

# POTTER ANDERSON & CORROON

BLAINE T. PHILLIPS  
JOSEPH H. GEOGHEGAN  
RICHARD L. McMAHON  
WILLIAM T. OUILLEN  
CHARLES S. CROMPTON, JR.  
ROBERT K. PAYSON  
LEONARD S. TOGMAN  
RICHARD E. POOLE  
MICHAEL D. GOLDMAN  
JAMES F. BURNETT  
PETER M. SIEGLAFF  
DAVID A. ANDERSON  
DANIEL F. WOLCOTT, JR.  
DAVID J. GARRETT  
CHARLES S. McDOWELL  
DAVID B. BROWN  
SOMERS S. PRICE, JR.  
DANIEL F. LINDLEY  
DONALD J. WOLFE, JR.  
GREGORY A. INSKIP  
DAVID B. STRATTON  
DAVID J. BALDWIN

DELAWARE TRUST BUILDING  
P. O. BOX 951  
WILMINGTON, DELAWARE 19899  
(302) 658-6771  
TELECOPIER (302) 658-1192  
CABLE: WARDGRAY

ROBERT P. BARNETT  
COUNSEL

DAVID F. ANDERSON  
WILLIAM POOLE  
JOHN P. SINCLAIR  
HUGH CORROON  
OF COUNSEL

FREDERICK H. ALTERGOTT  
JOHN E. JAMES  
W. HARDING DRANE, JR.  
MARY E. URANN  
W. LAIRD STABLER, III  
RICHARD L. HORWITZ  
WILLIAM J. MARSDEN, JR.  
GORDON W. STEWART  
MICHAEL B. TUMAS  
THOMAS R. PULSIFER  
KENT A. JORDAN  
KATHLEEN T. FUREY  
LAURIE A. SELBER

## MEMORANDUM

**TO:** R. Franklin Balotti                      Edward B. Maxwell, II  
Lewis S. Black                              Edward M. McNally  
Donald A. Bussard                         Joseph A. Rosenthal  
Michael D. Goldman                        John H. Small  
Stephen P. Lamb                            A. Gilchrist Sparks, III

**FROM:** David B. Brown *DBB*

**DATE:** April 8, 1986

**RE:** Corporation Law Section Council Meeting  
Friday, April 11, 1986 -- 3:30 P.M.

---

Attached are proposed minutes for the Council meetings of February 24, 1986 and March 10, 1986 mentioned in Item 3 of the Agenda for the meeting to be held this Friday, April 11, at 3:30 P.M. in Morris, Nichols' 16th Floor Conference Room.

DBB/jf

Attachments

**MINUTES OF MEETING OF  
COUNCIL OF CORPORATION LAW SECTION OF  
DELAWARE STATE BAR ASSOCIATION**

**February 24, 1986**

Present at the meeting were A. Gilchrist Sparks, III (Chairman), Edward M. McNally (Vice Chairman), John H. Small, Joseph A. Rosenthal, R. Franklin Balotti and Edward B. Maxwell, 2nd. Also attending by invitation were Edward P. Welch and John F. Johnston (members of the indemnification subcommittee) and E. Norman Veasey.

The special purpose of the meeting was to review the draft report submitted by John Small's subcommittee on indemnification which had been appointed to make suggested revisions to Section 145 in light of the critical situation nationwide in connection with the lack of availability of coverage for directors and officers liability insurance. Mr. Sparks advised the members present as to his current information. In summary, he advised the group that formerly there were ten carriers which wrote this type of insurance but three of those are no longer writing this insurance and the seven remaining that are writing policies have drastically reduced the coverage available and some will only write excess insurance. In summary, Mr. Sparks advised those present that there is very little coverage available and what is available is riddled with exclusions and that whole classes of corporations, such as financial institutions, cannot obtain director and officer liability coverage at

all. No significant change is expected during 1986, and it is predicted that in 1987 the situation will either become worse or, at best, may improve only modestly, and only if new insurers enter the market. Mr. Sparks also advised the Council that Delaware is not the only state taking a hard look at its indemnification statute, and that there recently has been some publicity regarding the inability of outside directors to serve on boards because of this insurance situation.

Mr. Rosenthal raised the issue as to the purpose for the recommended changes in the statute and questioned whether we are attempting to do things that will cause insurance companies to insure Delaware corporations. Mr. Sparks responded that the cause of the present situation has more to do with the decline in interest rates and the general economic situation in the insurance industry than any problem with substantive law and that it is our objective to try to relieve some of the pressures which are currently inhibiting outside directors in particular from serving on boards of Delaware corporations by reason of the situation in the insurance industry. In other words, it is not anticipated that directors will become more "insurable" as a result of any of the contemplated changes in our indemnification statute.

