Caremark’s Climate Failure

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Unless U.S. corporations take steps to harden their assets against natural disasters exacerbated by climate change and prepare for the transition to a zero-carbon economy, they face the prospect of catastrophic risk to their assets and market values, damaging both shareholders and, particularly where there are systemic effects, society at large. But surveys indicate that directors of American corporations do not view climate change as an important focus for their boards. In contrast, directors in Australia and Canada consider climate change one of the top two priorities for their governments and one of the top challenges for their companies. Different standards of liability for directors’ oversight failures, despite shared common law roots, may explain the differing attitudes toward climate risks.

In Delaware, under In re Caremark International Inc. Derivative Litigation*, failure to monitor corporate risks is reviewed for knowing disregard of duties under the duty of loyalty. The only cases that have survived dismissal have involved legal and accounting compliance failures, prompting leading lawyers to conclude that there is no duty to monitor noncompliance enterprise risks. In Australia, Canada, and the United Kingdom, on the other hand, directors are subject to liability for negligence in monitoring risks to the corporate enterprise, and their efforts are generally reviewed for reasonableness. As a result, leading lawyers in those other common law jurisdictions have opined that directors face a significant risk of liability for failure to monitor climate risks.*

In short, Caremark *has failed to encourage Delaware directors to be sufficiently attentive to one of the greatest risks of harm to their corporations in the twenty-first century. There are at least three ways that Delaware courts could clarify* Caremark *jurisprudence to improve directors’ incentives to be attentive to climate risks: (1) confirming that* Caremark *applies to compliance with laws that already require attention to climate risks; (2) clarifying that* Caremark *applies to failures to monitor significant risks to the business other than legal compliance risk; and (3) clarifying that the duty to monitor is, after all, a matter of the duty of care, subject to a gross negligence standard of liability, but that only the most egregious failures to monitor—those*

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involving a knowing failure to satisfy the duty of care—establish a nonexculpable breach of the duty of loyalty.

The first approach is uncontroversial but limited. The second, applying Caremark*'s oversight standard to enterprise risk management, has been unnecessarily controversial because it is framed as a question of institutional competence. When framed instead as an issue of expertise, it is apparent that there are several sources of expertise on which Delaware judges could rely to review risk-monitoring failures under the* Caremark *framework, including corporate expertise, third-party expertise, and social consensus. Finally, returning oversight to the duty of care makes intuitive sense, particularly in light of the common law approach, and can appeal to both proponents and critics of the* Caremark *standard.*

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INTRODUCTION

Pacific Gas and Electric Co. (PG&E), one of the largest utilities in the United States, declared bankruptcy in January 2019 after its poorly maintained electrical power lines sparked wildfires that caused billions of dollars of damage and many lost lives in 2017 and 2018.[1] PG&E acknowledged that its bankruptcy was a direct result of environmental conditions caused by climate change.[2]

In 2020, the year following PG&E's bankruptcy, the United States experienced a record twenty-two climate-related weather disasters that each caused more than $1 billion of damage.[3] Swiss Re reported in April 2021 that the effects of climate change can be expected to shave 11% to 14% off global economic output by 2050 unless companies reduce their emissions sufficiently to limit global warming to two degrees Celsius above preindustrial levels.[4] If, as expected based on current trajectories, global temperatures increase 2.6 degrees by 2050, the U.S. economy will be as much as 7% smaller than it would be in a world without such climate change.[5]

Unless U.S. corporations take steps to harden their assets against natural disasters exacerbated by climate change and prepare for the transition to a zero-carbon economy, they face the prospect of catastrophic risk to their assets and market values, damaging both shareholders and, particularly where there are systemic effects, society at large. But surveys indicate that directors of American corporations do not view climate change as an important focus for their boards.[6] In contrast, directors in Australia and Canada consider climate change one of the top two priorities for their governments and one of the top challenges for their

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1. Ivan Penn, *PG&E, Troubled California Utility, Emerges from Bankruptcy*, N.Y. TIMES, https://www.nytimes.com/2020/07/01/business/energy-environment/pge-bankruptcy-ends.html (July 28, 2020).

