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FEES ON FEES IN NEW YORK - CORPORATE AGENTS BEWARE

George Klidonas
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George Klidonas*

INTRODUCTION

It is well-settled in New York jurisprudence that in the event that a court is unable to
determine the plain meaning of a statute, it must often inquire as to the intent of the legislature.
However, when a court is incapable of properly ascertaining the legislative intent, it should
interpret the law in a fashion which is logical and consistent with public policy. There are
instances, however, where courts reach conclusions which initially seem consistent with the
intent of the legislature but have adverse effects on public policy.

One such example can be found in the case of Baker v. Health Management Systems,
Inc. In that case, the New York Court of Appeals came to a decision with respect to Section
722(a) of New York Business Corporation Law. This statute allows corporate officers to receive
indemnification, or receive reimbursement for money spent on attorney’s fees, for suits that stem
from their duties as an agent of the corporation. The issue in Baker was whether a director or
officer is entitled to attorney’s fees that were spent to defend an action brought against him or
her in the capacity of a corporate agent. The court, and this Note, addresses these attorneys' fees
as "fees on fees."

In its decision, the court limited recovery to those expenses that are “actually and

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* B.S. Fordham University; J.D., Benjamin N. Cardozo School of Law.
1 772 N.E.2d 1099 (N.Y. 2002).
2 N.Y. BUS. CORP. LAW § 722(a) (McKinney 2005).
3 The provisions states, in pertinent part:
   [a] corporation may indemnify any person mare, or threatened to be made, a party to an action or
   proceeding, whether civil or criminal ... by reason of the fact that [the person] ... was a director or
   officer of the corporation... against judgments, fines, amounts paid in settlement and reasonable
   expenses, including attorney's fees actually and necessarily incurred as a result of such action or
   proceeding, or any appeal therein, if such director or officer acted, in good faith, for a purpose .. .
   believed to be in ... the nest interests of the corporation.

Id. (emphasis added).
necessarily” incurred under Section 722(a). The Court held that attorney fees that were incurred pursuant to an indemnification suit cannot be recovered; accordingly “fees on fees” are not recoverable. The dissent in Baker, however, had a very different perspective on this issue. Chief Judge Kay, in the dissent, made a very persuasive public policy argument for corporate officers and directors, which will be discussed throughout the course of this Note.

Evaluating the majority’s reasoning from a public policy standpoint begs the conclusion that the decision is impracticable and produces a heavy burden for corporate officers. The rule in New York should be changed in a way that allows corporate officers to feel secure and confident in their positions. The court in Baker makes a valid point, however, by stating that officers and directors remain free to secure indemnification of “fees on fees” in “bylaws, employment contracts or through insurance.” What the majority does not discuss is whether these alternatives are, in fact, effective. Officers and directors are arguably not in the position to seek indemnification in bylaws, contracts or through insurance agreements. On the contrary, corporate individuals would be well-advised to decline board service that may be personally expensive. Furthermore, as areas of this Note will address, it is not always convenient for officers to avail themselves of these other “remedies.” Nevertheless, the law of New York exists despite the existence of this underlying problem. This Note will therefore attempt to provide proposals for a solution to this problem.

A proper way to determine whether the law of “fees on fees” is fair and equitable is to weigh the interests of both sides. On one hand, there exists the officer's interest in avoiding

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4 772 N.E.2d at 1104.
5 Id. at 1103-1104.
6 See infra, Part II(B)(2).
7 Baker, 772 N.E.2d at 1104.
8 Id. at 1106.
9 See infra, Part V.
liability for attorney fees, which were solely incurred due to the position that he or she held, coupled with the reluctance of the corporation to indemnify corporate agents. On the other hand, there exists a valid interest of the corporation in avoiding attorney fees, which officers are not entitled to, as a matter of case and statutory law. The corporation, however, has an interest in attaining the most capable and reliable corporate officers to direct the affairs of the corporation. By allowing for “fees on fees,” corporations would attract competent directors to serve on boards without the concern of incurring unnecessary expenses.

There are many policy considerations as well as possible solutions that this Note will address. In Part I, it will discuss the historical background and legislative intent of New York Business Corporation Law Section 722. In Part II, it will examine and compare relevant New York case law to Delaware case law, in an attempt to reconcile the cases with the legislature's intent. In Part III, it will balance the interests of both the corporation and the officer while attempting to develop a utilitarian and ethical solution to this anomaly in New York law. Finally, in Parts IV and V, this Note will attempt to show that the alternative remedies suggested in Baker are not effective as stated and will propose other remedies for corporate officers dealing with this issue in New York.

I. HISTORY AND LEGISLATIVE INTENT OF BUSINESS CORPORATION LAW §722

A. The American Rule

It is well established law in the United States that the prevailing litigant is ordinarily not entitled to collect a reasonable attorney's fee from the losing side.10 This body of law is referred to as the American Rule. The Supreme Court has recognized certain exceptions which would allow attorney's fees in particular situations. Two recognized exceptions are: 1) express statutory

authority and 2) contractual authority.\textsuperscript{11}

A third and very important exception grants attorney's fees to the winning litigant “when the losing party has acted in bad faith, vexatiously, wantonly, or for oppressive reasons.”\textsuperscript{12} It has been established that the determination of whether a losing party has conducted itself in bad faith is extremely fact-specific.\textsuperscript{13} A court may find that a party shall be awarded attorney fees under the bad faith exception if it finds “that a fraud has been practiced upon it, or that the very temple of justice has been defiled ... as it may when a party shows bad faith by delaying or disrupting the litigation or by hampering enforcement of a court order.”\textsuperscript{14}

The Second Circuit has used a test to identify the issue of bad faith; the trial court must find clear and convincing evidence that: “(1) the offending party's claims were entirely meritless and (2) the party acted for improper purposes.”\textsuperscript{15} In other jurisdictions, courts have explained that the purpose for the bad-faith exception is “to ‘deter abusive litigation in the future, thereby avoiding harassment and protecting the integrity of the judicial process.’”\textsuperscript{16}

The New York Court of Appeals has characterized the American Rule as an “implicit


\textsuperscript{12}Alyeska, 421 U.S. at 259; see Hall v. Cole, 412 U.S. 1, 5 (1973) ("[i]n this class of cases, the underlying rationale of ‘fee shifting’ is, of course, punitive, and the essential element in triggering the award of fees is therefore the existence of ‘bad faith’ on the part of the unsuccessful litigant."); Kaung v. Cole Nat'l Corp., 2005 Del. LEXIS 246, at 14-15 (Del. July 5, 2005).

\textsuperscript{13}Doyle v. Turner, 90 F. Supp. 2d 311, 323 (S.D.N.Y. 2000).

\textsuperscript{14}Id. (citing Chambers v. NASCO Inc., 501 U.S. 32, 46 (1991)).

\textsuperscript{15}Doyle, 90 F. Supp. 2d at 323 (citing Agee v. Paramount Comm'ns, Inc., 114 F.3d 395, 398 (2d Cit. 1997)). The Second Circuit has applied these principles and stated that:

To ensure that fear of attorneys' fees against them will not deter persons with colorable claims from pursuing those claims, we has declined to uphold awards under the bad faith exception absent both clear and convincing evidence that the challenged actions are entirely without color, and are taken for reasons of harassment or delay or for other improper purposes and a high degree of specificity in the factual findings of the lower courts.


legislative judgment regarding the allocation of legal fees.”\textsuperscript{17} Furthermore, the Supreme Court has held that the United States “follow[s] a general practice of not awarding fees to a prevailing party absent explicit statutory authority.”\textsuperscript{18} The New York Court of Appeals has adhered to the same position specifically in the context of a statutory claim for corporation indemnification of legal fees holding that to the extent that indemnification statutes “change the common-law rule that each party pays his own lawyer, [they are] to be construed strictly.”\textsuperscript{19}

B. Legislative History of N.Y. Business Corporation Law Section 722

“Fees on fees” fall under the category of attorney fees because parties are seeking reimbursement for costs arising from an indemnification suit. However, in order to fully understand the purpose and motivations for New York Business Corporation Law, one must analyze the history of the statute. Before the 1940’s, New York did not recognize that “vindicated directors were ... entitled to indemnification in derivative suits.”\textsuperscript{20} Later the legislature abrogated this common law rule by enacting the New York General Corporation Law.\textsuperscript{21} The court in

\textsuperscript{18} Baker, 772 N.E.2d at 1104 (quoting Buckhannon Bd. & Care Home, Inc. v. West Virginia Dept of Health & Human Res., 532 U.S. 598, 602 (2001)).
\textsuperscript{19} Baker, 772 N.E.2d at 1104 (quoting Diamond v. Diamond, 120 N.E.2d 819 (1954)).
\textsuperscript{21} See Phillips v. Investors Diversified Servs., 426 F. Supp. 208, 213 (S.D.N.Y. 1976). Section 64 of the New York General Corporation Law, which was replaced by §§ 722, 725 and 726, stated, in pertinent part:

Any person made a party to any action, suit or proceeding by reason that he ... is or was a director, officer or employee of a corporation shall be entitled to have his reasonable expenses, including attorneys' fees, actually and necessarily incurred by him in connection with the defense of such action, suit or proceeding ... assessed against the corporation ... upon court order ... except in relation to matters as to which it shall be adjudged in such action, suit or proceeding that such officer, director or employee is liable for negligence or misconduct in the performance of his duties.

