Message from the Chair

Dear Committee Members,

Our committee has had a busy year, sponsoring several successful presentations and programs at the Spring and Annual Business Law Section meetings. We continue to grow our membership, and with it our ability to monitor developments in the law that impact the interests of corporate directors and officers.

If you have not already registered, there is still time to attend the ABA Business Law Section Annual Meeting at the Ritz Carlton Hotel in Washington, DC, November 17-19, 2016. The complete meeting program is available on the ABA website. Please check the schedule. It includes many interesting CLE programs and complimentary networking opportunities.

The Director & Officer Liability Committee will hold its regular meeting on Friday morning, November 18. The agenda will include updates on a number of ongoing projects, including reports on our committee's efforts to mitigate the potential impact on the advancement and indemnification rights of directors and officers under proposed amendments to the Model Corporations Act and current case law developments in director and officer liability. We will also discuss planning for the ABA Business Law Section Spring Meeting in New Orleans.

Director & Officer Liability Committee Meeting
Friday, November 18, 2016
9 a.m. - 10 a.m.
Jefferson, Ballroom Level

Please use the following dial-in information if you cannot attend in person:

U.S. Dial-in: 866-646-6488
International: 707-287-9583
Conference Code: 8192972741

I look forward to seeing you in DC!

Frances Floriano Goins
ULMER & BERNE LLP
Chair, Director and Officer Liability Committee
ABA Business Law Section
Featured Articles

The Surprisingly Unknown: A Look Into the Murky Waters of Corporate Officer Liability and the Business Judgment Rule
By Francis G.X. Pileggi, Esquire and Alexandra D. Rogin, Esquire of Eckert Seamans Cherin & Mellott, LLC

In a short blurb about a footnote in a recent opinion of the U.S. District Court for the District of Delaware, The Delaware Corporate & Commercial Litigation Blog recently observed the lack of settled law on the issue of whether corporate officers are protected by the business judgment rule. The post cited to: Palmer v. Reali, Civ. No. 15-994-SLR, 2016 WL 5662008 (D. Del. Sept. 29, 2016). One footnote of the opinion was dedicated to the intriguing issue at hand. See Palmer, 2016 WL 5662008, at *8 n.8. However, the Palmer court left the question unanswered, noting that the defendant did not provide it with any controlling authority on the issue, and it was not aware of any.

It is well-settled under Delaware law, however, that corporate officers are bound by the same fiduciary obligations as corporate directors. See, e.g., Gantler v. Stephens, 965 A.2d 695, 708-09 (Del. 2009) (citing Ryan v. Gifford, 935 A.2d 258, 266 (Del. Ch. 2007)). Yet, corporate officers are not entitled to the exculpatory provisions of 8 Del. C. § 102(b)(7). See id. at 709 n.37 (recognizing that corporations may adopt a provision in their certificates of incorporation exculpating directors from liability for breach of due care pursuant to § 102(b)(7), but that no statutory provision authorizes comparable exculpation of corporate officers). It is understandable for one to assume that because officers have the same fiduciary duties as directors, they would be entitled to the same standard of review-the business judgment rule-when appropriate. This may not be the case though, as evidenced by the inapplicability of § 102(b)(7) and recent decisions, which decline to take a stance on the issue. At the very least, it is clear that controlling precedent has not yet been established.

Read more...

No Indemnity Coverage for Facebook IPO Claims Under D&O Policy
By Lindsey D. Dean, Esquire of Tressler LLP

A professional services exclusion in a D&O policy barred indemnity coverage for securities lawsuits arising out of NASDAQ's system failures on the day of Facebook's initial public offering according to a New York federal judge in Beazley Ins. Co. v. ACE Am. Ins. Co.

NASDAQ's professional liability insurers, including Beazley, accepted coverage for the lawsuits, while NASDAQ's D&O liability insurers, including ACE, denied coverage pursuant to the professional services exclusion. NASDAQ settled and assigned its rights under the D&O policies to Beazley, which sued the D&O insurers. The Honorable Judge Jed Rakoff ruled that ACE owed a duty to advance defense costs after which the parties engaged in discovery. Beazley then sought summary judgment on the issue of the D&O insurers' indemnity obligations.

