Conceptualizing Caremark

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I thank Jennifer Arlen, David Berger, Jesse Fried, Joel Friedlander, Travis Laster, Amir Licht, Elizabeth Pollman, Amanda Rose, and participants at NYU's Institute of Corporate Governance and Finance roundtable for their helpful comments and discussions.

Abstract

Who is accountable for corporate compliance failures? The issue of compliance has emerged as one of the most significant developments in corporate governance over the past decades. However, until recently, corporate law has had surprisingly little to say about the question, leaving the policing of issues such as toxic pollution, product safety, or data privacy to other regulators. This situation has changed dramatically over the past few years. Today, virtually every corporate fiasco is followed by an oversight duty lawsuit against the company's directors and officers for not doing enough to prevent the debacle. But the rapid resurgence of oversight duties has created a mismatch: the doctrine has become one of the most important in corporate law yet remains one of the least articulated. This Article bridges this mismatch by conceptualizing the doctrine (often dubbed Caremark, after Delaware's leading precedent). In particular, the Article makes the following four contributions. First, the Article clarifies what determines a breach of oversight duties. The standard of liability across all types of oversight duty claims is bad faith. Failure-of-oversight claims thus usually boil down to what courts can infer about directors' mental state from external evidence about directors' actions and the circumstances in which they took them. The Article identifies the external "markers" that courts use to infer directors' bad faith: from the centrality of the compliance risk in question, to the relationship between past warnings and current problems, to the clarity of the legal obligations that were violated. Second, the Article articulates the main policy arguments behind each Caremark claim, namely, combatting "willful blindness," "cosmetic compliance," corporate recidivism, and managerial short-termism. Third, the Article highlights several ostensibly procedural aspects of oversight duty litigation that have a disproportionate impact on corporate behavior: from privileges to "laches" (when are Caremark claims time-barred?), to how to respond to findings by noncorporate legal forums. In a series of rulings on first impression in 2023, corporate law courts adopted a "liberal" approach across all these issues that boosts the ability to hold individual decision-makers accountable. Finally, the Article evaluates the overall desirability of the resurgence in oversight duty litigation and identifies concrete policy implications, such as how to calculate damages when the company profited from skirting regulations, or what deference to give to the company's own investigation of failure-of-oversight claims.

Keywords: Corporate Law, Compliance, ESG, Oversight Duties, Bad Faith, Corporate Wrongdoing, Litigation, Discovery, Privileges, Corporate Governance, Aiding-and-Abetting, Director Liability, Officer Liability, Willful Blindness, Cosmetic Compliance, Corporate Recidivism, Externalities, Short-Termism

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First, the Article clarifies what determines a breach of oversight duties. The standard of liability across all types of oversight duty claims is bad faith. Failure-of-oversight claims thus usually boil down to what courts can infer about directors' mental state from external evidence about directors' actions and the circumstances in which they took them. The Article identifies the external "markers" that courts use to infer directors' bad faith: from the centrality of the compliance risk in question, to the relationship between past warnings and current problems, to the clarity of the legal obligations that were violated. Second, the Article articulates the main policy arguments behind each Caremark *claim, namely, combatting "willful blindness," "cosmetic compliance," corporate recidivism, and managerial short-termism. Third, the Article highlights several ostensibly procedural aspects of oversight duty litigation that have a disproportionate impact on corporate behavior: from privileges to "laches" (when are* Caremark *claims time-barred?), to how to respond to findings by noncorporate legal forums. In a series of rulings of first impression in 2023, corporate law courts adopted a "liberal" approach across all these issues that boosts the ability to hold individual decision-makers accountable. Finally, the Article evaluates the overall desirability of the resurgence in oversight duty litigation and identifies concrete policy implications, such as how to calculate damages when the company profited from skirting regulations, and what deference to give to the company's own investigation of failure-of-oversight claims.*

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* Professor of Law, Reichman University; Research Member, ECGI. I thank Jennifer Arlen, David Berger, Jesse Fried, Joel Friedlander, Travis Laster, Amir Licht, Elizabeth Pollman, Amanda Rose, and participants at NYU's Institute of Corporate Governance and Finance roundtable for their helpful comments and discussions.

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INTRODUCTION

Every major corporate fiasco these days is followed by a derivative action in corporate law against the company's directors for not doing enough to prevent the debacle. To illustrate, recall Boeing's 737 MAX crashes, Walmart's involvement in the opioid crisis, Facebook's violations of user privacy, sexual misconduct at McDonald's, false allegations of vote stealing by Fox, and so on. All these cases rest on the same legal principle, namely, directors' oversight duties. The board of directors is the corporate organ responsible for risk oversight. And while directors are not expected to detect and prevent all wrongdoing by lower-level employees, they are expected to keep apprised of important compliance risks and to address red flags.[1]

The oversight duty doctrine is corporate law's tool for policing the effectiveness of corporate compliance programs. With compliance having emerged as a major corporate governance issue,[2] companies are pouring hundreds of billions of dollars into internal programs meant to detect and prevent wrongdoing by their employees.[3] If these costly programs fail, shareholders have the right to bring an oversight duty claim to hold directors and officers accountable for the attendant legal and financial harms suffered by the company. In fact, the effect of oversight duties extends beyond the interests of shareholders. These duties also impact broader social issues, such as product safety (Boeing), data privacy (Facebook), public health (Walmart), and democratic discourse (Fox). Oversight duties thus represent a departure from the conventional wisdom that treated corporate anti-social behavior as a matter for other laws and regulations rather than as an internal corporate law issue.

As a result, the stakes of understanding and calibrating oversight duties could not be higher. Yet the doctrine is underarticulated, and many fundamental questions remain unanswered. For example, we know that the standard of liability in failure-of-oversight cases is bad faith.[4] But we do not know how courts will apply the standard to real-world situations. How deeply will courts probe the effectiveness of board oversight? When will courts hold directors liable not only for what they knew but also for what they should have known? Beyond the uncertainties regarding how to determine a breach of oversight duties, we do not know which form of causation applies or how to calculate damages in oversight duty cases. Additionally, it is unclear what the scope of oversight duties entails. Do these duties apply to overseeing business risks or strictly to overseeing clear illegalities? Do they apply to third-party compliance advisors or solely to corporate insiders? Perhaps the most significant concern is that we do not have a strong understanding of the policy rationales that support oversight duty claims.

These fundamental questions have yet to be fully explored because the oversight duty doctrine is still in a nascent stage. Although the doctrine has existed in various formulations for over six decades,[5] in practice, it lay dormant much of this time and was widely perceived by corporate legal scholars and practitioners as an irrelevant

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1. *See* Stone v. Ritter, 911 A.2d 362, 370 (Del. 2006).

2. Sean J. Griffith, *Corporate Governance in an Era of Compliance*, 57 WM. & MARY L. REV. 2075, 2077 (2016).

3. *See, e.g.*, Eugene Soltes, *Evaluating the Effectiveness of Corporate Compliance Programs: Establishing a Model for Prosecutors, Courts, and Firms*, 14 N.Y.U. J.L. & BUS. 965, 969 (2018).

4. *Stone*, 911 A.2d at 370.

5. *See* Graham v. Allis-Chalmers Mfg. Co., 188 A.2d 125,130 (Del. 1963); *In re* Caremark Int'l Inc. Deriv. Litig., 698 A.2d 959, 967 (Del. Ch. 1996).

"toothless tiger."[6] Failure-of-oversight claims (often dubbed *Caremark* claims, after Delaware's leading precedent) were routinely dismissed due to a combination of a high evidentiary bar and the procedural stance in these cases.[7] This situation has changed dramatically over the past few years.[8] Courts are now showing (1) increased willingness to scrutinize board oversight efforts and fault directors not just for what they knew but also for what they did not know, and (2) increased willingness to grant shareholders access to internal company documents in order to investigate potential failure-of-oversight claims.[9] The combination of the courts' increased willingness to scrutinize directors' conduct and plaintiffs' improved ability to expose directors' conduct has resulted in a series of successful *Caremark* cases and a slew of pending *Caremark* claims.[10]

The rapid resurgence of the doctrine of oversight duties thus created an incongruity. The doctrine has become one of the most relevant theories in corporate law, yet it remains one of the least articulated.[11] This Article bridges this gap by conceptualizing the doctrine. It synthesizes the growing body of case law, highlights areas of uncertainty, and identifies areas where newly developed law deviates from the social optimum. In the process, the Article makes the following four contributions.

First, the Article clarifies what determines a breach of oversight duties. There are three variants of oversight duty claims. The *information-systems* variant requires directors to implement a system that monitors misconduct and reports back to them. The *red-flags* variant requires directors to identify and address obvious warning signs. And the *business-plan* (*Massey*[12]) variant prohibits directors from affirming a

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6. *See, e.g.*, Anne Tucker Nees, *Who's the Boss? Unmasking Oversight Liability Within the Corporate Power Puzzle*, 35 DEL. J. CORP. L. 199, 215–16 (2010).

7. *See, e.g.*, Elizabeth Pollman, *Corporate Oversight and Disobedience*, 72 VAND. L. REV. 2013, 2032–35 (2019) (providing a comprehensive overview of *Caremark* claims up until 2019).

8. *See infra* Section I.A.

9. *Id.*

10. *Id.*; Constr. Indus. Laborers Pension Fund *ex rel.* SolarWinds Corp. v. Bingle, No. 2021-0940-SG, 2022 WL 4102492, at *1 (Del. Ch. Sept. 6, 2022), *aff'd* 297 A.3d 1083 (Del. 2023) ("*Caremark* claims, once relative rarities . . . have in recent years bloomed like dandelions after a warm spring rain . . . .").

11. To illustrate just how important *Caremark* has become for practitioners, see, for example, Jennifer Kay & Mike Leonard, *Delaware's Judge Laster Is Making His Mark on Corporate America*, BLOOMBERG L. (Jul. 31, 2023, 5:00 AM), https://news.bloomberglaw.com/us-law-week/delawares-judge-laster-is-making-his-mark-on-corporate-america [https://perma.cc/8T2B-QJJP] (discussing the "transformation of *Caremark* cases from long-shot lawsuits that were barely worth bringing into a staple of Delaware's corporate accountability regime"); Kevin LaCroix, *The Top Ten D&O Stories of 2022*, D&O DIARY (Jan. 3, 2023), https://www.dandodiary.com/2023/01/articles/director-and-officer-liability/the-top-ten-do-stories-of-2022/ [https://perma.cc/T5A3-ZDNX] (placing *Caremark* at the top of important corporate governance issues). To illustrate just how underarticulated *Caremark* is, see *infra* the text accompanying notes 99–101.

12. Named after Delaware's leading precedent: *In re Massey Energy Co. Derivative & Class Action Litigation*, No. 5430–VCS, 2011 WL 2176479 (Del. Ch. May 31, 2011).

plan that is based on making profits by skirting regulations.[13] Because the standard of liability across all three variants is that of bad faith, plaintiffs must present evidence of directors' state of mind in order to prove a breach. However, mental states are not directly observable, and directors rarely openly condone lawbreaking or admit to not even trying to oversee risks.[14] As a result, failure-of-oversight cases boil down to what courts can infer about directors' subjective intent from objective evidence of their actions and the circumstances in which they took these actions.[15]

In each one of the three types of claims, courts use different external "markers" to infer directors' bad faith. In information-systems claims, courts examine the centrality of the compliance risk in question. The idea is to distinguish legitimate decisions to delegate oversight of risks from bad-faith decisions to deliberately overlook problematic practices. When directors delegate oversight of the company's most critical risks and uncritically accept whatever information is supplied to them, it is likely that they are not trying in good faith to engage in oversight. The key question is therefore which missions are critical.

In red-flags claims, courts examine how clear the warning signs were and how directly they were tied to the trauma the corporation suffered. Directors are constantly receiving reports about potential and emerging risks and are not expected to act in response to each one. Failing to identify and address the risk amounts to bad faith only when the warnings are of clear and present risks. The key question, then, is which flags are red (as opposed to merely yellow).

In business-plan (*Massey*) claims, courts focus on the clarity of the legal obligations and the pervasiveness of the violations of these obligations. Large corporations operate in a dynamic regulatory environment and often assume the risk that regulators will disagree with their operational decisions. The business-plan theory distinguishes commonplace assumptions of legal risks from premeditated decisions to violate clear preexisting regulatory requirements.

When making all these distinctions, corporate law courts rely on rules of thumb and "state of mind" tests.[16] These tests are analogous to measures other courts apply to infer scienter in different settings, such as federal courts in securities fraud litigation.[17] Comparing these contexts helps to clarify the unique challenges that litigation involving oversight duties presents.

The Article's second contribution comes from identifying the main policy arguments behind each *Caremark* claim. Corporate law commentators have long lamented that case law has never fully articulated the "why" behind oversight duty claims.[18] For example, why is maximizing profits by skirting regulations a breach of

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13. A business-plan claim is technically not a failure-of-oversight claim, but litigants and courts often group all three variants together for practical reasons. *See infra* Section I.B.

14. Ont. Provincial Council of Carpenters' Pension Tr. Fund v. Walton (*Walmart II*), No. 2021-0827-JTL, 2023 WL 3093500, at *32 (Del. Ch. Apr. 26, 2023) ("Sophisticated and well-advised individuals do not formally document bad faith decisions . . . .").

15. *Cf.* Allen v. El Paso Pipeline GP Co., 113 A.3d 167, 178 (Del. Ch. 2014), *aff'd* No. 399, 2015 WL 803053 (Del. Feb. 26, 2015).

16. Ont. Provincial Council of Carpenters' Pension Tr. Fund v. Walton (*Walmart I*), 294 A.3d 65, 90–91 (Del. Ch. 2023).

17. *See infra* note 126 and accompanying text.

18. *See infra* Section I.B.

loyalty? Why are some types of director ignorance considered blameworthy and others not? Understanding the why is critical for applying the what of legal doctrines. And it is especially critical with oversight duties, given how context specific the bad-faith inquiry is and how dynamic compliance risks are. This Article identifies the following rationales by distilling rapidly emerging case law and borrowing insights from the literature on corporate deterrence.

The information-systems theory is primarily designed to combat *willful blindness*. Directors have strong incentives to remain ignorant about decisions that prioritize profits over everything else. Information-systems theory counters these incentives by emphasizing culpable ignorance and proper documentation. The courts' increased tendency to classify issues as "mission critical" means that directors now increasingly face liability for what they should have known. And the courts' increased willingness to grant shareholders access to internal communications incentivizes directors to maintain a proper record of all internal discussions regarding compliance risks. As a result, damning information about misconduct inside the company is more likely to flow up the organizational hierarchy, and the company is more likely to deal with problems early before these problems deteriorate.

The red-flags theory serves to combat *cosmetic compliance*.[19] When courts examine whether directors saw and addressed red flags, they focus on whether directors were merely "going through the motions" or genuinely attempting to address noncompliance. The red-flags theory also helps combat corporate *recidivism*. Repeated rule violations count as red flags that put directors on notice. The more a company is recidivist, the more likely directors are to be personally liable for future problems. The prospect of red-flags claims thus incentivizes directors to address the root causes of recidivism.

The business-plan theory has a two-pronged rationale. It can be interpreted as *minimizing agency costs*. For example, corporate managers may suffer from short-termism when approving a business plan that is based on making profits from violating the law. Managers whose pay is tied to short-term yardsticks benefit from projects whose returns accrue in the short term, while the costs of illegalities (fines and reputational fallouts) may surface only over the long term. The business-plan theory can also be interpreted as *minimizing externalities*. Here the focus is on minimizing harm to third-party stakeholders, such as the environment and nearby communities, rather than on minimizing harm to long-term shareholders.

The notion of a corporate law doctrine dealing with externalities runs counter to conventional wisdom that suggests that corporate law should accept as given whatever other regulators determine.[20] In other words, once other regulators calibrate rules and sanctions, companies should be able to decide whether the sanction is a price worth paying for rule violations that benefit the company. Just as corporate law allows companies to breach contracts and pay expectation damages ("efficient breach"), so should corporate law allow companies to violate regulations and pay fines ("efficient lawbreaking"), or so the argument goes.[21] However, the efficient

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19. "Cosmetic compliance" denotes check-the-box programs that seem sound from the outside but do very little to curb corporate wrongdoing. *See infra* note 245.

20. *See infra* Section IV.C.

21. *Id.*

lawbreaking approach is flawed on many levels. For one, it assumes that regulatory sanctions accurately reflect the social harm caused by the misbehavior in question. In reality, large companies do not consider expected sanctions as inevitable but can dilute them in a number of ways, such as by hiding information from the regulator. Companies can thus engage in behaviors that are beneficial to the company even when they are extremely costly from a social perspective.[22] Therefore, there is value in providing a corporate law mechanism that disincentivizes corporate decision-makers from engaging in such behaviors.[23]

The Article's third contribution is to highlight several ostensibly procedural aspects of oversight duty litigation that have a disproportionate impact on corporate behavior. Consider for example five issues that courts addressed on first impression during 2023. One important question is how to treat privileges and redactions. Defendant directors frequently invoke attorney-client and work-product privileges and heavily redact internal documentation of compliance discussions. *Walmart* clarified just how much heavy redactions can backfire at the pleading stage, where they may serve as indications that the directors never discussed or failed to properly address central compliance risks.[24] Another question involves how to deal with findings by noncorporate legal forums. Most *Caremark* claims come at the heels of public enforcement or litigation against the company in other courts. *AmerisourceBergen* limited defendants' ability to rely on factual findings that had exonerated the company in other courts.[25] A third question is how much deference courts should give to a Special Litigation Committee (SLC) appointed by the company to investigate whether to pursue *Caremark* claims. *Chou* applied the traditional framework and deferred to the SLC's decision to dismiss well-pled claims against directors.[26] However, this Article explains that the value of SLCs is limited in *Caremark* settings, and so it is far from clear whether the standard deference to SLCs should be exercised.

Yet another question revolves around when *Caremark* claims become time-barred. The issue of timeliness is especially crucial in *Caremark* settings, because the purported failure of oversight typically occurs over a period of several years. *Walmart* and *AmerisourceBergen* implemented a liberal approach to accrual

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22. *See infra* notes 316–18 and the accompanying text.

23. *See* Jennifer Arlen, *The Compliance Function* (N.Y.U.L. & Econ. Working Paper No. 23-38, N.Y.U. Pub. L. Working Paper No. 23-54, 2023), https://ssrn.com/abstract=4502973 [https://perma.cc/DV7G-KVRS] [hereinafter Arlen, *The Compliance Function*]; Jennifer Arlen, *Evolution of Director Oversight Duties and Liability under* Caremark*: Using Enhanced Information-Acquisition Duties in the Public Interest*, *in* RESEARCH HANDBOOK ON CORPORATE LIABILITY 194 (Martin Petrin & Christian A. Witting eds., 2023) [hereinafter Arlen, *Oversight Duties*].

24. *Walmart II*, No. 2021-0827-JTL, 2023 WL 3093500 (Del. Ch. Apr. 26, 2023).

25. Lebanon Cnty. Emps.' Ret. Fund. v. Collis (*Collis III*), 311 A.3d 773, 798–803 (Del. 2023).

26. Teamsters Loc. 443 Health Servs. & Ins. Plan v. Chou, No. 2019-0816-SG, 2023 WL 7986729, at *1–2 (Del. Ch. Nov. 17, 2023), *aff'd sub nom.*, Teamsters Loc. 443 Health Servs. & Ins. Plan v. Cencora, Inc., No. 2019-0816, 2024 WL 429773 (Del. Sept. 20, 2024).

methods, lookback dates, and equitable tolling, thereby significantly reducing the likelihood that future *Caremark* claims would be time-barred.[27] The fifth issue that was addressed on first impression during 2023, and the one that received the most attention, is *McDonald's* clarification that corporate officers have oversight duties too.[28] This Article highlights two important differences between the duties of officers and those of directors, which could make claims against the latter more likely to survive than claims against the former.

There are also two core questions that remain unanswered but are likely to be addressed in the forthcoming months. One concerns the scope of third-party liability. Virtually all the important compliance decisions in large companies are outsourced to third-party advisors.[29] Yet, these outside advisors are rarely held accountable for compliance failures.[30] In other words, while directors are increasingly held accountable for remaining in the dark about noncompliance, those who were paid to create the information environment for directors are not. This is attributable in large part to the intricacies of the aiding-and-abetting doctrine and how it interacts with *Caremark*. However, the Article calls attention to a few seemingly disparate developments in *McDonald's* and *Walmart* that could potentially revive aiding-and-abetting claims in *Caremark* settings. Last but certainly not least among the unanswered questions in oversight duties lawsuits is how to assess causation and remedies. Here the Article draws on longstanding fiduciary law principles to clarify the elements required to prove breach, the type of causation that applies, and the method of calculating damages when the company profited from violating the law.

The Article's final set of contributions concerns policy implications: The Article evaluates the overall desirability of the resurgence in oversight duty litigation and identifies concrete lessons for courts. The main disadvantages of the revamped mode of the oversight duty doctrine are that it exacerbates the risk of judicial hindsight bias and discourages corporate investment in remedial measures. The main advantages are that it nicely complements the flaws of public enforcement and facilitates market discipline. Overall, the evolution of oversight duties is likely to prove socially advantageous. However, there are still areas that can be further improved. The Article provides specific recommendations for addressing regulatory influence-seeking and for incorporating company size into *Caremark* claims assessments.

A few words on scope and terminology are in order at the outset. Unless noted otherwise, references to corporate law are to Delaware corporate law. Most large corporations are governed by Delaware law, and other states tend to follow its lead.[31]

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27. *Walmart I*, 294 A.3d 65, 94–95 (Del. Ch. 2023); *Collis III*, 287 A.3d at 1204–05, 1218–20.

28. *In re* McDonald's Corp. Deriv. Litig. (*McDonald's I*), 289 A.3d 343, 358–60 (Del. Ch. 2023).

29. *See* Asaf Eckstein & Roy Shapira, *Compliance Gatekeepers*, 41 YALE. J. ON REGUL. 469, 478–81 (2024).

30. *See id.* at 484–89.

31. *See* Charlotte Morabito, *Here's Why More Than 60% Of Fortune 500 Companies Are Incorporated in Delaware*, CNBC (Mar. 13, 2023, 8:00 AM), https://www.cnbc.com/2023/03/13/why-more-than-60percent-of-fortune-500-companies-incorporated-in-delaware.html [https://perma.cc/FXV8-ARG5] (discussing how most large companies incorporate in Delaware); Kevin LaCroix, *Cardinal Health Opioid-Related*

References to corporate directors in the Article usually also include corporate officers, with the exception of Section V.E, which explains how the oversight duties of officers are similar in principle but different in practice from those of directors. Finally, oversight duty doctrine has been developing at a breakneck pace, with most of the relevant court decisions in this Article dating from 2022 and 2023. I emphasize this point here because it affects how readers should approach this Article. It would not be surprising if some of the trends described here will be reversed in three or four years. Indeed, most of the decisions cited here are from Delaware's Court of Chancery—the Delaware Supreme Court may end up taking different views. What one needs to glean from this Article is therefore not necessarily specific conjectures, but rather the general mode of reorganizing the case law, identifying the key questions, and ascertaining the underlying logic of oversight duties.

The Article proceeds in seven parts. Part I provides the background of the causes and consequences of the resurgence of oversight duties. Parts II–IV examine the two primary questions—how to infer bad faith, and what is the underlying policy rationale—for each of the three *Caremark* claims. Part V highlights seven secondary questions that will determine the prospect of oversight liability going forward, from privileges to "laches" and "judicial notice." Part VI outlines policy implications. A short Conclusion clarifies the Article's original contributions and identifies areas for future development, such as AI-based board oversight.

I. BACKGROUND: THE RESURGENCE OF OVERSIGHT DUTIES

Over the past four years, oversight duty doctrine has shifted from being an irrelevant, "toothless tiger" to being one of the most relevant theories in corporate law. Section A explains what the causes and consequences of this shift are. Section B highlights the thorny questions that this shift has brought to the fore.

A. From the Least Relevant to the Most Relevant Theory in Corporate Law

Compliance has become a key corporate governance issue.[32] Companies are facing increased regulatory and societal demands these days.[33] In response, companies are spending hundreds of billions on internal programs meant to detect and prevent wrongdoing by their employees.[34] And regulators are counting on these

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Derivative Suit Settled for $124 million, D&O DIARY (May 30, 2022), https://www.dandodiary.com/2022/05/articles/shareholders-derivative-litigation/cardinal-health-opioid-related-derivative-suit-settled-for-124-million/ [https://perma.cc/RGK6-HCA7] (offering an example of out-of-Delaware developments that mimic the trends described here).

32. *See* Stavros Gadinis & Amelia Miazad, *The Hidden Power of Compliance*, 103 MINN. L. REV. 2135, 2146 (2019).

33. *See* Leo E. Strine, Jr., Kirby M. Smith & Reilly S. Steel, Caremark *and ESG, Perfect Together: A Practical Approach to Implementing an Integrated, Efficient, and Effective* Caremark *and EESG Strategy*, 106 IOWA L. REV. 1885, 1886–87 (2021).

34. Soltes, *supra* note 3.

internal programs to curb corporate wrongdoing.[35] Getting corporate compliance right is therefore crucial.

