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You're the Problem, Officer: Whether Executive Officers Should be Subjected to the Same Standards of Liability as Directors Under Current Corporate Governance Law

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YOU’RE THE PROBLEM, OFFICER: WHETHER EXECUTIVE OFFICERS SHOULD BE SUBJECT TO THE SAME STANDARDS OF LIABILITY AS DIRECTORS UNDER CURRENT CORPORATE GOVERNANCE LAW

Margo Brandenburg

I. INTRODUCTION

Many recent corporate scandals involved executive officers’ improper behavior. In the past twenty years, big names like Disney, Enron, and Nissan have all experienced officer misconduct at the expense of the corporation. In one notably outrageous example, Disney awarded its newly appointed executive officer Michael Orvitz more than $38 million in cash, plus $3 million in stock options to leave the position, even after he proved utterly incapable of performing the duties required and was completely disinterested in the position itself. Orvitz must have finally begun to believe in the “magic” of Disney on that payday, to be sure.

Executive officer misconduct can lead to public humiliation, client loss, federal investigations, and shareholder distrust. As one leading corporate governance scholar stated, “the single major challenge addressed by corporate governance is how to grant managers enormous discretionary power over the conduct of business while holding them

2. See Troy Segal, Enron Scandal: The Fall of the Wall Street Darling, INVESTOPEDIA (May 29, 2019), https://www.investopedia.com/updates/enron-scandal-summary/. Enron executives lead the company in using mark-to-market accounting procedures to hide unprofitable activities and defraud shareholders, who were led to believe the company was more profitable than it truly was. Id. As a result, several Enron executives were charged with securities fraud, conspiracy, and insider trading. Id.
4. In re Walt Disney Co. Derivative Litig., 825 A.2d 275, 289 (Del. Ch. 2003). This case explains that Michael Eisner, Disney’s CEO (and notably Orvitz’s good friend of over twenty-five years), allowed Orvitz to begin serving as Disney’s President even before Disney executed his employment contract. Id. at 281. During his time in the position, Orvitz stated on Larry King Live that he knew about 1% of what he needed to know in order to fulfill his job’s duties. Id. at 283. In addition, Vanity Fair published an article explaining that Orvitz cancelled all meetings with Disney’s chief financial officer to learn more about his position, stating that Orvitz “didn't understand the duties of an executive at a public company[,] and he didn't want to learn.” Id. Not to mention, instead of working on improving in his position at Disney, he had already begun seeking employment elsewhere before he was even asked to leave. Id.
accountable for the use of that power.”

Today’s business world is surrounded by nonstop media coverage, so an executive officer’s reputation undeniably matters to a corporation’s success and is one of its most valuable assets.

The consequences are real when a company’s executive officer misbehaves. Thus, there is a need for authority in determining how a court is supposed to act when an executive officer blunders while performing their duties. Must a court intervene and punish the officer? Or should a court give deference to the officer’s decision, knowing that hindsight judgment is never a proper way to analyze a business choice? Despite the ever-increasing need for legal authority regarding officers, there is surprisingly very little case law discussing the liability standards of these executives.

Consistent instruction relating to officer liability and responsibility has “remained under the legal radar,” and today there is still no concrete answer. As such, this Comment will examine the duties and liabilities of both corporate directors and officers, and address whether, given the current corporate governance landscape, officers should receive the deference and protections that directors have. Part II of the Comment will discuss the governing law, the duties of directors and officers, and the discrepancies between them in terms of the business judgment rule and other exculpatory protections. Part III of this Comment will discuss the rationales behind the business judgment rule and exculpatory protections and opine about how the discrepancies in officer and director liability should be resolved. Part IV will conclude by noting that this dearth of officer case law should be given more attention, and that officers should be afforded the same protections as corporate directors.

II. BACKGROUND

This Section will proceed by giving a brief overview of Delaware law and its importance in study of corporate law. Next, this Section will discuss the fiduciary duties that officers and directors owe to corporations under Delaware law. Finally, this Section will outline the discrepancies between the protections that Delaware law affords officers and directors by virtue of their positions.

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9. Id.
A. Delaware Law

State law generally governs the internal affairs of a corporation. Since the early 1900s, Delaware has been the most influential state in regulating the formation and management of corporations. Sixty-five percent of Fortune 500 companies and more than fifty percent of all publicly traded companies in the United States are incorporated in Delaware. Such a large percentage of corporations choose to incorporate in Delaware because its law provides both the stability and flexibility for a corporation to govern its own affairs with minimal judicial encroachment.

The Delaware General Corporation Law ("DGCL") governs Delaware corporate law issues. The DGCL "helps entrepreneurs, corporate managers, and stockholders create wealth through the corporate form." The law governs the internal affairs of the corporation and the relationship between the company’s owners (stockholders) and managers (the directors and officers). Partisan divides when making amendments to the DGCL are virtually unheard of because the political parties understand that trillions of dollars are invested in corporations and they recognize the importance of ensuring that all stakeholders can rely on the DGCL for integrity and efficiency.

