THE REVIEW OF
SECURITIES & COMMODITIES REGULATION
AN ANALYSIS OF CURRENT LAWS AND REGULATIONS AFFECTING THE SECURITIES AND FUTURES INDUSTRIES

Vol. 54 No. 12 June 16, 2021

THE DUTY OF DISCLOSURE FOR CORPORATE OFFICERS: AVOIDING LIABILITY IN THE FACE OF GROWING LITIGATION TREND

In this article the authors outline the fiduciary duties of officers and directors under Delaware law and the limits of their protections from liability. They then turn to recent Delaware cases involving allegations against officers in M & A transactions for breach of the duty of disclosure. They close with practical guidance for officers in such transactions to mitigate the risk of liability.

By Tyler J. Leavengood, Jaclyn C. Levy, and Justin T. Hymes *

In 2009, the Delaware Supreme Court eliminated any doubt as to whether officers of a Delaware corporation owe fiduciary duties to the corporation and its stockholders, confirming in *Gantler v. Stephens* that directors and officers owe the same duties.[1] Yet, in the wake of the *Gantler* decision, there was not a sudden uptick in the number of decisions holding officers liable for breach of fiduciary duty. In the last two years, however, several decisions by Delaware courts have denied motions to dismiss claims against officers – acting solely in their officer-capacity – for breaches of the duty of care, and more specifically, for breaches of the duty of disclosure in connection with proxy statements relating to proposed transactions. Although the number of such decisions remains relatively small, they nevertheless serve as a warning to officers that their merger-related actions may be subjected to judicial review.

Delaware law requires that when a corporation's fiduciaries request stockholder approval of a transaction (such as a merger, asset sale, or charter amendment), an officer, like a director, is required to disclose fairly and fully all information that would be material to the stockholders' consideration of the proposed transaction. Understandably, corporate officers, who will often have less direct involvement with or control over the transaction process than will a board of directors, may be concerned about the potential for litigation alleging that stockholders were denied access to information that may later be deemed "material" information by a court. While recent cases provide useful lessons for officers about "what not to do" in exercising their disclosure duties, they also demonstrate that officers can minimize litigation risk through the adoption of certain procedures

[1] *Gantler v. Stephens*, 965 A.2d 695, 708 (Del. 2009) ("In the past, we have implied that officers of Delaware corporations, like directors, owe fiduciary duties of care and loyalty, and that the fiduciary duties of officers are the same as those of directors. We now explicitly so hold.").

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and practices. This article highlights recent officer liability cases in Delaware involving the duty of disclosure and sets forth practical guidance for officers to follow to satisfy their fiduciary duty of disclosure in connection with requests for stockholder action.

FIDUCIARY DUTIES OWED BY DIRECTORS AND OFFICERS

In carrying out their responsibilities, directors and officers have a fiduciary duty to protect the interests of the corporation and act in the best interests of the corporation and its stockholders.[2] As noted above, an officer of a Delaware corporation owes the same fiduciary duties to the corporation and its stockholders as are owed by a director.[3] Delaware law has long recognized two principal fiduciary duties owed by officers and directors alike: the duty of loyalty and the duty of care.[4]

Duty of Loyalty and Duty of Care

The duty of loyalty requires an officer or director to place the interests of the corporation and its stockholders above any personal interest when making decisions that affect the corporation. "Corporate officers and directors are not permitted to use their position of trust and confidence to further their private interests . . . [A]n undivided and unselfish loyalty to the corporation demands that there shall be no conflict between duty and self-interest."[5] Included in the duty of loyalty is a requirement that officers and directors act in good faith, motivated by "a true faithfulness and devotion to the interests of the corporation and its shareholders."[6] Directors and officers must act honestly and in a manner not knowingly unlawful or contrary to public policy. A director or officer who "intentionally acts with a purpose other than that of advancing the best interests of the corporation" may be found to have acted in bad faith; however, another hallmark of bad faith involves a director or officer acting with deliberate indifference or failing to act in the face of a known duty.[7]

