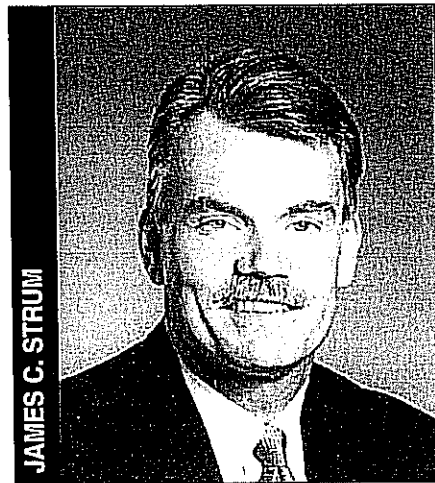


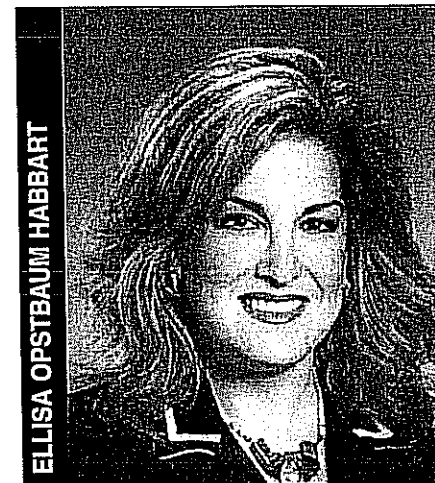
# Indemnification under Delaware law

By James C. Strum, Esq. and Ellisa Opstbaum Habbart, Esq.

*James C. Strum and Ellisa Opstbaum Habbart, of The Delaware Counsel Group, LLP, routinely advise Delaware corporations and alternative business entities in connection with the formation, operation and governance issues under Delaware law. The authors can be reached at (302) 576-9600 or at [jstrum@delawarecounselgroup.com](mailto:jstrum@delawarecounselgroup.com) and [ehabbart@delawarecounselgroup.com](mailto:ehabbart@delawarecounselgroup.com). The authors would like to thank Samuel C. Fiechter for his assistance with this article. For more information about the firm, please visit [www.delawarecounselgroup.com](http://www.delawarecounselgroup.com).*



JAMES C. STRUM



ELLISA OPSTBAUM HABBART

**I**ndemnification and advancement can be used by companies to attract qualified candidates to their boards. Companies offer these benefits in an effort to provide assurance to potential directors and officers that they will not be, assuming they do not act in contravention of law, financially at-risk for their service. The following article touches on these two concepts generally and how companies can determine their needs in this area.

A Delaware corporation may indemnify its directors and officers, and can decide to extend such a benefit to employees and agents, in connection with legal proceedings brought against or otherwise involving such individuals based on their service to the corporation. A corporation also may provide advancement of expenses, including attorneys' fees, to these individuals relating to such proceedings. This can be a particularly attractive benefit because it allows for the payment of

expenses as the legal proceedings are in progress rather than at the conclusion. Thus, a director or officer who has been sued in his or her corporate capacity does not need to "front" the legal expenses. The corporation will bear that cost throughout the litigation or proceeding.

Because the compliance role often involves getting into the line-of-fire on matters of corporate misconduct, there is the inherent risk of becoming tangled into litigation and government investigations. When

*Continued on page 40*

good intentions: to continue building the organization and to continue providing jobs for employees. But the slope is slippery from there. What often begins as a one-person effort eventually involves many. A corporate compliance program, seriously initiated, implemented and maintained, is the only way to ensure that nascent fraud does not begin and spread throughout an organization. Once that happens, the only option often available for an otherwise honest organization without a corporate compliance program is to confess or otherwise self-disclose the matter. The organization must seriously consider approaching the OIG before it and/or the Justice Department approaches the organization. ■

Reprinted with the permission of New Jersey Lawyer ©, February 21, 2005.

## Call for Authors

SCCE seeks authors for upcoming issues of **Compliance & Ethics**. We welcome all who wish to propose corporate compliance-related topics and write articles. Among the topics to consider are: the Sarbanes-Oxley Act, enterprise risk management, corporate responsibility, corporate governance, professional liability, audit accounting, legal industry reforms, ethically responsible corporate behaviors, and responsibility in organizations. Articles when the topic allows, should include "how-to" tips. Articles generally run between 1,250 and 2,500 words, but are not limited to this.

If you are interested in submitting articles, please contact Marlene Robinson at:

[marlene.robinson@corporatecompliance.org](mailto:marlene.robinson@corporatecompliance.org)

888-277-4977  
952-933-4977 (direct)

---

## Indemnification under Delaware law...continued from page 35

drafting the provisions for indemnification and advancement whether in the certificate or by-laws, a company should consider defining the meaning of "officer" to include compliance officers. Many companies in today's regulatory environment will have a Chief Compliance Officer or similar position(s) and will want to offer such person(s) protection.

