plained, but Messrs. Arsht and Stapleton stated that the words "or not opposed to" were

> intended to bring within the scope of permissible indemnification the officer or director who did not realize that his corporation had any interest at all in the subject matter of his action. Thus, the director who engages in a purely personal transaction, such as a purchase of stock or a business for his own account, and who reasonably believed that the corporation had no interest in the transaction, can be indemnified with respect to a suit charging that he had diverted to himself a corporate opportunity.[196]

3. Procedure to Authorize Indemnity

The procedure for making the requisite good faith determination is specified in section 145(d). Such a finding must be made by: (1) the board by a majority vote of a quorum of disinterested directors, or (2) if such a quorum is not obtainable, or even if obtainable such a quorum so directs, by independent legal counsel, or (3) by the stockholders.[197]

The authorization of independent counsel to make the required finding raises the question as to who may qualify. Such counsel should have had no previous professional relationship with the director seeking indemnification and, of course, should not be house counsel or the firm regularly used by the company.[198]

---

196. Arsht & Stapleton, *Changes, supra* note 192, at 78-79. The commentary to the Model Act is that the "concept of good faith involves a subjective test, which would include 'a mistake of judgment,' . . . even though made unwisely by objective standards." RMBCA, *supra* note 98, § 8.51.

197. DEL. CODE ANN. tit. 8, § 145(d) (1983).

198. RMBCA, *supra* note 98, § 8.55. Section 8.55 refers to "special" counsel rather than independent counsel. The comment to this section states that special legal counsel "should normally be counsel having no prior professional relationship with those seeking indemnification, should be retained for the specific occasion, and should not be either inside counsel or regular outside counsel."

In Schmidt v. Magnetic Head Corp., 97 A.D.2d 151, 468 N.Y.S.2d 649, 655 (N.Y. App. Div. 1983), the court held that an attorney qualified as "independent legal counsel" even though he was retained by a partner in a law firm that represented the corporation and the directors who were parties to the litigation. The court noted that the attorney selected as independent counsel had no previous professional relationship with the parties. *See* RMBCA, *supra* note 98, § 8.56. *See also* Pease, *Indemnification Under Section 145 of the Delaware General Corporation Law*, 3 DEL. J. CORP. L. 167, 170-71 (1978).

4. Advancement of Expenses

The advancement to directors of legal expenses incurred in an action or proceeding is provided for in section 145(e). Arsht pointed out that "[n]ormally, the decision to advance expenses is made almost at the outset [of the litigation] before the defendants receive their first bill for legal services, or if not before, then immediately thereafter."[199]

As noted in the official RMBCA comment on advances for expenses, it "is often critically important to a director who is made a party to a complex proceeding that the corporation . . . have the power to make advances for expenses at the beginning of and during the proceeding."[200] The comment added: "Adequate legal representation and adequate preparation of a defense may require substantial payments of expenses before a final determination, and unless the corporation may make advances for expenses, a defendant may be unable to finance his own defense."[201]

The previous practice of having the same firm represent both the corporation and its directors in derivative suits is disappearing. Because of the inherent conflict of interest in many cases of this dual representation, it has been condemned by the courts. For example, in the case of *Lewis v. Shaffer Stores Co.*,[202] the court required separate counsel for the corporation and the directors.

The revision to section 145 included the several amendments to subsection 145(e) shown in appendix A.[203] The commentary to section 145(e) states that the phrase "in the specific case" was deleted to permit "general authorization of advancement of expenses including a mandatory certificate of incorporation or by-law provision to that effect."[204] Hence, through this amendment the discretionary or permissive aspect of the advancement as to the corporation can

---

199. Arsht, *Indemnification Under Section 145 of the Delaware General Corporation Law*, 3 DEL. J. CORP. L. 176, 177 (1978) [hereinafter Arsht, *Indemnification*].

200. RMBCA, *supra* note 98, § 8.53.

201. *Id.*

202. 218 F. Supp. 238 (S.D.N.Y. 1963). *See also* Cannon v. U.S. Acoustics Corp., 398 F. Supp. 209 (N.D. Ill. 1975); MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.7 (1983); MODEL CODE OF PROFESSIONAL RESPONSIBILITY CANON 5 (1979); Miller & Warren, *Conflicts of Interest and Ethical Issues for the Inside and Outside Counsel*, 40 BUS. LAW. 631, 659-60 (1985).

203. DEL. CODE ANN. tit. 8, § 145(e) (1986) (amending DEL. CODE ANN. tit. 1, § 145(e) (1983), was enacted June 10, 1986).

204. *See* Appendix A.

be made mandatory by a properly drafted provision in the charter or bylaws.[205]

The other amendment to 145(e)—the removal of "unless" and adding "if" and "not"—was made "so as not to create an obligation to repay unless a specific determination is made that the director or officer is not entitled to be indemnified as authorized by Section 145."[206] This is an important revision, for now the director must repay the corporation only if it is determined that he is not entitled to indemnification. Before this change the director had an obligation to repay unless there was a finding that he was entitled to indemnification. But the commentary also states that nothing in "these changes to subsection (e) relieves the board of directors from its affirmative duty to see that the determination required by subsection (d) is made for any indemnification under subsections (a) and (b)."[207]

Subsection (e) raises several questions. Should the director to whom the advance is made be required to post security and is the board obligated to investigate whether the director is a good credit risk? The Revised Model Business Corporation Act answers these questions in the negative.[208] With respect to these questions, Arsht stated:

> [I]t is my view that the directors can make the advance even though they feel that the director will be unable to pay both his litigation expenses and a judgment against him. I have this view because the Delaware indemnification statute, particularly this subsection which authorizes advances, manifests the policy that a director be given or provided the wherewithal to defend the case to the best of his ability in light of the facts and the law.[209]

An additional question is whether the directors must determine that there is a benefit to the corporation before making the loan as required by section 143,[210] the section of the DGCL that authorizes loans to directors. After all, an advance to a director creates a debt that may

---

205. *See supra* text accompanying notes 183-86.

206. *See* Appendix A.

207. *Id.*

208. RMBCA, *supra* note 98, § 8.53(b). Subsection(b) reads: "(b). The undertaking required by subsection (a)(2) must be an unlimited general obligation of the director but need not be secured and may be accepted without reference to financial ability to make repayment." *Id.*

209. Arsht, *Indemnification*, *supra* note 199, at 178.

210. DEL. CODE ANN. tit. 8, § 143 (1983).

or may not have to be repaid. In my view, such a finding need not be made; it is implicit in the statute itself and in the authorization for the advance that it is for the benefit of the corporation.[211] Moreover, that subsection (e) is not conditional upon other sections of the DGCL is supported by the rule that action taken pursuant to the authority of one section is an act of independent legal significance.[212]

A remaining issue is whether the interest of the directors in the advance transaction invokes the provisions of section 144[213] of the DGCL. The purpose and effect of this section are to validate a contract between a corporation and one or more of its directors if the statutory tests are met.[214] Mr. Veasey, a well-known commentator on corporation law, observed that "[t]he fact that directors are interested [in the advancement of expenses] should not invalidate the authorization."[215] He added:

> Section 144(a)(3) of the General Corporation Law removes the disqualification of interested directors if the transaction "is fair to the corporation as of the time it is authorized, approved or ratified by the board of directors . . . ." Section 145(e) is a legislative statement that a transaction advancing litigation expenses under the circumstances is fair to the corporation if the corporation receives an undertaking to repay.[216]

Moreover, the independent legal significance rule also applies to the question of whether section 145(e)[217] is qualified by section 144.

5. Section 145 Not Exclusive

Section 145(f) has been the subject of many questions and comments. It contains the promising language that the indemnification provided by section 145 shall not be deemed exclusive of other rights to which the director may be entitled "under any bylaw,

---

211. *See* Arsht, *Indemnification*, *supra* note 199, at 179.

