Indemnification of the Corporate Insider: Directors' and Officers' Liability Insurance

Minn. L. Rev. Editorial Board

Follow this and additional works at: https://scholarship.law.umn.edu/mlr

Part of the Law Commons

Recommended Citation
https://scholarship.law.umn.edu/mlr/2960

This Article is brought to you for free and open access by the University of Minnesota Law School. It has been accepted for inclusion in Minnesota Law Review collection by an authorized administrator of the Scholarship Repository. For more information, please contact lenzx009@umn.edu.
Indemnification of the Corporate Insider: Directors' and Officers' Liability Insurance

I. INTRODUCTION

Any individual in the position of a corporate director or officer faces potential liability from a number of sources. The threat of liability and attendant litigation expense leads an insider to seek means of transferring the risk of loss from himself to his corporation. He may seek assurance of indemnification through the common law, state statutory schemes or contractual provisions with the corporation. These methods, however, cannot provide complete security and the insider may be forced to examine the comprehensive director and officer liability insurance plans that are now available. The insurance not only indemnifies insiders in many instances where the corporation cannot, but also reimburses the corporation for those expenses it does incur through indemnification of its insiders. The purpose of this Note is to determine how well this insurance meets the separate needs of insiders and their corporations in light of the liabilities to which each may be exposed. This evaluation will be made with special emphasis on the new Minnesota indemnification statute and under the assumption that the corporation has exercised its power to indemnify to the limits of that or a similar act.

II. BASIS OF INSIDER LIABILITY

When an individual accepts a directorship or office in a corporation he also accepts the accompanying potential personal

1. Professor Hornstein as early as 1939 estimated that attorney's fees average 20 percent of the amount recovered in a derivative suit. Hornstein, The Counsel Fee in Stockholder's Derivative Suits, 39 Colum. L. Rev. 784, 813 n.187 (1939). In the past the insider has usually been represented by the same counsel that represented the corporation. However, recent decisions in derivative suits have denied this privilege because of the adverse interests of each party. E.g., Lewis v. Shaffer Stores, 218 F. Supp. 238 (S.D.N.Y. 1963). This trend may be further extended to third party suits where it is the attorney's duty to "contend for that which duty to another client requires him to oppose." A.B.A., Canons of Professional Ethics § (1967).

2. Even the most liberal indemnification statute does not allow the corporation, for example, to indemnify for all costs, other than expenses including attorney's fees, incurred in the settlement of a derivative suit. Del. Code Ann. tit. 8, § 145(b) (Supp. 1968); Minn. Stat. § 301.095(2) (Minn. Sess. L. Serv. ch. 983 (1969)).

3. See note 2 supra.

4. Minn. Stat. § 301.085 (Minn. Sess. L. Serv. ch. 983 (1969)).

5. Directors and officers will be referred to hereinafter collec-
liabilities. These liabilities may arise from suits by a shareholder on behalf of the corporation as well as from suits by third parties. In either type of suit, liability will be based on either a failure to exercise due care in corporate affairs or a lack of undivided loyalty to the corporation in corporate transactions.

Shareholders' derivative suits are brought by stockholders on behalf of the corporation to enforce corporate rights against insiders who have allegedly breached their duty to the corporation. Since the suit enforces corporate rights, all benefits derived therefrom accrue to the corporation and not to the stockholder directly. Derivative suits are brought for various relatively as "insiders." This definition is not to be confused with the statutory definition of an insider—a holder of 10 percent of the shares of a corporation—for 16(b) purposes. See Securities Exchange Act of 1934 § 16(b), 15 U.S.C. § 78p(b) (1964).

6. See generally 1 G. Hornstein, CORPORATION LAW & PRACTICE § 446 (1959 & 1963 supp.); Nielson, Director's Duties Under Anglo-American Corporation Law, 43 DET. L.J. 605 (1966); Adkins & Janis, Some Observation on Liabilities of Corporate Directors, 20 Bus. Law. 817 (1965). Some jurisdictions have enacted statutory standards of due care. The main difference between them is whether the insider should be held to a standard of care commensurate with that which he would exercise in his personal business affairs or to a standard of care which ordinarily prudent men would exercise in similar positions. Compare PA. STAT. ANN. tit. 15, § 2852-408 (1958), with N.Y. Bus. CORP. LAW § 717 (McKinney 1963).

7. See M. Feuer, PERSONAL LIABILITIES OF CORPORATE OFFICERS AND DIRECTORS 31-34 (1961). As long as the insider considers only the corporation in his decisions, he exercises proper loyalty. However, he may be liable for a breach of loyalty in those situations where his decision, although seemingly in the interests of the corporation, was actually in his own interest or the interest of another. Globe Woolen Co. v. Utica Gas & Elec. Co., 224 N.Y. 483, 121 N.E. 378 (1918). See generally Marsh, Are Directors Trustees? Conflict of Interest and Corporate Morality, 22 Bus. Law. 35 (1966); DEL. CODE ANN. tit. 8, § 144 (1968).


9. In the past, all damages from a settlement agreement were the property of the stockholder who brought the suit. Hornstein, New Aspects of Stockholders' Derivative Suits, 47 Colum. L. Rev. 1 (1947). With this in mind stockholders had brought suit with little more than a colorable claim in hopes of settlement. To remedy this situation, courts and legislatures provided that all benefits would be the property of the corporation. E.g., Clarke v. Greenberg, 296 N.Y. 146, 71 N.E.2d 443 (N.Y. Ct. App. 1947); Wis. STAT. ANN. § 180.405(2), (3) (1957). As a further guard against unfounded litigation, legislatures made it more costly for the stockholders to bring suit by passing security-for-expenses statutes requiring bonds to be posted covering the cost of the litigation. N.Y. GEN. CORP. LAW § 61-b (McKinney 1943) (security must be furnished if requested unless the shareholder represents either
sons: conflict of interest,\textsuperscript{10} personal appropriation of a corporate opportunity,\textsuperscript{11} negligence in permitting antitrust violations to occur,\textsuperscript{12} misuse of corporate funds,\textsuperscript{13} performance of \textit{ultra vires} acts\textsuperscript{14} and self dealing\textsuperscript{15}—the most common of all allegations.