### **Is indemnification currently addressed in the corporation's governing documents?**

#### **Is indemnification addressed in the certificate of incorporation?**

Indemnification may be addressed in a corporation's certificate of incorporation. While not required, a number of companies, including public companies, have chosen this approach. The practical result of addressing indemnification in the certificate of incorporation is that it is more

difficult for shareholders, as well as directors, to modify the indemnification rights once set forth in the certificate. Such a substantive amendment to the certificate of incorporation requires a resolution of the board of directors of the corporation, and/or a vote of shareholders. Thus, it is an advantage to the indemnified persons, assuming the indemnification rights are broad and satisfactory, for the certificate to include an indemnification provision.

A corporation may want to address indemnification in its by-laws, rather than the certificate of incorporation, which is a public document accessible through the Delaware Secretary of State's Office.

#### **What if indemnification is addressed only in the by-laws?**

If indemnification is not addressed in the certificate, it may be addressed in the corporation's by-laws. The practical difference

between these two approaches is that the board of directors can typically amend the by-laws without a shareholder vote, if such power is given to it in the certificate. Thus, if the board of directors decides to modify the indemnification terms set forth in the by-laws, at a later date, it may do so promptly by resolution.

### **Indemnification options**

The following are some features relating to indemnification that can be included in a governing document. Based on how the document is written, there may be substantial differences in whether a director, officer or employee may be entitled to indemnification, when they will be entitled to it, and who will decide if they are indemnified.

### **Permissive or mandatory**

Delaware law provides "the power" to

*Continued on page 42*

indemnify. Greater protection for directors and officers may be made available by making certain indemnification and indemnification related rights mandatory, by removing the discretion of the board of directors to determine whether to provide for indemnification in a particular instance. The certificate of incorporation or by-laws may provide for mandatory indemnification of directors and officers. This protection may be extended to employees and agents. When it is not extended, the board of directors retains the power to indemnify employees and agents, even if a provision in the certificate or by-laws provides for mandatory indemnification only for directors and officers.

Note that "mandatory" indemnification, while removing the discretion of the Board to refuse to provide for indemnification in some instances, does not eliminate the requirement that the actions of the person in question be in good faith and in the interests of the corporation, or that the expenses be reasonable, in the case of advancement.

#### **Advancement of expenses and legal fees**

Expenses may be advanced to a director, officer, employee or agent: prior to a final determination that indemnification is justified, provided the indemnified person agrees to repay the corporation if it is later determined that indemnification was not warranted. Advancement, like indemnification, may also be made mandatory in the certificate or by-laws.

#### **"Fees for fees"**

The certificate of incorporation and by-laws may also include a provision that attorney fees will be paid to indemnified persons who must litigate to obtain

indemnification or advancement following a refusal or delay by the corporation in doing so.

#### **What is recommended?**

It is recommended that the following factors be considered when drafting or amending an indemnification provision:

- ❑ Is the amendment to indemnification rights designed to provide greater rights to directors and officers, or employees and agents?
- ❑ How will shareholders react to amendments to the certificate of incorporation if an amendment makes indemnification and advancement more director and officer friendly?
- ❑ Is an initial certificate being drafted? If so, is it desirable to retain greater flexibility to make future amendments to indemnification rights and obligations?
- ❑ Are indemnification and advancement rights crucial in attracting skilled individuals to serve on the corporation's board of directors or as officers?

Regardless of the answers to these questions, during the drafting of an initial certificate of incorporation, or if the corporation is in the process of presenting an amended certificate to the shareholders for consideration, it is recommended that including indemnification rights in the certificate be considered.

Providing for mandatory indemnification and advancement has been the approach most companies, particularly public companies have chosen to adopt. Extension of these benefits to employees or agents may only be desirable if such coverage is necessary to attract competent senior employees.

The certificate of incorporation or by-laws should expressly provide, if it is so desired, that an indemnified person be reimbursed for attorneys' fees incurred in seeking indemnification or advancement, if such person is successful in their efforts. If the corporation does not want to be responsible for indemnifying for or advancing "fees for fees", it should expressly exclude such in its certificate or by-laws.

To defray the costs of defending against litigation and the corresponding costs of indemnification and advancement, Delaware Law provides that companies may, and many do, purchase director and officer insurance. Companies should therefore include a provision in their indemnification section providing for the purchase of insurance. Note: however, such insurance policies typically include various exclusions which may be invoked by an insurance company as a basis for refusing to pay for indemnification and advancement in certain circumstances. ❑

**SOCIOBIS**  
**MISSION**

*SCCE exists to champion ethical practice and compliance standards in the corporate community and to provide the necessary resources for compliance professionals and others who share these principles.*