NOTE

FIDUCIARY DUTIES AND DISCLOSURE OBLIGATIONS: RESOLVING QUESTIONS AFTER *MALONE v. BRINCAT*

ABSTRACT

In Malone v. Brincat, *the Delaware Supreme Court announced that, under Delaware law, stockholders may state a cause of action arising out of directors' misdisclosures made in the absence of a request for stockholder action. This note re-emphasizes the court's holding that such claims are not made under any extension of the duty of disclosure. Rather they are based on corporate directors' general — and ever present — fiduciary duties of care, loyalty and good faith.*

This note explains that Malone *did not produce a limitless new disclosure rule. As discussed, traditional concepts of materiality and damages are still relevant to whether a stockholder can state a cognizable claim for fiduciary misdisclosures. In addition, this note argues that in one narrow instance, a rule for an affirmative obligation to disclose in the absence of requested stockholder action can be extracted from* Malone. *This rule is necessary, justified, and compatible with the coexistence of federal securities and Delaware state laws.*

Through examining the limits and requirements of such a rule, this note argues that a director's mental state must be a critical component. An examination of this component concludes that corporate charter provisions, which attempt to shield directors from personal liability, will not be available where a stockholder has made a successful claim for damages arising out of misdisclosures made in the absence of a request for stockholder action.

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I. INTRODUCTION

With its decision in *Malone v. Brincat*,[1] the Delaware Supreme Court finally addressed whether, and under what theory, directors may be liable for faulty disclosures made in the absence of a request for stockholder action. Two issues that now arise involve the applicability of the conventional materiality standard and allegations of damages in disclosure-related causes of action. First, although a materiality standard may apply differently in cases not involving requested stockholder action, some level of "importance" should obtain to those misdisclosures.[2] Second, while the duty of disclosure concept may have been narrowed, its applicability should not give rise to per se nominal damages.[3] Moreover, plaintiffs are not prevented from alleging private harm in the absence of stockholder action.[4]

In addition, this note will explain the narrow instance where, in the absence of requested stockholder action, an affirmative common law

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[1]722 A.2d 5 (Del. 1998).

[2]*See infra* Part III.A (discussing materiality standard for misstatements and omissions).

[3]*See infra* Part III.B.

[4]*See infra* Part III.B.2 (surveying no-stockholder-action cases).

obligation to disclose information to stockholders arises.[5] Finally, this note will address a director's ability to invoke the protections of an exculpation provision in the context of disclosure violations.[6]

II. BACKGROUND: THE EVOLVED CONCEPT OF A DUTY OF DISCLOSURE

Commentators have described *Lynch v. Vickers Energy Corp.*[7] as the origin[8] of, or perhaps more appropriately, a significant "growth point"[9] in, the concept of a fiduciary duty of disclosure.[10] As Delaware disclosure law has developed post *Lynch*, it has become "well-established that the duty of disclosure 'represents nothing more than the well-recognized proposition that directors of Delaware corporations are under a fiduciary duty to disclose fully and fairly all material information within the board's control *when it seeks shareholder action*.'"[11]

Prior to the Delaware Supreme Court's decision in *Malone v. Brincat*,[12] however, it was "by no means clear that full disclosure [was] required only when stockholder action [was] sought."[13] Commentators described the court of chancery as "hopelessly divided" on the issue.[14] While a majority of decisions held that liability for breach of the duty of disclosure required that the misdisclosure be made "in connection with" a request for

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[5]*See infra* Part IV.

[6]*See infra* Part V (discussing the availability of a section 102(b)(7) defense).

[7]383 A.2d 278 (Del. 1977).

[8]"The modern concept of a fiduciary duty of disclosure was first introduced by the Delaware Supreme Court in the case of *Lynch v. Vickers Energy Corp.*" A. Gilchrist Sparks, III & Donna L. Culver, *The Delaware Fiduciary Duty of Disclosure*, 1997 P.L.I. CORP. 383, 386. *See also* Lawrence A. Hamermesh, *Calling Off the* Lynch *Mob: The Corporate Director's Fiduciary Disclosure Duty*, 49 VAND. L. REV. 1087, 1115-18 (1996) (collecting other commentators' descriptions of *Lynch*).

[9]Hamermesh, *supra* note 8, at 1115-21 (examining pre-*Lynch* cases and explaining that *Lynch* "did not truly break new legal ground" but rather "aligned Delaware with jurisdictions" that require a fiduciary to disclose material information to the outside stockholders from whom the fiduciary purchases stock).

[10]The *Lynch* court held that a majority stockholder who offers to purchase stock from a minority stockholder owes "a fiduciary duty . . . which require[s] 'complete candor' in disclosing fully 'all of the facts and circumstances surrounding' [a] tender offer." *Lynch*, 383 A.2d at 279.

[11]Malone v. Brincat, 722 A.2d 5, 9 (Del. 1998) (quoting Zirn v. VLI Corp., 681 A.2d 1050, 1056 (Del. 1996) (*Zirn II*) (quoting Stroud v. Grace, 606 A.2d 75, 84 (Del. 1992))). *See also* Sparks & Culver, *supra* note 8, at 385-86 (citing Kahn v. Roberts, 679 A.2d 460, 467 (Del. 1996); Arnold v. Society for Sav. Bancorp., Inc., 650 A.2d 1270, 1277 (Del. 1994); Zirn v. VLI Corp., 621 A.2d 773, 777-78 (Del. 1993) (*Zirn I*)).

[12]722 A.2d 5 (Del. 1998).

[13]Sparks & Culver, *supra* note 8, at 392.

[14]*See id.*

shareholder action[15] (what this note will refer to as the "stockholder-action" context), some held that the duty was applicable even when no shareholder action was sought[16] (the "no-stockholder-action" scenario).[17]

After finally accepting an "invitation" to address the issue,[18] the Delaware Supreme Court held in *Malone* that, even in the absence of a request for shareholder action, "directors who knowingly disseminate false information that results in corporate injury or damage to an individual

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[15]*See, e.g.*, Kahn v. Roberts, No. 12,324, 1995 Del. Ch. LEXIS 151, at *21-*22 (Del. Ch. Dec. 6, 1995), *reprinted in* 21 DEL. J. CORP. L. 674 (1996), *aff'd*, 679 A.2d 460 (Del. 1996) (holding that even if Board's disclosure was incomplete and misleading, it "could not be, as a matter of law, subject to a breach of duty of candor analysis" because no shareholder action was required in connection with the disclosure); Bragger v. Budacz, No. 13,376, 1994 Del. Ch. LEXIS 202, at *14 (Del. Ch. Dec. 7, 1994) ("Since no shareholder action was sought by the Information Statement a fiduciary obligation of full disclosure is not implicated."); Herd v. Major Realty Corp., No. 10,707, 1990 Del. Ch. LEXIS 211, at *32-*33 (Del. Ch. Dec. 21, 1990) (finding no "exception to the general rule against requiring directors to disclose alleged improper motives" because, *inter alia*, the transaction at issue "[was] not even subject to a stockholder vote"); Raskin v. Birmingham Steel Corp., No. 11,365, 1990 Del. Ch. LEXIS 194, at *15-*16 (Del. Ch. Dec. 4, 1990) ("If the board does not seek shareholder action . . . it has . . . no distinctive state law duty to disclose material developments with respect to the company's business.").

