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By Donald L. Shaneyfelt*

The Personal Liability Maze of Corporate Directors and Officers

I. INTRODUCTION

The precedent shattering impact of *Escott v. BarChris Construction Corp.*,¹ *Mitchell v. Texas Gulf Sulphur Co.*,² and related cases coupled with more stringent standards imposed by state legislatures and courts mandate that corporate directors and officers re-examine their duties and responsibilities if they are to avoid personal liability for improper actions taken in the corporate name. This is true even though the United States Supreme Court recently has shown some moderation in its approach to such liability in *Sante Fe Industries, Inc. v. Green*,³ *Blue Chip Stamps v. Manor Drug Stores*,⁴ and *Ernst & Ernst v. Hochfelder*.⁵ However, the trend towards strict accountability leading to possible individual liability still thrives and extends to corporations, their officers, inside directors, outside directors, underwriters, accountants, lawyers and even to "tippees."⁶ Further encouragement to plaintiffs in shareholder derivative actions is the availability of jury trials.⁷ This trend will continue so long as society follows the practice, "if in doubt, litigate."

In approaching this topic it is essential to maintain the distinc-

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1. 283 F. Supp. 643 (S.D.N.Y. 1968).

2. 446 F.2d 90 (10th Cir.), cert. denied, 404 U.S. 1004 (1971).

3. 430 U.S. 462 (1977) (plaintiff must allege deception derived from some material misstatement or omission).

4. 421 U.S. 723 (1975) (there must be a purchaser/seller relationship to meet standing requirement).

5. 425 U.S. 185 (1976) (scienter required for rule 10b-5 liability).

6. SEC v. Texas Gulf Sulphur Co., 401 F.2d 833, 841 n.4 (2d Cir. 1968), cert. denied, 394 U.S. 976 (1969) (defendants had divulged material inside information to friends outside the corporation, and such information was used by the "tippees" to make purchases). See also Note, *Rule 10b-5: Scope of Liability Extended as Former Outsiders Become Market Insiders*, 58 NEB. L. REV. 866 (1979).

7. *Ross v. Bernhard*, 396 U.S. 531 (1970).

tion between suits involving internal mismanagement and those in connection with securities sales. This is particularly important in view of the Supreme Court's emphasis on the desirability of leaving supervision of most areas of corporate management to the state courts.⁸ This article will discuss potential individual liability of corporate directors and officers in shareholder derivative suits and third party actions under selected federal laws, the Nebraska Business Corporation Act,⁹ and the common law as interpreted by Nebraska courts. Indemnification, contribution and liability insurance will be included in this discussion. However, Securities and Exchange Commission (SEC) enforcement actions are not included.

II. LIABILITY IN NEBRASKA

A. Nebraska Business Corporation Act

With regard to director liability, Section 21-2046 of the Nebraska Business Corporation Act¹⁰ which has been adopted for the most part from the Model Business Corporation Act,¹¹ specifically provides that all directors who vote for or assent to declarations of illegal dividends, sales of shares, or distributions of assets shall be jointly and severally liable to the corporation for specific amounts determined by a procedure set forth in the statute.¹² A director is

8. *Piper v. Chris-Craft Indus. Inc.*, 430 U.S. 1 (1977). See *Santa Fe Indus., Inc. v. Green*, 430 U.S. 462 (1977).

9. NEB. REV. STAT. §§ 21-2001 to 21-20,134 (Reissue 1977).

10. *Id.* § 21-2046.

11. AMERICAN BAR FOUNDATION, MODEL BUSINESS CORPORATION ACT ANNOTATED § 48 (1st ed. 1960) [hereinafter cited as MODEL BUS. CORP. ACT. ANN.].

12. In addition to any other liabilities imposed by law upon directors of a corporation:

(1) Directors of a corporation who vote for or assent to the declaration of any dividend or other distribution of the assets of a corporation to its shareholders contrary to the provisions of section 21-2001 to 21-20,134 or contrary to any restrictions contained in the articles of incorporation, shall be jointly and severally liable to the corporation for the amount of such dividend which is paid or the value of such assets which are distributed in excess of the amount of such dividend or distribution which could have been paid or distributed without a violation of the provisions of sections 21-2001 to 21-20,134 or the restrictions in the articles of incorporation;

(2) Directors of a corporation who vote for or assent to the purchase of its own shares contrary to the provisions of sections 21-2001 to 21-20,134 shall be jointly and severally liable to the corporation for the amount of consideration paid for such shares which is in excess of the maximum amount which could have been paid therefor without a violation of the provisions of sections 21-2001 to 21-20,134;

(3) The directors of a corporation who vote for or assent to any distribution of assets of a corporation to its shareholders during the liquidation of the corporation without the payment and discharge of, or making adequate provision for, all known debts, obligations, and

presumed to assent to actions taken unless his dissent is entered in the minutes of the meeting or unless he files a written dissent with the person acting as secretary for the meeting.¹³ The section also establishes certain defenses to personal liability where the director relied and acted in good faith on financial statements of the corporation which were represented as being correct by the president or officer having charge of its books of account, or which were stated in a written report by an independent accounting firm.¹⁴ The Act further provides that any director held liable for an improper dividend or distribution of assets shall be entitled to contribution in proportion to the amounts received by the shareholder who accepted or received the dividends or assets knowing them to have been improper.¹⁵ A director is also entitled to contribution from other directors who voted for or assented to the improper ac-

liabilities of the corporation shall be jointly and severally liable to the corporation for the value of such assets which are distributed, to the extent that such debts, obligations and liabilities of the corporation are not thereafter paid and discharged; and

(4) The directors of a corporation who vote for or assent to the making of a loan to an officer or director of the corporation, or the making of any loan secured by shares of the corporation, except as permitted in sections 21-2001 to 21-20,134, shall be jointly and severally liable to the corporation for the amount of such loan until the repayment thereof.

Neb. Rev. Stat. § 21-2046 (Reissue 1977).

13. A director of a corporation who is present at a meeting of its board of directors at which action on any corporate matter is taken shall be presumed to have assented to the action taken unless his dissent shall be entered in the minutes of the meeting or unless he shall file his written dissent to such action with the person acting as the secretary of the meeting before the adjournment thereof or shall forward such dissent by registered mail to the secretary of the corporation immediately after adjournment of the meeting. Such right to dissent shall not apply to a director who voted in favor of such action.

Id.

14. A director shall not be liable under subdivision (1), (2) or (3) of this section if he relied and acted in good faith upon financial statements of the corporation represented to him to be correct by the president or the officer of such corporation having charge of its books of account, or stated in a written report by an independent public or certified public accountant or firm of such accountants fairly to reflect the financial condition of such corporation, nor shall he be so liable if in good faith in determining the amount available for any such dividend or distribution he considered the assets to be of their book value.

Id.

15. Any director against whom a claim shall be asserted under or pursuant to this section for the payment of a dividend or other distribution of assets of a corporation and who shall be held liable thereon, shall be entitled to contribution from the shareholders who accepted or received any such dividend or assets, knowing such dividend or distribution to have been made in violation of sections 21-2001 to 21-20,134, in proportion to the amounts received by them.

Id.

tion.¹⁶ Since no other provision concerning liability of directors and officers is found in the Nebraska Business Corporation Act much is left to common law principles of liability. This is particularly true in view of the lack of a defense under the Act where an illegal payment has been made and the director was not aware of the illegality through his own negligence.

