Corporate Oversight and Disobedience

Elizabeth Pollman
University of Pennsylvania Carey Law School

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Corporate Oversight and Disobedience

Elizabeth Pollman*

Over a decade has passed since landmark Delaware corporate law decisions on oversight responsibility, and only a small handful of cases have survived a motion to dismiss. Scholars have puzzled over what it means to have the potential for corporate accountability lodged within the duty of good faith, but almost never brought to fruition in terms of trial liability.

This Article explores the public-regarding purpose of the obedience and oversight duties in corporate law and provides a descriptive account of how they are applied in practice. The Article argues that the fidelity to external law required by the duty of good faith largely serves a legitimizing role for corporate law. Expressing obligations of legal compliance and oversight within corporate law acknowledges societal interests in the rule of law and preserves the ability of courts to flexibly respond to particularly salient and egregious violations of public trust, should they arise, without upending case law developed over decades.

Further, this Article examines the body of Delaware law concerning the oversight and obedience aspects of the duty of good faith and argues that they have become functionally linked. In practice to date, Delaware courts have prioritized giving directors broad latitude to take business risk by drawing a line at legal risk, despite the possibility that both types of activity could create social value or harm depending on the circumstances. Under current Delaware case law, courts have allowed Caremark claims to proceed where evidence exists to infer that the board utterly failed to implement a compliance monitoring system or that the directors engaged in disobedience by consciously flouting, violating, or ignoring the law. Bringing together these threads of discussion, this Article concludes that corporate law’s public-regarding commitment to the rule of law supports accountability in these

* Professor of Law, Loyola Law School, Los Angeles. For helpful comments and suggestions, thanks to participants in the symposium convened by the Vanderbilt Law Review and the Institute for Law and Economic Policy, and commentators Vice Chancellor Joseph Sights, Lisa Fairfax, and Salvatore Graziano. This Article also benefited from excellent comments from Hillary Sale and her corporate governance seminar at Georgetown Law, Ann Lipton, and participants at the National Business Law Scholars Conference 2019 at Berkeley Law.
instances of disobedience as well as more broadly when fiduciaries act with willful ignorance or an awareness that their efforts at compliance are insufficient.

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INTRODUCTION

In the corporate law canon lies the promise of powerful accountability. Decades ago, the potential for the fiduciary duty of care to be the source of this accountability for corporate directors was lost. It was stripped of its sting just after its bite in Smith v. Van Gorkom.¹ Nearly as soon as the Delaware Supreme Court ruled in the 1985 case that the directors had acted with gross negligence in corporate decisionmaking, the state legislature enacted section 102(b)(7) of the General Corporation Law.² The outcry from corporate America

1.  488 A.2d 858 (Del. 1985); see also William T. Allen, The Corporate Director’s Fiduciary Duty of Care and the Business Judgment Rule Under U.S. Law, in COMPARATIVE CORPORATE GOVERNANCE: THE STATE OF THE ART AND EMERGING RESEARCH 307, 324 (Klaus J. Hopt et al. eds., 1998) (“The long history that was inconsistent with courts directly imposing liability on corporate directors for violation of the objective standard of care was interrupted by the decision of the Delaware Supreme Court in Smith v. Van Gorkom.”); Henry Ridgely Horsey, The Duty of Care Component of the Delaware Business Judgment Rule, 19 Del. J. Corp. L. 971, 977 (1994) (“[B]efore the mid-eighties . . . the business judgment rule had been applied in such a manner as to constitute an almost per se bar to shareholder claims of directors’ breach of their fiduciary duty of care.”).

demanded this response—corporations were given the freedom to put exculpatory provisions in their charters eliminating the personal liability of directors for monetary damages for breach of the duty of care. Corporate directors could thereafter rest easy knowing that absent fraud, bad faith, or self-dealing, they would rarely, if ever, pay out of pocket for harming the corporation, even if their service had been far less than perfect.

But the potential for corporate accountability through fiduciary duty law was not entirely extinguished. Setting aside traditional duty of loyalty issues such as self-dealing, the duty of good faith remained as a potential mechanism for accountability that could not be exculpated. Two aspects of the duty of good faith—obedience and oversight—soon came into sharper focus through a series of cases that joined *Smith v. Van Gorkom* in the corporate law canon: *In re Caremark International Inc.*; *In re Walt Disney Co.*; and *Stone v. Ritter.*

Through these cases, the Delaware courts established a claim for what became known as Caremark liability, which involves an utter failure to implement an information and reporting system to allow the board to monitor the legal compliance of the corporation or a conscious failure to monitor its operations. A successful claim requires showing that “the directors knew that they were not discharging their fiduciary obligations”—that is, a “conscious disregard” of their oversight responsibilities, which implicates the duty of good faith. Further, the Delaware Supreme Court clarified that a breach of the duty of good faith can also be shown in any instance in which the fiduciary acts...
with a purpose other than advancing the best interests of the corporation, intentionally disregards duties, or intends to violate positive law.\textsuperscript{10} As part of the fiduciary duty of loyalty, claims of bad faith cannot be exculpated.\textsuperscript{11}

Over a decade has passed since these landmark decisions, and with virtually no cases going to trial and resulting in liability, scholars have puzzled over whether \textit{Caremark} oversight responsibility is a “practical irrelevance”\textsuperscript{12} or only “soft law.”\textsuperscript{13} And, despite a constant stream of media headlines exposing corporate illegality, shareholder suits successfully holding directors liable for breaking the law are extremely rare.\textsuperscript{14} This state of affairs raises the question of what it means to have the potential for corporate accountability lodged within the duty of good faith but almost never brought to fruition in terms of trial liability.

This Article offers a two-fold answer to this question—a descriptive theory of the purpose of the obedience and oversight duties in corporate law, and a functional account of how they are applied in practice. First, this Article argues that the fidelity to external law required by the duty of good faith largely serves a legitimizing role for corporate law.\textsuperscript{15} Shareholders cannot be counted on to police corporate illegality, and oversight failures may rarely rise to the level of conscious disregard. The fiduciary duty of good faith is neither irrelevant nor toothless, however—it embeds a safety valve for public policy in the obligations of fiduciaries that cannot be eliminated. Expressing legal compliance and oversight obligations within corporate law acknowledges societal interests in the rule of law and preserves the ability of courts to flexibly respond to particularly

\begin{itemize}
  \item \textsuperscript{10} \textit{Id.} at 369–70; \textit{In re Walt Disney Co.}, 906 A.2d at 67.
  \item \textsuperscript{11} \textit{Stone}, 911 A.2d at 367, 369–70.
  \item \textsuperscript{13} Claire A. Hill, \textit{Caremark as Soft Law}, 90 TEMP. L. REV. 681, 682, 697 (2018) (arguing that \textit{Caremark} has “considerable, albeit soft force”).
  \item \textsuperscript{14} See Elizabeth Pollman, \textit{Corporate Disobedience}, 68 DUKE L.J. 709, 756 (2019) ("Despite widespread corporate illegality, there are few modern cases in which shareholders have successfully held directors liable for breaking the law."); see also KENT GREENFIELD, \textit{THE FAILURE OF CORPORATE LAW: FUNDAMENTAL FLAWS AND PROGRESSIVE POSSIBILITIES} 75 (2006) ("[T]here is not a single, modern case that holds directors liable to shareholders just because the directors or the corporation broke the law."); Norwood P. Beveridge, \textit{Does the Corporate Director Have a Duty Always to Obey the Law?}, 45 DePaul L. REV. 729, 732 (1996) ("[T]here is no such thing as a corporation . . . in compliance with law; rather, there are only corporations (and businesses) out of compliance with law to varying degrees. Despite that fact, there are no modern cases holding directors liable to shareholders for breaking the law.").
  \item \textsuperscript{15} \textit{See infra} Part II.
\end{itemize}
salient and egregious violations of public trust, should they arise, without upending case law developed over decades.

Second, this Article examines the body of Delaware law concerning the oversight and obedience aspects of the duty of good faith and argues that they have become functionally linked. Corporate law takes legal obedience as a strict requirement, and the Caremark doctrine creates a mandate for the board to put in place and monitor some system of compliance, but beyond this minimal threshold courts have not policed the effectiveness of oversight. Rather, the potential for oversight liability through fiduciary duty doctrine arises in the limited context of an utter failure to implement a board-level monitoring and reporting system or when fiduciaries flout, violate, or ignore laws with a level of scienter that rises to conscious disregard or intent. In practice, Delaware courts have prioritized giving directors broad latitude to take business risk by drawing a line at legal risk, despite the possibility that both types of activity could create social value or harm depending on the circumstances. Moreover, examining Delaware case law reveals that courts have stringently reviewed the pleadings for Caremark claims, requiring particularized factual allegations of conscious disregard that resembles intent to violate the law or acquiescence in misconduct. With limited exception, the handful of Delaware cases alleging Caremark claims that have survived motions to dismiss involved particularized allegations of a complete lack of board oversight or egregious disobedience—in circumstances in which the corporation was allegedly engaged in pervasive wrongdoing, when facts supported an inference that directors were complicit in fraudulent business models or deceiving regulators, and when rogue corporations expressed disagreement with underlying laws.

Bringing together these threads of discussion, this Article’s analysis concludes with the observation that corporate law’s public-regarding commitment to the rule of law supports accountability in these instances of disobedience as well as more broadly when fiduciaries act with willful ignorance or an awareness that their efforts at compliance are insufficient. Knowing action or inaction that does not further lawful business is inconsistent with the dictates of corporate law. Although derivative litigation is often an imperfect tool for corporate accountability and drawing a line between business and legal risk is debatable from a social welfare perspective, the doctrinal

16. See infra Section III.A.
17. See infra Section III.B.
foundations exist for a robust understanding of the obligations of oversight and obedience.

