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WHERE HAVE ALL THE DIRECTORS GONE: CORPORATE DIRECTOR AND OFFICER LIABILITY AND COPING WITH THE INSURANCE CRISIS

In the United States, as in other countries, senior corporate managers have long anticipated the day when they would occupy a seat on the board of their own or some other company, a prestigious reward for a successful career. Senior executives are increasingly reluctant to accept this once desirous position since they are finding that their personal assets could be seriously at risk following their election to a corporate board.

There are two overlapping reasons for this alarming development. First, directors and officers insurance may be either unavailable or unaffordable, and second, disgruntled shareholders and employees are increasingly apt to second-guess boardroom decisions in the courts. These two problems have begun to affect the traditional boardroom style of operations of many American corporations.[1]

In recent years, the number of legal actions brought against directors and officers of both private and public corporations has increased dramatically. In 1985, there were more than 500 claims of $1 million or more against directors compared with only two fifteen years ago.[2] In the last two years alone, there have been at least ten court settlements of $20 million or more, including a $110 million settlement against five former directors and officers of the bank holding company Seafirst Corporation.[3] With the exception of directors of financial institutions, less than half of one percent of all directors sued are the subject of an adverse judgment.[4] However, adverse or not, the director or officer is still faced with an average of six years of litigation with the average cost to defend the action at $470,000.[5] It is the cost of defending against these claims that directors and officers are worried about. The cost of defense is the issue,

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[1] Harris, *Corporate Directors Run for Cover*, MGMT. TODAY, Apr. 1987, at 19. Dudley, *D&O Alternatives Discussed at RIMS*, NAT'L. UNDERWRITERS: PROP. AND CASUALTY/EMPLOYEE BENEFITS EDITION, May 18, 1987, at 66.

[2] Verespej, *Boardroom Roulette. Who's Ready to Risk His Personal Wealth to Sit on a Corporate Board*, INDUSTRY WEEK, Aug. 10, 1987, at 47.

[3] Nat'l Union Fire Ins. Co. of Pittsburgh v. Seafirst Corp., No. C85-3962R (W.D. Wash. Dec. 19, 1980).

[4] Verespej, *supra* note 2, at 47.

[5] *Id.*

not the question of guilt.[6] Not surprisingly, corporate directors are becoming uneasy about putting their personal wealth at risk for a job fraught with potential liability, and a salary that fails to match the risk.[7]

As a result, many outside directors are declining to serve on a board unless the corporation will provide them with adequate protection from the risk of personal liability.[8] The traditional protection provided by corporations in past years has been director and officer liability insurance. However, as a result of a recent rash of litigation brought under such policies, as well as large losses incurred by liability insurers in other lines of business, insurers have been prompted to either cease writing director and officer coverage or to provide such coverage at greatly inflated premiums with an increased number of exclusions.[9] Director and officer liability insurance premiums increased an average of 506% in 1986 and the three-year policy has disappeared, being replaced by a one-year policy.[10] The standard policy provides exclusions for proxy fights, takeover battles, claims by one director against another, public offerings, fraud, environmental changes, and lawsuits by a corporation against its directors.[11] The larger industrial corporations should have the financial resources to cope with the increased insurance costs and provide their directors and officers with adequate protection. However, smaller firms and emerging companies that are experiencing rapid growth and the need for outside director guidance will have the greatest degree of difficulty coping with the insurance crisis. Several Cleveland director and officer liability insurance brokers stated that directors and officers involved in small corporations, condominium developments or charitable corporations (typically low asset corporations) will find it difficult if not impossible to secure insurance coverage.[12] The insurance companies are looking to the financial stability of a company before providing any coverage. Corporations with minimal assets will be without the financial basis needed to secure insurance to protect their directors and officers. Although the market for director and officer insurance seems to have stabilized during 1987 as a result of corporate and legislative response to

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[6] *Id.* at 48.

[7] *Id.* at 47.

[8] Goldwasser, *An Overview of Director's and Officer's Liability Insurance*, DIRECTOR'S AND OFFICER'S LIABILITY INS. AND SELF INS. 12-23 (Commercial Law and Practice, Course Handbook Series, Number 381, (1986)).