212. *See* Rothschild Int'l Corp. v. Liggett Group, Inc., 474 A.2d 133, 136 (Del. 1984); Orzeck v. Englehart, 195 A.2d 375, 378 (Del. 1963); Hariton v. Arco Elec., Inc., 188 A.2d 123, 125 (Del. 1963).

213. DEL. CODE ANN. tit. 8, § 144 (1983).

214. *See* E. FOLK, THE DELAWARE GENERAL CORPORATION LAW, A COMMENTARY AND ANALYSIS 75 (1972).

215. Veasey, *Directors*, *supra* note 139, at 192-93.

216. *Id.*

217. DEL. CODE ANN. tit. 8, § 145(e) (1983).

agreement, vote of stockholders or disinterested directors, or otherwise both as to action in his official capacity and as to action in another capacity . . . ."[218] This provision raises the question of whether the corporate bylaws or a contract with the directors can provide that directors will be indemnified for whatever they have to pay if they are sued and lose or settle, particularly in a derivative suit. Arsht has no doubt that the answer is "no."[219] His view is that subsection (f) 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 directors' conduct."[220] He cited as authority *Mooney v. Willys Overland Motors, Inc.*,[221] where the court in interpreting the original Delaware indemnification statute said that the non-exclusive clause of that statute was limited by public policy and would not be read to authorize any and all indemnification.

For this reason, the most supportable position is that the implementation of the non-exclusive provision requires "some independent legal basis to support it—for example, a contract right supported by adequate consideration."[222] To illustrate, assume that a company invites a scientist to its board primarily because of his expertise in a certain scientific teaching and he agrees to accept if the company will indemnify him for his expenses and amounts paid in settlements should he be made party to any action or suit. Since any such arrangement would be supported by independent legal consideration, his indemnification should be permissible under section 145(f).

6. Other Forms of Indemnification

There are other methods that may be used by corporations to broaden the indemnification of directors. These include:

---

218. DEL. CODE ANN. tit. 8, § 145(f) (1986) (amending DEL. CODE ANN. tit. 8, § 145(f) (1983) was enacted June 10, 1986). *See* Appendix A (amended § 145(f)). Mr. Arsht commented that the question most frequently asked of him is what subsection (f) means. Arsht, *Indemnification*, *supra* note 199, at 176.

219. Arsht, *Indemnification*, *supra* note 199, at 176.

220. *Id.* at 177.

221. 204 F.2d 889 (3d Cir. 1953).

222. Arsht, *Indemnification*, *supra* note 199, at 177. *See also* Sparks, *Framework*, *supra* note 182, at 74-76. Unless the non-exclusive contract is extended to only the minority of directors or ratified by stockholders, there is a risk that the granting of an indemnification contract will be deemed an interested transaction with the burden on the contracting directors to demonstrate the fairness of the contract if its validity is challenged. *Id.* at 76.

1. A provision in the charter or bylaws that transforms the discretionary authority of a company to indemnify into an express obligation to indemnify the director "to the fullest extent permitted by law . . . ."[223]

2. A bylaw or charter provision that creates broader mandatory indemnification than that provided by the statute.[224] The provision would:

a. Place on the company the burden of proof that the applicable statutory standards of conduct of section 145(a) and (b) have not been met and provide that the failure of the director to establish the section 145(a) and (b) standards of conduct would not be a defense to a suit by the director or officer for indemnification under section 145.

b. Provide that the right to indemnification is a contract right, and that it would include the expense of prosecuting a claim for indemnification.

c. Create a procedure for making a claim to the corporation and for bringing suit against the corporation if the claim is not paid within a specified time.

d. Provide for the mandatory advancement of expenses before the final disposition of a third party or a derivative suit. The recent amendment to subsection 145(e) now makes clear that this can be done.

e. Provide for indemnification and the advancement of expenses in suits brought by the director or officer.

Another protective device for directors is an indemnity contract. This has an advantage over a mandatory bylaw provision because

---

223. Such a bylaw provision is in the bylaws of E.I. du Pont de Nemours and Company Incorporated. It provides:

> *Indemnification of Directors or Officers.* Each person who is or was a Director or officer of the Company (including the heirs, executors, administrators or estate of such person) shall be indemnified by the Company as of right to the full extent permitted or authorized by the General Corporation Law of Delaware against any liability, cost or expense asserted against such Director or officer and incurred by such Director or officer in any such person's capacity as a Director or officer, or arising out of any such person's status as a Director or officer. The Company may, but shall not be obligated to, maintain insurance, at its expense, to protect itself and any such person against any such liability, cost or expense.

224. *See* Sparks, *Framework, supra* note 182, at 64, 65, 81-82 (example of a model charter or bylaw indemnification provision). *See also* Rovner, *D&O Indemnity, Discrete Contracts Seen as an Option,* Legal Times, Nov. 25, 1985, at 1, col. 3 [hereinafter Rovner, *D&O Indemnity*].

the contract cannot be voided without the consent of both parties, whereas a board might be able to change the bylaw.[225] However, advocates of this procedure note that there are no cases to support the view that these contracts afford additional protection to directors.[226] And, of course, as is true in all indemnification by contract or otherwise, reimbursement can be made only to the extent the corporation is financially able to do so.[227]

D. *D&O Insurance*

1. Statutory Authority

Section 145(g)[228] of the DGCL authorizes a corporation to purchase, and pay the entire premium for, D&O insurance. This subsection has been the subject of strong law review criticism.[229] In this regard, Arsht noted:

---

225. *See* Rovner, *D&O Indemnity*, *supra* note 224, at 1-2.

226. *Id.* at 2.

227. The SEC policy on indemnification could limit the director's right to indemnification as to violations of the Securities Act of 1933. First, if acceleration of a registration statement is requested, language specified in the applicable SEC rule must be included in the statement. This required language states, in part:

> Insofar as indemnification for liabilities arising under the Securities Act of 1933 may be permitted to directors, officers and controlling persons of the registrant . . . , the registrant has been advised that in the opinion of the Securities and Exchange Commission such indemnification is against public policy as expressed in the act and is therefore unenforceable.

SEC Regulation S-K, 17 C.F.R. § 229.512 (1986). The regulation then states that if a director asserts a claim for indemnification in connection with the securities being registered, the registrant will, unless in the opinion of counsel the matter has been settled by controlling precedent, submit to a court of appropriate jurisdiction the question of whether such indemnification is against public policy as expressed in the Act. The registrant agrees further that it will be governed by the court's decision in this regard. *Id.*

Even if acceleration of the registration statement is not requested, the registrant is required to disclose that any indemnification for liabilities under the 1933 Act in the opinion of the SEC is against public policy as expressed in the Act. *Id.* § 229.510.

In addition, disclosure is required in the registration statement under the 1933 Act of the general effect of any arrangements under which directors (and others) may be indemnified in any manner against liability that a director may incur in his capacity as a director. *Id.* § 229.702.

228. DEL. CODE ANN. tit. 8, § 145(g) (1983).

229. *See* Arsht, *Indemnification*, *supra* note 199, at 179; Bishop, *New Problems in Indemnifying and Insuring Directors: Protection Against Liability Under Federal Securities Laws*, 1972 DUKE L.J. 1153.