The Delaware Court of Chancery is tasked with interpreting the statutes within the DGCL. This court is widely recognized as having a specialized focus in dealing with corporate law issues. The court’s ability to parse out complex corporate law issues is unparalleled by any other court in the United States. Rather than having one judge and a panel of jury members, the court is comprised of five chancellors who are

13. See About Delaware’s Corporation Law, supra note 10. To attest to Delaware law’s stability, “Delaware’s constitution requires a super-majority vote by the legislature to amend the corporation law, protecting the DGCL from one-time amendments proposed by special-interest groups or influential corporations.” Id.
14. See id.
15. Id.
16. Id.
20. Id.
appointed by the Governor, subject to the advice and consent of the Senate.\textsuperscript{21} All appeals from the Court of Chancery go directly to the Delaware Supreme Court, which is composed of five justices who have specialized experience dealing with corporate law disputes.\textsuperscript{22}

With specialized judges weighing legal arguments and ultimately deciding corporate law disputes, the Delaware courts are known to produce well-reasoned and thoughtfully articulated decisions.\textsuperscript{23} This approach serves to create a large archive of case law that corporations may look to for guidance on a particular corporate law dispute.\textsuperscript{24}

Interestingly, while Delaware courts have the largest collection of information on corporate governance in the country, neither Delaware statutes nor case law delves deep into the responsibilities of arguably the most important actors in corporate affairs: a company’s executive officers.\textsuperscript{25} In fact, judicial and legislative directives on this front are quite sparse.\textsuperscript{26} In contrast, Delaware law contains a large amount of directives regarding director responsibilities, and the guidance is continually increasing over time.\textsuperscript{27}

\textbf{B. Fiduciary Duties of Directors}

A corporation’s board of directors plays a critical role in the managing of its internal affairs: it has the power to make every high-level business decision for the corporation.\textsuperscript{28} However, when using this power, directors must comply with the duties of care and loyalty to the corporation.\textsuperscript{29} The duty of care requires a director to stay informed about developments in the corporation in order to make wise decisions.\textsuperscript{30} This duty of care requires that directors have a good faith belief that their actions are in the best interest of the corporation.\textsuperscript{31} In contrast, the duty of loyalty requires that directors act in the best interest of the corporation and not in their own self-interest.\textsuperscript{32}

With these duties in mind, directors must be vigilant in their conduct.\textsuperscript{33} If directors fail to adhere to their duties of care and loyalty, they may be held liable for any losses incurred by the corporation as a result.\textsuperscript{34} To ensure that directors are fulfilling their obligations, Delaware courts have established a number of legal principles that govern the conduct of directors.\textsuperscript{35} These principles include the duty of care, the duty of loyalty, and the duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of duty of
business decisions. A director’s duty of loyalty requires a director to act in the best interests of the corporation at all times, rather than advance their own self-interest. The Delaware Supreme Court has explicitly stated that the duties of care and loyalty are the only duties that directors owe to the corporation. However, some circumstances require special applications of the duties of care and loyalty, such as the duties of candor or disclosure (the “Revlon duties”). Revlon duties require that a corporate board perform its fiduciary duties in a manner that maximizes the sale price of the enterprise. A director’s duty of candor or disclosure rests on the proposition that directors “fully and fairly” disclose all material information to shareholders in order to elicit shareholder action within the corporation. A breach of these duties on the part of a director is determined by a standard of gross negligence.

C. Fiduciary Duties of Officers

1. Corporate Officers Generally

When directors make decisions regarding the corporation, the officers are tasked with executing those decisions. The duties of a corporation’s officers are set forth in the bylaws of the corporation, or are decided by the directors pursuant to guidelines in the bylaws. In addition to duties of care and loyalty, officers owe additional duties of good conduct, a duty to provide information and assist directors in understanding reported information, and a duty to obey the principal, among others.

While executive officers are tasked with being the loyal servants of the corporation, this is not the reality for many corporations in the United States today. In addition to planning for the overall success of the corporation, the chief executive officer (“CEO”) is tasked with leading

30. Id.
31. Id.
33. Id.
34. Malpiede v. Townson, 780 A.2d 1075, 1083 (Del. 2001). In Revlon, the court found that where directors allow considerations other than maximizing shareholder profit affect their decision making, directors do not act in shareholders’ best interests and thus amounts to a breach of the business judgment rule. Revlon, Inc. v. Macandrews & Forbes Holdings, Inc., 506 A.2d 173, 185 (Del. 1986).
38. Id.
the development and execution of long-term goals to maximize shareholder wealth. Executive officers have been known to lead their companies "like corporate emperors and empresses," exerting power over other managers, directors, and even shareholders, who in their job description they are tasked with serving. To attest to this officer dominance, one scholar compared the CEO of a corporation to the President of the United States, deeming those occupations two of the most intriguing and influential positions in law and society to date.

Executive officers wield considerable power. When an officer uses that power but makes mistakes along the way, it raises the question of whether and how to hold them liable. The inquiry of whether officers should be treated the same as directors in terms of liability gets more complex when individuals hold dual positions as executive officers and directors. Over half of the companies in the S&P 500 Index have CEOs who contemporaneously hold the position of chairman of the board of directors. The CEO is the primary operational decision-maker at the company, while the chairman of the board is responsible for protecting the investors' interests and overseeing the corporation in its entirety. The chairman of the board is tasked with being the “boss” of the corporation and is not typically involved with the day-to-day operations of the business, allowing the CEO to run the corporation in a manner of their choosing.

