

Delaware Permits Exculpation of Officers

Amendments Will Allow Companies to Limit Personal Liability of Officers

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Securities and Capital Markets

On August 1, 2022, amendments to the Delaware General Corporation Law (“DGCL”) took effect that permit corporations to eliminate or limit the personal liability of officers for claims of breach of the fiduciary duty of care. Historically, the DGCL has allowed corporations to exculpate directors from breach of fiduciary duty of care claims, if the corporation’s certificate of incorporation includes an exculpation provision. The amendments have now expanded that exculpation authority to corporate officers.

Below we discuss the new officer exculpation in further detail and outline considerations for boards of directors of Delaware corporations that are weighing whether to extend exculpation to officers.

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Scope and Effect of Officer Exculpation

For more than three decades, Section 102(b)(7) of the DGCL has permitted Delaware corporations to adopt exculpation provisions in their certificates of incorporation. Directors owe fiduciary duties under Delaware law, and claims may be brought against directors for breaches of those duties. Exculpation provisions shield directors from personal liability in connection with claims of breach of the fiduciary duty of care. In 2009, the Delaware Supreme Court held that corporate officers owe fiduciary duties that are identical to those owed by directors.¹ Following this decision, claims have been brought against corporate officers for breach of fiduciary duties, but corporations have not been permitted to exculpate officers as they do directors. This discrepancy has also created confusion over the application of exculpation provisions to individuals serving as both a director and officer.

Amended Section 102(b)(7) of the DGCL now permits Delaware corporations to exculpate officers, in addition to directors, from these breach of fiduciary duty claims. Under the amended statute, corporations may provide for exculpation of the following officers: (i) the corporation’s president, chief executive officer, chief operating officer, chief financial officer, chief legal officer, controller, treasurer or chief accounting officer, (ii) “named executive officers” identified in the

¹ *Gantler v. Stephens*, 965 A.2d 695, 708–09 (2009).

corporation's SEC filings, and (iii) individuals who have agreed to be identified as officers of the corporation.

Under amended Section 102(b)(7), a corporation must affirmatively elect to include an exculpation provision in its certificate of incorporation. Exculpation of directors, and now officers, is not required by the DGCL. If a corporation already has a director exculpation provision in its certificate of incorporation, it would need to amend the provision if it wishes to provide exculpation to officers. Similarly, a corporation that does not have any exculpation provision would need to amend its certificate of incorporation to include such a provision.

Exculpation provisions are subject to certain exceptions. A corporation's exculpation provision, for both officers and directors, will only apply to claims for breach of the duty of care, and not to breaches of the duty of loyalty. Exculpation provisions also do not apply to acts or omissions not in good faith or that involve intentional misconduct, knowing violations of the law, or transactions involving the receipt of any improper personal benefits. And, importantly, unlike directors, officers may not be exculpated from claims brought against them by or in the right of the corporation (such as through derivative actions).

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Factors Boards Should Consider

Board action and shareholder approval will be required to extend the protections of an exculpation provision to officers, or to adopt such a provision for the first time. For this reason, boards seeking to amend their certificates to provide or expand exculpation provisions will need to present an affirmative rationale to shareholders as to why such action is in the best interests of the corporation. In this respect, boards will have to consider potential objections to officer exculpation on the grounds, for example, that officer exculpation is unnecessary or could possibly allow for careless behavior at the officer level.

Boards may want to emphasize that amended Section 102(b)(7) remedies the inconsistent treatment of officers and directors under Delaware law, despite both having similar fiduciary duties. Additionally, a board might note that several other states already permit corporations to eliminate or limit officer liability.² Finally, a board will want to highlight that, unlike director exculpation, officer exculpation may not be provided in connection with claims brought against an officer by or in the right of the corporation.

When considering whether to propose an officer exculpation provision, boards may also weigh other factors.

- **View of Proxy Advisory Firms.** Although ISS and Glass Lewis have not yet weighed in on the amendments to Section 102(b)(7), it is possible that they may oppose officer exculpation and recommend a vote against a corporation's proposal to implement officer exculpation. Even if neither firm recommends a vote against such a proposal, either firm may adopt an unfavorable policy with respect to officer exculpation which could factor into a corporation's governance scores.

² States permitting limitation of officer liability include Louisiana, Maryland, Nevada, New Hampshire, New Jersey, and Virginia.

- **ISS.** ISS' current guidelines indicate that ISS would vote against a proposal that would eliminate entirely an officer's liability for monetary damages for violating the duty of care.³ ISS' voting guidelines with regard to director exculpation proposals are the same.⁴
- **Glass Lewis.** Glass Lewis' voting guidelines state that some liability protections for officers are appropriate, including reasonable indemnification and liability insurance.⁵ Glass Lewis is silent on officer exculpation.
- **Shareholder Sentiment.** Assessing the views of a company's large, institutional shareholders will be a key consideration for boards. Despite the rationales noted above and the longstanding acceptance of director exculpation, it is possible that some shareholders may not be initially receptive to arguments that officer exculpation is necessary or desirable. Further, given increased shareholder focus on accountability and transparency around ESG risk management and oversight, extending exculpation to officers may be viewed with disfavor. Assessing the level of such dissonance will be important in calculating the likelihood of approval of the board's recommendation to amend the certificate of incorporation.
- **Potential Target for Shareholder Proposals.** Even if an expanded exculpation provision is likely to be adopted, it is possible that disagreeing shareholders may submit shareholder proposals in future years. Such proposals may be an overhang that the board assumes as a cost of the expanded exculpation provision.
- **New and Untested Law.** Section 102(b)(7) has long permitted exculpation of directors, but officer exculpation has not been litigated or tested in Delaware courts. It is possible that future judicial decisions may impact the effectiveness or scope of officer exculpation provisions. In short, a board may conclude that it is too soon to avail the corporation of the new officer exculpation.
- **Potential Media Scrutiny.** Boards should also consider the potential for media scrutiny. Particularly for high profile corporations, a board may want to assess whether a proposal to adopt an officer exculpation provision would attract negative media scrutiny and adverse attention.

³ ISS' 2022 Proxy Voting Guidelines can be found at, <https://www.issgovernance.com/file/policy/active/americas/US-Voting-Guidelines.pdf>.

⁴ *Id.*

⁵ Glass Lewis' 2022 Policy Guidelines can be found at, <https://www.glasslewis.com/wp-content/uploads/2021/11/US-Voting-Guidelines-US-GL-2022.pdf>.

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