This Article proceeds as follows. Part I provides background on the fiduciary duty doctrines of legal obedience and oversight. Part II looks to the content and structure of the duty of good faith, and specifically the obedience and oversight obligations, to evince a positive theory of the role of these obligations within corporate law. It argues that evolving statutory law and fiduciary duty jurisprudence have recognized that these obligations cannot be eliminated because they preserve a safety valve for protecting public policy, which springs from the same source as corporate charters—the state. The obedience and oversight aspects of the duty of good faith serve to legitimate corporate law. Part III provides a descriptive account of the doctrines in practice, showing that Caremark and its progeny set forth a minimum threshold for establishing and maintaining a compliance system at the board level, after which the possibility of liability arises once conduct enters a zone of disobedience. The Part concludes with observations about the implications of this doctrinal trend.

I. OBLIGATIONS OF OVERSIGHT

State corporate law expresses fidelity to legal compliance through dual requirements of obedience and oversight. The obligation of obedience concerns the corporation itself, which must serve a "lawful purpose," and its directors, who have fiduciary duties that prohibit them from acting with the intention of violating the law. The obligation of oversight concerns the monitoring function of the board of directors to ensure the legal compliance of actors within the corporation. This Part examines both of these obligations in turn, laying the groundwork for exploring their underlying purpose in theory and function in practice.

A. The Longstanding Requirement of Legal Obedience

An endless variety of businesses may organize through the corporate form, but as a matter of fundamental principles, they are all required to engage in only lawful conduct. Corporate statutes enshrine this prime directive of obedience. For example, section 101(b) of the Delaware General Corporation Law provides: “A corporation may be incorporated or organized under this chapter to conduct or promote
any lawful business or purposes, except as may otherwise be provided by the Constitution or of the law of this State."19

As I have observed elsewhere, this statutory requirement “of lawful conduct can be understood in historical context and as a function of the basic fact that it is only through government-granted charters that corporations exist.”20 Until the mid-nineteenth century, state legislatures chartered corporations through special acts for specifically authorized activity.21 It logically follows from the government grant of a corporate charter that the provision of power was limited to the confines of state-imposed legal boundaries.22 Further, when states adopted general incorporation statutes, the specification of a particular business purpose in the charter was liberalized, but the requirement of lawful conduct remained.23 And, although corporate statutes typically refer to the granting of charters for a lawful purpose, courts and commentators have generally interpreted this language to broadly refer to an ongoing obligation of lawful business operation.24

Following this statutory requirement, longstanding judicial practice dictates that deference is not accorded to fiduciaries who

19. DEL. CODE ANN. tit. 8, § 101(b) (2019).
22. See Gregory A. Mark, Comment, The Personification of the Business Corporation in American Law, 54 U. CHI. L. REV. 1441, 1452 (1987) (“That a corporation derived its powers from the sovereign was inherent in the contractual conception of the grant theory. The government granted nothing unless it agreed to the objects of the proposed corporation.”).
Financial institutions and railroads were generally regarded as requiring special treatment, but the earlier manufacturing corporation acts tended to evolve, either by the inclusion of other types of corporations or by the insertion of a provision for the formation of corporations for any lawful purpose other than those specifically excepted, into substantially what we know today as business corporation acts.
On the topic of illegality and the ultra vires doctrine, 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, 1314 (2001) (“During the height of the ultra vires doctrine, a corporation’s illegal activities were considered a subset of the larger category of ultra vires activities. In no sense were corporations considered as having the authority to perform illegal activities, even when performed to advance the interest of the firm.”); and Alan R. Palmeter, Duty of Obedience: The Forgotten Duty, 55 N.Y.L. SCH. L. REV. 457, 460 (2011) (“[T]he original ultra vires doctrine not only set the boundaries of corporate power as established by corporate norms, it also recognized that the corporation is powerless to violate non-corporate norms—that is, external law.”).
direct the corporation to violate the law. As a doctrinal matter, over a century of case law provides that corporate directors and officers who engage in unlawful conduct on behalf of the corporation do not receive business judgment rule protection. Courts have explained that “a fiduciary may not choose to manage an entity in an illegal fashion, even if the fiduciary believes that the illegal activity will result in profits for the entity.”

In 2006, in the landmark case of In re Walt Disney Co., the Delaware Supreme Court clarified how this deep-rooted requirement of legal obedience fits within the framework of fiduciary duties. Plaintiff shareholders in the derivative suit challenged an “unfortunate hiring decision at Disney” that had resulted in a $130 million severance package paid to a senior executive upon his termination after little more than a year of work at the company. As the Disney charter had a director exculpation provision pursuant to section 102(b)(7), any liability for the breach of the duty of care was foreclosed. This left only claims of waste—easily disposed of by the court—and breach of the duty of good faith, since no traditional duty of loyalty issue was implicated in the context of independent decisionmaking. Acknowledging the duty to act in good faith had played a prominent role in the plaintiff-shareholders’ case and was an area of corporate fiduciary law “up to this point relatively uncharted,” the court took the opportunity to provide “conceptual guidance to the corporate community.” It explained:

25. See, e.g., Miller v. AT&T, 507 F.2d 759, 762 (3d Cir. 1974) (holding that shareholders had stated a claim for breach of fiduciary duty arising from the alleged violation of federal campaign finance law and noting the business judgment rule “cannot insulate the defendant directors from liability if they did in fact breach [a statutory prohibition], as plaintiffs have charged”); Roth v. Robertson, 118 N.Y.S. 351, 354 (N.Y. Sup. Ct. 1909) (sustaining recovery from a director who used corporate funds to bribe individuals who had threatened to complain about the corporation operating in violation of the state’s Sunday closing laws).

26. Metro Commc’n Corp. BVI v. Advanced Mobilecomm Techs. Inc., 854 A.2d 121, 131 (Del. Ch. 2004); see also 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.”).

27. 906 A.2d 27 (Del. 2006). For a tracing of the historical shift from treating obedience as an issue of corporate power to fiduciary duty related to “compliance with noncorporate legal norms,” see Palmiter, supra note 23, at 462–64, 474.


29. Id. at 35.

30. See Strine et al., supra note 3, at 692:

Prevented from arguing a breach of the duty of care, . . . plaintiffs’ lawyers saw an opportunity to reframe the debate and argue that the independent directors had approved a transaction in bad faith, and to push judges to treat directorial behavior that appeared to be less adroit and diligent than was reasonable as indicative of bad faith.

31. In re Walt Disney Co., 906 A.2d at 64.
[T]he universe of fiduciary misconduct is not limited to either disloyalty in the classic sense (i.e., preferring the adverse self-interest of the fiduciary or of a related person to the interest of the corporation) or gross negligence. Cases have arisen where corporate directors have no conflicting self-interest in a decision, yet engage in misconduct that is more culpable than simple inattention or failure to be informed of all facts material to the decision. To protect the interests of the corporation and its shareholders, fiduciary conduct of this kind, which does not involve disloyalty (as traditionally defined) but is qualitatively more culpable than gross negligence, should be proscribed. A vehicle is needed to address such violations doctrinally, and that doctrinal vehicle is the duty to act in good faith.32

Further, the court clarified that a fiduciary could breach the duty to act in good faith in a variety of ways, including through acts of legal disobedience:

A failure to act in good faith may be shown, for instance, where the fiduciary intentionally acts with a purpose other than that of advancing the best interests of the corporation, where the fiduciary acts with the intent to violate applicable positive law, or where the fiduciary intentionally fails to act in the face of a known duty to act, demonstrating a conscious disregard for his duties.33

After In re Walt Disney Co., acting with intent to violate the law was clearly proscribed as a breach of the duty of good faith, stamped with the moral judgment of being more culpable than gross negligence and out of bounds for exculpation.34 In sum, as a matter of Delaware corporate law, both the statute and case law from the highest arbiter have required legal obedience, without qualification or exceptions, as an “essential bottom-line requirement.”35

B. Oversight and Compliance Responsibility in Fiduciary Law

Moving to a relatively more modern area of doctrinal development, the starting point for tracing the evolution of Delaware’s oversight jurisprudence is, by common practice, the 1963 case Graham v. Allis-Chalmers Manufacturing Co.36 The derivative action alleged that the directors of Allis-Chalmers had breached their fiduciary duties by failing to prevent violations of federal antitrust laws by the corporation’s employees.37 The Delaware Supreme Court found no liability on the facts, holding that “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.”

Three decades later, the Delaware Court of Chancery reassessed this precedent in the case that became synonymous with oversight responsibility: *In re Caremark International Inc.* The story began in 1994 when the federal government indicted Caremark for violating the Anti-Referral Payments Law, a statute prohibiting healthcare businesses from paying doctors and other providers for referring Medicare or Medicaid patients. By mid-1995, Caremark settled the federal litigation by pleading guilty to mail fraud, paying criminal fines, and entering into a monetary settlement for civil claims. Together with settlement payments for related private party litigation, the company paid $250 million in total to resolve the claims regarding its improper business practices.