2. Gantler v. Stephens: A Semi-Saving Grace for Officer Responsibilities

Before 2009, there was no concrete answer of what fiduciary duties executive officers owed under Delaware law. A conclusive answer did not come into fruition until the Delaware Supreme Court issued its opinion in Gantler v. Stephens. In Gantler, shareholders of a corporation alleged that a group of the corporation’s directors and officers violated

41. Tom C.W. Lin, CEOs and Presidents, 47 U.C. DAVIS L. REV. 1351, 1364 (2014).
42. Id.
44. What is a CEO (Chief Executive Officer)?, supra note 40.
45. Id.
46. 965 A.2d 695 (Del. 2009).
47. Id.
their fiduciary duties. The shareholders supported their allegations by explaining that the directors and officers refused to sell the corporation and, in turn, benefitted themselves by merely reclassifying shares and releasing a misleading proxy statement to induce shareholder approval.

In deciding the fiduciary breach question, the court first addressed whether both officers and directors owe identical fiduciary duties to the corporations they serve. The court, noting this question as being a matter of first impression, answered affirmatively. However, the court failed to mention whether officers should be given the benefit of the business judgment rule and whether they would be held to a standard of simple negligence as agents of the corporation or a lesser standard of gross negligence like directors.

3. Executive Officers Expanding their Reach: Increased use of Technology and The Business Roundtable Statement on the Purpose of a Corporation

Executive officers constantly look to make corporate governance decisions that maximize the long-term value of the corporations they serve. Two ways executive officers have generally attempted to keep up with the ever-changing business world in modern times are the increased use of social media and electronic news outlets, and an enlarged focus on the stakeholders of the corporation through the issuance of the Business Roundtable’s Statement on the Purpose of a Corporation.

In the digital age, executive officers are under an increased microscope. Because they are the faces of their companies, the way officers are perceived by stakeholders affects both public opinion and profitability of the corporation overall. Thus, officers’ individual careers and the corporation’s profitability rests upon the extent to which they mitigate reputational risks and negative public perception. However, reputation management proves to be increasingly difficult. In these days of round-the-clock access to sites like Facebook, Twitter, and Yelp, executive officers—particularly CEOs—must work to guard and manage

48. Id.
49. Id. at 698.
50. Id. at 708-09.
51. Id.
52. Follett, supra note 26, at 575.
54. The Importance of a Business Executive’s Reputation, supra note 7.
55. See id.
56. Id.
their reputations more than ever before in history.  

Today, a CEO’s reputation may extend to activities that are beyond the corporation, and its products or services, in a practice known as CEO activism. CEO activism occurs when corporate leaders take public stances on controversial political and social issues—topics that have not traditionally been spoken of in the business world. While some CEOs claim they engage in activism out of personal conviction, others have stated that their speaking out contributes to a higher sense of corporate purpose, which is vital in modern society. This extension of the purpose of the corporation—to one that is responsible in social and political spheres, as well as economic,—is of great importance to millennials, who are beginning to dominate the markets as customers, employees, and shareholders.

The rise of CEO activism has incited formal statements from some top corporations committing to serve a purpose higher than merely creating shareholder value. While CEOs are tasked with running the corporation’s day-to-day activities, generating profits, and returning value to the shareholders, some have chosen to formally broaden the scope of their duties. In 2019, the Business Roundtable, composed of 188 CEOs of major U.S. corporations, redefined the duties of a corporation in its *Statement on the Purpose of the Corporation*. The statement, signed by 181 of the Roundtable’s members, outlined a modern standard for corporate governance that pledges each CEO’s support of each corporation’s stakeholders, rather than just their shareholders. It highlights that corporations should work to deliver value to customers, invest in employees, deal fairly with suppliers, and support local communities, all alongside the traditional duty to maximize shareholder wealth.

57. Id.
58. Id.
60. Id.
61. Id. Millennials tend to put significantly more weight on the social responsibility of corporations when making decisions on where to work and make purchases than the generation before them. See Ryan Rudominer, *Corporate Social Responsibility Matters: Ignore Millennials At Your Peril*, CENTER OF SOCIAL IMPACT COMM., https://csic.georgetown.edu/magazine/corporate-social-responsibility-matters-ignore-millennials-peril/ (last visited Apr. 30, 2020). Millennials currently account for $1 trillion of U.S. consumer spending. Id. Businesses that ignore the higher sense of corporate purpose do so at their peril. Id.
64. Id.
D. Protections Given to Directors that are not Definitively Afforded to Officers

Both directors and officers owe fiduciary duties to the corporations they serve.65 This raises the question of whether it is proper to have a uniform approach in holding them liable for their breaches of those duties. Today, directors are afforded more definitive protections in their decision making. Delaware law provides that directors are to be afforded the presumption of the business judgment rule and other exculpatory protections. But these protections are not consistently or uniformly applied to officers. Where these protections are applied, courts provide sparse reasoning for their applications of the protections and to what extent they may apply in other instances.

