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Plumbing in the Boardroom: Plugging Boardroom Leaks Through a Good Faith Duty of Confidentiality

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NOTES

PLUMBING IN THE BOARDROOM: PLUGGING BOARDROOM LEAKS THROUGH A GOOD FAITH DUTY OF CONFIDENTIALITY

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I. INTRODUCTION: BOARDROOM DRAMA AT HEWLETT-PACKARD

On January 24, 2005, the *Wall Street Journal* published a front-page article detailing confidential boardroom discussions at Hewlett-Packard's (H-P) annual board meeting.[1] The article described, in explicit detail, discussions about granting three named senior executives more authority over day-to-day operations of the company despite objections by Carly Fiorina, H-P's then-chairwoman and chief executive.[2] After the *Wall Street Journal* article caused rumors of management reorganization, the board fired Ms. Fiorina in February 2005.[3] In May 2005, newly appointed chairwoman Patricia Dunn launched an investigation to determine who leaked information from H-P's January 2005 board meeting.[4] This investigation failed to identify the source of the leak.[5]

In January 2006, *C-NET* published an article detailing long-term strategy discussions from the H-P board's annual retreat.[6] Although the article revealed mostly positive information,[7] Dunn remained concerned about director leaks to the press.[8] Dunn hired outside investigators who tailed suspected leakers and used pretexting[9] to obtain private phone

1. Pui-Wing Tam, *Hewlett-Packard Board Considers a Reorganization—Management Moves Stem from Performance Concerns; Helping Fiorina 'Succeed,'* WALL ST. J., Jan. 24, 2005, at A1.

2. *Id.* According to the article, Fiorina initially resisted the moves but later acquiesced. *Id.*

3. *See* Pui-Wing Tam, *H-P's Board Ousts Fiorina as CEO*, WALL ST. J., Feb. 10, 2005, at A1.

4. Patricia Dunn, Opinion, *The H-P Investigation*, WALL ST. J., Oct. 11, 2006, at A14.

5. *Id.*

6. David A. Kaplan, *Suspicions and Spies in Silicon Valley*, NEWSWEEK, Sept. 18, 2006, at 40, *available at* 2006 WLNR 15902182; Dawn Kawamoto & Tom Krazit, *HP Outlines Long-Term Strategy*, CNET NEWS.COM, Jan. 23, 2006, http://news.com.com/HP+outlines+long-term+strategy/2100-1014_3-6029519.html.

7. Justin Fox, *Board Games: Leaks, Spies, and Governance*, FORTUNE, Oct. 2, 2006, at 23, *available at* 2006 WLNR 16198424 (noting that the January 2006 leak was "neither embarrassing nor very revealing").

8. *See* Patricia Dunn, *supra* note 4.

9. Pretexting is a spying technique for obtaining phone records, credit card records, and other personal information about an individual or company. *See* Pui-Wing Tam, *I Spy—A Reporter's Story: How H-P Kept Tabs on Me for a Year*, WALL ST. J., Oct. 19, 2006, at A1. In the H-P case, investigators impersonated Mrs. Tam (a *Wall Street Journal* reporter covering H-P) in calls to her phone carrier. *Id.* The investigators used the last four digits of her social security number to obtain her phone records. *Id.* Corporate snooping is hardly limited to H-P. *See* Michael Orey, *Corporate Snoops*, BUS. WK., Oct. 9, 2006, at 47, *available at* 2006 WLNR 17243485 ("Several prominent Hollywood bigwigs and attorneys used the services of . . . [a] private investigator . . . indicted . . . in February for illegal wiretapping. And Oracle Corp. acknowledged in 2000 that it hired detectives who had attempted to obtain the trash of a think tank that defended the aggressive business practices of its archrival, Microsoft Corp."); *see also* Chistopher Conkey, *FTC Tries to Fight Phone Pretexting but Has Few Weapons*, WALL ST. J., Oct. 13, 2006, at B1 (outlining the Federal Trade Commission's struggle to fight pretexting without federal laws

records of directors and of newspaper reporters covering H-P.[10] Dunn clearly believed the leaks were damaging the corporation, no matter their content.[11]

Before accepting a position on the board, H-P directors sign agreements stating that they will not grant unauthorized interviews,[12] but many directors are not bound by confidentiality agreements.[13]

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specifically banning the practice). Despite media criticism and the dubious legality of pretexting and other investigative tactics, the private investigation industry remains strong. *See id.* (stating that the "diffuse, opaque nature of the often unregulated information-trafficking industry" limits regulators' capabilities, and that customers continue to demand private records). However, the indictment of Patricia Dunn and others involved in the H-P pretexting scandal may chill demand for private investigators. *See* Peter Waldman & Don Clark, *California Charges Dunn, 4 Others In H-P Scandal*, WALL ST. J., Oct. 5, 2006, at A1. The charges against Dunn were eventually dropped. *See* Peter Waldman & Christopher Lawton, *H-P Case Fizzles in State Court*, WALL ST. J., Mar. 15, 2007, at A3; Editorial, *Dunn & Lockyer*, WALL ST. J., Mar. 15, 2007, at A16 (congratulating "California Judge Ray Cunningham for showing both mercy and wisdom by dropping all charges against Patricia Dunn"). The House of Representatives also held hearings to discuss the legality of pretexting. *See generally U.S. Rep. Edward Whitfield (R-KY) Holds a Hearing on the Hewlett-Packard Pretexting Scandal: Hearing Before the Subcomm. on Oversight and Investigations of the H. Comm. on Energy and Commerce*, 109th Cong. (2006) [hereinafter *House Hearing*].

10. *See* Kaplan, *supra* note 6, at 40.

11. Patricia Dunn disclosed her personal views in a letter to the *Wall Street Journal*. *See* Patricia Dunn, *supra* note 4. She stated:

> The most sensitive aspects of a company's business come before its board: strategy, executive succession, acquisitions, new product development. This is exactly the type of information a company's competitors and those who trade in its stock would love to have before that information is properly disseminated. This is exactly why it is so essential that directors respect the confidentiality of the discussions and decisions that occur in the boardroom.

Id.; *see also House Hearing*, *supra* note 9, at 31-32 (opening statement of Patricia Dunn, Ex-Chairman of the Board of Hewlett-Packard, Inc.). Dunn is not alone in her stance. In a recent *New York Times* article, George J. Terwilliger III, a former attorney general and current corporate defense lawyer in Washington D.C., stated, "The boardroom is supposed to be a place where the people who have a fiduciary duty to manage the company can discuss things amongst themselves, including performance issues with the management of the company, in the utmost of confidence that there will not be public disclosure and maneuvering." Julie Creswell, *A Board in Need of an Emily Post*, N.Y. TIMES, Sept. 7, 2006, at C1, *available at* 2006 WLNR 15481039.

12. Patricia Dunn, *supra* note 4. "At H-P, all directors, officers and employees are bound by the same Standards of Business Conduct, to which they attest compliance annually, including a section which says, 'You may not grant interviews or provide comments to the press without prior approval from H-P Corporate Communications . . . .'" *Id.*

13. Corporate leaks provide one reason for the increased use of corporate snoops. According to a Merrill Lynch survey, more than half of fifty executives surveyed stated that leaks of confidential or proprietary information were their primary "information-security concern." Phred Dvorak & Vauhini Vara, *At Many Companies, Hunt for Leakers Expands Arsenal of Monitoring Tactics*, WALL ST. J., Sept. 11, 2006, at B1. Though more infrequent than employee leaks, director leaks are still a problem at many companies. *Id.*

Accordingly, the H-P leaker, later identified as George Keyworth,[14] might have violated his contractual duties to H-P by granting personal interviews to reporters.[15] But is Keyworth liable to H-P shareholders for breaching his state-law fiduciary duties to the company?[16] Surprisingly, the answer appears to be no; directors currently do not owe their corporations a general fiduciary duty of confidentiality.[17]

Part II of this Note describes recent changes to the legal landscape in corporate governance. Part III outlines a director's fiduciary duties under current Delaware law. Part IV describes how a general duty of confidentiality would fit squarely within a director's duty of good faith. Finally, Part V analyzes the implications of recognizing a general duty of confidentiality before concluding that such a duty would benefit shareholders, directors, and investors.

> [B]oardroom leaks can be a symptom of larger problems. "The leaks are because someone feels disempowered" on the board . . . . "You can make a rule 'You can't leak to the press.' But if you don't have a constructive process for people to feel heard and then commit to decisions, then you've left the door wide open" for problems.

Id. (quoting Dell Larcen, a management consultant).

14. George Anders & Alan Murray, *Boardroom Duel: Behind H-P Chairman's Fall, Clash with a Powerful Director*, WALL ST. J., Oct. 9, 2006, at A1.

15. *See* Patricia Dunn, *supra* note 4.

16. H-P's use of pretexting in its leak investigations led to both criminal and civil charges against H-P and H-P executives involved in the investigations. *See supra* note 9. H-P paid $14.5 million to settle a California civil complaint stemming from the company's use of pretexting in its investigations. *See* Christopher Lawton, *H-P Settles Civil Charges in 'Pretexting' Scandal*, WALL ST. J., Dec. 8, 2006, at A3. The pretexting issue is outside the scope of this Note, which focuses on directors' duty of confidentiality.

17. Research revealed no caselaw outside the insider-trading realm addressing whether a director who reveals corporate confidences fails to act in good faith. *Compare* COMMITTEE ON CORPORATE LAWS, AM. BAR ASS'N, CORPORATE DIRECTOR'S GUIDEBOOK 18-19 (4th ed. 2004) [*hereinafter* DIRECTOR'S GUIDEBOOK] ("A director should keep confidential all matters involving the corporation that have not been disclosed to the general public."), *with* Viet D. Dinh, *Dunn and Dusted*, WALL ST. J., Sept. 26, 2006, at A14 ("[T]here is no general duty of confidentiality for directors, only a duty of loyalty to act in the best interests of the corporation and its shareholders."). Despite its recommendation, the *Director's Guidebook* explicitly states that "[i]ts description of director conduct is not intended as legal advice or a suggestion that different conduct will result in violation of the law or potential personal liability." DIRECTOR'S GUIDEBOOK, *supra*, at 2. Accordingly, the *Director's Guidebook* is best understood as an outline of "best practices" as opposed to minimum practices to avoid liability. It should also be noted that Mr. Dinh represents Tom Perkins, another H-P director and close friend of George Keyworth. *See* Anders & Murray, *supra* note 14 ("When the leak issue came to a head, Mr. Perkins tried to play down the matter and protect his friend, Mr. Keyworth, who was fingered as the leaker.").

II. RECENT CHANGES IN THE CORPORATE CLIMATE

Recent corporate scandals have greatly influenced the field of corporate governance. Increased media attention since the corporate scandals at Enron, Tyco, and WorldCom[18] has caused courts to express less deference toward directors' business judgment[19] and to hold directors accountable to higher standards of conduct.[20] As a trendsetter in corporate law, the Delaware judiciary has heightened standards for director conduct through the developing duty of good faith.[21]

In the past, the business judgment rule[22] and director shield statutes[23] effectively eliminated director liability for all but the most egregious conduct.[24] In support of director shield statutes, commentators argue that the risk of liability prevents otherwise willing candidates from accepting directorships.[25] The recent corporate scandals have brought corporate

18. *See* CG Hintmann, Comment, *You Gotta Have Faith: Good Faith in the Context of Directorial Fiduciary Duties and the Future Impact on Corporate Culture*, 49 ST. LOUIS U. L.J. 571, 571 (2005) ("Everyone remembers the highly publicized financial scandals involving WorldCom, Qwest, Global Crossing, Tyco, and Enron, which ultimately cost shareholders $460 billion.").