> When we drafted the subsection, we did not purport to restate what we knew the insurance law to be and what we knew the invariable practices of insurance companies to be. We knew that insurance is not obtainable against the kind of wrongdoing that the critics conjure up. We knew that it is against public policy to insure a director against liability for his own deliberate wrongdoing . . . . D&O policies are not obtainable for anything more serious than negligent misconduct. In this respect, they are no different than doctors' and lawyers' malpractice insurance or the ordinary motorist liability policy.[230]

As Arsht stated, courts in many jurisdictions have held that public policy prohibits contractual indemnification for damages awarded for fraud or intentionally harmful misconduct. For example, in *Globus v. Law Research Service, Inc.*,[231] an underwriter was prohibited from being indemnified by the issuer because it had actual knowledge of the material misstatements and omissions. The court said it would be contrary to the public policy of the federal securities laws to permit the underwriters to enforce the indemnification agreement. The court further stated: "It is well established that one cannot insure himself against his own reckless, wilful or criminal misconduct."[232]

2. General

Currently, D&O insurance affords questionable protection for directors for diverse reasons. There are only a limited number of carriers and the premium for available insurance is so high that

---

230. Arsht, *Indemnification, supra* note 199, at 179-80.

231. 418 F.2d 1276 (2d Cir. 1969), *cert. denied*, 397 U.S. 913 (1970).

232. *Id.* at 1288. In this regard, there is a serious question whether a director may recover for liability for a claim under the federal Racketeer Influenced and Corrupt Organizations Act (RICO), 18 U.S.C. §§ 1961-1968 (1981) (amending 18 U.S.C. §§ 1961-1968 (1970). First, the treble damage aspect of recovery under RICO makes it doubtful that there can be recovery under a D&O policy. In addition, recovery may be barred because of the intentional misconduct of the defendant director. But there may be recovery by the innocent directors—those who had no knowledge of the misdeeds. For discussions of RICO and D&O insurance, see Ichel, *Directors' and Officers' Insurance Coverage: An Overview and Current Problems*, in DIRECTOR AND OFFICERS LIABILITY INSURANCE AND SELF INSURANCE 79-80 (PLI 1986) [hereinafter Ichel, *Coverage*]; Boyle, Naughton & Ween, *Coverage of RICO Claims Under a Directors' and Officers' Policy: Are Treble Damages Covered?* in DIRECTOR AND OFFICERS LIABILITY INSURANCE AND SELF INSURANCE 79-80 (PLI 1986). Moreover, policies can specifically exclude RICO claims.

many companies have discontinued their coverage.[233] Moreover, the deductibles are higher, the policy limits are lower, the number and reach of the standard exclusions in the D&O policy have been significantly increased and, even where the insured asserts the liability is covered, the insurer will resist paying the claim.[234] In addition, in many cases if there is an event involving the insured that the carrier believes may give rise to claims, the policy may be cancelled.[235]

The coverage provided is for losses arising from the directors and officers committing a "wrongful act," a term that is defined in one policy as follows:

> The term "Wrongful Act" shall mean any breach of duty, neglect, error, misstatement, misleading statement, omission or other act done or wrongfully attempted by the directors or any of the foregoing so alleged by any claimant or any matter claimed against them solely by reason of their being such directors or officers.[226]

D&O insurance policies usually are in two parts: one provides

---

233. In 1984, there were well over 30 carriers; today there are only six companies offering D&O insurance. Schauer, *Cure, supra* note 4, at 1. *Director Insurance Drying Up*, N.Y. Times, Mar. 7, 1986, at D1, D4, col. 3.

234. *See* Schauer, *Cure, supra* note 4, at 1. A review of the principal available D&O markets and capacity shows that one insurer has reduced its policy limits from $50 million in 1984 to $15 million in 1986 and another company has reduced its limits from $15 million to $5 million in the same period. Brown, *Protecting Directors and Officers*, in ALI-ABA VIDEO LAW REVIEW, PROTECTING DIRECTORS AND OFFICERS IN AN ERA OF UNCERTAIN D&O LIABILITY INSURANCE 93, 94 (1986) [hereinafter Brown, *Protecting*]. *See also* Herzel, *Crisis, supra* note 3, at 103. According to the 1984 Wyatt survey, 57% of the reported closed claims were closed without payment. In 1984, a total of 444 claims were made by the 1,269 United States companies included in this survey. WYATT, *supra* note 3, at 4.

235. For example, Unocal Corporation and Union Oil Company of California charged their insurers with bad faith in cancelling $100 million worth of directors and officers liability insurance after it was widely speculated that Mesa Petroleum Company and its Chairman T. Boone Pickens, Jr. were planning a hostile takeover of the companies. Unocal Corp. v. Harbor Ins. Co., No. C550 393 (Los Angeles Super. Ct. June 4, 1985). Unocal replaced its cancelled D&O insurance for total premiums of $6,695,000 and in addition it was required to pay $13 million to the insurer as a loss reserve. *Insurance Coverage:* Unocal Corp. v. Harbor Ins., in LITIGATION REPORTER 9-10 (Nov. 8, 1985). *See also Director Insurance Drying Up*, N.Y. Times, Mar 7, 1986, at D1, D4, col. 3. Of 70 respondent directors to a recent survey who had submitted claims to insurers, 23 reported that after submission of claims the insurer attempted to cancel or add exclusions for the coverage on which the claims were based. Special Report, *Don't Expect Major Easing of D&O Market, NACD Told*, 1 Corp. Counsel Weekly (BNA) No. 42, at 8 (Oct. 29, 1986).

236. Ichel, *Coverage, supra* note 232, at 29, 31.

for reimbursement to the corporation if it is required to indemnify the directors; the other indemnifies the directors directly if the corporation is unable to reimburse them under applicable indemnification provisions. The policies cover defense costs and liabilities incurred by directors for wrongful acts. Defense costs are considered part of the total coverage and are a significant part of the claim. According to a 1984 survey, the average D&O insurance settlement or award was $1,306,000, and the average legal defense cost was estimated at $461,000.[237]

3. Exclusions

New exclusions have been incorporated into D&O policies. One of these includes claims brought by or on behalf of other insureds, including the company, and including derivative actions brought by a director or officer. This exclusion (known as the "Insured v. Insured Exclusion") was written into policies to cover cases such as those where the Bank of America, Seafirst Corporation, and Chase Manhattan sued their officers to invoke coverage for losses incurred as a result of certain officers entering into disastrous business transactions.[238]A new provision excludes losses from actions taken by the

---

237. *See* WYATT, *supra* note 3, at 9.

238. The losses in *Chase Manhattan* arose out of a series of transactions between Chase and Penn Square Bank and Drysdale Government Securities, Inc. The court stated that the "settlement would not have occurred but for the participation of the defendants directors' and officers' liability insurance carriers, who are contributing the $32.5 million payment." Fox v. Chase Manhattan Corp., No. 8192-85, slip op. at 3 (Del. Ch. 1985). *See also* Galante, *The D&O Crisis—Corporate Boardroom Woes Grow*, 8 NAT'L L.J. 1, 29, col. 1 (Aug. 4, 1986) (Bank of America in 1985 sued its D&O insurer to recover $95 million from a current officer and six former officers, for their alleged negligence in a mortgage-backed securities scandal) [hereinafter Galante, *Boardroom*].

The Seafirst Corporation, a Seattle-based bank, sued its key management team for millions of dollars in losses from imprudent energy lending. Seafirst was rescued by Bank of America in 1983. The case was settled for $110 million when Seafirst and the officers agreed to an entry of a judgment for $110 million with the understanding that Seafirst would not collect the damages from the officers, but would limit its recovery to the money it will be paid by its insurers. It was reported that the insurer, CNA, would pay about $15 million. The other insurer, National Union Fire Insurance Company, was contesting the validity of Seafirst's policy. *Seafirst Settles Suit Against 5*, N.Y.Times, July 9, 1986, at D4, col. 4. *See also Showdown Over Insuring Corporate Officers*, FORTUNE, Dec. 9, 1985, at 70.