B. Nebraska Securities Act¹⁷

Section 8-1102(1) of the Nebraska Revised Statutes makes it unlawful for anyone engaged in the offer, sale, or purchase of a security to employ any scheme to defraud, make any untrue statement of a material fact, omit a material fact making the statements misleading, or engage in any fraudulent act.¹⁸ This section is patterned after SEC rule 10b-5¹⁹ and is likely to be given a similar application by the courts insofar as the personal liability of directors and officers is concerned.²⁰ There are two major differences, however: (1) In most rule 10b-5 cases the burden of proof rests with the plaintiff,²¹ while under the Nebraska Act the burden of proof rests with the defendant.²² (2) Recovery is also permissible for negligent omission or untruth under the Nebraska Act,²³ while scienter is required under rule 10b-5.²⁴ On the other hand, under the Nebraska Act standing is limited to purchasers of securities.²⁵ The Act contains no language which would indicate an intent to preempt the area; therefore, it appears that common law actions may be pursued in lieu of bringing action under the Act.²⁶

C. Common Law

The Nebraska Supreme Court has consistently followed a strict common law policy with regard to director and officer liability. The 1935 case of *Ashby v. Peters*²⁷ involved the sale of bonds. The

16. "Any director against whom a claim shall be asserted under or pursuant to this section shall be entitled to contribution from the other directors who voted for or assented to the action upon which the claim is asserted." *Id.*

17. *Id.* §§ 8-1101 to -1124.

18. *Id.* § 8-1102(1).

19. 17 C.F.R. § 240.10b-5 (1978).

20. See § III-B of text *infra*.

21. 17 C.F.R. § 240.10b-5 (1978).

22. NEB. REV. STAT. § 8-1102(1) (Reissue 1977).

23. *Id.*

24. *Ernst & Ernst v. Hochfelder*, 425 U.S. 185 (1976).

25. NEB. REV. STAT. § 8-1102(1) (Reissue 1977).

26. For a complete discussion of this aspect of the Securities Act of Nebraska, see Comment, *The Securities Act of Nebraska: An Overview*, 56 NEB. L. REV. 836 (1977).

27. 128 Neb. 338, 258 N.W. 639 (1935).

bonds themselves and the selling circulars indicated the bonds would be a first mortgage on certain property while in fact there was already a sizable mortgage on the property. Individual directors were sued for fraud by a purchaser of the bonds. The directors defended on the theory that they did not know what the statements contained and that they had delegated the responsibility of drafting the statements to an executive committee.²⁸ The court held that "[w]here the duty of knowing exists, ignorance due to neglect of duty on the part of a director creates the same liability as actual knowledge and a failure to act thereon."²⁹ The court further adopted the language that "[directors] may not delegate their responsibility, and are not excused from liability because they committed their duties to an executive committee."³⁰ The test used by the court was that "[t]he law requires of directors such diligence and supervision as the situation and the nature of the business requires. Their duty is to watch over and guard all the interests committed to them."³¹ In *Ashby*, plaintiff alleged that the directors had fraudulently induced him to purchase the bonds in question. The court in this regard stated: "Fraud in Nebraska may be without scienter or knowledge."³²

In a 1977 case, *Fowler v. Elm Creek State Bank*,³³ the Nebraska Supreme Court reinforced its position with regard to individual liability. The case was tried on two causes of action—one for fraud, the other for negligent mismanagement and dissipation of corporate assets. The trial court held for plaintiff on both counts and its findings were upheld by the supreme court. In its decision, the supreme court stated:

[A]n individual director cannot escape liability for fraudulent corporate action taken under authorization affirmatively approved by him merely by asserting his ignorance of facts he had a duty to know and should have known. Where the duty of knowing facts exists, ignorance due to neglect of duty on the part of the director creates the same liability as actual knowledge and a failure to act thereon.³⁴

From the language of the *Fowler* case, an allegation of negligence appears to suffice as a basis for civil liability in Nebraska. The neg-

28. *Id.* at 345, 258 N.W. at 643.

29. *Id.* at 348, 258 N.W. at 644.

30. *Id.* at 346-47, 258 N.W. at 643.

31. *Id.* at 347, 258 N.W. at 643.

32. *Id.* at 346, 258 N.W. at 643.

33. 198 Neb. 631, 254 N.W.2d 415 (1977).

34. *Id.* at 638, 254 N.W.2d at 419.

ligence test applied by the court may be higher for one individual than for another depending upon the individual's position of responsibility in the company, but scienter is not required in any event.

Recently the Nebraska Supreme Court handed down its decision in *Doyle v. Union Insurance Co.*³⁵ which adopts the position set out above and clarifies to a great extent common law director and officer liability in Nebraska. This case involved the sale of assets of one company to another company at a price much below their actual value. The sale had been approved by a majority of the board of directors, a majority of the policyholders and the Nebraska Director of Insurance. The lower court found the directors who voted for the sale personally liable on the basis that they had breached their fiduciary duty to the corporation and shareholders. This decision was upheld by the supreme court. The legal basis for liability of the directors was their negligence in failing to inform themselves in an appreciable degree on a matter of utmost importance to the policyholders. In reaching this result the court adopted certain general principles³⁶ as to director duties. Directors are fiduciaries or trustees and must comply with their fiduciary duties in dealing with the corporation and its shareholders. Where a director has acted in complete good faith and breached no fiduciary duty then he is not liable for mere mistakes in judgment. However, a violation by a trustee of a duty required by law, whether willful, fraudulent or negligent is a breach of trust and the trustee is liable for any damages proximately caused by the breach. Where directors are empowered to sell all the assets of the corporation, they must act with at least the degree of care that ordinary prudent man would exercise in their own affairs. With regard to the question whether policyholder approval ratified avoidable acts of the directors and thereby absolved them of liability, the court found that a complete disclosure of all material facts was not made to the policyholders and for that reason policyholder approval did not operate as a ratification.³⁷ The Nebraska common law standard of conduct for directors and officers is now clearly established at a standard as high or higher than that imposed by the courts with regard to civil actions under the Federal Securities Act of 1933³⁸ and the Securities Exchange Act of 1934.³⁹

35. 202 Neb. 599, 277 N.W.2d 36 (1979).

36. *Id.* at 608, 277 N.W.2d at 41.

37. *Id.* at 622, 277 N.W.2d at 47.

38. Securities Act of 1933, 15 U.S.C. § 77 (1933) [hereinafter cited as 1933 Act].

39. Securities Exchange Act of 1934, 15 U.S.C. § 78 (1934) [hereinafter cited as 1934 Act].

III. LIABILITY UNDER THE FEDERAL SECURITIES ACTS

A. Liability Under Sections 11, 12 and 15 of the Federal Securities Act of 1933

The main source of litigation covering personal liability under these sections involves the registration statement⁴⁰ which must be filed with the SEC before any public offers of securities can be made through the mail or in interstate commerce. Although only a majority of the board of directors is required to sign the statement, every person who at the time of filing was a director of the issuing corporation or performed functions similar to those of a director or who, with his consent, is named in the registration statement as being or about to become a director, is also responsible for its contents.⁴¹

Under section 11, an innocent purchaser who had no reason to doubt the accuracy of a company's registration statement, has a right of action against these individuals if there were material omissions or untruths as of the effective date of the statement. A "material" omission or untruth is one which, if it had been revealed or truthfully reported, would deter, or tend to deter, an average person from buying the security.⁴²

Liability under section 11, however, is not absolute. The available statutory defenses include (1) proof that the investor knew of the untrue omission at the time he acquired the security; (2) proof that the investor relied on the misrepresentation or omission if securities were acquired subsequent to the time an earnings statement was generally available to security holders;⁴³ (3) due diligence on the part of directors and officers, but not on the part of the issuer;⁴⁴ (4) a resignation prior to the effective date of the registration statement, with notification to the SEC and issuer; and (5) where a registration statement became effective without the knowledge of the individual and he informed the SEC and the public he was unaware of the registration statement as soon as he learned it had become effective.⁴⁵

40. A registration statement is composed of a prospectus and other information which is available to the public from SEC files.