The duty of care requires corporate fiduciaries to act in a fully informed manner.[8] Officers and directors are required to fully inform themselves of all material information reasonably available to them before making a decision on behalf of the corporation.[9] They are expected to exercise the degree of care and prudence that would be expected of them in the management of their own affairs. In addition, having become so informed, directors and officers must then act with care in the discharge of their duties.[10] In determining whether an officer or director failed to make a sufficiently informed decision and violated the duty of care, Delaware courts apply a "gross negligence" standard, analyzing whether the officer or director acted outside "the bounds of reason" or with "reckless indifference to or a deliberate disregard of the stockholders . . . or actions which are without the bounds of reason."[11]

The Duty of Disclosure

Under Delaware law, the "duty of disclosure is not an independent duty, but derives from the duties of care and

[2] *Arnold v. Soc'y for Sav. Bancorp, Inc.*, 678 A.2d 533, 539 (Del. 1996) ("Fiduciary duties are owed by the directors and officers to the corporation and its stockholders.").

[3] *Gantler*, 965 A.2d at 708.

[4] *Malone v. Brincat*, 722 A.2d 5, 10 (Del. 1998).

[5] *Guth v. Loft, Inc.*, 5 A.2d 503, 510 (Del. 1939).

[6] *In re Walt Disney Co. Deriv. Litig.*, 907 A.2d 693, 755-72 (Del. Ch. 2005); *Stone v. Ritter*, 911 A.2d 362, 370 (Del. 2006).

[7] *In re Walt Disney Co. Deriv. Litig.*, 906 A.2d 27, 64 (Del. 2006).

[8] *Smith v. Van Gorkom*, 488 A.2d 858, 890 (Del. 1985).

[9] *Brehm v. Eisner*, 46 A.2d 244, 259 (Del. 2000) ("The duty of care requires that in making business decisions, directors [and officers] must consider all material information reasonably available . . . ."). This does not mean, however, that directors and officers must be informed of *every* fact, but rather need only seek out and learn "*material* facts that are *reasonably available*." *Id.* (emphasis added).

[10] *See, e.g.*, *Cede & Co. v. Technicolor, Inc.,* 634 A.2d 345, 367 (Del. 1994).

[11] *Rabkin v. Philip A. Hunt Chem. Corp.*, 547 A.2d 963, 970 (Del. Ch. 1986) (internal quotations omitted).

loyalty."[12] While the scope and requirements defining the duty of disclosure depend on the context in which the duty arises, the Delaware Court of Chancery has identified recurring scenarios in which the duty is often invoked and scrutinized.[13] In recent cases, the most prominent of those scenarios in which the duty of disclosure is at the forefront is a request for stockholder approval of a corporate transaction.[14] In seeking stockholder approval of a transaction like a merger, directors and officers have a duty to disclose all information that would be material to the stockholders' consideration of the contemplated transaction.[15] "Corporate fiduciaries can breach their duty of disclosure under Delaware law . . . by making a materially false statement, by omitting a material fact, or by making a partial disclosure that is materially misleading.[16]

Of particular importance for officers is how the Court defines "material" in the context of disclosure duties. In cases involving an alleged breach of the duty of disclosure (which is often subsumed in an analysis of the duty of care), the plaintiff bears the burden of demonstrating "a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available."[17] The Court has clarified the "materiality" standard and what it means for an omitted fact to alter the total mix of information:

> An omitted fact is material if there is a substantial likelihood that a reasonable shareholder would consider it important in deciding how to vote . . . . It does not require proof of a substantial likelihood that disclosure of the omitted fact would have caused a reasonable investor to change his vote. What the standard does contemplate is a showing of a substantial likelihood that, under all the circumstances, the omitted fact would have assumed actual significance in the deliberations of the reasonable shareholder.[18]

The duty to disclose material facts "attaches to proxy statements and any other disclosures in contemplation of stockholder action."[19] Proxy materials ensure that officers and directors do not use their "special knowledge" to their own advantage, to the detriment of the voting stockholders.[20] Delaware law therefore emphasizes the importance of full disclosure in proxy statements because large public companies must solicit proxies when seeking a stockholder vote and because proxy voters generally do not attend stockholder meetings.[21] A plaintiff bringing a claim against an officer for material proxy omissions need not prove "actual reliance on the disclosure, but simply that there was a material misdisclosure," further emphasizing the importance of full disclosure in these filings.[22]

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[12] *Pfeffer v. Redstone,* 965 A.2d 676, 684 (Del. 2009) (internal quotation marks omitted).

[13] *See, e.g.*, *In re Wayport, Inc. Litig.*, 76 A.3d 296, 314 (Del. Ch. 2013).

