Recent Trends in Officer Liability

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More than a decade ago in the seminal case *Gantler v. Stephens*,[1] the Delaware Supreme Court clarified that officers of Delaware corporations owe the same fiduciary duties of care and loyalty that directors owe to the corporation and its stockholders.

While directors and officers owe the same fiduciary duties, they are not entitled to the same defenses. Section 102(b)(7) of the Delaware General Corporation Law (DGCL) permits a corporation to adopt a provision in its certificate of incorporation exculpating directors from money damages for breaches of the duty of care. Those provisions, which are routinely adopted by Delaware corporations, do not apply to corporate officers.

To adequately plead a breach of the duty of loyalty, a plaintiff must show that fiduciaries acted in a self-interested manner or in bad faith, which is a high bar to meet. By contrast, to plead a breach of the duty of care, a plaintiff must allege only that the fiduciaries acted in a grossly negligent manner, a far lower bar that makes care claims a prime target for stockholder plaintiffs. Even so, until recently, officer liability cases were still few and far between. The rare officer liability claim was typically brought in derivative litigation and involved either allegations of disloyal conduct for which neither a director nor an officer could be exculpated[2] or conduct by an individual serving in both an officer and director role.[3] Claims against an officer for breach of the duty of care — particularly in class action merger litigation — were exceedingly rare.

Over the past year, however, stockholder plaintiffs have increasingly pursued claims against officers for breaches of the duty of care. Moreover, such claims have been raised not only in the derivative context but in class action merger litigation as well, with mixed results.

Plaintiffs Target Officers in Deal Litigation

In December 2019, the Court of Chancery's motion to dismiss the ruling in *Morrison v. Berry*[4] shined a new spotlight on officer liability, particularly in a class action merger litigation context. The ruling, which addressed post-closing claims for money damages arising out of the sale of Fresh Market, dismissed duty of loyalty claims against directors but allowed claims against the company's founder/director, CEO and general counsel to proceed.

Of particular significance, the court declined to dismiss claims against Fresh Market's general counsel, holding that the complaint stated a claim for breach of the duty of care based on his alleged gross negligence in "preparing" inadequate merger disclosures. The court explained that, "[g]iven [his] role as General Counsel ... [it] c[ould] infer that the omitted facts were omitted with his knowledge." The court also relied on allegations that the CEO, who was also a director, "participated" in his capacity as an officer

[1] *Gantler v. Stephens*, 965 A.2d 695 (Del. 2009).

[2] *See, e.g.*, *In re Dole Food Co., Inc. Stockholder Litig.*, C.A. No. 8703-VCL (Del. Ch. Aug. 27, 2015) (finding that Dole's COO/general counsel, who also served as director, was liable for breaching his duty of loyalty to Dole's stockholders); *Ryan v. Gifford*, 935 A.2d 258, 272 (2007) (holding complaint stated claim for breach of duty of loyalty against CFO and vice president).

[3] *See, e.g.*, *Arnold v. Soc'y for Sav. Bancorp, Inc.*, 650 A.2d 1270, 1288 (Del. 1994) (rejecting argument that claims against CEO-director should survive because the plaintiff "failed to highlight any specific actions [CEO] undertook as an officer (as distinct from actions as a director)").

[4] *Morrison v. Berry, et al.*, C.A. No. 12808-VCG (Del. Ch. Dec. 31, 2019).

in drafting the registration statement. The court concluded it was "reasonably conceivable that crafting such a narrative to stockholders, while possessed of the information evincing its inadequacy, represents gross negligence ... ."

Since *Morrison v. Berry*, the Court of Chancery has seen a notable uptick in class action deal litigations involving claims against corporate officers, which present plaintiffs' attorneys with an additional avenue for recovery when directors are entitled to greater protections against liability.