See also People v. Uran Mining Corp., 216 N.Y.S.2d 985, 987-988 (N.Y. App. Div. 1961). Section 68 explained how Section 64 is applied:

Sections sixty-four, sixty-five, sixty-six and sixty-seven of this chapter shall apply to an application made to a court in this state in any of the following cases: (a) when the corporation against whom the application is made for assessment of expenses pursuant to section sixty-four or for payment of expenses under the provisions of a certificate of incorporation, or other certificate filed pursuant to law, by-law or resolution, is a domestic corporation or a corporation doing business in this state; (b)
Schwarz v. General Aniline & Film Corp.\textsuperscript{22} stated that the purpose for this legislative action was to alleviate the “financial difficulties that had befallen certain corporate directors, officers and agents when they were sued, individually, in stockholders' suits, and had to pay their own lawyers.”\textsuperscript{23}

These sections were enacted into law on April 18, 1945, and remained in force until September 1, 1963, at which time they were replaced by Sections 722, 725 and 726 of the New York Business Corporation Law.\textsuperscript{24} When the legislature first authorized corporate indemnification for expenses incurred in connection with the defense of an action commenced against individuals in their capacity as directors, officers, and employees, the purpose was to specifically overrule a lower court's decision denying indemnification to directors who had been vindicated in a derivative suit.\textsuperscript{25} Furthermore, the statute provided that “a director, officer, [or] employee of a corporation” was entitled to reimbursement for his “reasonable expenses, including attorney's fees, \textit{actually and necessarily} incurred by him” in defense of actions covered by the statute.\textsuperscript{26} The statute was intended to alleviate the burden placed on directors and officers by large attorneys' bills.\textsuperscript{27} The court stated that the section was passed to change the common law rule.\textsuperscript{28}

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\textsuperscript{22} 113 N.E.2d 533 (N.Y. 1953).
\textsuperscript{23} Id. at 535.
\textsuperscript{26} Phillips, 426 F. Supp. at 215.
\textsuperscript{27} Id.
\textsuperscript{28} Id. (citing Schwarz, 113 N.E.2d at 537). The court stated:
Today, the relevant statutory authority enacted by the New York State Legislature allows corporations to indemnify directors, officers, and employees against third-party actions and derivative suits.\textsuperscript{29} The objective of enacting New York Business Corporation Law was to codify and apply indemnification principles under the law of agency in suits against corporate officials arising from their conduct undertaken in good faith belief that they were acting in the best interests of the corporation.\textsuperscript{30} Section 722 (a) permits indemnification against judgments, fines, settlements, payments, and reasonable litigation expenses; Section 722 (c) limits indemnification

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the corporation in whose behalf a stockholder's suit is brought, was not obligated ... to pay legal fees incurred by directors in defending themselves as individual defendants in such an action. That left corporate directors (and officers) in an unsatisfactory position since, when sued and although successful in a stockholder's suit, they would find themselves exonerated from fault but subject to the heavy attorneys' fees characteristic of the defense of such actions...

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\textit{Phillips, 426 F. Supp. at 215.}
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\textsuperscript{29} New York Business Corporation Law Section 722(a) states, in pertinent part:

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A corporation may indemnify any person made ... a party to an action or proceeding, ... whether civil or criminal, including an action by or in the right of any other corporation... which any director or officer of the corporation served in any capacity at the request of the corporation, by reason of the fact that he ... was a director or officer of the corporation, or served such other corporation, partnership, joint venture, trust, employee benefit plan or other enterprise in any capacity, against judgments, fines, amounts paid in settlement and reasonable expenses, including attorneys' fees actually and necessarily incurred as a result of such action or proceeding, or any appeal therein, if such director or officer acted, in good faith, for a purpose which he reasonably believed to be in ... the best interests of the corporation and, in criminal actions or proceedings, in addition, had no reasonable cause to believe that his conduct was unlawful.

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\textit{N.Y. BUS. CORP. LAW § 722(a) (McKinney 2005); See also New York Business Corporation Law Section 722(c) which states, in pertinent part:}
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\begin{quote}
A corporation may indemnify any person made ... a party to an action 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 or officer of the corporation, . . . against amounts paid in settlement and reasonable expenses, including attorneys' fees, actually and necessarily incurred by him in connection with the defense or settlement of such action, or in connection with an appeal therein, if such director or officer acted, in good faith, for a purpose which he reasonably believed to be in ... the best interests of the corporation, except that no indemnification under this paragraph shall be made in respect of (1) a threatened action, or a pending action which is settled or otherwise disposed of, or (2) any claim, issue or matter as to which such person shall have been adjudged to be liable to the corporation, unless and only to the extent that the court in which the action was brought ... determines upon application that ... the person is fairly and reasonably entitled to indemnity for such portion of the settlement amount and expenses as the court deems proper.

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\textit{N.Y. BUS. CORP. LAW § 722(a) (McKinney 2005).}
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to settlement payments and litigation expenses. The key similarity between these two subsections is the standard of conduct: “a corporation may indemnify a director who acts ‘in good faith, for a purpose which he reasonably believed to be in ... the best interest of the corporation.’” Furthermore, termination of an action by a judgment or settlement does not create the presumption that the standard of conduct has been dissatisfied.

Within the 1986 amendments to the statute, the New York Court of Appeals has found two major changes. The first is with regards to what is now Section 723 (a), which requires indemnification for a person who has been successful, rather than wholly successful, in defense of an action or proceeding. The second change was the addition of Section 721, which renders statutory rights to indemnification non-exclusive, which means that corporations may provide directors greater rights to indemnification than explicitly provided for by statute, so long as it is not violative of public policy.

In other words, the first change alleviated the burden of officers and directors with regards to the requirements for indemnification. The second change allowed officers and directors to be indemnified for more than what the statute calls for which gives broader indemnification rights than there existed before the amendment. Accordingly, the trend of the legislature is clearly in favor of officers and directors on the issue of indemnification.

32 Id. (citing N.Y. BUS. CORP. LAW §§ 722(a) (c) (McKinney’s 2004)) (emphasis in original).
33 Biondi, 731 N.E.2d at 580 (citing N.Y. BUS. CORP. LAW § 722 (b) (McKinney's 2004)) (emphasis added).
34 Stephen A. Radin, Directors Beware: Statutory D&O Indemnification Obligations Do Not Include Fees on Fees, Corporate Governance, (2002) (citing Baker, 772 N.E.2d at 1103). The court in Baker, stated that the amendment specifically indicates that the business corporation statutes of several states were examined for possible incorporation of their provisions. Baker, 772 N.E.2d at 1103. These states included California and Indiana. Id.; see CAL. CORP. CODE § 317(a) (2005) (The statute “includes without limitation attorneys’ fees and any expense of establishing a right to indemnification...); see also Ind. Code § 23-1-37-11 (2005) (The statute allows “a director of a corporation who is a party to an [underlying] proceeding [to] apply for indemnification to the court conducting the proceeding...”) (emphasis added).
35 Radin, supra note 34 (citing Baker, 772 N.E.2d at 1103).
II. RELEVANT CASE LAW

A. The Beginning - Biondi v. Beekman Hill

The court in *Biondi v. Beekman Hill House Apartment Corporation* stated that the New York Business Corporation Law previously made the statutes exclusive.\(^{36}\) The New York Court of Appeals explained that the legislature, in an attempt to “attract capable officers and directors,” amended Section 721 to “expand indemnification to include any additional rights conferred by a corporation in its certificate of incorporation or by-laws.”\(^{37}\) The only limitations established, which barred indemnification were: 1) if the there was an adverse judgment or other final adjudication to the director or officer; or 2) if the facts of the case established that he or she engaged in conduct which was pursuant to bad faith or the result of deliberate dishonesty and was material to the cause of action adjudicated.\(^{38}\) The court also stated that “[even though] section 721's non-exclusivity language *broadens* the scope of indemnification, its ‘bad faith’ standard manifests a public policy limitation on indemnification.”\(^{39}\) The limitation is reflected in the statutory indemnification provisions, which restrict indemnification to acts of “good faith” that are “reasonably believed to be in ... the best interest of the corporation.”\(^{40}\)

In *Biondi*, the president of the board of directors of an apartment corporation was found liable to a shareholder and prospective tenants for discriminatory leasing practices.\(^{41}\) The court held that “the key to indemnification is a director's good faith *toward the corporation* and that a

\(^{36}\) *Biondi*, 731 N.E.2d at 580.