[16]*See, e.g.*, Kahn v. Roberts, No. 12,324, 1994 Del. Ch. LEXIS 33, at *7-*8 (Del. Ch. Feb. 28, 1994), *dismissed by* 1995 Del. Ch. LEXIS 151 (Del. Ch. Dec. 6, 1995) (citing Kelly v. Bell, 254 A.2d 62, 71 (Del. Ch. 1969), *aff'd*, 266 A.2d 878 (Del. 1970)) (stating that "where stockholder approval was not sought or needed, directors who decide voluntarily to disclose information relating to a corporate transaction to stockholders are subject to the duty of full and frank disclosure of all material facts"); Marhart, Inc. v. CalMat Co., No. 11,820, 1992 Del. Ch. LEXIS 85, at *8 (Del. Ch. Apr. 22, 1992), *reprinted in* 18 DEL. J. CORP. L. 330, 336 (1993) (recognizing that "even where there is no obligation to disclose certain information, if it is volunteered, the information must be stated truthfully and candidly"); Freedman v. Restaurant Assocs. Indus., Inc., No. 9212, 1990 Del. Ch. LEXIS 142, at *24 (Del. Ch. Sept. 19, 1990), *reprinted in* 16 DEL. J. CORP. L. 1462, 1476 (1991) ("Although management may have no general obligation to disclose its purposes or motivation, once it undertook to disclose its purpose in revising the offer, it had an obligation to do so truthfully and candidly.").

[17]In a comprehensive pre-*Malone* article on the subject, one commentator suggested the following "restatement":

> Where directors make a statement to the public generally which does not on its face solicit or recommend action by the stockholders, the directors have no fiduciary duty of disclosure, although they may be liable to stockholders under common law fraud principles for actual damages if their statement is false or misleading due to a knowing misstatement or omission of a material fact, and the stockholders rely on such misstatement or omission and sustain injury as a result.

Hamermesh, *supra* note 8, at 1104.

[18]Commentators have aptly observed that the court, faced squarely with the issue in *Kahn*, avoided the issue altogether by ruling that in any event, the alleged disclosure violations were all immaterial. *See* Sparks & Culver, *supra* note 8, at 394-96. As discussed in Part III.A, *infra*, the court's decision in *Malone* has called into question the very reasoning by which it previously avoided the issue in *Kahn*.

stockholder violate their fiduciary duty, and may be held accountable in a manner appropriate to the circumstances."[19] The court explained:

> [The] triparte fiduciary duty [of due care, good faith, and loyalty] does not operate intermittently but is the constant compass by which all director actions for the corporation and interactions with its shareholders must be guided.
>
> Although the fiduciary duty of a Delaware director is unremitting, the exact course of conduct that must be charted to properly discharge that responsibility will change in the specific context of the action the director is taking . . . .[20]

The court emphasized that in the absence of a request for stockholder action, it was *not* the specific duty of disclosure that was implicated, but rather the more general duties of care, loyalty, and good faith.[21] Moreover, there "now appears to be a distinction between 'the fiduciary duty of disclosure' and disclosure violations that implicate fiduciary duties in the broad sense but do not involve communications that contemplate stockholder action."[22]

III. RESOLVING QUESTIONS ABOUT DISCLOSURE RELATED CLAIMS AFTER *MALONE V. BRINCAT*

An action involving the "duty of disclosure" when stockholder action is requested "does not include the elements of reliance, causation and actual quantifiable monetary damages. . . . The essential inquiry in such an action is whether the alleged omission or misrepresentation is material."[23] The *Malone* court did not, however, explicitly address whether, or to what extent, those elements are *required* in a cause of action involving misdisclosures when no stockholder action is contemplated.

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[19]*Malone*, 722 A.2d at 9.

[20]*Id.* at 10. *Cf.* Greg V. Varallo & Kelly A. Herring, *Delaware Law & Directors' Duties in Change of Control Transactions*, 1999 P.L.I. CORP. 43, 45 ("The nature and extent of the duties owed may differ depending upon the type of transaction under consideration.").

[21]*Malone*, 722 A.2d at 10 ("The issue in this case is *not* whether [the] directors breached their duty of disclosure. It is whether they breached their more general fiduciary duty of loyalty and good faith . . . .") (emphasis added).

[22]O'Reilly v. Transworld Healthcare, Inc., 745 A.2d 902, 917 (Del. Ch. 1999). Then Vice-Chancellor Steele characterized the "duty of disclosure" as a "subset" of the general triad of fiduciary duties owed by directors; a duty that "is implicated only when stockholder action is contemplated." *Id.* at 916.

[23]*Malone*, 722 A.2d at 12 (footnotes omitted).

In a no-stockholder-action chancery court case decided pre-*Malone*, a stockholder stated a cognizable claim for relief where the alleged misrepresentations were both *knowingly* made by fiduciaries and *material* to the stockholders, and as a result, the plaintiff *suffered damages*.[24] The following two Parts discuss questions about the applicability of a materiality standard in the no-stockholder-action scenario and claims for damages after *Malone*.[25]

A. *A Materiality Standard*

Under Delaware law, alleged misstatements or omissions must be judged under a materiality standard in stockholder-action scenario.[26] As recently reiterated by the court, "Materiality is determined with respect to the shareholder action being sought."[27] This begs the question, recently addressed by the court of chancery,[28] whether "materiality" of misdisclosures

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[24]*See* Marhart, Inc. v. CalMat Co., No. 11,820, 1992 Del. Ch. LEXIS 85, at *9 (Del. Ch. Apr. 22, 1992), *reprinted in* 18 DEL. J. CORP. L. 330, 336 (1993).

[25]A "scienter" element is considered in Part IV.D, *infra* (discussing intentional misstatements and omissions).

Then Vice-Chancellor Steele very colorfully expressed his frustrations with a chancellor's role and the Delaware Supreme Court's guidance in this area:

> [T]rial judges approaching issues similar to the appropriate analysis of directors' disclosure obligations in the context of a motion to dismiss a pleading feel much like field mechanics attempting triage on a disabled vehicle. The trial judge under enormous pressures of time and conflicting advice on how to diagnose and then make the repairs, has only experience and a sketchy field manual from the factory with which to work. Certain knowledge that the owners will immediately take the vehicle back to the factory for repair and that there are three or more mechanics, who prepared the field manual, who will then assess the nature and quality of the field repairs, make changes to them and/or send the vehicle back with instructions for additional work (often accompanied by a previously unknown, newly published supplement to the existing manual in the field) makes the task even more daunting. Nonetheless, the work must be done and I do so with an introductory attempt to outline principles that I think I have correctly discerned from the current version of the field manual.

O'Reilly, 745 A.2d at 916.

