

# More on the Myth

A Little Fear Can  
Go a Long Way

# of Director Accountability

By Mark Lebovitch and Jeremy Friedman



Challenging the common lament that the risk of personal liability deters good people from serving as corporate directors — and that salaries must be high as a result — Professor Davidoff points out that officers and directors “have about the same chance of being held liable for their poor management of a public firm as they have of being struck by lightning.”

While personal liability has always been rare, corporate directors once knew that if they did not try to do their jobs or were blatantly asleep at the switch, they faced some risk of liability. Although the legal standards governing director behavior have not materially changed in years, recent decisions indicate that how judges apply those standards may be less protective of shareholders than in the past.

While many factors may combine to sway the application of law in a particular direction, we believe one reason for softening judicial oversight of directors in recent years may be the Delaware Supreme Court’s opinion in *Ryan v. Lyondell*. The trial judge in that case declined to dismiss claims against directors and required them to stand trial to determine whether “two months of slothful indifference [by the defendant board] despite knowing that the Company was in play” (that is, considering a

potential sale) amounted to bad faith. Although the judge’s opinion showed his skepticism of the shareholders’ position, he held it was a close enough call that a trial was merited.

The corporate community publicly attacked the judge for daring to make the directors sit through trial. The Delaware Supreme Court not only reversed the judge, but it seemed to rebuke him for his decision. The resulting backlash was applauded by Wall Street and corporate CEOs, and it undoubtedly sent a clear message to Chancery Court judges (and even other judges) considering whether to hold directors personally liable.

As Davidoff’s article demonstrates, the status quo essentially guarantees that directors face no risk of personal liability, regardless of their conduct. In our view, the benefits — to shareholders, corporations, and the economy in general — of judges casting even a slightly more critical eye on director conduct far outweigh any risk of misplaced personal liability. ♦

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