CLOSING DELAWARE'S LIABILITY DONUT HOLE: SECTION 102(B)(7) PROTECTION IS EXTENDED TO CORPORATE OFFICERS

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INTRODUCTION

Directors of Delaware corporations have long enjoyed protection from personal liability for breaches of the duty of care. Delaware has enacted statutes allowing corporations to provide an array of protections to their directors—including liability insurance,[1] indemnification,[2] and statutory exculpation under Section 102(b)(7).[3] In contrast, officers of Delaware corporations have not received the same statutory protection under Delaware law,[4] even though the Delaware Supreme Court held in *Gantler v. Stephens*[5] in 2009 that corporate officers owe the same fiduciary duties as directors.[6]

Section 102(b)(7) was enacted in 1986 as a response to the Director and Officer ("D&O") insurance crisis[7] and authorizes

1. Roberta Romano, *What Went Wrong With Directors' and Officers' Liability Insurance?*, 14 DEL. J. CORP. L. 1, 4 (1989).
2. DEL. CODE ANN. tit. 8, § 145 (1986).
3. *Id.* § 102(b)(7) (1986).
4. *Id.* § 102(b)(7) (1986).
5. 965 A.2d 695 (Del. 2009).
6. *Id.* at 708–09 ("In the past, we have implied that officers of Delaware corporations, like directors, owe fiduciary duties of care and loyalty, and that the fiduciary duties are the same as those of directors. We now explicitly so hold.").
7. Meeting Minutes from David B. Brown, Sec'y, Council of Corp. Law Section of the Del. State Bar Ass'n, to A. Gilchrist Sparks III, Chairman, Council of Corp. Law Section of the Del. State Bar Ass'n, 3–6 (Apr. 18, 1986),

corporate shareholders to exculpate directors from personal monetary liability for breaches of the duty of care through an opt-in clause in the corporation's charter.[8] Following its enactment, director exculpation statutes became commonplace in the United States.[9]

In August 2022, the Delaware General Assembly amended Section 102(b)(7) to authorize corporations to exculpate officers from personal liability for a breach of the duty of care in direct (but not derivative) lawsuits.[10] Part I of this Comment explores the history of Section 102(b)(7), the reasons officers were originally excluded, and the problems that arose as a result of their exclusion. Part II discusses the 2022 amendment to the charter-option statute, including how to opt-in to the provision, the mechanics of the statute, its implications on fiduciary duty law in Delaware, and how Delaware's amendment compares to other states' statutory frameworks for officer liability. Part III explains why shareholders benefit from adopting officer exculpation provisions in their corporate charters. The Comment concludes with recent developments and an outlook to the future.

I. BACKGROUND

A combination of court decisions and market reactions form the backdrop to the exculpatory charter-option statute and its recent amendment in Delaware. The history of the statute re-affirms Delaware's commitment to maintaining its status as the venue of choice for incorporation in the United States.

A. A Brief History of Delaware's Charter-Option Provision

1. Smith v. Van Gorkom and the D&O Insurance Crisis

The Delaware General Assembly enacted Section 102(b)(7) in response to the D&O insurance crisis that came to a head with the Delaware Supreme Court's landmark decision in *Smith v. Van Gorkom*[11] in 1985.[12] In *Van Gorkom*, the court held that TransUnion's directors were not protected by the business judgment rule, which allowed the shareholder-plaintiffs to hold them personally

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https://www.law.upenn.edu/live/files/6684-a-hreflivefiles6684-860417-council-minutespdf [hereinafter *Meeting Minutes Apr. 18, 1986*].

8. § 102(b)(7) (1986).

9. James J. Hanks, Jr., *Evaluating Recent State Legislation on Director and Officer Liability Limitation and Indemnification*, 43 BUS. L. 1207, 1210 (1988) ("The most popular form of director liability statute has been the so-called 'charter option' statute, first enacted by Delaware, effective July 1, 1986. Since then, charter option statutes have been adopted by thirty other states.").

10. § 102(b)(7) (2022).

11. 488 A.2d 858 (Del. 1985).

12. *See Meeting Minutes Apr. 18, 1986*, *supra* note 7, at 1–5.

liable.[13] The business judgment rule "is a presumption that in making a business decision, the directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company."[14] It provides judicial deference to the discretion of directors in their management of the corporation.[15] A plaintiff must overcome the presumption of the business judgment rule in order to plead a claim for a director's breach of the duty of care.[16]

Until *Van Gorkom*, the business judgment rule had routinely protected directors from personal liability for breaches of the duty of care.[17] The court's decision against the directors in *Van Gorkom* exacerbated an already unraveling D&O insurance market with skyrocketing premiums.[18] The difficulty of obtaining D&O insurance, sky-high premiums, and exposure to personal liability for breaches of duty despite good faith decisions resulted in widespread resignations from directorship positions on corporate boards and made it difficult for corporations to attract qualified directors.[19]

2. Legislative Response to the D&O Crisis

In October 1985, the Council of Corporation Law Section of the Delaware State Bar (the "Council") agreed to form a committee to determine the appropriate legislative response to the D&O insurance crisis.[20] Two statutory solutions were proposed. The first proposal was an amendment to the statutes that would cap the aggregate liability of the members of a board of directors at $1 million for breach of fiduciary duty, unless a director was interested in the transaction, derived a material financial benefit from the transaction, or acted in bad faith.[21] The second proposal was an amendment to the statutes,

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13. *Van Gorkom*, 488 A.2d at 871, *overruled on other grounds by* Gantler v. Stephens, 965 A.2d 695 (Del. 2009).

14. *Id.* at 872 (quoting Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984)).

15. *Id.* at 872 ("The business judgment rule exists to protect and promote the full and free exercise of the managerial power granted to Delaware directors.").

16. *Id.* at 872–73.

17. *See* Bayless Manning, 41 BUS. L. 1, 1 (1985) ("The Delaware Supreme Court in *Van Gorkom* exploded a bomb. Stated minimally, the court there pierced the business judgment rule . . . . The corporate bar generally views the decision as atrocious.").

18. *See* Romano, *supra* note 1, at 25; Sara R. Slaughter, *Statutory and Non-Statutory Responses to the Director and Officer Liability Insurance Crisis*, 63 IND. L.J. 181, 183–84 (1987).

19. Slaughter, *supra* note 18, at 185.

20. Meeting Minutes from David B. Brown, Sec'y, Council of Corp. Law Section of the Del. State Bar Ass'n, to A. Gilchrist Sparks III, Chairman, Council of Corp. Law Section of the Del. State Bar Ass'n, 2 (Oct. 21, 1985), https://www.law.upenn.edu/live/files/6679-a.

21. Memorandum from Stephen P. Lamb, Council of Corp. Law Section of the Del. State Bar Ass'n, to R. Franklin Balotti et al., Council of Corp. Law

namely Section 102(b), that would allow corporations to amend their charters to add an exculpation provision to shield directors from personal liability for breaches of the duty of care.[22]

The Council agreed that a corporate charter option was preferable to a monetary cap.[23] First, the charter option was fairer to shareholders because a shareholder vote to amend the corporation's charter is required to opt-in to the statutory limitation on directors' liability.[24] Second, the charter option avoided selecting an arbitrary monetary cap that could start an arms race with other states to enact the lowest cap.[25]

Until August 2022, Section 102(b)(7) provided corporations with the option to protect directors (but not officers) from personal liability for breaches of the duty of care in both direct and derivative lawsuits.[26] The Council originally considered including officers in the 1986 amendment to Section 102(b)(7).[27] Council members expressed concern that, by excluding officers from the charter-option protections, Delaware "might be perceived as doing too little if officers are not given the same protection as directors and . . . the corporate officials who decide where to incorporate are almost invariably officers."[28] One Council member also noted that "directors and officers are generally treated similarly for purposes of liability, as indeed they are in § 145, and that [the Council] should not be quick to draw a distinction between them in [their] proposed amendment."[29]

The Council ultimately decided to exclude officers from the 1986 version for three reasons. First, Delaware's long-arm statute—Title 10, § 3114(b)— for purposes of personal jurisdiction did not extend to officers of Delaware corporations at the time,[30] so there was no

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Section of the Del. State Bar Ass'n, 1–3 (Apr. 10, 1986), https://www.law.upenn.edu/live/files/6683-a-hreflivefiles6683-860410-cap-proposal-lambpdf.

22. *See Meeting Minutes Apr. 18, 1986*, *supra* note 7, at 3.

23. *Id.* at 5–6.

24. *Id.* at 3.

