INDEMNIFICATION AND ADVANCEMENT THROUGH AN AGENCY LENS

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I

INTRODUCTION

Doctrines that define entitlements to indemnification carry high stakes for corporate directors and officers because, through a right to indemnity, a director or officer may shift litigation-related costs to his or her corporation. A right to advancement obliges the corporation to bear the cost of funding an ongoing defense, subject to a requirement that the individual repay the advanced amounts upon a final determination that the individual is not entitled to or eligible for indemnification. Costs may mount during long-running proceedings, and the corporation's present decisionmakers may regret a prior decision that supplants their discretion with an enforceable duty to make advancements, even when the loan that the advancement represents may prove uncollectible in the end. Additionally, rights to indemnification and advancement may undercut incentives for proper conduct, but may also make service as an officer or director less daunting to qualified candidates, especially those who believe a corporation's circumstances create a material risk of litigation against them personally.

Although the practical stakes and policy tradeoffs are evident, the conceptual rationales and normative justifications underlying these doctrines are unsettled and potentially in conflict. In particular, indemnification in the corporate context is often characterized as an offshoot of common-law agency doctrine. Judicial opinions and scholarly treatments refer to agency law in general terms in attempting to ground rights to indemnity.[1] Despite its longevity, the "agency" rationale is weak and not helpful in answering questions that inevitably arise. For starters, many within the corporate cast of characters

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1. *See, e.g.*, HENRY W. BALLANTINE & GRAHAM L. STERLING, CALIFORNIA CORPORATION LAWS 121 (1949) ("The theory of those who drafted the California act as to the basis of reimbursement of directors, officers, and employees for litigation expenses incurred in their employment without their fault, is not that of benefit to the corporation but that of a duty of a principal to indemnify and reimburse his employee or agent for expenses springing from the proper performance of the duties of his employment.").

who may be indemnified and receive advancements are not agents within the common-law definition. Moreover, indemnification doctrines within agency law diverge in their presuppositions and operation from statutory indemnification provisions. Agency law presupposes an agent's indemnity rights are subject to agreement with the principal, which enables the principal to assess its risks relative to individual agents. Agency law also presupposes the existence of a principal capable of credible arm's-length bargaining with the agent, in contrast to the structural reality that (absent action by shareholders) a corporation's board will adopt policies and make individual decisions concerning indemnity and advancement for its members as well as for officers who work closely with the board. Additionally, within agency law, the rationale for indemnification is to internalize into the principal's enterprise the costs incurred by an agent who acts with actual authority on the principal's behalf. Thus, common-law agency allocates to the principal the right to control the defense of a suit against an agent, in contrast to the assumption underlying indemnification in the corporate context, which allocates control to the individual defendant. Finally, under some corporation statutes and the governance documents of many corporations,[2] service as a corporation's "employee or agent" is equivalent to service as a director or officer, with consequences potentially at odds with those that stem from agency law itself.

In the corporate context, indemnification is better grounded, as in the Model Business Corporation Act (MBCA), in the necessity of furnishing corporate directors with "appropriate protection against personal risk."[3] Likewise, it is best to focus on directors (who typically do not act as a corporation's agents) as the prototypical "object of concern" whose rights to indemnification and advancement will stem from bylaws and other corporate-governance documents that operate categorically. That directors typically take action collectively, as members of boards and committees of boards rather than as individuals, corresponds with categorical treatment through a governance document. Such a focus is warranted, moreover, from the perspective of regulating "the concerns of self-dealing when directors provide for their own indemnification and expense advances,"[4] in contrast with arm's-length, one-by-one agreements with corporate personnel who are not members of the board.

To be sure, as the MBCA's official comments implicitly acknowledge, the position of officers, especially senior executive officers, does not fit neatly and exclusively into either an "agent" or a "non-agent" category for indemnification purposes. An officer's role often places the officer within the common-law definition of agent and assumes the officer possesses a specific set of skills that the officer must deploy to serve the interests of the corporation as the officer's principal.[5] Directors' duties, in contrast, are more generalized considerations of

2. *See infra* text accompanying notes 40 and 42.

3. MODEL BUS. CORP. ACT ch. 8, subchapter E, introductory cmt. 1 (2008).

4. *Id.* § 8.56 official cmt.

5. RESTATEMENT (THIRD) OF AGENCY § 8.08 (2006).

care and loyalty; in the MBCA's formulation, a director's duties are to act in good faith and "in a manner the director reasonably believes to be in the best interests of the corporation."[6] On the other hand, directors may empathize with officers with whom they work through service on the board or board committees, suggesting that the board's dealings with officers in this context may have a texture that is not fully at arm's-length,[7] and that the corporation's status as a principal is, at the least, complicated.