[26]*See, e.g.*, Loudon v. Archer-Daniels-Midland Co., 700 A.2d 135, 141 (Del. 1997) (citing *In re* Santa Fe Pac. Corp. Shareholder Litig., 669 A.2d 59, 66 (Del. 1995)) ("[N]on-disclosure claims must provide some basis for a court to infer that the alleged omissions were material."); *Kahn*, 679 A.2d at 467 (quoting Kelly v. Bell, 254 A.2d 62, 71 (Del. Ch. 1969), *aff'd*, 266 A.2d 878 (Del. 1970) ("[D]irectors owe a duty to honestly disclose all material facts when they undertake to give out statements about the business to stockholders.")); *Arnold*, 650 A.2d at 1277 (citing *Stroud*, 606 A.2d at 84) ("The essential inquiry is whether the alleged omission or misrepresentation is material.")).

[27]*Malone*, 722 A.2d at 12 (footnote omitted).

[28]*See* Jackson Nat'l Life Ins. Co. v. Kennedy, No. 16,472, 1999 Del. Ch. LEXIS 154 (Del. Ch. July 15, 1999) (discussed *infra* notes 35-41 and accompanying text).

must, should, or even can be required in no-stockholder-action cases.[29] To answer this question, it is useful to look into the rationale of the materiality requirement in conventional "duty of disclosure" cases. This Part concludes that at least some variation of a "materiality" standard can and should be required to properly state a cause of action, based on misdisclosures, for breach of fiduciary duties shareholder action.

In the stockholder-action context, Delaware has specifically adopted the materiality of disclosures standard used under Section 14 of the Securities Exchange Act of 1934.[30] "This is an objective standard, measured from the standpoint of a reasonable investor and not from the subjective perspective of what the directors deem important."[31] This "standard . . . contemplate[s] . . . a showing of a substantial likelihood that, under all the circumstances, the omitted fact *would* have assumed actual significance in the deliberations of the reasonable shareholder."[32] Years earlier, the United States Supreme Court rejected the plaintiff-friendly "might" standard of materiality.[33] The court was concerned that in an attempt to avoid potential liability, management would "bury the shareholders in an avalanche of trivial information — a result that is hardly conducive to informed decisionmaking."[34]

When fiduciaries impart allegedly misdisclosed information in the no-shareholder-action context, stockholders are not explicitly called on to make a concrete or immediate decision. Stockholders, however, hold basic rights under the corporate charter. These rights implicitly and continuously contemplate their decision-making; i.e., the right to decide whether or not to sell stock, or whether to remain a stockholder. The concern over fiduciaries bombarding stock-holders with useless information is equally relevant. This becomes evident when considering what information is so important to the exercise of basic stockholder rights that liability ought to be imposed on fiduciaries for improperly disclosing the information.

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[29]Commentators have stated that a "violation of the fiduciary duties of care, good faith and loyalty in connection with disclosure of information not involving stockholder approval, implicates a *different* standard than the 'materiality' standard" traditionally used to evaluate duty of disclosure claims. Varallo & Herring, *supra* note 20, at 64-65 (emphasis added) (citing *Malone*, 722 A.2d at 12).

[30]Securities Exchange Act of 1934, § 14(a), 15 U.S.C. § 78(j) (1994). *See* Rosenblatt v. Getty Oil Co., 493 A.2d 929, 944 (Del. 1985) (citing TSC Indus., Inc. v. Northway, Inc., 426 U.S. 438, 449 (1976)). *See also Zirn I*, 621 A.2d at 778; *Stroud*, 606 A.2d at 84.

[31]Sparks & Culver, *supra* note 8, at 389 (citing *Zirn I*, 621 A.2d at 779).

[32]*Rosenblatt*, 493 A.2d at 944 (emphasis added) (quoting *TSC Indus., Inc.*, 426 U.S. at 449).

[33]*See TSC Indus., Inc.*, 426 U.S. at 448-49.

[34]*Id.*

In a recent no-stockholder-action case, the court of chancery predicted that the Delaware Supreme Court would not require use of a "materiality standard to scrutinize intentionally deceptive communications."[35] Nevertheless, the court of chancery found the standard "helpful in determining the types of false statements which might give rise to a breach of duty of loyalty claim."[36] The court found it "sufficient" to allege that "a reasonably prudent preferred stockholder would have found those omissions asserted . . . to be *important to its consideration of its rights under the Certificate* and that the communicating director or directors could not have reasonably concluded otherwise."[37]

In the absence of a request for stockholder action, the concept of materiality as traditionally applied is somewhat elusive.[38] The *Malone* court, however, did not explicitly abandon the requirement of the *TSC/Rosenblatt*[39] materiality standard for no-stockholder-action cases.[40] Even if the court were to do so, there ought to be some measure by which to evaluate the "importance" of the alleged infringing disclosure. It would not be asking too much to require the "helpful" standard articulated in *Jackson National*, i.e., to evaluate the alleged misdisclosures to determine whether they would "have assumed actual significance in [the stockholder's] approach to the exercise of its . . . contractual rights."[41]

Moreover, fully rejecting any form of a materiality standard would call into question the very reasoning by which the Delaware Supreme Court was previously able to avoid the issue finally resolved by *Malone*. In *Kahn v. Roberts*,[42] a no-stockholder-action case, the court decided that regardless of whether a disclosure duty may have been implicated, the alleged disclosure violations in that case were all immaterial: "If there is any duty, it extends only to material factual omissions or misstatements."[43] Although it is not the specific "duty of disclosure," but rather general fiduciary duties that are implicated when disclosures are challenged in a no-shareholder-

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[35]*Jackson Nat'l Life Ins. Co.*, 1999 Del. Ch. LEXIS 154, at *32.

[36]*Id.* at *31 n.22.

[37]*Id.* at *32 (emphasis added).

[38]In a no-stockholder-action context, "it will often be difficult to conclude as to what the misleading communication could be '*material*'." *Id.* (emphasis added).

[39]*See supra* text accompanying notes 30-34 (exemplifying the materiality standard adopted in Delaware).

[40]Plaintiff's explicitly couched their claims in terms of "materiality" and thus the court would have had no need to address it. *See Malone*, 722 A.2d at 8 ("'every communication . . . was materially false'"); *id.* at 14 ("the complaint alleges . . . [dissemination of] materially false information").

[41]*Jackson Nat'l Life Ins. Co.*, 1999 Del. Ch. LEXIS 154, at *33.

[42]679 A.2d 460 (Del. 1996).

[43]*Id.* at 467.

action context, some level of "importance" ought to be ascribed to the allegedly misstated or omitted information before a plaintiff can obtain redress based on that information. Otherwise, the decision in *Kahn v. Roberts*[44] would make little sense.

B. *Claims for Damages*

Because *Malone* has characterized the "duty of disclosure" as being implicated only when stockholder action is contemplated, and the duties of loyalty and good faith when it is not, questions arise with respect to stating a proper cause of action for damages related to fiduciaries' faulty disclosures. In the former scenario, need damages even be alleged, and in the latter, how may damages be shown?