2. Chunka Mui, *PG&E Is Just the First of Many Climate Change Bankruptcies*, FORBES (Jan. 24, 2019, 10:14 AM), https://www.forbes.com/sites/chunkamui/2019/01/24/pge-is-just-the-first-of-many-climate-change-bankruptcies/#3ebd21c37e5f; Kendra Pierre-Louis & Nadja Popovich, *Climate Change Is Fueling Wildfires Nationwide, New Report Warns*, N.Y. TIMES (Nov. 27, 2018), https://www.nytimes.com/interactive/2018/11/27/climate/wildfire-global-warming.html. PG&E's directors were promptly sued by shareholders for breaches of their duty of care in connection with the disasters that pushed the company into bankruptcy. *See* Class Action Complaint at 48, Burnett v. PG&E Corp., No. CGC-18-571849 (Cal. Super. Ct. filed Dec. 5, 2018) [hereinafter PG&E Class Action Complaint]. The claims became part of the bankruptcy estate and were subsequently assigned to the trustee representing claimants from Paradise and other communities in California that were destroyed by the wildfires. *In re* PG&E Corp., No. 19-30088, 2019 WL 2122733 (Bankr. N.D. Cal. May 13, 2019). The litigation, which is in California state courts, since PG&E is a California corporation, is ongoing.

3. Press Release, Climate Action 100+, Investors Seek Greater Climate Action in 2021 Proxy Season (Apr. 2, 2021), https://www.climateaction100.org/news/investors-seek-greater-climate-action-in-2021-proxy-season/.

4. Christopher Flavelle, *Climate Change Could Cut World Economy by $23 Trillion in 2050, Insurance Giant Warns*, N.Y. TIMES, https://www.nytimes.com/2021/04/22/climate/climate-change-economy.html (Nov. 4, 2021).

5. *Id.* The consequences would be far more dire for many less developed nations in vulnerable economies, with Malaysia, the Philippines, and Thailand, for instance, expected to grow 20% less than they would otherwise at a two-degree increase, and have one-third less wealth at a 2.6 degree Celsius increase. *Id.*

6. *See infra* Part I.C.

companies.[7] While there are, presumably, a variety of reasons for this discrepancy, different standards of liability for director failures to be attentive to corporate risks certainly play a role. Although directors' duties in each of these jurisdictions share common antecedents from eighteenth-century England,[8] they have developed very differently over time.

In Delaware, the standard of review for director attention to corporate interests is bifurcated. Decisions of directors are reviewed under a gross negligence duty of care standard, generally subject to business judgment review and exculpation, leading to the dismissal of most shareholder complaints. On the other hand, directors' duty of oversight to establish and monitor corporate information systems—established in the 1996 case *In re Caremark International Inc. Derivative Litigation*[9]—is subject to a more challenging, but nonexculpable, scienter-based, bad faith standard of review. A recent spate of cases surviving motions to dismiss have caused some scholars and practitioners to declare a "new era of enhanced oversight duties,"[10] particularly with respect to "mission critical" issues; but like the small number of cases that survived dismissal in the first twenty-five years following the *Caremark* decision, the new cases focus on legal and accounting *compliance* failures.[11] Thus, it is unclear whether the *Caremark* oversight duty even applies to climate risks or other enterprise risks where there is no regulatory requirement to avoid or mitigate the risks.

It should come as no surprise, then, that in an opinion commissioned by the United Nations Principles for Responsible Investment ("UNPRI"), Debevoise & Plimpton LLP, a leading New York law firm, declined to opine that Delaware directors have a fiduciary obligation to monitor climate risks unrelated to compliance obligations.[12] Debevoise took the view that directors of Delaware

7. *See infra* Part I.D.

8. The notion that directors are fiduciaries of the corporations they serve was developed under English law by analogy to agents and trustees in the eighteenth century. *See, e.g.*, Jennifer G. Hill & Matthew Conaglen, *Directors' Duties and Legal Safe Harbours: A Comparative Analysis*, *in* RESEARCH HANDBOOK ON FIDUCIARY LAW 305, 306 (D. Gordon Smith & Andrew S. Gold eds., 2018). The focus on care and loyalty as the primary duties of corporate directors appeared at that time. *See*, *e.g.*, Charitable Corp. v. Sutton (1742) 26 Eng. Rep. 642, 643.

9. 698 A.2d 959 (Del. Ch. 1996).