II

INDEMNIFICATION WITHIN AGENCY LAW

The common law defines an agent as a person who consents to act "on the principal's behalf and subject to the principal's control."[8] Acting "on behalf of" a principal means acting as the principal's representative in legally salient interactions with third parties, who may either be within the principal's organization or external to it.[9] The basic idea is that an agent acts as the principal's representative, whether or not the principal benefits from the agent's actions "on behalf of" the principal.

The representative quality of an agent's position explains much about indemnification doctrine. If an agent makes a payment on behalf of a principal, subject to the terms of any contract between principal and agent, the principal has a duty to indemnify the agent only when the agent (1) acted with actual authority in making the payment, or (2) acted without actual authority, but benefitted the principal and did not act officiously (that is, without excuse).[10] An agent acts with actual authority by acting consistently with a reasonable interpretation of any manifestation from the principal concerning how the principal wishes the agent to act.[11] One might think of an agent's action under these circumstances as an extension of the principal and as an action that, through the agent's intermediation, the principal has taken itself.

The same perspective also explains the scope of a principal's duty to indemnify an agent for litigation-related costs borne by the agent unless this duty is abrogated by a contract between them. The principal's duty is limited to claims asserted by third parties against the agent and to circumstances in which the agent acted with actual authority in taking the action at issue in the third

6. MODEL BUS. CORP. ACT § 8.30(a) (2008).

7. *Id.* ch. 8, subchapter E, introductory cmt. (observing that the "spectre of structural bias" is created by the prospect of "sympathetic directors approving indemnification for themselves or for colleagues on the board or for officers, who may work closely with board members").

8. RESTATEMENT (THIRD) OF AGENCY § 1.01 (2006).

9. *Id.* § 1.01 cmt. g.

10. *Id.* § 8.14(2). On "officious," see RESTATEMENT (THIRD) OF RESTITUTION & UNJUST ENRICHMENT § 2 cmt. d (2000) (no liability in restitution for benefit intentionally conferred unless "the circumstances of the transaction are such as to excuse the claimant from the necessity of basing a claim to payment on a contract with recipient of benefit").

11. RESTATEMENT (THIRD) OF AGENCY § 2.01 (2006).

party's claim.[12] The principal's duty is not triggered unless the agent gives the principal timely notice of the third party's suit so that the principal may furnish the agent with a defense, a requirement that treats the agent's authorized action—and litigation in its aftermath—functionally as action of the principal.[13]

Moreover, a principal's duty to indemnify extends downward in a chain of agency relationships to subagents (agents appointed by agents) unless the subagent agrees otherwise.[14] Indeed, a subagent's claim for indemnification occasioned a memorable judicial rationalization of indemnification doctrine. In *Admiral Oriental Line v. United States*,[15] a ship's owner engaged an agent under an operating contract; the agent, in turn, engaged a subagent to fit out the ship in the Philippines. An owner of cargo on the ship sued the subagent in the aftermath of a typhoon in which all hands aboard (and the cargo) were lost. The subagent successfully defended against the suit and sought indemnity from the principal. The court held that the principal had a duty to indemnify the subagent against the costs of its successful defense. The appointing agent had a duty to indemnify the subagent; were it to discharge that duty, the principal would have a duty to indemnify the appointing agent. Thus, the subagent may proceed directly against the principal. More broadly, Learned Hand, writing for the court, explained:

> The doctrine stands upon the fact that the venture is the principal's, and that, as the profits will be his, so should be the expenses. Since by hypothesis the agent's outlay is not due to his mismanagement, it should be regarded only as a loss, unexpected it is true, but inextricably interwoven with the enterprise.[16]

The principal's downward-reaching duty to indemnify subagents does not, however, encompass performing an appointing agent's duty to pay compensation to the subagents it engages. Unless it agrees to do so, a principal does not bear the risk of making payments to subagents that a financially unreliable appointing agent may have promised.[17] In Judge Hand's terminology, compensation agreements between an appointing agent and its employees and other agents remain outside the principal's enterprise, not interwoven with it. Instead, the liabilities created by such agreements remain part of the agent's "enterprise," as do many costs incurred by specific types of agents.[18]

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12. *Id.* § 8.14 cmt. d.

13. *Id.*

14. A subagent "is a person appointed by an agent to perform functions that the agent has consented to perform for the agent's principal and for whose conduct the appointing agent is responsible to the principal." *Id.* § 8.14(1) & cmt. b.

15. *See generally* Admiral Oriental Line v. United States, 86 F.2d 201 (2d Cir. 1936).

16. *Id.* at 202.

