Splitting Caremark's Atom

Law Working Paper N° 951/2026
August 2026

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ECGI Working Paper Series in Law

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Abstract

Corporate law does more than police managers for investors. Through the fiduciary duty of oversight, it also enlists boards and shareholder plaintiffs in promoting corporate obedience to public law. Delaware has fused those two projects—policing agency costs and facilitating public ordering—into a single standard: an unstable structure we call Caremark's "atom." The atom explains a central doctrinal puzzle. Courts generally treat a violation of law as a prerequisite for oversight liability, leaving even catastrophic failures to monitor ordinary business risks beyond Caremark's reach. Yet they also screen compliance claims by whether the risk was central (or "mission critical") to the corporation's business. The illegality prerequisite reflects the doctrine's public-ordering commitment, rooted in corporate law's longstanding duty of obedience. The business-centrality screen translates that commitment into shareholder-protective terms: importance to the firm becomes the ordinary basis for inferring culpable inattention. Each purpose thus supplies the limiting principle for the monitoring duty the other would otherwise support, and viable claims concentrate overwhelmingly where public obligations and shareholder interests coincide. This accommodation undermines both projects. It leaves boards virtually unaccountable for failures to monitor core business risks, while inviting them to treat legal sanctions as costs of doing business and to comply only when it pays. That approach is economically inefficient: the state uses sanctions rather than prices where it can specify prohibited conduct more reliably than it can monetize the resulting external harm. We propose splitting the atom. An agency-cost duty, grounded in the duty of care, would require reasonable systems for monitoring business performance and operational risks, subject to gross-negligence review and Section 102(b)(7) exculpation. A public-ordering duty, grounded in the duty of obedience, would require corporate systems oriented toward compliance with sanction law regardless of business centrality; inattention to the monitoring process would be reviewed for gross negligence, and conscious facilitation of noncompliance for bad faith. Each duty, freed from the other, can finally be tailored to the purpose it serves.

Keywords: Caremark, duty of oversight, corporate compliance, duty of obedience, agency costs, public enforcement, board monitoring

JEL Classifications: K22, G34, K42

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TABLE OF CONTENTS

INTRODUCTION ... 3

I. *CAREMARK*'S ATOM ... 10

A. Caremark *and the Duty to Monitor* ... 10

B. The Two Purposes of the Duty to Monitor ... 12

1. Policing Agency Costs ... 12
2. Facilitating Public Ordering ... 13

C. The Fusion of the Two Purposes in Caremark *Doctrine* ... 14

1. The Illegality Prerequisite ... 15
2. The Business-Centrality Screen ... 17

II. IMPLICATIONS OF THE ATOM ... 23

A. Undermining Public Ordering ... 23

1. Concentrating Fiduciary Scrutiny on Business-Central Risks 23
2. Encouraging an "Efficient Compliance" Approach ... 24

B. Undermining the Policing of Agency Costs ... 26

1. The Pre-*Caremark* Baseline ... 26
2. *Caremark*'s Expansive Promise ... 27
3. The Paradoxical Narrowing ... 27

C. The Unstable Atom ... 31

III. SPLITTING THE *CAREMARK* ATOM ... 36

A. The Agency-Cost Duty ... 36

1. Removing the Illegality Prerequisite ... 37
2. Restoring Gross Negligence Review ... 38

B. The Public-Ordering Duty ... 40

1. The Economic Foundation ... 41
2. Designing the Public-Ordering Duty ... 49
3. Objections ... 55

CONCLUSION ... 61

Introduction

Corporate fiduciary law is conventionally understood as private law: it protects the firm's investors from the managers who run it. The duty of oversight sits uneasily within that understanding. When Delaware requires directors to monitor the corporation's compliance with law—and permits shareholders to sue them for failing to do so—it makes corporate governance an instrument for the enforcement of public law. Criminal and regulatory law set the conduct standards; fiduciary law requires those who govern the firm to build systems capable of surfacing potential violations. That arrangement places corporate governance within the broader architecture of public enforcement. It also raises a question Delaware doctrine has never squarely answered: when fiduciary law requires a board to monitor legal compliance, whose interests is it serving?

Modern *Caremark* doctrine answers that question only indirectly, and in a puzzling way: the duty to monitor is enforceable, in practice, only where the corporation's legal obligations and its own business interests are *both* at stake. In his original 1996 *Caremark* decision, Chancellor Allen described a duty of boards to establish information systems sufficient to inform their judgments concerning both "the corporation's compliance with law and its business performance."[1] The obligation was symmetric: the law and the business were coordinate objects of the board's attention. In the doctrine that developed, however, each became a condition of liability for neglecting the other. Courts generally treat a violation of external law as a prerequisite for oversight liability. Even catastrophic failures to monitor ordinary business risks—the board inattention preceding the collapse of Silicon Valley Bank, for example—fall beyond the doctrine's reach. Yet illegality alone is ordinarily not enough. Since the Delaware Supreme Court's decision in *Marchand v. Barnhill*, courts have also asked whether the compliance risk was "essential and mission critical" to the corporation's business.[2] However serious the underlying violation, a compliance risk peripheral to the corporation's business ordinarily supports no claim. The doctrine thus looks in two directions at once: outward to the corporation's public obligations and inward to the corporation's own welfare. Why must a failure to monitor implicate both?

The question has taken on new importance as *Caremark* has moved from the periphery toward the center of Delaware fiduciary law. The duty gained little traction during its first two decades. But since *Marchand*, it has become a significant tool for addressing corporate misconduct involving food safety,

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1 698 A.2d 959, 970 (Del. Ch. 1996).

2 212 A.3d 805, 822–24 (Del. 2019).

drug approval, aviation safety, and other regulatory obligations.[3] The doctrine, however, has run ahead of its theory. Courts increasingly invoke it without a coherent account of why corporate law imposes a duty to monitor or why its reach should turn on the conjunction of legal compliance and business centrality.

This Article identifies the normative structure that produces these puzzling features. The duty to monitor serves two distinct social purposes. First, it polices the agency costs arising from the separation of ownership and control in the modern public corporation. Boards need information about the corporation's affairs to supervise managers on behalf of shareholders. Second, the duty facilitates public ordering by promoting corporate compliance with external law. Compliance systems bring potential violations to the attention of directors positioned to investigate and prevent corporate conduct that harms workers, consumers, and the public.

Each purpose, standing alone, is familiar. Our central claim concerns their relationship: *Caremark* neither chooses between the two purposes nor pursues them in parallel. It fuses them, so that each purpose supplies the limiting principle of the other. Public ordering keeps *Caremark* from becoming a general duty to monitor the business; agency costs keep it from becoming a general duty to monitor the law. That structure—two purposes bound into a single standard, each confining the other—is what we call *Caremark*'s "atom."

The atom explains the conjunction, though the two limits differ in doctrinal form. The illegality prerequisite reflects the doctrine's public-ordering commitment, rooted in corporate law's longstanding duty of obedience, and operates principally by narrowing the duty's domain: however catastrophic the monitoring failure, the absence of a legal violation places it beyond the doctrine's practical reach. The business-centrality screen recasts that commitment in the shareholder-protective terms of agency costs and operates principally through the structure of proof: the compliance risk's importance to the firm supplies the ordinary basis for inferring the bad faith required for liability. Together the two limits concentrate viable monitoring claims where legal compliance and the corporation's own interests coincide.

What the atom does not yet explain is itself: why would Delaware law bind two normative commitments together rather than pursue each on its own terms? The fusion persists, we argue, because it allows courts to manage a tension internal to Delaware law. The modern duty draws its force from the

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3 For a comprehensive survey of the doctrinal developments of this new era, see Roy Shapira, *Conceptualizing Caremark*, 100 IND. L.J. 467 (2025). While Shapira seeks to harmonize the various strands of the revamped oversight doctrine into a unified conceptual framework, our analysis reveals a fundamental tension between the doctrine's two purposes that harmonization cannot resolve.

duty of obedience. Delaware's condemnation of fiduciaries who knowingly cause or permit corporate illegality is old, categorical, and uncontroversial, and the monitoring duty carries that commitment one step upstream—from how directors must respond once illegality is known to the systems through which potential violations become known. Oversight claims accordingly survive, in practice, when legal violations are at issue but fail when not—a line agency-cost logic alone cannot draw, since ignorance of a catastrophic business risk can threaten shareholders every bit as much as ignorance of a legal violation.

Business monitoring paid the price. *Caremark* subjected both forms of monitoring to a single liability standard calibrated to the compliance half—Allen's demanding good-faith test, which hardened into the modern bad-faith requirement. Bad faith asks whether directors consciously disregarded a known obligation, and compliance supplies one: the obedience norm. Ordinary business risk supplies no comparable substantive command; the board decides which lawful strategies to pursue and which attendant risks to accept or mitigate. Once the bad-faith framework absorbed board inattention generally, displacing the older care-based route, business-monitoring failures largely escaped review. Public ordering is not *Caremark*'s sole purpose. But under the fused doctrine, the agency-cost purpose is enforceable only when obedience supplies the obligation. Hence the illegality prerequisite.

The obedience commitment, however, is one Delaware has been reluctant to theorize openly. Doing so would mean acknowledging that the law arms shareholders—suing derivatively, with any recovery flowing to the corporate treasury—to enforce a duty whose ultimate beneficiaries include workers, consumers, and the public. That proposition sounds novel and sits uneasily with the compensatory conception of derivative litigation. But the precedent is Delaware's own: its doctrine already recognizes a derivatively enforceable prohibition on knowingly causing corporate illegality, however profitable the violation. Rather than build on it in the monitoring context, courts take refuge in agency-cost language, and always have: Allen built the standard around compliance yet defended it entirely in the currency of shareholder welfare. By asking whether a compliance risk is "mission critical" to the company, courts today police public obligations while describing their work as the protection of shareholders. Hence the business-centrality screen.

Seeing the atom also reveals its costs. On the public-ordering side, making the corporation's own stake in compliance the ordinary basis for treating inattention as culpable implicitly endorses a norm of "efficient compliance." It invites boards to treat legal sanctions as costs of doing business and to neglect compliance risks that are not sufficiently important to the firm's business model. On the agency-cost side, the atom has paradoxically left shareholders *worse off* than they were before *Caremark*. *Citigroup*'s narrowing of oversight to legal-compliance contexts, combined with *Stone*'s bad-faith standard, produces what is effectively a "super bad faith" threshold for business-risk oversight claims. Recovery becomes practically unavailable even for catastrophic failures of board attention. The same fusion that explains the doctrine's architecture therefore undermines both purposes.

What Delaware needs is not one doctrine doing two jobs badly, but two doctrines each doing one job well. We thus propose to split the atom. The unified *Caremark* duty should be replaced by two duties, each with its own normative foundation, domain, standard of review, and rules governing exculpation and damages. An *agency-cost duty*, grounded in the duty of care, would require boards to maintain reasonable information systems concerning the corporation's business performance and significant operational risks. Courts would review the monitoring process for gross negligence while continuing to defer to informed substantive judgments, and Section 102(b)(7) exculpation would remain available. A separate *public-ordering duty*, grounded in the duty of obedience, would require boards to orient corporate systems toward compliance with "sanction" law, as distinguished from mere "price" law. Its scope would not depend on whether the compliance risk was central to the firm's business. Inattention to the monitoring process would be reviewed for gross negligence; conscious facilitation of noncompliance, for bad faith. And the duty would be non-exculpable, because shareholders cannot waive a duty that does not exist exclusively for their benefit. Damages would likewise be measured by the corporation's gross enforcement-related losses, without netting gains from illegality.

The split would be an act of articulation rather than invention. It gives separate doctrinal form to two commitments Delaware law already holds. Freed from the public-ordering function, the agency-cost duty can return to the objective, process-based review traditionally associated with the duty of care. Freed from the need to establish a threat to shareholder interests, the public-ordering duty can address legal compliance directly.

Caremark's atom is therefore more than a taxonomic defect in corporate law. It is a concrete example of what happens when a doctrine cast in private-law terms is made to carry a public-ordering commitment: the inherited limits of the private function distort the public one, while the public function crowds out the private one. Splitting the atom makes explicit the institutional choice the fused doctrine obscures—when fiduciary law protects investors, and when it reinforces the commands of public law.

This account makes three principal contributions. First, it identifies the atom—a descriptive claim about Delaware law: the doctrine has fused two purposes, each limiting the other, so that the duty to monitor bites overwhelmingly at their intersection. That account explains both the doctrine's architecture and its emerging instability. Prior scholarship has recognized *Caremark*'s public-regarding dimension[4] and the legal-risk/business-risk divide,[5] but not why liability should turn on the conjunction of illegality and business centrality or why the cases have begun to fracture along the fault line between the doctrine's two purposes. Existing reforms generally take the unity of the duty as given, asking how that single duty should be strengthened or harmonized.[6] The two commitments require different answers to the basic questions of oversight design: what boards must monitor, how courts should evaluate the process, whether liability may be exculpated, and how damages should be measured. No unified duty can answer those questions both ways at once.

Second, the Article inverts the conventional account of *Caremark*'s legacy for shareholders. *Caremark* is widely understood to have strengthened board accountability for failures of attention; we argue that, in its post-*Citigroup* form, the doctrine weakened it. Before *Caremark*, directorial inattention was cognizable under the duty of care through objective review of board process, and Delaware's gross-negligence standard had been applied to failures of supervision.[7] Modern doctrine relocated oversight to loyalty, replaced objective process review with a subjective bad-faith inquiry, and after *Citigroup* largely confined liability to legal-compliance settings—narrowing the duty's scope and ratcheting up its standard at the same time.[8] Statutory exculpation does not explain that decline: it weakened the remedy for care violations,

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4 *See, e.g.,* Donald C. Langevoort, *Cultures of Compliance*, 54 Am. Crim. L. Rev. 933, 939 (2017); Elizabeth Pollman, *Corporate Oversight and Disobedience*, 72 Vand. L. Rev. 2013, 2026–27 (2019); 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, 197–98, 209, 212–14 (2023) [hereinafter Arlen, *Evolution*]; Ann M. Lipton, *The Legitimation of Shareholder Primacy*, 51 J. Corp. L. 83, 118–19 (2025); Shapira, *Conceptualizing Caremark*, *supra* note 3, at 509–12, 517.

5 *See* James D. Cox & Randall S. Thomas, *Corporate Darwinism: Disciplining Managers in a World with Weak Shareholder Litigation*, 95 N.C. L. Rev. 19, 55–56 (2016); Pollman, *supra* note 4, at 2043.

6 *See, e.g.,* Arlen, *Evolution*, *supra* note 4, at 212–14 (proposing a unified regime of enhanced information-acquisition duties); Shapira, *Conceptualizing Caremark*, *supra* note 3 (seeking to harmonize the doctrine's strands within a unified conceptual framework).

7 *See infra* Section II.B.1; *Seminaris v. Landa*, 662 A.2d 1350, 1355 (Del. Ch. 1995).

8 Our account builds on prior work emphasizing how *Stone*'s turn to loyalty undermined the duty to monitor. *See* Stephen M. Bainbridge, Star Lopez & Benjamin Oklan, *The Convergence of Good Faith and Oversight*, 55 UCLA L. Rev. 559 (2008); 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 (2008).

whereas *Stone* and *Citigroup* later contracted the underlying conduct standard. Because conduct standards shape legal advice and board behavior outside litigation, the result is less accountability, not merely fewer damages claims.

Third, on the public-ordering side, the Article supplies a fundamental economic foundation for both the duty of obedience and the duty to monitor for compliance—one the literature has lacked. Delaware forbids fiduciaries from knowingly operating the corporation in violation of law, however profitable the violation, and courts and scholars have long treated that prohibition as a doctrinal fixture. What it forbids is precisely the "efficient compliance" approach: treating expected penalties as prices and complying only when compliance pays. On a familiar economic view, that approach is not a pathology but sound management, because expected penalties tell the firm what compliance is worth.[9]

But that view rests on an empirical premise: that expected penalties approximate the external social costs of regulated conduct. They do not. The penalties imposed under major regulatory regimes—including the FCPA, the federal sentencing guidelines for organizations, environmental statutes, and OSHA—reflect rough judgments about deterrence, structured by administrable considerations such as culpability and gain; they are not monetized estimates of social harm. The reason is a matter of information costs: the state typically cannot measure external social costs precisely enough to price them. The state's choice to prohibit rather than price conduct therefore locates its welfare judgment in the legal standard, not the expected penalty, making compliance with the legal standard—not optimization against expected penalties—the economically appropriate corporate objective.[10] And because a corporation complies—or fails to—through its internal systems,

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9 *See, e.g.*, Frank H. Easterbrook & Daniel R. Fischel, *Antitrust Suits by Targets of Tender Offers*, 80 Mich. L. Rev. 1155, 1168 n.36 (1982).

10 Prior accounts defend corporate obedience on different grounds. Palmiter reconstructs it as a distinct fiduciary duty rooted in corporate legitimacy and the corporation's character as a social institution. *See* Alan R. Palmiter, *Duty of Obedience: The Forgotten Duty*, 55 N.Y.L. Sch. L. Rev. 457, 458–59, 475–78 (2010–11). Greenfield invokes Cooter's sanctions/prices distinction to separate law requiring abstention from law requiring payment, but grounds the prohibition principally in a hypothetical bargain among corporate stakeholders. *See* Kent Greenfield, *Ultra Vires Lives! A Stakeholder Analysis of Corporate Illegality (With Notes on How Corporate Law Could Reinforce International Law Norms)*, 87 Va. L. Rev. 1279, 1323–26, 1363–69 (2001). Williams attacks the law-as-price view by impeaching the penalty benchmark, but expressly disclaims supplying an account of why corporations must obey law, taking that obligation as a background premise from jurisprudence and political theory. *See* Cynthia A. Williams, *Corporate Compliance with the Law in the Era of Efficiency*, 76 N.C. L. Rev. 1265, 1268–70, 1278–79, 1364–72, 1385 (1998). None derives the categorical rule from the information-cost implications of the state's choice to prohibit rather than price conduct.

the monitoring duty carries that objective into the governance of the firm.[11]

The distinction between laws that function as "prices" and laws that function as "sanctions"[12] makes the point precise. A price attaches a charge to permitted conduct, and the charge carries the regime's welfare judgment: it is the state's estimate of the conduct's social cost. A sanction has a different anatomy. It pairs a behavioral norm—conduct marked as forbidden—with a penalty for noncompliance, and the state reaches for this form precisely when information costs cut the other way: when it can specify right conduct more reliably than it can measure the social costs of departing from it. In a sanctions regime, the welfare information is accordingly encoded in the behavioral norm, not in the penalties, which do the different work of inducing compliance. A firm that optimizes against the expected penalty therefore reads the regime backwards. It extracts welfare guidance from the component that does not carry it, discards the component that does, and thereby converts the sanction into a price the state declined to set because it could not set it well. Such "efficient compliance" is not merely morally questionable. It is economically *inefficient*.

