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Regulatory: Director liability for proxy statement disclosure

Recent lawsuits highlight directors' duty to properly inform shareholders

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Shareholders have brought a number of recent lawsuits against companies alleging, among other things, that the proxy statements used to solicit their votes were false or misleading. These lawsuits stand as a reminder that when a company is soliciting shareholder votes, directors have a duty to shareholders to ensure that the proxy statement fully and accurately discloses the material facts necessary for shareholders to make an informed vote.

This duty arises under Section 14(a) of the Securities Exchange Act of 1934, specifically Rule 14a-9 promulgated thereunder. Rule 14a-9 prohibits a company from soliciting the votes of its shareholders with a proxy statement that contains materially false or misleading information or that fails to disclose material information that is necessary for full and fair disclosure to shareholders.

To help ensure that shareholders receive the material information they need to make an informed decision on how to vote, Schedule 14A was promulgated. Schedule 14A identifies the minimum disclosure standards for proxy statements. It is important to note that while Schedule 14A sets minimum disclosure standards for proxy statements, compliance with Schedule 14A does not necessarily guarantee that a proxy statement will satisfy Rule 14a-9's requirement that the document contain full and fair disclosure regarding the matters on which shareholders are voting.

To increase the incentives for directors to carefully read proxy statements, the proxy rules provide that negligence alone can result in liability for a director involved in a proxy solicitation. The courts have stressed that this negligence standard does not impose upon directors the role of guarantors or insurers of the accuracy of proxy statements. This means, for example, that directors are not required to recalculate or reassemble financial reports (absent some evident misstatement or irregularity that should be within the director's knowledge).

On the other hand, this negligence standard does increase the incentives for directors to more rigorously police proxy statements. These incentives exist because a director who fails to carefully read a proxy statement to correct statements and facts that he knew or should have known were erroneous or misleading may be held liable for them. In this regard, directors should note that shareholders and investors who have been injured as a result of an incorrect proxy statement may directly bring an action for damages or other appropriate relief.

Fortunately, for shareholders or investors to successfully recover damages against an individual director, they must be able to establish some degree of culpability. So, an individual director can take steps to insulate himself against liability for a problematic proxy statement by carefully correcting facts that he knew or should have known were erroneous or misleading.

About the Author

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