with the statute and applicable public policy.<sup>109</sup>

While it is clear that subsection (f) is limited by public policy, those limitations do not render that section impotent. Subsection (f) still provides a corporation with the authority to provide broader indemnification rights than those provided elsewhere in § 145, even under the public policy constraints.<sup>110</sup> Through the use of the nonexclusivity provision, a cor-

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federal securities laws); *Globus v. Law Research Servs. Inc.*, 418 F.2d 1276, 1288 (2d Cir. 1969) (same). For an in-depth discussion of federal securities laws limitations upon indemnification of directors and officers, see Allan Applebaum & Robert A. McDowell, *Indemnification Against Securities Acts Liabilities*, 27 BUS. LAW. 131 (1972); Bishop, *New Problems*, *supra* note 2; Sparks et al., *supra* note 3, at 953-57; David B. Schultz, Comment, *Indemnification of Directors and Officers Against Liabilities Imposed Under Federal Securities Laws*, 78 MARQ. L. REV. 1043 (1995).

108. See KNEPPER & BAILEY, *supra* note 2, at 297-98 ("Public policy prohibits indemnification of corporate officers for intentional illegal conduct."); see also CAL. CORP. CODE §§ 204(10)-(11), 317(g) (prohibiting corporations from indemnifying individuals for "acts or omissions that involve intentional misconduct"); FLA. STAT. ch. 607.0850(7)(d) (prohibiting corporations from indemnifying for "willful misconduct"); IOWA CODE § 490.858 (providing corporation may not provide indemnification for "intentional misconduct"); N.C. GEN. STAT. § 55-8-57(a) (1995) (allowing corporations to provide additional indemnification except "that a corporation may not indemnify or agree to indemnify a person against liability or expense he may incur on account of his activities which were at the time taken known or believed by him to be clearly in conflict with the best interests of the corporation"); 15 PA. CONS. STAT. ANN. § 1746(b) (providing that corporations may not "provide for indemnification in the case of willful misconduct or recklessness"); TENN. CODE ANN. § 48-18-509(a)(2) (1996) (prohibiting indemnification where individual has been adjudged liable for "intentional misconduct"); VA. CODE ANN. § 13.1-704 (Michie 1996) (prohibiting indemnification for expenses incurred in "willful misconduct").

109. See Sparks et al., *supra* note 3, at 975 (discussing applicability of subsection (f) and stating that it is understood by "Delaware practitioners as permitting indemnification broader than that authorized in [subsection] (a)-(e) only in limited circumstances" and is subject to public policy); see also *Waltuch*, 88 F.3d at 87 (holding any use of subsection (f) must be consistent with other substantive provisions of statute).

110. See BALOTTI & FINKELSTEIN, *supra* note 5, § 4.16, at 196-200.1 (discussing permissible expansions of indemnification under subsection (f)); KNEPPER & BAILEY, *supra* note 2, at 308-09 (listing 29 allowable expansions of indemnification through nonexclusivity provisions); Veasey et al., *supra* note 2, at 415 (providing list of permissible expansions of indemnification pursuant to § 145(f) that are consistent with public policy); see also *Hibbert v. Hollywood Park, Inc.*, 457 A.2d 339, 344 (Del. 1983) (listing "other rights" to indemnification consistent with statute and public policy that corporations can provide). In the *Waltuch* district court opinion, Judge Lasker noted that, notwithstanding public policy constraints, § 145(f) "still 'may authorize the adoption of various procedures and presumptions to make the process of indemnification more favorable to the indemnitee without violating the statute.'" *Waltuch*, 833 F. Supp. at 309 (quoting R. FRANKLIN

poration may make mandatory many of the items that are simply permissible under the statute.<sup>111</sup> Many corporations achieve this result by including a provision in its certificate or by-laws that the corporation will provide indemnification to its directors and officers "to the fullest extent permissible by law."<sup>112</sup>

## 2. *Mandatory Indemnification*

Section 145(c) of the Delaware Code defines a specific set of circumstances under which indemnification is mandatory.<sup>113</sup> This section requires a corporation to indemnify directors and officers for expenses incurred when they have been "successful on the merits or otherwise" in

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BALOTTI & JESSE A. FINKELSTEIN, *THE DELAWARE LAW OF CORPORATIONS AND BUSINESS ORGANIZATIONS*, § 4.16, at 4-318 (2d ed. Supp. 1992)).

111. See *Citadel Holding Corp. v. Roven*, 603 A.2d 818, 823 (Del. 1992) (enforcing agreement between corporation and officer to make advancements of expenses to director because corporation made what was permissible under § 145(d) mandatory through agreement); see also *B & B Inv. Club v. Kleinert's, Inc.*, 472 F. Supp. 787, 793 (E.D. Pa. 1979) (construing Pennsylvania nonexclusivity provision as allowing corporation to make that which is permissible under statute mandatory in its by-laws).

112. See Pease, *supra* note 2, at 172-73 (noting that corporations commonly make what is permissible under subsections (a) and (b) mandatory by inserting "a bylaw provision which states that 'to the full extent permitted by law, the corporation shall indemnify'"); Sparks et al., *supra* note 3, at 958-60 (discussing creation of "broader mandatory indemnification than that required by statute" through use of "fullest extent" provision).

113. See DEL. CODE ANN. tit. 8, § 145(c) (1994). Section 145(c) provides:

To the extent that a director, officer, employee or agent of a corporation has been successful on the merits or otherwise in defense of any action, suit or proceeding referred to in subsections (a) and (b) of this section, or in defense of any claim, issue or matter therein, he shall be indemnified against expenses (including attorneys' fees) actually and reasonably incurred by him in connection therewith.

*Id.*

For examples of mandatory indemnification statutes in other states, see ARIZ. REV. STAT. § 10-005(C) (1995); ARK. CODE ANN. § 4-27-850(C) (Michie 1995); CAL. CORP. CODE § 317(d); CONN. GEN. STAT. § 33-772 (1994); FLA. STAT. ch. 607.0850(3); GA. CODE ANN. § 14-2-852 (1996); 805 ILL. COMP. STAT. 5/8.75(c) (West 1996); IND. CODE ANN. § 23-1-37-9 (Michie 1996); IOWA CODE § 490.852; N.Y. BUS. CORP. LAW § 723(a) (Consol. 1996); N.C. GEN. STAT. § 55-8-52; 15 PA. CONS. STAT. ANN. § 1743; S.C. CODE ANN. § 33-8-520 (Law Co-op. 1995); TENN. CODE ANN. § 48-18-503; TEX. BUS. CORP. ACT ANN. art. 2.02-1(H) (West 1996); VA. CODE ANN. § 13.1-698; WASH. REV. CODE ANN. § 23B.08.520 (West 1995); W. VA. CODE § 31-1-9(c) (1996). The Revised Model Business Corporation Act also contains a mandatory indemnification provision. See REV. MODEL BUS. CORP. ACT ANN. § 8.52 (1994).

For an in-depth discussion of mandatory indemnification, see BALOTTI & FINKELSTEIN, *supra* note 5, § 4.13, at 185-87; BISHOP, *INDEMNIFICATION AND INSURANCE*, *supra* note 5, § 6.26, at 6-41 to 6-45; CHEW, *supra* note 2, at 234-234.1; FERRARA ET AL., *supra* note 5, § 12.04; KNEPPER & BAILEY, *supra* note 2, at 302-04; Monteleone & Conca, *supra* note 5, at 574-82; Sparks et al., *supra* note 3, at 957-60.

defending against an action.<sup>114</sup> This section applies in the event of a successful defense to both actions brought by a third party and those brought by or in the right of the corporation.<sup>115</sup> Courts have liberally construed this section to provide corporate directors and officers with the broadest protection possible when they have successfully defended against a claim or action.<sup>116</sup> In contrast to subsections (a) and (b), this subsection requires no action on the part of the corporation for the right to indemnification to vest.<sup>117</sup> Under § 145(c), a director or officer is entitled to

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114. DEL. CODE ANN. tit. 8, § 145(c). Some courts at common law also permitted indemnification for expenses incurred in a successful defense.

115. *Id.* Section 145(c) explicitly provides that mandatory indemnification is triggered upon the successful defense "of any action, suit or proceeding referred to in subsections (a) and (b) of this subsection, or in defense of any claim, issue or matter therein." *Id.* Thus, mandatory indemnification under § 145(c) applies equally to the successful defense of suits brought by third parties and those brought by or in the right of the corporation (e.g., derivative suits). See WELCH & TUREZYN, *supra* note 5, § 145.4, at 249 (noting that subsection (c) applies to any successful defense and action "whether it be a third party action or a derivative suit").