Yet, until recently, corporate law has played a surprisingly limited role in holding directors and officers accountable for compliance failures. On paper, the leading precedent on oversight duties (*Caremark*) called on directors to be proactive about their companies' compliance efforts; instead of waiting for someone to flag problems to them, directors must put in place a system that consistently monitors problems.[36] But in practice, a combination of the procedural stance and the standard of review in failure-of-oversight claims presented a virtually insuperable pleading hurdle for plaintiffs, rendering the doctrine largely irrelevant.[37]

Failure-of-oversight claims are derivative in nature (regulatory fines for noncompliance harm the company, not individual shareholders). To survive a motion to dismiss, plaintiffs effectively need to show that placing a demand on the board to pursue the claims was futile.[38] To prove demand futility in *Caremark* settings, plaintiffs usually must show that the majority of directors face a substantial likelihood of liability for their role in the corporate trauma in question.[39] Accordingly, the court needs to evaluate, already in such a preliminary stage, the merits of the claims against directors.

The standard of liability against which courts assess the merits of *Caremark* claims is bad faith.[40] A bad-faith standard means that it is not enough to show that directors breached their oversight duties; plaintiffs must show that directors *knowingly* breached these duties. Plaintiffs can do it, for example, by pleading with particularity facts indicating that directors *deliberately* ignored obvious warning signs of noncompliance.[41] Yet, it is extremely hard for outside shareholders to show already at the pleading stage (before discovery) what directors knew, when they knew it, and what they did or did not do to stop the problem. As a result, *Caremark* claims basically amounted to a parade of early dismissals and were widely perceived by academics and practitioners as a "toothless tiger."[42]

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35. Eckstein & Shapira, *supra* note 29, at 513.

36. *In re* Caremark Int'l Inc. Deriv. Litig., 698 A.2d 959 (Del. Ch. 1996), *adopted by* Stone v. Ritter, 911 A.2d 362, 365 (Del. 2006).

37. Pollman, *supra* note 7. Jennifer Arlen, *The Story of* Allis-Chalmers*,* Caremark*, and* Stone*: The Directors' Evolving Duty to Monitor*, *in* CORPORATE LAW STORIES 323 (Ramseyer ed., 2009) (noting that the bad faith standard was coupled back then with the anemic and not-very-concrete duty of installing some system that reports information to someone in the organization).

38. Del. Ch. Ct. R. 23.1. Shareholder derivative litigation displaces the board's usual authority to assert its company's legal claims. The courts will allow such displacement only if shareholders can show that they made a demand on the board to pursue the company's purported claims or show that making such a demand would have been futile.

39. Rales v. Blasband, 634 A.2d 927, 932–34 (Del. 1993); *see generally* United Food & Com. Workers Union v. Zuckerberg, 250 A.3d 862 (Del. Ch. 2020), *aff'd*, 262 A.3d 1034 (Del. 2021).

40. *Stone*, 911 A.2d at 370.

41. *Id.*

42. *See, e.g.*, Nees, *supra* note 6; Megan W. Shaner, *The (Un)Enforcement of Corporate Officers' Duties*, 48 U.C. DAVIS L. REV. 271, 307 n.153 (2014).

This state of affairs changed quickly following the 2019 *Marchand* decision.[43] Blue Bell, a leading ice cream manufacturer, suffered from a listeria outbreak in one of its product lines, causing three deaths, massive recalls, and attendant financial, legal, and reputational costs to the company.[44] The Court of Chancery routinely dismissed the shareholders' failure-of-oversight claim, reasoning that they were not able to locate evidence linking the directors to the corporate trauma (no bad faith). Yet, for Delaware's Supreme Court, the fact that there was no discussion of the listeria issues at the board level serves in itself as an indication that directors were breaching their oversight duties.[45] If you are a director of a company that sells nothing but ice cream and you do not allocate time and responsibilities to discussing potential food safety issues, you are probably not trying in good faith to oversee the company's operations.[46]

Marchand opened the doors to many other successful *Caremark* claims: *Clovis*, for noncompliance with FDA drug-development protocols;[47] *Hughes*, for noncompliance with financial reporting requirements;[48] *Chou*, for illegal repackaging of cancer-treatment drugs;[49] *Boeing*, for the MAX 737 debacle;[50] *Walmart*, for its role in the opioid crisis;[51] and so on.[52] Within a couple of years, oversight duties thus transformed from being irrelevant to being super relevant.

The reason for this shift is twofold.[53] First, courts these days are increasingly willing to apply heightened scrutiny to directors' compliance efforts.[54] In particular, when the compliance failure in question concerns central compliance risks, courts are willing to view absence of proof that the board discussed the issue as a pleading-stage indication that the board breached its duties.[55]

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43. Marchand v. Barnhill, 212 A.3d 805 (Del. 2019).

44. *Id.* at 812–13.

45. *Id.* at 821.

46. *Id.* at 824.

47. *In re* Clovis Oncology, Inc. Deriv. Litig., No. 2017-0222-JRS, 2019 WL 4850188 (Del. Ch. Oct. 1, 2019).

48. Hughes v. Hu, No. 2019-0112-JTL, 2020 WL 1987029 (Del. Ch. Apr. 27, 2020).

49. Teamsters Loc. 443 Health Servs. & Ins. Plan v. Chou, No. 2019-0816-SG, 2020 WL 5028065 (Del. Ch. Aug. 24, 2020).

50. *In re* Boeing Co. Deriv. Litig., No. 2019-0907-MTZ, 2021 WL 4059934 (Del. Ch. Sept. 7, 2021).

51. *Walmart II*, No. 2021-0827-JTL, 2023 WL 3093500 (Del. Ch. Apr. 12, 2023).

52. *See, e.g.*, Inter-Mktg. Grp. USA v. Armstrong, No. 2017-0030-TMR, 2020 WL 756965 (Del. Ch. Jan. 31, 2020) (discussing noncompliance with pipeline safety regulations in a master limited partnership); Leslie Pappas, *Facebook Board to Face "Colossal" Privacy Violations Suit*, LAW360 (May 10, 2023, 9:23 PM) https://www.law360.com/articles/1605140/facebook-board-to-face-colossal-privacy-violations-suit [https://perma.cc/S7PP-E3A8] (addressing noncompliance with data privacy regulations).

53. Roy Shapira, *Max Oversight Duties: How* Boeing *Signifies a Shift in Corporate Law*, 48 J. CORP. L. 119, 121 (2022).

54. *Id.*

55. Marchand v. Barnhill, 212 A.3d 805, 821 (Del. 2019).

Second, courts are also more willing to grant shareholders access to internal company documents to investigate potential failure-of-oversight claims.[56] Shareholders have always enjoyed a qualified right to inspect their company's books and records, nestled in DGCL Section 220.[57] But in recent years, courts have liberalized their interpretation of Section 220's requirements,[58] so that they now order provision of internal documents in more cases,[59] and order the provision of a broader scope of documents (not just formal board materials, but also informal electronic communications).[60] Shareholders thus enjoy much better pre-filing discovery powers, which they can utilize to plead with particularity facts about how the boards never even discussed a critical compliance issue, or how they knew about critical problems but chose to ignore them. In *Boeing*, for example, plaintiffs had access to 630,000 pages of internal company documents.[61] When sophisticated plaintiffs' attorneys gain such access, they are much more likely to find smoking gun indications of what the insiders knew and when they knew it.

The impact of this shift in oversight duties on real-world corporate behavior cannot be overstated. To fully appreciate it, we need to take a step back and understand how corporate law works. As of this writing, none of the abovementioned *Caremark* cases made it to trial and were ultimately decided in favor of plaintiffs. These cases were "successful" in the sense of surviving the motion to dismiss. But corporate law's impact on behavior cannot be measured by the size of the sanction imposed after a full trial. In corporate law, in general, very few cases are ultimately decided in final verdicts.[62] And when cases are decided, corporate decision makers almost never pay out-of-pocket.[63] Still, the law evolves through judicial decisions at the preliminary stages. And corporate decision makers are deterred from the prospect of paying settlements ex post and planning how to avoid the risks and costs of litigation ex ante. The costs of litigation are also nonlegal, such as the emotional stress of having to go through depositions, or the reputational fallout from having damning information about you dug out for everyone in the market to see. When

56. Shapira, *supra* note 53, at 144.

57. DEL. CODE ANN. tit. 8, § 220 (2021).

58. Roy Shapira, *Corporate Law, Retooled: How Books and Records Revamped Judicial Oversight*, 42 CARDOZO L. REV. 1949, 1952 (2021); Geeyoung Min & Alexander M. Krischik, *Realigning Stockholder Inspection Rights*, 27 STAN. J.L. BUS. & FIN. 225, 233 (2022).

59. *See, e.g.*, AmerisourceBergen Corp. v. Lebanon Cnty. Emps.' Ret. Fund, 243 A.3d 417, 427 (Del. 2020) (clarifying that to demonstrate a "proper purpose" for inspection, shareholders do not need to show indications of an actionable claim against the directors).

60. *See, e.g.*, *In re* Facebook, Inc. Section 220 Litig., No. 2018-0661-JRS, 2019 WL 2320842, at *53 n.185 (Del. Ch. May 30, 2019) (ordering Facebook's top executives and directors to produce not just formal board materials, but also private emails).

61. *In re* Boeing Co. Deriv. Litig., No. 2019-0907-MTZ, 2021 WL 4059934, at *1 n.1 (Del. Ch. Sept. 7, 2021).

62. Lawrence A. Hamermesh & Michael L. Wachter, *The Importance of Being Dismissive: The Efficiency Role of Pleading Stage Evaluation of Shareholder Litigation*, 42 J. CORP. L. 597, 606–07 (2017) (finding that during a five-year period, only five final verdicts were reached after a full trial in derivative or class actions).

63. Bernard Black, Brian Cheffins & Michael Klausner, *Outside Director Liability*, 58 STAN. L. REV. 1055, 1055 (2006) (finding that during a twenty-five-year period, there were only thirteen instances in which outside directors of public companies paid out of pocket).

planning how to avoid large settlements and the costs of the litigation process, corporate managers rely on memos that their legal advisors circulate following important judicial decisions.

The new *Caremark* era has significantly increased the deterrent factor of all these components, namely, settlements, legal advice, and reputational fallouts. Consider settlements first. A prominent blog runs an updated list of the largest derivative lawsuit settlements.[64] Prior to 2019, no oversight duty lawsuit made the list. By 2023, five oversight duty cases made it to the top ten largest settlements ever.[65]

Next, consider the shift in legal advice. The prominent Harvard Corporate Governance Forum posts the most important "law firm memos" containing advice to corporate clients. The Forum tags these posts according to the specific area in corporate law that the advice addresses. In the ten years leading up to *Marchand* (2019), there were only five posts dedicated to oversight duties. In the four years since then, thirty-five posts were dedicated to oversight duties. Even more important than the change in volume is the change in tone in those memos concerning the board's role in compliance. Elsewhere I analyzed the content of law firm memos following *Caremark* decisions from 2019–2021, concluding that the main recurring themes are calls for action by boards to place compliance issues higher on the agenda and to ensure that compliance discussions are properly documented.[66] From 2022–2023, the law firm memos following newer *Caremark* decisions contained more fine-grained advice, such as calling on boards to conduct prioritization of compliance risks and to consider adding directors with expertise on topics that were once considered niche, such as cybersecurity and safety.[67] When virtually all top legal advisors to boards prompt directors to adopt certain measures, it is safe to assume that change is underway.

Finally, the new *Caremark* era has reshaped the volume and tone of media coverage of corporate debacles. To illustrate, let us revisit our previous examples: Blue Bell initially managed to control how the listeria outbreak was framed in the media and curtailed an initial reputational fallout.[68] But after the Delaware Supreme Court's decision, the media went back to covering the listeria debacle and changed its tone, this time highlighting Blue Bell's systemic disregard for food safety.[69]

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64. Kevin LaCroix, *Largest Derivative Lawsuit Settlements*, THE D&O DIARY (Dec. 5, 2014), https://www.dandodiary.com/2014/12/articles/shareholders-derivative-litigation/largest-derivative-lawsuit-settlements/ [https://perma.cc/LY68-9TNY].

65. *Id.*

66. Roy Shapira, *A New* Caremark *Era: Causes and Consequences*, 98 WASH. U. L. REV. 1857, 1881 (2021).

67. *See, e.g.*, Gail Weinstein, Philip Richter & Steven Epstein, *Chancery Court Addresses Board Responsibility Under Caremark for Cybersecurity Risk*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Nov. 17, 2022), https://corpgov.law.harvard.edu/2022/11/17/chancery-court-addresses-board-responsibility-under-caremark-for-cybersecurity-risk/ [https://perma.cc/U85X-T5BY]; Yaron Nili & Roy Shapira, *Specialist Directors*, 41 YALE J. ON REGUL. 652 (2024).

68. Brandyl Brooks Calley et al., *A Comparative Content Analysis of News Stories and Press Releases During the 2015 Blue Bell Ice Cream Recall*, 103 J. OF APPLIED COMMC'NS 1 (2019).

69. *See, e.g.*, Angela Spivey, Andrew Phillips & Alan Pryor, *The Blue Bell Ice Cream Listeria Outbreak and Its Fallout*, FOOD SAFETY NEWS (Aug. 1, 2019),

Facebook faced an initial wave of bad media after the Cambridge Analytica story broke in 2018. The company and its CEO Mark Zuckerberg went on a public campaign to limit the reputational fallout, communicating a newfound commitment to user privacy.[70] But then shareholders filed a Section 220 action and a subsequent *Caremark* lawsuit, which renewed the media's attention to Facebook's "scant regard for users' privacy."[71] Boeing initially weathered the public-relations storm of its MAX 737 debacle, managing to frame it as a one-off technical oddity and shifting blame to the pilots. Indeed, one academic study analyzing the content of media coverage in the ten months following the crashes concluded that "the mainstream media served primarily as a Boeing's [sic] loudspeaker. Critical tones were rare."[72] But after Vice Chancellor Zurn sustained *Caremark* claims against Boeing's directors and scolded them in a detailed opinion, the media focused on Boeing's deep-seated problems and called out specific directors and officers by name.[73]

The shift in oversight duties is therefore much more consequential than a simple count of successful *Caremark* cases would suggest. In fact, the impact is even more pronounced once we factor transcript rulings and Section 220 actions.

"Transcript rulings" refer to the common practice in Delaware of orally dictating rulings from the bench.[74] These rulings are not published or posted to mainstream legal databases. As a result, they usually escape the attention of corporate law academics. But practicing corporate lawyers frequently "read, inquire about, cite, and disseminate" them.[75] Of relevance here are several oversight duty decisions that come to us through transcript rulings. The 2023 *Meta* decision is one.[76] Following

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https://www.foodsafetynews.com/2019/08/the-blue-bell-ice-cream-listeria-outbreak-and-its-fallout/ [https://perma.cc/VK5F-UZXX].

70. *See, e.g.*, Julia Carrie Wong, *Mark Zuckerberg Apologises for Facebook's 'Mistakes' over Cambridge Analytica*, THE GUARDIAN (Mar. 22, 2018, 2:53 PM), https://www.theguardian.com/technology/2018/mar/21/mark-zuckerberg-response-facebook-cambridge-analytica [https://perma.cc/Y76J-D5BM].

71. *See, e.g.*, Zak Doffman, *Facebook Loses Court Battle to Keep Internal Privacy Breach Records Private*, FORBES (May 31, 2019, 7:56 PM), https://www.forbes.com/sites/zakdoffman/2019/05/31/facebook-loses-in-court-over-privacy-emails-as-zuckerberg-votes-to-keep-full-control/ [https://perma.cc/326E-DNXQ].

72. Bob Travica, *Mediating Realities: A Case of the Boeing 737 MAX*, 23 INFORMING SCI. INT'L J. OF AN EMERGING TRANSDISCIPLINE 25, 34 (2020).

73. *See, e.g.*, Eda Aker, *Lynn Good Wins SOM Leadership Award While Facing Negligence Lawsuit for Time at Boeing*, YALE DAILY NEWS (Oct. 7, 2021, 1:23 AM), https://yaledailynews.com/blog/2021/10/07/lynn-good-wins-som-leadership-award-while-facing-negligence-lawsuit-for-time-at-boeing/ [https://perma.cc/B45F-ESAW].

74. *See generally* Joel Edan Friedlander, *Performances of Equity: Why Court of Chancery Transcript Rulings Are Law*, 77 BUS. LAW. 51 (2021).

75. *Id.* at 52 ("To the practitioner, [bench rulings] are an indispensable tool. They influence our behavior and those of our adversaries. They help predict future litigation outcomes.").

76. Randall Chase, *Delaware Judge Refuses to Dismiss Facebook Shareholder Suit over User Data Privacy Breaches*, AP NEWS (May 11, 2023, 8:28 PM), https://apnews.com/article/facebook-zuckerberg-privacy-lawsuit-shareholders-d8663ed12d5cd18bb086a10700ff5eb6 [https://perma.cc/9LS6-ZXBY]; see also Friedlander, supra note 74 at 76–80 (highlighting *Puda Coal* as a transcript ruling harbinger of the new *Caremark* Era).

many violations of user privacy regulations, Meta's (Facebook) shareholders sought inspection of internal documents to investigate what directors and officers knew about the problem in real time. Shareholders then filed a detailed *Caremark* lawsuit, and the court denied defendants' motion to dismiss in a bench ruling. The ruling contained important lessons regarding what constitutes red flags that directors and officers cannot ignore.[77] And while the ruling was not posted to Lexis or Westlaw, it was highlighted in mainstream media outlets and leading legal blogs, where its implications to legal counsels and corporate directors were discussed.[78]

"Section 220 actions" refer to litigation over what documents shareholders can get in order to investigate potential failures of oversight. Much like successful merit-based *Caremark* litigation, successful Section 220 litigation often imposes costs on defendants in ways that make them internalize the costs of failures of oversight. A successful Section 220 action not only increases the expected legal sanction down the road, it also, pertinently, imposes nonlegal costs—the reputational damage that comes from media coverage of the Section 220 dispute (as in the previously mentioned *Meta* case).[79] In other words, transcript rulings and Section 220 actions over failure-of-oversight claims can yield similar consequences to actual *Caremark* litigation.

At this point, there can be no doubt that oversight duties are an important element of corporate law.[80] But there remains much doubt about the contours of the doctrine. That is, one can predict with certainty that following a major corporate debacle, a *Caremark* claim will be filed. But one would be hard put to predict how the claim will fare. The next Section distinguishes between questions on which the law has recently settled, questions on which the law is emerging, and questions that remain unanswered.

B. Open Questions

The slew of recent *Caremark* cases has provided opportunities for courts to address thorny legal issues that had lain dormant for decades. At the most basic level, the resurgence in oversight claims gave courts a chance to reclassify the different claims. Prior to the 2020s, it was customary to refer to failure-of-oversight claims as "*Caremark* prong one" and "*Caremark* prong two,"[81] where prong one deals with utterly failing to implement any reporting system and prong two concerns

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77. Friedlander, *supra* note 74, at 72.

78. *See, e.g.*, Kevin LaCroix, *Court Denies Dismissal Motion in Facebook User Data Privacy Derivative Suit*, D&O DIARY (May 14, 2023), https://www.dandodiary.com/2023/05/articles/shareholders-derivative-litigation/court-denies-dismissal-motion-in-facebook-user-data-privacy-derivative-suit/ [https://perma.cc/G8TV-F58E].

79. Doffman, *supra* note 71.

80. *See, e.g.*, Ann Lipton, *Possibly the Easiest Theory in Corporation Law*, BUS. L. PROF. BLOG, https://lawprofessors.typepad.com/business_law/2023/05/the-easiest-theory-in-corporation-law.html [https://perma.cc/V4J2-RNFS]. Lipton's title inverts the well-cited, but arguably outdated, notion that *Caremark* is "the most difficult theory in corporation law upon which a plaintiff might hope to win a judgment." *In re* Caremark Int'l, Inc. Deriv. Litig., 698 A.2d 959, 967 (Del. Ch. 1996).

81. Stone v. Fitter, 911 A.2d 362, 370 (Del. 2006).

deliberately ignoring warning signs. *Hamrock* clarified that (1) these old nametags could be improved for accuracy and functionality, and (2) a third type of claim should be added to the mix.[82]

What was once dubbed "*Caremark* prong two" is now referred to as a "red-flags claim." The underlying duty is the same: Directors must see and address clear warning signs of noncompliance. But it would be somewhat misleading to view this duty as emanating from *Caremark*, when in fact the duty predates *Caremark* and derives from the 1963 precedent of *Allis-Chalmers*.[83] What was once referred to as "*Caremark* prong one" is now termed an "information-systems claim." That duty is the one that truly emanated from the 1996 *Caremark* decision, which required directors to be proactive and put in place a system that regularly reports problems to the board.

A third type of claim arises when directors knowingly approve acts of noncompliance.[84] This type is referred to as a "*Massey* claim," following Delaware's leading precedent.[85] But I think that a better term would be "business-plan claim," to convey the essence of the duty more clearly: Directors cannot affirm a business plan that is predicated on profiting by skirting regulations. That is, even if the directors' decision is informed and based on the belief that skirting regulations will net profits to the company (after factoring the expected penalty), such a decision violates the directors' duty of loyalty. Up until the 2010s, it was unclear to some practitioners and academics that such a duty exists.[86] Indeed, several corporate legal scholars argued that directors may rationally opt to break the law if the corporation profits off it.[87] But a series of decisions clarified that "Delaware law does not charter lawbreakers."[88] The doctrinal hook is straightforward: The Delaware corporate law statute begins by stating that a corporation can only promote *lawful* lines of

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82. City of Detroit Police & Fire Ret. Sys. v. Hamrock, *ex rel.* NiSource, Inc. v. Hamrock, No. 2021-0370-KSJM, 2022 WL 2387653 (Del. Ch. June 30, 2022).

83. *In re* McDonald's Corp. S'holder Deriv. Litig., 289 A.3d 343, 359–60 (Del. Ch. 2023) (referring to Graham v. Allis-Chalmers Mfg. Co., 188 A.2d 125, 130 (Del. 1963)).

84. Guttman v. Huang, 823 A.2d 492, 506 n.34 (Del. Ch. 2003) (noting that the duty not to intentionally violate positive law is a subset of the duty to act loyally to the corporation); *In re* Walt Disney Co. Deriv. Litig., 906 A.2d 27, 67 (Del. 2006) (noting same).

85. *In re* Massey Energy Co. Deriv. & Class Action Litig., No. 5430–VCS, 2011 WL 2176479 (Del. Ch. May 31, 2011).

86. *See, e.g.*, Thomas A. Uebler, *Shareholder Police Power: Shareholders' Ability to Hold Directors Accountable for Intentional Violations of Law*, 33 DEL. J. CORP. L. 199, 206 (2008) ("Delaware courts have not had the opportunity to analyze the source of corporate directors' duty to obey the law or when personal liability for a breach will result."); Kent Greenfield, *Ultra Vires Lives! A Stakeholder Analysis of Corporate Illegality*, 87 VA. L. REV. 1279, 1291 (2001) ("[T]here is no consensus on the question of whether there is an obligation, enforceable within corporate law, on the part of a firm and its managers to obey the law." (emphasis omitted)).

87. Norwood P. Beveridge, *Does the Corporate Director Have a Duty to Always Obey the Law?*, 45 DEPAUL L. REV. 729, 730–31 (1996).

88. *Massey*, 2011 WL 2176479, at *20. *See also* Desimone v. Barrows, 924 A.2d 908, 934–35 (Del. Ch. 2007); Leo E. Strine, Jr., Lawrence A. Hamermesh, R. Franklin Balotti & Jeffrey M. Gorris, *Loyalty's Core Demand: The Defining Role of Good Faith in Corporation Law*, 98 GEO. L.J. 629, 651 (2010).

business.[89] Complying with the law thus takes priority over seeking profits, and directors who try to seek profits through noncompliance are breaching their duties.[90]

A business-plan claim is technically not a *Caremark* claim.[91] While information-systems and red-flags claims deal with acts of omission, business-plan claims deal with acts of commission.[92] But the claims usually arise within similar fact patterns, and the line between the first two types of claims and the third one is blurred.[93] In a common scenario, there are indications that directors knew about noncompliance, and the only question separating red-flags from business-plan claims is whether directors looked away or proactively charged ahead.[94]

In practice, plaintiffs need not belabor the distinction between the claims and need not analyze directors' conduct separately for each one of the claims. The court will look at the evidentiary record as a whole and make inferences on defendants' state of mind.[95] Accordingly, the much more important (and much harder) question is how to infer directors' bad faith.

Mental state is not directly observable, and so motions to dismiss *Caremark* claims usually revolve around what external evidence courts can use to infer defendants' subjective intentions.[96] In information-systems claims, courts usually look at the centrality of compliance risk in question. In red-flags claims, courts examine how specific the warning signs were. And in business-plan claims, courts consider how clear the legal obligations were and how pervasive the violations of said obligations were. It is harder to glean, however, how courts apply these general indicia to real-world scenarios. In other words, it is hard to predict which missions count as critical, which flags count as red, and which business plans count as illegitimate.[97]

While the classification of claims is being settled, and the indicia of breach are emerging,[98] one area in *Caremark* law that remains unsettled is the underlying policy

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89. DEL. CODE. ANN. tit. 8, § 101(b) (2024).

90. *Massey*, 2011 WL 2176479, at *19.

91. Lebanon Cnty. Emps.' Ret. Fund v. Collis (*Collis II*), No, 2021-1118-JTL, 2022 WL 17841215, at *18 (Del. Ch. Dec. 22, 2022), *rev'd and remanded*, *Collis III*, 311 A.3d 773 (Del. 2023).

92. *Id.*

93. *Massey*, 2011 WL 2176479, at *19.

94. *In re* Genworth Fin., Inc. Consol. Deriv. Litig., No. 11901-VCS, 2021 WL 4452338, at *14 (Del. Ch. Sep. 29, 2021).