41. 1933 Act, § 6(a), 15 U.S.C. § 77f(a) (1976). A majority of the board of directors, the principal executive officer, principal finance officer, and the comptroller or principal accounting officer must sign the registration statement.

42. 1933 Act, § 11(a), 15 U.S.C. § 77h(b) (1976). See generally R. JENNINGS & H. MARSH, *SECURITIES REGULATION: CASES AND MATERIALS* 825-35 (4th ed. 1977).

43. The earnings statement must cover a period of at least 12 months beginning after the effective date of registration.

44. The standards of required diligence differ as between the expert and nonexpert.

45. 1933 Act, § 11b(2), 15 U.S.C. § 77k(b)(2) (1976).

Section 12 of the Act provides for civil liability where a person offers or sells a security without complying with registration requirements required by section 5 of the Act.⁴⁶ A director or officer is an "offerer" or "seller" within the meaning of section 12 if his "actions are a substantial factor in causing a purchaser to buy a security. . . . It is unnecessary to show that the offeror or seller owns the security for the definition encompasses any significant participation in the sale on behalf of the actual owner."⁴⁷ In such a case the individual liability extends to "the consideration paid for such security with interest thereon, less the amount of any income received thereon, upon tender of such security, or for damages if he no longer owns the security."⁴⁸

Is a director or officer of the issuer which sells securities in violation of section 5 liable if he personally does not make the sale? In such a case if he "controls" the issuer, he is liable under section 15 "unless the controlling person had no knowledge of or reasonable ground to believe in the existence of the facts by reason of which the liability of the controlled person is alleged to exist."⁴⁹ No requirement of reasonable investigation is imposed on a controlling person, but there must be a reasonable basis for his belief.

The SEC in rule 405 defines control as "the possession, direct or indirectly, of the power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting securities, by contract, or otherwise."⁵⁰ This definition obviously covers most corporate directors and officers.

All section 11 and 12 suits must be brought "within one year after the discovery of the untrue statement or the omission, or after such discovery should have been made by the exercise of reasonable diligence In no event shall any such action be brought . . . more than three years after the security was bona fide offered to the public"⁵¹ Recoverable damages are the difference between the amount paid for the security (not exceeding the price at which it was offered to the public) and its value at the time of the suit; or if the damages are less than the damages represented by the difference between the amount paid for the security and its value at the time of the suit, the difference between the amount paid and the price at which the security could have been disposed of in the market before suit, or the price at which the security could have been disposed of after suit but before judg-

46. 1933 Act, § 12(1), 15 U.S.C. § 77i(1976); 1933 Act, § 5, 15 U.S.C. § 77e (1976).

47. *Lawler v. Gilliam*, 569 F.2d 1283, 1287-88 (4th Cir. 1978).

48. 1933 Act, § 12, 15 U.S.C. § 77i (1976).

49. 1933 Act, § 15, 15 U.S.C. § 77o (1976).

50. 17 C.F.R. § 240.12b-2(f) (1978).

51. 1933 Act, § 13, 15 U.S.C. § 77m (1976).

ment.⁵²

Except for the defense of due diligence⁵³ and the question of what is a "material" omission,⁵⁴ the above enumerated defenses permit only rudimentary interpretation.

1. Due Diligence

With regard to due diligence, the court in *Escott v. BarChris Construction Corp.*⁵⁵ extensively analyzed the section 11 due diligence defenses. The statutory defense is two-pronged, requiring a more stringent standard for non-expert portions of the registration statement as opposed to those purported to be made on the authority of an expert.⁵⁶ Judge McLean, under the facts of *BarChris*, held that auditors were experts while attorneys and underwriters were not.⁵⁷

Where the questioned statement is made by an expert, an investigation is not required if the non-expert directors or officers had no reason to believe that the statement was false or misleading.⁵⁸ However, on all non-expert information, the directors and officers have a duty to thoroughly investigate to meet the due diligence test.⁵⁹ The test set forth in the Act is "that required of a prudent man in the management of his own property."⁶⁰

The prudent man test must be applied in connection with the relative position of the individual in the corporate hierarchy. Inside directors and officers are the individuals potentially most liable under the Act as they are in the best position to discover and correct false or misleading statements. Their participation in the transaction in question may make it impossible for them to prove ignorance of any misrepresentation.⁶¹ Outside directors, on the other hand, have placed management in a position of trust and are entitled to rely on its information about the day-to-day conduct of the business. To require that outside directors maintain an ad-

52. 1933 Act, § 11(e), 15 U.S.C. § 77k(e) (1976).

53. See text accompanying notes 55-63 *infra*.

54. See text accompanying notes 64-67 *infra*.

55. 283 F. Supp. 643, 682-703 (S.D.N.Y. 1968). See generally Folk, *Civil Liabilities under the Federal Securities Acts: The BarChris Case*, 55 VA. L. REV. 1 (1969).

56. Non-expert portions of a registration settlement are those "not purporting to be made on the authority of an expert, and not purporting to be a copy of or extract from a report or valuation of an expert, and not purporting to be made on the authority of a public official . . ." 1933 Act, § 11(b)(3)(A), 15 U.S.C. § 77k(b)(3)(A) (1976).

57. *Escott v. BarChris Constr. Corp.*, 283 F. Supp. at 683.

58. *Id.*

59. *Id.*

60. 1933 Act, § 11(c), 15 U.S.C. § 77k(c) (1976).

61. *Escott v. BarChris Constr. Corp.*, 283 F. Supp. at 684.

verse relationship in overall management would interject a potentially detrimental conflict. Nevertheless, the outside directors, while they need not personally verify every representation made by management, may not avoid the responsibility to know and guide the affairs of the company.⁶² They should have an independent knowledge of the company's business drawn from a close reading of the documents which constitute the corporate history and any other documents which come before them for approval; they should be aware of the general conditions in the industry involved and the reputation which the company enjoys for sound management; and they should bring to bear any specialized knowledge they may have as lawyers, accountants, or underwriters. Outside directors should carefully read the registration statement and if it is inconsistent with the independent knowledge they should reasonably have acquired, they should verify the representations made by management through an adversary investigation.⁶³ Compliance with these guidelines would meet the due diligence test as established by the *BarChris* court.

2. Materiality⁶⁴

Liability under section 11 arises only when the omission or misrepresentation is "material." In *BarChris*, the court applied a test of materiality to a purchase from a primary offering by the issuer. In this factual setting, the court held material matters are those "which such an investor needs to know before he can make an intelligent, informed decision whether or not to buy the security."⁶⁵ It is most difficult, however, to apply this same standard comprehensively. What is material to a purchaser from an original issue may be completely different in other circumstances such as in an exchange offer or proxy contest. This problem was recognized by the court in *Feit v. Leasco Data Processing Equipment Corp.*⁶⁶ In that case, the action under section 11 was brought on behalf of shareholders who had exchanged their shares. The court used the "hypothetical reasonably prudent shareholder" test: "a fact is 'material' in a registration statement whenever a rational connection exists between its disclosure and a viable alternative course of action by any appreciable number of investors."⁶⁷ Thus, the specific

62. *Id.* at 688-89.

63. *Id.*

64. Materiality is an issue under all the antifraud sections of the Federal Securities Acts.

65. 283 F. Supp. at 681.

66. 332 F. Supp. 544 (E.D.N.Y. 1971).

67. *Id.* at 571.

facts of the case will determine the question of materiality and the courts will make the ultimate decision.

