THE BOARD’S DUTY TO MONITOR RISK AFTER CITIGROUP

Robert T. Miller*

Across the ideological spectrum, from Paul Krugman1 to Richard Posner2 and from Lucien Bebchuk3 to Stephen Bainbridge,4 commentators agree that one of the main causes of the financial crisis was that banks took on too much risk.5 Not surprisingly, therefore, there are many proposals to prevent such excessive risk-taking in the future. The Securities and Exchange Commission has already promulgated new rules requiring all public companies to provide greater disclosure about their risk oversight practices, including information about the board’s role in managing risk.6 Senator Schumer has introduced a bill that would require all public

---

* Associate Professor of Law, Villanova University School of Law. I thank Colleen Baker, Richard A. Booth, Thomas C. Crimmins, John Y. Gotanda, Joan G. Miller, Mark L. Movsesian, John F. Murphy, Jennifer O’Hare, Richard E. Redding, Chaim Saiman, and Mark A. Sargent for helpful comments and discussion about the ideas presented in this Article. I thank Courtney Magnarella for her excellent work as my research assistant. Most of all, I thank Jennifer L. Miller, whose assistance and comments on all aspects of this piece were absolutely indispensable to its completion.

1. See Paul Krugman, Reform or Bust, N.Y. TIMES, Sept. 21, 2009, at 23 (arguing that the compensation packages of bank executives encouraged “excessive risk-taking”).


5. I myself have some doubts. See Robert T. Miller, Morals in a Market Bubble, U. DAYTON L. REV. (forthcoming) (arguing that when banks took on more risk in the years leading up the crisis, their decisions were commercially rational given the abnormally low interest rates set by the Federal Reserve).

companies to establish board committees to supervise enterprise-wide risk management practices. More recently, President Obama has proposed prohibiting banks with insured deposits from trading securities for their own account. Perhaps most comprehensively, Senator Dodd has introduced a bill consolidating various financial regulatory agencies and creating others, including a new Financial Services Oversight Council that would, among other things, “monitor the financial services marketplace to identify potential threats to the stability of the United States’ financial system.”

Others have suggested that an important way to limit corporate risk-taking lies in stricter enforcement by the courts of the board’s duty to monitor the company’s exposure to risk. Although hardly agreeing with the wisdom of such ideas, Martin Lipton has written that “the risk oversight function of the board of directors . . . has taken center stage . . . and expectations for board engagement with risk are at all-time highs.” At least initially, relying on the oversight or monitoring duties of corporate boards may seem like a plausible way for society to control corporate risk-taking. For, under Delaware law, the board’s authority to manage the business and affairs of the corporation implies a fiduciary duty to monitor the activities of the corporation, which could easily be thought to include


12. DEL. CODE ANN. tit. 8, § 141 (1953).

the company’s exposure to risk. For example, if the corporation is taking on excessive risk through the decisions of its traders or other junior employees, and if the board of directors fails to discover and prevent this excessive risk-taking, with the result that the corporation suffers losses when the risks materialize, then perhaps the directors have breached their fiduciary duties to monitor the corporation and could, in some circumstances, be liable.\textsuperscript{14}

This theory of oversight liability underlies the plaintiffs’ principal claim in \textit{In re Citigroup Inc. Shareholders Derivative Litigation},\textsuperscript{15} which was decided by the Delaware Court of Chancery (Chancellor Chandler) early last year. In that case, shareholders of Citigroup sued some of the bank’s current and former directors, alleging that they “breached their fiduciary duties by failing to properly monitor and manage the risks the Company faced from problems in the subprime lending market,”\textsuperscript{16} which resulted in Citigroup’s overexposure to such risks\textsuperscript{17} and subsequent severe losses when the subprime market collapsed.\textsuperscript{18} Chancellor Chandler had little trouble ruling for the defendant directors on their motion to dismiss.\textsuperscript{19}

\textsuperscript{14} See, e.g., Bainbridge, \textit{supra} note 4, at 978 (2009) (describing the recent \textit{Citigroup} decision and how it illustrates how plaintiffs will adapt \textit{Caremark} claims in cases of risk management failure); Pan, \textit{supra} note 10, at 27-28 (arguing that “[t]he management of risk is a corporate governance problem” and courts should “expand[] the scope and application of the duty [to monitor] in future cases”).