Read more...

Flash Report

SEC Sues General Counsel of RPM International Based on Alleged Disclosure and Accounting Failures, Apparently in Violation of Corporate Reporting and Disclosure Requirements
By Brett M. Amron, Esquire of Bast Amron LLP, Development Chair of the D&O Liability Committee
On September 9, 2016, the U.S. Securities and Exchange Commission (SEC) filed civil fraud charges against Edward W. Moore, who serves as general counsel for the Ohio-based chemical products company, RPM International Inc. The 28-page complaint accuses Moore of violating "antifraud, books and records, and misleading accountant or auditor provisions of the securities laws" based on his alleged failure to disclose a material loss contingency, or record an accrual for, a government investigation when required to do so.

Beginning in 2011, RPM and one of its subsidiaries, Tremco, were under investigation by the U.S. Department of Justice (DOJ) for overcharging the government by at least $11.9 million on various roofing contracts. According to the SEC, Moore oversaw RPM's response to the investigation, but failed to keep senior management and auditors abreast of material facts regarding the investigation and did not inform shareholders of the investigation in a timely manner. As a result, when RPM settled for $60.9 million in 2013, the company had not established a reserve to make the payment.

Knowing that disclosure of the investigation could cause reputational harm to the company, the agency alleges that Moore chose to downplay the situation to protect his own financial position. At the time, Moore held over $1.8 million worth of RPM's stock. The SEC further stated that in the last few months of 2012 "Moore was aware of pressure to avoid, or at least postpone, recording another one-time charge," after the company disclosed two one-time charges unrelated to the DOJ investigation totaling $56 million.

As a result of Moore's conduct, the SEC contends that RPM submitted "false and misleading filings" from October 2012 through December 2013. Because the $11.9 million estimate was equal to 30 percent of its first quarter revenues, it was "material" and therefore needed to be disclosed.

This is a unique case where the SEC takes action against an individual corporate officer, alleging that he caused a company's failure to disclose an investigation and settlement, in violation of the notoriously broad corporate disclosure requirements. According to the complaint, the agency now claims that "A public company facing a loss contingency, such as a lawsuit or a government investigation, is required under accounting principles and the securities laws to (1) disclose the loss contingency if a material loss is reasonably possible, and (2) record an accrual for the loss contingency if a material loss is probably and reasonably estimable."

RPM CEO and chairman Frank C. Sullivan has issued a statement that these accusations by the SEC "have absolutely no merit and are the product of prosecutorial overreach. We intend to vigorously defend ourselves and expect our position to be vindicated in court."

A copy of the complaint is available at: https://www.sec.gov/litigation/complaints/2016/comp23639.pdf
The Surprisingly Unknown:  
A Look Into the Murky Waters of Corporate Officer Liability and the Business Judgment Rule

By: Francis G.X. Pileggi, Esq. and Alexandra D. Rogin, Esq.¹

INTRODUCTION

In a short blurb about a footnote in a recent opinion of the U.S. District Court for the District of Delaware, The Delaware Corporate & Commercial Litigation Blog recently observed the lack of settled law on the issue of whether corporate officers are protected by the business judgment rule.² The post cited to: Palmer v. Reali, Civ. No. 15-994-SLR, 2016 WL 5662008 (D. Del. Sept. 29, 2016). One footnote of the opinion was dedicated to the intriguing issue at hand. See Palmer, 2016 WL 5662008, at *8 n.8. However, the Palmer court left the question unanswered, noting that the defendant did not provide it with any controlling authority on the issue, and it was not aware of any. Id.