Subsequently, Caremark shareholders brought derivative suits against the board, seeking to hold the members individually liable for the losses suffered by the corporation. The suits ended in a settlement agreement, which provided for no monetary liability but created a plan designed to ensure legal compliance going forward. All that was before the Delaware Court of Chancery in 1996 was judicial approval of the settlement, which was deemed fair and reasonable to the class. Chancellor William Allen did not let the moment pass unnoticed, however, and seeded into the opinion’s dicta the notion that an altogether different claim than negligent decisionmaking had been at stake. Invoking *Graham*, the opinion observed evolving regulatory trends at the time, such as the increasing use of criminal sanctions in federal law to ensure corporate compliance and the mitigation of sanctions under federal criminal sentencing guidelines for corporate defendants that had compliance programs in place. In light of these developments, the court noted it could no longer interpret *Graham* in a way that suggested a board has no affirmative obligation to put some information and reporting system in place to monitor legal compliance. Consequently, the court explained that in carrying out their oversight responsibility, the

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38. Id. at 130.
40. Id. at 961–63.
41. Id. at 960–61.
42. Id.
43. See id. at 964.
44. Id. at 966.
45. Id. at 969–70.
46. Id. at 970.
directors had “a duty to attempt in good faith to assure that a corporate information and reporting system, which the board concludes is adequate, exists and that failure to do so under some circumstances may, in theory at least, render a director liable for losses caused by noncompliance with applicable legal standards.”

Commenting that this basis for oversight liability “is possibly the most difficult theory in corporation law upon which a plaintiff might hope to win judgment,” the court opined that

plaintiffs would have to show either (1) that the directors knew or (2) should have known that violations of law were occurring and, in either event, (3) that the directors took no steps in a good faith effort to prevent or remedy that situation, and (4) that such failure proximately resulted in the losses complained of.

Chancellor Allen concluded on the record before him that there was “essentially no evidence” of a violation—the facts did “not support the conclusion that the defendants either lacked good faith in the exercise of their monitoring responsibilities or conscientiously permitted a known violation of law . . . to occur.

The landmark case gave rise to the notion under corporate law of a “Caremark claim”—alleging breach of fiduciary duty for failure to provide board oversight. And a decade later, in 2006, a pair of cases came before the Delaware Supreme Court that affirmed the validity of a Caremark claim, gave meaning to the fiduciary duty of good faith, and cabined it within the fiduciary duty of loyalty, which cannot be exculpated. First, as discussed above, In re Walt Disney Co. elucidated a variety of ways in which a fiduciary could breach the duty to act in good faith—notably including not only acting with an intent to violate positive law, but also acting with a purpose other than that of advancing the best interests of the corporation or with a conscious disregard of duties. Second, in Stone v. Ritter, an oversight case involving “a classic Caremark claim” in which a bank corporation paid $50 million in fines and penalties for violations of federal anti-money laundering regulations, the court explained that the previous articulation of director oversight liability was valid and required a showing of scienter constituting bad faith.

47. Id.
48. Id. at 967.
49. Id. at 971.
50. Id. at 971–72; see also Hillary A. Sale, Monitoring Caremark’s Good Faith, 32 Del. J. CORP. L. 719 (2007) (discussing the Caremark opinion and its implications for the development of corporate law and governance).
51. 906 A.2d 27, 67 (Del. 2006).
53. Id. at 370–73.
Specifically, the Stone court held that “the necessary conditions predicate for director oversight liability” include showing either “(a) the directors utterly failed to implement any reporting or information system or controls; or (b) having implemented such a system or controls, consciously failed to monitor or oversee its operations thus disabling themselves from being informed of risks or problems requiring their attention.” 54 Further, “[i]n either case, imposition of liability requires a showing that the directors knew that they were not discharging their fiduciary obligations.”55 Such a showing of “conscious disregard” for discharging fiduciary obligations in good faith amounts to a breach of the duty of loyalty.56

Notably, the case law has developed in the context of settlement opinions and motions to dismiss. As in Graham and Caremark, the Stone court found that despite significant financial loss to the corporation for the violation of criminal laws by employees, the plaintiffs had failed to plead demand futility with regard to their oversight claim against the directors.57 According to the court, the plaintiffs sought “to equate a bad outcome with bad faith” without recognizing that “good faith exercise of oversight responsibility may not invariably prevent employees from violating criminal laws, or from causing the corporation to incur significant financial liability, or both.”58 Critically, “[i]n the absence of red flags, good faith in the context of oversight must be measured by the directors’ actions ‘to assure a reasonable information and reporting system exists’ and not by second-guessing after the occurrence of employee conduct that results in an unintended adverse outcome.”59

A small number of cases involving Caremark claims have survived motions to dismiss. In Marchand v. Barnhill, for example, the Delaware Supreme Court applied the standard articulated in Stone and found that the plaintiffs had successfully pled particularized facts to support a claim that the board of ice cream manufacturer Blue Bell Creameries “failed to implement any system to monitor Blue Bell’s food safety performance or compliance.”60 In

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54. Id. at 370 (emphasis in original).
55. Id. For an argument that the convergence of good faith and oversight was “one of those unfortunate marriages that leaves both sides worse off,” see Stephen M. Bainbridge et al., The Convergence of Good Faith and Oversight, 55 UCLA L. REV. 559, 605 (2008).
56. Stone, 911 A.2d at 370.
57. Id. at 373.
58. Id.
59. Id. (quoting In re Caremark Int’l Inc. Derivative Litig., 698 A.2d 959, 971 (Del. Ch. 1996)).
that case, the company suffered a listeria outbreak that killed three people and caused the company to recall all its products, shut down production, lay off a significant portion of its workforce, and accept a dilutive private equity financing. As the ice cream manufacturer makes only a single product, the court noted that food safety is a central compliance issue for the company and the complaint therefore created a reasonable inference that the “dearth of any board-level effort at monitoring” was a conscious failure. Although few cases have met the stringent standard applied at the motion to dismiss stage, the Delaware courts have consistently recognized the potential validity of claims against directors based on oversight failures.

II. A POSITIVE ACCOUNT OF THE LEGITIMIZING ROLE OF THE DUTY OF GOOD FAITH

With this groundwork set, we can now turn to a deeper question: What is the purpose of these dual requirements of obedience and oversight? Delaware law is largely enabling—it has, “for the most part, chosen to let corporations decide what constraints, if any, they should impose on their fiduciaries.” Corporations can eliminate monetary damages for directors stemming from a breach of the duty of care and can carve out significant aspects of the duty of loyalty through waivers of corporate opportunity doctrine. Yet a certain core of fiduciary duty remains mandatory, beyond the reach of private ordering, and at the heart of this is the elusive duty of good faith, which contains both obedience and oversight responsibility.

Scholars have offered wide-ranging accounts of the content and structure of the duty of good faith, its scienter-like nature, its
rhetorical value, and its shortcomings. But little literature has highlighted that its obedience and oversight obligations serve a public function. The requirement of fidelity to the law aims to protect society’s interests, not those of the corporation.

This point can be evinced, as a positive matter, by the fact that directors may not, consistent with their fiduciary obligations, choose to violate the law, even if they intend to benefit the corporation or its shareholders in doing so. Delaware courts reflect this understanding, noting that “the fiduciary duty of loyalty is not limited to cases involving a financial or other cognizable fiduciary conflict of interest.” Fiduciaries may violate the duty of loyalty even when they pursue profits for the corporation and are not acting out of self-interest. In Guttman v. Huang, the chancery court explained:

The General Assembly could contribute usefully to ending the balkanization of the duty of loyalty by rewriting § 102(b)(7) to make clear that its subparts all illustrate conduct that is disloyal. For example, one cannot act loyally as a corporate director by causing the corporation to violate the positive laws it is obliged to obey.

66. See Strine et al., supra note 3, at 644 (describing good faith as “the state of mind required of a loyal fiduciary exercising corporate powers”).

67. See Sean J. Griffith, Good Faith Business Judgment: A Theory of Rhetoric in Corporate Law Jurisprudence, 55 DUKE L.J. 1, 34 (2005) (“[C]ourts applying the good faith standard do not confine themselves to the analytics of either traditional fiduciary duty. Instead, good faith is used as a loose rhetorical device that courts can wield to find liability or enjoin actions that do not quite fit within established doctrinal categories.”).

68. See, e.g., Elizabeth A. Nowicki, Not in Good Faith, 60 SMU L. REV. 441, 491 (2007) (arguing that an “exacting definition of the phrase ‘not in good faith,’ “ which describes non-exculpable conduct by directors, “is needed to ensure directors are held accountable”); Sale, supra note 63, at 482–94 (offering suggestions for the role of good faith and its application to corporate fiduciaries).

69. Notable works to do so include Hillary A. Sale, Fiduciary Law, Good Faith and Publicness, in THE OXFORD HANDBOOK OF FIDUCIARY LAW 763 (Evan J. Criddle, Paul B. Miller & Robert H. Sitkoff eds., 2018) (discussing the relationship between the duty of good faith, the rule of law, and publicness); Donald C. Langevoort, Cultures of Compliance, 54 AM. CRIM. L. REV. 933, 939 (2017) (observing that the government’s interest in compliance is not mainly to reduce agency costs, but rather to push corporations toward “accepting public-regarding responsibilities”); and Pollman, supra note 14, at 749–50 (“The statutory dictate serves not only this expressive function, but it also, quite notably, embeds society’s interests into corporate law . . . .”).

70. Pollman, supra note 14, at 717; see also PRINCIPLES OF CORPORATE GOVERNANCE: ANALYSIS & RECOMMENDATIONS § 2.01(b) (AM. LAW INST., Proposed Final Draft 1992) (“Even if corporate profit and shareholder gain are not thereby enhanced, the corporation, in the conduct of its business: (1) Is obliged, to the same extent as a natural person, to act within the boundaries set by law . . . .”).