\textsuperscript{15} 964 A.2d 106 (Del. Ch. 2009).

\textsuperscript{16} Id. at 111.

\textsuperscript{17} Id. at 121.

\textsuperscript{18} See id. at 113 (detailing billions of dollars in losses Citigroup suffered from its exposure to subprime debt).

\textsuperscript{19} More accurately, Chancellor Chandler granted the defendant directors’ motion to dismiss under Court of Chancery Rule 23.1 for failure to plead demand futility. Id. at 140. There is a subtlety here not relevant to the primary concerns of the text. In particular, in a derivative action, shareholder-plaintiffs must either (a) make a pre-suit demand on the board presenting their allegations and requesting that the board bring suit, and, if the directors refuse, show that they wrongfully refused to do so, or else (b) plead facts showing that demand upon the board would have been futile. See, e.g., Stone v. Ritter, 911 A.2d 362, 366-367 (Del. 2006). If plaintiffs plead demand futility, the complaint must plead with particularity facts showing that a demand would have been futile. Court of Chancery Rule 23.1; Stone, 911 A.2d at 367 n.9. When the underlying claim is one of oversight liability, the plaintiff must allege particularized facts that create a reasonable doubt whether the board of directors “could have properly exercised its independent and disinterested business judgment in response to the demand.” Rales v. Blasband, 634 A.2d 927, 933-934 (Del. 1993). This means that the plaintiffs must properly plead either that a majority of the board was interested or lacked independence (which the plaintiffs in \textit{Citigroup} did not allege) or else plead particularized facts showing that board’s conduct was “so egregious on its face that board approval cannot meet the test of business judgment, and a substantial likelihood of director liability therefore exists.” Citigroup, 964 A.2d at 121 (quoting Aronson v. Lewis, 473 A.2d 805, 815 (Del. 1984)). The upshot of all this is that, to survive a motion to dismiss, the plaintiffs in \textit{Citigroup} had to plead with particularity facts that, if true, would show that the Citigroup board faced a substantial threat of oversight liability. Id. at 121. As
a result that naturally led to some academic criticism.\textsuperscript{20} Professor Pan, for instance, has written that it “seems fantastic that the duty to monitor . . . incentivizes boards to take no responsibility for the business results of the company—a complete disregard for the principle that the corporation should be managed by or under the direction of the board,”\textsuperscript{21} and he has urged Delaware judges to “begin speaking out about the importance of a board’s duty to monitor and to back up their exhortations by expanding the scope and application of the duty in future cases.”\textsuperscript{22}

In this brief article, I want to make one main point about proposals to expand director oversight liability to police the problem of excessive risk-taking by financial institutions—namely, that they are entirely impracticable. Such proposals may seem to involve only relatively minor tinkering with Delaware law, but to have any meaningful effect on the outcome of cases, they would have to effect changes tantamount to repealing the business judgment rule. Merely as a practical matter, the Delaware courts and the Delaware General Assembly are not going to implement such changes. I happen to agree with that result, but I am not going to defend it here. Instead, my purpose is to describe how radical proposed expansions of director oversight liability really are.

I. DIRECTOR OVERSIGHT LIABILITY UNDER CAREMARK AND STONE

Suits alleging that a board failed to properly monitor the business of the corporation are generally known as Caremark claims after the eponymous case decided by then-Chancellor Allen in the Delaware Court of Chancery in 1996.\textsuperscript{23} More recently confirmed by the Delaware Supreme Court in Stone v. Ritter,\textsuperscript{24} the current doctrine is that, in order to prevail on

\textsuperscript{20} For example, referring to the case, Professor Alces says that “the board could easily be considered asleep at the switch when corporate catastrophe occurs to their apparent surprise.” Kelli A. Alces, Debunking the Corporate Fiduciary Myth, 35 IOWA J. CORP. L. 239, 252 (2009).

\textsuperscript{21} Pan, supra note 10, at 26. Simply as a matter of logic, at worst Citigroup gives boards no incentive to monitor risk; it does not give boards “incentives . . . to take no responsibility” for such matters, which is a quite different thing. Id. A legal rule may fail to encourage certain conduct without thereby discouraging it.

\textsuperscript{22} Pan, supra note 10, at 28.

\textsuperscript{23} In re Caremark Int’l Inc. Deriv. Litig., 698 A.2d 959, 970 (Del. Ch. 1996).

