CORPORATE RESPONSIBILITY FOR LITIGATION EXPENSES OF MANAGEMENT

The past twelve years have produced notable development in the law pertaining to indemnification of corporate officials for litigation expenses. Case law, always sparse, has not grown impressively by numerical measure, but for the first time the issues have been defined clearly and policy considerations have received deserved attention.¹ Many states have been added to the list of those with statutes permitting reimbursement of successful defendant officers, directors and, in some cases, employees.² The strength of this trend is shown by the fact that, at least in derivative actions, an old and oft-criticized decision of an intermediate Ohio appellate tribunal remains as the only case denying indemnification which has not been overruled by statute.³

Although the scope of the statutes is not limited to derivative actions, a reaction against these suits may have played a part in the new development. Indemnification legislation gained in popularity at the same time as that requiring a complaining shareholder to furnish security for expenses as a condition precedent to maintaining an action.⁴ Much has been said for and against the social desirability of shareholders' derivative actions, but the fact remains that indemnification legislation discourages the "strike" suit.⁵ If management is assured of reimbursement when the defense is successful, it will not be easy prey to the "striker."

The argument that corporate officers should bear litigation expenses as one of the risks of corporate management⁶ has not been accepted, either by the courts of most jurisdictions⁷ or by the legislatures of the states enacting

¹ See *In re Dissolution of E. C. Warner Co.*, 232 Minn. 207, 45 N.W.2d 388 (1950); *Solimine v. Hollander*, 129 N.J. Eq. 264, 19 A.2d 344 (1941); *New York Dry Dock Co., Inc. v. McCollum*, 173 Misc. 106, 16 N.Y.S.2d 844 (1939).

² CAL. CORP. CODE § 830; CONN. GEN. STATS. § 5129 (1949); DEL. REV. CODE § 2034(10), as amended by L. 1943, c. 125, § 1; KY. REV. STAT. § 271.375 (1948); ME. REV. STAT. c. 49, § 23 (1944); Md. Laws 1941 art. 23, c. 135, § 60; Mich. Acts 1931, No. 327, § 450.10-1; Minn. Laws 1951, c. 98, § 301.09(7); Mo. REV. STAT. tit. 23 § 351.355 (1949); MONT. REV. CODE § 5942.2 (1947); N.J. STAT. ANN. tit. 14, § 3-14 (1946); N.Y. GEN. CORP. LAW §§ 63-68; PA. STAT. ANN. tit. 12, § 1323 (Purdon's); R. I. Acts 1948, c. 2154, p. 517; Wis. Laws 1951, c. 731, § 180.04, p. 592, Wis. Stat., c. 180, § 180.34, p. 2140 (1949), Wis. Stat., c. 182, § 182.01 (9a), p. 2146 (1949).

³ *Griesse v. Lang*, 37 Ohio App. 553, 175 N.E. 222 (1931), criticized in Washington, *Litigation Expenses of Corporate Directors in Stockholders' Suits*, 40 COL. L. REV. 431, 435 (1940); Note, 27 Ky. L. J. 102 (1938).

⁴ For discussion of the security for expenses statutes see Ballantine, *Abuses of Shareholders Derivative Suits: How Far Is California's New "Security For Expenses" Act Sound Regulation?*, 37 CALIF. L. REV. 399 (1949); Bowes, *Should New York's "Security For Expenses" Act Be Amended?*, 2 SYRACUSE L. REV. 37 (1950); Hornstein, *The Death Knell of Stockholders' Derivative Suits in New York*, 32 CALIF. L. REV. 123 (1944).

⁵ *In re Dissolution of E. C. Warner Co.*, *supra* note 1 at 214, 45 N.W.2d at 393; *Solimine v. Hollander*, *supra* note 1 at 272, 19 A.2d at 348; Ballantine, *supra* note 4; Bowes, *supra* note 4; Hornstein, *supra* note 4. See *Cohen v. Beneficial Loan Corp.*, 337 U.S. 541, 547-549 (1949); *Brendle v. Smith*, 46 F. Supp. 522, 525-526 (S.D.N.Y. 1942).

⁶ See *New Dry Dock Co., Inc. v. McCollum*, *supra* note 1.

⁷ *In re Dissolution of E. C. Warner Co.*, *supra* note 1; *Solimine v. Hollander*, *supra* note 1; *accord*, *Marron v. Wood*, 55 N.M. 367, 233 P.2d 1051 (1951).

indemnification legislation.⁸ Rather, it has been determined that indemnification is necessary to induce capable and responsible businessmen to accept positions in management, particularly as directors.⁹

Furthermore, the objection that throwing the corporate weight behind the directors' or officers' defense would overwhelm the minority shareholder has been obviated by allowing indemnification only after termination of the action, so that the corporate officials have the immediate burden of supporting their defense.¹⁰

Thus the issues in this field no longer revolve on the question of whether there should be indemnification. Instead, granting the right, concern is now directed to the circumstances and restrictions controlling it.

CASE LAW

Limitations Imposed by the Older Cases

The older cases did not define clearly the circumstances under which indemnification would be granted or denied. Some principles were developed, however, and the foundation laid for the more recent cases and legislation.¹¹ It was early decided that directors or officers adjudged guilty of wrongful actions were not entitled to reimbursement,¹² and this doctrine has continued in force.¹³ The right to reimbursement was made to depend upon the outcome of the litigation concerning the conduct of the directors.¹⁴

In *Figge v. Bergenthal*, the first decision upholding the right to reimbursement, the Wisconsin court sanctioned a procedure by which expenses had been paid during the trial and before exoneration.¹⁵ A later case limited *Figge* by holding that the corporation could not anticipate the decision and throw its financial strength behind the defense until the directors were vindicated.¹⁶

⁸ Statutes cited note 2 *supra*. The *New York Dock Co.* case, *supra* note 1, was the immediate cause of the New York statute, and probably can be said to have begun the discussion in the field which led to the other enactments. WASHINGTON, CORPORATE EXECUTIVES' COMPENSATION 340 (1942); Note, 30 CORNELL L. Q. 249 (1944).

⁹ Statutes cited note 2 *supra*; *In re* Dissolution of E. C. Warner Co., *supra* note 1 at 214, 45 N.W.2d at 393; *Solimine v. Hollander*, *supra* note 1 at 272, 19 A.2d at 348; STEVENS, CORPORATIONS 831-836 (2d ed. 1949).

¹⁰ See note 9 *supra*.

¹¹ The older cases were mainly derivative actions.