The same logic grounds the duty to monitor. A sanction aims to orient conduct toward the legal standard rather than toward the price of violating it. For a natural person, the law can use the sanction and the behavioral norms surrounding it to shape the environment in which that choice is made. But the cognitive process by which the person treats the legal standard as binding—or instead weighs the expected costs and benefits of violation—remains private to the actor. A corporation is different in exactly this respect. It acts only through institutional machinery—the information systems, incentives, and internal controls that determine what the organization detects, rewards, and tolerates—and that machinery is observable and amenable to direct legal regulation. The monitoring duty therefore carries the sanction's command into the firm: it requires the board to orient that machinery toward compliance with the legal standard, rather than toward the firm's expected

[11] Prior economic accounts generally begin with the downstream problem of implementation—how legal instruments can induce a posited optimal level of prevention or monitoring. *See* Arlen, *Evolution*, *supra* note 4, at 200–02 (justifying board-level compliance duties as responses to agency costs and under-enforcement); Jennifer Arlen & Reinier Kraakman, *Controlling Corporate Misconduct: An Analysis of Corporate Liability Regimes*, 72 N.Y.U. L. Rev. 687, 708–10 (1997) (identifying the "liability enhancement effect"). The question of why compliance with the legal standard, rather than optimization against expected penalties, is the economically appropriate objective lies upstream of these accounts. That prior question is the one our foundation begins with; it holds even where enforcement is perfect and agency costs are absent, and it yields a monitoring duty that differs from Arlen's proposals in both scope and design. *See infra* Section III.B.

[12] Robert Cooter, *Prices and Sanctions*, 84 Colum. L. Rev. 1523 (1984).

exposure to penalties.[13]

The Article proceeds in three parts. Section I identifies *Caremark*'s atom; Section II traces the resulting costs and instability; and Section III develops separate agency-cost and public-ordering duties.

I. *Caremark*'s Atom

Caremark's atom is a claim about the structure of oversight doctrine: Delaware law has bound the policing of agency costs and the facilitation of public ordering into a single standard that is enforced, in practice, overwhelmingly where the two purposes coincide. Establishing that claim takes three steps. This Section first sets out the doctrinal architecture of the duty to monitor, then identifies the two distinct social purposes that architecture is called on to serve, and finally shows how the case law has fused the two into the compound we call the atom.

A. Caremark *and the Duty to Monitor*

Caremark's central doctrinal innovation was to make board oversight affirmative. Under the Delaware Supreme Court's earlier decision in *Graham v. Allis-Chalmers Manufacturing Co.*, directors generally had no duty, absent grounds for suspicion, to install a "corporate system of espionage" to uncover employee wrongdoing.[14] *Caremark* declined to read that rule as allowing boards to wait for signs of trouble before establishing any means of learning what was happening within the corporation. Relevant and timely information, Chancellor Allen reasoned, is an "essential predicate" to the board's supervisory and monitoring role. A director's obligations therefore include a duty to attempt in good faith to assure that the corporation maintains a reasonable information and reporting system.[15] Oversight was no longer merely reactive—a duty to respond when problems came to the board's attention. It included an obligation to construct the information architecture through which the board would learn of them.

Caremark paired this affirmative obligation with an exceptionally demanding standard for personal liability. The appropriate level of detail for a reporting system is a matter of business judgment, and no rationally designed system can eliminate the possibility that employees will violate the law,

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13 *See infra* Section III.B.

14 *In re Caremark Int'l Inc. Derivative Litig.*, 698 A.2d 959, 969 (Del. Ch. 1996) (quoting *Graham v. Allis-Chalmers Mfg. Co.*, 188 A.2d 125, 130 (Del. 1963)).

15 *Id.* at 970.

mislead the board, or otherwise expose the corporation to loss.[16] When a corporate loss arises from the board's ignorance of the underlying conduct, only "a sustained or systematic failure of the board to exercise oversight—such as an utter failure to attempt to assure a reasonable information and reporting system exists" will establish the lack of good faith necessary for liability.[17]

The Delaware Supreme Court's subsequent endorsement of this doctrinal innovation in *Stone v. Ritter* did two things. First, it restated *Caremark*'s liability standard as the now-familiar two-pronged test. Under prong one, directors may be liable if they "utterly failed to implement any reporting or information system or controls." Under prong two, directors who have implemented such a system may be liable if they "consciously failed to monitor or oversee its operations," thereby disabling themselves from learning of risks or problems requiring their attention.[18] Failures to respond to "red flags" are commonly analyzed under the second prong.[19] Both prongs require a showing that the directors knew they were not discharging their fiduciary obligations. Negligence, even gross negligence, is not enough.[20] Second, *Stone* relocated oversight liability within the structure of fiduciary law. *Caremark* had analyzed the monitoring obligation as an aspect of the duty of care—a duty satisfied in part by assuring adequate information flows to the board. *Stone* held instead that a failure to act in good faith is a subsidiary element of the duty of loyalty and that bad-faith failures of oversight therefore constitute breaches of loyalty.[21]

Alongside these two forms of inattention lies a related principle governing knowing illegality. *Caremark* itself treated knowing violations as a distinct route to liability: Chancellor Allen separately examined "the possibility that the Caremark directors knew of violations of law," and framed the ultimate question as whether the defendants "either lacked good faith in the exercise of their monitoring responsibilities or conscientiously permitted a known violation of law by the corporation to occur"—finding no evidence of either.[22] *In re Massey Energy Co.* later stated the principle directly: because Delaware charters corporations to pursue lawful business through lawful acts, "a fiduciary of a Delaware corporation cannot be loyal to a Delaware

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16 *Id.*

17 *Id.* at 971.

18 *Stone ex rel. AmSouth Bancorporation v. Ritter*, 911 A.2d 362, 370 (Del. 2006).

19 *See id.* at 370–71.

20 *Id.* at 369–70.

21 *Caremark*, 698 A.2d at 967, 970; *Stone*, 911 A.2d at 369–70.

22 *Caremark*, 698 A.2d at 971–72.

corporation by knowingly causing it to seek profit by violating the law."[23] We refer to claims based on this principle as *Massey* claims.

B. The Two Purposes of the Duty to Monitor

The duty to monitor under *Caremark* serves two distinct social purposes. First, it aims to reduce the managerial agency costs endemic to modern public corporations. Second, it seeks to facilitate public ordering of corporate behavior by improving corporate compliance with external law. The distinction turns not on what the board monitors but on why monitoring is valuable: compliance monitoring may serve either purpose, or both, and much of what boards monitor implicates no law at all.

1. Policing Agency Costs

In the modern public corporation, dispersed shareholders elect a board, which in turn delegates day-to-day management to professional executives. The resulting separation of ownership from control creates agency costs: managers may pursue their own interests at shareholders' expense. The board exists in large part to police that problem. But the separation of ownership from control is also a separation of information. A board cannot supervise what it cannot see. Information and reporting systems therefore serve its shareholder-protective function by surfacing managerial misconduct, operational failures, and accumulating risks to firm value.[24]

Compliance failures can themselves reflect agency costs. Employees may receive immediate compensation or career benefits from unlawful conduct while discounting penalties and reputational harm borne by the firm. Equity compensation can exacerbate the problem when managers can realize short-term gains before compliance costs materialize. Directors may share the same short-term orientation or hesitate to challenge management. A monitoring duty counters these tendencies by giving directors both a legal incentive and an institutional mandate to build compliance systems and intervene when warning signs emerge. When unlawful conduct reduces firm value, compliance monitoring thus serves the same shareholder-protective function as monitoring ordinary business risk.[25]

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23 *In re Massey Energy Co.*, 2011 WL 2176479, at *20 (Del. Ch. May 31, 2011). *See also In re Walt Disney Co. Derivative Litig.*, 906 A.2d 27, 67 (Del. 2006) ("A failure to act in good faith may be shown … where the fiduciary acts with the intent to violate applicable positive law…").

24 *See* Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs, and Ownership Structure*, 3 J. Fin. Econ. 305, 308–10 (1976); Melvin Aron Eisenberg, The Structure of the Corporation: A Legal Analysis 139–48, 156–70 (1976).

25 *See* Arlen & Kraakman, *supra* note 11, at 691–93; John Armour, Jeffrey Gordon & Geeyoung Min,

But the agency-cost purpose neither depends on illegality nor reaches every violation. Empire-building acquisitions, operational neglect, and unmanaged concentration or liquidity risks can threaten shareholders without violating external law; the case for monitoring would remain intact in a world of perfect legal compliance. Conversely, a violation can maximize expected shareholder value when the gains to the firm exceed expected penalties, reputational harm, and other costs. A firm might, for example, violate environmental regulations when expected fines are lower than the costs of compliance. Shareholder-aligned managers may then favor the violation, and agency-cost logic supplies no reason to forbid it, even if external costs make it socially harmful.[26]

2. Facilitating Public Ordering

The duty to monitor also serves a second, distinct social purpose: facilitating public ordering of corporate behavior by promoting compliance with external legal mandates. By public ordering we mean corporate law's reinforcement of the conduct standards set by external law: criminal, regulatory, and other bodies of public law define those standards, and fiduciary law requires those who govern the corporation to respect them. The knowing-illegality principle described in the preceding section is the modern expression of this commitment: corporate fiduciaries may not knowingly cause the corporation to violate the law.[27] We refer to that obligation as the "duty of obedience." The term originated in the older *ultra vires* conception of the corporation.[28] Because a corporation possessed only the powers conferred by its charter and governing law, its fiduciaries were obligated not to cause it to act beyond those powers. The duty was one of "obedience" because it required fiduciaries to observe the legal limits constitutive of the corporation they served. And because those limits authorized only lawful business,[29] knowing corporate

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Taking Compliance Seriously, 37 Yale J. on Regul. 1, 3–5, 22–27, 36–38 (2020); Arlen, *Evolution*, *supra* note 4, at 210.

26 *See* Bainbridge et al., *supra* note 8, at 593–94; Roy Shapira & Luigi Zingales, *Is Pollution Value-Maximizing? The DuPont Case*, Nat'l Bureau of Econ. Rsch. Working Paper 23866 (2017); D. Daniel Sokol, *Policing the Firm*, 89 Notre Dame L. Rev. 785, 798 (2013).

27 *See* Guttman v. Huang, 823 A.2d 492, 506 n.34 (Del. Ch. 2003) ("[O]ne cannot act loyally as a corporate director by causing the corporation to violate the positive laws it is obliged to obey."); *In re Massey*, 2011 WL 2176479, at *20.

28 *See* Palmiter, *supra* note 10, at 459–64, 474; Greenfield, *supra* note 10, at 1281–83, 1314–19.

29 Del. Code Ann. tit. 8, § 101(b) (2023) (providing that a Delaware corporation may be formed only "to conduct or promote any lawful business or purposes"); *id.* § 102(a)(3) (providing that a certificate of incorporation may define the corporation's purpose as engaging in "any lawful act or activity").

illegality was, on this account, a form of disobedience.[30]

The duty of obedience governs fiduciaries' response to known illegality; compliance monitoring extends the same public-ordering commitment to the systems through which illegality becomes known. Without monitoring, the prohibition on knowing illegality could be defeated by systematic ignorance. The monitoring duty therefore requires boards to maintain reporting systems that surface potential violations to those positioned to investigate and prevent them. Corporations are comparatively well positioned to perform this task: boards can draw on existing reporting infrastructure to detect misconduct more cheaply than the state[31] and implement firm-wide preventive measures where diffuse responsibility would otherwise obscure culpability.[32] The contrast with ordinary business monitoring marks the boundary: business monitoring helps directors choose among permissible courses of action; compliance monitoring keeps the corporation within limits the board has no authority to cross.

The two purposes—policing agency costs and facilitating public ordering—therefore overlap, but neither subsumes the other. Monitoring legal violations produced by agency costs serves both purposes: it protects the firm and facilitates the enforcement of external law. Monitoring business and operational risks that involve no legal violation serves shareholders without advancing public ordering. And monitoring profit-maximizing illegality advances public ordering without reducing agency costs. Oversight liability could in principle attach in any of these domains. Where Delaware law in fact attaches it is the question to which we now turn.

C. The Fusion of the Two Purposes in Caremark *Doctrine*

The answer: overwhelmingly, where the two purposes coincide. No single holding announces that result. It is instead the work of two doctrinal features that together concentrate viable claims at the overlap. The first—the illegality prerequisite—generally requires that an oversight claim involve a violation of external law. The second—the business-centrality screen—makes the corporation's stake in a compliance risk the ordinary ground for inferring the bad faith that liability requires. Each makes one purpose the limiting

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[30] *See* Gearhart Indus., Inc. v. Smith Int'l, Inc., 741 F.2d 707, 719–20 (5th Cir. 1984) (applying Texas law and describing the duty of obedience as requiring directors to avoid acts beyond the corporation's powers); Palmiter, *supra* note 10, at 459–60; Greenfield, *supra* note 10, at 1314–19.

[31] *See* Arlen & Kraakman, *supra* note 11, at 699–700 (identifying the firm as the "least-cost administrator" of sanctions); Arlen, *Evolution*, *supra* note 4, at 204 (describing companies' comparative advantage in detecting, investigating, and terminating misconduct).

[32] *See* Samuel W. Buell, *The Blaming Function of Entity Criminal Liability*, 81 Ind. L.J. 473, 491–92 (2006).

principle of the other. The sections that follow take each in turn.

1. The Illegality Prerequisite

Delaware courts now draw a sharp line between oversight claims involving business risk and those involving compliance risk.[33] *Caremark* drew no such line. Chancellor Allen required information systems sufficient to support informed judgments about "*both the corporation's compliance with law and its business performance*," and *Stone* endorsed that formulation.[34] Yet the decisions that followed narrowed the duty to the first half of that formulation, dismissing claim after claim that alleged no violation of law.[35]

The turn came in *In re Citigroup*, a case arising from the financial crisis. Shareholders alleged that Citigroup's directors had failed to monitor the company's exposure to the subprime mortgage market.[36] Chancellor Chandler called the theory "a bit of a twist on the traditional Caremark claim": a typical claim concerns "a failure to properly monitor or oversee employee misconduct or violations of law," whereas these plaintiffs challenged the board's failure to monitor "Citigroup's *business risk*."[37] Oversight duties, he wrote, "are not designed to subject directors … to personal liability for failure to … properly evaluate business risk."[38] The opinion stopped short of foreclosing such claims[39] but made them nearly impossible to plead.

That distinction, which came to define *Citigroup*'s legacy, was unnecessary to its holding. Even if *Caremark* reached business risk, the complaint was too thin to support an inference of bad faith. Citigroup maintained a board-level risk-monitoring system; the alleged red flags concerned deterio-

33 *See* Cox & Thomas, *supra* note 5, at 55–56 (suggesting that the distinction between *Massey* and *Citigroup* is that the latter involved "a challenge to legitimate business practices"); Pollman, *supra* note 4, at 2043 ("*Caremark* case law has been shaped by an emphasis on the line between business risk and legal risk.").

34 *In re Caremark*, 698 A.2d at 970 (emphasis added); *Stone*, 911 A.2d at 368–70.

35 *See, e.g.*, *In re Citigroup Inc. S'holder Derivative Litig.*, 964 A.2d 106 (Del. Ch. 2009); *In re ProAssurance Corp. S'holder Derivative Litig.*, No. 2022-0034-LWW, 2023 WL 6426294 (Del. Ch. Oct. 2, 2023); *Constr. Indus. Laborers Pension Fund v. Bingle*, No. 2021-0940-SG, 2022 WL 4102492 (Del. Ch. Sept. 6, 2022), *aff'd*, 297 A.3d 1083 (Del. 2023); *Segway Inc. v. Cai*, 349 A.3d 628 (Del. Ch. 2023) (the first three dismissing the oversight claims for failure to plead demand futility and the fourth for failure to state a claim).

36 *In re Citigroup Inc. S'holder Derivative Litig.*, 964 A.2d 106, 112 (Del. Ch. 2009).

37 *Id.* at 123 (emphasis in original).

38 *Id.* at 131.

39 *Id.* at 126 ("it may be possible for a plaintiff to meet the burden under some set of facts … on a theory that the directors did not fulfill their oversight obligations by failing to monitor the business risk of the company.").

rating conditions in the subprime market rather than Citigroup's own risk position; and the plaintiffs identified neither a deficiency in the system nor facts suggesting that the directors consciously ignored one.[40] The plaintiffs instead argued backward from the magnitude of Citigroup's losses to the conclusion that oversight must have been deficient—the hindsight reasoning that the business judgment rule exists to foreclose. The claim could therefore have been dismissed without making legality the dividing line.

Citigroup was a red-flags claim, not an information-systems claim.[41] That posture matters. In a red-flags case the question is not whether the board should have built a monitoring system; it is what the board was obliged to do with the warnings it received. And to that question the duty of obedience supplies an answer that turns on exactly Chandler's distinction. A board confronted with a red flag of *business* risk may decide whether and how to respond. A board confronted with a red flag of *legal* risk may decide how to respond, but not whether: it may not consciously permit the corporation to violate the law.[42]

The Court of Chancery has since generalized the point, treating a compliance issue as a virtual prerequisite for a red-flags claim: where the warning signs concern business risk rather than illegality, the board's response ordinarily remains protected by the business judgment rule. Vice Chancellor Will put it bluntly in *ProAssurance*: because the "only so-called red flags were of business risks—not illegality," "[h]ow (and whether) to respond was entirely within the directors' discretion."[43]

The same divide runs through the doctrine's other branch—the claim that a board failed to implement a monitoring system at all. Here the pattern is stark. Every information-systems claim to survive a motion to dismiss has involved legal compliance: for example, food safety in *Marchand*,[44] airplane

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40 *In re Citigroup*, 964 A.2d at 127–29.

