California's 1943 Statute as to Directors' Litigation Expenses: An Exclusive Remedy for Indemnification of Directors, Officers and Employees

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California at the 1943 legislative session adopted a comprehensive and exclusive statutory provision for indemnifying directors, officers and agents of a corporation for litigation expenses when they arise out of unjustified charges against them. In order to give adequate protection to shareholders the granting of such indemnity is made exclusively a judicial question. This is the first statute to abrogate management sponsored by-laws and charter provisions for directors' and officers' indemnity for litigation expenses. This has seemed to those who drafted this statute to be absolutely the only method to avoid interminable litigation as to the validity of such by-laws and provisions and also to prevent much imposition which may result from permitting the management to be judges in their own cause.

In recent years many important shareholders' suits have been prosecuted against corporate directors and officers on charges of mismanagement, abuse of fiduciary powers, secret profits, misappropriation of corporate opportunities, excessive compensation and miscomputation of bonuses. The directors and officers of some of our largest corporations have been called upon to defend their official acts in litigation brought by shareholders on behalf of the corpora-

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1 Cal. Stats. 1943, c. 934. This act adds a new section 375 to the Civil Code, relating to the award and assessment of expenses and attorneys' fees in actions or proceedings against directors, officers or employees of corporations brought by or on behalf of a corporation.

2 It was drafted and urged by some of those connected with the State Bar committee responsible for the General Corporation Law of 1931, revised somewhat in 1933. As to the question of public policy raised by the indemnity movement, see Bates and Zuckert, Directors' Indemnity (1942) 20 Harvard Bus. Rev. 244.

tion on charges involving large sums and complicated transactions covering many years. Such litigation has given rise to widespread alarm, not to say panic, among corporate officials. The authority of the corporation or its management to reimburse directors and officers voluntarily, or even when authorized by charter or by-law provision, has been found so uncertain as to call for legislative authorization in the state of New York. In 1941 New York adopted a statute authorizing provisions for voluntary indemnity of directors and also by another statute granted judicial authority to reimburse directors and officers for their litigation expenses in event of the successful defense of suits for misfeasance or non-feasance in office.

A Kentucky indemnity statute of 1942 goes so far as to provide for mandatory indemnification of directors and officers against claims, liabilities, expenses and costs incurred in litigation by reason of their position, unless adjudged liable for actual negligence or misconduct in the performance of their duties. It also gives a right for indemnification for amounts paid in compromise settlements without approval of court.

The California statute was suggested by and based upon the New York statute as to judicial indemnity. But various deficiencies in the New York act have been met in the light of the New York decisions upon their statute and also the criticism of able writers. The New York statute was defective in not making express provision for notice to the corporation and to the plaintiff shareholder and other shareholders and giving them opportunity to make objections to the application for indemnity. This was read into the statute by implication in the case of Hayman v. Morris and is expressly provided for in the California act.

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4 Hays, loc. cit. supra note 3; Hornstein, loc. cit. supra note 3.
5 N. Y. Gen. Corp. Law, §27a, L. 1941, ch. 209; Washington, Corporate Executives' Compensation (1942) 416, 427, "Section 27a is based on bargaining between management and stockholders. Section 61a is based on judicial enforcement of equitable claims." Bates and Zuckert, supra note 2, at 249, 250.
9 Supra note 8. No express provision as to notice is made by Kentucky act, supra note 6a.
DIRECTORS' LITIGATION EXPENSES

MAIN FEATURES OF THE CALIFORNIA ACT

1. As pointed out above the California act makes the statutory judicial remedy exclusive. Indemnification is made to depend upon the defendant being successful either in whole or in part, and upon a finding by the court that the conduct of the party is such as fairly and equitably to merit such indemnity for reasonable expenses, including attorneys' fees.

2. The remedy extends not only to directors but also to officers and employees for expenses incurred in litigation for any alleged misfeasance or non-feasance in the performance of their duties.

3. The remedy applies not only to shareholders' derivative suits, but also to actions by the corporation, by a receiver or trustee of a corporation, by creditors, by any governmental body or by any person or corporation.

   This means that there is no limitation upon the class of complainants or the kind of proceedings to which indemnity applies. There seems no reason or principle why indemnity should be confined to one type of proceeding.