10. Roy Shapira, *A New* Caremark *Era: Causes and Consequences*, 98 WASH. U. L. REV. 1857, 1857, 1895–96 (2021).

11. *See* Marchand v. Barnhill, 212 A.3d 805, 807–09 (Del. 2019) (reversing the denial of a motion to dismiss in the food-safety context); *In re* Clovis Oncology, Inc. Derivative Litig., No. 2017-0222, 2019 WL 4850188, at *10 (Del. Ch. Oct. 1, 2019) (denying motion to dismiss in the pharmaceutical regulatory approval context); Hughes v. Xiaoming Hu, No. 2019-0112, 2020 WL 1987029, at *1 (Del. Ch. Apr. 27, 2020) (denying motion to dismiss in the financial reporting and oversight context); Inter-Mktg. Grp. USA, Inc. *ex rel.* Plains All Am. Pipeline, L.P. v. Armstrong, No. 2017-0030, 2020 WL 756965, at *1 (Del. Ch. Jan. 31, 2020) (denying motion to dismiss in part in the environmental compliance context); Teamsters Local 443 Health Servs. & Ins. Plan v. Chou, No. 2019-0816, 2020 WL 5028065, at *2 (Del. Ch. Aug. 24, 2020); *In re* Boeing Co. Derivative Litig., No. 2019-0907, 2021 WL 4059934, at *1 (Del. Ch. Sept. 7, 2021).

12. WILLIAM D. REGNER, DEBEVOISE & PLIMPTON LLP, THE DUTY OF US COMPANY DIRECTORS TO CONSIDER RELEVANT ESG FACTORS 4 (2020), https://www.unpri.org/download?ac=11696 ("[T]he existence of such a [*Caremark*] duty does not, of course, answer the question of how directors ought to think about ESG factors that have not been reduced to legal obligation . . . .").

corporations are only obligated, rather than permitted, to take into account ESG factors, such as climate risks, when either (1) ESG factors implicate material *legal compliance* issues for the corporation, or (2) they present material risks or opportunities to the corporation in connection with board decisions.[13]

In contrast to Delaware, Australia, Canada, and the United Kingdom have a unified duty of care standard for director attentiveness. Whether making decisions for the corporation or monitoring risks to the corporate enterprise, directors are subject to liability for negligence in carrying out their duties, and their efforts are generally reviewed for reasonableness.[14] Though loser-pays rules in those countries make it riskier for private plaintiffs to bring lawsuits to enforce directors' duties, corporations are prohibited from exculpating their directors from liability for duty of care violations.[15] In Australia, the federal government has actively exercised its power to enforce directors' fiduciary duties, imposing fines and, in some cases, criminal sentences for fiduciary lapses.[16] In striking contrast with the Debevoise opinion delivered to the UNPRI, opinions of leading lawyers in Australia, Canada, and the United Kingdom suggest that directors in those countries face a significant risk of liability for failure to monitor climate risks.[17] These stricter standards and stark opinions from leading lawyers seem to have had an impression on directors in those countries, as evidenced by the surveys described above.

Thus, it seems reasonable to infer that *Caremark* has failed to encourage Delaware directors to be sufficiently attentive to one of the greatest risks of harm to their corporations in the twenty-first century.[18] That is unlikely to change unless the Delaware judiciary clearly extends its *Caremark* jurisprudence to oversight responsibility for climate risks. If it does not take steps to do so, that lack of action may produce pressure for more federal regulation of corporate governance—establishing, for example, a Securities and Exchange Commission (SEC) or stock exchange requirement for risk management committees at the board level.[19]

There are at least three ways that Delaware courts could clarify their *Caremark* jurisprudence to improve directors' incentives to be attentive to climate risks: (1) confirm that *Caremark* applies to compliance with laws that

13. *Id.* at 7.

14. *See infra* Part III.A.

15. *See infra* Part III.B.3.

16. *See infra* Part III.B.4.

17. *See infra* Part III.C.

18. From the shareholder's perspective, it doesn't matter whether material harm to the corporation is caused by directors' failure to monitor compliance with the law or directors' failure to monitor other operational risks. The harm to the corporation is the same. The harm to third parties may be even greater with the latter.