72. Guttman v. Huang, 823 A.2d 492, 506 n.34 (Del. Ch. 2003); see Palmiter, supra note 23, at 458–59 (arguing for the revival of a separate fiduciary duty of obedience to “resolve much of the confusion engendered by the ‘duty of good faith’ “ and serve as a “reminder of the corporation’s exogenous effects”); see also Gold, supra note 65, at 477 (noting “the loyalty
The mode of analysis that courts apply to issues of obedience and oversight also reflects an understanding that fidelity to the law is nonnegotiable and is a requirement that aims to protect a public realm to which corporate law must subscribe, rather than to protect shareholders from agency costs.\textsuperscript{73} Case law focuses on public law obligations.\textsuperscript{74} Courts not only refrain from applying business judgment rule protection when the issue at stake involves a potential legal violation—they also do not engage in entire fairness analysis, which would look to the fiduciary’s treatment of the corporation, as that is not the relevant inquiry.\textsuperscript{75} Instead, the doctrine of good faith inquires into the intent or conscious disregard of the director in making decisions concerning legality or the monitoring of unlawful conduct within the corporation.\textsuperscript{76}

Further, to the extent that fidelity to the law is imposed not only through the corporate statute but also through fiduciary law, it must be lodged in a nonexculpable duty if it is to provide legitimacy and preserve the ability of courts to act in the face of egregious violations. This is the path that the legislature took in section 102(b)(7) by carving out “acts or omissions not in good faith or which involve intentional misconduct or a knowing violation of law” and the Delaware Supreme Court followed in \textit{In re Walt Disney Co.} and \textit{Stone}—to do otherwise would undermine the utility of good faith to

\textsuperscript{73} Some aspects of the fiduciary duty of good faith may serve to combat agency costs, such as the use of appropriate and adequate monitoring systems which may constrain management from engaging in legal violations for self-serving purposes. See Donald C. Langevoort, \textit{Caremark and Compliance: A Twenty-Year Lookback}, 90 Temp. L. Rev. 727, 739–40 (2018) (examining how selection, promotion, and compensation decisions can influence corporate culture and risk-taking); Sale, \textit{supra} note 50, at 752 (discussing good faith and agency costs). The point here is that the aspect of good faith that is focused on legal compliance also, or perhaps primarily, serves a public purpose and legitimizing role for corporate law, as can be seen from the fact that corporate law does not tolerate illegality even when it would be profit maximizing for corporations.

\textsuperscript{74} See Edward B. Rock, \textit{Adapting to the New Shareholder-Centric Reality}, 161 U. Pa. L. Rev. 1907, 1965–66 (2013) (“The case law articulating the ‘duty to legality’ seems to focus on public law obligations such as campaign finance laws, bribery, price fixing, mine safety regulations, off-label marketing of prescription drugs, and unfair labor practices.” (footnotes omitted)); see also Frank Partnoy, \textit{ Corporations and Human Life}, 40 Seattle U. L. Rev. 399, 418 (2017) (“[T]he focus of risk management oversight is often on considerations of regulatory violations and tort liability.”).

\textsuperscript{75} See Eisenberg, \textit{supra} note 65, at 29 (arguing that “limiting rules [such as the business judgment rule and entire fairness] should be and are inapplicable to conduct that violates the duty of good faith, because of the high degree of wrongfulness that such conduct involves”).

\textsuperscript{76} For an argument that mental-state inquiry such as the corporate law doctrine of good faith is the best way to identify evasive actors, see Samuel W. Buell, \textit{Good Faith and Law Evasion}, 58 UCLA L. Rev. 611 (2011).
serve as a safety valve in the interest of public policy. 77 In this interpretation, the obligations of obedience and oversight are mandatory not because they would likely be the subject of bargaining failure or divergence between the interests of shareholders and managers but because they allow corporate law to reflect public values and police extreme cases at the margins. 78

Taking this observation a step further, by requiring legal obedience of the corporation and its directors, both in their decisionmaking capacity and in their role in establishing and maintaining an information and reporting system for compliance, we could view corporate law as acknowledging that ultimately corporations exist by grace of the state and an implicit social contract that protects public policy. Arguably, a clear way to reflect respect for this bargain underpinning corporate law is to affirm allegiance to the rule of law without second-guessing the merits of external laws or allowing for exceptions motivated by profit. Lodging these expressions within the duty of good faith amplifies the foundational statutory requirement of lawful conduct and allows for judicial review. 79 Corporations produce a continual flow of externalities; embedding a

77. Then-Vice Chancellor Leo E. Strine, Jr. charted this path in Guttman v. Huang by characterizing Caremark as implicating the duty of loyalty instead of care. Guttman, 823 A.2d at 506 n.34 (“It does no service to our law’s clarity to continue to separate the duty of loyalty from its own essence; nor does the recognition that good faith is essential to loyalty demean or subordinate that essential requirement.”); see Stephen M. Bainbridge, Caremark and Enterprise Risk Management, 34 J. Corp. L. 967, 975 (2009) (“In Guttman, however, Vice Chancellor Strine ripped the Caremark claim from its original home in the duty of care and reinvented it as a duty of loyalty . . . .”); see also Eisenberg, supra note 65, at 12–21 (critiquing Strine’s dyadic approach to fiduciary duties).

78. This view potentially supplements other explanations for why some fiduciary obligations remain mandatory in corporate law. See, e.g., Melvin Aron Eisenberg, The Structure of Corporation Law, 89 Colum. L. Rev. 1461, 1462 (1989) (arguing that fiduciary duties should be mandatory at the core given the limits of bargaining, the potential for divergence between the interests of shareholders and managers, and because variations may not be accurately priced); Jeffrey N. Gordon, The Mandatory Structure of Corporate Law, 89 Colum. L. Rev. 1549, 1554 (1989) (arguing “the mixed system of optional and mandatory legal rules that we observe may be best even from an essentially contractarian perspective”); see also Brian Broughman, Elizabeth Pollman & D. Gordon Smith, Fiduciary Law and the Preservation of Trust in Business Relationships, in FIDUCIARIES AND TRUST: ETHICS, POLITICS, ECONOMICS AND LAW (Paul B. Miller & Matthew Harding eds., forthcoming 2020) (arguing that mandatory fiduciary duties enable the preservation of trust in business relationships).

79. See Buell, supra note 76, at 653 (“Stone and Lyndell, and their embrace of Caremark, are a choice by the Delaware courts to make clear that good faith is not a duty but an ancillary tool that fortifies background law.”). Delaware courts have acknowledged their public role. See, e.g., Steinberg v. Bryant, No. 2017-0736-SG, 2017 WL 6054943, at *2 (Del. Ch. Dec. 7, 2017) (“The Court of Chancery, like any public court, ‘serves not only the litigants before it; it has a public function as well.’” (quoting Al Jazeera Am., LLC v. AT&T Servs., Inc., No. 8823-VCG, 2013 WL 5614284, at *1 (Del. Ch. Oct. 14, 2013)).
duty of obedience to laws and regulations that constrain these externalities for the good of society helps to legitimize corporate law.

Along these lines, fidelity to the law has been the subject of a number of “corporate law sermons,” proclaiming corporate law’s dedication to the rule of law. For example, in *Desimone v. Barrows*, the Delaware Court of Chancery explained:

> [B]y consciously causing the corporation to violate the law, a director would be disloyal to the corporation and could be forced to answer for the harm he has caused. Although directors have wide authority to take lawful action on behalf of the corporation, they have no authority knowingly to cause the corporation to become a rogue, exposing the corporation to penalties from criminal and civil regulators.81

Similarly, *In re Massey Energy Co.* includes the following passage:

Delaware law does not charter law breakers. Delaware law allows corporations to pursue diverse means to make a profit, subject to a critical statutory floor, which is the requirement that Delaware corporations only pursue “lawful business” by “lawful acts.” As a result, a fiduciary of a Delaware corporation cannot be loyal to a Delaware corporation by knowingly causing it to seek profit by violating the law.82

Further, the court invokes the role of the strict parent who will not tolerate a teenager’s excuse for youthful shenanigans and trouble with the law:

> Telling your parents that all the kids are getting caught shoplifting, cheating, or imbibing illegal substances is not, fortunately, a good excuse. For fiduciaries of Delaware corporations, there is no room to flout the law governing the corporation’s affairs. If the fiduciaries of a Delaware corporation do not like the applicable law, they can lobby to get it changed. But until it is changed, they must act in good faith to ensure that the corporation tries to comply with its legal duties.83

Caremark itself can be viewed as a “seminal ‘message’ opinion,” catalyzing lawyers to advise corporate clients to put in place compliance systems and be mindful of oversight obligations.84 In all,
this moralizing and messaging underscores an awareness of the legitimizing role that obedience and oversight serve within corporate law.

To the extent that corporations do not display minimal respect for the law and compliance failures become salient, we could expect public pushback and the threat of further federalization of corporate law. The good faith obligations of obedience and oversight thus serve the expressive purpose of reinforcing the legitimacy of corporate law and also preserve its ability to react—a failsafe for egregious violations, rather than an effective and fine-tuned mechanism for the bulk of instances, which are left for other regulators and enforcers. Providing a failsafe within the structure of corporate law allows for flexible adaptation when needed, rather than upending the entire system when a major controversy demands an unprecedented response.