¹² *Wickersham v. Crittenden*, 106 Cal. 329, 39 Pac. 603 (1895); *McCourt v. Singers-Bigger*, 145 Fed. 103 (8th Cir. 1906); *Chabot & Richard Co. v. Chabot*, 109 Me. 403, 84 Atl. 892 (1912); *Apfel v. Auditors*, 223 App. Div. 457, 228 N.Y. Supp. 489 (1928), *aff'd mem.*, 250 N.Y. 600, 166 N.E. 339 (1929).

¹³ Cases cited note 1 *supra*.

¹⁴ *In re* Dissolution of E. C. Warner Co., *supra* note 1; *Hollander v. Breeze Corporations*, 131 N. J. Eq. 585, 26 A.2d 507 (1941); *Solimine v. Hollander*, *supra* note 1; WASHINGTON, CORPORATE EXECUTIVES' COMPENSATION 550. However, when the plaintiff is the person who has rendered the services, compensation has been allowed despite bad faith and guilt on the part of the officers. *Taylor v. Rosehill Cemetery Co.*, 210 Ill. App. 209 (1918); *General Mortgage & Loan Corp. v. Guarantee Mortgage & Sec. Corp.*, 264 Mass. 253, 162 N.E. 319 (1928); *cf. Kanneberg v. Evangelical Creed Congregation*, 146 Wis. 610, 131 N.W. 353 (1911). *But cf. People v. Commercial Alliance L. Ins. Co.*, 148 N.Y. 563, 42 N.E. 1044 (1896).

¹⁵ 130 Wis. 594, 109 N.W. 581 (1907).

¹⁶ *Jesse v. Four-Wheel Drive Auto Co.*, 177 Wis. 627, 189 N.W. 276 (1922). Until the *Solimine* case, *supra* note 1, in 1941, *Figge* remained the only square holding sanctioning reimbursement in a derivative suit. *But see, Coeur D'Alenes Lead Co. v. Kingsbury*, 59 Idaho 627, 635, 85 P.2d 691, 694 (1938).

Misinterpreting the limit placed on *Figge* as overruling it, an Ohio intermediate court in *Griesse v. Lang* decided that without the unanimous ratification of the shareholders the corporation could not pay the expenses of successful directors.¹⁷ Lack of shareholder approval¹⁸ has not persisted in the case law as a reason for denial of recovery and has not been adopted by statute.¹⁹ Any requirement of shareholder approval would involve a process so cumbersome as to be impractical.

A more persistent and difficult enemy of reimbursement has been the idea that some benefit must accrue to the corporation before expenses can be paid.²⁰ This idea found support in the *Griesse* case although benefit was not there defined.²¹ Probably the elusive concept remains undefined. Unfortunately it remains a factor which has carried over into the later cases, causing no little difficulty.²²

Modern Case Law on Indemnification

Should reimbursement be denied unless a direct corporate benefit can be shown from management's successful defense of itself? This is probably the focal issue in the modern cases. In 1939 a New York lower court in the case of *New York Dry Dock Co. v. McCollum* denied reimbursement to defendant directors for expenses incurred in a successful defense of a derivative action, stating that in order to recover the directors must show that a substantial corporate interest was preserved or that a benefit accrued to the corporation.²³ While compelling arguments have been put forth showing that the result was unnecessary and should not be a binding precedent,²⁴ these became moot when in 1944 the New York Court of Appeals affirmed a decision holding that no common law right to reimbursement existed and

¹⁷ *Supra* note 3.

¹⁸ *Id.* at 556-557, 175 N.E. at 223; *accord*, *Jesse v. Four-Wheel Drive Auto Co.*, *supra* note 16.

¹⁹ Three state indemnification statutes provide for a special group of three shareholders to approve settlements when a majority of disinterested directors cannot be found. KY. REV. STAT. § 271:375 (1948); MO. REV. STAT. tit. 23 § 351.355 (1949); MONT. REV. CODE § 5942.2 (1947). Shareholder approval has only been a factor in cases involving corporate interest or corporate policies, in which unsuccessful directors have been reimbursed when they acted in good faith with the approval of the shareholders. *E.g.*, *Albreeht, Maguire & Co., Inc., v. General Plastics, Inc.*, 256 App. Div. 134, 9 N.Y.S.2d 415 (1939), *aff'd mem.*, 280 N.Y. 840, 21 N.E.2d 887 (1939); *Kanneberg v. Evangelical Creed Congregation*, *supra* note 14.

²⁰ *Kanneberg v. Evangelical Creed Congregation*, *supra* note 14 (no benefit required).

²¹ *Griesse v. Lang*, *supra* note 3 at 558, 175 N.E. at 223. *Griesse* mistakenly relied on *Godley v. Crandall & Godley Company*, 181 App. Div. 75, 168 N. Y. Supp. 251 (1917), *aff'd mem.*, 227 N.Y. 656, 126 N.E. 908 (1920), which concerned the right of a corporation to defend against receivership, the benefit to the corporation being the retention of control.

²² See *Mann v. Hearst*, Super. Ct., L. A. County, Civil No. 432 (1941) (benefit rule discussed and approved); *Wickersham v. Crittenden*, *supra* note 12 (court stated that defense against shareholder suit by officer was for the officer's own benefit and denied recovery for legal fees); *In re E. C. Warner Co.*, *supra* note 1 (held no benefit required); *Solimine v. Hollander*, *supra* note 1 (held no benefit required). New York cases have stated that a benefit is necessary. *E.g.*, *Drivas v. Lekas*, 182 Misc. 567, 48 N.Y.2d 785 (1944); *Neuberger v. Barrett*, 180 Misc. 222, 39 N.Y.S.2d 575 (1942); *New York Dry Dock Co., Inc. v. McCollum*, *supra* note 1.

²³ *Supra* note 1 (note that this case was tried with a stipulation that there would be no appeal).

²⁴ *Washington*, *supra* note 3, at 441-444.

that there could be no recovery in actions decided before the New York indemnity legislation became effective.²⁵

A directly contrary result was reached by New Jersey in 1941 in the case of *Solimine v. Hollander*,²⁶ a decision lauded by legal writers.²⁷ Recognizing that the defense and vindication of management was itself a benefit to the corporation, the court nevertheless repudiated the necessity for any showing of benefit and held that directors were entitled to indemnification. Reimbursement was allowed only after the directors had successfully vindicated themselves on the merits; the court emphasized that the ultimate result of the litigation was the test of the right to counsel fees, and that this result should be determined without the power of the corporation being thrown in to aid the defendants.²⁸

In re Dissolution of E. C. Warner Co., the most important recent decision on indemnification, approved and broadened *Solimine*.²⁹ The court stressed the policy arguments that indemnification would "actuate and induce responsible businessmen to accept the post of directors," and would tend to discourage the undesirable type of strike suit, summing up its argument by stating:³⁰

This right of reimbursement has its foundation in the maintenance of a sound public policy favorable to the development of sound corporate management as a prerequisite for responsible corporate action.