19. Scholars and members of the Delaware judiciary have discussed the prospect of federal intervention in situations where Delaware statutory and case law is perceived as providing inadequate protection to some corporate constituencies, especially shareholders. *See, e.g.*, Mark J. Roe, *Delaware's Competition*, 117 HARV. L. REV. 588, 600 (2003) ("[N]otwithstanding the internal affairs doctrine, the federal government can displace state corporate law, and it has . . . . [T]he securities laws themselves can directly pull corporate law issues away from the states . . . .").

already require attention to climate risks; (2) clarify that *Caremark* applies to failures to monitor significant risks to the business other than legal compliance risks; or (3) clarify that the duty to monitor is, after all, a matter of the duty of care, subject to a gross negligence standard of liability, while only the most egregious failures to monitor involving a knowing failure to satisfy the duty of care establish a *nonexculpable* breach of the duty of loyalty.

The first approach is uncontroversial but limited. Scholars have noted that where climate risks adversely affect compliance with prescriptive or proscriptive regulatory obligations, such obligations should incentivize attention to the risks.[20] For public companies, the SEC's mandatory disclosure requirements require disclosure of material climate risks, and conscious failure to establish or monitor a system for reporting such risks could arguably constitute a *Caremark* failure.[21] However, in many instances, climate risks and the harms they cause to corporations will not be subject to compliance obligations. In those cases, adopting the second or third option will be crucial to incentivizing attention to those risks.

Applying *Caremark*'s oversight standard to enterprise risk management failures has been controversial because of the close relationship between risk management, risk-taking, and business judgment.[22] The issue is often described by courts and scholars as a question of institutional competence. They question the ability of courts to review the business decisions of directors and fear the application of hindsight bias when business choices have gone sour. A more appropriate framing would be to ask whether courts have the expertise to review the relevant action or omission. Expertise can be measured as a function of

20. Susan S. Kuo & Benjamin Means, *Climate Change Compliance*, 107 IOWA L. REV. 2135, 2173 (2022).

21. Cynthia A. Williams, *Fiduciary Duties and Corporate Climate Responsibility*, 74 VAND. L. REV. 1875, 1911–12 (2021).

22. Some Delaware judges and scholars express concern that applying *Caremark* to risk management would undermine the protections of the business judgment rule and duty of care exculpation. *See, e.g.*, *In re* Citigroup Inc. S'holder Derivative Litig., 964 A.2d 106, 130 (Del. Ch. 2009); Robert T. Miller, *Oversight Liability for Risk-Management Failures at Financial Firms*, 84 S. CAL. L. REV. 47, 57 (2010). Others have argued that risk management and ESG issues are, or should be, part of the board's oversight obligations. *See, e.g.*, Leo E. Strine, Jr., Kirby M. Smith & Reilly S. Steel, Caremark *and ESG, Perfect Together: A Practical Approach To Implementing an Integrated, Efficient, and Effective* Caremark *and EESG Strategy*, 106 IOWA L. REV. 1885, 1905 (2021); E. Norman Veasey & Randy J. Holland, Caremark *at the Quarter-Century Watershed: Modern-Day Compliance Realities Frame Corporate Directors' Duty of Good Faith Oversight, Providing New Dynamics for Respecting Chancellor Allen's 1996* Caremark *Landmark*, 76 BUS. LAW. 1, 26 (2020); Stavros Gadinis & Amelia Miazad, *Corporate Law and Social Risk*, 73 VAND. L. REV. 1401, 1458–70 (2020) (proposing that directors' duties should be modified to include ESG duties). Stephen Bainbridge has expressed variations of both views. *Compare* Stephen M. Bainbridge, Caremark *and Enterprise Risk Management*, 34 J. CORP. L. 967, 968, 990 (2009) [hereinafter Bainbridge, *Enterprise Risk Management*] (stating that "[t]here is no doctrinal reason that *Caremark* claims should not lie in cases in which the corporation suffered losses . . . due to lax risk management," but arguing that the bar should be particularly high for such claims), *with* Stephen M. Bainbridge, *Don't Compound the* Caremark *Mistake by Extending It to ESG Oversight*, 77 BUS. LAW. 651, 655 (2021) [hereinafter Bainbridge, *Don't Compound* Caremark] (arguing that *Caremark* oversight obligations should not be extended to ESG issues because that would undermine the business judgment rule and threaten "the board-centric model of corporate governance that lies at the heart of Delaware's dominance of the market for corporate charters").