B. The "New Fraud" and Implied Liability Under the Securities Acts

This discussion will be limited to the general antifraud sections of the Securities Acts—section 10 of the 1934 Act and section 17 of the 1933 Act. Section 10 has produced considerable litigation in this area while section 17 has excellent potential as a source of plaintiff litigation.⁶⁸

A director or officer may incur civil and criminal liabilities under the Securities Exchange Act of 1934 in connection with

1. applications, reports, or documents filed or required to be filed by the corporation;⁶⁹
2. statements as to stock ownership in the corporation, required to be filed by the director, and transactions in such stock;⁷⁰
3. manipulation of security prices;⁷¹
4. use of manipulative and deceptive devices;⁷²
5. improper solicitation of proxies;⁷³
6. unlawful representations;⁷⁴
7. concealing material information.⁷⁵

Section 10(b) and Rule 10b-5 of the 1934 Act are broader than Section 11 of the 1933 Act in a number of respects. The 1934 Act and implementing rule apply to a large number of areas, only one of which concerns misrepresentations and omissions in registration statements.⁷⁶ In *Sargent v. Genesco, Inc.*,⁷⁷ the court held

68. For an excellent table depicting express and implied civil liabilities for misrepresentation and insider trading under the securities acts, see Hazen, *Corporate Chartering and the Securities Markets: Shareholder Suffrage, Corporate Responsibility and Managerial Accountability*, 1978 WIS. L. REV. 391, 438-39.

69. This liability may be based on sections providing express private remedies. *E.g.*, 1933 Act, §§ 11, 12(2), 15 U.S.C. §§ 77k, 771(2) (1976); 1934 Act, § 18(a), 15 U.S.C. § 78r(a) (1976). Or it may be based upon those sections creating implied remedies. *E.g.*, 1933 Act, § 17(a), 15 U.S.C. § 77q(a) (1976); 1934 Act, §§ 10(b), 14(a), 15 U.S.C. §§ 78j(b), 78n(a) (1976).

70. Such provisions include 1934 Act, §§ 13(d), 16(a), 15 U.S.C. §§ 78m(d), 78p(a) (1976).

71. Section 9(e) of the 1934 Act provides an express private remedy for manipulation, while litigants have relied on § 10(b) and rule 10b-5 as well. 15 U.S.C. §§ 78i(e), 78j(b); 17 C.F.R. § 240.10b-5 (1978).

72. 15 U.S.C. § 78j(b) (1976).

73. *Id.* § 78n(a); 17 C.F.R. § 240.14a-9 (1978).

74. See notes 69-73 *supra*.

75. *Id.*

76. So far as is here pertinent, Section 10, 15 U.S.C. 78j (1976) provides:

It shall be unlawful for any person, directly or indirectly, by the

three basic elements must be pleaded to prevail in 10b-5 actions: "(1) conduct by the defendants proscribed by the rule; (2) a purchase or sale of securities by the plaintiffs 'in connection with' such proscribed conduct; and (3) resultant damages to the plaintiff."⁷⁸ In addition, the *Genesco* court pointed out that a rule 10b-5 "plaintiff does not have to allege privity or any contemporaneous market trading by the plaintiff and defendant to state a claim for relief."⁷⁹ Although privity does not have to be alleged, privity may be a factor in establishing a causal connection between the defendant's conduct and the plaintiff's injury, and privity may determine the availability of a remedy such as rescission or restitution.⁸⁰ The necessary causal connection can also be established by pleading a nexus which reinforces the full disclosure theory underlying the Act and rule rather than one which attempts to protect a shareholder's proprietary interest.⁸¹ In *Sante Fe Industries, Inc. v. Green*,⁸² plaintiff maintained a rule 10b-5 action alleging that under a short-form merger there was an undervaluation of his shares in connection with the forced sale required by the merger. Although the lower court upheld the complaint, the Supreme Court reversed on the basis that plaintiff failed to allege an act of deception derived from some material misstatement or omission.⁸³ State law

use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—

(b) To use or employ, in connection with the purchase or sale of any security registered in a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

SEC Rule 10b-5, 17 C.F.R. § 240.10b-5 (1978), states:

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate [sic] commerce, or of the mails or any facility of any national securities exchange.

- (a) To employ any device, scheme, or artifice to defraud.
- (b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
- (c) To engage in any act, practice or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

Rule 10b-5 was promulgated pursuant to the 1934 Act, § 10(b), 15 U.S.C. § 78j(b) (1976).

77. 492 F.2d 750 (5th Cir. 1974).

78. *Id.* at 759.

79. *Id.* at 760.

80. *Id.* at 761.

81. *Id.*

82. 430 U.S. 462 (1977).

83. *Id.* at 474.

requirements on short-form merger had been fully complied with and plaintiff had been advised of all valuations of the assets including not only the one used but other valuations showing a much higher value.⁸⁴

By focusing on the element of deception, the Court clearly reinforced holdings limiting rule 10b-5 actions to actions based on full disclosure rather than the protection of proprietary interests. In this connection, Mr. Justice White stated: "[T]he court repeatedly has described the 'fundamental purpose' of the Act [10(b)] as implementing a 'philosophy of full disclosure'; once full and fair disclosure has occurred, the fairness of the terms of the transaction is at most a tangential concern of the statute."⁸⁵

In *Blue Chip Stamps v. Manor Drug Stores*,⁸⁶ the Court reversed the lower court and upheld the "*Birnbaum*" rule⁸⁷ requiring that plaintiff be either a seller or purchaser of securities in a rule 10b-5 action.⁸⁸ The question left unanswered by the Court was whether exceptions to the purchaser-seller requirement previously approved by circuit courts are still valid. Situations in which the individual makes a "delay" purchase⁸⁹ and transactions based upon a contractual agreement would appear to be situations entitled to standing.⁹⁰

In further support of the disclosure concept, the Supreme Court in *Ernst & Ernst v. Hochfelder*⁹¹ held that scienter must be present under rule 10b-5. In reaching this conclusion, Mr. Justice Powell relied heavily on a contrast of the language of rule 10b-5 with the elaborate safeguards on expert liability found in other sections of the Act such as section 11. Justice Powell defined scienter as "a mental state embracing intent to deceive, manipulate, or defraud."⁹² He noted that in certain cases recklessness is considered a form of intentional conduct for purposes of imposing liability, but stated that the court need not "address . . . the question whether, in some circumstances, reckless behavior is sufficient for civil liability under § 10(b) and Rule 10b-5."⁹³ This language indicates that simple negligence will not be sufficient for a successful rule 10b-5

84. *Id.* at 474 n.14.

85. *Id.* at 477-78.

86. 421 U.S. 723 (1975).

87. *Birnbaum v. Newport Steel Corp.*, 193 F.2d 461 (2d Cir. 1952); *Stockwell v. Reynolds & Co.*, 252 F. Supp. 215, 219 (S.D.N.Y. 1965).

88. 193 F.2d at 463.

89. A "delay" purchase is a sale of securities subsequent to the frustration of an intended transaction.

90. *Commerce Reporting Co. v. Puretec, Inc.*, 290 F. Supp. 715 (S.D.N.Y. 1968).

91. 425 U.S. 185 (1976).

92. *Id.* at 194 n.12.