[9] *Id.*

[10] Kettrell, *D & O Premiums up 506%*, POLL BUS. WEEK, Jan. 19, 1987, at 3.

[11] *Id.* Verespej, *supra* note 2, at 47. Mulcany, *Directors Quit in Wake of Huge D&O Rise*, NAT'L UNDERWRITERS: PROP. & CASUALTY/INS. EDITION, Feb. 14, 1986, at 12.

[12] Telephone interview with Brooks & Stafford Co., Cleveland, Ohio (12/87). Telephone interview with Alexander & Alexander, Co., Cleveland, Ohio (12/87).

the impact of the insurance crisis, it remains an unstable and unreliable basis for director and officer protection.

As a general rule, the best way to cope with the change in the business environment and the insurance crisis is to plan in advance for it. Through careful corporate structuring and planning, while remaining flexible, a small company can maximize their protection from liability. The factors to consider range from a careful drafting of the corporate articles and bylaws to the creation of captive insurance companies.

Before delving into the means to supplement director and officer liability insurance, a brief discussion of the cause for the instability would be proper. In *Smith v. Van Gorkom*,[13] the Supreme Court of Delaware, the state that was traditionally known for its pro-corporation posture, set a trend for expanding the scope of the directors' duties and responsibilities. In *Van Gorkom*, the board of directors of Trans Union Corporation were held individually liable for a judgment of $13.5 million in excess of the Company's director and officer policy.[14]

The court found that the directors breached their duty of care in approving a proposed cash merger of fifty-five dollars per share even though the price represented a forty-eight percent premium over the stock's last closing prior to the offer, and a thirty-nine percent premium over the highest price in the six month period preceding the offer. The court ruled the fifty-five dollars per share amount was considerably below the "intrinsic value" of the stock. The court found the board grossly negligent for hastily acting without reviewing the proposed merger agreement or obtaining documentary support adequately calculating the price and, as a result, were uninformed as to the intrinsic value of the company.[15] The fact that this was done within a two-hour period without prior notice to the shareholders and the absence of an emergency supported the court's holding. The court did not care that the price was so much more than the market price, that the directors acted on legal advice that no independent opinion was needed, or that the directors were advised they would be sued if the offer was rejected. It did not care about the board's experience, and disregarded the legal presumption that directors act in good faith. All these factors cited were found irrelevant in determining the threshold issue of whether the directors as a board exercised an informed business judgment.[16] Consequently, the directors were found liable for breach of the duty of care. *Van Gorkom* set in motion a trend of increased exposure for directors and officers of American corporations.[17]

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[13] 488 A.2d 858 (Del. 1985).

[14] *Id.* at 891.

[15] *Id.* at 876.

[16] *Id.* at 889.

[17] Sealy Mattress Co. of N.J. v. Sealy Inc., 532 A.2d 1324 (Del. 1987); A.C. Aquisitions

Means of Supplementing Director & Officer Liability Insurance

The first way to combat the increased exposure to corporate directors and officers is the formation of a captive insurance company or insurance pooling.[18] A captive insurance company is one owned exclusively by the group for whom coverage is provided. The theory is that a corporation can provide less expensive coverage if it owns and controls the insurer. A primary benefit of a captive is the assurance of the availability of insurance to the corporation coupled with the reduced possibility of an availability crisis in the future. A captive has the benefit of knowing its own losses and being able to share the loss history with its insureds to justify premiums. Many commercial carriers do not share this information. Consequently, insured parties often suspect commercial insurance of looking for a windfall. Captives may also be able to provide better claims service than commercial carriers because of greater knowledge about their market.

The major disadvantage is cost. Premiums of a captive will generally be higher than those of a commercial carrier because it must charge premiums sufficient to provide for a strong, well-capitalized company which can pay the losses of the insured. The problem of high premiums is intensified by the categorization of the captive. They are not purely self-insurance nor are they insurance in the sense that laymen think of insurance purchased from an independent company. A captive resembles more closely an incorporated self-insurance reserve. The IRS has taken the position that premiums paid to a captive are not deductible. Further, captives are in the precarious position of being a single line insurance company. With only one line of insurance, a captive cannot offset losses of director and officer liability coverage by profits in another type of insurance. One large loss or series of losses can be devastating to a captive. Captives must have strict underwriting standards to eliminate these unacceptable risks.