17. RESTATEMENT (THIRD) OF AGENCY § 8.13 cmt. d (2006). For cases applying this principle, see *id.* reporter's n.b.

18. *Id.* cmt. a. (noting that real-estate agents with whom property is listed for sale customarily bear the cost of advertising the property); *see also* RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 38(3)(a) & cmt. e (2000) (a lawyer may not, unless the contract with the client requires otherwise, "charge separately for the lawyer's general officer and overhead expenses"; prevailing

A final component of agency doctrine completes the picture. If an agent causes loss to the principal through unauthorized actions and other breaches of duty, the agent has a duty to compensate the principal for the loss.[19] Loss to the principal may stem from breaches of the agent's basic duty of loyalty[20] as well as from conduct for which the agent lacked actual authority but nonetheless bound the principal—through the operation of apparent authority—to third parties who reasonably believed the agent to be authorized.[21] A principal has no duty to indemnify an agent (unless it has agreed to do so) for losses incurred by the agent stemming from unauthorized conduct that inflicted loss on the principal.

III

CORPORATE LAW CONTRASTED

The background of common-law agency highlights both the distinctiveness and complexity of indemnification in the corporate context.[22] One minor datum is telling: In the Restatement (Third) of Agency, the section addressing a principal's duty to indemnify its agent runs for eleven pages inclusive of the reporter's notes, while the MBCA's chapter 8, subchapter E runs for thirty-three pages. Delaware's three-page counterpart,[23] a relatively long section within the Delaware general corporation law, is amplified by many cases. Two tenets of indemnification in the corporate context underlie its divergence from common-law agency doctrine and help explain its relative complexity: (1) the circumstances under which indemnification and advancement are permissible and often, in practice, mandatory; and (2) more narrowly, the structure of indemnification rights in connection with litigation.

A basic structural fact about the corporate context adds to the complexity. First, unless the principal's contract with an agent so requires, the principal's duty to indemnify a common-law agent against a loss incurred by the agent requires the agent to act with actual authority or confer a benefit on the principal through the agent's underlying conduct. In contrast, in the corporate setting, "[t]he concept of indemnification recognizes that there will be situations in which the director does not satisfy all of the elements of the standard of conduct set forth [by statute] . . . but where the corporation should nonetheless be permitted (or required) to absorb the economic costs of any ensuing

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practice that disbursements made by lawyer "to persons outside the office for hired consultants . . . and the like ordinarily are charges in addition to the lawyer's fee.").

19. RESTATEMENT (THIRD) OF AGENCY § 8.14 cmt. b (2006).

20. *Id.* § 8.01 cmt. d(1) ("An agent's breach subjects the agent to liability for loss that the breach causes the principal.").

21. *Id.* § 2.03.

22. MODEL BUS. CORP. ACT ch. 8, subchapter E, official cmt. (2008) ("The provisions for indemnification and advance for expenses . . . are among the most complex and important in the entire Act."). Subchapter E is "based almost entirely on an amendment to the 1969 Model Act adopted in 1980 and substantially revised in 1994." *Id.*

23. DEL. CODE ANN. tit. 8, § 145 (2010).

litigation."[24] The challenge, of course, is to identify "situations" in which a director should be indemnified notwithstanding the director's conduct and distinguish them from situations in which indemnification is unacceptable.

Although establishing that an agent acted with actual authority or conferred a benefit on the principal can be less than straightforward, the normative concepts readily connect the agent's underlying conduct with the principal's "enterprise." In contrast, under the MBCA, whether a corporation may indemnify a director against the costs of an unsuccessful defense turns on whether the director acted in good faith and in conduct undertaken in an official capacity with a reasonable belief that the conduct was in the corporation's best interests.[25] For conduct not undertaken in an official capacity—which does seem removed from any definition of the principal's "enterprise"—a director must have acted in good faith and with a reasonable belief that the conduct "was at least not opposed to the best interests of the corporation."[26] Indemnification in the wake of an unsuccessful defense of criminal charges requires that the director had "no reasonable cause to believe his conduct was unlawful."[27] A corporation may oblige itself to exercise its power to indemnify in these situations through a provision in its articles or bylaws, or through a contract or resolution adopted by its board.[28] Additionally, under the MBCA, shareholders may, through a provision in the corporation's articles, approve enhanced duties to indemnify directors, up to the limit of situations in which an articles provision could not exculpate a director against liability. Nonexculpable situations are: liability for receipt of a financial benefit to which the director was not entitled, an "intentional infliction of harm on the corporation or its shareholders," an intentional violation of criminal law, and voting or assenting to an unlawful distribution of corporate assets to shareholders.[29]

Thus, a corporation has power to—and may undertake a duty to—indemnify a director when the director's underlying conduct has itself likely caused loss to the corporation. Additionally, the MBCA itself imposes a duty to indemnify when a director is wholly successful in the defense of the underlying proceeding.[30] Amounts indemnified by a corporation may include more than the costs of an unsuccessful defense; amounts paid in settlement, fines, and penalties are within the MBCA's defined category of "liability" that may be indemnified.[31] To be sure, common-law agency acknowledges that a principal

24. MODEL BUS. CORP. ACT ch. 8, subchapter E, official cmt. (2008).

25. *Id.* § 8.51(1)(a)(i).