93. *Id.* See generally Bucklo, *The Supreme Court Attempts to Define Scienter Under Rule 10b-5: Ernst & Ernst v. Hochfelder*, 29 STAN. L. REV. 213 (1977).

action. Where the line will be drawn is still unclear.⁹⁴ Later circuit court cases have held that scienter should be read to include recklessness.⁹⁵

In rule 10b-5 cases, plaintiff must show that the omission or erroneous statement was material to his decision. In arriving at a test of "materiality," the Supreme Court has employed different language. For example, *SEC v. Texas Gulf Sulphur Co.*⁹⁶ has been cited by the Supreme Court in a rule 10b-5 case as supporting a test that facts are material if "a reasonable investor might have considered them important in the making of this decision."⁹⁷ However, in a later proxy case, the Supreme Court used as a test whether "there is a *substantial likelihood* that a reasonable shareholder *would* consider it important in deciding how to vote."⁹⁸ As a practical matter the problem of proof will be the same under either definition used by the Court. Whichever test is used, the ultimate result will require an objective evaluation of that particular case. In this regard, Justice Marshall in *TSC Industries, Inc. v. Northway, Inc.*⁹⁹ held materiality to be "a mixed question of law and fact" and stated that the determination of materiality "requires delicate assessments of the inferences a 'reasonable shareholder' would draw from a given set of facts and the significance of those inferences to him" ¹⁰⁰ "[T]hese assessments," he declared, "are peculiarly ones for the trier of fact."¹⁰¹

The three basic elements designated by the *Genesco* court¹⁰² to be pleaded in rule 10b-5 actions are still valid within the restraints imposed by the United States Supreme Court. Although the trend towards liberal interpretation of section 10(b) and rule 10b-5 has been stayed, at least for the present, liability for directors and officers of corporations in such actions is still possible and should be carefully considered by potential defendants before taking any action which might subject themselves to personal liability.

94. The complaint alleged that proper accounting procedures would have revealed the fact that the president had a rule that only he personally could open mail addressed to him or to his attention. This rule would have facilitated his juggling of investment accounts. 425 U.S. at 190.

95. *Rolf v. Blyth, Eastman Dillon & Co.*, 570 F.2d 38, 40 (2d Cir. 1978) (where "aider and abettor owes a fiduciary duty to the defrauded party, recklessness satisfies the scienter requirement"); *Sundstrand Corp. v. Sun Chemical Corp.*, 553 F.2d 1033 (7th Cir. 1977).

96. 401 F.2d 833 (2d Cir. 1968), *cert. denied*, 394 U.S. 976 (1969).

97. *Affiliated Ute Citizens v. United States*, 406 U.S. 128, 153-54 (1972).

98. *TSC Industries, Inc. v. Northway, Inc.*, 426 U.S. 438, 449 (1976) (emphasis added).

99. 426 U.S. 438 (1976).

100. *Id.* at 450.

101. *Id.*

102. See notes 43-45 & accompanying text *supra*.

Federal securities statutes contain no limitation period expressly applicable to claims under section 10(b) and rule 10b-5. Such claims are governed by statutes of limitations of the forum state. The trend in the federal courts is to select the statute of limitation period by applying a "resemblance test." Thus, the limitation period that the forum state applies to the state remedy which bears close substantial resemblance to rule 10b-5, or which best effectuates its purpose, will be applied in the federal action.¹⁰³ In applying the resemblance test the federal courts have generally held that broad remedial purposes of the Federal Securities Act are best served by a longer, not shorter, statute of limitations and consequently will pick the longer statute of limitations. This position has been supported by the Supreme Court in *Ernst & Ernst v. Hochfelder*.¹⁰⁴ Mr. Justice Powell, in a footnote, adopted the following language:

Since no statute of limitations is provided for civil actions under § 10(b), the law of limitations of the forum State is followed as in other cases of judicially implied remedies. . . . Although it is not always certain which state statute of limitations should be followed, such statutes of limitations usually are longer than the period provided under § 13.¹⁰⁵

Federal law fixes the date when the claim accrues so as to trigger the state law limitation period.¹⁰⁶ The general rule appears to be that the limitation period in a fraud case begins to run on the date when the unlawful acts were discovered,¹⁰⁷ or should have been discovered in the exercise of due diligence.¹⁰⁸

C. Section 17(a) of the 1933 Act¹⁰⁹

Although section 17(a) has not been utilized as fully as section

103. *Ernst & Ernst v. Hochfelder*, 425 U.S. 185 (1976); *Sargent v. Genesco, Inc.*, 492 F.2d 750 (5th Cir. 1974); *Parrent v. Midwest Rug Mills, Inc.*, 455 F.2d 123 (7th Cir. 1972).

104. 425 U.S. 185 (1976).

105. *Id.* at 210 n.29.

106. *E.g.*, *Vanderboom v. Sexton*, 422 F.2d 1233, 1240 (8th Cir. 1970). *See generally* Bateman & Keith, *Statutes of Limitations Applicable to Private Actions Under SEC Rule 10b-5: Complexity in Need of Reform*, 39 Mo. L. REV. 165 (1974).

107. *Sargent v. Genesco, Inc.*, 492 F.2d 750, 758 (5th Cir. 1974).

108. *Clement A. Evans & Co. v. McAlpine*, 434 F.2d 100 (5th Cir. 1970), *cert. denied*, 402 U.S. 988 (1971).

109. It shall be unlawful for any person in the offer or sale of any securities by the use of any means or instruments of transportation or communication in interstate commerce or by the use of the mails, directly or indirectly—

(1) to employ any device, scheme, or artifice to defraud, or
(2) to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact nec-

10(b) and rule 10b-5, recent cases indicate that liability under it is potentially much more expansive than that under those provisions. Several lower court decisions subsequent to the Supreme Court cases restricting the application of rule 10b-5 have held that scienter is not an element of a claim based on section 17(a) of the Securities Act of 1933. In *SEC v. Southwest Coal & Energy Co.*,¹¹⁰ Judge Stagg concluded that since section 17(a)(1) prohibits the employment of devices or schemes to defraud, application of a scienter requirement to section 17(a)(2) would be meaningless as every act covered by it would also be covered by section 17(a)(1). Therefore, he concluded: "Congress must have intended not to require proof of scienter to establish a claim under § 17(a)(2) of the 1933 Act."¹¹¹ In *Reid v. Madison*,¹¹² the court held that *Blue Chip Stamps*¹¹³ does not preclude non-purchaser action under section 17(a) of the 1933 Act. If the holdings of the lower courts are upheld by the Supreme Court, this section of the Act will no doubt be employed for plaintiff actions to a far greater extent.¹¹⁴

IV. LIABILITY UNDER THE FEDERAL CIVIL RIGHTS ACTS

State corporation laws and federal and state securities laws are not the only source of potential liability for corporate directors and officers. The United States Supreme Court held in 1968 that Section 1982 of the Civil Rights Act¹¹⁵ prohibits private as well as pub-

essary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(3) to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser.

(b) It shall be unlawful for any person, by the use of any means or instruments of transportation or communication in interstate commerce or by the use of the mails, to publish, give publicity to, or circulate any notice, circular, advertisement, newspaper, article, letter, investment service, or communication which, though not purporting to offer a security for sale, describes such security for a consideration received or to be received, directly or indirectly, from an issuer, underwriter, or dealer, without fully disclosing the receipt, whether past or prospective, of such consideration and the amount thereof.

(c) The exemptions provided in section 3 shall not apply to the provisions of this section.

NEB. REV. STAT. § 21-2004(15)(A)-(B) (REISSUE 1977).

1933 Act, § 17(a), 15 U.S.C. § 77q (1976).

110. 439 F. Supp. 820 (W.D. La. 1977).

111. *Id.* at 826.

112. 438 F. Supp. 332 (E.D. Va. 1977).

113. 421 U.S. 723 (1975). See notes 86-90 *supra*.

114. For an in-depth discussion of implied remedies under section 17(a), see Hazen, *A Look Beyond the Pruning of Rule 10b-5: Implied Remedies and Section 17(a) of the Securities Act of 1933*, 64 VA. L. REV. 641 (1978).