According to an insurance executive these suits are the "prime reason why there has been a mass exodus in this coverage by the insurers who wrote it previously, and more important than that, by the reinsurers who have no confidence in the American system." Mr. De Alessandro, the president and CEO of National Union

board to prevent a takeover (including greenmail and other takeover and acquisition transactions). Traditionally policies have not covered claims stemming from charges of pollution or for violation of section 16(b) of the Securities Exchange Act. Established exclusions also include claims based on unauthorized and excessive remuneration, libel and slander, bribery or ERISA claims, dishonesty, and personal profit to which the insured was not legally entitled.[239] Other exclusions relate to all pending and prior litigation, failure to maintain insurance, antitrust violations, discrimination in employment, commodity speculation, and real estate investment trusts.[240]

4. Other Aspects of D&O Insurance

Contrary to other forms of liability insurance, D&O policies do not generally require the insurance company to take over or otherwise manage the defense of the claim. This is said to be an advantage because the insureds can retain counsel of their choice and control the defense of the action.[241]

D&O policies also have substantial deductibles and co-insurance clauses. There are usually two deductibles: one for the individual director and officer relative to each loss, and the other for the corporation. A typical deductible for each director is $5,000, subject to a maximum for all directors of $25,000 to $50,000.[242] The deductible for the corporation in the past has varied from $50,000 to $100,000 for each loss,[243] and currently ranges from $250,000 to $500,000.[244] The co-insurance features usually provide that the insureds bear five percent of each loss at their own risk. It is possible,

---

Fire Insurance Company of Pittsburgh, discussed the break-up of the partnership between the insurers and the company caused by such suits. He further averred that the "last vestige of hope is that we can once again establish a partnership." DIRECTOR ROUNDTABLE: THE D&O CRISIS AND BOARD LIABILITY, DIRECTORS & BOARDS 15 (Summer 1986). Of course, a shareholder could claim that the directors violated their fiduciary duty if they did not attempt to collect under the insurance coverage.

239. *See* Ichel, *Coverage, supra* note 232, at 52-53 (outline gives an overview, including the current problems, of D&O insurance). *See also* WYATT, *supra* note 3, at 28-30; Goldwasser, *Insurance, supra* note 4, at 182, 184-203.

240. WYATT, *supra* note 3, at 28-30.

241. Sparks, *Framework, supra* note 182, at 68; Ichel, *Coverage, supra* note 232, at 41. Ichel's article discusses defense cost coverage. *Id.* at 41-46.

242. *See* Johnston, *Liability, supra* note 3, at 2014; WYATT, *supra* note 3, at 24.

243. *See* Johnston, *Liability, supra* note 3, at 2014.

244. *See* Brown, *Protecting, supra* note 234, at 94.

however, to negotiate the removal of the five percent co-insurance for losses in excess of $1 million.[245]

Another aspect of D&O insurance is that coverage is on a claims-made basis—the insurer will respond only to claims first made against the insured during the period that the policy is in force.[246] Currently, instead of three-year terms, policies have terms of only one year.[247] But some permit the insured, upon the payment of an additional premium, to secure an extension provided the alleged wrongful acts were committed during the original policy period. Such extension is made possible under a "discovery clause" or by filing a notice of occurrence of a possible claim prior to the end of the policy period.[248]

If the application for D&O insurance has a material misrepresentation or omits a material fact, the insurer can deny coverage and seek rescission of the contract. The misrepresentation is material if it affected (a) the decision of the insurer to underwrite the risk, (b) the nature of the risk, or (c) the insurer's determination of the premium for the policy.[249]

The question is how to protect the innocent outside director. *Bird v. Penn Central*[250] illustrates the serious problem for these directors when an officer of the corporation is guilty of a material misrepresentation in completing the application. In that case, the insurers issued a policy to Penn Central when, unknown to them, it had serious financial problems and a number of suits were pending against

---

245. *See* Johnston, *Liability, supra* note 3, at 2014. Wyatt's 1984 Survey states that the original concept of D&O coverage

> involved payment of 95% of the loss above the deductible. This later evolved to providing 100% coverage after the first million dollars of loss, and this became the prevalent practice by 1978. Since then retentions have been limited still further, with about three-quarters of the U.S. and Canadian participants having 100 percent coverage above the basic deductible, and another 7 percent having no personal coverage retention above the deductible on corporate reimbursement. In many of those cases, the retention above the corporate reimbursement deductible is limited to 5 percent of the first million dollars of loss.

WYATT, *supra* note 3, at 24.

246. *See* Sparks, *Framework, supra* note 182, at 68-69. Ichel, *Coverage, supra* note 232, at 33.

247. *See* Brown, *Protecting, supra* note 234, at 96.

248. *See* Ichel, *Coverage, supra* note 232, at 33-37.

249. *See* Falkowski & Monteleone, *Misrepresentation in the Applications for Directors' and Officers' Liability Insurance; Severability and Other Issues*, in DIRECTORS AND OFFICERS LIABILITY INSURANCE AND SELF INSURANCE 443, 446 (PLI 1986) [hereinafter Falkowski, *Applications*]; Metropolitan Life Ins. Co. v. Fugate, 313 F.2d 788 (5th Cir. 1963).

250. 334 F. Supp. 255 (E.D. Pa. 1971), *motion for summary judgment denied on rehearing*, 341 F. Supp. 291 (E.D. Pa. 1972).

the company and its directors and officers.[251] Item 10 of the application read as follows: "No person proposed for this insurance is cognizant of any act, error, or omission which he had reason to suppose might afford valid grounds for any future claim such as would fall within the scope of the proposed insurance except as follows . . . ."[252] The chairman of the Finance Committee of Penn Central in answering the question, replied, "None known." The insurers claimed that answer was a material misrepresentation and asked the court to rescind the coverage. Certain of the outside directors moved for summary judgment, arguing that they had no knowledge of any possible claims.[253] The court denied the motion, holding that the insured Penn Central was bound by the misrepresentation and that the rights of the outside directors could be no greater than those of Penn Central.[254] However, the court in *Bird* observed that the result might have been different if each director had executed a separate application in which the declarations and statements of one director would not be imputed to any other director.[255]

5. The Benefit of D&O Insurance

Considering all the exclusions and the language of the policies in general, it is questionable whether D&O insurance provides any benefit for directors.[256] One commentator opined that "D&O insurance would cover acts which do not satisfy the statutory standards of conduct in Section 145(a) and (b) . . . but which do not constitute 'active and deliberate dishonesty.' "[257]

This comment then gives as an example the *Trans Union* case[258]

---

251. *Id.* at 257.

252. *Id.*

253. *Id.* at 257-58.

254. *Bird*, 334 F. Supp. at 261-62. *See* Johnston, *Liability*, *supra* note 3, at 2030-33. *See also* Shapiro v. American Home Assurance Co., 584 F. Supp. 1245 (D. Mass. 1984) (insurer's motion for summary judgment that the policy be voided was granted on the ground that the president's answer to a question in the application was materially misleading).

255. *Bird*, 334 F. Supp. at 261-62. *See also* Falkowski, *Applications*, *supra* note 249, at 461-68. Although the SEC has a policy against indemnification as to violations of the Securities Act of 1933, it does not object to insurance for such liabilities. 17 C.F.R. § 230.461(c) (1986). Thus, unless the violation is willful or knowing or is within one of the exclusions, D&O insurance could provide a significant protection not available through indemnification.

256. *See supra* text accompanyng notes 233-40.