1. Stockholder-Action Cases

In a pre-*Malone* stockholder-action case, the Delaware Supreme Court explained that a director's personal liability for violations of the duty of disclosure "depends upon the nature of the stockholder action that was the object of the solicitation of stockholder votes and the misstated or omitted disclosures in connection with that solicitation."[45] Absent the implication by the misdisclosure of the stockholders' voting or economic rights, "there is no *per se* doctrine imposing damage liability on directors in a disclosure case."[46] The court explained that "under Delaware law there is no *per se* rule that would allow damages for *all* director breaches of the fiduciary duty of disclosure. . . . Damages will be available *only* in circumstances where disclosure violations are concomitant with deprivation to stockholders' economic interests or impairment of their voting rights."[47]

In a later court of chancery case,[48] then Vice-Chancellor Steele stated that plaintiffs who successfully claim a breach of the duty of disclosure are *entitled* to per se nominal damages "without pleading causation or actual quantifiable damages."[49] Conversely, he stated that "[t]he *per se* rule of damages does not apply to disclosure violations that arise out of communications that do not contemplate stockholder action."[50]

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[44]679 A.2d 460 (Del. 1996).

[45]Loudon v. Archer-Daniels-Midland Co., 700 A.2d 135, 137-38 (Del. 1997).

[46]*Id.* at 138.

[47]*Id.* at 146-47 (emphasis added) (footnote omitted).

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

[49]*Id.* at 917.

[50]*Id.* at 919.

This author believes that then Vice-Chancellor Steele correctly recognized that a disclosure violation in a no-stockholder-action case "neither automatically impairs stockholder voting rights nor automatically deprives stockholders of their economic interests."[51] A reading of *Malone* and *Loudon*, however, does not support the proposition that a violation of the duty of disclosure, as *Malone* narrowly defines it, "entitles" a plaintiff to per se nominal damages.[52] This is because it is not necessarily true that "a disclosure violation arising out of a communication contemplating stockholder action . . . neither automatically impairs stockholder voting rights nor automatically deprives stockholders of their economic interests."[53]

Indeed, this recognition was the force behind *Loudon*'s limitation of *Tri-Star* to only the latter's case.[54] In *Loudon*, the court found no recognizable cause of action for damages where the plaintiff rested a "per se" damages claim "solely on the issue of election of directors."[55] Even after *Malone*, a board election contemplates stockholder action. The court, however, noted the distinction between "enterprise issues" and "ownership claim issues" which "have an immediate and profound impact on stockholders' rights."[56] Then Vice-Chancellor Steele's reasoning that *Malone*'s definition of the "duty of disclosure" automatically entitles plaintiffs to per se damages when they are successful for breach of the duty of disclosure, however, is not consistent with *Loudon* and *Malone*.

First, the court's statement in *Malone* that an action for a breach of the duty of disclosure does not require "the elements of reliance, causation and *actual quantifiable monetary damages*"[57] was unnecessary to its holding.[58]. Also, in support of that statement, the court specifically cited *Loudon*'s reference to the context of a "corporate transaction,"[59] implicating an "ownership" as opposed to an "enterprise" issue.[60] More importantly, "actual quantifiable monetary damages" are not equivalent to impaired voting or economic rights. To say that the former is not required does not mean the latter is not. Conversely, to require an impairment of voting or economic

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[51]*Id.* at 920. See *infra* Part III.B.2 for a discussion of damages in this context.

[52]*See O'Reilly*, 745 A.2d at 919.

[53]*Id.*

[54]*Loudon*, 700 A.2d at 142-43 (discussing *In re* Tri-Star Pictures, Inc. Litig., 634 A.2d 319 (Del. 1993)).

[55]*Id.* at 141-42.

[56]*Id.* at 147 n.47.

[57]*Malone*, 722 A.2d at 12 (emphasis added).

[58]Similarly, the court in *Loudon* explicitly noted that it need "not decide whether or not a pleader must also allege any other elements" in a claim for damages because "[t]hose issues [we]re not before the court." *Loudon*, 700 A.2d at 142 n.28.

[59]*Malone*, 722 A.2d at 12 n.27 (quoting *Loudon*, 700 A.2d at 142).

[60]*See Loudon*, 700 A.2d at 147 n.47.

rights does not necessarily mean that "quantifiable" monetary damages must be demonstrated. Moreover, nothing since *Loudon* has altered the notion that per se damages are not available for disclosure violations, absent a showing of harm to the stockholders' economic or voting rights.[61]

2. No-Stockholder-Action Cases

Turning back to the no-stockholder-action case, one might question how a plaintiff can plead and demonseerate dages. *Malone* has indirectly answered that question in the case of a derivative action: there, the plaintiffs alleged that the company lost $2 billion as a result of the directors' dissemination of false information.[62] The court noted that although the plaintiffs' claims were not properly articulated, it was possible that they could state a derivative claim on behalf of the corporation.[63] The difficult question is *how* plaintiffs can demonstate any damages in a no-stockholder-action context.

More than six years before *Malone*, commentators queried whether the United States Supreme Court opinion in *Virginia Bankshares*[64] would affect private causes of action under Delaware state law concerning disclosure violations where stockholder action was not required.[65] In *Virginia Bankshares*, minority stockholders whose votes were neither required nor necessary, challenged disclosures made in connection with the directors' request for their approval of a merger.[66]

Commentators, noting the *Virginia Bankshares*' finding that such plaintiffs could not maintain a federal private action under Section 14(a)[67] because they could not establish "causation of damages,"[68] surveyed Delaware disclosure cases. The question remained "whether a showing of damages is necessary with respect to . . . disclosure claims" under Delaware state law.[69] Those commentators pointed out the possible — and plausible - argument that "the complaining shareholders, since their votes are not

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[61]*See Loudon*, 700 A.2d at 146-47.

[62]*See Malone*, 722 A.2d at 8. Because the case was dismissed at the summary judgment stage, plaintiffs had only *alleged* causation. Whether, and with what evidence, one must allege and prove causation in a claim for damages related to disclosure violations is not within the scope of this note.

[63]*See Malone*, 722 A.2d at 14.

[64]Virginia Bankshares, Inc. v. Sandberg, 501 U.S. 1083 (1991).

[65]*See* Jesse A. Finkelstein et al., *The Potential Implications of* Virginia Bankshares *for Delaware Law*, INSIGHTS, May 1992, at 26.

[66]*Virginia Bankshares, Inc.*, 501 U.S. at 1087.

[67]Securities Exchange Act of 1934, § 14(a), 15 U.S.C. § 78n (1994).

[68]*Virginia Bankshares, Inc.*, 501 U.S. at 1099-107.