95. *Walmart I*, 294 A.3d 65, 85–86 (Del. Ch. 2023); *cf.* IBEW Local Union 481 Defined Contribution Plan & Tr. *ex rel.* GoDaddy, Inc. v. Winborne, 301 A.3d 596, 626 (Del. Ch. 2023) (explaining that "the good faith inquiry is a holistic one").

96. *Winborne*, 301 A.3d at 621 (quoting Mihailis E. Diamantis, *How to Read a Corporation's Mind*, *in* THE CULPABLE CORPORATE MIND 209, 222–23 (Elise Bant ed., 2023)); Allen v. El Paso Pipeline GP Co., 113 A.3d 167, 178 (Del. Ch. 2014), *aff'd* No. 399, 2015 WL 803053 (Del. Feb. 26, 2015).

97. *See, e.g.*, Barak Orbach, *D&O Liability for Antitrust Violations*, 59 SANTA CLARA L. REV. 527, 554 (2020) (lamenting the lack of clarity regarding what counts as central compliance risks).

98. *Cf.* Hillary A. Sale, *Leveraging Information Forcing in Good Faith*, *in* RESEARCH HANDBOOK ON LAW AND TIME (F. Fagan & S. Levmore, eds., 2024) (forthcoming) (noting that "the contours of good faith are some of the least clear in corporate law").

rationales. Articulating policy rationales is especially important given the dynamic nature of compliance risks (consider for example the emerging issue of AI bias). The more judges, practitioners, and academics understand the underlying rationales, the better they can apply, predict, and criticize the oversight duty doctrine. But as notable commentators have long lamented, the case law has yet to fully explain why directors must address red flags,[99] why maximizing profits by skirting regulations is a breach of loyalty,[100] and why certain types of director ignorance should be culpable.[101]

This is where we move to now: The next three Parts address the questions of how to infer bad faith and what the policy rationale is in each one of the three *Caremark* claims.

II. INFORMATION-SYSTEMS CLAIMS

When *Caremark* came out in 1996, the compliance industry was still nascent.[102] *Caremark*'s credo—namely, directors must put in place a system that monitors misconduct and reports back to them—was seen back then as an innovative call for action.[103] Nowadays, virtually every large company boasts an elaborate compliance program.[104] One could therefore argue that corporate America already follows *Caremark*'s information-systems requirement. But such an argument misconstrues how information-systems theory works. Instead of simply asking whether information systems exist, courts examine whether information systems are effective.[105]

To be sure, courts are largely deferential to directors' decisions on how to design information systems, and what types of information needs to flow up to the board.[106] Still, for a certain subset of compliance risks, courts do not hesitate to scrutinize directors' decisions. Certain compliance risks are simply too important for directors to delegate away and uncritically accept whatever information others are feeding them. For these risks, courts may treat a lack of indication that directors knew about problems as an indication that directors were breaching their duties.

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99. *See, e.g.*, Alan R. Palmiter, *Duty of Obedience: The Forgotten Duty*, 55 N.Y.L. SCH. L. REV. 457, 478 (2010).

100. *See, e.g.*, Andrew S. Gold, *The New Concept of Loyalty in Corporate Law*, 43 U.C. DAVIS L. REV. 457, 475 (2009); Charles R. Korsmo, *Illegality and the Business Judgment Rule*, *in* RESEARCH HANDBOOK ON REPRESENTATIVE SHAREHOLDER LITIGATION 98, 105 (Sean Griffith, Jessica Erickson, David Webber & Verity Winship, eds., 2018).

101. Orbach, *supra* note 97.

102. Todd Haugh, Caremark*'s Behavioral Legacy*, 90 TEMP. L. REV. 611, 620 (2018) (citing data on the negligible investment in compliance).

103. On *Caremark*'s role in transforming compliance into the multibillion-dollar industry it is today, see, for example, Todd Haugh, *The Criminalization of Compliance*, 92 NOTRE DAME L. REV. 1215, 1229 (2017); Brian R. Cheffins, *Delaware and the Transformation of Corporate Governance*, 40 DEL. J. CORP. L. 1, 47 (2015); Claire A. Hill & Brett McDonnell, Stone v. Ritter *and the Expanding Duty of Loyalty*, 76 FORDHAM L. REV. 1769, 1795 (2007).

104. Haugh, *supra* note 102, at 621.

105. City of Detroit Police & Fire Ret. Sys. *ex rel.* NiSource, Inc. v. Hamrock, No. 2021-0370-KSJM, 2022 WL 2387653, at *12 (Del. Ch. June 30, 2022) ("[T]his court must look beyond the mere existence of a system to some indicia of effectiveness.").

106. *Walmart I*, 294 A.3d 65, 86 (Del. Ch. 2023).

The most important question in oversight duty litigation these days is what those central compliance risks are.[107] Section A breaks down the guidelines for which compliance risks count as "mission critical." Section B explains what type of scrutiny applies to oversight of mission-critical risks. Section C clarifies the underlying policy rationales of information-systems theory, namely, combatting directors' incentives to remain willfully blind about risky activities.

A. Which Missions Are Critical?

Not all compliance risks are created equal. From a business perspective, some risks can materialize and make only a small dent, while others pose a serious threat to the company's long-term viability.[108] From a legal perspective, directors are not expected to regularly oversee every risk.[109] Large corporations face numerous risks, and directors' time and attention are limited.[110] Only the risks that are deemed most important regularly appear on the board's agenda and board committees' charters. Corporate law courts recognize this, and they immunize most decisions of directors on how to structure compliance information systems and what risks to delegate.[111] At the same time, courts insist that certain compliance risks are too important to delegate away.

When is the fact that the board delegated away oversight of an issue indicative of bad faith? In practice, the answer to these questions comes down to two words: mission critical. When the compliance risk at hand strikes at the core of the company's business (is "mission critical"), lack of evidence that directors discussed it may become evidence that directors were not trying in good faith to engage in oversight.[112] If you are a director of a company that sells only ice cream, and you do not discuss food safety issues, you are breaching your oversight duties.[113] If you are a director of a young biotech company whose success hinges on the development of one drug, and you do not discuss issues with meeting FDA testing protocols, you are breaching your oversight duties.[114]

This is the innovation that *Marchand* brought to oversight duty doctrine. In the 1960s, *Allis-Chalmers* told directors that once they are on notice of wrongdoing, they cannot look away.[115] In the 1990s, *Caremark* added that directors cannot just sit and

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107. *In re* McDonald's Corp. S'holder Deriv. Litig. (*McDonald's II*), 291 A.3d 652, 679 (Del. Ch. 2023) (noting that "[o]utside of central compliance risks . . . a plaintiff will have difficulty rebutting the business judgment rule where officers or directors have made a good faith decision regarding the level of monitoring resources, if any, to assign to a risk").

108. Roy Shapira, *Mission Critical ESG and the Scope of Director Oversight Duties*, 2022 COLUM. BUS. L. REV. 732, 737 (2022) ("Mission Critical ESG").

109. *Walmart I*, 294 A.3d at 86.

110. *Id.*

111. *In re* Caremark Int'l Inc. Deriv. Litig., 698 A.2d 959, 970 (Del. Ch. 1996).

112. Marchand v. Barnhill, 212 A.3d 805, 824 (Del. 2019).

113. *Id.*

114. *In re* Clovis Oncology, Inc. Deriv. Litig., No. 2017-0222-JRS, 2019 WL 4850188, at *12–13 (Del. Ch. Oct. 1, 2019).

115. Graham v. Allis-Chalmers Mfg. Co., 188 A.2d 125, 130 (Del. 1963).

wait for others to put them on notice.[116] Directors rather must ensure that others are collecting information and regularly reporting back to them.[117] In the end of the 2010s, *Marchand* clarified that directors cannot uncritically accept what others are regularly reporting to them.[118] On issues that are central to the company's viability, board-level reporting cannot be discretionary, and directors must be more hands on.

Based on rapidly emerging case law, we can glean three indicators that courts use to designate risks as mission critical. Critical risks are those that are either (1) self-evident, (2) self-disclosed, or (3) reputationally disastrous.

In the first type of risk, the centrality of a risk is self-evident.[119] The abovementioned examples of "monoline" companies clearly fit the bill: When a company sells only one product, issues with that product's safety are mission critical. But the mission-critical zone extends beyond single-product companies. Even boards of multinational corporations with dozens of products and subsidiaries face risks that are critical and cannot be ignored. For a giant airplane-manufacturing company, airplane safety is mission critical.[120] For a giant drug distributor, meeting FDA regulatory requirements is mission critical.[121] For a pipeline-operating company, pipeline safety is mission critical.[122] To generalize, for a company that operates in a heavily regulated environment, meeting core regulatory requirements is a critical task that the board must put on its agenda.[123]

There are parallels here to how federal courts apply the "core operations" construct in securities fraud litigation.[124] In securities litigation, similarly to *Caremark* litigation, the main question is whether courts can infer scienter already at the pleading stage.[125] One of the tools that federal courts use to infer scienter is to examine the centrality of the issue that was supposed to be disclosed.[126] When the

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116. Stone v. Ritter, 911 A.2d 362, 370 (Del. 2006).

117. *Id.*

118. *Marchand*, 212 A.3d at 824. Pre-*Caremark*, *Allis-Chalmers* has been regularly cited for the proposition that directors can rely on information given to them by officers. *See, e.g.*, Cheff v. Mathes, 199 A.2d 548, 556 (Del. 1964). Post-*Caremark* and pre-*Marchand*, the courts regularly dismissed claims that relied on an "information void" theory. *See, e.g.*, Horman v. Abney, No. 12290–VCS, WL 242571, at *10 (Del. Ch. Jan. 19, 2017) (noting that a lack of board documents referencing continued compliance is not enough to establish a pleading-stage indication of a *Caremark* claim).

119. *Walmart I*, 294 A.3d 65, 85 (Del. Ch. 2023) ("Sometimes the inherent nature of the issue will support a reasonable inference that it qualifies as a central compliance risk . . . .").

120. *In re* Boeing Co. Deriv. Litig., No. 2019-0907-MTZ, 2021 WL 4059934 (Del. Ch. Sept. 7, 2021).

121. Teamsters Loc. 443 Health Servs. & Ins. Plan v. Chou, No. 2019-0816-SG, 2020 WL 5028065 (Del. Ch. Aug. 24, 2020).

122. City of Detroit Police & Fire Ret. Sys. *ex rel.* NiSource, Inc. v. Hamrock, No. 2021-0370-KSJM WL 2387653, at *15 (Del. Ch. June 30, 2022).

123. *In re* Clovis Oncology, Inc. Deriv. Litig., No. 2017-0222-JRS, 2019 WL 4850188, at *13 (Del. Ch. Oct. 1, 2019).

124. Makor Issues & Rts., Ltd. v. Tellabs Inc., 513 F.3d 702, 709 (7th Cir. 2008).

125. Roy Shapira, *Mandatory Arbitration and the Market for Reputation*, 99 B.U. L. REV. 873, 896 (2019).

126. Michael J. Kaufman & John M. Wunderlich, *Messy Mental Markers: Inferring Scienter from Core Operations in Securities Fraud Litigation*, 73 OHIO ST. L.J. 507, 537

issue concerns the primary product or other matters of utmost importance to the company's success, courts are more likely to charge senior management with scienter even when there is no smoking-gun evidence that managers discussed the issue.[127]

When the criticality of a certain risk is not self-evident, courts can turn to the company's own disclosures to learn about what risks matter most to it. An issue can qualify as mission critical when a company's enterprise risk management system identifies it as such, when a company's mission statement declares it as a priority of the company, or when a company consistently touts its proficiency in it as important to the company's success.[128] To illustrate, the *McDonald's* decision opens by highlighting that the fast-food giant prides itself on being "America's best first job," that fifty-five percent of entry-level workers are women, and that the company's code of conduct stresses the need to cultivate "respectful workplaces."[129] The decision then concludes that "[t]he court does not have to infer that sexual harassment and misconduct constituted a mission critical risk. The company said it."[130]

The third category is the hardest one, where a risk is not externally regulated, nor identified by the company itself as critical. This category usually involves business risks that do not amount to clear illegalities. In general, courts are reluctant to classify nonlegal risks as mission critical.[131] The reasoning is straightforward and applies to all types of *Caremark* claims: Allowing plaintiffs to frame business decisions that failed as failures to prevent bad consequences would effectively bypass the business judgment rule.[132] Bypassing the business judgment rule is bad law and bad policy.[133] Corporate boards should enjoy discretion to decide which business risks to take and which business decisions to delegate.[134]

Still, some business risks are so germane to the company's success that boards that do not proactively monitor them do so at their company's peril and may not be acting in good faith. This is especially true in today's climate, where failures to address critical environmental, social, and governance (ESG) concerns could lead to colossal reputational fallouts that hurt the company's ability to attract and retain talent, access capital, and sell products.[135]

(2012).

127. *Id.* at 517.

128. *Walmart I*, 294 A.3d 65, 86 (Del. Ch. 2023).

129. *McDonald's II*, 291 A.3d 652, 664 (Del. Ch. 2023).

130. *Id.* at 681.

131. Firemen's Ret. Sys. *ex rel.* Marriott Int'l Inc. v. Sorenson, No. 2019-0965-LWW, 2021 WL 4593777, at *12 (Del. Ch. Oct. 5, 2021); Reiter *ex rel*. Cap. One Fin. Corp. v. Fairbank, No. 11693-CB, 2016 WL 6081823, at *8 (Del. Ch. Oct. 18, 2016).

132. *In re* Citigroup Inc. S'holder Deriv. Litig., 964 A.2d 106, 126 (Del. Ch. 2009).

133. *See* Stephen M. Bainbridge, *The Business Judgment Rule as Abstention Doctrine*, 57 VAND. L. REV. 83, 87 (2004).

134. *Id.* at 84; Lisa M. Fairfax, *Managing Expectations: Does the Directors' Duty to Monitor Promise More Than It Can Deliver?*, 10 U. ST. THOMAS L.J. 416, 432 (2012).

135. *See* Strine et al., *supra* note 33, at 1886; Stavros Gadinis & Amelia Miazad, *The ESG Information System*, 47 SEATTLE U. L. REV. 695, 696 (2024).

Such reasoning was behind a couple of recent decisions that classified cybersecurity as mission critical for certain companies.[136] When a company is being attacked by third-party hackers, the company's failure to protect itself may not be punishable by law. But the lack of clear illegalities does not absolve directors from ignoring cybersecurity risks to their company. For companies that sell products online, cybersecurity is too critical to ignore: If customers do not trust a company enough to share their personal information with it, the company's business model may not be viable.[137] As a result, directors must ensure that the full board or a dedicated subcommittee is apprised of cybersecurity risks periodically.[138]

Similar reasoning arguably applies to sexual misconduct in certain companies. To revisit *McDonald's*, say that a company is a large employer of a young workforce that is predominantly female. Or to use the *Victoria's Secret* example,[139] say that a company sells products to a predominantly young female customer base. In both scenarios, even if the company did not designate workplace environment as a critical issue, courts may infer that the board cannot afford to ignore repeated sexual misconduct complaints. For example, if constant complaints in the company's internal hotlines never made it to the board, the court may infer that the board consciously did not want to know.[140] Not wanting to know about rampant sexual misconduct is not just morally repugnant, it is against the best interests of the company. Indeed, empirical studies document just how much sexual misconduct hurts companies' operational productivity.[141] And according to the *Victoria's Secret* complaint, news about rampant sexual harassment significantly depressed the price that acquirers were willing to pay for the company's shares.[142]

How can we generalize from these examples and predict what other nonlegal risks could count as mission critical? I propose a relatively simple guideline: Look at the risk's potential impact on the company's reputation. Only the rare risks that could disastrously impact the company's long-term reputation count as critical for *Caremark* purposes. It is tempting to assume that because trillions of dollars are being invested according to ESG criteria, any ESG risk could have a critical effect on the company's reputation and should therefore be on boards' agendas. But

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136. *Sorensen*, 2021 WL 4593777, at *12; Constr. Indus. Laborers Pension Fund *ex rel.* SolarWinds Corp. v. Bingle, No. 2021-0940-SG, WL 4102492, at *1 (Del. Ch. Sept. 6, 2022).

137. *See generally* H. Justin Pace & Lawrence J. Trautman, *Mission Critical:* Caremark*, Blue Bell, and Director Responsibility for Cybersecurity Governance*, 2022 WIS. L. REV. 887 (2022). For more on how *Caremark* is one area of corporate law where the legal and reputational realms are intertwined, see generally Claire A. Hill, Caremark *as Soft Law*, 90 TEMP. L. REV. 681 (2018).

138. Shapira, *supra* note 108, at 768.

139. *Id.* at 772.

140. *Cf.* Daniel Hemel & Dorothy S. Lund, *Sexual Harassment and Corporate Law*, 118 COLUM. L. REV. 1583, 1660 (2018).

141. *See, e.g.*, Shiu-Yik Au, Ming Dong & Andréanne Tremblay, *How Much Does Workplace Sexual Harassment Hurt Firm Value?*, 190 J. BUS. ETHICS 861 (2024) (showing that companies that are perceived as high-risk harassment environments experience a significant reduction in stock returns, and an increase in labor costs).

142. Verified S'holder Deriv. Compl., Lambrecht *ex rel.* L Brands, Inc. v. Wexner, No. 2021-0029-JTL, 2022 WL 2305313 (Del. Ch. June 24, 2022).

systematic empirical studies show that most ESG news hardly impacts markets.[143] Carbon emissions, for example, are a first-order problem from a societal perspective. But their impact on a specific company's reputation is relatively limited for most companies. As a result, most corporate boards do not have to fear personal liability if they do not move carbon emissions to the top of their agendas.[144]

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Before we turn to examining the implications of classifying a risk as critical, a couple of additional observations about the classification itself are in order. First, whether a risk classifies as critical or not changes over time.[145] In the 1990s, cybersecurity was hardly mission critical; it is now, for many companies. As of this writing, AI bias is still not mission critical for many companies; in a couple of years, it probably will be.[146] As issues gain significance, they are also more likely to be regulated, and switch from posing a pure business risk to posing a legal risk.

The upshot for corporate boards is the need to conduct periodic assessments of the risks that their company is facing and reallocate responsibilities to subcommittees accordingly.[147] The upshot for courts is the need to resist hindsight bias: *Caremark* litigation often implicates conduct that happened many years before the case is litigated. It would be problematic if courts look at the way that boards treated a certain risk in 2015 through a 2025 lens.

Second, *McDonald's* recently clarified that the relevant classification is not whether a risk is critical but rather whether a risk is central.[148] As Vice Chancellor Laster explains, the "mission critical" language appeared in *Marchand* not when describing the information-systems standard, but rather when applying the general standard to the specific facts of the Blue Bell debacle.[149] *Marchand* used different language to describe the general standard, namely, "*central* compliance risks."[150] The difference is more than just semantics: All critical risks qualify as central risks, but not all central risks are necessarily critical.[151] On paper, then, *McDonald's* implies that the scope of information-systems claims is broader than the "mission critical" rhetoric implies. While I agree with the Vice Chancellor's analysis, I find it hard to envision a real-world scenario where the court sustains an information-

143. *See, e.g.*, George Serafeim & Aaron Yoon, *Which Corporate ESG News Does the Market React to?* (Harv. Bus. Sch. Acct. & Mgmt. Unit, Working Paper No. 21-115, 2021).

144. Shapira, *supra* note 108, at 779.

145. Firemen's Ret. Sys. *ex rel.* Marriott Int'l Inc. v. Sorenson, No. 2019-0965-LWW, 2021 WL 4593777, at *11 (Del. Ch. Oct. 5, 2021); *Walmart I*, 294 A.3d 65, 85–86 (Del. Ch. 2023).

146. Shapira, *supra* note 108, at 785.

147. All too often, boards rely on copycat compliance, fighting yesteryear's wars. *Cf.* Miriam Hechler Baer, *Insuring Corporate Crime*, 83 IND. L.J. 1035, 1065 (2008) (discussing the problem of compliance programs adhering to "common practices" as if they were "best practices").

148. *McDonald's II*, 291 A.3d 652, 678 (Del. Ch. 2023).

149. *Id.* (quoting Marchand v. Barnhill, 212 A.3d 805, 824 (Del. 2019)).

150. *Id.* (emphasis added).

151. *Id.*

systems claim on risks that are not self-evident, self-disclosed, or reputationally disastrous. In other words, even if practitioners and academics heed *McDonald's* and switch rhetoric from "critical compliance risks" to "central compliance risks," the analysis here on how to identify these risks remains largely intact.

B. How Much Monitoring of Critical Risks Is Enough?

Determining that a certain risk is central is only the first step. To sustain an information-systems claim, plaintiffs must also show that defendants did not put in place a functioning system to monitor said risk.[152] This is a high bar to clear. Large companies rarely ignore critical compliance risks. Boards are usually able to point to the hiring of outside compliance advisors, or to the wording of board subcommittees' charters, to show that some discussions and allocation of responsibilities for major risks existed. And courts are careful to distinguish between bad form compliance (which does not give rise to *Caremark* liability) and bad faith compliance (which does).[153]

Still, we can glean from rapidly emerging case law three types of scenarios that typically support an inference of insufficient monitoring: (1) lack of any evidence that board-level discussions existed, (2) evidence of superficial board-level discussions that merely "[went] through the motions,"[154] and (3) evidence of directors uncritically accepting information from others.

The easiest cases are those where the board minutes do not reflect *any* meaningful discussions of critical risks. For instance, in *China Agritech* the company had an audit committee in place, but defendants failed to produce any minutes of audit committee meetings.[155] And in *Fuqi*, the company never met plaintiffs' demands to inspect relevant books and records and defunded its audit committee to prevent further investigation.[156]

Closely related are cases where the paper trail shows that compliance systems did exist, but that they were there mostly for show. In *Hughes*, for example, the company persistently struggled to meet the legal requirements for financial reporting.[157] Defendants argued that the company had an audit committee tasked with oversight of reporting and hired an external auditor. But the court looked beyond these "trappings of oversight,"[158] and examined how frequently the committee met (it did so only sporadically and after regulators forced them to), and whether the amount of time it allotted to discussions of critical risks was adequate (it patently was not).[159]

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152. *Walmart I*, 294 A.3d 65, 85 (Del. Ch. 2023).

153. *In re* Caremark Int'l Inc. Deriv. Litig., 698 A.2d 959, 971 (Del. Ch. 1996) (noting that courts should intervene only when the failure is systematic or sustained).

154. City of Detroit Police & Fire Ret. Sys. *ex rel.* NiSource, Inc. v. Hamrock, No. 2021-0370-KJSM, WL 2387653, at *6 (Del. Ch. June 30, 2022).

155. *In re* China Agritech, Inc. S'holder Deriv. Litig., No. 7163-VCL, 2013 WL 2181514, at *19 (Del. Ch. May 21, 2013).

156. Rich *ex rel.* Fuqi Int'l, Inc. v. Yu Kwai Chong, 66 A.3d 963, 979 (Del. Ch. 2013).

157. Hughes v. Hu, No. 2019-0112-JTL 2020 WL 1987029, at *2 (Del. Ch. Apr. 27, 2020).

158. *Id.* at *35.

159. *Id.* at *32.

A less clear-cut and more practically relevant category of cases is those where the company in question boasts well-constituted corporate governance mechanisms: from a board full of independent and experienced directors, to a well-funded internal compliance program, to well-paid outside compliance advisors. In these cases, courts can follow the *Marchand-Boeing* blueprint to decipher whether an otherwise functioning board did not try in good faith to monitor a specific central risk[160]: Did the board assign responsibility of said risk to a specific committee? Did the board as a whole discuss said risk regularly or only in passing? Did the board receive reports from management on said risk only ad hoc and passively, without probing further?

To be sure, this type of inquiry can deteriorate quickly into second-guessing the design of information systems. And on a first read, the case law seems to provide contrasting answers on how to draw the line between bad faith monitoring and less-than-ideal monitoring. To illustrate, compare *Bingle* with *Boeing*. *Bingle* qualified cybersecurity as mission critical for the company in question.[161] And plaintiffs showed that the board did not meet to discuss cybersecurity issues in the twenty-six months leading up to the cyberattack.[162] The court nevertheless dismissed the *Caremark* claim, reasoning that the board did not utterly ignore cybersecurity: It rather charged one of its committees with responsibility for oversight of cybersecurity risks.[163] The court acknowledged that said committee should have elevated concerns to the full board prior to the cyberattack.[164] But it treated the flaws in the board's oversight process as indications of suboptimal compliance rather than as indications of bad faith.[165]

Boeing, on the other hand, illustrates heightened scrutiny of directors' oversight of critical risks[166]: Boeing's board agenda reflected allocating time to discuss airplane safety, yet the court criticized them for not allotting enough time. Boeing's board minutes invoked "safety" several times, yet the court criticized them for doing this only in passing and in the context of getting on the regulator's good side. The minutes also showed that management shared information on airplane safety with the board, yet the court faulted directors for not treating information from management more critically.

How can we reconcile the seemingly forgiving approach in *Bingle* with the seemingly exacting scrutiny in *Boeing*? Some have morbidly suggested that the difference comes down to the death toll.[167] Oversight of corporate behavior that can

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160. *In re* Boeing Co. Deriv. Litig., No. 2019-0907-MTZ, 2021 WL 4059934, at *32 (Del. Ch. Sept. 7, 2021); Marchand v. Barnhill, 212 A.3d 805, 822 (Del. 2019).

161. Constr. Indus. Laborers Pension Fund *ex rel.* SolarWinds Corp. v. Bingle, No. 2021-0940-SG, 2022 WL 4102492, at *1 (Del. Ch. Sept. 6, 2022).