It is well-settled under Delaware law, however, that corporate officers are bound by the same fiduciary obligations as corporate directors. See, e.g., Gantler v. Stephens, 965 A.2d 695, 708–09 (Del. 2009) (citing Ryan v. Gifford, 935 A.2d 258, 266 (Del. Ch. 2007)). Yet, corporate officers are not entitled to the exculpatory provisions of § 102(b)(7). See id. at 709 n.37 (recognizing that corporations may adopt a provision in their certificates of incorporation exculpating directors from liability for breach of due care pursuant to § 102(b)(7), but that no statutory provision authorizes comparable exculpation of corporate officers). It is understandable for one to assume that because officers have the same fiduciary duties as directors, they would be entitled to the same standard of review—the business judgment rule—when appropriate. This may not be the case though, as evidenced by the inapplicability of § 102(b)(7) and recent decisions, which decline to take a stance on the issue. At the very least, it is clear that controlling precedent has not yet been established.

CONFLICTING AUTHORITY

At least one Delaware court has suggested that “the decision[s] of executive officers may…come within the [business judgment rule].” Kaplan v. Centex Corp., 284 A.2d 119, 124 (Del. Ch. 1971) (emphasis added). Kaplan, however, was not unequivocal, finding only that the rule “probably does” apply. Id. It should also be noted that Kaplan was decided long before the Delaware Supreme Court affirmatively decided in Gantler v. Stephens, 965 A.2d 695 (Del. 2009), that officers owe the same fiduciary duties as corporate directors. Gantler, 965 A.2d at

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The Delaware Court of Chancery has acknowledged that the question of whether the business judgment rule applies to officer decision-making remains unanswered. See, e.g., Hampshire Grp. Ltd. v. Kuttner, C.A. No. 3607-VCS, 2010 WL 2739995, at *11 (Del. Ch. July 12, 2010) (“There are important and interesting questions about the extent to which officers and employees should be more or less exposed to liability for breach of fiduciary than directors.”). For example, in Chen v. Howard-Anderson, 87 A.3d 648 (Del. Ch. 2014), the court noted that “[a] lively debate exists regarding the degree to which decisions by officers should be examined using the same standards of review developed for directors.” Chen, 87 A.3d at 666 n.2 (Comparing Lawrence A. Hamermesh & A. Gilchrist Sparks III, Corporate Officers and the Business Judgment Rule: A Reply to Professor Johnson, 60 Bus. Law. 865 (2005), and A. Gilchrist Sparks, III & Lawrence A. Hamermesh, Common Law Duties of Non–Director Corporate Officers, 48 Bus. Law. 215 (1992), with Lyman P.Q. Johnson, Corporate Officers and the Business Judgment Rule, 60 Bus. Law. 439 (2005)).

Additionally, in February this year, the Delaware Court of Chancery similarly explained that

a vibrant debate exists over the extent to which the full agency law regime should apply to officers. One of the principal disputes appears to be whether officers should be liable for simple negligence, like agents generally, or whether some form of more deferential standard of review, such as the business judgment rule, should apply to their decisions. Amalgamated Bank v. Yahoo! Inc., 132 A.3d 752, 781 n.24 (Del. Ch. 2016). Despite such acknowledgement, both courts declined to weigh in on the issue. See id. (“This opinion does not speculate on that issue.”); Chen, 87 A.3d at 666 n.2 (“this decision need not weigh in on these issues and intimates no view upon them.”).

While some argue against the applicability of the business judgment rule to corporate officers, others suggest that court language indicates that officers are entitled to deference. Compare Lyman P.Q. Johnson, Corporate Officers and the Business Judgment Rule, 60 Bus. Law. 439 (2005) (arguing that the rule should not apply to officers on bases of policy implications and that case law on the topic is “weak[”]) with Megan Wischmeier Shaner, Officer Accountability, 32 Ga. St. U. L. Rev. 357, 390 (2016) (asserting that case law suggests the opposite).