Where the insider's action has caused harm to third parties in addition to, or instead of, the corporation, those parties may bring an action in their own right against the insider. Although the corporation is normally joined, the insider may be personally liable for a portion of the expenses or entirely liable for fines imposed.\textsuperscript{16} Unlike the derivative action, all benefits derived from the suit inure to the plaintiff. Several classes of third parties may be harmed by the insider and thus have standing to sue: a shareholder may attempt to protect an individual rather than a corporate right; a competitor may bring action alleging antitrust or patent infringements; parties in con-
tractual relationships with the corporation may allege inducement to breach the contract\textsuperscript{20} or the federal and state governments might bring criminal actions alleging violation of federal security, antitrust or income tax laws.\textsuperscript{21}

In certain actions, in addition to their common law duties to act with care and undivided loyalty, insiders must, because of their status, comply with restrictive statutory standards of responsibility.\textsuperscript{22} A status liability is a liability imposed when personal dealings are presumed to create a conflict of interest with the insider's position. The liability would not attach but for the fact that the party is an insider, and as such subject to restrictive conduct because of his proximity to internal corporate affairs. Federal security laws, for example, impose status liability on the insider who makes a short-swing transaction in his corporation's stock.\textsuperscript{23} He is liable to the corporation in a hybrid derivative suit for his profits.\textsuperscript{24}

III. THE LAW OF INDEMNIFICATION

A. THE COMMON LAW

At common law an insider who had been unsuccessful in his defense of a derivative suit had no right of indemnification from the corporation.\textsuperscript{25} The wrongdoing insider could not justifiably be reimbursed by the very party that his misconduct had harmed. Though this rationale is inappropriate when the insider is successful in his defense of a derivative suit, early cases denied indemnification in such situations because the expenditure of corporate funds would not produce a benefit to the corpora-

\textsuperscript{20} Potter v. Minskoff, 2 App. Div. 2d 513, 156 N.Y.S.2d 872, 874 (4th Dept. 1956) (liable only when inducement was in bad faith).

\textsuperscript{21} See generally 3 L. Loss, SECURiTiES REGULATION 1682-1682, 1894-2004 (2d ed. 1961); H. BALLANTINE, CORPORATIONS § 347 et seq. (Rev. ed. 1946); 7 J. MERTENS, LAW OF FEDERAL INCOME TAxATIoN § 39.01 (1955).

\textsuperscript{22} See Bishop, New Cure For An Old Ailment: Insurance Against Directors' and Officers' Liability, 22 Bus. Law. 92, 95-96 (1966).


\textsuperscript{24} Professor Bishop also characterizes liability arising from a 10(b)-5 action as status liability. Bishop, supra note 22, at 95-96. Since SEC v. Texas Gulf Sulphur Co., 401 F.2d 833 (2d Cir. 1968), the class of insiders that is subject to this restrictive statutory conduct, i.e. use of insider information, is not subject to succinct definition. The uncertainty as to whom may be deemed an insider may render the status label useless as to this liability.

\textsuperscript{25} E.g., Hollander v. Breeze Corp., 131 N.J. Eq. 585, 26 A.2d 507 (Ch. 1941). See also Washington, Litigation Expenses of Corporate Directors in Stockholders' Suits, 40 COLUM. L. REV. 431, 433 (1940).
tion, and thus would be *ultra vires*. In *Griesse v. Lang*, an action for restitution of company funds paid for attorneys' fees in the insider's successful defense of a derivative suit, the court held that there must be "some benefit to the corporation, or that some interest of the corporation" must be threatened before the directors could be reimbursed from the corporate treasury. The landmark case of *New York Dock Company v. McCollom* climaxed the confusion over the common law theory that a successful defendant insider must show corporate benefit as a condition of indemnification. In that case, the corporation brought a declaratory judgment action to determine whether it had an obligation to indemnify the insider. The court not only held that there was no obligation to indemnify, but also intimated that there was no power to do so in the absence of any benefit extended to the corporation by a successful defense. The court refused to recognize that the real test of benefit lay not in a tangible item which could be shown in the corporation's balance sheet, but in the intangible relationship between the corporation and the insider. As one commentator suggests, indemnification of insiders who successfully defend charges against their conduct insures that they will remain with the corporation and continue to aid and improve it.

In an attempt to overcome the holding of *Griesse* and the implications of *McCollom*, several states passed statutory provisions authorizing indemnification of successful insider defendants. At the same time, the Supreme Court of New Jersey declined to follow *McCollom*, holding that there was a common law obligation to indemnify the insider for a successful defense of a derivative suit even in the absence of any direct, tangible benefit to the corporation. In so holding, the court compared

---

27. Id. at 558, 175 N.E. at 223.
28. The earlier case of *Figge v. Bergenthal*, 130 Wis. 594, 109 N.W. 581 (1907) had allowed indemnification to an insider who was successful in defending a quasi-derivative suit. During the litigation, a shareholders' resolution was passed authorizing indemnification, although it was not mentioned by that court. However, *Figge* was distinguished in *Griesse* on the ground that the corporation in *Griesse* had not passed such a resolution. See generally G. Washington & J. Bishop, *Indemnifying the Corporate Executive* 56-58, 85 (1963).
33. "While I find that the company was benefited, I am not to be understood as holding that the fact of benefit to the company is an
the position of the insider to that of the trustee, stating that the insiders had a duty to the stockholders to defend their position. In the later case of In re E. C. Warner Company, also involving a derivative suit, the Minnesota Supreme Court found an obligation to indemnify the successful insider on the sole ground that to do so would produce sound corporate management—a prerequisite for responsible corporate action. The New Jersey and Minnesota decisions cast doubt upon the implications of McCollom that at common law a corporate benefit must accrue to the corporation before it might indemnify the successful insider.35

A third party action against an insider does not involve the enforcement of a corporate right. Consequently, there is no possibility of producing a conflict of interest between the corporation and the insider by indemnifying the latter with corporate funds. Courts, therefore, have not been concerned with whether or not a benefit has been extended to the corporation. Rather, the inquiry is whether the insider was acting as an agent of the corporation when committing the act causing the litigation.

Under accepted agency principles, the principal has a duty to reimburse an agent for expenses incurred by the agent in his capacity as such.36 In the two major cases in this area, however, the insider-agent has failed in his attempt to compel the corporation-principal to indemnify him.37 In both cases, the insider could not demonstrate satisfactorily that his authorized agency powers included the act in question.38 Presumably, however, the

---

34. 232 Minn. 207, 45 N.W.2d 388 (1950).
36. Hollandale Marketing Ass'n v. Goemat, 245 Minn. 154, 72 N.W. 2d 376 (1955); Restatement (Second) of Agency § 439, comments f & h (1958).
37. Standard Galvanizing Co. v. Commissioner, 202 F.2d 736 (7th Cir. 1953); Hoch v. Duluth Brewing & Malting Co., 173 Minn. 374, 217 N.W. 503 (1928).
38. The factual situation in Hoch v. Duluth Brewing & Malting Co., 173 Minn. 374, 217 N.W. 503 (1928) is worthy of note. The plaintiff-president secured a customer's debt by accepting title to certain lands in his own name. He reconveyed the property when the debt was satisfied. Fifteen years later he was joined with all parties whose names were in the chain of title in an action in which the Government charged
corporation would be obligated to indemnify the insider if such inclusion could be established.