The holding was restricted to reimbursement after a successful defense on the merits.

The opinion goes a long way toward eliminating some of the dogma established by the older cases. First, the court rejected the necessity for supporting director's indemnification by analogy to other fiduciaries, saying that his position is unique. This characterization left the court free to decide the issue on pertinent policy grounds.³¹ Previously, arguments by analogy had led to unnecessary rationalization.

Second, and most important, the court unqualifiedly rejected the old "corporate benefit" idea. The court recognized that the right to indemnification should be based upon the sound corporate policy that directors and officers acting in the interests of the corporation should not be required to pay litigation expenses when they have not acted wrongfully. The fact that

²⁵ *Bailey v. Bush Terminal Co.*, 46 N.Y.S.2d 877 (1943), *aff'd mem.*, 267 App. Div. 899, 48 N.Y.S.2d 324 (1944), *aff'd mem.*, 293 N.Y. 735, 56 N.E.2d 739 (1944).

²⁶ *Supra* note 1.

²⁷ BALLANTINE, CORPORATIONS 372 (rev. ed. 1946); WASHINGTON, CORPORATE EXECUTIVES' COMPENSATION 343-344.

²⁸ But *cf.* *Marron v. Wood*, *supra* note 7; *Hornsby v. Lohmeyer*, 364 Pa. 271, 72 A.2d 294 (1950).

²⁹ *Supra* note 1; 26 NOTRE DAME LAW. 540 (1951). As in *Solimine*, there were no by-law or contract provisions so that the decision was based strictly on a common law right to indemnity.

³⁰ *Supra* note 1 at 214-215, 45 N.W.2d at 393.

³¹ Even the *Solimine* case, *supra* note 1, had relied on an analogy to the position of a trustee, citing *Jessup v. Smith*, 223 N.Y. 203, 119 N.E. 403 (1918), and other authorities. For discussion to the effect that analogy to other fiduciaries is unnecessary see, BALLANTINE, CORPORATIONS 168; WASHINGTON, CORPORATE EXECUTIVES' COMPENSATION 346-350; Note, 35 MINN. L. REV. 564 (1951).

their defense might or might not produce a benefit to the corporation was seen as a separate question, and one which had no bearing on the indemnification issue.

It is significant to note that within a year or two after each of these decisions the legislatures of the three states, New York, New Jersey and Minnesota, enacted indemnification legislation, either providing for or broadening the right to indemnity.³² The major changes included relaxation of the requirement of success on the merits, provision for reimbursement except in case of misconduct, and authorization for a corporation to enact its own provisions covering indemnification.³³ None included any mention of the necessity for corporate benefit.

Policies and Interest Sufficient to Allow Corporation to Employ Counsel

The ultimate aim of those seeking indemnification is to shift the burden of litigation expenses to the corporation. If the corporation can be brought in as the principal defendant, management can avoid the indemnification problem. Certain challenges to management action by their nature either question corporate policies or involve corporate interests to such an extent that the corporation itself is held entitled to employ counsel, perhaps to bear the entire burden of litigation, and to defend even a derivative suit.³⁴

This is not the usual situation and placing the corporation in the position of principal defendant militates against all the principles now developing in the indemnification case law and statutes. The corporation's usual role in such litigation is that of a nominal defendant only,³⁵ although it is an indispensable party and must be joined and served.³⁶ Once it departs from the role of nominal defendant the minority holders bringing suit face a defense backed by the entire corporate resources, which are paid out before there is any vindication of the challenged actions of management.³⁷

The areas in which the corporation will be allowed to interpose defenses, thus relieving management, are not defined clearly and case law fails to provide a satisfactory basis for generalization.³⁸ Probably the best example of a sufficient *corporate interest* occurs when the plaintiff requests the ap-

³² Minn. Laws, 1951, c. 98, § 301.09 (7); N. J. STAT. ANN., tit. 14, § 3-14 (1946); N. Y. GEN. CORP. LAW §§ 63-68.

³³ See text at notes 52 *et seq. infra*.

³⁴ See *Blish v. Thompson Automatic Arms Corp.*, 64 A.2d 581, 607 (Del. 1948).

³⁵ *Meyers v. Smith*, 190 Minn. 157, 251 N.W. 20 (1933); BALLANTINE, CORPORATIONS 367; Note, 43 YALE L.J. 661 (1934); *cf.* *Apfel v. Auditore*, *supra* note 12 (recovery denied for expenses of unsuccessful director, but attorney allowed value of services for entering a nominal appearance for the corporation).

³⁶ *E.g.*, *Turner v. United Mineral Lands Corp.*, 308 Mass. 531, 33 N.E.2d 282 (1941); see BALLANTINE, CORPORATIONS 366; Note, 44 YALE L.J. 1091 (1935). This theory has been criticized because the technical difficulties arising from venue requirements may block a suit. BALLANTINE, CORPORATIONS 366-367, WASHINGTON, CORPORATE EXECUTIVES' COMPENSATION 318-319.

³⁷ *Meyers v. Smith*, *supra* note 35; WASHINGTON, CORPORATE EXECUTIVES' COMPENSATION 325.

³⁸ BALLANTINE, CORPORATIONS 367. See *Albrecht, Maguire & Co., Inc. v. General Plastics, Inc.*, *supra* note 19; *Atwater v. Elkhorn Valley Coal-Land Co.*, 184 App. Div. 253, 171 N.Y. Supp. 552 (1918), *aff'd mem.*, 227 N.Y. 611, 125 N.E. 912 (1919); *Godley v. Crandall & Godley Company*, *supra* note 21; *Kanneberg v. Evangelical Creed Congregation*, *supra* note 14.

pointment of a receiver.³⁹ Management action taken after shareholder approval has also provided a corporate interest sufficient to sustain the corporation in defending a derivative suit brought against the management.⁴⁰ The wrongful attempt to overthrow present management by preferred shareholders has been held to justify corporate defense.⁴¹ Even where the challenged management had been acting wrongfully, the use of corporate funds for the defense has been sustained where, as a result of the suit, the corporation would suffer tangible loss or be deprived of property.⁴²

Where a *corporate policy* is challenged, such as a stock bonus plan,⁴³ an executive profit sharing plan,⁴⁴ a reorganization,⁴⁵ or the handling of the underwriting of bond issues,⁴⁶ corporations have also been allowed to defend the action.

