Director Fiduciary Duties Under Delaware Law: What Board Members Need to Know

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Under Delaware General Corporation Law (the "DGCL"), the business and affairs of a corporation are managed by or under the direction of a corporation's board of directors. Pursuant to the DGCL, directors of Delaware corporations owe fiduciary duties to the corporation and its stockholders, principally the duty of care and the duty of loyalty. A breach of these duties can result in director liability. However, the DGCL provides important protections in certain cases where directors act on an informed basis, in good faith, and without conflicts of interest. In addition, a corporation's certificate of incorporation may contain a provision exculpating directors from monetary liability for certain breaches of the fiduciary duty of care, subject to the limitations set forth in Section 102(b)(7) of the DGCL.

Duty of Care

The duty of care requires directors to make informed business decisions. In carrying out this duty, directors should act in good faith, with the same level of care that an ordinarily prudent person in a similar position and under similar circumstances would act, and in a manner that the director reasonably believes to be in the best interests of the corporation and its stockholders. More specifically, Delaware law requires directors to take affirmative steps to become informed, prior to making a business decision, of all material information reasonably available to them and to act with appropriate care in discharging their duties. To satisfy this duty, among other things, directors should review all reasonably available material information, ask questions, hold board meetings to discuss and deliberate issues, consider alternatives, and devote a reasonable amount of time to reviewing relevant issues. Directors should also be informed about the business and its financial condition, conduct appropriate diligence, consult with financial, legal, or other advisors or experts where appropriate, receive input from management and advisors, and review the records of the corporation and opinions or reports presented by the corporation's management, board committees, or other persons reasonably believed to have relevant expertise. In addition, directors should take sufficient time to understand the transaction or issue presented and carefully deliberate before making material business decisions.

If a director is sued for breach of the duty of care, the default judicial standard of review is typically the Business Judgment Rule. The Business Judgment Rule generally provides a presumption that, in making a business decision, the directors acted on an informed basis, in good faith, and in the honest belief that the action taken was in the best interests of the corporation. The rule reflects Delaware courts' general reluctance to substitute their judgment for that of directors in making business decisions. The Business Judgment Rule therefore may provide protection from liability. However, this standard is a rebuttable presumption, so if a plaintiff can demonstrate that the director did not act on an informed basis or in good faith in the interests of the corporation, or that such director was not sufficiently independent or disinterested under the circumstances, or acted in bad faith, engaged in fraud or illegal conduct, engaged in conduct constituting corporate waste, or failed to appropriately address a conflict of interest, then the Business Judgment Rule may not apply. Similarly, certain conflicted transactions may be subject to a different or more exacting standard of review depending on the nature of the conflict and the circumstances of the transaction. If the Business Judgment Rule does not apply, the applicable standard of review will depend on the circumstances. In certain conflicted transactions, for example, the burden may shift to the defendant directors under a more exacting standard of review, including the entire fairness standard, under which the defendants must demonstrate that the challenged transaction was entirely fair to the corporation and its stockholders.

Duty of Loyalty

The duty of loyalty requires directors to act in good faith and with a reasonable belief that what the director does is in the best interests of the corporation and its stockholders, and should not put any personal interest ahead of the interests of the corporation or its stockholders. The duty of loyalty generally requires directors to act in the good-faith belief that they are advancing the interests of the corporation and its stockholders and to refrain from using their positions to advance personal interests at the expense of the corporation or its stockholders. A director must refrain from self-dealing and must not use the director's position to obtain an improper personal benefit. Breaches of the duty of loyalty can often arise in conflict-of-interest situations, such as when a director sits on the board of directors of two different corporations and a conflict of interest arises, or where a director usurps a corporate opportunity without first presenting it to the corporation, or where a director participates in setting their own compensation. The duty of loyalty is not limited, however, to traditional financial conflicts of interest. Delaware law also treats certain bad-faith conduct, including certain failures of oversight, as implicating the duty of loyalty. To try to avoid breaching the duty of loyalty, directors should disclose known conflicts, refrain from self-dealing, and, where appropriate, recuse themselves from board deliberations and decisions involving matters in which they are self-interested or where a conflict may reasonably appear to exist. In certain circumstances, it may be appropriate to have fully informed, disinterested, and independent directors approve a particular transaction pursuant to which the interested director has recused itself from any deliberations, discussions, or voting. Depending on the circumstances, approval by a properly constituted committee of disinterested directors or approval by informed, uncoerced disinterested stockholders may provide important statutory or judicial protections. Section 144 of the DGCL specifically addresses certain interested-director, officer, and controlling stockholder transactions and provides statutory safe harbors where its requirements are satisfied. It is important to note that conflicted transactions and other circumstances involving potential breaches of the duty of loyalty may be subject to enhanced scrutiny or entire fairness review. Directors therefore should carefully identify, disclose, and appropriately address potential conflicts of interest.

Indemnification

Delaware law allows corporations to indemnify directors in certain circumstances and to advance expenses incurred in defending claims, subject to statutory limitations and the corporation's governing documents. These rights are commonly addressed in the corporation's certificate of incorporation and bylaws, and many corporations also enter into separate indemnification agreements with directors that set forth indemnification and advancement rights in greater detail. Corporations should also consider purchasing directors' and officers' liability insurance, commonly referred to as D&O insurance, which can help cover costs and expenses for directors and officers associated with defending certain claims and, in some circumstances, resulting liabilities.

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