reliability and consistency.[23] These qualities are also critical to judicial efficacy and legitimacy. Judicial decisions can be potent signals that incentivize value-enhancing actions by officers and directors, but only to the extent the decisions are reliable and consistent.[24]

Courts regularly utilize third-party expertise to review various kinds of malpractice claims because such claims are amenable to expert opinions. In reviewing dilatory legal compliance programs in *Caremark* cases, judges have significant expertise of their own to apply. When it comes to choices about investments of corporate assets, however, the considerations are generally so idiosyncratic that they are not amenable to any expertise.[25] On the other hand, decisions about which risks should be monitored and whether certain information constitutes a risk management red flag are less idiosyncratic and more amenable to expert input than investment decisions. When perceived as a question of expertise, not institutional competence, it is apparent that there are several sources of expertise on which Delaware judges could rely to review enterprise risk monitoring failures under the *Caremark* framework, including (1) corporate expertise, (2) third-party expertise, and (3) social consensus.

While shareholders and society would be better protected if climate risks were included in directors' *Caremark* oversight duties, it is also desirable to rethink the doctrinal standards of liability that apply to those duties. *Caremark* creates an anomalous situation where directors making decisions without adequate consideration of material risks are reviewed under a gross negligence standard.[26] Yet directors who fail to establish or monitor a system for gathering information about risks to the corporation required for making decisions are reviewed for a more culpable knowing disregard of their duties.[27] Under this stricter standard of culpability, if the complaint is to survive a motion to dismiss, shareholder plaintiffs must allege facts permitting an inference that directors *knew* they were not fulfilling their duties to the corporation.[28] It is odd that the standard of review for inattention should shift from a negligence standard to a

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23. The Cochran-Weiss-Shanteau ("CWS") measure, a popular standard in the social science literature, calculates expertise as the ratio of discrimination divided by inconsistency, where discrimination is the ability to differentiate between similar—but not identical—cases, and consistency is the ability to repeat judgments in similar situations. James Shanteau, David J. Weiss, Rickey P. Thomas & Julia C. Pounds, *Performance-Based Assessment of Expertise: How To Decide If Someone Is an Expert or Not*, 136 EUR. J. OPERATIONAL RSCH. 253, 258 (2002).

24. Holger Spamann, *Monetary Liability for Breach of the Duty of Care?*, 8 J. LEGAL ANALYSIS 337, 344 (2016).

25. *Id.* at 357.

26. *See In re* Caremark Int'l Inc. Derivative Litig., 698 A.2d 959, 967–70 (Del. Ch. 1996).

27. *Id.* at 970.

28. *Id.* at 971. One way to resolve the inconsistency would be to decide that harms based on inaction were a result of a "conscious decision not to act," which would justify the application of the business judgment rule unless it is rebutted for gross negligence. *See* Arthur H. Kohn, Elizabeth K. Bieber & Vanessa C. Richardson, Caremark *and Reputational Risk Through #MeToo Glasses*, CLEARY GOTTLIEB: CLEARY M&A & CORP. GOVERNANCE WATCH (May 18, 2018), https://www.clearymawatch.com/2018/05/caremark-reputational-risk-metoo-glasses.

scienter standard depending on whether directors were inattentive in their action or inaction. After all, in both cases, they were inattentive. Applying a duty of loyalty standard of review to failures of attention is particularly odd given that the duty of loyalty involves issues of fairness, and that breaches are compensated by invalidation or disgorgement.[29] In contrast, oversight failures, like the duty of care, involve inattentiveness and are compensated by reference to the harm caused by the inattention.[30] Rather than applying a scienter-based standard to oversight obligations, it would be more appropriate to recognize the duties of care and oversight as one continuum of attention subject to a unified gross negligence standard of review. However, as Bayless Manning proposed in 1984, compliance with the duties should be measured on a "flow" basis, focusing on directors' performance of their duties over the course of time rather than at a given moment.[31] As Chancellor Allen's *Caremark* opinion concluded, only those directors who are derelict over a sustained period should be subject to liability.[32] On the other hand, moving back to a duty of care standard for oversight violations would make injunctions for utter failures to consider climate risks more easily available, even if monetary damages would not be. For plaintiffs seeking monetary damages, a breach of good faith would still be available as a basis for liability.