When the dispute is really nothing more than a struggle for control between rival factions the courts have been divided as to the right of the corporation to pay the expenses of either party. In a bizarre New Mexico case it was held that the corporation could pay the litigation expenses of both the successful plaintiff and the unsuccessful defendant, since both parties were to blame for the litigation, despite the fact that one party was adjudged successful on the merits.⁴⁷ A deadlock in the board of directors had precipitated the suit. Most courts have held to the contrary, finding that in such personalized litigation the corporation itself should bear no part of the expenses.⁴⁸

COMPARATIVE PROVISIONS OF INDEMNIFICATION STATUTES

Comparison of the fifteen state indemnification statutes discloses marked dissimilarities.⁴⁹ It is apparent that with regard to the same ques-

³⁹ Geiman-Herthel Furniture Co. v. Geiman, 162 Kan. 48, 174 P.2d 117 (1946); Esposito v. Riverside Sand & Gravel Co., 287 Mass. 185, 191 N.E. 363 (1934); Barnes v. Newcomb, 89 N.Y. 108 (1882); Watson v. Johnson, 174 Wash. 12, 24 P.2d 592 (1933). *But cf.* Brock v. Automobile Livery & Sales Co., 137 La. 9, 68 So. 195 (1915); People v. Commercial Alliance L. Ins. Co., 148 N.Y. 563, 42 N.E. 1044 (1896) (corporation officers knew before, and when action commenced, that the company was insolvent).

⁴⁰ Albrecht, Maguire & Co., Inc. v. General Plastics, Inc., *supra* note 19; Kenneberg v. Evangelical Creed Congregation, *supra* note 14.

⁴¹ Central Shorewood Building Corp. v. Saltzstein, 245 Wis. 138, 13 N.W.2d 525 (1944). Rival factions held elections to fill vacancies in the board of directors. A quo warranto proceeding was brought against the management. The court held the corporation had properly paid for the defense because of its interest in preserving the management in proper hands.

⁴² Atwater v. Elkhorn Valley Coal Land Co., *supra* note 38; Kanneberg v. Evangelical Creed Congregation, *supra* note 14; *cf.* Heller v. Boylan, 29 N.Y.S.2d 653, 694-696, 704 (1941), *aff'd mem.*, 32 N.Y.S.2d 131 (App. Div. 1941) (corporation only allowed to pay a share of the fees based on the corporate interest in the suit, directors having to pay the remainder).

⁴³ Heller v. Boylan, *supra* note 42.

⁴⁴ Osbin v. Celanese Corporation, 37 N.Y.S.2d 548 (1942), *aff'd mem.*, 39 N.Y.S.2d 984 (1942), *aff'd mem.*, 291 N.Y. 170, 51 N.E. 694 (1943); Kirby v. Schenck, 25 N.Y.S.2d 431 (Sup. Ct. 1941).

⁴⁵ Corey v. Independent Ice Co., 226 Mass. 391, 115 N.E. 488 (1917).

⁴⁶ Otis & Co. v. Pennsylvania R. Co., 57 F. Supp. 680 (E.D. Pa. 1944), *aff'd*, 155 F.2d 522 (3rd Cir. 1946).

⁴⁷ Marron v. Wood, *supra* note 7.

⁴⁸ Mason v. Pewabic Min. Co., 66 Fed. 391 (6th Cir. 1894); Red Bud Realty Co. v. South, 96 Ark. 281, 131 S.W. 340 (1910); *In re* St. Clair Estate Co., 66 Cal. App. 2d 964, 153 P.2d 453 (1944); Chabot & Richard Co. v. Chabot, *supra* note 12; Schindel v. Brenauer, 136 N. J. Eq. 94, 40 A.2d 631 (1944). *But cf.* Central Shorewood Building Corp. v. Saltzstein, *supra* note 41.

⁴⁹ Statutes cited note 2 *supra*.

tions legislatures have been guided by disparate policy considerations, and the results display the varying degrees of favor in which management is held.

Even the two most comprehensive treatments, those of New York and California, provide diverse solutions on many issues. Judged by the standards set by these more complete statutes, most of the others leave gaps which must be filled by further legislation or judicial interpretation.

The greatest amount of judicial discretion, and probably shareholder protection, is granted by the California statute, which makes its remedy exclusive.⁵⁰ "Indemnification is made to depend upon the defendant being successful in whole or in part, and upon a finding by the court that the conduct of the party is such as fairly and equitably to merit such indemnity for reasonable expenses"⁵¹

Authority for Indemnification Through Corporate By-Laws

It appears that management has won at least a partial victory in its battle for authority to set up its own rules.⁵² Corporate action on reimbursement outside the indemnity statute is allowed by nine of the fifteen statutes, either through by-law, charter provision, special resolution of the board of directors, agreement, or vote of the shareholders.⁵³ Only California expressly makes its statute an exclusive remedy.⁵⁴ The remainder of the statutes do not deal with the problem but merely provide either for permissive⁵⁵ or mandatory indemnification⁵⁶ without discussing other possible corporate action.

Of the nine states specifically providing for by-law indemnification, six have statutes limited to authorizing corporate enactment of an indemnification by-law, and do not cover indemnification without such a provision.⁵⁷

⁵⁰ CAL. CORP. CODE § 830.

⁵¹ Ballantine, *California's 1943 Statute as to Directors' Litigation Expenses: An Exclusive Remedy for Indemnification of Directors, Officers and Employees*, 31 CALIF. L. REV. 514, 517 (1943) (complete discussion of the California statute); see also, BALLANTINE AND STERLING, CALIFORNIA CORPORATION LAWS 118-124 (1949 ed.).

⁵² As an example, it appears that one of the Wisconsin statutes was drafted at the request of a registered corporation lobbyist. See Note, [1950] WIS. L. REV. 157, 161 (discussing the Wisconsin indemnification statutes).

⁵³ CONN. GEN. STATS. § 5129 (1949); DEL. REV. CODE § 2034 (10), as amended by L. 1943, c. 125, § 1; ME. REV. STAT. c. 49, § 23 (1944); Md. Laws 1941 art. 23, c. 135, § 60; Minn. Laws 1951, c. 98, § 301.09 (7); N. J. STAT. ANN. tit. 14, § 3-14 (1946); N. Y. GEN. CORP. LAW § 63; R. I. Acts 1948, c. 2154, p. 517; WIS. STAT., c. 182, § 182.01(9a), p. 2146 (1949).

⁵⁴ CAL. CORP. CODE § 830. Although § 830 nullifies by-laws providing indemnification for costs and expenses the California draftsman may still wish to include an indemnification provision to cover indemnification for personal liability to third parties. "Directors and officers . . . may incur personal liability to a third party even though acting within the scope of their authority and solely for the corporation benefit." BALLANTINE AND STERLING, CALIFORNIA CORPORATION LAWS 768, n. 78.

⁵⁵ Mich. Acts 1931, No. 327, § 450.10-1.

