SENIOR CORPORATE OFFICERS AND THE DUTY OF CANDOR: DO THE CEO AND CFO HAVE A DUTY TO INFORM?

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We found no evidence that members of the Board of Directors, other than Ebbers [Chairman and CEO] and Sullivan [CFO], were aware of the improper accounting practices at the time they occurred. We have reviewed materials (including slide presentations) the Board received and have not found information that should reasonably have led it to detect the practices or to believe that further specific inquiry into the accounting practices at issue was necessary.¹

I. INTRODUCTION

In the wake of corporate debacles resulting from accounting and other forms of fraud by corporate officers, oversight failures by public company boards have received widespread criticism.² As a result, laws

¹ Dennis R. Beresford, Nicholas de B. Katzenbach & C.B. Rogers, Jr., Report of Investigation by the Special Investigative Committee of the Board of Directors of WorldCom, Inc. 29 (Mar. 31, 2003) (on file with author), available at http://fl1.findlaw.com/news.findlaw.com/hdocs/docs/worldcom/bdspcomm609003rpt.pdf [hereinafter WorldCom SIC Report]. The Special Investigative Committee (“SIC”) consisted of directors not on the board at the time of the financial fraud. Although their investigation was thorough, the report is arguably somewhat self-serving, notwithstanding the special committee’s independence. The First Interim Report of the Bankruptcy Court Examiner corroborates some of the SIC’s findings but also raises questions about the oversight duties of the board of WorldCom. See First Interim Report of Dick Thornburgh, Bankruptcy Court Examiner 6-8 (Nov. 4, 2002), available at http://fl1.findlaw.com/news.findlaw.com/hdocs/docs/worldcom/thornburgh11rpt.pdf.

and regulations have been enacted to strengthen the role of public company boards.\(^3\)

However, in many recent high profile public company scandals, it was not the board's failure to act on the information provided by senior officers, but the failure of senior officers to provide directors all relevant information that resulted in unsatisfactory corporate governance. Directors either were deliberately kept in the dark about certain details, provided only minimum levels of information, or senior officers remained silent, knowing directors believed false assumptions or inaccurate information.\(^4\)

Few Delaware cases directly address the duties and liabilities of senior corporate officers in their capacity as officers and not as directors or non-director officers.\(^5\) Instead, most cases and commentaries combine a discussion of director and officer obligations, generally concluding that their fiduciary duties are the same.\(^6\) However, this Article argues that accepting the fact that senior corporate officers and directors owe the same fiduciary duties fails to acknowledge the nature of the agency relationship that exists between officers and directors, and between officers and shareholders. Simply defining officers' fiduciary duties the same as directors does little to hold senior corporate officers accountable for failing to provide information to directors. Senior corporate officers of public companies, CEOs and CFOs, owe directors and the corporation a duty to inform in a way that is not owed by directors to shareholders.\(^7\)


\(^5\) The Chief Executive Officer in modern public corporations is typically the Chairman of the Board. It varies in public companies whether the Chief Financial Officer is a director.


\(^7\) The Chief Executive Officer ("CEO") and Chief Financial Officer ("CFO") are the focus of this Article because they are the two most senior officers within a public company. In addition, Delaware's personal jurisdiction statute covers senior officers and is defined to
Corporate crises and eventual bankruptcies of several public companies illustrate the catastrophic consequences that occur when senior corporate officers use their position of power, control, and influence to keep directors in the dark about corporate misdoings.\(^8\) Absent an underlying affirmative duty to disclose to directors, senior corporate officers will provide only minimal information to directors.\(^9\) And, disclosure of minimal information is not enough for directors to adequately interpret and digest complex corporate-wide transactions made by cross-corporate subsidiaries, to assess "red flags," or to evaluate the integrity of information, thereby enabling directors to meet their fiduciary and statutory obligations to shareholders.\(^10\)

This Article focuses on the duty to inform as a framework to assess liability of senior officers of public companies who withhold information from directors.\(^11\) The broadening of the definition of the duty to inform that senior officers owe directors to include an underlying affirmative duty to provide information, even when director or shareholder action is not requested, offers an opportunity for greater monitoring of corporate governance by focusing on those often most culpable.\(^12\) Currently, the plain language of Delaware's delegation of authority statute protects directors who reasonably rely in good faith on the reports of corporate officers.\(^13\) However, officers' reports must include more than minimum

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10. Enron SIC Report, supra note 4, at 157 (describing the complexity of subsidiary transaction making it difficult for the board to see the entire corporate risks). See Bala G. Dharan & William R. Bufkins, Enron Corporate Fiascos and Their Implications 97, 111, 113, 115 (2004).

11. A. Gilchrist Sparks III & Lawrence A. Hamermesh, Common Law Duties of Non-Director Corporate Officers, 48 BUS. LAW 215, 226-29 (1992). The focus is on the CEO and CFO as the senior most responsible corporate officers. CEOs are directly hired by boards.


disclosure requirements. An affirmative duty to inform means senior corporate officers may not remain silent when in possession of superior information unknown to directors and that they have an underlying obligation of disclosure to enable directors to properly meet their oversight obligations. Part II of this Article provides an overview of the Disney litigation. Specifically, this part examines an aspect of the Disney opinion where the court discusses whether senior officers and directors are comparable fiduciaries.

Part III of this Article explores the rationale that senior corporate officers and directors owe the same fiduciary duties. More specifically, this Part examines the duty to inform and its functional ability to impose agency cost controls to manage the position of power senior officers have over boards. The duty to inform serves as a separator of management duties and is an identifiable way to explain how senior officers’ roles as agents differ from directors and what that difference ought to mean for accountability to directors, the corporation, and, ultimately, the shareholders.

Part IV examines the duty of disclosure in Delaware. In particular, this Part examines the disclosure duties directors owe shareholders and the shift of the duty of candor to a duty of disclosure. Comparing the disclosure duties directors owe shareholders to the disclosure duties senior officers owe directors exposes gaps in fiduciary responsibility. This gap is a result of underdeveloped case law defining the fiduciary duties owed by corporate officers to directors. However, Part IV suggests that Delaware case law does speak to the different roles of senior officers and directors and may offer some support for finding an underlying duty to inform owed to directors.

Part V explores the fiduciary duties of senior officers as managers of the day-to-day affairs of the corporation and their superior position of control over directors. This Part calls for finding an underlying affirmative and separate duty to disclose for senior officers. Part V also

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14 See Malone v. Brincat, 722 A.2d 5, 9 (Del. 1998) (holding that directors who provide false information to shareholders violate fiduciary duties even in the absence of a request for action by shareholders).
15 See Sparks & Hamermesh, supra note 11, at 227-28 (discussing the meaning of the non-director officers’ duties to inform).
16 This Article is part of a broader research project to assess the ability of corporate governance theories to define the responsibilities and liabilities of senior corporate officers to the corporation and directors.
briefly examines agency theories of sub-agent and co-agent in three-way agency relationships.

Finally, in Part VI, this Article concludes that Delaware state fiduciary claims remain an important tool for shareholders to monitor corporate governance. Finding an underlying affirmative duty to disclose, judged from a standard of materiality, provides strict liability enforcement of such breaches. In a derivative suit, enjoining a board’s decision as voidable when senior officers fail to provide information causes a board not to satisfy its fiduciary or statutory obligations. In a direct claim, raising the standard of review allows enhanced scrutiny for materiality, rather than the business judgment rule for senior corporate officer liability.

Recently, Delaware’s personal jurisdiction statute has been amended to extend personal jurisdiction over corporate senior officers and executives.\(^\text{17}\) With this amendment, we are likely to see a more robust interpretation of Delaware fiduciary law as it applies to senior corporate officers.\(^\text{18}\) Further, Delaware’s exculpation statute, limiting the monetary liability for breach of certain fiduciary duties of directors, does not limit the monetary liability of officers.\(^\text{19}\) Consequently, there is a potential for monetary recovery against senior officers who fail to provide directors information needed to meet their statutory and fiduciary obligations.\(^\text{20}\)

\(^\text{17}\) DEL. CODE ANN. tit. 10, § 3114(b). The statute defines officer to mean the CEO, CFO, and the top five mostly highly compensated executives under SEC filings among others as being subject to personal jurisdiction in Delaware. Id.


\(^\text{19}\) DEL. CODE ANN. tit. 8, § 102(b)(7). The statute does not include limitation of liability protections to officers. Id. Of course, the legislature is free to amend the statute to limit the liability of officers. Id. See, e.g., MODEL BUS. CORP. ACT § 8.42(c) (1984). Several states include officers in their limitations of liability provisions. Id. See Arnold v. Soc’y for Sav. Bancorp, Inc., 650 A.2d 1270, 1288 (Del. 1994); Goodwin v. Live Entertainment, No. Civ.A. 15765, 1999 WL 64265 (Del. Ch. Jan. 25, 1999).