162. *Id.* at *12.

163. *Id.*

164. *Id.* at *13.

165. *Id.*

166. *In re* Boeing Co. Deriv. Litig., No. 2019-0907-MTZ, 2021 WL 4059934, at *27–28 (Del. Ch. Sept. 7, 2021).

167. Kevin LaCroix, *Del. Court Substantially Denies Boeing Duty of Oversight Claim Dismissal Motion*, D&O DIARY (Sept. 9, 2021), https://www.dandodiary.com/2021/09/articles/shareholders-derivative-litigation/del-court-substantially-denies-boeing-duty-of-oversight-claim-dismissal-motion/ [https://perma.cc/3KG8-76SJ].

lead to loss of human life (as in *Marchand* and *Boeing*) would be scrutinized more heavily than oversight of corporate behavior that can only lead to loss of data privacy (as in *Bingle* and *Sorenson*). But the case law does not follow the deadly versus non-deadly distinction. To illustrate, *Hughes* sustained an information-systems claim even though failure to meet financial reporting regulations is hardly deadly.[168] And *Hamrock* rejected an information-systems claim even though failure to meet pipeline safety regulations is deadly.[169]

Another way to reconcile the differences between *Bingle* and *Boeing* is to recast the distinction between business risks and violations of positive law. Even if business risks can count as mission critical, courts are less likely to attribute failures of oversight of these risks to directors' bad faith.[170] The reason has to do with causation: When the company suffers harm because its employees violated positive law, the primary wrongdoing that boards should have overseen is "internal" to the company. By contrast, when the company suffers harm because third parties hacked its databases, the primary wrongdoing is "external" to the company,[171] making the harm less easily attributable to directors' misconduct.[172]

The distinctions between business and legal risks and internal and external misconduct carry a lot of weight. But they require fine-tuning before they can be generalized. For instance, they do not map perfectly onto each other: A business risk can arise from misconduct inside the company, such as sexual misconduct. More importantly, they do not explain the different treatment of board oversight of risks arising from inside the company: The offered rationale does not explain, for example, why oversight of pipeline safety was enough in *Hamrock*, but oversight of food safety was not enough in *Marchand*.

To me, the one criterion that best explains the courts' approach to board oversight of central risks is the *distinction between cosmetic compliance and genuine compliance*. Once courts qualify the risk as central to the company, they look at the evidentiary record for indications that directors genuinely tried to keep themselves apprised of said risk. Indeed, virtually every information-systems decision uses terms such as a "cloak[]"[173] or "going through the motions" when evaluating whether the formal compliance mechanisms were genuine or for show.[174]

The focus on genuine versus cosmetic compliance helps us reconcile *Bingle* with *Boeing*. *Bingle* repeatedly describes how the committee charged with cybersecurity oversight was not "sham": It met several times, received presentations from management about cybersecurity, and amended its charter to expressly address

168. Hughes v. Hu, No. 2019-0112-JTL, 2020 WL 1987029 (Del. Ch. Apr. 27, 2020).

169. City of Detroit Police & Fire Ret. Sys. *ex rel.* NiSource, Inc. v. Hamrock, No. 2021-0370-KSJM, 2022 WL 2387653, at *1 (Del. Ch. June 30, 2022).

170. *Bingle*, 2022 WL 4102492, at *1.

171. Firemen's Ret. Sys. *ex rel.* Marriott Int'l Inc. v. Sorenson, No. 2019-0965-LWW, 2021 WL 4593777, at *18 (Del. Ch. Oct. 5, 2021); Benjamin P. Edwards, *Cybersecurity Oversight Liability*, 35 GA. ST. U. L. REV. 663, 676 (2019).

172. *See* Arlen, *supra* note 37, at 10.

173. La. Mun. Police Emps.' Ret. Sys. v. Pyott, 46 A.3d 313, 356 (Del. Ch. 2012).

174. *In re* Massey Energy Co. Deriv. & Class Action Litig., No. 5430–VCS, 2011 WL 2176479, at *19 (Del. Ch. May 31, 2011).

cybersecurity.[175] *Boeing*, by contrast, emphasizes how the board treated the first 737 MAX crash mostly as a public-relations problem rather than as a safety problem. In other words, while the Boeing board was proactively discussing the debacle, it was doing so not in the context of genuine efforts to come into compliance, but rather in the context of saving face in the court of public opinion.[176]

To be sure, no single guideline can fully answer the hard question of how much oversight is enough oversight. The hardest cases to predict are those where the board uncritically accepted information on central risks from others. When the board allows itself to be kept in the dark about central risks, courts do not hesitate to infer bad faith. The thornier situations are those where the board allows itself to be duped. When the board requests and receives information from others, but said information turns out to be biased, can we infer directors' bad faith? In the not-so-distant past, the answer was clear: no. *Horman*, for example, held that directors have no duty to proactively monitor the monitors.[177] But over the past couple of years, cases such as *Boeing* insisted that directors cannot uncritically accept what others are telling them.[178]

C. Underlying Policy Rationales: Combatting Willful Blindness

The main policy rationale behind the information-systems theory is combatting willful blindness.[179] Directors have strong incentives to remain ignorant about decisions that prioritize profits over everything else. Prioritizing profits is good for directors who receive substantial stock-based compensation.[180] And remaining ignorant about how profits were obtained is good for directors' ability to maintain plausible deniability and escape accountability.[181] Public enforcement, particularly criminal law, is ill equipped to tackle willful blindness, especially when dealing with large companies where information is widely dispersed.[182]

The recalibrated information-systems theory counters willful blindness dynamics by emphasizing *culpable ignorance* and *proper documentation*. The courts' increased willingness to designate issues as mission critical means that directors now increasingly face liability for what they should have known.[183] And the courts' increased willingness to grant shareholders access to internal communications

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175. *Bingle*, 2022 WL 4102492, at *12.

176. *In re* Boeing Co. Deriv. Litig., No. 2019-0907-MTZ, 2021 WL 4059934, at *29 (Del. Ch. Sept. 7, 2021).

177. Horman v. Abney, No. 12290–VCS, 2017 WL 242571, at *9 (Del. Ch. Jan. 19, 2017).

178. Ultimately, the question is perhaps better viewed from the angle of aiding-and-abetting claims. We revisit this angle in Section V.F below.

179. *Cf. Walmart II*, No. 2021-0827-JTL, 2023 WL 3093500, at *147–148 (Del. Ch. Apr. 26, 2023).

180. *See generally* John Armour, Jeffrey Gordon & Geeyoung Min, *Taking Compliance Seriously*, 37 YALE J. ON REGUL. 1 (2020).

181. *See, e.g.*, Miriam H. Baer, *Too Vast to Succeed*, 114 MICH. L. REV. 1109, 1112 (2016).

182. Roy Shapira, *The Challenge of Holding Big Business Accountable*, 44 CARDOZO L. REV. 203, 218 (2022).

183. *See, e.g.*, Teamsters Loc. 443 Health Servs. & Ins. Plan v. Chou, No. 2019-0816-SG, 2020 WL 5028065, at *2 (Del. Ch. Aug. 24, 2020).

incentivizes directors to maintain a proper record of all internal discussions of compliance risks. Together, these two points of emphasis reverse directors' incentives not to document thorny issues. Indeed, a cursory look at the websites of every major law firm over the past couple of years reveals a litany of memos advising corporate clients to start documenting their compliance efforts more meticulously.[184]

This emphasis on board-level documentation has prophylactic value, by increasing the chance that damning information about misconduct inside the company will flow up the organizational hierarchy.[185] Directors are more likely these days to ask others in the organization to prepare written materials for them on thorny issues. When compliance personnel are asked to document their observations and report them to the board, it is more likely that they will flush out illegalities relatively early in the process, when they can still be addressed.[186] And in instances where problems are not addressed in real time, having a detailed paper trail makes management involvement more provable ex post.[187]

Looking at information-systems cases through the willful-blindness lens clarifies the theory and carries practical implications. For example, the willful-blindness rationale tips the scale in favor of an expansive approach to shareholder inspection rights. The reason that courts could start effectively sanctioning willful blindness over the past few years is that enhanced pre-filing discovery led to more detailed *Caremark* complaints. When the Section 220 production nets thousands of pages of internal communications, the courts can more readily hold lack of evidence that directors discussed problems as an indication that directors were not trying hard enough.[188] Further, the fact that courts are more willing to grant access even to informal e-communications neutralizes defendants' attempts to manufacture paper trails without truly addressing compliance.[189] Unlike formal board minutes, which can be slickly manicured after the fact by lawyers, real-time electronic messages often provide a more realistic version of what directors had in mind.

Recognizing the willful-blindness rationale also helps us understand *what* risks boards can delegate and *how* to delegate them. Consider for example *Bingle*, which focused on scrutinizing the delegation of cybersecurity oversight (mission critical) to a board committee. *Bingle* reads like an attempt by the court to distinguish between delegation of authority meant to improve information flows, and delegation of

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184. *See, e.g.*, Robert C. Bird, Caremark *Compliance for the Next Twenty-Five Years*, 58 AM. BUS. L.J. 63, 90–97 (2021).

185. On how bottom-up information flows are a key determinant of the effectiveness of compliance, see, for example*,* Soltes, *supra* note 3, at 976.

186. *See* Gadinis & Miazad, *supra* note 32 (opening lines of communication to the board incentivize better board oversight); Donald C. Langevoort, *Gatekeepers, Cultural Captives, or Knaves?: Corporate Lawyers Through Different Lenses*, 88 FORDHAM L. REV. 1683, 1688–89 (2020) (suggesting that dealing with problems early mitigates the slippery slope dynamics of corporate misbehavior).

187. *Cf.* CHRISTOPHER HODGES, LAW AND CORPORATE BEHAVIOUR ENFORCEMENT, SUPPORT OR ETHICAL CULTURE? 511–12 (2015).

188. *Chou*, 2020 WL 5028065, at *17.

189. *Cf.* Joel Edan Friedlander, *Confronting the Problem of Fraud on the Board*, 75 BUS. LAW. 1441, 1472–76 (2020) (discussing the importance of access to e-communications in different contexts, such as M&A litigation).

authority meant to jam information flows. Sometimes boards delegate oversight because they do not want to ever hear about certain risks again. Other times, boards delegate oversight to other actors who enjoy better bandwidth and expertise in understanding the risk, so that the other actors can screen and process the information and report back to the board with actionable items. *Bingle* insists that the SolarWinds' board was pursuing the latter course of action: The committee met, received reports from experts, and regularly discussed cybersecurity.[190] The reason that the committee did not report to the board prior to the cyberattack was not because they were operating under an implicit "don't ask don't tell" understanding, but rather because of external circumstances: The board had its hands full in the months leading up to the cyberattack with the transition to a publicly traded company and the first COVID-19 outbreak.[191]

III. Red-Flags Claims

Beyond establishing a system that collects information on material risks, directors must monitor and react to information coming from that system. When directors ignore clear warning signs, they can be liable under the red-flags theory. To sustain a red-flags claim, plaintiffs must show that (1) the warning signs were clear and obvious, and (2) directors deliberately ignored said signs.

Section A explains how courts distinguish between types of warnings. Section B examines how courts determine whether directors' reaction to red flags was so tepid that it indicates bad faith. Section C identifies the policy rationales supporting the red-flags theory, namely, combatting cosmetic compliance and recidivism.

A. Which Flags Are Red?

Directors constantly receive new information alerting them to potential risks. It would be impracticable to treat all such reports as putting directors on notice for *Caremark* purposes. This is where the "red flags" metaphor comes in handy: Courts limit the scope of oversight liability only to instances where the warning signs were clear and obvious in real time. A mere "yellow" is not enough; the warning must be coded "red."[192] And a small "sign" is not enough either; the warning must be waved visibly like a "flag" in directors' faces.[193]

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190. Constr. Indus. Laborers Pension Fund *ex rel.* SolarWinds Corp v. Bingle, No. 2021-0940-SG, 2022 WL 4102492, at *12 (Del. Ch. Sept 6, 2022).

191. *Id.*

192. Reiter *ex rel.* Cap. One Fin. Corp. v. Fairbank, No. 11693-CB, 2016 WL 6081823, at *13 (Del. Ch. Oct. 18, 2016).

193. Wood v. Baum, 953 A.2d 136, 143 (Del. 2008) (noting that red flags "are only useful when they are either waved in one's face or displayed so that they are visible to the careful observer").

1. Which Warnings Are Actionable?

One overarching criterion in determining whether a warning amounts to a red flag is the extent to which past warnings are connected to the current trauma.[194] General abstract warnings do not count as red flags; only *specific* warnings do.[195] To illustrate, in *Bingle*, plaintiffs pointed to a briefing that a board committee received on cybersecurity concerns, suggesting that the briefing put directors on notice before the cyberattack occurred.[196] But the court stressed that said briefing did not warn of a concrete, imminent attack on the company.[197] Instead, the briefing warned of a theoretical possibility that the company might suffer attacks at some point. General briefings of this kind are too disconnected from the specific trauma in question to constitute red flags.[198]

Relatedly, the warnings must flag misconduct inside the company that the board can respond to. *Citigroup*, for example, distinguishes between macro-level warnings and company-level warnings. The fact that directors heard reports about deteriorating conditions in the subprime lending market (prior to the 2008 financial crisis) did not constitute a red flag.[199] After all, warnings about the state of the economy do not implicate potential wrongdoing that directors can ferret out.[200]

Similar reasoning leads to a distinction between legal and business risks. Past warnings are much more likely to count as red flags when they flag violations of law than when they flag violations of best practices.[201] Not adhering to best practices may be bad business, but directors should enjoy latitude to decide which business problems are serious enough to address.[202] In November 2023, *ProAssurance* came close to suggesting that business risks could never count as red flags.[203] But I would

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194. City of Detroit Police & Fire Ret. Sys. *ex rel.* NiSource, Inc. v. Hamrock, No. 2021-0370-KSJM, 2022 WL 2387653, at *20 (Del. Ch. Jun. 30, 2022) ("For a red-flag theory to work, the red flag must be sufficiently connected to the corporate trauma at issue to elevate the board's inaction in the face of the red flag to the level of bad faith."); *In re* Dow Chem. Co. Deriv. Litig., No. 4349-CC, 2010 WL 66769, at *13 (Del. Ch. Jan. 11, 2010) (noting that the relationship between the red flag and the corporate trauma cannot be attenuated); *In re* ProAssurance Corp. S'holder Deriv. Litig, No. 2022-0034-LWW, 2023 WL 6426294, at *15 (Del. Ch. Oct. 2, 2023) (compiling references).

195. *Hamrock*, 2022 WL 2387653, at *25.

196. Const. Indus. Laborers Pension Fund *ex rel.* SolarWinds Corp. v. Bingle., No. 2021-0940-SG, 2022 WL 4102492, at *3–4 (Del Ch. Sept. 6, 2022), *aff'd*, 297 A.3d 1083 (Del. 2023).

197. *Id.* at *11.

198. *Id.*

199. *In re* Citigroup Inc. S'holder Deriv. Litig., 964 A.2d 106, 115, 126 (Del. Ch. 2009).

200. *Id.* at 128–29.

201. *See, e.g.*, Firemen's Ret. Sys. *ex rel.* Marriott Int'l Inc. v. Sorenson, No. 2019-0965-LWW, 2021 WL 4593777, at *12 (Del. Ch. Oct. 5, 2021).

202. *See, e.g.*, *In re* Walt Disney Co. Deriv. Litig., 906 A.2d 27, 64–65 (Del. 2006).

203. *In re* ProAssurance Corp. S'holder Deriv. Litig, No. 2022-0034-LWW, 2023 WL 6426294, at *14 (Del. Ch. Oct. 2, 2023) ("Evaluating business risk is 'the quintessential board function.' So long as the challenged conduct is lawful, directors have broad discretion to advance the corporation's interests as they see fit. The directors' responsibility to oversee fundamental risks 'does not eviscerate the core protections of the business judgment rule[]'

not rule out the possibility that warnings of imminent reputational catastrophes would count as red flags in future cases.[204]

Finally, a warning that constituted a red flag at some point in the past could stop counting as a red flag over time. To illustrate, consider *Horman*, which dealt with UPS's noncompliance with laws regulating cigarettes delivery.[205] The company entered an agreement with the regulator in 2005, following past violations.[206] When it was caught violating again from 2010–2014, shareholders sought to hold directors and officers liable. But the court insisted that enforcement agreements in the distant past (2005) could not count as a red flag for violations occurring in the near past (2010–2011).[207] The UPS board had no reason to believe that the controls that were put in place in 2005 and brought the company into compliance had stopped working.[208] The lengthy period of compliance thus severed the link between past warnings and current violations.

2. Which Warnings Are Visible?

Thus far we have concentrated on cases where the evidentiary record shows that directors received a warning, and the only question is how serious and actionable the warning was. In cases where the record shows that flags existed internally but does not show that directors saw these flags, the key question is whether the flags were so visible that the only way the directors could not have seen them was if they were consciously looking away. When answering this question, the case law seemingly focuses on the following four indicators: (1) how pervasive the misconduct was; (2) what information came out of past enforcement actions; (3) what the company's own disclosures said; and (4) whether the warnings concerned a compliance risk that was central to the company.

First, an oft-used criterion to determine whether directors should have seen the warnings is how "pervasive and widespread" the noncompliance was.[209] In the recent opioid cases against Walmart and AmerisourceBergen, for example, the courts

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204. Note, for example, how *Walmart I* couches a red-flags claim as an argument "that the corporate fiduciaries were put on notice that the corporation was violating the law *or otherwise headed for a corporate trauma*." 294 A.3d 65, 91 (Del. Ch. 2023) (emphasis added). *See also* Shapira, *supra* note 53, at 737 (elaborating on the conditions under which oversight duties could encompass also critical reputational risks).

205. Horman v. Abney, No. 12290–VCS, 2017 WL 252571 (Del. Ch. Jan. 19, 2017).

206. *Id.* at *11.

207. *Id.*

208. *Id.*

209. This is yet another area of oversight duty litigation that resembles the way that federal courts infer scienter in securities fraud litigation: When the wrongdoing in question is widespread, federal courts tend to impute knowledge of the problems to top management. Kaufman & Wunderlich, *supra* note 126, at 539 (quoting City of Austin Police Ret. Sys. v. ITT Educ. Servs., Inc., 388 F. Supp. 2d 932, 949 (S.D. Ind. 2005)); James J. Park, *ESG Securities Fraud*, 58 WAKE FOREST L. REV. 1149, 1178 (2023); *see also* Andrew F. Tuch, *Multiple Gatekeepers*, 96 VA. L. REV. 1583, 1645, n.232 (2010) (on courts using the "red-flags" construct to impute knowledge to third-party advisors).

repeatedly described warnings as a "barrage," "avalanche," and "torrent" to imply that directors and officers must have been on notice.[210]

Such reasoning reflects the *aggregation principle*: The quantity of past warnings can transform into quality.[211] That is, a myriad of yellow flags can count as a big red flag once the number of warnings crosses a certain threshold. Such thinking also implies that the nature of flags is dynamic: What was once yellow can quickly turn red, including in instances when "the regulatory and enforcement environment [is] intensifying."[212]

Second and relatedly, a common point of contention is whether past law enforcement actions against the company constitute red flags. The abovementioned opioid cases were easy to solve because of the sheer volume: When a company faces dozens of enforcement actions, it is safe to assume that directors were on notice and should have reacted to the problem that kept getting the company in trouble. But most other cases are less straightforward.[213]

The deciding factor is seemingly not whether the company faced enforcement actions but rather what information came out of past enforcement actions. The fact that a regulator initiated an investigation, or a plaintiff filed a lawsuit, may not count as a red flag if said investigation did not result in clear findings of corporate misbehavior.[214] To illustrate, consider *Rojas ex rel. J.C. Penney Co. v. Ellison*, which revolved around allegations of false price advertising by J.C. Penney. Plaintiffs suggested that the fact that J.C. Penney settled a class action for $50 million serves as a red flag that should have put its directors on notice regarding future violations of price advertising regulations.[215] The court disagreed, noting that the legal proceedings against J.C. Penney were purely civil and that the settlement contained no admission of wrongdoing.[216]

Third, courts can impute knowledge to directors by looking at the company's general disclosures. In *Chou*, for example, the fact that the company's Form 10-K disclosure recognized a DOJ subpoena served as an indication that the board knew

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210. *Collis II*, No. 2021-1118-JTL, 2022 WL 17841215, at *1–2 (Del. Ch. Dec. 22, 2022), *rev'd and remanded*, *Collis III*, 311 A.3d 773 (Del. 2023).

211. The concept of aggregation—whereby many small events can cross a threshold and turn into a big event—is familiar in other areas of law. *See generally* Ariel Porat & Eric A. Posner, *Aggregation and Law*, 122 YALE L.J. 2 (2012) (on aggregation in torts, contracts, criminal law, and administrative law); Yaniv Roznai, *The Straw That Broke the Constitution's Back? Qualitative Quantity in Judicial Review of Constitutional Amendments*, *in* CONSTITUTIONALISM: OLD DILEMMAS, NEW INSIGHTS (Alejandro Linares-Cantillo, Camilo Valdivieso-León & Santiago García-Jarmillo eds., 2021) (on aggregation in public law, international law, and constitutional law).

212. *Collis II*, 2022 WL 17841215, at *7.

213. *See, e.g.*, Fisher *ex rel.* Lendingclub Corp. v. Sanborn, No. 2019-0631-AGB, 2021 WL 1197577, at *12 (Del. Ch. Mar. 30, 2021) (emphasizing that the answer depends on the specific circumstances); *Walmart II*, No. 2021-0827-JTL, 2023 WL 3093500, at *44 (Del. Ch. Apr. 26, 2023) (emphasizing the same).

214. *See, e.g.*, Firemen's Ret. Sys. *ex rel.* Marriott Int'l, Inc. v. Sorenson, No. 2019-0965-LWW, 2021 WL 4593777 (Del. Ch. Oct. 5, 2021); *Fisher*, 2021 WL 1197577, at *12 (Del. Ch. Mar. 30, 2021).

215. No. 2018-0755-ABG, 2019 WL 3408812, at *10 (Del. Ch. July 29, 2019).

216. *Id.* at *13.

about the underlying problem.[217] After all, directors sign off on 10-K disclosures, and so it can be assumed that they are aware of warning signs appearing there.[218]

Finally, the mission-critical designation is relevant not only when deciding information-systems claims but also when deciding whether to impute knowledge of red flags to directors. This point bears emphasizing, if only because it largely escaped commentary about *McDonald's*. Many corporate law commentators highlighted the proclamation in *McDonald's* that the mission-critical designation is dispositive only in information-systems claims and not in red-flags claims.[219] The idea was that "a red flag can come out of the blue"[220]: Directors cannot ignore clear signals of imminent harm to the company just because the warnings concern compliance risks that are not considered critical. Commentators overlooked that the centrality of a risk increases courts' willingness to infer that directors must have seen red flags about it.[221] Inside the mission-critical zone, even yellow flags may become actionable.[222]

3. Where Do Warnings Come From?

A common refrain is that information-systems and red-flags claims cannot coexist.[223] Once plaintiffs claim that red flags were waved in directors' faces, they concede that there existed a system that generated warnings and reported these warnings to the board, or so the argument goes.[224] But this common refrain can be misleading, because red flags can come from outside the board's information system.[225] *Boeing* is a classic example: Directors completely failed to monitor airline safety before the first crash (an information-systems breach), and then they failed to respond to known safety risks after that crash (a red-flags breach).[226] Indeed, this theme is underappreciated in compliance failures: Often the problems are flushed out

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217. Teamsters Loc. 443 Health Servs. & Ins. Plan v. Chou, No. 2019-0816-SG, 2020 WL 5028065, at *24 (Del. Ch. Aug. 24, 2020).

218. *Id.*

219. *See, e.g.*, Caroline H. Zalka, Amanda K. Pooler & Joshua M. Glasser, *New* McDonald's *Opinion Provides Directors a Playbook for Responding to "Red Flags" of Alleged Workplace Misconduct* (Mar. 3, 2023), https://www.weil.com/-/media/mailings/2023/q1/new-mcdonalds-opinion-provides-directors-a-playbook-for-responding-to-red-flags-of-alleged-workplace.pdf [https://perma.cc/6CPJ-7XKD].

220. *McDonald's II*, 291 A.3d 652, 680 (Del. Ch. 2023).

221. *Id.* ("All else equal, if a red flag concerns a central compliance risk, then it is easier to draw an inference that a failure to respond meaningfully resulted from bad faith."); *In re* Clovis Oncology, Inc. Deriv. Litig., No. 2017-0222-JRS, 2019 WL 4850188, at *12–13 (Del. Ch. Oct. 1, 2019).

222. *See, e.g.*, SARAH BARKER, CYNTHIA WILLIAMS & ALEX COOPER, COMMONWEALTH CLIMATE & L. INITIATIVE, FIDUCIARY DUTIES AND CLIMATE CHANGE IN THE UNITED STATES 5 (2021), https://ccli.ubc.ca/wp-content/uploads/2021/12/Fiduciary-duties-and-climate-change-in-the-United-States.pdf [https://perma.cc/8KSF-AJV6].

223. *See, e.g.*, City of Detroit Police and Fire Ret. Sys. *ex rel.* NiSource, Inc. v. Hamrock, No. 2021-0370-KSJM, 2022 WL 2387653, at *11–12 (Del. Ch. June 30, 2022).

224. *Id.*

225. *Walmart II*, No. 2021-0827-JTL, 2023 WL 3093500, at *32 (Del. Ch. Apr. 26, 2023).