85. See Langevoort, supra note 73, at 741–42 (“The Chancellor knew that if boards failed to become more sophisticated and sensitive to doing [compliance] well—the cultural part as well as the policies and procedures—external pressures would continue to grow without regard to cost or efficiency.”); see also Hill, supra note 13, at 695 (arguing that “a profit-maximizing firm will have to consider not only what law requires but also what reputation requires,” which may “increasingly come to include corporate social responsibility”); Donald C. Langevoort & Robert B. Thompson, “Publicness” in Contemporary Securities Regulation After the JOBS Act, 101 GEO. L.J. 337, 341 (2013) (arguing “that, to a greater extent than generally acknowledged, the broader demands of publicness drive the creation of contemporary securities regulation”); Palminter, supra note 23, at 475 (“The corporation, as distrusted as ever, would lose its social standing if it openly declared itself to be an unrepentant sociopath.”); Hillary A. Sale, The New “Public” Corporation, L. & CONTEMP. PROBS., Winter 2011, at 137, 138 (describing the influence of government and the media on corporations and their “changing obligations”).

86. See Renee M. Jones, Rethinking Corporate Federalism in the Era of Corporate Reform, 29 J. CORP. L. 625, 625 (2004) (arguing that “a realistic threat of federalization is necessary to ensure the robust development of corporate law at the state level”); Marcel Kahan & Edward Rock, Symbiotic Federalism and the Structure of Corporate Law, 58 VAND. L. REV. 1573, 1576 (2005) (arguing that “the possibility of federal preemption constitutes a threat to Delaware, but this threat is significant only in times—such as during the recent corporate scandals—when systemic change is seen as generating a significant populist payoff”); Mark J. Roe, Delaware’s Competition, 117 HARV. L. REV. 588, 644–46 (2003) (“What remains with the states is the corporate law that the federal players tolerate, and what gets reversed is that which they do not.”). For an argument that the standard of liability for compliance oversight failures is too lax and directors should be subject to a clawback of stock-based pay, see John Armour, Jeffrey N. Gordon & Geeyoung Min, Taking Compliance Seriously (Columbia Law and Econ., Working Paper No. 588, 2019), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3244167 [https://perma.cc/XU4-J3P].

87. See Strine et al., supra note 3, at 634 (“[W]e acknowledge that the duty of loyalty remains, as it always has, most difficult to apply to circumstances when directors act without an apparent selfish interest to injure the corporation. We also acknowledge that it is in that context that the concept of good faith has its greatest utility.”).

88. Pollman, supra note 14, at 751–57 (explaining why shareholder litigation cannot be relied on to police corporate disobedience).

89. Good faith in contract law also serves this policy objective of allowing a judge to invoke the doctrine “to do justice and do it according to law.” See Robert S. Summers, “Good Faith” in
III. THE DOCTRINAL CONVERGENCE OF CAREMARK CLAIMS AND DISOBEDIENCE

Obedience and oversight obligations are not only linked conceptually through expressions of fidelity to the law and as part of the safety valve that good faith provides within corporate law, but are also connected in practice through the standard that has evolved for Caremark liability. This Part turns to an examination of this case law.

At the time of this writing, approximately one hundred Delaware cases have cited the 1996 landmark Caremark opinion. Oversight liability after a trial on the merits is extremely rare. Instead, the case law has developed through settlement opinions and motions to dismiss under Rule 12(b)(6) and the pre-suit demand requirement of Rule 23.1, with few claims surviving such motions. Examining these cases reveals that oversight has evolved in application to require a showing that borders on, or includes, utter failure or disobedience.

As the first part of the discussion below explores, a board can immunize itself from liability under the first prong of Caremark by simply demonstrating that it has put in place some system of compliance that is monitored at the board level. And, as the second part of the discussion demonstrates, successful pleading of the second Caremark prong has in practice involved particularized factual assertions that suggest board-level participation in illegality or improper managing of legal risk. Through these cases, courts have drawn a line between the oversight of business risk and legal risk—the former given wide allowance and the latter deemed improper. In

General Contract Law and the Sales Provisions of the Uniform Commercial Code, 54 Va. L. Rev. 195, 198–99 (1968) (“Without legal resources of this general nature [a judge] might, in a particular case, be unable to do justice at all, or he might be able to do it only at the cost of fictionalizing existing legal concepts and rules, thereby snarling up the law for future cases.”).

90. In a post-trial opinion in ATR-Kim Eng Financial Corp. v. Araneta, the Delaware Court of Chancery found that two directors breached their duty of loyalty by failing to monitor the controlling shareholder and board chair’s self-dealing and by being “complicit[ ] in his wrongful endeavors.” No. CIV-A. 489-N, 2006 WL 3783520, at *1 (Del. Ch. Dec. 21, 2006).

91. If one looks to jurisdictions outside of Delaware applying the Caremark standard, the universe of cases that survived motions to dismiss expands significantly. See, e.g., In re Abbott Labs. Derivative S’holders Litig., 325 F.3d 796 (7th Cir. 2003); McCall v. Scott, 239 F.3d 808 (6th Cir. 2001), amended on denial of rehearing, 250 F.3d 997 (6th Cir. 2001); In re Wells Fargo & Co. S’holder Derivative Litig., 282 F. Supp. 3d 1074 (N.D. Cal. 2017); In re Intuitive Surgical S’holder Derivative Litig., 146 F. Supp. 3d 1106 (N.D. Cal. 2015); In re Pfizer Inc. S’holder Derivative Litig., 722 F. Supp. 2d 453 (S.D.N.Y. 2010); In re Biopure Corp. Derivative Litig., 424 F. Supp. 2d 305 (D. Mass. 2006). Plaintiffs might expect more favorable outcomes in non-Delaware venues, but at least some are limited by charter and bylaw provisions that require derivative claims to be brought in Delaware courts. See Langevoort, supra note 73, at 735 n.39 (citing Verity Winship, Shareholder Litigation by Contract, 96 B.U. L. Rev. 485 (2016)).
this way, Caremark has largely been cabined to the most extreme cases involving legal violations. This evolution is consistent with corporate law’s focus on establishing legitimacy through affirmations of legal obedience, but it is often anemic in application and lacks tailoring to the potential for social value and harm that corporations produce for shareholders and stakeholders through business and legal risk. The third part of the discussion concludes with additional observations about the implications of this doctrinal trend and the potential for a more capacious approach to oversight claims.

A. The Common Path of Dismissal

Since Caremark, “compliance has grown in size, scope, and stature at nearly all large corporations.” The rise of corporate compliance systems has been accompanied by a parade of shareholder litigation defeated at the motion to dismiss stage. Two Delaware cases illustrate the typical dynamic of directors who fail to provide effective oversight but succeed in defending against suit: In re Citigroup Inc. and In re General Motors Co.

The first of these cases takes us back to the era of the 2008 financial crisis. Citigroup had approximately $55 billion in exposure to the subprime mortgage market via collateralized debt obligations and other investments. When the market collapsed, Citigroup suffered serious financial losses and shareholder litigation followed, claiming that the director defendants were liable under Caremark for failing to adequately implement and oversee an information and reporting system regarding the company’s exposure to the subprime mortgage market. As corporate law scholars James Cox and Randall Thomas explained in their examination of the case,

The suit alleged ample red flags that should have caught the board’s eye, such as an economist’s forecast that a speculative bubble was nearing its end, a leading subprime lender closing its 229 offices, another lender filing bankruptcy, analysts downgrading

95. In re Citigroup Inc., 964 A.2d at 113.
96. Id. at 114, 123, 128.
subprime mortgages, and a warning of increasing subprime delinquencies by another
lender.97

In the eyes of the Delaware Court of Chancery, however, the warning
signs “at most . . . evidence[d] that the directors made bad business
decisions.”98 The alleged “ ‘red flags’ . . . amount[ed] to little more than
portions of public documents that reflected the worsening conditions
in the subprime mortgage market and in the economy generally.”99
Consequently, the court concluded that the plaintiffs failed to plead
“particularized facts suggesting that the Board was presented with
‘red flags’ alerting it to potential misconduct.”100 Despite “staggering
losses” and the understandable “desire to force those responsible to
account for their wrongdoing,” the court would not engage in judicial
second-guessing of what it characterized as business decisions, and
granted the defendants’ motion to dismiss for failure to adequately
plead demand futility.101

Notably, in 2017, Citigroup directors faced another Caremark
case, stemming from corporate traumas involving anti–money
laundering violations, accounts receivable fraud, fraudulent
manipulation of benchmark foreign exchange rates, and deceptive
card practices.102 The court noted that the plaintiffs had “produced a
ponderous omnibus of a complaint,” describing red flags “dating back
to the financial crisis of a decade ago as well as more recently, in
connection with activities of Citigroup and its subsidiaries that led to
large fines levied against the bank.”103 Again finding the complaint
lacking against Citigroup directors, the court explained: “The
Complaint makes it reasonably conceivable that the directors, despite
these red flags, failed to take actions that may have avoided loss to the
company. That is not the standard, however.”104 In the court’s view,
although the facts suggested bad results, the plaintiffs had not
succeeded in implying that bad faith scienter had existed on the part
of the directors.105

97. James D. Cox & Randall S. Thomas, Corporate Darwinism: Disciplining Managers in a
World with Weak Shareholder Litigation, 95 N.C. L. REV. 19, 54 (2016).
98. In re Citigroup Inc., 964 A.2d at 128.
99. Id.
100. Id. (quoting David B. Shaev Profit Sharing Account v. Armstrong, No. CIV.A. 1449-N,
2006 WL 391931, at *3 (Del. Ch. Feb. 13, 2006)).
101. Id. at 126, 131, 139–40.
*3 (Del. Ch. Dec. 18, 2017).
103. Id. at *2.
104. Id.
105. Id. at *24 (noting “[t]he bad results . . . do not imply bad faith”); see also In re Goldman
Sachs Grp., Inc. S’holder Litig., No. 5215-VCG, 2011 WL 4826104, at *1, 23–24 (Del. Ch. Oct. 12,
2011) (rejecting the possibility that directors would be liable for establishing and not sufficiently
Similarly, the ignition switch crisis at General Motors ("GM")
did not yield Caremark liability for the directors.\textsuperscript{106} The company had
manufactured cars with defective ignition switches that malfunctioned
during consumer use, leading to a number of serious personal injuries
and deaths, as well as fines and damages from private lawsuits and
government investigations.\textsuperscript{107} Shortly after the company issued the
first of forty-five recalls, it also disclosed that information about the
ignition defect had been known to certain engineers and other
employees within the company for years.\textsuperscript{108}