19. *See generally* Sean J. Griffith, *Good Faith Business Judgment: A Theory of Rhetoric in Corporate Law Jurisprudence*, 55 DUKE L.J. 1, 7-8 (2005) (describing how the corporate scandals of the early 2000s have forced courts to express less deference toward a director's business judgment).

20. *See* Tara L. Dunn, *The Developing Theory of Good Faith in Director Conduct: Are Delaware Courts Ready to Force Corporate Directors to Go Out-of-Pocket After* Disney IV*?*, 83 DENV. U. L. REV. 531, 536 (2005) (describing how Delaware courts are increasing the standards required of directors by providing "specific instructions to help plaintiffs overcome procedural obstacles and substantive explanations of what a breach of good faith might look like").

21. This Note focuses on Delaware state law because the Delaware judiciary is a trendsetter in corporate law and because H-P is incorporated in Delaware. *See* Hewlett-Packard Co., Annual Report (Form 10-K), at 1 (Dec. 22, 2006). Many commentators have written about the Delaware courts' increased recognition of the duty of good faith. *See generally* Tara L. Dunn, *supra* note 20 (discussing how the duty of good faith exposes corporate directors to personal liability); Melvin A. Eisenberg, *The Duty of Good Faith in Corporate Law*, 31 DEL. J. CORP. L. 1 (2006) (outlining the development of the duty of good faith in Delaware law); Thomas Rivers, Note, *How to Be Good: The Emphasis on Corporate Directors' Good Faith in the Post-Enron Era*, 58 VAND. L. REV. 631 (2005) (describing good faith as another procedural device courts can use to hold directors personally liable); Hillary A. Sale, *Delaware's Good Faith*, 89 CORNELL L. REV. 456 (2004) (distinguishing between the duty of good faith and the duties of care and loyalty).

22. *See infra* note 37.

23. *See infra* note 46 and accompanying text.

24. *See generally* Stuart R. Cohn, *Demise of the Director's Duty of Care: Judicial Avoidance of Standards and Sanctions Through the Business Judgment Rule*, 62 TEX. L. REV. 591 (1983) (asserting, shortly before the Delaware Supreme Court's 1985 decision in *Smith v. Van Gorkom*, that courts' overly broad interpretations of the business judgment rule had rendered the fiduciary duty of care meaningless); *see also infra* notes 30-31.

25. *See* R. Franklin Balotti & Mark J. Gentile, *Elimination or Limitation of Director Liability for Delaware Corporations*, 12 DEL. J. CORP. L. 5, 8 (1987); Nanette Byrnes & Jane Sasseen, *Board*

governance to the forefront, however, and the states have increased their supervision of director conduct.[26] In addition, the federal government has begun intruding more into the field of corporate governance with the passage of both the Sarbanes-Oxley Act of 2002[27] and Regulation Fair Disclosure.[28]

Further, judges are increasingly scrutinizing director decisions and showing a higher propensity to impose personal liability on directors who breach their fiduciary duties.[29] The willingness of directors at Enron and WorldCom to pay out-of-pocket class action settlements of $13 million and $25 million, respectively,[30] exemplifies the current trend toward increased scrutiny of directors since the recent wave of corporate scandals. This shift directly contrasts with courts' previous reluctance to impose

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of Hard Knocks, BUS. WK., Jan. 22, 2007, at 36, 38, *available at* 2007 WLNR 1239482 (noting that "[a]ctivist shareholders, tougher rules, and anger over CEO pay have put directors on the hot seat," and that "[m]any board candidates no longer find the job attractive"). *But see* Lisa M. Fairfax, *Spare the Rod, Spoil the Director? Revitalizing Directors' Fiduciary Duty Through Legal Liability*, 42 HOUS. L. REV. 393, 449-55 (2005) (asserting that no proof exists that increased director liability will lead to "wholesale desertion of corporate directorships").

26. Tara L. Dunn, *supra* note 20, at 541 (describing how the Delaware courts have incrementally increased standards for director conduct while working within the constraints of precedent and stare decisis).

27. Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (codified in scattered sections of 11, 15, 18, 28, and 29 U.S.C.).

28. Regulation FD, 17 C.F.R. §§ 243.100-243.103 (2006). The Sarbanes-Oxley Act of 2002 and Regulation FD represent two instances of federal intrusion into areas of law typically reserved to the states. *See generally* Roberta S. Karmel, *Realizing the Dream of William O. Douglas—The Securities and Exchange Commission Takes Charge of Corporate Governance*, 30 DEL. J. CORP. L. 79 (2005) (analyzing the increased role of federal law in corporate governance after the Sarbanes-Oxley Act of 2002); *infra* note 156.

29. *See* Smith v. Van Gorkom, 488 A.2d 858, 874 (Del. 1985) (holding directors personally liable for gross negligence in approving a merger); *In re* Caremark Int'l Inc. Derivative Litig., 698 A.2d 959, 970 (Del. Ch. 1996) (stating that directors must assure reporting and information systems exist to provide sufficient information to reach informed judgments). *See generally* Tara L. Dunn, *supra* note 20 (arguing that institutional plaintiffs have enough power and sophistication to use the duty of good faith to circumvent director liability shields and force directors to pay damages out-of-pocket). *But see generally* Griffith, *supra* note 19 (arguing that the appearance of the duty of good faith since the recent corporate scandals is part of an oscillating pattern of judicial oversight in direct response to public pressure and media attention).

30. *See* Bernard Black et. al., *Outside Director Liability*, 58 STAN. L. REV. 1055, 1118 (2006). Despite these large settlements against Enron and WorldCom directors, some commentators argue that outside directors still face relatively low exposure to out-of-pocket liability as long as they have appropriate insurance policies and standard indemnification agreements with the corporation. *Id.* at 1137-39. For an alternative view, see Tara L. Dunn, *supra* note 20, at 533-34 (arguing that directors face a "very real possibility of personal liability" due to the Sarbanes-Oxley Act of 2002, increasingly aggressive and sophisticated institutional investors, and more refined judicial standards for director conduct pursuant to the duty of good faith).

personal liability on directors.[31]

Since Enron and WorldCom, the corporate legal landscape has changed dramatically. Media coverage and public outrage have changed social norms and expectations for director behavior. As courts respond to the media attention given to the recent corporate scandals, the duty of good faith has evolved as an appropriate way to proscribe culpable director conduct otherwise permitted by the traditional duties of care and loyalty.[32] By emphasizing the duty of good faith, courts allow shareholder-plaintiffs to avoid director exculpatory and indemnification provisions,[33] therefore increasing the likelihood that directors will be held personally liable for breaches of their fiduciary duties.

III. DIRECTOR FIDUCIARY DUTIES PURSUANT TO DELAWARE LAW

Pursuant to Delaware law, "the business and affairs of a Delaware corporation are managed by or under its board of directors."[34] In performing his managerial duties, a director is "charged with an unyielding fiduciary duty to the corporation and its shareholders."[35] When shareholders attempt to challenge director conduct in a derivative action, a court "presumes that 'in making a business decision the directors of a corporation act[] on an informed basis, in good faith, and in the honest belief that the action taken [i]s in the best interests of the company.'"[36]

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31. *See* Black et al., *supra* note 30, at 1067 (stating that *Van Gorkom* was the only case in which a court forced outside directors to pay out-of-pocket damages to shareholder-plaintiffs); Cohn, *supra* note 24, at 638 (noting that the business judgment rule had become an insurmountable barrier to imposing liability on culpable directors); Fairfax, *supra* note 25, at 411 (noting that *Van Gorkom* is "the exception that proves the rule" that directors face little risk of out-of-pocket liability).

32. *See infra* Part III.C.

33. *See infra* notes 77-80 and accompanying text.

34. *Van Gorkom*, 488 A.2d at 872; *see also* DEL. CODE ANN. tit. 8, § 141(a) (2006); FLA. STAT. § 607.0801(2) (2006). The statute states,

> The business and affairs of every corporation organized under this chapter shall be managed by or under the direction of a board of directors, except as may be otherwise provided in this chapter or in its certificate of incorporation. If any such provision is made in the certificate of incorporation, the powers and duties conferred or imposed upon the board of directors by this chapter shall be exercised or performed to such extent and by such person or persons as shall be provided in the certificate of incorporation.

Id.

35. *Van Gorkom*, 488 A.2d at 872.

36. Brehm v. Eisner (*In re* Walt Disney Co. Derivative Litig.), 906 A.2d 27, 52 (Del. 2006) (quoting Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984)).

This presumption, known as the business judgment rule,[37] can be rebutted if a plaintiff shows that a director breached any of his fiduciary duties of loyalty, care, or good faith.[38] If a plaintiff proves that a director breached a fiduciary duty, the breaching director must either prove that the challenged act or transaction is entirely fair to the corporation and its shareholders or pay damages caused by the breach.[39] The remainder of Part III outlines the three duties that a director owes to his corporation and its shareholders: loyalty, care, and good faith.[40]

A. *The Duty of Care*

The duty of care requires a director to act in a manner he reasonably believes to be in the best interests of the corporation.[41] When evaluating

37. Under the business judgment rule, a court presumes that directors who are not financially interested in a transaction act on an informed basis and reasonably believe that their actions are in the best interests of the corporation. *See Aronson*, 473 A.2d at 812; *In re* Walt Disney Co. Derivative Litig., 825 A.2d 275, 286 (Del. Ch. 2003); *see also* MODEL BUS. CORP. ACT § 8.30 (2004) (defining "Standards of Conduct for Directors"); A.L.I., PRINCIPLES OF CORPORATE GOVERNANCE § 4.01(c) (2005). Courts justify this deference to director judgment by asserting that shareholders voluntarily invest in risky businesses for profit and that "after-the-fact litigation is a most imperfect device to evaluate corporate business decisions." Joy v. North, 692 F.2d 880, 885-86 (2d Cir. 1982). For an analysis of the business judgment rule as applied to corporate officers, see Lyman P.Q. Johnson, *Corporate Officers and the Business Judgment Rule*, 60 BUS. LAW. 439 (2005) (arguing that the business judgment rule "does not and should not be extended to corporate officers in the same broad manner in which it is applied to directors").

38. *Disney*, 906 A.2d at 52. Commentators and judges dispute whether the duty of good faith is a separate fiduciary duty or is included within the duties of loyalty and care. *See* Eisenberg, *supra* note 21, at 10-15 (outlining the conflict between the Delaware Supreme Court's "triadic" view of director fiduciary duties and the "dyadic" view expressed by Vice Chancellor Strine of the Delaware Court of Chancery); see also, MODEL BUS. CORP. ACT § 8.31 (2004) (defining standards of liability for improper director conduct). In *Stone v. Ritter*, 911 A.2d 362 (Del. 2006), the Delaware Supreme Court adopted the dyadic view, stating that "the requirement to act in good faith 'is a subsidiary element,' i.e., a condition, 'of the fundamental duty of loyalty.'" *Id.* at 370 (quoting *Guttman v. Huang*, 823 A.2d 492, 506 n.34 (Del. Ch. 2003)).

39. *Disney*, 906 A.2d at 52. *But see* Cohn, *supra* note 24, at 594-95 ("So common is the disposition of cases by reference to the business judgment rule that a casual observer could readily conclude that the obligation of care and the defensive presumption of the business judgment rule are mirror images of a unitary standard. It is doubtful whether there still exists a sanction for lack of care, unadulterated by self-enrichment or other opprobrious behavior." (footnote omitted)).

40. In *Stone*, the Delaware Supreme Court noted that "although good faith may be described colloquially as part of a 'triad' of fiduciary duties that includes the duties of care and loyalty, . . . [o]nly the latter two duties, where violated, may directly result in liability, whereas a failure to act in good faith may do so, but indirectly." *Stone*, 911 A.2d at 370. This Note refers to the duty of good faith in this "colloquial" sense.