The committee first considered a letter from Mr. Johnston and Mr. Small dated February 24, 1986 relative

to a new subsection (j) to Section 145. The suggestion in that letter was tentatively adopted.

With respect to the draft report of the subcommittee forwarded to the members of the Council by John Small's letter dated February 21, 1986, the following was decided, subject in each case to further review:

1. The suggested revision to subsection (d) of Section 145 would not be adopted since it was uncertain whether the changes recommended would be needed in light of other contemplated changes. Also, the suggested changes raised a question as to whether they would cause more mandatory indemnification than was intended and also whether the suggested changes could open up certain areas of abuse as, for example, all directors seeking indemnification and then the board simply doing nothing with respect to it, with the result being that indemnification must be made even if the required standards are not met.

2. It was determined to adopt the suggested changes to subsection (e) as set forth in the subcommittee's draft report. The Council determined not to make any changes at this time with respect to the situation where the entire board of directors is sued.

3. The discussion of changes to subsection (f) focused upon a proposed amendment headed "2/24/86 Draft" which was designed to make some changes in the beginning paragraph of the proposed amendment to subsection (f) submit-

ted with the draft report of the subcommittee. It was determined that the draft of the proposed amendment would be changed so as to provide, in the second sentence, as follows:

"... provided that no such by-law, agreement or resolution shall permit indemnification of any person for the results of such person's willful or intentional misconduct, other misconduct to the extent such conduct results in improper personal benefit to such person, or acts or omissions by such person not in good faith, and provided further such other rights to indemnification are...."

The reference to "willful or intentional misconduct" is intended to refer to acts of disloyalty and the provision as to "improper personal benefit" is intended to forbid indemnification only to the extent of such benefit. Thus, if a director is merely negligent or grossly negligent and there is no personal benefit involved, this revision to subsection (f) would permit the corporation to contract or have a by-law giving such director indemnification under the circumstances as set forth in the remainder of the proposed subsection (f).

Continuing with the draft of the proposed amendment to subsection (f) and in particular subsection (i), the draft provision states that a by-law, if not an original by-law, must be adopted by a majority of the outstanding stock entitled to vote thereon, and it was determined that the subcommittee would draft appropriate language so as to assure that the approval of a majority of disinterested

stockholders would be necessary for approval. Subsection (ii) provides that indemnification may be contained "in an agreement" with the thought that any such "agreement" must be supported by some benefit to the corporation as in stock option cases, etc. However, subsection (ii) was not adopted because of a concern that a committee of directors could effectively moot a pending derivative action under this provision.

4. With respect to subsection (g) the suggestion was made that the following language should be added to that subsection:

"In the absence of actual fraud, the judgment of the directors as to the terms and conditions of such insurance, as well as the identity of the insurer (the stock of which may be owned in whole or in part by the corporation), as set forth in the resolution or resolutions of the board of directors providing for the purchase and maintenance of such insurance, shall be conclusive."

Due to a concern that this language could be used to justify captive insurance programs even where director and officer liability insurance were otherwise available at reasonable premiums from outside sources, and due to the lateness of the hour, the subcommittee was requested to reconsider the concept quoted above but with the addition of adequate safeguards against abuse in this area.

The chairman requested that the subcommittee do its redrafting and also draft legislative comments as well

as general comments regarding the operation and intent of these proposed amendments by March 10, at which time the Council will meet again to review the proposed amendments.

The meeting was adjourned at approximately 6:45 p.m.

---

Edward B. Maxwell, 2nd  
Acting Secretary

3/31/86

**MINUTES OF MEETING OF COUNCIL  
OF CORPORATION LAW SECTION OF  
DELAWARE STATE BAR ASSOCIATION**

**MARCH 10, 1986**

A meeting of the Council of the Corporation Law Section was held on March 10, 1986 at 4:00 P.M. in the offices of Morris, Nichols, Arsht & Tunnell. Council members present were: A. Gilchrist Sparks, III, Stephen P. Lamb, Edward M. McNally, Donald A. Bussard, Lewis S. Black, Joseph A. Rosenthal, David B. Brown, Michael D. Goldman and John H. Small. Also in attendance were John F. Johnston and E. Norman Veasey.