B. Statutory Law

The inadequacies and uncertainties of common law indemnification prompted the majority of states to enact statutory provisions on indemnification. These statutes fall into four general classes: those which obligate the corporation to indemnify the insider; those which give the corporation power to indemnify; those which provide for court approved indemnification, and those which combine "corporate obligation" and "corporate power" to indemnify.

that there had been fraud in securing the patent to the land. He successfully defended that suit and brought the present action to compel indemnification. The court stated that the "complaint shows the expenses in defending the suit ... were caused by the independent and unexpected wrongful act of the United States, for which the defendant corporation was in nowise responsible." Id. at 377-78, 217 N.W. at 504. This reasoning implies that the act would not come within the authorized power of the agent unless the action of the principal caused liability to the agent. Cf. Hadley v. Coffin, 188 Iowa 896, 176 N.W. 885 (1920). Contra, Admiral Oriental Line v. United States, 86 F.2d 201 (2d Cir. 1936).


40. ALASKA STAT. tit. 10, § 10.05.009(15) (Supp. 1968); COLO. REV. STAT. ANN. §§ 31-2-1(15) (1963); CONN. GEN. STAT. ANN. § 33-320 (1960); D.C. CODE ANN. § 29-904(p) (1968); FLA. STAT. ANN. § 608.13 (14), (15) (Supp. 1968); IND. ANN. STAT. § 25-202(b)(10) (1960); IOWA CODE ANN. § 496A.4(15) (1962); ME. REV. STAT. ANN. tit. 13, § 146 (1964); MD. ANN. CODE art. 23, § 64 (1957); MICH. STAT. ANN. § 450.10 (L) (1967); MISS. CODE ANN. § 5309-04(o) (1968); MONT. REV. ANN. § 15-2204(o) (replacement volume 1966); NEB. REV. STAT. § 21-2005 (Supp. 1967); NEV. REV. STAT. § 78.070(6) (1967); N.M. STAT. ANN. § 51-24-4(o) (Supp. 1987); N.D. CENT. CODE § 10-19-04(15) (1960); OHIO REV. CODE ANN. § 1701.13(E) (1964); OR. REV. STAT. § 57.003 (15) (1967); R.I. GEN. LAWS ANN. § 7-9-12 (1968); S.D. SESS. LAWS ch. 23 § 11.1103(4) (1966); TEX. BUS. CORP. ACT art. 2.02(16) (1956); UTAH CODE ANN. § 16-10-4(o) (replacement volume 1962); W. VA. CODE ANN. § 31-1-18a (1966); WYO. STAT. ANN. § 17-36.4(o) (replacement volume 1965).

41. CAL. CORP. CODE § 830 (West 1955); N.C. GEN. STAT. §§ 55-19 to 55-21 (replacement volume 1965).

The major shortcoming of most of these indemnification statutes is their failure to differentiate third party suits from derivative actions. The statutes were enacted to eliminate the necessity of a "corporate benefit" as a prerequisite for voluntary indemnification of a successful insider. However, they have been applied to third party actions even though the policy behind the statutes is pertinent only to derivative suits. In contrast, the newly enacted Minnesota statute, a member of the fourth class, recognizes the fundamental differences between the actions. The statute thus preserves the derivative suit by not allowing its effect to be easily abrogated by unlimited indemnification of insiders. A comparison of the Minnesota statute with those of other states highlights the problems which all attempt to meet and the various means by which they may be solved.

1. The Unsuccessful Insider

Most states deny corporations the power to indemnify an insider in either a derivative or third party action where the insider is found liable for negligence or misconduct in the performance of his duties. An insider's unsuccessful defense, therefore, will normally preclude any corporate indemnification, even where he had acted in complete good faith and in a manner which he felt was in the best interests of the corporation. The Minnesota statute, however, allows indemnification of unsuccessful insiders when a particular subjective standard of conduct has been met. The unsuccessful insider may be fully indemnified in a third party suit if he acted in good faith and in a man-

46. See text accompanying note 36 supra.
47. Minn. Stat. § 301.095 (Minn. Sess. L. Serv. ch. 983 (1969)). This statute was modeled after the new Delaware indemnification statute. Del. Code Ann. tit. 8, § 145 (Supp. 1968). The Delaware indemnification statute is the product of the combined efforts of the Delaware Revision Commission and the Committee on Corporate Laws of the Section of Corporation and Business Law of the American Bar Association. The Model Business Corporation Act's counterpart to the Delaware statute replacing section 4(o), is section 4A. It is substantially identical to the Delaware Act.
48. For a lengthy comparison of the particulars of each statute, see G. Washington & J. Bishop, supra note 28, at 112-68.
ner he reasonably believed to be in, or not opposed to, the best interests of the corporation. With respect to any criminal action or proceeding, he may be indemnified if he had no reasonable cause to believe his conduct was unlawful. However, in a derivative suit, because of the anomalous situation that would be present by allowing indemnification of an unsuccessful insider—payment from the insider to the corporation and back to the insider—the insider, when acting in good faith and in a manner he reasonably believes to be in, or not opposed to, the best interests of the corporation, can be reimbursed only for expenses. Where the insider has been adjudged liable for negligence or misconduct he may receive indemnity for such expenses only if the court finds him "fairly and reasonably entitled to indemnity."

2. The Successful Insider

The statutes which flatly preclude indemnification of insiders who have been adjudged liable have an additional shortcoming in that they provide no guarantee that the successful insider will be indemnified. He is thus left to the mercy of the corporation's board of directors or stockholders. The Minnesota statute, on the other hand, is both protective and certain. In addition to its protection of the unsuccessful insider who is found equitably deserving, it obligates the corporation to indemnify the insider who "has been successful on the merits or otherwise" in defense of either a derivative or third party action.

50. Minn. Stat. § 301.095(1) (Minn. Sess. L. Serv. ch. 983 (1969)). The determination of whether the standard of conduct has been met is to be made "... (1) by the board of directors by a majority vote ... (2) ... by independent legal counsel in a written opinion, or (3) by the shareholders." Minn. Stat. § 301.095(4) (Minn. Sess. L. Serv. ch. 983 (1969)).


52. See note 40 supra. On the other extreme are the statutes that obligate the corporation to indemnify the successful insider, yet do not grant a concurrent power to indemnify the unsuccessful yet equitably deserving insider. E.g., Ky. Rev. Stat. § 271.375 (1962).


54. Minn. Stat. § 301.095(3) (Minn. Sess. L. Serv. ch. 983 (1969)), [Emphasis added.] This provision obligates the corporation to indemnify where the suit has been dismissed on a procedural ground, e.g., the running of the statute of limitations.
3. Settlements

Most statutes appear to treat settlements and successful adjudications alike. Those statutes that do differentiate usually allow indemnification of settlemen's only where the insider is free from actual negligence or misconduct, as determined by the board of directors or independent legal counsel. Minnesota goes further and distinguishes settlement agreements in third party suits from those in derivative actions. It allows reimbursement in settled third party actions subject to the same standards required for indemnification of expenses accruing from an unsuccessful defense, and explicitly states that the "termination of any action . . . by . . . settlement" does not imply that the standard has not been met. In settlements of derivative actions, however, only expenses, including attorneys' fees, are indemnifiable, since reimbursement of the amount paid in settlement would have the effect of nullifying the suit.