26. *Id.* § 8.51(1)(a)(ii).

27. *Id.* § 8.51(1)(a)(iii).

28. *Id.* § 8.58(a).

29. *Id.* § 2.02(b)(5). One expanded category of liability that an articles provision might cover would be intentional tort claims brought by third parties.

30. MODEL BUS. CORP. ACT § 8.52 (2008).

31. *Id.* § 8.50 (3) (defining "liability").

could contract to indemnify its agents, but a major structural difference from the corporate context is telling. Agency law presupposes that agent and principal are separate persons and that the principal determines at arm's-length how its interests might best be served, including the terms on which it contracts with its agents. In the corporate context, the board of directors is the decisionmaker on indemnification and advancement (unless shareholder involvement is sought), and the board's members have an intense interest in how indemnification rights are structured.

Moreover, indemnification's scope is broader in the corporate context because it is mandatory in connection with the costs of litigation and other proceedings to a degree well beyond agency doctrine. A principal's duty to indemnify an agent against litigation expenses is limited to actions brought against the agent by third parties. Corporate indemnification, in contrast, encompasses claims made by the corporation itself as well as claims made on its behalf by shareholders and other representative parties, such as bankruptcy trustees, but not amounts paid to settle or satisfy obligations stemming from such claims.[32] Indeed, in the oft-told history leading to the addition of indemnification provisions to corporation statutes, the court held in *New York Dock Co. v. McCollum*[33] that the corporation had no obligation to indemnify directors who were vindicated in a derivative suit because the directors' triumph yielded no benefit for the corporation.[34] From the perspective of common-law agency, the outcome in *McCollum* may seem unsurprising; had the shareholder suit succeeded in recovering a judgment, it would have benefitted the corporation (the principal). However, the prospect that a corporate principal might be obliged to indemnify its personnel in connection with direct claims it asserts against them is startling, even more so if the principal must fund their defenses through advancements.[35] On the other hand, from the perspective of a corporation's board of directors, the prospect that the corporation itself might sue one or all of them is not unimaginable. The principal—the corporation—may retain a continuous identity, but the identity of those in control of it may shift, and a new controlling shareholder (or a bankruptcy trustee) may look unfavorably on decisions made by now-former directors.

The MBCA reflects some of agency law's insights. The official comments urge consideration of "whether obligatory expense advance is intended for direct suits by the corporation as well as for derivative suits by shareholders in the right of the corporation," noting that advancement could require funding a

32. *Id.* § 8.51(d)(1) (2005).

33. *See generally* N.Y. Dock Co. v. McCollum, 16 N.Y.S.2d 844 (N.Y. Sup. Ct. 1939).

34. *See, e.g.*, James H. Cheek III, *Control of Corporate Indemnification: A Proposed Statute*, 22 VAND. L. Rev. 255, 259 (1968); James J. Hanks, Jr. & Larry P. Scriggins, *Protecting Directors and Officers from Liability*—The Influence of the Model Business *Corporation Act*, 56 BUS. LAW. 3, 5–13 (2000).

35. It has been argued that corporate indemnification provisions were not intended to apply to direct suits. *See* Diane H. Mazur, *Indemnification of Directors in Actions Brought Directly by the Corporation: Must the Corporation Finance Its Opponent's Defense?*, 19 J. CORP. L. 201, 205 (1994).

defendant's defense "even where the board of directors has already concluded that he has engaged in significant wrongdoing."[36] Tellingly, though, the MBCA provisions, like those in all other states, focus solely on specifying a corporation's power and obligations to indemnify individual actors associated with it, not the individuals' obligations to indemnify the corporation against loss caused by their breaches of duty. Nonetheless, a corporation may not indemnify against amounts paid to settle claims asserted by or in its right, or to satisfy obligations stemming from such claims.[37] The consequence of indemnification would be payments of the same amount to and from the same corporate "enterprise."[38] Finally, the MBCA recognizes, as does agency doctrine, that not all that befalls an individual is a consequence of a position held by that individual; whether a corporation may indemnify a director against liability depends on whether it stems from a proceeding to which the director is "a party . . . because he is a director."[39]