⁵⁶ KY. REV. STATS. § 271.375 (1948); Mo. REV. STAT. tit. 23, § 351.355 (1949); MONT. REV. CODE § 5942.2 (1947); N. Y. GEN. CORP. LAW §§ 64 and 67 (if there is no by-law provision under the authority of § 63, indemnification is mandatory with court approval. See *Diamond v. Diamond*, 126 N.Y.L.J. 1406, P.H. CORP. SERV. ¶ 21612 (S. Ct. N.Y. Co. 1951); PA. STAT. ANN. tit. 12, § 1323 (Purdon's); WIS. STAT., c. 180, § 180.34, p. 2140 (1949).

⁵⁷ CONN. GEN. STAT. § 5129 (1949); ME. REV. STAT., c. 49, § 23 (1944); N. J. STAT. ANN. tit. 14, § 3-14 (1946); N. Y. GEN. CORP. LAW § 63 (see also § 64); R. I. Acts 1948, c. 2154, p. 517; WIS. STAT., c. 182, § 182.01 (9a), p. 2146 (1949).

Thus, absent a by-law, indemnification would depend on the common law. The other three statutes specifically state that the authority permitting indemnification does not exclude other corporate action on indemnity, such as further by-law provisions, agreements, or charter provisions.⁵⁸ This further action might well be unfair to shareholders and contrary to the policy evinced in the statute.⁵⁹

All the statutes, including the nine discussed above, provide that under the specific remedy authorized there can be no indemnity if the defendant is adjudged guilty of negligent conduct or misconduct in office. However, since the statutory remedy is not made exclusive in some states, and since other corporate action is provided for, the possibility is left open that by-laws or employment contract provisions could be drawn which would allow blanket indemnification regardless of the result of the litigation.⁶⁰ Such agreements can hardly be said to be entered into by arm's length bargaining.⁶¹ While it is possible, perhaps even probable, that such by-laws would not stand the test of litigation, in the meantime corporate assets could be diverted by payments which went unquestioned. Such action should not be permitted.⁶² However, with the present form of such statutes the limits governing reimbursement must be determined now by litigation.

Types of Actions Covered

The statutes appear designed to cover any litigation into which the management may be drawn because of actions taken in connection with corporate duties. The phraseology employed is very broad; as an example, one statute covers "an action, suit or proceeding in which he is made a part by reason of being or having been a director or any officer of the corporation."⁶³ In California the specific actions to which the statute is applicable are enumerated.⁶⁴ Only one state has limited indemnification coverage to derivative suits.⁶⁵

Criminal proceedings probably will also come within the purview of the indemnification statutes. In a recent New York case it was held that a

⁵⁸ DEL. REV. CODE § 2034 (10), as amended by L. 1943, c. 125, § 1; Md. Laws 1941 art. 23, c. 135, § 60; Minn. Laws 1951, c. 98, § 301.09 (7).

⁵⁹ E.g., CONN. GEN. STATS. § 5129 (1949) which provides that the corporation may enact a by-law covering indemnification in case of success or reasonable settlement, except in cases where the defendant is adjudged liable for negligence or misconduct. The statute then provides: "This section shall not affect any right to which such director, trustee, officer or employee is entitled under any statute, by-law, agreement vote of stockholders or otherwise." (Emphasis added.) The effect of such a statute with this "open door" clause certainly leaves room for doubt and speculation. It really provides two avenues for corporate action, one being limited to the statutory terms, the other expressly unlimited.

⁶⁰ CONN. GEN. STAT. § 5129 (1949); DEL. REV. CODE § 2034 (10), as amended by L. 1943, c. 125, § 1; ME. REV. STAT. c. 49, § 23 (1944); Md. Laws 1941 art. 23, c. 135, § 60; Minn. Laws 1951, c. 98, § 301.09 (7); WIS. STAT., c. 182, § 182.01 (9a), p. 2146 (1949).

⁶¹ Ballantine, *supra* note 51, at 516.

⁶² *Id.* at 521-526; WASHINGTON, CORPORATE EXECUTIVES' COMPENSATION 369-392, 396-409, 478-495; Bates and Zuckert, *Directors' Indemnity; Corporate Policy or Public Policy*, 20 HAR. BUS. REV. 244 (1942); Jervis, *Corporate Agreements to Pay Directors' Expenses*, 40 COL. L. REV. 1192 (1940); Comment, 30 CALIF. L. REV. 667 (1942).

⁶³ Md. Laws 1941, art. 23, c. 135, § 60.

⁶⁴ CAL. CORP. CODE § 830(d).

⁶⁵ PA. STAT. ANN. tit. 12, §§ 1321 and 1323 (Purdon's).

director who pleaded *nolo contendere* could not recover his expenses in defense of a criminal action. The court dealt with the problem as one covered by the indemnity statutes, by implication acknowledging that if the defendant had been acquitted on the merits he could have qualified for reimbursement under the statute.⁶⁶ The same policy arguments applicable in other actions support indemnification here.

In *Blish v. Thompson Automatic Arms Corp.* the Delaware court recently held that the corporation was justified in paying the litigation expenses of the president in connection with an investigation for alleged violation of the Securities Exchange Act.⁶⁷ The expenses were paid as the investigation progressed. However, the result was not reached on the ground that indemnification was merited, but on the ground that the corporation was protecting its own interest. Unfavorable publicity would have jeopardized the corporation's position in important contract negotiations with the federal government.⁶⁸ Under such a decision indemnification is by-passed because the corporation had already paid the expenses. This raises the question whether criminal defense should come under the corporate interest classification or whether it would not be better to catalogue it with the other director indemnification cases and postpone corporate payment until a determination of the innocence of the official.⁶⁹ The latter result would be more in line with the modern trend in indemnification cases⁷⁰ and in legislation.⁷¹

Personnel Covered

Directors and officers are protected under all the statutes.⁷² Six states have gone further by covering employees as well.⁷³ This appears reasonable since minor corporate officials or employees often may be joined as defendants and perhaps need protection even more than the officers and directors.⁷⁴

⁶⁶ *Schwarz v. General Aniline & Film Corp.*, 198 Misc. 1046, 102 N.Y.S.2d 325 (Sup. Ct. 1951). *But see*, *United States v. General Aniline and Film Corp.*, 1 G. Farbenindustrie, A. G., 94 F. Supp. 129, 130 (S.D.N.Y. 1950).

⁶⁷ *Supra* note 34.

⁶⁸ See text discussion of corporate interest at note 34 *et seq. supra*.

⁶⁹ Two older cases have denied recovery on the ground that criminal prosecution was not the fault of the corporation and not a natural consequence of the officials' actions as agent for the corporation. Since in both cases the prosecution arose directly from actions taken in pursuit of corporate business the holdings would appear to be unnecessarily strict. *Du Puy v. Crucible Steel Co.*, 288 Fed. 583 (W.D. Pa. 1923); *Hoch v. Duluth Brewing & Malting Co.*, 173 Minn. 374, 217 N.W. 503 (1928) (the new Minnesota indemnification statute may be broad enough to cover such a situation now).