4. Exclusiveness of Statutes

The majority of the statutes provide that the statute "shall not be deemed exclusive of any other rights to which those seeking indemnification may be entitled under any bylaw, agreement, vote of stockholders or disinterested directors or otherwise . . . ." A literal interpretation would allow a corporation maximum freedom to indemnify pursuant to any bylaw, agreement or vote of the shareholders, and would abrogate rather than complement the statutory policy of allowing indemnification only under certain circumstances. Courts have bypassed chances to interpret this provision and its exact meaning is unclear. Nevertheless, dicta in several cases imply that the stat-

55. E.g., ME. REV. STAT. ANN. tit. 13, § 146 (1964). The statutes are silent on how they might treat settlements. Since the only exclusion from the statute is that for an adverse final adjudication, it seems logical that reimbursement pursuant to settlement would be allowed.
57. E.g., KY. REV. STAT. § 271.375 (1955).
59. See text accompanying note 50 supra.
60. MINN. STAT. § 301.095(1) (MINN. SESS. L. SERV. ch. 983 (1969)).
61. MINN. STAT. § 301.095(2) (MINN. SESS. L. SERV. ch. 983 (1969)).
62. DEL. CODE ANN. tit. 8, § 145(f) (Supp. 1968). The statutes that allow only judicially approved indemnification do not have nonexclusive clauses. See note 41 supra.
utory provision is indeed not exclusive as long as a corporation does not attempt to override the policy of the statute. In Minnesota the nonexclusive clause refers only to corporate personnel other than directors and officers; the statute is thus exclusive as to directors and officers. In addition, the statute specifically proscribes any indemnification inconsistent with the overall statutory policy. These statutory provisions are peculiar to Minnesota; they are not found in the new Delaware statute nor in any of its counterparts. Instead, the Delaware statute has retained the nonexclusive clause, and thus fails in its attempt to clarify and to delineate the law of indemnification.

5. Statutory Provisions Detailing and Developing the Law of Indemnification

The Minnesota statute has further clarified the area of indemnification by specifically defining the type of proceedings which may lead to indemnifiable expenses. While most statutes merely refer to "any action, suit, or proceeding," the Minnesota statute addresses itself to any "threatened, pending or completed action, suit or proceeding, wherever brought, whether civil, criminal, administrative, or investigative ..." This provision is an attempt to avoid litigation over the power to indemnify in nonjudicial and unripe proceedings.

The statute also specifically defines the classes of persons who may be indemnified. Most statutes provide for indemnification only of a limited group of individuals such as "each officer and each director of the corporation" who incurs certain expenses. Minnesota includes a far wider class of individuals:

[A]ny person who was or is a party or is threatened to be made a party to any threatened, pending, or completed action ... 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 ... These inclusions—especially those of agents and insiders serving at the request of the corporation in any other entity—increase greatly the number of individuals subject to indemnification.

64. See Mooney v. Willys-Overland Motors, Inc., 204 F.2d 888, 896 (3d Cir. 1953); Essential Enterprises Corp. v. Dorsey Corp., 182 A.2d 647, 653 (Del. Ch. 1962).
65. MINN. STAT. § 301.095(6) (MINN. SESS. L. SERV. ch. 983 (1969)).
66. E.g., MICH. STAT. ANN. § 450.10(1) (1967).
67. MINN. STAT. § 301.095(1) (MINN. SESS. L. SERV. ch. 983 (1969)).
69. MINN. STAT. § 301.095(1) (MINN. SESS. L. SERV. ch. 983 (1969)).
With the exception of an independent contractor, it is difficult to conceive of a person whose services ultimately accrue to the corporation who could not be indemnified. In addition, the act provides that indemnification will inure to the benefit of an insider's heirs, executors and administrators.\textsuperscript{70}

There is no need for the individual actually to incur personal expenses before he is eligible for indemnification as is true under other acts.\textsuperscript{71} The Minnesota statute authorizes a corporation to advance expense money to the insider on condition that it be returned if the corporation is not ultimately permitted to indemnify.

The statute also specifies the expenses for which an insider may be indemnified. In third party suits, these costs include "expenses (including attorneys' fees), judgments, fines and amounts paid in settlement." In contrast, the unsuccessful insider in a derivative suit may be reimbursed only for expenses, including attorneys' fees. Other statutes use language such as "expenses actually and reasonably incurred . . ."\textsuperscript{72} While such language could possibly be construed to cover the items specified in the Minnesota statute, they lack the specificity and certainty inherent in the latter provision. Expenses such as fines in other jurisdictions might be subject to attack as unnecessary or not truly an expense.

The Minnesota statute further provides that the individual may be indemnified for a status liability\textsuperscript{73} as long as the act creating the liability was not opposed to the corporation's interests.\textsuperscript{74} Statutes in other states have been interpreted to cover only liabilities which arise from negligent acts or omissions of insiders acting in their capacities as such. These statutes exclude liabilities arising out of personal dealings proscribed because of the insider's position.\textsuperscript{75} Thus, under other statutes, insiders will not be indemnified for liabilities resulting from personal dealings, such as a 16(b) action, even though the liability is incurred solely because of their status as an insider.

\textsuperscript{70} MINN. STAT. § 301.095(6) (Minn. Sess. L. Serv. ch. 983 (1969)).
\textsuperscript{71} E.g., IOWA CODE ANN. § 496A.4(15) (1982).
\textsuperscript{72} E.g., ORE. REV. STAT. § 57.030(15) (1967).
\textsuperscript{73} See Bishop, New Cure For An Old Ailment: Insurance Against Directors and Officers Liability, 22 BUS. LAW 92, 95-96 (1966).
\textsuperscript{74} MINN. STAT. § 301.095(1), (2) (Minn. Sess. L. Serv. ch. 983 (1969)). See generally, S. ARSHT & W. STAPLETON, ANALYSIS OF THE NEW DELAWARE CORPORATION LAW 327 (1967).
\textsuperscript{75} Tomash v. Midwest Tech. Dev. Corp., 281 Minn. 21, 160 N.W.2d 273, 278 (1968) (former Minnesota indemnification statute conferring power to indemnify upon the corporation).
In essence, the Minnesota act permits indemnification in a far broader area than do the statutes of most other states. An insider in a corporation with a permissive indemnification bylaw who has acted in good faith will be indemnified for all expenses except those paid pursuant to a judgment or settlement in a derivative suit.

C. CORPORATE AGREEMENTS FOR INDEMNIFICATION

Some form of contractual provision between the corporation and insiders which sets guidelines for reimbursement of insiders is a prerequisite to indemnification in most states, since the statutes are merely permissive. This provision, whether bylaw, resolution or otherwise, can obligate the corporation to indemnify the insider as long as the standard of conduct that must be followed is in harmony with the statute. The following provision may also be essential in "corporate obligation" states, in that the statute may allow indemnification following affirmative corporate action. Furthermore, with either type of statute, the agreements may be interpreted as conferring broader powers or rights of indemnification under the statute's nonexclusive clause.