IV

IMPLICATIONS

Although common-law agency doctrine is inadequate as an underpinning for indemnification in the corporate context, contrasts between the two highlight policy choices made by drafters of corporation statutes. Agency doctrine may also afford insights into specific points of difficulty in applying indemnification and advancement bylaws and statutes, in particular the inclusion of "agents"—among those whom a corporation has a duty to

36. MODEL BUS. CORP. ACT § 8.58 official cmt. (2008).

37. *Id.* § 8.51(d). A court may order indemnification of amounts paid to settle a shareholder derivative suit or a suit alleging a director received an improper financial benefit if the court determines that indemnification is "fair and reasonable" in light of "all relevant circumstances." *See id.* § 8.54 (a)(3) & official cmt. A corporation may obligate its board "to cooperate in the procedural steps required to obtain a judicial declaration" that indemnification should be ordered. *Id.* § 8.59 official cmt. In contrast, under the counterpart Delaware statute, indemnification of settlement amounts is not available in derivative suits. *See* DEL. CODE ANN. tit. 8, § 145(b) (2010). The Delaware statute also requires judicial approval for indemnification of the costs of an unsuccessful defense of an action brought by or in the right of the corporation upon a showing that the proposed indemnitee "is fairly and reasonably entitled to indemnity for such expenses which the [court] shall deem proper." *Id.*

38. More pragmatically, if it is less expensive for a corporation to indemnify its directors against the damage amounts claimed in a shareholder derivative suit than to bear the costs of inquiry required to seek judicial dismissal of the suit, more "meritless derivative proceedings" might be filed "in order to generate small but immediately payable attorneys' fees." MODEL BUS. CORP. ACT § 8.51 official cmt. (2008). The process that may lead to judicial dismissal under the MBCA begins with a shareholder demand on the board (which is mandatory in most circumstances) followed by reasonable inquiry and a determination by the board or a committee that maintaining the derivative suit is not in the corporation's best interests. *Id.* § 7.44.

39. *Id.* § 8.51. On this general limitation, compare *Stifel Financial Corp. v. Cochran*, 809 A.2d 555, 562 (Del. 2002) (holding a former officer acted in personal, not official, capacity in obtaining an allegedly improper compensation from the corporation), with *Reddy v. Electronic Data Systems Corp.*, No. CIV.A. 19467, 2002 WL 1358761, at *6 (Del. Ch. June 18, 2002) (finding the financial fraud that enabled a former officer to obtain improper compensation was committed in the course of performing official duties).

indemnify or make advancements—as well as issues associated with former officers' claims for advancement.

A. Differentiating Among "Agents"

Some corporation statutes include "agents" in a generic cast of corporate characters for purposes of indemnification. Indeed, the California statute uses "agent" as the inclusive term in this context; under section 317(a) of the general corporation law, an "agent" is "any person who is or was a director, officer, employee or other agent of the corporation."[40] In contrast, the MBCA drafters chose to confine its coverage to directors and officers, noting that a corporation has power, consistent with applicable law, to indemnify and make advancements to its employees and agents.[41] The drafters also note, though, that many corporations exercise this power "in the same provisions in the articles, bylaws, or otherwise in which they provide for expense advance and indemnification for directors and officers."[42] Viewed from the perspective of common-law agency, this practice may not always be wise.

The term "agents," even more than "employees," does not work well as a trigger for categorical rights. Consider first the heterogeneous host of nonemployee agents that a corporation might engage: real-estate, commodities, securities, and insurance brokers; securities-transfer agents; lawyers; private investigators and debt collectors; and on and on. The functions agents perform vary widely, as do the legal risks associated with their activity. Some litigation-related expenses borne by an agent may conventionally be viewed as part of the agent's cost of doing business, not intertwined with the principal's "enterprise," against which the agent should insure itself. These factors are all consistent with specifying indemnification rights (if any) through individualized contracts. Indeed, the MBCA's drafters urge "careful consideration" about "extending mandatory maximum indemnification and expense advance to employees and agents" because this may not be necessary to "encourag[e] qualified individuals to serve," given that enabling this encouragement justifies such rights for directors and officers.[43]

Cases in which agents seek indemnification or advancement of expenses under a generic provision in a corporation statute or corporate-governance document illustrate the misfit of "agents" in this context. In several recent cases, lawyers sued by corporate clients sought indemnification or advancement, under either a corporate bylaw or statute, on the basis that they were parties to

40. CAL. CORP. CODE § 317 (2010). This formulation originated in 1975. The statutory predecessor did not define an inclusive term for corporate personnel whom the corporation might indemnify. *See* CAL. CORP. CODE § 830(a) (1947) ("When a person is sued . . . because he is or was a director, officer, or employee of a corporation . . . ."). The formulation in section 317 is confusing because a director as such is not a corporation's agent. *See* RESTATEMENT (THIRD) OF AGENCY § 1.01 cmt. f(2) (2006) (explaining that directors ordinarily are not agents either of a corporation or its shareholders).