1. Business Judgment Rule

   i. Policies Behind the Business Judgment Rule

   The business judgment rule provides that courts, when determining director liability, should not examine the quality of a director’s business decisions, but only the procedures used in reaching those decisions.66 The business judgment rule is “a presumption that, in making a business decision, the directors of a corporation acted on an informed basis, in good faith, and in the honest belief that the action taken was in the best interests of the company.”67 The rule is a defense that can reduce the liability exposure of directors to claims for mismanagement and breach of their duty of care.68

   Without subjecting officers to the more deferential business judgment rule, they would be held to a standard of simple negligence. For example, if an officer could have purchased a large piece of equipment at a cheaper price from an international retailer rather than domestic, then they could be deemed liable under a simple negligence standard.69 Or, if an officer failed to take into consideration input from an employee that would have prevented losses to the corporation, the officer could be held liable for their failure to consult the employee.70 In both of those scenarios, the

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66. KNEPPER & BAILEY, supra note 8, § 2.01. The business judgment rule is not a substantive rule of law, but it is a presumption given to directors in their decision-making process. In re Walt Disney Co. Derivative Litig., 907 A.2d 693, 758 (Del. Ch. 2005).
67. KNEPPER & BAILEY, supra note 8, § 2.01.
68. Id.
69. Graf, supra note 6.
70. Id.
officers could arguably be deemed negligent even though these types of mistakes occur frequently in the business world.\textsuperscript{71}

The business judgment rule seeks to protect and promote the role of the board of directors as the ultimate manager of the corporation.\textsuperscript{72} Thus, the rule serves to protect directors who made business decisions diligently, carefully, and who have not acted fraudulently, illegally, or in bad faith.\textsuperscript{73} The rule is supported by three general policy rationales: (1) encouraging director risk-taking, (2) avoiding judicial encroachment into business decisions, and (3) ensuring the board’s role as the central decision-maker of the corporation.\textsuperscript{74}

With the added backing of a diversified portfolio, many shareholders prefer corporate directors to take more risks in their business decisions, hoping that the decisions lead to a higher payout for them.\textsuperscript{75} The directors themselves, who may hold relatively small portions of the whole corporation’s stock, many times may not see the payoffs from their risk-taking measures.\textsuperscript{76} Thus, the tension emerges of directors wanting to be risk-averse in order to keep the corporation on the straight-and-narrow, while shareholders advocate for the corporation to take risks to maximize profit. The business judgment rule seeks to resolve this issue by allowing directors to ease their apprehensions of making risky decisions that, in hindsight, may prove to be imprudent.\textsuperscript{77}

Directors already face informal sanctions for bad decisions, including unhappy shareholders who may vote them out of office or a decline of the corporation’s value.\textsuperscript{78} Judges do not stand to gain or lose in the same capacity as directors, and so the board should be afforded deference to make decisions without judicial interference.\textsuperscript{79}

The DGCL states that “[t]he business and affairs of every corporation . . . shall be managed by or under the direction of a board of directors.”\textsuperscript{80} The business judgment rule preserves the corporate governance scheme that was envisioned by the Delaware legislature.\textsuperscript{81} Deference to director decisions, rather than judicial interference in the decision-making of directors, assists in preserving the authority of the board of directors in

\begin{thebibliography}{99}
\bibitem{71} Id.
\bibitem{72} In re Walt Disney Co. Derivative Litig., 907 A.2d 693, 696 (Del. Ch. 2005).
\bibitem{73} KNEPPER & BAILEY, supra note 8, § 2.01.
\bibitem{74} Lyman P.Q. Johnson, Corporate Officers and the Business Judgment Rule, 60 BUS. LAW. 439 (2005).
\bibitem{75} Id.
\bibitem{76} Id.
\bibitem{77} Id.
\bibitem{78} Id.
\bibitem{79} Id.
\bibitem{80} DEL. CODE ANN. tit. 8, § 141(a) (2001).
\bibitem{81} Johnson, supra note 74.
\end{thebibliography}
the internal affairs of the corporation, rather than passing the authority to shareholders or judges who are unfamiliar with the business. This means that directors, upon learning about a fiduciary wrongdoing of a corporate officer, must investigate the alleged wrong and then decide whether to pursue a claim by means of litigation, settlement, or intra-firm sanction.

ii. Court Confusion Surrounding the Rule

During In re Walt Disney Co. Derivative Litig., the court explained that “even where decision-makers act as faithful servants . . . their ability and the wisdom of their judgments will vary.” The court also noted that “the redress for failures that arise from faithful management must come from the markets, through the action of shareholders and the free flow of capital, and not from . . . Court[s].” In sum, the business judgment rule is supported by three general policy rationales: (1) encouraging director risk-taking measures, (2) avoiding judicial encroachment into business decisions, and (3) ensuring the board’s role as the central decision-maker of the corporation.