4. The indemnity may be assessed against the corporation "or its representative," either in the same action or proceeding or in a separate action or proceeding. The term "representative" is intended to refer to the receiver or trustee of a corporation. It is used in a sense similar to "personal representative" of a deceased person who administers his estate.

5. Indemnity may be awarded by the court if the defendant is successful "in whole or in part," or if the action against him is settled with the approval of the court. Under this it would seem that a defendant might be reimbursed if successful as to part of the charges made against him if they prove unjustified. No provision is made for attorneys' fees arising out of a voluntary settlement which is not brought before a court.

6. The award is in all cases to be discretionary in the sense that it turns on a determination by the court that the conduct of the party is such as fairly and equitably to merit such indemnity and extends only to reasonable expenses. It would thus not include the amount of any judgment or settlement.

7. The method of procedure is by application to the court for indemnity for expenses. Notice is to be served upon the corporation or its representative and upon the plaintiff and other parties in the action or proceeding. Provision is made that notice may be given to
the shareholders generally in the same way in which notice may be
given under section 314 of the Civil Code with respect to sharehold-
ers' meetings. It is discretionary with the court whether to order
such notice to be given and to direct its form. In some cases a posi-
tive requirement of notice to all the shareholders might be unduly
burdensome.

8. The application for indemnity may be made either by one of
the parties litigant or by the attorney or other person rendering ser-
vice to him. The court may order fees and expenses of an attorney,
accountant or other person rendering services to the party litigant to
be paid to him direct, although such person is not himself a party to
the action.

This provision was suggested by a point decided by the District
Court of Appeal in Koshaba v. Koshaba.10 The court there ordered
payment to an accountant direct for his charges for an audit of the
corporate books. This expense the court was authorized by section
357, Civil Code, to charge against the corporation. In order to re-
mote any doubt on the question provision was included in the act
giving express authority for what the court did in the case cited by
implied authority.

9. It is expressly declared that the awarding of indemnity or ex-
penses, including attorneys' fees, to the parties defendant in any such
action or proceeding, however terminated, shall be by order of court
and shall not be governed by any provision of the charter, by-laws,
resolution or agreement of the corporation, its directors or share-
holders. The rights and remedy given by this section are declared
exclusive.

10. The act does not attempt to cover the right of the plaintiff
and his attorneys to reimbursement for expenses and attorneys' fees
in shareholders' suits or otherwise as this is already covered ade-
quately at common law.11

10 (1942) 56 Cal. App. (2d) 302, 132 P. (2d) 854, 860. See also Mann v. Superior
Court (1942) 53 Cal. App. (2d) 272, 282, 127 P. (2d) 970.

Superior Court, supra note 10, at 281, 127 P. (2d) at 975; Sprague v. Ticonic National
Bank (1939) 307 U. S. 161; Allen v. Chase National Bank (1943) Misc. 40
N. Y. S. (2d) 245, 251; Kalven and Rosenfield, Contemporary Function of the Class Suit
(1941) 8 U. OF CHI. L. REV. 684, 717; Hornstein, The Counsel Fee in Stockholders' De-
rivative Suits (1939) 39 Col. L. REV. 784; Comment, Right to Attorneys' Fees in Share-
holders' Derivative Suits, op. cit. supra note 8.
THE BASIS OF LIABILITY

The only California case dealing with the reimbursement of defendant directors and officers in shareholders' suits is the superior court decision of Mann v. Hearst which was not appealed and is unreported. It is a good illustration of the amounts involved in such suits and the expenses which may be incurred. This suit was one to recover unfair profits made in violation of fiduciary duties at the expense of Hearst Consolidated Publications, Inc. against W. R. Hearst and certain other individuals and against holding companies under common control.

Judgment was granted in favor of Consolidated for over $5,000,000 against certain Hearst holding companies on the basis of various transactions found to be unfair to Consolidated through the use of dominating influence and in violation of fiduciary duty on the part of certain corporations and certain officers, executives and employees in dealings with Consolidated. Attorneys for plaintiffs and interveners were awarded attorneys' fees in excess of $800,000 and an award was made to one individual defendant of attorneys' fees in the sum of $60,000 to be paid to his assisting counsel. Nothing was allowed for his own extensive efforts as an attorney in his own behalf.