[14] *In re Wayport*, 76 A.3d at 314. The Court identified three other scenarios where the duty of disclosure typically arises: stockholder ratification, in which approval is sought for a transaction that does not involve a vote; a scenario where a director or officer makes public statements about the affairs of the corporation; and a scenario where a fiduciary buys or sells shares directly to or from an existing outside stockholder. *Id.* While this article focuses on proxy statements and associated disclosures in connection with requests for stockholder action, the lessons gained from the cases discussed herein are applicable to all of these common scenarios, as the officer is required to disclose "material" information in all such instances.

[15] *In re Columbia Pipeline Group, Inc. Merger Litigation*, 2021 WL 772562, at *56 (Del. Ch. Mar. 1, 2021).

[16] *O'Reilly v. Transworld Healthcare, Inc.,* 745 A.2d 902, 916 (Del.Ch.1999).

[17] *Arnold,* 650 A.2d at 1277 (*citing Stroud v. Grace*, 606 A.2d 75, 84 (Del. 1992)).

[18] *Id.* (citations and emphasis omitted).

[19] *Id.* at 1277 (*citing* Stroud, 606 A.2d at 85).

[20] *Weinberger v. UOP, Inc.*, 457 A.2d 701, 703 (Del. 1983).

[21] *Stroud*, 606 A.2d at 87.

[22] *Metro Commc'n Corp. BVI v. Adv. Mobilecomm Techs. Inc.*, 854 A.2d 121, 156 (Del. Ch. 2004). A plaintiff bringing a claim for breach of the duty of disclosure usually seeks injunctive relief or damages. "When seeking injunctive relief for a breach of the duty of disclosure in connection with a request for stockholder action, a plaintiff need only show a material misstatement or omission. However, when seeking post-closing damages for a breach of the duty of disclosure, a plaintiff must demonstrate quantifiable damages that are "logically and reasonably related to the harm or injury for which compensation is being awarded." *In re J.P. Morgan Chase & Co. S'holder Litig.*, 906 A.2d 766, 773 (Del. 2006). Moreover, when seeking damages for breach of the duty to disclose, a plaintiff "must establish that the fiduciary acted with a culpable state of mind or engaged in non-exculpated gross negligence." *In re Columbia Pipeline*, 2021 WL 772562, at

Exculpation

Delaware corporations can include in their certificate of incorporation an exculpation provision that eliminates or limits the personal liability of a director to the corporation or its stockholders for monetary damages for any breach of the duty of care.[23] Such a provision, however, does not eliminate or limit liability of a director for breach of the duty of loyalty.[24] Thus, even "actions taken that are even grossly negligent, so long as not falling within one of the exceptions contained in 102(b)(7), will be shielded by a § 102 (b)(7) provision."[25]

Unlike directors, however, officers cannot be exculpated from money damages stemming from the breach of the duty of care, as Section 102(b)(7) does not apply to corporate officers. With no ability to exculpate officers for either duty of care or duty of loyalty claims, it follows that corporations are similarly prevented from exculpating officers for breaches of the duty of disclosure (as discussed further below) when the officer is acting solely in an officer-capacity.[26]

Section 141(e): A Protection for Directors Unavailable to Officers

Delaware statutory law vests the responsibility of managing the business and affairs of a Delaware corporation in the board of directors.[27] Recognizing that directors need to be provided deference and a certain level of protectionary discretion in carrying out their management duties, Delaware statutory law provides a protection to directors.[28] In addition to allowing corporations to exculpate directors for breach of the duty of care, Delaware law, under Section 141(e), provides that, in discharging their duty of care, directors may rely on the advice of corporate officers and expert advisors as long as they chose the officers and experts with care.[29] Directors must assess, however, whether an expert or advisor has potential conflicts of interest and should also assess whether any such potential conflicts could negatively affect the reliability of the advice in question.[30] At least statutorily, the protection of Section 141(e) is not extended to officers. Therefore, officers must exercise an added degree of care in relying on advisors in discharging their duty of care.