41. MODEL BUS. CORP. ACT ch. 8, subchapter E, official cmt. (2008).

42. *Id.* § 8.56 official cmt.

43. *Id.*

the suit because they had served as an agent of the corporation. The cases reach outcomes that are not entirely consistent. For example, in *Fasciana v. Electronic Data Systems Corp.*, the plaintiff sought advancement of litigation expenses under the language of a corporate bylaw that mandated advancement to, among others, the corporation's agents.[44] The court held that the bylaw did not apply to the plaintiff's work for his former client to the extent he furnished advice on a private basis, as opposed to interacting with third parties on the corporation's behalf.[45] The court reasoned that the Delaware legislature, in using the word "agent" in the indemnification statute, intended "the term to be used in the more precise common law definition, which embraces the 'essential' requirement that an agent have 'the power to act on behalf of the principal with third persons.'"[46] In contrast, in cases in which a lawyer acts as a corporation's litigation counsel, the lawyer surely interacts with third persons on behalf of the client.[47] But outcomes in cases involving this variation turn, additionally, on the nature of the client's claim against its former counsel. In *Jackson Walker L.L.P. v. Spira Footwear*,[48] in which the court held that a mandatory-advancement bylaw applied, the client's claim was that the plaintiff law firm breached its fiduciary duties through litigation maneuvers that furthered the cause of shareholders who were then in control of the corporation. In contrast, in *Western Fiberglass, Inc. v. Kirton, McConkie & Bushnell*[49] and *Channel Lumber Co. v. Porter Simon, Inc.*,[50] the lawyers succeeded in the defense of malpractice claims and then proceeded under statutory provisions mandating indemnification. The lawyers lost in both cases, with both courts holding that they were not "agents" within the meaning of the statute. *Western Fiberglass* relies solely on a finding that the purpose of the statute was to "protect persons exercising corporate discretion and authority, not the attorneys those persons hire to give them legal advice."[51] *Channel Lumber* relies on a comparable finding of statutory purpose as well as the court's conclusion that outside lawyers are independent contractors, in a role similar to that of "other professionals, such as doctors and nurses."[52] *Jackson Walker*, like most

44. Fasciana v. Elec. Data Sys. Corp., 829 A.2d 160, 163 (Del. Ch. 2003).

45. *Id.* at 172–73.

46. *Id.* at 169 (quoting Borders v. Townsend Assocs., No. CIV.A. 98L12023RFS, 2002 WL 725266, at *5 (Del. Super. Ct. Apr. 17, 2002).

47. *See* Jackson Walker L.L.P. v. Spira Footwear, Inc., No. 3150-VCP, 2008 WL 2487256, at *6 (Del. Ch. June 23, 2008) (question of first impression under Delaware law where a corporation's litigation counsel acted as its agent).

48. *Id.*

49. W. Fiberglass, Inc. v. Kirton, McConkie & Bushnell, 789 P.2d 34, 34 (Utah Ct. App. 1990).

50. Channel Lumber Co. v. Porter Simon, Inc., 93 Cal. Rptr. 2d 482, 484 (Cal. Ct. App. 2000).

51. *W. Fiberglass, Inc.*, 789 P.2d at 38.

52. *Channel Lumber Co.*, 93 Cal Rptr. 2d at 488.

authorities,[53] finds that the law firm acted as its client's agent in its actions as litigation counsel but carefully notes the absence of malpractice claims.[54]

Mirroring the outcomes in these cases, agency doctrine furnishes two conflicting insights into them. An agent becomes no less an agent on the basis of the nature of a principal's claims against the agent. Even an agent who has acted in a manner totally contrary to the principal's instructions and interests is still, vis-à-vis the principal, an agent; the principal otherwise would be unable to hold the agent to account for major breaches of duty.[55] On the other hand, it does seem "odd," as it did to the *Fasciana* court, that a principal would have agreed to fund its agent's defense, in particular, that a corporation would retain outside counsel using a retention agreement that counsel's defense costs would be "fronted" by the corporation in the event of a malpractice dispute.[56] Those costs, like the cost of insuring against them, seem part of counsel's cost of doing business, but not costs intertwined with the principal's "enterprise." Thus, the perspective of agency doctrine suggests the folly of "agents" as a trigger for categorical indemnification rights.