25. *Id.* at 4. Additional reasons that the charter option was preferable to a monetary cap were that it "avoids the stigma of a cap, which groups like the trial lawyers' association [typically] oppose," it parallels the limitations on liability developed in agency and trust law, and the Bar President and Bar Executive Committee were more likely to endorse it to the Delaware General Assembly. *Id.*

26. DEL. CODE ANN. tit. 8, § 102(b)(7) (2022).

27. Meeting Minutes from David B. Brown, Sec'y, Council of Corp. Law Section of the Del. State Bar Ass'n, to A. Gilchrist Sparks III, Chairman, Council of Corp. Law Section of the Del. State Bar Ass'n, 2–3 (Apr. 28, 1986) (on file with the Univ. of Penn. Carey Law School), https://www.law.upenn.edu/live/files/6685-a-hreflivefiles6685-860423-council-minutespdf [hereinafter *Meeting Minutes Apr. 28, 1986*].

28. *Meeting Minutes Apr. 28, 1986*, *supra* note 27, at 2.

29. *Id.* at 2–3.

30. DEL. CODE ANN. tit. 10, § 3114(b) (2004).

significant reason to include them in the 1986 amendment.[31] Second, the original purpose of the 1986 amendment "was to encourage outside directors to continue serving" on corporate boards.[32] A decision to extend it further likely would have been "widely criticized."[33] Third, in recognition of the board's authority to manage corporate affairs,[34] "preserving liability for acts of gross negligence by officers would promote the salutary policy of encouraging officers to bring matters to the board."[35] It is notable that the reasons for excluding officers from the 1986 statute did not include the concern that officers are more inclined than directors to make uninformed decisions that would constitute gross negligence.

B. Issues that Arose as a Result of Officers' Exclusion from the 1986 Statute

Although the drafters of the 1986 statute did not intend to expose officers to a different litigation process or significantly more personal liability than directors, officer liability became a problem that intensified with several developments in Delaware corporate law following the Sarbanes-Oxley Act of 2002 and the Delaware Supreme Court's decision in *Gantler*.[36] The following developments "prompt[ed] the [Delaware] General Assembly to authorize exculpation for officers for stockholder claims."[37]

1. Delaware's Amendment to its Long-Arm Statute

In 2004, Delaware amended its long-arm statute, Section 3114, to include senior executives within the reach of personal jurisdiction in Delaware.[38] The Delaware General Assembly amended Section 3114 to include these executive officers in response to corporate governance changes after scandals like Enron.[39] As a result of corporate reforms such as the Sarbanes-Oxley Act of 2002, corporations increased the number of independent directors sitting on their boards, and decreased the number of officer-directors.[40] However, this created a problem in Delaware because the pre-2004 version of Section 3114 did not subject officers to personal

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31. *Id.*
32. *Id.*
33. *Id.*
34. DEL. CODE ANN. tit. 8, § 141(a) (2023).
35. *Meeting Minutes Apr. 28, 1986*, *supra* note 27, at 3.
36. Lawrence A. Hamermesh et al., *Optimizing the World's Leading Corporate Law: A Twenty-Year Retrospective and Look Ahead*, 77 BUS. L. 321, 365–66 (2022).
37. *In re* McDonald's Corp. S'holder Derivative Litig., 289 A.3d 343, 368 (Del. Ch. 2023).
38. Hamermesh et al., *supra* note 36, at 365.
39. *Id.*
40. *Id.* at 365–66.

jurisdiction, so it was difficult to hold them accountable for breaches of the duty of loyalty.[41] Delaware amended Section 3114 to target egregious breaches of the duty of loyalty by executive officers, not to police executives' duty of care.[42]

2. Gantler v. Stephens

In 2009, the Delaware Supreme Court held in *Gantler v. Stephens* that directors and officers owe the same fiduciary duties to shareholders.[43] This was an explicit signal that officers were liable to shareholders for breaches of fiduciary duty, and yet officers had no liability shield for breaches of the duty of care.[44]

The *Gantler* decision fully exposed the existing donut hole in the charter-option statute. Most corporations had opted to exculpate directors from shareholder claims for a breach of the duty of care. And pleading requirements make it difficult to successfully plead a duty-of-loyalty claim against a board of directors that consists of a supermajority of disinterested directors.[45] *Gantler* thus effectively encouraged duty-of-care claims against officers because those claims became the path of least resistance to a financial recovery related to corporate decisions, particularly in mergers and acquisitions ("M&A") litigation.[46] Plaintiffs also have exploited the gap in the charter-option statute by tacking on claims against director-officers acting in their "officer capacity" in order to survive a motion to dismiss, trigger discovery, and increase the costs of litigation so as to provide leverage for an early settlement.[47] The statutory gap has created a distorted liability framework, whereby directors who played the same, or even greater, role than officers in the alleged misconduct have less liability exposure.[48]

II. THE 2022 AMENDMENT TO THE CHARTER-OPTION STATUTE

Delaware's 2022 amendment to the charter-option statute closes the considerable hole in the statute by allowing corporations to

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41. *Id.* at 366.
42. *Id.*
43. 965 A.2d 695, 708–09 (2009).
44. Hamermesh et al., *supra* note 36, at 366–367.
45. *Id.* at 367.
46. *See id.* at 366–70.
47. *Id.* at 369; *see, e.g.*, Olenik v. Lodzinski, 208 A.3d 704, 719 n.74 (Del. 2019); Voigt v. Metcalf, No. 2018-0828-JTL, 2020 WL 614999, at *27–28 (Del. Ch. Feb. 10, 2020); *In re* Baker Hughes Inc., Merger Litig., No. 2019-0638-AGB, 2020 WL 6281427, at *2, *18–21 & n.190 (Del. Ch. Oct. 27, 2020) (plaintiffs argued that Baker Hughes' CEO and CFO breached fiduciary duties of loyalty and care, both of which were non-exculpated under Section 102(b)(7) at the time).
48. Hamermesh et al., *supra* note 36, at 370; *see, e.g.*, Chen v. Howard-Anderson, 87 A.3d 648, 654–64, 685–87 (Del. Ch. 2014).

provide similar exculpation to their officers that they provide to their directors.

A. Opting-in to the Exculpation Provision

The amendment to Section 102(b)(7) does not itself exculpate officers for personal liability. Instead, it authorizes the shareholders to opt-in to the protections through an amendment to the corporate charter, i.e., the articles of incorporation.[49] Because the opt-in requires amending the articles, the board must make a proposal to the shareholders entitled to vote on its adoption.[50] Section 242(a) of the Delaware corporate statutes authorizes a corporation to amend its articles "in any and as many respects as may be desired, so long as its certificate of incorporation as amended would contain only such provisions as would be lawful and proper to insert in an original certificate of incorporation filed at the time of filing the amendment."[51]

Section 242(b) sets forth the process in which the articles are amended.[52] First, the board of directors must "adopt a resolution setting forth the amendment proposed, declaring its advisability, and either calling a special meeting of the stockholders entitled to vote [on the proposed amendment] or directing that the [proposed amendment] be considered at the next annual meeting."[53] The proposed amendment is adopted "if a majority of the outstanding stock entitled to vote thereon, and a majority of the outstanding stock of each class entitled to vote thereon as a class has been voted in favor of the amendment."[54]

All shareholders, regardless of their shares' voting rights, are entitled to vote on a proposed amendment if it would "alter or change the powers, preferences, or special rights of the shares of [a] class so as to *affect them adversely*[.]"[55] It is a long-standing principle of Delaware jurisprudence that a class has the "right to a class vote when the proposed amendment adversely affects the peculiar legal characteristics of *that* class of stock."[56] Adoption of the charter-option provision does not "affect [a non-voting class] adversely" because it

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49. DEL. CODE ANN. tit. 8, § 102(b)(7) (2022).
50. *Id.* § 242(b)(1)–(2).
51. *Id.* § 242(a).
52. *Id.* § 242(b).
53. *Id.* § 242(b)(1).
54. *Id.*
55. *Id.* § 242(b)(2) (emphasis added).
56. *In re* AMC Entertainment Holdings, Inc. S'holder Litig., No. 2023-0215-MTZ, 2023 WL 5165606, at *22 (Del. Ch. Aug. 11, 2023) (quoting Orban v. Field, CIV. A. 12820, 1993 WL 547187, at *8 (Del. Ch. Dec. 30, 1993)) (emphasis added). *See also* Hartford Accident & Indem. Co. v. W.S. Dickey Clay Mfg. Co., 24 A.2d 315, 318–19 (Del. 1942).

does not affect the peculiar legal interests of *that* class.[57] Under this provision then, only shareholders with voting rights are entitled to vote on amending the articles to opt-in to the exculpation provision.[58]

B. Introduction to the Changes

The amendment to Section 102(b)(7) now allows corporations to amend their charters to include an exculpatory provision for officers (although the exculpation differs slightly from the protections afforded to directors).[59] The amended statute now states:

> [i]n addition to the matters required to be set forth in the certificate of incorporation by subsection (a) of this section, the certificate of incorporation may also contain . . . [a] provision eliminating or limiting the personal liability of a director *or officer* to the corporation or its stockholders for monetary damages for breach of fiduciary duty as a director *or officer*.[60]

An officer within the meaning of the amendment to Section 102(b)(7) is "a person who at the time of an act or omission as to which liability is asserted is deemed to have consented to service by the delivery of process to the registered agent of the corporation pursuant to § 3114(b) of Title 10."[61]

Section 3114(b) of Title 10 provides that an "officer" subject to service of process in Delaware includes: the president, chief executive officer ("CEO"), chief financial officer ("CFO"), chief legal officer ("CLO"), controller, treasurer, or chief accounting officer at any time during the alleged wrongful conduct, any person identified in the corporation's public Securities and Exchange Commission ("SEC") filings because such person is or was one of the most highly compensated executive officers of the corporation at the time of the alleged wrongful conduct, and any person who has consented in writing to be identified as an officer under Section 3114.[62] The amendment to Section 102(b)(7) thus authorizes a corporation to exculpate senior officers for personal liability from a breach of the duty of care.