Indemnification bylaws are typically modeled after modern, comprehensive statutes. In general their purpose is to require indemnification when a certain standard has been met, to segregate third party and derivative suits, and to deal specifically with settlements. The bylaws usually state that they shall not be exclusive of other rights which an insider may have, presumably under common law or statute.

The basic difference among corporation bylaws is the standard of conduct that must be maintained by the insider prior to the allowance of indemnification by the board or the shareholders. The standards vary from denying indemnification to the insider where he has been finally adjudged liable for negligence or misconduct, to denying indemnification only

---

76. Most obligate the corporation to indemnify for amounts paid in settlement when the corporation is advised by counsel that the insider did not commit a breach of duty—General Motors Corp. Bylaws, quoted in G. Washington & J. Bishop, supra note 28, at 289—or if the stockholders approve—Massachusetts Investors Growth Stock Fund, Inc. Bylaws, copy on file in the office of the Minnesota Law Review.

77. E.g., General Motors Corp. Bylaws, quoted in G. Washington & J. Bishop, supra note 28, at 289.
where the insider's action constituted gross negligence or willful misconduct.  

The basic problem with any corporate agreement to indemnify is uncertainty over the treatment it may receive in the courtroom. It is questionable whether a court will give literal effect to the scheme of indemnification if the bylaw expands the area of permissible indemnification beyond that expressly stated in the statute. In essence, the question concerns the effect that may be given to the nonexclusive clause of a statute.

Few courts have faced the problem of indemnification under a corporate bylaw or board resolution when the insider has unsuccessfully defended a derivative suit, but where the question has been raised the insider has not fared well. In Essential Enterprises Corporation v. Dorsey Corporation, a resolution by the board of directors was not sufficient to allow indemnification in the settlement of a derivative suit. The court held that even if the statute allowed indemnification, it was prohibited by a bylaw because the suit resulted from insiders' failure to perform their duties. Thus, the resolution allowing indemnification could not affect the narrowly drawn bylaw. In Teren v. Howard, the court ignored the nonexclusive clause and disallowed indemnification even though the board of directors had passed a resolution providing therefor. The court simply held that, "the present case falls within the exception provided for in the statute," namely, that there will be no indemnification if the insider has been adjudged liable. A third case, SEC v. Continental Growth Fund, demonstrates the very restrictive effect given to corporate action purporting to broaden the statutory area of indemnification. An insider was adjudged liable due to his negligence in a derivative suit. A charter provision of the corporation allowed indemnification except where the insider had been "adjudged liable because of willful misfeasance, bad faith, gross negligence or reckless disregard of the duties involved in the conduct of his office." The court disallowed indemnification by reading the nonexclusive clause quite restrictively as allowing bylaw but not charter indemnification provisions.

78. E.g., National Steel Corp. Bylaws, quoted in G. Washington & J. Bishop, supra note 28, at 293.
79. See generally Mace, Directors and Officers Liability Insurance, 85 Banking L.J. 39, 43-44 (1968); Bishop, supra note 73, at 99-101.
80. 182 A.2d 647 (Del. Ch. 1962).
81. 322 F.2d 949 (9th Cir. 1963).
82. Id. at 956.
84. Id. at ¶ 94,722.
These cases demonstrate that a corporation cannot circumvent a narrowly drawn statute since the contractual provision must be in harmony with the general statutory scheme. As previously mentioned, indemnification inconsistent with the statute is specifically proscribed in Minnesota. Other acts, that are modeled after Delaware's, will meet the same reception as in the cases noted above even though they contain the widest permissible coverage. Corporate agreements beyond the policy of the statute will not be tolerated, notwithstanding the nonexclusive clause. Thus, amounts paid pursuant to a judgment or settlement of a derivative suit, and possibly expenses incurred in a derivative action, must be borne by the insider.

IV. DIRECTORS' AND OFFICERS' LIABILITY INSURANCE

Some of the risks of loss to the insider and his corporation may be transferred by the purchase of indemnification insurance. The insider purchases this insurance to cover those liabilities which will not be indemnified by the corporation—those risks the corporation will not or cannot indemnify. The corporation purchases the policy to obtain reimbursement for any indemnification actually paid to its insiders. Ideally it seeks coverage for all indemnification expenses imposed on it by statute and assumed by it in its corporate agreements.

A. POWER TO PURCHASE INSURANCE

The Minnesota statute attempts to quash speculation that a corporation cannot legally purchase directors' and officers' liability insurance. Previously, the expenditure of corporate funds on this insurance was said to be ultra vires because the purchase was not for the benefit of the corporation.\(^8\) Insurance companies disputed such allegations by asserting that since the premium was apportioned between the insiders and the corporation at a ratio of one to nine, the corporation was not expending its funds on the insiders' coverage. This division of payment, however, has been challenged by commentators as illusory since the potential liabilities of the insiders are far greater than 10 percent of the policy's overall coverage.\(^8\) Therefore, the corporation is, in fact, buying insurance for the insiders. The statute ends such controversy by specifically empowering the corporation to purchase and maintain insurance on behalf of the insiders.

---

85. Bishop, supra note 73, at 112.
86. Id.
The Minnesota statute, however, unlike the Delaware act, does not allow the corporation to buy insurance covering insiders in areas where the corporation is specifically not permitted to indemnify. This provision stems from a legislative decision that indirect means such as insurance cannot be used to accomplish prohibited corporate indemnity, presumably because insurance might abrogate the deterrent effect of liability. This departure from the Delaware norm is unfortunate, particularly as applied to derivative actions, where liability may result from seemingly innocent yet negligent conduct. Possibly indemnification will be tolerated if the insider continues partial payment, such as 10 percent of the premium. In that way, it might be argued that the corporation is not purchasing the insurance, and therefore, the indemnification will be allowed, notwithstanding the fact that the corporation could not have indemnified the insider directly. However, since this apportionment of the premiums is questionable, an insider may have a difficult time being protected from liabilities outside the scope of liabilities indemnifiable by the corporation.

B. Mechanics of the Policy

While many companies write directors' and officers' liability insurance, there are only two significantly different forms: that used by St. Paul Fire and Marine and that used by the London insurers. The former is the only true American underwriter, since all other American companies reinsure with the London syndicates of Lesley Dew or Huxtable, both members of Lloyd's Underwriters.