116. See, e.g., *Witco Corp. v. Beekhuis*, 38 F.3d 682, 692 (3d Cir. 1994) ("The Delaware courts and legislature under state law have chosen to provide broad statutory indemnification protection in situations where a corporate officer or director successfully defends against claims."); *McLean v. International Harvester Co.*, 902 F.2d 372, 374 (5th Cir. 1990) (holding officer entitled to mandatory indemnification for expenses incurred in expungement action to remove name from record of another proceeding notwithstanding fact that officer lost expungement action but nonetheless succeeded in defending criminal action that caused him to seek expungement); *Stewart v. Continental Copper & Steel Indus., Inc.*, 414 N.Y.S.2d 910, 915 (App. Div. 1979) (upholding mandatory indemnification for expenses incurred by director summoned to testify before federal grand jury who was never ultimately indicted; finding director successful on merits or otherwise); see also *Sparks et al.*, *supra* note 3, at 957 (citing *Green v. Westcap*, 492 A.2d 260 (Del. Super. Ct. 1985)) ("The phrase 'successful on the merits or otherwise' has been construed broadly by courts in Delaware and elsewhere.").

117. DEL. CODE ANN. tit. 8, § 145(a)-(c). For a discussion of the permissive nature of § 145(a) and (b), see *supra* notes 65-95 and accompanying text. Subsections (a) and (b) are enabling provisions that conclusively establish that corporations have the authority to agree to indemnify their directors, officers and others. See DEL. CODE ANN. tit. 8, § 145(a)-(b). Typically, this agreement takes the form of a provision in the corporation's certificate of incorporation or its by-laws. Thus, § 145(a) and (b) do not, in and of themselves, create a right to indemnity, but rather, they require some action on the part of the corporation. In contrast, indemnification under § 145(c) is always available regardless of the content of the corporate by-laws or the certificate of incorporation. The statute provides that a corporation "shall" indemnify an officer or director "to the extent that [they have been] successful on the merits or otherwise in defense of any action suit or proceeding referred to in subsections (a) and (b), or in defense of any claim, issue or matter therein." *Id.* § 145(c). Thus, indemnification under subsection (c) is a matter of right wholly independent of corporate action. See BALOTTI & FINKELSTEIN, *supra* note 5, § 4.13, at 186 (noting that "the indemnitee [is] to be indemnified as a matter of right in the event he wins a judgment on the merits"); WELCH & TUREZYN, *supra* note 5, § 145.4, at 249 (noting that "the right to indemnity under [§ 145(c)] is mandatory" and that it vests at "successful conclusion of the action"); Beveridge, *supra* note 51, at 750-51 ("[A director's] right to indemnity is absolute in the event of a successful defense.").

indemnification once he or she has successfully defended against an action or claim, irrespective of the corporation's by-laws or certificate of incorporation.<sup>118</sup> Additionally, mandatory indemnification is limited to successful defense expenses and, thus, will never include amounts paid in satisfaction of a judgment or settlement.<sup>119</sup>

Any claim for indemnification under § 145(c) requires the claimant to establish that he or she was "successful" within the meaning of that term as used in the statute.<sup>120</sup> Two characteristics have defined the parameters of success under subsection (c).<sup>121</sup> First, a termination of legal proceedings will be deemed successful under the statute only if it is final.<sup>122</sup> A full defense resulting in a total victory on the merits with *res judicata* effect will always satisfy the success requirement of the statute.<sup>123</sup> A technical or procedural defense, such as the running of the statute of limitations, will also

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In contrast, some states have enacted mandatory indemnification frameworks that do not guarantee indemnification as a matter of right upon the successful defense of an action. Instead, these states have created a default rule of mandatory indemnification that corporations can opt-out of in their certificate, articles or charter. See, e.g., CONN. GEN. STAT. § 33-772; IND. CODE ANN. § 23-1-37-9; IOWA CODE § 490.852; N.C. GEN. STAT. § 55-8-52; S.C. CODE ANN. § 33-8-520; TENN. CODE ANN. § 48-18-503; VA. CODE ANN. § 13.1-698; WASH. REV. CODE ANN. § 23B.08.520. For example, the Indiana statute provides:

*Unless limited by its articles of incorporation, a corporation shall indemnify a director who was wholly successful, on the merits or otherwise, in the defense of any proceeding to which the director was a party because the director is or was a director of the corporation against reasonable expense incurred by the director in connection with the proceeding.*

IND. CODE ANN. § 23-1-37-9 (emphasis added).

118. See KNEPPER & BAILEY, *supra* note 2, at 302 (noting that under subsection (c) "the right [to indemnification] is absolute and the statute is self-activating"); WELCH & TUREZYN, *supra* note 5, § 145.4, at 249 (noting that right to mandatory indemnification vests upon successful conclusion of action); Monteleone & Conca, *supra* note 5, at 575 ("The purpose of the mandatory indemnification provision is to give vindicated directors and officers a judicially enforceable right to indemnification.").

119. See FERRARA ET AL., *supra* note 5, § 12.04 ("Mandatory indemnification is generally required when a director or officer has successfully defended a claim. Consequently, mandatory indemnification is largely limited to defense expenses (such as attorneys' fees and costs) as opposed to damage awards."). Indemnification under subsection (c) is not permitted if an officer or director has paid any amounts in settlement or assumed any liability because such payments are deemed to abrogate the "success" requirement of the section. For a discussion of this non-payment requirement to mandatory indemnification, see *infra* notes 127-29 and accompanying text.

120. DEL. CODE ANN. tit. 8, § 145(c).

121. For a discussion of the two characteristics that have defined "success" under the statute, see *infra* notes 122-29 and accompanying text.

122. See KNEPPER & BAILEY, *supra* note 2, at 302 ("There is an element of finality in the success provision of the statute.").

123. See BALOTTI & FINKELSTEIN, *supra* note 5, § 4.13, at 186 ("The effect of [§ 145(c)] in the case of total victory on the merits is clear."); Veasey et al., *supra* note 2, at 406 (noting that result "in the case of total victory on the merits is clear").

be deemed a final success.<sup>124</sup> Although there is no Delaware precedent directly on point, most commentators agree that a settlement and dismissal with prejudice of an action will also satisfy the finality requirement of success under the statute.<sup>125</sup> A settlement and dismissal without preju-

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124. See BALOTTI & FINKELSTEIN, *supra* note 5, § 4.13, at 186 (stating that phrase “[o]n the merits or otherwise,” permits the indemnitee to be indemnified as a matter of right in the event he . . . successfully asserts a ‘technical’ defense”); CHEW, *supra* note 2, at 234 (“The inclusion of the word ‘otherwise’ permits defendants who succeed on procedural defenses, such as statute of limitations arguments, to be indemnified.”); WELCH & TUREZYN, *supra* note 5, § 145.4, at 249 (noting that “a preliminary technical defense will suffice” for “success” requirement); Klink et al., *supra* note 5, at 116 (noting term “‘otherwise’ would include situations where an action is dismissed based on the statute of limitations”).

The district court in *Waltuch* acknowledged this rule when it required Conti to reimburse Waltuch for the expenses he incurred in defending the *Michelson* suit. *Waltuch v. Conticommodity Servs., Inc.*, 833 F. Supp. 302, 310 (S.D.N.Y. 1993), *aff'd in part, rev'd in part* by 88 F.3d 87 (2d Cir. 1996). The *Michelson* suit was dismissed for insufficient process, a traditional technical defense. *Michelson v. Merrill Lynch Pierce Fenner & Smith, Inc.*, 619 F. Supp. 727 (S.D.N.Y. 1985). The district court held that this technical defense satisfied the “success” requirement under § 145(c). *Waltuch*, 833 F. Supp. at 310.

The asserted rationale for allowing technical defenses is that it would be unreasonable to require a claimant to go through the lengthy and expensive process of presenting a full defense on the merits in order to establish his or her eligibility for mandatory indemnification. CHEW, *supra* note 2, at 234 (“The drafters believe it is unreasonable to require directors and officers to incur the expense of proving their case on the merits, when a successful [technical] defense is available.”); WELCH & TUREZYN, *supra* note 5, § 145.4, at 249 (noting that allowing for technical defenses “avoids forcing on a director or officer (and ultimately on the indemnifying corporation) the additional expense of litigating an issue on the merits where a preliminary technical defense will suffice”). Occasionally, a defendant who has engaged in misconduct will be able to assert a technical defense and reap the benefit of mandatory indemnification, nonetheless, it is still deemed unreasonable to require a defendant to submit to the expensive and time consuming process of a full determination on the merits. See Block et al., *supra* note 50, at 242 (noting defendant “who has in fact done something wrong may be ‘entitled to indemnification’ through technical defense because it is unreasonable to require “prolonged and expensive trial on the merits in order to establish eligibility for mandatory indemnification’”). The Revised Model Business Corporation Act also provides for mandatory indemnification as the result of a successful technical defense. REV. MODEL BUS. CORP. ACT § 8.52 cmt. (1994) The comments to § 8.52 provide, in pertinent part:

While this standard may result in an occasional defendant becoming entitled to indemnification because of procedural defenses not related to the merits . . . it is unreasonable to require a defendant with a valid procedural defense to undergo a possibly prolonged and expensive trial on the merits in order to establish eligibility for mandatory indemnification.

*Id.* But see Klink et al., *supra* note 5, at 111-12 (noting “there would be less than complete agreement . . . that a successful technical defense . . . should give rise to a right to indemnification”); McAdams, *supra* note 101, at 2135-36 (proposing amendment to Model Act requiring establishment of good faith and best interests for mandatory indemnification).