\(^{37}\) *Id.*.

\(^{38}\) *Id.*


\(^{40}\) *Biondi*, 731 N.E.2d at 580 (citing N.Y. BUS. CORP. LAW § 722 (a)(c) (McKinney 2005)).

\(^{41}\) *Biondi*, 731 N.E.2d at 577-578.
judgment against the director, standing alone, may not be dispositive of whether the director acted in good faith.”

The reasoning was that “[b]y intentionally denying the ... sublease application on the basis of race, Biondi knowingly exposed [the corporation] to liability under the civil rights law.”

B. Baker v. Health Management Systems—“Fees on Fees”

The law on indemnification for corporate officers, directors, and employees was clear in New York following the decision in Biondi. Yet, in 2002, the New York Court of Appeals received certification from the Second Circuit Court of Appeals regarding an issue of first impression:

Where a corporate officer is ‘successful’ in the defense of an underlying action, within the meaning of New York Business Corporation Law § 723 (a), where the corporation unsuccessfully contests the duty to indemnify and contests with partial success the amount of indemnification, and where there is no bad faith on the part of the corporation, does the phrase the phrase ‘attorneys’ fees actually and necessarily incurred as a result of such action or proceeding,’ as used in New York Business Corporation Law § 722(a), provide for recovery of reasonable fees incurred by a corporate officer in making an application for fees before a court (as authorized by New York Business Corporate Law § 724(a))? More clearly stated, if a corporate officer satisfies the requirements of New York Business Corporation Law in regards to indemnification, and subsequently files a suit to obtain those fees can he or she also acquire the fees associated with the indemnification suit? The court, and this Note, addresses these attorneys' fees as "fees on fees.”

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42 Id. at 580-581 (citing N.Y. Bus. CORP. LAW § 721, 722(a) (b) (McKinney 2005); see also Titley v. Amerford Int'l Corp., 671 N.Y.S.2d 497, 498 (N.Y. App. Div. 1998); cf., Waltuch, 88 F.3d 87, 95 (2d Cir. 1996)) (emphasis in original).
43 Biondi, 731 N.E.2d at 581.
45 Id.
1. The Facts of Baker

In *Baker*, the plaintiffs in the underlying lawsuit alleged that Health Management Systems and various corporate officers made false and misleading statements in order to inflate the price of the company's stock.46 Siegel, the main director in this action, joined Health Management System *after* the beginning date of the class period when the misconduct occurred.47 Unlike other officers, Siegel *purchased, rather than sold,* shares of the company's stock *during* the relevant period; therefore Siegel retained separate counsel.48 The key fact to focus on is that “[Health Management System] *denied* Siegel's written request for indemnification, asserting that the legal fees sought were not necessarily incurred by Siegel because he did not require separate counsel.”49

1. The Majority of Baker

The majority opinion answered the aforementioned question in the negative.50 The court affirmatively held that corporate officers and directors cannot retrieve “fees on fees” arising from a strict interpretation of the statute.51 There were three reasons that the court found for the corporation and denied Siegel’s application for “fees on fees.” First, the court found that since the legislature researched the statutory provisions of Indiana and California, which explicitly provide for “fees on fees,” and decided not to incorporate the language of those states’ provisions, the legislature’s intent does not call for the attainment of “fees on fees.”52 Second,

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46 *Id.*
47 *Id.*
48 *Id.* (emphasis added).
49 *Id.* (emphasis added).
50 *Baker*, 772 N.E.2d at 1100.
51 See generally *id.*
52 *Id.* at 1103. The Indiana provisions state in pertinent part: [a] director of the corporation who is a party to a proceeding may apply for indemnification to the court conducting the proceeding or to another court of competent jurisdiction. On receipt of an
the court relied on the American Rule, which provides that “attorney’s fees are incidents of litigation and a prevailing party may not collect them from the loser unless an award is authorized by agreement between the parties, statute or court rule.” Finally, the court concluded that it does not leave corporate officers remediless; corporations remain free to provide indemnification of “fees on fees” in bylaws, employment contracts, or director and officer liability insurance.

2. The Dissent in Baker

On the other hand, the dissent, led by Chief Judge Kaye, vigorously defended the rights of officers and directors to acquire their legal fees. The dissent focused on four issues to counter the arguments of the majority: 1) the interpretation of the New York Business Corporation Law; 2) the legislative intent and public policy considerations behind the statute; 3) the “bad faith” of the corporation; and 4) the inapplicability of the American Rule.

First, the dissent opined that the unambiguous words of the statute include fees reasonably and necessarily incurred by directors in enforcing their statutory right and absolving application, the court after giving any notice the court considers necessary may order indemnification if it determines ... (1) the director is entitled to mandatory indemnification [or] (2) the director is fairly and reasonably entitled to indemnification in view of all the relevant circumstances, whether or not the director met the standard of conduct set forth in ... this chapter.

IND. CODE § 23-1-37-11 (Lexis 2005). The California provisions state in pertinent part:

... any indemnification under [Section 3 171 shall be made by the corporation only if authorized in the specific case, upon a determination that indemnification of the agent is proper in the circumstances because the agent has met the applicable standard of conduct ... by ... [a] court in which the proceeding is or was pending upon application ... whether or not the application by the agent, attorney or other person is opposed by the corporation.

CAL. CORP. CODE § 317(e) (4) (Lexis 2005).

54 Baker, 722 N.E.2d at 1104.
55 See generally id. at 1105-1107.
56 Id. at 1105.
57 Id. at 1105-1106.
58 Id. at 1105.
59 Id. at 1106.
themselves from corporate expense in defending an action.\textsuperscript{60} Second, the result is inconsistent with the language and the purpose of the statute.\textsuperscript{61} On the issue of policy, the dissent stated that:

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[it] is particularly unfortunate in today's corporate climate, when “it is crucial to secure the continued service of competent and experienced people in senior corporate positions and to assure that they will be able to exercise business judgment without fear of personal liability so long as they fulfill the basic duties of honesty, care and good faith.\textsuperscript{62}
\end{quote}

Third, the conduct of the company, which emanated an absence of bad faith, should not preclude the director from acquiring attorney fees by allowing the company to use their leverage as a large entity.\textsuperscript{63} Finally, regarding the American Rule, the dissent stated that this body of law is not an issue in this case because the right to indemnification is provided by statute, not contract.\textsuperscript{64}

Likewise, Chief Judge Kaye would permit directors and officers to collect reasonable attorney fees pursuant to New York Business Corporation Law. According to the majority, however, directors and officers who act in the best interest of the corporation and are exonerated from any liability are exposed to personal liability for attorney fees if the corporation refuses to satisfy its indemnification obligation. Furthermore, the policy considerations for attracting capable and qualified individuals have reached more crucial bounds in the post-Enron corporate climate.\textsuperscript{65}

Although the law on this issue is established and well-settled in New York, the dissenters appear to have engaged in more persuasive and effective arguments. The majority of the court compares New York Law with Indiana and California law, which are, in effect, irrelevant to finding how the court should rule. Such information is, in fact, persuasive, but simply because

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\textsuperscript{60} Baker, 772 N.E.2d at 1105.
\textsuperscript{61} Id. at 1106.
\textsuperscript{62} Id. (citing Governor’s Mem. Approving L 1986, ch. 513, 1986 McKinney’s Session Laws of NY, at 3171).
\textsuperscript{63} Baker, 772 N.E.2d at 1105.
\textsuperscript{64} Id. at 1106.
\textsuperscript{65} Parker & Saison-Dodd, supra note 25, at 28. For a discussion on Enron, see infra, note 111.
\end{footnotesize}
one state explicitly includes something in their statute, and the other state does not, under the court's reasoning, the latter state's omission signifies the purposeful exclusion and, therefore, cannot be implied in the statute. The application of extra-jurisdictional law is usually unsuitable but it arguably the laws of Delaware would have been better-suited as a model.66

Furthermore, even under the American Rule, attorney's fees may be successfully obtained if both parties agree, by statute or by court rule.67 Obviously the parties did not agree to give Siegel his “fees on fees” but the statute does not explicitly preclude it. Assuming that the statute does not mandate indemnification, the court had the opportunity to come in line with legislative intent and issue a court ruling which allowed for “fees on fees” in New York. Therefore, the New York Court of Appeals may interpret the statute broadly in order to allow for “fees on fees.” The Supreme Court has granted attorney's fees to the winning litigant “when the losing party has acted in bad faith, vexatiously, wantonly, or for oppressive reasons.”68 Concededly there is no evidence of bad faith or wanton or vexatious behavior. However, there is a compelling argument that corporations, such as Health Management Systems, may use their position as employers as leverage to avoid paying directors or officers whereby creating oppressive environments which will lead to more costs than necessary. Therefore, the New York Court of Appeals should have strictly scrutinized the conduct of Health Management Systems.