41. This Note is principally concerned with the duty of good faith. For detailed analyses of the duty of care, see Henry Ridgely Horsey, *The Duty of Care Component of the Delaware Business Judgment Rule*, 19 DEL. J. CORP. L. 971 (1994) (outlining former Delaware Supreme Court Justice Horsey's views concerning the interplay between the duty of care and the business judgment rule);

duty of care claims, courts generally focus on the process directors use to reach corporate decisions.[42] Thus, duty of care claims typically concern a director's obligations to monitor corporate actions[43] and to act only after reasonable investigation and consideration.[44] Although the duty of care imposes hefty obligations, directors generally face liability only if they act in a grossly negligent manner.[45] Additionally, directors enjoy substantial statutory protection from liability for breaches of the duty of care. Director shield[46] and indemnification[47] statutes allow a corporation to limit or eliminate director personal liability for breaches of the duty of care. As a result, courts almost never impose liability for these types of breaches.[48]

Lyman Johnson, *Rethinking Judicial Review of Director Care*, 24 DEL. J. CORP. L. 787 (1999) (critiquing judicial standards of review in duty-of-care cases).

42. *See* JAMES D. COX & THOMAS LEE HAZEN, CORPORATION 203-04 (2d Ed. 2003).

43. *In re* Caremark Int'l Inc. Derivative Litig., 698 A.2d 959, 970 (Del. Ch. 1996) ("I am of the view that a director's obligation includes a duty to attempt in good faith to assure that a corporate information and reporting system, which the board concludes is adequate, exists, and that failure to do so under some circumstances may . . . render a director liable for losses caused by non-compliance with applicable legal standards."). *But see* Rosenblatt v. Getty Oil Co., 493 A.2d 929, 943 (Del. 1985) (noting that directors "cannot be expected to manage the day-to-day activities of a company").

44. Smith v. Van Gorkom, 488 A.2d 858, 893 (Del. 1985) (holding directors personally liable for failing "to inform themselves of all information reasonably available to them and relevant to their decision to recommend" a merger).

45. *See id.* at 881 (concluding that directors' gross negligence in approving a merger breached their duty of care).

46. *See, e.g.*, DEL. CODE ANN. tit. 8, § 102(b)(7) (2006); FLA. STAT. § 607.0831 (2006). Pursuant to Delaware's statute, the certificate of incorporation of a corporation may contain the following:

> [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, provided that such provision shall not eliminate or limit the liability of a director: (i) For any breach of the director's duty of loyalty 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 any unlawful dividend payment or stock purchase]; or (iv) for any transaction from which the director derived an improper personal benefit.

tit. 8, § 102(b)(7). For cases outlining the protections of Delaware's exculpation statute, see Emerald Partners v. Berlin, 726 A.2d 1215, 1223-24 (Del. 1999); Arnold v. Soc'y for Sav. Bancorp, Inc., 650 A.2d 1270, 1286-89 (Del. 1994). For the American Law Institute's version of the exculpatory statute, see A.L.I., *supra* note 37, § 7.19.

47. *See* DEL. CODE ANN. tit. 8, § 145 (2006); FLA. STAT. § 607.0850 (2006); *see also* MODEL BUS. CORP. ACT § 8.51 (2004).

48. *See supra* notes 30-31 and accompanying text.

B. *The Duty of Loyalty*

In contrast to the duty of care, which focuses on a director's decision-making process, the duty of loyalty generally focuses on a director's motives.[49] The duty of loyalty requires a director to prioritize corporate interests ahead of the director's personal interests.[50] "Simply put, a director should not use the director's corporate position for personal profit or gain or for other personal or non-corporate advantage."[51] Thus, a loyalty concern typically arises when a director either has a financial conflict of interest with the corporation[52] or usurps a corporate opportunity.[53]

The Delaware Supreme Court expanded the scope of the duty of loyalty, however, in its recent decision in *Stone v. Ritter*.[54] Amid the Delaware courts' recent focus on the duty of good faith (discussed more

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49. *See* COX & HAZEN, *supra* note 42, at 204.

50. DIRECTOR'S GUIDEBOOK, *supra* note 17, at 14. This Note principally concerns the good faith aspect of the duty of loyalty. For further analysis of the general duty of loyalty, see Lyman Johnson, *After Enron: Remembering Loyalty Discourse in Corporate Law*, 28 DEL. J. CORP. L. 27 (2003) (describing changes in the duty of loyalty since the scandal at Enron).

51. DIRECTOR'S GUIDEBOOK, *supra* note 17, at 14.

52. *See* Eisenberg, *supra* note 21, at 27-28 ("A manager is interested, for purposes of the duty of loyalty, when he, an associate, or a family member has a financial interest in the transaction or the conduct."). Thus, director conflict-of-interest issues generally arise when a director acts on both sides of a transaction or fails to disclose a direct or indirect financial interest in a corporate transaction. Perlegos v. Atmel Corp., Nos. Civ. A. 2320-N, Civ. A. 2321-N 2007 WL 475453, at *16 (Del. Ch. Feb. 8, 2007) ("The facts differ from case to case, but the question of directors' loyalty almost universally centers on whether they were interested or laced the independence relative to the matter before them."); DIRECTOR'S GUIDEBOOK, *supra* note 17, at 15; *see also* Nagy v. Bistricer, 770 A.2d 43, 47 (Del. Ch. 2000) (holding directors liable for failing to inform a minority shareholder that the directors served on both sides of a merger agreement).

53. The corporate opportunity doctrine originated with the Delaware Supreme Court's decision in *Guth v. Loft*, 5 A.2d 503 (Del. 1939). The court stated,

> Corporate officers and directors are not permitted to use their position of trust and confidence to further their private interests. While technically not trustees, they stand in a fiduciary relation to the corporation and its stockholders. A public policy, existing through the years, and derived from a profound knowledge of human characteristics and motives, has established a rule that demands of a corporate officer or director, peremptorily and inexorably, the most scrupulous observance of his duty, not only affirmatively to protect the interests of the corporation committed to his charge, but also to refrain from doing anything that would work injury to the corporation, or to deprive it of profit or advantage which his skill and ability might properly bring to it, or to enable it to make in the reasonable and lawful exercise of its powers. The rule that requires an undivided and unselfish loyalty to the corporation demands that there shall be no conflict between duty and self-interest.

Id. at 510.

54. 911 A.2d 362 (Del. 2006).

fully below), courts and scholars disagreed whether the duty of good faith was a separate fiduciary duty or simply an element of the duty of loyalty.[55] In *Stone*, the Delaware Supreme Court resolved this conflict by holding that the duty of good faith was a "subsidiary element" of the duty of loyalty.[56]

When a loyalty concern arises, a court will evaluate the act or transaction under the "entire fairness" standard.[57] Under this standard, the transaction must be substantively fair and must affirmatively benefit the corporation.[58] If a court deems the questioned transaction fair to the corporation, the transaction is valid and the director has not breached his duty of loyalty.[59]

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55. *Compare* Eisenberg, *supra* note 21, at 27-31 (distinguishing the duty of good faith from the traditional duties of care and loyalty), *and* Sale, *supra* note 21, at 464 (arguing that the courts have "laid the groundwork" for a freestanding duty of good faith), *with* Guttman v. Huang, 823 A.2d 492, 506 n.34 (Del. Ch. 2003) ("A director cannot act loyally towards the corporation unless she acts in the good faith belief that her actions are in the corporation's best interest."), *and* Nagy v. Bistricer, 770 A.2d 43, 49 n.2 (Del. Ch. 2000) ("By definition, a director cannot simultaneously act in bad faith and loyally towards the corporation and its stockholders.").

56. *Stone*, 911 A.2d at 370 (noting that one doctrinal consequence of its formulation of the obligation to act in good faith was that "the fiduciary duty of loyalty is not limited to cases involving a financial or other cognizable fiduciary conflict of interest. [The duty of loyalty] also encompasses cases where the fiduciary fails to act in good faith.").

57. Cinerama, Inc. v. Technicolor, Inc., 663 A.2d 1156, 1168 (Del. 1995). The fairness standard is extremely fact-specific. *See* Marciano v. Nakash, 535 A.2d 400, 405-06 (Del. 1987) (analyzing detailed facts surrounding loans made by directors to the corporation). Relevant factors a court might consider include the following:

> (i) whether the terms of the proposed transaction are at least as favorable to the corporation as might be available from other persons or entities, (ii) whether the proposed transaction is reasonably likely to further the corporation's business activities and (iii) whether the process by which the decision is approved or ratified is fair.

DIRECTOR'S GUIDEBOOK, *supra* note 17, at 16.

58. *See* Johnson, *supra* note 50, at 41.

59. *Id.* In the past, transactions involving interested directors were voidable upon proof of a director conflict of interest. *See Marciano*, 535 A.2d at 403. Under current law, however, an interested-director transaction is voidable only if the transaction is unfair to the corporation. *See id.* at 404. Ordinarily, an interested director must prove that the transaction is fair to the corporation. *Id.* Section 144 of the Delaware General Corporation Law, however, shifts the burden of proof to the plaintiff to prove the unfairness of a transaction if the transaction is approved by a majority of disinterested directors or shareholders. Cinerama, Inc. v. Technicolor, Inc., 663 A.2d 1134, 1154 (Del. Ch. 1994), *aff'd*, 663 A.2d 1156 (Del. 1995); *see also* DEL. CODE ANN. tit. 8, § 144 (2006); FLA. STAT. § 607.0832 (2006). Section 144 operates only as a "burden switch"; courts will still analyze the intrinsic fairness of a transaction even if the transaction has been approved by disinterested directors or shareholders. *See Marciano*, 535 A.2d at 404-05.

C. *The Evolving Duty of Good Faith*

As a matter of statutory law, most states require directors to discharge their duties in good faith.[60] In Delaware, the duty of good faith is not an independent fiduciary duty, but a necessary condition to a director's compliance with his fiduciary duty of loyalty.[61]However, the duty of good faith was typically disregarded by courts in favor of a director's fiduciary duties of loyalty and care.[62] In contrast, the Delaware judiciary has recently begun using the duty of good faith as a "doctrinal vehicle" to proscribe questionable director conduct not covered by the traditional definitions of loyalty and care.[63]

In *In re Walt Disney Company Derivative Litigation*,[64] the Delaware Supreme Court outlined the contours of the evolving duty of good faith.[65] The *Disney* derivative litigation arose from Disney's employment and subsequent termination of Michael Ovitz as president.[66] In August, 1995, Disney signed a five-year employment agreement with Ovitz.[67] After fourteen months of mediocre performance by Ovitz, Disney terminated his employment without cause, paying him a severance package valued at approximately $130 million.[68] Disney shareholders sued both Ovitz and Disney's directors, claiming that the board was grossly negligent in its cursory review of Ovitz's employment contract and subsequent no-fault

60. *See* Eisenberg, *supra* note 21, at 6-10 (outlining the "legal status" of the duty of good faith pursuant to statutory law); *see also* MODEL BUS. CORP. ACT § 8.30(a) (2004) ("Each member of the board of directors, when discharging the duties of a director, shall act . . . in good faith . . . .").

61. *See Stone*, 911 A.2d at 369-70; *supra* notes 54-56 and accompanying text.

62. *See, e.g.*, Emerald Partners v. Berlin, 2001 WL 115340, at *25 n.63 (Del. Ch. Feb. 7, 2001).