89. Interview with Minneapolis Office of Johnson and Higgins, Insurance Brokers, April 2, 1969. Both Dew and Huxtable have variations in their particular form, yet in most respects they are identical. For purposes of this Note the Huxtable London form, used by Stewart, Smith as Form SS-3A & 3B [hereinafter cited as Stewart, Smith] will be the policy used for the basis of analysis. Where there are substantive
The Stewart, Smith policy, written on a London form, has a “bi-policy” format with the main policy divided into two subsidiary policies: (1) the Reimbursement for Directors’ and Officers’ Liability Insurance Policy, and (2) the Directors’ and Officers’ Liability Insurance Policy. The former reimburses the corporation for expenses of indemnification and the latter indemnifies the insider where the corporation has not. The policy covers all present, past or future directors and all holders of certain positions. Coverage inures, where applicable, to the benefit of the estate, heirs or legal representatives of the directors or officers. Newly created positions may be included in the policy on giving notice to the insurer and remitting an additional premium. The two subsidiary policies, although mutually exclusive in their coverage, are complementary. The best example of their interlocking nature is the provision in the directors and officers coverage which excludes from coverage any liability for which the insider has received indemnification from the corporation, thus avoiding payment under both subsidiary policies. The insurers will not write one subsidiary policy without writing its complement, presumably because of an inability to calculate separate premiums.

The policy, although serving to indemnify the corporation and its insiders, is subject to the interpretation that it is in fact a liability policy. Actual payment of the liability is a condition precedent to collecting under an indemnification policy, while under a liability policy, the insured’s liabilities need only be established. The “loss” clause in early policies obligated the insurer to indemnify or reimburse the insured for “any

differences from this form, the other London form of Dew or the St. Paul Fire & Marine form, they will be noted.

90. Hereinafter referred to as “the corporate coverage.”
91. Hereinafter referred to as “the directors’ and officers’ coverage.”
92. The policies differ as to when notice must be given. The Stewart, Smith policy and the policies of Travelers, Liberty Mutual and Employer’s of Wausau provide for notice to the insurer in 120 days; the policies of St. Paul Fire & Marine, American Home and American Employers’ provide 30 days.
93. E.g., Stewart, Smith, Form supra note 89, at SS-3A ¶ 5(h). Other subsidiary policies even make reference to a “companion policy,” e.g., Employer’s of Wausau.
94. See Note, Liability Insurance for Corporate Executives, 80 Harv. L. Rev. 648 n.83 (1967). St. Paul Fire & Marine Ins. Co. has offered customers an individual director’s policy. This policy, however, extends coverage to the director only so long as he does not become chairman of the board or a salaried officer.
95. See generally Note, supra note 94, at 651-53.
payment by the insured," implying the policy was one of indemnification. Since the word "payment" has been deleted in the present directors' and officers' coverage and the policy is by name a liability policy, it would seem that the insured need not make the payment before the policy is operative.

The policy is written for a three-year period, and its cost varies depending on the limit of liability and size of the company. Upon application for coverage, the corporation must supply current information as to the financial condition of the corporation, including an annual report to stockholders, a Dun & Bradstreet Report, and a statement as to the existence of any previous legal difficulties. Combined premiums to the corporation and the insider for coverage from one to 20 million dollars can run from 2,500 to 30,000 dollars a year. As previously stated, the premium is apportioned on a nine to one ratio between the corporation and the insiders. Upon termination of

96. Lesley Dew Form of August 1, 1966 [emphasis added], cited in Note, supra note 94, at 652. See also Employer's of Wausau, supra note 88, at ¶ 2(c) ("the term 'loss' shall mean any payment by an Insured in respect of his legal liability, whether actual or asserted"); Travelers, supra note 88, IID ("loss means any payment made by the" insured); St. Paul Fire & Marine, Conditions ¶ 1 (payment made).

97. Stewart, Smith Form SS-3A, supra note 89, at ¶ 4(c); accord Liberty Mutual ¶ 2(c). The corporate coverage leaves no question that the policy is in the nature of liability insurance: "[L]oss shall mean any amount the Company is required or permitted to pay ... for a claim ... whether actual or asserted ... ." Other policies also seem to be liability policies: in the American Home policy the loss must be one which the insider is "legally obligated to pay;" accord American Employers'.

98. Employer's of Wausau has a conflict between the name of the policy, Directors and Officers Liability Policy—and its wording of the "loss" clause, see note 96 supra. Travelers and St. Paul Fire & Marine, in addition to the verbiage of the "loss" clause implying that the policy is an indemnification policy, also refer to their policies as Corporate Reimbursement Indemnity Policies and Directors and Officers Indemnity Policies, respectively. It seems that these policies will be interpreted as indemnification policies.

99. "No claim, which if insurance had been in force similar to that now proposed, would have fallen within the scope of such insurance has been made . . . ." Proposal for Directors and Officers Liability and Company Liability Insurance, American Employers' Form A1881.


101. As earlier noted, this apportionment has been attacked as illusory on the ground that the insider's compensable liabilities are greater than 10 percent of the total liabilities covered, and the corporation, therefore, is expending its resources on the insider's insurance. Bishop, supra note 94, at 112; see text accompanying note 86 supra. Some companies have attempted to overcome this criticism by selling the subsidiary policies "separately." Though these companies still insist
the policy, an additional year's coverage may be obtained for liabilities arising in that year due to a wrongful act committed previously.

The loss is incurred at the time written notice is given to the insurer stating either that a third party intends to hold the insured responsible for a wrongful act, or that the insured themselves have become aware of an occurrence that might give rise to a future claim. The notice is to be given as soon as practicable, and failure to give notice will act as a waiver of the insured's rights under the policy.

The insider gives up independent control of any lawsuit, since he may neither incur expenses nor settle unilaterally without the consent of the insurer. Such consent, however, cannot be unreasonably withheld. Likewise, while the insured is required to contest legal proceedings upon the advice of mutually selected counsel, the insurer is liable for all costs if it unreasonably forces the insured to contest.

The insurer agrees to pay 95 percent of the incurred loss over the deductible amount, which is usually set at $20,000 for each loss. This amount serves both as a cushion protecting the underwriter from small claims and as a deterrent to liability-producing conduct. It is deductible for each loss, and thus it might be possible to have the deductible amount subtracted twice from on selling both subsidiary policies, they write physically separate policies. See note 91 supra. See also Brook, Officers and Directors Liability Insurance, 2 The Forum 229, 235 (1967). Much comment has been devoted to other public policy considerations, especially to the question of whether indemnification will remove the deterrent effect of liability on improper conduct. See generally Bishop, Sitting Ducks and Decoy Ducks: New Trends in the Indemnification of Corporate Directors and Officers, 77 Yale L.J. 1078 (1968); Note, supra note 94; Note, Public Policy and Directors' Liability Insurance, 57 Colum. L. Rev. 716 (1957); Bishop, supra note 73.

102. The St. Paul Fire & Marine policy, supra note 89, at ¶ 7 requires notice "[i]n the event of any occurrence likely to involve the indemnity provided under this Policy . . . ."

103. An insider may have various reasons for controlling or settling a suit, whereas the underwriter is concerned only with the financial aspect. Thus, relinquishing the decision to settle might be detrimental to the insider. He may be forced to settle at times when he desires to vindicate his name. Likewise, in cases where the insider may desire to settle to avoid adverse publicity, he relinquishes this right if independent counsel feels that the claim should be contested.