125. See BALOTTI & FINKELSTEIN, *supra* note 5, § 4.13, at 186 (noting that § 145 “contemplates the dismissal of the suit in conjunction with a negotiated settlement where the dismissal is with prejudice and without any payment or assumption of liability”); FERRARA ET AL., *supra* note 5, § 12.04 (noting that “the ‘or otherwise’

dice, however, is not sufficient for the purposes of the statute because it lacks the necessary element of finality.<sup>126</sup>

Second, the successful conclusion of the underlying suit for which indemnification is sought must have been achieved without any payment or assumption of liability by the defendant director or officer who is now a claimant seeking indemnification.<sup>127</sup> As a practical matter, this condition to qualifying for "success" under the statute is an issue only when the origi-

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language has been found not to support mandatory indemnification . . . when a matter is dismissed with prejudice as a result of a settlement" without any payment); Beveridge, *supra* note 51, at 751-52 ("Where a case is settled and dismissed with prejudice without any payment [then the defendant] has been successful for purposes of indemnification."); Monteleone & Conca, *supra* note 5, at 575 ("[A] settlement that is with prejudice and results in the dismissal of the case without any payment or assumption of liability may be considered a 'success' within the meaning of that provision."); Veasey et al., *supra* note 2, at 406-07 ("The phrase found in section 145(c), 'on the merits or otherwise,' . . . contemplates the dismissal of the suit in conjunction with a negotiated settlement where the dismissal is with prejudice and without any payment or assumption of liability."). Two non-Delaware courts interpreting statutes virtually identical to subsection (c) have concluded that a dismissal of an action with prejudice and without payment is success under their respective statutes. *Wisener v. Air Express Int'l Corp.*, 583 F.2d 579, 583 (2d Cir. 1978) (interpreting Illinois law, which is substantially similar to § 145(c), and holding that language "success 'on the merits or otherwise,' [was] surely broad enough to cover a termination of claims by agreement without any payment"); *B & B Inv. Club v. Kleinert's, Inc.*, 472 F. Supp. 787, 791 & n.5 (E.D. Pa. 1979) (interpreting language of Pennsylvania statute similar to § 145(c) and holding settlement without payment resulting in dismissal with prejudice satisfied "successful on the merits or otherwise" requirement of statute).

It is important to note, however, that a dismissal with prejudice that is accompanied by any payment in settlement by the defendant will not meet the "success" requirement of the statute notwithstanding the fact that the claim has been disposed of with clear finality. For a further discussion of settlement payment issues, see *infra* notes 127-29 and accompanying text.

126. See *Galdi v. Berg*, 359 F. Supp. 698, 702 (D. Del. 1973) (denying mandatory indemnification and stating "when a case is dismissed without prejudice so that the same issue may be litigated in another pending case, an indemnification award would be premature and contrary to the spirit of the statute"); *BALOTTI & FINKELSTEIN*, *supra* note 5, § 4.13, at 186 ("A dismissal without prejudice . . . is insufficient to invoke mandatory indemnification under the statute."); *Monteleone & Conca*, *supra* note 5, at 575 ("Settlements that are without prejudice to a claimant's right to assert further claims against an officer are not 'successes' under section 145(c) of the Delaware statute.").

127. See *FERRARA ET AL.*, *supra* note 5, § 12.04 ("When . . . an action is dismissed as part of a settlement in which money is paid by or on behalf of the party seeking indemnification, mandatory indemnification has been found not to lie."). The Second Circuit's holding in *Waltuch* clearly establishes this rule. *Waltuch*, 88 F.3d at 96 (holding dismissal of action with prejudice without payment by claimant constitutes "success" under § 145(c)); see also *Wisener*, 583 F.2d at 583 (interpreting identical Illinois statute stating "success on the merits or otherwise" includes settlement without payment that results in dismissal with prejudice); *B & B Inv. Club*, 472 F. Supp. at 791 (holding settlement without payment by claimant resulting in dismissal with prejudice of action constitutes success under Pennsylvania statute identical to subsection (c)).

nal action was concluded by settlement.<sup>128</sup> Synthesizing the above, it is clear that in order for a settlement to qualify as a "success" under § 145(c), it must result in a dismissal with prejudice without any payment or assumption of liability by the defendant director or officer.<sup>129</sup>

Mandatory indemnification under subsection (c) does not require that a defendant succeed "on the merits or otherwise" with respect to all claims asserted.<sup>130</sup> Rather, subsection (c) requires that a director or officer be "successful on the merits or otherwise" in defending against either the entire legal proceedings or, in the alternative, against "any claim, issue or matter therein."<sup>131</sup> One court has interpreted this language to allow for mandatory indemnification when the defendant has only been par-

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128. See *Monteleone & Conca*, *supra* note 5, at 575 (noting that "most D&O claims are settled" and that only "a settlement that is with prejudice and without any payment or assumption of liability may be considered a 'success' within the meaning of [the] provision"). Obviously, the payment or assumption of liability never becomes an issue when a defendant has prevailed on the merits at trial or has succeeded in asserting a technical defense. For a further discussion of the effect of a successful defense at trial or through technical defenses, see *supra* notes 123-24 and accompanying text.

129. *BALOTTI & FINKELSTEIN*, *supra* note 5, § 4.13, at 186 (noting that § 145 "contemplates the dismissal of the suit in conjunction with a negotiated settlement where the dismissal is with prejudice and without any payment or assumption of liability"); *FERRARA ET AL.*, *supra* note 5, § 12.04 (noting that "or otherwise" language of subsection (c) has been found to include actions dismissed with prejudice as long as "the settlement was not the result of any payment by or on behalf of the indemnified party"); *KNEPPER & BAILEY*, *supra* note 2, at 302 ("The statute is broad enough to cover a termination of actions by agreement without any payment or assumption of liability.").

Before the district court and Second Circuit opinions in *Waltuch*, no court had interpreted § 145(c) in a claim arising out of a civil action settlement. *Waltuch*, 88 F.3d at 95. In *Merritt-Chapman & Scott Corp. v. Wolfson*, 321 A.2d 138 (Del. Super. Ct. 1974), however, one lower Delaware court had applied § 145(c) to a settlement in a criminal action. *Id.* at 141. In *Wolfson*, the agents of a corporation were charged with several criminal counts which they settled with the prosecution by agreeing to plead *nolo contendere* as to one count in exchange for a dismissal of the remaining counts. *Id.* at 140. Following the "settlement," the agents brought an action under § 145(c) claiming the corporation was required to indemnify them for expenses incurred in defending the counts that were dismissed. *Id.* at 143. The agents argued that their dismissal constituted "success" under § 145(c), and therefore, indemnification was required. *Id.* The corporation contended that the agents had not been "successful" because the dismissals were part of a settlement that was contingent upon their pleading *nolo contendere* to one count, and therefore, the dismissals were the result of practical considerations and not a finding of innocence on their part. *Id.* The court agreed with the agents, and deemed the dismissals "successes" and refused to "go behind the result" to determine the reason for the success. *Id.* at 141. The court in *Wolfson* stated: "In a criminal action, any result other than conviction must be considered success. Going behind the result, as [the corporation] attempts, is neither authorized by subsection (c) nor consistent with the presumption of innocence." *Id.*

130. *Beveridge*, *supra* note 51, at 751 ("Generally, any successful defense, in whole or in part (in which case fees are prorated), has been held to qualify [under § 145(c)].").

131. DEL. CODE ANN. tit. 8, § 145(c) (1994).

tially successful in defending the underlying suit in a criminal action.<sup>132</sup> Thus, in Delaware, a director or officer is entitled to indemnification for the expenses associated with those claims or issues that he or she successfully defended against, notwithstanding the fact that he or she did not succeed with respect to other claims or issues.<sup>133</sup>

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132. *Wolfson*, 321 A.2d at 141. In *Wolfson*, the Delaware Superior Court held that an officer was entitled to indemnification under § 145(c) for the expenses incurred in defending the three out of four criminal counts that were dismissed notwithstanding his having pled *nolo contendere* to the fourth. *Id.* The court stated its reasoning as follows:

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

*Id.*; see also CHEW, *supra* note 2, at 234 (stating that because § 145(c) requires only that defendants be "successful" that "[i]t consequently allows partial indemnification for partial successes"); Block et al., *supra* note 50, at 241 (noting that § 145(c) "mandates partial indemnification in cases of partial success").

133. See FERRARA ET AL., *supra* note 5, § 12.04 (noting that under subsection (c) indemnification may be required where an individual "has successfully defended some of the claims brought against him, but has been adjudged liable or acknowledged liability for other claims"); Monteleone & Conca, *supra* note 5, at 575-76 ("[S]o long as the person to be indemnified is partially successful on the merits, he or she may be partially indemnified for expenses incurred in connection with the claims or allegations that were successfully defended. . . . [E]ven if . . . unsuccessful in defending other claims asserted against him or her.").