The theory as to the indemnity of the defendant director set forth by the Superior Court in a separate opinion seems unsound and unsatisfactory, although the award made seems reasonable enough. According to the view of the court it would normally be within the discretion of the management of a corporation to reimburse an officer or director who was successful in a derivative suit. According to that view the court should treat a refusal by the directors to reimburse a defendant as final and should sustain a resolution to reimburse "if the proof were such as to show that the directors believed and had reasonable ground for believing that the corporation had received substantial benefit." The reason that the court undertook to make an award in favor of the defendant Neylan was that the directors of Consolidated were disqualified to pass on the defendants' claim

12 Mann v. Hearst (Sept. 1941) Los Angeles Superior Court, No. 432,229; Comment, Right to Attorneys' Fees in Shareholders' Derivative Suits, op. cit. supra note 8, at 669, 673; Note (1942) 31 CALIF. L. REV. 59. See Mann v. Superior Court, supra note 10, as to right of an intervenor in that suit.

13 Mann v. Hearst, supra note 12, memorandum opinion re attorney's fees for John Francis Neylan, defendant. The opinion states that mere vindication of director's conduct of corporate affairs is not enough to warrant reimbursement. There must have been "direct and tangible" benefit to the corporation.
for reimbursement as all of them had been made defendants in the action.\textsuperscript{14}

It seems to be an entirely mistaken idea to base the claim of a party defendant to reimbursement on benefit or advantage to the corporation in vindicating himself against an unfounded charge of misconduct. The New York Supreme Court in \textit{New York Dock Co. v. McCollom}\textsuperscript{15} denied that the relationship of directors to their corporation is that of agent to principal or that any legal right of indemnity for expenses existed in the absence of benefit to the corporation.\textsuperscript{16}

A New Jersey court, on the other hand, in \textit{Solimine v. Hollander}\textsuperscript{17} found a right of reimbursement of directors by the corporation for reasonable expenses of derivative suits in an analogy to trustees and other fiduciaries subjected to unjust charges and vindicated of the alleged misconduct, even though the expenses incurred did not bring property or other benefit to the corporation.

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 that of the 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.\textsuperscript{18} The same principle is recognized as between trustee and beneficiary and in other representative relations.\textsuperscript{19} There seems to be no reason to withhold indemnity from employees other than officers as the line between officers and such executive employees as managers may be difficult to draw.

\textsuperscript{14} Comment, \textit{Right to Attorneys' Fees in Shareholders' Derivative Suits}, \textit{op. cit. supra} note 8, at 673.


\textsuperscript{17} (1941) 129 N.J. Eq. 264, 19 A. (2d) 344, noted (1941) 26 \textit{Minn. L. Rev.} 119. “That faithful fiduciaries are to be indemnified out of the trust property for their necessary expenses” see citations in Application of Bailey, \textit{supra} note 16, 37 N.Y.S. (2d) at 279.

\textsuperscript{18} MECHEM, \textit{AGENCY} (2d ed. 1914) §1603; WILLISTON ON \textit{CONTRACTS} (rev. ed. 1936) §1026; \textit{RESTATEMENT OF \textit{AGENCY}}, §43a. See Comment (1940) 49 \textit{Yale L.J.} 1423, 1427-1438.

\textsuperscript{19} 4 \textit{BOGERT, TRUSTS AND TRUSTEES} (1935) §971; 2 \textit{SCOTT, TRUSTS} (1939) §188.5; Washington, \textit{op. cit. supra} note 15, at 446-448. See note 17 \textit{supra}. \textit{CAL. CIV. CODE} §2273.
It is perhaps unusual to impose on a principal the obligation to reimburse his agent for the expenses of litigation in the successful defense of a suit brought by the principal himself on charges of non-performance or misperformance of his duties as contrasted with suits brought against the agent by third parties. The basis of liability in a direct suit is, however, the same as in a derivative suit, viz., that the employee has been put to unjustified expense by reason of his employment.