41 *See In re Citigroup*, 964 A.2d at 127–29.

42 *See* La. Mun. Police Emps.' Ret. Sys. v. Pyott, 46 A.3d 313, 356 n.34 (Del. Ch. 2012) (Laster, V.C.) (inferring conscious wrongdoing where the board treated off-label exposure as "a source of legal risk to be managed, rather than a boundary to be avoided"), *rev'd on other grounds*, 74 A.3d 612 (Del. 2013); *In re ProAssurance Corp. S'holder Derivative Litig.*, No. 2022-0034-LWW, 2023 WL 6426294, at *14 (Del. Ch. Oct. 2, 2023) ("Directors lack the discretion 'to consciously cause the corporation to act unlawfully.' ").

43 *In re ProAssurance Corp. S'holder Derivative Litig.*, No. 2022-0034-LWW, 2023 WL 6426294, at *1 (Del. Ch. Oct. 2, 2023); *see also Segway Inc. v. Cai*, 349 A.3d 628, 634 (Del. Ch. 2023) (dismissing a red-flags claim because the alleged warning signs were "generic financial matters," not signs of "accounting improprieties, fraudulent business practices, or other material legal violations").

44 *Marchand v. Barnhill*, 212 A.3d 805, 822–24 (Del. 2019) (sustaining a claim where the board had "no board committee that addressed food safety" and no protocol requiring management to report on food-safety compliance).

safety in *Boeing*.[45] No decision has sustained one on a failure to monitor *business* risk—not in *Citigroup*, and not in the risk-management and cybersecurity cases that followed.[46]

One reason is that the legal character of the risk determines how closely the monitoring system must be tailored to it. For a central compliance risk, no general risk committee, routine management reporting, or facial regulatory compliance suffices; the board must maintain a system directed at the risk itself.[47] For business risk, a generic risk-management apparatus suffices, and the degree of tailoring is itself protected business judgment.[48] The same omission can therefore count as culpable inattention or protected discretion, depending on whether the neglected risk implicates external law or only the corporation's business.

This is the first dimension of the atom: monitoring failures ground liability only where they implicate external law—the illegality prerequisite. The agency-cost function reaches only as far as the public-ordering function lets it.

2. The Business-Centrality Screen

The illegality prerequisite largely determines which risks enter the doctrine. Once a compliance risk is inside, a second feature governs whether the absence of monitoring itself supports an inference of bad faith.

That second feature took shape in *Marchand v. Barnhill*. Blue Bell Creameries, one of the country's largest ice cream manufacturers, suffered a listeria outbreak in early 2015. The company recalled all of its products, shut down production at all of its plants, and laid off over a third of its workforce. Three people died.[49] A stockholder brought a derivative suit alleging, among other things, that the board had made no good-faith effort to oversee the safety

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45 *In re The Boeing Co. Derivative Litig.*, No. 2019-0907-MTZ, 2021 WL 4059934, at *26–*28 (Del. Ch. Sept. 7, 2021) (sustaining a prong-one claim where the board had "no committee charged with direct responsibility to monitor airplane safety" and no regular process for safety reporting).

46 *See In re Citigroup*, 964 A.2d at 126–31; *Constr. Indus. Laborers Pension Fund v. Bingle*, No. 2021-0940-SG, 2022 WL 4102492, at *12–*13 (Del. Ch. Sept. 6, 2022) (cybersecurity), *aff'd*, 297 A.3d 1083 (Del. 2023); *In re ProAssurance*, 2023 WL 6426294, at *4 (underwriting and reserve risk).

47 *Marchand*, 212 A.3d at 823–24 (holding that regulatory compliance and general management reports did not establish a board-level food-safety system); *In re Boeing*, 2021 WL 4059934, at *27–*28 (holding that general risk oversight did not suffice where the responsible committee's mandate omitted airplane safety and focused on financial risk).

48 *See In re Citigroup*, 964 A.2d at 127–28 (holding that a general Audit and Risk Management Committee sufficed against a subprime-concentration claim); *Bingle*, 2022 WL 4102492, at *12–*13 (holding that general committees with cybersecurity among their responsibilities sufficed despite the absence of a cybersecurity-specific briefing to the full board).

49 *Marchand*, 212 A.3d at 807.

of the company's only product. The Delaware Supreme Court held that the complaint supported that inference: Blue Bell's board had no committee overseeing food safety, no full-board process for considering it, and no protocol by which the board was to be advised of food-safety reports.[50]

In sustaining the claim, *Marchand* stated the governing standard in general terms: a board must make a good-faith effort to establish "a reasonable system of monitoring and reporting about the corporation's central compliance risks."[51] But the facts invited a narrower shorthand. Because ice cream was Blue Bell's only product, the Court deemed food safety "essential and mission critical."[52] The mission-critical formulation soon acquired what Vice Chancellor Laster called "talismanic importance" in *Caremark* litigation.[53]

We refer to this criterion, in either version—"essential and mission critical" risks or the broader category of "central compliance risks"—as the *business-centrality screen*. The two formulations differ in breadth: every mission-critical risk is a central compliance risk, but not conversely.[54] But both sort risks by their importance to the corporation's business rather than by the character of the legal norm at stake.

McDonald's clarified the screen's doctrinal form. Centrality, Vice Chancellor Laster explained, is not an element of a *Caremark* claim; bad faith is. But when directors make no good-faith effort to establish an information system addressing a central compliance risk, the omission itself supports an inference of bad faith.[55] Outside that domain, the omission does not itself support the same inference; the plaintiff must come forward with independent, particularized facts supporting an inference of conscious dereliction.[56] Centrality thus governs what the omission itself can prove: Delaware infers indifference to the law from indifference to the business. That is an agency-cost test of fault. What a board should have noticed is measured in the currency of firm

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[50] *Id.* at 809.

[51] *Id.* at 824.

[52] *Id.*; *see id.* at 822 (describing "what has to be one of the most central issues at the company: whether it is ensuring that the only product it makes—ice cream—is safe to eat").

[53] *In re McDonald's Corp. S'holder Derivative Litig.*, 291 A.3d 652, 677 (Del. Ch. 2023); *see, e.g.*, *In re Boeing*, 2021 WL 4059934, at *26 (airplane safety "was essential and mission critical" to Boeing's business); *In re Clovis Oncology, Inc. Derivative Litig.*, 2019 WL 4850188, at *12 (Del. Ch. Oct. 1, 2019) (FDA compliance "mission-critical" for Clovis).

[54] *See McDonald's*, 291 A.3d at 678.

[55] *McDonald's*, 291 A.3d at 679; *accord Ontario Provincial Council of Carpenters' Pension Tr. Fund v. Walton*, 294 A.3d 65, 85–86 (Del. Ch. 2023).

[56] *See Pettry ex rel. FedEx Corp. v. Smith*, 2021 WL 2644475, at *12 n.125 (Del. Ch. June 28, 2021) (the absence of mission criticality means only that bad faith will not be inferred from the alleged conduct alone; the plaintiff "must plead additional facts"), *aff'd*, 273 A.3d 750 (Del. 2022).

value.

McDonald's makes that translation explicit. The case arose from the board's response to a corporate culture that condoned sexual harassment. After holding that a red-flags claim need not involve a mission-critical risk, Vice Chancellor Laster nevertheless went on to deem employee safety mission critical—because "[s]exual harassment and misconduct render the workplace unsafe" and "[e]mployees perform the work that affects the value of the corporation."[57] He thus translated worker protection into protection of the corporation's capacity to create long-term value. Even when centrality was unnecessary, the court reached for the vocabulary of the firm's interests.[58]

The business-centrality screen is thus a rule of inference in form but an effective prerequisite in operation. In principle, a plaintiff can plead bad faith without centrality—by alleging, say, that the fiduciaries knew of wrongdoing or serious control deficiencies and consciously failed to act.[59] But that escape route offers little help in the ordinary information-systems case. If the board consciously decides in good faith to assign no monitoring resources to a noncentral compliance risk, the decision is ordinarily protected by the business judgment rule. If the board makes no decision at all, the omission ordinarily generates no affirmative evidence that it was conscious. Centrality is therefore ordinarily the only realistic route to bad faith.[60]

This is the second dimension of the atom: a monitoring failure ordinarily grounds liability only where it implicates a central compliance risk—the business-centrality screen. The public-ordering function reaches only as far as the agency-cost function lets it.

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The preceding analysis answers the question with which Section I.B closed. Of the three domains mapped there, viable monitoring claims are overwhelmingly concentrated in one: the region where the two purposes coincide. Put

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57 *McDonald's*, 291 A.3d at 677, 680.

58 *See infra* Section II.C (examining this pattern across the case law).

59 *See, e.g.*, *In re Am. Int'l Grp., Inc. Consol. Deriv. Litig.*, 965 A.2d 763, 799 (Del. Ch. 2009); *Rich ex rel. Fuqi Int'l, Inc. v. Chong*, 66 A.3d 963, 984 (Del. Ch. 2013).

60 This account follows the reconstruction of *Marchand* in *McDonald's*, which subsequent decisions of the Court of Chancery have adopted. *See In re Plug Power Inc. S'holder Derivative Litig.*, 2025 WL 1277166, at *13 (Del. Ch. May 2, 2025) (observing, following *McDonald's*, that oversight obligations "do not cease beyond what is mission critical" and that a failure to establish an information system addressing central compliance risks supports an inference of bad faith); *Giuliano v. Grenfell-Gardner*, 2025 WL 2502176, at *8 n.61 (Del. Ch. Sept. 2, 2025) (McCormick, C.) (emphasizing, per *McDonald's*, that *Marchand*'s governing formulation is "central compliance risks," of which "essential and mission critical" risks are a subset).

the two features together and the architecture is plain. Each purpose supplies the limiting principle for the monitoring duty the other would otherwise support. An agency-cost duty standing alone would reach the corporation's business performance and operational risks; the illegality prerequisite confines it to compliance settings. A public-ordering duty standing alone would reach corporate compliance without regard to the risk's centrality to firm value; the business-centrality screen conditions its ordinary enforcement on precisely that centrality. Public ordering keeps *Caremark* from becoming a general duty to monitor the business; agency costs keep it from becoming a general duty to monitor the law. That reciprocal limitation is *Caremark*'s atom.

The two limits differ in doctrinal form. The prerequisite narrows the duty's domain, and nearly categorically; the screen operates through the structure of proof, and defeasibly. The asymmetry makes the fusion less categorical, not less consequential. A proof rule can be nearly as consequential as an element at the pleading stage: where the challenged omission is precisely what deprived the record of evidence, the rule governing what that omission can prove largely determines which claims reach merits discovery—no small thing in a doctrine whose claims are typically effectively resolved on the pleadings.

Figure 1 maps that structure: the illegality prerequisite largely empties the agency-cost crescent, the business-centrality screen thins the public-ordering crescent, and viable monitoring claims therefore concentrate at the intersection—*Caremark*'s atom.

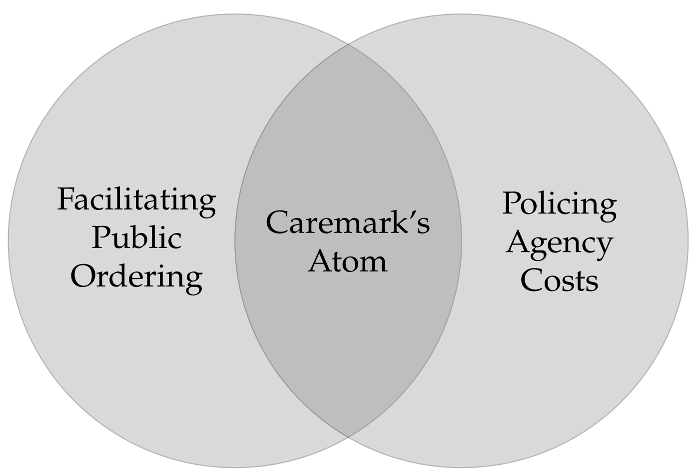

Figure 1: *Caremark*'s Atom

What remains in the public-ordering crescent is noteworthy. Delaware enforces there—but only against knowledge: red flags that reached the fiduciaries, independently pleaded scienter, and, most clearly, knowing illegality itself. A *Massey* claim reaches the fiduciary who knowingly causes the corporation to violate the law, without regard to the violation's centrality to the business and without regard to its profitability for the firm.[61] The duty of obedience itself, that is, never passed through the agency-cost apparatus. What the atom fused, on the public-ordering side, is the monitoring extension of the obedience commitment—the duty to build the systems through which illegality becomes known to the board. The conduct prohibition survived unfused; the informational infrastructure it presupposes did not. Delaware thus condemns the director who knows of corporate lawbreaking while ordinarily measuring, in the currency of firm value, the culpability of the board that never organized itself to know.

The atom's reciprocal limits are, moreover, accretions rather than features of *Caremark*'s original design. *Caremark* itself required information systems sufficient to inform judgments about "both the corporation's compliance with law and its business performance."[62] The illegality prerequisite arrived thirteen years later, in *Citigroup*'s recharacterization of the tradition—reasoning, as we have seen, that the disposition did not require. The business-centrality screen arrived a decade after that, when *Marchand* made central compliance risks the organizing category for information-systems claims; it then hardened as litigants recast the opinion's "essential and mission critical" application as the standard itself. Neither limiting device was present at the creation. The atom, in other words, is not the fundamental design of the duty; it is what the case law deposited on top of it.

Prior scholarship has identified pieces of this structure—approaching it from opposite directions—without explaining the conjunction. Pollman, observing that *Caremark* claims survive only when they implicate the duty of obedience, effectively identifies the public ordering component—the doctrine's functional dependence on legal compliance as the trigger for liability.[63] Lipton goes further, treating public ordering as the doctrine's true character: because Delaware courts cannot inquire whether a violation was profitable to shareholders, she concludes that *Caremark* "has very little to do with protecting shareholders."[64]

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61 *See* Guttman v. Huang, 823 A.2d 492, 506 n.34 (Del. Ch. 2003); *In re Massey*, 2011 WL 2176479, at *20; *see supra* Section I.B.2.

62 *In re Caremark*, 698 A.2d at 970.

63 *See* Pollman, *supra* note 4, at 2036 (arguing that *Caremark* claims "reflect that a more fundamental sorting is occurring that identifies extreme circumstances implicating the issue of obedience").

64 *See* Lipton, *supra* note 4, at 118–19. Lipton notes that the doctrine mixes "shareholder harm and societal harm," but she frames this as a conflation of *harms* rather than the fusion of two

Arlen's diagnosis, in contrast, begins with *Caremark*'s agency-cost premise. Reconstructing Allen's original design choices, she argues that he assumed oversight duties were needed to address only agency costs, and that this assumption led him to give directors discretion over compliance system design that they predictably exploited.[65] But Arlen's solution is to redesign a unified duty so that it serves both ends at once. Ours is to separate the ends because they generate different answers to the duty's basic design questions.

Shapira's comprehensive synthesis of the revamped doctrine organizes the case law by claim type rather than by purpose. He assigns each claim variant its own set of deterrence rationales—combatting willful blindness, cosmetic compliance, recidivism, short-termism, and externalities in turn—without asking whether those rationales cohere or whose interests the duty ultimately serves.[66] The result is a catalogue of rationales that never confront one another—exactly what one would expect from a doctrine fused from two distinct functions.

But none of these accounts sees the atom as a whole—the fusion of two genuine, separable functions as the source of the doctrine's difficulties. Other scholarly treatments do not engage the atom's structure so much as reproduce it, treating the relevant domain as legal compliance and the relevant normative framework as agency costs.[67]

In Section II we examine the consequences and persistence of this structure: each purpose, confined by the other's limiting principle, is undermined in turn, and the case law grows unstable as cases press on the boundary between them. Section III then develops our solution: splitting the atom—removing each cross-limit, so that each purpose gains the monitoring duty it supports and loses its veto over the other's.

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distinct *functions* that we identify, and she takes it to show that *Caremark*'s shareholder-protective rationale is largely illusory. We draw the narrower conclusion that *Caremark* is not exclusively shareholder-protective; it can still serve shareholders when illegality reflects an agency cost.

65 *See* Arlen, *Evolution*, *supra* note 4, at 197–98, 209 (characterizing Allen's agency cost framing as producing the "central flaw" in *Caremark*—the grant of full discretion over system design—and arguing that oversight duties must instead be structured to promote society's interest in deterring misconduct). We engage with Arlen's specific proposals, and the ways in which our approach differs from hers, in Section III.B *infra*.

66 *See* Shapira, *Conceptualizing Caremark*, *supra* note 3, at 493–95, 502–03, 509–12. His project aims to "harmonize" a single doctrine governed by the unified bad-faith standard. *Id.* at 533. On our account, no such harmonization is available. *See* Section III *infra*.

67 *See, e.g.,* Armour et al., *supra* note 25, at 20–31 (considering only compliance failures that reflect agency costs); Sean J. Griffith, *Corporate Governance in an Era of Compliance*, 57 Wm. & Mary L. Rev. 2075, 2134–36 (2016) (proposing that compliance be "wholly owned by firms" and subject to their "internal cost-benefit calculations"); Hillary A. Sale, *Monitoring Caremark's Good Faith*, 32 Del. J. Corp. L. 719, 723–25 (2007) (treating the relevant domain of *Caremark* as legal compliance and the operative problem as agency costs).

II. Implications of the Atom

By making each purpose of the duty to monitor the limiting principle of the other, the atom weakens both purposes and destabilizes the doctrine itself. Section II.A shows how the business-centrality screen, reinforced by bad-faith review, creates efficient-compliance incentives that undermine public ordering. Section II.B shows how the illegality prerequisite, compounded by *Stone*'s loyalty classification, has left shareholders with weaker protection against business-risk monitoring failures than they had on the eve of *Caremark*. Section II.C shows how the doctrine's failure to acknowledge its two purposes leaves courts without a stable basis for resolving cases at the boundary between them—and why, despite these costs, the fusion persists.