B. Officers and Advancements

As the introduction notes, officers often act as a corporation's agents but, especially at the most senior level, are also likely to work more intimately with its directors than are most "agents" who are situated externally to the corporation. Moreover, if an officer occupies a full-time position, the officer is not comparable to an externally situated agent with a separate "enterprise" distinct from the corporation, as principal, to which costs of litigation defense might conventionally be allocated. On the other hand, in large corporations, a senior officer's role is more likely than that of a director to be associated with conduct that inflicts injury on the corporation and results in liability for the officer.[57] In large corporations, operational decisions are the immediate responsibility of officers, as is the accuracy of the corporation's financial statements. As part III notes, the MBCA (like other contemporary corporation statutes)[58] permits the corporation's directors to obligate it to make advancements to officers in connection with litigation and other proceedings brought against them because of their service as officers. The MBCA's official comments highlight the potential gravity of including suits brought by the

53. *See, e.g.*, RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 17 (2000) (characterizing lawyers as agents albeit not typical ones). *See generally* Deborah A. DeMott, *The Lawyer as Agent*, 67 FORDHAM L. REV. 301 (1998).

54. Jackson Walker L.L.P. v. Spira Footwear, Inc., No. 3150-VCP, 2008 WL 2487256, at *8 (Del. Ch. June 23, 2008).

55. For the principal's duties vis-à-vis third parties when the agent acts adversely, the analysis is more complicated and beyond the modest scope of this article.

56. Fasciana v. Elec. Data Sys. Corp., 829 A.2d 160, 172 (Del. Ch. 2003).

57. *See* Samuel W. Buell, *Criminal Procedure Within the Firm*, 59 STAN. L. REV. 1613, 1656 (2007).

58. *See, e.g.*, CAL. CORP. CODE § 317(f) (2010); DEL. CODE ANN. tit. 8, § 145(e) (2010); N.Y. BUS. CORP. LAW §§ 723(c), 725(a) (McKinney 2010).

corporation itself within mandatory advancement provisions[59] and suggest that it may be preferable "to retain the discretion to decide, on a case-by-case basis, whether to indemnify and advance expenses to employees and agents (*and perhaps even officers, especially non-executive officers*) rather than binding the corporation in advance to do so."[60] Anecdotal evidence suggests some corporations have had occasion to regret binding commitments to make advancements to executive officers as well, leaving them funding expensive defenses without strong prospects of recovering if, at the end, a now-former executive officer is not eligible to be indemnified.[61] Thus, one might question whether the MBCA's cautionary instincts go far enough.

The backdrop of common-law agency, although not answering this question, casts it in a different light. The justification that underlies indemnification is, as developed by part II, internalizing, into the principal's enterprise, its costs. Along these lines, the MBCA's official comments, focusing on advancement, state that the underlying policy "is based on the view that a person who serves an entity in a representative capacity should not be required to finance his or her own defense."[62] Despite the use of the agency-feeling term "representative," the MBCA's perspective does not entirely replicate agency law's insights because agency doctrine confers on the principal the right to control the defense of third-party litigation against an agent.[63] That is, the defense is not entirely the agent's own. Mirrored in the corporate context, this facet of agency doctrine would be consistent with the retention of greater control in the corporation's board, just as the board exercises control over other litigation-related costs that are part of the corporation's enterprise.

Agency doctrine's broader implication stresses the significance of allowing a decisionmaker—here a corporation's board of directors—to exercise discretion on an ongoing basis. For starters, well-settled agency doctrine empowers a principal to terminate its agent even though the termination breaches a contract between principal and agent.[64] This doctrine reflects the consensual nature of agency and the relevance of the principal's consent on an ongoing basis. However, the force of this doctrine is confined to the principal's power to end its relationship with an agent; agency doctrine does not also empower a principal to renounce contracts it has made with agents when it comes to regret

59. *See supra* text accompanying note 36.

60. MODEL BUS. CORP. ACT § 8.56 official cmt. (2008) (emphasis added).

61. For example, Brocade Communications funded a nearly $50 million defense of its former CEO against a host of criminal, SEC, and civil cases stemming from a scheme to backdate stock options. The corporation settled with its former CEO by making a payment of $12.5 million, while his defense costs were almost $50 million by the time of settlement. *See* Zusha Elinson, *Brocade's Closely Watched Backdating Lawsuit Ends in the Red*, LAW.COM (June 6, 2010), http://www.law.com/jsp/law/LawArticleFriendly.jsp?id=1202431585820.

