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**Exculpation and Indemnification of Corporate
Directors and Officers under Delaware and Texas
Law**

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Exculpation and Indemnification of Corporate Directors and Officers under Delaware and Texas Law¹

I. Introduction

Directors and officers of Delaware and Texas business or for-profit corporations are exposed to possible substantial liability in performing their obligations to the corporations they serve. As fiduciaries, corporate directors and officers owe two primary fiduciary duties – the duty of loyalty (perhaps coupled with the duty of good faith) and the duty of care. The duty of loyalty, stated broadly, obligates directors and officers to put the interests of the corporation ahead of their personal interests – i.e., to refrain from self-dealing. The duty of care generally obligates directors and officers to act with the care that a reasonable person in a like position would believe to be appropriate. Violation of either the duty of loyalty or the duty of care can result in the personal liability of directors and officers.²

As a counter-weight to potential liability for breaches of the duty of care, the business judgment rule under Delaware and Texas common law generally will preclude liability in circumstances where a business judgment, not involving self-dealing, turns out to be a mistake. Moreover, a corporation may be able to further limit claims against its directors and officers for breach of the duty of care by adopting optional exculpatory language to the extent permitted under the applicable Delaware or Texas corporate statute.

Notwithstanding the apparent protections afforded by the business judgment rule and by exculpation provisions, however, derivative and class-action lawsuits asserting claims against directors and officers, based on various legal theories, are regularly brought. Those lawsuits potentially expose directors and officers to personal monetary liability and are expensive to defend (even if the defense is successful).

Against this backdrop, corporate directors and officers have important protections that, in practice, can serve to assure them that they can serve their business organizations without undue concern about personal liability or expense. These protections include not only exculpation, but also indemnification and advancement of expenses.

II. Exculpation

A. Statutory Provisions

The Delaware statute authorizes a corporation to include in its certificate of incorporation a “provision eliminating or limiting the personal liability of a director to the corporation or its stockholders for monetary damages for breach of fiduciary duty as a director.” DEL. CODE ANN. tit. 8, § 102(b)(7). The statute, however, also contains limitations on the scope of the exculpation. It does not permit any elimination or limitation of personal monetary liability “(i) for any breach of the director’s duty of loyalty

¹ Thanks to Tom D. Harris and Ernest Martin, Jr., partners in the Dallas office of Haynes and Boone, LLP, for their permission to use a portion of their paper on a similar topic for an Advanced Business Law Course sponsored by TexasBar CLE a number of years ago.

² Directors and officers also can incur personal liability other than through breaches of fiduciary duties – for example, as a result of violations of federal or state laws such as securities statutes and regulations – though that liability is beyond the scope of this paper.

to the corporation or its stockholders; (ii) for acts or omissions not in good faith or which involve intentional misconduct or a knowing violation of law; (iii) [for an unlawful payment of dividend or unlawful stock purchase or redemption]; or (iv) for any transaction from which the director derived an improper personal benefit.”

Although the Texas statute uses some different language, the scope of permitted exculpation is substantially similar regarding a corporate director. TEX. BUS. ORG. CODE §7.001.

Each statute authorizes exculpation, but exculpation will apply only if expressly so provided in the corporate charter (i.e., the certificate of incorporation of a Delaware corporation or the certificate of formation or, for corporations formed before the application of the Texas Business Organizations Code, the articles of incorporation of a Texas corporation). There is no specific language required to be in the charter. In many cases, the charter contains only “shorthand” language (e.g., directors’ monetary liability is or will be eliminated or limited “to the fullest extent permitted by law”). In other cases, the charter contains language that substantially conforms to the applicable statutory provision. The charter may contain the exculpatory provision when originally filed, or the charter may be amended (in accordance with applicable charter-amendment requirements) to include such a provision.

B. Rationale

The statutory exculpation provisions were adopted in the mid-to-late 1980s in response to significant lawsuits against corporate directors, court decisions imposing substantial liability on corporate directors, and the difficulty in obtaining D&O liability insurance. The provisions were – and still are – intended to encourage capable persons to serve as corporate directors by affording them the freedom to make risky, good-faith business decisions for their corporations without the fear of personal liability.

C. Scope of Exculpated Claims

Because the exculpation provisions do not apply to any breach of the duty of loyalty or any action or omission not in good faith, they are understood by courts and commentators to provide protection against monetary liability only with respect to a director’s breach of the duty of care (where there is no finding of bad faith). In general, duty-of-care claims include negligence, gross negligence, and recklessness. Accordingly, Delaware courts have made it clear that a claim for monetary damages against a director based solely on a violation of the duty of care must be dismissed if the corporation’s charter contains an exculpation provision. *See, e.g., In re Cornerstone Therapeutics Inc. Stockholder Litigation*, 115 A.3d 1173 (Del. 2015) (clarifying that this approach applies even when the underlying standard of review is entire fairness); *In re Novell, Inc. Shareholder Litigation*, 2013 Del.Ch. LEXIS 1 (Jan. 3, 2013); *In re BJ’s Wholesale Club, Inc. Shareholders Litigation*, 2013 Del.Ch. LEXIS 28 (Jan. 31, 2013). The result under Texas law is generally the same, though at least one court has raised the possibility that a gross-negligence claim under Texas law might involve a lack of good faith, which would make the exculpation provision inapplicable. *See FDIC v. Schreiner*, 892 F.Supp. 869, 885 (W.D.Tex. 1995).

An exculpation provision eliminates liability for monetary damages, but does not eliminate a director’s duty of care. Therefore, a plaintiff could still be entitled to equitable remedies, such as injunctive relief or rescission, upon a breach of a director’s duty of care.

An exculpation provision applies by its terms only to liability for monetary damage to “the corporation or its stockholders” (under the Delaware statute) or “the organization or its owners” (which is the equivalent, under the Texas statute). Because the Delaware courts have held that a creditor’s claim against a director for a breach of fiduciary duty (e.g., when the corporation is insolvent) is in effect a derivative claim on behalf of the corporation, however, an exculpation provision also protects against

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