II. THE DISNEY LITIGATION: A QUESTION FROM THE COURT

Recently, the Delaware Chancery Court, in *In re The Walt Disney Company Derivative Litigation*,21 concluded that Michael Eisner, CEO and Chairman of Walt Disney Company ("Disney"), did not act in a grossly negligent manner when hiring and subsequently terminating its president.22 However, the court sharply criticized Eisner’s actions as a corporate executive as less than stellar.23 Eisner had negotiated with and hired Michael Ovitz, a personal friend, as president of Disney.24 Ovitz was later terminated and paid a substantial sum of money under the terms of a negotiated employment contract.25

The court determined that in his capacity as CEO, Eisner had failed to keep the board informed, stretched the outer boundaries of his authority, and had taken actions to pressure the board to approve his decisions.26 Notwithstanding, the court concluded that Eisner still had not breached any fiduciary duty and had acted in good faith in meeting his obligations as director to the Disney shareholders.27 Yet the court still called Eisner the most culpable of defendants because he was the one "pulling the strings" and was the most informed on the details of the employment contract.28 The court then noted that, because the parties treated both officers and directors as comparable fiduciaries, it was not necessary to address corporate officers’ liability.29

Why is it that Eisner, in his capacity as CEO, can be the one "pulling the strings" as a senior officer of Disney, and yet, as a director, still have met his fiduciary duties?30 As with the majority of public company boards, CEOs control almost all aspects of information provided to the board.31 Yet when the CEO dominates the board process by failing to

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21 *In re The Walt Disney Co. Derivative Litig.*, No. Civ.A. 15452, 2005 WL 2056651 (Del. Ch. Aug. 9, 2005). Eisner, CEO and Chairman of the board, was sued in his capacity as Chairman of the board.
22 *Id.* at *41.
25 *Id.*
26 *Id.* at *41. *See also* Brehm v. Eisner, 746 A.2d 244, 256 (Del. 2000) (explaining that failure to meet aspirational goals alone does not necessarily violate Delaware law).
28 *Id.* at *40. The court describes Eisner as "Machiavellian" and blamed Eisner for the failure in corporate governance at Disney. *Id.*
29 *Id.* at *50 & n.588.
30 *See Brehm*, 746 A.2d at 256.
31 *See Lorsche & McIver, supra* note 9, at 110-12.
provide adequate reports to directors, it is the board that is potentially responsible to shareholders for the oversight failure.\textsuperscript{32} The Delaware Chancery Court reflected on this dichotomy in board governance and asked whether officers and directors are comparable fiduciaries.\textsuperscript{33} If Eisner had been sued in his capacity as CEO, would he be liable for failing to fully inform the board? The Disney Litigation illustrates the difficulty of ferreting out senior officers' liability in non-loyalty situations. The aim of this Article is to suggest a theory of liability for senior corporate officers of public companies in the specific context of the duty to inform.\textsuperscript{34}

III. AGENCY PRINCIPLES AND CORPORATE MANAGEMENT

The position of the president is different. Practically he [is] the master of the situation.\textsuperscript{35}

A. Agency Theory

The corporate governance debate over the duties of management and the role of shareholders has often centered on who really owns the corporation.\textsuperscript{36} Although the principal-agent model is the predominant theory for defining the duties of directors to shareholders, it is limited in defining senior officers' duties to directors.\textsuperscript{37} A focus on agency principles as a foundation for understanding senior officers' duties to directors seems obvious and logical, but a deeper examination reveals that the different roles and nature of the agency relationship between officers and directors lacks clarity or is simply not defined.\textsuperscript{38} The dominating force of senior executives on corporate governance has led to a call for more discourse on understanding, defining, and assessing officers' corporate duties to directors and shareholders and the officers'


\textsuperscript{33} In re The Walt Disney Co., 2005 WL 2056651, at *50 & n.588

\textsuperscript{34} The focus of this Article is limited to senior corporate officer of public companies; the analysis for private closely held companies may be more compelling.

\textsuperscript{35} Bates v. Bates, 251 U.S. 524, 530 (1920).


\textsuperscript{38} Johnson & Millon, supra note 6, at 1601-02.
roles in corporate governance.\textsuperscript{39} The conversation begins with a simple and straightforward reminder that officers are agents of the corporation.\textsuperscript{40} However, an analysis of agency case law reveals that agency theory is primarily focused on the authority of senior officers to act on behalf of the corporation, and there is less analysis on the fiduciary duties of officers to directors.\textsuperscript{41}

Delaware’s delegation of authority statute is typical of most, as it authorizes the board to manage the business and affairs of the corporation and to delegate certain day-to-day management of corporate business to officers.\textsuperscript{42} It provides that directors’ roles are that of oversight to senior officers,\textsuperscript{43} and that directors cannot delegate their absolute responsibilities to officers of the corporation.\textsuperscript{44} What makes this corporate governance observation so palpable is that its simplicity escapes a more detailed analysis of the agency relationship that turns the question of “who runs the corporation” on its head.\textsuperscript{45} In reality, senior corporate executives manage and control a great deal in the hiring of board members and in deciding what information gets communicated to the board.\textsuperscript{46} However, current law does not appropriately address the effect of such a role reversal on agency principles in defining fiduciary duties.\textsuperscript{47}

\textsuperscript{39} Id. at 1605, 1623 (discussing the blurring of corporate law officer fiduciary duties with agency costs theory); Donald C. Langevoort, Agency Law Inside the Corporation: Problems of Candor and Knowledge, 71 U. CIN. L. REV. 1187, 1189 (2003) [hereinafter Langevoort, Agency Law Inside the Corporation].

\textsuperscript{40} Johnson & Millon, supra note 6, at 1617 (discussing the control of CEOs over corporate boards and its impact of agency theory and corporate governance); Langevoort, Agency Law Inside the Corporation, supra note 39, at 1187, 1193.

\textsuperscript{41} See Del.Code Ann. tit. 8, § 141 (2005) (providing references to cases exploring apparent authority and implied powers of corporate officers).

\textsuperscript{42} Id. § 141(a); Maldonado v. Flynn, 413 A.2d 1251, 1257 (Del. Ch. 1980), rev’d on other grounds, 430 A.2d 779 (Del. 1981). The rationale for concluding that officers and directors owe the same fiduciary duties to shareholders is that, as management, both know more about the day-to-day business affairs of the corporation than shareholders and both are agents of the corporations. Id. See also Model Bus. Corp. Act § 8.01 (1984); Grimes v. Donald, 673 A.2d 1207, 1211 (Del. 1996) (quoting Abercrombie v. Davies, 123 A.2d 893, 899 (Del. Ch. 1956)).

\textsuperscript{43} See generally Veasey & DiGuglielmo, supra note 18, at 1436-40 (providing an overview of the boards’ oversight roles).

\textsuperscript{44} See generally Lehman v. Cohen, 222 A.2d 800, 805 (Del. 1966); Adams v. Clearance Corp., 121 A.2d 302, 304 (Del. 1956).

\textsuperscript{45} See Lorsche & Mclver, supra note 9, at 110-13.

\textsuperscript{46} See Commission on Public Trust, supra note 2.

Fiduciary principles of agency theory are the predominant theory of corporate governance for defining the relationship between centralized management and shareholders.\textsuperscript{48} Broadly defined, the fiduciary duties of the agent to the principal are the duties of loyalty, obedience, care, and to provide information.\textsuperscript{49} The Restatement (Second) of Agency defines this last duty to give information, or the duty of candor, as an affirmative duty to use reasonable efforts to provide the principal relevant information.\textsuperscript{50} This duty not only arises when the agent must communicate with the principal,\textsuperscript{51} but also binds the agent to provide material information to the principal relevant to the scope of the relationship.\textsuperscript{52} As a result, the Restatement balances the self-interest of the agent and the information needs of the principal by holding the agent to a negligence standard of liability.\textsuperscript{53} Absent a conflict of interest, the duty to inform remains an underlying duty judged in the context of what the principal deems relevant.\textsuperscript{54}

Cases relying on agency theories to hold officers liable primarily relate to the authority of officers vis-à-vis third parties.\textsuperscript{55} Most cases and commentaries conclude that officers are agents of the corporation with

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\textsuperscript{49} See RESTATMENT (SECOND) OF AGENCY §§ 379-87 (1958) (duty of agent to principal as the duty of care and skill, duty of good conduct and the duty to give information, duty to keep and render accounts, duty to act as authorized, duty not to act impractically, duty to obey, and duty of loyalty). See also Sci. Accessories Corp. v. Summagraphics Corp., 425 A.2d 957, 962 (Del. 1980) (defining basic duties of agent to principal).
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\textsuperscript{50} RESTATMENT (SECOND) OF AGENCY § 381. See generally Lawrence A. Hamermesh, Calling Off the Lynch Mob: The Corporate Director's Fiduciary Disclosure Duty, 49 Vand. L. Rev. 1087, 1105 (1996) [hereinafter Hamermesh, Calling off the Lynch Mob] (discussing history of director duty to disclose to shareholders).
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\textsuperscript{51} RESTATMENT (SECOND) OF AGENCY § 381.
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\textsuperscript{52} Id.
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\textsuperscript{55} See generally DEL. CODE ANN. tit. 8, § 142(b) (2005) (containing cross references of cases on authority of officers). The rationale for concluding that officers and directors owe the same fiduciary duties to shareholders is that, as management, both know more about the day-to-day business affairs of the corporation than shareholders and both are agents of the corporations. Id.
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little definition as to the nature of the agency relationship. Over time, corporate governance began to view the rules of governance, fiduciary principles, and standards of liability for directors and officers as the same—management as a single agent of shareholders. Courts are mostly comfortable with the conclusion that officers and directors are management of the corporation and owe the same fiduciary duties of care, loyalty, and good faith. However, treating senior officers and directors the same also means that standards of liability and review, and the business judgment rule apply equally to officers’ and directors’ decisions. Yet officers’ agency relationships to directors and shareholders are rarely directly addressed.