Approximately one-third of the states follow the Delaware partial indemnification approach. *Id.* See, e.g., ARIZ. REV. STAT. § 10-005(C) (1996); ARK. CODE ANN. § 4-27-850(C) (Michie 1995); CAL. CORP. CODE § 317(d) (West 1996); FLA. STAT. ch. 607.0850(3) (1995); 805 ILL. COMP. STAT. 5/8.75(c) (West 1996); N.Y. BUS. CORP. LAW § 723(a) (Consol. 1996); 15 PA. CONS. STAT. ANN. § 1743 (West 1996); W. VA. CODE § 31-1-9(c) (1996). In contrast, many states follow the approach of the Revised Model Business Corporation Act ("Model Act") and the American Law Institute's (ALI's) Principles of Corporate Governance. See, e.g., CONN. GEN. STAT. § 33-772 (1994); GA. CODE ANN. § 14-2-852 (1996); IND. CODE ANN. § 23-1-37-9 (Michie 1996); IOWA CODE § 490.852 (1995); N.C. GEN. STAT. § 55-8-52 (1995); S.C. CODE ANN. § 33-8-520 (Law Co-op. 1995); TENN. CODE ANN. § 48-18-503 (1996); TEX. BUS. CORP. ACT ANN. art. 2.02-1(H) (West 1996); WASH. REV. CODE ANN. § 23B.08.520 (West 1995). Virginia's statute requires that an indemnitee "entirely prevails in the defense of any proceeding." VA. CODE ANN. § 13.1-698 (Michie 1996). These approaches both impose mandatory indemnification only when a director or officer has been "wholly successful on the merits or otherwise" in defending against an action. FERRARA ET AL., *supra* note 5, § 12.04 (discussing Model Act and ALI Principles). In fact, the Model Act adopted the "wholly successful" standard to avoid precisely the result in *Wolfson*. See REV. MODEL BUS. CORP. ACT § 8.52 cmt. (1994) ("The word wholly added to avoid the argument accepted in [*Wolfson*] that a defendant may be entitled to partial mandatory indemnification."); see also Report of Committee on Corporate Laws, *supra* note 97, at 113 (discussing new revisions to Model Act and noting that it specifically changed wording to require directors be "wholly successful" to avoid repetition of the result in the *Wolfson* case").

In contrast to permissive indemnification, it appears that there is no requirement that a director or officer act in good faith or with a reasonable belief that his or her actions were consistent with the best interests of the corporation in order to receive mandatory indemnification.<sup>134</sup> Instead, a director or officer need only demonstrate that he or she successfully defended against the claim that gave rise to the expenses that he or she seeks to recover.<sup>135</sup>

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134. See *Green v. Westcap Corp.*, 492 A.2d 260, 264 (Del. Super. Ct. 1985) (holding director successful in defense was entitled to indemnification and was not required to establish good faith or reasonable belief). In *Westcap*, a corporate officer sought to recover expenses incurred in successfully defending against a criminal action brought against him by the State of Texas. *Id.* at 262. The corporation resisted the claim for indemnification, claiming that § 145(c) incorporated the tests of subsections (a) and (b), which require good faith and a reasonable belief that the officer's actions were in or not opposed to the best interests of the corporation. *Id.* at 264. The court rejected the argument, holding that the only prerequisite to mandatory indemnification is success on the merits or otherwise. *Id.* at 265. In so holding, the court stated:

In contrast to subsections (a) and (b), subsection (c) predicates recovery on indemnitee's success "on the merits or otherwise in defense of the proceeding." The distinction is understandable. Subsections (a) and (b) do not require a prior judicial determination of the validity of the indemnitee's position as to the proceeding for which indemnification is sought. Hence, in the absence of success on the merits of the defense, there is a requirement that specific factual prerequisites be established as a condition for indemnification. Subsection (c) applies only where there has been a prior proceeding in which the lack of merit of the attack upon the indemnitee has been established. In such case the director, officer, or employee is entitled to be indemnified for expenses incurred in resisting the criminal charge against him if the prior proceeding arose by reason of the fact that he is or was a director, officer, or employee of the corporation.

*Id.*; see also *KNEPPER & BAILEY*, *supra* note 2, at 302 ("The statutory standards for permissive indemnification [i.e., good faith and reasonable belief] do not apply when mandatory indemnification is in order.")

In contrast, some courts in other states construing similar statutes have denied mandatory indemnification notwithstanding the claimant's unquestionable success on the merits in defending the underlying action because of a lack of good faith on the claimant's part in the conduct questioned in the underlying action. See, e.g., *Diamond v. Diamond*, 120 N.E.2d 819, 821 (N.Y. 1954) (denying mandatory indemnification notwithstanding director having been wholly successful in defending action because to do so "would place the statute in opposition to the fundamental principles not only of law but of good conscience and morals"); *People v. Uran Mine Corp.*, 216 N.Y.S.2d 985 (App. Div. 1961) (denying indemnification where plaintiff had been successful in defending suit because of failure to prove good faith).

One commentator has proposed amending the mandatory indemnification provision of the old Model Act, which is substantially identical to § 145(c), to require a finding not only that the claimant was successful, but that he or she met the standards applicable to permissive indemnification as well. *McAdams*, *supra* note 101, at 2135-36. For a further discussion of good faith and mandatory indemnification, see *infra* note 206.

135. See *Westcap*, 492 A.2d at 265 (holding that only prerequisite to mandatory indemnification is success on merits or otherwise); *Monteleone & Conca*, *supra* note 5, at 575 ("The person to be indemnified need not demonstrate his or her

## IV. ANALYSIS

A. *Waltuch v. Conticommodity Servs., Inc.: Narrative Analysis*

In *Waltuch*, the Second Circuit addressed two significant issues regarding the scope of § 145.<sup>136</sup> First, the court had to decide whether the supplemental indemnification provision of subsection (f) gave Conti the power to indemnify Waltuch even in the absence of good faith on his part.<sup>137</sup> Second, the court had to determine whether Waltuch's dismissal with prejudice without any payment on his part as a result of Conti's settlement was sufficient to entitle him to mandatory indemnification under subsection (c).<sup>138</sup>

1. *The Scope of § 145(f)*

No Delaware court had directly considered the scope of additional indemnification that could be provided pursuant to subsection (f).<sup>139</sup> Notwithstanding the paucity of precedent, the Second Circuit discerned what it termed a "rule of consistency" governing the use of subsection (f) from the relevant case law, commentary and the court's own interpretation of the statute as a whole.<sup>140</sup> According to this rule, subsection (f) could be used to provide directors and officers with additional rights to indemnification other than those found in the statute, provided however,

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own good faith or that he or she was free from wrongdoing, but only that the claim asserted against him or her was without merit."); see also *Wolfson*, 321 A.2d at 138 (requiring only "success" in underlying suit to trigger § 145(c) in criminal case). Similarly, the Second Circuit adopted a narrow definition of "success" under § 145(c). For a discussion of the Second Circuit's treatment of the term "success" in § 145(c), see *infra* notes 163-79 and accompanying text. For a critical analysis of the Second Circuit's interpretation of § 145(c), see *infra* notes 190-97 and accompanying text.

136. *Waltuch v. Conticommodity Servs., Inc.*, 88 F.3d 87, 89 (2d Cir. 1996). For a further explanation of the facts and procedural history of the *Waltuch* appeal, see *supra* notes 13-40 and accompanying text.

137. *Waltuch*, 88 F.3d at 89.

138. *Id.*

139. *Id.* at 91. The competing interpretations advocated to the court by the parties can be briefly summarized as follows. Waltuch argued that subsection (f) was a separate grant of indemnification power allowing a corporation to provide indemnification rights beyond those provided for in the other substantive provisions of the statute. *Id.* at 89. Specifically, Waltuch argued that subsection (f) allowed Conti to agree to indemnify him even if he had acted in bad faith. *Id.* Conti countered that subsection (a) was the true source of a corporation's indemnification power, and that because subsection (a) contains a good faith requirement, Waltuch was not entitled to indemnification unless he could show he acted in good faith. *Id.* at 89-90. For a discussion of § 145(a) and its requirements, see *supra* notes 73-83 and accompanying text. Because Waltuch had elected to forgo a trial on the merits as to his good faith, the Second Circuit entered its analysis assuming Waltuch had acted with less than good faith. *Waltuch*, 88 F.3d at 89.

140. See *Waltuch*, 88 F.3d at 91 (announcing "rule of 'consistency'"). For a further discussion of the Second Circuit's reasoning in developing its "rule of consistency," see *supra* notes 136-39, *infra* notes 141-62 and accompanying text.

that such rights would be valid only to the extent that they are consistent with the other substantive provisions of the statute.<sup>141</sup>

The Second Circuit began its analysis by examining two decisions of the Delaware Supreme Court interpreting § 145.<sup>142</sup> The court acknowledged that these cases did not deal directly with the scope of subsection (f); nevertheless, the court asserted that these cases tended to support its "rule of consistency."<sup>143</sup> The court concluded that the language in these opinions stood for two complimentary propositions which form the basis of its "rule of consistency": "[I]ndemnification rights may be broader than those set out in the statute but they cannot be inconsistent with the 'scope' of the corporation's power to indemnify, as delineated in the statute's substantive provisions."<sup>144</sup>

Turning to the language of the statute itself, the court determined that a reasonable reading of the statute as a whole reinforced the court's view that a "rule of consistency" governed subsection (f).<sup>145</sup> Central to the court's construction of § 145 was the premise that § 145 is a legislative grant of power to corporations.<sup>146</sup> With this premise in mind, the court primarily focused upon defining the structure and scope of that grant of power.