A. Undermining Public Ordering

The *Caremark* atom undermines the public-ordering function of corporate law. The corporation's stake in a compliance risk ordinarily determines whether the board's failure to monitor it can itself support liability, while the bad-faith standard confines review of monitoring design to whether the board made any good-faith effort at all. Together, these features encourage boards to treat compliance monitoring as a business investment—allocating resources where monitoring serves shareholder interests and economizing where it does not—and thereby create pressure toward an "efficient compliance" approach to oversight.

1. Concentrating Fiduciary Scrutiny on Business-Central Risks

The business-centrality screen is a rule of inference rather than an element of liability. It nonetheless withdraws the ordinary path to an information-systems claim for a large class of serious legal risks. A company's violations of environmental, labor, consumer-protection, or anti-corruption law may impose grave harms even when the particular compliance risk is peripheral to the enterprise; in that setting, board inattention alone ordinarily will not support the required inference of bad faith, and the plaintiff must plead independent facts of conscious dereliction.[68] From a public-ordering perspective, this is backwards. Because business centrality tracks the firm's own reasons to self-police—violations in core domains threaten the business itself apart from whatever sanctions the law imposes—the screen concentrates fiduciary pressure where private incentives are already strongest and withdraws it where its incremental value is greatest.

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[68] *McDonald's*, 291 A.3d at 679; *Pettry*, 2021 WL 2644475, at *12 n.125; *see supra* Section I.C.2.

Outside a central compliance risk, *McDonald's* explained, "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."[69] The phrase "if any" does real work. It treats a good-faith decision to devote zero dedicated board-level resources to a noncentral compliance risk—including a sanction-law risk the corporation is obligated to obey—as presumptively protected by the business judgment rule.

The knowledge-based claims that remain outside the screen do not cure the distortion. A red-flags claim may proceed without a showing that the risk was mission critical when warnings actually reached the fiduciaries, and a *Massey* claim reaches fiduciaries who knowingly cause or permit corporate illegality without regard to centrality.[70] But those theories begin after information or knowledge exists. The two *Stone* prongs therefore create an acquisition-response asymmetry: the red-flags prong regulates what directors do with compliance warnings once they arrive, while the information-systems prong governs whether the board has built a route by which they will arrive at all. That asymmetry creates a perverse incentive at the margin. A board that establishes reporting channels for a noncentral risk may receive warnings it may not consciously disregard; one that establishes none ordinarily leaves a plaintiff without the facts needed to plead bad faith. When undetected illegality benefits the firm, the rational response is not to look: a board that looks and finds problems cannot safely look away.

2. Encouraging an "Efficient Compliance" Approach

That concentration of fiduciary scrutiny makes the corporation's private return from monitoring the natural guide to resource allocation. It creates incentives for what we call an "efficient compliance" approach: withholding effective monitoring when the violations it would uncover are profitable enough to leave undetected.[71]

The bad-faith standard reinforces this logic. Quality is not wholly unreviewable: a cosmetic system—one that does not function "in earnest"—can itself support an inference that the board made no good-faith monitoring effort.[72] But review runs only to the outer boundary of good faith. The

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[69] *McDonald's*, 291 A.3d at 679 (emphasis added); *accord Walton*, 294 A.3d at 86.

[70] *See McDonald's*, 291 A.3d at 677, 680; *In re Massey*, 2011 WL 2176479, at *20; *see supra* Section I.C.2.

[71] *See supra* note 12 and accompanying text.

[72] *Plug Power*, 2025 WL 1277166, at *12 (courts evaluate "whether the system functions in earnest, as oversight requires more than just 'go[ing] through the motions' "); *see also* Hughes v. Hu, 2020 WL 1987029, at *14 (Del. Ch. Apr. 27, 2020) ("The mere existence of an audit committee and the

question is not whether the board's design was negligent, suboptimal, or objectively unreasonable; it is whether its deficiencies are so fundamental that they evidence no good-faith effort at all. Inside that boundary, the board's allocation decisions—how many resources to devote to compliance monitoring, which sub-risks to prioritize, how to balance the costs of monitoring against the expected costs of noncompliance—remain protected business judgments. The doctrine polices monitoring's quality only at the frontier of loyalty, not under any standard of reasonableness.

Efficient compliance is not the same as cost-conscious compliance design. Boards must compare monitoring technologies, consider their marginal effectiveness, and allocate finite resources across legal risks. A board may reasonably conclude that one compliance system is cheaper than another but still reasonably effective. The public-ordering problem arises when it concludes that preventing violations would cost more than their expected legal consequences.[73]

One might try to firewall the board's discretion over monitoring from the corporation's obligation to comply. But that firewall cannot hold. Boards design both the information systems that surface misconduct and the incentives under which managers operate. Incentives tied to profitability push managers to increase firm value; monitoring determines which legally prohibited means of doing so are detected and stopped. The two choices operate in tandem. When reporting channels are thinnest where illegality is profitable, the institutional architecture tends toward the same result as a conduct-level efficient-compliance policy: profitable violations persist. In that setting, the distinction between "we choose not to look" and "we choose not to comply" is formal rather than functional. Nor does that implication depend on a board's announcing a policy of efficient compliance. Ordinary resource-allocation decisions can produce the same monitoring gaps, while the resulting absence of information makes the forbidden rationale difficult to plead.[74]

We evaluate efficient compliance from a welfare perspective, including the possibility that it is socially efficient, in Section III.B.

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hiring of an auditor does not provide universal protection against a *Caremark* claim.").

73 *See infra* Section III.B.2 (explaining how cost considerations remain relevant to the design of compliance systems under the proposed public-ordering duty).

74 Whether a board that candidly adopted such a strategy would be protected is unresolved. *McDonald's* protects good-faith resource-allocation decisions, while *Massey* condemns knowing, profit-driven lawbreaking. *See McDonald's*, 291 A.3d at 679; *In re Massey*, 2011 WL 2176479, at *20. We are aware of no decision that squarely identifies where permissible allocation ends and conscious facilitation of illegality begins.

B. Undermining the Policing of Agency Costs

The atom weakens the agency-cost function of oversight, and *Stone*'s loyalty classification compounds the damage. The illegality prerequisite removes from *Caremark*'s ordinary domain failures to monitor business and operational risks, even though the legal character of a risk is irrelevant to the agency-cost case for board attention. *Stone*, meanwhile, makes subjective bad faith the exclusive route to oversight liability, displacing the objective, process-based framework through which the duty of care had addressed directorial inattention. Together, these moves produce a striking inversion. *Caremark* announced a broader monitoring obligation than prior law, but modern doctrine supplies a narrower route to enforce that obligation where the agency-cost rationale operates without the public-ordering rationale. In that limited but important sense, shareholders are worse off today than they were on the eve of *Caremark*.

1. The Pre-*Caremark* Baseline

Before *Caremark*, Delaware law imposed no general affirmative duty to install reporting systems before grounds for suspicion appeared. *Graham v. Allis-Chalmers* was the governing case, and its posture was reactive. But the absence of an affirmative systems duty did not place directorial inattention outside fiduciary law. Two related strands of the duty of care supplied limited routes for addressing it.

The first was the line of abdication cases, which reached the extreme of near-total disengagement. In *Lutz v. Boas*, for example, the Court of Chancery held mutual-fund directors jointly and severally liable after they gave "almost automatic approval" to the management agreement, failed to examine basic filings carefully, and did not even know who selected securities for the fund.[75]

The second strand extended beyond total abdication. *Aronson v. Lewis* and *Smith v. Van Gorkom* fixed gross negligence as the duty of care's standard for claims that directors had failed to become adequately informed.[76] The Court of Chancery then carried that standard into the supervision context. In *Seminaris v. Landa*, decided the year before *Caremark*, Vice Chancellor Chandler explained that a plaintiff challenging the directors' failure to supervise a CEO who misrepresented the company's financial condition would have to show that the directors "were grossly negligent in failing to supervise these

75 *Lutz v. Boas*, 171 A.2d 381, 395–96 (Del. Ch. 1961). *See also Francis v. United Jersey Bank*, 87 N.J. 15 (1981) (requiring directors to exercise the diligence, care, and skill of ordinarily prudent persons in like positions).

76 *Aronson v. Lewis*, 473 A.2d 805, 812 (Del. 1984); *Smith v. Van Gorkom*, 488 A.2d 858, 873 (Del. 1985).

subordinates."[77] Gross negligence was a demanding standard, but it was an objective one.

This baseline was modest. Abdication cases were rare; Section 102(b)(7) allowed corporations to eliminate directors' personal monetary liability for care violations;[78] and *Graham* required attention to warning signs but no proactive system for discovering them.[79] The point is therefore not that pre-*Caremark* law robustly protected shareholders from monitoring failures. It is narrower. Directorial inattention was cognizable within the duty of care; the inquiry was objective and process based; and nothing made an external legal violation a condition of the claim.

2. *Caremark*'s Expansive Promise

Against that baseline, *Caremark* looked like an addition. It supplemented *Graham*'s reactive rule with an affirmative obligation to establish information systems and expressly extended that obligation to information about "*both* the corporation's compliance with law *and* its business performance."[80] Allen paired that broad standard of conduct with a narrow liability rule: only a "sustained or systematic failure" of oversight amounting to "a lack of good faith" would suffice.[81] But the demanding standard of review neither confined the duty to legal risk nor displaced the preexisting care framework. On its face, *Caremark* added an ex ante systems obligation to the objective care rules governing abdication and grossly negligent supervision.

3. The Paradoxical Narrowing

Modern doctrine turned *Caremark*'s addition into a practical substitution. *Stone*'s loyalty classification made subjective bad faith the exclusive route to oversight liability; *Citigroup* and its progeny then confined the ordinary operation of that liability rule to legal-compliance settings. Relative to the pre-*Caremark* care baseline, the first move displaced an objective inquiry into board process with subjective bad faith; the second narrowed the domain in which even that demanding standard could realistically be met. Their

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77 *Seminaris v. Landa*, 662 A.2d 1350, 1355 (Del. Ch. 1995). The statement arose at the demand-futility stage; it shows the standard the court understood to govern a failure-to-supervise claim, not a merits holding imposing liability.

78 Del. Code Ann. tit. 8, § 102(b)(7) (2023).

79 *Graham v. Allis-Chalmers Mfg. Co.*, 188 A.2d 125, 130 (Del. 1963) ("absent cause for suspicion there is no duty upon the directors to install and operate a corporate system of espionage to ferret out wrongdoing which they have no reason to suspect exists").

80 *In re Caremark*, 698 A.2d at 970.

81 *Id.* at 971.

interaction explains why the illegality prerequisite so thoroughly empties the agency-cost crescent.

a. The Narrowing to Legal Risk

Although *Citigroup* left open the possibility that some business-risk oversight claim might succeed, the qualification has done little practical work. Subsequent decisions treat a compliance problem as a virtual prerequisite: when the alleged warning signs or system deficiencies concern only business risk, the board's response—or decision not to create a more tailored system—ordinarily remains within business-judgment discretion.[82]

That practical screen removes from oversight doctrine the cases the agency-cost purpose supports most directly. Whether managerial self-interest, passivity, or incompetence permits an unlawful practice to persist or a business risk to accumulate, the board's failure to become informed may expose the corporation to loss. The legal character of the risk determines whether the case also implicates public ordering; it does not determine whether the failure of attention reflects an agency cost.

The bad-faith standard magnifies the effect. For a central compliance risk, the absence of a risk-specific board system can itself support an inference of bad faith. When the same omission concerns business risk alone, it ordinarily supplies no comparable inference.[83] A business-risk plaintiff must therefore plead subjective bad faith in a domain where the omission ordinarily cannot prove it and the underlying subject is presumptively committed to business judgment.

The loss is not confined to litigation. Standards of conduct also shape board practice through counsel, investors, and directors' understanding of what their office requires. Allen expected *Caremark*'s articulation of the duty, rather than the remote prospect of liability, to shift boardroom norms.[84] By declaring that oversight duties "are not designed" to reach business risk, *Citigroup* contracted the conduct standard itself.[85]

Citigroup's stated justification was hindsight bias. Chancellor Chandler warned that extending oversight to business risk would involve courts in

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[82] *In re Citigroup*, 964 A.2d at 126–31; *see supra* Section I.C.1 (collecting the cases).

[83] *See supra* Sections I.C.2 and II.A.1.

[84] *See Technicolor, Caremark, Interco, & Blasius: William Allen Interview* 42–43 (2018) (interview by Paul Rowe, Del. Corp. L. Oral History Project, Univ. of Pa. Carey Law Sch.), https://www.law.upenn.edu/live/files/8634-wt-allen-corrected-transcriptdocx.; *see also* Melvin A. Eisenberg, *The Divergence of Standards of Conduct and Standards of Review in Corporate Law*, 62 FORDHAM L. REV. 437, 462–68 (1993).

[85] *In re Citigroup*, 964 A.2d at 131.

"hindsight evaluations of decisions at the heart of the business judgment of directors."[86] The concern is real, but it cannot draw the line *Citigroup* drew. External law supplies a clearer substantive endpoint; it does not design the board's monitoring process. Compliance and business-risk monitoring alike require ex ante judgments about reporting, priorities, and resources. If courts can review those judgments in compliance cases without impermissible second-guessing, they can do the same in business-risk cases. More fundamentally, *Citigroup* conflated review of substantive business choices with review of the process by which the board became informed. A process inquiry asks not whether directors chose the right strategy, but whether they equipped themselves to understand its risks. Hindsight concerns justify a demanding, ex ante, process-focused standard; they do not justify making legality the boundary of the duty. Section III.A.2 develops that standard.

If hindsight bias does not explain the boundary, what does? The answer, we suggest, lies in the other half of the atom: the duty of obedience. Compliance monitoring implicates a distinct source of normative force that ordinary business-risk monitoring does not. When courts evaluate compliance-related *Caremark* claims, they are drawing—often implicitly—on this deep well of normative authority. *Citigroup* itself makes this plain. In contrasting the business-risk allegations before it with the successful claims in *AIG*, Chandler drew a sharp line between "failing to oversee employee fraudulent or criminal conduct" and "failing to recognize the extent of a Company's business risk," insisting that directors "must under Delaware law" maintain systems that could alert them to fraud or crime.[87] Chandler called the two categories "fundamentally different" but did not explain why. The unstated premise, we believe, is the duty of obedience. That premise explains the boundary, but it does not justify allowing the public-ordering purpose to extinguish the agency-cost claim. The public-ordering purpose should support an additional duty where illegality is involved; it should not veto the shareholder-protective duty where illegality is absent.

b. *The Severance from the Duty of Care*

The second contraction concerns the standard used to evaluate inattention. *Caremark* framed the board's obligation in the vocabulary of care and process but limited liability for the new affirmative systems duty to a sustained or

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86 *In re Citigroup*, 964 A.2d at 131.

87 *In re Citigroup*, 964 A.2d at 131. *See also* Pollman, *supra* note 4, at 2026, 2031, 2043 (reading the differential treatment of legal and business risk as reflecting corporate law's public commitment to legal obedience).

systematic failure amounting to a lack of good faith.[88] That threshold was calibrated to the compliance problem before Allen: because no rationally designed system could prevent every corporate violation, illegality itself could not establish a breach. Allen also defended the demanding test as beneficial to shareholders, reasoning that it would encourage qualified people to serve as directors while continuing to stimulate good-faith performance. But those considerations supported a demanding test of liability; they did not require eliminating objective review of the board's process for becoming informed. *Stone* nevertheless selected the subjective strand, holding that oversight liability requires directors to know they are not discharging their obligations and locating that failure within loyalty.[89] That move displaced the objective care framework through which abdication and grossly negligent supervision had previously been reviewed.

A subjective standard is poorly suited to omissions because the challenged inattention often prevents creation of the evidence needed to prove knowledge. It can also invert culpability: a board attentive enough to recognize a serious gap in its reporting structure may face exposure if it leaves the gap uncorrected, while a board too disengaged to recognize the gap can argue that it lacked the knowledge *Stone* requires. Deeper ignorance may thus strengthen the defense. Objective process review avoids this scienter paradox by asking whether the board's process for becoming informed was grossly deficient, not whether the directors appreciated their own failure in real time. Section III.A.2 develops that standard.

Taken together, the two contractions create a one-sided regime. Compliance failures may enter loyalty because the duty of obedience supplies a risk-specific obligation and business centrality ordinarily supplies the inference that its neglect was conscious. Business-risk failures ordinarily receive neither loyalty review nor the care-based process review that preceded *Caremark*; absent something approaching outright abdication, subjective bad faith has little to grip. That asymmetry is the "super bad faith" threshold in operation. A viable oversight claim thus assembles its elements from both purposes of the doctrine: the public-ordering commitment supplies the obligation, and the corporation's own stake supplies the proof. A doctrine introduced to make boards more accountable for becoming informed has, where monitoring serves the agency-cost function alone, made accountability

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88 *Caremark*, 698 A.2d at 970–71. Allen also doubted that "[t]he vocabulary of negligence" was "well-suited to judicial review of board attentiveness," *id.* at 967–68 n.16, but his concern was reasonable-person review of the substance of business choices, not objective review of the board's process for becoming informed. *See supra* note 84; *infra* Section III.A.2.

89 *Stone*, 911 A.2d at 369–70; Miller, *supra* note 8, at 937–41.

more difficult than before.

Section 102(b)(7) does not explain (or eliminate) that contraction. The statute authorizes charter provisions eliminating damages liability for care violations but leaves the standard of conduct, objective process review, and equitable relief intact. Nor did exculpation compel the doctrinal narrowing: enacted in 1986, it coexisted with an actionable care claim for grossly negligent supervision on the eve of *Caremark*.[90] It was *Stone*'s reclassification and *Citigroup*'s confinement—moves within the fused doctrine—that extinguished the care-based route.

C. The Unstable Atom

The atom does more than weaken each of *Caremark*'s purposes. It makes the doctrine unstable. At the level of conduct, the command is clear: fiduciaries may not operate the corporation unlawfully, even when doing so would increase its value. The difficulty arises in monitoring cases—and in adjacent loyalty cases that press the same boundary—when judges must decide whether misconduct whose immediate victims are third parties is also a fiduciary wrong to the corporation. The unified doctrine supplies no stable answer. Unsurprisingly, judges reach contradictory conclusions.