Fiduciary principles applicable to directors have developed with two basic understandings—the need for directors to exercise reasonable business judgment and the limitations inherent in the directors’ abilities to really know the details of corporate business. In particular, when senior executives foster corporate cultures of deception and lack of candor, directors are unable to reasonably rely on the information provided and may fail to meet their fiduciary and statutory obligations. However, a return to agency theories and a focus on the duty to inform properly refocuses the analytic framework for assessing corporate officer misconduct on those who are often the most culpable or minimally have the most information about corporate affairs and exercise the most control. Additionally, agency principles do not require the advancement of new theories of liability and they bring a source of

56 See R. FRANKLIN BALOTTI & JESS A. FINKELSTEIN, THE DELAWARE LAW OF CORPORATIONS AND BUSINESS ORGANIZATIONS ch. 4 (Aspen 1997) (discussing officer and director duties). See also Johnson & Millon, supra note 6, at 1602-03 (discussing the need for clarity of the nature of the agency relationship between directors and officers).
57 See Johnson & Millon, supra note 6, at 1610-17.
58 See BALOTTI & FINKELSTEIN, supra note 56. See also Hamermesh & Sparks, supra note 20, at 866-67; Johnson, Corporate Officers, supra note 20, at 442. The authors argue that the Business Judgment Rule and policy rationales for treating officers and directors the same are valid. Id.
59 See generally BALOTTI & FINKELSTEIN, supra note 56. See also Johnson, Corporate Officers, supra note 20, at 442.
60 See Johnson, Corporate Officers, supra note 20, at 444-47; Johnson & Millon, supra note 6, at 1613-14.
63 See Johnson & Millon, supra note 6, at 1623 (discussing the blurring of corporate law officer fiduciary duties with agency costs theory); Langevoort, Agency Law Inside the Corporation, supra note 39, at 1200.
defined principles to the duties owed by senior corporate officers to directors and, ultimately, the shareholders.\footnote{Johnson & Millon, supra note 6, at 1617 (discussing the control of CEOs over corporate boards and its impact on agency theory and corporate governance); Langevoort, Agency Law Inside the Corporation, supra note 39, at 1193 (discussing recalling why officers are agents will better able attorneys to advise corporate officers on their fiduciary obligations).}

B. Officers' Fiduciary Duties

What duties do officers—directors in their capacity as officers and non-director officers—owe to the Board? Few Delaware cases directly address the fiduciary obligations of corporate officers who are directors or non-director officers.\footnote{See generally Marcel Kahan & Edward Rock, Symbiotic Federalism and the Structure of Corporate Law, 58 VAND. L. REV. 1573, 1590-1609 (2005) (discussing the intertwined relationship between state law and federal law on disclosure duties); Carl W. Mills, Breach of Fiduciary Duty as Securities Fraud: SEC v. Chancellor Corp., 10 FORDHAM J. CORP. & FIN. L. 439, 448-54 (2005).} There are many likely reasons for this. First, CEOs are also directors and are sued rarely in their capacity as an officer.\footnote{See Johnson & Millon, supra note 6, at 1612-13 (suggesting a lack of personal jurisdiction over officers as the reason for few lawsuits).} Second, a claim for breach of fiduciary duties against corporate officers is likely derivative.\footnote{See Langevoort, Agency Law Inside the Corporation, supra note 39, at 1206-07 (discussing derivative suit and breach of the duty of candor).} Finally, the majority of claims against public companies' officers for breach of disclosure duties are for violations of federal securities laws.\footnote{See Johnson & Millon, supra note 6, at 1612-13 (discussing other reasons officers are not directly sued by shareholders; employment contract and terminations are not public); Kahan & Rock, supra note 65, at 1578-84 (discussing relation of state and federal law); Langevoort, Agency Law in the Corporation, supra note 39, at 286; Mills, supra note 65, at 447 (discussing federal vs. state law in disclosures breaches); Michael A. Perion, Fraud and Federalism: Preempting Private State Securities Fraud Causes of Action, 50 STAN. L. REV. 273, 279-90 (1998) (discussing state and federal securities laws).} Although there are few Delaware cases, the American Bar Association and the American Law Institute offer some guidance on senior officers' duties to directors. The Model Business Corporation Act ("MBCA") defines standards of conduct and liability for officers as nearly identical to those for directors.\footnote{MODEL BUS. CORP. ACT § 8.42 & cmt. (1984).} Additionally, commentary to the MBCA suggests that in certain circumstances, officers may be judged under different standards due to the officers' greater access to information.\footnote{Id.} Similarly, American Law Institute ("ALI") principles define the duties of senior officers as nearly identical to those of
directors. Specifically, ALI principles provide that directors and officers owe a duty of fair dealing premised on disclosure.

However, an important Delaware decision serves as a starting point to understand the duty of officers. Remembering the Smith v. Van Gorkom, (Trans Union Corp.), case is useful to begin a retro-perspective on how the Delaware court views officers' failure to inform. Van Gorkom remains an important case to understand the impact of an officer’s failure to properly inform the Board and reminds us that Delaware’s Supreme Court recognizes the role of senior officers in corporate culpability when they fail to keep directors informed. Twenty years later, although criticized heavily at the time, Van Gorkom demonstrates the prescience of Delaware’s Supreme Court in the post-Enron environment for corporate governance.

C. A Lesson from Van Gorkom: The Failure To Inform

In Smith v. Van Gorkom, the Delaware Supreme Court concluded that the directors of Trans Union breached their fiduciary duty of care to shareholders by failing to reasonably inform themselves of all relevant and reasonably available information. Additionally, the court determined that the directors had also breached their duty by failing to inform themselves of Van Gorkom’s role in the sale and purchase price for the company. Consequently, Van Gorkom, who served as both Chairman and CEO of Trans Union, was found liable along with the

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71 Principles of Corporate Governance: Analysis & Recommendations §§ 5.02-5.09 (1994).
72 Id. § 5.02. The plain reading of § 141(b) of the Delaware Code is that officers are agents of directors of which the board is entitled to rely. See Del. Code Ann. tit. 8, § 141(b) (2005). See also Langervoot, Agency Law Inside the Corporation, supra note 39, at 1200; Lorsch & McLers, supra note 9, at 1629 (discussing the fiduciary duties of officers as loyalty and care); Sparks & Hamermesh, supra note 11, at 216.
73 Smith v. Van Gorkom, 488 A.2d 858, 863 (Del. 1985). The class action also involved the defendant Trans Union Corporation ("Trans Union"). Id.
74 See Symposium, Van Gorkom and The Corporate Board: Problem, Solution, or Placebo, 96 Nw. U. L. Rev. 2 (2005) (providing a compilation of articles addressing the impact of the Trans Union case on Delaware corporate law).
75 See generally Lawrence A. Hamermesh, Why I Do Not Teach Van Gorkom, 34 Ga. L. Rev. 477, 485 (2000) (discussing the analytical flaws of the case); Van Gorkom and the Corporate Board, supra note 74 (providing compilation of articles addressing the impact of the Trans Union case on Delaware corporate law).
76 Van Gorkom, 488 A.2d at 864.
77 Id.
other directors for breaching their duty of care and failing to disclose material information to shareholders.78

Much like the court in Disney, the Van Gorkom court’s sharper language concerns the behavior of Van Gorkom. The court described Van Gorkom’s “report” to the board concerning the sale of the company as uninformed and emphasized that the board had made its decisions based upon an unwarranted reliance of the CEO’s report.79 Additionally, the court noted that Van Gorkom suggested the premium price but did not disclose to the board his methodology for selecting the premium.80 In fact, the court inferred that the board may have been the victim of a “fast shuffle” by Van Gorkom.81

In the motion for reargument, the court noted that in the early supplemental briefing of the case, the court had questioned the attorney representing all nine individual defendants on whether Van Gorkom should be distinguished from the other director defendants.82 Van Gorkom provided no documentation or support to the board concerning the basis for his recommendation to approve the transaction and the board was reliant on a twenty minute presentation by Van Gorkom.83 Accordingly, the court suggested that Van Gorkom, in his role as CEO, failed to inform the board of all information known to him at the time. In particular, Van Gorkom’s failure caused the directors to breach their disclosure obligations to shareholders.84

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78 Id. at 864-66.
79 Id. at 874.
80 Id.
81 Id. at 877; id. at 894 (McNeilly, J., dissenting).
82 Id. at 898-99 (McNeilly, J., dissenting).
83 Id. at 868 (majority opinion). What is not addressed by the court is Van Gorkom’s duty to the board. Did Van Gorkom have a duty to speak and provide all relevant information to the board? There is nothing to indicate the board was on notice that reliance on Van Gorkom was unwarranted. Absent evidence the board unreasonably relied on Van Gorkom, what was the basis for concluding the board should not have relied on Van Gorkom? The Trans Union case has been critiqued for its weak rationale. Specifically, the court’s rationale is weak because it failed to analyze an important corollary to the director’s duty to be informed—that is the officers’ (agents’) duty to inform the directors (principal) of all relevant information needed to make a decision. Did Van Gorkom breach a duty of candor owed by an agent to a principal? Does the duty of candor include the duty to speak up? Are the duty of candor and the duty of disclosure the same? Is the duty of candor owed by officers to directors different from the duty owed by directors to shareholders? Do corporate officers owe greater fiduciary duties than directors?
84 Id. at 890. In the context of materiality one can argue over whether what he failed to inform was material.
D. Providing Information: The Role of Officers

In Smith v. Van Gorkom and in In re The Walt Disney Company Derivative Litigation, Delaware courts suggested, without directly finding, a greater culpability of the director who is also an officer, than for other directors. The Delaware Chancery Court raised the question of whether theories of liability against corporate directors should differ from theories of liability against corporate officers. In this post-scandal world of corporate governance, the role of officers as a pivotal conduit of vital corporate information is highlighted when hindsight review of catastrophic failures reveals that directors were not fully aware of corporate business facts that were necessary to make informed decisions and to engage in proper oversight. Finding an underlying duty to inform requires senior officers to have candid, open conversations with directors, and reinforces the function of the board as oversight to management. It also offers the opportunity to balance the relationship of control exercised by senior officers over boards.