⁷⁰ *In re Dissolution of E. C. Warner Co.*, *supra* note 1; *Solimine v. Hollander*, *supra* note 1.

⁷¹ The indemnification statutes' wording appears broad enough to cover criminal actions, the typical phrase being "any action."

⁷² Statutes cited note 2 *supra*.

⁷³ CAL. CORP. CODE § 830; CONN. GEN. STATS. § 5129 (1949); N.Y. GEN. CORP. LAW §§ 63-64; PA. STAT. ANN. tit. 12, § 1323 (Purdon's) ("any party defendant"); WIS. STAT., c. 180, § 180.34, p. 2140 (1949).

⁷⁴ Eight states specifically provide that the right shall extend to heirs or representatives of deceased persons entitled to indemnification. It may be that in the remainder of the states the right would not abate at death, but the problem should be considered. CONN. GEN. STATS. § 5129 (1949); KY. REV. STATS. § 271.375 (1948); MO. REV. STAT. tit. 23, § 351.355 (1949); MONT. REV. CODE § 5942.2 (1947); N.J. STAT. ANN. tit. 14, § 3-14 (1946); N.Y. GEN. CORP. LAW § 64; R. I. ACTS 1948, c. 2154, p. 517; WIS. STAT., c. 180, § 180.34, p. 2140 (1949).

Types of Corporations Covered

The statutes are worded so that they cover any corporation, at least any organized under the laws of the particular state. Some specifically refer to non-stock and non-profit corporations and the language in the remainder appears sufficiently broad to extend to such corporations also. In addition many of the statutes cover actions brought because of an association with a corporation in which the parent owns stock or a debtor corporation.⁷⁵

Most indemnification statutes are not designed to cover foreign corporations, specifically applying only to corporations organized under the laws of the particular state.⁷⁶ However, California, New York, and Pennsylvania provide that their statutes shall apply to foreign as well as domestic corporations.⁷⁷ The validity of the New York provision has been tested and upheld.⁷⁸

Degree of Success Required for Recovery

An important question, meriting the careful attention of statutory draftsmen, is that of the degree of success necessary in order to qualify for reimbursement. Eleven states have made an attempt to solve the problem.⁷⁹ Even among these the treatment is not uniform. Few cover in terms all the major problems, such as the effect of dismissal, of a plea of the statute of limitations, of success in part only, and of settlement or compromise, whether with or without court approval.

Those statutes which make no attempt to break down the problem,⁸⁰ and those which cover some problems but ignore others, all deal with the situation by implication in excluding indemnification only when the person

⁷⁵ DEL. REV. CODE § 2034 (10), as amended by L. 1943, c. 125, § 1; Md. Laws 1941 art. 23, c. 135, § 60; Mich. Acts 1931, No. 327, § 450.10-1; Mo. REV. STAT. tit. 23, § 351.355 (1949) (subsidiary only); MONT. REV. CODE § 5942.2 (1947) (50% of voting stock owned); N. J. STAT. ANN. tit. 14, § 3-14 (1946) ("interest in such other corporation"); N. Y. GEN. CORP. LAW § 63 (serving at the request of the principal corporation) (§ 64 does not cover this problem); R. I. Acts 1948, c. 2154, p. 517 (principal corporation owns majority of stock in the other corporation); WIS. STAT., c. 182, § 182.01 (9a), p. 2146 (1949).

⁷⁶ CONN. GEN. STATS. § 5129 (1949); DEL. REV. CODE § 2034 (10), as amended by L. 1943, c. 125, § 1; KY. REV. STATS. § 271.375 (1948); ME. REV. STAT. c. 49, §§ 1, 23 (1944); Md. Laws 1941 art. 23, c. 135, § 60; Mich. Acts 1931, No. 327, §§ 450.2(a), 450.10-1; Minn. Laws 1951, c. 98, §§ 301.02(2), 301.09(7); Mo. REV. STAT. tit. 23, § 351.355 (1949); MONT. REV. CODE § 5942.2 (1947); N. J. STAT. ANN. tit. 14, § 3-14 (1946); Wis. Laws 1951, c. 731, § 180.04, p. 592; WIS. STAT., c. 180, § 180.34, p. 2140 (1949), WIS. STAT., c. 182, § 182.01(9a), p. 2146 (1949).

⁷⁷ CAL. CORP. CODE § 830(a); N. Y. GEN. CORP. LAW § 68 (only when the state of incorporation does not prohibit indemnification); PA. STAT. ANN. tit. 12, §§ 1321, 1323 (Purdon's).

⁷⁸ Hayman v. Morris, 179 Misc. 265, 37 N.Y.S.2d 884 (1942). See also BALLANTINE AND STERLING, CALIFORNIA CORPORATION LAWS 123; STEVENS, CORPORATIONS 836-837 (2d ed. 1949); Ballantine, *supra* note 51, at 527-528.

⁷⁹ CAL. CORP. CODE § 830; CONN. GEN. STATS. § 5129 (1949); KY. REV. STAT. § 271.375 (1948); Mich. Acts 1931, No. 327, § 450.10-1; Minn. Laws 1951, c. 98, § 301.09 (7); Mo. REV. STAT. tit. 23, § 351.355 (1949); MONT. REV. CODE § 5942.2 (1947); N. J. STAT. ANN. tit. 14, § 3-14 (1946); N. Y. GEN. CORP. LAW § 67; PA. STAT. ANN. tit. 12, § 1323 (Purdon's); R. I. Acts 1948, c. 2154, p. 517.

⁸⁰ DEL. REV. CODE § 2034 (10), as amended by L. 1943, c. 125, § 1; ME. REV. STAT. c. 49, § 23 (1944); Md. Laws 1941, art. 23, c. 135, § 60; Mich. Acts 1931, No. 327, § 450.10-1; Wis. Laws 1951, c. 731, § 180.04, p. 592, WIS. STAT., c. 180, § 180.34, p. 2140 (1949), WIS. STAT., c. 182, § 182.01 (9a), p. 2146 (1949).

is adjudged liable for negligence or misconduct.^{80a} It would seem a reasonable interpretation to hold that indemnification thus was intended in all cases for which there has been no special provision. This view finds support in the New York decisions. In allowing indemnification in a situation not covered by statute one New York court stated:⁸¹

The purpose of the Legislature thus appears to have been to authorize an assessment of expenses except in the single instance where there had been an adjudication that the applicant was liable for negligence or misconduct in the performance of his duties.