257. Sparks, *Framework*, *supra* note 182, at 72.

258. Smith v. Van Gorkom, 488 A.2d 858 (Del. 1985).

and concludes that "given the finding that the directors were 'grossly negligent' in not making a sufficiently informed decision in approving the merger, indemnification under section 145(a) would . . . have been problematical."[259] Nevertheless, as noted before, the D&O carrier paid the policy limit of $10 million and the successor corporation in a merger paid most of the remaining $23.5 million settlement amount.[260]

D&O insurance also has the merit of encouraging settlements. This is illustrated by the previously noted unreported case of *Fox v. Chase Manhattan Corp.*,[261] a derivative action against the directors of Chase to recover losses caused by the improvident investment decisions of certain officers of Chase. The court observed that although the disputed insurance coverage was as high as $120 million, the settlement called for a payment of $32.5 million. The court noted that the settlement would not have occurred but for the participation of the defendant D&O insurance carriers.[262]

In addition, a D&O policy would protect the director if the corporation has financial problems and cannot indemnify him. This may not be a realistic benefit because a financially plagued company is unlikely to have insurance, either because a carrier will refuse to insure or because the premium demanded will be so high that the company cannot afford it. However, assuming there is no basis for an exclusion or rescission, insurance could indemnify the director if the corporation refuses to pay.

E. *Alternatives to D&O Insurance*

The D&O insurance crisis has caused corporations to search for other ways to protect their directors, particularly those who are outsiders. One alternative is self insurance, which has the defect that complete protection depends on whether the corporation will have the necessary funds when the time arrives for payment. Moreover, it is doubtful that a self insurer would be permitted to indemnify a director where it would conflict with the state indemnification statute.

Other options are to create a captive insurance company or an insurer owned by a group of companies to provide insurance for members of the group. The captive company has the following

---

259. *See* Sparks, *Framework, supra* note 182, at 72.
260. *See supra* note 96 and accompanying text.
261. No. 8192-85 (Del. Ch. Dec. 6, 1985).
262. *Id.* at 2.

problems: (1) doubt as to the deductibility of the premium, (2) uncertainty as to the legality of payment when the corporation is unable to indemnify under state law, and (3) the difficulty of adequately funding the captive. The group captive company also has problems: (1) the deductibility of premiums if the group is small, (2) the confidentiality of underwriting and loss data, and (3) the potential inability to meet losses.[263]

In addition, letters of credit have been used to provide liability insurance and currently are being considered in the D&O context. In this procedure, the corporation supplies an irrevocable letter of credit and the insurer issues the policy. If there is a successful claim against the director, the insurer pays the claim and then is reimbursed by the corporation. If the corporation does not pay, the insurer draws down the letter of credit. This approach is said to be "akin to a large self-insured retention."[264]

Other alternatives include trust deposits, a more expensive method than the letter of credit since the funds must be deposited and are not available for alternative applications; the purchase of a surety bond used to secure the corporation's obligation to indemnify the director; and segregated defense funds or paying advance retainer fees to attorneys selected by the directors to defend them if a claim arises.[265]

Excess coverage in amounts not available in the commercial insurance market has been arranged by a number of major corporations who joined forces to form an insurance company in the Cayman Islands. The companies pay annual premiums between $300,000 and $1 million to obtain $100 million general liability coverage in excess of $100 million and $50 million of D&O insurance coverage excess of $25 million.[266]

---

263. *See* Middleton, *A Broker's View of the Directors and Officers Market and Placing Risks*, in DIRECTORS AND OFFICERS LIABILITY INSURANCE AND SELF INSURANCE 429, 435-36 (PLI 1986).

The Bank of America recently formed a captive insurance subsidiary. In addition, it is reported that a number of industries have formed offshore captives in places like Bermuda and the Cayman Islands, jurisdictions that are free from United States insurance regulations. Schauer, *Cure, supra* note 4, at 2-3.

264. Schauer, *Cure, supra* note 4, at 3.

265. *See id.*

266. Companies that formed a group insurer—the A.C.E. Insurance Co.—include IBM, Ford, General Electric, Du Pont, U.S. Steel, Dow Chemicals, Shell Oil, Upjohn, Public Service Co. of New Mexico, and Chase Manhattan. They are reported to have contributed $300 million in capital. *Id.* Other offshore companies

F. *New Section 102(b)(7) of DGCL to Eliminate or Limit Director Liability*

1. Overview

By an amendment to section 102 of the DGCL effective July 1, 1986, Delaware corporations may seek shareholder approval of charter revisions to eliminate or limit the liability of directors (not officers as officers) for violations of the duty of care.[267] This change in the law was proposed by the Council of the Corporation Law Section of the Delaware Bar Association and was approved by members of the section on May 14, 1986.[268] A memorandum from the subcommittee which drafted the proposed bill made clear that its purpose was to meet the D&O insurance crisis and the unwillingness of outside directors to continue to serve on the boards of their corporations without insurance.[269]

---

are EXCEL, with investments of $395 million from 66 major corporations, and American Excess Insurance Association. Newsletter, *supra* note 31, at 3-11.

267. *See* Appendix B (full text of amendment). As previously discussed, other amendments adopted at the same time by the Delaware General Assembly revised certain parts of section 145. *See supra* text accompanying notes 194-222. Laws similar to the Delaware statute have been passed or proposed in other states including California, Connecticut, Indiana, Louisiana, Michigan, Missouri, Pennsylvania, New York, Utah, and Virginia.

See, e.g., 1986 Ind. Acts 21:IC 23-1-37; 1981 La. Acts 12:83; 1986 Mo. Laws 351.355; VA. CODE § 13.1 (1985). Indiana and Missouri allow indemnity to directors and officers for negligence, including gross negligence. The Indiana indemnity act covers violations of securities laws if directors thought they were acting in good faith and in the corporation's best interests. Louisiana is the only state that by law allows corporations to provide director and officer insurance obtained from a wholly owned insurance company. Galante, *Boardroom*, *supra* note 238, at 30. Furthermore, it is understood that Pennsylvania and Oregon are now considering similar laws.

268. The approval was not unanimous and one prominent member of the Delaware bar published his "strong disagreement" to the proposed amendments. Memorandum from Bruce M. Stargatt, Esquire, to members of the Corporation Law Section (May 7, 1986) [hereinafter Stargatt Memorandum]. Mr. Stargatt's memorandum in opposition included the following:

> For Delaware, which leads in the development of our country's corporate law, to exercise that leadership by abolishing the duty of care rule is, to me, unacceptable. . . . Further, until our Supreme Court's recent decision in *Smith v. Van Gorkom*, . . . I heard not even a faint murmur of dissatisfaction with the duty of care formulation as a matter of legal concept.

Id. at 2 (copy available at Delaware Law School Library).

269. Memorandum from Subcommittee on Director Liability to Members of the Corporation Law Section, Proposed Amendments to DGCL §§ 102 & 145: A Response to Bruce M. Stargatt, Esquire, at 3 (May 9, 1986) (copy available at Delaware Law School Library) [hereinafter Subcommittee Memorandum].

The Council considered alternatives. These included placing a statutory "cap" on the liability of a director for a duty of care violation. This was rejected, however, because a "cap" is arbitrary and the belief exists that stockholders themselves should limit director liability to the extent they deem appropriate.[270] Another proposal would have permitted indemnification under section 145 for judgments in derivative actions where directors violated their duty of care. This approach was not approved because "[i]t seemed illogical to provide a statutory scheme whereby the corporation would, in effect, pay off the very liability asserted by it or on its behalf against the directors."[271]

The subcommittee gave several reasons why the proposed legislation was fair and reasonable:

1. It does not permit any director to avoid personal liability (i) for any breach of the director's duty of loyalty to the corporation and its stockholders, (ii) for acts or omissions not in good faith or which involve intentional misconduct or a knowing violation of law, (iii) for unlawful payment of a dividend under section 174 of the DGCL, or (iv) for any transaction from which the director derived an improper personal benefit.[272]

2. The proposal does not remove the duty of care owed by directors of Delaware corporations. It only permits shareholders to limit or eliminate a director's liability for money damages for violations of that care. The duty of care remains unchanged and will be enforceable through such equitable remedies as "injunctive relief, rescission, etc." even if stockholders should approve the elimination of personal liability.[273]

---

270. *Id.* at 3. The ALI Draft No. 1 of its *Principles of Corporate Governance* recommended a "cap" of $200,000 on the liability of outside directors for ordinary negligence. ALI Draft No. 1, *supra* note 35, § 7.06(c). The chief reporter stated that the underlying theory for this cap "was that it was unfair to subject directors to astronomical liability for negligence." Kaplan, *Misconceptions*, *supra* note 23, at 589. However, this recommended cap was removed in a later draft with the comment that the recommendation neither endorses nor rejects a cap. ALI, PRINCIPLES OF CORPORATE GOVERNANCE: ANALYSIS AND RECOMMENDATIONS § 7.16 (Tent. Draft No. 6, 1986). Section 7.17 would permit shareholders to amend the articles of incorporation to limit directors' and officers' liability to "an amount that is not disproportionate to the economic benefits to the defendant for serving the corporation." *Id.* § 7.17. This provision will be on the agenda at the next meeting of the Counsel of the American Law Institute. 1 Corp. Counsel Weekly (BNA) No. 43, at 8 (Nov. 5, 1986).