The analysis begins with an examination of the duty of disclosure owed by the board to shareholders. It indicates that imposing directors' duties on officers does not always hold the most culpable corporate actors responsible. The need to differentiate the duties of officers and directors is illustrated by understanding the history and rationale for the duty of candor, and the movement away from the duty of candor to a disclosure duty. The benefits and limits to corporate governance are also demonstrated.

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85 Id. at 899. In denying the motion for reargument, the court questions whether Van Gorkom is distinguishable from the other directors in assessing liability. Id. The issue before the court was to decide the liability of the directors; as is often the case, the court was not asked to decide the liability of a corporate officer as officer and in particular the liability of Van Gorkom as chief executive officer for breach of the duty of care. Id.


88 Langevoort, Agency Law Inside the Corporation, supra note 39, at 1206.

89 Langevoort, Resetting the Corporate Thermostat, supra note 87, at 304 (discussing the imbalance of corporate power).

90 Id.

91 Langevoort, Agency Law Inside the Corporation, supra note 39, at 1200 (discussing the specific duties of the CEO owed to the corporation).

92 Hamermesh, Calling off the Lynch Mob, supra note 50, at 1114-16 (describing Lynch as the "genesis of" Delaware Law on disclosure).
IV. THE DUTY TO DISCLOSE IN DELAWARE: FROM CANDOR TO DISCLOSURE

A. Directors’ Duties To Disclose to Shareholders

Directors’ duties to disclose to shareholders have developed over a series of cases involving a board’s communication to shareholders seeking action in mergers, majority and minority shareholder transactions, and tender offers. In Lynch v. Vickers Energy Corp., an early case on the duty of candor, the court defined the duty of candor as the duty an agent owes a principal when in possession of special knowledge. The court concluded that when the board sought shareholder approval in the context of a tender offer by majority shareholders to minority shareholders, the board owed shareholders a duty of “complete candor.” Lynch established that directors owe a duty of candor to shareholders and that the basis of this duty is the superior position of directors. As a result, the fiduciary duty of candor requires disclosure of all “germane facts” to communications requiring shareholder action.

Several issues remain unanswered after Lynch. The first is the meaning of “germane facts.” Second, do directors have an underlying affirmative duty of candor absent communication to shareholders? Third, is the duty of candor a separate duty or an underlying obligation of the duties of care, loyalty, and good faith?

1. “Germaine Facts” and Materiality

In subsequent Delaware decisions, “germane facts” were interpreted to mean material facts. Materiality thus became the primary focus of

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93 Id.
95 Id.
96 Id. The basis of this duty is also reflected in the fundamental rights of shareholders to a voice in corporate transactions directly affecting stockholder ownership. Arnold v. Soc’y for Sav. Bancorp, Inc., 650 A.2d 1270, 1276 (Del. 1994).
97 Lynch, 383 A.2d at 281.
98 Hamermesh, Calling off the Lynch Mob, supra note 50, at 1115-18 (discussing the meaning of Lynch).
99 Id. (discussing key cases on director’s fiduciary duty of disclosure).
disclosure cases in shareholder litigation.\textsuperscript{101} Once the court established that the board had an affirmative obligation to communicate to shareholders, or that it voluntarily chose to communicate to shareholders, complete material disclosure is required.\textsuperscript{102} Directors who fail to disclose material information are per se liable for the false communication.\textsuperscript{103}

2. Affirmative Duty

Later, the Delaware Supreme Court established that directors do not owe shareholders an underlying duty of disclosure absent mandatory or voluntary communications to shareholders.\textsuperscript{104} Moving away from \textit{Lynch}, which suggested that the duty to inform means “complete” candor at all times and\textsuperscript{105} preferring to describe the duty of candor as a disclosure duty, the court concluded that directors do not have a duty of disclosure until required or when they voluntarily communicate.\textsuperscript{106} After directors communicate to shareholders, then the duty of disclosure mandates disclosure of all relevant material information to shareholders.\textsuperscript{107} However, the duty to disclose does not include an obligation that directors engage in “self-flagellation.”\textsuperscript{108} Boards are not

\textsuperscript{101} See \textit{Arnold}, 650 A.2d at 1279; \textit{Zinn v. VLI Corp.}, 621 A.2d 773, 777-78 (Del. 1993); \textit{Shell Petroleum, Inc. v. Smith}, 606 A.2d 112, 115 (Del. 1992); \textit{Bershad}, 555 A.2d at 847-48; \textit{Rosenblatt}, 493 A.2d at 944-45; \textit{Hamermesh, Calling off the Lynch Mob, supra note 50}, at 1124-41 (discussing key cases on director's fiduciary duty of disclosure).


\textsuperscript{103} Malone, 722 A.2d at 9; \textit{Tri-Star Pictures}, 634 A.2d at 333. Both courts indicate that a fiduciary duty of disclosure breach is a per se violation not requiring reliance by shareholders. \textit{See also} Hamermesh, \textit{Calling off the Lynch Mob, supra note 50}, at 1124-41 (discussing key cases on director’s fiduciary duty of disclosure). \textit{See also} Faith Steveman Kahn, \textit{Transparency and Accountability: Rethinking Corporate Fiduciary Law’s Relevance to Corporate Disclosure}, 34 Ga. L. Rev. 505, 520 (providing an analysis of the implications of Malone on Delaware’s fiduciary law).

\textsuperscript{104} Malone, 722 A.2d at 9 (holding that “directors who knowingly disseminate false information that results in corporate injury or damage to an individual stockholder violate their fiduciary duty, and may be held accountable in a manner appropriate to the circumstances”); \textit{Brody}, 697 A.2d at 754; \textit{Stroud v. Grace}, 606 A.2d 75, 84-85 (Del. 1992); \textit{Citron v. Fairchild Camera & Instrument Corp.}, 569 A.2d 53, 66-67 (Del. 1989).

\textsuperscript{105} Hamermesh, \textit{Calling off the Lynch Mob, supra note 50}, at 1124-41 (discussing key cases on director’s fiduciary duty of disclosure).


\textsuperscript{107} Malone, 722 A.2d at 9.

\textsuperscript{108} Stroud, 606 A.2d at 84; \textit{Shell}, 606 A.2d at 115. Directors are under no affirmative duty to speak up unless communicating with shareholders either as required or voluntarily. “Delaware corporations are under a fiduciary duty to disclose fully and fairly all material
required to present all information available to directors to shareholders. Specifically, if a transaction does not require shareholder approval, directors are under no underlying obligation to inform. The rationale for not finding an affirmative duty is based on the need to allow directors to manage the corporation and not overwhelm shareholders with information.

3. Separate Duty

It matters whether the duty of disclosure is a separate duty under Delaware law for two reasons. First, under Delaware’s expulsion statute, only breaches of good faith and loyalty are exceptions to the limitations of liability. Second, if the duty of disclosure is part of the duty of care or an independent duty, then it is subject to the limitation of liability provisions.

In Arnold v. Society for Savings Bancorp, Inc., the Delaware Supreme Court concluded the duty of disclosure is a separate duty subject to Delaware’s expulsion statute. The court then determined that disclosure violations can be subject to limitation of liability provisions unless the disclosure violations are alleged to have breached a duty of good faith or loyalty. Moreover, the Arnold court directly addressed the issue of whether the duty of disclosure was a separate duty under the limitation of liability provisions and concluded that it was subject to the statute because it was not expressly included by the legislature as an exception. However, the court did not directly address whether the duty of disclosure was part of good faith or part of the duty of loyalty.

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information within the board’s control when it seeks shareholder action.” Stroud, 606 A.2d at 84-88. Yet, Stroud limits itself to private companies and Cinerama, citing the same rule in context of merger. Id. at 84. The duty to loyalty also raises obligations to disclosure conflicts of interest. See generally Brody, 697 A.2d 749.