BENEFITS OF A FULLY INFORMED STOCKHOLDER VOTE

Under Delaware law, directors and officers are entitled to a "presumption that in making a business decision [they] 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."[31] This presumption is known as the "business judgment rule," and it exists to protect and promote the full and free exercise of powers granted to directors and officers of a Delaware corporation.[32] However, the presumption that directors and officers acted loyally can be rebutted by establishing that the officers or directors were either interested in the outcome of the transaction or otherwise lacked the independence to consider whether the transaction was in the best interest of the company and all of its shareholders.[33] If a challenger to a corporate transaction successfully meets its burden and rebuts the presumption, officers and directors lose the protection of the business judgment rule, and the burden of proof is shifted to the directors and officers, the proponents of the challenged transaction, to prove the entire fairness of the transaction to the corporation and its stockholders.[34]

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footnote continued from previous page…

*57 (citing *Wayport*, 76 A.3d at 315) (internal quotation marks omitted).

[23] 8 *Del. C.* § 102(b)(7).

[24] Section 102(b)(7) also does not permit exculpation for acts or omissions not in good faith, or which involve intentional misconduct or a knowing violation of law, claims under Section 174 of Delaware's General Corporation Law for unlawful payment of dividends or unlawful stock purchases or redemptions, or any transaction from which the director derived an improper personal benefit.

[25] *Official Comm. of Unsecured Creditors of Integrated Health Servs., Inc. v. Elkins*, 2004 WL 1949290, at *9, n.37 (Del. Ch. Aug. 24, 2004).

[26] *Morrison v. Berry*, 2019 WL 7369431, at *22 (Del. Ch. Dec. 31, 2019); *Arnold*, 650 A.2d at 1288 ("[O]nly those actions taken solely in the [direct-officer] defendant's capacity as an officer are outside the purview of Section 102(b)(7).").

[27] 8 *Del. C.* § 141(a) ("The business and affairs of every [Delaware] corporation . . . shall be managed by or under the direction of a board of directors").

[28] 8 *Del. C.* § 141(e).

[29] *Id.*; *Smith*, 488 A.2d 858 at 880.

[30] *Smith*, 488 A.2d at 880.

[31] *Unitrin, Inc. v. American General Corp.*, 651 A.2d 1361, 1373 (Del. 1993).

[32] *Smith*, 488 A.2d at 872.

[33] *Orman v. Cullman*, 794 A.2d 5, 22 (Del. Ch. 2002).

[34] *See Cede & Co. v. Technicolor, Inc.*, 634 A.2d at 360-61.

Importantly, though, under the *Corwin* doctrine, the protection of the business judgment rule will still be provided to officers and directors, even if they are shown to lack independence or be interested in the transaction, if the transaction "was approved by a majority of the shares held by disinterested stockholders of [the company] in a vote that was fully informed."[35] Thus, the duty of disclosure assumes particular importance in the context of significant corporate transactions that require a stockholder vote for their approval or adoption, as "*Corwin* cleansing" can only occur if the stockholder vote was fully informed and not coerced.[36] Indeed, "[t]o defeat *Corwin* cleansing, a plaintiff must plead the existence of a disclosure violation.[37] And, as discussed, a Delaware court considers a vote "fully informed" when the corporation's disclosures "apprised stockholders of all material information and did not materially mislead them."[38]

RECENT DELAWARE CASES INVOLVING ALLEGATIONS AGAINST OFFICERS FOR BREACH OF THE DUTY OF DISCLOSURE

Morrison v. Berry

In this decision, the Court of Chancery denied a former CEO and former General Counsel's motion to dismiss claims against them for breaches of the duty of care stemming from their alleged failure to disclose material facts in the corporation's Schedule 14D-9 and proxy statement that the officers prepared in connection with a going private deal with a private equity firm, Apollo.[39]

In connection with a potential go-private sale of Fresh Market, Fresh Market filed with the SEC a Form 14D-9 and related proxy statement. Plaintiff alleged that the filed Form 14D-9 and proxy failed to include a laundry list of material facts concerning the founder and director of Fresh Market, Ray Berry, and his dealings with Apollo, including: (1) his side-agreements with the buyer to roll over his equity in the event of a Apollo acquisition, (2) Berry's numerous secret communications with the buyer, (3) Berry's communication stating he would sell his shares if Fresh Market remained public, (4) information about intense stockholder pressure to sell, (5) Berry's statements indicating a strong preference to consummate the sale with the buyer, and (6) the truthful assertion that the disclosed financial scenarios were prepared by J.P. Morgan and not Fresh Market's management. Plaintiff further alleged that Fresh Market's General Counsel was aware of these omissions, and that he knowingly omitted this information from the Form 14D-9 because he had an interest in the transaction. Importantly for this analysis, plaintiff alleged that the General Counsel acted with gross negligence, invoking the duty of care, by preparing and certifying the Form 14D-9 and proxy statement in a misleading way and by omitting from the filings facts the General Counsel knew stockholders would want to know about the sale. Plaintiff similarly alleged that Fresh Market's CEO (who was also a director) breached the duty of care in his officer-capacity by helping draft and disseminate the 14D-9, which contained information that the CEO knew was misleading or inadequate.