GM shareholders brought suit against the directors, alleging
that the board lacked a process by which it adequately received
information about safety risks and the risk of punitive damages in
pending litigation, including National Highway Traffic Safety
Administration inquiries and responses.\textsuperscript{109}

The court observed the story was "sadly familiar": "An iconic
American company produces a product or service that goes terribly
awry, causing the company financial and reputational damage, and
perhaps doing damage to society at large as well."\textsuperscript{110} Reviewing the
specific allegations of the complaint, the court explained: "GM had
a system for reporting risk to the Board, but in the Plaintiffs’ view it
should have been a better system."\textsuperscript{111} Granting the motion to dismiss,
the court concluded: "Pleadings, even specific pleadings, indicating
that directors did a poor job of overseeing risk in a poorly-managed
corporation do not imply director bad faith."\textsuperscript{112} So long as some board-
level system exists, and without "red flags" or other bases from which
the court can infer knowledge on the part of the board that its system
was inadequate, the complaint will be dismissed.\textsuperscript{113}

\textsuperscript{107} Id.
\textsuperscript{108} Id. at *2.
\textsuperscript{109} Id.
\textsuperscript{110} Id. at *1.
\textsuperscript{111} Id. at *14.
\textsuperscript{112} Id. at *17.
\textsuperscript{113} Hill, supra note 13, at 682–83 ("Having no system of controls will yield liability, but
having an imperfect or even apparently inadequate system generally will not."); Kimberly D.
Krawiec, Cosmetic Compliance and the Failure of Negotiated Governance, 81 WASH. U. L.Q. 487,
491 (2003) ("A growing body of evidence indicates that internal compliance structures do not
deter prohibited conduct within firms, and may largely serve a window-dressing function that
provides both market legitimacy and reduced legal liability."); Langevoort, supra note 73, at 729–30 ("It is at least arguable that independent directors do not have the capacity to engage with
As these cases demonstrate, as a matter of corporate law, courts do not condemn boards for faulty monitoring systems. The case law is replete with failures to provide information to the board, ineffective oversight to make sure compliance violations do not occur, and even problematic responses to warning signs that were not well calculated to resolve compliance issues. Corporate boards must have some system and some response, but in corporate law these are generally treated as matters of business judgment absent a complete dearth of board-level monitoring or egregious facts—seemingly any level of business risk is permissible. Concerns that boards would not be given leeway to exercise discretion concerning their approach to internal controls and compliance have not come to fruition; instead, the opposite concern emerges upon examination—that managerial motivations toward business risk and legal compliance are not fully aligned with achieving optimal deterrence of social harm.

114. Federal and state regulatory enforcement is, of course, another matter and not limited to Caremark's standard. Langevoort, supra note 73, at 732 (“[I]n principle, at least, regulators and enforcers who have prosecutorial discretion and the ability to seek compliance-related sanction adjustment have no reason to feel beholden to Caremark's focus on corporate well-being, and almost surely do not in fact.”). 115. See, e.g., Okla. Firefighters Pension & Ret. Sys. v. Corbat, No. 12151-VCG, 2017 WL 6452240, at *17 (Del. Ch. Dec. 18, 2017):

At issue is the duty of loyalty; a board's efforts can be ineffective, its actions obtuse, its results harmful to the corporate weal, without implicating bad faith. Bad faith may be inferred where the directors knew or should have known that illegal conduct was taking place, yet "took no steps in a good faith effort to prevent or remedy that situation." (quoting In re Caremark Int'l Inc. Derivative Litig., 698 A.2d 959, 971 (Del. Ch. 1996)) (emphasis in original); Horman v. Abney, No. 12290-VCS, 2017 WL 242571, at *11 (Del. Ch. Jan. 19, 2017) (“If the members of the board become aware of the red flags and do nothing in response, and thereby consciously disregard their fiduciary duties, then they each individually are subject to liability for a failure of oversight.”).

116. See Langevoort, supra note 73, at 730 (“Caremark was quite clear that these resources and deployment choices are matters of business judgment, and hence receive strong deference when made in good faith.”). The Delaware Supreme Court has emphasized that a complete “dearth of any board-level effort at monitoring” of a significant compliance issue states a claim for an oversight failure. Marchand v. Barnhill, 212 A.3d 805, 809 (Del. 2019) (emphasis added).

117. See, e.g., Bainbridge et al., supra note 55, at 603–04 (expressing concern that after Stone v. Ritter “a conscious decision by the board of directors that the costs of a law compliance program outweigh the benefits may no longer be protected by the business judgment rule”).

118. See Geoffrey P. Miller, An Economic Analysis of Effective Compliance Programs, in RESEARCH HANDBOOK ON CORPORATE CRIME AND FINANCIAL MISDEALING 247, 254–55 (Jennifer Arlen ed., 2018) (arguing that managerial judgment about compliance should be designed to penalize firms that underinvest in legal precaution from a social risk perspective even if reasonable in terms of expected shareholder value); Langevoort, supra note 73, at 733 (“Suffice it to say that managerial motivations toward legal compliance are not fully aligned with either the corporation's best interests or the optimal avoidance of social harm.”); Langevoort, supra note 69, at 970–71 (explaining how corporate culture can vary a firm's risk-return calculus and how this
From the start, the Caremark court announced that this claim was “possibly the most difficult theory in corporation law upon which a plaintiff might hope to win a judgment.”119 This oft-quoted refrain about Caremark has created difficulty for Delaware plaintiffs at the demand excusal stage, who must demonstrate that a majority of the board face a “substantial likelihood” of personal liability.120

The small handful of Caremark cases that have survived this nearly insuperable standard on a motion to dismiss for failure to plead demand futility or state a viable claim have all included facts that cross a line between business risk and legal risk. Much has been made of determining how to analyze cases involving “red flags” and whether Caremark itself sets the standard for these cases, as it involved none as a factual matter.121 But in practice, the cases reflect that a more fundamental sorting is occurring that identifies extreme circumstances implicating the issue of obedience, which has resonance for the legitimacy of corporate law, as discussed in Part II above. With limited exception,122 these cases involve either an utter and absolute

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119 Caremark, 698 A.2d at 967.
120 See Rales v. Blasband, 634 A.2d 927, 934 (Del. 1993) (“[A] court must determine whether or not the particularized factual allegations of a derivative stockholder complaint create a reasonable doubt that, as of the time the complaint is filed, the board of directors could have properly exercised its independent and disinterested business judgment in responding to a demand.”); see also Aronson v. Lewis, 473 A.2d 805, 815 (Del. 1984) (stating “substantial likelihood” aspect of demand futility standard), overruled on other grounds, Brehm v. Eisner, 746 A.2d 244, 254 (Del. 2000).
121 See, e.g., Gadinis & Miazad, supra note 84, at 2169–77 (examining whether a board has discharged its monitoring obligation in terms of red flags reaching the board and prompting a response); Paul Graf, Red Flags in the Morning, Directors Take Warning . . . . 6 BUS. L. BRIEF 19, 19 (2010) (exploring how “[t]he knowledge requirement hinges on what information or signals, ‘red flags,’ come to the board’s attention”); Langevoort, supra note 73, at 735 (“[T]he moment the board is brought into the compliance risk discussion, liability exposure increases to at least a small extent, and Caremark itself no longer sets the applicable standard.”); Eric J. Pan, Rethinking the Board’s Duty to Monitor: A Critical Assessment of the Delaware Doctrine, 38 FLA. ST. U. L. REV. 209, 210 (2011) (criticizing “the Delaware doctrine of the duty to monitor” on various grounds, including that “the doctrine incentivizes directors to avoid asking questions or otherwise making efforts to uncover possible red flags”).
122 A small number of cases involved allegations of accounting improprieties or complicity in self-dealing. See Stewart v. Wilmington Tr. SP Servs., Inc., 112 A.3d 271, 281, 301 (Del. Ch. 2015) (denying a motion to dismiss from a “resident” director who “allegedly went along without raising a peep” with a “fraudulent scheme year after year”); Saito v. McCall, No. CIV.A. 17132-NC, 2004 WL 3029876, at *1, *7 (Del. Ch. Dec. 20, 2004) (denying a motion to dismiss regarding an oversight claim that directors “presided over a fraudulent accounting scheme”), overruled on other grounds, Lambrecht v. O’Neal, 3 A.3d 277 (Del. 2010); see also ATR-Kim Eng Fin. Corp. v.
failure to put any board-level monitoring in place for an “intrinsically critical” compliance issue, such as in Marchand, or a board that improperly ignored or managed legal risk, such as in the cases discussed below.

To start with a contrast to the Citigroup case from the financial crisis era, which involved massive amounts of business risk and a typical result of dismissal, a different case from this time involving the insurance giant AIG survived a motion to dismiss with allegations of disobedience. The AIG plaintiffs alleged that the directors had engaged in transactions designed to hide AIG’s true financial situation, sold illegal financial products, rigged markets, and illegally avoided taxes. Denying a Rule 12(b)(6) motion to dismiss, the chancery court explained: “The Complaint fairly supports the assertion that AIG’s Inner Circle led a—and I use this term with knowledge of its strength—criminal organization. The diversity, pervasiveness, and materiality of the alleged financial wrongdoing at AIG is extraordinary.” Drawing all reasonable inferences in favor of the plaintiffs, the court found that “given the pervasiveness of the fraud, [the defendants] knew that AIG was engaging in illegal conduct.”

