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Important Changes to Corporate Officers Fiduciary Duties in Delaware

Legal Alert

April 25, 2023

Corporate officers take note: Recent changes to Delaware law introduce a path towards additional protection and new potential liability for corporate officers. First, corporations may now amend their articles of incorporation to exculpate corporate officers from monetary damages stemming from breaches of their duty of care. Second, corporate officers are now affirmed to have a duty of oversight regarding the operations of the corporation. Finally, a recent court decision indicates that egregious acts of corporate officers that are determined to not be in the best interests of the corporation, may violate the duty of loyalty. These changes are discussed below.

The Duty of Care and Exculpatory Provisions

One of the major fiduciary duties owed by directors and officers of corporations is the duty of care, which is generally interpreted to mean the requirement to be fully and adequately informed and act with care when making decisions and/or acting for the corporation.

Prior to August 1, 2022, Delaware corporations were permitted to include a provision in their articles of incorporation to exculpate directors (but not officers) from personal liability from monetary damages stemming from breaches of their duty of care. As of August 1, 2022, Delaware amended its General Corporation Law to allow corporations to extend the exculpatory provision to corporate officers, in addition to directors.

The revised exculpatory provision is still limited to breaches of the duty of care; it does not extend (either for officers or directors) to breaches of the duty of loyalty, acts in bad faith, or derivations of improper personal benefits, which Delaware has never made eligible for exculpation. Further, inclusion of an exculpatory provision does not prevent courts from ordering injunctive relief to remediate any violations that otherwise would have warranted claims for monetary damages.

The statutory amendment includes a significant differentiation between directors and officers, as only directors may be exculpated from derivative claims brought on behalf of the corporation, meaning corporate officers may still be liable in such suits. Therefore, the additional protection offered to officers by an exculpatory provision only applies to actions brought individually by stockholders, including class actions.

An amendment made to the articles of incorporation to add an exculpatory provision may not be retrospective, meaning officers are only protected for breaches occurring after the adoption of the exculpatory provision and only if the exculpation is specifically indicated in the (amended) articles of incorporation as filed with the State.

The Duty of Oversight

Delaware has a long-established framework for evaluating whether directors have violated their duty of oversight. Under this framework, a plaintiff may claim: (i) directors either utterly failed to implement any reporting systems or controls regarding the corporations operations; or (ii) after implementing such systems or controls, directors consciously failed to monitor them. This duty of oversight previously did not explicitly extend to officers of corporations.

However, on January 26, 2023, in *In re McDonalds Corporation Stockholder Derivative Litigation* (Del. Ch. 2023), the Delaware Court of Chancery extended this duty of oversight and the requirement to establish an oversight framework to corporate officers. The Court noted that while some corporate officers, such as a Chief Executive Officer or Compliance Officer, have corporation-wide duties of oversight, other officers will have more narrow responsibilities, but could retain the same level of oversight responsibility within their respective spheres. Such officers are required to address any issues within their sphere directly or report them to a superior officer or the board.

In *McDonalds*, a narrower sphere of oversight was at issue. Specifically, the Global Chief People Officer was accused of consciously avoiding addressing or reporting a culture of sexual misconduct at the corporation. His alleged failure was sufficient for plaintiffs to bring a claim for a breach of the duty of oversight against him. Tying back to the discussion above regarding the exculpation of officers from the duty of care, this failure to exercise oversight is an example of bad faith and therefore, it is not eligible for inclusion in any exculpatory provision.

The Duty of Loyalty

The fiduciary duty of loyalty requires a director or officer to make decisions in the best interest of the corporation and not their personal interest. In *McDonalds*, the Court clarified that specific acts of sexual misconduct by a corporate officer constitute acts not in the best interest of a corporation and thus are a violation of the duty of loyalty. The Court reasoned that behavior for an improper purpose unrelated to the best interests of the company is an example of bad faith, and therefore disloyal behavior. As noted, above, officers may not be exculpated for breaches of their duty of loyalty, so acts of sexual misconduct by corporate officers now subject officers to claims for breaches of their fiduciary duty of loyalty, in addition to traditional employment and discrimination claims.

Flaster Greenberg Can Help

The corporate attorneys at Flaster Greenberg can help Delaware corporations evaluate and amend their articles of incorporation to provide the enhanced protection now available to directors and corporate officers. Our team can also evaluate or assist in creating oversight programs to ensure all parties properly comply with their duties of oversight and loyalty.

If you have questions, please dont hesitate to contact Mariel Giletto, William Burnett, Anthony Gruzdis, or any member of our firms Corporate Department.

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