Finally, the court leaves it up to the directors and officers, as their duty and obligation to voluntarily seek “fees on fees” via contracts, insurance agreements or bylaws. The court's legal reasoning, in essence, is that since there are other remedies available to directors and officers, there is no need to entitle them to “fees on fees.” Conceding the fact that these alternatives are effective, there is no substantial reason to preclude corporate agents from statute imposed fees.

66 For a discussion on why Delaware law is more a suitable comparison, see infra, Part III(B).
B. Baker and Biondi – Who’s Right?

In light of both Biondi and Baker, there appears to be a divergence of authority between the two cases. First, the New York Court of Appeals stated that it is a “fundamental principle that no one shall be permitted to take advantage of his own wrong.”69 Furthermore, the court has found that the determination of bad faith will bar a person, namely a director or officer, from being indemnified if that person acted in bad faith, even if the bylaws state otherwise.70 The reasoning behind the principle of bad faith is that it is adverse to public policy.71 Accordingly, the 1986 amendment72 was an “attempt to ‘attract’ capable officers and directors.”73 Finally, the “key to indemnification [in Biondi was] a director's good faith toward the corporation.”74

1. "Taking Advantage of Your Own Wrongdoing"

It appears that the outcome in Baker is illogical in light of the decision in Biondi. Health Management Systems wronged Siegel by denying the latter's written request for indemnification, claiming that “the legal fees sought are not necessarily incurred by Siegel because he did not require separate counsel.”75 Why should a corporation reap the benefit of avoiding the payment of fees when the corporation has wronged the officer, namely by causing the officer to incur more expenses? This is adverse to the fundamental principle laid out in Biondi76 which stated that no one should be allowed to take advantage of his or her own wrong, namely the

70 Biondi, 731 N.E.2d at 580.
71 Id.
72 See supra, p. 9.
73 Biondi, 731 N.E.2d at 580.
74 Id.
76 Biondi, 731 N.E.2d at 580.
arbitrariness in Health Management System's declining of Siegel's request for his statutorily prescribed attorney fees. On the other hand, had Siegel been on the board before the illegal activities took place and had he sold the stock rather than bought the stock, like the other officers, then the denial of fees because of a separately retained attorney may not have been so arbitrary.

2. Bad Faith

Another departure from the Biondi case is the issue of bad faith. The Baker court quickly came to the troubling conclusion of denying Siegel fees on fees because there was no requirement to use separate counsel which did not constitute bad faith. Assuming such conduct truly does not constitute bad faith, does this mean that we have a blanket rule in New York which states that a corporation may arbitrarily deny an officer's or director's demand for indemnification if that director or officer seeks separate counsel? Does this signify that a corporation may never act in bad faith when a director or officer seeks separate counsel? Even though the New York Court Appeals clearly does not mean for this rule of law to arise from the Baker case, there surely is concern for such an effect.

3. 1986 Amendments and Legislative Intent

Finally, the court in Biondi specifically states that the 1986 amendments were created to

77 See In re Health Mgmt. Sys., Inc. Sec. Litig., 82 F. Supp. 2d 227, 231-232 (S.D.N.Y. 2000). The court stated that the issue of bad faith is a close one. Id. at 231. One the one hand, it should have been clear that to HMS that Siegel's unique circumstances, i.e., Siegel joined HMS three months after the alleged fraudulent conduct had commenced and Siegel had purchased rather than sold HMS stock at the allegedly inflated price, warranted separate representation. Id. at 231-232. On the other hand, HMS backed away from this original position. Id. at 232. HMS originally argued that the fees sought were unreasonable and not necessarily incurred because there was no need for Siegel to seek separate representation. Id. Later, HMS modified its position and stated that it was appropriate for Siegel to be independently represented. Id. Note that the trial court does not give a reason as to how HMS did not act in bad faith. Had HMS originally, i.e., pre-commencement of action, indemnified Siegel when it was demanded, there would not have been a need for the indemnification suit.

78 Id. at 231-232.
“attract capable officers and directors.” Yet how are capable officers and directors attracted to take such positions when the law is disproportionately biased in favor of corporations? It may be argued that “fees on fees” are a nominal amount in comparison with the fees in the underlying suit and those directors and officers will not be concerned with such expenditures. Yet legal fees are expensive, and it is certain that “fees on fees” will offset the underlying costs by a substantial percentage therefore causing a significant detriment to officers and directors.

A prime example of the offsetting of legal fees is in the *Baker* case. Siegel claimed, in total, $84,825.15 in fees and costs. The district court awarded Siegel indemnification against Health Management Systems for $60,959.50 in attorneys' fees and $6,677.23 in expenses, yet precluded $17,147.64 on the grounds that these fees and costs were incurred in attempting to secure indemnification. Therefore, Siegel was indemnified for $67,636.73 and denied $17,147.64 which means he was actually made eighty percent whole, as opposed to one-hundred percent whole. Siegel had to actually pay almost $20,000 to file a suit to attain money which he was rightfully entitled to meanwhile offsetting what his indemnification should have been.

Although $20,000 may not seem excessive, assume that the underlying suit cost Siegel $40,000 in attorneys' fees. Does this mean that the legislature would intend for Siegel to have his indemnification fees offset by nearly fifty percent simply due to the resistance of the corporation to pay what Siegel is rightfully entitled to by law? Other jurisdictions, namely Delaware would beg to differ with the New York Court of Appeals.

**D. Delaware Law: Delaware General Corporation Law**

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79 *Biondi*, 731 N.E.2d at 580.
82 $67,636.73/$84,825.15 = .7973664
Similar to New York Business Corporation Law, Section 145 of the Delaware General Corporation Law gives the inherent power to Delaware corporations to protect officers, directors, employees, and agents from expenses incurred in connection with litigation and other legal proceedings.  The statute first appeared in 1967 and, like the New York statute, was designed to serve the important public policy of encouraging capable persons “to serve as corporate directors, secure in the knowledge that expenses incurred by them in upholding their honesty and integrity will be borne by the corporation they serve.” In Delaware, rights to indemnification have become so fundamentally rooted in the public policy of corporate law that they are viewed as “a desirable underwriting of risk by the corporation in anticipation of greater corporate-wide rewards” rather than an individual benefit arising from personal employment.

E. Mayer v. Executive Telecard, Ltd. - “No Fees on Fees”

Even though the Delaware Supreme Court has ultimately found that the legislature intended to allow officers and directors to collect “fees on fees,” this was not always the case. The director, plaintiff, in *Mayer v. Executive Telecard, Ltd.* argued that Section 145(e) of the Delaware General Corporation Law required that the corporation indemnify him for his fees he had incurred in connection with his successful prosecution of the action to enforce his indemnification rights. The court held that the statute mandated indemnification only with respect to fees and expenses incurred in the original, underlying action, therefore barring the

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84 1-8 Corp & Commercial Practice in DE Court of Chancery § 8-2 (2005).
85 Id. (citing Perconti v. Thornton Oil Corp., CA 18630-NC, 2002 Del. Ch. LEXIS 51 (May 3, 2002)).
89 Mayer, 705 A.2d at 221-222.
plaintiff from attainting “fees on fees.”

**F. Stifel Financial Corporation v. Cochran - "Yes to Fees on Fees"

Contrary to New York law and the decision in *Mayer*, the Delaware Supreme Court later changed its position on “fees on fees” and held that these costs are allowed under Section 145 of the Delaware Corporation Law unless expressly precluded by contract or corporate bylaws.

Cochran had been an officer for Stifel Financial Corporation whereby he had been tried and convicted on several counts of fraud by the U.S. Attorney. The Tenth Circuit nevertheless reversed his conviction. Cochran filed an action for indemnification and expenses incurred in bringing the indemnification action.