[35] *Corwin v. KKR Fin. Holdings LLC*, 125 A.3d 304, 312 (Del. 2015) (explaining doctrine that fully informed, non-coerced stockholder approval renders the business judgment rule the applicable standard).

[36] *Id.* A "fully informed" stockholder vote may also entitle directors to the protections of the business judgment rule even if the transaction is a sale, change of control, or defensive measure that would otherwise be subject to enhanced judicial scrutiny. *Id.* Moreover, in the landmark "*MFW*" case, the Delaware Supreme Court held that business judgment review also applied to a merger proposed by a controlling stockholder if conditioned before the start of negotiations on "both the approval of an independent, adequately empowered Special Committee that fulfills its duty of care; and the uncoerced, *informed* vote of a majority of the minority stockholders." *Kahn v. M & F Worldwide Corp.*, 88 A.3d 635 (Del. 2014) (emphasis added). Four years later, in *Flood v. Synutra International, Inc.*, the Court explained how to invoke the *MFW* protections in a controller transaction — *i.e.*, a transaction between, on the one hand, the company and, on the other hand, either (1) a stockholder who controls a majority of the company's voting power or exercises a combination of potent voting power and management control such that the stockholder could be deemed to have effective control of the board without actually owning a majority of stock or (2) a third party where the controlling stockholder has an interest in the transaction that differs from the non-controlling stockholders. To invoke *MFW* protections, the controller is required to "self-disable before the start of substantive economic negotiations," and the board's special committee and controller must also "bargain under the pressures exerted on both of them by these protections." *Flood v. Synutra Int'l, Inc.*, 195 A.3d 754 (Del. 2018). Importantly for purposes of this analysis, *MFW* protections are granted only if the minority stockholder vote was "fully informed." *Kahn v. M & F Worldwide Corp.*, 88 A.3d at 644. Thus, the duty of disclosure also takes on critical importance in the context of controller transactions analyzed under the *MFW* framework.

[37] *In re Columbia Pipeline*, 2021 WL 772562, at *11.

[38] *Morrison v. Berry*, 191 A.3d 268, 282 (Del. 2018).

[39] *Morrison*, 2019 WL 7369431, at *3.

The Court held that it was not reasonably conceivable that the General Counsel breached the duty of loyalty, but that it was reasonably conceivable that the General Counsel acted with gross negligence, in breach of his duty of care, in preparing a 14D-9 and proxy that omitted material facts that the General Counsel knew concerning the sale process and at least some of the undisclosed information concerning Berry (in addition to the fact that J.P. Morgan prepared the financial scenarios). These omissions, according to the Court, "offer[ed] stockholders a version of events that . . . left them lacking information material to a decision." Ultimately, rather than parsing through what the General Counsel did or did not know, the Court simplified its reasoning, stating:

> (1) the 14D-9 disclosures were materially inadequate; (2) Duggan [the General Counsel] drafted those disclosures; (3) I can infer that Duggan possessed sufficient facts to know they were materially inadequate; (4) I can infer, then, that Duggan knew he was creating a misleading proxy, and was at least indifferent to his contrary duty to stockholders; and thus (5) the inadequate proxy was the result of Duggan's gross negligence.[40]

The Court did recognize, however, that the General Counsel relied on false statements made to him by Berry, and could not be faulted for this, which is partially why the breach of the duty of loyalty claim against the General Counsel was dismissed. Nonetheless, the duty of care claim tied to disclosure duties survived because of the General Counsel's knowledge of material omitted information.