[69]*See* Finkelstein et al., *supra* note 65, at 31.

necessary" to effect any solicited action, "have *suffered no damages* and thus cannot maintain disclosure claims."[70]

Those early commentators countered their own argument with the significance of the fiduciary relationship itself:

> One could envision an argument that even in a voluntary disclosure setting, the harm to the shareholders results not from any monetary loss or even the loss of the right to cast an informed vote per se, but from a violation of the fiduciary relationship itself. Courts undoubtedly will be troubled by the notion that directors or other fiduciaries can mislead or even intentionally lie to shareholders without fear of reprisal or judicial review. . . . Perhaps in this setting, it is the duty of loyalty rather than the duty of disclosure that is implicated, although such a distinction may be purely academic.[71]

As *Malone* would later reveal, the distinction between implication of a duty of loyalty, and a duty of disclosure, was not purely academic. When directors breach their fiduciary duties as a result of the manner in which they impart information to stockholders, stockholders may properly show "a cause of action for damages."[72]

IV. AN AFFIRMATIVE OBLIGATION TO DISCLOSE

As discussed above,[73] the Delaware Supreme Court in *Malone v. Brincat* did not expand the "duty of disclosure" to cases where no-shareholder- action was contemplated. Rather, it clarified that directors may violate their fiduciary duties to stockholders if they knowingly disseminate false information, even if stockholder action is not contemplated.[74] Extrapolating from *Malone*, this Part discusses that in the absence of stockholder action there generally is not — and should not be — what may broadly be termed a common law "affirmative obligation to disclose." Not to be confused with the duty of disclosure, what this note calls an "affirmative obligation to disclose" means an obligation on fiduciaries to give out information to stockholders in the first instance. Commentators have explained:

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[70] *Id.* at 30 (emphasis added).

[71] *Id.* at 31.

[72] *Malone*, 722 A.2d at 14 (citation omitted).

[73] *See supra* Part II (surveying the evolution of the duty of disclosure).

[74] *See Malone*, 722 A.2d at 9.

> As a general rule, and excepting principles of common law and fraud, Delaware law does not impose an affirmative obligation on the management or board of directors of a corporation voluntarily to provide financial information or other data to stockholders other than the very limited information mandated by the Delaware General Corporation Law.[75]

In certain circumstances, however, failing to disclose information should give rise to a stockholder's cause of action against directors for breach of the fiduciary duties of loyalty and good faith.

Below is a discussion of why there generally is no such affirmative obligation. An examination of the rationale for obligating fiduciaries to avoid misleading "partial" disclosures follows. Finally, these Parts conclude with an explanation of the narrow instance when there should be an affirmative obligation to disclose in the no-stockholder-action context.

A. *Why No General Disclosure Duty?*

The following concepts generally developed when courts and commentators considered whether the "duty of disclosure" should be implicated in the absence of a request for stockholder action. They are also relevant to when, and to what extent, there ought to be an affirmative common law obligation to disclose information in the above situation.

First, there are valid business concerns when considering whether to obligate directors to give out corporate information.[76] Directors may be able to help the company obtain and maintain competitive advantages, thus increasing the value of the stockholders' investments, if it does not have to reveal certain information.[77] Moreover, increased disclosure obligations could cause fearful fiduciaries to dump vast amounts of information on stockholders.[78] Not only could this be counterproductive to the general

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[75]Sparks & Culver, *supra* note 8, at 385 (citations omitted).

[76]*See* Raskin v. Birmingham Steel Corp., No. 11,365, 1990 Del. Ch. LEXIS 194, at *16 (Del. Ch. Dec. 4, 1990) ("There are good business reasons to permit the company to treat material information confidentially.").

[77]*See* Stroud v. Grace, No. 10,719, at *40 (Del. Ch. Nov. 1, 1990), *reprinted in* 16 DEL. J. CORP. L. 1588, 1610 (1991), *aff'd in part, rev'd in part*, 606 A.2d 75 (Del. 1992) (noting that privately-held corporation "apparently developed a competitive advantage by keeping confidential its financial and proprietary information").

[78]*See TSC Indus., Inc.*, 426 U.S. at 448-49 ("Some information is of such dubious significance that insistence on its disclosure may accomplish more harm than good. . . . [M]anagement's fear of exposing itself to substantial liability may cause it simply to bury the shareholders in an avalanche of trivial information - a result that is hardly conducive to informed decisionmaking.").

decision-making rights of the stockholders,[79] but it could also waste the company's resources (by wasting the directors' "company time").

Second, there is a "panalopy of federal protections that are available to investors in connection with the purchase or sale of securities of Delaware corporations."[80] Some pre-*Malone* decisions found this dispositive in dismissing suits against directors for disclosure violations in the absence of a request for shareholder action. For example, the trial court in *Malone* noted that "[t]he federal securities laws ensure the timely release of accurate information into the marketplace" and "should not be duplicated or impliedly usurped by Delaware."[81] The court concluded that "[w]hen a shareholder is damaged merely as a result of the release of inaccurate information into the marketplace, unconnected with any Delaware corporate governance issue, that shareholder must seek a remedy under federal law."[82]

Absent Delaware law, relevant federal securities laws include Section 10(b) of the Securities Exchange Act of 1934[83] and corresponding Rule 10b-

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For example, "[d]isclosure of the underlying analysis supporting a fairness opinion 'is not ordinarily required.' Rather, the potential benefits of such disclosure must be weighed against the potential harm." Goodwin v. Live Entm't, Inc., No. 15,765, 1999 Del. Ch. LEXIS 5, at *33 (Del. Ch. Jan. 22, 1999), *reprinted in*, 24 DEL. J. CORP. L. 1084, 1110 (1999), *aff'd*, 741 A.2d 16 (Del. 1999) (citations omitted). *See also Arnold*, 650 A.2d at 1279 ("Materiality requires a careful balancing of the potential benefits of disclosure against the possibility of resultant harm."). The *Goodwin* court agreed that a board "should have legitimately been concerned about disclosing an analysis its financial advisor considered unreliable." *Goodwin*, 1999 Del. Ch. LEXIS 5, at *38, *reprinted in*, 24 DEL. J. CORP. L. at 1112. "The risk that an unreliable analysis could lead stockholders to reject a good deal based on the false hope that a better deal was around the corner is one a board must consider in assessing whether to disclose." *Id.*

[79]*Goodwin*, 1999 Del. Ch. LEXIS 5, at *38, *reprinted in*, 24 DEL. J. CORP. L. at 1112; *see also Arnold*, 650 A.2d at 1280 ("[A]s an abstraction, Delaware law does not require disclosure of inherently unreliable or speculative information which would tend to confuse stockholders or inundate them with an overload of information."). *Cf. Raskin*, 1990 Del. Ch. LEXIS 194, at *15-*16 (holding that unless information is necessary for stockholders to make a meaningful decision, the board has "no distinctive state law duty to disclose material developments").

[80]Malone v. Brincat, 722 A.2d 5, 13 (Del. 1998) (citations omitted). *See infra* notes 84-93 and accompanying text (outling some of the federeal protections that are available under the Securities Exchange Act of 1934).

[81]Malone v. Brincat, No. 15,510, 1997 Del. Ch. LEXIS 158, at *7 (Del. Ch. Oct. 30, 1997), *aff'd in part, rev'd in part*, 722 A.2d 5 (Del. 1998).

[82]*Id.* at *7-*8.

> The federal security laws, not Delaware statutory or common law, police the market. Where no transaction requires shareholder approval, the propriety of a board's public disclosure may be subject to a claim under federal securities law. In the absence of required shareholder action, Delaware law simply has no application to boards' or directors' disclosures or omissions.