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57. *In re* Snap Inc. Section 242 Litig., Consol. C.A. No. 2022-1032-JTL, D.I. 22 at 33–34 (Del. Ch. March 29, 2023) (TRANSCRIPT); Pamela Millard, *Amendment to Certificate of Incorporation Adopting Provision to Exculpate Officers from Monetary Liability for Breaches of Fiduciary Duty under Section 102(b)(7) of the DGCL Does Not Trigger a Class Vote of Stockholders under Section 242(b)(2) of the DGCL*, ABA (April 30, 2023), https://www.americanbar.org/groups/business_law/resources/business-law-today/2023-april/april-2023-corporations-llc-partnerships/. As of September 2023, the case is pending appeal with the Delaware Supreme Court.

58. DEL. CODE ANN. tit. 8, § 242(b)(2).

59. *Id.* § 102(b)(7).

60. *Id.* (emphasis added).

61. *Id.*

62. DEL. CODE ANN. tit. 10, § 3114(b)(1)–(3).

C. Textual Analysis of Amended Section 102(b)(7)

Amended Section 102(b)(7) limits officer exculpation to duty-of-care violations by specifically excluding a swath of non-exculpated claims, i.e., duty-of-loyalty violations, lack of good faith, intentional misconduct, knowing violations of the law, and transactions in which an officer derived an improper personal benefit.[63] Director exculpation features the same limitations in this respect.[64] The amended statute also does not protect officers (or directors) from equitable relief, e.g., injunctions, declaratory judgments, etc.[65] However, unlike directors, officers are not protected from any fiduciary duty claims in derivative actions, including the duty of care.[66] This is the one notable difference that remains between officer and director exculpation in amended Section 102(b)(7).[67]

1. The Duty of Care

An officer's duty of care is predicated on concepts of gross negligence.[68] The duty of care requires that officers, like directors, "act[] on an informed basis, in good faith and in the honest belief that the action was taken in the best interests of the company."[69] To fulfill the duty of care, directors and officers must make decisions only after informing themselves of "all material information reasonably available to them,"[70] by engaging in due diligence, and by seeking the opinion of experts, such as outside legal counsel, independent audit firms, and investment bankers when appropriate.[71]

A corporate fiduciary's decision amounts to gross negligence if it is "so grossly off-the-mark as to amount to reckless indifference or a

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63. DEL. CODE ANN. tit. 8, § 102(b)(7).

64. *Id.*

65. *Id.*

66. *Id.* § 102(b)(7)(v).

67. In addition to adoption of a charter-option provision under amended Section 102(b)(7), officers can be protected from personal liability through indemnification and D&O insurance. *Id.* § 145(a)–(b); MARSH & MCLENNAN, *Directors and Officers Liability*, https://www.marsh.com/ca/en/services/financial-professional-liability/sectors/directors-and-officers-liability.html.

68. *In re* Baker Hughes, Inc., No. 2019-0638, 2020 WL 6281427, at *15 (Del. Ch. Oct. 27, 2020); Smith v. Van Gorkom, 488 A.2d 858, 872–73 (Del. 1985). In Delaware, gross negligence by corporate fiduciaries is "reckless indifference to or a deliberate disregard of the whole body of stockholders or actions which are without the bounds of reason." Firefighters' Pension Sys. of City of Kansas City, Mo. Trust v. Presidio, Inc., 251 A.3d 212, 287 (Del. Ch. 2021) (quoting Tomczak v. Morton Thiokol, Inc., CIV. A. 7861, 1990 WL 42607, at *12 (Del. Ch. Apr. 5, 1990)).

69. Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984).

70. *Id.*

71. § 141(e) (2023).

gross abuse of discretion."[72] *Van Gorkom*, the seminal duty-of-care case, illustrates director and officer decision-making that rises to a level of gross negligence and therefore constitutes a breach of the duty of care.[73] In *Van Gorkom*, the Delaware Supreme Court held that TransUnion's board of directors, which included both its CEO and chief operating officer ("COO"), had breached their duty of care by approving a merger agreement that none of them had reviewed after a two-hour meeting that included only an oral presentation about the proposed merger.[74] Further, the consideration in the merger agreement was not based on a financial valuation by an expert or even by TransUnion's CFO.[75] Because the board's decision-making process amounted to gross negligence, and Section 102(b)(7) did not exist at the time, the directors were personally liable for monetary damages.[76]

In comparison to duty-of-care claims against directors, claims against officers often arise in the M&A context with the preparation of disclosure documents for a stockholder vote.[77] For example, in *Morrison v. Berry*,[78] the Chancery Court held on remand from the Delaware Supreme Court that the plaintiffs adequately stated a claim for a breach of the duty of care against The Fresh Market's CEO and CLO arising out of their preparation of a Schedule 14D-9 that omitted material information about a merger between The Fresh Market and Apollo Global Management ("Apollo").[79]

Other than the exception for derivative litigation, Section 102(b)(7)'s limitation on officer liability parallels the limitation on director liability: if a corporation adopts a charter-option provision for officer exculpation, then a plaintiff will not be able to plead a viable duty-of-care claim despite pleading gross negligence.[80] Corporations that adopt charter-option provisions for officers will exculpate those officers from personal liability in direct shareholder lawsuits for breaches of the duty of care to the same extent as the directors.[81] Conversely, officers of corporations that do not adopt charter-option provisions remain exposed to personal liability for those breaches.[82]

There is less of a risk of a breach of the duty of care by officers than directors, and therefore there is a better case for their

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72. *Firefighters' Pension Sys.*, 251 A.3d at 287 (quoting Solash v. Telex Corp., CIV. A. 9518, 1988 WL 3587, at *9 (Del. Ch. Jan. 19, 1988)).

73. *See* 488 A.2d at 858.

74. *Id.* at 869.

75. *Id.* at 866, 868–69.

76. *Id.* at 866, 893.

77. Hamermesh et al., *supra* note 36, at 368.

78. C.A. No. 12808-VCG, 2019 WL 7369431 (Del. Ch. Dec. 31, 2019).

79. *Id.* at *24–27.

80. *See* DEL. CODE ANN. tit. 8, § 102(b)(7) (2023).

81. Officers, unlike directors, are not exculpated for breaches of the duty of care in derivative litigation. *Id.* § 102(b)(7)(v).

82. *Id.* § 102(b)(7).

exculpation.[83] Officers work for the corporation full-time. A careless decision could end in their termination and damage their career, and could expose the corporation to an enterprise risk that could jeopardize their employment. Officers also have greater access to information about the corporation than the directors, so that their decisions are inherently more fully informed.[84]

2. The Duty of Loyalty

An officer's duty of loyalty requires that he or she place the corporation's interests above their own.[85] Common scenarios that implicate an officer's duty of loyalty are usurping a corporate opportunity,[86] standing on both sides of a transaction, or receiving a benefit from a transaction that is not shared with the corporation's shareholders.[87] The duty of oversight and the duty of good faith are also subsidiary parts of the broader duty of loyalty.[88]

The duty of loyalty for both directors and officers is unaffected by the 2022 amendment to Section 102(b)(7).[89] An officer of a corporation that has adopted a charter-option provision for officers will not be exculpated from personal liability for breaches of the duty of loyalty.[90] The duty of loyalty remains an important check on officer conduct.

Like duty of care claims, duty of loyalty claims against officers often arise in the M&A context.[91] In this context, the typical duty of loyalty claim arises "when a supine board under the sway of an

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83. Hamermesh et al., *supra* note 36, at 367.

84. Lawrence A. Hamermesh & A. Gilchrist Sparks III, *Corporate Officers and the Business Judgment Rule: A Reply to Professor Johnson*, 60 BUS. LAW. 865, 872 (2005).