The Court similarly rejected the breach of loyalty claims against the CEO, but it sustained the claims for breach of duty of care against the CEO stemming from the disclosure deficiencies in the 14D-9. For the Court, it was enough that the CEO "participated" in his capacity as an officer in drafting parts of the filings, as the Court found it was reasonably conceivable that the CEO crafted a false narrative to stockholders with knowledge of its inadequacy, given the CEO's knowledge of at least some of the undisclosed facts concerning Berry.

During the discovery phase, the remaining parties entered into a stipulated settlement agreement, which, if approved by the Court, would dismiss all claims against the defendants in exchange for a class settlement payment in the amount of $27.5 million. A settlement hearing has been scheduled for July 7, 2021.

[40] *Id.* at *25.

In re Baker Hughes Inc. Merger Litigation

In this decision, the Court of Chancery did not dismiss a limited claim against the CEO of Baker Hughes for breach of the duty of disclosure because it was reasonably conceivable the CEO failed to disclose material information in a proxy statement in connection with Baker Hughes' merger with the oil and gas segment of General Electric.[41]

Stockholders of Baker Hughes brought claims for breach of fiduciary duty against the CFO and CEO of Baker Hughes alleging that they omitted from the proxy statement – which the CEO signed – GE's actual unaudited financial statements that Baker Hughes relied on in agreeing to the merger. According to plaintiffs, the differences between these unaudited statements and the audited statements disclosed were material because the deal included protections giving Baker Hughes the right to terminate if there were major differences, subject to certain carveouts, between those preliminary statements and the audited financials it eventually received. Plaintiffs further alleged the proxy was deficient because the reasons for the divergences between the two sets of financial statements were not disclosed, and because the disclosures concerning the termination provision were misleading.

The officer defendants, in turn, argued that the omitted unaudited financial statements were not material because they were publicly available in GE's SEC filings and because the unaudited financial statements were rendered obsolete by the disclosed audited financial statements. They also argued that the disclosure of the termination provision was not misleading.

While dismissing all other claims against all other defendants in the case (including the board of directors), the Court did not dismiss the limited claim against the CEO concerning the failure to disclose the unaudited financial statements in the proxy statement. On the facts alleged, the Court explained that the unaudited financial statements would have been material because their disclosure would allow stockholders to observe the differences between the sets of financial statements to assess what the Board found to be immaterial when

[41] *In re Baker Hughes Inc. Merger Litig.*, 2020 WL 6281427, at *16 (Del. Ch. Oct. 27, 2020).

determining that the termination right in the Merger Agreement was not available. The Court further explained that the materiality of the unaudited statements could be reasonably inferred "from the fact that the Merger Agreement expressly provided that they would be attached to the Merger Agreement, ostensibly so that the Unaudited Financials would be included in the Proxy." The Court disagreed with defendants' argument that the unaudited statements were immaterial because certain unaudited metrics for GE were disclosed in other public filings, explaining that Delaware law "does not impose a duty on stockholders to rummage through a company's prior public filings" to obtain relevant, material facts.

The Court ultimately concluded that plaintiffs sufficiently alleged that the failure to include the unaudited financials in the proxy was a material omission, which prevented the stockholder vote approving the deal from invoking business judgment rule review. The Court thus allowed the claim against the CEO for breach of the duty of care to go forward, noting that the allegation that the CEO signed the proxy, "although not overwhelming, . . . is sufficient to support a reasonably conceivable claim that [the CEO] breached his duty of care with respect to the preparation of the Proxy he signed as Baker Hughes' CEO."[42]

Since the Court's denial of the motion to dismiss, the parties have engaged in discovery.

In re Columbia Pipeline Group, Inc. Merger Litigation

In this decision, the Court of Chancery denied a motion to dismiss claims against the CEO and CFO of Columbia Pipeline for breaches of the duty of disclosure in connection with a sale of the company because it was reasonably conceivable that both officers, likely motivated by their interests in the transaction, omitted material information from the proxy statement and otherwise presented a misleading narrative about the sale to stockholders through the proxy statement.[43]