62. MODEL BUS. CORP. ACT § 8.53 official cmt. (2008).

63. RESTATEMENT (THIRD) OF AGENCY § 8.14 cmt. d (2008).

64. RESTATEMENT (THIRD) OF AGENCY § 3.10(1) (2006). The same doctrine empowers an agent to renounce its position albeit in breach of contract.

their consequences.[65] At the point of contracting, and consistent with the MBCA's cautions, a corporation's board has the opportunity to consider how categorically and comprehensively to make a commitment to advancement, as well as the financial implications of that commitment in relation to third-party insurance the corporation may purchase.[66] How a corporation's insurer prices its director- and liability-insurance policies reflects, inter alia, the insurer's assessment of risk;[67] an insurer's perception of relatively high risk should counsel caution in a board's consideration of advancement obligations.

A recent case illustrates how a board might implement a measure of caution. In *Flood v. ClearOne Communications, Inc.*,[68] a year after the Securities Exchange Commission (SEC) and the United States Department of Justice began investigating the conduct of a corporation's CEO, the corporation agreed to advance and indemnify her costs of defense stemming from her tenure in office. The corporation's undertaking to make advancements—one element of a comprehensive agreement that otherwise ended the CEO's relationship with the corporation—was conditioned, inter alia, on a determination "that the facts then known to those making the determination would not preclude indemnification" under either the corporation's bylaws or the corporation statute.[69] In particular, the corporation's bylaws prohibited indemnification absent a conclusion that it "has the financial ability to make the payment, and the financial resources of the corporation should be devoted to this use rather than some other use."[70] Although the corporation advanced its former CEO's costs of defense in the wake of her criminal indictment, advancements ceased when the board determined that the CEO herself had reason to believe her prior conduct was neither legal nor in the corporation's best interests, which belied an affirmation from the former CEO required under the bylaw.[71] Additionally, the board determined that the corporation's best interests did not require continued advancements.[72] The Tenth Circuit reversed the district court, which had preliminarily enjoined the corporation to continue making advancements on the reasoning that the conditions of the obligation rendered the obligation illusory.[73] In the Tenth Circuit's assessment, the obligation, far

65. *Id*. § 8.13.

66. If the costs of a defense outrun the coverage limits of an insurance policy, former officers may enforce the corporation's obligation to make advancements. *See* Stockman v. Heartland Indus. Partners, L.P., No. 4227-VCS, 2009 WL 2096213, at *3 (Del. Ch. July 14, 2009).

67. Sean J. Griffith, *Uncovering a Gatekeeper: Why the SEC Should Mandate Disclosure of Details Concerning Directors' and Officers' Liability Insurance Policies*, 154 U. PA. L. REV. 1147, 1175–78 (2006).

68. Flood v. ClearOne Commc'ns, Inc., 618 F.3d 1110, 1111–12 (10th Cir. 2010).

69. *Id.* at 1113.

70. *Id.* at 1112.

71. *Id.* at 1113.

72. *Id.*

73. The district court decided not to give effect to the express conditions, effectively reforming the terms of the parties' agreement. *See id.* at 1119 (discussing Flood v. ClearOne Commc'ns, Inc., No. 2:08-CV-631, 2009 WL 87006, at *5 (D. Utah Jan. 12, 2009)).

from being illusory, was both enforceable and subject to expressly stated conditions that required determinations to be made in good faith by the board.[74]

Although the specific occasion for the agreement in *Flood* was a senior officer's separation from service, the case illustrates contractual mechanisms through which a board may retain control to exercise discretion on an ongoing basis as litigation and other developments provide additional material information about the recipient of advancements. Future revisions to the MBCA might nudge boards in the direction of retaining such discretion. Most strongly, the MBCA might require that such discretion be retained; alternatively, retained discretion could be cast as a default rule from which an individual board could derogate through explicit terms, either generically in the corporation's general governance documents or in individual-by-individual determinations and agreements. Cast as a default rule, a mandate of retained discretion would require an informed decision by the board to proceed otherwise, likely preceded by a discussion aided by legal counsel of the prospective risks, costs, and benefits of the board's decision.

V

CONCLUSION

Common-law agency doctrine answers simpler questions than those surrounding indemnification in the corporate context. Its perspective is nonetheless enlightening. Agency doctrine envisions risk-balancing through negotiation of indemnification terms between principal and agent. Corporate indemnification differs from this vision in several critical ways, complicating any attempt to apply common-law agency doctrine to the corporate context: corporate indemnification has a broader definition of "agent," a wider field of liability subject to indemnification, the presence of structural bias among board members who tailor indemnification provisions favorably to appointed officers with whom the board shares a close or special relationship, and the inevitable self-interest of board members who themselves will be subject to generic indemnification terms. These differences distort efforts to balance risk, sometimes leading to absurd results. Future revisions to the MBCA should at least discuss, if not mandate, tactics that strengthen negotiation to create an environment conducive to indemnification and advancement agreements that more accurately reflect the risks shared between the principal and agent in the corporate context.

74. *Flood*, 618 F.3d at 1120.