The court rested its holding on numerous principles of law. First, since the bylaws permit indemnification to the “fullest extent” of the law, and the statute does not explicitly prohibit it, Cochran is entitled to “fees on fees.” Second, the court had previously held that “fees on fees”

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90 Id. at 225. (emphasis added).
91 The statute states, in pertinent part:
To the extent that a present or former director or officer of a corporation has been successful on the merits or otherwise in defense of any action, suit or proceeding referred to in subsections (a) and (b) of this section, or in defense of any claim, issue or matter therein, such person shall be indemnified against expenses (including attorneys' fees) actually and reasonably incurred by such person in connection therewith.
DEL. CODE ANN. tit. 8, § 145 (c) (2005) (emphasis added). “This statute first appeared in 1967, replacing in far more specific and comprehensive language authorization previously included among the specific corporate powers enumerated in Section 122.” 1-8 Corp. & Commercial Practice in DE Court of Chancery § 8-2. “The statute is designed to serve the important public policy of encouraging capable individuals, particularly those not otherwise affiliated with the corporation, ‘to serve as corporate directors, secure in the knowledge that expenses incurred by them un upholding their honesty and integrity will be borne by the corporation they serve.’” Id. (citing Essential Enters. Corp. v. Automatic Steel Prods., 164 A.2d 437, 441 (Del. Ch. 1960); Hibbert v. Hollywood Park, 457 A.2d 339, 344 (Del. 1983)).
93 Id. at 557.
94 Id.
95 Id.
96 Id. at 560.
were required in other types of suits.\textsuperscript{97} Third, the court focused on the policy of Delaware legislation on indemnification; the purpose being to allow corporate officials the peace of mind to know that their reasonable expenses will be borne by the corporation that they have served if they are held to be absolved from liability.\textsuperscript{98}

The court further stated that the larger purposes sought out by the statute, similar to the purposes of New York Business Corporation Law, is to encourage capable persons to serve as corporate directors or officers, and to promote security with the knowledge that the expenses incurred by them in fulfilling their roles in an honest manner will be borne by the corporation.\textsuperscript{99} There exists no compelling reason to deprive officers of complete indemnification.\textsuperscript{100} Allowing for “fees on fees” prevents a corporation from using its “deep pockets” to wear down an officer or director by dragging him or her through expensive litigation.\textsuperscript{101}

Delaware has raised the interest of commentators and scholars in the legal community. Primarily, “the analysis would appear to apply with equal force to actions to enforce advancement obligations initiated pursuant to Section 145(k).”\textsuperscript{102} It is also “noteworthy that ... the Delaware Supreme Court appears ... to have limited [the] capacity [of a Delaware corporation to provide ‘fees on fees’], permitting ‘fees on fees’ only to the extent that the underlying enforcement actions for indemnification prove successful, thus appearing to apply a standard

\begin{itemize}
\item \textsuperscript{97} Id. (citing DiGiacamo v. Bd. of Pub. Educ. in Wilmington, 507 A.2d 542, 547 (Del. 1986) (holding that awarding attorney's fees for time spent on a fee application is appropriate in a claim for worker's compensation).
\item \textsuperscript{98} Stifel, 809 A.2d at 561 (citing Folk, on Delaware General Corporation Law §145 (2001)).
\item \textsuperscript{99} Stifel, 809 A.2d at 561.
\item \textsuperscript{100} Id. (citing Josiah O. Hatch, Policing the Limits of Indemnification: Is Delaware Changing its Public Policy on Director and Officer Protection?, 12 No. 1 Insights 9, * 11 (1998) (stating that courts which do not allow for "fees on fees" seems a "glass half empty" view of the Delaware statute and a departure from the spirit and reasoning of earlier cases construing it)).
\item \textsuperscript{101} Stifel, 809 A.2d at 561 (mentioning that corporations would not be unduly punished by this result since they remain free to tailor their indemnification bylaws to exclude "fees on fees," if that is the desirable goal).
\item \textsuperscript{102} 8 Corporate and Commercial Practice in DE Court of Chancery §8-2(f) (citing Advanced Mining Sys. v. Fricke, 623 A.2d 82 (Del. Ch. 1992) (holding that these rights are independent and must be separately conferred in the relevant corporate instruments); In re Cent. Banking Sys., Inc., 1993 Del. Ch. LEXIS 235 (May 11, 1993) (same)).
\end{itemize}
similar to that ...under Section 145(c)“.\textsuperscript{103}

III. BALANCING THE INTERESTS

Despite Delaware's decision in \textit{Stifel}, the New York Court of Appeals stands by its rule that officers and directors are not entitled to “fees on fees.” However in order to fully understand the ramifications of such a decision, one must look at both sides and take into account the interests that corporations and officers in New York are trying to preserve.

A. \textit{Negative Effect on Directors and Officers}

The decision in \textit{Baker}, although it may appear irrelevant or insignificant in the grand scheme of corporate governance, will actually have a negative effect on the corporate structure as well as adversely affect agents of New York corporations. Directors will have their original indemnification fees offset because of the corporation's failure to meet their initial obligation.\textsuperscript{104} Thus employees' interest of becoming whole under the indemnification statute is impinged upon by the offsetting of “fees on fees.” New York corporations also have the luxury of withholding indemnification fees, which successful directors are entitled to without considering any negative repercussions. Accordingly, corporations appear to have carte blanche in denying officers and directors their statutorily prescribed attorney fees, which deprives these agents of any monetary recourse.

This imbalance promotes a great amount of leverage over officers who have been named parties in litigation “to control or stifle those officers’ or directors’ independent legal positions

\textsuperscript{103} 8 Corporate and Commercial Practice in DE Court of Chancery §8-2 (f).

\textsuperscript{104} Parker & Saison-Dodd, \textit{supra} note 25, at 32.
when such positions are at odds with the corporation’s planned defense.”

Therefore, according to the law in the *Baker* decision, an officer whose meritorious legal position diverges from that of the corporation, or majority of its officers, will in turn be pressured to give up that independent position since it is the corporation who controls the outcome of the indemnification expenses. Furthermore, a corporation's failure to wholly indemnify an officer or director may create a chilling effect on independent business judgment.

After the *Baker* decision, a corporation has more power to impose greater costs on an officer or director. Because of this possibility, an officer may be more reluctant to break rank and exercise independent business judgment and have a greater incentive to adhere to the corporation. Therefore, an executive's interest in running the company without the fear of incurring more costs because of the possibility of a denial of “fees on fees” even though the executive has done nothing wrong is encroached upon by the denial of indemnification.

Likewise, in light of Enron, the consequences could be grave if the corporation has the ability to exert pressure and compel the upper echelon to comply with the corporation’s unified strategy. It is apparent that many scholars and legal writers agree with the dissent in the *Baker*

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105 *Id.*; see also *Stifel*, 809 A.2d at 561.
106 *Id.*
107 *Id.*
108 *Baker*, 772 N.E.2d 1009.
109 *Id.*
110 Parker & Saison-Dodd, *supra* note 25, at 32.
111 Enron Corporation is an energy company based in Houston, Texas. Prior to its bankruptcy in late 2001, Enron employed around 21,000 people and was one of the world's leading electricity, natural gas, and communications companies, with claimed revenues of $101 billion in 2000. Fortune magazine named Enron "America's Most Innovative Company" for six consecutive years. It became most famous at the end of 2001 when it was revealed that it was sustained mostly by institutionalized, systematic, and well-planned accounting fraud. Its European operations filed for bankruptcy on November 30, 2001, and it sought Chapter 11 protection in the U.S. two days later, on December 2. It still exists mostly to operate what property it has left, carry out bankruptcy proceedings and respond to legal challenges. It has since entered the common consciousness as a symbol of corporate fraud and corruption.
112 *Id.*

decision that the majority’s view undermines what the corporate indemnification statute was designed to accomplish.  

B. New York Adversely Affected

Aside from the interest of the directors and officers, New York has an interest as the number two state in the amount of incorporations throughout the United States. There are many similarities between New York and Delaware in regards to corporate law. The reality is that more organizations incorporate in Delaware than in any other state; New York ranks second. Furthermore, almost half of the jurisdictions follow the Delaware indemnification model. Therefore, Delaware generally sets the corporate standard for all other jurisdictions and Delaware's law governing indemnification is no exception. This is in accord with the idea that Delaware is thought of as the most director-friendly state because it confers broad, flexible indemnification powers on corporations.

However, for some reason, the New York Court of Appeals has chosen to go against the common trend in Delaware by interpreting the indemnification statute extremely narrowly and precluding “fees on fees.” It would appear that, as a state which competes with Delaware with regard to encompassing the most competent directors and officer to serve on boards, New York

113 Parker & Saison-Dodd, supra note 25, at 32.
115 Id.
law would achieve such a policy-oriented goal if it followed Delaware. Nonetheless, state corporate codes offer the choice of providing certain degrees of protection to the officers and directors of the corporation, but it is always up to the corporation itself to make, or change, its indemnification standards or procedures in this area.