As Washington says in his article on Litigation Expenses of Corporate Directors in Stockholders’ Suits, “Under modern conditions, then, it seems unfair to ask directors to bear the expense of defending stockholders’ suits which turn out to be groundless . . . stockholders cannot expect to obtain high-calibre directors under such conditions.”

THE EVILS OF UNFAIR BY-LAW REGULATIONS

Many lawyers may feel inclined to raise objection to the feature of this statute abrogating all indemnity provisions heretofore adopted by corporations by vote of their shareholders and embodied in their by-laws or even in their articles of incorporation. By-law amendment has been the favorite method of securing indemnity provisions from the shareholders.

While some by-laws may be reasonably fair and satisfactory, many of them are quite otherwise. The necessity for outlawing by-law provisions may best be ascertained by an examination of the facts as to the terms, scope and tendency of the by-laws which have actually been adopted. Such a painstaking examination has been made by Bates and Zuckert as the basis for their noteworthy article, “Directors’ Indemnity: Corporate Policy or Public Policy?” This article demonstrates a most pernicious and dangerous development. Many

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22 Washington, op. cit. supra note 5, at 396, 399, 478-495 (sample forms); Jervis, Corporate Agreements to Pay Directors’ Expenses in Stockholders’ Suits (1940) 40 Col. L. Rev. 1192, 1202.

23 (1942) 20 HARV. Bus. REV. 244. See also Comment, Right to Attorneys’ Fees in Shareholders’ Derivative Suits, op. cit. supra note 8, at 674; Washington, op. cit. supra note 5, at 373, 389.
of the indemnity provisions in common use will probably be held void, in whole or in part, if tested by litigation. In the meantime, however, they are likely to be relied and acted upon by the illegal disbursement of thousands of dollars to directors and officers who have been seriously at fault. Shareholders will have no adequate remedy to recover such illegal payments.

As Washington and other writers have shown, there is the greatest variety in these by-laws as to what is indemnified against and as to the authority granted to the directors to disburse corporate funds for their own benefit, not only in payment of litigation expenses, but also for amounts paid on judgments and settlements. Some of these provisions extend to situations where indemnity could scarcely be upheld by the courts. Some provisions grant indemnity in all cases except when a director or officer is finally adjudged liable for willful misconduct. This exculpates officials for negligent breach of duty and in effect changes the legal standard of fiduciary obligation. Under some provisions a director who has acted in bad faith could settle and still be fully reimbursed. In others indemnity is granted where suits have been defended on technical, procedural grounds, and not on the merits, or even where suits have been unsuccessfully defended. Indemnity may be granted for suits settled without court approval and for the expenses of preparing for threatened suits. Many of the by-laws are ambiguous and difficult to interpret and apply. There is also the problem of the effect of adverse interest and of self dealing on the part of the directors in granting themselves and their associates indemnity.24

Some by-laws provide for indemnity to officers and directors of a corporation who are requested to act as officers or directors for some subsidiary corporation. Thus a person may be guaranteed indemnity for litigation expenses incurred in services performed at the request of a parent corporation for a subsidiary corporation although the interests of the parent may be adverse to the interests of the corporation to which he is a fiduciary. It would seem that officers and directors should look for indemnity to the corporation on whose behalf the expenses were incurred and should not be granted immunity by a parent for acting as puppets in the management of a subsidiary corporation.24a

24a See Archer's Case [1892] L. R. 1 Ch. Div. 322, 341, "The director is really a watch-dog, and the watch-dog has no right . . . to take a sop from a possible wolf."
These matters may be illustrated by quotations from the proxy statements sent out to the shareholders in certain corporations whose shares are listed on the New York Stock Exchange. For example in a notice of annual meeting sent out by such a corporation in March, 1943, the following information is given as to a proposed indemnification provision to be included in the by-laws of the company:

"The reason for this proposed amendment is that the management believes that persons serving as directors and officers are entitled to a reasonable measure of protection against financial loss for serving in those capacities and that the amendment will aid the Company in continuing to secure and retain the services of competent and responsible persons to perform the duties of such offices. The proposed amendment entitles each director and officer to indemnity against expenses, judgments, court costs, attorney fees, incidental expenses and the cost of certain settlements to the extent provided hereinafter, incurred in connection with any claim or litigation or other proceeding in which he may be involved by reason of being or having been a director or officer of the Company, but not in cases where he shall be finally adjudged liable by reason of having being derelict in the performance of his duties, nor in cases where the claim of liability is asserted by the Company itself or is settled by payment to the Company itself.