271. Subcommittee Memorandum, *supra* note 269, at 3.

272. *Id.* at 4.

273. *Id.*

3. The proposal is consistent with the rationale underlying section 145, particularly section 145(g), which permits a Delaware corporation to purchase and maintain D&O insurance.[274]

4. A number of other states have taken similar action.[275]

5. The benefits that would be gained from enactment of the proposed legislation outweigh any potential detriments.[276]

The synopsis of section 102(b)(7) states that the amendment is a response to recent changes in the market for directors liability insurance. It further observes that recent increases in the premiums for D&O insurance or its unavailability to certain companies "have threatened the quality and stability of the governance of Delaware corporation because directors have become unwilling, in many instances, to serve without the protection which such insurance provides and, in other instances, may be deterred by the unavailability of insurance from making entrepreneurial decisions."[277]

Section 102(b)(7) provides that the liability of a director may be eliminated or limited for breach of a fiduciary duty through a revision to the charter, provided that such liability shall not be so affected "for acts or omissions not in good faith or which involve intentional misconduct or a knowing violation of law."[278] If a section 102(b)(7) charter provision had been in effect prior to the decision in *Trans Union*, who would have determined whether the directors' gross negligence in not being properly informed about the value of Trans Union stock conformed to the requirement of good faith? Since

---

274. *Id.* at 5.

275. *Id.* at 5-6. *See supra* note 267.

276. *Id.* at 6. Another memorandum on the proposed amendment was circulated by an eminent member of the Delaware bar, E. Norman Veasey. The memorandum stated that:

> [a]s insurance becomes less and less available, qualified outside directors will refuse in increasing numbers to serve without adequate insulation from personal liability. That phenomenon presents the ultimate irony in corporate governance. Our courts have properly paid heightened deference to the decisions of boards where there has been a preponderance of independent directors. If competent directors are not willing to serve because of an unreasonable risk of exposure of their own assets, the policy of having a majority of independent directors as decisionmakers is seriously undermined. That would leave corporate governance either to insiders or to outsiders who are marginally competent to serve.

E. NORMAN VEASEY, PROPOSED AMENDMENT TO SECTION 102(B) OF THE DELAWARE GENERAL CORPORATION LAW 1-2 (May 13, 1986) (copy is available at Delaware Law Library).

277. *See* Appendix B.

278. DEL. CODE ANN. tit. 8, § 102(b)(7) (1986).

in that case the plaintiff did not allege fraud, bad faith, or self dealing,[279] would the 102(b)(7) charter provision automatically have eliminated liability? It is unlikely that a plaintiff's attorney would have agreed that such a provision was self-executing and it is probable that he would have contended that the uninformed decision-making of the Trans Union directors did not eliminate their liability because their "patently" unadvised decisions were "acts or omissions not in good faith."

The defendants, of course, could file a motion to dismiss the complaint on the ground that the 102(b)(7) charter provision eliminated liability. But if the complaint alleged particularized facts—presumed to be true in a motion to dismiss—of the directors' gross negligence in not informing themselves of the value of the Trans Union shares, it is hardly likely that a judge would grant the motion. In this situation, the defendant could move for a summary judgment with accompanying affidavits showing that they were informed as to the value of the Trans Union stock and that they acted in good faith and exercised requisite care. But at this stage of the case, the court may well want to consider more evidence before deciding whether the directors are eligible for the protection of the 102(b)(7) charter provision.

Perhaps the procedure for establishing the eligibility of the directors where it is deemed appropriate could be explained in the proxy material seeking stockholder approval of the 102(b)(7) revision. The procedure could include the appointment of a committee of disinterested outside directors similar to a special litigation committee in derivative suits which could make the good faith and other 102(b)(7) determinations. If it is not possible to obtain a committee of disinterested outside directors, the matter could be referred to independent or special counsel for determination.[280] A court should accord significant weight to the finding of such a committee or counsel, especially where the procedure for their acting in the matter has been fully disclosed to or approved by the stockholders.

---

279. *Trans Union*, 488 A.2d at 889. According to the comment to § 8.30 of the RMBCA, "[t]he concept of good faith involves a subjective test which would include a 'mistake of judgment.' " RMBCA, *supra* note 98, § 8.51, at 1116.

280. *See* Lewin, *Special Counsel: Ticklish Role*, N.Y. Times, Business Section, Apr. 8, 1986, at D1, col. 3. *See generally* Aronson v. Lewis, 473 A.2d 805 (Del. 1984); Zapata v. Maldonado, 430 A.2d 779 (Del. 1981); Payson, Goldman & Inskip, *After* Maldonado—*The Role of the Special Litigation Committee in the Investigation and Dismissal of Derivative Suits*, 37 BUS. LAW. 1199 (1981).

2. Is the New Delaware Law a Significant Benefit for Outside Directors?

One can justifiably question whether new section 102(b)(7) will give any significant relief to corporate directors. In fact, there are few cases where directors have paid damages for violations of the duty of care, the *Trans Union* case being a notable exception.[281] It may be that a corporation will be able to purchase D&O insurance more easily and at reasonable cost, but with all of the exclusions in current policies it is not apparent how such a development would comfort a director.[282] However, a 102(b)(7) charter amendment might prove beneficial to certain directors in the case of some unexpected lawsuit or unknown development. A recent comment noted that "the ability to eliminate or limit, pursuant to stockholder approval, personal liability of the directors for monetary damages for violations of their duty of care—i.e., gross negligence—is significant."[283]

It also should be noted that a section 102(b)(7) charter revision cannot eliminate or limit liability for violations of the duty of loyalty. It is therefore predicted that complaints will be drafted alleging breaches of this duty even though the issue may relate primarily to the duty of care.

Finally, a 102(b)(7) charter provision cannot limit or eliminate liability if a director is liable for the infraction of a federal law. This limitation would include damages under the federal securities laws, the antitrust laws, or the Racketeer Influenced and Corrupt Practices Act.[284]

---

281. Professor Bishop stated in 1968 that the search "for cases in which directors of industrial corporations have been held liable in derivative suits for negligence uncomplicated by self-dealing is a search for a very small number of needles in a very large haystack." Bishop, *Sitting Ducks and Decoy Ducks: New Trends in the Indemnification of Corporate Directors and Officers*, 77 YALE L.J. 1078, 1099 (1968). The situation has not changed a great deal since that time. *See also* Frankel, *Corporate Director's Duty of Care: The American Law Institute's Project on Corporate Governance* 52 GEO. WASH. L. REV. 705, 715 (1984). Mr. Stargatt in his memorandum pointed out that adjudication of liability based on violations of duty of care is quite rare. Stargatt Memorandum, *supra* note 268, at 4.

282. In the proxy statement of Control Data Corporation for its Special Stockholder Meeting of October 15, 1986, it is stated that at least one carrier indicated that it would charge decreased premium if the company has a § 102(b)(7) amendment in effect. *See* Appendix C.