Despite the fact that the majority in *Baker* makes a valid legal decision, which is supported by proper authority, the case is a close and difficult one. A policy oriented reading of the language better supports the dissenters. History evinces intent to create incentive to attract competent people to serve in corporate management without fear of personal liability so long as they perform their basic duties. The result reached by the majority, with its needlessly narrow reading of language which certainly permits a broader reading, subverts the policy goal rather than promoting. As a practical matter, both sides point out that directors and officers will now be well advised to explicitly provide for "fees on fees" in their bylaws and employment contracts. Otherwise, as the dissent ominously concludes, “individuals would be well advised to decline board service which, as this case shows, may be personally expensive.” Nevertheless, until the New York Court of Appeals comes to a logical disposition similar to that of *Stifel*, attorneys who represent directors and officers are well advised to examine their clients’ employment contract and company bylaws in order to determine whether or not they are entitled

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119 Notice that the New York Court of Appeals was willing to look at statutes in Indiana and California for intent and legislative history. It seems that, in accordance with precedential trends, the court should have discussed and examined Delaware corporate law.
120 Id.
122 Id.
123 Id. (citing *Baker*, 772 N.E.2d at 1104 (Kaye, J., dissenting)).
C. Corporations Adversely Affected

There is an argument that corporations are actually the ones who will be disadvantaged in the long run. In light of the *Baker* decision, companies will need to consider their interest in recruiting and retaining top notch executive talent by explicitly guaranteeing that directors and officers will be fully compensated for fees incurred in obtaining indemnification, or whether the potential costs of such a policy is too high a price to pay. Rights to indemnification have become so deeply rooted in the public policy of corporate law that they are viewed as an individual benefit arising from personal employment rather than as "a desirable underwriting of risk by the corporation in anticipation of greater corporate-wide rewards." Thus, it is a possibility that the ruling in *Baker* will be practically overruled by keen directors and officers who will become aware of the divergence in New York and take "fees on fees" into account.

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125 Ethan M. Posner & Christopher M. Denig, *Jury is Still Out on 'Fees on Fees'*; N.Y.L.J., November 23, 2001, at 1; see also Lenckus, *supra* note 114. Mr. Lenckus highlights precautionary measures for accepting high positions in corporations:

As a condition of accepting a directorship or a top management position, an executive should insist that the organization cover fees on fees.... "You can provide in your bylaws for fees on fees coverage, and that's enforceable," said insurer attorney Dan A. Bailey, a partner with Arter & Hadden L.L.P. of Columbus, Ohio. "It's something (directors and officers) should look at in this age of trying to maximize your financial protection," advised Mr. Bailey, a D&O specialist.... "I think it points out the importance of tailoring bylaws to address various situations, rather than taking a cookie-cutter approach that doesn't address all circumstances," observed D&O policyholder attorney Carolyn Rosenberg, a partner with Sachnoff & Weaver Ltd. of Chicago.

*Id.; see also* William G. Passannante & Alex D. Hardiman, "Fees on Fees"; Can Directors and Officers Recover Attorney's Fees to Enforce Corporate indemnities?, AKO Executive Insurance Alert, Anderson, Kill & Olick, P.C. (Winter 2003), *available at*, www.andersonkill.com/publications/eia/pdf/spring_02.pdf; see also Parker & Saison-Dodd, *supra* note 25, at 30-31. ("... officers and directors of New York corporations should consider supplementing existing statutory framework by providing for the payment of fees on fees in bylaws or by contract."); *see also* Radin, *supra* note 34 ("corporations remain free to provide indemnification of fees on fees in bylaws, employment contracts or through insurance.") (citing Baker, 772 N.E.2d at 1104).

126 *Baker*, 772 N.E.2d at 1104.


128 1-8 Corporate and Commercial Practice in DE Court of Chancery §8-2 (citing Scharf v. Edgcomb Corp., 1997 Del. Ch. LEXIS 169, at * 15 (Dec. 2, 1997), appeal denied, 705 A.2d 243 (Del. 1998) (As a result, it has been stated that any attempt to analyze such provisions as if they were salary or other personal employment requisites "simply makes not sense."). Note that since New York and Delaware are very equal in their corporate laws, many comparisons will and have been made throughout this note.
when deciding where to engage in employment.

IV. CORPORATE BYLAWS, EMPLOYMENT CONTRACT AND INSURANCE; ARE THEY REALLY EFFECTIVE SOLUTIONS?

At the conclusion of the Baker opinion, the New York Court of Appeals suggested that corporate officers have other avenues of recourse besides the New York Business Corporation Law.129 The court recommended that corporations may indemnify corporate officers or directors by allowing for “fees on fees” in corporate bylaws, employment contracts and insurance agreements.130 This section will analyze the aforementioned possibilities addressed by the court and attempt to evaluate whether officers truly are safeguarded by the court's recommendations, or whether the attainment of “fees on fees” in New York is futile for directors and officers.

A. Articles of Incorporation and Bylaws

On the issue of articles of incorporation and bylaws, the Delaware Chancery Court interpreted a certificate of incorporation with regard to “fees on fees.”131 In 1997 there was a criminal investigation into Columbia/HCA Healthcare Corporation whereby many high-level officers were terminated, including plaintiff, Samuel A. Greco.132 Greco was later terminated and during the negotiations of his severance package he was given a copy of the certificate of incorporation provision, Article SIXTEENTH,133 which he was told set forth the basis for the

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129 Baker, 772 N.E.2d at 1104.
130 Id.
132 Id. at 3.
133 The Article states, in pertinent part:

  the right to indemnification or advances as granted by this Article SIXTEENTH, shall be enforceable by the directors, officer, employee or agent in any court of competent jurisdiction, if the Corporation denies such request, in whole or in part, or if no disposition thereof is made within 60 days. Such persons’ costs and expenses incurred in connection with successfully establishing his or her right to indemnification, in whole or in part, in any such action shall be indemnified by
defendant's indemnification obligations to him in the event that he was later sued as a result of his service.\textsuperscript{134}

The court held that Greco is entitled to “fees on fees” pursuant to the articles of incorporation and rested its reasoning on the following theories. First, the reading of the articles includes “fees on fees” since “any such action” refers to any action for determining the right to indemnification or advances.\textsuperscript{135} Further, there is well settled contract law, which is sound in Delaware, New York and the overwhelming majority of the United States: an ambiguity must be construed against the drafter.\textsuperscript{136} The reasoning was that the provision was drafted by Columbia without the involvement of Greco and, therefore, any ambiguity should be construed against Columbia.\textsuperscript{137}

1. Ambiguities in Articles or Bylaws Construed in Favor of Officers and Directors

Luckily, officers and directors in New York have the well-settled principle that an ambiguity is construed against the drafter as a fallback and if there is a bylaw or article of incorporation that states, e.g., any action will be indemnified or indemnification is allowed to the fullest extent of the law, such directors or officers may have a valid claim to “fees on fees.”

\textsuperscript{134}Id. at 5-6.
\textsuperscript{135}Id. at 38.
\textsuperscript{136}Id. at 39 (citing Kaiser Aluminum Corp. v. Matheson, 681 A.2d 391, 398-399 (Del. Supr. 1996) (under principles of contra proferentum, construing certificate of designation creating preferred shares against corporation); Sl Mgmt. L.P. v. Wininger, 707 A.2d 37, 43 (Del. Supr. 1998) (principle applied to limited partnership agreements); Penn Mut. Ins. Co. v. Oglesby, 695 A.2d 1146, 1149-1150 (Del. Supr. 1997) (principle applied to insurance policy)); see also Dworkwitz v. New York C. R. Co., 129 N.E. 650, 651 (N.Y. 1920) (stating that it is a well settled rule that "an ambiguity in an instrument must be resolved against the one who prepares it and that written portions of an instrument must under certain circumstances prevail over printed portions, those rules are only applicable to particular facts in response to the demands of justice or necessity").
\textsuperscript{137}Greco, 1999 Del. Ch. LEXIS 24, at 39.
Furthermore, it is more than likely that the bylaws\textsuperscript{138} and articles of incorporation\textsuperscript{139} were already in existence at the time the director or officer commenced employment and, therefore, the corporation would be the drafter. However the problem in \textit{Baker} would arise for officers and directors if the articles of incorporation or the bylaws were silent on indemnification. In the case of silence, the New York Business Corporation Law would apply and directors and officers would be subject to a strict construction of the statute, which precludes them from collecting “fees on fees.”\textsuperscript{140} Therefore, directors and officers must seek amendments of such bylaws and articles of incorporation if such silence exists.