Under the court's analysis of § 145, the residual power of a corporation to indemnify was found in subsections (a) and (b).<sup>147</sup> Of primary significance to the court, these sections are clearly worded as grants of power, explicitly stating "a corporation *shall have power* to indemnify."<sup>148</sup>

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141. *Waltuch*, 88 F.3d at 91.

142. *Id.* at 91-92. The Second Circuit looked primarily at the Delaware Supreme Court's holdings in *Citadel Holding Corp. v. Roven*, 603 A.2d 818 (Del. 1992) and *Hibbert v. Hollywood Park, Inc.*, 475 A.2d 339 (Del. 1983). For a discussion of these cases, see *supra* note 104.

143. *Waltuch*, 88 F.3d at 91-92. Acknowledging the lack of precedent, the court stated nonetheless that "the applicable cases tend to support the proposition that a corporation's grant of indemnification rights cannot be inconsistent with the substantive statutory provisions of section 145." *Id.* at 91.

144. *Id.* at 92. Further, the court characterized *Citadel* as standing for the proposition that "the express limits in [§] 145's substantive provisions are not subordinated to [§] 145(f)." *Id.*

145. *Id.* The court stated, "[t]he 'consistency' rule suggested by these Delaware cases is reinforced by our reading of [§] 145 as a whole." *Id.*

146. See *id.* at 92-94 (construing § 145 as grant of power to indemnify). The power of a corporation to indemnify its officers and directors was uncertain at common law. *Arsht*, *supra* note 5, at 176. For a discussion of the common law on corporate indemnification, see *supra* notes 51-55 and accompanying text. State statutes such as § 145 of the Delaware Code were enacted to end the uncertainty at common law by conclusively establishing the corporate power to indemnify. For a further discussion of the purpose behind enacting indemnification statutes such as § 145, see *supra* notes 58-60 and accompanying text.

147. *Waltuch*, 88 F.3d at 92-93 (stating that subsections (a) and (b) "expressly grant a corporation the power to indemnify directors, officers and others").

148. *Id.* at 90 (emphasis added). In the opinion, the court recognized confusion as to the precise wording of the statute. *Id.* at 90 n.6. There was a conflict between the language of § 145(a) as originally enacted and the language as it ap-

These grants are not plenary and unlimited, but rather, they are both significantly circumscribed by the requirement that indemnification under both subsections may not be provided unless the director or officer to be indemnified "acted in good faith and in a manner reasonably believed to be in or not opposed to the best interests of the corporation."<sup>149</sup> Thus, the court noted that these provisions "limit the scope of the power they confer."<sup>150</sup> In contrast, subsection (f) is not a grant of power similar to subsections (a) and (b).<sup>151</sup> The language of subsection (f) does not speak in terms of "corporate power," instead the court stated, § 145(f) "merely acknowledges that one seeking indemnification may be entitled to 'other rights.'"<sup>152</sup> Because subsection (f) is not a separate grant of power, the court reasoned that it cannot be read to free a corporation from the good faith limit explicitly imposed upon the real grant of power to indemnify found in subsections (a) and (b).<sup>153</sup>

The Second Circuit noted that when the legislature "intended a subsection of [§] 145 to augment the powers limited in subsection (a), it set out the additional powers expressly."<sup>154</sup> The court illustrated this point by examining § 145(g), which states that "[a] corporation *shall have power*" to provide insurance to protect a director and officer against any liability "*whether or not the corporation would have the power to indemnify him against such liability under this section.*"<sup>155</sup> According to the court, this subsection

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pears codified in the Michie Company's popular compilation. *Id.* The language of the original enactment of § 145(a) used the phrase "a corporation shall have power to indemnify." 56 Del. Laws 50, § 1, at 170 (1967), *codified at* Del. Code Ann. tit. 8, § 145(g) (1994). On the other hand, the popular codified version uses the phrase "a corporation may indemnify." DEL. CODE ANN. tit. 8, § 145(a). Citing Delaware precedent, the court resolved the conflict in favor of the original version. *Waltuch*, 88 F.3d at 90 n.6 (citing *Elliott v. Blue Cross & Blue Shield*, 407 A.2d 524, 528 (Del. 1979) (recognizing that original language of enactment controls)). Thus, the Second Circuit's interpretation of § 145(a) and (b) is premised upon the language "a corporation shall have power to indemnify," which undeniably connotes a grant of power. *Id.*

149. *Waltuch*, 88 F.3d at 92. Under the court's analysis, a corporation cannot claim § 145(a) or (b) as its source of authority to indemnify a director or officer who has acted in bad faith or in a manner that he or she could not have reasonably believed to be in or not opposed to the best interests of the corporation. *Id.*

150. *Id.* The court expressly disagreed with the holding in *PepsiCo, Inc. v. Continental Casualty Co.*, 640 F. Supp. 656 (S.D.N.Y. 1986), which characterized subsections (a) and (b) as mere "backstop provisions." *Waltuch*, 88 F.3d at 93 n.8. The court rejected the notion that subsections (a) and (b) were mere default rules that subsection (f) could be used to opt-out of. *Id.* For a discussion of *PepsiCo* and commentary on § 145(f)'s limitations, see *supra* notes 96-112 and accompanying text.

151. *Waltuch*, 88 F.3d at 92-93.

152. *Id.* at 93.

153. *Id.*

154. *Id.*

155. DEL. CODE ANN. tit. 8, § 145(g) (1994) (emphasis added). Section 145(g) provides:

A corporation shall have power to purchase and maintain insurance on behalf of any person who is or was a director, officer, employee or agent

"reflects the principle that corporations have the power under [§] 145 to indemnify in some situations and not in others."<sup>156</sup> Moreover, if subsection (f) were an unlimited plenary grant of power to indemnify, as Waltuch contended, then the "whether or not" language of subsection (g) would be utterly superfluous.<sup>157</sup> Under the court's interpretation, the "whether or not" language of subsection (g) must be referring to the limitations upon corporate indemnity power set forth in subsections (a) and (b), which include the good faith limitation.<sup>158</sup>

Finally, the court found additional support for its "rule of consistency" in an article written by the principal drafter of the 1967 amendments to § 145, which added the good faith and best interests requirements to subsections (a) and (b).<sup>159</sup> There, the author explained that these requirements were specifically intended to limit a corporation's power to indemnify.<sup>160</sup> Thus, the court reasoned, subsection (f) could not be interpreted as a separate grant of indemnity power because to do so would be diametrically opposed to the legislative intent to limit such power by incorporating the standard of conduct requirements in subsections (a) and (b).<sup>161</sup> In short, the Second Circuit determined that Waltuch's interpretation of the statute failed to make sense of the statute as a whole.<sup>162</sup>

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of the corporation . . . against any liability asserted against him and incurred by him in any such capacity, or arising out of his status as such, whether or not the corporation would have the power to indemnify him against such liability under this section.

56 Del. Laws 50, § 1, at 172 (1967), *codified at* DEL. CODE ANN. tit. 8, § 145(g).

156. *Waltuch*, 88 F.3d at 93.

157. *Id.*

158. *Id.*

159. *See id.* 93-94 (citing Arshnt & Stapleton, *supra* note 56, at 77-78). Arshnt was the Chairman of the Drafting Committee of the Delaware Corporation Law Revision Commission in 1967. Arshnt, *supra* note 5, at 176 n.\*.

160. *Waltuch*, 88 F.3d at 93. Arshnt & Stapleton's article, *Delaware's New General Corporation Law: Substantive Changes*, *supra* note 56, is considered by many "to be part of (if not all of) '[t]he legislative history to section 145.'" *Waltuch*, 88 F.3d at 94 n.9 (citation omitted). The authors noted that a great deal of uncertainty existed under § 145's predecessor as to the permissible scope of corporate indemnification powers. Arshnt & Stapleton, *supra* note 56, at 77-78. The authors also stated that the good faith and best interests requirements were added as "limitations which must necessarily be placed on the power to indemnify in order to prevent the statute from undermining the substantive provisions of the criminal law and corporation law." *Id.* at 78. More specifically, the drafters added the limitations to protect the integrity of the duty of loyalty imposed upon a director and officer in corporate law. *Id.*

161. *Waltuch*, 88 F.3d at 94 n.9. The court recognized Arshnt & Stapleton's explanation that "the Legislature enacted the 'good faith' clause . . . to make the State's 'public policy' explicit: a corporation could not indemnify directors and officers who breached their duty of loyalty to the corporation." *Id.*

162. *Id.* at 91. The court reasoned that if it accepted Waltuch's construction of subsection (f) as a separate, unlimited grant of corporate power to indemnify in any situation irrespective of the other substantive provisions of the statute, then the other carefully crafted provisions of the statute would be unnecessary. *Id.* The

## 2. *Mandatory Indemnification Under § 145(c)*

The second issue facing the court was whether the dismissal of the private suits without any payment by Waltuch as a result of Conti's settlement constituted "success" under § 145(c).<sup>163</sup> The court initially noted that no Delaware court had specifically applied § 145(c) to a claim arising from the settlement and dismissal of a civil suit.<sup>164</sup> In *Merritt-Chapman & Scott Corp. v. Wolfson*,<sup>165</sup> however, one lower Delaware court had applied § 145(c) to a settlement in a criminal action.<sup>166</sup> The Second Circuit interpreted the holding in *Wolfson* as adopting a narrow interpretation of "success" stating that *Wolfson* stood for the proposition that "[e]scape from an adverse judgment or other detriment, for whatever reason, is determinative" as to whether a party has been "successful" under § 145(c).<sup>167</sup> Accordingly, the court reasoned, the "only question" a court considering a claim

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court called the district court's opinion a "thorough and scholarly opinion," and it approvingly quoted the following:

[T]here would be no point to the carefully crafted provisions of Section 145 spelling out the permissible scope of indemnification under Delaware law if subsection (f) allowed indemnification in additional circumstances without regard to these limits. The exception would swallow the rule.