85. Cede & Co. v. Technicolor, Inc., 634 A.2d 345, 361 (Del. 1993).

86. Broz v. Cellular Info. Sys., Inc., 673 A.2d 148, 154–55 (Del. 1996).

> The corporate opportunity doctrine . . . holds that a corporate officer or director may not take a business opportunity for his own if: (1) the corporation is financially able to exploit the opportunity; (2) the opportunity is within the corporation's line of business; (3) the corporation has an interest or expectancy in the opportunity; and (4) by taking the opportunity for his own, the corporate fiduciary will thereby be placed in a position inimicable to his duties to the corporation.

Id.

87. *Cede & Co.*, 634 A.2d at 362.

88. *In re* McDonald's Corp. S'holder Derivative Litig., 289 A.3d 343, 350 (Del. Ch. 2023) ("As with the director's duty of oversight, establishing a breach of the officer's duty of oversight requires pleading and later proving disloyal conduct that takes the form of bad faith.").

89. DEL. CODE ANN. tit. 8, § 102(b)(7)(i) (2023).

90. *Id.*

91. *See, e.g.*, Firefighters' Pension Sys. of City of Kansas City, Mo. Trust v. Presidio, Inc., 251 A.3d 212, 235–36 (Del. Ch. 2021); City of Fort Myers Gen. Emps.' Pension Fund v. Haley, 235 A.2d 702, 724 (Del. 2020); *In re* El Paso Corp. S'holder Litig., 41 A.3d 432, 443 (Del. Ch. 2012).

overweening CEO bent on a certain direction[] tilts the sales process for reasons inimical to the stockholders' desire for the best price."[92]

Firefighters' Pension System of City of Kansas City, Missouri Trust v. Presidio, Inc.[93] is a paradigmatic example of this phenomenon. In *Firefighters' Pension System*, the CEO of Presidio, Inc., the target company, engaged in merger negotiations with prospective bidders Clayton, Dubilier & Rice, LLC, ("CD&R") and BC Partners Advisors L.P. ("BCP").[94] CD&R was positioned to offer a higher price for Presidio because its ownership of another company in Presidio's industry provided business synergies.[95] For Presidio's CEO, the caveat of a deal with CD&R was that it would not retain Presidio's management after closing since it already owned another company in the industry.[96]

BCP offered to purchase Presidio at $16.00 per share, which was a premium of twenty percent over the stock's trading price at the time.[97] Presidio and BCP entered into a merger agreement with a post-signing go-shop clause, which allowed Presidio to solicit other offers and terminate the merger agreement at a discounted fee if it received a superior offer from a company with "Excluded Party" status.[98] If Presidio merged with BCP, Presidio's CEO would not only retain his position as CEO, but he also stood to gain substantial financial benefits from the deal through equity.[99]

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92. *In re* Toys "R" Us Inc. S'holder Litig., 877 A.2d 975, 1002 (Del. Ch. 2005). Such reasons may include profit, the promise of a lucrative compensation package from the surviving entity, and the ability to retain a senior officer position. *See, e.g., Firefighters' Pension Sys.*, 251 A.3d at 235–36.

93. 251 A.3d 212 (Del. Ch. 2021).

94. *Id.* at 235–36.

95. *Id.* at 232.

96. *Id.* at 235–36.

97. *Id.* at 239.

98. *Id.* at 240. The Original Merger Agreement defined an "Excluded Party" as one "who, before the No-Shop Period Start Date, made a Company Takeover Proposal that the Board determined in good faith 'constitutes or would be reasonably expected to lead to a Company Superior Proposal.'" *Id.* (quoting the Original Merger Agreement). The Original Merger Agreement defined a "Company Superior Proposal" as one

> which the Company Board determines in good faith . . . to be more favorable to the Company and its stockholders from a financial point of view than the Transactions and is reasonably likely to be timely consummated in accordance with its terms, in each case, taking into account all relevant factors (including all the terms and conditions of such proposal or offer (including the transaction consideration, conditionality, timing, certainty of financing, and/or regulatory approvals and likelihood of consummation) and this Agreement . . .).

Id.

99. *See id.* at 241.

During the go-shop phase, CD&R offered to purchase Presidio at $16.50 per share, which made it an "Excluded Party."[100] After CD&R's offer, LionTree Advisors, LLC ("LionTree"), the financial advisor to Presidio's controlling stockholder, Apollo, tipped BCP about CD&R's higher offer.[101] BCP then increased its offer only ten cents over CD&R's offer to $16.60 per share, and conditioned it on the elimination of the discounted termination fee attributable to terminating the agreement to instead engage with an Excluded Party.[102] BCP gave Presidio only twenty-four hours to respond to its revised offer.[103] The court opined that the board gave mere pretextual reasons for preferring BCP's offer over CD&R's.[104] The court denied the motion to dismiss the duty of loyalty claim against Presidio's CEO because the complaint gave rise to a reasonable inference that he steered the board to engage with BCP instead of CD&R for "obvious [self-interested] reasons."[105]

Shareholder claims arising under similar facts implicate an officer's duty of loyalty and remain non-exculpated for all Delaware corporations under Section 102(b)(7)(i), regardless of the corporation opting-in to the officer exculpation provision.[106] Delaware officers are still liable for monetary damages and susceptible to equitable remedies for a breach of the duty of loyalty.[107]

3. Bad Faith, Intentional Misconduct, and Knowing Violations of the Law Under Amended Section 102(b)(7)

Section 102(b)(7)(ii) now provides that a corporation may not exculpate directors and officers from liability for "acts or omissions not in good faith or which involve intentional misconduct or a knowing violation of law."[108] As briefly discussed earlier, the duty of good faith is a component of the larger umbrella of the duty of loyalty rather than a standalone fiduciary duty, but this Comment addresses it separately because Section 102(b)(7) separates them within its exceptions.[109]

Because the duty of good faith is intertwined with the duty of loyalty, the initial impression is that the bad faith exception overlaps with the duty of loyalty exception under Section 102(b)(7)(i).

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100. *Id.* at 242.
101. *See id.* at 243.
102. *See id.* at 244. The discounted termination fee was $18 million. *Id.* at 240. The full termination fee in BCP's final offer was $41 million. *Id.* at 244. The $18 million termination fee "was a key benefit of Excluded Party status." *Id.* at 240. Thus, BCP's revised offer stripped CD&R of this benefit.
103. *See id.* at 244.
104. *See id.* at 271.
105. *Id.* at 283.
106. *See* DEL. CODE ANN. tit. 8, § 102(b)(7)(i) (2023).
107. *See id.*
108. *Id.* § 102(b)(7)(ii).
109. *See* Stone v. Ritter, 911 A.2d 362, 369–70 (Del. 2006).

However, Delaware courts have developed the duty of good faith framework to address a gray area where director and officer misconduct "does not involve disloyalty (as traditionally defined) but is qualitatively more culpable than gross negligence."[110] In a scenario within this gray area, directors and officers "have no conflicting self-interest in a decision, yet engage in misconduct that is more culpable than simple inattention or failure to be informed of all facts material to the decision."[111]

Delaware's disloyalty and bad faith jurisprudence also implicates the duty of oversight.[112] Shareholder claims arising from a breach of the subsidiary duty of oversight have ordinarily been brought against directors, but as of January 25, 2023, the Chancery Court has explicitly held that the duty of oversight also applies to officers.[113] The Chancery Court's recent holding in *In re McDonald's Corporation Shareholder Derivative Litigation*[114] expressly states that the two oversight claims articulated in *In re Caremark International Inc. Derivative Litigation*[115] and *Graham v. Allis-Chalmers Manufacturing Co.*[116]—the information systems claim and the red-flags claim—apply equally to officers.[117]

In re Caremark involved the information systems claim, which imposes liability on corporate fiduciaries "if they knowingly fail to adopt an internal information and reporting system that is 'reasonably designed to provide to [officers and directors] accurate information sufficient to allow [them] to reach informed judgments concerning both the corporation's compliance with law and its business performance.'"[118] And *In re Caremark* further developed the red-flags claim set out in *Graham*, which holds corporate fiduciaries liable for failing to respond to red flags generated by the corporation's established information systems.[119]

The exception in Section 102(b)(7)(ii) therefore does not exculpate officers of corporations that adopt a charter-option provision where the misconduct rises to the level of bad faith, intentional misconduct, or a knowing violation of the law.

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110. *In re* Walt Disney Co. Derivative Litig., 906 A.2d 27, 66 (Del. 2006).

111. *Id.* The Delaware Supreme Court's non-exhaustive list of examples of bad faith conduct include when a fiduciary intentionally acts against the best interest of the corporation, intentionally violates statutory law, or shows a "conscious disregard for his [or her] duties" by intentionally failing to act when he or she has a duty to act. *Id.* at 67.

112. *See In re* McDonald's Corp. S'holder Derivative Litig., 289 A.3d 343, 373 (Del. Ch. 2023).