2. \textit{Amendment of Articles of Incorporation and Bylaws}

What the New York Court of Appeals failed to address in \textit{Baker} was the ability to amend the articles of incorporation. Pursuant to New York Business Corporation Law Section 803 (a), an amendment to the certificate of incorporation may be authorized by the vote of the board, “followed by vote of a majority of all outstanding shares entitled to vote thereon at a meeting of shareholders.”\textsuperscript{141}

Theoretically, this procedure appears to be in favor of corporate directors and officers because of the certainty that the board would unanimously vote for mandatory “fees on fees” indemnification. However, this conclusion is based on the assumption that shareholders would be willing to vote in favor of “fees on fees.”\textsuperscript{142} It is more likely that a shareholder would vote against such an amendment since there appears to be no benefit for their financial interest. Thus

\begin{itemize}
\item \textsuperscript{138} A bylaw is “[a] rule or administrative provision adopted by an organization for its internal governance and its external dealings.” \textsc{Black’s Law Dictionary} 213-214 (8th ed. 2004).
\item \textsuperscript{139} An article of incorporation is ”[a] governing document that sets forth the basic terms of a corporation's existence, including the number and classes of shares and the purposes and duration of the corporation." \textsc{Black’s Law Dictionary} 120 (8th ed. 2004).
\item \textsuperscript{140} See generally \textit{Baker v. Health Mgmt. Sys., Inc.}, 772 N.E.2d 1099 (N.Y. 2002).
\item \textsuperscript{141} \textsc{N.Y. Bus. Corp. Law} § 803(a) (McKinney 2005).
\item \textsuperscript{142} Emphasis added.
\end{itemize}
the proposition that directors and officers can alter the bylaws or articles of incorporation as a remedy is significantly flawed since the suggestion rests on the assumption that shareholders would vote in favor of awarding “fees on fees.”

**B. Contractual Agreements**

The second contingency that agents of corporations may rely on is contractual agreements. In other words, directors and officers can contractually avail themselves of “fees on fees.” Courts in Delaware, New York and other jurisdictions have recognized that corporations can grant indemnification rights beyond those expressly provided for in the statute. Nevertheless, there is a concern for policy violations. In other words, nonexclusive provisions of indemnification statutes could provide the basis for corporate indemnification practices that exceed the bounds of public policy. For example, the corporation and the director can engage in an employment agreement whereby the indemnification provision states that “an agent of the corporation shall be fully indemnified even if the agent acted in bad faith.” According to many commentators, such a provision should not be upheld due to the adverse effect on policy.

1. **Undermining Contractual Agreements**

143 VARALLO & DREISBACH, supra note 116, at 156 (citing Hibbert v. Hollywood Park, Inc., 457 A.2d 339, 344 (Del. 1983) (holding that directors were entitled to indemnification for attorney fees with respect to suits filed by them in an unsuccessful bid for reelection under bylaw provision); Meritt-Chapman & Scott Corp. v. Wolfson, 321 A.2d 138, 142 (Del. Super. Ct. 1974) (stating that a corporation may pass a bylaw making mandatory the statutory provision for permissive indemnification although the bylaw in question does not effectuate this); Choate, Hall & Stewart v. SCA Servs, Inc., 495 N.E.2d 562, 565 (Mass. App. Ct. 1986) (stating that a provision of settlement agreement obliging corporation to indemnify director for his or her legal expenses was authorized under the Delaware statute's nonexclusive provision)); see also Baker, 772 N.E.2d at 1104 (opining that New York Business Corporation Law § 721 expressly provides that article 7 is not an exclusive remedy and therefore corporations may provide indemnification of fees on fees in contracts).


145 VARALLO & DREISBACH, supra note 116, at 156.
Regarding the issue of “fees on fees,” public policy cannot be violated. Posit the following hypothetical: the corporation and corporate officer engage in an employment agreement whereby the indemnification provision states that “an agent of the corporation shall be fully indemnified even if the agent acted in bad faith;” the officer is sued and it is determined by a trial court that he or she did not act in bad faith and that the corporate officer is still entitled to attorneys' fees, regardless of the indemnification provision's invalidity. When the officer files the indemnification suit and asks for “fees on fees,” there could be no violation of public policy. As per public policy, the issue of contractual agreements would be moot since the officer is inclined to act in good faith, i.e., to prevent the corporation from using their leverage to overcome employees, agents, directors and other officers. Thus, a contractual agreement for “fees on fees” would appear more prudent and practical in contrast with amending bylaws and articles of incorporation. However, the statute is silent on the officer's good faith of preventing a corporation from using its leverage as a weapon to overcome the disbursement of “fees on fees.”

2. Typical Provisions

Standard of conduct aside, there are various types of contractual provisions that corporations and agents may agree upon. One type is mandatory indemnification unless it is expressly prohibited by statute, e.g., violation of bad faith.\[146\] Another example is mandatory advancement of expenses by the corporation which the officer or director may, in many instances, obtain on demand.\[147\] A third type is an accelerated procedure for the determination

\[146\] VARALLO & DREISBACH, supra note 116, at 157-158 (citing E. Norman Veasey, et al., Delaware Supports Directors with a Three-Legged Stool of Limited Liability, Indemnification & Insurance, 42 BUS. LAW. 399, 415 (Feb. 1987) ("Such agreements should contain standard severability clauses so that if any provision is declared invalid, the remainder of the agreement will survive.))

required by the indemnification law to be made in the case at hand. The fourth is the right of the director or officer to appeal in the event of an unfavorable outcome. The fifth includes a provision which enlists a procedure under which a favorable determination will be deemed to have been made under the circumstances where the board has failed to act. Finally, another example is a type of reasonable funding mechanism, i.e., a trust or a letter of credit. These funding mechanisms guarantee that funds will be available in the event it is established that the indemnitee has a clear right under the agreement to be indemnified.

3. Benefits of Contracts Over Insurance

One commentator has stated that contractual agreements, as opposed to insurance, have unique benefits for the purposes of indemnification. The first benefit for corporate officers is that the burden of proving that the applicable statutory standard has not been met is on the corporation. The second is that contractual agreements create the right for directors and officers to recover expenses of prosecuting a claim for indemnification. The third benefit is that contracts provide directors and officers with the right to bring an indemnification suit against the corporation if the indemnification is not paid within a specified period of time. The final benefit of contractual agreements is that they provide for indemnification and the advancement

148 Id.
149 Id. at 157-158.
150 Id. at 158.
151 Id.
152 Id.; see generally Security Am. Corp. v. Walsh, Case, Coale, Brown & Burke, 1985 U.S. Dist. LEXIS 23482, at * 12-13 (January 11, 1985) (holding that the creation of irrevocable trusts by a corporation for payment of litigation expenses incurred by directors did not violate Delaware law). Note that “[p]articular caution should be exercised in deploying such devices in the face of a threat to control, however, for a court may conclude such action is evidence of entrenchment motive.” VARALLO & DREISBACH, supra note 116, at 166 n.50.
153 VARALLO & DREISBACH, supra note 116, at 158 (citing A. GILCHRIST SPARKS, ET AL., INDEMNIFICATION, DIRECTORS AND OFFICERS LIABILITY INSURANCE AND LIMITATIONS OF DIRECTOR LIABILITY PURSUANT TO STATUTORY AUTHORIZATION: THE LEGAL FRAMEWORK UNDER DELAWARE LAW, 696 PLI/Corp. 941, 959-960 (May 7, 1990)).
154 VARALLO & DREISBACH, supra note 116, at 158.
155 Id. at 158-159.
of expenses in connection with suits initiated by the director or officer if authorized by the board of directors.\textsuperscript{156}

Even though it is suggested that the corporation is the one who drafts the employment contract and therefore any ambiguity is construed against the corporation, this argument lacks merit for the mere fact that the director or officer usually plays an active role in contract negotiations and therefore both parties assist in drafting the agreement. Thus, similar to New York Business Corporation Law, if “fees on fees” are not explicitly prescribed, the director or officer will not be indemnified.

\textit{C. Insurance Agreements}

Finally, a third way that directors and officer may avail themselves of a remedy for “fees on fees” is through insurance contracts.\textsuperscript{157} There are three primary functions for director and officer insurance: (1) to fill in the gaps where indemnification is legally unavailable, (2) to provide coverage where indemnification is legally allowable but otherwise unavailable because the corporation is either incapable or disinclined to indemnify, and (3) to reimburse the corporation for amounts it pays to indemnify.\textsuperscript{158} Under the first two functions, "fees on fees" fits smoothly for functional purposes. First, indemnification for “fees on fees” is unavailable in New York that would allow a director to seek insurance specifically for that type of indemnification. Second, it is likely that the corporation will be disinclined to distribute more money than needed (similar to the conduct of Health Management Systems) and therefore a director or officer may choose to take out insurance in the case of such an event.

The first category includes judgments or amounts paid for a settlement in a derivative

\textsuperscript{156} \textit{Id.} at 159.
\textsuperscript{158} \textsc{Varallo & Dreisbach}, \textit{supra} note 116, at 160.
suit, violations pertaining to securities laws, and if the director, for some reason, cannot satisfy the standards of good faith or reasonable belief. The second category covers situations where the corporation cannot indemnify the director or officer because of insolvency or the corporation's unwillingness due to a change in control. The final category covers contractual obligations of the corporation. Typically, every state in the United States, except Vermont, permits a corporation to purchase insurance to protect directors and officers against liability; the statutes make no effort to define what types of arrangements for corporations to engage in, nor do they seek to limit the types of activities for which insurance may be obtained.