While the business judgment rule certainly applies to directors’ decision-making, the business judgment rule has not found uniform acceptance in its application to officers of a corporation. In Gantler, the court assessed the defendant directors’ and officers’ conduct under some application of the business judgment rule. First, the court directed that on a motion to dismiss, the plead facts must support a reasonable inference that the board of directors breached either its duty of loyalty or its duty of care. After assessing the defendant directors’ alleged breaches of fiduciary duties, the court proceeded to look at whether the officers breached their fiduciary duties. The court concluded that because the officers never responded to a due diligence request, there could be a reasonable inference that they breached their duties as officers of the corporation. While not explicitly mentioning that the business judgment rule also applied to officers, the court implicitly applied the rule by determining that the officers acted in gross negligence of their duties.

82. Id.
83. Id.
84. 907 A.2d 693, 698 (Del. Ch. 2005).
85. Id.
86. Id.
87. Johnson, supra note 74.
89. Id. at 706.
90. Id. at 709.
91. Id.
The Third Circuit also addressed the business judgment rule’s application to officers, but its reasoning was vague. In the case of *In Re Tower Air, Inc.*, the court partly affirmed the holding of a Delaware District Court and applied the business judgment rule to a decision made by corporate officers.\(^92\) The court confusingly and interchangeably talked about the business judgment rule’s application to directors only and to directors and officers together, without distinguishing between the two groups.\(^93\) The Third Circuit offered no discussion of its analytical approach in determining that the business judgment rule indeed applied to officers in the same capacity as it did directors.\(^94\)

Other Delaware courts have made a blanket statement that includes officers in the definition of those who are protected by the business judgment rule.\(^95\) However, in more recent Delaware cases, courts have acknowledged the controversy of whether the business judgment rule applies to officers.\(^96\) For example, in a 2016 case, *Amalgamated Bank v. Yahoo! Inc.*, the court noted that a “vibrant debate” exists whether officers should be liable for simple negligence, like agents generally, or whether some other deferential standard of review, such as the business judgment rule, should apply.\(^97\) In addition, during *In re Xura, Inc. Stockholder Litig.*, a 2018 Delaware Chancery Court opinion, the Vice Chancellor qualified his presumption that the business judgment rule applied to officers in a footnote of the opinion.\(^98\) He noted that “in deciding this motion, I have presumed . . . that the business judgment rule applies to [the defendant] as CEO. . . . this point is not settled in our law and . . . there is a lively debate among members of the academy regarding whether corporate officers may avail themselves of business judgment rule protection.”\(^99\)

One court has refused to apply the business judgment rule to officers altogether. In *Palmer v. Reali*,\(^100\) a Delaware District Court did not address whether the business judgment rule applied to officers of a corporation because the parties did not cite any Delaware cases where the

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92. 416 F.3d 229, 238 (3d Cir. 2005).
93. *Id.* at 238-39.
94. *Id.*
95. See, e.g., *In re Volcano Corp. Stockholder Litig.*, 143 A.3d 727, 737 n.16 (Del. Ch. 2016), Cede & Co. v. Technicolor, 634 A.2d 345, 361 (Del. 1993); *In re Walt Disney Co. Derivative Litig.*, 907 A.2d 693, 777 n.588 (Del. Ch. 2005).
99. *Id.*
100. 211 F. Supp. 3d at 666 n.8.
courts applied the business judgment rule to corporate officers.101

Model lawmaking bodies have realized the contours of determining executive officer liability and have drafted laws that support their stance. The Model Business Corporation Act states that non-director officers holding discretionary authority must discharge their duties with the same standards of care imposed upon directors.102 In addition, the American Law Institute’s Principles of Corporate Governance: Analysis and Recommendations treats the duties of directors and officers alike. It notes that the law is rather well-settled that officers are held to the same duty of care and business judgment standards as directors.103 However, in a comment to the Model Business Corporation Act, the drafters suggested that an officer’s access to more corporate information than directors may potentially subject them to higher standards of scrutiny.104

Evidently, current case law falls short of giving reasoned arguments in deciding to apply or not apply the business judgment rule to officers. Overall, case law and other legal materials indicate that courts still do not apply the business judgment rule to officers in the same definitive and broad fashion that they apply it to directors.

2. Exculpatory Protections

While both directors and officers have identical fiduciary duties, the consequences for a breach of those duties may not be the same.105 The Delaware Supreme Court decided in Smith v. Van Gorkom106 that directors of a corporation were grossly negligent in failing to inform themselves of the material facts surrounding a merger, and thus were personally liable for damages to shareholders.107 As a result, critics began predicting that the decision would lead talented board members to step down out of fear of being held personally liable for decisions made in good faith.108 The Van Gorkom decision received significant negative attention, prompting the Delaware legislature to create § 102(b)(7) of the DGCL.109

Under DGCL § 102(b)(7), a corporation’s certificate of incorporation may include a provision that limits or fully eliminates the personal

101. *Id.*
102. REvised MODEL BUS. CORP. ACT § 8.42 cmt.
103. KNEPPER & BAILEY, supra note 8.
104. Graf, supra note 6.
106. 488 A.2d 858, 884 (Del. 1985).
107. *Id.* at 893.
liability of a corporate director or its shareholders for breach of a fiduciary duty.\textsuperscript{110} Most Delaware corporations have exculpation provisions within their certificate of incorporation, to the extent that § 102(b)(7) provides for them to be used.\textsuperscript{111} The purpose of DGCL § 102(b)(7) is “to encourage directors to undertake risky, but potentially value-maximizing, business strategies, so long as they do so in good faith.”\textsuperscript{112}