Kahn v. Roberts, No. 12,324, 1995 Del. Ch. LEXIS 151, at *22 (Del. Ch. Dec. 6, 1995), *reprinted in* 21 DEL. J. CORP. L. 674, 689 (1996), *aff'd*, 679 A.2d 460 (Del. 1996).

[83]15 U.S.C. § 78(j) (1994).

5.[84] The "foundational requirement" of a 10b-5 claim is that an alleged fraud occurred "in connection with the purchase or sale of a security."[85] There is an implied private right of action available to stockholders if they have purchased or sold securities.[86] If the stockholders lack standing to assert a private action, they may bring a derivative action if the corporation itself purchased or sold the securities.[87] Although the "purchase and sale" requirement should "be read flexibly in order to effect [the] securities laws' remedial purposes,"[88] stockholders cannot invoke the rule's protections absent an underlying transaction.[89] Other relevant federal laws include Sections 9(e),[90] 18(a),[91] and 14(a)[92] and corresponding Rule 14(a).[93] Those sections similarily require an underlying transaction.[94]

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[84]17 C.F.R. § 240.10b-5 (2000).

[85]Ambassador Hotel Co. v. Wei-Chuan Inv., 189 F.3d 1017, 1025 (9th Cir. 1999). Once a plaintiff proves this "foundational requirement," she "must prove five [additional] elements: 1. misrepresentation (or omission, where there exists some duty to disclose); 2. materiality; 3. scienter (intent to defraud or deceive); 4. reliance; and 5. causation." *Id.* (citing McGonigle v. Combs, 968 F.2d 810, 817 (9th Cir. 1992)).

[86]*See, e.g.*, Ciro, Inc. v. Gold, 816 F. Supp. 253, 261 (D. Del. 1993); *In re* American Cont'l Corp./Lincoln Sav. & Loan Sec. Litig., 49 F.3d 541, 542 (9th Cir. 1995); Greenstein v. Paul, 400 F.2d 580, 580-81 (2d Cir. 1968).

[87]*Ciro, Inc.*, 816 F. Supp. at 262; *Greenstein*, 400 F.2d at 582.

[88]*In re American Continental Corp.*, 49 F.3d at 542.

[89]*Greenstein*, 400 F.2d at 581 (stating "that to maintain . . . [a private] action under § 10(b) of the Act and Rule 10b-5 of the Securities and Exchange Commission the plaintiff must have been a seller of the stock involved"). Had there been an underlying transaction in *Malone*, the stockholders might have been able to meet the "in connection with" requirement because of the kind of misstatements allegedly made: "Deception related to the value or merit of the securities in question has sufficient connection to securities transactions to bring the fraud within the scope of § 10(b)." *Ambassador Hotel Co.*, 189 F.3d at 1026 (citation omitted).

[90]15 U.S.C. § 78i(e) (1994). Section 9(e) prohibits manipulation of security prices by, *inter alia*, the use of false or misleading statements, and provides a private right of action to "any person who shall purchase or sell any security which was affected by such act." *Id.* §§ 78i(a), (e).

[91]*Id.* § 78r(a). In addition to a "purchase or sale" requirement, private actions under Section 18(a) for damages must be based on misstatements in a document "filed pursuant to" — i.e., *required* to be filed by — the Act. *See, e.g.*, Staffin v. Greenberg, 509 F. Supp. 825, 838 (E.D. Pa. 1981), *aff'd*, 672 F.2d 1196 (3d Cir. 1982).

[92]15 U.S.C. § 78n(a).

[93]17 C.F.R. § 240.14a-9 (2000).

[94]*See supra* notes 90-91 and accompanying text.

B. *Delaware Law Concerning Partial Disclosures*

The Delaware Supreme Court additionally derived from the duty of disclosure cases the "law of partial disclosure."

> In addition to the traditional duty to disclose all facts material to the proffered transaction, directors are under a fiduciary obligation to avoid misleading partial disclosures. The law of partial disclosure is . . . clear: "[O]nce defendants travel[ ] down the road of partial disclosure . . . they . . . [have] an obligation to provide the stockholders with an accurate, full, and fair characterization of those historic events."[95]

Thus, even if the information that was partially disclosed was not material — a critical requirement in the usual duty of disclosure case[96] — the directors may be obligated to give out additional, even immaterial, information in order to avoid misleading the stockholders.[97]

C. *A Narrow Affirmative Obligation to Disclose in the Absence of a Request for Stockholder Action*

In a no-stockholder-action scenario, should arise only an affirmative obligation to disclose information when disclosure is necessary to prevent misleading stockholders through previously disclosed information. The rationale is twofold. The first scenario is where the "panalopy" of federal laws[98] do not protect stockholders. The second, and more fundamental scenario, is where Delaware law can logically invoke traditional fiduciary duty principles to fill in that gap.[99]

If directors have not misstated any information, but rather have given out information that is literally true but misleading because relevant information was omitted, there should be an affirmative state law obligation to disclose the omitted information.[100] The harm to be avoided is that individual stockholders may rely on the misleading information and

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[95]*Zirn II*, 681 A.2d at 1056 (alteration in original) (quoting *Arnold*, 650 A.2d at 1280).

[96]*See supra* notes 26-33 and accompanying text.

[97]*Zirn II*, 681 A.2d at 1056 (citing *Arnold*, 650 A.2d at 1280) ("Under *Arnold*, the disclosure of even a non-material fact can, in some instances, trigger an obligation to disclose additional, otherwise non-material facts in order to prevent the initial disclosure from materially misleading the stockholders.").

[98]*See supra* notes 80-93 and accompanying text.

[99]*See infra* notes 106-09 and accompanying text.

[100]This obligation is qualified below. *See infra* Part IV.D.

consequently remain stockholders to their detriment.[101] Although federal securities laws afford protection against misleading disclosures and omissions, that protection arises only where the stockholder purchased or sold securities, and the misleading disclosure or omission was "in connection with" that purchase or sale.[102]

Reasoning against a disclosure obligation, one court stated that "[n]either the Delaware corporation code nor the common law suggests that Delaware can or should pick up the perceived regulatory slack when federal scrutiny may not include review of every actionable theory divinable by a dogged plaintiff."[103] That the duty of disclosure "is separate and distinct from disclosure obligations imposed by federal law"[104] does not mean, however, that together they exhaust situations where the law can and should protect stockholders by requiring affirmative disclosure. Indeed, while federal law may mandate that certain items be disclosed to stockholders, "state fiduciary duty law has a role to play in regulating what directors actually say."[105]

This author does not believe that in the absence of contemplated stockholder action, "there is no fiduciary relation at stake at all."[106] As with the law concerning partial disclosures in the stockholder-action context,[107]

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[101]This harm is similar to that which the *Malone* plaintiffs might have pled in conjunction with a private cause of action. *Malone*, 722 A.2d at 14. The plaintiffs did appear to make an attempt at asserting a derivative action on behalf of the corporation, as they alleged a $2 billion loss in value. *See id.* Allegedly, the directors knowingly overstated financial information about the corporation. *See id.* at 8. The plaintiffs apparently were and continued to be stockholders, i.e., they did not sell. *See id.* at 13. Had there been an allegation of harm to the individual stockholders, such as reliance on the directors' misstatements to remain stockholders, their claim may not have been dismissed. *See id.* "[P]laintiffs should have the opportunity to replead to assert any individual cause of action and articulate a remedy that is appropriate on behalf of the named plaintiffs individually." *Id.* at 14.