A striking recent illustration comes from a pair of opinions addressing when workplace sexual misconduct becomes a fiduciary wrong. In *Brola v. Lundgren*, Vice Chancellor Will dismissed a derivative claim brought against a director who had sexually harassed employees. Such "interpersonal" conduct, she held, was "not a matter of corporate internal affairs," and "[t]he legal system provided a remedy for his wrongdoing through New York's employment laws."[91] She warned against turning the duty of loyalty into "a general morality code" and inviting "doctrinal sprawl" that would reach "a breakroom fistfight, a defamatory social media post, or theft of office supplies."[92]

Just weeks later, Chancellor McCormick squarely declined to follow *Brola* in *Los Angeles City Employees' Retirement System v. Sanford*. The derivative action asserted *Caremark* claims arising from a pattern of sexual misconduct by agents of eXp Realty, including allegations that the company's founder covered up reports of drugging and sexual assault at corporate events.[93] McCormick reasoned that the duty of loyalty has always been defined "capa-

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[90] *See Seminaris*, 662 A.2d at 1355.

[91] *Brola v. Lundgren*, No. 2024-1108-LWW, 2025 WL 3439671, at *1 (Del. Ch. Dec. 1, 2025).

[92] *Id.* at *4–5.

[93] *L.A. City Emps.' Ret. Sys. v. Sanford*, 352 A.3d 276, 284, 313 (Del. Ch. 2026).

ciously" to reach conduct contrary to the corporation's best interests. "Human resources are company resources," she wrote, and their misuse "for selfish purposes" is no different from embezzlement.[94] Will's limiting principles, she concluded, were innovations that "moved Delaware law," not faithful applications of it.[95]

This intramural disagreement is illuminating not primarily for what it says about the law of workplace misconduct, but for what it reveals about the *Caremark* atom. Both cases required the court to decide whether wrongdoing against employees lay within corporate fiduciary law. Will concluded that employment law supplied the remedy and the alleged wrong fell outside corporate law. McCormick concluded that the misuse of employees as corporate resources, compounded by a fiduciary's cover-up, was itself a corporate wrong. Each opinion speaks in the conventional vocabulary of corporate interests. Yet their disagreement ultimately turns on a public-ordering question that vocabulary cannot resolve by itself: when should fiduciary law reinforce obligations the corporation and its agents owe to third parties?

Will's sprawl concern—her worry that the duty of loyalty could become "a general morality code"—is framed as a concern about the *breadth* of fiduciary duty.[96] At bottom, however, it is a concern about fiduciary duty doing public-ordering work. Will does not use that language, but it captures precisely the threat she identifies. Her limiting principles—the boundary between "internal affairs" and "interpersonal" conduct—are designed to prevent it.[97]

McCormick's response is revealing in a different way. She begins on agency-cost ground, describing the derivative suit as an indemnification device that "shift[s] losses from the company that was harmed to the fiduciary that harmed it."[98] Her substantive answer to Will's sprawl concern is that employees are corporate resources whose selfish misuse is disloyalty. But that answer does not say how far the duty extends. On the question of scope, her argument is pragmatic. She points to the procedural architecture of derivative litigation—the demand requirement, the collective action problem, and judicial control over attorneys' fees—and argues that these mechanisms will cabin the practical consequences of a capacious duty of

94 *Id.* at 305 (quoting 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, 639 (2010)).

95 *Id.* at 305.

96 *Brola*, 2025 WL 3439671, at *4–5.

97 *Id.* at *7–9.

98 *Sanford*, 352 A.3d at 307.

loyalty.[99] A contingent-fee attorney "has no incentive to pursue a claim where the recovery would be minimal"; a one-off "fistfight in the breakroom" will never generate a recovery large enough to attract the plaintiffs' bar.[100] This is a market-based answer to a normative question. It explains why a capacious duty may not produce unmanageable litigation. It does not explain why fiduciary duty should reach the conduct—whether because the conduct reflects an agency cost, violates an obligation to third parties, or both.

And then, in the middle of this argument, the atom is suddenly visible on the surface of the opinion. McCormick writes:

> Holding fiduciaries accountable for misconduct that harms the corporation can give rise to collateral benefits external to the corporation. For example, requiring that fiduciaries create a system to monitor legal compliance encourages legal compliance. That, in turn, benefits the communities that the laws governing the corporation were intended to protect. To the extent that the system generates these knock-on effects, it is a positive thing. But minimizing negative externalities is *not* the purpose of a derivative suit; nor is the equitable vehicle of derivative claims intended to police some "general morality code." Derivative suits serve a very limited purpose—they provide stockholders standing to pursue claims that shift losses from the company that was harmed to the fiduciary that harmed it.[101]

This passage articulates both purposes of *Caremark* liability in consecutive sentences, acknowledges the value of each, and then denies the public-ordering purpose any role in fixing the claim's reach. The fusion could hardly be stated more plainly, but the doctrinal apparatus gives McCormick no way to do anything with it other than disclaim half of what she has just described.

The *Brola–Sanford* divide thus reveals the fusion problem from a different angle than the cases examined in Section II.A. There, the business-centrality screen uses the corporation's stake in a compliance risk to determine whether a monitoring omission can support an inference of bad faith. Here, corporate-interest vocabulary performs public-ordering work by default: it brings within fiduciary law claims whose normative force derives from obligations to third parties, but only by translating those obligations into corporate injury, misuse of corporate resources, or abuse of fiduciary authority. The resulting corporate injury may be entirely real; the point is the doctrinal route by which the third-party wrong becomes cognizable.

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99 *Id.* at 307–08.

100 *Id.* at 308.

101 *Id.* at 307.

McCormick reads the corporate-interest vocabulary capaciously. Will reads it narrowly and responds to the expansion by inventing limiting principles that find no support in the unified standard. The questions the divide leaves open are ones the fused doctrine cannot answer. Must the misconduct exploit authority peculiar to the fiduciary's office, or is a resulting corporate loss enough? When does mistreatment of an employee become selfish misuse of a corporate resource? And if employee protection can always be translated into long-term corporate value—as Vice Chancellor Laster did in *McDonald's*—does the vocabulary impose any meaningful limit? Will and McCormick give different answers to questions the unified framework has never made explicit. As McCormick herself acknowledged, the disagreement may already constitute "a split in Delaware law" that the appellate process will need to resolve.[102]

The conflict is not isolated. In *In re Massey Energy*, Vice Chancellor Strine observed that the purpose of mine-safety laws "is not to protect Massey and its stockholders, it is to protect miners," and that such laws address "the incentive for entities to generate externalities in their pursuit of profits."[103] Set *Massey* beside *Brola* and the instability is visible in a single contrast. Strine treated the fact that mine-safety law protects third parties as a reason fiduciary law must reinforce it. Will treated the fact that employment law protects third parties as a reason fiduciary law should stand down: "[t]he legal system provided a remedy."[104] The fused framework offers no account of when either response should follow.

In *Teamsters v. Chou*, Vice Chancellor Glasscock posed the fusion question more explicitly than perhaps any other Delaware jurist, asking whether *Caremark* liability "is merely a branch of fiduciary liability designed to make the beneficiaries of that duty whole for breach, or whether it should be seen also as a blunt but useful tool to encourage good corporate citizenship."[105] But having brought the tension to the surface, Glasscock retreated, insisting that a judge "must be mindful that it is the corporation, not that corporation's victims, to whom any recovery will flow," and proceeding to apply the unified standard without further engaging the question he had raised.[106]

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[102] *Sanford*, 352 A.3d at 313.

[103] *In re Massey Energy Co. Derivative & Class Action Litig.*, No. 5430-VCS, 2011 WL 2176479, at *23 (Del. Ch. May 31, 2011).

[104] *Brola*, 2025 WL 3439671, at *1.

[105] *Teamsters Local 443 Health Servs. & Ins. Plan v. Chou*, No. 2019-0816-SG, 2020 WL 5028065, at *1 (Del. Ch. Aug. 24, 2020).

[106] *Id.*

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Why does the fusion persist? The cases just surveyed suggest an answer. Judges repeatedly bring the public-ordering function to the surface while declining to give it independent force in fixing the reach of monitoring liability. McCormick welcomes the collateral benefits and, in the same breath, disclaims them as the purpose of derivative litigation; Glasscock poses the question but retreats to the fact that recovery flows to the corporation; Laster reaches employee protection by translating it into long-term firm value. Agency-cost vocabulary makes that avoidance sustainable: it lets courts reinforce public law in the register of corporate injury. The fusion persists, in part, because it is useful.

But this avoidance should not be mistaken for either absence or incapacity. Both sides of the atom reflect authentic, longstanding commitments of Delaware law. The agency-cost commitment is explicit and well theorized. The public-ordering commitment is longstanding as well: it descends from the duty of obedience traced in Section I.B and has shaped *Caremark* doctrine from its inception. *Caremark* itself is emblematic—a case arising from a health-care company's violation of federal anti-kickback law, reasoned through the vocabulary of shareholder protection. The post-*Marchand* cases have carried that commitment forward, policing failures involving food safety, drug approval, and aviation safety even as the opinions continue to explain that work in agency-cost terms. The doctrine has thus run ahead of its own theory.

In declining to resolve whether *Caremark* is merely about agency costs or also about public ordering, Vice Chancellor Glasscock concluded that "[t]hat question is for academic discussion, not judicial resolution."[107] We disagree. Delaware's courts created *Caremark*—indeed, the entire edifice of a board's fiduciary duties—and are responsible for determining its reach. So long as the unified *Caremark* standard binds into a single doctrine two normative purposes whose design requirements are incompatible, the tension will remain latent—until cases press on the fault line between agency costs and public ordering, and the energy that has been building within the fused doctrine is released in unpredictable and contradictory ways. The *Brola–Sanford* split is one such release. The solution is not to paper over the tension with yet more epicycles, but to split the atom deliberately. The proposed split is an act of articulation rather than invention: it gives each existing commitment its own doctrinal form, allowing each to operate openly and on its own terms. Section III develops the two duties that would accomplish that split.

[107] *Chou*, 2020 WL 5028065, at *1; *see supra* note 105.

III. Splitting the *Caremark* Atom

The pathologies we have documented are artifacts of fusion. *Caremark*'s agency-cost and public-ordering functions pull in divergent directions. The first protects shareholders against failures of corporate governance; it calls for objective review of the board's monitoring process and business-judgment deference to informed choices about which risks to bear. The second reinforces the commands of external law; its reach cannot depend on whether compliance advances the corporation's interests, and it cannot permit a board to treat expected sanctions as the price of noncompliance. One standard cannot do both jobs without distorting one of them.

We therefore propose to split the atom into two distinct duties operating in parallel, each with its own foundation, domain, standard of review, and rules governing exculpation and damages. Section III.A develops an *agency-cost duty*, grounded in the duty of care, that reaches failures to monitor business risks and those compliance risks that threaten the corporation or reflect an agency cost, and subjects the board's monitoring process to gross-negligence review. Section III.B develops a *public-ordering duty*, grounded in the duty of obedience and the economic logic of sanctions, that reaches sanction-law compliance without regard to business centrality and that, we argue, should be non-exculpable. A compliance failure may violate both duties; each claim would be evaluated on its own terms.

A. The Agency-Cost Duty

Once the public-ordering function is separated, the agency-cost duty returns to familiar ground. Its standard of conduct requires the board to maintain and use a reasonable monitoring process designed to keep it informed about the corporation's business performance and significant operational risks. The duty includes compliance risks insofar as inadequate monitoring threatens the corporation or reflects a divergence between corporate agents and shareholders, but its domain does not depend on whether the underlying risk implicates external law.

The proposal therefore makes two changes: removing the illegality prerequisite to restore the duty's domain and reconnecting the affirmative monitoring obligation to objective gross-negligence review under the duty of care. Together, the two moves give oversight claims grounded in agency costs an independent doctrinal basis—ending the public-ordering function's veto over the shareholder-protective duty.

1. Removing the Illegality Prerequisite

Under the agency-cost duty, a risk's legal character would determine only whether the public-ordering duty also applies. It would no longer determine whether a shareholder-protective claim is cognizable. A plaintiff would still have to plead a grossly deficient monitoring process; a large loss or mistaken business judgment would not suffice.

Silicon Valley Bank's collapse illustrates the stakes. During a period of acute interest-rate exposure, SVB operated for eight months without a chief risk officer; its board lacked large-bank experience and had failed to establish appropriate risk management; and the report found no evidence that management made the full board aware that a key interest-rate-risk metric had breached limits for years.[108] These allegations present an oversight question in the ordinary sense: did the board equip itself to understand a risk at the center of the bank's business? Yet the underlying choices—holding long-duration bonds and deciding how much interest-rate exposure to hedge—were lawful business decisions. A Delaware shareholder claim would therefore encounter *Citigroup*'s practical screen.[109]

Federal banking law makes the resulting gap concrete. SVB Financial Group was incorporated in Delaware, but FIRREA permits the FDIC to sue failed-bank directors and officers for gross negligence. In litigation arising from SVB's collapse, the federal court denied motions to dismiss the FDIC's negligence and gross-negligence claims.[110] Federal law thus permits objective review of materially similar board conduct that Delaware oversight doctrine largely excludes when the object of monitoring is business risk.

Change only that object—from an unhedged bond portfolio to an employee fraud ring—and the same failure of attention could support a *Caremark* claim. Under the agency-cost duty, the risk's legal character would determine only whether the public-ordering duty also applies. The shareholder claim would turn on whether the board's monitoring process was grossly

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[108] *See* Bd. of Governors of the Fed. Reserve Sys., *Review of the Federal Reserve's Supervision and Regulation of Silicon Valley Bank* 3–4, 45–49, 61–64 (Apr. 2023).

[109] Treating the allegations as compliance failures merely because SVB was subject to safety-and-soundness regulation would collapse the distinction between business risk and compliance risk for every regulated firm. Citigroup was itself a regulated financial institution, yet Chancellor Chandler treated its failure to monitor subprime exposure as a business-risk claim outside *Caremark*'s ordinary domain. *See In re Citigroup*, 964 A.2d at 123, 126–31.

[110] 12 U.S.C. § 1821(k); *FDIC v. Becker*, No. 25-cv-00569-NW, slip op. (N.D. Cal. Oct. 23, 2025), ECF No. 140. The court characterized the complaint as challenging specific acts and omissions rather than pleading a *Caremark* claim and therefore did not reach bad faith. *Id.* at 3. But the complaint included alleged failures to establish and use adequate risk-management processes alongside challenges to affirmative decisions.

inadequate in light of the risk to the enterprise.

The change would also restore the broader conduct standard Allen articulated. *Citigroup* contracted that standard by signaling that business-risk monitoring lay largely outside fiduciary obligation. The same channels that transmitted the narrowing would transmit the correction.

2. Restoring Gross Negligence Review

a. Doctrinal Basis

The agency-cost duty combines *Caremark*'s affirmative systems obligation with the duty of care's objective gross-negligence standard.[111] Gross negligence remains demanding: it requires "reckless indifference" or conduct "without the bounds of reason," while intentional dereliction and conscious disregard remain bad faith.[112] Applied to oversight, the inquiry is whether the board's monitoring process—both its reporting structure and its use of the information produced—was grossly deficient given what was known or reasonably knowable at the time, not whether directors recognized the defect in real time.

b. Hindsight Bias and the Oversight Context

The principal objection to gross-negligence review is hindsight bias. The concern is serious when a court reviews an affirmative business decision: knowledge that a merger failed or a market turned makes it difficult to reconstruct the uncertainty confronting directors ex ante. Courts face a systematic pull toward concluding that a bad outcome reflected a bad decision. That is the problem the business judgment rule principally addresses.

Oversight, however, is less susceptible to hindsight bias. It asks a prior question: did the board maintain and use a reasonable monitoring process before deciding what to do? At the review stage, the plaintiff must show that the process was grossly inadequate given what was known or reasonably knowable ex ante. An imperfect process or one that failed to catch the risk that materialized does not suffice. The inquiry can focus on contemporaneous facts: whether oversight responsibility was assigned, appropriate personnel and reporting channels were in place, committees met, and the board attended to the information its systems produced.[113] Courts can evaluate

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[111] *See supra* Sections II.B.1–3.

[112] *McPadden v. Sidhu*, 964 A.2d 1262, 1274 (Del. Ch. 2008).

[113] The distinction is Eisenberg's. *See* Eisenberg, *supra* note 84, at 447. *Aronson* likewise observed that the business judgment rule "has no role where directors have either abdicated their functions, or absent a conscious decision, failed to act." *Aronson v. Lewis*, 473 A.2d 805, 813 & n.7 (Del. 1984).

those facts without prescribing an optimal monitoring structure or deciding whether the corporation should have avoided the underlying risk. If gross-negligence review is workable for the monitoring process preceding affirmative business decisions, where hindsight pressure is greatest, it is *a fortiori* workable for oversight.

c. Exculpation Under Section 102(b)(7)

Because the agency-cost duty is grounded in care, Section 102(b)(7) permits a corporation to eliminate directors' personal monetary liability for grossly negligent monitoring. At an exculpated firm, a grossly negligent breach would therefore not by itself support damages against directors. But exculpation limits the remedy, not the underlying duty: objective conduct and review standards would continue to shape board practice, and equitable relief would remain available.[114] Two narrower monetary consequences would also remain.

First, Section 102(b)(7) does not protect bad faith. Under current doctrine, however, the carve-out has little purchase in the business-risk domain: bad faith requires conscious disregard of a known obligation, and *Citigroup* denies that the oversight duty supplies one there. The agency-cost duty changes the predicate rather than the standard. Once boards owe a duty to maintain reasonable information systems for business risk, particularized facts that directors consciously disregarded that duty state a non-exculpable bad-faith claim—just as conscious disregard of compliance oversight does today.