9 Stroud, 606 A.2d at 84.
10 Malone, 722 A.2d at 9. When directors communicate to shareholders even when no action is requested directors owe a fiduciary duty of disclosure and must provide accurate information. Id.
11 Hamermesh, Calling off the Lynch Mob, supra note 50, at 1124-41 (discussing key cases on director’s fiduciary duty of disclosure).
14 Del. Code Ann. tit. 8, § 102(b)(7); Arnold, 650 A.2d at 1286-87.
15 Id. (stating duty of disclosure is a separate duty from good faith and loyalty and therefore included in definition of fiduciary duties in Del. Code Ann. tit 8, § 102(b)(7) and can be limited by liability as with duty of care).
16 Arnold, 650 A.2d at 1287.
17 Id. at 1288.
A narrow reading of Arnold is that for purposes of determining whether Delaware's limitation of liability provisions apply to a disclosure breach, it is subject to exculpation, unless the lack of disclosure is plead as a good faith or loyalty breach.118 A broader reading of Arnold is that the duty of disclosure is a separate, independent duty.119

In Malpiede, the court somewhat narrowed Arnold and concluded that the duty of disclosure is not separate, but is part of the duties of care and loyalty.120 In particular, the court in Malpiede v. Townson concluded the fiduciary duty of disclosure is not an "independent duty[y] but [applies] in a specific context of the board's fiduciary duties of care, good faith, and loyalty."121 The court then reconciled Arnold by concluding that when there is an affirmative duty to communicate to shareholders, specifically in a merger, directors' disclosure duty breaches must be alleged in the context of one of the duties of care, good faith, or loyalty.122

As a result of these cases, it remains unclear whether a duty of disclosure is an independent duty outside of the transactional communication to shareholders.123 Absent an underlying duty of disclosure, it is difficult to rationalize any independent duty of directors.124 Directors' duties to inform are narrower than the Restatement suggests is appropriate for an agent to disclose to a principal. Limitations on directors' duties to inform when communicating to shareholders became necessary because of the role of directors in managing the affairs of the corporation. Thus, cases evolved to define directors, duties to inform to reconcile the limitation on directors' informational knowledge, and the need of shareholders to have information when called to vote or to act.

118 Hamermesh, Calling off the Lynch Mob, supra note 50, at 1124-41 (discussing key cases on director's fiduciary duty of disclosure).
119 Id.
120 Malpiede v. Townson, 780 A.2d 1075, 1086 (Del. 2001); Cinerama, Inc. v. Technicolor, Inc., 663 A.2d 1156, 1166 (Del. 1995) (citing Zirm v. VLI Corp., 621 A.2d 773 (Del. 1993)). The duty of disclosure is an obligation that has been characterized as a derivative of the duties of care and loyalty. Additionally, the focus of candor is disclosure and materiality in communication to shareholders and tender offer communications by directors to shareholders related to materiality of all information disclosed to board.
121 Malpiede, 780 A.2d at 1086; Malone v. Brinca, 722 A.2d 5, 9 (Del. 1998).
122 Malpiede, 780 A.2d at 1086. Arnold and Malpiede are difficult to reconcile. Id.
123 Id. at 1086; Malone, 722 A.2d at 9.
124 See Hamermesh, Calling off the Lynch Mob, supra note 50, at 1149 (arguing it is an affirmative duty). But see Malpiede, 722 A.2d at 9.
B. Officers' Duties To Disclose to Directors

Delaware courts have not directly defined an officer’s duty to disclose (in non-loyalty breach cases) where a shareholder vote is not required. However, Delaware courts have concluded that, in communications to shareholders, officers also owe a duty to inform and must not provide false or misleading information. Applying the materiality, affirmative duty, and separate duty analyses to senior officers reveals the need for clarity in defining the duty to inform owed by CEOs and CFOs to the board.

1. Materiality

The Restatement of Agency defines the duty of the agent to inform the principal of material or relevant facts that the agent knows and which the principal wants to know. Officers are subject to the same standards of materiality as directors in cases where directors’ communications to shareholders are reliant upon material disclosure from officers.

In Malpiede, the Delaware Supreme Court defined materiality to be consistent with the federal definition—likelihood of a reasonable investor viewing the information as material. Accordingly, issues of materiality of disclosures require enhanced scrutiny by the courts to assess disclosure from the perspective of the shareholder. A failure to disclose material information would be a per se violation of the duty of

125 Sparks & Hamermesh, supra note 11, at 226-29 (discussing senior officers’ duties to the board). The court faced the issue in Arnold v. Society for Saving Bancorp, Inc., 650 A.2d 1270, 1273, 1286, 1287 (Del. 1994), but did not decide the issues because the plaintiff “failed to highlight any specific actions [CEO] undertook as an officer (as distinct from actions as a director) that fall within the two pertinent exceptions to Section 102(b)(7).” See also Langervoot, Agency Law Inside the Corporation, supra note 39, at 1195 (discussing duty of candor and the CEO).
126 RESTATEMENT (SECOND) OF AGENCY § 381 (1958). “Duty To Give Information. Unless otherwise agreed, an agent is subject to a duty to use reasonable efforts to give his principal information which is relevant to affairs entrusted to him and which, as the agent has notice, the principal would desire to have and which can be communicated without violating a superior duty to a third person.” Id.
127 Malpiede, 780 A.2d at 1086; Shell Petroleum, Inc. v. Smith, 606 A.2d 112, 113-14 (Del. 1992); Mills, 559 A.2d at 1283; see also Brehm v. Eisner, 746 A.2d 244, 260 (Del. 2000) (discussing whether materiality on matters not involving shareholders approval may be viewed differently).
128 Malpiede, 780 A.2d at 1086.
disclosure. Additionally, an officer's duty to disclose to directors in the context of the oversight duties of directors will depend on the scope of the senior officers' duties.

In Arnold, although the issue was raised, the court did not directly answer the question of officer liability. Rather, the court concluded that absent specific facts and allegations to highlight actions of a director who is also an officer carried out solely as an officer, the court would not address whether an officer is liable for failure to disclose. Later, the court in Disney would further explain that absent allegations which detail the breach of duties by an officer in his capacity as an officer, the court will not find culpability, even when it thinks the behavior of the senior officer is egregious. Although the court in Arnold ultimately determined that the board may have failed to disclose material facts, it did not directly decide the issue of whether the officer is more culpable. Consequently, it is clear from Arnold and Malpiede that materiality is closely tied to whether there is an affirmative duty.

2. Affirmative Duty

Directors owe no affirmative duty to disclose absent an obligation to speak or in voluntary communication to shareholders. In fact, directors are given the statutory authority to manage the affairs of the corporation and need only communicate to shareholders in certain transactions. However, an affirmative duty to inform owed by officers

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132 Langevoort, Agency Law Inside the Corporation, supra note 39, at 1193 (explaining that an officer with complete discretion in corporate matters may have a lesser disclosure duty than an officer with defined parameters to act).


134 Id.


136 Arnold, 650 A.2d at 1288.


138 DEL. CODE ANN. tit. 8, § 141(a) (2005). There is no statutory basis for disclosure. The duty of disclosure is a Delaware common law principle applied to communications to
to directors is reasonably inferred from the plain reading of the delegation of authority statute, which permits directors to delegate and rely on officers for information.\textsuperscript{139} Under the \textit{Restatement of Agency}, the duty to inform is an underlying duty owed by the agent to the principal.\textsuperscript{140} Nevertheless, the Delaware Supreme Court decision in \textit{Mills Acquisition Co. v. Macmillan, Inc.} provides support for finding an underlying duty of disclosure applicable to senior officers when communicating to directors and provides more direct support for a duty of disclosure when communicating to shareholders.\textsuperscript{141}

More specifically, the court in \textit{Mills} concluded that officers of a corporation in a merger have the fiduciary duty to disclose information to directors that directly prevents the board from meeting its duty of disclosure to shareholders.\textsuperscript{142} Stating that officers must not use their position of superior knowledge to mislead directors and that this duty to inform is unremitting, the court explained that the board was completely reliant on senior management for critical information needed to assess the merger.\textsuperscript{143} As a result, the decision in \textit{Mills} clearly supports an underlying duty of affirmative disclosure owed by senior officers to shareholders.

3. \textbf{Separate Duty}

Delaware law is somewhat muddled on whether the duty to disclose is a separate duty.\textsuperscript{144} Although officers are not included in Delaware's shareholders. \textit{See} Veasey \& Diguglielmo, \textit{supra} note 18, at 1473-74 (discussing federal disclosure invasion of state law and transactions mostly defined by federal law).

\textsuperscript{139} \textit{See} Malone, 722 A.2d at 9 (holding directors do have a duty to disclosure in the absence of a request for shareholder action). Although the decision is carefully worded as not to encroach on federal securities laws, it further supports finding an underlying duty of senior officers owed to directors. \textit{See also} Sparks \& Hamermesh, \textit{supra} note 11, at 226-27.

\textsuperscript{140} \textit{Restatement (Second) of Agency} \textsection 381 (1958); \textit{see also} Sci. Accessories Corp. v. Summagraphics Corp., 425 A.2d 957, 961 (Del. 1980) (explaining that an agent owes a duty to disclose relevant information to the principle but is not required to do so in breach of a confidential agreement).

\textsuperscript{141} \textit{Mills Acquisition Co. v. Macmillan, Inc.}, 559 A.2d 1261, 1280-81 (Del. 1989). \textit{Mills} involved mandatory disclosure to shareholders. \textit{Id. See also} Malone, 722 A.2d at 9 (holding directors do have a duty to disclosure in the absence of a request for shareholder action).

\textsuperscript{142} \textit{Mills}, 559 A.2d at 1280-81. \textit{See also} Malone, 722 A.2d at 9 (holding that when directors communicate even without duty they must disclose honestly). \textit{But see} Mills, 559 A.2d at 1280-81 (raising issues of whether senior officers breached the duty of loyalty).

\textsuperscript{143} \textit{Mills}, 559 A.2d at 1267, 1283.

