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Delaware Approves Permitting Exculpation of Officers from Personal Liability in Corporate Charters

For over 45 years, Delaware law has permitted directors of Delaware corporations to be exculpated from personal monetary liability to the extent such protections are set forth in the certificate of incorporation, subject to certain exceptions. However, such protective statutory provisions did not reach officers. As contemplated in our April 2022 memorandum, Delaware has now adopted important amendments to Delaware’s General Corporation Law that 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 Smith v. Van Gorkom) but now also corporate officers.

The officer liability exculpation provision is not self-effectuating; instead, the amendment to Delaware law allows companies to take action to adopt exculpation provisions that protect covered 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, intentional misconduct or knowing violations of law – with an additional exception that claims against officers will not be barred “in any action by or in the right of the corporation.”

Under the newly amended provision of Delaware law, covered officers eligible for such exculpation from liability, if implemented by the corporation, will include the president, chief executive officer, chief operating officer, chief financial officer, chief legal officer, controller, treasurer or chief accounting officer, the company’s most highly compensated executive officers as identified in SEC filings and certain other officers who have consented (or deemed to have consented) to be identified as an officer and to service of process. Companies and boards themselves will retain the right to bring appropriate actions against officers, and this additional exception will permit stockholder derivative claims against officers for breach of the duty of care to continue to be brought if demand requirements are met.

We believe that Delaware corporations should consider proposing amendments to their exculpation provisions to extend the protection to corporate officers. Companies going public (e.g., through an IPO or spin-off or certain other transactions) can implement these protections in a straightforward manner as part of the new company’s certificate of incorporation. Companies that are currently publicly traded may amend their charter to reflect such a provision through a board-sponsored proposal that would be voted on by the shareholders at a stockholder meeting, with the benefit of the disclosures and solicitation made via the company’s proxy statement.
An illustrative form of charter provision is set forth below; companies with existing director only provisions may want to consider tailored officer-specific exculpation clauses that are separate and apart from the director liability provisions:

No director or officer of the Company shall be liable to the Company or its stockholders for monetary damages for breach of fiduciary duty as a director or officer, as applicable, except to the extent such an exemption from liability or limitation thereof is not permitted under the Delaware General Corporation Law (the “DGCL”) as presently in effect or as the same may hereafter be amended. No amendment to or repeal of this provision shall apply to or have any effect on the liability or alleged liability of any director or officer of the Company for or with respect to any acts or omissions of such director or officer occurring prior to such amendment or repeal.

Leading Delaware corporate law experts advocated for this protective amendment in an article published last year entitled “Optimizing the World’s Leading Corporate Law: A 20-Year Retrospective and Look Ahead,” and the highly respected Delaware Corporation Law Council carefully considered and proposed the specific text of the amendments for adoption. Eliminating the unequal and unfair targeting of officers for negligence claims in stockholder litigation, including but not limited to the M&A context, is a prudent and value-enhancing step, which warrants the support of major institutional investors and the proxy advisory firms.

Long-term (and other) institutional investors should support this change given their broad support for provisions that exculpate directors for duty of care liability, the realities that officers work under the direction and oversight 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, is a primary function of the board. Given these realities, we believe that 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.

The passage of this important amendment by Delaware is a positive recognition that the current imbalance in the law should be redressed. Our hope is that business leaders will work together with leading institutional investors to take advantage of this opportunity to make our system of representative litigation more cost-effective and equitable.

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