For example, in *In re Mindbody, Inc., Stockholders Litigation*,[5] the Court of Chancery denied a motion to dismiss breach of fiduciary duty claims against a chairman/CEO and a CFO/COO in merger litigation challenging the sale of Mindbody. The court found that the complaint supported a reasonable inference that the CEO was conflicted based on an interest in near-term liquidity and an expectation that he would receive post-merger employment; tilted the sales process in favor of the buyer; and "failed to disclose material information to the board," namely, his alleged conflicts in the sales process and communications with the buyer. The court also declined to dismiss duty of care claims against Mindbody's CFO because as an officer, he was "not exculpated by the Company's 102(b)(7) provision," and he had allegedly acted with gross negligence. He allegedly obeyed the CEO's instructions that aided in tilting the sales process to the buyer and was "at least recklessly indifferent" to the steps the CEO took.

A few weeks later, in *In re Baker Hughes Inc. Merger Litigation*,[6] the court addressed breach of fiduciary duty claims against officers in class action merger litigation arising from the July 2017 merger of Baker Hughes Incorporated and the oil and gas segment of GE. Plaintiffs alleged that the proxy statement issued in connection with the transaction failed to disclose unaudited financials provided to the board. Plaintiff stockholders alleged, among other things, that Baker Hughes's CEO/chairman and CFO "breached their disclosure duties" based on that alleged omission. The court sustained claims against the CEO as an officer because "the Complaint allege[d] that '[he] signed both the Proxy, as the Chairman and CEO of Baker Hughes, and the Form S-4, as a person about to become a director of New Baker Hughes.'" The court concluded that "[a]lthough not overwhelming, this allegation [wa]s sufficient to support a reasonably conceivable claim that [he] breached his duty of care with respect to the preparation of the Proxy he signed as Baker Hughes' CEO." On the other hand, the court dismissed claims against the CFO based on "exceedingly thin" allegations.

More recently, in *City of Warren General Employees' Retirement System v. Roche*,[7] the Court of Chancery addressed breach of fiduciary duty claims against two officers of Blackhawk Network Holdings, Inc. in class action litigation arising from the June 2018 acquisition of Blackhawk by two private equity firms. Plaintiffs, after demanding to inspect Blackhawk's books and records, alleged that Blackhawk's CEO and its executive chairman breached their fiduciary duties by manipulating the board to favor the buyout and for misleading stockholders through a materially misleading proxy statement. The proxy allegedly contained inaccurate descriptions of the go-shop and misleading projections. The court dismissed the breach of the duty of loyalty claims because the complaint pled neither that they had a "material conflict of interest" nor that the board was manipulated or deceived. The court dismissed the claims against the executive chairman related to the proxy because the complaint did not allege that he was involved in preparing or signing the proxy statement. However, the court, much like in *Baker Hughes*, sustained the claims against the CEO for the allegedly misleading proxy because she was involved in preparing the proxy as an executive officer and she signed it.

[5] C.A. No. 2019-0442-KSJM (Del. Ch. Oct. 2, 2020).

[6] C.A. No. 2016-0638-AGB (Del. Ch. Oct 27, 2020). Recently the Court of Chancery described Baker Hughes as "well reasoned" in *In re USG Corporation Stockholder Litigation*, C.A. No. 2018-0602-SG (Del. Ch. Dec. 1, 2020).

[7] C.A. No. 2019-0740-PAF (Del. Ch. Nov. 30, 2020).

The Court of Chancery also recently sustained breach of the duty of loyalty claims in two separate merger litigations against CEOs in *Voigt v. Metcalf*[8] and *In re Coty Inc. Stockholder Litigation*,[9] noting in both cases that exculpation defenses did not apply.

Stockholder Plaintiffs Still Face Hurdles in Stating Claims Against Officers

Although officers are not afforded the same protections as directors under Section 102(b)(7), the Court of Chancery has stopped short of giving plaintiff stockholders a free pass. Rather, a number of cases made clear that to state a claim, they must adequately allege both a breach of the duty of care *and* that the individual against whom they seek to impose liability acted in his or her capacity as an officer and not a director. In three recent cases, the Court of Chancery dismissed claims against officers for failure to state a claim.