Shareholders similarly pleading pervasive and widespread fraud also succeeded past motions to dismiss in two cases that arose in 2013 involving Chinese corporations that had accessed the U.S. public markets through reverse mergers—China Agritech and Fuqi. In China Agritech, according to the plaintiffs’ allegations, rampant misconduct was occurring at the company, including the failure to use proceeds from a securities offering for its stated purpose and “repeated
failures to maintain effective internal controls” that ultimately resulted in delisting from the public exchange. 128 Similarly, in Fuqi, the plaintiffs asserted particularized allegations that “the directors did nothing to ensure that its reporting mechanisms were accurate” and “the board knew that it had problems with its accounting and inventory processes” because it announced a financial restatement. 129 After the plaintiff made demand to the board to remedy claimed breaches of fiduciary duty and improve its internal controls, the board failed to respond for two years. 130 During this time, the directors allowed $130 million to be transferred out of the company. 131 Based on Fuqi’s self-disclosed accounting inadequacies, the court concluded that Fuqi “had no meaningful controls in place. The board of directors may have had regular meetings, and an Audit Committee may have existed, but there does not seem to have been any regulation of the company’s operations in China.” 132 In total, in both cases the court concluded that the plaintiffs had pled facts that, when assumed true, were sufficient to infer that the directors knew that the internal controls were inadequate and had failed to correct the deficiencies. More generally, the picture that emerges from the pleadings is of pervasive fraud and that the boards facilitated, or were complicit, in this wrongdoing.

Three other Delaware cases also succeeded in surviving motions to dismiss and suggest the directors participated, at some level, in disobedience: In re Massey Energy Co.; Louisiana Municipal Police Employees’ Retirement System v. Pyott; and In re Clovis Oncology, Inc. As the number of cases surviving the motion to dismiss is exceedingly thin, it is worth examining each in turn.

Massey involved “a coal mining corporation . . . [c]onvinced that it knew better than the public authorities charged with enforcing laws designed to make mining a safer and cleaner business.” 133 Tragedy struck amid this company culture of lax safety precautions: an explosion occurred at one of the company’s mines in West Virginia, resulting in the death of twenty-nine miners. 134 This tragedy was not

130. Id.
131. Id.
132. Id. at 983. The court further noted: “[E]ven if I were to find that Fuqi had some system of internal controls in place, I may infer that the board’s failure to monitor that system was a breach of fiduciary duty.” Id.
134. Id.
the first time that Massey miners had suffered death and serious injuries.”

The company “had pled guilty to criminal charges, had suffered other serious judgments and settlements as a result of violations of law, had been caught trying to hide violations of law and suppress material evidence, and had miners suffer death and serious injuries at its facilities.”

Shareholder litigation followed, alleging that the Massey directors did not make a good faith effort to ensure that the company complied with its legal obligations.

On a procedural posture seeking a preliminary injunction against a merger, the court concluded that the plaintiffs had likely pled a Caremark claim that would survive a motion to dismiss, even under the heightened pleading standard applicable under Rule 23.1. Crucial to this finding were extensive factual allegations suggesting that the Massey directors had knowingly caused the company to seek profit by violating the law. According to the detailed pleading, the company culture involved a CEO and other top managers that knowingly flouted applicable miner safety laws, took an openly aggressive attitude against the relevant agency, made cost-cutting decisions to put miners at risk, publicly suggested that they knew mine safety better than the regulators, and “often argued with the law itself.” The directors were allegedly under the domination of this management and had participated in “foster[ing] a business strategy expressly designed to put coal production and higher profits over compliance with the law.” Accordingly, the court concluded that the plaintiffs had successfully pled “particularized facts creating an inference that the Board and management were aware of a troubling continuing pattern of non-compliance in fact and of a managerial attitude suggestive of a desire to fight with and hide evidence from the company’s regulators.”

Again, as in the China Agritech and Fuqi cases, Massey was not a straightforward case of failed business oversight, but rather one that suggested something more—that the directors had engaged in disobedience.

Pyott presents another example fitting this pattern. In that case, plaintiff-shareholders brought a Caremark claim against the Allergan board for failing to prevent the company’s violations of the

135. Id.
136. Id. at *20.
137. Id.
138. Id. at *21.
139. Id. at *20.
140. Id. at *19–21.
141. Id. at *19.
142. Id. at *21.
ban on off-label drug marketing. Doctors can legally prescribe a drug such as Botox for an off-label therapeutic use that is not FDA approved, but it is illegal for a manufacturer to market a drug for such off-label use. Allergan’s annual report reflected an understanding of “the critical distinction between off-label sales and marketing,” and its general counsel advised the board about an FDA inquiry and incident that indicated the company had likely engaged in illegal conduct in its marketing practices. Despite this warning, “the Board discussed and approved a series of annual strategic plans that contemplated expanding Botox sales dramatically within geographic areas that encompassed the United States” and those “plans contemplated new markets for Botox that involved applications that were off-label uses in the United States.” Allergan eventually entered into a settlement with the U.S. Department of Justice pursuant to which Allergan pled guilty to criminal misdemeanor misbranding and paid a total of $600 million in civil and criminal fines.

Denying the motion to dismiss, Vice Chancellor Travis Laster remarked, “It is not unreasonable to infer that the Board and CEO saw the distinction between off-label selling and off-label marketing as a source of legal risk to be managed, rather than a boundary to be avoided.” The complaint set out detailed factual allegations that “the CEO and his management team devised, and the Board approved, a business plan that relied on off-label-use-promoting activities, confident that the risk of regulatory detection was low, that most regulatory problems could be solved, and that dealing with regulatory risk was a cost of doing business.” Pyott thus involved more than an allegation of conscious disregard for duties—rather, it implicated a direct connection between the board and a business plan premised on illegal activity.

144. Id. at 317–18.
145. Id. at 318.
146. Id. at 320.
147. Id. at 352.
148. Id. at 316.
149. Id. at 355.
150. Id. at 356.
151. See Melbourne Mun. Firefighters’ Pension Tr. Fund v. Jacobs, No. 10872-VCNR, 2016 WL 4076369, at *12 (Del. Ch. Aug. 1, 2016) (“[T]he board’s alleged bad faith in Pyott was not based on its conscious disregard for its duty to prevent the company from engaging in illegal conduct. Instead it was based on the board’s alleged decision to cause the company to engage in illegal conduct.”); see also In re Facebook, Inc. Section 220 Litig., No. 2018-0661-JRS, 2019 WL 2320842, at *8 (Del. Ch. May 31, 2019) (granting plaintiffs’ request for books and records to
Finally, the plaintiffs in Clovis Oncology pled with particularity a Caremark claim alleging that the directors of a biopharmaceutical company “did nothing” after repeatedly receiving signals from management that the company was violating the FDA’s clinical trial protocol for its most promising drug under review. These protocols and related FDA regulations were “mission critical regulatory issues” for the company, which had no drugs on the market, and the defendants “viewed detailed information” regarding the clinical trial at each board meeting. Although less egregious than some cases that have survived a motion to dismiss, the Clovis Oncology pleadings nonetheless fit the pattern described of a board that allegedly facilitated, or was complicit, in wrongdoing.

Most problematic was the plaintiff’s allegation that the board knowingly ignored “that the Company was violating—perhaps consciously violating—the [clinical trial] protocol and then misleading the market and regulators” about the company’s “mission critical product.” In the face of management’s revelation that it was improperly calculating drug trial success, the board, “comprised of experts,” had allegedly “allowed the Company to deceive regulators and the market regarding the drug’s efficacy.”

In all these cases, plaintiff–shareholders survived motions to dismiss with detailed factual allegations that suggested defendant directors not only ignored red flags, but had gone farther down a path of participation or complicity in wrongdoing. Caremark claims in these cases resemble allegations of disobedience—facts supporting an inference that directors knew or should have known the corporation was engaged in legal risk or illegality.

In the recent case involving Duke Energy before the Delaware Supreme Court, a divergence of opinion on the application of this principle explains the filing of majority and dissenting opinions. In this case, the country’s largest electricity producer suffered a ruptured pipe that sent coal ash and toxic wastewater into the Dan River. It led the company to plead guilty to nine misdemeanor criminal violations of the Federal Clean Water Act and to pay a fine exceeding $100

investigate potential wrongdoing by the Facebook directors and top executives in “implement[ing] a business model that exposed private user data to unauthorized third-party access” in violation of a FTC consent decree).