63. Brehm v. Eisner (*In re* Walt Disney Co. Derivative Litig.), 906 A.2d 27, 66 (Del. 2006) (stating that the duty of good faith is an appropriate "doctrinal vehicle" to protect a corporation's interests from fiduciary misconduct that "does not involve disloyalty (as traditionally defined) but is qualitatively more culpable than gross negligence"); *see also Berlin*, 726 A.2d at 1221 (noting that "a breach of any one of the board of directors' triad of fiduciary duties, loyalty, good faith or due care, sufficiently rebuts the business judgment presumption and permits a challenge to the board's action under the entire fairness standard"). Vice Chancellor Strine has consistently criticized the Delaware Supreme Court's formulation of the duty of good faith. *See, e.g.*, Guttman v. Huang, 823 A.2d 492, 506 n.34 (Del. Ch. 2003) (arguing that the duty of good faith is simply an element of the duty of loyalty); Nagy v. Bistricer, 770 A.2d 43, 49 n.2 (Del. Ch. 2000) ("By definition, a director cannot simultaneously act in bad faith and loyally towards the corporation and its stockholders.").

64. 906 A.2d 27 (Del. 2006).

65. *Id.* at 62-68.

66. *Id.* at 35.

67. *Id.*

68. *Id.*

termination.[69] The shareholders asserted that the directors' gross negligence breached both their duty of care and, in an attempt to circumvent Delaware's director shield statute, their duty of good faith.[70] The court of chancery concluded that each Disney director fulfilled his fiduciary duties,[71] and the shareholders appealed.[72] The Delaware Supreme Court affirmed and clarified the distinctions between a director's fiduciary duties of care and good faith.[73]

The Delaware Supreme Court sharply criticized the *Disney* shareholders for trying to "collapse" the duty of good faith into the duty of care.[74] The court asserted that the shareholders' claims amounted only to claims of gross negligence—the typical standard for a breach of the duty of care.[75] Although the duties of good faith and care might cross conceptually when a director is grossly negligent, the court asserted that the need to draw precise legal lines mandates that grossly negligent conduct "without any malevolent intent" cannot constitute a breach of the duty of good faith.[76]

The *Disney* court further noted that the Delaware legislature also supports the distinction between the duties of care and good faith.[77] The Delaware General Corporation Law authorizes Delaware corporations to exculpate[78] and indemnify[79] directors from monetary damages for breaches of the duty of care but not for violations of the duty of good faith. From these two legislative actions, the Delaware Supreme Court failed to find any "basis in policy, precedent or common sense" to justify destroying the distinction between gross negligence—breach of the duty of care—and bad faith.[80]

To further distinguish the duty of good faith from the duty of care, the court examined two other categories of director conduct that might breach the duty of good faith.[81] The first category, "subjective bad faith," includes

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69. *Id.* at 51.
70. *Id.* at 52.
71. *Id.* at 35.
72. *Id.*
73. *Id.* at 62-68.
74. *Id.* at 63. The court stated that the shareholders' "effort to collapse the duty to act in good faith into the duty to act with due care[] is not unlike putting a rabbit into the proverbial hat and then blaming the trial judge for making the insertion." *Id.*
75. *Id.* at 53.
76. *Id.* at 64-65.
77. *Id.* at 65-66.
78. *Id.* at 65; *see also* DEL. CODE ANN. tit. 8, § 102(b)(7)(ii) (2006) (allowing a corporation to exculpate directors for a breach of the duty of care except in certain limited circumstances, notably "for acts or omissions not in good faith").
79. *Disney*, 906 A.2d at 65; *see also* DEL. CODE ANN. tit. 8, § 145(a)-(b) (2006).
80. *Disney*, 906 A.2d at 66.
81. *See id.* at 64-68.

conduct motivated by intent to harm the corporation.[82] Such conduct is "quintessential bad faith."[83]

The second category consists of director conduct between subjective bad faith and gross negligence.[84] For this category, the Delaware Supreme Court agreed with the court of chancery's definition of bad faith: "[I]ntentional dereliction of duty [or] a conscious disregard for one's responsibilities."[85] The Delaware Supreme Court noted that the duty of good faith encompasses conduct that is not disloyal in the classic sense, but consists of misconduct more culpable than simple inattention or failure to inform.[86]

Thus, the court described the duty of good faith as a convenient "vehicle" for doctrinally addressing misconduct not contained within the traditional duties of care or loyalty.[87] For examples of possible breaches of the duty of good faith, the court listed the following: an intentional act not in the best interest of corporation, an act that violates applicable positive law, and a conscious disregard of a duty to act.[88] These examples illustrate that the duty of good faith fills an important doctrinal gap between the duty of loyalty and the duty of care. The duty of good faith allows courts to sanction director behavior that complies with the director's traditional duties of loyalty and care but contradicts public policy.[89] Over time, courts can adapt to changes in policy and corporate mores by proscribing questionable director conduct under the duty of good faith.[90]

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82. *Id.* at 64.

83. *Id.*

84. *Id.*

85. *Id.* at 66.

86. *Id.*

87. *Id.*

88. *Id.* at 67 (quoting *In re* Walt Disney Co. Derivative Litig., 907 A.2d 693, 755-56 (Del. Ch. 2005)).

89. *See id.* at 66-67. Although a failure to act in good faith alone will not result in the direct imposition of liability, Stone v. Ritter, 911 A.2d 362, 369-70 (Del. 2006), such a failure would likely remove the director from the protection of the business judgment rule, exposing the director's actions to more critical judicial scrutiny under the entire fairness standard. *See supra* Part III.B.

90. The duty of good faith is one way for courts to express social norms within the field of corporate law. However, morality and social norms have always played important roles in corporate law. *See* Melvin A. Eisenberg, *Symposium: Corporate Law and Social Norms*, 99 COLUM. L. REV. 1253, 1264-87 (1999) (arguing that social norms, not the threat of liability, cause courts to increase required levels of directorial care); *see also* Stuart R. Cohn, *Corporate Natural Law: The Dominance of Justice in a Codified World*, 48 FLA. L. REV. 551, 552 (1996) (arguing that courts resolve "most of the really difficult and interesting corporate law problems by resort to principles of fairness and equity, rather than statutory or similar positivist standards").

IV. DIRECTOR LEAKS AND THE DUTY OF GOOD FAITH

This Part argues that director leaks violate the duty of good faith. In recent years, the Delaware Supreme Court has provided more guidance to both directors and shareholder-plaintiffs on the duty of good faith.[91] As discussed above, the duty of good faith proscribes conduct that might not violate a director's traditionally defined fiduciary duties of loyalty and care but should be culpable as a matter of public policy.[92]

The boardroom leaks at H-P demonstrate how a director who leaks confidential information cannot be acting in good faith.[93] Former H-P chairman Patricia Dunn hired investigators for the sole purpose of determining the source of boardroom leaks.[94] As a result of the 2005 leak,[95] the board was forced to fire Carly Fiorina.[96] Although the information leaked for the *C-NET* article[97] in January 2006 was mostly positive, Dunn knew neither the leaker's motivation nor whether the leaks would continue.[98] Indeed, if the board failed to address the leaks, the directors might expose themselves to liability for breaching their duty of care.[99]

Because the leaker, George Keyworth, received no personal financial benefit from the leaks, he did not breach his traditional duty of loyalty to

91. *See Disney*, 906 A.2d at 61-68.

92. *See supra* Part III.C.

93. *See* Eisenberg, *supra* note 21, at 30-31 (arguing that courts can respond to social changes by using the duty of good faith to articulate new fiduciary obligations).

94. Patricia Dunn, *supra* note 4.

95. The 2005 director leak led to an article in the *Wall Street Journal*. *See* Tam, *supra* note 1.

96. *See* Tam, *supra* note 3.

97. Kawamoto & Krazit, *supra* note 6.

98. *See* Patricia Dunn, *supra* note 4; *see also* James B. Stewart, *The Kona Files*, NEW YORKER, Feb. 19, 2007, at 152, *available at* 2007 WLNR 3892177 ("Leaking 'good' information is as unacceptable as leaking 'bad' information—no one can foretell how such information may advantage or disadvantage one investor relative to another." (quoting former H-P chairwoman Patricia Dunn)).

99. In the past, directors had no duty "to install and operate a corporate system of espionage to ferret out wrongdoing" absent some cause for suspicion. *See* Graham v. Allis-Chalmers Mfg. Co., 188 A.2d 125, 130 (Del. 1963). However, the Delaware Court of Chancery rejected a broad interpretation of this rule in *In re Caremark International Inc. Derivative Litigation*, 698 A.2d 959 (Del. Ch. 1996), which held that a director, to satisfy his obligation to remain reasonably informed, must assure that "information and reporting systems exist" to provide accurate and timely information to the board. *Id.* at 970; *see also* Francis v. United Jersey Bank, 432 A.2d 814, 822 (N.J. 1981) ("Directors may not shut their eyes to corporate misconduct and then claim that because they did not see the misconduct, they did not have a duty to look. The sentinel asleep at his post contributes nothing to the enterprise he is charged to protect." (citation omitted)). If the director leaks continued to cause problems for H-P and the board failed to act, shareholders might have had a viable claim against the directors for breach of their duty of care for failing to stop—or at least investigate—the leaks.

H-P.[100] Further, Keyworth likely complied with his duty of care because he attended board meetings and remained informed about the operations of the company.[101] But, by leaking confidential corporate information, Keyworth failed to act in good faith. Director leaks, such as Keyworth's, cannot be in good faith for several reasons. First, boardroom leaks manipulate and undermine the power of the board of directors.[102] Second, boardroom leaks expose the corporation and the director to liability for violating securities laws.[103] Finally, boardroom leaks violate general agency principles.[104] For all these reasons, a director who leaks confidential corporate information to outsiders fails to act in good faith.

A. *Boardroom Leaks Manipulate Board Actions*

Boardroom leaks cannot be in good faith because these leaks manipulate[105] boardroom actions. In the cases described below, Delaware courts held directors liable for breaches of their fiduciary duties for manipulating board actions in merger situations. These two cases—resolved before the Delaware Supreme Court clarified the contours of the duty of good faith in *Disney*—do not involve leaks of confidential information, but they exemplify the courts' willingness to consider manipulative actions in finding directors personally liable for breaches of their fiduciary duties. Boardroom leaks, like the manipulative actions of directors in the following two cases, epitomize the type of conduct the Delaware Supreme Court intends to proscribe through the duty of good faith. Consequently, a director who leaks confidential corporate information should face liability for failing to act in good faith.

In the first case, *Smith v. Van Gorkom*,[106] the Delaware Supreme Court held directors of a publicly-owned corporation personally liable for approving a questionable merger in violation of their fiduciary duties.[107]

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100. *See* Tara L. Dunn, *supra* note 20, at 543 ("A question of the duty of loyalty arises when a director has a self-interest in a corporate transaction that is not generally shared by the corporation's stockholders." (citing Cede & Co. v. Technicolor, Inc., 634 A.2d 345, 361 (Del. 1993))); *supra* Part III.B.

101. *See* Smith v. Van Gorkom, 488 A.2d 858, 893 (Del. 1985); *supra* Part III.A.

102. *See infra* Part IV.A.

103. *See infra* Part IV.B.

104. *See infra* Part IV.C.

105. Pursuant to federal securities laws, "manipulation is 'a term of art' limited to certain types of transactions specifically designed to artificially affect the price of a security." THOMAS LEE HAZEN, THE LAW OF SECURITIES REGULATION § 12.1 (5th ed. 2005). This Note uses "manipulate" in its conventional sense, meaning "to control, manage, or play upon by artful, unfair, or insidious means, [especially] to one's own advantage." WEBSTER'S THIRD NEW INTERNATIONAL DICTIONARY OF THE ENGLISH LANGUAGE UNABRIDGED 1376 (Philip Babcock Gove ed., 1993).

106. 488 A.2d 858 (Del. 1985).

107. *Id.* at 893.

