

Business Organizations Bulletin

Protecting Personal Assets of Officers and Directors

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Litigation poses obvious risks to an officer or director whose corporation does not have a comprehensive plan to protect their personal assets. To significantly limit personal exposure, officers and directors contemplating such transactions are advised to adopt certain corporate charter and by-law provisions that mandate indemnification; enter into a separate indemnification agreement with the corporation; and require that the corporation maintain general director's and officer's liability insurance (D&O).

Certificate of Incorporation and By-Laws

Many states allow corporations to provide some level of indemnification to officers and directors. For example, for those officers and directors of Delaware corporations acting in good faith and in the interest of the corporation, indemnification is sometimes mandatory, but most often only permissive. While the Delaware General Corporation Law explicitly requires indemnification for officers and directors who are "successful on the merits or otherwise,"¹ a corporation has the right to determine whether or not it should be required to provide indemnification or the advancement of legal expenses as articulated in its certificate of incorporation and by-laws.

An officer or director is best sheltered when such provisions require mandatory protection.

Most troubling to officers and directors is the prospect that the right to indemnification under a corporation's charter documents might be unilaterally revoked by the corporation after they have left the corporation.² While Delaware corporations can prohibit revocation³, the issue remains unresolved in many states.

Regardless of the jurisdiction of incorporation, indemnification and protection from revocation can be procured by an officer or director in a separate agreement with the corporation.

Indemnification Agreement

Indemnification agreements made between officers or directors and a corporation complement the protections offered by a corporation under its certificate of incorporation and by-laws. Officers and directors should seek language that protects them in connection with a broad range of proceedings, including investigations by a governmental agency such as the Securities and Exchange Commission or the Department of Justice, and provides for the advancement of all legal costs on a strict timeline.

A comprehensive agreement should also require that the corporation maintains a D&O policy with a reputable insurance carrier that names the officer or director as an insured. An officer or director should demand that such a policy remain in force for a period of years after insolvency or a change in control. Unlike charter documents, an indemnification agreement cannot be modified unilaterally, which should give comfort to officers and directors of corporations incorporated outside of the State of Delaware who have an indemnification agreement in place.

Directors and Officers Insurance

For both private and public corporations, a D&O policy will provide insurance coverage for allegations of misconduct against a corporation's directors and officers. Private corporation claims typically come from shareholders, customers or a corporation's own employees who bring claims relating to employment practice matters such as discrimination or wrongful termination.

The most significant claims against public entities are from shareholders alleging a failure to disclose material facts or misleading the public. To protect against this increased exposure, public corporation D&O insurance offers three main coverage parts, commonly referred to as Side A, B and C. Side A coverage protects the officer or director against claims

for which a corporation provides no indemnification or when the corporation cannot provide indemnification (like a bankruptcy). Under Side B, a corporation is reimbursed in connection with claims against an officer or director for which a corporation provided indemnification. Side C coverage protects the corporation against some securities claims made pursuant to federal statutes regulating securities.

The D&O marketplace is currently experiencing a soft market cycle that favors buyers who are finding more leverage in negotiating protective terms and conditions. To achieve maximum insurance coverage, a buyer should obtain a policy that is non-rescindable, provides limited exclusions, broadly defines the types of claims and losses covered, and contains severability language preventing the actions of any guilty party from precluding coverage for innocent insureds. However, if a comprehensive policy is too costly, then officers and directors should, at minimum, evaluate the prospect of purchasing Side A-only coverage protecting the individual director and officers from non-indemnifiable loss.

1. Delaware General Corporation Law (DCGL) §145(c)
2. The Court in *Schoon v. Troy*, 948 A.2d 1157 (Del. Ch. 2008) permitted revocation of indemnification absent explicit statutory guidance to the contrary.
3. The amendment in DCGL §145(f) was adopted in response to *Schoon*.



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