\textsuperscript{24} 911 A.2d 362 (Del. 2006). There is a debate of questionable importance as to whether Caremark included in its definition of oversight liability the scienter element clearly articulated in Stone. In adopting the scienter element, the Delaware Supreme Court expressly said that it was merely confirming the holding in Caremark. Id. at 370 (“We hold that Caremark articulates the necessary conditions predicate for director oversight
a claim that the board breached its duty to monitor the corporation, a plaintiff must prove that either (a) “the directors utterly failed to implement any reporting or information system or controls” to monitor the business, or else (b) “having implemented such a system or controls, [the directors] consciously failed to monitor or oversee its operations thus disabling themselves from being informed of risks or problems requiring their attention.”

In Stone, the Delaware Supreme Court made it clear that “[i]n either case, imposition of liability requires a showing that the directors knew that they were not discharging their fiduciary obligations,” that is, that they were “demonstrating a conscious disregard for their responsibilities.”

Thus, to prevail, plaintiffs must prove not only that the directors breached their duty of care but also that they knew they were breaching that duty when they breached it.

Historically, Caremark claims have virtually always concerned illegality or fraud by officers or employees of the corporation. That is, such claims alleged that the board failed to detect and prevent criminal or fraudulent conduct by corporate employees that ultimately resulted in losses for the corporation, especially criminal fines or civil penalties or liability.”). Similarly, Vice Chancellor Strine had, by the time of Stone, been advocating this understanding of Caremark for some time. See, e.g., Guttmann v. Huang, 823 A.2d 492, 506 (Del. Ch. 2003) (“Although the Caremark decision is rightly seen as a prod towards the greater exercise of care by directors in monitoring their corporation’s compliance with legal standards, by its plain and intentional terms, the opinion articulates a standard for liability for failures of oversight that requires a showing that the directors breached their duty of loyalty by failing to attend to their duties in good faith. Put otherwise, the decision premises liability on a showing that the directors were conscious of the fact that they were not doing their jobs.”). By contrast, Professor Bainbridge thinks that “the content of [the original Caremark] standard changed significantly” because “[t]he fiduciary duty at issue in the original Caremark opinion demonstrably was the duty of care” but Vice Chancellor Strine’s reading of Caremark “ripped the Caremark claim from its original home in the duty of care and reinvented it as a duty of loyalty.” Bainbridge, supra note 4, at 974-975; see also Peter D. Bordonaro, Comment, Good Faith: Set In Stone?, 82 Tul. L. Rev. 1119, 1126 (2008) (arguing that Vice Chancellor Strine’s opinion in Guttmann “effectively transformed director oversight liability from a duty of care claim into a duty of loyalty claim.”); Pan, supra note 10, at 17 (“[T]he Delaware Supreme Court reinterpreted Caremark, a case originally decided by Chancellor Allen as [being] about the duty of care, to rather be about the duty of good faith.”). For the reasons given infra note 59, I think the Delaware Supreme Court and Vice Chancellor Strine have the better of the argument here.

25. Stone, 911 A.2d at 370.
26. Id. at 370 (both emphases added).
settlements. In *Caremark* itself, for example, junior employees of the company had caused the corporation to enter into transactions that violated the federal Anti-Referral Payments Law (one of the statutes governing Medicare and Medicaid), thus subjecting the corporation to criminal and civil liability.  

Similarly, in *Stone*, employees of the defendant bank had caused the bank to violate the federal Bank Secrecy Act and various anti-money-laundering regulations.  

Other oversight claims have been premised on the board’s supposed failure to detect and prevent lesser though still intentional forms of wrongdoing in the corporation. Thus, in *Guttman v. Huang*, the plaintiffs alleged that the directors failed to prevent accounting irregularities that caused the corporation to have to restate its financial statements for certain fiscal periods, perhaps subjecting the corporation to liability under the federal securities laws, and in *ATR-Kim Eng Financial Corp. v. Araneta*, the plaintiffs alleged that the directors had failed to prevent an officer and controlling shareholder from effectively looting the corporation.