"The expenses indemnified against do not include any amounts paid in settlement to the Company itself; nor any amounts paid to others unless the settlement and the amount of the indemnity shall have been approved by a disinterested majority of the Board of Directors or by a majority vote of the outstanding shares other than those held by the persons involved in any such claim or by a court of competent jurisdiction.

"It is recognized that indemnification will be available in respect of judgments and other expenses in cases where there is no adjudication on the question of dereliction in the performance of duty, and in cases where a director or officer succeeds in defeating the claim on grounds other than the merits, for example, on procedural grounds or because of unwarranted delay in bringing the action. In respect of settlements there is, of course, no final adjudication as to whether or not the director or officer has been derelict in the performance of his duties. However, amounts paid in settlement and expenses incurred in connection therewith are limited as hereinafore set forth."

One of the most extreme by-law provisions adopted by a few corporations purports to give the company the right to intervene in and defend all actions in which directors or officers are sued for negligence or misconduct in performance of their duties. This is a very extraordinary provision because in general a corporation is forbidden
to step in and defeat what is practically its own suit when a shareholder brings a suit against officers or directors on behalf of the corporation which the management has failed or refused to bring. It is exceedingly unfair for the officers in control to use the corporate resources in their own behalf and to impose on it the burden of fighting their own case when by the general law the corporation is required to take a wholly neutral position in the contest.\footnote{Meyers v. Smith (1933) 190 Minn. 157, 251 N.W. 20; Slutzker v. Rieber (1942) 132 N.J. Eq. 412, 28 A. (2d) 528; see Washington, \textit{Company's Role in Stockholders' Derivative Suits} (1940) 25 \textit{Corn. L. Q.} 361, 367; \textit{Washington, op. cit. supra} note 5, at 321, 325, 333, 408, 409.}

A quotation may be made from a proxy statement issued in September, 1941, by a shipbuilding company whose shares are listed on the New York Stock Exchange, in support of a by-law for indemnification of directors and officers, containing such a provision on behalf of the management.

"Under the proposed By-law, directors and officers of the Company will be entitled to indemnity in relation to matters as to which they shall not be finally adjudged to be liable for negligence or misconduct in the performance of their duties as such directors and officers, such indemnity to include indemnification for amounts of judgments and amounts paid in settlement of claims in addition to expenses incurred in connection with such judgments and such settlements.

"It is pointed out that within the scope of the above amendment any director or officer shall be indemnified in respect of any claim asserted or proceeding brought which does not involve a determination of the question of negligence or misconduct, and further, that in case of a settlement of any action or proceeding before final adjudication, such right of indemnification shall exist (except as to amounts paid or payable to the corporation) to the extent that the Board of Directors may determine, even though such settlements may include cases in which liability involving negligence or misconduct might have been established had the case proceeded to adjudication.

"In case of judgments in favor of a director or officer, reimbursement for costs and expenses will be available under the proposed amendment, although the judgment is rendered on grounds other than freedom from negligence or misconduct, such as procedural defects or unwarranted delay of the plaintiff in bringing the action.

"Under the proposed amendment,—in the event that the Company intervenes in and defends any action, suit or proceeding brought against a director or officer, the Company shall have the right to make payments in settlement of liability asserted against such director or officer, provided such director or officer be not finally adjudged to be liable for negligence or misconduct in the performance
of his duties as such director or officer, and any director or officer will be entitled to claim indemnification against expenses incurred by him in addition to expenses incurred in his defense, if he be not so adjudged.

"It is pointed out that there is no provision in the proposed amendment requiring a director or officer to reimburse the Company for its expenses incurred in the event that the Company shall intervene in any action or proceeding brought against such director or officer, so that if the Company intervenes in or defends any such action or proceeding, it may not be entitled to be reimbursed for its expenses by such director or officer.