113. *Id.* at 349 ("This decision confirms that officers owe a duty of oversight.").

114. *Id.* at 343.

115. 698 A.2d 959 (Del. Ch. 1996).

116. 188 A.2d 125 (Del. 1963).

117. *See McDonald's*, 289 A.3d at 360, 362.

118. *Id.* at 361 (quoting *Caremark*, 698 A.2d at 970).

119. *McDonald's*, 289 A.3d at 361.

4. Derivative Litigation

While Section 102(b)(7) protects officers from personal liability for breaches of the duty of care in direct shareholder actions, it preserves the corporation's (and the shareholders') ability to hold officers liable for duty of care claims in derivative actions.[120] Shareholders can either make a demand on the board to sue an officer for breach of the duty of care in a derivate suit, or shareholders can prove that demand is excused as futile and institute a derivative action themselves.[121]

D. Comparison to Other States' Statutes

Despite Delaware's reputation as a leader in developing corporate law, it was not the first state to allow corporations to exculpate officers from personal liability. Prior to Delaware's amendment in August 2022, six other states—Maryland, New Hampshire, Louisiana, Nevada, New Jersey, and Virginia—allowed corporations to exculpate officers for breaches of fiduciary duty.[122] Following Delaware's amendment, in January 2023, Pennsylvania amended its statutory scheme to authorize officer exculpation.[123] A comparison of Delaware's statutory limitation on officer liability to other states' statutory schemes follows.

1. Maryland

Maryland law authorizes officer exculpation for monetary damages for any breach of fiduciary duty except in cases where there is an improper benefit conferred upon the officer, the officer acted with deliberate dishonesty,[124] or the officer of a financial institution is sued by a governmental entity.[125] Unlike Section 102(b)(7), Maryland's statute does not distinguish between direct or derivative claims brought against officers.[126] Further, it allows exculpation for officers that violate the duty of loyalty provided that an exception does not apply.[127] Like the Delaware statute, Maryland's statute allows exculpation for officers for monetary damages, but not for equitable relief.[128]

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120. *See* DEL. CODE ANN. tit. 8, § 102(b)(7)(v) (2023).

121. *See* United Food & Com. Workers Union & Participating Food Indus. Emps. Tri-State Pension Fund v. Zuckerberg, 262 A.3d 1034, 1047 (Del. 2021).

122. *See infra* notes 125–63 and accompanying text.

123. 15 PA. CONS. STAT. § 1735 (2023).

124. MD. CODE ANN., CTS. & JUD. PROC. § 5-418(a) (West 2023).

125. *Id.* § 5-418(b).

126. *See id.* § 5-418(a).

127. *Id.*

128. *Id.*

2. New Hampshire

New Hampshire's statutory exculpation provision is similar to Maryland's in that it allows exculpation for officers in claims for a breach of the duty of care and breach of the duty of loyalty, provided that none of the exceptions applies.[129] The three exceptions applicable to officers[130] are improper financial benefit received by an officer, intentional harm to the corporation or its shareholders, and intentional violation of criminal law.[131] New Hampshire's statute does not distinguish between direct and derivative claims against officers.[132] However, like Delaware, New Hampshire's statute limits exculpation to monetary damages claims.[133]

3. Louisiana

Louisiana's officer exculpation provision is an opt-out default rule,[134] as compared to Delaware's opt-in provision.[135] Thus, unless a Louisiana corporation opts-out of the default statutory liability limitation via a statement in its corporate charter, its officers will be protected from personal monetary liability for breaches of duty, provided that no exception applies.[136] The exceptions to Louisiana's statutory limitation on officers' liability include breaches of the duty of loyalty, intentional harm to the corporation or its shareholders, and "intentional violation of criminal law[.]"[137] Unlike Delaware's opt-in, Louisiana's opt-out applies to both direct and derivative claims.[138] However, Louisiana, like Delaware, does not allow exculpation for breaches of the duty of loyalty[139] and limits exculpation to monetary personal liability.[140]

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129. N.H. REV. STAT. ANN. § 293-A:2.02(b)(4) (2023).

130. New Hampshire's statute includes one other exception (i.e., a violation of section 293-A:8.33). *See id.* § 293-A:8.33 (covering directors' liability for unlawful distributions and therefore does not pertain to officers unless the officer also holds a board position).

131. *Id.* § 293-A:2.02(b)(4)(A)–(B), (D).

132. *Id.* § 293-A:2.02(b)(4).

133. *Id.*

134. LA. STAT. ANN. § 12:1-832(A) (2023) ("Except to the extent that the articles of incorporation limit or reject the protection against liability provided by this Section, no director or officer shall be liable to the corporation or its shareholders for money damages . . . .").

135. DEL. CODE ANN. tit. 8, § 102(b)(7) (2023) ("[T]he certificate of incorporation may also contain . . . a provision eliminated or limiting the personal liability of a director or officer to the corporation or its stockholders for monetary damages . . . .").

136. LA. STAT. ANN.§ 12:1-832(A).

137. *Id.* § 12:1-832(A)(1)–(2), (4).

138. *Id.* § 12:1-832(A).

139. *Id.* § 12:1-832(A)(1).

140. *Id.* § 12:1-832(A).

4. Nevada

Nevada's statutory scheme codifies the deferential business judgment rule[141] and provides that an officer is personally liable if liability is imposed either under specific statutes[142] or if three requirements are met.[143] The first requirement is that the plaintiff must rebut the presumption of the business judgment rule.[144] Second, the plaintiff must prove that the officer's act or omission was a breach of his or her fiduciary duty as an officer.[145] Third, the breach of fiduciary duty must involve intentional misconduct, fraud, or a knowing violation of law.[146]

Unlike Delaware's statute, the Nevada statute does not distinguish between direct and derivative claims.[147] Nevada's statute also allows officer exculpation for breaches of the duty of loyalty and transactions involving the receipt of improper personal benefits, unless the "breach [or transaction] involved intentional misconduct, fraud, or a knowing violation of law."[148] Nevada's regime is also an opt-out default rule rather than an opt-in provision like Delaware's.[149] Finally, Nevada's exculpation provision covers only damages.[150]

5. New Jersey

New Jersey's statute essentially mirrors Section 102(b)(7), exculpating officers from liability for damages from breaches of duty owed to the corporation or its shareholders, except for breaches of the duty of loyalty and the duty of good faith, knowing violations of the law, or the receipt of improper personal benefits.[151] Given its list of exceptions, it effectively limits exculpation to breach of the duty of care like Section 102(b)(7). New Jersey's statute is also an opt-in

141. NEV. REV. STAT. § 78.138(3) (2023).

142. *Id.* §§ 35.230, 90.660, 91.250, 452.200, 452.270, 668.045, and 694A.030 (explaining when an officer may not be exculpated if he or she is liable).

143. *Id.* § 78.138(7) (explaining that the first requirement imposes a high bar on the plaintiff by requiring a rebuttal of the business judgment rule, and the third requirement drastically restricts the number of situations in which officer liability will arise for breach of a fiduciary duty if a Nevada corporation does not opt-out of the default rule).

144. *Id.* § 78.138(7)(a).

145. *Id.* § 78.138(7)(b)(1).

146. *Id.* § 78.138(7)(b)(2).

147. *Id.* § 78.138(7).

148. *Id.* § 78.138(7)(b)(2).

149. *Id.* § 78.138(7)

> ([U]nless the articles of incorporation or an amendment thereto . . . provide for greater individual liability, a director or officer is not individually liable to the corporation or its stockholders . . . for any damages as a result of any act or failure to act in his or her capacity as a director or officer unless . . .).

150. *Id.*

151. N.J. STAT. ANN. § 14A:2–7(3) (West 2023).

provision like Delaware's, instead of a default opt-out provision like Nevada and Louisiana.[152] However, unlike Delaware, New Jersey does not distinguish between direct and derivative actions.[153]

6. Virginia

The Virginia Stock Corporation Act authorizes corporations to provide for officer exculpation in the articles of incorporation by modifying officers' fiduciary duties.[154] If a Virginia corporation has modified an officer's duties in the articles or bylaws, then monetary liability for breaches of those duties would of course be capped at zero, provided that the opt-in is exercised to the fullest extent of the law.[155] However, even if a corporation has not opted-in to a duty modification provision, Virginia law limits an officer's personal monetary liability in both direct and derivative claims by imposing a cap on it,[156] insofar as the officer's act or omission does not involve willful misconduct, a knowing violation of criminal law, or of any federal or state securities law, including insider trading and market manipulation.[157] As compared to Delaware, Virginia does not distinguish between direct and derivative actions and also does not specifically exclude breaches of the duty of loyalty from exculpation.[158]

7. Pennsylvania

Pennsylvania's statute authorizes a corporation, through an opt-in clause in its bylaws, to exculpate officers from personal monetary

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152. *Id.* ("The certificate of incorporation may provide that a director or officer shall not be personally liable, or shall be liable only to the extent therein provided, to the corporation or its shareholders . . .").