The Chairman, Mr. Sparks, began the meeting by distributing additional materials on D & O insurance and indemnification. The entire meeting was devoted to discussing possible amendments to the provisions in Section 145 regarding D & O insurance and indemnification. Mr. Sparks stated that further study has made it apparent to him that resolution of the D & O problem is an extremely difficult task and has created doubts in his mind concerning the proper legislative response. He noted that most proposals to change the provisions on D & O insurance or indemnification are, in reality, changes in the substantive law on director liability.



There was extensive discussion of the pros and cons of placing a maximum limit (a "cap") on a director's liability for breach of his duty of care. Mr. Sparks stated, without dissent, that there should be no cap on a director's breach of his duty of loyalty. A wide range of opinion was expressed regarding the need for a cap. Mr. Lamb expressed the view that damage actions for breach of a director's duty of care should be eliminated altogether. Mr. Rosenthal expressed the view that imposition of a cap on liability effects a change in substantive law which should not be made, at least not without extensive deliberation over time. Most Council members present expressed support for the concept of a cap, at least with respect to the liability of outside directors.

Mr. McNally argued that a cap is desirable because it would bring D & O insurers back into the market by limiting the potential amount of claims against insurers. Mr. Rosenthal expressed the view that the scarcity of D & O insurance is attributable more to insurance industry problems than to actual claim experience with respect to Delaware corporations. Mr. Black stated that a cap in the appropriate amount achieves rough justice by protecting plaintiffs yet permitting Delaware corporations to retain and attract the best and brightest directors. It was noted that Martin Lipton is pushing for adoption under New York law of a cap equal to the higher of \$100,000 or the amount of benefit

received by the directors. If this is adopted, it was pointed out, it may offer a significant advantage to incorporation in New York since the cap would draw D & O insurers back into the market and reduce rates. Thus, it was argued, Delaware may need a cap to maintain its competitive edge.

The concerns expressed about a cap were as follows: There may be a public perception that directors should not be singled out and insulated from the full extent of the damages they cause through their gross negligence. Mr. Sparks noted that we simply do not know what impact caps would have on the decision of judges and juries. Mr. Veasey expressed the view that a cap in Delaware would limit negligence claims to the amount of the cap but that other claims might be inflated and that settlements would tend to be at the level of the cap. Mr. Rosenthal argued that the adoption of a cap would result in other states adopting lower caps in an effort to compete. Others disagreed that a "cap war" would result.

There was also discussion concerning the appropriate amount of a cap if one were to be adopted. Amounts of \$100,000 to several million dollars were discussed with no consensus being expressed as to the most appropriate amount.

There was also a discussion of the timing of legislation imposing a cap. Mr. Rosenthal argued that we should not rush through legislation on a matter of this

importance and that we should approach the idea of a cap with caution and careful deliberation. Messrs. Sparks and Bussard argued that time is of the essence and that we should move quickly to have proposed legislation ready by June 1986 or at the latest, September 1986.

The discussion of a cap ended with Mr. Sparks requesting Mr. Veasey and Mr. Bussard to have Richards, Layton & Finger pull together writings on the subject for the Council to consider. Mr. Sparks stated that further consideration should be given to the proposal for a cap after these writings are considered.

There followed a brief discussion concerning specific provisions in the draft legislation on Section 145 that had been circulated. There was general agreement expressed in favor of the proposed amendments to Section 145(e) (requiring repayment of advances only if a determination is made that the director is not entitled to indemnification) and the addition of Section 145(j) (moving a portion of existing Section 145(f) to a separate subsection). In addition, there was general agreement with Mr. Veasey's suggestion that Section 145(b) be amended to delete the words "negligence or" so that the reference is solely to "misconduct."

There was also discussion of the proposed amendments to Section 145(g) which would expressly authorize

the use of subsidiaries to provide D & O insurance. Mr. Black spoke in favor of the amendment, noting that it may help provide insurance for directors who otherwise cannot obtain it and cannot serve as a result. Mr. Rosenthal and Mr. Goldman expressed opposition to the proposal, voicing concern that insurance by a subsidiary amounts to indemnification, especially where a subsidiary is established solely to provide insurance. It was suggested that a requirement could be added to proposed Section 145(g) requiring the subsidiary to be a licensed insurance company subject to the same reserve and other requirements that apply to regulated insurance companies. The meeting ended with no consensus having been reached with respect to Section 145(g).

Mr. Sparks suggested that the next meeting of the Council be scheduled sometime in the first week of April. The meeting was then adjourned at approximately 5:45 P.M.