[102]*See supra* notes 80-93 and accompanying text. *See also Malone*, 722 A.2d at 13 (stating that the Securities Litigation Uniform Standards Acts of 1998, Pub. L. No. 105-353, 112 Stat. 3227 (1998), applies to "securities class actions involving the purchase or sale of nationally traded securities"); Hamermesh, *supra* note 8, at 1176 (explaining that private recovery under Rule 10b-5 is foreclosed where the stockholders' alleged injury occurred as a result of their not selling or purchasing more shares in reliance on the alleged misdisclosure).

[103]Malone v. Brincat, No. 15,510, 1997 Del. Ch. LEXIS 158, at *8 (Del. Ch. Oct. 30, 1997), *aff'd in part, rev'd in part*, 722 A.2d 5 (Del. 1998).

[104]Varallo & Herring, *supra* note 20, at 63.

[105]Matador Capital Mgmt. Corp. v. BRC Holdings, Inc., 729 A.2d 280, 294-95 (Del. Ch. 1998) (acknowledging that federal law "prescribes the items of disclosure required by Schedule 14D-9 and . . . mandates the dissemination of that disclosure statement" while noting that the approval and recommendation are judged under state law norms). *Cf. Ciro, Inc.*, 816 F. Supp. at 263 ("Congress did not intend to federalize all corporate law touching upon securities transactions. Corporations are creatures of state law and state law governs their internal affairs.").

[106]Hamermesh, *supra* note 8, at 1173.

[107]*See supra* Part IV.B (discussing Delaware law concerning partial disclosures).

fiduciary duties embrace the notion that in no-stockholder-action scenarios, once initial disclosures have been made, directors must divulge any additional information necessary to avoid misleading stockholders.[103] Even in the absence of a request for shareholder action, fiduciaries are still bound by the general fiduciary duties of care, loyalty, and good faith. As stated by the court in *Marhart*, "It is entirely consistent with this settled principle of law that fiduciaries who undertake the responsibility of informing stockholders about corporate affairs, be required to do so honestly."[109]

D. *Qualifying the Affirmative Obligation*

On the latter point of honesty, this author agrees that "fiduciary claims based on market misstatements that are unconnected to any request for shareholder action will likely also require allegations of intentional [or reckless] director wrongdoing . . . sufficient to warrant an inference of disloyalty or bad faith."[110] This should be true in the case of misleading omissions as well.

A 1999 court of chancery opinion[111] is consistent with the proposition that "the mental state of directors is compellingly relevant"[112] to stating a proper cause of action related to misleading omissions made without a connection to stockholder action. Then Vice-Chancellor Steele was correct in *Jackson National* when he stated:

> [I]t follows from the Court's reasoning [in *Malone*] that one who pleads that directors deliberately omitted information from

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[103]The court of chancery has "note[d] the admonition of the Delaware Supreme Court in *Zirn* that 'a fiduciary's duty is best discharged through a broad rather than a restrictive approach to disclosure.'" *Matador Capital Mgmt. Corp.*, 729 A.2d at 296 (quoting *Zirn I*, 621 A.2d at 779-80).

[109]Marhart, Inc. v. CalMat Co., No. 11,820, 1992 Del. Ch. LEXIS 85, at *9 (Del. Ch. Apr. 22, 1992), *reprinted in* 18 DEL. J. CORP. L. 330, 336 (1993).

[110]Paul L. Regan, *Attention to Intention*: Malone v. Brincat *Might Set Recklessness Standard for Similar Cases of Director Disloyalty*, DEL. L. WKLY., Aug. 31, 1999, at 7. Interestingly, while allegations of "deliberate" and "knowing" conduct were present in *Malone*, the court did not answer whether they were required. Earlier, the court in *Loudon* explicitly left that issue open: "We do not decide whether or not a pleader must also allege any other elements (*e.g.*, negligence, gross negligence, intentional misconduct . . .) to state a claim for damages based on disclosure violations." *Loudon*, 700 A.2d at 142 n.28.

[111]Jackson Nat'l Life Ins. Co. v. Kennedy, No. 16,472, 1999 Del. Ch. LEXIS 154 (Del. Ch. July 15, 1999) (released for publication Aug. 27, 1999). Ironically, this opinion was released practically simultaneously with Professor Regan's article. Sharing important principles, these authorities were unknowingly on the same "wavelength."

[112]Regan, *supra* note 110, at 8. *Cf.* Hamermesh, *supra* note 8, at 1102 ("Where director self-interest is absent, there is no need for strict liability of disgorgement-type remedies to discourage fiduciary opportunism.").

> a communication with . . . stockholders under circumstances that suggest an intent to mislead the stockholders has set forth a violation of the fiduciary duty of loyalty owed to [the] . . . stockholders.[113]

Jackson National thus "extends" *Malone* in the sense that, where no stockholder action is requested, directors may be liable for a breach of the fiduciary duties of loyalty and good faith. This is true, not only if they intentionally misstate information, but also if they *omit* information with an "intent to mislead."[114]

Then Vice-Chancellor Steele's understanding is consonant with the theory that in order to state a proper claim based on faulty disclosures in the no-stockholder-action context, a "complaint *must* plead the claim as a breach of [the] fiduciary duty of *loyalty*."[115] Taking this one step further, it follows that if a stockholder is successful with such a claim against directors for monetary relief, a charter provision adopted pursuant to Section 102(b)(7)[116] *cannot* protect directors from personal liability. This is discussed in the next Part.

V. AVAILABILITY OF A SECTION 102(b)(7) DEFENSE

If a corporate charter includes a provision authorized by Section 102(b)(7), directors may be shielded from personal liability for monetary damages in claims arising out of disclosure violations. This protection hinges on whether the violation implicates the duties of loyalty and/or good faith, in which case that section's exceptions prohibit liability limitation.[117] The question may play out very differently in duty of disclosure cases than in cases involving misdisclosures where no shareholder action is contemplated.

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[113] *Jackson Nat'l Life Ins. Co.*, 1999 Del. Ch. LEXIS 154, at *30 (emphasis added).

[114] *Id.* Regan explains that the disloyalty involved is a "conceptual disloyalty" as opposed to the "conventional sort of loyalty claim involving allegations of financial gain for the directors at the expense of the shareholders." Regan, *supra* note 110, at 7.

[115] *Jackson Nat'l Life Ins. Co.*, 1999 Del. Ch. LEXIS 154, at *30 (emphasis added). *See also* Regan, *supra* note 110, at 7 (stating that "it was imperative for the plaintiffs to allege intentional (or at least reckless) misconduct by the . . . board so as to make out a claim of director disloyalty or bad faith").