\textsuperscript{144} Malpiede v. Townson, 780 A.2d 1075, 1086 (Del. 2001); Malone, 722 A.2d at 9; \textit{see also} Hamermesh, \textit{Calling Off the Lynch Mob}, \textit{supra} note 50, at 1149 (arguing it is an affirmative duty in cases of waste); Veasey \& Diguglielmo, \textit{supra} note 18, at 1473-74 (discussing lack of clarity in Delaware).
exculpation statute, it matters whether the duty of disclosure is a separate duty or part of a mixed duty of care, good faith and loyalty. First, a separate, underlying, and affirmative duty of disclosure means that officers may owe the duty even when directors are not communicating to shareholders. In other words, the duty is not transaction specific for officers. Second, if the duty of disclosure is a subset of broader fiduciary duties, then it is inconsistent with agency principles that view the duty to inform separate from other duties owed by agents.\textsuperscript{145} Further, a breach of the duty to disclose largely depends on whether the information not disclosed is material.\textsuperscript{146} Upon finding a duty and false disclosure, a court can find a per se violation of the disclosure duty.\textsuperscript{147}

The few Delaware cases addressing the issue support the principles that senior officers owe an unremitting affirmative duty to disclose material information, and that the duty is a separate duty.\textsuperscript{148} Additionally, Delaware case law recognizes that senior corporate officers owe more than the same duties of disclosure directors owe to shareholders and that officers’ duties are different.\textsuperscript{149} Why should senior officers owe an affirmative duty to disclose when directors do not? Boards are dependent on the CEO and CFO for the accurate flow of information and cannot perform their oversight functions without it. The board’s duty of oversight is unremitting; therefore, the duty of senior officers to inform is also incessant.\textsuperscript{150}

\textsuperscript{145} Restatement (Second) of Agency § 381 (1958); see Sci. Accessories Corp. v. Summagrafics Corp., 425 A.2d 957, 961 (Del. 1980) (explaining an agent owes a duty to disclose relevant information to the principle but is not required to do so in breach of a confidential agreement).

\textsuperscript{146} Malpine, 780 A.2d at 1086; Shell Petroleum, Inc. v. Smith, 606 A.2d 112-14 (Del. 1992); Mills, 559 A.2d at 1283. See Brehm v. Eisner, 746 A.2d 244, 260 (Del. 2000) (discussing whether materiality on matters not involving shareholders approval may be viewed differently); Malone, 722 A.2d at 9. When directors communicate to shareholders, even when no action is requested, directors owe a fiduciary duty of disclosure and must provide accurate information. Id.

\textsuperscript{147} Malone, 722 A.2d at 9; In re Tri-Star Pictures, Inc. Litig., 634 A.2d 319, 333 (Del. 1993). Both courts indicate that a fiduciary duty of disclosure breach is a per se violation not requiring reliance by shareholders. See Hamermesh, Calling Off the Lynch Mob, supra note 50, at 1124-41 (discussing key cases on a director’s fiduciary duty of disclosure).

\textsuperscript{148} Mills, 559 A.2d at 1280-81. See Malone, 722 A.2d at 9 (holding when directors communicate even without duty they must disclose honestly).

\textsuperscript{149} Mills, 559 A.2d 1261.

\textsuperscript{150} Public company boards must demand unremitting duty of disclosure of senior officers in order for directors to engage in proper oversight in managing the affairs of the corporation. This duty should not be dependent subsequent disclosure to shareholders. See Sparks & Hamermesh, supra note 11, at 237 (discussing an officer’s duty).
V. AGENTS AND THE DUTY TO INFORM

A. Officers vs. Directors

The duty of disclosure owed by directors to shareholders does not go far enough to hold CEOs or CFOs responsible for failing to inform their boards. Senior corporate officers maintain a superior position of knowledge over directors; similarly, senior officers' superior knowledge differs from the position of control a board exercises over shareholders.

In fact, senior corporate officers of public companies are the bottleneck for the flow of corporate information. However, the directors' current duties of disclosure do not properly fit the reality of dependence of the board on complete information from senior officers. Just as the fiduciary duties of directors evolved to accommodate the limits on directors in providing information to shareholders, the role of senior corporate officers as the controllers of corporate information must evolve as well.

More specifically, the position of power and influence of senior corporate officers, the CEO and CFO, as the conduits of corporate information should be recognized in assessing the nature of the agent relationship between and among senior officers, directors, and shareholders. In cases where courts have concluded otherwise, the cases have relied on the fact that the officer failed to carry out his job as officer.

Advising senior corporate officers of the duties to directors with a defined boundary for disclosure encourages CEOs and CFOs to be more candid with the board. In fact, open dialogue between senior officers and directors is frequently encouraged as a way to improve corporate governance. Such discussions are not an overly-broad intrusion into CEOs or CFOs ability to run the business and make sound business

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151 Langevoort, Resetting the Corporate Thermostat, supra note 87, at 312.
152 Id. at 309-12.
153 Id.
154 Sci. Accessories Corp. v. Summagraphics Corp., 425 A.2d 957, 962 (Del. 1980). Limiting liability of directors makes it difficult if not impossible to hold directors monetarily liable, but when directors fail to do their job because of officers' failure to disclose officers should be accountable to the corporation and shareholders. Id.
155 Langevoort, Agency Law Inside the Corporation, supra note 39, at 1202 (arguing against an affirmative duty to disclose).
156 Veasey & Diguglielmo, supra note 18, at 1507 (suggesting best practices for corporate governance). See also Business Roundtable CEOs Issues Updated “Best Practices” in Corporate Governance, supra note 2.
decisions. Instead, it is a balanced cost of monitoring that appropriately views the role of the board as oversight for management. The board can decide how much information they want from senior officers, either in the bylaws, employment contracts or less formal communications. These documents will serve to judge materiality.

However, the duty of disclosure is but one example where the special position of senior corporate officers lends itself to application of a different assessment of the underlying fiduciary duties that officers owe directors and the corporation. Judged in the light of what we know about CEO and CFO conduct in the wake of scandals, there is little quarrel that CEOs with strong, charismatic personalities tend to exert dominance and control over public company boards.

Accordingly, finding an affirmative duty of senior corporate officers gives greater meaning to the oversight role of directors. The duty of disclosure must be a separate duty so that issues of materiality are judged in the context of what the Board deems relevant and material. Moreover, an affirmative duty to disclose should not be subsumed into the duty of care or loyalty when senior officers are properly understood as the agents of directors. Based on these understandings, the question arises: what is the form of the agency relationship between senior officers and directors and why does it matter?

B. Sub-Agents or Co-agents

To whom do officers owe their duties? In returning to agency principles to more precisely define the nature of the three-way agency relationship among senior officers, directors, and shareholders, it is

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157 Johnson & Millon, supra note 6, at 1640-41.
158 Properly defined parameters for senior officers are not an intrusion into their ability to run the business affairs of the corporation. See Langervoort, Agency Law Inside the Corporation, supra note 39, at 1204.
159 Malone v. Brincat, 722 A.2d 5, 9 (Del. 1998) (holding directors do have a duty to disclosure in the absence of a request for shareholder action).
160 Commission on Public Trust, supra note 2. See generally SKEEL, supra note 8, at 170-72 (discussing corporate culture and the CEO).
161 See Johnson & Millon, supra note 6, at 1652. See also Clark, supra note 37, at 71 (discussing the common attribute of the fiduciary relationship as includes an affirmative duty to disclose).
162 Malpiede v. Townsend, 780 A.2d 1075, 1086 (Del. 2001).
163 See Johnson & Millon, supra note 6, at 1636; Langervoort, Agency Law Inside the Corporation, supra note 39, at 1203 (stating the duty to disclose is subsumed into other duties. It is subsumed for directors, but not officers).
necessary to understand issues of sub-agency and co-agency. A subagent is an agent who performs functions on behalf of the agent's principal. The principal's agent is primarily responsible for the subagent's conduct provided the agent and principal have agreed. As a result, the subagent is subject to the control of the agent and has two principals—the delegating agent and the delegating agent's principal.

Agency law developed around sub-agency and focuses on the authority of the agent to delegate authority to the subagent, the authority of the subagent, and liability of the agent for acts or omissions of the subagent. The sub-agent owes duties to the agent and to the principal. Additionally, in sub-agency, where the agent properly delegates to a subagent due to the subagent's particular skill and the agent has exercised diligence in hiring the subagent, the principal or the delegator may seek a remedy directly against the subagent for misconduct.

In comparison, co-agents have a common principal, each owing the duties of an agent to a principal. The agents are not vicariously liable to each other, but owe duties to the common principal. Co-agents are

164 Johnson & Millon, supra note 6, at 1602 (discussing the need for agency law discourse). See also Warren A. Seavey, Subagents and Subservants, 68 HARV. L. REV. 658, 661 (1955) (discussing how courts rarely distinguish between agents appointed by another agent).

165 RESTATEMENT (SECOND) OF AGENCY §§ 5(1) (1958). "A subagent is a person appointed by an agent empowered to do so, to perform functions undertaken by the agent for the principal, but for whose conduct the agent agrees with the principal to be primarily responsible." Id. See also RESTATEMENT (THIRD) OF AGENCY (Tentative Draft No. 3) § 3.15(1) (2002) [hereinafter RESTATEMENT (THIRD), Tentative Draft No. 3]. "Subagent. A subagent is a person appointed by an agent to perform functions that the agent has consented to perform on behalf of the agent's principal." Id.