The action arose out of a proposed sale of Columbia Pipeline to TransCanada. Plaintiff stockholders alleged that, prior to the sale, Columbia's CEO, Skaggs, and CFO/VP, Smith, both had compensation packages providing lucrative change-in-control arrangements. According to the plaintiffs, both Skaggs and Smith planned to retire immediately following the merger and viewed the change-in-control payments as a retirement nest egg. Plaintiffs alleged that, once TransCanada emerged as a committed cash bidder, Skaggs and Smith tilted the playing field in favor of TransCanada because of their desire to do a cash deal. After receiving bids, TransCanada contacted Smith in violation of its standstill provision and, without telling the board, Smith told Skaggs and the company's financial advisor and scheduled a meeting with TransCanada. Smith allegedly sent confidential company information to TransCanada without board approval and, allegedly gave TransCanada talking points intended for Smith's use only, prepared by a financial advisor, detailing how TransCanada could convince the board to agree to a deal. According to plaintiffs, Smith, without board approval, also told TransCanada they were unlikely to face competition. Skaggs allegedly downplayed the interest of other bidders, and presented misinformation and material omissions to the board while it considered TransCanada's bid. Plaintiffs alleged that Skaggs and Smith repeatedly ignored and delayed following board instructions to inform other bidders that the board was waiving the standstills.

Importantly, plaintiffs also alleged that the officers breached their duty of disclosure by assisting in the preparation and submission of a misleading proxy statement that omitted material facts about the sale process and the officers' interest in the deal. In making their disclosure arguments, plaintiffs relied on, and the Court adopted, a ruling from a prior appraisal case, where the Court found that "the Proxy contained material misstatements and omissions."[44] For example, in the appraisal action, the Court found that the proxy failed to disclose that Columbia entered into NDAs containing standstill provisions with "don't ask don't waive" provisions and that TransCanada was permitted to breach its standstill agreement. The Court explained that the failure to disclose the standstill provisions was material, and that a reasonable stockholder would have found it significant that TransCanada and other bidders were bound by standstill agreements, which TransCanada was permitted to breach to pursue the merger.

Other disclosure violations included that Skaggs and Smith did not disclose their near-term retirement plans or Smith's initial meetings with TransCanada inviting the company to make a bid. After finding these omissions material, the Court then determined that Skaggs and Smith withheld the information knowingly, as the omitted information related to their own actions,

[42] *Id.*

[43] *In re Columbia Pipeline*, 2021 WL 772562, at *56-58.

[44] *In re Appraisal of Columbia Pipeline Grp., Inc.*, 2019 WL 3778370, at *36 (Del. Ch. Aug. 12, 2019).

and that it was "reasonably conceivable that their interest in early retirement and the benefits conferred by the Merger tainted their decisions about what to disclose, supporting a reasonable inference that their failure to disclose information resulted from a breach of the duty of loyalty."[45] Finally, the Court found that plaintiffs adequately pled damages, as plaintiffs sought rescissory damages, "which can be awarded for fraud or for a disloyal breach of the duty of disclosure."[46]

Because plaintiffs alleged material disclosure violations, the Court held that the transaction was not entitled to *Corwin* cleansing. The Court also held that it was reasonably conceivable that the sale process failed enhanced scrutiny under *Revlon* because Skaggs and Smith favored doing a deal with TransCanada for personal reasons.[47]

Following the Court of Chancery's ruling on the motion to dismiss, the CEO and CFO sought to have the Delaware Supreme Court review the ruling on interlocutory appeal. As of this writing, the request for an interlocutory appeal remains pending.

MITIGATING THE RISK OF LIABILITY: PRACTICAL GUIDANCE FOR OFFICERS

Perhaps the most obvious takeaway from these recent duty of disclosure cases is that a corporate officer cannot escape liability simply because they were not involved in the allegedly wrongful or disloyal conduct that, according to the plaintiff, tainted the challenged transaction. As a fiduciary, an officer may be subject to liability if he or she has knowledge of the material information and acts in a grossly negligent manner with respect to any affirmative misstatements or omissions of material information in the proxy statement. By signing or even helping prepare a proxy statement, an officer exposes himself or herself to potential liability.

Thus, an officer should adopt a "the-buck-stops-here" mentality in preparing a proxy statement. However, to do so, the officer must become adequately informed of all material aspects of the sale or transaction process. The officer should implement procedures before the process commences, aimed at facilitating open disclosure of potential material information by all those involved, including information concerning potential self-interested aspects of the transaction and any perceived missteps taken in conducting a sales process. Furthermore, in preparing the proxy statement (or certifying it), the officer must check that certain common material information is disclosed, such as updated relevant financial information and key terms of the transaction.