I. Climate Risks and Director Inattention

A. Climate Risks

Climate risks are dynamic, far-reaching in breadth and magnitude, and involve uncertain and extended time horizons.[33] Global business organizations have recognized climate risks as among the most important risks to corporate value and well-being,[34] and the impacts of climate change are pervasive, affecting almost every industry.[35]

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29. *See generally* Deborah A. DeMott, *Causation in the Fiduciary Realm*, 91 B.U. L. REV. 851 (2011).

30. Bainbridge, *Don't Compound* Caremark, *supra* note 22, at 663. Bainbridge states that oversight failures involve issues of judgment. *Id.* It would be more accurate to say that oversight failures involve lack of attentiveness, not judgment.

31. Bayless Manning, *The Business Judgment Rule and the Director's Duty of Attention: Time for Reality*, 39 BUS. LAW. 1477, 1494 (1984) ("In the case of a director, the proper referent for his legal duty should be the *flow* of his performance of his directoral functions, not the individual incident.").

32. *See* 698 A.2d at 971.

33. Prudential Regul. Auth., *Enhancing Banks' and Insurers' Approaches To Managing the Financial Risks from Climate Change* ¶ 2.5 (Bank of Eng. Consultation Paper, Paper No. 23/18, 2018), https://www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/consultation-paper/2018/cp2318.pdf.

34. The World Economic Forum has identified climate risks from extreme weather events, natural disasters, and climate adaption and mitigation failures as three of the top five risks facing corporations globally in terms of both likelihood and impact in 2019. WORLD ECON. F., THE GLOBAL RISKS REPORT 2019, at 5 (14th ed. 2019), https://www.weforum.org/reports/the-global-risks-report-2019.

35. The Sustainability Accounting Standards Board (now the Value Reporting Foundation) determined in 2016 that seventy-two of seventy-nine industries in the United States faced material impacts from climate change. *Climate Risk: Technical Bulletin* 1 (Sustainability Acct. Standards Bd., Technical Bulletin No. TB001-10192106, 2016), https://www.eenews.net/assets/2016/10/20/document_cw_01.pdf.

Climate risks are typically described in terms of physical risks, transition risks, and litigation risks. Physical risks damage operational assets and interrupt supply chains through changes in the physical environment resulting from climate change.[36] Physical risks can be either gradual or extreme. Gradual physical risks arise from gradual changes in the environment such as desertification, drought, mean temperature increases, and sea-level rise.[37] Extreme physical risks arise from extreme weather events such as floods, hurricanes, and massive wildfires.[38] Extreme weather events will have an estimated annual impact in the hundreds of billions of dollars for some sectors by the end of the twenty-first century.[39]

Transition risks refer to higher costs or lower revenues resulting from a transition to a lower-carbon economy.[40] They arise as a result of changing consumption patterns, competition from clean energy sources, and reputational losses, as well as policy and regulatory changes.[41] Transition risks may generate increased costs due to regulatory changes such as laws requiring companies to pay for carbon emissions, lost revenues due to regulatory prohibitions, or changes in consumer preferences.[42] President Biden's April 2021 pledge that the United States would reduce its greenhouse gas emissions by 50% from 2005 levels by 2030 will require significant adjustments by U.S. companies that may lead to increased costs or lower revenues for some companies while creating new growth opportunities for others. A key transition risk for fossil fuel extraction enterprises is the prospect of stranded assets. Fossil fuel assets such as coal and oil reserves become "stranded" when demand models suggest (based on private or public carbon-reduction targets) that the costs associated with extracting the assets will no longer be justified by the revenues that can be expected from selling what can be sold.[43]

36. Lisa Benjamin, *The Road to Paris Runs Through Delaware: Climate Litigation and Directors' Duties*, 2020 UTAH L. REV. 313, 319.

37. *See* BASEL COMM. ON BANKING SUPERVISION, CLIMATE-RELATED RISK DRIVERS AND THEIR TRANSMISSION CHANNELS 7 (2021), https://www.bis.org/bcbs/publ/d517.pdf.