166 RESTATEMENT (SECOND) OF AGENCY §§ 5(b), 406; RESTATEMENT (THIRD), Tentative Draft No. 3 § 3.15 cmt. b.

167 RESTATEMENT (SECOND) OF AGENCY §§ 5(b), 406; RESTATEMENT (THIRD), Tentative Draft No. 3 § 3.15 cmt. b.

168 RESTATEMENT (SECOND) OF AGENCY §§ 5(b), 406; RESTATEMENT (THIRD), Tentative Draft No. 3 § 3.15 cmt. c.

169 RESTATEMENT (SECOND) OF AGENCY §§ 5(b), 406; RESTATEMENT (THIRD), Tentative Draft No. 3 § 3.14 cmt. b.

170 RESTATEMENT (SECOND) OF AGENCY §§ 5(b), 406; RESTATEMENT (THIRD), Tentative Draft No. 3 § 3.15 cmt. b.

171 RESTATEMENT (THIRD) AGENCY (Tentative Draft No. 2) § 1 (2001) [hereinafter RESTATEMENT (THIRD), Tentative Draft No. 2]. "Co-agents. Co-agents have agency relationships with the same principal. A co-agent may be appointed by the principal or by another agent actually or apparently authorized by the principal to do so." Id. See Seavey, supra note 164, at 666 (discussing liability of subagents).

172 RESTATEMENT (THIRD), Tentative Draft No. 2 § 1.
selected by either the agent designated by the principal, or the principal, and owe duties directly to the principal.\textsuperscript{173}

In corporations, directors are properly authorized to delegate certain duties to officers.\textsuperscript{174} Directors and officers are defined as agents of shareholders, but there is little case law defining senior officers selected by directors as either sub-agents or co-agents.\textsuperscript{175} Sorting out the nature of the agency relationship is necessary in order to figure out to whom the duty to inform is owed and how it is enforced.\textsuperscript{176} If senior officers are sub-agents properly appointed by the board, acting within the scope of their employment, senior officers who fail to inform are accountable to the directors for their acts and omissions.\textsuperscript{177} However, if senior officers and directors are co-agents, then they are not vicariously liable to each other; instead, senior officers owe their duties to shareholders. All of this matters only to determine if a claim is direct or derivative.

Application of the duty to inform as applied to senior officers reveals that officers and directors are different kinds of agents, each owing the same but different fiduciary obligations to the direct principal. Using the same standards of conduct and liability for directors does little to recognize the total dependence of directors on officers to carry on their fiduciary obligations.

What happens when directors rely in good faith on senior corporate officers who do not provide enough information for directors to be informed in circumstances where directors do not communicate to shareholders?\textsuperscript{178} The board is potentially responsible for the oversight failure and breach of fiduciary duties to shareholders. But what about WorldCom, where the board exercised reasonable oversight, but was deliberately presented with fraudulent or

\textsuperscript{173} Id.
\textsuperscript{175} Johnson & Millon, supra note 6, at 1623 (discussing the blurring of corporate law officer fiduciary duties with agency costs theory).
\textsuperscript{176} A more detailed analysis of the case law interpreting the duties and liabilities of subagents and coagents is beyond the scope of this paper. The majority of cases on issues of subagent and coagents are not on matters of officers' duty to directors and shareholders. An analysis of the cases is needed to understand the ramifications of subagents and coagents on corporate governance.
\textsuperscript{177} They may also be indirectly liable to the shareholder for breach of duties owed the corporation.
\textsuperscript{178} When directors communicate to shareholders based on misleading information provided by senior officer the law supports holding senior officers responsible directly to shareholders. The more troubling scenarios are the WorldCom and Enron examples where the Board is regularly provided misleading information making it impossible for the Board to meet its oversight responsibilities.
misleading information by senior officers? Shareholders' class actions seeking to recover under securities laws for misleading disclosure by senior corporate officers provide potential monetary recovery. Such shareholder class action litigation may not recover monetary or equitable remedies for the corporation.\textsuperscript{179} These questions raise implications for corporate governance, which are discussed below.

VI. IMPLICATIONS FOR CORPORATE GOVERNANCE

A. The Business Judgment Rule

As case law continues to develop and define the fiduciary duties of senior officers, there are several implications for corporate governance in finding an underlying affirmative duty to disclose. In a direct shareholder suit, one implication is the relevance of the business judgment rule to senior officers' failure to inform directors.\textsuperscript{180}

In his insightful article, Professor Johnson suggests application of the business judgment rule to officers is not as clear in Delaware case law as is presumed.\textsuperscript{181} He argues that the rationales for the business judgment rule should not apply equally to officers and directors.\textsuperscript{182} Additionally, in the context of improper disclosures and materiality, Delaware case law suggests that the business judgment rule is less relevant.\textsuperscript{183}

In \textit{Shell Petroleum, Inc. v. Smith}, the court concluded that misstatements in communications to minority shareholders amounted to a per se disclosure violation and that whether the majority shareholder knew or should have known of the disclosure error does not negate the disclosure duty.\textsuperscript{184} The holding in \textit{Shell} suggests a duty to disclose may not raise issues of gross negligence or good faith in the context of assessing the materiality of disclosures.\textsuperscript{185} Indeed, the Delaware Chancery court suggested that the failure to inform on matters

\textsuperscript{179} Langevoort, \textit{Agency Law Inside the Corporation}, \textit{supra} note 39, at 1207 (discussing the difficulties on derivative Litig, in the context of senior officer misconduct).


\textsuperscript{181} Johnson, \textit{Corporate Officers}, \textit{supra} note 20, at 441.

\textsuperscript{182} Id.


\textsuperscript{185} \textit{Id.} See \textit{In re} Anderson, Clayton Shareholders' Litig., 519 A.2d 669 (Del. Ch. 1986).
fundamental to shareholders is not "a decision concerning the management of business and affairs of the enterprise of the kind the business judgment rule is intended to protect... The quality of disclosure is inherently something that the court itself must ultimately evaluate." As a result, what matters is materiality, which warrants enhanced judicial review.

Moreover, directors who unknowingly rely on misinformation provided to them by senior officers risk claims of lack of good faith in carrying out their oversight duties. Presumably, boards otherwise able to demonstrate good faith in meeting their fiduciary duties can present evidence to show that they were provided misleading or false information by senior officers. Arguably, it follows that if senior corporate officers were under an affirmative duty to disclose, the need for judicial review would increase to assess materiality. Additionally, it would render the business judgment rule less relevant to senior officers who fail to provide material information to directors. Consequently, it would be up to the interested parties to demonstrate the full disclosure. However, there would be no need to continuously inform the board; instead, senior officers must inform only on those matters requiring shareholder approval and on those matters that directly affect the ability of the directors to engage in oversight of significant corporate business matters. So, how is the affirmative duty to inform enforced and what is the remedy?

B. Derivative Claims and Demand

A second implication for corporate governance in finding an underlying affirmative duty to inform by senior corporate officers is in the derivative claim. It potentially allows for recovery on behalf of the corporation, either in equity or monetary damages, against more

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186 Anderson Clayton Shareholders' Litig., 519 A.2d at 675 (citations omitted). The case involved mandatory disclosure to shareholders in a vote to recapitalize the corporation. Id.
187 Malpiede v. Townsend, 780 A.2d 1075 (Del. 2001); Malone, 722 A.2d 5; see also Shell, 606 A.2d at 115-16; Anderson Clayton Shareholders' Litig., 519 A.2d at 675.
188 See Smith v. Van Gorkom, 488 A.2d 858 (Del. 1985). It is reasonable to argue that all information to directors requiring action or not then are to be judged under the standards of materiality. Concerns about not allowing senior officers the protections of the business judgment rule are unwarranted when there is an affirmative duty to disclose. Senior officers' failure to disclose would be judged under the same exacting standards Delaware uses to assess materiality. Senior officers will then be counseled in the context of materiality in regular communications to the board.
189 Johnson, Corporate Officers, supra note 20, at 441. But see Hamermesh & Sparks, supra note 20, at 866.
190 Id. at 870-71.
culpable senior officers.\textsuperscript{191} This serves to complement federal disclosure violations that provide direct recovery to shareholders.\textsuperscript{192}

A claim by shareholders alleging a breach of the duty to inform must satisfy the two part test for determining if a suit is derivative: (1) who suffered the injury; and (2) who is owed the remedy.\textsuperscript{193} Any recovery in a derivative suit flows to the corporation; \textsuperscript{194} who suffered the injury in part turns on who is owed a duty.\textsuperscript{195} As previously discussed, senior officers owe fiduciary duties to directors, the corporation, and, ultimately, the shareholders. Whether senior officers are sub-agents or co-agents is debatable and matters to properly define the nature of the three-agency relationship among senior officers, directors, and shareholders. However, in all cases, failure of senior officers to properly inform directors of material information harms the corporation when there is a shareholder vote or when shareholders are not otherwise provided communications.\textsuperscript{196}

In \textit{Mills}, the Delaware Supreme Court stated that board decisions made on the basis of undisclosed information from senior officers amount to deception and that the uninformed decisions are thus voidable by those owed the fiduciary duty.\textsuperscript{197} The potential to void even ratified decisions and monetary liability found to have been made based on false information can be a formidable tool to monitor the behavior of a CEO or CFO inclined to deliberately mislead the board.