1. Insurance as Ineffective Means

The main problem with insurance is that it is used to protect the interest of the corporation. Therefore, assuming that New York mandates indemnification for “fees on fees,” the corporation would protect itself by purchasing a policy which covered such fees in the event that it would have to make payments. However, because “fees on fees” are not necessary under the New York statute, there is no reason for corporations to purchase insurance policies for such claims. Thus the court’s suggestion for insurance requires corporate agents to purchase separate insurance for “fees on fees.” A typical analogy would be if New York Business Corporation Law did not command mandatory indemnification. Corporate officers and directors would be compelled to purchase their own insurance. This is not much of a remedy since the court is asking the officers and directors to expend money in insurance premiums in order to save money which is in direct contradiction with the remedies of contract and amendment of bylaws and

159 Id. (citing DAN A. BAILEY, DIRECTOR AND OFFICER LIABILITY AND INSURANCE: CURRENT DEVELOPMENTS, Second Annual Conference on Directors' and Officers' Duties and Liabilities, at 50-52 (Nov. 18 1991)).
160 VARALLO & DREISBACH, supra note 116, at 160 (citing Veasey, et al., supra note 146, at 419).
161 VARALLO & DREISBACH, supra note 116, at 160.
162 Id. at 160-161.
163 Emphasis added.
articles of incorporation.

V. PROPOSALS

A. Good Faith Standard

Another important aspect for corporations and officers is the issue of good faith. The most imperative requirement under Delaware Law is the adherence to the “good faith” standard; indemnification is permissible only if the indemnitee acted in good faith and in a manner he or she reasonably believed to be in or not opposed to the best interest of the corporation. Good faith is not defined under Section 145, however members of the committee who drafted the statute intended to bring within the scope of permissible indemnification, the officer or director who did not realize that his corporation had any interest at all in the subject matter of the action.

1. Example of Negative Effect of Current New York Standard

New York Business Corporation Law does not provide for “fees on fees” but that does not mean that they cannot be awarded. Posit this extreme example: assuming a corporation's bylaws or contract allows for a corporate officer to collect attorney's fees pursuant to all situations where the director did, in fact, act in a deceptive and fraudulent manner. If the New York Court of Appeals was interpreting the New York Business Corporation Law, the outcome would be clear;

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164 8 Corporate and Commercial Practice in DE Court of Chancery §8-2(a)(1)(ii) (citing 8 DEL. C. § 145(a)-(b)); see also VARALLO & DREISBACH, supra note 116, at 153.

Although the Delaware legislature did not attempt to define “good faith,” the drafters of the Model Act explain that under their indemnification provision, the concept of good faith involves a subjective test, which would include “a mistake in judgment,” even if the challenged decision was made unwisely by objective standards.

Id. (emphasis added).
in conformance with public policy, officers and directors who act in bad faith cannot acquire standard attorney fees. The statute also specifically states that attorney's fees are precluded under this situation and the statute would supersede the bylaw or contract. Therefore, both the court and the corporation would have an interest in making sure that directors and officers do not act in bad faith.

However, assume now, another extreme example, that "fees on fees" are what is being sought and that the contract or bylaw stated that the corporation must indemnify a director to the fullest extent of the law except for “fees on fees” which the corporation may deny in bad faith or capriciously. The court must now take into account the mental state of the corporation for denying these fees which, according to the bylaw or contract, are in violation of public policy. The interest of the court and the corporate agent are compelling with regard to protecting the director from oppressive behavior by the corporation. Thus, in this example, such behavior is evident, yet in the case of Baker such behavior is harder to prove.

2. Burden-Shifting Standard

One suggestion this Note proposes is a burden shifting procedure with regards to "fees on fees." In other words, the burden is on the director to meet the threshold requirement of demanding reimbursement for the fees in the underlying suit. If he or she fails to do so, the agent waives the right to obtain “fees on fees.” Then, once the corporation has failed to do so and the director has filed an indemnification suit, there is a presumption that the corporation acted in bad faith. The corporation may rebut this presumption by showing factual or legal circumstances which would tip the scale in favor of the corporation. If the corporation successfully does so then “fees on fees” are not awarded; yet if the corporation has failed to do so indemnification is
mandatory. Finally the director should be allowed to introduce evidence relating to bad faith conduct. This approach will balance both interests. First, the burden is higher on the corporation to prove that there was no bad faith which fulfills the interests of the director. Second, the corporation has an opportunity to give justifications as to why the original fees were denied and if done successfully “fees on fees” shall be reimbursed.

B. Arbitration Solution

Another solution which would balance both interests of the parties, as well as the court is arbitration. One commentator has noted that indemnity provisions or agreements may provide for third-party resolution of all indemnity questions. According to this critic, this manner would be useful to expedite a resolution regarding the question of indemnity and provide an impartial basis for such a determination. An example of such would be binding arbitration by the American Arbitration Association, or some other impartial mediation or arbitration panel relating to the question of whether a director or officer is entitled to “fees on fees.” The incentive for the corporation is that costs are relatively lower with respect to legal fees and transaction costs when arbitrating a claim. On the other hand, legal rules of evidence are not applicable and, just like a judge’s decision, an arbitrator’s opinion is binding on the parties despite the proper or improper application of the law.

Also an agreement to arbitrate any question of indemnity should withstand any

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166 Pierce, supra note 117, at 417.
167 Id.
170 Id.
subsequent judicial attack.\textsuperscript{171} Therefore, assuming arguendo that the arbitrator is convinced that the corporation has acted arbitrarily and capriciously towards the officer or director, the arbitrator may deviate from the strict rule in \textit{Baker}\textsuperscript{172} and decide that the director or officer should be awarded “fees on fees.” Furthermore, a major problem which may arise during the course of an indemnification suit is that the parties must still conduct business relations, namely the director or officer will most likely be under the employ of the corporation. Accordingly, a major benefit of arbitration which both parties will enjoy is that due to the less adversarial and informal nature of arbitration, it is more likely that parties can continue a business relationship afterwards.\textsuperscript{173}

\section*{VI. Conclusion}

The statute at issue is New York Business Corporation Law Section 722(a) and the case which makes it controversial is \textit{Baker v. Health Management Systems}.\textsuperscript{174} This Note has suggested that the New York Court of Appeals has failed to uphold the New York Business Corporation Law in an accurate manner by failing to apply the history of the American Rule, the legislative intent of the statute and the relevant case law. Further, the alternative solutions suggested by \textit{Baker} leave directors and officers of a corporation at a dead-end in terms of an equitable remedy.

The American Rule specifically forbids attorney fees unless a party has acted for oppressive reasons. Corporations can and will use their leverage in order to avoid paying extra costs, especially if they know that New York courts will narrowly apply the indemnification

\textsuperscript{171} Pierce, supra note 117, at 417 (citing Fletcher et al., supra note 169, at 3:20).
\textsuperscript{173} Newhall, supra note 170.
\textsuperscript{174} 722 N.E.2d 1099.
statute. Furthermore, the legislative intent behind the statute specifically seeks to alleviate the burden placed on directors and officers by large attorneys' fees. Pursuant to the decision in *Biondi v. Beekman Hill House Apartment Corporation*, the decision in *Baker* is completely illogical because *Biondi* stated that no one should be allowed to take advantage of his or her own wrong, namely the arbitrariness in denying attorneys' fees.

The *Biondi* case makes more sense in light of the recent decision passed down by the Supreme Court of Delaware. *Stifel Financial Corporation v. Cochran* goes towards the proposition that corporate officers should be allowed the peace of mind that their reasonable expenses will be borne by the corporation that they have served if they are held to be absolved from liability.

The interests of New York and corporate agents lean towards the mandatory indemnification of “fees on fees.” Executives of a corporation want to preserve their interests of becoming *actually* whole as opposed to *partially* whole as well as engaging in their business judgment without the worry about whether or not they will be fully indemnified. However, corporations have the interest of not paying expenses that are not required by law. New York has an interest in allowing for "fees on fees" in enticing competent directors to hold prominent board positions. Both parties, share an interest in regards to acting with good faith and not engaging in arbitrary or capricious behavior. The allowance of “fees on fees” will preclude bad faith activity by prohibiting corporations from illogically rejecting requests for such fees.

This Note does not suggest that officers and directors are entitled to mandatory relief for “fees on fees.” Rather that the law and legislation proves that they do in fact legally deserve such indemnification. By omitting *Biondi* from its analysis of legislative intent, the New York

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175 731 N.E.2d 577.
176 809 A.2d 555.
Court of Appeals failed to fully examine the history of this area of the law. The legislatures should make clear what they wish to include and exclude in the indemnification laws. Until then, the Court of Appeals should reevaluate their legal standpoint and correct the inequity which has befallen our corporate agents in New York. The anomaly is obvious and must be corrected.

177 See supra, Part II(A).