226. *In re* Boeing Co. Deriv. Litig., No. 2019-0907-MTZ, 2021 WL 4059934, at *25–26, *33–34 (Del. Ch. Sept. 7, 2021).

by people from outside the company, such as journalists or regulators.[227] To illustrate, a March 2023 complaint against Meta's directors and officers cited journalistic reporting that flagged in real time issues with sex trafficking on Facebook.[228]

An especially interesting development in this regard comes from *Garfield v. Allen*, which suggested that plaintiffs themselves can generate red flags that put directors on notice.[229] That issue involved a board decision to award compensation to the company's CEO, in violation of the company's compensation plan. Plaintiff sent a demand letter to the board, alerting them to the violation. The board did not budge. The court then ruled that once directors received the demand letter, they were on notice of the violation. Accordingly, the directors' decision not to fix the issue can be considered bad faith. The court emphasized that this outcome is problematic from a policy standpoint, since it opens space for plaintiffs to create their own claims by sending demand letters.[230] But from a doctrinal perspective, where the red flags come from does not make a difference. All that matters is that directors knew of a serious problem and consciously ignored it.[231] The extent to which courts will be willing to recognize such plaintiff-produced red flags in future *Caremark* cases remains to be seen.

B. Which Responses Are Sufficient?

To sustain a red-flags claim, plaintiffs must show not only that flags were waved in directors' faces, but also that directors deliberately ignored them. The fact that directors were warned about a problem before a corporate trauma happened does not mean that they did not try in good faith to address the problem. What matters is not whether directors succeeded in preventing the trauma but whether they genuinely tried.[232] In *McDonald's*, for example, directors who became aware of sexual misconduct by senior managers took several steps to "establish a renewed commitment to a safe and respectful workplace": They hired outside consultants, revised company policies, and implemented new training programs.[233] Once the directors responded with those steps, they could not be held liable for the fact that the sexual harassment never fully stopped.

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227. *See generally* Michael J. Borden, *The Role of Financial Journalists in Corporate Governance*, 12 FORDHAM J. CORP. & FIN. L. 311 (2007) (giving a prescient analysis on how investigative journalism may interact with board oversight duties).

228. Kevin M. LaCroix, *Meta Board and Execs Hit with Oversight Duty Breach Claim Based on Trafficking Allegations*, THE D&O DIARY (Mar. 23, 2023), https://www.dandodiary.com/2023/03/articles/director-and-officer-liability/meta-board-and-execs-hit-with-oversight-duty-breach-claim-based-on-trafficking-allegations/ [https://perma.cc/EEQ6-4QSN].

229. 277 A.3d 296, 337, 340 (Del. Ch. 2022).

230. *Id.* at 338.

231. *Id.* at 340.

232. Firemen's Ret. Sys. *ex rel.* Marriott Int'l Inc. v. Sorenson, No. 2019-0965-LWW, 2021 WL 4593777, at *13 (Del. Ch. Oct. 5, 2021); Richardson v. Clark, No. 2019-2015-SG, 2020 WL 7861335, at *11 (Del. Ch. Dec. 31, 2020).

233. *McDonald's II*, 291 A.3d 652, 662 (Del. Ch. 2023).

Still, not every response to red flags is protected. Several sets of circumstances give rise to an inference that directors had to know that their response was tepid and that it would fall short.[234] Consider the following three examples. First and most straightforwardly, completely failing to follow up could constitute a bad-faith response. In *Chou*, for instance, directors hired a law firm to investigate potential violations of drug repackaging regulations, but the minutes of the board and its audit committee in subsequent years did not contain a single reference to what that law firm found.[235]

Second, when on-the-ground numbers show that the problem has only worsened since the directors were put on notice, courts may infer bad faith. *Massey*, for example, emphasizes how there was an *uptick* in mining safety violations after directors found out about past safety problems.[236] Directors of a large mining company are not expected to eliminate all safety issues, but it is hard to credit their response when safety issues only worsen.

While lack of follow-ups (as in *Chou*) or a deterioration of compliance (as in *Massey*) illustrates a straightforward application of the red-flags standard, the recent opioid cases reflect a third, more nuanced approach, where the scrutiny of responses to red flags fluctuates as a function of the centrality of the risk and the severity of the allegations.[237] When AmerisourceBergen's directors pointed to three instances where the board requested and received in-depth reviews of its opioid diversion controls, the court was unimpressed given what was at stake: "Three instances are better than none, but they would not be enough to warrant dismissal *when evaluated against the panoply of allegations* in the complaint."[238]

In both *AmerisourceBergen* and *Walmart*, the courts looked past rosy presentations to the board and nice-sounding policy revisions and instead focused on the on-the-ground numbers and incentives.[239] AmerisourceBergen's opioid-diversion controls identified and reported an infinitesimal number of suspicious opioid orders. The court explained that no director operating in good faith could look at such numbers and think that their compliance program was responding properly to warning signs.[240] And Walmart's management responded to red flags by dedicating more resources to cutting costs and gaining market share than to opioid-

234. *In re* Boeing Co. Deriv. Litig., No. 2019-0907, 2021 WL 4059934, at *34 (Del. Ch. Sept. 7, 2021).

235. Teamsters Loc. 443 Health Servs. & Ins. Plan v. Chou, No. 2019-0816-SG, 2020 WL 5028065, at *10 (Del. Ch. Aug. 24, 2020).

236. *In re* Massey Energy Co. Deriv. & Class Action Litig., No. 5430–VCS, 2011 WL 2176479, at *19 (Del. Ch. May 31, 2011).

237. In other words, just as Part II showed that inside the mission-critical zone directors are scrutinized not just for what they knew but also for what they should have known, this Part claims that inside the mission-critical zone directors are scrutinized not just for doing nothing but also for not doing enough.

238. *Collis II*, No. 2021-1118-JTL, 2022 WL 17841215, at *16 (Del. Ch. Dec. 22, 2022), *rev'd and remanded*, *Collis III*, 311 A.3d 773 (Del. 2023) (emphasis added).

239. *Id.* at *5–6; *Walmart II*, No. 2021-0827-JTL, 2023 WL 3093500, at *36 (Del. Ch. Apr. 26, 2023).

240. *Collis II*, 2022 WL 17841215, at *9.

diversion controls.[241] The last point segues perfectly into the main policy rationale behind red-flags theory, namely, combatting cosmetic compliance.

C. Underlying Policy Rationales: Combatting Cosmetic Compliance and Recidivism

Various legal programs now either directly require or indirectly incentivize companies to implement compliance programs.[242] To receive regulatory credit for their compliance efforts, companies' compliance programs must be considered "effective."[243] Yet measuring effectiveness is hard even for the companies themselves, to say nothing of external regulators.[244] As a result, corporate compliance is susceptible to deteriorating into *cosmetic compliance*—paper programs that seem fine from the outside (and may help the company reduce the expected legal sanction) but in reality do little to curb corporate wrongdoing.[245]

The need to combat cosmetic compliance is an underlying theme in how corporate law courts apply the red-flags theory. When courts examine whether directors addressed red flags, they constantly invoke the construct of "going through the motions," to separate on-paper compliance from genuine compliance. *AmerisourceBergen* scolded directors for responding to warnings by adopting superficial measures while saving potent recovery measures as a bargaining chip in a future settlement with regulators (a settlement currency to obtain a global release).[246] *Walmart* called out directors for establishing nice-sounding policies while not allocating enough resources for successful implementation of said policies.[247] And *Chou* scolded the board for paying an outside law firm to identify weaknesses and not taking actual steps to remedy the weaknesses.[248]

A secondary policy rationale of the red-flags theory is fighting recidivism. Corporate recidivism is a well-known problem that imposes significant costs on society. Some companies count on their ability to systematically skirt regulations while evading enforcement.[249] Public enforcers are bad at targeting such corporate recidivism, if only because regulatory enforcement is disparate and uncoordinated, with each enforcer having a narrow, circumscribed authority.[250] Further, public

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241. *Walmart II*, 2023 WL 3093500, at *36.

242. Eckstein & Shapira, *supra* note 29, at 472–73.

243. *See, e.g.*, U.S. Dep't of Just., Just. Manual § 9-28.800 (2018).

244. Maurice E. Stucke, *In Search of Effective Ethics & Compliance Programs*, 39 J. CORP. L. 769, 802 (2014).

245. Kimberly D. Krawiec, *Cosmetic Compliance and the Failure of Negotiated Governance*, 81 WASH. U. L.Q. 487, 491–92 (2003); Veronica Root Martinez, *Complex Compliance Investigations*, 120 COLUM. L. REV. 249, 299 (2020) (compiling references).

246. *Collis II*, No. 2021-1118-JTL, 2022 WL 17841215, at *16 (Del. Ch. Dec. 22, 2022), *rev'd and remanded*, *Collis III*, 311 A.3d 773 (Del. 2023).

247. *Walmart II*, No. 2021-0827-JTL, 2023 WL 3093500, at *35 (Del. Ch. Apr. 26, 2023).

248. Teamsters Loc. 443 Health Servs. & Ins. Plan v. Chou, No. 2019-0816-SG, 2020 WL 5028065, at *10 (Del. Ch. Aug. 24, 2020).

249. *Cf.* Samuel W. Buell, *Good Faith and Law Evasion*, 58 UCLA L. REV. 611, 662–63 (2011).

250. Veronica Root, *Coordinating Compliance Incentives*, 102 CORNELL L. REV. 1003, 1054–55 (2017).

enforcers are incentivized to allocate their scarce resources to working new cases over policing old settlements.[251]

Caremark litigation targets recidivism by treating past violations as red flags that put directors on notice.[252] In other words, the more recidivist a company is, the more likely directors and officers are to be personally liable. Indeed, courts often explicitly mention the company's recidivism as an indicator of directors' bad faith. A recent example comes from Facebook's data privacy scandal, where the court sustained *Caremark* claims because the complaint painted a picture of "recidivist lawbreaking."[253]

IV. BUSINESS-PLAN (*MASSEY*) CLAIMS

Information-systems and red-flags claims require directors to try genuinely and proactively to ensure that others in their organization comply with the law. A business-plan claim requires directors not to cause the corporation to break the law in pursuit of profit. On paper, the latter seems easier to prove than the former: It is supposedly easier to infer bad intentions from actions than from omissions. Yet applying the business-plan theory to real-world circumstances often turns out to be anything but automatic. Large corporations operate in a dynamic regulatory environment with much uncertainty. As a result, it is not straightforward to assume that the business plan in question was predicated from the start on lawbreaking. Further, directors rarely openly condone or document their orders to others to violate laws.[254] As a result, it is not straightforward to assume that directors proactively affirmed a plan to profit from lawbreaking.[255]

Section A elaborates on how courts tackle the question of whether the business plan in question was illegitimate. In the process, we get to revisit age-old distinctions between criminal law and civil law, malum in se and malum prohibitum, local law and foreign law, and torts and contracts. Section B examines the types of circumstantial evidence that courts use to infer that directors were in on the scheme. Section C crystalizes the underlying policy rationales for holding directors personally liable even when the business plan in question was profitable for the company; the Section highlights how the business-plan theory implicates the core question of corporate law's limits on shareholder wealth maximization.

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251. Andrew K. Jennings, *Follow-Up Enforcement*, 70 DUKE L.J. 1569, 1573–74 (2021).

252. To be sure, as Section III.A demonstrated, not every past misconduct serves as evidence against defendants in *Caremark* cases. Nor should it: Every large corporation is bound to clash with regulatory requirements at some point.

253. Pappas, *supra* note 52.

254. H. Justin Pace, *Rogue Corporations: Unlawful Corporate Conduct and Fiduciary Duty*, 85 MO. L. REV. 1, 10 (2020).

255. *In re* Massey Energy Co. Deriv. & Class Action Litig., No. 5430–VCS, 2011 WL 2176479, at *22 (Del. Ch. May 31, 2011).

A. Which Business Plans Are Illegitimate?

The first step toward proving a business-plan claim seems straightforward: Plaintiffs must show that the company violated "positive law."[256] Yet what qualifies as positive law and what qualifies as a violation of positive law are not always clear.[257]

1. Which Laws?

Many state laws and academic commentators have distinguished between laws whose violations give rise to director liability and laws whose violations do not. The American Law Institute (ALI) Principles of Corporate Governance, for example, distinguishes between culpable and nonculpable violations: Companies can exculpate directors even when directors sign off on knowing violations of law, as long as the violations are not "culpable."[258] The Model Business Corporation Act goes even further, allowing exculpation from all violations, except intentional violations of *criminal* law.[259] An influential strand in the economic analysis of corporate law literature similarly distinguishes between "regulatory laws," which govern conduct that is malum prohibitum, and criminal laws, which govern conduct that is malum in se.[260] To these academics, only the latter is part of corporate law's duty of obedience.[261] Managers "have no general obligation to avoid violating regulatory laws."[262] In fact, some claim that managers have a duty to violate regulatory laws "when violations are profitable to the firm."[263]

Delaware corporate law eschews all these distinctions and treats violations of criminal law and violations of civil regulation equally. Delaware's statute does not permit exculpation from any type of law violation.[264] And Delaware's case law has

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256. Stone v. Ritter, 911 A.2d 362, 369 (Del. 2006) (quoting *In re* Walt Disney Co. Deriv. Litig., 906 A.2d 27, 67 (Del. 2006)).

257. Pace, *supra* note 254, at 11; William J. Moon, *Transnational Corporate Law Litigation*, 74 DUKE L.J. (forthcoming 2025) (manuscript at 21). It is clear, for example, that stock exchange listing rules or industry guidelines do not count as positive law. *See, e.g.*, Firemen's Ret. Sys. *ex rel.* Marriott Int'l, Inc. v. Sorenson, 2019-0965-LWW, 2021 WL 4593777, at *13–14 (Del. Ch. Oct. 5, 2021). What this Section focuses on is whether all *enacted* laws count as "positive law" for *Caremark* purposes.

258. PRINCIPLES OF CORPORATE GOVERNANCE: ANALYSIS AND RECOMMENDATIONS § 2.01 (AM. L. INST. 1994).

259. MODEL BUS. CORP. ACT § 2.02(b)(4)(iv) (AM. BAR ASS'N 2016).

260. Cynthia A. Williams, *Corporate Compliance with the Law in the Era of Efficiency*, 76 N.C. L. REV. 1265, 1275 (1998) (compiling references); Adi Libson & Gideon Parchomovsky, *Are All Risks Created Equal? Rethinking the Distinction Between Legal and Business Risk in Corporate Law*, 102 B.U. L. REV. 1601, 1607 (2022).

261. Williams, *supra* note 260, at 1297–98.

262. Frank H. Easterbrook & Daniel R. Fischel, *Antitrust Suits by Targets of Tender Offers*, 80 MICH. L. REV. 1155, 1168 n.36 (1982).

263. *Id.*

264. DEL. CODE ANN. tit. 8, § 102(b)(7)(ii) (2024).

repeatedly clarified that there are no "shades of gray" when it comes to meeting a baseline of legality.[265]

Notwithstanding this general proclamation, even under Delaware law there remain some important distinctions. Contractual breaches, for example, probably do not give rise to *Massey* liability. After all, Delaware law espouses "efficient breaches": If a company finds a more profitable economic opportunity, directors and officers will not be liable if they chose to breach and pay damages.[266] Common law torts, by contrast, seemingly do give rise to *Massey* liability.

To illustrate, consider the ongoing *Fox* case.[267] The background story will be familiar to anyone who followed the 2020 presidential election: The Fox News network aired statements accusing Dominion, a voting machine company, of facilitating election fraud. Dominion sued for defamation, and Fox settled for $787.5 million. Then came the less publicized corporate law part: Fox's shareholders filed several derivative actions against the company's directors and officers, each relying on various types of *Caremark* claims. In December 2023, the Court of Chancery decided on the leadership dispute, namely, which one of the teams that filed different complaints would lead the derivative action on behalf of the company.[268] In its leadership decision, the court factored in the type of *Caremark* theories that each team advanced.[269] While one team relied on an information-systems claim, the other team asserted a *Massey* claim as well. The court chose the latter to lead the case, reasoning that its *Massey* claim appeared promising: Fox's decision-makers arguably signed off on a business model predicated on knowingly engaging in defamation and assuming the legal risk.[270] Pertinently here, the decision implies that a business model relying on committing a common law tort (defamation) gives rise to *Massey* liability.

There is a broader point at play here, namely, the distinction between "law as price" and "law as prohibition." Some laws are best interpreted as establishing a price for certain behaviors. Breaching contracts and paying expectation damages is one example. Another oft-used example revolves around a delivery company that orders its drivers to double-park under the theory that occasional parking fines are a price worth paying for on-time delivery.[271] Laws like that are unlikely to give rise to

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265. *In re* ProAssurance Corp. S'holder Deriv. Litig, No. 2022-0034-LWW, 2023 WL 6426294, at *14 (Del. Ch. Oct. 2, 2023); *see generally* Asaf Raz, *The Legal Primacy Norm*, 74 FLA. L. REV. 933 (2022).

266. *See, e.g.*, E.I. DuPont de Nemours & Co. v. Pressman, 679 A.2d 436, 445 (Del. 1996); Nacco Indus., Inc. v. Applica Inc., 997 A.2d 1, 35 (Del. Ch. 2009).

267. Kevin LaCroix, *The Derivative Suit Against the Fox Board Just Got a Lot More Interesting*, THE D&O DIARY (Apr. 20, 2023), https://www.dandodiary.com/2023/04/articles/shareholders-derivative-litigation/the-derivative-suit-against-the-fox-board-for-just-got-a-lot-more-interesting/ [https://perma.cc/G55V-7YRG].

268. *In re* Fox Corp. Deriv. Litig., 307 A.3d 979, 984–85, 988 (Del. Ch. 2023). Leadership disputes are governed, among other things, by Rule 23.1(c)(3)(B)(iii), which "calls on the court to consider the quality of the pleadings that the applicants have filed." *Id.* at 988.

269. *Id.*

270. *Id.* at 988–89, 998.

271. *See, e.g.*, STEPHEN M. BAINBRIDGE, CORPORATION LAW AND ECONOMICS 272–73 (2002); Palmiter, *supra* note 99, at 458; Uebler, *supra* note 86, at 201; Greenfield, *supra* note 86, at 1364.

Massey liability. Other laws are best interpreted as setting a limit on how to behave ("law as prohibition"). Robert Cooter suggested a simple criterion to distinguish between the two, namely, whether the penalty increases for repeated offenses.[272] When an individual is caught double-parking in 2023 and then again in 2024, he or she will pay the same penalty each time. By contrast, if an individual is repeatedly caught driving under the influence or speeding, he or she will face increased sanctions. The former reflects an approach of law as price, whereas the latter reflects an approach of law as limit. In terms of corporate law, ordering truck drivers to always double-park does not necessarily lead to *Massey* liability, but ordering truck drivers to always break speed limits does.[273]

Another important question that remains unanswered is the extent to which *Massey* applies to violations of foreign law. Academic commentators have long suggested that it does apply.[274] But Delaware judges have framed the theory in terms that can suggest otherwise. Former Chief Justice Strine, for example, talks about "an obligation to be faithful to the laws *of the chartering society* in exercising corporate powers,"[275] and explains that the "affirmative obligation to honor society's laws is the foundation that permits the principled use of the enabling form of current *American* general corporation statutes."[276] From such formulations one could arguably deduce that violations of the laws of foreign societies do not fall within Delaware corporate law's duty of obedience.

Ultimately, the scope of business-plan claims depends on what theory grounds them. Those who base *Massey* claims on a traditional "concession theory"—that companies owe their existence to the state chartering them[277]—may limit the claims to violations of local law. Those who espouse a revised concession theory—that companies depend on the legal and administrative apparatus surrounding them wherever they operate[278]—may expand *Massey*'s reach to violations of the laws of other countries in which the company enjoys significant presence and revenues.[279] And those who believe that the dominant justification for *Massey* is shareholder wealth maximization may support applying it to foreign law in situations where the expected legal sanctions and reputational fallouts from violating foreign law are significant.[280] In other words, when the potential injury to the corporation from being

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272. Robert Cooter, *Prices and Sanctions*, 84 COLUM. L. REV. 1523, 1551 (1984).

273. Williams, *supra* note 260, at 1282; PRINCIPLES OF CORPORATE GOVERNANCE, *supra* note 258, § 2.01 cmt. g.

274. Elizabeth Pollman, *The Supreme Court and the Pro-Business Paradox*, 135 HARV. L. REV. 220, 255 (2021); Greenfield, *supra* note 86, at 1373; *see generally* Moon, *supra* note 257.

275. Strine, et al., *supra* note 88, at 649 (emphasis added).

276. Chris Brummer & Leo E. Strine, Jr., *Duty and Diversity*, 75 VAND. L. REV. 1, 71 (2022) (emphasis added).

277. *See* Mohsen Manesh, *The Corporate Contract and the Internal Affairs Doctrine*, 71 AM. U. L. REV. 501, 535–37 (2021) (detailing the theory and its roots).

278. *See* William J. Moon, *Beyond Profit Motives*, 122 MICH. L. REV. 1059, 1074 (2024); Williams, *supra* note 260, at 1329–31.

279. *See* Moon, *supra* note 257, at 22, 26–28.

280. *See id.* at 26–28.

caught lawbreaking is similar in the United States and elsewhere, the legal consequences for directors should be similar as well.[281]

2. Which Violations?

Just as not all laws are created equal for *Massey* purposes, not all types of violations are created equal. In practice, only significant violations of positive law give rise to *Massey* liability. As a matter of law, minor violations are subject to the "de minimis" exception.[282] And as a matter of practice, *Massey* litigation hinges on the incentives of entrepreneurial plaintiff attorneys. These attorneys will not bring *Massey* claims when the rule violations in question are small, if only because of the big, front-loaded investment needed to plead with particularity facts about what directors knew and when they knew it.[283] The bounty at the end of the process (fees) must justify the hunting (pre-filing investigations).

Besides not applying to minor violations, *Massey* claims are also unlikely to apply to good faith efforts to promote causes that result in unintentional violations.[284] To illustrate, in early 2022, Brummer and Strine discussed a hypothetical scenario of a company facing an unlawful-reverse-discrimination lawsuit because it promoted individuals based on diversity criteria.[285] Brummer and Strine assured directors that they do not have to worry about personal liability in such scenarios, given that the directors' diversity-promoting plan was not in bad faith.[286] By late 2022, their hypothetical scenario became a reality when a derivative action against Starbucks's directors and officers for approving the company's diversity-promoting policies was summarily dismissed.[287]

Ultimately, business-plan duties operate along a continuum,[288] and the more serious the violations are, the more likely courts are to impose liability. Indeed, the rare decisions that sustained business-plan claims explicitly referenced the consequences of violations. *Massey*, for example, faulted directors for accepting "as ordinary the idea that the company would regularly be accused of violating *important safety* regulations."[289] Academic commentators similarly refer to "particularly salient and egregious violations" when discussing the theory.[290]

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281. Uebler, *supra* note 86, at 201.

282. *Id.* at 213 n.69.

283. *See id.*

284. *See* Brummer & Strine, *supra* note 276, at 89; PRINCIPLES OF CORPORATE GOVERNANCE: ANALYSIS AND RECOMMENDATIONS, *supra* note 258, § 2.01 cmt. g.

285. Brummer & Strine, *supra* note 276, at 89.

286. *Id.* at 89–90.

287. Rachel Riley, *Starbucks Judge Blasts Challenge to Its Diversity Policies*, LAW360 (Sept. 12, 2023, 8:11 PM), https://www.law360.com/articles/1720839/starbucks-judge-blasts-challenge-to-its-diversity-policies [https://perma.cc/B8F9-TEBX]; Ann Lipton, *To Whom Are Caremark Duties Owed?*, BUS. L. PROF BLOG (Sept. 15, 2023), https://lawprofessors.typepad.com/business_law/2023/09/to-whom-are-caremark-duties-owed.html [https://perma.cc/3ZCS-6BVS].

288. Palmiter, *supra* note 99, at 474.

289. *In re* Massey Energy Co. Deriv. & Class Action Litig., No. 5430–VCS, 2011 WL 2176479, at *1 (Del. Ch. May 31, 2011) (emphasis added).

290. Pollman, *supra* note 37, at 2016–17.

B. What Ties Directors to Illegitimate Business Plans?

It is easier to find evidence that a company violated positive law than to find evidence that the company's directors were instructing others to violate laws.[291] The crucial question in *Massey* claims is, therefore, what circumstantial evidence allows an inference that the board knowingly fostered an illegitimate business plan.[292] A synthesis of the case law reveals three important indicators: (1) how openly the company was flouting the law; (2) how widespread the lawbreaking was; and (3) what incentive structures were in place.

In the first type of case, the company's decision-makers openly flout the law, thereby allowing an inference that directors signed off on an illegitimate business plan. In *Massey*, for example, the CEO openly expressed contempt for mining regulators,[293] and the company pled guilty to knowing violations of mining safety laws.[294]

In the second type of case, plaintiffs cannot locate statements that openly prioritize profits over compliance, but they can marshal evidence about the sheer volume of lawbreaking.[295] In these cases, plaintiffs argue that if a company constantly breaks the law, one can infer that the company's board views lawbreaking as a feature rather than as a bug.[296] The courts have trodden carefully when asked to make the leap from repeated regulatory violations to directors' bad faith.[297] Instead of focusing on the raw number of violations, courts focus on how serious the violations were, or what portion of the company's overall activity was tainted.[298] In other words, a couple of serious rule violations can be more suggestive of directors' bad faith than a dozen minor violations. And 1000 violations out of 1,000,000 transactions are less suggestive of directors' bad faith than 100 out of 400 transactions.