153. *Id.*

154. VA. CODE ANN. § 13.1-619(B)(5) (2023).

155. *Id.* § 13.1-692.1(A)(1).

156. *Id.* § 13.1-692.1(A)

> (In any proceeding brought by or in the right of a corporation or brought by or on behalf of shareholders of the corporation, the damages assessed against an officer or director arising out of a single transaction, occurrence or course of conduct shall not exceed the lesser of: (1) The monetary amount, including the elimination of liability, specified in the articles of incorporation or, if approved by the shareholders, in the bylaws as a limitation on or elimination of the liability of the officer or director; or (2) The greater of (i) $100,000 or (ii) the amount of cash compensation received by the officer or director from the corporation during the 12 months immediately preceding the act or omission for which liability was imposed.).

Virginia's statute thus caps liability at the lesser of: the monetary cap in the articles or bylaws (which can be zero if it provides for exculpation and no exception to exculpation applies) and the greater of $100,000 or the officer's cash compensation during the 12 months immediately preceding the event giving rise to liability.

157. *Id.* § 13.1-692.1(B).

158. *Id.* § 13.1-692.1(A)–(B).

liability, unless the officer breached his or her duties and the breach "constitutes self-dealing, willful misconduct or recklessness."[159] The amendment to the bylaws must be adopted by the corporation's shareholders.[160] The Pennsylvania statute differs from Section 102(b)(7) in two respects. First, it authorizes exculpation for all officers, rather than a specific group of senior-ranking officers.[161] Second, it does not distinguish between direct and derivative actions.[162]

III. REASONS FOR OPTING-IN TO THE EXCULPATION PROVISION

Following the 2022 amendment to Section 102(b)(7), proxy advisory firms such as Institutional Shareholder Services ("ISS") and Glass Lewis have generally recommended that shareholders vote "against such proposals eliminating monetary liability for breaches of the duty of care for certain corporate officers, unless compelling rationale for the adoption is provided by the board, and the provisions are reasonable."[163] Compelling rationale spans three categories: the nature of an officer's role in the corporation, financial and business considerations, and the availability of non-exculpated claims.

A. The Nature of an Officer's Role in the Corporation

1. Officers are generally in a better position to make more informed decisions than directors, who already benefit from exculpation, because of the officer's position as corporate insiders.

First, shareholders should not be reluctant to vote in favor of proposals to exculpate officers for breaches of the duty of care because officers' unique and intimate position as corporate insiders actually makes them less likely to breach the duty of care than directors.[164] This conclusion follows logically from an examination of the duty of care: it requires corporate fiduciaries to make decisions "on an *informed basis*, in good faith and in the honest belief that [an] action

159. 15 PA. CONS. STAT. § 1735 (2023).
160. *Id.* § 1504(b).
161. *Id.* § 1735.
162. *Id.*
163. GLASS LEWIS, 2023 POLICY GUIDELINES 72 (2022) https://www.glasslewis.com/wp-content/uploads/2022/11/US-Voting-Guidelines-2023-GL.pdf?hsCtaTracking=45ff0e63-7af7-4e28-ba3c-7985d01e390a%7C74c0265a-20b3-478c-846b-69784730ccbd; *see generally* ISS, PROPOSED ISS BENCHMARK POLICY CHANGES FOR 2023 21 (2022), https://www.issgovernance.com/file/policy/2022/2023-Benchmark-Policy-Changes-For-Comment.pdf.
164. Hamermesh et al., *supra* note 36, at 367; *see infra* notes 166–67.

was taken in the best interests of the company."[165] The Delaware Chancery Court has specifically noted that "an indispensable part of an officer's job is to gather information and provide timely reports to the board about the officer's area of responsibility."[166] Officers' employment within the corporation and their information gathering function make it very difficult for them to make uninformed decisions. By the very nature of their employment they are informed fiduciaries.

While directors are charged with managing the corporation,[167] "it is the rare corporation that is actually 'managed' by the board; most corporations are managed 'under the direction of' the board[.]"[168] "In the typical corporation, it is the officers who are charged with, and responsible for, running the business of the corporation."[169] Officers' roles give them far greater "familiarity with corporate affairs"[170] and put them in a better position than directors to make the informed decisions that the duty of care requires.

Moreover, even the most diligent boards will have information asymmetries that officers do not experience, simply due to the structure and characteristics of the board of directors. For example, the board of directors of a typical large U.S. corporation only meets an average of eight times per year.[171] In comparison, officers are around-the-clock employees of the corporation 365 days per year and are in a better position for real-time information flow.[172] Officers'

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165. Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984) (citing Kaplan v. Centex Corp., 284 A.2d 119, 124 (Del. Ch. 1971); Robinson v. Pittsburgh Oil Refinery Corp., 126 A. 46, 48 (Del. Ch. 1924) (emphasis added)).

166. *In re* McDonald's Corp. S'holder Derivative Litig., 289 A.3d 343, 366 (Del. Ch. 2023).

167. DEL. CODE ANN. tit. 8, § 141(a) (2023) ("The business and affairs of every corporation organized under this chapter shall be managed by or under the direction of a board of directors . . .").

168. *McDonald's*, 289 A.3d at 360 (quoting J. Travis Laster & John Mark Zeberkiewicz, *The Rights and Duties of Blockholder Directors*, 70 BUS. LAW. 33, 36 (2015)).

169. *Id.* (quoting Megan W. Shaner, *The (Un) Enforcement of Corporate Officers' Duties*, 48 U.C. DAVIS L. REV. 271, 285 (2014)).

170. A. Gilchrist Sparks III & Lawrence A. Hamermesh, *Common Law Duties of Non-Director Corporate Officers*, 48 BUS. LAW. 215, 236 (1992).

171. David F. Larcker & Brian Tayan, *Board of Directors: Structure and Consequences*, CORPORATE GOVERNANCE RESEARCH INITIATIVE, https://www.gsb.stanford.edu/sites/default/files/publication-pdf/cgri-quick-guide-05-board-directors-structure-consequences.pdf (last visited Sept. 9, 2023); Omari Scott Simmons, *The Corporate Immune System: Governance from the Inside Out*, 2013 U. ILL. L. REV. 1131, 1160 (2013) ("Whereas a corporate board meets periodically—roughly six to ten times a year—senior officer engagement with the corporation is continuous.").

172. *McDonald's*, 289 A.3d at 360–61 (quoting Simmons, *supra* note 171, at 1160–61) (noting that "[m]onitoring and strategy are not exclusively the dominion of the board. Actually, nondirector officers may have a greater capacity to make oversight and strategic decisions on a day-today basis.").

intimacy and daily contact with the corporation optimizes their ability to make informed decisions.

Additionally, many directors are "professional directors"[173] who divide their attention between multiple boards, or they have full-time jobs outside of their directorship positions. This problem is mitigated for officers as a result of their full-time employment with the corporation. Other incentives for officers to provide undivided attention to the corporation include equity-based executive compensation and the reputational threat of a public termination. Officers' frequent interaction with the corporation and the quality of their attention put them in a better position to fulfill the duty of care and warrant liability protection that is equal to the protection afforded to directors.

2. Exculpating officers for breaches of the duty of care eliminates an unwarranted distinction between directors and officers.

Shareholders should vote in favor of adopting the exculpation provision because it eliminates an unwarranted loophole between officers and directors that allows directors to shift the risk of business decisions authorized by the directors themselves to non-exculpated officers who are merely charged with carrying out those decisions.[174] Officers are agents of the corporation and their authority is derived from directors.[175] Despite this delegation of authority, directors of Delaware corporations have been exculpated for the same conduct for which officers bear liability. In fact, the absence of officer exculpation in the 1986 version of Section 102(b)(7) is just an incentive "for corporations to route more decisions through the board of directors in order to take advantage of their insulation from liability[.]"[176] It is a fallacy to believe that voting against an officer exculpation provision will prevent corporate management from engaging in conduct that rises to a level of gross negligence. Management can engage in this conduct regardless by re-routing it through exculpated directors.

The distinction between officers' and directors' conduct further confounds the analysis of a fiduciary duty claim where the officer operates in a dual capacity as a director and it is unclear whether the alleged conduct took place in his or her director or officer capacity. For example, in *Morrison*, the Chancery Court as a threshold matter

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173. David F. Larcker & Brian Tayan, *Board Composition, Quality, and Turnover*, CORPORATE GOVERNANCE RESEARCH INITIATIVE, https://www.gsb.stanford.edu/sites/default/files/publication-pdf/cgri-research-spotlight-board-composition-quality-turnover_0.pdf (last visited Sept. 9, 2023).