II. IN RE CITIGROUP INC. SHAREHOLDER DERIVATIVE LITIGATION

The oversight claim in *Citigroup*, however, was premised on a supposed failure by the board to detect and prevent not illegality or fraud by corporate employees but merely excessively risky business decisions by such employees. This theory was a somewhat novel application of *Caremark*. Indeed, Chancellor Chandler’s opinion in *Citigroup* is not entirely clear on the issue of whether oversight liability can even be premised on such claims. On the one hand, he writes that although “it may be tempting to say that directors have the same duties to monitor and oversee business risk” as they do “to intervene and prevent frauds and other wrongdoing that could expose the company to risk of loss,” nevertheless “imposing *Caremark*-type duties on directors to monitor business risk is fundamentally different” because doing so “would involve courts in

---

32. *Citigroup*, 964 A.2d at 123 (noting that plaintiffs’ *Caremark* claims were based on defendants’ alleged failure to monitor the company’s business risks).
33. See id. (stating that the “[p]laintiffs’ theory of how the director defendants will face personal liability is a bit of a twist on the traditional *Caremark* claim” because “[i]n a typical *Caremark* case, plaintiffs argue that the defendants are liable for damages that arise from a failure to properly monitor or oversee employee misconduct or violations of law,” but in the instant case “plaintiffs’ *Caremark* claims are based on defendants’ alleged failure to properly monitor Citigroup’s *business risk*, specifically its exposure to the subprime mortgage market.”).
conducting hindsight evaluations of decisions at the heart of the business judgment of directors,”34 which Chancellor Chandler is obviously (and correctly) loathe to do. He thus concludes, “Oversight duties under Delaware law are not designed to subject directors . . . to personal liability for failure to predict the future and to properly evaluate business risk.”35 This makes it sound as if Caremark claims founded on alleged failures by the board to monitor the company’s business risk are barred as a matter of law, and this is indeed how some scholars, such as Professor Pan, read the decision.36

On the other hand, elsewhere in his Citigroup opinion, Chancellor Chandler seems to leave open the possibility that, in an appropriate case, a board might be subject to liability under Caremark for failing to monitor the corporation’s business risks. Noting that “plaintiffs allege that the defendants are liable for failing to properly monitor the risk” that the company was taking on, and concluding that the “plaintiffs in this case have failed to state a Caremark claim,” Chancellor Chandler nevertheless stated that “it may be possible for a plaintiff to meet the burden under some set of facts.”37 This, to be sure, sounds as if Caremark claims can, at least as a matter of law, be premised on a failure by the board to properly monitor the business risks borne by the company, even if in practice such claims are even less likely to succeed than Caremark claims premised on a board’s failure to detect and prevent illegality or fraud. Although the matter is not free from doubt, I think this is the correct reading of the opinion because, to reach the result he does, Chancellor Chandler in fact performs a standard Caremark analysis. That is, he does not simply dismiss the suit by noting that the plaintiffs have alleged a failure by the board to oversee the company’s business risk rather than its compliance with law. Rather, he actually applies the doctrine from Caremark and Stone to the plaintiffs’ factual allegations—a procedure that would be superfluous unless oversight liability may lie for failures to monitor such risk.

Moreover, the application of Caremark and Stone principles to the allegations in Citigroup turns out to be quite straightforward. First,

34. Id. at 131.
35. Id.
36. Professor Pan writes that “Chancellor Chandler rejected the plaintiffs’ claims on two grounds,” one of which was that “a board cannot be held liable for failure to monitor business risk.” Pan, supra note 10, at 25.
37. Citigroup, 964 A.2d at 126 (both emphases added). Professor Bainbridge, considering the matter at length, concludes that although risk management, on the one hand, and legal compliance and accounting controls, on the other, do “not differ in kind,” nevertheless they do “differ . . . in degree,” and “Caremark claims thus appropriately lie with respect to each,” even if “courts need to be especially sensitive in applying Caremark to the former class of cases.” Bainbridge, supra note 4, at 981, 985.
Chancellor Chandler quickly noted that the plaintiffs “do not contest that Citigroup had procedures and controls in place that were designed to monitor risk,” including an audit and risk management committee of the board of directors that met regularly and was charged with monitoring the credit, market, liquidity, and operational risk exposures of the bank. Hence, the plaintiffs could not prevail on a theory that the “directors utterly failed to implement any reporting or information system or controls” to monitor business risks. Second, although the plaintiffs argued that the director defendants “did not make a good faith effort to comply with the established oversight procedures,” nevertheless as Chancellor Chandler said, “to establish director oversight liability, plaintiffs would ultimately have to prove bad faith conduct by the director defendants” and thus had to plead “particularized factual allegations that raise a reasonable doubt that the director defendants acted in good faith”—that is, that they consciously disregarded their duties. The plaintiffs, however, failed to plead any particularized facts tending to show that the directors knew that they were not properly monitoring the company’s risk. Although Chancellor Chandler never puts it this way, the plaintiffs simply did not plead facts tending to show scienter, and so their complaint failed to state a claim under Caremark and Stone.