Finally, courts can infer that directors were in on the scheme by looking at the incentive structures that permeated the company. *AmerisourceBergen* focused on the understaffing of compliance personnel: The company aggressively expanded its opioid distribution networks without a commensurate increase in the resources it allocated to opioid-diversion controls.[299] *Massey* referred to internal promotion criteria: The company fired a whistleblower and fostered a culture whereby mid-

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291. *See* Pace, *supra* note 254, at 10.

292. *Walmart I*, 294 A.3d 65, 91 (Del. Ch. 2023) ("It is highly unlikely that any formal record of such a decision would exist, nor will there be an after-the-fact confession. What will exist are external manifestations from which, using the theory of mind, an external observer like a judge or a jury can infer conscious intent.").

293. *Massey*, 2011 WL 2176479, at *18–19.

294. *Id.*

295. City of Detroit Police & Fire Ret. Sys. *ex rel.* NiSource, Inc. v. Hamrock, No. 2021-0370-KSJM, 2022 WL 2387653, at *24–25 (Del. Ch. June 30, 2022).

296. *Id.* at *19.

297. *See id.* at *1–2, *19.

298. *Id.* at *19; Horman v. Abney, No. 12290–VCS, 2017 WL 242571, at *14 (Del. Ch. Jan. 19, 2017).

299. *See* AmerisourceBergen Corp. v. Lebanon Cnty. Emps.' Ret. Fund, 243 A.3d 417, 421–22 (Del. 2020).

level employees could perceive that "if you wished to stay or get ahead . . . the priority of profits over safety was one not to be questioned."[300] Walmart revised its anti-diversion policies, yet it did not purchase enough database capacity to monitor opioid diversions nor set realistic timetables for implementing the nice-sounding policies.[301]

C. Underlying Policy Rationales: Combatting Short-Termism and Externalities

The line between red-flags claims and business-plan claims can be blurry,[302] and consequently the same cosmetic compliance and recidivism rationales that we highlighted for the former can be relevant when discussing the latter as well. The previous discussion of *Walmart* illustrates how business-plan claims can combat cosmetic compliance: The court saw through nice-sounding policies and sustained the claims based, for example, on evidence of the company providing hefty bonuses to pharmacists who attracted opioid customers.[303] To illustrate how business-plan claims can combat recidivism, consider how the first sentence of *Massey* notes that the company has "a controversial reputation."[304] The recidivism gun that appeared in the first act then fires in the final act: The court dismisses defendants' arguments, reasoning that "when a company has a 'record' as a recidivist, its directors and officers cannot take comfort in the appearance of compliance."[305]

The business-plan theory also relies on strong rationales of its own. The rationale for preventing companies from making profits by skirting laws is less straightforward than it seems. Indeed, a prevalent view in corporate legal scholarship holds that it is for other laws to protect broader societal interests: Labor laws protect against toxic working environments, environmental laws protect against pollution, consumer safety laws protect against product defects, and so on. Corporate law should focus on minimizing agency costs between shareholders who invest money in the company and managers who make decisions for the company, or so the argument goes. Proponents of this view do not believe that incorporating as a company gives a businessperson a blank check to violate all rules. Proponents simply claim that it is not for corporate law to police all rule violations: Other regulators can calibrate the sanction such that corporations internalize the costs of their conduct.[306] Once the sanction is set, shareholders should not be able to sue directors if the latter decided that the sanction was a price worth paying for rule violations that benefit the company.[307] Yet we have already seen that this prevalent view is bad law: Fiduciaries

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300. *In re* Massey Energy Co. Deriv. & Class Action Litig., No. 5430–VCS, 2011 WL 2176479, at *5–6 (Del. Ch. May 31, 2011).

301. *Walmart II*, No. 2021-0827-JTL, 2023 WL 3093500, at *36, *38 (Del. Ch. Apr. 26, 2023).

302. *Id.* at *32.

303. *Id.* at *10–11.

304. *Massey*, 2011 WL 2176479, at *1.

305. *Id.* at *21.

306. Easterbrook & Fischel, *supra* note 263, at 1177 n.57; *see also* Mariana Pargendler, *Controlling Shareholders in the Twenty-First Century: Complicating Corporate Governance Beyond Agency Costs*, 45 J. CORP. L. 953, 969–972 (2020).

307. Stephen M. Bainbridge, Star Lopez & Benjamin Oklan, *The Convergence of Good*

that treat laws as mere recommendations are breaching their duty of loyalty. Now let us understand why it is bad policy.

Allowing corporate fiduciaries to operate business plans that are based on making profits from breaking the law is often bad for shareholders, if only for the following three reasons. First, public shareholders may have longer time horizons than managers whose compensation is tied to short-term performance.[308] Illegalities may surface over the long term and end up creating a net negative to the company due to legal sanctions and reputational fallouts. Yet managers would still promote such illegalities in the hope of benefiting in the short term from the spikes in profitability. In such scenarios, business-plan claims rein in managerial short-termism.[309] On paper, shareholders can monitor managers to prevent the latter from undertaking such risky business plans to begin with. But unlike other corporate activities, illegalities usually occur under the public radar.[310] Therefore, the second reason that illegalities can be bad for shareholders is that shareholders have a much harder time monitoring managers' decisions in that realm. Indeed, several empirical studies corroborate the notion that illegalities are (also) an agency problem by showing that corporate crime occurs less frequently when managers have a larger ownership stake in the company.[311]

Third, even if lawbreaking could prove net positive to shareholders qua shareholders, one could argue that many shareholders would *prefer* that the company not profit from lawbreaking.[312] Shareholders are consumers, workers, and people too, and they have social and ethical concerns.[313] As a result, maximizing shareholder welfare does not necessarily mean maximizing corporate profits at all costs. Shareholders would like to earn good returns, but they may not like to earn good returns by emitting toxic chemicals or cutting corners on product safety. In that respect, the business-plan theory can be consistent with corporate law's commitment to maximizing shareholder welfare (as opposed to maximizing shareholder wealth).

A different policy argument for business-plan claims is that they combat externalities.[314] Here the focus is on minimizing harms to third parties rather than on

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Faith and Oversight, 55 UCLA L. REV. 559, 592–93 (2008); Daniel R. Fischel, *The Corporate Governance Movement*, 35 VAND. L. REV. 1259, 1271 (1982).

308. Greenfield, *supra* note 86, at 1338; *see also* Zachary J. Gubler, *The Neoclassical View of Corporate Fiduciary Duty Law*, 91 U. CHI. L. REV. 165, 215 (2024) (arguing that corporate law duties run to the hypothetical permanent shareholder).

309. *Cf.* Akshaya Kamalnath, *Social Movements, Diversity, and Corporate Short-Termism*, 23 GEO. J. GENDER & L. 449, 469–70 (2022) (discussing short- and long-term consequences of corporate activism).

310. Greenfield, *supra* note 86, at 1335.

311. Cindy R. Alexander & Mark A. Cohen, *Why Do Corporations Become Criminals? Ownership, Hidden Actions, and Crime as an Agency Cost*, 5 J. CORP. FIN. 1, 2 (1999).

312. *See generally* Oliver Hart & Luigi Zingales, *Companies Should Maximize Shareholder Welfare Not Market Value*, 2 J.L. FIN. & ACCT. 247 (2017) (providing a formal model); Scott Hirst, Kobi Kastiel & Tamar Kricheli-Katz, *How Much Do Investors Care About Social Responsibility?*, 2023 WIS. L. REV. 977 (2023) (providing empirical evidence).

313. Hart & Zingales, *supra* note 312, at 248.

314. *See* Arlen, *Oversight Duties*, *supra* note 23, at 195 (arguing that the revamped mode of *Caremark* duties gives directors a reason to deter misconduct within their companies even when such misconduct could benefit shareholders); Pollman, *supra* note 7, at 2028–30; *cf.*

minimizing harms to shareholders. This policy argument is not without its detractors. While saving the environment, building safer products, and creating better workplaces all seem laudable and politically palatable, it is not completely clear that they are goals that corporate law should focus on. To illustrate, let us recast the prevalent notions of "law-as-price" and "efficient breach."[315] Just as corporate law allows companies to breach contracts and pay expectation damages ("efficient breach"), so should corporate law allow companies to violate regulations and pay fines ("efficient lawbreaking"). Paying expectation damages leads to internalizing the harm to the second party from breaching contracts, and paying fines leads to internalizing the harm to the public from lawbreaking.

The efficient lawbreaking view is wrong on multiple levels. To understand why, consider the real-world case of DuPont. For over six decades, DuPont discharged a highly toxic chemical dubbed PFOA into the environment while making Teflon.[316] The company's decision-makers realized by the 1980s that PFOA is extremely toxic, that it does not break up in the environment and accumulates over time in the human body, and that it had leaked into the drinking water of nearby communities.[317] Yet they refused seemingly inexpensive abatement and continued production for three more decades.[318] Internal documents show that DuPont's decision-makers discussed in real time the possibility of suffering their "biggest legal problem" and reputational fallout yet if news of PFOA got out.[319] They nevertheless continued polluting.

Economist Luigi Zingales and I demonstrated that DuPont's decision to pollute was probably rational from the point of view of shareholder wealth maximization, even if it was catastrophic from an overall social welfare perspective.[320] The reason is twofold: The sanction for toxic emissions was not properly calibrated, and DuPont's decision-makers could count on their ability to delay and dilute the expected sanction. DuPont managed to conceal damning information from the public and regulators for decades. And once damning information about PFOA started leaking out, they pulled various levers to limit enforcement, such as by hiring former regulators.[321]

The DuPont case illustrates why we cannot assume that the penalty for rule violations will make corporate decision-makers internalize the social harms of their

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Assaf Hamdani & Kobi Kastiel, *Superstar CEOs and Corporate Law*, 100 WASH. U. L. REV. 1353, 1408 (2023) (arguing that directors have good reasons not to confront charismatic CEOs who generate value for the company, and so the fact that *Caremark* requires directors to do so must mean that *Caremark* is (also) about benefiting third parties).

315. Williams, *supra* note 260, at 1267–68.

316. Leach v. E.I. Du Pont de Nemours & Co., No. 01-C-608, 2002 WL 1270121, at *3 (Cir. Ct. W. Va. Apr. 10, 2002).

317. *Id.* at *3–4.

318. *See* Nathaniel Rich, *The Lawyer Who Became DuPont's Worst Nightmare*, N.Y. TIMES (Jan. 6, 2016), https://www.nytimes.com/2016/01/10/magazine/the-lawyer-who-became-duponts-worst-nightmare.html [https://perma.cc/VSM9-F46R].

319. Roy Shapira & Luigi Zingales, *Is Pollution Value-Maximizing? The DuPont Case* 17 (Eur. Corp. Governance Inst., Working Paper No. 723/2023, 2023), https://ssrn.com/abstract=3037091 [https://perma.cc/4HC2-TL5H].

320. *Id.* at 11–16.

321. *Id.* at 16–20.

behavior. What matters is not the penalty on the books but rather the perceived expected penalty. The expected sanction is a function of the magnitude, the perceived probability of detection, and the time lag between violating rules and paying fines for it. Big business companies can pour significant resources into diluting all three aspects: lobbying the regulators when the penalty is set (magnitude); distorting the information environment (probability of detection); and engaging in delay tactics (time lag). Therefore, there is value in providing a corporate law mechanism that disincentivizes corporate decision-makers from engaging in such behaviors.[322]

V. Secondary Questions: Privileges, Timeliness, Scope, and Remedies

Beyond the major question of how to infer bad faith, the recent slew of oversight duty cases has brought to the fore ostensibly procedural issues that have an outsized impact on corporate compliance. Five of these issues were addressed in rulings of first impression over the past year: when to provide plaintiffs access to prefiling discovery and how to treat privileges (discussed in Section A), when *Caremark* claims are time-barred (Section B), the level of deference to give Special Litigation Committees (Section C), the weight that should be given to findings of other, non-corporate law tribunals (Section D), and the scope of officers' oversight duties (Section E). Two of these issues remain unanswered, namely, the scope of third-party liability (Section F), and causation and remedies in *Caremark* claims (Section G).

This Part distills the case law and policy objectives for each one of these seven issues, while seeing the forest for the trees: Across all these issues, the courts have seemingly developed the law in ways that enhance shareholders' ability to hold directors accountable for compliance failures.[323]

A. Discovery and Privileges

For decades, the leading precedent on directors' oversight duties—*Allis-Chalmers*—was cited mostly for its position against discovery (i.e., as a warning against plaintiffs' "fishing expeditions") and in favor of privileges.[324] Over the past

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322. The argument here is connected to the concept of "publicness" that Hillary Sale and Donald Langevoort developed in a series of articles. *See, e.g.*, Hillary A. Sale, *Fiduciary Law, Good Faith and Publicness*, *in* THE OXFORD HANDBOOK OF FIDUCIARY LAW 779 (Evan J. Criddle, Paul B. Miller & Robert H. Sitkoff eds., 2018) ("The theory of good faith developed here rejects the 'law-as-price' theory and reaches beyond the entity to protect stakeholders and the public. . . . Why? Because the implications of fiduciary failures and failed entities extend beyond the financial concerns of shareholders and thus connect to publicness." (footnote omitted)); Donald C. Langevoort, *The Effects of Shareholder Primacy, Publicness, and Privateness on Corporate Culture*, 43 SEATTLE U. L. REV. 377, 386 (2020).

323. The one exception may be the *Chou* decision, which adopted a deferential approach to companies' own investigations of *Caremark* claims. *See infra* Section V.C.

324. *See, e.g.*, Rome v. Archer, 197 A.2d 49, 56 (Del. 1964); Schreiber v. Carney, No. 6202, 1983 WL 17998, at *2 (Del. Ch. Jan. 26, 1983). See Alexandra D. Lahav, *A Proposal to End Discovery Abuse*, 71 VAND. L. REV. 2037, 2039 (2018) for the definition and costs of "fishing expeditions."

couple of years, the approach to discovery and privileges in oversight cases has dramatically changed.

AmerisourceBergen signifies the more expansive approach to pre-filing discovery. Prior to *AmerisourceBergen*, some believed that only actionable (read: non-exculpated) wrongdoing was considered a proper purpose for shareholders to inspect their companies' books and records.[325] *AmerisourceBergen* clarified that any credible suspicion of wrongdoing at the company level (regardless of whether directors are exculpated) could justify inspection.[326] The upshot is that regulatory investigations against the company form a credible basis for pre-filing investigations to figure out what directors knew about the problems in real time. To be sure, the courts still guard against abuse of pre-filing discovery, such as by limiting the scope of inspection.[327] Here, as well, the mission-critical designation plays an important role: The more central a compliance risk, the more courts are willing to grant access to internal communications.[328]

Whatever one thinks about the merits of today's more liberal approach to pre-filing discovery, one must acknowledge that pre-filing discovery is more important in *Caremark* claims than it is in other corporate law claims. When the underlying claim invokes scienter, pleading it with particularity requires access to internal communications.[329] Granting broad pre-filing discovery in such a context helps not just plaintiffs but also courts (and corporate America as a whole), because it facilitates early screening of meritless suits. Indeed, decisions like *Horman* and *Hamrock* credited the detailed Section 220 record as a factor that allowed courts to dismiss claims early.[330]

Together with this expansive approach to pre-filing discovery, oversight duty cases now espouse a restrictive approach to privileges and redactions on the part of defendants. Nowhere was this approach more evident than in *Walmart II*, in which the company responded to a Section 220 action by producing heavily redacted documents.[331] The court rejected the motion to dismiss while noting that heavy redactions and assertions of privileges work against defendants at the pleading stage[332]: Redactions create an inference that Walmart's directors and officers were not doing enough in response to warning signs of opioid diversion.[333] Law firm

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325. Lebanon Cnty. Emps.' Ret. Fund v. AmerisourceBergen Corp., No. 2019-0527-JTL, 2020 WL 132752, at *19–23 (Del. Ch. Jan. 13, 2020), *aff'd*, AmerisourceBergen Corp. v. Lebanon Cnty. Emps.' Ret. Fund, 243 A.3d 417 (Del. 2020).

326. *Id.* at *19; AmerisourceBergen Corp. v. Lebanon Cnty. Emps.' Ret. Fund, 243 A.3d 417, 437 (Del. 2020).

327. Saito v. McKesson HBOC, Inc., 806 A.2d 113, 117 n.10 (Del. 2002).

328. Pettry v. Gilead Scis., Inc., No. 2020-0132-KSJM, 2020 WL 6870461, at *15 (Del. Ch. Nov. 24, 2020).

329. *See* South v. Baker, 62 A.3d 1, 23 (Del. Ch. 2012).

330. Horman v. Abney, No. 12290–VCS, 2017 WL 242571, at *12 (Del. Ch. Jan. 19, 2017); City of Detroit Police & Fire Ret. Sys. v. Hamrock, No. 2021-0370-KSJM, 2022 WL 2387653, at *16–17 (Del. Ch. June 30, 2022).

331. *Walmart II*, No. 2021-0827-JTL, 2023 WL 3093500, at *7 (Del. Ch. Apr. 26, 2023).

332. *Id.*

333. To be sure, there is nothing new about drawing reasonable inferences in plaintiffs' favor at the pleading stage. What is new here is the extent to which the court used redactions as pleading-stage indications against defendants. In the words of Ann Lipton, "The net effect

memos quickly recognized just how consequential this approach is in oversight cases: Defendants cannot claim that they discussed how to address problems if the evidence that they point to is redacted and privileged.[334]

B. Laches

When are failure-of-oversight claims time-barred? The timeliness question is especially important in *Caremark* settings, where plaintiffs usually challenge not a singular act but rather a continuous failure to engage in oversight over an extended period. In 2023, a couple of decisions clarified, in rulings of first impression, what accrual method, lookback date, and equitable tolling rules apply to *Caremark* claims.

The accrual method for all three *Caremark* claims is "separate accrual."[335] Under this method, each decision or conscious nondecision within an ongoing failure-of-oversight claim gives rise to a separate limitations period. Delaware courts eschewed the more commonly used "discrete act" method, whereby a claim accrues when the decision or conscious nondecision is first made.[336] To illustrate, if a board failed to respond to clear warning signs of a breakdown of opioid-distribution controls between 2006 and 2012, the discrete act method will start the limitations period in 2006, whereas the separate accrual method will start the limitations period only in 2012. Adopting the separate accrual method thus reduces the likelihood that a claim will be time-barred.[337] The rationale that the courts offered for adopting a liberal approach was two-pronged: First, all three *Caremark* claims were of an ongoing, developing nature, and so it would have been difficult to apply the discrete act method, which requires identifying a clear starting point.[338] Second, applying the discrete act method would have effectively cut off an important conduit to hold corporate fiduciaries accountable.[339]

Regarding the lookback date, the courts similarly adopted a liberal approach that extends the actionable period. Instead of setting the lookback date to when the suit

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was a near weaponization of the *lack* of record evidence on various topics in order to conclude that the Walmart board failed to conduct proper oversight of the company." Ann Lipton, *VC Laster Goes to War*, BUS. L. PROF. BLOG (Apr. 28, 2023), https://lawprofessors.typepad.com/business_law/2023/04/vc-laster-goes-to-war.html [https://perma.cc/VTJ2-VPXE] (emphasis in original).

334. *Id.*; Gail Weinstein, Philip Richter & Steven Epstein, *Chancery Rejects Dismissal of Caremark Claims Against Walmart's Officers and Directors*, HARV. L. SCH. F. ON CORP. GOVERNANCE (May 13, 2023), https://corpgov.law.harvard.edu/2023/05/13/chancery-rejects-dismissal-of-caremark-claims-against-walmarts-officers-and-directors/ [https://perma.cc/4PNZ-YVWP] ("[A]lthough conventional advice to preparers of minutes often has been to include only short, non-substantive descriptions of discussions, it is clear that that advice generally is no longer apt.").

335. Lebanon Cnty. Emps.' Ret. Fund v. Collis (*Collis I*), 287 A.3d 1160 (Del. Ch. 2022) (applying "separate accrual" to red-flags and business-plan claims); *Walmart I*, 294 A.3d 65 (Del. Ch. 2023) (applying "separate accrual" to information-systems claims).

336. *Walmart I*, 294 A.3d at 87.

337. *Id.* ("When the wrongdoing is ongoing, the discrete act approach cuts off the accountability mechanism . . . .").

338. *Id.* at 85–87.

339. *Id.* at 87.

was filed, as is par for the course, the *Collis* court was willing to set it earlier, to when the Section 220 action to inspect the company's books was filed.[340]

And if that was not enough, the courts applied equitable tolling. Equitable tolling stops the presumptive three-year statute of limitations from running as long as the beneficiaries in a fiduciary relationship can reasonably rely on the good faith and competence of their fiduciaries.[341] Specifically, the *Walmart* court reasoned that public shareholders normally have no reason to suspect that their directors proactively approved a plan to violate laws, or consciously disregarded their oversight duties.[342] As a result, even *Caremark* claims that otherwise accrue outside the actionable period would not be time-barred.

Granted, equitable tolling does not solve all timeliness issues: Defendants can argue, for example, that once shareholders learn about a failure of compliance, they can no longer reasonably rely on their fiduciaries to do a good job of monitoring compliance. But here as well, the courts adopted an approach that decreases the likelihood that *Caremark* claims will be time-barred. In *Walmart*, defendants argued that the company disclosed its failure to comply with opioid distribution regulations, thereby putting shareholders on notice.[343] The court insisted that for such disclosure to stop equitable tolling, it must be specific: Walmart's disclosure put shareholders on notice of noncompliance with a general regulatory statute, but the disclosure did not notify shareholders of noncompliance with specific obligations that the company had accepted as part of a previous settlement with the regulator.[344]

Across the board, then, the courts favored a liberal interpretation of laches, with the explicit purpose of facilitating accountability for compliance failures.[345] The ramifications of these seemingly procedural decisions cannot be overstated. While most legal claims are backward-looking, *Caremark* claims are *way*-backward-looking, often involving a series of decisions or conscious nondecisions occurring more than a decade before litigation ensued. Indeed, practically all the 2022–2023 cases that we have discussed throughout this Article implicate behavior going back to the early 2010s. The liberal approach to timeliness makes it likely that we will see additional *Caremark* actions being filed over the next few years, implicating behavior from 2015–2020.

C. Special Litigation Committees

Once *Caremark* claims started surviving motions to dismiss, it was only a matter of time until directors and officers tried to overtake and dismiss these claims by

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340. *Collis I*, 287 A.3d at 1208–11 (noting that as long as plaintiffs made a steady, diligent effort to investigate potential failures of oversight, the lookback date could be the filing of a Section 220 action).

341. *See, e.g.*, *In re* Tyson Foods, Inc. Consol. S'holder Litig., 919 A.2d 563, 585 (Del. Ch. 2007).

342. *Walmart I*, 294 A.3d at 71.

343. *Id.*

344. *Id.* at 97.

345. As with other aspects of *Caremark* case law, one should insert here a caveat about the difference between the pleading stage and the trial stage. At the pleading stage, laches would apply only if it is clear from the complaint that the claim is time-barred. *Id.* at 72.

appointing a "Special Litigation Committee" (SLC).[346] In November 2023, *Chou* ruled for the first time on the issue, allowing AmerisourceBergen's (ABC) directors to dismiss well-pled allegations against them.[347] One of ABC's subsidiaries was pooling overfills from oncology vials, which were not intended for patient use, and repackaging them into syringes that they then sold and distributed. This behavior violated multiple regulations and ended up costing ABC hundreds of millions of dollars in criminal and civil fines.[348] Shareholders sought inspection of internal documents and filed a detailed complaint. The court rejected defendants' motion to dismiss, finding multiple pleading-stage indications of red flags that were ignored by ABC's directors.[349]

Then, a new director joined ABC's board and was appointed as a one-man committee to independently investigate the failure-of-oversight allegations.[350] The one-man SLC concluded that pursuing *Caremark* claims would not be in the company's best interests and moved to dismiss the case. Plaintiffs objected, arguing that (1) the director was not independent (due, for example, to his social ties with former directors who faced *Caremark* liability), and (2) his investigation was not reasonable. The court's decision to reject plaintiffs' objections and grant the SLC's motion to dismiss may look ordinary to those steeped in corporate law[351]: It applies the usual *Zapata* framework to credit the SLC's independence and reasonableness and concludes that the dismissal of the claims is proper.[352]

But from a policy perspective, it is far from clear that the usual deference to SLCs should apply in *Caremark* settings. SLCs have two roles, namely, (1) finding out what happened and (2) deciding whether what happened merits pursuing litigation. And in both roles, SLCs' value is more limited in *Caremark* claims than in other corporate law claims.

Consider fact-finding first. Proponents of SLCs note that they often produce information not otherwise available, thereby providing a better basis for directors and judges to decide whether to pursue or settle a claim.[353] SLCs' investigations add

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346. SLCs are meant to allow boards to have independent directors (who were not implicated in the misconduct in question) investigate whether it is in the best interests of the company to continue pursuing claims that survived the motion to dismiss. In other words, SLCs are used to reclaim the board's power to decide on its legal claims. *See* C.N.V. Krishnan, Steven Davidoff Soloman & Randall S. Thomas, *How Do Legal Standards Matter? An Empirical Study of Special Litigation Committees*, 60 J. CORP. FIN. 1, 3 (2020).