174. Hamermesh & Sparks, *supra* note 84, at 872.

175. DEL. CODE ANN. tit. 8, § 142(a) (2023).

176. Michael W. Mitchell, *North Carolina's Statutory Limitation on Directors' Liability*, 24 WAKE FOREST L. REV. 117, 138 (1989).

had to determine whether a CEO acted in his capacity as an officer or as a director when addressing the plaintiff's duty of care claim.[177]

Adopting an officer exculpation provision eliminates a loophole that makes officers to be scapegoats for conduct that directors authorized and equally participated in, and it minimizes judicial speculation over what capacity an officer-director was operating in when the alleged conduct occurred.

B. Financial and Business Considerations

1. D&O insurance prices will pressure corporations to adopt the exculpatory clause.

Perhaps the least theoretical but most pragmatic reason for a corporation to exculpate its officers is that corporations without officer exculpation will incur the cost of higher D&O insurance than corporations that adopt exculpation provisions. The corporation's role in the D&O insurance market is to sell risk more so than it is to purchase insurance.[178] Corporations that sell themselves as low risk are therefore the most attractive ones to insure.

D&O insurers look at many data points to price insurance policies for corporations,[179] and their primary objective is to assess the risk of shareholder litigation.[180] Corporate governance practices are important indicators of the risk of shareholder litigation for D&O insurers.[181] D&O insurers scrutinize corporate governance practices such as committees, director and officer independence, executive compensation, and directors' and officers' prior involvement in shareholder litigation.[182]

Charter option provisions are also of critical importance in examining corporate governance.[183] Corporations that exculpate both officers and directors for breaches of the duty of care carry lower risk for D&O insurers than corporations that only exculpate directors. Thus, as more corporations amend their articles, a divergence in the price of D&O policies is likely to emerge between corporations that make use of the exculpatory clause and those that do not. This divergence in turn will motivate more corporations to amend their articles to obtain the best D&O insurance policy prices.[184]

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177. Morrison v. Berry, C.A. No. 12808-VCG, 2019 WL 7369431, at *25 (Del. Ch. Dec. 31, 2019).

178. Tom Baker & Sean J. Griffith, *Predicting Corporate Governance Risk: Evidence from the Directors' & Officers' Liability Insurance Market*, 74 U. CHI. L. REV. 487, 511 (2007).

179. *Id.* at 510–23.

180. *Id.* at 494.

181. *Id.* at 513, 516.

182. *Id.* at 512–13.

183. *Id.* at 513, 517.

184. D&O insurance costs have been rising due to increased shareholder litigation. In the first quarter of 2020, "premium rates for directors-and-officers

Additionally, while shareholders may receive a settlement in litigation, the cost of shareholder litigation to the corporation is "either directly or indirectly [passed to the shareholders] through increased insurance premiums."[185] Shareholders should vote in favor of the exculpation provision because it will decrease costs they ultimately bear.

2. The exculpation provision prevents the corporation from incurring the costs of officer indemnification for claims for breach of the duty of care.

Shareholders should vote in favor of adopting the exculpation provision because it avoids the expense of officer indemnification for breaches of the duty of care. Delaware authorizes a corporation to indemnify an officer against litigation expenses if the officer "acted in good faith and in a manner the [officer] reasonably believed to be in or not opposed to the best interests of the corporation, and, with respect to any criminal action or proceeding, had no reasonable cause to believe the [officer's] conduct was unlawful."[186] An officer who breaches only the duty of care can fulfill the first two requirements—good faith and the best interests of the corporation.[187] If the officer has an indemnification agreement with the corporation, as is typical for large corporations and their officers, the officer can get indemnification from the corporation for litigation expenses. Further, even in the absence of an indemnification agreement, the corporation must indemnify an officer who succeeds on the merits in defending a duty-of-care claim.[188] The corporation bears the initial expense of indemnification before being reimbursed by its D&O insurer, which ultimately leads to increased insurance premiums, the cost of which is passed onto the shareholders indirectly.[189]

However, the corporation and its shareholders can avoid the cost of indemnification for expenses incurred in defending a duty-of-care claim through adopting an officer exculpation provision. The

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insurance jumped 44% to 104% in the first quarter compared with the year-earlier period, based on different indexes of corporations that are published by brokerage firms at AON PLC and Marsh & McLennan Cos." Alice Uribe & Leslie Scism, *Companies Are Paying a Lot More to Insure Their Directors and Officers*, WALL ST. J. (June 21, 2020, 5:30 AM), https://www.wsj.com/articles/companies-are-paying-a-lot-more-to-insure-their-directors-and-officers-11592731801?mod=hp_listc_pos2.

185. Memorandum from Theodore N. Marvis, David A. Katz & Sabastian V. Niles, Wachtell, Lipton, Rosen & Katz, *Delaware Approves Permitting Exculpation of Officers from Personal Liability in Corporate Charters* 2 (Aug. 3, 2022) [hereinafter *Wachtell Memorandum*].

186. DEL. CODE ANN. tit. 8, § 145(a) (2023).

187. The duty of care is predicated on a gross negligence standard and therefore concerns unintentional conduct that does not involve bad faith.

188. DEL. CODE ANN. tit. 8, § 145(c)(1).

189. *Wachtell Memorandum*, *supra* note 185.

exculpation provision deters shareholders from bringing claims for a breach of the duty of care because they will be dismissed. Shareholders and corporations, regardless of whether they have indemnification agreements with officers, will be insulated from the costs of indemnification for a duty-of-care claim.

3. The exculpation provision helps Delaware corporations attract and retain talent in a tight labor market for corporate executives.

Shareholders should vote in favor of adopting the exculpation provision because it will help attract and retain talented officers. Attracting and retaining talented officers is of critical importance to corporations—executive talent plays a significant role in corporate governance decisions[190] and the stock market is reactive to leadership changes.[191] Delaware is home to many of the world's largest corporations[192]—corporations that have a relatively small pool of qualified officers to choose from for key leadership positions, such as CEO.[193] Attracting and retaining talented officers is a major concern for these corporations, and the Delaware amendment gives talented officers an incentive to seek out corporations that will exculpate them. Top performing officers, if not all officers, are more likely to seek employment at corporations with officer exculpation provisions because they will be protected from personal monetary liability for breaches of the duty of care.[194]

Officers not only want to protect their personal assets, but also want to protect their reputations for later in their careers. Shareholder litigation stemming from an officer's breach of the duty of care can follow an officer for the rest of his or her career, because

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190. Baker & Griffith, *supra* note 178, at 502

> (The most commonly cited reason for the purchase of D&O insurance is the recruitment and retention of qualified officers. Corporations are eager to assure their officers and directors that their personal assets will not be at risk as a result of accepting a board seat or other position with the company.).

191. Matthew C. Clayton, Jay Hartzell & Joshua Rosenberg, *The Impact of CEO Turnover on Equity Volatility*, 78 J. OF BUS. 1779, 1781, 1796 (2005).

192. Delaware is home to 66.8% of Fortune 500 companies. DEL. DIV. OF CORPS., 2021 ANN. REP, (2021); Leslie Wayne, *How Delaware Thrives as a Corporate Tax Haven*, N.Y. TIMES (June 30, 2012), https://www.nytimes.com/2012/07/01/business/how-delaware-thrives-as-a-corporate-tax-haven.html?pagewanted=all&_r=0.

193. Peter Cziraki & Dirk Jenter, *The Market for CEOs,* 26 (Eur. Corp. Governance Inst., Finance Working Paper No. 831, 2022).

194. This follows logically from the objectives behind the initial adoption of director exculpation (i.e., attracting and retaining talented directors), the result of adopting such clauses, and for the reasons corporations are eager to obtain D&O insurance (i.e., recruiting and retaining qualified officers). *See supra* notes 19 & 187.

officers of many Delaware corporations are in the public eye and subject to public scrutiny, and because D&O insurers have access to databases that include information on whether an officer has been a defendant in shareholder litigation.[195] Officers therefore have incentives to seek employment at corporations that offer them protections from being tagged as a corporate executive who is expensive to insure.[196] Attracting talent will drive corporations to adopt the exculpatory clause for officers, just as it did for directors.

4. Officer exculpation incentivizes reasonable risk-taking that maximizes profit for shareholders.

Corporations should adopt a charter-option provision for officers because it will incentivize officers to take reasonable risks that bring value to the corporation and its shareholders. If officers are insulated from personal monetary liability for breaches of the duty of care, they will make "risky but valuable corporate decisions" instead of either driving up costs to the corporation by "engag[ing] in unnecessary investigations and obtain[ing] unnecessary second and third opinions" before coming to a decision, or failing to act altogether.[197]

The charter-option provision counters corporate officers' disincentives to take healthy risks. Equity-based executive compensation, CEO termination for poor performance, and reputational damage disincentivize even healthy risk-taking by corporate officers.[198]

Officers that receive executive compensation packages with equity ownership in the corporation have an incentive to take less risks that would benefit shareholders because increasing risk could impact the executive's personal wealth since it is tied to the corporation's share price.[199] Although this executive compensation practice aligns officer interests with shareholder interests, it disincentivizes officers from making risky but beneficial business decisions that maximize profit for shareholders. The exculpatory charter provision counterbalances this tension by placing a boundary on personal financial loss stemming from an officer's decisions, thereby removing one of the drawbacks of calculated risk-taking.