*Id.* (quoting *Waltuch v. Conticommodity Servs., Inc.*, 833 F. Supp. 307, 309 (S.D.N.Y. 1993), *aff'd in part, rev'd in part* by 88 F.3d 87 (2d Cir. 1996)). Instead, the court refused to ignore the explicit terms of the statute holding that any attempt to provide additional rights to indemnification under subsection (f) must be consistent with the other provisions of the statute. *Id.* Accordingly, the court denied Waltuch's claim that Article Ninth of Conti's certificate provided for indemnification even if he acted in bad faith because to so hold would be inconsistent with section 145(a)'s requirement of "good faith." *Id.* at 94.

163. For a discussion of mandatory indemnification under § 145(c), see *supra* notes 113-35 and accompanying text. Waltuch argued that because he had been dismissed with prejudice without any payment or assumption of liability, he had been "successful on the merits or otherwise" as required by subsection (c) and was entitled to indemnification as a matter of law. *Waltuch*, 88 F.3d at 95. Conti responded by arguing that Waltuch had not been successful because part of the \$35 million it paid in settlement was paid "on behalf of Waltuch." *Id.* Conti argued that "success" under subsection (c) was synonymous with "vindication" requiring an element of moral exoneration. *Id.* The district court agreed with Conti and summarized the argument:

Vindication is . . . ordinarily associated with a dismissal with prejudice without any payment. However, a director or officer is not vindicated when the reason he did not have to make a settlement payment is because someone else assumed that liability. Being bailed out is not the same thing as being vindicated.

*Waltuch*, 833 F. Supp. at 311.

164. *Waltuch*, 88 F.3d at 95.

165. 321 A.2d 138 (Del. Super. Ct. 1974).

166. *Waltuch*, 88 F.3d at 95 (citing *Wolfson*, 321 A.2d at 138). For a further discussion of the *Wolfson* case, see *supra* notes 129, 132.

167. *Id.* (emphasis added). The Second Circuit noted that the court in *Wolfson* "rejected the more expansive view of vindication" or moral exoneration urged by the corporation in that case, which was similar to that urged by Conti. *Id.*

under § 145(c) has to ask is what the result in the underlying litigation was, not why it was.<sup>168</sup>

Applying the *Wolfson* principles, the Second Circuit determined that Waltuch was entitled to indemnification under § 145(c).<sup>169</sup> The court concluded that when the suits against Waltuch were dismissed with prejudice without any payment or assumption of liability on his part, he had been "successful on the merits or otherwise" as that term is used in the statute.<sup>170</sup> The court rejected Conti's contention that Waltuch did not truly achieve a settlement without payment because part of Conti's \$35 million settlement was paid on behalf of Waltuch.<sup>171</sup> According to the court, Conti's argument was inconsistent with *Wolfson* because it required the court "to go behind the result" and inquire as to why the suits were dismissed, an endeavor the court deemed expressly prohibited by *Wolfson*.<sup>172</sup>

The court found additional support for its narrow definition of "success" in the fact that technical defenses are considered sufficient to satisfy the "success on the merits or otherwise" requirement of § 145(c).<sup>173</sup> The court noted that in such cases a defendant who has successfully asserted a technical defense to an underlying action is deemed "successful" under the statute irrespective of whether that victory would have been deserved had there been an adjudication on the merits.<sup>174</sup> Accordingly, the court reasoned that it should not matter whether Waltuch would have prevailed on the merits in the absence of Conti's settlement because, as in the case of the technical defense, Waltuch was "successful," as that term is used in the statute, regardless of whether his success was deserving.<sup>175</sup>

Finally, the court noted that its holding was consistent with the decisions of two non-Delaware courts interpreting virtually identical mandatory indemnification statutes.<sup>176</sup> Both decisions support the proposition that dismissal of a suit with prejudice without any payment or as-

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168. *Id.* at 96 ("According to [*Wolfson*], the only question a court may ask is what the result was, not why it was.").

169. *Id.* at 97.

170. *Id.* at 96 ("Here, Waltuch was sued, and the *suit* was dismissed without his having paid a settlement. . . . Once Waltuch had achieved his settlement gratis, he achieved success 'on the merits or otherwise.'" (emphasis added)).

171. *Id.*

172. *Id.* ("Under the approach taken in [*Wolfson*], it is not our business to ask why this result was reached.").

173. *Id.* For a discussion of technical defenses as a means to establishing success under § 145(c), see *supra* note 124 and accompanying text.

174. *Waltuch*, 88 F.3d at 96.

175. *Id.*

176. *Id.* (citing *Wisener v. Air Express Int'l Corp.*, 583 F.2d 579, 583 (2d Cir. 1978); *B & B Inv. Club v. Kleinert's, Inc.*, 472 F. Supp. 787 (E.D. Pa. 1979)). For a discussion of *Wisener*, see *infra* note 177. For a discussion of *B & B Inv. Club*, see *infra* notes 177-78.

sumption of liability constitutes "success" as used in the statute.<sup>177</sup> Furthermore, both decisions supported the court's conclusion that § 145(c) is satisfied when a defendant has been "successful" irrespective of how that success was achieved or whether it would have been deserving on the merits.<sup>178</sup> Accordingly, the court reversed the district court's decision and granted Waltuch indemnification for the expenses he incurred in defending the private actions.<sup>179</sup>

B. *A Critical Analysis of the Second Circuit's Decision in Waltuch v. Conticommodity Servs., Inc.*

1. *The Second Circuit's "Rule of Consistency"*

The Second Circuit's holding that any attempt to provide additional indemnification rights under § 145(f) must be consistent with the other substantive provisions of § 145 is solidly correct.<sup>180</sup> Virtually every applicable source of authority on the issue appears to unanimously support the court's "rule of consistency."<sup>181</sup> Moreover, a common sense reading of § 145 as a whole clearly demonstrates that an alternative construction is logically inconsistent.

While the case law on subsection (f) is sparse, the court correctly asserted that statements in the applicable decisions on Delaware law tend to support the court's "rule of consistency."<sup>182</sup> Additionally, commentators

177. *Waltuch*, 88 F.3d at 97. In *Wisener*, the Second Circuit interpreted an Illinois statute identical to § 145(c) and concluded that the term "success on the merits or otherwise . . . surely is broad enough to cover a termination of claims by agreement without any payment or assumption of liability." *Wisener*, 583 F.2d at 583. In *B & B Investment Club*, the district court concluded that when an officer "negotiate[d] a dismissal with prejudice without making any payment . . . [he or she] was 'successful on the merits or otherwise.'" *B & B Inv. Club*, 472 F. Supp. at 791. Accordingly, Waltuch was entitled to indemnification because the suits were dismissed with prejudice without any payment or assumption of liability on his part. *Waltuch*, 88 F.3d at 97.

178. *Waltuch*, 88 F.3d at 97. The decision of the United States District Court for the Eastern District of Pennsylvania in *B & B Investment Club* was also consistent with the Second Circuit's conclusion and its interpretation of *Wisener*. In *B & B Investment Club*, an officer sought mandatory indemnification for expenses incurred in a suit from which he was dismissed with prejudice and without any payment on his part. *B & B Inv. Club*, 472 F. Supp. at 791. Nonetheless, his dismissal without payment was only possible because a co-defendant had paid a large amount to the plaintiff in settlement. *Id.*

179. *Waltuch*, 88 F.3d at 97. In short, the court concluded that "[w]hatever the impetus for the plaintiffs' dismissal of their claims against Waltuch, he still walked away without liability and without making a payment. This constitutes a success that is not tarnished by the process that achieved it." *Id.*

180. For a discussion of the Second Circuit's analysis in *Waltuch*, see *supra* notes 136-62 and accompanying text.

181. For a discussion of these sources of authority, see *supra* notes 88-89, *infra* notes 182-84 and accompanying text.