While, as the \textit{Gantler} court noted, a similar provision is “legislatively possible” with respect to corporate officers, there is currently no section within the DGCL that allows for the creation of exculpation provisions for corporate officers.\textsuperscript{113} Thus, unless the Delaware legislature creates such a provision, the finding of a fiduciary breach will likely not be the same for both directors and officers, and could hinge entirely on the position that an individual holds. For example, even if a director and an officer of the same corporation are found to have committed the same form of misconduct, the director could be shielded from personal liability under DGCL § 102(b)(7)’s exculpatory provisions, while the officer could be held personally liable for hundreds of thousands of dollars. Outside of Delaware, however, seven states have resolved this inconsistency and allowed for exculpatory protections for corporate officers.\textsuperscript{114}

\section*{III. Discussion}

This Section will start by discussing whether directors and officers should be subject to the same standards of liability and will opine about if, and to what extent, the business judgment rule should apply to officers. Then, this Section will comment on whether officers should receive any exculpatory protections for their wrongdoings.

\textit{A. The Business Judgment Rule}

\textit{1. Policy Rationales Applied to Officers}

As discussed above, directors of corporations are held to a gross negligence standard, while officers, as agents of the corporation, have historically been held liable for simple negligence.\textsuperscript{115} Some commentators

\begin{footnotesize}
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\textsuperscript{110} DE\textsc{l.} CODE ANN. tit. 8, § 102(b)(7) (2001). \\
\textsuperscript{111} \textit{In re Walt Disney Co. Derivative Litig.}, 907 A.2d 693,752 (Del. Ch. 2005). \\
\textsuperscript{112} \textit{Id.} \\
\textsuperscript{113} \textit{Gantler v. Stephens}, 965 A.2d 696,709 n.37 (Del. 2009). \\
\textsuperscript{114} Follett, \textit{supra} note 26. \\
\textsuperscript{115} Johnson & Millon, \textit{supra} note 36, at 1639.
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argue that directors and officers should be treated the same for liability purposes and be given the benefit of the business judgment rule because the rationale for the rule applies equally to officer decisions. Others conclude that because of the officers’ proximity to the day-to-day workings of the corporation, and since corporate scandals are typically perpetrated by officers rather than directors, officers should be subjected to higher standards of liability. Commentators that support the latter argument contend that imposing an ordinary negligence standard of conduct without the benefit of the business judgment rule is proper.

To determine whether the business judgment rule should be applied to officers, a starting point is to look at the policy rationales surrounding the presumption. The reasoning in support of the presumption’s applications to directors is to protect business decisions that were made diligently and carefully, and not fraudulently, illegally, or in bad faith. One scholar, arguing that the business judgment rule should not apply to officers, stated that the business judgment rule is supported by three general policy rationales: (1) encouraging director risk-taking measures, (2) avoiding judicial encroachment into business decisions, and (3) ensuring the board’s role as the central decision-maker of the corporation. This Section will discuss this scholar’s policy rationales, weighing whether the rationales’ application to corporate directors would similarly apply to officers.

i. Encouragement of Director Risk-Taking Measures

Like directors, executive officers may hold very little portions of the corporation’s stock compared to the total stock issued and have diversified portfolios themselves. As such, officers, like directors, are unlikely to reap the total upside potential that comes from their risk-taking measures, even if they are given a pay raise. Arguably, while officers might be more prone to making risky business decisions because a larger portion of their income is incentivized, in many cases officers choose to “play it safe” to protect their jobs. If the corporation performs badly, officers have more on the line—including potentially their entire career—than directors, whose income tends to be more stable. In addition, officers

116. See Graf, supra note 6.
117. See Johnson, supra note 74.
118. Id.
119. KNEPPER & BAILEY, supra note 8.
120. Johnson, supra note 74.
121. Id.
122. Id. A CEO’s compensation “is variable in nature, in the sense that they only benefit if their company meets or exceeds prescribed targets.” Id.
face more severe intra-firm sanctions by way of being agents of the corporation. Before the corporation has even suffered, if the board or shareholders finds their actions ill-advised, they may remove officers from their position immediately.

ii. Avoidance of Judicial Encroachment into Business Decisions

Hindsight vision is 20/20. This applies to decisions made by both officers and directors. Like directors, officers make reasoned decisions they believe to be in the best interests of the corporation given the information they have at the time. With any decision, when given a second look at some point in the future, a chosen course of action may turn out to not have been the most prudent. While some argue that officers have more information than directors, an officer’s access to information is not absolute, and decision-making can be burdened by time constraints and additional stresses in times of corporate crisis.123 In addition, directors have the same authority within the corporation to gain access to information as officers, so a difference in decision-making scrutiny by way of informational access is not persuasive.124 Officers should be afforded the same protections as directors when making tough calls. Courts are not in a position to second-guess an officer’s decision-making tactics because doing so would be a second-guessing of the decision itself, which courts cannot, in good faith, attempt to do given a court’s limited information about each corporation in the context of litigation.