[116] DEL. CODE ANN. tit. 8, § 102(b)(7) (Supp. 1998).

[117] "[S]uch provision shall not eliminate or limit the liability of a director: (i) For any breach of the director's duty of loyalty . . . [or] (ii) for acts or omissions not in good faith or which involve intentional misconduct or a knowing violation of the law . . . ." *Id.*

"[A] violation of the duty of disclosure is not necessarily a breach of the duty of loyalty."[118] In stockholder-action scenarios, practitioners have noted a distinction between "self-interested" transactions where the fiduciary sought stockholder approval, and "arm's-length" transactions involving a disinterested and independent board of directors.[119] In the former, "the duty of disclosure is recognized as a product of the . . . duty of loyalty,"[120] while in the latter it "is most appropriately viewed as an offshoot of the fiduciary duty of care."[121] Commentators aptly find that "the characterization of the breach of the duty of disclosure . . . is of the utmost significance . . . where the corporation has a charter provision exempting directors from breaches of the fiduciary duty of care."[122] One commentator has expressed concern, stating that as long as the duty of disclosure is described "as an ill-defined hybrid of the duties of care and loyalty," protection from personal liability under 102(b)(7) authorized provisions will remain uncertain.[123]

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[118]Cinerama, Inc. v. Technicolor, Inc., 663 A.2d 1156, 1163 n.9 (Del. 1995) (citation omitted).

[119]*See* Sparks & Culver, *supra* note 8, at 389-92.

[120]*Id.* at 390 (citation omitted) (describing cases where a majority stockholder was held to the duty in connection with offers to purchase stock from minority stockholders).

[121]*Id.* at 391 (citing *Zirn II*, 681 A.2d at 1062 ("A good faith erroneous judgment as to the proper scope or content of required disclosure implicates the duty of care rather than the duty of loyalty.")). The court in *Zirn II* retreated in part from *Zirn I*. *Compare Zirn I*, 621 A.2d at 783 *with Zirn II*, 681 A.2d at 1062 n.7.

The court has rejected the argument that Section 102(b)(7) does not extend to violations of the duty of disclosure: "claims alleging disclosure violations that do not otherwise fall within any exception are protected by Section 102(b)(7) and any certificate of incorporation provision . . . adopted pursuant thereto." *Arnold*, 650 A.2d at 1287. In *Arnold*, the director defendants were protected from monetary liability because they "acted in good faith and did not intentionally violate their duty of disclosure or breach their duty of loyalty." Arnold v. Society for Savings Bancorp., Inc., 678 A.2d 533, 535 (Del. 1996) (citing *Arnold*, 650 A.2d at 1273, 1286, 1290). Recently, the court of chancery stated:

> Directors' disclosure obligations arise out of both the fiduciary duty of care and loyalty. A claim for breach of the fiduciary duty of disclosure implicates only the duty of care when the factual basis for the alleged violation suggests that the violation was made as a result of a good faith, but nevertheless, erroneous judgment about the proper scope or content of the required disclosure. However, where a complaint alleges or pleads facts sufficient to support the inference that the disclosure violation was made in bad faith, knowingly or intentionally, the alleged violation implicates the duty of loyalty.

O'Reilly v. Transworld Healthcare, Inc., 745 A.2d 902, 914-15 (Del. Ch. 1999) (footnotes omitted). Thus, a plaintiff may "survive a motion to dismiss . . . disclosure claims against . . . directors despite the looming spectre of . . . [an] Exculpation Provision" tracking Section 102(b)(7). *Id.* at 915.

[122]Sparks & Culver, *supra* note 8, at 406-07.

[123]Hamermesh, *supra* note 8, at 1095-96. *Cf.* Curtis Huff, *Fiduciary Obligations of Directors in Considering and Responding to Acquisition Proposals*, 1013 PLI/CORP. 561, 574 (1997). "Because [Section] 102(b)(7) does not limit liability for breaches of duty of loyalty, its application to matters involving changes of control is often uncertain where the lines between the duty of care and loyalty are often blurred." *Id.* So too with disclosure issues.

When dealing with misleading omissions and misstatements not occurring in connection with any request for shareholder action, it may not even be necessary to articulate whether the violation falls within the Section 102(b)(7) provision exceptions. In this context, an exculpation provision's applicability will fundamentally depend on whether the court would even recognize a cause of action where there has been no intentional or reckless wrongdoing.[124] Because the court will likely not recognize such a cause of action,[125] a Section 102(b)(7) provision will simply not be available to shield directors from personal monetary liability imposed on them for disclosure violations committed in the absence of any request for stockholder action.[126]

VI. CONCLUSION

Although the Delaware Supreme Court has made some clarifications to the Field Manual,[127] some issues remain cloudy. In post-*Malone* disclosure cases, the court of chancery has done fairly well with its difficult task.[128] Allegations of disclosure violations, unconnected with any request for shareholder action, should articulate why those misdisclosures are so important or material that they should be actionable. Claims seeking damages for violations of the duty of disclosure where the disclosures are connected to stockholder action, should prove some harm to nonetheless stockholders' economic or voting rights.

Additionally, if stockholder ation is not requested and directors take it upon themselves to information, then the directors should have an obligation to disclose additional information if it would prevent the initial disclosures from misleading stockholders in the consideration of their rights. A successful cause of action under these circumstances should require the same form of scienter — recklessness or intentional deceit — as required in any breach of fiduciary duty case involving misdisclosures in the absence of

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[124]*See supra* Part IV.D (qualifying the affirmative obligation of disclosure).

[125]*See id.*

[126]The *Malone* court did note that "[i]naccurate information . . . *may be* the result of a violation of the fiduciary duties of *care*, loyalty *or* good faith." *Malone*, 722 A.2d at 11 (emphasis added). "When the directors disseminate information to stockholders when no stockholder action is sought, the fiduciary duties of care, loyalty and good faith apply. Dissemination of false information could violate one or more of those duties." *Id.* at 12. Honesty and loyalty, however, were the driving forces behind the holding in *Malone*. *See* Regan, *supra* note 110, at 7. "[T]he fiduciary claim potentially available in *Malone* was a claim for breach of the duties of loyalty and/or good faith. That is why the plaintiffs' allegation of intentional deception by the . . . directors was crucial . . . ." *Id.*

[127]*See supra* note 25.

[128]*See* O'Reilly v. Transworld Healthcare, Inc., 745 A.2d 902 (Del. Ch. 1999) (discussed *supra* Part III.B.1; Jackson Nat'l Life Ins. Co. v. Kennedy, No. 16,472, 1999 Del. Ch. LEXIS 154 (Del. Ch. July 15, 1999) (discussed *supra* Parts III.A and IV.D).

requested stockholder action. Thus, directors will be unable to invoke the protection of charter provisions that limit director liability for monetary damages for breaches of the duty of care.

As Delaware courts continue to sift through the issues of disclosure related cases, the preservation of the fiduciary relationship will continue to be a very important guiding principle.

Holly M. Barbera