During the remainder of this discussion only the statutes and case law specifically covering a particular problem will be discussed. The above analysis should apply with equal force to the statutes lacking individual provisions in each of the following situations.^{81a}

Dismissal: California's is the only statute which mentions indemnification in case of dismissal. Recovery may be obtained, subject to the restriction that the court determine the applicant "fairly and equitably merits such indemnity."⁸² Absent specific provision a New York court has held that dismissal for failure to post security for costs entitled the defendant to recovery.⁸³

Plea of the Statute of Limitations: None of the statutes mention the problem of the plea of the statute of limitations. The question has been litigated in New York, and reimbursement was sustained when the plea was successful.⁸⁴ The result appears reasonable since it would be too burdensome and expensive to force an adjudication on the merits when a plea of the statute of limitations would end the litigation at an early stage, saving the corporation considerable expense. Of course there is a risk that wrongdoers will be indemnified under such a holding. Here such a provision as that in the California statute providing for court determination

^{80a} WIS. STAT., c. 180, § 180.34, p. 2140 (1949), giving a general right to reimbursement absent by-law provision, excludes only those adjudged liable for misconduct and does not cover negligence. It has been suggested that this might be interpreted too loosely, allowing undeserving defendants to recover. Note, [1950] WIS. L. REV. 157, 166.

⁸¹ Tichner v. Andrews, 193 Misc. 1050, 1052, 85 N.Y.S.2d 760, 762 (1949), *aff'd mem.*, 275 App. Div. 749, 90 N.Y.S.2d 920 (1949); *accord*, Dornan v. Humphrey, 278 App. Div. 1010, 106 N.Y.S.2d 142 (1951).

^{81a} However, note that under the first New York statute the court read in the requirement of a benefit to the corporation in a case involving success in part. Drivas v. Lekas, *supra* note 22. The same result had been reached in the case of a settlement. Neuberger v. Barrett, *supra* note 22. Further legislation was required to change these interpretations, a permissive "may" being changed to a mandatory "shall" in directions to the court.

⁸² CAL. CORP. CODE § 830 (e).

⁸³ Tichner v. Andrews, *supra* note 81. In Diamond v. Diamond, 126 N.Y. L.J. 1406, P. H. CORP. SERV. ¶ 21612 (S. Ct. N.Y. Co. 1951) a New York lower court, relying on the Tichner and Dornan cases, has held that dismissal on the ground that plaintiff shareholder participated in the actions of which she complained entitled the defendant directors to indemnification. Absent statute it has been held that there is no right to reimbursement when a case is discontinued; the courts state that vindication on the merits is a necessity. Schindel v. Brenauer, *supra* note 48; Hooker, Corser & Mitchell Co. v. Hooker, 88 Vt. 335, 92 Atl. 443 (1914).

⁸⁴ Dornan v. Humphrey, *supra* note 81. See Hornsby v. Lohmeyer, *supra* note 28; Figge v. Bergenthal, *supra* note 15.

of the equities would give a better measuring stick for the court than the negative reasoning applied by the New York courts, that recovery is available except in those cases in which the defendant is adjudged liable for negligence or misconduct.

Success in Part: The problem of partial success arises when the case is carried through to the merits and the defendant is successful on some charges, but found guilty on others. The three statutes which deal with this situation permit recovery.⁸⁵ In each case the amount is left to the determination of the court, based on its finding as to what is reasonable under the circumstances.⁸⁶

Settlement or Compromise: Reimbursement in cases of settlement or compromise is covered by all but four states,⁸⁷ although the treatment accorded is by no means uniform.⁸⁸

Michigan and New Jersey provide that there can be no recovery when the settlement is based upon the existence of liability for negligence or misconduct.⁸⁹ California allows recovery if the court finds that the conduct "fairly and equitably merits such indemnity."⁹⁰ The remainder of the statutes dealing with the problem speak of recovery in phrases such as "reasonable settlement."⁹¹

There is a distinct cleavage in the statutes with respect to whether there must be court approval of a settlement or compromise before there can be indemnification. The Kentucky act, followed in this respect by Montana,⁹² provides for reimbursement without court approval if the settlement is approved by the board of directors.⁹³ This provision has been severely criticized.⁹⁴

The Kentucky act of 1942 is in striking contrast to the California act It is modeled on some of the current management-sponsored by-law provisions There is no provision for judicial approval of settlements, or

⁸⁵ CAL. CORP. CODE § 830(a) (1); N. Y. GEN. CORP. LAW § 67; PA. STAT. ANN. tit. 12, § 1323 (Purdon's). For discussion of the development of the New York act in this regard see Notes, 30 CORNELL L. Q. 249 (1944); 20 ST. JOHN'S L. REV. 67 (1945).

⁸⁶ Reimbursement is mandatory under the New York and Pennsylvania acts. California requires a finding of fair and equitable conduct.

⁸⁷ DEL. REV. CODE § 2034(10), as amended by L. 1943, c. 125, § 1; ME. REV. STAT. c. 49, § 23 (1944); MD. LAWS 1941, art. 23, c. 135, § 60; WIS. LAWS 1951, c. 731, § 180.04, p. 592, WIS. STAT., c. 180, § 180.34, p. 2040 (1949), WIS. STAT., c. 182, § 182.01(9a), p. 2146 (1949).

⁸⁸ E.g., *Neuberger v Barret*, *supra* note 22.

⁸⁹ Mich. Acts 1931, No. 327, § 450.10-1; N. J. STAT. ANN. tit. 14, § 3-14 (1946).

⁹⁰ CAL. CORP. CODE § 830(a) (1, 2).

⁹¹ CONN. GEN. STAT. § 5129 (1949); KY. REV. STAT. § 271.375 (1948); MINN. LAWS 1951, c. 98, § 301.09(7); MO. REV. STAT. tit. 23, § 351.355 (1949); MONT. REV. CODE § 5942.2 (1947); N. Y. GEN. CORP. LAW §§ 63, 64; PA. STAT. ANN. tit. 12, § 1323 (Purdon's); R. I. Acts 1942, c. 2154, p. 517.

⁹² MONT. REV. CODE § 5942.2 (1947).

⁹³ KY. REV. STAT. § 271.375 (1948). If an independent quorum of directors cannot be obtained, then the directors are allowed to select three disinterested shareholders to make the judgment. Missouri and Montana provide that either the shareholders or the directors may rely conclusively on the opinion of independent counsel.

⁹⁴ Ballantine, *supra* note 51, at 529. See WASHINGTON, CORPORATE EXECUTIVES' COMPENSATION 352-353.

for a judicial finding that the conduct of the party has been such as fairly and equitably to merit indemnity

The act leaves too much to the discretion of the directors There is no assurance of careful investigation by competent persons [T]he allowance and assessment of attorneys' fees to fiduciaries who are sued is properly a matter for a court to decide.