104. The St. Paul Fire & Marine policy does not include the condition of reasonableness.

the limit of liability for two unrelated losses in the same year.
In addition, five percent of the liability above the deductible
amount is paid by the insured. This amount also is designed to
deter the insider from conduct which might produce liability.

C. THE EXTENT OF THE DIRECTORS' AND OFFICERS' COVERAGE

1. The Breadth of the Coverage

The policy purports to indemnify directors and officers for
"loss" arising out of any "wrongful act" committed by them.
The definition of those terms is the key to the breadth of the cov-
erage. "Loss" is defined as

any amount an [insider] is obligated to pay in respect of his
legal liability, whether actual or asserted, for a wrongful act . . .
and . . . shall include damages, judgments, settlements, and
expenses incurred in the defense of actions, suits, or proceedings
and appeals therefrom; provided always that such subject of
loss shall not include fines or penalties imposed by law, or
other matters which may be deemed uninsurable under the law
pursuant to which this policy shall be construed.106

One question immediately apparent is whether coverage
could be limited by interpreting the term "penalties" to include
punitive damages. In the majority of states, punitive damages
serve as a penalty107 but in others they are viewed as compen-
satory.108 The literal meaning of the phrase "penalties im-
posed by law" is subject to the valid interpretation that punitive
damages are a penalty imposed by law and thus, excluded from
coverage.

Treble damages might also be excluded because of their
 punitive nature. The purpose of treble damages also varies
among jurisdictions. In some jurisdictions, treble damages are
thought to compensate the plaintiff for damages which cannot
be reasonably calculated.109 Other jurisdictions regard them as
an inducement to provide those who have been wronged with
the incentive to sue.110 Still others believe that treble damages

106. Stewart, Smith Form SS-3A, supra note 89, at ¶ 4(c).
107. See, e.g., Motor Equip. Co. v. McLaughlin, 156 Kan. 258, 274,
133 P.2d 149 (1943).
108. Connecticut, Michigan and New Hampshire do not view puni-
tive damages as a penalty. See, e.g., Doroszka v. Lavine, 111 Conn.
575, 577-78, 150 A. 692, 692-93 (1930).
109. See Vold, Are Threefold Damages Under the Anti-Trust Act
Penal or Compensatory?, 28 Ky. L.J. 117 (1940).
110. See, e.g., Julius M. Ames Co. v. Bostitch, Inc., 240 F. Supp. 521,
525 (S.D.N.Y. 1965).
are punitive in nature, deterring certain types of conduct.\[^{111}\] In the latter type of jurisdiction, treble damages will probably be termed a "penalty imposed by law," and thus not covered by the policy.

Expenses in defense of an action seem to be covered by the policy even where a criminal sanction or other penalty is imposed. The allowance of a tax deduction for expenses incurred in defense of a criminal suit\[^{112}\] provides an analogy for the proposition that the expenses of an unsuccessful defense are not a penalty. Public policy is not offended by their deduction since they arise from an individual's constitutional right to be represented by counsel.\[^{113}\] They should not be treated as a penalty merely because other penalties may be imposed in the litigation.

Even if attorney's fees for an unsuccessful criminal defense are not considered penalties, those fees, as well as other expenses incurred in an action based on dishonesty, may be disallowed under another provision excluding any claim brought about or contributed to by the dishonesty of \[\text{[the insured]}\]; however, notwithstanding the foregoing \[\text{[the insured]}\] shall be protected under the terms of this policy as to any claim upon which suit may be brought against \[\text{[the insured]}\], by reason of any alleged dishonesty on the part of \[\text{[the insured]}\], unless a judgment or other final adjudication thereof adverse to \[\text{[the insured]}\] shall establish that acts of active and deliberate dishonesty committed by \[\text{[the insured]}\] with actual dishonest purpose and intent were material to the cause of action so adjudicated.\[^{114}\]

This exclusion becomes operative only when the "appropriate" dishonesty is material to a "judgment or other final adjudication adverse to" the insider. It is not apparent from the exclusion what "other final adjudication adverse to" the insider means. It might possibly refer to a disposition other than judgment, such as dismissal with prejudice, yet it is difficult to conceive of a dismissal wherein the dishonesty would be material. It might also refer to a judgment against the insider in a suit to compel indemnification from the corporation. The exclusion, however, cannot be invoked without "acts of active and deliberate dishonesty committed . . . with actual dishonest purpose and intent." The unsuccessful insider is thus covered if there is merely an allegation of dishonesty. Presumably, this exclusion would

\[^{113}\] Id. at 690-91.
\[^{114}\] Stewart, Smith Form 33A, supra note 89, at ¶ 5(e).
deny coverage for any criminal liability and accompanying expense, except where there was no criminal intent. 115

2. Coverage of Status Liabilities

The "wrongful act" clause, unlike the "loss" clause restricting the insider's coverage, seems to create an ambiguity that may increase coverage. The insuring clause binds the insurer to reimburse any "loss" incurred by reason of a "wrongful act" of the officer or director while acting in his capacity as an insider, that is, by reason of what he does. A "wrongful act" is any actual or alleged error or misstatement or misleading statement or act or omission or neglect or breach of duty by the [insiders] while acting in their individual or collective capacities or any matter . . . claimed against them solely by reason of their being Directors or Officers of the Company. 116

The last portion of this clause provides that an insurable "wrongful act" can be one claimed against the insider solely because of his capacity as an insider. In particular, this language expressly states that the insider can be indemnified for liabilities imposed because of status, that is, because of what he is. 117

This conflict over whether the policy includes coverage of liabilities incurred solely because of status in addition to coverage of wrongful acts while acting in the capacity of an insider will probably be resolved in favor of the insured. The usual insurance policy is written with a broad insuring clause or coverage clause that is limited by subsequent conditions and exclusions. Courts readily give effect to the exclusions "which reduce the risk otherwise assumed under the insuring clause." 118 There seems to be no reason why the opposite should not be true: courts should give effect to the conditions that have the effect of expanding the coverage, especially when there is an ambiguity in the insuring clause. Since insurance contracts are construed strictly against the insurer, 119 it is probable that status liability will be covered by the policy. 120

115. Those lacking criminal intent would not be covered because of the limitation in the scope of the "loss" clause wherein criminal penalties are excluded from coverage.


117. See text accompanying note 22 supra.


120. The St. Paul Fire & Marine policy is not subject to this interpretation. There is no provision that would extend coverage to
Under certain circumstances, however, status liability will be excluded from coverage by specific exclusions. Liabilities arising under rule 10b-5 of the Securities Exchange Act of 1934\textsuperscript{121} may be denied coverage through the “personal profit exclusion,”\textsuperscript{122} which operates to deny indemnification for claims arising from liability where the insider gains a personal, and thus illegal, profit.\textsuperscript{123} In the absence of personal profit, however, indemnification would not be barred even though the insider is found liable for a violation of rule 10b-5.\textsuperscript{124}

The policy explicitly excludes any claim for an accounting of the profits resulting from a short-swing transaction under section 16(b) of the 1934 Act.\textsuperscript{125} Presumably, the expenses of a successful defense to a 16(b) action are indemnifiable if the policy is interpreted to cover status liabilities.\textsuperscript{126}

3. Unsuccessful Defenses to Derivative Suits

The insider would greatly benefit from comprehensive coverage of liability arising from derivative suits since this is the one area where the insider can receive little indemnification directly from the corporation. If he is unsuccessful in his defense,
he will never receive the amount of the judgment. The most that he can receive is expenses, including permitted attorney's fees, but then only when he is fairly and equitably deserving thereof. He would be understandably eager to obtain insurance which would indemnify him for amounts paid pursuant to a settlement or judgment.

