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Delaware Bar Council Proposes Allowing Exculpation of Officers from Personal Liability

The Council of the Corporation Law Section of the Delaware State Bar Association has adopted a number of proposed amendments to Delaware's General Corporation Law. In the past, the Council's recommendations have generally been adopted by the Delaware Legislature. The most important proposed amendment would expand the right of a corporation to adopt an "exculpation" provision in its certificate of incorporation to cover not only directors (as has been allowed and widely adopted since 1986 (following the *Smith* v. *Van Gorkom* decision)) but now also corporate officers. The proposed amendment allows the adoption of exculpation provisions that would protect officers from personal liability on the same basis as directors – that is, for all fiduciary duty claims other than breaches of the duty of loyalty or knowing violations of law – with an additional exception that claims against officers are not barred "in any action by or in the right of the corporation." While that exception would permit stockholder derivative claims against officers for breach of the duty of care to continue to be brought, the requirement that stockholders first make demand on the board to bring suit would eliminate those claims except in the truly rare case where a majority of the directors are somehow compromised as to the officer in question (thus rendering demand futile).

If the Council's recommendation is adopted by the Delaware Legislature, Delaware corporations should consider proposing amendments to their exculpation provisions to extend the protection to corporate officers. Leading Delaware corporate law experts advocated for the amendment in an important article published last year. Since amendment of the certificate of incorporation requires stockholder approval, it will be important to convince the major institutional investors and, ideally, the proxy advisory firms that eliminating the unequal and unfair targeting of officers for negligence claims in stockholder litigation is a prudent and value-enhancing step. This should be feasible given the widespread support of long-term investors for provisions that exculpate directors for duty of care liability, and the realities that officers work under the direction of boards that are typically comprised of super-majorities of independent directors; that there is more disclosure than ever about corporate transactions and implementation of business strategies; and that disciplining managers for concerns about their diligence, rather than their loyalty, seems a primary function of the board and management. Given these realities, the only effect of allowing duty of care suits against officers when such claims cannot be brought against directors is to increase the cost and therefore settlement value of stockholder suits with little or no discernable value to the corporation or its stockholders, who ultimately bear those costs either directly or indirectly through increased insurance premiums. If the recommendation is adopted by the Delaware Legislature, companies who will be newly public (*e.g.*, through an IPO) or are implementing spin-off transactions would presumably be able to implement these protections in a straightforward manner as part of the newco/spinco's initial certificate of incorporation.

The Council's proposal is a positive recognition that the current imbalance in the law should be redressed. Our hope is that Delaware's General Assembly will adopt this amendment and that business leaders will then work together with leading institutional investors to take advantage of this chance to make our system of representative litigation more cost-effective.

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