In *Van Gorkom*, defendant Van Gorkom, the chairman and chief executive officer of the defendant corporation, sought a leveraged buyout.[108] At a senior management meeting, the company's chief financial officer presented a "preliminary study" supporting the feasibility of a leveraged buyout at a price between $50 and $60 per share.[109] The computations were a rough estimate however, and the study did not claim to establish a fair price for the whole company.[110] Van Gorkom vetoed the possibility of a management buyout at the meeting,[111] although he asserted that he would accept $55 per share for his personal shares in the company.[112]

After the meeting, Van Gorkom directed the company's controller to assess the feasibility of a leveraged buyout at fifty-five dollars per share.[113] Van Gorkom did not consult with any other senior managers or the board and demanded that the controller keep the analysis strictly confidential.[114] After confirming the feasibility of a sale, Van Gorkom presented the idea to a "well-known corporate takeover specialist" who offered to buy the company at Van Gorkom's proposed $55 price several days later.[115] When Van Gorkom met with senior management two days after receiving the offer, management objected strongly to the proposed sale.[116] Despite management objections, Van Gorkom met with the board immediately afterward to discuss the offer.[117]

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108. *Id.* at 865-66.
109. *Id.* at 865.
110. *Id.*

> According to [the CFO]: They did not "come up" with a price for the Company. They merely "ran the numbers" at fifty dollars per share and at sixty dollars per share with the "rough form" of their cash figures at the time. Their "figures indicated that $50 would be very easy to do but $60 would be very difficult to do under those figures." This work did not purport to establish a fair price for either the Company or 100% of the stock. It was intended to determine the cash flow needed to service the debt that would "probably" be incurred in a leveraged buy-out based on "rough calculations" . . . .

Id.

111. *Id.* Interestingly, the court specifically questioned Van Gorkom's motive to veto a management-led buyout, stating, "It is noteworthy in this connection that he was then approaching 65 years of age and mandatory retirement." *Id.* at 866. Presumably, Van Gorkom would prefer a third-party buyout (as opposed to a management-led buyout) to effect pre-retirement liquidity of his shares in the company.
112. *Id.* at 865. Management failed to agree on any buyout plan at this meeting. *Id.* at 865-66.
113. *Id.* at 866.
114. *Id.*
115. *Id.* at 866-67.
116. *Id.* at 867.
117. *Id.* at 868.

Van Gorkom presented the proposed sale to the board in a twenty-minute oral presentation; however, Van Gorkom failed to furnish the board with copies of the proposed merger agreement before the meeting and disclosed neither the fact that he initially proposed the $55 price nor how he arrived at that price.[118] The directors approved the merger at the meeting, which lasted less than two hours.[119] The shareholders of the defendant corporation sued the company's directors, alleging that the directors breached their fiduciary duties by approving the merger.[120] The Court of Chancery ruled for the director-defendants, asserting that the directors were entitled to the presumptive protections of the business judgment rule.[121]

The Delaware Supreme Court reversed, holding that the directors failed to reach an informed business decision about the merger.[122] Indeed, by relying solely on a twenty-minute oral presentation by Van Gorkom, who himself failed to read the merger agreement before the presentation, the directors neglected to use any business judgment whatsoever.[123] The directors failed to inform themselves about the intrinsic value of the company and deliberated the sale for only two hours without questioning the need for immediate action.[124] Because the directors relied solely on Van Gorkom's brief oral presentation in making one of the most important decisions in the corporation's life, the court asserted that the directors were grossly negligent in approving the sale.[125]

The business judgment rule did not protect the directors because their gross negligence breached the directors' fiduciary duty of care to the company.[126] In essence, the court required the directors to use business judgment[127] before benefiting from the protection of the business judgment rule.[128] Accordingly, the court held the directors personally liable and remanded the case to the court of chancery to compute the shareholders' damages.[129]

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118. *Id.*

119. *Id.* at 869.

120. *Id.* at 863, 871.

121. *Id.* at 864; *see also supra* note 37 (describing the business judgment rule).

122. *Van Gorkom*, 488 A.2d at 864.

123. *Id.* at 874.

124. *Id.* The potential buyer imposed a three-day window to approve the merger. *Id.* at 867. But, no board member questioned the need for immediate action despite the fact that the board was being asked to act without full information. *See id.*

125. *Id.* at 874.

126. *Id.* at 893.

127. *Id.* at 874.

128. *Id.* at 893.

129. *See id.* In response to *Van Gorkom*, the Delaware legislature amended the Delaware General Corporation law to allow a corporation, in its charter, to exculpate its directors from liability for any breach of their duty of care. *See* Sale, *supra* note 21, at 458 (stating that the

Though imposing liability based on the duty of care, the Delaware Supreme Court strongly criticized Van Gorkom's unilateral actions in pushing for the sale throughout its opinion. Van Gorkom manipulated the board both by concealing how he arrived at the proposed price and by failing to furnish copies of the merger agreement to his fellow directors.[130] Van Gorkom also vetoed other potentially more lucrative buyout offers and adopted amendments to the merger agreement without conferring with the board.[131] In fact, Van Gorkom even failed to read the final merger agreement before executing it.[132] By strongly criticizing Van Gorkom's conduct, the court indicated its willingness to hold directors personally liable for manipulative boardroom behavior.

In the second case, *Nagy v. Bistricer*,[133] the court imposed personal liability on directors for coercively executing a merger over objections from a minority shareholder.[134] In *Nagy*, two defendants owned 85% and served as the only two directors of Riblet Products Corporation (Riblet).[135] The plaintiff owned the other 15% of Riblet.[136] The two directors merged Riblet with Coleman Cable Acquisition, Inc. (Coleman), another corporation majority-owned and controlled by the two director-defendants.[137] Pursuant to the merger agreement, which was signed by the director-defendants on behalf of both corporations, Riblet shareholders would receive a tentatively set amount of Coleman shares in exchange for their shares in Riblet.[138] However, this exchange rate could be adjusted

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Delaware legislature responded to *Van Gorkom* "by abdicating part of its role in regulating corporate governance and adopting the now ubiquitous exculpatory statute that allows companies, at the directors' initiative, to exempt themselves from damages for failing to adhere to their duty of care"); *supra* note 46 and accompanying text.

130. *Van Gorkom*, 488 A.2d at 874, 877 n.19.

131. *Id.* at 884-85. The Delaware Supreme Court mentioned two potentially more lucrative offers. The first, solicited by the defendant-corporation's senior management, offered $60 per share under terms and conditions substantially the same as the sale solicited by Van Gorkom. *Id.* at 884. "Van Gorkom's reaction to the [alternative] proposal was completely negative." *Id.* Van Gorkom refused to issue a press release announcing the offer and never presented the offer to the board. *Id.* at 885. As a second alternative, the potential buyer was prepared to offer between $2 and $5 more per share than the merger that the directors approved. *Id.* The second alternative, however, never materialized into a full offer because of the impending "deadline" imposed by the original merger agreement. *Id.*

132. *Id.* at 869.

133. 770 A.2d 43 (Del. Ch. 2000).

134. *Id.* at 64.

135. *Id.* at 46.

136. *Id.* The plaintiff had a history of problems with the defendant-directors. *Id.* The plaintiff served as Riblet's chief executive officer for fifteen years before Riblet's two directors terminated his employment. *Id.* at 47. The plaintiff sued the directors and was awarded compensatory damages of more than $1 million for breach of his employment contract. *Id.*

137. *Id.* at 46-47.

138. *Id.* at 46.

upward or downward by the Coleman board, upon the advice of an investment banker selected by Coleman.[139]

Under the merger agreement, the plaintiff's sole remedy was to seek appraisal of his shares.[140] However, the directors notified the plaintiff of the merger only after the merger was consummated, and the appraisal demand was due before the Coleman board determined the final consideration for the merger.[141] The documents the directors sent to advise the plaintiff of his rights contained no financial information about either Riblet or Coleman, no discussion of how the merger was negotiated, and no reasons why the Riblet board agreed to the merger.[142]

The plaintiff sued the two directors and Riblet, arguing that the directors breached their fiduciary duties by abdicating the final decision on the merger consideration to the Coleman board.[143] The court agreed and granted summary judgment to the plaintiff.[144] By abdicating their duty to negotiate a fair price for the merger, the directors breached their duty of loyalty to the plaintiff as a Riblet shareholder.[145]

Furthermore, the court found particularly persuasive the plaintiff's argument that the directors structured the merger in an "inequitably coercive" manner.[146] The directors failed to provide to the plaintiff any financial information about either company, and denied the plaintiff any knowledge of the final merger consideration.[147] Accordingly, the directors "exerted maximum pressure on [the plaintiff] to exercise the lesser of two non-optimal options: appraisal."[148]

These two cases demonstrate courts' willingness to hold accountable manipulative directors. Van Gorkom manipulated his board into approving a questionable merger, and the director-defendants in *Nagy* coerced the plaintiff into seeking appraisal for his shares. Director leaks are just as damaging and equally manipulative as the behavior in the cases above.

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139. *Id.*

140. *Id.* Pursuant to Delaware law, a shareholder of a company targeted for merger or consolidation may demand an appraisal of the fair value of his shares by the Delaware Court of Chancery. *See* DEL. CODE ANN. tit. 8, § 262 (2006); *see also* FLA. STAT. § 607.1302 (2006) (detailing shareholders' appraisal rights pursuant to Florida law).

141. *Nagy*, 770 A.2d at 47-48.

142. *Id.* at 48.

143. *Id.* at 48-49.

144. *Id.* at 65.

145. *Id.* at 62. Pursuant to Delaware law, the board of directors must approve any merger. DEL. CODE ANN. tit. 8, § 251(b) (2006); *see also* FLA. STAT. § 607.1101 (2006) (detailing Florida's requirement that the board of directors approve any merger). Directors must act in an informed and deliberate manner in approving a merger and may not abdicate this duty to shareholders alone. *See* Smith v. Van Gorkom, 488 A.2d 858, 873 (Del. 1985).

146. *Nagy*, 770 A.2d at 63.

147. *Id.*

148. *Id.*

For example, a director who disagrees with a board strategy to develop a new product line could leak news of the strategy to the press. Once the strategy is leaked, the corporation might lose important "first-to-market" advantages because the director revealed the corporation's strategy to its competitors. The director's leak could force the corporation to forgo developing the product line because it has lost its "head start" on the competition. By leaking news of the new product development to the press, the director has manipulated the board into reversing course and rejecting the new product development strategy. In this example, the director's leak violates the public policies of preventing manipulative behavior in the boardroom and encouraging the collegiality of board actions.[149] Accordingly, director leaks are manipulative and against public policy, and should be proscribed under the duty of good faith.

B. *Director Leaks Violate Federal Securities Laws*

A director who causes his corporation to violate the law fails to act in good faith.[150] Director leaks expose both the director and his corporation to liability for violating federal securities laws in two situations. First, corporations have a duty under the securities laws to respond promptly to market rumors.[151] Director leaks may render corporate statements materially misleading, causing the corporation to violate § 10(b)[152] of the

149. *See generally* Stewart, *supra* note 98 (describing former H-P CEO Carly Fiorina's and former H-P chairwoman Patricia Dunn's views regarding the role of trust and collegiality in the boardroom). For a response to the *New Yorker* article by Tom Perkins, who protested the leak investigations at H-P by resigning from the H-P board, see Tom Perkins, Opinion, *The 'Compliance' Board*, WALL ST. J., Mar. 2, 2007, at A11.

150. *See* Brehm v. Eisner (*In re* Walt Disney Co. Derivative Litig.), 906 A.2d 27, 64 n.102 (Del. 2006).

151. *See* State Teachers Ret. Bd. v. Fluor Corp., 654 F.2d 843, 850 (2d Cir. 1981) ("A company has no duty to correct or verify rumors in the marketplace unless those rumors can be attributed to the company." (citations omitted)).

