



Exculpation of Personal Liability Expanded to Include Certain Corporate Officers

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Amendment to Delaware General Corporation Law: Exculpation of Personal Liability Expanded to Include Certain Corporate Officers

Effective August 1, 2022, Section 102(b)(7) of the Delaware General Corporation Law (the “DGCL”) was amended to authorize exculpation of certain senior officers of Delaware corporations from personal liability for monetary damages in connection with breaches of their fiduciary duty of care (the “Officer Exculpation Amendment”).

The Officer Exculpation Amendment Explained

Since its original adoption in 1986, Section 102(b)(7) of the DGCL has authorized exculpation of directors of Delaware corporations from personal liability for monetary damages in connection with breaches of their fiduciary duty of care. However, until the recent enactment of the Officer Exculpation Amendment, officers of Delaware corporations were not afforded the same protection—despite often having overlapping roles and, in recent years, being susceptible to similar lawsuits. The Officer Exculpation Amendment reduces the differential treatment between directors and officers, but Section 102(b)(7) imposes additional limitations on exculpating senior officers from liability.

Now, Delaware corporations may include provisions in their certificates of incorporation that limit or eliminate the personal liability of certain enumerated officers.¹ As is the case with director exculpation, officer exculpation is limited to instances in which there has been a breach of the

¹ These enumerated officers include persons who, at the time of an act of omission as to which liability is asserted are deemed to have consented to service by the delivery of process to the registered agent of the corporation pursuant to Section 3114(b) of the DGCL. This includes any person who (i) is or was the president, chief executive officer, chief operating officer, chief financial officer, chief legal officer, controller, treasurer or chief accounting officer of the corporation, (ii) is or was identified in the corporation’s summary compensation table included in the corporation’s proxy statement or annual report on the corporation’s Form 10-K or (iii) has, by written agreement with the corporation, consented to be identified as an officer for purposes of accepting service of process.

fiduciary duty of care. Exculpation from liability is not available under the DGCL to directors or officers for breaches of their duty of loyalty or for “acts or omissions not in good faith or which involve intentional misconduct or a knowing violation of the law,” among other exclusions.

An important difference between officer and director exculpation under the DGCL is that officer exculpation is not permitted in connection with claims brought by or in the right of the corporation, including stockholder derivative claims, while director exculpation under the DGCL is not subject to that limitation. Such distinction is intended to strike a balance between reducing the inequality in treatment between directors and officers and recognizing the need for predictability and stockholders’ right to rely on the long-standing premise that officers are expected to devote their full-time attention and undivided loyalty to the corporation. As a result, the Officer Exculpation Amendment reduces (but does not eliminate) this imbalance in the treatment of directors and officers, by retaining the right of stockholders to enforce fiduciary obligations of officers and bring claims on behalf of the corporation for any breaches by officers of their duties that are inconsistent with these obligations.

In order to afford senior officers with the protection from personal liability afforded by exculpation under Section 102(b)(7), Delaware corporations must “opt-in” by including an exculpation clause in their original certificate of incorporation or by adopting an amendment to their certificate of incorporation.² Pursuant to Section 242(b) of the DGCL, in order to amend a corporation’s certificate of incorporation, its board of directors must approve the amendment and declare its advisability and submit the amendment to a vote of stockholders at an annual or special meeting of stockholders. Adoption of such amendment requires the affirmative vote of holders of a majority of the outstanding shares of stock entitled to vote on the proposed amendment (unless a greater number of votes, or any separate class or series of votes, is required to amend the corporation’s certificate of incorporation pursuant to the terms thereof).³

Proxy Advisor Response

Although the Officer Exculpation Amendment was adopted just several months ago, at least eleven corporations have filed proxy statements as of [December 2, 2022] seeking stockholder approval to amend their certificates of incorporation to include an officer exculpation clause. Although preliminary indications suggest that ISS and Glass Lewis have viewed officer exculpations amendments as generally acceptable, as described below that may not be the case for Glass Lewis in all cases going forward. In issuing voting recommendations to date, neither ISS nor Glass Lewis has expressed any material concerns or made any adverse voting recommendations specifically addressing officer exculpation proposals (or made adverse voting recommendations in the re-election of directors who have approved such exculpation proposals).

The first two publicly filed proxy statements seeking stockholder approval of officer exculpation amendments were put forth as part of a “bundled” package proposal, where stockholders were asked to vote either “for” or “against” a number of changes to the corporations’ certificates of

² A proposal to amend the certificate of incorporation to include officer exculpation will require a preliminary proxy filing. Companies should consider and incorporate such preliminary proxy filing in their timeline for their 2023 annual meeting filings.

³ In two instances, the corporations’ stockholders failed to approve the officer exculpation amendment, due to, in large part, each corporation having a supermajority voting requirement and a significant amount of retail stockholders that did not vote on such proposal.

incorporation in their entirety, rather than on each individual amendment. In both instances, ISS and Glass Lewis did not explicitly take a position with respect to the officer exculpation amendment, focusing instead on the aggregate impact of the “bundled” amendments on stockholder rights. In one instance, Glass Lewis recommended a vote “against” the bundled certificate of incorporation amendment proposal, noting that the practice of bundling several amendments into a single proposal “negatively impacts the ability of shareholders to judge each amendment on its own merits.”

Nine corporations have subsequently put forth stand-alone proposals to amend the certificate of incorporation to include officer exculpation provisions. Of those nine, proxy advisor recommendations are available in six instances as of the date of this writing, and in all six cases, both ISS and Glass Lewis have specifically recommended that stockholders vote “for” the officer exculpation amendments. Glass Lewis noted that such amendments will not “have a negative impact on shareholders” and ISS echoed this outlook.

These favorable recommendations highlight the importance of separating proposals for stockholder approval of officer exculpation clauses from other proposals in order to enhance the likelihood that such proposals receive a favorable recommendation and ultimately obtain stockholder approval.

Despite its lack of adverse voting recommendations on officer exculpation proposals thus far, Glass Lewis’ recently adopted 2023 Policy Guidelines, which are effective for annual meetings in 2023, state that Glass Lewis “will closely evaluate proposals to adopt officer exculpation provisions on a case-by-case basis [and] generally recommend voting against [officer exculpation] 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.” ISS also recently published its Benchmark Policy Changes for 2023, noting, among other things, that ISS will “vote case-by-case on proposals on director and officer ... exculpation.”

Certain Additional Legal Considerations

To date, two separate complaints have been filed in Delaware Chancery Court challenging the adoption by two separate issuers of an amendment to their certificate of incorporation implementing an officer exculpation clause. Both lawsuits relate to whether a class of non-voting shares is entitled to vote on officer exculpation amendments and seek to invalidate the amendment.

Next Step: Proposing and Adopting a Certificate of Incorporation Amendment

Corporations wishing to adopt an amendment to their certificate of incorporation to include officer exculpation should consult their legal advisor to consider the requirements, legal considerations and implications involved in amending their certificates of incorporation. In addition, corporations also should consider a holistic governance review to ensure their governing documents are up to date with market standards and recent trends, and in line with those of their peers.