347. Teamsters Loc. 443 Health Servs. & Ins. Plan v. Chou, No. 2019-0816-SG, 2023 WL 7986729, at *1–2 (Del. Ch. Nov. 17, 2023), *aff'd sub nom.* Teamsters Loc. 443 Health Servs. & Ins. Plan v. Cencora, Inc., No. 2019-0816, 2024 WL 429773 (Del. Sept. 20, 2024).

348. *Id.*

349. *Id.* at *25–27.

350. *Id.* at *25. For a critique of one-man SLCs, see Elizabeth Pollman, *Strengthening Special Committees*, 9 U.C. DAVIS BUS. L.J. 137, 139 (2008).

351. To illustrate, the indomitable Chancery Daily described the decision as not breaking much precedential ground in that regard. *The Long Form*, THE CHANCERY DAILY (Legist Media, Wilmington, Del.), Nov. 28, 2023.

352. *Chou*, 2023 WL 7986729, at *25, *32–34; Zapata Corp. v. Maldonado, 430 A.2d 779 (Del. 1981).

353. *See, e.g.*, Érica Gorga & Michael Halberstam, *Litigation Discovery and Corporate Governance: The Missing Story About the Genius of American Corporate Law*, 63 EMORY

value by pushing "fact investigation, which usually takes places during discovery, into the prediscovery phase," or so the argument goes.[354] But the new mode of *Caremark* litigation is already front-loaded and rich in information. Even in the pre-filing stage, directors and judges can usually lean on regulatory enforcement actions to learn what went wrong with the company. Following pre-filing discovery (Section 220), directors and judges usually have a good sense of what directors knew about the problem in real time. By the time an SLC is appointed, the record usually contains encyclopedic complaints and judicial decisions on Section 220 actions and motions to dismiss. SLCs' investigations of failure-of-oversight claims are thus likely to add less informational value than they could in other types of claims.

Once facts are gathered, SLCs decide whether it is in the best interests of the company to pursue claims based on the facts. In that respect as well, *Caremark* claims are different, because they often implicate broader societal interests. Other common derivative claims, such as self-dealing, revolve around agency problems and allocating money and power within the corporation. *Caremark* claims, by contrast, often implicate behavior that harms third parties. While it may make sense to let independent directors decide whether it is in the company's best interests to go after those who enriched themselves at the company's expense, it makes less sense to let directors decide whether it is in the company's best interests to go after those who enriched the company at the expense of third parties. *Caremark* claims should not be treated as business decisions.[355] If the law does not allow directors to make a business decision that violates laws,[356] why should the law allow a committee comprised of directors to make a business decision not to pursue claims against fiduciaries who decided to violate laws?

The purported advantages of SLCs are therefore attenuated in *Caremark* contexts. In general, relying on SLCs trades off "superior ability to identify meritless cases ex post" for "reduced deterrence ex ante."[357] In *Caremark* settings, the informational advantage is more limited, and the deterrence disadvantage is more pronounced. Recognizing these dynamics should make courts scrutinize SLCs' conclusions more closely.

After the first drafts of this Article were circulated, Delaware's Supreme Court affirmed the Chancery's decision to defer to the SLC, without adding further comment.[358] I expect deference to SLCs to remain yet another area of *Caremark* law that could evolve.

L.J. 1383, 1448 (2013).

354. *Id.*

355. *Cf.* Quinn Curtis, *Information and Deterrence in Shareholder Derivative Litigation*, 23 AM. L. & ECON. REV. 395, 398 (2021) (noting that the case law considers derivative suits to be business decisions).

356. *In re* Massey Energy Co. Deriv. & Class Action Litig., No. 5430–VCS, 2011 WL 2176479, at *1 (Del. Ch. May 31, 2011).

357. Curtis, *supra* note 355, at 396.

358. Teamsters Loc. 443 Health Servs. & Ins. Plan v. Cencora, Inc., No. 2019-0816, 2024 WL 429773 (Del. Sept. 20, 2024).

D. Public Enforcement

Caremark and public enforcement go together: Almost all *Caremark* claims come on the heels of regulators' press releases or public enforcement actions (or private enforcement of noncorporate law claims). Unsurprisingly, the surge in *Caremark* claims has brought to the fore thorny questions regarding how decisions in noncorporate law forums affect *Caremark* litigation, and vice versa.

An oft-debated question is whether courts should stay *Caremark* litigation until the public enforcement action is decided. The argument for staying is two-pronged: (1) litigating *Caremark* claims before a public enforcement action ends could arguably hurt the company's chances of defending itself in the latter,[359] and (2) waiting for the public enforcement action to end before litigating *Caremark* could help inform decisions on the latter.[360] Still, as *Walmart* recently clarified, instead of staying the *Caremark* litigation for years until all public enforcement actions are resolved, corporate law courts can simply bifurcate the liability and damages phases by trying liability first and addressing the size of the trauma (which is a function of the outcome of public enforcement actions) within the later damages stage only if liability is established.[361]

In December 2023, Delaware's Supreme Court ruled in the AmerisourceBergen-opioid saga on the most important issue of first impression—how decisions in favor of the company in noncorporate law settings affect corporate law failure-of-oversight claims.[362] The case began with a protracted Section 220 action, which led to a highly detailed complaint that pled with particularity facts sufficient to create an inference of bad faith on the part of defendants.[363] But right before the Court of Chancery was going to reject the motion to dismiss, a West Virginia court ruled in favor of ABC in a public nuisance case.[364] The West Virginia court conducted a two-month trial on the merits and found that ABC's anti-diversion efforts complied with relevant regulations.[365] The Chancery viewed this finding as pulling the rug out from under the shareholders' claims in the corporate law case: If the company did not violate laws, its directors cannot be liable for failing to oversee or for proactively affirming violations of law.[366] The Chancery therefore dismissed the case. Plaintiffs appealed, and Delaware's Supreme Court reversed the dismissal.[367]

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359. Horman v. Abney, No. 12290–VCS, 2017 WL 242571, at *5 n.10 (Del. Ch. Jan. 19, 2017).

360. *Walmart II*, No. 2021-0827-JTL, 2023 WL 3093500, at *51–52 (Del. Ch. Apr. 26, 2023).

361. *Id.*

362. *See Collis III*, 311 A.3d 773, 802, 806 (Del. 2023).

363. *See id.* at 780.

364. City of Huntington v. AmerisourceBergen Drug Corp., 609 F. Supp. 3d 408 (S.D. W. Va. 2022); *Collis II*, No. 2021-1118-JTL, 2022 WL 17841215 (Del. Ch. Dec. 22, 2022), *rev'd and remanded*, *Collis III*, 311 A.3d 773 (Del. 2023).

365. *City of Huntington*, 609 F. Supp. at 412; Collis *II*, 2022 WL 17841215, at *3.

366. *Collis II*, 2022 WL 17841215, at *3.

367. *Collis III*, 311 A.3d at 781–82.

The Delaware Supreme Court focused on whether to treat the West Virginia decision as a notice of what the law is or as a notice of what the facts are.[368] The Supreme Court decided that it is the latter, which meant that, according to Delaware's rules of evidence, the Chancery should not have taken adjudicative notice of the West Virginia decision unless the underlying facts were undisputed.[369] In other words, the Delaware Supreme Court overturned based on judicial notice rules.

For our purposes, the more important point is the generalizable one: Delaware courts are not necessarily bound in *Caremark* cases by other courts' determinations of how the board behaved. One could criticize the Delaware Supreme Court's approach, arguing that it may turn Delaware into the "backup regulator" for all regulators.[370] Delaware courts should accept whatever specialized regulators, who enjoy better information and expertise, decide, or so the argument goes. Further, Delaware judges do not enjoy the bandwidth to second-guess regulators' decisions, given the huge caseloads that they handle.

This criticism is exaggerated on both counts. For one, *AmerisourceBergen* did *not* overrule the regulator. In fact, the relevant regulators (of drug diversion) have long established that ABC failed to maintain controls required by law.[371] Their regulatory decisions were the impetus behind the entire corporate law case here.[372] If any court overruled the regulator, it was the West Virginia one. The question before the corporate law court was whether bad corporate governance was behind ABC's regulatory failures. This is a question on which no one has better information and expertise than a Delaware judge looking at a record developed over a multi-year pre-filing investigation. The administrative-burden argument is not convincing either. The question is where to allocate the Court of Chancery's scarce resources. In *Caremark* cases, the Chancery is ruling on generalizable issues regarding corporate behaviors that greatly impact society. This is arguably a much better use of resources compared to the disclosure-only settlements that once flooded the court or the one-off dyadic contractual disputes and restrictive covenants that are currently flooding the court.[373]

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368. *Id.* at 797.

369. *Id.* at 798–802. In reality, the West Virginia decision was hardly undisputed: Plaintiffs immediately appealed it, and a seven-judge panel found it unpersuasive. Jeff Overley, *Landmark Opioid Opinion 'Not Persuasive,' W.Va. Panel Says*, LAW360 (Aug. 5, 2022, 8:41 PM), https://www.law360.com/articles/1518500/landmark-opioid-opinion-not-persuasive-w-va-panel-says [https://perma.cc/TF2J-LS62].

370. Ann Lipton, *AmerisourceBergen, and Who Decides?*, BUS. L. PROF BLOG (Dec. 29, 2023), https://lawprofessors.typepad.com/business_law/2023/12/amerisourcebergen-and-who-decides.html [https://perma.cc/4K4B-69T6]. *But see* Pollman, *supra* note 7, at 2028 (suggesting that corporate law's insistence on holding managers accountable for corporate lawbreaking serves the purpose of boosting corporate law's legitimacy in society).

371. Lebanon Cnty. Emps.' Ret. Fund v. AmerisourceBergen Corp., No. 2019-0527-JTL, 2020 WL 132752, at *2 (Del. Ch. Jan. 13, 2020), *aff'd*, AmerisourceBergen Corp. v. Lebanon Cnty. Emps.' Ret. Fund, 243 A.3d 417 (Del. 2020).

372. *Id.*

373. *See* Sunder Energy, LLC v. Jackson, 305 A.3d 723, 730–31 (Del. Ch. 2023); *The Long Form*, THE CHANCERY DAILY (Legist Media, Wilmington, Del.), Feb. 1, 2024 ("Delaware has created value by building a body of broadly applicable and well-rendered case law. One-shot-deal rulings on bespoke contracts contribute minimally to Delaware's unique

Finally, even if the West Virginia decision did create judicial notice that ABC was compliant with the law, it is not clear to me that the red-flags claims against ABC's directors should have been dismissed. After all, the evidentiary record contained ample pleading-stage indications that the board's failure to oversee diversion controls had already cost the company billions in legal fines and long-term reputational harm.[374] Even if ABC was superficially compliant, the record indicates at minimum a colossal failure on the part of the board to address mission-critical business risks.

E. Officers' Liability

In 2023, *McDonald's* clarified for the first time that corporate officers have oversight duties too.[375] Much like directors, officers must put in place a system that monitors noncompliance within their purview, react to obvious warning signs, and refrain from promoting a business plan that profits from lawbreaking. *McDonald's* is the rare corporate law decision that was covered by the popular press, and law firms reported that many of their clients called in to inquire about it.[376] Most of the hoopla revolved around the proclamation that officers' oversight duties exist. But for corporate legal scholars and practitioners, that was not necessarily news: Case law has long established that officers owe fiduciary duties of care and loyalty that are comparable to those of directors.[377] Practically, the different scope and the different procedural stance of officers' oversight duties relative to directors' duties are more important to decipher.

McDonald's highlighted several ways in which the scope of officers' oversight duties differs from that of directors' oversight duties. The board is the organ in charge of risk oversight across the company. As a result, directors' sphere of oversight responsibility is wide. Officers, by contrast, have a specific remit.[378] As a result, their oversight responsibility is cabined.[379] *McDonald's* was an easy case in that regard because the underlying misconduct was rampant sexual misconduct, and the officer in question was the chief people officer, whose remit is to ensure that the work environment does not become toxic.[380] One indicator to keep in mind for future cases is that *McDonald's* based its recognition of officers' oversight duties on the need to

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value proposition").

374. *See Collis II*, No. 2021-1118-JTL, 2022 WL 17841215 (Del. Ch. Dec. 22, 2022), *rev'd and remanded*, *Collis III*, 311 A.3d 773 (Del. 2023).

375. *McDonald's I*, 289 A.3d 343, 370 (Del. Ch. 2023).

376. For an example of media coverage, see Alison Frankel, *McDonald's Case is Wake-up Call for Corporate Execs – Botch Oversight, Risk Liability*, REUTERS (Jan. 26, 2023, 4:18 PM), https://www.reuters.com/legal/government/mcdonalds-case-is-wake-up-call-corporate-execs-botch-oversight-risk-liability-2023-01-26/ [https://perma.cc/L3V9-HGQS]. For an example of lawyers reporting interest from clients, see John L. Weinberg Center for Corporate Governance, *Delaware Law Update 040423*, YOUTUBE (Apr. 4, 2023), https://www.youtube.com/watch?v=Bxa5sRU0Fig (opening remarks of Gary A. Bornstein).

377. Gantler v. Stephens, 965 A.2d 695, 708–09 (Del. 2009).

378. *McDonald's I*, 289 A.3d at 370.

379. *Id.* at 369.

380. *Id.* at 378.

ensure that officers report red flags upward to the board.[381] From that, we can deduce that the officers who are more likely to be implicated in *Caremark* claims are those who report directly to the board.

Later in 2023, *Segway* showed how even when failures happen within an officer's specific remit, mounting a *Caremark* claim against said officer is a tall task.[382] Segway was purchased, and then the new management brought a claim against the old president for failure to address red flags concerning increases in receivables. Said president was, indeed, in charge of financials, and she did receive reports about increasing receivables.[383] Yet Vice Chancellor Will clarified that this is not what *Caremark* claims are made of.[384] Reports about potentially deteriorating business conditions are the kind of information that Chief Financial Officers (CFOs) and CEOs receive daily. Faulting officers in retrospect for not doing enough to respond to these daily reports would basically make officers guarantors against bad business decisions, which is neither feasible nor desirable.[385]

The one area in which plaintiffs may have an easier path to hold officers accountable is through business-plan claims. It is more likely to find indications of proactive involvement in shady business plans at the officer level than at the director level.[386] And courts could find it easier to infer officers' bad faith in such claims, if only because officers' compensation packages are usually more heavily tied to short-term stock performance.[387]

The second important aspect of *Caremark* claims against officers is the unique procedural stance and, in particular, demand futility considerations of such claims. The board is the organ normally responsible for deciding what claims to pursue. As a result, plaintiffs who wish to bring *Caremark* claims need to show that directors cannot be trusted with the decision to pursue the claims because they face the risk of *Caremark* liability.[388] When the *Caremark* claim is against officers, directors do not face liability and arguably *can* be trusted to decide for the company whether to pursue the claim. Indeed, the same *Boeing* decision that sustained information-systems and red-flags claims against directors dismissed these claims against officers, and not because the latter behaved properly.[389] In fact, *Boeing* painstakingly details how it was top management that quickly pushed the 737 MAX to the market, lied to the regulators, tried to shift blame to the (dead) pilots, and withheld

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381. *Id.* at 364–66; *see also* Omari Scott Simmons, *The Corporate Immune System: Governance from the Inside Out*, 2013 U. ILL. L. REV. 1131, 1160 (2013).

382. Segway Inc. v. Cai, No. 2022-1110-LWW, 2023 WL 8643017 (Del. Ch. Dec. 14, 2023).

383. *Id.* at *4.

384. *Id.* at *5.

385. *Id.*

386. *See* Uebler, *supra* note 86, at 200.

387. *Cf. In re* Massey Energy Co. Deriv. & Class Action Litig., No. 5430–VCS, 2011 WL 2176479, at *22 (Del. Ch. May 31, 2011) (arguing that independent directors have much weaker incentives to put profits above everything else).

388. DEL. CH. CT. R. 23.1; *see* United Food & Com. Workers Union v. Zuckerberg, 250 A.3d 862, 878 (Del. Ch. 2020), *aff'd*, 262 A.3d 1034 (Del. 2021).

389. *In re* Boeing Co. Deriv. Litig., No 2019-0907-MTZ, 2021 WL 4059934, at *36 (Del. Ch. Sept 7, 2021).

information from the board.[390] The only reason for letting officers off the hook was demand futility: Because no one argued that Boeing's directors are beholden to its officers, there was no reason not to leave the decision on whether the company should sue the latter to the former.[391]

Demand futility considerations thus make it practically harder to pursue *Caremark* claims against officers. But I believe that courts should rethink this approach. Going forward, courts should not automatically trust directors' judgments on whether to pursue failure-of-oversight claims against the company's officers. Top officers are usually in a position to point fingers to where the board was not behaving optimally on compliance. Accordingly, directors may have some concerns that a *Caremark* lawsuit against officers might generate documents and testimonies that would shed a problematic light on the directors' own behavior. Indeed, the same *Boeing* decision mentions the realistic possibility that pursuing derivative claims against the officers would have caused them to fight back and air dirty laundry in public.[392]

F. Third-Party Liability

I have focused thus far on the role that corporate directors and officers play in compliance. But corporate insiders—from directors to executive managers, to chief compliance officers and general counsels—rarely perform compliance tasks on their own.[393] They rather heavily rely on outside compliance advisors. Virtually every large law firm and accounting firm these days sell compliance services: from advising companies on how to design reporting systems to meet evolving regulatory demands, to conducting internal investigations and negotiating with regulators for leniency once wrongdoing has been uncovered.[394]

These outside compliance professionals play an important role in corporate compliance, yet they are rarely accountable for compliance failures. Indeed, a careful look at the origin story of successful *Caremark* cases reveals the same pattern: Directors are held accountable for remaining in the dark, yet the outside professionals who created the information environment in which directors operated are not. Blue Bell's directors heard a report from a third-party sanitation auditor suggesting that their plants were fine.[395] And then the listeria outbreak happened. ABC's directors heard a report from an outside law firm suggesting that the company's anti-diversion program worked fine.[396] We know in retrospect that it did not. In these examples and others,[397] third-party assurances played a role in keeping directors in the dark

390. *Id.* at *29–31.

391. *Id.* at *36.

392. *See id.* at *35–36.

393. Eckstein & Shapira, *supra* note 29, at 478–89.

394. *Id.*

395. Marchand v. Barnhill, No. 2017-0586-JRS, 2018 WL 4657159, at *6 (Del. Ch. Sept. 27, 2018), *rev'd*, 212 A.3d 805 (Del. 2019).

396. *Collis II*, No. 2021-1118-JTL, 2022 WL 17841215, at *9 (Del. Ch. Dec. 22, 2022), *rev'd and remanded*, *Collis III*, 311 A.3d 773 (Del. 2023).

397. Eckstein & Shapira, *supra* note 29, at 487.

regarding the state and causes of noncompliance. Yet these third parties were not even named as defendants in *Caremark* litigation.

Why was the surge in *Caremark* claims against directors and officers not matched with a surge of aiding-and-abetting claims against outside advisors? Part of the reason is doctrinal.[398] Aiding-and-abetting claims usually cannot coexist with information-systems claims. To prove aiding-and-abetting claims, plaintiffs first must prove a predicate breach of fiduciary duties. Yet the mere fact that the board hired outside compliance advisors is often indication enough that the board tried to address compliance (no predicate breach).[399] On paper, aiding-and-abetting claims could coexist with red-flags claims. For example, plaintiffs could argue that the outside compliance advisors colluded with the CEO or the general counsel and withheld critical information from the board, which in turn led to a failure to respond to red flags on the part of the board.[400] In reality, plaintiffs face an uphill battle in such settings, because they must clear not one but two very high evidentiary bars: showing bad faith on the part of directors and showing "knowing participation" on the part of outside advisors. Plaintiffs must thus marshal evidence about what outside advisors knew, what the advisors knew that the directors knew, and what discussions outsiders and insiders had in real time.[401]

However, a couple of 2023 decisions signaled that a change could be coming to this area of oversight duties as well. First, *Walmart* clarified the circumstances under which reliance on advice by others could fully protect directors from oversight liability.[402] To simplify, if directors are advised that the company is in compliance, they will probably be fully protected.[403] By contrast, if directors are advised that the company is currently not in compliance, but that the expected sanction for noncompliance is low, they will probably not be protected.[404] Going forward, directors and officers are likely to ask in real time for legal advice confirming that the company is in compliance. In turn, future defendants in oversight cases are likely to use such advice as a shield, and future plaintiffs are likely to attack the advice as blatant and flawed. As a result, we are likely to see public shareholders demand to inspect internal communications with the advisors in real time and then challenge the advisors' good faith in court.

Second, recognition of *officers'* oversight duties in *McDonald's* is likely to make litigation against outside compliance advisors more realistic going forward.[405] The reason is that outside compliance advisors usually work directly with top officers such as general counsels, chief compliance officers, or chief financial officers. Accordingly, when shareholders submit requests to inspect their company's books

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398. *Id.* at 489–507.

399. Marchand v. Barnhill, 212 A.3d 805, 823 (Del. 2019).

400. Enron's collapse is a case in point. *See, e.g.*, JOHN C. COFFEE, JR., GATEKEEPERS 26–32 (2006).

401. *In re* Columbia Pipeline Grp., Inc. Merger Litig., No. 2018-0484-JTL, 2021 WL 772562, at *53–55 (Del. Ch. Mar. 1, 2021).

402. Del. Code Ann. tit. 8, § 141(e) (2024); *Walmart II*, No. 2021-0827-JTL, 2023 WL 3093500, at *40 (Del. Ch. Apr. 26, 2023).

403. *See Walmart II*, 2023 WL 3093500, at *40.

404. *Id.* at *41.

405. *See* Eckstein & Shapira, *supra* note 29, at 490.

in order to investigate potential failure-of-oversight claims on the part of these officers, they are likely to come across work product of outside advisors and internal communications showing what the advisors knew, when they knew it, and what they did or did not do to stop the noncompliance. In other words, the prospect of claiming aiding-and-abetting breaches of officers' oversight duties is more likely to succeed than the prospect of claiming aiding-and-abetting breaches of directors' oversight duties.

G. Causation and Remedies

Since no *Caremark* case has gone to trial yet, the fundamental questions of how to assess causation and what remedies are available have not been addressed.[406] This is likely to change soon. As more cases survive the motion to dismiss, one of them is bound to continue to trial rather than settle early.[407] And with more cases surviving the motion to dismiss, more companies will appoint SLCs to reexamine *Caremark* claims.[408] SLCs' recommendations and judicial review of these recommendations tend to focus not just on what happened but also on whether the value of the "asset" (the derivative claim against directors) is worth its price (going through a full trial).[409] Entering the SLC stage thus directly implicates issues of causation and remedies.

When addressing causation and remedies, the courts will have to establish: (1) the elements for establishing liability; (2) the applicable form of causation; and (3) how to calculate damages.[410] For all three questions, the courts will have to determine who bears the burden of proof. By merging first principles in fiduciary law with *Caremark*-specific policy rationales, we can predict how courts are likely to approach each question.

The elements of a *Caremark* claim are a function of its nature as a breach of a duty of loyalty. A breach of oversight duties is unlike a common law tort, where plaintiffs must prove duty, breach, causation, and damages.[411] Instead, plaintiffs only

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406. City of Detroit Police & Fire Ret. Sys. *ex rel.* NiSource, Inc. v. Hamrock, No. 2021-0370-KSJM, 2022 WL 2387653, at *20 (Del. Ch. June 30, 2022).

407. As of this writing, the above-mentioned *AmerisourceBergen* case seems to be proceeding to trial. *See Collis III*, 311 A.3d 773, 802 (Del. 2023).

408. *See supra* Section V.C.

409. *Massey* itself touched on these issues because of its unique procedural stance: After the mining explosion, Massey agreed to a merger with another company. The merger would have extinguished the old company's shareholders' standing to pursue the derivative claims against directors and officers. Shareholders then filed a suit to enjoin the merger, arguing that the merger price did not reflect the value of these derivative claims. The court thus had to assess not just what happened but also the ultimate expected value of the claims. *In re* Massey Energy Co. Deriv. & Class Action Litig., No. 5430–VCS, 2011 WL 2176479, at *1–2 (Del. Ch. May 31, 2011).

410. *Hamrock*, 2022 WL 2387653, at *49.

411. *See, e.g.*, Cede & Co. v. Technicolor, Inc., 634 A.2d 345 (Del. 1993). More recently, Vice Chancellor Laster has resuscitated the notion that a breach of fiduciary duty is "an equitable tort." J. Travis Laster & Michelle D. Morris, *Breaches of Fiduciary Duty and the Delaware Uniform Contribution Act*, 11 DEL. L. REV. 71, 71 (2010); *see also* Jessica Erickson, *Investing in Corporate Procedure*, 99 B.U. L. REV. 1367, 1398 n.156 (2019). Chief Justice Strine, in his capacity as Vice Chancellor, has also explored this notion. Hampshire Grp., Ltd.

need to show the first two elements, namely, that a duty exists, and that the duty was breached.[412] Once they do, the burden of proof shifts to defendants.[413] This simple observation can escape courts and lead to premature dismissals of *Caremark* claims. To illustrate, *Rojas* dismissed red-flags claims while noting that plaintiffs must show at that stage not only that directors knew about the problem and failed to address it, but also that directors' failures "resulted in damage to the corporation."[414] Showing damages may indeed become very relevant in later stages, but it is less relevant in the demand-futility stage, where the focus is on pleading facts that create an inference of directors facing likelihood of being held liable (regardless of how much directors are likely to ultimately pay).[415]

Once plaintiffs establish breach, the focus turns to causation. Causation in *Caremark* cases will be determined as a function of the remedy that plaintiffs seek.[416] Breaches of the fiduciary duty of loyalty give rise to gain-based remedies.[417] That is, disloyal fiduciaries are liable not just to compensate beneficiaries for their losses, but also to account for all the gains that they realized through their breach.[418] Consider, for example, a scenario in which plaintiffs seek to claw back performance-based compensation that directors and officers received while the company was skirting regulations. In such a scenario, plaintiffs need not prove causation.[419] However, the more realistic scenario is that plaintiff attorneys will seek loss-based remedies, if only because of the size of the bounty: The recovery and the size of the pocket to recover from (Directors and Officers insurance)[420] are usually larger for loss-based remedies.