Second, Section 102(b)(7) does not permit corporations to exculpate officers from liability in actions brought by or in the right of the corporation. Derivative claims for grossly negligent oversight would therefore remain non-exculpable as to officers.[115] Demand will ordinarily constrain shareholder suits against officers when an independent board controls the claim.[116] The consequence is most important after control passes to a successor board, trustee, receiver, acquirer, or other decisionmaker that can pursue the corporation's claims directly—the setting in which monitoring failures often come to light. The SVB litigation illustrates that posture: the FDIC, acting as receiver for the bank, is pursuing negligence and gross-negligence claims

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[114] Del. Code Ann. tit. 8, § 102(b)(7) (2023); *see Arnold v. Soc'y for Sav. Bancorp, Inc.*, 678 A.2d 533, 542 (Del. 1996). A request for equitable relief does not, however, by itself excuse demand. *See* MCG Capital Corp. v. Maginn, 2010 WL 1782271, at *21 (Del. Ch. May 5, 2010) (holding that a requested injunction concerning board information practices did not create the disabling interest necessary to excuse demand).

[115] 83 Del. Laws ch. 377 (2022); Del. Code Ann. tit. 8, § 102(b)(7); *see In re McDonald's Corp. S'holder Derivative Litig.*, 289 A.3d 343, 349–50, 370 (Del. Ch. 2023) (recognizing officers' oversight duties).

[116] *See United Food & Commercial Workers Union v. Zuckerberg*, 262 A.3d 1034, 1059 (Del. 2021).

against its former officers.[117]

The monetary consequences just described are real but narrow: the agency-cost duty would increase exposure at the margins while leaving existing exculpation of directors for gross negligence intact. The reform's principal value lies in restoring the standard of conduct, which shapes board practice through the channels Allen expected *Caremark* to work through,[118] and in giving the doctrine a coherent architecture: objective review of the board's monitoring process, business-judgment protection for informed substantive choices, and shareholder control over director exculpation would all reside within the duty built for them. That separation in turn allows the public-ordering duty to be designed without making shareholder interests the measure of its reach.

B. The Public-Ordering Duty

The agency-cost duty reaches its limit at the point where illegality pays. An informed board can be perfectly aligned with stockholders and still prefer a violation whose expected private gains exceed its expected costs to the firm. The agency-cost duty has no reason to condemn that choice. Delaware's duty of obedience does. It treats legality as a constraint on the use of corporate power, not as an input into a shareholder-welfare calculation.

The public-ordering duty is thus new in its standard for culpable ignorance, but not in the commitment it serves. It joins two existing premises: the duty of obedience bars fiduciaries from knowingly causing corporate illegality, and *Caremark* makes boards responsible for the corporation's information systems. The resulting duty gives obedience its own monitoring rule without making business centrality the ordinary bridge from omission to bad faith. But separating the duty from firm value exposes a question the fused doctrine has obscured: why should corporate law demand compliance when a violation would increase firm value? Section III.B.1 answers that question by supplying a fundamental economic foundation for both the duty of obedience and its monitoring extension. Drawing on the distinction between prices and sanctions, it explains why the state's choice to prohibit rather than price conduct makes compliance with the legal standard—not optimization against expected penalties—the economically appropriate corporate objective. Section III.B.2 derives the duty's scope, standard of review, treatment under Section 102(b)(7), and damages rule; Section III.B.3 addresses five objections.

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[117] *See supra* Section III.A.1 (discussing *FDIC v. Becker*).

[118] *See supra* note 84 and accompanying text.

1. The Economic Foundation

a. Sanctions, Prices, and the Information Problem

Robert Cooter defined a "sanction" as a "detriment imposed for doing what is forbidden," and defined a "price" as "money extracted for doing what is permitted."[119] Sanctions function by creating a significant penalty that is imposed abruptly as one crosses from permissible to impermissible behavior.[120] Think, for example, of a fine for running a red light. Prices, on the other hand, adjust more continuously with behavior. A classic example of such a legal "price" in economic theory is a tax on emitting some pollutant, assessed per unit of pollutant emitted.

The distinction turns in part on the response the law seeks. A driver facing a red-light fine is expected to stop, not decide whether the trip is worth the expected ticket. An emitter facing a per-unit pollution tax is expected to decide how much to emit at the stated price. Prices invite optimization; sanctions call for conformity.

The choice between sanctions and prices turns largely on informational considerations. The state regulates under uncertainty about who is acting, about the consequences of the conduct it seeks to shape, and about the costs its tools impose on those they reach. Prices and sanctions are, in large part, two different responses to that uncertainty.

Pricing makes heavy demands on the state's information. To set the right price, the state must know the external social cost of the activity—ideally, as a function of how the activity is conducted and at what level. A regulator who knew that much could in principle dispense with prohibitions altogether, set a price equal to the external social cost, and let private decision-making produce the socially optimal outcome. Private law often takes this approach: contract law's expectation-damages rule and the strict-liability regimes of tort law both put a price on the actor's conduct equal to the harm imposed on an identifiable victim, and the actor decides whether to proceed against that price. But public law regulation does not often admit of comparable pricing. The harms it addresses are typically diffuse and dispersed, lacking the concentrated, observable victim whose losses anchor private-law damages calculations. For a narrow class of public-law harms, the state can still construct something approximating a price: a per-ton tax on a measurable pollutant, for example. But for most of the harms public law addresses, it cannot. What is the marginal social cost of bribing a foreign official? Of marketing a drug without testing it for safety? Of the diffuse

[119] Cooter, *supra* note 12, at 1523.

[120] *Id.*

erosion of trust in markets caused by accounting fraud at a single large issuer?

The sanction form makes a different informational demand: it requires the state to determine the appropriate standard of behavior. That is also a hard task—but a different hard task, and one for which the state in many cases has better information than it does on the price side. One way to do it would be to precisely measure both social costs and benefits, an approach that would be even more informationally demanding than pricing. But the state can often make comparative judgments—about whether the social costs of an activity exceed its benefits—without precisely measuring either.

When private parties have information about both costs and benefits—either through the symmetry of everyday domains, where each person is potentially injurer or victim, or through reputational discipline in specialized communities of repeat players—a *community standard* may emerge among them, encoding a consensus about socially optimal behavior. Officials can adopt that standard as the legal standard and attach a sanction to it, without themselves observing the underlying costs and benefits.[121]

In other cases, officials must assess socially optimal behavior themselves and set what Cooter calls a *legislative standard*.[122] Scientists prove an ingredient carcinogenic and the legislature bans it; engineers identify the practices that prevent industrial accidents and regulators codify them. Whether through a community standard or a legislative one, the state's information about right conduct can run well ahead of its information about the cost of departures from it.

The FCPA's ban on foreign bribery illustrates the legislative-standard case. The private gains from a bribery transaction are concrete and largely bounded: a foreign contract or license won by the bribing firm, a payment received by the foreign official. The costs are diffuse and borne by other parties. They include the displacement of a more efficient competitor, the erosion of rule-of-law institutions in the recipient country, reputational harms to U.S. firms operating abroad, and second-order effects on governance and economic development. None admits of a precise figure. Even so, the state can reach a comparative judgment that the costs of bribery to other parties generally exceed the bounded gains to the transacting ones. Political deliberation plays a distinctive aggregative role here: legislative and regulatory processes pull together partial information about the diffuse harm—from affected parties, experts, and civil society—into a comparative verdict no single contributor could produce alone, and translate that verdict into the categorical form sanction law takes: a prohibition, not a tax.

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[121] *See* Cooter, *supra* note 12, at 1532–35 & tbl. 1.

[122] *Id.*

Cooter's normative prescription follows from these informational requirements. When the state can measure the external cost of conduct more reliably than it can specify right behavior, it should price. When it can specify right behavior more reliably than it can measure the cost of departures, it should sanction.[123]

b. Why "Efficient Compliance" Is Inefficient

Now consider two orientations toward sanction law. Under *efficient compliance*, the firm treats the expected penalty as a price and authorizes a violation whenever its expected private benefit exceeds the expected legal cost. Under *simple compliance*, the firm treats the behavioral standard itself as the operative guide: it conforms its conduct to what the standard requires and forgoes profitable deviations from it. Which of these two general approaches[124] to sanction-law compliance produces more socially efficient corporate behavior across the relevant domains?

The economic defense of efficient compliance is Pigouvian: if expected legal penalties equal expected external harm and private gains equal social benefits, maximizing profits net of penalties also maximizes social welfare. Easterbrook and Fischel state the implication directly: "Managers have no general obligation to avoid violating regulatory laws, when violations are profitable to the firm, because the sanctions set by the legislature and courts are a measure of how much firms should spend to achieve compliance."[125]

A useful way to frame this comparative analysis is to start from simple compliance and ask what switching to efficient compliance would do. Assume for simplicity that simple compliance yields full compliance with the law's behavioral standards. Adopting efficient compliance in place of simple compliance then authorizes a particular set of deviations from those standards: those for which the firm's expected private benefit exceeds the firm's expected penalty. Call the function that selects that set the firm's *profit screen*. The key question is whether, on average across the deviations the profit screen selects, the resulting conduct is more or less socially valuable than compliance with the standard. Three features of sanction law speak to that question, and each cuts against the screen.

First, the penalty side of the screen is not, in fact, a measure of exter-

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[123] Cooter, *supra* note 12, at 1527, 1532.

[124] This Section's comparative question is posed at the level of the firm's general decision rule. We do not address whether simple compliance produces better outcomes than efficient compliance for every particular sanction law. We discuss the problem of poorly designed laws in Section III.B.3., *infra*.

[125] Easterbrook & Fischel, *supra* note 9, at 1168 n.36. *See also* Bainbridge et al., *supra* note 8, at 593–94 (suggesting that corporate law should permit directors to engage in efficient compliance).

nal harm. Sanction-law penalties are built principally to induce compliance, and their magnitudes turn on administrable and politically defensible considerations—the actor's gain, the monetary harm to identifiable victims, the gravity of the offense, the actor's mental state, repeat-offender status—rather than on an effort to monetize the full social harm. The Clean Water Act authorizes per-day civil penalties that scale with the type and duration of the violation, not with the resulting harm to ecosystems and downstream populations. FCPA exposure rests on flat statutory caps, supplemented by an alternative maximum tied to gross gain or gross loss, rather than on any estimate of rule-of-law erosion in the recipient country. The federal sentencing guidelines compute an organizational base fine from an offense-level table, the firm's pecuniary gain, or the pecuniary loss it caused, and then multiply it by a culpability score keyed to senior management's involvement, prior misconduct, the compliance program, obstruction, and self-reporting.[126] None of these inputs is an externality measure. "Pecuniary loss" means monetary harm to identifiable victims—the overcharge to a direct purchaser, the amount a defrauded counterparty paid—not the broader social cost of the conduct, which typically far exceeds it. And the culpability multipliers raise the penalty as management's involvement deepens and the compliance program weakens, though a pollution event, bribe, or fraud does no more external harm for being knowingly produced than negligently produced. This is what Cooter's analysis predicts of the sanction form: the penalty need only be large enough to deter; it is not built to value external harm.

Second, the benefit side is distorted as well. In many sanction-law domains, much of the firm's gain is a transfer from the very parties the prohibition protects. A bribe can divert a contract from a better-priced or higher-quality bidder; collusion transfers consumer surplus to cartel members while generating deadweight loss; fraud transfers wealth from defrauded investors and counterparties to the issuer and its insiders. In each case the private benefit overstates—often by a wide margin—the social value the conduct creates, yet the profit screen counts every dollar of it as a reason to violate. On such a screen, large private gains are not evidence of large social gains: the violation a firm finds most profitable may be precisely the one a planner would most want to prevent.

Third, the state's choice of a sanction signals where the regime's welfare

[126] *See* 33 U.S.C. § 1319(d) (Clean Water Act per-day civil penalties); 42 U.S.C. § 7413(b) (Clean Air Act); 15 U.S.C. §§ 78dd-2(g)(1)(A), 78dd-3(e)(1)(A), 78ff(a), (c)(1)(A) (FCPA corporate fines); 18 U.S.C. § 3571(d) (alternative maximum of twice the gross gain or twice the gross loss); U.S. Sent'g Guidelines Manual §§ 8C2.4–8C2.7 (U.S. Sent'g Comm'n 2025) (base fine and culpability-score multiplier); *id.* § 2B1.1(b)(1) note (defining loss as the greater of actual or intended pecuniary harm to victims).

information resides. The state generally reaches for a sanction when it can specify prohibited conduct more reliably than it can value the costs of departures from that standard. The regime's welfare judgment is accordingly impounded in the behavioral standard, while the penalty schedule is built to deter. Efficient compliance substitutes the penalty schedule and the firm's partial private-benefit calculus for the regime's principal source of welfare information.

Taken together, these features answer the comparative question. The profit screen does not select for socially beneficial conduct, and the deviations it authorizes therefore tend to reduce rather than increase social value relative to compliance with the behavioral standard. That conclusion grounds the central economic argument for the public-ordering duty: simple compliance is generally the more efficient decision rule, and the label "efficient compliance" is a misnomer.

This claim is more fundamental than the familiar objection that expected penalties are too low because violations escape detection.[127] The Beckerian response to under-enforcement is to raise the sanction by the inverse of the detection probability.[128] Scaling a non-Pigouvian sanction cannot make it Pigouvian. That adjustment restores an expected price only if the state knows the right price. Here it does not. To reproduce the socially correct decision, the expected penalty would have to capture the full gap between private and social value: not only external harm, but also any wedge between private gain and social gain. The argument thus holds even with perfect enforcement and in the absence of agency costs.

c. Why a Fiduciary Duty

The preceding analysis established the objective: simple compliance, rather than optimization around expected penalties, is the socially efficient response to sanction law. We now turn to the means. Why add a fiduciary duty rather than just rely on the primary sanctions already imposed on corporations and individuals?

When sanction law addresses individuals, the law has limited tools for displacing cost-benefit reasoning about whether to comply. The state sets the penalty, articulates the standard, and then relies on what might be called the behavioral infrastructure of compliance—community norms, the salience of the prohibition, internalized rule-following, the moral force of "forbidden"

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127 *See, e.g.*, A. Mitchell Polinsky & Steven Shavell, *The Optimal Tradeoff Between the Probability and Magnitude of Fines*, 69 Am. Econ. Rev. 880 (1979); Arlen, *Evolution*, *supra* note 4, at 196–201.

128 *See* Gary S. Becker, *Crime and Punishment: An Economic Approach*, 76 J. Pol. Econ. 169, 183–84 (1968).

as against "priced." It can shape the environment of decision through stigma, procedure, and public expression, and it can raise the penalty. What it cannot do is regulate the weighing directly; it remains a private mental operation.

Corporations are structurally different in a way that matters here. A firm's decisional architecture is not opaque cognition; it is boards, reporting lines, compensation systems, internal controls, and compliance programs—institutions that law can see, hold to account, and regulate directly. A fiduciary duty to monitor compliance can reconfigure that corporate "operating system"; sanction law has no comparable access to individual deliberation. The public-ordering duty is in this sense a distinctively corporate tool: it fulfills a regulatory ambition built into sanction law that is only partially realizable in the individual-conduct context.[129]

The duty's work is to orient that architecture toward compliance with the legal standard. The information-systems prong requires reporting channels that surface potential violations; the red-flags prong requires investigation and response when warnings appear. But information alone is not enough. The substantive compliance apparatus—compensation, internal controls, training, and investigative capacity—must itself be configured to track the legal standard: a reporting system is of little use if the firm's incentives reward the misconduct it reports. None of this forbids cost-conscious program design. It forbids treating expected sanctions as a reason to prefer noncompliance.[130] The duty thus does at the corporate level what the underlying sanction is designed to do at the level of conduct: displace cost-benefit reasoning about whether to comply.

A natural alternative is simply to raise the corporate penalty. At some point, the argument goes, a sufficiently high penalty will deter. But relying on that instrument alone creates two problems. First, residual violations are unavoidable: even a sound compliance system cannot prevent every act of subordinate misconduct. Penalties high enough to eliminate violations would impose potentially ruinous liability on firms that had made every reasonable effort to comply—and would in any event encounter the judgment-proof constraint. Second, very high penalties can induce excessive compliance

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[129] *Cf.* Rebecca Stone, *Legal Design for the "Good Man,"* 102 Va. L. Rev. 1767, 1779–95, 1826–27 (2016) (arguing that the Good Man framework is largely inapposite to self-interested corporate actors). That inference does not follow for a monitoring duty, which can produce compliance structurally by regulating corporate decisional architecture rather than relying on individual internalization.

[130] *See infra* Section III.B.2. Arlen offers a different account, justifying fiduciary monitoring duties as responses to agency costs and under-enforcement. Arlen, *Evolution*, *supra* note 4, at 200–02. Her diagnosis is gap-filling; ours is categorical: it survives perfect enforcement and perfect alignment because it rests on the state's choice of a sanction rather than a price. *Cf. infra* note 131 (developing the parallel divergence with Arlen's 2012 analysis).

investment. The state's uncertainty about social cost—the very feature that led it to choose a sanction over a price—means the penalty cannot be tuned to social harm, and a level sufficient to eliminate violations may exceed their true social cost. The firm then invests until the marginal expenditure on compliance equals the marginal reduction in expected liability. That level may lie beyond the socially optimal point where marginal expenditure equals the marginal harm avoided.[131] A process duty works on a different margin: it disciplines the firm's *ex ante* architecture without requiring penalties high enough to eliminate every violation or making the corporation a guarantor that no employee will ever violate the law.[132]

Nor can primary sanctions against individual wrongdoers substitute for firm-level monitoring. External enforcers detect hidden intra-firm violations and attribute them to culpable individuals only imperfectly, and the judgment-proof constraint binds harder still: the sanction required to deter can quickly exceed individual wealth. Diffuse organizational fault, moreover, may not be attributable to any single prosecutable person. More important, because the gains from agent misconduct often accrue to the firm, individual sanctions can leave intact the firm's incentive to encourage, tolerate, or conceal violations. The monitoring duty instead enlists the party with superior information and control to police misconduct *ex ante*. Individual sanctions and fiduciary monitoring are therefore complements with a division of labor: one punishes culpable actors, while the other governs the institution.[133]

d. Doctrinal Anchor

This information-cost account supplies a justification for the duty of obedience that prior accounts have not. Scholars have defended corporate obedience in terms of legitimacy, stakeholder interests, and the inadequacy of

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[131] Jennifer Arlen develops a related but distinct point: she shows that even asssuming a Pigouvain corporate fine, monitoring can increase the firm's expected liability and thus be undersupplied. Arlen's response is a duty-based refinement of corporate-level liability to produce a calculated optimum monitoring level. Jennifer Arlen, *Corporate Criminal Liability: Theory and Evidence*, in Research Handbook on the Economics of Criminal Law 144, 172–77 (Alon Harel & Keith N. Hylton eds., 2012).