As I noted above, this result has occasioned some academic criticism. Is there a practicable way to apply or, if need be, modify Caremark and Stone “to define director duties with respect to risk assessment” and “to define the types of information that ought to be reported to the board in order to fulfill its oversight function,” as Professor Brown would have it? Likewise, is there a way to “expand the scope and application of the duty [to monitor] in future cases,” as Professor Pan would have it? In other words, is there some change in the law that would have allowed the plaintiffs in Citigroup to prevail or, at least, to have survived a motion to dismiss and get to trial? The fact that Professors Brown and Pan are so vague here as to what changes they might like to see in the law is telling,

38. Citigroup, 964 A.2d at 127.
40. Citigroup, 964 A.2d at 127.
41. Id.
42. Id. at 128.
45. Pan, supra note 10, at 28.
for the answers to all these questions are in the negative. No changes in the doctrines governing oversight liability are likely to affect the outcomes of real world cases unless we are also prepared to completely repeal the business judgment rule.

III. WHAT EXPANDING DIRECTOR OVERSIGHT CLAIMS WOULD ENTAIL

The reason for this is somewhat complex and is best explained in three stages. First, regardless of what the standard of care may be in oversight cases, regardless of what the law says boards ought to do to monitor risk, and regardless of whatever other changes would-be reformers desire, it is next to impossible for plaintiffs to prevail in Caremark suits because they have to prove scienter—that is, they have to prove not just that the board failed to properly monitor the business (however this duty may be understood) but also that the board knew that it was failing to do so. In whatever cases in which would-be reformers think the directors should be liable for failing to monitor the business, even if the directors were being negligent or grossly negligent, often the directors did not in fact know that they were failing in their duties. In those cases where the directors actually did know this, proving this is, in the nature of the case, extremely difficult. Absent the proverbial telltale email or evidence collected by wiretaps (which is obviously not available in civil cases), proving that the defendants had a certain state of mind is next to impossible. Hence, the scienter requirement in Caremark is a powerful, almost insuperable, barrier to using oversight liability to hold boards responsible for monitoring risk.

Second, even if the scienter requirement were eliminated from Caremark, the claims plaintiffs might then bring would sound only in the duty of care, and in that case they would be immediately dismissible, provided only that the corporation had an exculpatory Section 102(b)(7) provision in its certificate of incorporation. Section 102(b)(7) of the Delaware General Corporation Law authorizes Delaware corporations to include in their certificates of incorporation provisions eliminating the personal liability of directors for breaches of their duty of care (but not for, among other things, breaches of their duty of loyalty or actions not taken in good faith). The Delaware General Assembly enacted this provision to

46. More precisely, Section 102(b)(7) provides that a Delaware corporation’s certificate of incorporation may contain “[a] provision eliminating or limiting the personal liability of a director to the corporation or its stockholders for monetary damages for breach of fiduciary duty as a director, provided that such provision shall not eliminate or limit the liability of a director: (i) [f]or any breach of the director’s duty of loyalty to the corporation or its stockholders; (ii) for acts or omissions not in good faith or which involve intentional misconduct or a knowing violation of law; (iii) under §174 of [the Delaware General Corporation Law]; or (iv) for any transaction from which the director derived an improper personal benefit.” 8 Del. Code § 102(b)(7) (2009).
quell the crisis caused by the Delaware Supreme Court’s decision in Smith v. Van Gorkom, and nowadays all well-advised Delaware corporations—and thus virtually all public companies incorporated in Delaware—have such provisions in their certificates. When a suit seeking monetary damages (and not equitable relief) against the directors alleges only a breach of the duty of care, it is dismissible once the defendant directors properly invoke the Section 102(b)(7) provision in the corporation’s charter.49