The most basic argument in favor of treating directors and officers the same in terms of liability is that because they have identical fiduciary duties, as determined in Gantler, the consequences for breaches of those duties should be identical as well.125 However, the argument that officers should be held to a simple negligence standard, while valiant, fails in a real-world application. If officers were held to a standard of simple negligence, they could be held liable for activities that frequently occur in the regular course of business.126 In transactions that occur all the time in corporate America, it is not justifiable or equitable for courts to hold well-intending officers liable for monetary damages for going about in the regular course of business. Holding officers to such stringent standards can cause officers to face “decision paralysis” in the midst of complex transactional decisions they make every day that require immediate, well-reasoned solutions.127 The frequency with which

123. Graf, supra note 6.
124. Id.
125. Id.
126. Id.
127. Id.
business decisions are made, which later turn out to be unwise, is not evidence of officer misconduct so much as it shows the inherent risk of business.

Allowing officers to benefit from the business judgment rule will not destroy accountability. The purpose of the business judgment rule is not to excuse officers from the duty to exercise due care in their decision-making processes.128 Rather, its aim is to prohibit the retrospective use of a business decision’s poor outcome to conclude that care was not exercised.129 Just as with directors, officers have informal sanctions within the corporation—like termination and pay decreases—that will hold them accountable for their wrong actions. At the end of the day, as noted in In re Walt Disney Co. Derivative Litig., it is the markets and shareholders that should be a reflection of the decisions that officers make every day, not the courts.130

iii. Ensuring the Board’s Role as the Central Decision-Maker of the Corporation

Affording officers the presumption of the business judgment rule still preserves the corporate governance scheme that the DGCL drafters envisioned.131 However, one may argue that sheltering an officer’s conduct from judicial review by using the business judgment rule undermines a board’s decision to hold its agent to the relevant standard.132 For example, if an officer was charged with breaching a duty of care in their decision-making, a court could use the business judgment rule to shield the officer from liability even against the boards wishes to hold the officer accountable. Allowing courts to defer to officer decisions against the wishes of the board is a shortfall of applying the business judgment rule to officers. But it is worrisome to think that officers could be held to higher standards of liability than the ultimate managers of the corporation, its board of directors.133 Shielding the board members with the business judgment rule while subjecting officers to a higher standard of liability is inconsistent with the corporate governance scheme envisioned by the DGCL. True managers of the corporation should be subject to the same—if not higher—thresholds of liability as their agents. Given the large

128. Johnson, supra note 74.
129. Id. The author of this article conceded this even though he did not support the proposition that the business judgment rule should be applied to officers.
130. 907 A.2d 693, 698. 907 (Del. Ch. 2005).
131. DEL. CODE ANN. tit. 8, § 141(a) (2001). (the business and affairs of every corporation should be managed by the board of directors).
132. Johnson, supra note 74.
133. Graf, supra note 6.
number of CEOs who contemporaneously serve as chairman of the corporation’s board of directors, it is also troubling to think that these individuals can be held to different standards of liability based entirely on the position they hold.

2. Other Considerations Given Case Law, Legislative Precedent, and an Expansion of Officer’s Scope

Compelling judicial authority indicates that jurisdictions support the application of the business judgment rule to officer decisions. A large majority of corporations incorporate in Delaware based on the freedom Delaware law provides a company to manage its affairs internally, with minimal interference from the courts. Such freedom, as vital to corporations as it is, must be considered when determining the scope of officer liability. Delaware, the weightiest state in regards to corporate governance, has taken the stance that officers should enjoy the business judgment presumption as recently as in 2018. In addition, various model rules indicate that directors and officers should be routinely held to the same standards of liability. While not completely settled, if a Delaware court were to take up this issue, it should find that the business judgment rule applies to decisions made by officers and that they should be held to a standard of gross negligence, just as directors are.

Recent corporate scandals seen in the news should not be a factor in deciding whether officers should be afforded the business judgment rule’s presumptions. Due to the mainstream media, executive officers already have more checks than ever before on what they do on a day-to-day basis. Today, when officers commit misdeeds, people will quickly hear about it in great detail. This suggests that the rate of corporate officers committing misdeeds has not increased, but that the general public hears about these scandals more by way of social media and news sites. There are bad apples in every profession. The fact that the public knows more about corporate officer misdeeds than ever before should stay out of the equation in determining whether officers deserve the benefit of the business judgment rule.

If recent scandals perpetrated by corporate officers can be a factor in determining whether officers deserve the benefit of the business judgment

134. See, e.g., In re Volcano Corp. Stockholder Litig., 143 A.3d 727, 737 n.16 (Del. Ch. 2016); Cede & Co. v. Technicolor, 634 A.2d 345, 361 (Del. 1993); In re Walt Disney Co. Derivative Litig., 907 A.2d at 777 n.588; Stanziale v. Nachtomi (In re Tower Air, Inc.), 416 F.3d 229, 238 (3d Cir. 2005); In re Xura, Inc. Stockholder Litig., No. 12698-VCS, 2018 Del. Ch. LEXIS 563, at *27 n.113 (Ch. Dec. 10, 2018).