[132] *See* Steven Shavell, *The Judgment-Proof Problem*, 6 Int'l Rev. L. & Econ. 45 (1986); Steven Shavell, *Liability for Harm versus Regulation of Safety*, 13 J. Legal Stud. 357 (1984) (identifying inability to pay for the full harm and the chance that suit will not be brought as conditions favoring *ex ante* regulation alongside, or in place of, *ex post* liability).

[133] *See* A. Mitchell Polinsky & Steven Shavell, *Should Employees Be Subject to Fines and Imprisonment Given the Existence of Corporate Liability?*, 13 Int'l Rev. L. & Econ. 239, 239–41 (1993) (explaining why public sanctions on employees can complement corporate liability when firms cannot impose adequate internal discipline); Arlen & Kraakman, *supra* note 11, at 706–15 (explaining why individual liability alone may underdeter and how entity liability can enlist firms to prevent, monitor, investigate, and report employee wrongdoing).

penalties as measures of social cost. None derives the categorical rule from the information problem that leads the state to prohibit conduct rather than price it.[134] The public-ordering duty carries the same proposition into governance by requiring the informational and organizational infrastructure through which compliance becomes possible.

Delaware doctrine already recognizes both sides of the distinction. On the price side, fiduciary law permits cost-benefit optimization around contractual obligations: "a board of directors may choose to breach if the benefits (broadly conceived) exceed the costs (again broadly conceived)."[135] On the sanction side, Delaware treats knowing corporate illegality as bad faith. *Massey Energy* declared that "Delaware law does not charter law breakers."[136] *TransUnion* likewise identified as the paradigmatic oversight violation a board that "purposely caused the corporation to break the law in pursuit of greater profits."[137] And the post-*Marchand* cases apply the monitoring duty to regulatory regimes governing food, drug, and aviation safety.[138]

What the cases lack is an organizing line. They still ordinarily rely on business centrality to infer bad faith, importing an agency-cost limitation into the public-ordering domain. The sanctions-prices distinction explains both Delaware's existing commitment and the limiting principle for a duty designed to carry it out.

One might still object that a duty whose beneficiaries include the public is not fiduciary in any traditional sense. That objection confuses the duty's beneficiaries with its object. The object remains the fiduciaries' exercise of delegated corporate power. Chancery does not enforce the underlying regulatory regime or impose its sanctions; agencies and courts charged with the substantive law do that. Chancery reviews how the board organized the corporation it controls, through the obedience strand of fiduciary doctrine it already administers. The alternative would be perverse: fiduciary law would condemn a director who knows of corporate lawbreaking but protect a board that organizes itself not to know. The public-ordering duty closes that path to strategic ignorance. It gives the duty of obedience the informational

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[134] *See supra* note 10.

[135] *Frederick Hsu Living Tr. v. ODN Holding Corp.*, No. CV 12108-VCL, 2017 WL 1437308, at *24 (Del. Ch. Apr. 14, 2017), as corrected (Apr. 25, 2017); *see also In re Essendant, Inc. S'holder Litig.*, 2019 WL 7290944, at *13 (Del. Ch. Dec. 30, 2019).

[136] *In re Massey Energy Co.*, 2011 WL 2176479, at *20 (Del. Ch. May 31, 2011).

[137] *In re TransUnion Deriv. S'holder Litig.*, 324 A.3d 869, 886–87 (Del. Ch. 2024).

[138] *See Marchand v. Barnhill*, 212 A.3d 805, 809–12 (Del. 2019); *In re Clovis Oncology, Inc. Derivative Litig.*, 2019 WL 4850188, at *1–3 (Del. Ch. Oct. 1, 2019); *In re The Boeing Co. Derivative Litig.*, 2021 WL 4059934 (Del. Ch. Sept. 7, 2021) (denying motion to dismiss as to board oversight claim).

infrastructure its command presupposes, while leaving the agency-cost duty to protect stockholders.

2. Designing the Public-Ordering Duty

The design problem is to give simple compliance doctrinal form without making directors guarantors of perfect compliance. The duty must orient the corporation's compliance apparatus toward the behavioral standards imposed by sanction law while preserving board discretion over the reasonable design of that apparatus. Five questions structure the analysis: the duty's scope; the standard of review for inattention to compliance; the standard of review for conscious facilitation of noncompliance; the duty's status under Section 102(b)(7); and the appropriate measure of damages.

a. Scope: Sanctions, Not Prices

The first question is where the duty begins and ends. The answer is sanction law. When law prescribes a behavioral standard and attaches consequences designed to induce conformity, the corporation is expected to comply. When law instead permits conduct upon payment of a charge meant to internalize its social cost, the corporation may optimize. A price enters the corporate calculus; a sanction constrains it.

That boundary does different work from the business-centrality screen. It asks what kind of legal rule the state has adopted, not how important the regulated activity is to the firm. In the fused doctrine, Delaware infers indifference to the law from indifference to the business. The public-ordering duty severs that inference. A compliance risk's importance to firm value therefore neither determines whether the duty applies nor supplies the inferential bridge from omission to culpability. Current doctrine produces the opposite result. A technology company's board faces far weaker fiduciary pressure to build a serious process for detecting foreign bribery than a pharmaceutical company's board faces for drug safety, even though the FCPA's prohibition is no less binding because anti-bribery compliance is peripheral to the technology business. Both bodies of law impose sanctions. Both call for compliance rather than optimization. This broader scope is intentionally more demanding: it is the operational counterpart of the duty of obedience's command that the corporation pursue only lawful business.

But expanding the monitoring domain does not eliminate prioritization. The scale, likelihood, and complexity of the corporation's exposure, the feasibility and cost of monitoring, and the marginal effectiveness of additional safeguards all bear on what an adequate process requires. The duty does not demand equal board-level attention to every sanction-law obligation. What drops out is the proposition that only a risk central to firm value can make the failure to look culpable.[139]

What, then, counts as a sanction? Courts can answer that question using ordinary tools of legal interpretation. Cooter's state-of-mind diagnostic supplies a useful starting point. Sanctions characteristically escalate with intent, recklessness, or repetition because those features identify conduct that requires greater deterrence; prices ordinarily vary instead with the external harm to be internalized. Compensatory damages are the paradigmatic price-form remedy, while punitive damages and criminal enhancements for premeditation or recidivism are sanction-form remedies for this reason.[140]

The inference runs one way. Sensitivity to state of mind reliably identifies a sanction, but indifference to state of mind does not establish a price. Many categorical prohibitions impose strict liability—the red-light fine Cooter treats as paradigmatic and FDA penalties for adulterated food, for example. Price form instead requires affirmative structural hallmarks: permission to engage in the conduct upon payment, an assessment varying with the quantity or harm at issue, and a design oriented toward internalizing social cost rather than suppressing the conduct. Penalty magnitude is evidence of form, not the criterion of it. A moderate fine attached to a categorical prohibition on bribing foreign officials remains an underdeterring sanction; it does not become a price merely because the expected penalty is too small to deter a particular firm. That underdeterrence is a reason for the monitoring duty to have work to do, not a reason to reclassify the legal rule.

Some regulatory regimes combine both forms, and courts should classify them rule by rule rather than statute by statute. A pollution regime, for example, may impose a per-unit charge for authorized emissions below a threshold and a penalty for discharges above it. The court should identify the function of the particular obligation the plaintiff says the board failed to monitor, looking to its text, structure, remedial design, and enforcement practice. Difficult cases will remain at the margin. But the distinction is already doing meaningful work in Delaware's compliance jurisprudence, and the existing cases track it well enough for the duty's core applications.

b. Gross Negligence: Culpable Inattention

A board can violate the public-ordering duty without ever deciding to violate the law. It may simply leave the corporation without a process reasonably capable of detecting and preventing sanction-law violations. Gross negligence

[139] *See supra* Section II.A (documenting the distortions the screen produces for public ordering).

[140] Cooter, *supra* note 12, at 1537–40 (developing the state-of-mind diagnostic and explaining why sanctions, but not prices, are sensitive to the actor's mental state).

is the appropriate standard for that failure. The form of review is familiar from the agency-cost duty: courts examine process, not outcomes. But the reference point is different. The agency-cost duty asks whether the board equipped itself to protect the corporation's interests; the public-ordering duty asks whether it equipped the corporation to comply with sanction law. A given failure may implicate both duties when inadequate monitoring also threatens the corporation or reflects an agency cost. Neither duty depends on the other.

What does gross negligence look like here? The question is not whether the compliance system failed. Systems fail. The question is whether the board's systems, and its use of them, were so deficient that no reasonable board could regard the process as adequate, judged ex ante in light of what was known or reasonably knowable at the time. To plead an inattention claim, a plaintiff must allege facts supporting a reasonable inference that the process met that threshold. The clearest case is substantial, reasonably foreseeable exposure to a sanction-law regime with no process directed to it. A program that exists on paper may also be grossly deficient if it lacks qualified personnel, fails to bring significant problems to the board or a designated committee, leaves recurring deficiencies unreviewed, or remains static as the corporation's exposure changes. A board that receives credible evidence of sanction-law violations and takes no meaningful investigative or remedial step may likewise be grossly negligent even absent subjective bad faith.[141]

A compliance apparatus can also defeat itself. Reporting channels cannot do the work if compensation systems, internal controls, or investigative arrangements push the organization in the opposite direction. Consider a trucking company whose monitoring system reliably detects hours-of-service violations but whose compensation scheme rewards delivery targets achievable only by committing them. The monitoring system says stop, but the compensation system says keep driving. Taken as a whole, the apparatus is tilted away from compliance, whether or not any director consciously chose that orientation.

External benchmarks such as SOX 404, the FCPA Resource Guide, and DOJ's *Evaluation of Corporate Compliance Programs* can supply evidence of reasonable practice, but not elements of the fiduciary claim.[142] Meaningful

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141 *See In re McDonald's Corp. S'holder Derivative Litig.*, 291 A.3d 652, 678 (Del. Ch. 2023); *Stone*, 911 A.2d at 370.

142 *See* 15 U.S.C. § 7262; U.S. Dep't of Justice, Crim. Div. & U.S. Sec. & Exch. Comm'n, Enforcement Div., *A Resource Guide to the U.S. Foreign Corrupt Practices Act* (2d ed. 2020); U.S. Dep't of Justice, Crim. Div., *Evaluation of Corporate Compliance Programs* (rev. Sept. 2024).

conformity is strong evidence that the process falls within the range of reasonableness; departure may point the other way but does not itself establish gross negligence. Boards retain substantial room to delegate, choose among monitoring technologies, allocate resources across regulatory regimes, and decline measures with slight marginal compliance value. A reasonable process need not treat every obligation equally or prevent every violation. The standard polices only the outer boundary—a process no reasonable board could regard as adequate.

Our formulation overlaps with Arlen's enhanced information-acquisition duties but differs in scope and design. It reaches sanction law generally rather than only laws that are mission-critical to the firm or guard against serious physical injury; it encompasses incentives and controls as well as information acquisition; and it uses gross negligence rather than bad faith.[143] Arlen rejects negligence-based liability on epistemic grounds. We instead apply Delaware's familiar gross-negligence standard for director process failures: the epistemic and hindsight concerns are no greater here than in the duty-of-care cases that standard already governs.[144]

c. Bad Faith: Conscious Facilitation

Inattention is only half the problem. A board can investigate carefully, understand the prohibition, and choose noncompliance anyway. That is not a failure of diligence but a deliberate choice to facilitate the corporation's violation of sanction law. This is the doctrinal home of *Massey*-style claims, and the appropriate standard is bad faith.

The board's process may be exemplary. Consider a board that, after careful deliberation, determines that an effective environmental compliance program would cost more than the expected sanctions for noncompliance and therefore declines to adopt one.[145] The board became fully informed, deliberated, and selected the course that maximizes shareholder value. The problem is its objective. It has engaged in precisely the "efficient compliance" approach the public-ordering duty is designed to prevent: it has treated a sanction as a price and optimized around it.[146]

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143 *See* Arlen, *Evolution*, *supra* note 4, at 199, 202–04, 207–13.

144 *See supra* Section II.B.1.

145 Bainbridge and his coauthors describe this as "the board that weighs costs and benefits" and argue that the business judgment rule should protect its informed decision. Bainbridge et al., *supra* note 8, at 600–04. The agency-cost duty protects that informed choice; bifurcation gives the public-ordering duty independent force against conscious facilitation of noncompliance.

146 *Cf.* Cooter, *supra* note 12, at 1524–25 (distinguishing prices, for which cost-benefit optimization is the expected response, from sanctions, for which compliance is the expected response).

The same principle reaches deliberate blind spots. An anti-money-laundering system may flag transactions above the applicable reporting threshold while being intentionally designed to ignore patterns of related transactions structured to fall just below it. The system has not merely failed to see the evasion; it was built not to see it. That is a *Massey*-style claim translated into compliance architecture.

The bad-faith line turns on the comparison the board makes, not the amount it spends. A board may compare a compliance measure's cost with its contribution to compliance; it may not treat the expected gains from violation, net of penalties, as a reason to prefer noncompliance. Thus, two boards may adopt the same compliance budget for different reasons: one because further spending would add little to compliance, the other because violating the law is cheaper. The first has made a protected design judgment unless the resulting process is grossly inadequate. The second has consciously facilitated noncompliance.

d. Exculpation and Section 102(b)(7)

The public-ordering duty should be non-exculpable. Section 102(b)(7) permits a charter provision eliminating directors' personal monetary liability for certain fiduciary breaches. That allocation of authority makes sense for the agency-cost duty: because that duty protects stockholder interests, stockholders can decide whether the benefits of greater monitoring liability justify its costs. The public-ordering duty is different. Although formally owed to the corporation and enforced derivatively, its protective purpose extends to the workers, consumers, and other members of the public whom sanction law protects. Stockholders should not be able to waive a duty intended to protect persons who had no part in the decision.

The statutory path is straightforward for bad faith and harder for gross negligence. Section 102(b)(7) separately preserves liability for breaches of "the director's duty of loyalty to the corporation or its stockholders" and for "acts or omissions not in good faith or which involve intentional misconduct or a knowing violation of law."[147] The public-ordering duty's bad-faith component falls within the latter exclusion. Its gross-negligence component does not: gross negligence does not become bad faith merely because the subject of the monitoring duty is legal compliance.[148] The gross-negligence component therefore depends on the loyalty exclusion, which preserves liability for "any breach" of the duty of loyalty and contains no scienter requirement. That exclusion turns on the classification of the duty breached,

[147] Del. Code Ann. tit. 8, § 102(b)(7)(i)–(ii) (2023).

[148] *See In re Walt Disney Co. Derivative Litig.*, 906 A.2d 27, 64–66 (Del. 2006).

not the culpability of the breach.

There is a plausible basis for concluding that the duty qualifies. Delaware cases have repeatedly treated obedience to law as an aspect of loyalty, reasoning that a fiduciary cannot act loyally by causing the corporation to violate positive law, even when the violation might benefit the corporation financially.[149] That treatment is consistent with the distinction developed here. The duty of care governs the quality of directors' efforts in pursuing permissible corporate objectives. The duty of obedience marks which objectives are permissible in the first place: it denies directors authority to manage the corporation through violations of sanction law. The latter remains a loyalty principle even when the applicable standard of review is objective rather than intent based.

Nor does applying a gross-negligence standard convert the duty into one of care. Entire-fairness doctrine demonstrates that loyalty obligations can be enforced through an objective standard: "as to the interested party itself, a finding of unfairness after trial will subject it to liability for breach of the duty of loyalty regardless of its subjective bad faith."[150] The analogy does not itself establish that the public-ordering duty is one of loyalty; it establishes the narrower point that loyalty is not defined exclusively by subjective bad faith. The duty's classification rests instead on its object: preserving the limits that public law places on corporate action.

Finally, non-exculpable does not mean uninsurable. Section 145(g) permits corporations to insure directors against liabilities for which indemnification is unavailable.[151] Insurance attenuates directors' out-of-pocket exposure, but it preserves both the claim and the underwriting and pricing mechanisms through which liability can affect corporate conduct.

e. Damages: Rejecting the Net-Loss Rule

The public-ordering duty is itself sanction-form law at the board level: monetary liability is meant to induce directors to discharge the duty, not to establish a price at which they may disregard it. A social-harm measure of damages is neither available nor appropriate. The underlying law does not quantify

149 *See In re Massey Energy Co.*, 2011 WL 2176479, at *20 (Del. Ch. May 31, 2011); Metro Commc'n Corp. BVI v. Advanced Mobilecomm Techs., Inc., 854 A.2d 121, 131 (Del. Ch. 2004); Guttman v. Huang, 823 A.2d 492, 506 n.34 (Del. Ch. 2003); *Stone*, 911 A.2d at 370.

150 *In re Cornerstone Therapeutics Inc. S'holder Litig.*, 115 A.3d 1173, 1181 & n.30 (Del. 2015); *see also* William Penn P'ship v. Saliba, 13 A.3d 749, 756–58 (Del. 2011) (imposing liability for breach of the duty of loyalty on self-interested fiduciaries who failed to establish the entire fairness of a sale).

151 Del. Code Ann. tit. 8, § 145(b), (g) (2023); *see RSUI Indem. Co. v. Murdock*, 248 A.3d 887 (Del. 2021); Tom Baker & Sean J. Griffith, *Predicting Corporate Governance Risk: Evidence from the Directors' & Officers' Liability Insurance Market*, 74 U. CHI. L. REV. 487, 489–90, 533–36 (2007).

the full social harm caused by the violation, and derivative recovery runs to the corporation rather than to workers, consumers, or other victims. The remedy must therefore use administrable categories of corporate loss while preserving the duty's deterrent force.

A compensatory starting point would produce a "net-loss" measure. Gains from the illegal activity would be credited against the fines, settlements, remediation expenses, and other losses it produced; if the gains equaled or exceeded those losses, recovery would disappear.[152]

That arithmetic fits the agency-cost duty. Because that duty protects the corporation and its shareholders from financial harm, netting measures the injury it exists to prevent. It does not fit the public-ordering duty. Netting would make profitable noncompliance a partial or complete defense to the board's failure to discharge its compliance obligation: the more profitable the violation, the less consequence would attach to the fiduciary breach. The remedy would thereby push the duty back toward price form.