153. Id. at *13.
154. Id. at *10, *14.
155. Id. at *1, *6, *14.
million. The majority saw the case as fitting the typical pattern appropriate for dismissal, in which plaintiffs “conflate the bad outcome of the criminal proceedings with the actions of the board.”\footnote{157} It interpreted management presentations to the board on the status of environmental problems as evidence that the board had taken some action to address regulatory concerns, concluding that the board therefore had not consciously disregarded its oversight responsibility.\footnote{158} Chief Justice Leo E. Strine, Jr. dissented, finding that the facts raised a pleading stage inference that “it was the business strategy of Duke Energy, accepted and supported by its board of directors, to run the company in a manner that purposely skirted, and in many ways consciously violated, important environmental laws.”\footnote{159}

Chief Justice Strine acknowledged that the differing views on the court with regard to the \textit{Caremark} claim resulted from whether the facts were interpreted as legal disobedience:

\begin{quote}
Sadly, my dissent rests on my reluctant conclusion that the facts as pled support a fair inference that the board was all too aware that Duke's business strategy involved flouting important laws, while employing a strategy of political influence-seeking and cajolament to reduce the risk that the company would be called to fair account. Under the facts as pled, the only surprising thing about the Dan River spill that gave rise to the state regulator's issuance of a $6.8 million fine, twenty-three Notice of Violation letters, twenty-six Notice of Deficiency letters, and a finding that Duke committed more than 760 daily violations of environmental regulations, in addition to other severe civil and criminal penalties related to Duke's operations at other sites, is that something like it did not happen years earlier.\footnote{160}

The pleadings of extensive legal violations over a significant period of time, combined with evidence that the corporation cultivated lax oversight from the state regulator and helped to elect a governor who had spent decades as a Duke Energy employee, supported an inference that the board was aware the corporation was not on a path toward legal compliance. Although the management made presentations to the board on the status of environmental problems, the broader set of facts puts the case in line with other narratives of disobedience and underscores the rare path of survival for \textit{Caremark} claims in Delaware.
\end{quote}

\footnote{157} Id. at 59. \\
\footnote{158} Id. \\
\footnote{159} Id. at 65 (Strine, C.J., dissenting). \\
\footnote{160} Id. at 68.
C. Implications and Future Directions

Drawing together these threads of discussion on the role of good faith and the doctrinal convergence of *Caremark* and disobedience, two additional observations emerge.

First, *Caremark* case law has been shaped by an emphasis on the line between business risk and legal risk. We can understand this distinction in light of corporate law’s aim to further legal obedience and its own legitimacy. It is not, however, a distinction based on an evaluation of the merits of the underlying business activity, and it ultimately informs what we can expect of the doctrine.\(^{161}\)

The approach taken in the case law suggests, for example, that a distinction might be drawn between a financial institution that takes massive amounts of business risk—which would not give rise to oversight liability—and an innovative startup that knowingly flouts laws—which could potentially result in liability.\(^{162}\) Notably, the social value or harm created by each of these activities—for shareholders and stakeholders—is arguable and context specific\(^{163}\), but corporate

\(^{161}\) See Asbestos Workers Local 42 Pension Fund v. Bammann, No. 9772-VCG, 2015 WL 2455469, at *14 (Del. Ch. May 22, 2015) (“It is not entirely clear under what circumstances a stockholder derivative plaintiff can prevail against the directors on a theory of oversight liability for failure to monitor business risk under Delaware law; the Plaintiff cites no examples where such an action has successfully been maintained.”); *In re Goldman Sachs Grp., Inc. S’holder Litig.*, No. 5215-VCG, 2011 WL 4826104, at *21 (Del. Ch. Oct. 12, 2011) (“As a preliminary matter, this Court has not definitively stated whether a board’s *Caremark* duties include a duty to monitor business risk.”); see also Okla. Firefighters Pension & Ret. Sys. v. Corbat, No. 12151-VCG, 2017 WL 6452240, at 18* (Del. Ch. Dec. 18, 2017):

Banamex made a risky business decision that turned out poorly for the company. That suggests a failure to monitor or properly limit business risk, a theory of director liability that this Court has never definitively accepted. Indeed, evaluation of risk is a core function of the exercise of business judgment:

* Reiter ex rel. Capital One Fin. Corp. v. Fairbank, No. 11693-CB, 2016 WL 6081823, at *8 (Del. Ch. Oct. 18, 2016) (“In applying the *Caremark* theory of liability, even in the face of alleged red flags, this Court has been careful to distinguish between failing to fulfill one’s oversight obligations with respect to fraudulent or criminal conduct as opposed to monitoring the business risk of the enterprise.”); *In re Citigroup Inc. S’holder Derivative Litig.*, 964 A.2d 106, 131 (Del. Ch. 2009) (“There are significant differences between failing to oversee employee fraudulent or criminal conduct and failing to recognize the extent of a Company’s business risk.”).

\(^{162}\) The recent *Caremark* case involving the founder and directors of ride-hailing company Uber is instructive. The Delaware Court of Chancery dismissed the suit because the inaction at issue was not connected to the alleged corporate culture of lawbreaking—the legal violations and monitoring at issue did not concern a “single topic” as the mining law violations had in *Massey*. See McElrath v. Kulanick, No. 2017-0888-SE, 2019 WL 1430210, at *15 (Del. Ch. April 1, 2019). The case might have come out differently if the pleadings had, for example, concerned the conscious disregard of pervasive taxi law violations instead of Uber’s acquisition of Otto, which led to a lawsuit by Google for misappropriation of intellectual property.

\(^{163}\) See, e.g., Pollman, *supra* note 14, at 731–32 (noting the potential for social value in some activity that pushes or transgresses legal boundaries); *see also* Langevoort, *supra* note 69, at 936 (noting that psychologists have found experimental evidence linking cognitive creativity
law does not enter that debate. Corporate law instead seeks to preserve the legitimacy of broad business discretion by setting minimal process thresholds for compliance and otherwise drawing a strict prohibition against the conscious or intentional managing of risk of legal enforcement.

As a consequence, absent a dramatic shift in approach, the oversight doctrine is not an effective tool for holding fiduciaries accountable for failures to monitor business risk.\textsuperscript{164} Furthermore, as corporate law does not evaluate the merits of external laws or provide exceptions to the obligation of legal obedience, the Caremark doctrine could be problematic for fiduciaries of innovative companies that bump up against regulations.\textsuperscript{165} Oversight liability may be unlikely in light of the obstacles involved in derivative litigation, the lack of incentive for shareholders to bring suit if the company breaks laws in pursuit of profit, and the potential defense that it was unclear how existing laws would apply to an innovative product or service and thus there was no conscious disregard or intent.\textsuperscript{166} Nonetheless, it is notable that corporate law disfavors businesses that engage in legal risk.

Second, examining the Delaware case law reveals that two separate doctrines have evolved within the duty of good faith—obedience and oversight. In practice to date, the Caremark oversight obligation has been cabined to extreme cases involving legal violations, such as in cases of utter failure to engage in critical board-level oversight of legal compliance, allegedly pervasive wrongdoing, complicity in fraudulent or illegal business models and practices, misleading regulators, and repeat offenders. Corporate law’s commitment to the rule of law certainly supports oversight accountability in these instances of utter failure and disobedience.\textsuperscript{167}

and unethical behavior, thus leading to “the conundrum that the origins of noncompliance may be found in seemingly benign—even prized—behaviors, traits and cultural artifacts that are thought to generate success in a hyper-competitive marketplace”).

\textsuperscript{164} For this reason, defendants might also attempt to characterize their monitoring activity as related to business risk and to otherwise show that they acted in good faith. For an argument that some cases are “blended” insofar as they involve a legal violation but the damages sought also include losses caused by bad business oversight, see Ezra Wasserman Mitchell, Caremark’s Hidden Promise, 51 Loy. L.A. L. Rev. 239, 256–64 (2018).


\textsuperscript{166} Pollman, supra note 14, at 750–57.

\textsuperscript{167} Some corporations that engage in activity that pushes the boundaries of lawfulness may succeed in gaining popular support and even changing or clarifying the law, which may in turn be relevant to the analysis from a corporate law perspective. The cases discussed in Section III.B,
Moreover, corporate law's commitment to the rule of law supports a more robust application of oversight duties. The Delaware Supreme Court's recent decision in *Marchand* signals a willingness to recognize pleadings of an utter failure to establish a board-level monitoring system as required under the first prong of *Caremark*. Regarding the second prong, this Article's analysis suggests that the *Caremark* standard need not be applied so stringently as to require disobedience bordering on outright complicity or knowing misconduct. The stated standard of conscious disregard is amply capacious to also capture fiduciaries acting with willful ignorance or an awareness that their efforts at compliance are insufficient. The relevant inquiry is not the effectiveness of the system of compliance and monitoring, as such, but rather whether the fiduciary acted in good faith in actively attempting to carry out these obligations with the aim of full legal compliance. A stronger approach is possible and would further the public-regarding purpose of the good faith obligation and affirm that oversight liability can stem from conduct that falls short of an intent to violate law, which has been recognized as a separate basis for liability.

**CONCLUSION**

This Article has explored the legitimizing role of the duty of good faith in corporate law and the doctrinal convergence of oversight and disobedience. Corporate law acknowledges societal interests in the rule of law and embeds a safety valve for public policy in the obligations of fiduciaries that cannot be eliminated. The corporate law requirements of legal obedience and oversight preserve the ability for courts to flexibly respond to violations of public trust and provide legitimacy for the larger enterprise of state-chartered corporations.

Examining the *Caremark* doctrine on oversight responsibility, however, reveals that in practice the potential for accountability through fiduciary law has been narrowly circumscribed. With limited exception, the small handful of oversight cases decided by Delaware courts that have survived motions to dismiss involved pleadings of either a complete lack of board-level oversight or egregious disobedience such as allegations that a corporation was engaged in pervasive wrongdoing or directors were complicit in fraudulent business models or practices. Furthermore, in case law to date, Delaware courts have prioritized giving directors broad latitude to

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however, do not fit this characterization and instead reflect legal violations with little to no potential for social value or legal change or clarification.
take business risk by drawing a line at legal risk, despite the possibility that both types of activity could create social value or harm depending on the circumstances. Bringing together these observations, this Article’s analysis concludes that corporate law’s public-regarding commitment to the rule of law supports accountability in these instances as well as applying a more robust understanding of the obligations of oversight and obedience.