In *In re Essendant, Inc. Stockholder Litigation*,[10] the Court of Chancery dismissed breach of fiduciary duty claims raised in a class action merger litigation against a CEO arising from Essendant's merger with Staples. Because the CEO also was a director, the court explained that plaintiffs must "clearly draw the distinction between exculpated claims (due care claims relating to [the CEO/director's] conduct as Essendant Board member) and non-exculpated claims (those relating specifically to his role as CEO)." The court noted that the only officer-specific action that the CEO allegedly took was participating in a phone call with the buyer, which, "without more, [could not] support a reasonably conceivable inference of a breach of the duty of care or loyalty."

[8] C.A. No. 2018-0828-JTL (Del. Ch. Feb. 10, 2020).

[9] C.A. No. 2019-0336-AGB (Del. Ch. Aug. 17, 2020).

[10] C.A. No. 2018-0789-JRS (Del. Ch. Dec. 30, 2019).

Similarly, in *In re AmTrust Financial Services, Inc. Stockholder Litigation*,[11] the Court of Chancery dismissed claims against AmTrust's CEO brought in connection with plaintiff stockholders' challenge to a squeeze-out merger. The court explained that, while the complaint "repeatedly refer[red] to AmTrust management," it did "not contain allegations regarding specific actions taken or statements made by [the CEO] in his capacity as an officer." Further, whenever the complaint did mention the CEO by name, it did so "in his capacity as a director of AmTrust." Accordingly, the court dismissed claims against the CEO in his capacity as an officer (although it sustained claims against him in his capacity as a director and member of the control group).

Finally, in *Rudd v. Brown*,[12] the Court of Chancery dismissed a breach of fiduciary duty claim against a CFO in litigation arising from Apollo Global Management's acquisition of Outerwall. Plaintiffs alleged that the CFO was "conflicted by pursuit of post-close employment," but because the proxy issued in connection with the transaction disclosed that no discussion of post-closing employment had taken place, the court held that the plaintiffs failed to plead a duty of care or loyalty claim.

Books and Records Demands Target Officer Materials

Given the rise of officer breach of fiduciary duty claims in class action merger litigation, it is not surprising that there has been a corresponding uptick in stockholder plaintiffs using the "tools at hand" to obtain books and records demands under Section 220 of the DGCL to build their case against officers.[13]

[11] C.A. No. 2018-0396-AGB (Del. Ch. Feb. 26, 2020).

[12] C.A. No. 2019-0775-MTZ (Del. Ch. Sep. 11, 2020).

[13] In recent years, stockholders have increasingly turned to Section 220 to investigate potential wrongdoing in connection with merger transactions. *See Skadden Client Alert*, "Recent Trends in Books and Records Litigation" (Jan. 21, 2020).

Although these books and records demands are often resolved out of court, several were the subject of post-trial opinions. For example, in February 2020, the Court of Chancery ordered Empire Resorts to produce books and records so that a stockholder could, among other things, "test whether the Empire … management [was] motivated during the merger negotiations by the prospects of continued … employment."[14] In October, the Court of Chancery resolved another Section 220 demand where plaintiffs sought to "investigat[e] possible breaches of fiduciary duty by Grassroots officers and directors in connection with the Company's proposed acquisition," dismissing it on procedural grounds.[15]

Outside the deal context, Section 220 demands focusing on officer breach of fiduciary duty claims continue to proliferate. In *Gharrity v. Tesla, Inc.*, the court ordered Tesla to produce books and records so that a stockholder could investigate, among other things, whether "senior management" breached fiduciary duties in connection with an allegedly misleading Tweet from Tesla's controller, Elon Musk.[16]

In another recent ruling, *Lebanon County Employees' Retirement Fund and Teamsters Local 443 Health Services & Insurance Plan v. AmerisourceBergan Corp.*,[17] in the context of resolving a books and records demand seeking "senior management materials," the Court of Chancery expanded on officer liability, reiterating the longstanding principle that officers are "corporate fiduciaries" who "owe the same duties to the corporation and its stockholders as directors." The court further explained that officers also are "agents who report to the board of directors" and, as such, owe duties to provide information to the board necessary for the directors to carry out their duties, "comply with the board's directives" and "implement a compliance program, monitor its results, and report back to the board."[18]

These rulings, and the continued development in Section 220 law, have paved the way for plaintiffs to use books and records demands not only to bolster derivative claims, but to investigate potential claims against officers in deal litigation as well.