152. 15 U.S.C. § 78j (2000). The statute provides as follows:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—
>
> . . .
>
> (b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, or any securities-based swap agreement . . . , any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

Id.

Securities Exchange Act of 1934[153] and Securities Exchange Commission (SEC) Rule 10b-5.[154] Second, director leaks expose the director to insider trading liability as a "tipper" of material, non-public information.[155] An overarching policy of the federal securities laws is to promote investor confidence through equal access to information.[156] Directors who leak confidential corporate information undermine this policy and expose themselves to liability under federal securities laws. As noted above, a

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153. Securities Exchange Act of 1934, ch. 404, 48 Stat. 881 (codified at 15 U.S.C. §§ 78a-78nn).

154. 17 C.F.R. § 240.10b-5 (2006). Rule 10b-5 states,

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility or any national securities exchange,
>
> (a) To employ any device, scheme, or artifice to defraud,
>
> (b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
>
> (c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,
>
> in connection with the purchase or sale of any security.

Id.; *see also infra* Part IV.B.1.

155. *See infra* Part IV.B.2.

156. *See* Pinter v. Dahl, 486 U.S. 622, 638 n.14 (1988). Regulation Fair Disclosure (Regulation FD) demonstrates a clear federal policy advocating uniform dissemination of information to the market. *See* 17 C.F.R. § 243.100 (2006). The statute provides as follows:

> (a) Whenever an issuer, or any person acting on its behalf, discloses any material nonpublic information regarding that issuer or its securities to any [broker or dealer; investment adviser; investment company; or holder of the issuer's securities], the issuer shall make public disclosure of that information . . .
>
> (1) Simultaneously, in the case of an intentional disclosure; and
>
> (2) Promptly, in the case of a non-intentional disclosure.

Id.

The SEC has fined both corporations and individual insiders for violating Regulation FD. In 2003, the SEC settled an enforcement proceeding against Schering-Plough, fining the corporation $1 million and the company's Chief Executive Officer, Richard Kogan, $50,000. *See* Schering-Plough Corp., Exchange Act Release No. 48,461, 81 SEC Docket 54, 2003 WL 22082153, at *8 (Sept. 9, 2003) (fining Richard Kogan); SEC v. Schering-Plough Corp., Exchange Act Release No. 18,330, 81 SEC Docket 153, 2003 WL 22082154, at *1 (describing settlement between the SEC and Schering-Plough). For purposes of the statute, "acting on behalf of an issuer" does not apply to communications made by directors, officers, agents, or employees who communicate information in breach of a duty of trust or confidence to the issuer. 17 C.F.R. § 243.101(c) (2006). Thus, although the director leaks discussed in this Note fall outside the scope of Regulation FD, the statute evidences a clear federal policy favoring uniform dissemination of information to investors.

director who violates positive law or causes his corporation to violate positive law fails to act in corporate good faith.[157] Thus, by exposing his corporation to federal securities liability, a director who leaks corporate information fails to act in good faith.

1. Corporate Duty to Respond to Market Rumors

Rule 10b-5 prohibits a company from making materially misleading statements.[158] The Rule does not, however, generally obligate public corporations to disclose material information[159] or correct rumors not directly attributable to the corporation or its agents.[160] Accordingly, a corporation faced with market rumors may either quell the rumors with full disclosure or issue a "no comment" statement.[161]

However, the SEC maintains that a corporation may not issue a "no comment" statement if the rumors are directly attributable to the corporation or its agents.[162] In *In re Carnation Company*,[163] the SEC investigated public statements made by the Carnation Company (Carnation) in response to rumors that it was in preliminary acquisition discussions with Nestlé S.A. (Nestlé).[164] Carnation's share price increased dramatically after the press began reporting market rumors that Carnation was a takeover candidate.[165] Despite the fact that Carnation and Nestlé were negotiating a buyout by Nestlé, Carnation's treasurer released a statement denying that there were any corporate developments or company news that "would account for the stock action."[166] As negotiations continued and the rumor mill continued to churn, Carnation's treasurer stated in another press release that the company knew "of no corporate

157. *See* Brehm v. Eisner (*In re* Walt Disney Co. Derivative Litig.), 906 A.2d 27, 67 (Del. 2006) (quoting *In re* Walt Disney Co. Derivative Litig., 907 A.2d 693, 755-56 (Del. Ch. 2005)).

158. 17 C.F.R. § 240.10b-5 (2006); *see also supra* note 154.

159. Pub. Sch. Teachers' Pension & Ret. Fund v. Ford Motor Co. (*In re* Ford Motor Co. Sec. Litig.), 381 F.3d 563, 569 (6th Cir. 2004) ("'Silence, absent a duty to disclose, is not misleading under Rule 10b-5.'"(quoting Basic Inc. v. Levinson, 485 U.S. 224, 239 n.17 (1988))).

160. Raab v. Gen. Physics Corp., 4 F.3d 286, 288 (4th Cir. 1993) ("The securities laws . . . do not require [a] company to police statements made by third parties for inaccuracies, even if the third party attributes the statement to [the company]."); Elkind v. Liggett & Myers, Inc., 635 F.2d 156, 163 (2d Cir. 1980) (stating that a plaintiff must allege that the company "sufficiently entangled itself with the analysts' forecasts to render those predictions 'attributable to it'").

161. *In re* Carnation Co., Exchange Act Release No. 22,214, 33 SEC Docket 874, 1985 WL 547371, at *5 n.6 (July 8, 1985).

162. *Id.*

163. *Id.*

164. *Id.* at *1.

165. *Id.* at *2.

166. *Id.*

reason for the recent surge in its stock price."[167] Further, the treasurer acknowledged the rumor that Nestlé planned to acquire Carnation, but stated, "We are not negotiating with anyone."[168] Two weeks after the treasurer's second press release, Carnation and Nestlé issued a joint press release announcing that Nestlé had agreed to purchase Carnation.[169]

The SEC asserted that the treasurer's comments were materially misleading in violation of § 10(b) of the Exchange Act and SEC Rule 10b-5.[170] These provisions "prohibit an issuer from making public statements that are false or that fail to include material facts necessary to make the statements made, in light of the circumstances under which they are made, not misleading."[171] The SEC noted that any statement by an issuer triggers this prohibition.[172] Emphasizing the importance of accurate and complete disclosure to the integrity of securities markets, the SEC stated that whenever these antifraud provisions are not met, "'the company and any person responsible for the statements may be liable under the federal securities laws.'"[173]

The SEC stressed that any public statement concerning rumors or unusual market activity must be accurate and complete—this includes an obligation to disclose sufficient information to prevent the statement from being misleading.[174] In other words, the treasurer's denial that Carnation was negotiating with anyone was materially misleading.[175] Notably, the SEC emphasized that a "no comment" response may be appropriate in some circumstances, but not when market rumors are "attributable to leaks from the issuer."[176]

Accordingly, director leaks not only increase the likelihood that a corporation will make misleading statements resulting in securities laws violations but also bar a corporation from responding to market rumors with "no comment." Without the "no comment" response, a corporation may be forced to prematurely disclose material information such as merger negotiations or other corporate news. Director leaks limit a corporation's ability to conceal material information during deal negotiations and injure the corporation's bargaining position. Thus, a director who leaks confidential information fails to act in good faith both by increasing the

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167. *Id.* at *3.

168. *Id.*

169. *Id.* at *4.

170. *Id.* at *6.

171. *Id.* at *4 (citing SEC v. Tex. Gulf Sulphur Co., 401 F.2d 833, 860-62 (2d Cir. 1968)).

172. *Id.* at *5.

173. *Id.* (quoting Public Statements by Corporate Representatives, Exchange Act Release No. 20,560, 1984 WL 482557, at *1 (Jan. 13, 1984)).

174. *Id.*

175. *See id.*

176. *Id.* at *5 n.6.

corporation's exposure to securities laws violations and by increasing the corporation's disclosure obligations in the wake of market rumors.

2. Tipper Liability Pursuant to Section 10(b) of the Securities Exchange Act and SEC Rule 10b-5

Director leaks may also cause the director to violate insider trading rules. SEC Rule 10b-5 prohibits any act that "operate[s] as a fraud or deceit upon any person, in connection with the purchase or sale of any security."[177] In the insider trading context, corporate insiders must either abstain from trading in their company's securities or disclose any material non-public information before trading.[178]

Two theories have evolved to justify imposition of insider trading liability under SEC Rule 10b-5.[179] The classical theory imposes liability based on a fiduciary relationship between the insider in possession of material non-public information and the shareholders with whom the insider trades.[180] This relationship creates a duty to disclose or abstain from trading to prevent "a corporate insider from taking unfair advantage of uninformed stockholders."[181] Conversely, the misappropriation theory predicates liability on a breach of a fiduciary relationship between the insider and the source of the confidential information.[182] Thus, an insider deceives his corporation and violates SEC Rule 10b-5 by misappropriating confidential information for securities trading purposes.[183]

As a tipper of confidential information, a director who leaks consciously disregards his duties of confidentiality under the securities

177. 17 C.F.R. § 240.10b-5 (2006); *see supra* note 154.

178. *See* United States v. O'Hagan, 521 U.S. 642, 651-52 (1997).

179. *See id.* (comparing the classical and misappropriation theories of insider trading liability pursuant to SEC Rule 10b-5).

180. *Id.*

181. *Id.* at 652 (internal alterations omitted) (citing Chiarella v. United States, 445 U.S. 222, 228-29 (1980)).

182. *Id.* The U.S. Supreme Court first sanctioned the misappropriation theory in *United States v. O'Hagan*. In *O'Hagan*, the defendant, a partner in a law firm, discovered that his firm had been hired to represent a company planning to make a tender offer for the common stock of another company. *Id.* at 647. Although the defendant performed no work on the representation, he purchased securities in the target of the tender offer prior to public disclosure of the agreement. *Id.* As a result, the defendant "earned" a risk-free profit of more than $4.3 million. *Id.* at 648. The defendant was convicted for violating Rule 10b-5, but the Eighth Circuit Court of Appeals reversed the convictions, holding that criminal liability under Rule 10b-5 may not be predicated on the misappropriation theory. *Id.* at 649. The Supreme Court reversed and ruled that the misappropriation theory "is both consistent with [§ 10(b) of the 1934 Securities Exchange Act and Rule 10b-5] and with our precedent." *Id.* at 665. For further analysis of the *O'Hagan* decision, see Joel Seligman, *A Mature Synthesis:* O'Hagan *Resolves "Insider" Trading's Most Vexing Problems*, 23 DEL. J. CORP. L. 1 (1998) (cautioning against over-generalizing the *O'Hagan* holding).

183. *O'Hagan*, 521 U.S. at 652.

laws. A director who consciously disregards this duty of confidentiality cannot be acting in good faith.

Further, in *SEC v. Sargent*,[184] the First Circuit Court of Appeals hinted that a tipper of confidential information may be liable even if the tipper never trades based on the information and does not personally benefit from the tip.[185] In *Sargent*, the defendant and his coworker were the sole shareholders of a consulting business the two conducted from a one-room office in the defendant's basement.[186] The coworker was also a director of Purolator Products Co. (Purolator), a publicly held corporation.[187] When Purolator became the target of a tender offer, the coworker told the defendant, in confidence, about the negotiations.[188] Despite not trading himself, the defendant allegedly told a friend about the tender offer.[189] The friend bought more than twenty thousand Purolator shares, yielding a profit of $140,000 after public announcement of the tender offer.[190] The district court granted a directed verdict to the defendant, but the SEC successfully appealed and obtained a new trial.[191]

The circuit court ruled that the directed verdict was improper because a jury could infer that the defendant breached a duty of confidentiality owed to his coworker and that the defendant tipped his friend "to maintain a useful networking contact."[192] In dicta, however, the court questioned whether benefit to a tipper "is a required element of section 10(b) and Rule 10b-5 liability" under the misappropriation theory.[193] The court implied that a misappropriation followed by a tip "would create a presumption of section 10(b) and Rule 10b-5 liability."[194]

184. 229 F.3d 68 (1st Cir. 2000).