Despite the disadvantages, where captives are permitted, their formation may be an attractive long term solution. In fact, the current crisis situation may afford the opportunity for corporations to form captives because the fear of continued high premiums compared to liability exposure may provide the incentive for corporate groups to act.[19] This statement must, however, be hedged because of the stabilization of the insurance market during this year. The large initial capital outlay and

v. Anderson, Clayton & Co., 519 A.2d 803 (Del. 1986); Revlon, Inc. v. MacAndrews & Forbes Holding; 506 A.2d 173 (Del. 1986); Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946 (Del. 1985); Alford v. Shaw, 318 N.C. 289, 349 S.E.2d 41 (1986).

[18] *See* Rowner, *Banks Win Approval to Form Captive for Insurance*, LEGAL TIMES, March 3, 1986, at 1, col. 3.

[19] Grove and Tuuk, *Self Insurance: Is a Captive the Answer?*, 65 MICH. BAR J. 556 (June 1986).

high premiums must be weighed against the possible realignment of the insurance market in the near future.

The second factor to be considered is a careful selection of the corporation's state of incorporation. Although Delaware was the first state to pass legislative relief for director liability woes, the laws of that state do not provide the degree of protection to corporate directors and officers that the laws of Ohio and Indiana do.[20] While the Delaware law permits companies to amend their charters to protect directors from lawsuits that allege a breach of duty of care, it still leaves them liable for breaches of duty of loyalty as well as decisions not made in good faith. That makes directors particularly vulnerable to lawsuits that arise from hostile takeover battles. Under Delaware law, directors are placed in an inherent conflict of interest in takeover attempts. They have a duty to the shareholders to maximize the value of the company, a duty to evaluate the long term impact of the bid, and on top of that an inherent self-interest. So no matter what is done, chances are one of those duties will be breached.

In March of 1986, the Indiana General Assembly altered the liability rule in duty of care cases from a negligence standard to a willful misconduct or recklessness standard.[21] The Ohio law goes one step further. It states that directors are liable for monetary damages only if it is proved by clear and convincing evidence that a director deliberately intended to cause injury or recklessly disregarded the best interests of the corporation.[22] The statute also states that a director is not subject to a higher duty of care in takeovers.[23] That leaves directors in Ohio and Indiana financially liable only for reckless actions, unlawful payments and dividends, fraud, greenmail, illegal use of inside information, and violation of federal laws. As a result, the majority of board-type decisions are excluded from liability.[24] This creates a much more acceptable standard from which liability can be found against directors and officers. This added protection provided by Indiana and Ohio may help corporations within their jurisdictions to retain and obtain outside directors. The advantage that the careful selection of the state of incorporation offers in addition to the other considerations set forth in this Article, is that it must be done with shareholder approval. The effect is to minimize actionable objections by shareholders which might give rise to litigation, while at the same time provide maximum director and officer protection.

The next consideration in limiting the liability of directors and officers is properly drafted articles of incorporation and bylaws. In June of 1986,

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20 Verespej, *Lawsuit Troubles Still Hound Directors*, INDUSTRY WEEK, June 1, 1987, at 15.

21 IND. CODE ANN. § 23-1-35-1(e)(2)(Burns Supp. 1986).

22 OHIO REV. CODE ANN. § 1701.59 (Baldwin Supp. 1987).

23 *Id.*

24 Verespej, *supra* note 20, at 15.

the Delaware Legislature enacted legislation which enables a corporation to adopt a provision in its articles of incorporation which would limit or eliminate the personal liability of a director to the corporation or its shareholders for monetary damages for breach of fiduciary duty.[25] Seventeen states have currently adopted this type of legislation[26] and Ohio has drafted a similar statute, but has not legislatively adopted the provision.[27]