[14] *Brown v. Empire Resorts, Inc.*, C.A. No. 2019-0908-KSJM (Del. Ch. Feb. 20, 2020) (TRANSCRIPT); *The MH Haberkorn 2006 Trust, et al., v. Empire Resorts, Inc.*, C.A. No. 2019-0909-KSJM (Del. Ch. Feb. 20, 2020) (TRANSCRIPT); *Glasgow and Brown v. Empire Resorts, Inc.*, C.A. No. 2019-0910-KSJM (Del. Ch. Feb. 20, 2020) (TRANSCRIPT); *Hertz v. Empire Resorts, Inc.*, C.A. No. 2019-0918-KSJM (Del. Ch. Feb. 20, 2020) (TRANSCRIPT); and *Zaks v. Empire Resorts, Inc.*, C.A. No. 2019-0919-KSJM (Del. Ch. Feb. 20, 2020) (TRANSCRIPT).

[15] *MaD Investors GRMD, LLC and MaD Investors GRPA, LLC v. GR Companies, Inc.*, C.A. No. 2020-0589-MTZ (Del. Ch. Oct. 28, 2020).

[16] *Gharrity v. Tesla, Inc.*, C.A. No. 2019-0217-JRS (Del. Ch. Mar. 12, 2020) (TRANSCRIPT).

[17] C.A. No. 2019-0527-JTL (Del. Ch. Jan. 13, 2020), *aff'd*, No. 60,2020 (Del. Dec. 10, 2020).

[18] The *AmerisourceBergen* decision comes on the heels of a recent resurgence in so-called "*Caremark*," or "failure to monitor," claims. While such claims are notoriously difficult to plead and prove, *AmerisourceBergen* seemingly opens the door for plaintiffs to bring books and records demands to investigate claims against officers for failing, as agents of the board, to properly carry out oversight procedures.

Takeaways

- Recent Delaware decisions reaffirm that disinterested and independent directors who conduct themselves in good faith should not face liability for breach of fiduciary duty claims. In particular, where the corporation's certificate of incorporation includes an exculpation provision pursuant to Section 102(b)(7) of the DGCL, directors do not face liability for money damages for breaches of the duty of care, leaving only claims for breach of the duty of loyalty, which are more difficult to prove.
- On the other hand, officers of Delaware companies should be aware of the potential for claims against them for breach of the fiduciary duty of care, even where director liability is exculpated. Like directors, corporate officers owe fiduciary duties to the corporation and its stockholders, but unlike directors, they do not have the benefit of Section 102(b)(7) exculpation for breaches of the duty of care. As a result, even in circumstances where claims are dismissed against directors, officers who play a role in a challenged transaction — for example, by preparing disclosure documents — may face liability if they perform their duties in a grossly negligent manner, the standard necessary to establish a breach of the duty of care.
- It is important to understand that officer liability is not limited to derivative litigation. In the class action merger litigation context, it is imperative for officers tasked with merger-related projects, such as drafting or reviewing stockholder disclosures, to take reasonable steps to inform themselves (and board members) of material information. This is particularly true for officers who sign the proxies or other disclosure documents that are sent to stockholders in connection with the transaction.
- Boards of directors, as well as key officers, should consider (with their outside counsel) whether adequate procedures are in place for reporting merger-related conflicts to the board and ensuring that any such material conflicts are adequately disclosed to stockholders. Regardless of the specific approach a company takes, the critical insight from the recent case law is that some reasonable steps must be taken by officers to ensure disclosure of material information.
- In addition, because officer liability is increasingly the subject of merger challenges, Delaware companies should be prepared to respond to books and records requests aimed at building a challenge to the deal focused not only on the conduct of directors but of officers as well.

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