"The proposed amendment, according to its terms, may have the effect of authorizing the indemnification of directors and officers in certain cases against liability, adjudicated or compromised, and related expenses, under state or federal legislation, particularly federal legislation for the protection of investors commonly known as the Securities Act of 1933 and the Securities Exchange Act of 1934. However, it is not the intention of the Management that the proposed amendment shall have the effect of authorizing reimbursement in any case in which reimbursement or a contract therefor would be against public policy or in contravention of law."

By-law provisions are sometimes spoken of as giving a "contract indemnity" but there is no bargaining with the corporation nor any real contract. The scattered shareholders have no bargaining position and are not even represented. Counsel for the corporation is usually identified with the management and seeks to advance the management’s interest, when there is a conflict. The by-laws, as we have seen, are frequently drawn to give the maximum possible protection to the management, sometimes even more than is possible.

The right of shareholders to vote for by-laws is supposed to be a safeguard. But it may be observed in connection with by-laws authorizing compensation plans, bonus plans, stock purchase plans and pensions as well as indemnity provisions, that the proposals are dictated by the management. The proxies are signed by the scattered shareholders blindly without knowing or understanding what they are really voting about and authorize the application of a rubber stamp to the proposals of the management.

If a jurisdiction decides to continue to allow such by-law pro-

26 Indemnity provisions against the risk of these federal liabilities raise difficult questions. See Washington, op. cit. supra note 5, at 356, 363; Comment (1940) 49 Yale L. J. 1423.

27 See Berle and Means, The Modern Corporation and Private Property (1932) 81-89, 139, 245; Ballantine, Voting Trusts, Their Abuses and Regulation (1942) 21 Texas L. Rev. 139, 140.
visions at all, some regulation should be adopted to limit pernicious blanket provisions which are so extreme as to be of doubtful fairness or legality. In order that the shareholders may have some degree of protection, a standard form of provision should be prescribed by statute, or else all such provisions should be passed upon and subjected to the approval of an administrative board or securities commission as if they were changes in the terms of the shareholders’ contract. Such supervision has been considered in Illinois and also by the Securities and Exchange Commission. The provision made by section 27a of the New York General Corporation Law is entirely unsatisfactory as a regulation of indemnity provisions and should be drastically revised or better repealed. There are some legal disorders which cannot be cured by the poultice treatment but require a radical surgical operation. This was the view of those who drafted the California act.

SOME QUESTIONS OF CONSTITUTIONALITY

Mr. George D. Hornstein, in a recent article urging the revision of the present New York provisions as to indemnity of directors, raises certain questions of constitutionality of the New York section (61a) for judicial indemnity from which certain features of the California act have been drawn. He expresses the opinion that a statute discriminates arbitrarily against corporations when it directs that a corporation which unsuccessfully sues its fiduciaries must pay not only court “costs” but also actual expenses, whereas an individual who unsuccessfully institutes a suit against his agent is penalized only in the usual statutory costs.

It would seem that the great expense and burden of corporate litigation to corporate employees may furnish a sufficient ground for this classification. As Mr. Hays says in an article in the same issue of the Columbia Law Review, referring to stockholders’ derivative suits,

“They comprehend, from the factual side, all of the complexities and intricacies of modern business and corporate finance; and from the

28 Washington, op. cit. supra note 5, at 373, 390-392; Bates and Zuckert, op. cit. supra note 2, at 258.
29 See Washington, op. cit. supra note 5, at 416, 423, 427. It is reported that the New York Law Revision Commission is considering a possible revision of one or both New York provisions.
30 Hornstein, op. cit. supra note 3, at 309.
31 Hays, op. cit. supra note 3, at 280.
legal side, every aspect of the relationships between management and stockholders, of stockholders inter se, and between parent corporation and subsidiaries. Their preparation often involves years of work by a large staff of experienced lawyers and accountants."

Another point raised by Mr. Hornstein is the lack of any reciprocal provision in favor of the corporation against the defendants for its litigation expenses in event of success. The courts, however, do not in all cases require a reciprocal statutory provision for attorneys' fees. Such a provision might not be advisable. A recent California case recognizes a wide legislative discretion in making classifications as between parties litigant which cannot be overthrown unless palpably arbitrary and without any conceivable ground in policy. The legislature was dealing with an actual mischief and the act was made as broad in its scope as seemed necessary from a practical point of view. It is based on the policy of reasonably protecting officials and employees against the burdens of corporate litigation in which they may become involved. It is also based on the policy of regulating abuses and providing some substitute for the mass of by-laws which have been adopted by different corporations which are often unfair and oppressive to the shareholders.