283. Veasey & Finkelstein, *New Delaware Statute Allows Limits on Director Liability and Modernizes Indemnification Protection*, 6 BUS. LAW. UPDATE No. 6, at 1-3 (July/Aug. 1986).

284. Galante, *Boardroom*, *supra* note 238, at 30.

Nevertheless, a survey by the American Society of Corporate Secretaries shows that 212 of its members, all Delaware corporations, have or will submit 102(b)(7) proposals to their shareholders at special or annual meetings.[285] Thus, there are a significant number of companies which have determined that section 102(b)(7) and the other recent amendments to the DGCL offer benefits of sufficient importance to ask for shareholder approval. Further, 7,400 companies incorporated in Delaware between July 1, 1986, the date of the enactment of the amendments to the DGCL, and September 30, 1986.[286] A state official attributed this increase, in part, to the new provisions of the DGCL.[287]

VIII. CONCLUSION

Directors should not be so apprehensive about possible legal liability for their decisions that they will take little or no risk or innovative action in the boardroom. If directors spend most of their time building paper trails in order to assure the successful defense of lawsuits, the ingenuity of our system will diminish.

In the past, D&O insurance provided some assurance to the directors that their good faith action and conscientious oversight protected them from liability even in the current litigious environment. Now, however, D&O insurance is a doubtful protective device. It is true that if directors fulfill their roles with active oversight and on an informed basis, there is little chance of liability. Nevertheless, since diligence and good faith do not guarantee immunity from suit,

---

285. *See* American Soc'y of Corp. Secretaries, Newsletter 1, 7 (Nov. 1986). The ASCS Survey showed the following with respect to those corporations who will ask their shareholders to approve amendments to their certificates of incorporation. Of the 197 companies who responded to the question, 165 will propose an amendment to eliminate liability; 21 of the proposals will provide for a limit; and 11 companies were undecided as to the approach to take.

Nine of the 222 companies responding to the question incicated they will cancel or let their D&O insurance lapse if the shareholders approve their proposed revisions; 116 will not cancel; 13 answered they probably will cancel; and 84 were undecided.

In addition, the survey showed 181 of the 273 companies who responded to the question plan to seek amendments of their charter or bylaw provisions on indemnification to conform to amended § 145 of the DGCL, 17 will not so amend, and 28 were undecided.

An example of a statement in a proxy statement requesting shareholder approval of a § 102(b)(7) charter amendment is contained in Appendix C.

286. *Delaware Incorporations Up*, Wilmington News J., Oct. 8, 1986, at B10, col. 1.

287. *Id.*

many directors feel that any benefits from serving on boards simply are not worth the exposure to liability.

New laws limiting or eliminating the liability of directors, such as the recently enacted Delaware statute, have been enacted for the purpose of alleviating this serious situation. But it is premature to give any assurance that the goal of these laws will be realized. Meanwhile, many corporations will continue to have difficulty attracting and retaining experienced and desirable outside directors.

APPENDIX A

SYNOPSIS

Section 102(b)(7) and the amendments to Section 145 represent a legislative response to recent changes in the market for directors' liability insurance. Such insurance has become a relatively standard condition of employment for directors. Recent changes in that market, including the unavailability of the traditional policies (and, in many cases, the unavailability of any type of policy from the traditional insurance carriers) have threatened the quality and stability of the governance of Delaware corporations because directors have become unwilling, in many instances, to serve without the protection which such insurance provides and, in other instances, may be deterred by the unavailability of insurance from making entrepreneurial decisions. The amendments are intended to allow Delaware corporations to provide substitute protection, in various forms, to their directors and to limit director liability under certain circumstances.

Amendment to 8 Del. C. § 145(b)

Amend subsection (b) of § 145, Title 8, Delaware Code, by deleting the phrase "for negligence or misconduct in the performance of his duty" so that subsection (b) reads in its entirety as follows (bracketing indicates deletion):

> (b) A corporation shall have power to indemnify any person who was or is a party or is threatened to be made a party to any threatened, pending or completed action or suit by or in the right of the corporation to procure a judgment in its favor by reason of the fact that he is or was a director, officer, employee or agent of the corporation, or is or was serving at the request of the corporation as a director, officer, employee or agent of another corporation, partnership, joint venture, trust or other enterprise against expenses (including attorneys' fees) actually and reasonably incurred by him in connection with the defense or settlement of such action or suit if he acted in good faith

and in a manner he reasonably believed to be in or not opposed to the best interests of the corporation and except that no indemnification shall be made in respect of any claim, issue or matter as to which such person shall have been adjudged to be liable [for negligence or misconduct in the performance of his duty] 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.

Commentary on Section 145(b)

Paragraph (b) has been amended to conform the standard for indemnification under the statute with the recent holdings of the Delaware Supreme Court. No substantive change in the law is intended.

Amendment to 8 Del. C. § 145(e)

Amend the first sentence of Section 145(e) to read as follows (brackets indicate deletions and italicizing indicates additions):

(e) Expenses incurred by an officer or director in defending a civil or criminal action, suit or proceeding may be paid by the corporation in advance of the final disposition of such action, suit or proceeding as authorized by the board of directors [in the specific case] upon receipt of an undertaking by or on behalf of such director or officer to repay such amount [unless] *if* it shall ultimately be determined that he is *not* entitled to be indemnified by the corporation as authorized in this Section.

Commentary on Section 145(e)

The first amendment to Section 145(e) deletes the previous requirement for authorization of advancement of lit-

igation expenses, "as authorized by the board of directors in the specific case" so as to permit general authorization of advancement of expenses including a mandatory certificate of incorporation or by-law provision to that effect. The second amendment to Section 145(e) changes the undertaking required for the advancement of expenses to directors and officers so as not to create an obligation to repay unless a specific determination is made that the director or officer is not entitled to be indemnified as authorized in Section 145. Nothing in these changes to subsection (e) relieves the board of directors from its affirmative duty to see that the determination required by subsection (d) is made for any indemnification under subsections (a) and (b).

Amendment to 8 Del. C. § 145(f)

Amend Section 145(f) to read as follows (brackets indicate deletions and italicizing indicates additions):

> (f) 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 a person seeking indemnification *or advancement of expenses* may be entitled under any by-law, agreement, vote of stockholders or disinterested directors, or otherwise, both as to action in his official capacity and as to action in another capacity while holding such office [and shall continue as to a person who has ceased to be a director, officer, employee or agent, and shall inure to the benefit of the heirs, executors and administrators of such a person].

Commentary on Section 145(f)

The addition of the phrase "and advancement of expenses" is intended to make clear that the "other rights" provided for in Section 145(f) may include rights to have expenses advanced on terms other than those provided in Section 145(e). The phrase "and shall continue as to a person who has ceased to be a director, officer, employee or agent" has been relocated to a new subsection (j).

Amendment to § 145

[New § 145(j)]

Add a new subsection (j) to read as follows:

> (j) The indemnification and advancement of expenses provided by, or granted pursuant to, this section shall, unless otherwise provided when authorized or ratified, continue as to a person who has ceased to be a director, officer, employee or agent and shall inure to the benefit of the heirs, executors and administrators of such a person.

Commentary on Section 145(j)

New subsection 145(j) has been added to set forth the provision from Section 145(f) referred to above. No substantive change in the law is intended.

