masuda funai

News & Types: Client Advisories

Duty of Oversight Owed by Officers of Delaware Corporations

3/30/2023

By: Benjamin F. Gould

Practices: Corporate, Finance & Acquisitions

Co-Author: Tadashi Tahara, International Legal Advisor (Law Clerk)

For officers of U.S. subsidiary companies that are Delaware corporations, a recent Delaware case provides an important reminder of the duties owed by such officers to the corporation, which can be challenging to fulfill for officers outside of the United States. The Delaware Court of Chancery recently held that officers of a Delaware corporation owe a duty of oversight to the company and clarified the scope of the duty of oversight owed by officers. The Delaware Court of Chancery has recognized that a board of directors owes a duty of oversight to the company, which includes making a good faith effort to assure the adequacy of the information and reporting systems. However, the extent to which Delaware corporate law recognizes that officers also owe such a duty of oversight to a company has yet to be clear. This recent opinion has clarified the position regarding officers' oversight responsibility. It guides the duties of oversight for officers of a Delaware corporation.

These duties were described in a recent case at the Delaware Court of Chancery, which involved a derivative action by a corporation's stockholders against the Chief People Officer, an officer of the corporation, alleging that the officer owed a duty of oversight as his fiduciary duty and that the officer breached his duty by consciously ignoring the red flags of sexual harassment and misconduct in the company. The Court's important opinions can be summarized into the following three points. (1) First, while the Delaware Court of Chancery addressed that officers owe duties of oversight comparable to directors, it laid it out by stating that in contrast to the board of directors owing duties of oversight for the corporation as a whole, the scope of the officers' oversight duties is limited within an officer's area of responsibility. For example, the Chief Marketing Officer will be expected to oversee mainly the area of marketing. In contrast, the Chief Executive Officer will be expected to oversee the company as a whole, like the board of directors. (2) The Court then noted that when the officer notices any red flag which is "sufficiently prominent," the officer is responsible for reporting such red flag to the board of directors even when it is outside of their area of responsibility. (3) The Court further opined that the officer is liable only when the plaintiff can prove the officer's bad faith in breaching his oversight responsibility, specifically by consciously failing to make a good faith effort to establish the information system or consciously ignoring red flags.

Based on this opinion, the officers of a Delaware corporation must recognize that they should make a good faith effort to set up an information system to obtain the necessary information to conduct their duties within their area of responsibility and report any red flags they notice to the board of directors and/or any highest-ranked officer, such as the Chief Executive Officer. Suppose an officer lives in a foreign country and cannot oversee the day-to-day operation. In that case, an officer must appoint someone who conducts daily operations on-site and have them report any red flags that come to their attention. In addition, it is worth considering setting up an internal whistleblowing system to find issues that are not likely to be discovered by the regular reporting system. Suppose the officer finds any red flag issues within or outside their area of responsibility. In that case, the officer should consider whether to report to the board of directors and/or any higher-ranked officer in good faith.