Another point raised by Mr. Hornstein is with reference to the retroactive provision which makes the statute apply to pending proceedings as well as to those commenced after its enactment. It is true that the act purports to impose a duty on corporations to reimburse their directors, officers and agents as to expenditures which may in part already have been incurred in defending the due performance of their duties. In general, however, it has been held that such retrospective or retroactive legislation is not invalid. Even if the incidental provision of the statute on this point were to be held invalid it is not an essential part of the statutory scheme, but is clearly severable from the rest of the statute.

Some question may be raised as to the application of the statute to foreign corporations. A similar provision in the New York act has

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82 Hays, op. cit. supra note 3, p. 280 at n. 20, "The depositions taken in the case of Mann v. Hearst (Super. Ct., Cal. 1941), not reported, covered 11,482 pages. . . ."


been upheld by the New York Supreme Court. By the California Constitution, Article XII, Section 1, the legislature may prescribe by general laws for the powers, rights, duties and liabilities of corporations and of their officers and stockholders. By Section 15 of Article XII no corporation organized outside of this state shall be allowed to transact business within the state on more favorable conditions than are prescribed by law for similar corporations organized under the laws of this state.

Some question may also be raised as to the application of the statute to national banks. National banks are subject to all nondiscriminatory state laws that do not interfere with their functions or tend to impair their efficiency as federal agencies. Whether or not this act will come within this vague test is a question which can only be answered by the Supreme Court of the United States. In the meantime the safer course for national banks in this state would be to assume that they are governed by this act.

**COMPARISON WITH KENTUCKY STATUTE**

The writer believes that it will be found much better for all concerned for indemnity to be covered by a statute equally applicable to all corporations and their directors, officers and agents, and to do away as this act has done with all the great variety of by-law indemnity provisions which may be unfair and contrary to public policy. As it has been well expressed,

"The right to reimbursement should not turn on the existence of an individual contract or a corporation by-law. Nor should the right to reimbursement lie in the managerial discretion of the directors, as the California superior court has suggested. The allowance or denial of attorneys' fees and costs is properly a matter for the court to decide. Only the judge is in a position fairly to determine the merits of the cause and the value of the attorneys' services rendered therein. More often than not, the association of the members of a board of directors with a fellow director will be too intimate to permit an unbiased consideration of his claim for reimbursement, even where the board is possessed of the facts necessary to a just decision."

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35 Hayman v. Morris, supra note 8, at 897.
37 Comment, Right to Attorneys' Fees in Shareholders' Derivative Suits, op. cit. supra note 8, at 675, 676.
The California indemnity statute attempts to give adequate protection to the corporation and its shareholders. The Kentucky act of 1942 is in striking contrast to the California act. It gives a right of indemnity even when a director or officer escapes liability on grounds other than freedom from negligence or misconduct, such as procedural defects, dismissal or delay in suit. It is modeled on some of the current management-sponsored by-law provisions and embodies evils pointed out above. There is no provision for judicial approval of settlements, or for a judicial finding that the conduct of the party has been such as fairly and equitably to merit indemnity.

The Kentucky act gives a right to recover amounts paid by a director or officer in the compromise settlement of any claim asserted against him, provided the board of directors has first approved such settlement and determined that the director or officer involved is not guilty of actual negligence or misconduct. No director "involved" is qualified to vote thereon. If for this reason a quorum of directors cannot be obtained, the settlement shall be passed on by a committee of three disinterested stockholders appointed at a stockholders’ meeting.

The act leaves too much to the discretion of the directors. The provisions for impartial voting by directors or stockholders are utterly impractical and cannot be enforced. Who is to pass upon their impartiality? They themselves. It can all be handled very quietly. The question can be contested only after the fact when it will be impossible to ascertain the actual bias of those voting. There is no assurance of careful investigation by competent persons. As pointed out above, the allowance and assessment of attorneys' fees to fiduciaries who are sued is properly a matter for a court to decide.

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38 Supra note 6a.