The policy excludes any claim "based upon or attributable to [the insider's] gaining in fact any personal profit to which he is not legally entitled." Since virtually every derivative suit contains an allegation of self-dealing or personal gain, this exclusion would have a devastating effect on the insider if his unsuccessful defense would be considered as conclusive on the issue of personal profit. While an unsuccessful defense might generally imply personal profit, this is not always so. The real thrust of the action, for example, may be negligence, not self-dealing. The insurer can invoke the exclusion where self-dealing has been alleged because, unlike other exclusions, there is no requirement that a court determine applicability prior to the exclusion's operation. If the insurer invokes this exclusion whenever the complaint alleges self-dealing, the insider will find his coverage in derivative suits greatly limited.

The exclusion would also limit coverage in settlements of derivative actions as well as where judgment has been rendered. A settlement, even under the authority of the court, does not attest that the gain was illegal, but the insurer may urge such a conclusion as a basis for denial of indemnification.

Coverage of liabilities arising from a derivative suit is further limited by the exclusion of claims based on the return by the [insider] of any remuneration paid to [him] without the previous approval of the stockholders of the Company which payment without such previous approval shall be held by the Courts to have been illegal. This exclusion is narrower than that of "gaining in fact any personal profit" since it refers solely to the area of compensation. It is further restricted by the requirement that the compensation be found illegal by a court.

127. Stewart, Smith Form SS-3A, supra note 89, at ¶ 5(b).
128. E.g., Stewart, Smith Form SS-3A, supra note 89, at ¶ 5(c):
"... shall be held by the courts to have been illegal."
129. Id.
4. Material Misstatement Liability

Liabilities are imposed under section 11 of the Securities Exchange Act of 1933 for fraudulent misrepresentation or nondisclosure of material facts. The act may be one of active dishonesty or passive reliance upon a fellow insider's word. If the former, and if the dishonesty was material to the adjudication of liability, the dishonesty exclusion would bar coverage. In all other cases of section 11 liability, the insider would likely be indemnified under the policy. Even if passive reliance were considered dishonest, rather than negligent, conduct, it would not be considered active or deliberate dishonesty.

D. The Extent of Corporate Reimbursement Coverage

The problems of indefinite coverage of fines and penalties and questionable coverage of status liabilities that were present with the directors' and officers' coverage are also present with the companion reimbursement policy. The latter, however, does not have the former's extensive exclusions that would reduce its overall coverage.

The reimbursement policy is more restrictive in its coverage than existing corporate indemnification laws. Only indemnification of directors and officers is covered, while the class of individuals who may be indemnified, at least under the Minnesota statute, is far wider. Thus, a corporation may be bound to indemnify a larger class of insiders than that covered by the policy. In all probability, since the insurer will accept the risk of a newly created position, the insurer would include in the coverage specifically enumerated employees and agents. But obviously the corporation cannot secure coverage of an employee or agent after its liability to indemnify that employee or agent has been fixed. In such situations the corporation might find itself without insurance.

Notwithstanding the fact that the coverage inures to a smaller group of insiders, the reimbursement policy quite ade-

133. This is particularly true in light of the seemingly mild reprimand received by the defendants in BarChris, supra note 132, for activities which appeared rather deliberate.  
134. See text accompanying note 68 supra.
quately covers the corporation for indemnity payments made to directors and officers. Its basic inadequacy is the failure to include fines and penalties. As previously stated, fines and penalties are indemnifiable under the Minnesota statute if the insider meets the appropriate standard of conduct.\textsuperscript{135} Except for one company’s policy, fines and penalties are not covered by the insurance.\textsuperscript{136}

V. CONCLUSION

The primary issue in the desirability of indemnification insurance is the extent to which the policy increases the insider’s security over that afforded by the corporation’s bylaw. The first step in this inquiry is the determination of the validity and extent of the corporation’s bylaw. The more limited the bylaw, the greater the need for insurance. In addition, certain liabilities, such as those incurred in settlement of a derivative action, are statutorily prohibited from being indemnified by the corporation. Possible protection against the liabilities involved in the unsuccessful defense of a derivative suit may well be the motivating force behind the purchase of insurance. In states other than Minnesota, these liabilities seem to be reimbursable. It should be remembered that the Minnesota statute prescribes their coverage where the insurance is maintained by the corporation since the insurer cannot indemnify where the corporation is powerless to do so. But even elsewhere, this coverage may be circumvented by allegations of self-dealing.

From the corporation’s viewpoint, the insurance would cover most of the liabilities for which the corporation could indemnify the insider. The numerous exceptions in the directors’ and officers’ coverage are not present in the companion reimbursement policy. Except for the fact that the coverage inures to a smaller group of insiders and fines and penalties are not covered, the total spectrum of the corporation’s exposure is covered. In the final determination, whether a corporation should buy this insurance will depend upon its size. A large corporation may choose to be a self-insurer whereas a smaller corporation might desire to insure rather than be forced out of business by a large uninsured mandatory indemnification. However, the smaller the corporation, the less likely it will be to carry costly insurance,

\textsuperscript{135} See text accompanying note 72 supra.

\textsuperscript{136} St. Paul Fire & Marine extends the corporation’s coverage to any loss it may be required or permitted to pay, thus including fines and penalties.
since the premiums, taken together with the deductible and five percent liability amounts, might produce insolvency just as readily as the impact of the direct liability.

The companion insurance policies have many inadequacies and ambiguities. The directors' and officers' liability policy, in particular, suffers from far-reaching and ambiguous exclusions. In light of this inadequate and uncertain coverage, it is difficult to judge its exact value with any degree of accuracy. Obviously, a great many liabilities are covered, especially those resulting from a negligent act of the insider. Perhaps this coverage of negligent acts alone is enough to justify the purchase of insurance. In addition, the certainty of indemnification may appeal to the insider when the solvency of the corporation is questionable or the corporate bylaw conditions indemnification on the approval of the board. Yet it would be wrong for either the corporation or the insider to treat the purchase of the insurance as a complete funding of liability each must meet. In addition, the purchase of the insurance for the benefit of the insider by a large Minnesota corporation operating under a bylaw coextensive with the statute would be of no additional benefit to the insider, since the insider would be unable to receive coverage greater than that afforded by the bylaw.