115. 42 U.S.C. § 1982 (1976).

lic racial discrimination in the sale or rental of property.¹¹⁶ A year later the Court held that damages were recoverable for violations of section 1982.¹¹⁷ A similar cause of action is also available to compensate injured parties under section 1981¹¹⁸ where private racial discrimination occurs in the formulation and enforcement of contracts.¹¹⁹ The initial cases did not answer the question whether sections 1981 and 1982 imposed personal liability upon corporate directors and officers of the corporate violators of those provisions. The case of first impression in this respect was *Tillman v. Wheaton-Haven Recreation Association*.¹²⁰ In *Tillman*, the board of directors obtained an opinion from two attorneys who were both under the mistaken belief that the corporation, a non-profit swimming club, fell under the private club exception of the Civil Rights Act of 1964 and, therefore, could legally discriminate. After obtaining attorneys' opinions and concurrence by the membership, the board of directors imposed a policy of racial discrimination. The United States Supreme Court held that Wheaton-Haven was not a private club and that the discriminatory admission policy violated Section 1982 of the Civil Rights Act.¹²¹ On remand, the district court absolved the directors of all personal liability. However, the Court of Appeals for the Fourth Circuit held the directors liable on the grounds that they had committed an intentional tort and that due diligence was not a defense in such actions.¹²² As long as this holding prevails, corporate directors and officers must be extremely cautious when dealing with issues involving potential 1981 and 1982 violations.

V. INDEMNIFICATION AND CONTRIBUTION

In addition to discussing the potential liability of officers and directors, the purpose of this article is to discuss potential sources of contribution or indemnification. In many circumstances, a director or officer held personally liable by the courts will be entitled to at least partial reimbursement for losses. This reimbursement may include expenses of litigation and may include contribution by the corporation or by other directors and officers.

A. Traditional Indemnification

The basic premise of common law agency is that the principal

116. *Jones v. Alfred H. Mayer Co.*, 392 U.S. 409 (1968).

117. *Sullivan v. Little Hunting Park, Inc.*, 396 U.S. 229 (1969).

118. 42 U.S.C. § 1981 (1976).

119. *Olzman v. Lake Hills Swim Club, Inc.*, 495 F.2d 1333 (2d Cir. 1974).

120. 517 F.2d 1141 (4th Cir. 1975).

121. *Tillman v. Wheaton-Haven Recreation Ass'n*, 410 U.S. 431 (1973).

122. 517 F.2d 1141 (4th Cir. 1975).

has a duty to indemnify an agent for damages the agent is required to pay to a third person as a result of an authorized act which is held to constitute a tort or breach of contract.¹²³ However, there are serious gaps in the protection afforded directors and officers under this principle of common law. One of the more serious problems involves whether or not individuals can be considered agents of the corporation in a derivative suit where the action is brought for the benefit of the corporate principal against the director agent. Courts have divided in applying the common law rules to cases in which indemnification is sought for legal expenses incurred in a suit which was successfully defended.¹²⁴ On the other hand, where the defense was not successful, indemnification traditionally has not been permitted.¹²⁵

B. Model Act

To broaden the common law concept of indemnification, the committee on corporate law of the American Bar Foundation, in its draft of the Model Business Corporation Act, included in section 5 a provision covering indemnification of officers, directors, employees, and agents.¹²⁶ This provision of the Model Act has been adopted in Nebraska.¹²⁷

The Act allows indemnification of corporate agents, including any person who is or was a director, officer, employee or other agent of the corporation, or is or was serving at the request of the corporation as a director, officer, employee or agent of another corporation, partnership, joint venture, trust or other enterprise.¹²⁸

123. RESTATEMENT (SECOND) OF AGENCY § 439(c) (1958).

124. *Solimine v. Hollander*, 129 N.J. Eq. 264, 19 A.2d 344 (1941); *New York Dock Co. v. McCollom*, 173 Misc. 106, 16 N.Y.S.2d 844 (1939).

125. *In re E.C. Warner Co.*, 232 Minn. 207, 45 N.W.2d 388 (1950); *Hollander v. Breeze Corps.*, 131 N.J. Eq. 585, 26 A.2d 507, *aff'd*, 131 N.J. Eq. 613, 26 A.2d 522 (1941).

126. MODEL BUS. CORP. ACT. ANN. § 5.

127. NEB. REV. STAT. § 21-2004(15) (Reissue 1977).

128. (15) To indemnify as follows:

(a) A corporation shall have power to indemnify any person who was or is a party or is threatened to be made a party to any threatened, pending or completed action, suit or proceeding, whether civil, criminal, administrative or investigative, other than an action by or in the right of the corporation, by reason of the fact that he is or was a director, officer, employee or agent of the corporation, or is or was serving at the request of the corporation as a director, officer, employee or agent of another corporation, partnership, joint venture, trust or other enterprise, against expenses, including attorneys' fees, judgments, fines and amounts paid in settlement actually and reasonably incurred by him in connection with such action, suit or proceeding if he acted in good faith and in a manner he reasonably believed to be in or not opposed to the best interests of the corporation, and, with respect to any criminal action or proceeding, had no

Thus, an individual entitled to indemnification does not need to be an insider of the corporation at the time the act was committed. For example, Corporation *X* determines it should have *A* working for Corporation *Y* to protect Corporation *X*'s interest. Even though *A*'s salary is being paid by *Y*, the Act allows indemnification by Corporation *X* for actions arising out of *A*'s duty to it even though *A* was actually employed by *Y* at the time the act was committed. The agency concept can be extended to cover outside attorneys, accountants, and other professional advisors.

C. Federal Public Policy

The fact that indemnification is allowed under the state statute does not preclude a non-payment rule where federal laws and regulations reaching a different result have preempted the field. For example, in *Globus, Inc. v. Law Research Service, Inc.*¹²⁹ the court held that an underwriter who had actual knowledge of the omission of material facts from a prospectus could not enforce the indemnification provisions of the indemnity agreement against the issuer.¹³⁰ Although directors or officers were not involved, the decision was based upon the principle that one cannot insure oneself

reasonable cause to believe his conduct was unlawful. The termination of any action, suit or proceeding by judgment, order, settlement, conviction, or upon a plea of nolo contendere or its equivalent, shall not, of itself, create a presumption that the person did not act in good faith and in a manner which he reasonably believed to be in or not opposed to the best interests of the corporation, and, with respect to any criminal action or proceeding, had reasonable cause to believe that his conduct was unlawful;

(b) A corporation shall have power to indemnify any person who was or is a party or is threatened to be made a party to any threatened, pending or completed action or suit by or in the right of the corporation to procure a judgment in its favor by reason of the fact that he is or was a director, officer, employee or agent of the corporation, or is or was serving at the request of the corporation, partnership, joint venture, trust or other enterprise against expenses, including attorneys' fees, actually and reasonably incurred by him in connection with the defense or settlement of such action or suit if he acted in good faith and in a manner he reasonably believed to be in or not opposed to the best interests of the corporation, except that no indemnification shall be made in respect of any claim, issue or matter as to which such person shall have been adjudged to be liable for negligence or misconduct in the performance of his duty to the corporation unless and only to the extent that the court in which such action or suit was brought shall determine upon application that despite the adjudication of liability but in view of all circumstances of the case, such person is fairly and reasonably entitled to indemnity for such expenses which such court shall deem proper; . . .

NEB. REV. STAT. § 21-2004(15)(a)-(b) (Reissue 1977).

129. 318 F. Supp. 955 (S.D.N.Y. 1970).