Put another way, Section 102(b)(7) provisions block suits for monetary damages against boards for breaches of the duty of care, whether for their active business decisions or for their failures in monitoring or overseeing the business. No matter what the judge-made law concerning the duty to monitor or oversee may be, suits against public companies (which virtually always have Section 102(b)(7) provisions) sounding in oversight liability will be dismissible if they fail to allege bad faith—i.e., a knowing breach of duty. Currently, these suits are dismissible because Caremark and Stone make scienter an element of an oversight claim. If the Delaware Supreme Court reversed this holding and allowed oversight claims based solely on the negligence or gross negligence of the board, such suits would still be dismissible, but then the reason would be that the board was exculpated from liability for such suits under the corporation’s Section 102(b)(7) provision. Any meaningful change in director oversight liability in Delaware, therefore, would require repealing or significantly abridging Section 102(b)(7).

Strangely, this fact seems to have been overlooked by Citigroup’s critics. Thus, Professor Brown mentions that the plaintiffs in Citigroup alleged that the defendant directors consciously disregarded their duties and explains that such an allegation is “made necessary by the ubiquitous presence of waiver of liability provisions,”50 but he never averts to the fact

47. 65 Del. Laws c. 289 (1986).
49. Malpiede v. Townson, 780 A.2d 1075, 1093 (Del. 2001) (holding that a complaint that unambiguously and solely asserts only a duty of care claim is dismissible once the corporation’s Section 102(b)(7) provision is invoked).
that these provisions also make the expansion of director oversight liability he advocates quite pointless. Similarly, Professor Pan mentions Section 102(b)(7) often, but he seems to overlook its significance here. He writes that the Delaware courts had “limit[ed] . . . the duty to monitor” as originally articulated in Caremark, “first, by equating the duty to monitor with the duty of good faith” and then “second, by subsuming the duty of good faith into the duty of loyalty” in a manner such that a breach of the duty would require scienter. 51 “The re-categorization of the duty to monitor as part of the duty of loyalty,” he says, “removed monitoring failures from Section 102(b)(7) exculpation, but it also made it more difficult to show that directors breached their duty to monitor.” 52 This, I think, gets things rather backwards. It is not as if including a scienter element first did plaintiffs a favor by “removing [their oversight suits] from 102(b)(7) exculpation” but then made their cases harder to win by requiring that they prove scienter. Rather, in the presence of Section 102(b)(7) provisions, duty to monitor claims sounding solely in the duty of care were always going to lose. They could lose because they were excused under Section 102(b)(7) provisions, or they could lose because scienter was an element of oversight claims, but one way or another, they would lose. When Stone held that scienter was an element of oversight claims, all it really did was grant directors at the trivial number of corporations lacking Section 102(b)(7) provisions the same protection against oversight duty-of-care claims that directors at most corporations already had.

Others have carried this misunderstanding to significant heights. Thus, the authors of one law review article have worried that the “effect of [Stone’s] recasting Caremark as a loyalty claim [by including a scienter element in such claims] is to expose directors to a much higher level of oversight liability” because “[i]f oversight liability cases . . . are framed under the duty of loyalty instead of the duty of care, section 102(b)(7) is essentially irrelevant in these cases.” 53 Stone did indeed make Section 102(b)(7) provisions irrelevant in oversight suits, but not by depriving boards of their protection and thus exposing boards to oversight claims that might have been barred by such provisions. Rather, Stone made Section 102(b)(7) provisions irrelevant in oversight cases by barring at the outset oversight suits that would eventually have been blocked by such provisions anyway. Saying that Stone exposed directors to more liability rather than less because it made scienter an element of oversight liability

---

52. Id.
fundamentally misunderstands the situation.

Such confusions aside, the main point is that because virtually all public companies have Section 102(b)(7) provisions, oversight claims sounding merely in negligence and not alleging scienter were always going to fail, and any judicial expansion of the oversight duty-of-care is therefore quite pointless. It will not affect how cases are ultimately decided: the oversight duty of care can be as demanding as one likes, but since directors are exculpated from breaches of it, directors will always win when shareholders sue them for breaching the duty. Effectively expanding oversight liability would require excepting oversight duty-of-care claims from Section 102(b)(7) exculpation. Absent a herculean effort of judicial re-interpretation of that statutory provision, this would require action by the Delaware General Assembly, which is extremely unlikely to be forthcoming.