The Delaware statute applies only when a director violates his duty of care. Therefore, the extent of protection depends on the breadth of the definition of the duty of care. When a director acts in a negligent or grossly negligent manner, but in good faith, his action is treated as a breach of the duty of care, and the new statute will enable a corporation to prevent the director from incurring any personal monetary liability. But, if the director acts in a grossly negligent manner, and in conscious disregard of a known risk, or in a reckless manner, then such action may be viewed as taken in bad faith. The Delaware statute will not protect a director who has acted in bad faith from incurring monetary liability.[28] Whether the new legislation protects the director from liability for reckless action taken in good faith remains uncertain and must wait further judicial interpretation of the statute.[29]

If the court decides to enlarge the scope of the duty of loyalty, then the extent of protection available under the Delaware statute must be reconsidered. The business judgment rule[30] already protects directors from liability for mere negligence in most cases. A court, however, could hold that all grossly negligent behavior is per se in bad faith and thus a violation of the duty of loyalty. Alternatively, a court could view such behavior as reckless behavior that breaches the duty of loyalty. Should the courts choose to expand the scope of the duty of loyalty in either of these ways, the Delaware statute may be so circumscribed that it would in effect provide only very limited additional protection to directors.[31]

The Delaware statute is a product of the marketplace. It is a definite legislative response to *Van Gorkom*. Its clear intent is to afford directors

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[25] DEL. CODE ANN. tit. 8, § 102(b)(7)(Supp. 1986).

[26] King, *Director Protection Under Virignia Law*, 20 THE REVIEW OF SECURITIES AND COMMODITIES REGULATION, 129 (Aug. 1987).

[27] Schaffer, *Delaware's Limit on Director Liability & How the Market for Incorporation Shapes Corporate Law*. 10 HARV. J. L. & PUB.POL'Y 665, 687 (1987).

[28] DEL. CODE ANN. tit. 8, § 102(b)(7)(Supp., 1986).

[29] Schaffer, *supra* note 27, at 668.

[30] This rule immunizes management from liability in corporate transactions undertaken within both power of corporation and authority of management where there is reasonable basis to indicate that transaction was made in good faith. Nursing Home Bldg. Corp. v. DeHart, 13 Wash. App. 489, 535 P.2d 137 (1975). BLACK'S LAW DICTIONARY (5th ed. 1979).

[31] Schaffer, *supra* note 27, at 669.

of corporations broader protection from suits initiated by corporations and shareholders, draw qualified people onto the board as well as attempt to allow Delaware to remain the nation's leading corporate domicile. The advantage of such a statute is to broaden the safety net for directors in the current environment of hostile takeovers.

Many suits against directors are instituted by shareholders and employees of the corporation in the wake of mergers and acquisitions in an attempt to second guess the directors decision.[32] By providing for protection in this area of litigation, directors will realize a needed buffer zone to properly exercise their discretionary power within the corporation. The marketplace response to Delaware's statute appears favorable. In the six months following the enactment of the statute, Delaware increased the number of new incorporations by twenty-eight percent.[33] Whether the intended enhanced protection will materialize must be determined after future judicial application of the statute.

As previously stated, Ohio has drafted but not enacted a statute similar to Delaware's statute.[34] However, issues are raised as to whether Ohio needs such a statute under its current corporate law scheme. Ohio may enact the statute in order to achieve continued growth in the number of incorporations within its boundaries, and compete with other states for a large corporate base.

Under the Delaware statute, a director's liability for monetary damages may not be limited or eliminated for any breach of the director's duty of loyalty to the corporation or its stockholders; for acts or omissions not in good faith or which involve international misconduct or a knowing violation of law under section 174 of this title; or for any transaction from which the director derived an improper personal benefit.[35]

Under the Ohio statute,[36] the director of a corporation would not be liable in monetary damages for a breach of fiduciary duties unless the act or omission was undertaken with deliberate intent to cause injury to the corporation, and undertaken with reckless disregard for the best interest of the corporation.[37] The Ohio statute clearly provides a larger degree of protection for the director of a corporation than does the Delaware statute. Another advantageous feature of the Ohio statute is that protection will be provided unless expressly refuted in the corporate articles or bylaws.[38] The Delaware statute requires an express inclusion within the corporate articles. In order to amend the articles to provide