130. *Id.* at 957.

against one's own reckless, willful, or criminal misconduct.¹³¹

The SEC public policy position with regard to violations of the Federal Securities Act of 1933 is expressed in a note to rule 460 which concerns acceleration of the effective date of the registration statement.¹³² Federal courts have held that federal public policy precludes indemnification for expenses incurred as a result of negligent violations of Section 12(2) of the 1933 Act, as well as for fraudulent violations of rule 10b-5 under the 1934 Act.¹³³

For indemnification purposes, there are different categories of directors under the federal public policy concept. In *Goldstein v. Alodex Corp.*,¹³⁴ two outside directors sued the corporation for expenses incurred in connection with defending a section 11 action. A court-approved settlement of the action assessed liability for a faulty registration statement. The two outside directors had retained individual counsel to represent them in the case. The court held that where state statutes and corporate by-laws allow indemnification, reimbursement to directors for litigation expenses was not against public policy under the Securities Act of 1933.¹³⁵ The

131. *Id.* at 958.

132. Note to SEC Rule 460, 17 C.F.R. § 230.460 (1978):

(a) Where, by reason of any charter provision, by-law, contract, arrangements, statute, or otherwise, provision is made for indemnification by the registrant of a director, officer or controlling person of the registrant against liabilities arising under the act, unless waiver is obtained from such officer, director or controlling person of the benefits of such indemnification with respect to the proposed offering or there is included in the registration statement, a brief description of the indemnification provision and an undertaking in substantially the following form:

Insofar as indemnification for liabilities arising under the Securities Act of 1933 may be permitted to directors, officers and controlling persons of the registrant pursuant to the foregoing provisions, or otherwise, the registrant has been advised that in the opinion of the Securities and Exchange Commission such indemnification is against public policy as expressed in the act and is, therefore, unenforceable. In the event that a claim for indemnification against such liabilities (other than the payment by the registrant of expenses incurred or paid by a director, officer or controlling person of the registrant in the successful defense of any action, suit or proceeding) is asserted by such director, officer or controlling person in connection with the securities being registered, the registrant will, unless in the opinion of its counsel the matter has been settled by controlling precedent, submit to a court of appropriate jurisdiction the question whether such indemnification by it is against public policy as expressed in the act and will be governed by the final adjudication of such issue.

133. *Odette v. Shearson, Hammill & Co.*, 394 F. Supp. 946 (S.D.N.Y. 1975). This case provides an excellent summation of the federal public policy concept with regard to indemnification.

134. 409 F. Supp. 1201 (E.D. Pa. 1976).

135. *Id.* at 1206.

directors had to show they had acted in good faith and had a valid defense under section 11.¹³⁶ The court's finding that the two directors were not personally liable obviously influenced its decision, but the case clearly establishes that defendants may be categorized for indemnification purposes.

D. Classification

The Model Act¹³⁷ and Nebraska statutes distinguish between third party claims¹³⁸ and derivative actions.¹³⁹ Indemnification in the case of a derivative suit is restricted to expenses including attorneys' fees, while in third party suits, indemnification may be allowed not only for expenses but also for judgments, fines, and amounts paid in settlement.¹⁴⁰ The obvious policy reason for broader coverage of third party claims is that in a derivative action, the individual has allegedly violated his duty to a corporation while in a third party action, the individual was presumably working in good faith for the corporate interests and, therefore, should be protected under the principles of agency law. The Act further provides that in either type of action where the individual has been successful in defense of an action against him "he *shall* be indemnified against expenses, including attorneys' fees, actually and reasonably incurred by him in connection therewith."¹⁴¹

The corporation's power to indemnify directors and agents is limited. Otherwise, important public policies other than federal public policy could be undermined. The corporation may not indemnify with respect to any criminal action or proceeding unless the officer or director had no reasonable cause to believe that his conduct was unlawful.¹⁴² Also, the corporation may authorize indemnification in criminal actions only if the individual acted in good faith and in a manner he reasonably believed to be in, or not opposed to, the best interests of the corporation.¹⁴³ The meaning

136. *Id.*

137. MODEL BUS. CORP. ACT. ANN. § 5.

138. NEB. REV. STAT. § 21-2004(15)(a) (Reissue 1977). See note 128 *supra*.

139. NEB. REV. STAT. § 21-2004(15)(b) (Reissue 1977). See note 128 *supra*.

140. NEB. REV. STAT. § 21-2004(15)(a)-(b) (Reissue 1977).

141. (c) To the extent that a director, officer, employee or agent of a corporation has been successful on the merits or otherwise in defense of any action, suit or proceeding referred to in subdivisions (a) and (b) of this subdivision, or in defense of any claim, issue or matter therein, he shall be indemnified against expenses, including attorneys' fees, actually and reasonably incurred by him in connection therewith

NEB. REV. STAT. § 21-2004(15)(c) (Reissue 1977) (emphasis added). The use of "shall" means indemnification is mandatory.

142. NEB. REV. STAT. § 21-2004(15)(a) (Reissue 1977). See note 128 *supra*.

143. NEB. REV. STAT. § 21-2004(15)(a) (Reissue 1977). See note 128 *supra*.

of the term "has been successful on the merits or otherwise in defense of any action" has resulted in controversy, particularly with regard to partial success. In a Delaware case an officer of a corporation contended he was entitled to indemnification as a matter of right under this provision where the case had been dismissed without prejudice.¹⁴⁴ The court held that since the same issue may be litigated in another case, an indemnification award before conclusion of the other case would be premature and contrary to the spirit of the statute.¹⁴⁵ With regard to partial success, a Delaware court held the language means that success is vindication and that in a criminal action, any result other than conviction is success within the meaning of the statute.¹⁴⁶ The court also held that a director or officer is entitled to indemnification if successful in one count under an indictment but unsuccessful in another related count.¹⁴⁷ In such a situation the fee is prorated to the percent attributed to the defense on each count.¹⁴⁸

The Act has a nonexclusive remedy clause which appears to permit far broader indemnification remedies under by-laws, specific agreements or actions by shareholders.¹⁴⁹ The case of *Koster v. Warren*¹⁵⁰ illustrates this point. In *Koster*, the corporation induced its former president, Warren, to plead nolo contendere to avoid litigation and consequently limit corporate civil liability. As a price for changing his plea, the corporation agreed to pay litigation expenses and any fine he might have to pay. In a shareholder's suit attacking the payment, the court held the corporation acted reasonably in reimbursing Warren.¹⁵¹ However, there is a possibility that in certain cases such remedies would be found to violate public policy and therefore be nonenforceable.¹⁵²

144. *Galdi v. Berg*, 359 F. Supp. 698 (D. Del. 1973).

145. *Id.* at 702.

146. *Merritt-Chapman & Scott Corp. v. Wolfson*, 321 A.2d 138, 141 (Del. Super. Ct. 1974).

147. *Id.*

148. *Id.*

149. NEB. REV. STAT. § 21-2004(15) (f) (Reissue 1977):

(f) The indemnification provided by this section shall not be deemed exclusive of any other rights to which those indemnified may be entitled under any by-law, agreement, vote of shareholders, members, or disinterested directors or otherwise, both as to action in his official capacity and as to action in another capacity while holding such office, and shall continue as to a person who has ceased to be a director, officer, employee or agent and shall inure to the benefit of the heirs, executors and administrators of such a person

150. 176 F. Supp. 459 (N.D. Cal. 1959), *aff'd*, 297 F.2d 418 (9th Cir. 1961).

151. *Id.* at 462.