This settles the issue as a practical matter, for even if the Delaware Supreme Court overruled Stone to eliminate scienter as an element of oversight liability, it is very difficult to imagine the Delaware General Assembly abridging the protections of Section 102(b)(7). It is even more difficult to imagine the Delaware courts willfully misinterpreting that statute to accomplish the same result and still more difficult to imagine the Delaware courts so doing and the General Assembly not immediately acting to make it clear that Section 102(b)(7) extends to oversight claims not involving bad faith. Expanding director oversight liability, therefore, is simply a non-starter in practical terms.

Third, it is instructive to go further, and suppose per impossibilem that not only did the Delaware courts eliminate the scienter requirement from oversight claims but also that oversight claims based merely on breaches of the duty of care came somehow to be excepted from the scope of Section 102(b)(7) exculpation provisions. Director oversight suits based solely on alleged breaches of the duty of care could then at least reach trial. It is worth understanding, I think, that allowing such claims would stand Delaware’s business judgment jurisprudence on its head.

Courts have always been more reluctant to find directors liable for their failures to monitor the business than for their own actively taken business decisions. Thus, as far back as Caremark, Chancellor Allen famously wrote that oversight liability “is possibly the most difficult theory in corporation law upon which a plaintiff might hope to win a judgment.”

There are many reasons for this, but perhaps the most important is that, as Chancellor Allen went on to explain in Caremark, in reviewing duty-of-care claims concerning active business decisions by the board, Delaware courts consider not the content of the decision (that is, whether the decision

was on the merits right or wrong, reasonable or unreasonable, prudent or foolish, etc.) but only the process of decision-making leading up to the decision\(^{55}\) (that is, whether the directors considered all the material information reasonably available\(^{56}\) and made an honest judgment as to what was in the best interest of the company).\(^{57}\) In an oversight claim, the allegedly wrongful conduct is not a decision by the board and not even a decision to do nothing; it is, rather, mere inaction, or, as Chancellor Allen put it, “an unconsidered failure of the board to act.”\(^{58}\) Since there is no decision at issue in an oversight claim, there is no procedure leading up to that decision for the court to review. A wholly different standard must therefore apply. If that standard includes no scienter requirement but is a merely objective standard such as negligence or even gross negligence,\(^{59}\)

---

\(^{55}\) Id. at 967-968; see also Brehm v. Eisner, 746 A.2d 244, 264 (Del. 2000) (stating that “substantive due care . . . is a concept . . . foreign to the business judgment rule,” for courts “do not measure, weigh or quantify directors’ judgments” and “do not even decide if [such decisions] are reasonable,” and so in the business judgment context, “[d]ue care in the decisionmaking context is process due care only”). I agree with Judge Easterbrook and Professor Fischel’s view that there is no ultimate difference between (a) a court’s reviewing the procedure leading up to a business decision, and (b) a court’s reviewing the decision itself, for the decision of which information to gather before deciding is itself a business decision. See Frank H. Easterbrook and Daniel R. Fischel, The Economic Structure of Corporate Law 107-108 (1991) (“Judicial inquiry into the amount of information managers should acquire before deciding creates the precise difficulties that the business judgment rule is designed to avoid. Information is necessary for corporate managers to maximize the value of the firm. But there is a limit to how much managers should know before making a decision . . . . Information is costly, and investors want managers to spend on knowledge only to the point where an additional dollar generates that much in better decisions.”). At this point, however, the distinction between so-called substantive due care and procedural due care is, however, well engrained in Delaware’s business judgment jurisprudence. See Daniel R. Fischel, The Business Judgment Rule and the Trans Union Case, 40 Bus. Law. 1437, 1440-1441 (discussing costs of gathering information before making a business decision).


\(^{57}\) See Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984) (stating that the business judgment rule is “a presumption that in making a business decision the directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company”).