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v. Kuttner, No. 3607-VCS, 2010 WL 2739995, at *54 (Del. Ch. July 12, 2010).

412. Frederick Hsu Living Tr. v. Oak Hill Cap. Partners III, L.P., No. 12108-VCL, 2020 WL 2111476, at *29 (Del. Ch. May 4, 2020).

413. *Cede & Co.*, 634 A.2d at 371; Holger Spamann, *PLX, Burden of Proof for Damages, and the Internal Logic of Delaware Law*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Nov. 30, 2018), https://corpgov.law.harvard.edu/2018/11/30/plx-burden-of-proof-for-damages-and-the-internal-logic-of-delaware-law/ [https://perma.cc/48EF-HRNH].

414. Rojas *ex rel.* J.C. Penney Co. v. Ellison, No. 2018-0755-AGB, 2019 WL 3408812, at *10 (Del. Ch. July 29, 2019).

415. *Cf.* Pace, *supra* note 254, at 12–13 (discussing cases where the courts awarded attorneys' fees even when the breach of fiduciary duty did not result in measurable damages).

416. *See* Deborah A. DeMott, *Causation in the Fiduciary Realm*, 91 B.U. L. REV. 851, 864–66 (2011).

417. *See* Paul B. Miller, *Justifying Fiduciary Remedies*, 63 U. TORONTO L.J. 570, 570–72 (2013).

418. *Id.*

419. *See In re* Columbia Pipeline Grp., Inc. Merger Litig., 299 A.3d 393, 485 (Del. Ch. 2023).

420. On the role of insurers in board oversight efforts, see generally Angela N. Aneiros & Karen E. Woody, Caremark*'s Butterfly Effect*, 72 AM. U. L. REV. 719 (2023).

When plaintiffs seek damages, they must show causation.[421] At that stage, however, courts are likely to adopt a plaintiff-friendly approach.[422] Considerations of equity and deterrence militate against allowing fiduciaries to escape liability for being disloyal.[423] As a result, once a *Caremark* breach is established, the courts will resolve uncertainties in causation and damages against defendants.[424]

The final step is to calculate damages.[425] Here the biggest issue is whether to deduct the profits that accrued to the company from noncompliance. Judicial decisions and academic commentary have long suggested that a "net-loss" rule should apply.[426] According to the net-loss rule, if directors deliberately ignore or affirm a business plan of profiting from lawbreaking, they will pay damages only when the losses to the company from being caught outweigh the gains from lawbreaking. Yet applying the net-loss rule in our context is anachronistic and bad policy. The net-loss rule is antithetical to what the revamped business-plan theory stands for: It cuts off an accountability mechanism (namely, plaintiffs' incentives to pursue claims) based on the *outcome* of bad-faith behavior.[427] Proponents of the net-loss rule argue that, without it, companies and shareholders will enjoy a windfall: They will profit from lawbreaking at the outset and then shift the costs of lawbreaking to directors and officers after the fact.[428] But it seems that there are more creative ways to deal with the windfall problem other than letting bad-faith fiduciaries off the hook. For example, Cynthia Williams has suggested putting derivative recovery into funds meant to compensate those who were injured.[429]

VI. IMPLICATIONS

Thus far, this Article has largely sung the praises of the new *Caremark* era. But it should not be read as a paean. This Article explained why the revamped mode of oversight duties is an improvement over the doctrine's old dormant version. Still, one should not confuse this relative argument (the new version is better than the old one) with an absolute argument (the new version is socially optimal). This Part

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421. The academic literature and case law offer little guidance on what form of causation applies in this context. One could argue that once plaintiffs seek compensatory damages, normal but-for causation applies. *See, e.g.*, DeMott, *supra* note 416, at 853. Others can argue that, since a *Caremark* breach is predicated on bad faith (a mental state), the less stringent substantial-factor causation should apply, just as it does in intentional torts. *Id.* at 865.

422. Metro Storage Int'l LLC v. Harron, 275 A.3d 810, 859 (Del. Ch. 2022).

423. Gotham Partners, L.P. v. Hallwood Realty Partners, L.P., 817 A.2d 160, 176 (Del. 2002).

424. *Id.*; *see also In re* Primedia Inc. Deriv. Litig., 910 A.2d 248, 262 (Del. Ch. 2006).

425. Commentators have criticized the fit between how courts define a breach of oversight duties (loyalty) and what types of remedies are usually sought in failure-of-oversight claims. Breaches of loyalty are typically compensated by invalidation or disgorgement, whereas failure-of-oversight claims are compensated as a function of the harm caused by directors' bad faith. *See* Andrew W. Winden, Caremark*'s Climate Failure*, 74 HASTINGS L.J. 1167, 1176 (2023).

426. Williams, *supra* note 260, at 1308 n.152 (compiling references).

427. *See* Uebler, *supra* note 86, at 213 n.68.

428. *Cf.* Greenfield, *supra* note 86, at 1296–99.

429. Williams, *supra* note 260, at 1308 n.152.

spotlights several distinct disadvantages of the new *Caremark* era and outlines concrete steps that courts could take to further advance the doctrine.

Section A weighs the disadvantages and advantages of the revamped mode of oversight duties. The main disadvantages are ramping up the costs of pre-filing discovery, aggravating the risk of judicial hindsight bias, and disincentivizing companies' investment in remedial measures. The main advantages are counterbalancing the flaws of public enforcement and facilitating market discipline. Section B highlights lessons for courts, such as how to treat regulatory rent-seeking when assessing business-plan claims and how to factor company size when assessing red-flags claims.

A. Overall Desirability

1. Disadvantages

The biggest drawback of the revamped mode of oversight duty litigation is that it increases the risk of judicial hindsight bias.[430] When challenging business decisions, the well-tested mechanism that guards against hindsight bias is the business judgment rule.[431] But the business judgment rule does not apply in oversight duty litigation when the claim is one of omission.[432] The way that courts in oversight duty litigation have traditionally safeguarded against hindsight bias is by refraining from telling directors what information they *should* have collected leading up to the corporate trauma.[433] Instead, courts have interfered only in the rare cases where they had indications that directors *actually knew*—but neglected to act on—that information.[434] This is no longer the case. Courts today are increasingly willing to fault directors for what they should have known. Part II focused on the bright side of this development, namely, combatting willful blindness.[435] This Part shifts focus to the downside.

When sophisticated plaintiff attorneys gain access to mountains of internal documents, they are bound to locate instances where board oversight can be framed in a negative light. And when plaintiffs submit encyclopedic *Caremark* complaints to courts, judges have a hard time resisting the temptation to scrutinize the reasonableness of directors' decisions regarding what information to collect or react to (especially when the catastrophic consequences of an opioid crisis or airplane crashes are known).

A second drawback of the new mode of oversight duties is the (dis)incentives it creates for future boards to invest in post-fact remedial actions. To illustrate, let us

430. For a similar criticism of the problem of false positive scienter determinations in securities litigation, see Amanda M. Rose, *The Multienforcer Approach to Securities Fraud Deterrence: A Critical Analysis*, 158 U. PA. L. REV. 2173, 2194 (2010).

431. Bainbridge, *supra* note 133, at 114 & n.182.

432. *Id.* at 99.

433. Robert T. Miller, *Wrongful Omissions by Corporate Directors:* Stone v. Ritter *and Adapting the Process Model of the Delaware Business Judgment Rule*, 10 U. PA. J. BUS. & EMP. L. 911, 932 (2008).

434. *Id.*

435. *See supra* Part II.

revisit *Boeing* and *Walmart*. Following the second crash, Boeing's board took actions to supposedly shore up its commitment to safety, such as establishing a specific committee tasked with overseeing airplane safety. But instead of viewing these actions as an indication that the board reacted to red flags, the court viewed them as an indication that the board breached its information-systems duties (that is, that the board did not have a system of monitoring air safety prior to these changes). Walmart agreed to settle a nationwide opioid litigation in 2022.[436] While the company denied any liability, it agreed to implement extensive revisions to its anti-diversion procedures and policies.[437] The agreement to implement changes was then used against Walmart's directors and officers in the 2023 oversight duty litigation, as an indication that prior to 2022 the company did not have proper anti-diversion controls.[438]

Using remedial actions after harm occurred as evidence that directors could have done more before the harm occurred is problematic.[439] It discourages corporate decision-makers from taking steps to improve the situation.[440] Following *Boeing*, directors may be less willing to take steps to improve safety. Following *Walmart*, directors may be less willing to agree to behavioral changes when their company enters settlements. Instead, directors will push companies to negotiate with public enforcers by offering higher settlement amounts. While behavioral changes can be used against directors and officers in subsequent *Caremark* litigation, higher settlement amounts come out of shareholders' pockets.

Another drawback of the new mode of oversight duties is that it front-loads the costs of litigation. The emphasis on pre-filing discovery and detailed complaints has consumed sizeable resources of the demanding shareholder, the company, and the courts. Section V.A explained why this may be a feature rather than a bug in *Caremark* cases,[441] but we also have to consider the possibility of plaintiffs using the threat of protracted pre-filing discovery as leverage to extract meritless settlements.

2. Advantages

Parts II–IV have flushed out the different ways in which the oversight duty doctrine can improve corporate governance. As currently construed, the doctrine facilitates upward flows of information inside large corporations, mitigates attempts to engage in window dressing, and reduces short-termist incentives to earn quick profits by skirting regulations. This Part highlights the ways in which the doctrine counterbalances the flaws of noncorporate enforcement mechanisms.

First, *Caremark* nicely balances the flaws of public enforcement.[442] Perhaps the most glaring problem of public enforcement is its inability to hold top-level

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436. *Walmart II*, No. 2021-0827-JTL, 2023 WL 3093500, at *28 (Del. Ch. Apr. 26, 2023).

437. *Id.*

438. *Id.* at *40.

439. Jeffrey J. Rachlinski, *A Positive Psychological Theory of Judging in Hindsight*, 65 U. CHI. L. REV. 571, 617–18 (1998).

440. *Id.* at 618.

441. *See supra* Section V.A.

442. On the flaws of public enforcement, see Carliss Chatman & Tammi S. Etheridge, *Federalizing* Caremark, 70 UCLA L. REV. 908, 927–30 (2023).

individuals accountable.[443] Derivative oversight duty actions, by their nature, emphasize just that: individual accountability. In its revamped mode, *Caremark* places powerful investigatory tools (Section 220) in the hands of sophisticated bounty hunters (institutional investors and their attorneys) and promises them a hefty bounty if they locate damning evidence on the role that directors and officers played in the trauma. And the emphasis that *Caremark* litigation puts on better paper trails—treating no documentation or redactions as a pleading-stage indication against defendants—can help public enforcers hold individuals to account by creating a traceable record of who knew what and when.

As another example, consider public enforcement's susceptibility to regulatory capture. Large companies often invest significant resources in attempts to influence regulators, such as by hiring former regulators to negotiate with current ones. The opioid cases provide ample illustrations. From 2000–2018, the Drug Enforcement Administration (DEA) sent dozens of letters of admonition to Walmart for its lax dispensing practices.[444] Walmart apparently ignored them. Once lawsuits against it started piling up, Walmart recruited "the highest levels of the DOJ" and "its friends in Washington" to quash indictments and civil complaints against the company.[445] AmerisourceBergen similarly stalled regulators for years, and then once regulators started calling it out for lax anti-diversion controls, the company hired a thirty-year DEA veteran to deal with current DEA regulators.[446] Private litigation in corporate law increases the costs for companies of capturing the regulatory apparatus and is much less susceptible to influence campaigns.[447]

A second advantage of oversight duty litigation is that it facilitates better market (reputational) discipline of corporate misbehavior. Scholars often refer to reputational concerns as a force that disciplines companies and individual managers.[448] But these scholars too often suffer from indefensible optimism about how reputation markets work. When left to its own devices, the market often has a hard time discerning how things happened and whether past events are indicative of rotten company culture or just one-off mistakes. To illustrate, recall that Boeing, Facebook, and Blue Bell initially managed to control the way that their respective debacles were framed in the media.[449]

The new mode of oversight duty litigation helps the market by injecting objective information to which market actors were not privy (such as internal company documents discovered in Section 220 actions), and providing interpretations by well-

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443. *See generally* JOHN C. COFFEE, CORPORATE CRIME AND PUNISHMENT: THE CRISIS OF UNDERENFORCEMENT (2020) (noting that not a single top executive has been prosecuted in the largest corporate debacles of the past decade and offering various explanations); Samuel W. Buell, *The Responsibility Gap in Corporate Crime*, 12 CRIM. L. & PHIL. 471, 490 (2018).

444. *Walmart I*, 294 A.3d 65, 80 (Del. Ch. 2023).

445. *Walmart II*, No. 2021-0827-JTL, 2023 WL 3093500, at *23 (Del. Ch. Apr. 26, 2023).

446. *Collis II*, No. 2021-1118-JTL, 2022 WL 17841215, at *7–8 (Del. Ch. Sept. 23, 2022), *rev'd and remanded*, *Collis III*, 311 A.3d 773 (Del. 2023).

447. *See, e.g.*, Renee M. Jones, *Dynamic Federalism: Competition, Cooperation and Securities Enforcement*, 11 CONN. INS. L.J. 107, 122 (2004).

448. *See generally* Eugene F. Fama, *Agency Problems and the Theory of the Firm*, 88 J. POL. ECON. 288 (1980).

449. *See supra* Section I.A.

respected independent arbiters (Delaware judges). *Caremark* opinions often compare the conduct of the company in question to that of its industry peers. The opioid decisions, for example, repeatedly emphasized that other distributors fared much better in terms of identifying and reporting suspicious opioid orders relative to Walmart and AmerisourceBergen.[450] Such "benchmarking" is especially valuable for reputation judgment purposes.[451]

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All in all, there are plenty of reasons to like the new developments in oversight-duty litigation. To be sure, corporate fiduciary duty litigation suffers from serious flaws, but so does every other mechanism for curbing corporate illegality. What matters is not how each mechanism works in isolation, but rather how the different mechanisms (public enforcement, internal compliance systems, market discipline, and private litigation) work in tandem. There exist strong indications that the recent developments in *Caremark* litigation allow this mechanism to nicely compensate for the flaws of the other abovementioned mechanisms.

The main worry is that the pendulum has swung too far, in the sense that the scope of *Caremark* claims is constantly expanding.[452] While this criticism has merit, I believe it is exaggerated, if only because it does not account for the temporal effects of *Caremark*. *Caremark* is different from other corporate law claims: When corporate law courts rule on how to design a merger deal, corporate actors can immediately adjust the next deal accordingly. By contrast, when corporate law courts rule on how to engage in oversight, corporate actors cannot change how they oversaw risks over the past decade. Indeed, the slew of recent cases after *Marchand* (2019) all implicated corporate behavior that goes back to the early 2010s. Boards today are already focusing more than ever on compliance and meticulously document compliance discussions. The rate of successful *Caremark* claims is therefore unlikely to keep increasing, and for the right reason: namely, on-the-ground improvements in board oversight.

B. Concrete Applications

The framework developed here can be used to highlight areas of unsettled law or wrongly decided law, and to suggest relatively easy fixes that courts can apply. Consider the following two.

1. Regulatory Influence-Seeking

Business-plan theory seeks to discourage attempts to skirt regulations. But how would corporate law treat attempts to influence regulators? To concretize, consider two scenarios. In scenario A, a company decides to pollute the environment because

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450. *Walmart I*, 294 A.3d 65, 81 (Del. Ch. 2023).

451. Assaf Jacob & Roy Shapira, *An Information-Production Theory of Liability Rules*, 89 U. CHI. L. REV. 1113, 1115, 1126 (2022).

452. *See generally* Stephen M. Bainbridge, *Don't Compound the* Caremark *Mistake by Extending it to ESG Oversight*, 77 BUS. LAW. 651 (2022).

the fines for polluting are lower than the costs of investing in abatement. In scenario B, the company pollutes the environment but because it invested in influencing the regulator, no sanction applies. In scenario A, the company's directors and officers will probably be liable under the business-plan theory. In scenario B, it is not clear that the business-plan theory applies. In fact, in *City of Birmingham Retirement & Relief Systems v. Good*, Delaware's Supreme Court let directors off the hook in a very similar scenario (polluting while influencing the regulator to dilute the sanction for polluting).[453] It should be noted, however, that *Good* was decided in 2017, predating the resurgence of oversight duties. I believe that *Good* was wrong when it was decided, and that it does not reflect how courts will decide today.

The case started when Duke Energy's pipe ruptured, spilling toxic wastewater into a nearby river.[454] Duke had to pay a $100 million fine, and shareholders filed a derivative suit against the company's directors. The Delaware Supreme Court dismissed the suit despite Chief Justice Strine's dissent. The main point of contention was how to treat the special relationships that Duke had with environmental regulators. To the majority, the "cozy" relationships with regulators did not amount to bad faith, given that shareholders did not prove illegal corruption.[455] For Chief Justice Strine, by contrast, these relationships provided ample pleading-stage indications of bad faith: The company financed the campaign of the political overseer of the environmental regulator and then utilized this connection to preempt citizen suits.[456]

Good is bad law and bad policy. To illustrate why *Good* is bad law, let us return to the 2023 *Walmart* decision. The *Walmart* decision explicitly considered a scenario where corporate decision-makers make an informed decision to violate laws because they count on a low likelihood of enforcement, and clarified that such behavior qualifies as bad faith.[457] That was what Duke's managers did: They did not lobby the regulator to change the law. They ignored existing laws and lobbied the regulator to get away with polluting without suffering sanctions.

Letting directors take such an approach is also bad policy. Saying otherwise would amount to embracing the "efficient breach of regulations" approach, which views the expected sanction as the be-all and end-all of corporate compliance.[458] The company's investment in compliance should be capped by the expected sanction for lawbreaking, or so the efficient-breach argument goes. But cases such as *Good* illustrate that the expected penalty does not necessarily reflect the social harms from violating pipeline safety. Instead, these cases reflect companies' ability to influence regulators. As a result, an approach that focuses on the expected sanction may lead to suboptimal compliance. *Good*'s majority opinion incentivizes corporate decision-makers to invest company resources in socially wasteful regulatory rent-seeking, instead of investing resources in socially beneficial abatements and safer technologies.

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453. 177 A.3d 47, 50–54 (Del. 2017).
454. *Id.* at 50.
455. *Id.* at 59–60, 64 & n.106.
456. *Id.* at 67 (Strine, C.J., dissenting).
457. *Walmart II*, No. 2021-0827-JTL, 2023 WL 3093500, at *34 (Del. Ch. Apr. 26, 2023).
458. Williams, *supra* note 260, at 1268.

Going forward, corporate law courts should reject *Good*'s approach and adopt a two-pronged approach to regulatory influence-seeking: Efforts to influence regulatory enforcement give rise to *Massey* claims, while efforts to influence regulatory norm-setting do not. Flouting existing law is a breach of fiduciary duty while lobbying to get the law changed is not.[459] This distinction can also be justified by the differential information costs: It is easier for corporate law courts to assess behavior against a clear benchmark (an existing law) than to assess whether a given noncorporate law is optimal (and therefore should not be lobbied).

2. Company Size and Red-Flags Claims

How should company size factor into assessing *Caremark* claims? Historically, size served to *dilute* the prospect of *Caremark* liability: The *Allis-Chalmers* court based its refusal to impose liability on the presumed inability to monitor misconduct in massive corporations.[460] The court described in great length Allis-Chalmers's sheer number of employees (over 30,000) and plants (twenty-four) before concluding that it is not practicable to expect directors in such large companies to know when some employees engage in misconduct.[461]

But decisions from the past couple of years have not shied away from scrutinizing oversight in giant corporations.[462] In 2020, *Chou* sustained oversight claims against pharmaceutical giant AmerisourceBergen, regarding drug packaging violations in one of the company's many subsidiaries that involved only a tiny fraction of its total revenue.[463] In 2021, *Boeing* sustained claims against directors of a company with 140,000 employees.[464] And in 2023, *Walmart* did so against the biggest retailer.[465]

Still, it would be wrong to assume that company size plays no factor in *Caremark* claims these days. To illustrate, consider *Hamrock*, which examined the responsibility of directors of a big gas holding company for pipeline safety problems in one its many subsidiaries. The court explained that repeated past violations across the company's subsidiaries could not count as red flags for purposes of putting directors on notice of a concrete problem in the Massachusetts subsidiary where the explosion in question happened.[466] To generalize, problems in one area of a giant company will generally not count as red flags for traumas in another part.

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459. *In re* Massey Energy Co. Deriv. & Class Action Litig., No. 5430–VCS, 2011 WL 2176479, at *21 (Del. Ch. May 31, 2011).

460. Graham v. Allis-Chalmers Mfg. Co., 188 A.2d 125, 129 (Del. 1963).

461. *Id.* at 128.

462. *See* Mariana Pargendler, *The New Corporate Law of Corporate Groups* 27 (Eur. Corp. Governance Inst., Working Paper No. 702/2023), https://ssrn.com/abstract=4412997 [https://perma.cc/DV6A-6K6L].

463. Teamsters Loc. 443 Health Servs. & Ins. Plan v. Chou, No. 2019-0816-SG, 2020 WL 5028065, at *2–5 (Del. Ch. Aug. 24, 2020).

464. *In re* Boeing Co. Deriv. Litig., No. 2019-0907-MTZ, 2021 WL 4059934 (Del. Ch. Sept. 7, 2021); BOEING, THE BOEING COMPANY 2021 ANNUAL REPORT 1 (2022), https://s2.q4cdn.com/661678649/files/doc_financials/2021/ar/The-Boeing-Company-2021-Annual-Report.pdf [https://perma.cc/RP7V-2GQA].

465. *Walmart II*, No. 2021-0827-JTL, 2023 WL 3093500 (Del. Ch. Apr. 26, 2023).

466. City of Detroit Police & Fire Ret. Sys. *ex rel.* NiSource, Inc. v. Hamrock, No. 2021-

While *Hamrock*'s approach seems intuitive, there exists a strong policy argument against it. I explained elsewhere that super-large corporations have an accountability problem: Top decision-makers have stronger incentives and better ability to remain willfully ignorant relative to their counterparts in mid- and small-sized corporations.[467] Against this backdrop, corporate law's oversight duties may be the only viable mechanism for ensuring greater involvement of top management in oversight of compliance inside giant corporations. Going forward, courts will need to rethink how to balance the doctrine: On the one hand, even the most public-spirited and expert director cannot oversee everything that is going on inside giant corporations; on the other hand, granting directors in giant corporations a get-out-of-*Caremark*-free card is not advisable.

CONCLUSION

It is hard to think of a major corporate debacle involving a large American company over the past few years that did *not* turn out to be an oversight duty case. The resurgence of oversight duties has several causes. The immediate causes are the two-pronged shift in corporate law courts' approach: increased willingness to fault directors for constructive knowledge, and increased willingness to grant shareholders access to internal company documents. The underlying causes are the two biggest developments in corporate governance over the past decades, namely, compliance and ESG. Companies are facing increased societal and regulatory demands, and are pouring resources into internal programs meant to detect and prevent wrongdoing. When corporate compliance fails, shareholders and regulators wish to hold those at the top accountable.

The rapid resurgence of oversight duties has brought to the fore numerous thorny legal questions. Delaware courts have been wrestling with setting the parameters of the duties and applying them to ever-evolving compliance risks. This Article offered a conceptualization of the doctrine that sees the forest for the many new trees. It refined the doctrine, harmonized the seemingly conflicting treatment of key concepts in it, and highlighted the public policy implicated in the doctrine.

Delving into the oversight duty doctrine also provided important lessons about how corporate law works more generally. It illustrated how corporate law litigation is heavily front-loaded, with all the action taking place at the pre-filing stage. It showed that corporate law affects corporate behavior indirectly, by shaping norms and reputations in the business community. And it highlighted corporate law's view of business companies' role in society and the (loose) limits that corporate law puts on shareholder wealth maximization.

As oversight duties go through their exploratory phase, new compliance dynamics keep coming up and challenging the contours of the doctrine. It seems safe to say that the next big challenge will be AI-based monitoring. More and more companies are implementing board-level AI monitoring these days.[468] Such systems detect anomalies in large-scale data and generate predictions about suspicious conduct,

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0370-KSJM, 2022 WL 2387653, at *1 (Del. Ch. June 30, 2022).

467. Shapira, *supra* note 182, at 218.

468. Arlen, *The Compliance Function*, *supra* note 23, at 28.

which are reported to the board.[469] Going forward, this means that, in almost every future corporate debacle, plaintiffs will be able to point in hindsight to AI-generated warning signs, and the question for courts will be how to discern which of these warnings constitute red flags and how the board should have addressed them.

The upshot is clear: The oversight duty doctrine is not going away anytime soon and will continue to play an important role in corporate behavior. Some of the key issues described here—such as deference to the company's internal investigations—are pending on appeal. Other key issues, such as whether it is permissible to lie in order to preserve viewers (as in the Fox News case), are just making their way through trial courts. Practitioners and judges will thus continue to push the *Caremark* envelope over the next few years. This Article represents a step toward understanding the what and the why of the doctrine.

469. *Id.*

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