185. *Id.* at 77.

186. *Id.* at 71.

187. *Id.*

188. *Id.*

189. *Id.* at 72.

190. *Id.* at 72-73.

191. *Id.* at 71, 80.

192. *Id.* at 77.

193. *Id.* "However, the Court noted under the classical theory of insider trading, an insider who provides a tip but who does not himself trade will be liable under 10b-5 only if he 'will benefit, directly or indirectly, from his disclosure.'" *Id.* (quoting Dirks v. SEC, 463 U.S. 646, 662 (1983)).

194. *Id.* For further analysis of the personal benefit requirement, see David T. Cohen, Note, *Old Rule, New Theory: Revising the Personal Benefit Requirement for Tipper/Tippee Liability Under the Misappropriation Theory of Insider Trading*, 47 B.C. L. REV. 547, 552 (2006) (arguing that, in lieu of the tipper personal-benefit requirement, "courts should require that (1) the tipper was at least reckless as to whether he or she would *either* benefit personally *or* harm the information source by tipping, and (2) the tipper was at least reckless as to whether someone in the line of tippees would use the information to trade").

If a benefit to the tipper is not required under the misappropriation theory, tipper-directors expose themselves to a very real threat of insider trading liability. Under the First Circuit's interpretation of the misappropriation theory, a tipper is presumptively liable if the tippee trades based upon the tip.[195] Thus, if Keyworth leaked information to his press connection, and his connection traded based on the information prior to publishing it, both Keyworth and the press connection would be presumptively liable under § 10(b) and Rule 10b-5.[196] But why should Keyworth's liability hinge on whether the press connection trades based on the information prior to publishing the news? Keyworth betrayed his corporation's fiduciary trust and misappropriated the information whether or not he personally benefited from tipping the press.[197] Keyworth's securities law liability may be limited because if the tippee doesn't trade, there is no deceit "in connection with" the purchase or sale of security.[198] However, the agency underpinnings of the misappropriation theory are broader than just the securities laws; a director who leaks confidential information fails to act in good faith because he "consciously disregards his responsibility" to keep corporate information in confidence.

C. *Director Leaks Violate General Agency Principles*

Director leaks also violate general agency principles.[199] Prohibiting leaks through a "good faith" duty of confidentiality would harmonize a director's fiduciary duties with the fiduciary duties required by agency law in other situations.[200] In the corporate setting, directors serve as fiduciaries

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195. *See Sargent*, 229 F.3d at 77-78.

196. The *O'Hagan* misappropriation theory is limited to criminal liability. *O'Hagan*, 521 U.S. at 650 ("We hold . . . that *criminal* liability under § 10(b) may be predicated on the misappropriation theory." (footnote omitted) (emphasis added)); *see also* Salovaara v. Jackson Nat'l Life Ins. Co., 66 F. Supp. 2d 593, 601 (D.N.J. 1999) (declining to extend the *O'Hagan* holding "to a civil case involving a transaction for high yield debt securities"). Therefore, the SEC may impose criminal liability under the misappropriation theory; however, a private plaintiff may not recover damages based on the misappropriation theory.

197. Rule 10b-5 liability requires that the deception occur "in connection with" the purchase or sale of a security. 17 C.F.R. § 240.10b-5 (2006). The duty of good faith is not (and should not be) so limited.

198. *See id.*

199. For an analysis of the interaction between agency law and corporate law, see Donald C. Langevoort, *Agency Law Inside the Corporation: Problems of Candor and Knowledge*, 71 U. CIN. L. REV. 1187 (2003).

200. The idea of a board of directors serving as the primary agents for shareholders originates from medieval town halls and guilds. *See* Franklin A. Gevurtz, *The Historical and Political Origins of the Corporate Board of Directors*, 33 HOFSTRA L. REV. 89, 146-49 (2004). In guilds and town hall settings, a subset of the town met and deliberated on issues facing the town and, presumably, made decisions in the best interest of the town as a whole. *Id.*

of both the corporation and its shareholders.[201] As fiduciaries, directors owe fiduciary duties of loyalty, care, and good faith to the company's shareholders.[202] Similarly, a lawyer, as an agent, owes his clients similar duties of loyalty,[203] diligence,[204] and good faith.[205] Unlike directors, however, lawyers currently owe a general duty of confidentiality.[206] But why the difference? As fiduciaries, both lawyers and directors are privy to highly confidential information and are expected to act in the best interests of their principals.

Currently, a lawyer serving as both corporate counsel and director still owes a duty of confidentiality to his client, the corporation.[207]Outside directors, however, who are privy to the same confidential information but less equipped than a lawyer to deal with potential conflicts of interest, are not bound by the same duty of confidentiality.[208] The confidentiality principles that apply to counsel-directors should also apply to noncounsel-directors.[209] The duty of good faith provides a perfect vehicle to recognize that directors owe a general duty of confidentiality.

V. OTHER IMPLICATIONS OF A GENERAL DUTY OF CONFIDENTIALITY

Corporate boards make some of the most critical strategic decisions in a corporation's life, including those regarding mergers, executive succession, and new product development.[210] Despite the importance of boardroom confidentiality, leaks continue to be a pressing problem for corporations.[211] To solve this leak problem, courts should recognize that

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201. *See supra* note 35 and accompanying text.

202. *See supra* Part III; *see also* Eisenberg, *supra* note 21, at 3.

203. MODEL RULES OF PROF'L CONDUCT R. 1.7 cmt. 1 (2004) ("Loyalty and independent judgment are essential elements in the lawyer's relationship to a client.").

204. *Id.* R. 1.1 ("A lawyer shall provide competent representation to a client. Competent representation requires the legal knowledge, skill, thoroughness and preparation reasonably necessary for the representation."); *see also id.* R. 1.3 ("A lawyer shall act with reasonable diligence and promptness in representing a client.").

205. *See id.* R. 8.4 (describing acts that constitute lawyer misconduct).

206. *See id.* R. 1.6 (describing "Confidentiality of Information").

207. *See* Stephen M. Zaloom, *Legal Status of the Lawyer-Director: Avoiding Ethical Misconduct*, 8 U. MIAMI BUS. L. REV. 229, 236-38 (2000) (discussing attorney-client privilege issues arising when a lawyer serves as both director and lawyer for the same corporation); E. Norman Veasey & Christine T. DiGuglielmo, *The Tensions, Stresses, and Professional Responsibilities of the Lawyer for the Corporation*, 62 BUS. LAW. 1, 15-16 (Nov. 2006) (outlining special considerations for corporate counsel serving as a director of a client-corporation).

208. *See supra* note 17.

209. *See* MODEL RULES OF PROF'L CONDUCT, R. 1.6 cmt. 2 (2004) ("A fundamental principle in the client-lawyer relationship is that, in the absence of the client's informed consent, the lawyer must not reveal information relating to the representation.").

210. *See supra* note 11.

211. Dvorak & Vara, *supra* note 13 (noting that "[l]eaks are both harder to prevent and easier

a director owes a duty to his corporation to keep corporate information in confidence. Doctrinally, this duty should be included within the director's duty of good faith.[212] The remainder of this Part analyzes the benefits and consequences of recognizing a general duty of confidentiality within the duty of good faith.

A. *Positive Effects of a General Duty of Confidentiality*

A good faith duty of confidentiality offers several key benefits. First, a duty of confidentiality would diminish the corporate leak problem through the threat of personal liability for directors who leak confidential information. Second, this duty would help to ensure the collegiality of board action by preventing manipulative, unilateral director actions. Third, this duty would harmonize the duties of directors with existing agency principles. Finally, a duty of confidentiality would improve investor confidence in securities markets by limiting the selective disclosures of corporate information that might lead to insider trading violations.

The most obvious benefit of a duty of confidentiality is that it would deter leaks. Because a director who leaks would not be acting in good faith, the director would not be protected by an exculpatory provision under Delaware's liability shield statute or an indemnification agreement.[213] Without these protections, a director who leaks will face a significant threat of personal liability for any harm the leak causes to the corporation. This threat of liability should operate as a strong disincentive to leak confidential information.[214]

By limiting director leaks, a general duty of confidentiality would also ensure the collegiality of board actions. The underlying principle behind board management is collegiality.[215] Boards reach better decisions after exchanging and discussing ideas.[216] However, leaks allow one director to supplant his own view of a board meeting or corporate problem for that of

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to track as information and communication go digital" and quoting a Merrill Lynch survey finding that more than half of fifty surveyed executives rated leaks of confidential and proprietary information as their primary "information-security" concern).

212. *See supra* Part III.C.

213. *See supra* notes 46-47, 77-80 and accompanying text.

214. *See* Fairfax, *supra* note 25, at 395 (arguing that "legal liability represents an essential mechanism for ensuring directors' fidelity to their fiduciary duties and for questioning reform efforts that do not include such liability"). *But see* Geraldine Szott Moohr, *An Enron Lesson: The Modest Role of Criminal Law in Preventing Corporate Crime*, 55 FLA. L. REV. 937, 973-75 (2003) (arguing that *criminal* liability alone is an ineffective method for affecting behavior in a corporate setting).

215. DAVID A. DREXLER ET AL., DELAWARE CORPORATION LAW AND PRACTICE § 13.01 (2006) ("The underlying and overriding policy of Delaware law with respect to exercising the functions of the board of directors is collegiality.").

216. *Id.*

the entire board.[217] Once boardroom discussions are leaked to the press, the board loses options—which may be exactly what the leaker wants.

Under current law, a director may escape liability for leaking damaging information to the press, provided that he lacks a financial interest in the transaction—i.e., he is not trading the stock—and that he thinks the leaks are in the best interest of the corporation.[218] Leaks, however, are almost *never* in the best interests of the corporation.[219] Leaks harm the competitive position of the company[220] and allow a single director to preempt actions by the board. In the H-P case, for example, Keyworth's leaks forced the board to fire chief executive officer Carly Fiorina before it was ready to act.[221]

A duty of confidentiality would also harmonize corporate fiduciary duties with basic agency principles. Corporate directors, like other fiduciaries, should owe their corporations a duty of confidentiality.[222] According to the U.S. Supreme Court,

> A company's confidential information . . . qualifies as property to which the company has a right of exclusive use. The undisclosed misappropriation of such information, in violation of a fiduciary duty . . . constitutes fraud akin to embezzlement—the fraudulent appropriation to one's own use of the money or goods entrusted to one's care by another.[223]

The time has come for courts to recognize that directors who leak "embezzle" confidential corporate information. The duty of good faith provides a perfect vehicle for censuring this "embezzlement" through a general fiduciary duty of confidentiality.

Finally, a duty of confidentiality would bolster the SEC's efforts to boost investor confidence in securities markets by limiting selective disclosures of corporate information.[224] Director leaks are selective

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217. *See supra* Part IV.A.

218. *See supra* Parts III.B, IV.B.

219. *See* Flamm v. Eberstadt, 814 F.2d 1169, 1177 (7th Cir. 1987) (asserting that "silence pending settlement of the price and structure of a deal is beneficial to most investors, most of the time"). *But see* Basic, Inc. v. Levinson, 485 U.S. 224, 234-35 (1988) (questioning whether "secrecy necessarily maximizes shareholder wealth").

220. DIRECTOR'S GUIDEBOOK, *supra* note 17, at 18.

221. Peter Burrows, *Controlling the Damage at HP*, BUS. WK., Oct. 9, 2006, at 40, *available at* 2006 WLNR 17243538 (stating that the H-P board fired Fiorina after her spat with the board "found its way into the press").