Delaware derivative remedies, however, are not confined to compensation when compensation would undermine the fiduciary rule being enforced.[153] We therefore propose gross corporate loss: penalties, settlements, enforcement costs, and other corporate losses proximately caused by the fiduciary breach, without crediting gains from the underlying illegality. This is not disgorgement; the illegal gains are disregarded, not recovered. Nor does the measure reproduce social harm, calculate an optimal penalty, or make directors answer for every consequence of a violation. Ordinary rules of causation, apportionment, and mitigation remain. "Gross" means only that illegal gains do not offset losses caused by the breach.

3. Objections

Five objections warrant further discussion. They concern shareholder enforcement, stakeholderism, charter competition, bad or uncertain law, and defensive overinvestment.

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[152] *See* Patrick J. Ryan, *Strange Bedfellows: Corporate Fiduciaries and the General Law Compliance Obligation in Section 2.01(a) of the American Law Institute's Principles of Corporate Governance*, 66 Wash. L. Rev. 413, 452–57 (1991). This effect should not be overstated. Conduct that appeared profitable ex ante may produce a net loss once detection brings penalties and remediation costs. But every dollar of illegal gain would still reduce recovery, and a sufficiently profitable violation would eliminate it.

[153] Loyalty law, for example, permits gain-based recovery even when the corporation suffered no loss if allowing the fiduciary to retain the gain would weaken the prohibition on disloyal conduct. *See* Brophy v. Cities Serv. Co., 70 A.2d 5 (Del. Ch. 1949); Kahn v. Kolberg Kravis Roberts & Co., 23 A.3d 831, 840 (Del. 2011). These cases do not dictate the measure here; they establish the narrower point that compensation need not control when it would undermine the duty being enforced.

a. Shareholder Enforcement of a Public-Ordering Duty

The enforcement mechanism appears mismatched with the duty's purpose. Derivative suits are brought by shareholders, and recovery flows to the corporate treasury. Yet shareholders may benefit from profitable lawbreaking, while the public-ordering duty protects interests that extend beyond the corporation. Why rely on plaintiffs whose financial interests may diverge from the duty they are asked to enforce?[154]

The objection has intuitive appeal but dissolves upon examination. Under the net-loss rule, illegal gains offset enforcement-related losses and can extinguish the corporate claim.[155] But under the gross-loss measure we propose, recovery turns on the corporate losses proximately caused by the fiduciary breach; the gains from the underlying violation drop out. The corporation therefore retains a claim worth enforcing even when the violation paid.

More fundamentally, deploying private litigants to enforce duties whose benefits are primarily external is a thoroughly conventional institutional design choice. Qui tam actions under the False Claims Act are the clearest example: the relator receives a statutory share of the recovery, while the principal benefit of deterring fraud on the public fisc is external. Citizen-suit provisions similarly enlist private plaintiffs to enforce environmental commands.[156] These regimes give private actors enough of a stake to mobilize enforcement even though much of the resulting benefit accrues elsewhere. Gross-loss recovery performs the same incentive function.

The objection also proves too much. Ordinary derivative litigation already operates through the same demand machinery and separates the plaintiff's private recovery from the broader benefits of enforcement. A shareholder challenging self-dealing captures only a pro rata share of any recovery, while the resulting deterrence benefits shareholders of other corporations and the corporate system more generally.[157] Once a claim has value, the fee available to plaintiffs' counsel can supply the litigation incentive even though the nom-

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154 *See* Elizabeth Pollman, *Corporate Disobedience*, 68 DUKE L.J. 709, 750–56, 764 (2019) (arguing that fiduciary duties are "a poor fit for constraining corporate disobedience"); *see also* Pollman, *Corporate Oversight and Disobedience*, *supra* note 4, at 2042–45.

155 *See* Pollman, *Corporate Disobedience*, *supra* note 154, at 753–56 (describing net-loss recovery as an "insurance policy" under which shareholders benefit when illegality pays and recover when it does not); *see also id.* at 722 n.60 (noting disagreement over the continued authority of the net-loss cases).

156 *See* 31 U.S.C. § 3730(d)(1)–(2); Clean Water Act § 505, 33 U.S.C. § 1365; Clean Air Act § 304, 42 U.S.C. § 7604.

157 *Cf.* John C. Coffee, Jr., *Reforming the Securities Class Action: An Essay on Deterrence and Its Implementation*, 106 COLUM. L. REV. 1534, 1546–57 (2006) (arguing that securities class actions are justified by deterrence rather than compensation).

inal plaintiff's pro rata stake is small.[158] That structure does not cast doubt on derivative enforcement. It is part of the reason derivative enforcement exists. The same institutional logic carries over to public ordering.

Finally, the derivative vehicle preserves procedural unity. A single compliance failure may implicate both the agency-cost duty and the public-ordering duty, and the two claims will often depend on the same board materials, committee structures, reporting channels, incentives, and responses to warnings. Assigning the theories to separate derivative, administrative, or qui tam proceedings would duplicate discovery and risk inconsistent findings about the same events. A single derivative action permits both duties to be resolved on a common record, with the court applying each duty's own standard.

b. A Bounded Form of Corporate Social Responsibility

The public-ordering duty subordinates shareholders' interest in profitable illegality to interests protected by external law. In that broad sense, it is a form of corporate social responsibility,[159] and it invites two familiar objections: that boards charged with serving multiple constituencies are accountable to none, and that managers who pursue social ends trespass on democratic authority.[160] The first objection mistakes the duty's structure. Stakeholder governance authorizes boards to balance competing constituencies; a board told to serve everyone can rationalize almost any decision as serving someone.[161] The public-ordering duty supplies no such escape hatch. Its source and direction are fixed: orient the corporation's systems toward compliance with sanction law. Boards retain judgment over the means of compliance—including how to interpret uncertain requirements and allocate monitoring resources—subject to gross-negligence review; they do not retain judgment over whether to comply.

The second objection gets the institutional allocation backwards. Friedman's complaint was that managers who sacrifice profits for social objectives effectively "impose taxes" and decide how the proceeds will be spent—public

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[158] *See L.A. City Emps.' Ret. Sys. v. Sanford*, 352 A.3d 276, 307–08 (Del. Ch. 2026) (discussing the incentive of contingent-fee counsel to pursue fiduciary claims capable of producing a meaningful recovery).

[159] *See, e.g.*, Lucian A. Bebchuk & Roberto Tallarita, *The Illusory Promise of Stakeholder Governance*, 106 Cornell L. Rev. 91, 94, 100 (2020) (describing stakeholderism as a view that asks corporate leaders to "attach independent weight to the interests of all stakeholders" beyond shareholders).

[160] *See* Robert P. Bartlett III & Ryan Bubb, *Corporate Social Responsibility Through Shareholder Governance*, 97 S. Cal. L. Rev. 417, 419–23 (2024) (surveying the literature and its critiques).

[161] *See* Michael C. Jensen, *Value Maximization, Stakeholder Theory, and the Corporate Objective Function*, 14 J. Applied Corp. Fin. 8, 14 (Fall 2001); Bebchuk & Tallarita, *supra* note 159, at 117–23, 164–68.

functions entrusted to politically accountable institutions.[162] But those institutions have already made the policy choice embodied in sanction law. A board practicing "efficient compliance" substitutes its private cost-benefit calculation for that public command. Friedman himself required firms to conform to "the basic rules of the society."[163] The public-ordering duty gives that qualifier legal force: stakeholderism asks managers to make social policy; this duty prevents them from unmaking it.

c. State Competition and the Chartering Equilibrium

A third objection concerns the duty's institutional durability. Charter competition gives Delaware reason to offer rules that managers and shareholders prefer, while a non-exculpable duty requiring boards to forgo profitable illegality imposes a cost they may seek to avoid. Recent developments make the concern concrete. Delaware's 2025 amendments narrowed the books-and-records inspections that often supply oversight complaints; Texas permits corporations to bar derivative suits by holders of less than three percent; and eXp World Holdings identified pending derivative litigation as a factor in considering redomestication to Texas, where *Caremark* enforcement is sharply constrained.[164] If Delaware recognizes the duty and rival states do not, firms may leave and Delaware may retreat to protect its franchise.

The objection is serious, but it models only one side of Delaware's equilibrium. Delaware competes for charters under the continuing possibility that federal law will displace state corporate law when scandal makes state governance appear inadequate. Kahan and Rock describe the relationship as "symbiotic": federal intervention becomes most likely when corporate misconduct generates the political energy for preemption, as Enron and WorldCom helped produce Sarbanes-Oxley.[165] The threat waxes and wanes with the political cycle, but it remains a standing constraint. A regime perceived as allowing corporations to profit from lawbreaking without meaningful board accountability would help reactivate it.

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162 Milton Friedman, *A Friedman Doctrine—The Social Responsibility of Business Is To Increase Its Profits*, N.Y. TIMES (Sept. 13, 1970); *see also* Bebchuk & Tallarita, *supra* note 159, at 119–23, 164–68.

163 Friedman, *supra* note 162.

164 85 Del. Laws ch. 6 (2025) (amending Del. Code Ann. tit. 8, § 220); Tex. S.B. 29, 89th Leg., R.S. (2025) (codified at Tex. Bus. Orgs. Code § 21.552(a)(3)); eXp World Holdings, Inc., Definitive Proxy Statement (Schedule 14A), at 55–56, 63–66 (Mar. 9, 2026); AGNT, Inc. (f/k/a eXp World Holdings, Inc.), Current Report (Form 8-K) (June 11, 2026). For the strongest statement of the objection, see Lipton, *supra* note 4, at 107–08.

165 Marcel Kahan & Edward Rock, *Symbiotic Federalism and the Structure of Corporate Law*, 58 VAND. L. REV. 1573, 1576, 1588–90, 1609–16 (2005); *see* Mark J. Roe, *Delaware's Competition*, 117 HARV. L. REV. 588, 588–90 (2003).

Delaware's own history shows that competitive retrenchment and doctrinal development can coexist. *Van Gorkom* produced a liability and insurance crisis; Section 102(b)(7) answered by authorizing care exculpation while preserving liability for loyalty and bad faith. A decade later, *Caremark* articulated an affirmative monitoring obligation. Another decade later, *Stone* placed the bad-faith oversight claim within the non-exculpable loyalty framework.[166] The retrenchment of 1985 and 1986 did not freeze fiduciary doctrine or prevent the later emergence of a non-exculpable compliance core. Current redomestication pressure likewise does not foreclose further refinement.

The proposal also contains limits responsive to competitive pressure. It confines the public-ordering duty to sanction law, reviews process rather than outcomes, leaves substantial room for risk-based prioritization, and retains insurance. Bifurcation makes Delaware's existing public-ordering commitment more explicit while giving it limits keyed to its purpose rather than to business centrality.

Migration risk is real, and charter competition constrains the feasible design. Delaware's chartering position has nonetheless long depended on balancing private demand for managerial protection against the legal system's demand for credible corporate accountability. A calibrated public-ordering duty can fit within that balance.

d. Regulatory Complexity and Outdated Law

A fourth objection attacks the premise of obedience itself. Sanction-law regimes are not uniformly wise. Some are dense and internally inconsistent; others have become obsolete, protectionist, or poorly fitted to changed technology and markets. A duty that treats every sanction as a command may seem to freeze those defects into corporate law and force firms to spend socially valuable resources complying with rules that should instead be changed or ignored.

The proposal does not depend on every sanction law being well designed. It rests on an institutional claim about who should decide when a legal command no longer deserves obedience. Two problems must be separated. The first is uncertainty about what the law requires. The second is disagreement with a law whose meaning is clear.

Regulatory complexity principally raises the first problem, and gross-negligence process review supplies the answer. The duty does not impose strict liability for every violation or demand equal monitoring of every legal

166 *See Smith v. Van Gorkom*, 488 A.2d 858 (Del. 1985); Del. Code Ann. tit. 8, § 102(b)(7); *In re Caremark Int'l Inc. Derivative Litig.*, 698 A.2d 959, 970–71 (Del. Ch. 1996); *Stone v. Ritter*, 911 A.2d 362, 369–70 (Del. 2006).

requirement. It asks whether the board has oriented the corporation toward compliance through a defensible, risk-based process. Boards may prioritize among regulatory domains, rely on qualified officers and counsel, choose among monitoring technologies, and decline safeguards whose marginal contribution to compliance is slight relative to their cost. Reasoned interpretations of uncertain law bear on whether the board's process was grossly inadequate; an eventual violation does not by itself establish breach.[167]

The harder case is a board that understands the law and concludes that it is bad. Allowing the firm to decide that a sanction is outdated enough to ignore recreates the profit-screen problem that grounds the proposal: the firms most likely to benefit from noncompliance are also the firms most likely to pronounce the prohibition inefficient. Regulatory entrepreneurs present the strongest counterexample. Their defiance can expose obsolete or protectionist rules and catalyze useful reform. But it is driven by private profit, and its social value depends on an alignment between private and public interests that cannot be assumed.[168] A firm that knows its private gains but lacks the information and institutional responsibility to assess the full social consequences is poorly positioned to decide which public commands may be discarded.

The legal system supplies other channels. A firm may lobby for repeal, petition an agency, seek a waiver, challenge a rule's validity, seek enforcement discretion, or litigate a nonfrivolous interpretation of an uncertain command. It may not acknowledge that sanction law forbids its conduct and then treat the expected penalty as the purchase price for proceeding. The public-ordering duty leaves corporations room to contest the law. It denies them authority to repeal it for themselves.

e. Overcompliance and Defensive Monitoring

The final objection turns the proposal's incentive logic against it. The corporation bears the cost of compliance, while directors receive the personal benefit of reducing their exposure to a non-exculpable claim. Directors may therefore spend corporate money on monitoring beyond the point where the marginal social benefit of preventing additional violations justifies the marginal cost. Some of this pressure is the point. Section III.B.1 explains why privately optimal monitoring ordinarily falls short of the social optimum in sanction-law domains. The force of the objection is that personal liability may push the board past the social optimum.

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[167] *See supra* Section III.B.2.

[168] *See* Elizabeth Pollman & Jordan M. Barry, *Regulatory Entrepreneurship*, 90 S. Cal. L. Rev. 383, 385–88, 442–47 (2017).

Three features of the design contain that risk. First, gross-negligence review preserves a protected zone for conduct that falls short of reasonable care without becoming actionable. That zone gives boards room to make imperfect compliance-design judgments without incurring liability. It is also why we do not adopt ordinary negligence as the standard of review: ordinary negligence would make every departure from reasonable care potentially actionable, increasing the pressure toward defensive monitoring.[169]Second, review concerns the monitoring process. Once the board has adopted a defensible, risk-based architecture, spending enough to eliminate every residual violation does not necessarily purchase additional liability protection because a violation alone does not establish breach.[170] Third, insurance attenuates the personal exposure that drives defensive spending, while ordinary rules of causation and apportionment prevent directors from becoming guarantors of every loss following a regulatory violation.[171]

These features cannot fully eliminate defensive expenditure. No damages-backed duty can. Gross negligence deliberately accepts some underenforcement to preserve board discretion over compliance design and expenditure.

Conclusion

For three decades, *Caremark* doctrine has attempted to serve two masters with one instrument. This Article has argued that the duty to monitor fuses two distinct social purposes—policing agency costs and facilitating public ordering—into a single doctrinal compound, and that this fusion undermines both. We have proposed splitting the atom: replacing the unified duty with an agency-cost duty grounded in the duty of care and a public-ordering duty grounded in the duty of obedience and the prices-versus-sanctions distinction, each designed to serve its own purpose.

We close with a more personal observation about why we believe this bifurcation tracks something real about the structure of corporate law. One of us teaches Corporations; the other first encountered the duty to monitor as a student in that course. Between the two of us, we have experienced the doctrine's pedagogical tensions from both sides of the lectern—and it is in the classroom, where doctrine must be explained rather than merely applied, that the *Caremark* atom becomes most visible.

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[169] This is the familiar overdeterrence-control function of the divergence between standards of conduct and standards of review. *See* Eisenberg, *supra* note 84, at 462–68.

[170] *See supra* Section III.B.2.

[171] *See supra* Section III.B.2 (explaining that non-exculpability does not imply non-insurability and preserving ordinary causation and apportionment rules).

Consider first the agency-cost duty. The teaching materials for that Corporations course have long placed the duty-to-monitor cases—now featuring *Marchand* as the key case—in the chapter on the Duty of Care. That is because the doctrine makes intuitive sense as a duty of care problem: the board failed to pay adequate attention to the corporation's affairs, and a reasonable board would have done better. Students grasp this immediately. Yet the doctrine has drifted away from that location—reframed around compliance failures, bad faith, and loyalty, and then, in the post-*Marchand* era, organized around the business-centrality screen—so that it no longer sits comfortably in any doctrinal chapter. What we propose with the agency-cost duty is, in a sense, to restore the doctrinal home that the classroom already intuited. If the duty to monitor for agency costs *is* a duty of care, then it should be taught as one, analyzed as one, and reviewed as one.

Now consider the public-ordering duty from the opposite direction. It is awkward, in a Corporations course taught through the lens of law and economics, to explain why a board's failure to monitor for violations of positive law constitutes a breach of fiduciary duty. If fiduciary duties exist to reduce agency costs—to align managers' incentives with shareholders' interests—then the obligation to monitor legal compliance does not obviously belong. It sounds like a moral imperative grafted onto an economic framework. What our analysis reveals is that the unease is well-founded: the public-ordering function of oversight *is* different from the agency-cost function, and forcing both into a single doctrinal vessel is what makes the compliance obligation seem anomalous. But once the public-ordering duty is given its own economic foundation, grounded in the prices-versus-sanctions distinction, the awkwardness dissolves. The duty to monitor compliance with sanction law is not a moral overlay on an economic framework; it *is* the economic framework. The state deploys sanctions precisely where pricing fails, and a board that optimizes around sanctions converts them back into the prices the state rejected. The duty of obedience, far from being an embarrassment to the law-and-economics account of corporate law, turns out to be one of its most elegant applications.

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