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May 2, 2007

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THOUGHTS ON CORPORATE INDEMNIFICATION

Most corporations take advantage of provisions in their state corporation codes to provide, either in the articles or bylaws, or by specific contract, for the indemnification of their officers and directors in the event that a claim or proceeding is brought against them with respect to actions that they have taken, or are alleged to have taken, while serving the corporation. These bylaw or contractual protections usually supplement indemnification protections that are provided under the statutory scheme, which usually mandate indemnification if the person is successful in defending the claim, and permits, but does not require, the corporation to indemnify the person who was unsuccessful in the defense of the claim but met a minimum standard of conduct. Usually the indemnifications provided by charter or contract are more protective to the directors and officers, because they convert the permissive indemnification scheme into a mandatory indemnification obligation of the corporation, at least insofar as it can be established that the officer or director met the minimum standard of conduct, which is usually expressed as taking actions that the person reasonably believed to be in the best interest of the company and that the person had no belief were unlawful. In addition, most charter and bylaw provisions mandate the advancement of expenses, including legal fees, subject only to a duty to repay if the person is ultimately determined to have not met the standard of conduct.

While these provisions are certainly desirable, and likely necessary, to attract talent to the corporation, they also pose the risk of draining substantial fees and costs out of the corporation, even in situations where the conduct of the person was fairly egregious. Usually, a commitment of a person to repay fees or costs that have been advanced if it is determined that he or she did not meet the standard of conduct proves to be a fairly hollow promise, given that it is unlikely they will have the personal financial resources to do so. Moreover, even though the Thompson memo of the Justice Department was partially repealed earlier this year, mandatory indemnification can still prove to be problematic in proceedings involving the Justice Department or other federal regulatory agencies, particularly if the standard of conduct determination is made before the material facts have come to light.

We recommend that all corporations periodically review their indemnification arrangements to be sure that they continue to be in keeping with current case law, regulatory pronouncements and developments in the insurance markets. Among other things, be sure that your indemnification coverage extends to the right persons, that they dovetail appropriately with the company's insurance coverage, that they call for the determination of whether the standard of conduct has been met to be made by the appropriate persons at the appropriate time, and that they not push the limits of indemnification beyond what the courts currently allow.

- [Curtis R. Hearn](#)