152. *Merritt-Chapman & Scott Corp. v. Wolfson*, 264 A.2d 358 (Del. Super. Ct. 1970); *Diamond v. Diamond*, 307 N.Y. 263, 120 N.E.2d 819 (1954); *Mooney v. Willys-Overland Motors, Inc.*, 204 F.2d 888 (3d Cir. 1953). In *Diamond*, one of two

Under section 21-2004(15), indemnification other than that ordered by a court or provided for by a law or other appropriate agreement shall be made only where authorized in a specific case upon determination that indemnification of the eligible individual is proper under the statute. The determination must be made in each case by a majority vote of a quorum of the board of directors consisting of directors not parties to the action. If impossible to obtain the necessary quorum, or where the quorum of directors so directs, indemnification may be made upon written advice of independent legal counsel or upon approval by the shareholders.¹⁵³ Approval by shareholders would be most difficult particularly in publicly held corporations. This leaves the opinion of independent counsel as the most viable alternative. How is counsel classified as independent? Clearly the inside counsel would not be appropriate. Also questionable is whether regular outside counsel is independent within the statutory meaning. A safe course would be to seek the opinion of special counsel appointed for this purpose only. Such a procedure is not without its inherent problems such as how thorough an investigation can reasonably be made by the counsel before, in most cases, discovery proceedings have begun. One possible solution is to appoint additional neutral directors so the necessary neutral quorum of the board may be obtained.

In many cases, indemnification provisions of the Act may not be satisfactory. Therefore, corporate planners should consider in-

shareholders of a corporation brought a derivative action against the other alleging negligence and mismanagement. The lower court dismissed the case on the ground that plaintiff participated along with defendant and was thereby estopped from bringing the action. The court then granted defendant indemnification for his legal expenses on the ground that he was successful in the action. On appeal the court held defendant was not entitled to indemnification as he had been adjudged liable for misconduct. Indemnification in such a case, in the words of the court, "would place the statute in opposition to the fundamental principles not only of law but of good conscience and morals." *Id.* at 821. *See generally* Heiyyler, *Indemnification of Corporate Agents*, 23 U.C.L.A. L. REV. 1255 (1976).

153. NEB. REV. STAT. § 21-2004(15)(d) (Reissue 1977):

(d) Any indemnification under subdivisions (a) and (b) of this subdivision, unless ordered by a court, shall be made by the corporation only as authorized in the specific case upon a determination that indemnification of the director, officer, employee or agent is proper in the circumstances because he has met the applicable standard of conduct set forth in subdivisions (a) and (b) of this subdivision. Such determination shall be made by the board of directors by a majority vote of a quorum consisting of directors who were not parties to such action, suit or proceeding, or if such a quorum is not obtainable, or, even if obtainable a quorum of disinterested directors so directs, by independent legal counsel in a written opinion, or by the shareholders or members, as the case may be

See notes 141 & 149 *supra*.

demnification provisions within the by-laws of the corporation, thereby taking outside the scope of the Act the determination of when indemnification is to be paid. In addition, the basic provisions and safeguards of the Act could be incorporated into the by-laws to permit tailoring indemnification procedures to fit a particular corporation. In drafting such provisions, the drafter must consider the possible conflicts with public policy.¹⁵⁴

E. Contribution

Many states and certain sections of the Federal Securities Acts specifically provide for contribution among intentional wrongdoers.¹⁵⁵ Where the statutes do not specifically provide for contribution, there seems to be a definite trend to allow contribution even in the absence of specific statutory authority. Judge Frankel's position in this regard in *Globus*¹⁵⁶ illustrates this trend. Here one of the three defendants found jointly and severally liable attempted to recover from the other two where he had paid the full amount of the judgment. The judgment resulted from common law fraud and violation of Section 17(a) of the 1933 Act and Section 10(b) of the 1934 Act. New York law did not permit contribution. Nevertheless, Judge Frankel fashioned a federal rule of contribution stating: "Departing from the rugged flintiness of traditional common law, the general drift of the law today is toward the allowance of contribution among joint tortfeasors."¹⁵⁷ Judge Frankel cited *deHaas v. Empire Petroleum Co.*,¹⁵⁸ for the principle that since sections of the Securities Act expressly providing for civil liability contained express provisions for contribution, contribution should be extended to section 10(b) cases since the court had extended imposition of civil liabilities to such cases.¹⁵⁹ Although the extent of allowable contribution is not clearly established, the position of Judge Frankel appears to be the direction the courts are taking in this matter.¹⁶⁰

VI. INSURANCE

In addition to indemnification and contributions, another possi-

154. *Kansas City Operating Corp. v. Durwood*, 278 F.2d 354 (8th Cir 1960).

155. 1933 Act, § 11, 15 U.S.C. § 77k (1976); 1934 Act, §§ 9, 18, 15 U.S.C. §§ 78(i), 78(r) (1976). See also Radoff, *Contribution Among Joint Tortfeasors*, 44 Tex. L. Rev. 326 (1965).

156. *Globus, Inc., v. Law Research Serv., Inc.*, 318 F. Supp. 955 (S.D.N.Y. 1970).

157. *Id.* at 957.

158. 286 F. Supp. 809, 815-16 (D. Colo. 1968).

159. 318 F. Supp. at 958.

160. For a more complete discussion, as it specifically relates to rule 10b-5 actions, see Fischer, *Contribution in 10b-5 Actions*, 33 Bus. Law. 1821 (1978).

ble source of reimbursement for losses involving personal liability for actions taken in the corporate capacity is insurance. Section 21-2004 authorizes corporations to purchase and maintain insurance on directors and officers against personal liability whether or not the corporation has the power to indemnify the individual under the Corporation Act.¹⁶¹ The exclusions under the standard policy are numerous and include libel and slander, personal profit or advantage, illegal remuneration, section 16(b) cases, dishonesty, corporate indemnification, and pollution.¹⁶² If the numerous exclusions and relatively high cost are not a sufficient deterrent, there is the additional problem as to whether payment of the insurance is precluded in certain situations because of public policy considerations. For example, a well established principle of the law of liability insurance is that an insurance policy indemnifying an insured against liability due to his willful wrong is void as against public policy. Losses attributable to dishonesty or intentional misconduct, or other conduct which the courts find to be sufficiently serious to violate accepted notions of public policy, would be eliminated from coverage.¹⁶³ The real problem arises in the area of gross negligence where public policy application is not clearly defined. If one follows the doctrine that the public policy doctrine is applicable as a deterrent, then it can be argued persuasively that insurance should be valid in this area. This is so because gross negligence is determined as a matter of hindsight and is not likely to be deterred by uncertainty of insurance coverage. However, even if the public policy argument prevails, many policies specifically exclude coverage of losses resulting from gross negligence. Although insurance is not in most cases the ultimate solution to all personal liability situations, it should be considered with other alternatives.¹⁶⁴

161. NEB. REV. STAT. § 21-2004(15) (g) (Reissue 1977):

(g) A corporation shall have power to purchase and maintain insurance on behalf of any person who is or was a director, officer, employee or agent of the corporation, or is or was serving at the request of the corporation as a director, officer, employee or agent of another corporation, partnership, joint venture, trust or other enterprise against any liability asserted against him and incurred by him in any such capacity or arising out of his status as such, whether or not the corporation would have the power to indemnify him against such liability under the provisions of this section

162. See Johnston, *Corporate Indemnification and Liability Insurance for Directors and Officers*, 33 BUS. LAW. 993 (1978).

163. See R. KEETON, *INSURANCE LAW* § 5.4 (1971).

164. For an in-depth discussion of the problem, see Johnston, *supra* note 162. See also M. SCHAEFTLER, *THE LIABILITIES OF OFFICE: INDEMNIFICATION AND INSURANCE OF CORPORATE OFFICERS AND DIRECTORS* (1976).

VII. CONCLUSION

Personal liability for acts committed in the corporate name has become a potentially serious problem for directors and officers of corporations. Even though the United States Supreme Court has recently reduced the areas of liability under the Securities Acts, the potential of large losses in actions brought as a result of inadvertent acts is still real and very much alive. In addition, common law actions may possibly be substituted for many actions that were formerly brought under the Securities Acts. Ultimately, attorneys involved with corporation law should make sure that their director and officer clients are aware of their potential liability as well as the various steps available to reduce that liability.