For example, courts have made blanket statements that mention both directors and officers in the context of explaining the business judgment rule. See, e.g., In re Goldman Sachs Grp., Inc. S’holder Litig., Civil Action No. 5215-VCG, 2011 WL 4826104, at *1 (Del. Ch. Oct. 12, 2011) (so long as directors and officers “act within the boundaries of their fiduciary duties, judges are ill-suited...to secondguess [sic] the business decisions” of them); id. (the DGCL “affords directors and officers broad discretion to exercise their business judgment in the fulfillment of

In *Amalgamated Bank*, even where it declined to address the issue, the court quoted language related to the policy behind the business judgment rule in the waste context, which applied to both directors and officers: “If courts were permitted more freely to “second guess” the terms of corporate contracts…there would be a substantial disincentive created for officers and directors…to approve risky transactions.” *Amalgamated Bank*, 132 A.3d at 784 (quoting *Steiner v. Meyerson*, Civ. A. No. 13139, 1995 WL 441999, at *1 (Del. Ch. July 19, 1995)).

The Delaware Supreme Court, without deciding this issue, has also described the rule as a presumption related to both directors and officers. *See Cede & Co. v. Technicolor, Inc.*, 634 A.2d 345, 361 (Del. 1993), *modified on reargument*, 636 A.2d 956 (Del. 1994). In *Cede*—another pre-*Gantler* decision—the court stated that “the business judgment rule attaches to protect corporate officers and directors and the decisions they make, and our courts will not second-guess these business judgments.” *Id*. Accordingly, it seems as though Delaware courts consider directors and officers in the same vein when it comes to potential liability.

Various treatises have also weighed in. The American Law Institute explicitly states that “[a]lthough most precedents and statutory provisions deal solely with directors, it is relatively well settled, through judicial precedents and statutory provisions in at least 18 states, that officers will be held to the same duty of care standards as directors.” PRINCIPLES OF CORP. GOVERNANCE § 4.01 (1994); *see also* 18B AM. JUR. 2D Corporations § 1452 (2016 Update) (“The business judgment rule applies to decisions by directors…[and] officers…of corporations.”). The well-known Fletcher treatise seems to agree. 3A WILLIAM MEADE FLETCHER, FLETCHER CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS §§ 1029-39 (1975) (the business judgment rule “generally applies to decisions of executive officers as well as those of directors.”).

Yet, no Delaware court has explicitly addressed whether corporate officers are entitled to the deference of the business judgment rule. In as much, many have recognized the art of judicial restraint perfected by Delaware courts in addressing only those matters precisely before them. *See, e.g.*, Megan Wischmeier Shaner, *Officer Accountability*, 32 GA. ST. U. L. REV. 357, 392–93 (2016) (“Further contributing to an apparent stalling in the development of officer fiduciary doctrine is the Delaware courts’ exercise of judicial restraint”); *In re Tyson Foods, Inc. Consol. S’holder Litig.*, No. Civ.A. 1106-CC, 2007 WL 2351071, at *1 (Del. Ch. Aug. 15, 2007) (“Judicial restraint suggests that a court should limit itself to the case or controversy placed before it and, to the extent practicable, not engage in speculation about phantasmal parties or issues that might one day appear.”); *In Re Allergan, Inc. S’holder Litig.*, No. CIV.A. 9609-CB, 2014 WL 5791350, at *9 (Del. Ch. Nov. 7, 2014) (Delaware courts “typically decline to decide issues that may not have to be decided….”) (internal quotation omitted). Consequently, there currently exists no binding authority on the matter.
CONCLUSION

Delaware courts have danced around the question of the business judgment rule’s applicability to corporate officers, repeatedly acknowledging the ambiguity and revealing their reluctance to analyze the issue without more direction. See, e.g., Chen v. Howard-Anderson, 87 A.3d 648, 666 n.2 (Del. Ch. 2014); Amalgamated Bank v. Yahoo! Inc., 132 A.3d 752, 781 n.24 (Del. Ch. 2016). This suggests a veiled plea from the courts for guidance from the Delaware Supreme Court. Indeed, the need for such is apparent from an outside perspective. As practitioners, we will be watching and waiting for the right case to expressly present this matter of first impression before the Delaware Supreme Court.