\(^{59}\) See supra notes 26-27 and accompanying text (discussing whether the original Caremark decision included a scienter requirement). In my view, I think there can be little doubt that the original Caremark decision contemplated scienter as an element of oversight liability. Given Chancellor Allen’s well-known view that the holding in Smith v. Van Gorkom was ill-advised, see William T. Allen, et al., Van Gorkom and the Corporate Board: Problem, Solution, or Placebo?, 96 Nw. U. L. Rev. 449, 458 (2002) (advocating a standard of review of director business decisions under which liability would require “a
then implementing it would require a court to determine what the board should have known, that is, what kind of information and reporting system it should have designed and implemented. Hence, the court would have to review the content of the board’s decisions creating and implementing the system. If the point of such a system is to maximize value for the shareholders, however, then the key issue in designing such a system is whether the benefits of the system in the form of improved decision-making by the board exceed the costs of designing and implementing it. As Chancellor Allen put it, “the level of detail that is appropriate for such an information system is a question of business judgment,” and all the reasons that underlie the business judgment rule’s effective prohibition on courts’ reviewing the content of business decisions would apply as much to this decision as to any other. In other words, if courts are to review oversight claims other than under a standard involving scienter, they are inevitably involved in reviewing some of the board’s business judgments on the merits.

Not everyone has fully appreciated this point. Thus, in criticizing Citigroup, Professor Brown says that, if “the board considered relative risks and made a decision to go forward, the decision almost certainly would have fallen under the business judgment rule and almost certainly would have been insulated from liability”—a result of which Professor Brown presumably approves. Nevertheless, he faults the Citigroup ‘devil-may-care’ attitude or indifference to duty amounting to recklessness”), it is difficult to believe that he would hold that a purely objective standard applied to board omissions in oversight cases. Moreover, the language of Caremark is, in all pertinent passages, couched in terms of good faith, which tends to imply a scienter requirement. See Caremark, 698 A.2d at 971 (“Generally where a claim of directorial liability for corporate loss is predicated upon ignorance of liability creating activities within the corporation . . . in my opinion only a sustained or systematic failure to attempt to assure a reasonable information and reporting system exists will establish the lack of good faith that is a necessary condition to liability. Such a test of liability—lack of good faith as evidence by sustained or systematic failure of a director to exercise reasonable oversight—is quite high.”).

60. See 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, 939-940 (2008) (arguing that “whether an information and reporting system is reasonable is itself a substantive business decision” because “assuming that a reasonable system is one that maximizes shareholder value in the long run, a system will be reasonable if the benefits of the system, in the form of improved decision-making by the board, exceed the costs of designing and implementing it” and “[m]easuring these costs and benefits and balancing the one against the other is exactly the kind of highly uncertain judgment at issue in business decisions”).

61. Caremark, 698 A.2d at 970.

decision for failing “to define the types of information that ought to be reported to the board in order for it to fulfill its oversight function,” but apparently not realizing that this determination is just as much a business decision as any other. Similarly, Professor Pan agrees that it “is not for the court to decide” whether the [Citigroup] board exercised good business judgment, but he nevertheless thinks that Chancellor Chandler has “an overly-narrow interpretation of the duty to monitor” and should “strengthen[] the fiduciary duty to monitor” to ensure that “boards . . . make the effort to collect the right type of information about the corporation.” It cannot be both ways. A duty of care applicable in oversight cases necessarily involves substantive review of some of a board’s business decisions. If we are to have duty-of-care oversight claims, we give up on the fundamental tenet of the Delaware business judgment rule. This is presumably not what critics of Citigroup intend to accomplish.

IV. CONCLUSION

The upshot, therefore, is that any significant expansion of oversight liability would involve three things: (a) deleting the scienter requirement of oversight claims articulated in Stone in order to allow oversight suits sounding only in the duty of care (that is, as negligence or gross negligence claims); (b) amending or judicially re-writing Section 102(b)(7) to make exculpation provisions adopted thereunder inapplicable to such duty-of-care oversight claims; and (c) worst of all, significantly abridging the cardinal principle of Delaware business judgment jurisprudence that courts will not review on the merits the substantive content of business judgments of the board. Although many people, including such friends of Caremark as Martin Lipton, have worried that Caremark will not survive the financial


64. Pan, supra note 10, at 26.
65. Id.
66. Id.
67. Id. at 27.
68. Id.
crisis,\textsuperscript{69} in reality not one of the three things necessary to expand director oversight liability is actually likely to happen, and the third in particular would throw Delaware business judgment jurisprudence into the deepest confusion. I would oppose any of these possible changes in Delaware law, but there may be people in the world who think all of them are good ideas. Such people should be clear, however, both with themselves and with others, just how extreme their views really are.