137. E.g., KNEPPER & BAILEY, supra note 8.
rule, CEOs’ activism and extended scope into other areas must also come into the formula. Many CEOs of leading corporations in the United States have expressed their desire to serve all of their corporations’ stakeholders, rather than merely shareholders.\textsuperscript{138} The newly released \textit{Statement on the Purpose of a Corporation} shows these CEOs’ commitments to better themselves and to work on the way they are portrayed in their communities.\textsuperscript{139} While the signatory CEOs do not nearly represent all of the corporations in the country, many of the top corporations in the world are represented; thus, the statement is a step in the right direction that other CEOs and executives will surely follow.\textsuperscript{140} Even if, to take the cynical view, the rise in CEO activism is just an effort to appease millennials, more officers are starting to take notice of the effect of philanthropic measures on corporations’ bottom lines. Officers will continue to clean up their acts because they know the markets are watching.

\section*{B. Exculpatory Provisions}

Given that the rationale of the DGCL § 102(b)(7) is to encourage directors to undertake risky business strategies so long as they do so in good faith, exculpatory protections should also be permitted to officers.\textsuperscript{141} As afforded to directors, the exculpatory protections do not merely issue a free pass for board members to do as they please. Likewise, these protections, if they are applied to officers, would not shield officers from any decisions deemed to be made in bad faith or breaches of fiduciary duties, which generally is what a court would be most likely to find has occurred in the recent corporate scandals. Exculpatory protections are merely other tools to protect against judicial second-guessing into the decision-making of corporate officers. Allowing officers to receive the benefit of exculpatory protections will encourage officers to make value-maximizing, yet potentially risky, decisions.

In addition to encouraging officer risk-taking when they otherwise may be inclined to “play it safe,” exculpatory provisions should be afforded to officers because the current DGCL provision allows for inconsistent punishment of officers and directors who misbehave equally. Without officers receiving the benefit of exculpatory provisions, they are being severely punished monetarily for their misdeeds, while directors virtually get off scot-free, even if they committed the same act in good faith. The

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\bibitem{138} \textit{Statement on the Purpose of a Corporation}, supra note 53.
\bibitem{139} Id.
\bibitem{141} \textit{In re Walt Disney Co. Derivative Litig.}, 907 A.2d 693, 752 (Del. Ch. 2005).
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inconsistency must be resolved by officers receiving access to exculpation.

As critics predicted after the Van Gorkom decision, Delaware corporations will likely continue to lose qualified individuals to serve as officers if those individuals are not afforded exculpatory provisions. When faced with hard calls on business decisions, officers may instinctively try to put the blame on others, rather than take accountability themselves, out of fear of being held personally liable for a wrong decision. This blame-shifting can cause turmoil to the inner-workings of a corporation. It could change the officer’s focus to drumming up methods of avoiding responsibility for their decisions if they turn out badly. If the goal is to obtain talented and honest agents of the corporation, officers should be protected from decisions that in hindsight could prove to be imprudent. Policy rationales and inconsistencies in punishment under the current law dictate that the current DGCL provision should be amended. As seven other states have already done, the Delaware legislature should enact a provision that uniformly allows for the exculpation of a corporation’s directors and officers in their by-laws.\footnote{142. Follett, supra note 26.}

IV. CONCLUSION

It is justifiable to be skeptical of executive officers, given recent outrageous corporate scandals. Officers that partake in criminal activity deserve to be punished to the highest extent possible. However, while there have been numerous scandals perpetrated by corporate officers in the news today, the fact remains unclear whether officers have become increasingly more conniving, or if corporate scandals are merely receiving more attention as a reflection of the around-the-clock news media. Regardless, recent corporate scandals should not come into the equation in determining the application of the business judgment rule and exculpatory protections to executive officers.

The dearth of case law surrounding executive officer liability is alarming and should be resolved by officers receiving the business judgment presumption and exculpatory protections. Policy rationales behind the business judgment rule support its application to officers. In addition, the most current case law and model legislation favor officers and directors being held to the same standards of liability. Executive officers continue to take steps to clean up their acts and create long-term value in the political and social arenas—places traditionally outside of a corporation’s scope. Officers should also be afforded exculpatory provisions within a corporation’s by-laws. Without exculpatory...
provisions, corporations will continue to miss out on talented individuals who fear being held personally liable for mere negligent acts that occur in the regular course of business. Exculpatory protections should be offered to officers in order to show Delaware’s deference and confidence in officer’s good faith decision-making.

The cure for officer malfeasance should not be worse than the disease itself. 143 Allowing courts to intervene on the business decisions of corporate officers but not their director counterparts may be theoretically sound, but in practice may work to undermine the inner-workings of a corporation. Unless grossly negligent, officers should be afforded wide deference to their decisions, just as directors are. Courts should only interfere with a corporation’s internal affairs when prompted to by breaches of fiduciary duties, and leave the hindsight judgment and simple negligence issues to be handled by the corporation internally, shareholders, and the market.

143. Graf, supra note 6.