182. For examples of case law supporting the court's "rule of consistency," see generally *Mooney v. Willys-Overland Motors, Inc.*, 204 F.2d 888 (3d Cir. 1953); *Citadel Holding Corp. v. Roven*, 603 A.2d 818, 823 (Del. 1992); *Hibbert v.*

on Delaware law resoundingly agree that subsection (f) is limited by public policy and the other substantive provisions of the statute.<sup>183</sup> Moreover, the principal drafter of the 1967 revisions to § 145 has endorsed this view as well.<sup>184</sup>

The appropriateness of the court's holding is perhaps most clearly illustrated by examining the consequences of accepting the alternative argument. If subsection (f) is indeed a separate plenary grant of power to corporations to indemnify in any manner they see fit, then it would appear that the enactment of the other provisions of the statute was a pure act of legislative futility.<sup>185</sup> There would be no point to incorporating a good faith requirement or distinguishing between third party and derivative suits if a corporation could simply agree to provide unlimited indemnification to its directors and officers through the impetus of subsection (f).<sup>186</sup> In short, the district court appropriately summarized the fatal flaw in Wal-

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Hollywood Park, Inc., 457 A.2d 339, 344 (Del. 1983); *Shearin v. E.F. Hutton Group, Inc.*, 652 A.2d 578, 593-94 & n.19 (Del. Ch. 1994); Choate, Hall & Stewart v. SCA Servs., Inc., 495 N.E.2d 562 (Mass. App. Ct. 1986). *But see* PepsiCo, Inc. v. Continental Cas. Co., 640 F. Supp. 656 (S.D.N.Y. 1986).

183. For a discussion of limitations upon § 145(f), see *supra* notes 100-12 and accompanying text. Generally, commentators agree that subsection (f) is not an unlimited plenary grant of power to indemnify, but rather that it is limited by public policy constraints. See *Arsht*, *supra* note 5, at 176 (noting that "[t]he statutory language [of subsection (f)] is circumscribed by limits of public policy"); *Sparks et al.*, *supra* note 3, at 975 ("[P]ublic policy limits the power to indemnify under Section 145(f)."). Furthermore, most commentators agree that subsections (a) through (e) represent an affirmative statement of Delaware's public policy on corporate indemnification. *BALOTTI & FINKELSTEIN*, *supra* note 5, § 4.13, at 198-99 (noting that other provisions could bar certain uses of subsection (f)); *Klink et al.*, *supra* note 5, at 128 (noting that substantive provisions of section are statement of public policy). Therefore, commentators believe that attempts to provide supplementary indemnification rights under subsection (f) are valid only in so far as they are consistent with the public policy embodied in subsections (a) through (e) of the statute.

184. See generally *Arsht & Stapleton*, *supra* note 56, at 77-80 (discussing legislature's intent behind 1967 revisions to § 145). According to *Arsht & Stapleton*, the legislature amended § 145 because it "decided that the power to indemnify should not be granted unless it appeared that the person seeking indemnification had 'acted in good faith and in a manner he reasonably believed to be in or not opposed to the best interests of the corporation.'" *Id.* at 78 (citation omitted).

185. See *Waltuch v. Conticommodity Servs., Inc.*, 88 F.3d 87, 91-94 (2d Cir. 1996) (arguing that § 145(f) is not separate plenary grant of power to corporations to indemnify in any manner); see also *Waltuch v. Conticommodity Servs., Inc.*, 833 F. Supp. 302, 306-08 (S.D.N.Y. 1993) (arguing similarly), *aff'd in part, rev'd in part by* 88 F.3d 87 (2d Cir. 1996).

186. *Waltuch*, 88 F.3d at 92. An interpretation that would nullify the explicit "good faith" and "best interests" requirements would violate the legislative intent behind the statute. See *Arsht & Stapleton*, *supra* note 56, at 77-78 (discussing legislative intent behind 1967 revision to add "good faith" and "best interests" requirements to § 145). These requirements were intentionally added to limit the power of corporations to indemnify for breaches of fiduciary duties. *Id.* To interpret subsection (f) as a plenary grant of indemnification power would be to abrogate the legislative intent behind the statute. *Id.*

tuch's argument when it wrote that under Waltuch's premise, subsection (f) would become the proverbial "exception that swallowed the rule," rendering the remainder of the statute utterly meaningless.<sup>187</sup>

As a final observation, it is worth noting that a growing number of other states have codified "rules of consistency" in their indemnification statutes.<sup>188</sup> These statutes recognize that a corporation may agree to give directors and officers other rights to indemnification, but declare that any such agreement is valid only to the extent that they are consistent with the other provisions of the statute.<sup>189</sup> In light of this practice, it is within the realm of possibility that the Delaware Legislature simply failed to include the obvious and that the Second Circuit was called upon in *Waltuch* to clarify and fill in the gap.

## 2. *The Second Circuit's Test for "Success"*

The Second Circuit's holding that a dismissal of an entire suit with prejudice without any payment or assumption of liability satisfies the "success on the merits or otherwise" requirement of § 145(c) also appears to be well-grounded in both case law and commentary surrounding § 145(c).<sup>190</sup> The court, following the Delaware precedent in *Wolfson*, logically reasoned that if a complete success in the criminal context was sufficient to trigger mandatory indemnification in that case, then a complete success should operate similarly in the civil context.<sup>191</sup> Because the dismissal with prejudice of an entire suit without payment by the indemnitee is a complete success in a civil suit, the court's conclusion that Waltuch was entitled to indemnification stands firmly on precedent.<sup>192</sup> Moreover, the court's decision on this issue was anticipated in the commentary on § 145

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187. *Waltuch*, 833 F. Supp. at 309.

188. For examples of states with consistency provisions in their indemnification statutes, see CONN. GEN. STAT. § 33-778 (1994); S.C. CODE ANN. § 33-8-580(a) (Law Co-op. 1995); TENN. CODE ANN. § 48-18-509(3) (1996); TEX. BUS. CORP. ACT ANN. art. 2.02-1(M) (West 1996); WASH. REV. CODE ANN. § 23B.08.590(1) (West 1995).

189. See, e.g., WASH. REV. CODE ANN. § 23B.08.590(1). Section 23B.08.590(1) provides:

A provision treating a corporation's indemnification of or advance for expenses to directors that is contained in its articles of incorporation, bylaws, [or] a resolution of its shareholders or board of directors, or in a contract or otherwise, is valid only if and to the extent the provision is consistent with [the provisions of this statute].

*Id.*

190. For a discussion of § 145(c), see *supra* notes 113-35 and accompanying text. For a discussion of the Second Circuit's construction of subsection (c), see *supra* notes 163-79 and accompanying text.

191. See *Merritt-Chapman & Scott Corp. v. Wolfson*, 321 A.2d 138, 141 (Del. Super. Ct. 1974) (finding dismissal of criminal counts to be "success on the merits or otherwise" as used in section 145(c)). For further discussion of *Wolfson*, see *supra* notes 129, 132.

192. See *Waltuch v. Conticommodity Servs., Inc.*, 88 F.3d 87, 95 n.12 (2d Cir. 1996) (comparing criminal absolute success in criminal and civil actions).

and was consistent with decisions on the same issue in other jurisdictions.<sup>193</sup>

The court's bright-line test for "success" also appears to find support in Delaware precedent. The Delaware Superior Court's opinion in *Wolfson* clearly supports the court's conclusion that indemnification under § 145(c) is solely contingent upon a claimant's success in the underlying action regardless of how or why that success was achieved.<sup>194</sup> This test is also consistent with the holding of the Delaware Superior Court in *Green v. Westcap Corp.*<sup>195</sup> that a claimant's successful defense of an entire criminal action on the merits was sufficient to entitle the claimant to indemnification under subsection (c).<sup>196</sup> In *Westcap*, like *Wolfson*, the court refused to go behind the result of the underlying proceeding to determine whether the claimant's success was deserved.<sup>197</sup>

#### V. PRACTICAL CONSIDERATIONS IN THE WAKE OF *WALTUCH V. CONTICOMMODITY SERVS., INC.*

In the wake of *Waltuch*, corporate attempts to provide supplementary indemnification rights to their directors and officers under subsection (f) are clearly circumscribed by the other substantive provisions of the statute.<sup>198</sup> After *Waltuch*, it is settled that corporations may not, for instance, depend upon subsection (f) to indemnify directors and officers in the ab-

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193. See *Wisener v. Air Express Int'l Corp.*, 583 F.2d 579, 583 (2d Cir. 1978) (construing Illinois statute's success on merits or otherwise requirement as broad enough to encompass termination of claims by agreement without payment); *B & B Inv. Club v. Kleinert's Inc.*, 472 F. Supp. 787, 791 (E.D. Pa. 1979) (holding dismissal of suit with prejudice without payment constitutes success under Pennsylvania statute); *BALOTTI & FINKELSTEIN*, *supra* note 5, § 4.13, at 186 (noting dismissal of suit with prejudice without payment constitutes success under § 145(c)); *FERRARA ET AL.*, *supra* note 5, § 12.04 (same); *Beveridge*, *supra* note 51, at 751 (same); *Monteleone & Conca*, *supra* note 5, at 575 (same); *Veasey et al.*, *supra* note 2, at 406-07 (same). For a further discussion of what constitutes success under § 145(c), see *supra* notes 120-33 and accompanying text.

194. *Wolfson*, 321 A.2d at 141.

195. 492 A.2d 260 (Del. Super. Ct. 1985).