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[32] *See supra* note 1.
[33] Shaffer, *supra* note 27, at 688.
[34] *Id.* at 687.
[35] DEL. CODE ANN. tit. 8, § 102(b)(7)(Supp. 1987).
[36] OHIO REV. CODE ANN. § 1701.59(D) (Baldwin Supp. 1986).
[37] *Id.*
[38] *Id.*

directors with protection from personal liability, the shareholders must approve the amendment.[39] In the situation of a controlled corporation, a controlling shareholder who sits on the board may be faced with a conflict of interest and fall within exclusion of the statute and be exposed to monetary damages with personal liability. It is also noteworthy that the Delaware statute requires the clause to be in the articles of incorporation, and therefore, a matter of public record. The Ohio statute allows the corporation to elect from the statutory protection in its bylaws, an in-house document, not subject to public review. It should also be noted that both statutory models protect directors from certain monetary damage award, but not from equitable remedies.[40] This gives rise to the issue of the expense of defending actions previously discussed along with the choice of incorporation state.

The fourth factor to consider is the adoption of a clause in the corporate articles or bylaws providing for indemnification rights for the directors and officers of the corporation. Currently, all fifty states provide for indemnification of directors and officers for liabilities arising out of services to the corporation.[41] A broad right of indemnification is necessary, it is believed, to protect corporate directors and officers from unjustified suits and claims, and to promote their security by the knowledge that their reasonable expenses will be borne by the corporation they have served if they are vindicated. Beyond that, its larger purpose is "to encourage capable men to serve as corporate directors, secure in the knowledge that expenses incurred by them in upholding their honesty and integrity as directors will be borne by the corporation they serve."[42]

This broad right of indemnification is limited by the policy that indemnification will be permitted only where it furthers accepted corporate goals and does not provide protection or encourage wrongful or improper conduct.[43] As a result of these limitations on indemnification, many corporate officials have a grossly exaggerated assumption of the protection the statutes provide. The right to indemnification is statutorily divided into two types: mandatory and permissive indemnification.

Under the Ohio[44] and Delaware[45] statutes, which represent the major-

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[39] DEL. CODE ANN. tit. 8, § 102(b)(7)(Supp. 1986).

[40] OHIO REV. CODE ANN. § 1701.59 (Baldwin Supp. 1986); DEL. CODE ANN. tit. 8, § 102(b)(7)(Supp. 1986).

[41] Block, Barton & Radin, *Indemnification and Insurance of Corporate Officials*, 13 SEC. REG. L. J. 239 (1985).

[42] *Id.* at 239. *See, e.g.*, Mooney v. Willys-Overland Motors, Inc., 204 F.2d 888, 898 (3d Cir. 1953); Hibbert v. Hollywood Park, Inc., 457 A.2d 339, 343-44 (Del. Super. Ct. 1983)(quoting E. FOLK, THE DELAWARE GENERAL CORPORATION LAW 98 (1972); Essential Enters. Corp. v. Automatic Steel Prods., Inc., 38 Del. 371, 164 A.2d 437, 441-42 (1960).

[43] MODEL BUSINESS CORP. ACT, Official comment at 412-13 (1984 ed.).

[44] OHIO REV. CODE ANN. § 1701.13(E)(3)(Baldwin Supp. 1986).

ity of state laws, indemnification is mandatory where the person to be indemnified has been successful on the merits or otherwise.[46] The "on the merits or otherwise" formulation recognizes that even where the defendant has done something that violates his fiduciary duty to the corporation, they may be entitled to indemnification because of procedural defenses not related to the merits. The policy for these formulations is that it is unreasonable to require a defendant with a valid procedural defense to undergo the trial on the merits and the expense of defending the claims in order to establish eligibility for mandatory indemnification. California law, however, requires the director to be successful "on the merits" to appreciate mandatory indemnification.[47]