Only the California, Missouri and Pennsylvania acts make court approval of the settlement a prerequisite to reimbursement.⁹⁵ The other statutes dealing with the problem authorize the corporation itself to indemnify in case of settlement,⁹⁶ thus permitting indemnification without court approval.⁹⁷ New York allows indemnification on settlement without court approval if the corporation has taken advantage of the provision allowing it to adopt a by-law.⁹⁸ If the statutory remedy alone is relied on, court approval is necessary.⁹⁹

Procedure for Obtaining Indemnification

Only three states have provisions covering the procedure which must be followed in order to obtain indemnification.¹⁰⁰ These provide that the application may be made in either the same or a separate proceeding.¹⁰¹ California is unique in specifically providing that either the person sued or the attorney or other person rendering services to him may apply, and that the indemnification may be paid directly to the person rendering the services.¹⁰²

California is again unique in providing for notice to those who might be interested in the indemnification proceedings and who might have reason to question indemnity.¹⁰³ The statute provides for mandatory notice to "the corporation, its receiver or its trustee, and the plaintiff and other parties to the proceeding." In addition, the court is empowered to require

⁹⁵ CAL. CORP. CODE § 830(a)(1); MO. REV. STAT. tit. 23, § 351.355(2) (1949); PA. STAT. ANN. tit. 12, § 1323 (Purdon's).

⁹⁶ Mich. Acts 1931, No. 327, § 450.10-1 and N. J. STAT. ANN. tit. 14, §3-14 (1946) provide for reimbursement only if the settlement is not based on liability.

⁹⁷ CONN. GEN. STAT. § 5129 (1949); KY. REV. STAT. § 271.355 (1948); MINN. LAWS 1951, c. 98, § 301.09(7); MONT. REV. CODE § 5942.2 (1947); N. Y. GEN. CORP. LAW § 63; PA. STAT. ANN. tit. 12, § 1323 (Purdon's); R. I. Acts 1948, c. 2154, p. 517. Under the statutes not covering settlement the same result (indemnification without court approval) would be reached unless they were interpreted to exclude reimbursement on settlements.

⁹⁸ N. Y. GEN. CORP. LAW § 63 (shareholders must be notified of the action within eighteen months).

⁹⁹ N. Y. GEN. CORP. LAW §§ 64, 65, 67. In *Montro Corp. v. Moncrieff*, 127 N.Y.L.J. 126, P.H. CORP. SERV. ¶ 21651 (S.Ct.N.Y.Co.1952), a New York lower court ordered directors to pay back indemnification received from the corporation. The directors had bought up the plaintiff's stock and the case was discontinued without court approval. The directors had then voted themselves the indemnification.

¹⁰⁰ CAL. CORP. CODE § 830(a); MD. LAWS 1941, art. 23, c. 135 § 60(b); N. Y. GEN. CORP. LAW § 65. MO. REV. STAT. tit. 23, § 351.355(2) appears to require application to the trial court in case of the approval of a settlement.

¹⁰¹ See *United States v. General Aniline and Film Corp.*, I. G. Farbenindustrie, A. G., *supra* note 66 (under N. Y. GEN. CORP. LAW § 64 defendant need not bring his petition in the same action or apply to the New York Supreme Court).

¹⁰² CAL. CORP. CODE § 830(b).

¹⁰³ CAL. CORP. CODE § 830(e).

notice to the shareholders. The latter procedure may be criticized as an added expense. However, in this discretionary form it gives added protection to the shareholders.¹⁰⁴

The New York statute provides for notice to the shareholders only when the corporation has elected to provide for indemnity by by-law and has paid the amount "otherwise than pursuant to court order or action by the stockholders or members."¹⁰⁵

CONCLUSIONS AND RECOMMENDATIONS

Study of present case law fails to reveal sufficient answers to the many questions which can arise when indemnification is sought. This has been recognized and legislation has increased greatly in the last few years. Even in those jurisdictions favored by the better common law decisions statutory coverage has been deemed necessary.¹⁰⁶

But while large strides have been made by statutory enactments, a majority of the present acts still are inadequate. Major problems are covered only by implication. Such coverage, or lack of it, will certainly lead to litigation on dispositions of suits which amount to less than an adjudication on the merits.

In addition, too many statutes only whitewash official action because they expressly provide that the corporation may make further provisions on indemnity. Thus, management is afforded one sure pathway to reimbursement and the door is open for management to make other less stringent provisions. Very little protection is given to the shareholders.

To avoid needless litigation two general solutions appear possible. First, the California type plan could be followed.¹⁰⁷ Under this arrangement reimbursement is sanctioned in cases of dismissal, settlement, or success in whole or in part. More narrow issues, such as the plea of the statute of limitations, or dismissal for failure to put up security for costs, are not covered specifically but are subject to the court's decision that the conduct in question "fairly and equitably merits such indemnity." The policy expressed throughout is to eliminate management's place in a decision on indemnification and to substitute the decision of a court.¹⁰⁸ Since court approval is required regardless of the issue, greater particularity is unnecessary.

If such a remedy be thought too drastic a limit on corporate power, a second alternative is possible which still may assure greater stability and shareholder protection than that presently afforded in many states. This alternative remedy would consist in particularizing the various situations in which indemnification would be allowed. This would require dual coverage. First, the area in which management could operate by charter, by-law

¹⁰⁴ *Hayman v. Morris*, *supra* note 78, read in the requirement of notice to the shareholders, the corporation and the plaintiff so that they would have opportunity to object.

¹⁰⁵ N. Y. GEN. CORP. LAW § 63.

¹⁰⁶ See text at note 32 *supra*.

¹⁰⁷ The New York statute's scope is similar except that under § 63 the corporation can act through by-laws, charter, or resolution in a specific case, and avoid the indemnification provisions. As a drafting guide, the California statute provides a much simpler approach.

¹⁰⁸ Ballantine, *supra* note 51, at 517, 528-529; Note [1950] WIS. L. REV. 157, 166-168.

or resolution should be defined clearly, and limited, at least by the restrictions placed on reimbursement under the statutory remedy itself.¹⁰⁹ Second, great care should be taken to provide some guide for the courts by more carefully particularizing the situations in which recovery can be allowed when by-law provisions are not used.

Ultimately the decision to be made between the two pathways will depend upon the amount of power to be taken from the corporation and delegated to the courts in a situation where self-serving is a real danger.

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¹⁰⁹ Professor Ballantine suggests that if by-law provisions are allowed, "a standard form of provision should be prescribed by statute, or else all such provisions should be passed upon and subjected to the approval of an administrative board or securities commission as if they were changes in the terms of the shareholders' contract." Ballantine, *supra* note 51, at 526.