196. *Id.* at 262. It is important to note that *Westcap*, like *Wolfson*, involved claims for mandatory indemnification that arose out of the criminal context and not the civil context. *Id.*

197. *Id.* at 266. In *Westcap*, the officer successfully defended against all criminal claims against him and sought indemnification under § 145(c). *Id.* at 262. The corporation refused to grant indemnification, claiming that the officer was required to show good faith as in subsections (a) and (b). *Id.* at 264. The court rejected the corporation's argument, refused to inquire as to the officer's good faith and found that the successful defense alone was all that was needed to entitle the officer to indemnification under § 145(c). *Id.* at 265. Notably, the claims in both *Westcap* and *Wolfson* arose out of the criminal context where the lines between success and failure are clearly defined. For a discussion of the difference between the criminal and civil contexts for purposes of § 145(c), see *infra* notes 205-07 and accompanying text.

198. *Waltuch v. Conticommodity Servs., Inc.*, 88 F.3d 87, 90-91 (2d Cir. 1996).

sence of good faith.<sup>199</sup> Nonetheless, while the court's new "rule of consistency" places definitive limits upon subsection (f), it does not render subsection (f) meaningless.<sup>200</sup> That section may still be used to provide additional rights to indemnification as long as those rights are consistent with the rest of the section.<sup>201</sup>

The court's decision with respect to subsection (c) may prove to have significant practical importance to corporate practitioners. *Waltuch* conclusively establishes that a dismissal with prejudice of an entire civil action without payment satisfies § 145(c).<sup>202</sup> Most notably, the court's decision should be consulted by corporations contemplating settlements in actions in which they are co-defendants with a director or officer. In the wake of *Waltuch*, corporations should seriously consider making the director or officer contribute toward the settlement in order to avoid liability for their expenses in a subsequent indemnification action brought by such director or officer under § 145(c) citing *Waltuch* as precedent.<sup>203</sup>

It should be noted that the applicability of the court's decision to a civil action where less than the entire suit has been dismissed without payment remains unsettled.<sup>204</sup> This would be the case, for example, where a

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199. *Id.* at 94.

200. *See id.* (discussing expansions of indemnification under subsection (f) as consistent with § 145); *see also* *Hibbert v. Hollywood Park, Inc.*, 457 A.2d 339, 344 (Del. 1983) (listing "other rights" to indemnification consistent with statute and public policy); *BALOTTI & FINKELSTEIN, supra* note 5, § 4.16, at 198-200.1 (discussing permissible expansions of indemnification under subsection (f)); *KNEPPER & BAILEY, supra* note 2, at 308-09 (listing expansions of indemnification under subsection (f) consistent with statute and public policy); *Veasey et al., supra* note 2, at 415-16 (listing expansions of indemnification under subsection (f) consistent with statute and public policy).

201. *See Waltuch*, 88 F.3d at 91 (announcing "rule of 'consistency'").

202. *Id.* at 95. For a discussion of the court's holding with respect to § 145(c), *see supra* notes 163-79 and accompanying text. For a critical analysis of the Second Circuit's construction of subsection (c), *see supra* notes 190-97 and accompanying text.

203. *See Waltuch*, 88 F.3d at 87 (holding officer successful where suits were dismissed without payment). The court repeatedly stressed that *Waltuch* had escaped without making any payment. *Id.* Had *Conti* required *Waltuch* to contribute toward settlement, or assume some liability in the settlement, then *Conti* would have been spared having to later pay *Waltuch's* \$1.2 million in legal fees. This is especially true in light of the fact that *Waltuch* did not even bother to appeal the district court's denial of his claim for expenses in the CFTC proceeding because he had paid a \$100,000 fine in that case, making him clearly unsuccessful for purposes of § 145(c). *See id.* (noting *Waltuch* did not appeal district court's denial of mandatory indemnification for CFTC proceeding); *Waltuch v. Conticommodity Servs., Inc.*, 833 F. Supp. 302, 311 (S.D.N.Y. 1993) (denying *Waltuch's* claim for mandatory indemnification of expenses in CFTC proceeding because he paid fine).

204. *See Waltuch*, 88 F.3d at 96 n.12 (noting that case involved dismissal of entire suit without payment as opposed to dismissal with partial payment). The Second Circuit explicitly noted the difficulties with applying its opinion beyond the facts presented:

Our adoption of [*Wolfson's*] interpretation of the statutory term "successful" does not necessarily signal our endorsement of the result in that case.

settlement results in a dismissal of claims accompanied by partial payment for some claims but not others.<sup>205</sup> Such cases involve significantly more complex legal issues than those presented in *Waltuch*, and accordingly, future courts should resist the temptation to mechanically apply *Waltuch* under such circumstances.<sup>206</sup> Instead, future courts should narrowly con-

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The [*Wolfson*] court sliced the case into individual counts, with indemnification pegged to each count independently of the others. We are not faced with a case in which the corporate officer claims to have been "successful" on some parts of the case but was clearly "unsuccessful" on others, and therefore take no position on this feature of the [*Wolfson*] holding. . . . In a criminal case, conviction on a particular count is obvious failure, and dismissal of the charge is obvious success. In a civil suit for damages, however, there is a monetary continuum between complete success (dismissal of the suit without any payment) and complete failure (payment of the full amount of damages requested by the plaintiff). Because *Waltuch* made no payment in connection with the dismissal of the suits against him, we need not decide whether a defendant's settlement payment automatically renders that defendant "unsuccessful" under 145(c).

*Id.* The Second Circuit reasoned analogically that if complete success in the criminal context was sufficient to trigger mandatory indemnification in *Wolfson*, then it should operate similarly in the civil context. Thus, in *Waltuch*'s case, there was an absolute analogical match between complete success on both sides of the equation. Problems in applying the court's analysis arise, however, as one travels along the spectrum in civil suits where there is no longer an analogical match to reason from.

205. See *id.* (acknowledging difficulty in applying § 145(c) to settlements of civil actions with partial payment). An example of such a situation would be: *P* sues *D*, director of *C* corporation, alleging five claims based upon misconduct by *D* that was indisputably performed in bad faith. *P* and *D* then enter a settlement agreement expressly providing that *P* will dismiss all five claims and *D* assumes liability for only one. *D* then sues *C* for mandatory indemnification under § 145(c) for the four claims he technically dismissed without payment. This would be an example of a case along the continuum of civil success described by the court. For a discussion of the complex issues that arise in determining "success" in the civil context, see *supra* note 204.

206. For a hypothetical illustrating this point, see *supra* note 205. Under a wooden application of *Waltuch*, *D* would prevail and the court would be precluded from "going behind the result" to determine his success. This would be the case even though it clearly undermines the public policy behind the statute's other substantive provisions. For example, if *D* sought permissive indemnification under a provision in *C*'s by-laws or certificate it would be denied because *D* acted in bad faith. *Waltuch*, 88 F.3d at 92. Nonetheless, under the one-dimensional test of *Waltuch*, *D* would be entitled to indemnification under subsection (c) notwithstanding his undisputed bad faith because the court would be prevented from looking "behind the result" to determine whether the dismissal was deserved. *Id.* It seems fundamentally inconsistent to hold that a statute prohibits corporations from indemnifying an individual who has acted in bad faith while at the same time holding that the same statute requires corporations to indemnify an individual who has acted in bad faith. Nonetheless, this is precisely the result under a strict application of the court's analysis. For a discussion of the Second Circuit's analysis, see *supra* notes 163-79 and accompanying text.

While it is true that *Green v. Westcap*, 492 A.2d 260 (Del. Super. Ct. 1985), held that good faith is not needed under subsection (c), that case is easily distinguishable because it arose out of a criminal action in which the claimant had success-

fine the holding in *Waltuch* to its facts and perform the appropriate inquiry to determine the claimant's success where it is less than complete.<sup>207</sup>

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fully defended on the merits. *See id.* at 264 (holding director successful in defense was entitled to indemnification and was not required to establish good faith or reasonable belief). The court noted that where there had been a prior adjudication on the merits, it was not necessary to prove good faith for the purposes of subsection (c). *Id.* at 265. For a further discussion of *Westcap*, see *supra* note 134. In the case of *D*, however, there has been no such prior determination.

207. Applying *Waltuch's* bright-line test would allow defendants to structure settlements to create the illusion of success in order to optimize indemnification opportunities secure in the knowledge that a subsequent court will not review those settlements to determine their content or motivation. The better view would be to confine the application of *Waltuch* exclusively to those cases which fit within the scope of "complete success" on the civil litigation continuum (i.e., dismissal of the entire suit without payment), and allow the court to "look behind the result" and perform a deeper inquiry in cases that are not clearly "complete successes." Many states have avoided the problems posed by partial indemnification altogether by only allowing mandatory indemnification where a claimant has been "wholly" successful in defending the underlying suit. *See, e.g.*, IND. CODE ANN. § 23-1-37-9 (Michie 1996); N.C. GEN. STAT. § 55-8-52 (1995); TEX. BUS. CORP. ACT ANN. art. 2.02-1(H) (West 1996). As a final note, it is worth observing that in both of the non-Delaware cases relied upon by the court, the entire actions were dismissed without payment, and as such, they can be characterized as "complete successes" like *Waltuch*. *See Wisener v. Air Express Int'l Corp.*, 583 F.2d 579, 583 (2d Cir. 1978); *B & B Inv. Club v. Kleinert's Inc.*, 472 F. Supp. 787 (E.D. Pa. 1979).