222. *See supra* Part IV.C.

223. United States v. O'Hagan, 521 U.S. 642, 654 (1997) (internal citations and quotations omitted).

224. *Id.* at 658 (stating that an "animating purpose" of the Exchange Act is "to insure honest

disclosures that can lead to insider trading. If left unchecked, director leaks could eventually undermine the integrity of securities markets.[225] A good faith duty of confidentiality would help the SEC fight insider trading and selective disclosures as well as help to instill investors with confidence in securities markets.

B. *Potential Consequences of a General Duty of Confidentiality*

Recognizing a general duty of confidentiality might also have several negative consequences. First, the duty would expand the scope of director-tipper liability pursuant to federal securities laws. This increased liability exposure might diminish the pool of qualified people willing to serve as directors. Second, this increased liability exposure might reduce market efficiency by limiting corporate incentives to disclose insider information. Finally, a general duty of confidentiality might prevent potential whistleblowers, out of fear of liability, from exposing harmful corporate conduct.

The general duty of confidentiality's potential expansion of director liability for violations of SEC Rule 10b-5 could be problematic. Under the misappropriation theory, the tipper's tip must violate a duty that the tipper owes to the source of the information.[226] Because a director does not owe a general duty of confidentiality under current law, this requirement typically means that a director must personally benefit or the corporation must be harmed—in other words, the director must have breached his traditional duty of loyalty by disclosing the information.[227] If a director owes a general duty of confidentiality, any tip to an outsider would violate a duty owed to the corporation. This heightened duty could increase the probability that a director will be held personally liable for breaching his fiduciary duties. This expansion of liability could diminish the pool of qualified persons willing to serve as directors for corporations.

On the other hand, other requirements for a SEC Rule 10b-5 violation will still limit the scope of director-tipper liability. To establish a criminal violation of SEC Rule 10b-5, the government must still prove both the materiality element and the willfulness element.[228] For the materiality element, the government must show that the tipped information would

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securities markets and thereby promote investor confidence").

225. *See id.* ("Although informational disparity is inevitable in the securities markets, investors likely would hesitate to venture their capital in a market where trading based on misappropriated nonpublic information is unchecked by law.").

226. *Id.* at 652.

227. *See supra* Part III.B.

228. *O'Hagan*, 521 U.S. at 665-66; Elkind v. Liggett & Myers, Inc., 635 F.2d 156, 166 (2d Cir. 1980).

actually affect the decision of a potential buyer or seller.[229] For the willfulness element, the defendant must realize that he is committing a wrongful act.[230] Thus, a duty of confidentiality would not extend liability to directors who tip trivial information or who tip inadvertently or negligently.[231]

To the extent liability is expanded by a duty of confidentiality, this increased exposure might also reduce market efficiency by diminishing corporate incentives to disclose important information. A principal concern of the securities laws is to maintain market efficiency by encouraging full disclosure.[232] If a director fails to act in good faith by leaking information to outsiders, fewer directors will leak information and the overall amount of information in the market may be reduced. The securities laws' primary concern, however, is that all investors have equal access to information,[233] not to maximize the total amount of information available.[234] If a company ceases disclosing information, its investors will

229. *Elkind*, 635 F.2d at 166; SEC v. Tex. Gulf Sulphur Co., 401 F.2d 833, 849 (2d Cir. 1968) ("The basic test of materiality is whether a *reasonable* man would attach importance in determining his choice of action in the transaction in question. This, of course, encompasses any fact which in reasonable and objective contemplation *might* affect the value of the corporation's stock or securities." (internal citations and alterations omitted)).

230. *See* United States v. Chiarella, 588 F.2d 1358, 1370 (2d Cir. 1978), *rev'd on other grounds*, 445 U.S. 222 (1980).

231. One situation in which leaks should arguably be permitted is when necessary to expose corporate criminal activity. Obviously, a director should still try to prevent any corporate criminal activity through his normal monitoring role, but as a matter of public policy, directors should not be punished for exposing corporate crime. *See* Cohen, *supra* note 194, at 577-78 (arguing that tippers should have a defense to insider trading liability for a disclosure made "in a good faith attempt to prevent criminal activity reasonably certain to cause substantial physical or financial harm to others"); *see also infra* notes 234-41 and accompanying text.

232. *See In re* Carnation Co., Exchange Act Release No. 22,214, 33 SEC Docket 874, 1985 WL 547371, at *4 (July 8, 1985) ("The importance of accurate and complete issuer disclosure to the integrity of the securities markets cannot be overemphasized.").

233. *See supra* note 156 (discussing the policies behind Regulation FD).

234. An interesting First Amendment issue arises in the context of Regulation FD and the duty of confidentiality discussed in this Note. A corporation enjoys the same free speech rights as natural persons. *See* First Nat'l Bank of Boston v. Bellotti, 435 U.S. 765, 776-77 (1978). Commentators have criticized the SEC's Regulation FD as unconstitutional because it limits corporate free speech. *See* Antony Page & Katy Yang, *Controlling Corporate Speech: Is Regulation Fair Disclosure Unconstitutional?*, 39 U.C. DAVIS L. REV. 1, 5-6 (2005) (arguing that Regulation FD is an unconstitutional burden on corporate free speech). A general duty of confidentiality might raise some of the same concerns about free speech. However, "the Supreme Court has occasionally proclaimed, absent much explanation, that the securities markets remain subject to government regulation without interference from the First Amendment." Michael R. Siebecker, *Corporate Speech, Securities Regulation, and an Institutional Approach to the First Amendment*, 48 WM. & MARY L. REV. 613, 645, 674 (2006) (arguing that the "institutional approach" to the First Amendment advocated by Professor Frederick Schauer "provide[s] significant principled grounds for permitting greater speech regulation, at least when applied in the realm of securities regulation).

lose confidence and invest elsewhere. Market economics should force corporations to continue to disclose enough information to satisfy their shareholders that they are investing wisely.

A general duty of confidentiality might also silence potential whistleblowers. A director with knowledge of corporate malfeasance might be unwilling to expose the problem out of fear of liability for breaching his duty of good faith. This problem could be mitigated, however, by a narrow exception for leaks "in good faith."[235] The Supreme Court followed an analogous approach in the insider trading realm in *Dirks v. SEC*.[236]

The defendant in *Dirks*, who worked as a securities analyst, received tips from employees of Equity Funding of America that the company fraudulently overstated its assets.[237] The defendant owned no stock in the company, but he openly discussed the fraud with his clients and other investors.[238] The defendant also petitioned the *Wall Street Journal*, unsuccessfully, to publish a story exposing the fraud.[239]

The defendant was censured in the subsequent enforcement proceeding for trading on material insider information in violation of SEC Rule 10b-5.[240] The Supreme Court reversed, holding that the defendant did not violate SEC Rule 10b-5 because his informants "were motivated by a desire to expose the fraud."[241] The Court stated that the absence of breach by the insiders (in exposing the fraud) compelled its holding that there was no derivative breach by the defendant.[242] The Court's holding protects whistleblowers, and there is no reason directors who expose corporate fraud or malfeasance should not be similarly protected. To protect directors in these situations, leaks motivated by an intent to expose fraud or other corporate misconduct should be considered acts in good faith.

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235. *See* Kirk O. Hanson & Jerry Ceppos, *The Ethics of Leaking*, L.A. TIMES, Oct. 6, 2006, at B13, *available at* 2006 WLNR 17304796 (balancing the ethical considerations of leaks and concluding that some leaks "can be more easily ethically justified").

236. 463 U.S. 646 (1983).

237. *Id.* at 649. The Court asserted that the fraud at Equity Funding of America was "one of the most infamous frauds in recent memory" and that "the SEC repeatedly missed opportunities to investigate" the fraud. *Id.* at 652 n.8.

238. *Id.* at 649. Five investment advisers liquidated more than $16 million in Equity Funding securities after hearing about the fraud from the defendant. *Id.*

239. *Id.* at 649-50.

240. *Id.* at 650-52. "Recognizing . . . that Dirks 'played an important role in bringing [Equity Funding's] massive fraud to light,' the SEC only censured him." *Id.* at 651-52 (quoting Dirks, Exchange Act Release No. 17,480, 21 SEC Docket 1401, 1412 (1981) (footnotes omitted)).

241. *Id.* at 665-67.

242. *Id.*

As described above, the benefits of recognizing a good faith duty of confidentiality outweigh the costs. A duty of confidentiality would increase collegiality on the board and provide a strong disincentive to a director wishing to manipulate boardroom actions through leaks to the press. A general duty of confidentiality would also give directors a bright line rule to follow: If you misappropriate confidential corporate information by leaking to outsiders, you could incur liability for failing to act in good faith. Your liability will not be covered by director indemnification or liability limitation provisions, so you may be forced to pay damages out of your own pocket.

VI. CONCLUSION

The leak scandal at H-P highlights a key problem in corporate governance: Directors do not currently owe a general duty of confidentiality.[243] However, the increasingly important duty of good faith provides a perfect vehicle for recognizing such a duty. Leaks are manipulative acts that damage a corporation's competitive position, hurt investor relations, and expose the company and the director to liability for violating federal securities laws. Directors should owe a duty of confidentiality to prevent unilateral director action, promote collegiality in boardrooms, and align the duties of directors with the fiduciary duties of lawyers and other agents.

Through the Sarbanes-Oxley Act of 2002 and Regulation Fair Disclosure, the federal government is assuming more regulatory control over corporate governance.[244] Indeed, Regulation Fair Disclosure

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243. The leak problem may continue to worsen. A recent *Wall Street Journal* article outlines an increasingly common practice of institutional investors whereby these investors pay a network of informants for information about companies of interest. *See* Laurie P. Cohen, *Seeking an Edge, Big Investors Turn to Network of Informants*, WALL ST. J., Nov. 27, 2006, at A1, *available at* 2006 WLNR 20539724.

> "Sophisticated investors are potentially taking advantage of people who don't know they're going over the line" by disclosing nonpublic data such as internal sales figures, asserts Jill Fisch, director of the Fordham Center for Corporate, Securities and Financial Law. "Once someone is being paid, it's hard for them to draw the line and say 'no.'"

Id.

244. *See* Fairfax, *supra* note 25, at 405 ("Sarbanes-Oxley not only federalizes corporate fiduciary duties, but also adds substance to them."); James Fanto, *Paternalistic Regulation of Public Company Management: Lessons from Bank Regulation*, 58 FLA. L. REV. 859, 860 (2006) ("By all accounts, the Sarbanes-Oxley Act of 2002 . . . represented a significant intrusion by the federal government into the substantive regulation of corporate governance of U.S. public companies, an area long considered to be the province of state corporate law.").

represents a direct attempt by the SEC to silence some corporate leakers.[245] If Delaware and other states wish to retain control over corporate governance, the states must continue to adjust corporate governance structures to changing corporate social norms. Delaware has responded to this imperative by providing plaintiffs guidance on how to respond when a director fails to act in good faith.[246] But it is time for Delaware courts to recognize that a director who leaks confidential corporate information cannot be acting in good faith. If state courts miss this opportunity, Delaware and other states will continue to cede control of corporate governance to the federal government.[247]

245. *See supra* note 156.

246. *See* Marc Gunther, *Boards Beware!*, FORTUNE, Nov. 10, 2003, at 171, *available at* 2003 WLNR 13892104 ("'It would not be unreasonable to assume that the Delaware courts are responding to the Enron and WorldCom headlines and the intrusion, so to speak, of the federal government into the internal governance of corporations.'" (quoting former Chancellor William Allen)).

247. For a proposal suggesting full-time federal corporate monitors for large companies similar to current banking regulation arrangements, see generally Fanto, *supra* note 244.