APPENDIX B

Amendment to 8 Del. C. §102(b)

(b) In addition to the matters required to be set forth in the certificate of incorporation by subsection (a) of this section the certificate of incorporation may also contain any or all of the following matters —

* * *

(7) A provision eliminating or limiting the personal liability of a director to the corporation or its stockholders for monetary damages for breach of fiduciary duty as a director, provided that such provision shall not eliminate or limit the liability of a director (i) for any breach of the director's duty of loyalty to the corporation or its stockholders, (ii) for acts or omissions not in good faith or which involve intentional misconduct or a knowing violation of law, (iii) under section 174 of this title, or (iv) for any transaction from which the director derived an improper personal benefit. No such provision shall eliminate or limit the liability of a director for any act or omission occurring prior to the date when such provision becomes effective. All references in this subsection to a director shall also be deemed to refer to a member of the governing body of a corporation which is not authorized to issue capital stock.

SYNOPSIS

Section 102(b)(7) and the amendments to Section 145 represent a legislative response to recent changes in the market for directors' liability insurance. Such insurance has become a relatively standard condition of employment for directors. Recent changes in that market, including the unavailability of the traditional policies (and, in many cases, the unavailability of any type of policy from the traditional insurance carriers) have threatened the quality and stability of the governance of Delaware corporations because directors have become unwilling, in many instances, to serve

without the protection which such insurance provides and, in other instances, may be deterred by the unavailability of insurance from making entrepreneurial decisions. The amendments are intended to allow Delaware corporations to provide substitute protection, in various forms, to their directors and to limit director liability under certain circumstances.

Commentary on Section 102(b)(7)

This provision enables a corporation in its original certificate of incorporation or an amendment thereto validly approved by stockholders to eliminate or limit personal liability of members of its board of directors or governing body for violations of a director's fiduciary duty of care. However, the amendment makes clear that no such provision shall eliminate or limit the liability of a director for breaching his duty of loyalty, failing to act in good faith, engaging in intentional misconduct or knowingly violating a law, paying a dividend or approving a stock repurchase which was illegal under 8 *Del. C.* §174, or obtaining an improper personal benefit. This provision would have no effect on the availability of equitable remedies, such as an injunction or rescission, for breach of fiduciary duty.

APPENDIX C

Control Data Corporation
Notice of Special Meeting of Stockholders
October 15, 1986 and Proxy Statement
(Preliminary Copy)

On July 1, 1986, an amendment to the Delaware General Corporation Law became effective. The new law permits a Delaware corporation to include in its certificate of incorporation a provision that eliminates or limits a director's personal liability for monetary damages for breach of his or her fiduciary duty of care; that is, for negligence or gross negligence, subject to certain limitations. The new Delaware law does not permit elimination or limitation of the duty of care itself. It permits corporations to eliminate or limit a director's liability for monetary damages for breach of the duty of care under certain circumstances. The new law was prompted in part out of concern that directors not be subject to undue concern over litigation, and in part by the current crisis in the market for directors' and officers' liability insurance. The law is intended to help corporations attract and retain qualified individuals to serve as directors.

The Board of Directors of the Company views the new Delaware law favorably and has concluded it would be beneficial and advisable to amend the Company's Certificate of Incorporation to include the permitted provision. Accordingly, the Board has approved an amendment to the Certificate of incorporation (the "Amendment") and has directed that the Amendment be submitted to the stockholders for approval as required by the Delaware General Corporation Law.

Description and Effect of the Amendment

The Amendment provides that a director of the Company shall not be personally liable to the Company or its stockholders for monetary damages arising out of the director's breach of his or her fiduciary duty, except to the extent that Delaware law does not permit exemption from such liability. The Amendment does not eliminate the fiduciary *duty* of directors; instead the Amendment is designed to

limit or eliminate the *personal liability* of directors for monetary damages to the maximum extent permitted by Delaware law as it now exists or may be amended in the future. The Amendment would not affect the availability of injunctive or other equitable relief as a remedy for breach of fiduciary duty.

The Amendment applies only to the personal liability of directors (whether or not they are also officers) acting *as directors*, and has no effect on the potential liability of individuals for their actions as *officers* of the Company.

Under the Amendment, if future changes in the Delaware General Corporation Law permit further limitation of directors' liability, such further limitation automatically becomes effective with respect to the Company's directors. Conversely, if future changes in the Delaware General Corporation Law permit less limitation of directors' liability, such expanded liability would also automatically be effective with respect to the Company's directors. The Amendment also provides that any repeal or modification of the Amendment by the stockholders will not adversely affect any right or protection of a director that exists at the time of such repeal or modification.

Current Delaware law contains express limitations on the ability to limit or eliminate liability. Under these limitations, which the Amendment incorporates by reference, a director remains potentially liable for monetary damages (i) for breach of the director's duty of loyalty to the Company or its stockholders, (ii) for acts or omissions not in good faith or which involve intentional misconduct or a knowing violation of law, (iii) for an improper payment of a dividend or an improper repurchase of the Company's stock, as provided in Section 174 of the Delaware General Corporation law, or (iv) for any transaction from which a director derives an improper personal benefit.

The Amendment is subject to an additional limitation in that it eliminates liability only for conduct occurring on or after the date the Amendment becomes effective. The Amendment will not become effective until the stockholders have approved it, and the Company has filed a Certificate of Amendment with the State of Delaware. As a result, the

Amendment will have no impact on the potential liability resulting from pending suits against certain of the Company's directors arising from the Company's August 1985 earnings restatement.

Because the change in Delaware law is recent, little or no judicial guidance exists with respect to the scope of the limitations on liability afforded by the proposed Amendment under current law. There may be certain liabilities, such as those under the federal securities laws or other state or federal laws, which a court may hold are unaffected by the Amendment.

The Board of Directors believes that the Amendment will significantly increase the Company's ability to attract and retain qualified people to serve as outside directors by providing additional protection for these directors in making good faith business decisions. The Board also believes that prospective directors' and officers' liability insurance carriers will view the Amendment favorably, and that it may aid the Company in obtaining adequate directors' and officers' coverage. At least one potential insurance carrier has indicated that it would charge a decreased premium if the Company has the Amendment in effect. Regardless of whether such benefits are achieved with respect to insurance, the Board is of the opinion that enhancing the Company's ability to attract and retain qualified outside directors justifies the Amendment.

The Amendment does, however, limit the remedies available to a stockholder who has an otherwise valid claim that the Board has acted in violation of its fiduciary duties if the Board's action is among those for which Delaware law permits elimination or limitation of liability. Stockholders will no longer have a claim for money damages based on a breach of the directors' duty of care, even if the directors' conduct involved gross negligence, unless the conduct falls within the statutory limitations. In such a situation, a stockholder's only remedy may be to sue to enjoin the completion of the Board's action or to rescind a completed action. Stockholders may not be aware of a proposed transaction or other action until it is too late to prevent its completion. In such a case, the Company and the stockholders may

have no effective remedy for an injury occasioned by the directors' action.

The Board of Directors believes that the potential benefits to the Company resulting from an increased ability to attract and retain good outside directors and a potentially more advantageous position in seeking and maintaining directors' and officers' liability insurance far outweigh the potential limitations the Amendment places on stockholder remedies. The Amendment does not affect the duty of the Company's directors to act in good faith and in the honest belief that any action taken is in the best interests of the Company. The Board believes that the level of care and diligence exercised by directors will not decrease after adoption of the Amendment.

The Amendment reads in full as follows:

> TWELFTH: A Director of this Corporation shall not be liable to the Corporation or its stockholders for monetary damages for breach of fiduciary duty as a Director, except to the extent such exemption from liability or limitation thereof is not permitted under the Delaware General Corporation law as the same exists or may hereafter be amended.
>
> Any repeal or modification of the foregoing paragraph by the stockholders of the Corporation shall not adversely affect any right or protection of a Director of the Corporation existing at the time of such repeal or modification.

The Board recommends that the stockholders vote FOR approval of Proposal One. The affirmative vote of the holders of a majority of the shares of common and preferred stock entitled to vote (considered together as if one class) is necessary to approve this proposal. If not otherwise specified, proxies will be voted FOR approval of Proposal One.