\textsuperscript{191} See CG Hintmann, \textit{You Gotta Have Faith: Good Faith in the Context of Directorial Fiduciary Duties and the Future Impact on Corporate Culture}, 49 \textit{St. Louis U. L.J.}, 571, 598-99 (2005). See also Hamermesh & Sparks, supra note 20, at 871 (explaining how officer liability insurance is denied to officers when the corporation initiates a claim against the officer. This may explain why few Boards sue senior officers directly but it should not limit equitable remedies).

\textsuperscript{192} See Kahan & Rock, supra note 65, at 1575; Mills, supra note 65, at 440; Perion, supra note 68, at 278.

\textsuperscript{193} Tooley \textit{v.} Donaldson, Lufkin, \& Jenrette, Inc., 845 A.2d 1031, 1035 (Del. 2004). Delaware case law is being developed in this area. See Veasey \& DiGuglielmo, supra note 18, at 1469 (discussing borderline cases and the challenge of determining whether decisions not requiring shareholder approval or disclosure to shareholders by directors, or when directors choose not communicate with shareholders, is direct or derivative).

\textsuperscript{194} Tooley, 845 A.2d at 1036.

\textsuperscript{195} \textit{Id.}


\textsuperscript{197} \textit{Mills}, 559 A.2d at 1284. See also Brehm \textit{v.} Eisner, 746 A.2d 244 (Del. 2000) (suggesting compensation issues and disclosure are different); Rales \textit{v.} Blasband, 634 A.2d 927, 932 (Del. 1993); Langevoort, \textit{Agency Law Inside the Corporation}, supra note 39, at 1206-07 (discussing the challenges of a shareholder suit under a candor breach. Raises issue of possible recovery in CEO compensation cases).
The goal of this Article is not to argue that senior corporate officers should be liable for failing to meet aspiratory goals of good corporate governance. Rather, the point is simply that CEOs and CFOs who deliberately withhold material information from directors ought to be accountable to the corporation and shareholders for failure to satisfy fundamental duties owed by agents to principals. Enforcing state fiduciary duties are what agency cost theory encourages. Finding an underlying affirmative duty to disclose may offer an equitable solution to shareholders seeking to void decisions by directors that did not otherwise require shareholder approval. It also offers a potential for monetary recovery directly against senior corporate officers. The board can use employment contracts and ultimately terminate senior executives, although this offers only a partial solution to holding senior corporate officers responsible to directors, corporations, and stakeholders.

Additionally, a demand futility analysis poses a challenge to shareholders seeking to void a decision based on misinformation from a senior officer. Assuming that a shareholder can demonstrate demand futility by showing lack of independence, shareholders can seek equitable or other remedies. However, this can be a formidable challenge to many shareholders. Yet, by understanding the agency relationship between senior officers and directors, an underlying affirmative duty to inform also offers directors the option to seek recovery from senior officers or equitable remedies on behalf of the corporation.

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198 See Brehm, 746 A.2d at 256 (directly citing the aspirational goal of ALI and NACD principles).
199 See Langevoort, Agency Law Inside the Corporation, supra note 39, at 1206-07.
200 Id. at 1206-08.
201 See Rules, 634 A.2d at 933 (demonstrating the importance of a state remedy where matter challenged does not involve a business decision). See also Hamermesh & Sparks, supra note 20, at 871 (explaining how officer liability insurance is denied to officers when the corporation initiates a claim against the officer); Johnson, Corporate Officers, supra note 20, at 468.
203 Langevoort, Agency Law Inside the Corporation, supra note 39, at 1207 (discussing the challenges of a shareholder suit under a candor breach).
C. Importance of State Fiduciary Duties Under Federal Law

The Sarbanes-Oxley Act and regulations ("SOX") mandate the CEO and CFO to certify financial information and hold each personally accountable for the accuracy of financial information provided to shareholders.\textsuperscript{205} The Act further mandates that corporate attorneys advise management of state fiduciary duties.\textsuperscript{206} An affirmative underlying duty to inform serves to balance the role of state and federal laws in encouraging and enforcing open, candid corporate communication between senior officers and directors.

Federal regulations and national exchange requirements requiring director independence are demanding more accountability and oversight of directors and officers.\textsuperscript{207} Directors should expect that the underlying duty to inform requires non-misleading communications from senior officers when directors are dependent on the veracity of the information provided by CEOs or CFOs.\textsuperscript{208}

\textsuperscript{205} 17 C.F.R. § 228 (2005). The CEO and CFO are each required to certify in every quarterly and annual report, including any amendments thereto, the following: Reviewed the report; Report does not contain any untrue statement of a material fact or omit a material fact; Report fairly presents the financial condition of the company; Disclosure controls are in place to detect and ensure material information is known to the officers; They have evaluated the effectiveness of the disclosure controls; Report includes their evaluation and conclusions on the effectiveness of disclosure control procedures; The certifying officers have disclosed the auditors and audit committee any significant deficiencies in the design of internal controls; Disclosure of any fraud involving management; The certifying officers not any significant changes in internal controls and any corrective actions and material weaknesses. \textit{Id.} Disclosure controls and procedures are defined as controls and other procedures designed to ensure that information required to be disclosed in the reports filed or submitted to the SEC. \textit{Id.} § 228 (Certification of Quarterly and Annual Reports); see also \textit{id.} § 240.13a-14 (certification of disclosure in annual and quarterly reports).

\textsuperscript{206} \textit{Id.} § 205.1 (requires an attorney to report a material violation (including a breach of a fiduciary duty) by an officer and director (and others) "up the ladder" to a higher reporting authority); \textit{id.} § 205.2(d) (defines breach of a fiduciary duty as a breach of federal of state statutory or common law "including but not limited to misfeasance, nonfeasance, abdication of duty, abuse of trust, and approval of unlawful transactions").

\textsuperscript{207} \textit{Id.} § 228 (requiring listed companies to develop a code of ethics for a company’s principal executive officers (CEO and CFO)). Companies are not only to disclose a code of ethics, but if does not have a code of ethics explain why and disclose any waivers of the code of ethics. Codes of ethics combined with enforcement state fiduciary duty to disclose offer a twofold strategy for monitoring corporate governance. \textit{Id.}

Further, CEO and CFO certification of the veracity of federal disclosure mandates that officers not only know more information but also disclose it to shareholders. These regulations work to ensure equal access to information by corporate actors. SOX regulations look not only to the securities laws to ensure senior officers’ compliance with disclosure rules, but also state fiduciary laws to hold them accountable to shareholders. As a result, the affirmative underlying duty to inform balances state and federal law, allowing for more open communication between officers and directors.

VII. CONCLUSION

This Article argues for finding an underlying duty to inform owing from senior corporate officers, in particular the CEO and CFO, to directors. The basis for this underlying duty is consistent with basic agency principles and is also not inconsistent with Delaware case law that finds a duty to inform when communicating to shareholders and it suggests that the duty is an unremitting duty. The duty is also consistent with the plain reading of Delaware’s corporate statute. The benefits to corporate governance are twofold—potential voiding of transactions or business decisions of directors made based on misleading information and enhanced judicial scrutiny of senior officers’ disclosure to directors. The risks to senior officers’ ability to properly run corporate affairs when judicial review is judged under standards of materiality and appropriate use of the business judgment rule is minimal. Delaware courts have demonstrated their ability to effectively evaluate and balance these competing legal interests.

Public companies’ accounting and fraud scandals reveal the need for improvement in corporate governance. Finding an underlying affirmative duty to inform is not only consistent with agency principles, but it is also needed to provide shareholders a way to monitor and balance the superior positions of knowledge the CEO and CFO maintain over directors.

Stevelman Kahn, supra note 103, at 513-14 (discussing the role of corporate managers in disseminating information).

209 See Bratton, supra note 208, at 1283. See 17 C.F.R. § 205.2(d) (defining breach of a fiduciary duty as a breach of federal of state statutory or common law “including but not limited to misfeasance, nonfeasance, abdication of duty, abuse of trust, and approval of unlawful transactions”); see also Securities Litigation Uniform Standards Act of 1998 §2, Pub. L. No. 105353, 112 Stat. 3227 (Findings). “The Congress finds that— ... (4) State securities regulation is of continuing importance, together with Federal regulation of securities, to protect investors and promote strong financial markets ....” Id.
The relationship between senior officers and directors reveals a somewhat dysfunctional agency relationship, whereby the agent exercises a great deal of control over the principal. Agency theory is designed to give principals a means to monitor the risks of the self-interested agent, and thus, returning to agency principles to find an underlying affirmative duty of senior officers is appropriate. It seems illogical, and in many ways unfair, for the most influential and often most culpable in the corporation not to have an unrelenting duty to provide accurate information to directors. To conclude that senior officers owe the same kind of disclosure duties as directors ignores their position of power.

Delaware law offers a framework and some support for acknowledging the different role of senior officers and the rationale for finding an unremitting duty to inform. This does not encroach on the senior officers' jobs to manage the day-to-day, but instead, will encourage more communication with the board and encourage boards to define how they want senior officers to communicate with them. It does not necessarily increase liability risk, but merely allows the court to assess materiality in the context of what a reasonable director should expect. By finding an underlying affirmative duty to disclose, enhanced judicial review of senior officers' disclosure failures, judged in the context of materiality, offers shareholders state fiduciary law enforcement options to hold those most culpable accountable for corporate governance failures.