Where indemnification is not mandatory, Ohio[48] and Delaware[49] statutes provide for permissive indemnification of corporate officials where the requisite standard of care is met.[50] Most statutes have separate but similarly worded statutes for indemnification in third-party actions as compared to actions brought by or in the right of the corporation. These standards define the outer limits for which permissive indemnification is permitted, however, directors are not per se entitled to indemnification to these limits.[51] Corporations may adopt bylaws obligating the corporation to indemnify directors to a lesser extent than permitted by the statute. Most state statutes, including Ohio and Delaware, provide that indemnification may be granted in third-party actions if the director or officer involved acted in good faith, in a manner he reasonably believed to be in or not opposed to the best interests of the corporation, and with respect to a criminal proceeding, had no reasonable cause to believe his conduct was unlawful.[52]

Unlike the cases in derivative actions, most statutes authorize indemnification of judgments, fines, penalties, amounts paid in settlement, and reasonable expenses, including attorney fees, in third-party actions.[53] The termination of an action by judgment, order, settlement, conviction, or plea of nolo contendere or its equivalent does not by itself create a presumption that the standard of conduct required for indemnification has not been satisfied. The determination of the propriety of allowing indemnity in these situations will be discussed below.

As noted above, most states utilize similarly worded standards to

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[45] DEL. CODE ANN. tit. 8, § 145(d)(Supp. 1986).

[46] Block, Barton & Radin, *supra* note 41, at 241.

[47] *Id.* at 242.

[48] OHIO REV. CODE ANN. § 1701.13(E)(1) and (2) (Baldwin Supp. 1986).

[49] DEL. CODE ANN. tit. 8, § 145(a)(b)(Supp. 1986).

[50] Block, Barton & Radin, *supra* note 41, at 242.

[51] *Id.*

[52] OHIO REV. CODE ANN. § 1701.13(E)(1)(Baldwin Supp. 1986); DEL. CODE ANN. tit. 8, § 145(a)(Supp. 1986).

[53] Block, Barton & Radin, *supra* note 41, at 245.

permit indemnification of corporate officials in both third-party actions and derivative actions.[54] Most states, however, preclude indemnification where the party is adjudged to be liable for negligence or misconduct in the performance of their duty to the corporation unless and only to the extent the presiding court permits. In addition, judgments and amounts paid in settling or otherwise disposing of a derivative action are generally not subject to indemnification.[55] This rule is intended to avoid the circularity that would result if funds received by the corporation were simply returned to the persons who paid them.[56] Permissive indemnification must be authorized on a case-by-case basis. Specifically, a determination must be made that indemnification is proper under the circumstances because the person to be indemnified has met the applicable standards of conduct. This determination typically may be made by the board of directors, special counsel, or shareholders. A board decision must be by a majority vote of a quorum consisting of directors who are not parties to the proceeding.[57] Independent or special legal counsel chosen by a majority vote of nonparty directors is permitted by most states to render an opinion authorizing indemnification where the board of directors does not have the requisite number of nondefendant directors.[58]

Ohio and Delaware, like most states, permit the corporation to advance defense costs to the corporate official subjected to litigation, upon receipt of an undertaking by or on behalf of the director to repay such amount if it is determined that he is not entitled to indemnification by the corporation.[59] Most statutory indemnification provisions are not exclusive, that is, they do not prohibit indemnification in situations beyond the boundaries explicitly authorized by the statute.[60] For example, Section 145(e) of the Delaware statute states:

> The indemnification provided by this [statute] shall not be deemed exclusive of any other rights to which those seeking indemnification may be entitled under by-law agreement, vote of stockholders or disinterested directors or otherwise, both as to action in his official capacity and as to action in another capacity while holding such office. . . .[61]

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[54] *Id.* at 244. Block, Barton & Garfield, *Advising Directors the D&O Insurance Crisis*, 14 SEC. REG. L. J. 130 (1986).

[55] Block, Barton & Radin, *supra* note 41, at 239.

[56] *Id.* at 244.

[57] OHIO REV. CODE ANN. § 1701.13(E)(4)(Baldwin Supp. 1986); DEL. CODE ANN. tit. 8, § 145(d)(Supp. 1986). Block, Barton & Radin, *supra* note 41, at 245.