Establish Open Communication with the Board and Actively Participate in the Sale Process

- When the board first begins contemplating a potential transaction, an officer should inform the board and its advisors of any conflict of interest, perceived or actual, that the officer may have in connection with the potential transaction. Directors and fellow officers should be reminded of their reporting obligations and the company's policies for reporting material information, particularly with respect to potential conflicts that may arise as transaction negotiations progress.

- As demonstrated by several of the recent decisions discussed above, cases involving allegations against an officer for breach of the duty of disclosure often also involve some underlying conflict or potential breach of the duty of loyalty (often involving directors) that was not disclosed in the proxy statement. It is imperative that officers ensure that an adequate procedure is in place for reporting such conflicts.

- At the outset, procedures should be established for providing the officer with key information about all aspects of the possible transaction. When it comes to avoiding liability, ignorance is not bliss. The Court has made clear that mere participation in the transaction process may expose an officer to liability for breach of the duties of care and disclosure.[48] Therefore, if an officer is going to participate (even if that means simply signing the proxy statement), the officer is advised to participate fully, which means making a good-faith effort to gather material information.

Reliance on Disclosures and Statements by Directors and Fellow Officers May Undercut a Duty of Loyalty Claim, but Defendants Must Still Act with Due Care

- Officers should take comfort that their good-faith reliance on statements by directors and other officers

[45] *Id.* at *57.

[46] *Id.* at *58.

[47] *Corwin*, 125 A.3d at 309; *Revlon, Inc. v. MacAndrews & Forbes Hldgs., Inc.*, 506 A.2d 173, 179-82 (Del. 1986).

[48] *Morrison*, 2019 WL 7369431, at *25.

concerning, for example, conflicts or lack of independence, will serve as a helpful rebuttal to allegations that they violated their duty of loyalty or acted in bad faith.[49] Moreover, in assessing whether an officer should face liability for breach of the duty of disclosure, the court looks at what the officer actually knew. Thus, if the officer does not learn about a conflict or issue, despite good-faith efforts to gather material information, then the officer should not face liability for omitting that unknown fact.

- On the other hand, the officer cannot blindly rely on representations of directors and other officers because, in so doing, the officer could face liability for breach of the duty of care. The officer has a duty to stay informed, and the Court can impose liability on the officer for exhibiting gross negligence in not gathering pertinent information and then disclosing that inadequate, misleading statement in a proxy statement. Accordingly, officers should ask appropriate questions during the sale process and seek information from additional sources if the officer is not certain he or she has the full story.

Pay Attention to the Motivations of the Board and Officers in Pursuing Transactions, Including Your Own Motivations

- If an officer learns that another officer or a director is motivated to push through a transaction because of personal interests, or if the officer learns of related conflicts, this material information must be disclosed in the proxy.

- The *Columbia Pipeline* case underscores the need for officers to also be cognizant of their own motivations or interests in connection with a contemplated transaction.[50] If an officer finds himself or herself rooting for a transaction to be approved, the officer should take inventory of whether he or she has any personal motivation for seeing the transaction through, and importantly, whether that conflict or motivation caused the officer to omit information from the proxy or otherwise set forth a misleading narrative in the proxy statement.

Determine What Financial Information and Deal Provisions Constitute Material Information

- Certain information should be disclosed in proxy statements as a matter of course. For example, the proxy statement should disclose material financial information relied on during the sales process.[51] Proxy statements should also disclose material deal provisions like no-shop/go-shop provisions and standstill provisions.[52]

Actively Involve Counsel

- The question of whether information is “material” is very rarely a straightforward analysis and is necessarily dependent on the facts of each transaction. Officers are encouraged to involve counsel throughout the transaction process, and particularly when drafting or certifying the proxy statement.

Review D&O Policies and Indemnification Rights

- Considering the recent increase in complaints directed at officers, officers should review their D&O policies and ensure that they have broad indemnification and advancement rights, including coverage for alleged fraud. ■

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[49] *Id.* at *24-25.

[50] *In re Columbia Pipeline*, 2021 WL 772562, at *33-35 (sustaining breach of duty of disclosure claim when officer failed to disclose personal interest in doing cash deal, his retirement nest egg motivation, and his preference for doing the deal with the buyer).

[51] *In re Baker Hughes*, 2020 WL 6281427, at *16.

[52] *In re Columbia Pipeline*, 2021 WL 772562, at *34.