Another disincentivize to risk-taking stems from officers' access to information as insiders.[200] Officers' unique position within the corporation makes them less likely to take calculated risks than non-officer directors because access to information eliminates the defense

195. Baker & Griffith, *supra* note 178, at 513.

196. *Id.*

197. Hamermesh & Sparks, *supra* note 84, at 873.

198. Todd A. Gormley & David A. Matsa, *Playing It Safe? Managerial Preferences, Risk, and Agency Conflicts*, 122 J. FIN. ECON. 431, 432 (2016).

199. *Id.* at 449.

200. Hamermesh & Sparks, *supra* note 84, at 872.

of ignorance or reliance.[201] The charter-option provision balances disincentives to take risks that arise as a result of the officer's role in the corporation by protecting them from personal monetary liability for duty-of-care claims.

C. The Availability of Non-Exculpated Claims

1. The exculpation provision is a balanced approach that still preserves some important claims against officers.

The exculpatory provision does not fully sacrifice shareholders' ability to bring a duty-of-care claim against an officer because exculpation is not available in derivative actions.[202] Despite the procedural obstacles of derivative suits, the preservation of a derivative duty-of-care claim against officers (and directors) is an important check on their decision-making because it maintains a route for liability.

Further, officers are not exculpated from breaches of the duty of loyalty, and many fiduciary duty claims against officers are brought under the duty of loyalty.[203] Concerns about the duty of loyalty are more relevant for officers than the duty of care, especially in the M&A context.[204] In the M&A context, Delaware courts have "sustained claims where [officers] tainted the board's approval of a transaction by concealing material information . . . about the transaction, fail[ed] to disclose conflicts to the board, or misle[d] the board to benefit a favored suitor."[205]

For example, in *In re El Paso Corporation Shareholder Litigation*,[206] El Paso's CEO, who was "entrusted with all the key price negotiations" in a transaction with Kinder Morgan, the bidder, concealed from the board his interest in buying a portion of El Paso while he was supposed to be "getting the highest possible price as a seller of that same asset."[207] Additionally, *City of Fort Myers General Employees' Pension Fund v. Haley*[208] illustrates how a target

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201. *Id.*

202. DEL. CODE ANN. tit. 8, § 102(b)(7) (2023).

203. *See, e.g.*, Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173, 180 (Del. 1986); Firefighters' Pension Sys. of City of Kansas City, Mo. Trust v. Presidio, Inc., 251 A.3d 212, 212 (Del. Ch. 2021); Gantler v. Stephens, 965 A.2d 695, 709 (Del. 2009); City of Fort Myers Gen. Emps.' Pension Fund v. Haley, 235 A.3d 702, 724 (Del. 2020); Chen v. Howard-Anderson, 87 A.3d 648, 687 (Del. Ch. 2014); McElrath ex rel. Uber Techs., Inc. v. Kalanick, C.A. No. 2017-0888-SG, 2019 WL 1430210, at *10 (Del. Ch. Apr. 1, 2019), *aff'd sub nom.*, McElrath v. Kalanick, 224 A.3d 982 (Del. 2020)); *In re El Paso Corp.*, 41 A.3d at 432.

204. Hamermesh et al., *supra* note 36, at 367.

205. *In re* Baker Hughes Inc. Merger Litig., C.A. No. 2019-0638-AGB, 2020 WL 6281427, at *20 (Del. Ch. Oct. 27, 2020).

206. 41 A.3d 432 (Del. Ch. 2012).

207. *Id.* at 443.

208. 235 A.2d at 702.

company's CEO was conflicted due to a lucrative executive compensation package offered by the bidder company at the surviving ns.[209] Finally, *Firefighters' Pension System*, discussed above, exemplifies how a CEO can interfere in the bidding process by steering the board toward a bidder that would retain him as CEO.[210]

Numerous examples in Delaware caselaw of officers breaching the duty of loyalty through interestedness, lack of independence, or bad faith show that the duty of loyalty should be shareholders' focus when it comes to officers. These claims are preserved for shareholders notwithstanding adoption of the exculpation provision. Moreover, the statutory exceptions for intentional misconduct and knowing violations of the law allow shareholders to hold the most culpable officers—the Jeff Skillings, Ken Lays, and Bernard Ebbers of the world—liable for egregious wrongdoing.

2. The Delaware Chancery Court's recent decision in In re McDonald's Corporation provides shareholders with a non-exculpated duty of oversight claim against officers.

Shareholders should vote in favor of proposals to exculpate officers for breaches of the duty of care because they can now hold officers liable for breaches of the duty of oversight,[211] as discussed in Part II. In *In re McDonald's Corporation*,[212] the Chancery Court denied a motion to dismiss the plaintiffs' claim against McDonalds' former chief human resources officer for breaching the duty of oversight.[213] In its decision, the court held that "the duty of oversight for directors appl[ies] equally, if not to a greater degree, to officers."[214] However, the duty's application differs depending on the officer.[215]

In re McDonald's Corporation fills a significant gap in Delaware jurisprudence and might emerge as an important means of holding officers liable given their access to information. Based on Vice Chancellor Laster's holding that officers have a duty of oversight

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209. *Id.* at 724. The CEO's executive compensation package before the merger was "worth approximately $24 million . . . and [the] proposed plan (the "Proposal") . . . provided him with an opportunity allegedly worth more than $140 million. [Additionally] he understood that under the Proposal, he could earn upwards of $165 million." *Id.* at 709.

210. Firefighters' Pension Sys. of City of Kansas City, Mo. Trust v. Presidio, Inc., 251 A.3d 212, 235–36 (Del. Ch. 2021).

211. An officer breaches the duty of oversight when he or she acts "with a state of mind consistent with a *conscious* decision to breach [his or her] duty of care." *In re* McDonald's Corp. S'holder Derivative Litig., 289 A.3d 343, 371 (Del. Ch. 2023) (emphasis added).

212. *Id.* at 343.

213. *Id.* at 349.

214. *Id.*

215. *Id.* at 369. For example, the CEO of a corporation has a company-wide duty of oversight, whereas other officers, like the CFO, COO, and CLO will have a duty of oversight for a specific area. *Id.*

"equally, if not to a greater degree"[216] than directors, a *Caremark* claim[217] might be more successful against officers than it has proven to be against directors.

CONCLUSION

Officer exculpation in Delaware is expected to become commonplace over the next few years.[218] From August 2022 to February 2023, 11 companies, including Fox Corporation and Avid Biosciences, Inc., adopted officer exculpation provisions.[219] Shareholders' responses to those proposals have been generally positive—98% of Avid Biosciences' shareholders voted to exculpate officers.[220]

Corporations should prepare to make proposals to shareholders for adopting an officer exculpation provision due to the benefits that it provides both parties. Given the conditional responses from ISS and Glass Lewis, corporations should articulate compelling reasons for shareholders to vote in favor of adopting the provision. Publicly traded Delaware corporations have an especially strong incentive to adopt a provision. Finally, as Pennsylvania's recent amendment shows, other states are likely to amend their corporate statutes to authorize officer exculpation to at least the same extent as Delaware in order prevent corporate flight to other jurisdictions.

*Marguerite M. Mitchell**

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216. *Id.* at 349.

217. *See supra* note 118.

218. Matthew Bultman, *C-Suite Liability Shield Poised for More Shareholder Balloting*, Bloomberg Law (Nov. 15, 2002 5:00 AM), https://news.bloomberglaw.com/securities-law/c-suite-liability-shield-poised-for-more-shareholder-balloting.

219. Ethan Klingsberg et al., *To Exculpate, or Not to Exculpate: Is it Even a Question?*, Freshfields (March 3, 2023), https://blog.freshfields.us/post/102i9kf/to-exculpate-or-not-to-exculpate-is-it-even-a-question.

220. Bultman, *supra* note 218.

* Juris Doctor candidate, May 2024, Wake Forest University School of Law; B.A., 2019, University of North Carolina at Chapel Hill. Thank you, Dad. I am also grateful to Luul Lampkins for her support and to Christian Schweitzer for his feedback. "You can't ever reach perfection, but you can believe in an asymptote toward which you are ceaselessly striving." Paul Kalanithi, WHEN BREATH BECOMES AIR 115.