[58] Block, Barton & Radin, *supra* note 41, at 245.

[59] OHIO REV. CODE ANN. § 1701.13(E)(5)(b)(Baldwin Supp. 1986); DEL. CODE ANN. tit. 8, § 145(e)(Supp. 1986).

[60] Block, Barton & Radin, *supra* note 41, at 248.

[61] DEL. CODE ANN. tit. 8, § 145(e)(Supp. 1986).

Notwithstanding the breadth of nonexclusivity provisions, the few cases in which the issue has been presented suggest that courts will either ignore such provisions or read them restrictively.[62]

In addition to the false sense of security the existence of indemnification clauses create because the corporate official is not aware of its limitations, indemnification is only as good as the financial assets of the corporation.[63] If a firm goes bankrupt, all the indemnification in the world will not help a director facing a liability suit. As previously stated, much of the current litigation arises from corporate mergers and acquisitions. In the wake of hostile takeover, a director who opposes the takeover and is removed from his office as a result of the takeover, may be subjected to litigation that falls within the area of permissive indemnification. In these situations, it is fair to assume the new board will not authorize indemnification of the outside corporate official, leaving that person without protection. Another problem often recognized with indemnification is that it creates a potential liability for the corporation because it shifts the risk from outside the entity to inside the corporation and uses corporate assets to protect the directors.[64]

In the wake of *Van Gorkom* and so many suits resulting from activities involving corporate takeovers, management strategies making the corporation less of a target should be in place well before the takeover is imminent. Anti-takeover devices adopted after the takeover attempt has begun may not be in the best interest of shareholders. Strategies making the corporation less of a target should be in place early in the existence of a growing company.[65] A well drafted set of articles and bylaws will allow the corporate directors to be prepared for a takeover attempt instead of surprised and scrambling for protection. The corporate officers should have an effective strategy in place to avoid mistakes that can lead to claims against the corporation. One such strategy would be to adopt staggered directorships where one-third of the members are elected each year for a three-year term, with the provision that the shareholders may remove a director only for cause. This will make it harder for corporate raiders to gain board representation and start a proxy battle for control.[66] Another suggestion, in the wake of *Van Gorkom* and recent decisions of state courts indicating the minimum time that a board should spend making a major business decision in order to enjoy the protection of the business judgment rule, would be the careful creation of a record of all deliberations in the decision. The record should reveal whether the board has reviewed the intrinsic factors of the decisions; whether there is any

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[62] Block, Barton & Radin, *supra* note 41, at 244.
[63] Verespej, *supra* note 20, at 16.
[64] Verespej, *supra* note 2, at 50.
[65] Dudley, *supra* note 1, at 74.
[66] *Id.*

indication of favoritism or self-dealing of some kind affecting the decision; and whether any documentation can be produced to demonstrate that the decision of the board was informed. The best way to avoid liability to corporate officials is to plan for its possibility and have a record which indicates that the decision was within the proper boundaries of their fiduciary duties and thereby avoid exposure.

Conclusion

Though the planning considerations suggested above afford corporate directors and officers a degree of protection during the insurance crisis, none of them provide the full scope of protection afforded by commercial insurance. The need for director and officer insurance arises from the gaps in these items. For example, in most situations where statutes limit or eliminate director liability, the same situations permit indemnification by the corporation. In situations where the director will be exposed to monetary damages, the corporation may be statutorily prohibited from providing indemnification. Where corporations have attempted to extend the director's right to indemnification through the use of nonexclusivity provisions, courts will tend to narrowly interpret the provisions and limit their scope of protection, especially in derivative actions where indemnification would be circular.

What may be ascertained from this writing is that director and officer liability insurance still plays an important role in the corporate environment. Now that the insurance market has begun to settle, the risk factor in insuring corporate officials may be reduced through the careful employment of the considerations set forth above, allowing for the increased availability of corporate directors and officers insurance. The corporate and legislative responses that arose from the insurance crisis should provide the needed buffer zone for the insurance industry to realign itself with the market and re-enter it so as to afford corporate directors and officers protection in the American corporate atmosphere.

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