38. *See id.* at 6.

39. 2 U.S. GLOB. CHANGE RSCH. PROGRAM, FOURTH NATIONAL CLIMATE ASSESSMENT: IMPACTS, RISKS, AND ADAPTATION IN THE UNITED STATES ii, 26 (2018), https://nca2018.globalchange.gov/downloads/NCA4_2018_FullReport.pdf.

40. BASEL COMM. ON BANKING SUPERVISION, *supra* note 37.

41. TASK FORCE ON CLIMATE-RELATED FIN. DISCLOSURES, RECOMMENDATIONS OF THE TASK FORCE ON CLIMATE-RELATED FINANCIAL DISCLOSURES 5–6 (2017), https://www.fsb-tcfd.org/wp-content/uploads/2017/06/FINAL-TCFD-Report-062817.pdf.

42. Consumers may prefer products with lower carbon costs.

43. Sarah Barker, *An Introduction to Directors' Duties in Relation to Stranded Asset Risks*, *in* STRANDED ASSETS AND THE ENVIRONMENT: RISK, RESILIENCE AND OPPORTUNITY 203 (Ben Caldecott ed., 2018). The OECD has estimated that the total value of stranded assets, defined as "those [that do] not recover all or part of their investment during the time they are operational," for the oil and gas industry will be $852 billion between 2014 and 2050. HIGH-LEVEL EXPERT GRP. ON SUSTAINABLE FIN., FINANCING A SUSTAINABLE EUROPEAN ECONOMY 35 (2017), https://finance.ec.europa.eu/system/files/2017-07/170713-sustainable-finance-report_en.pdf.

Our financial industry and system are perceived by financial regulators as being particularly vulnerable to physical and transition climate risks.[44] The value of global assets at risk due to climate change up to the year 2100 has been estimated to be between $4.2 trillion—roughly equal to the total value of all the world's listed oil and gas companies (or Japan's entire GDP)—and $43 trillion—equal to 30% of the value of all manageable assets globally as of 2015, depending on which global warming scenario is applied.[45]

Corporations can also face litigation risk for contributions to, or damages incurred from, climate change.[46] Lisa Benjamin notes that litigation imposes both direct costs—associated with defending or settling litigations—and indirect costs—investor uncertainty, loss of customers or suppliers, diversion of management attention, and possible reputational damage.[47] The PG&E litigation in California is an example of this climate risk.[48] Fossil fuel companies have been subject to numerous suits in the last decade, primarily on tort and environmental law bases, but also in private and public enforcement actions alleging securities disclosure violations.[49] Litigation risks for individual companies will increase if the contribution each company makes to climate change can be accurately quantified.[50] Progress is being made in scientific efforts to quantify the proportion of climate change attributable to different human activities, and even to specific firms.[51] As attribution science advances and the ability to identify specific corporate contributions to environmental

44. *See* Matt Egan, *Climate Change Could Ignite a Financial Crisis, IMF Official Says*, CNN BUS. (June 3, 2021, 10:00 AM), https://www.cnn.com/2021/06/03/investing/climate-change-financial-crisis-imf/index .html; *see also* BASEL COMM. ON BANKING SUPERVISION, *supra* note 37, at 5–6. Christina Parajon Skinner has suggested, however, that concerns about the vulnerability of financial institutions to revaluation of their assets because of climate risk may be overblown. *See* Christina Parajon Skinner, *Central Banks and Climate Change*, 74 VAND. L. REV. 1301, 1319–20 (2021).

45. THE ECONOMIST INTEL. UNIT, THE COST OF INACTION: RECOGNIZING THE VALUE AT RISK FROM CLIMATE CHANGE 2 (2015). The high-end figure reflects the assumption of an extreme warming scenario of six degrees Celsius and applies a low public-sector discount rate to reflect the public-sector costs, as well as private losses, of such a scenario. *Id.*

46. *See, e.g.*, Jacqueline Peel & Hari M. Osofsky, *Climate Change Litigation*, 16 ANN. REV. L. & SOC. SCI. 21, 30 (2020); Javier Solana, *Climate Litigation in Financial Markets: A Typology*, 9 TRANSNAT'L ENV'T L. 103, 104–05 (2020).

47. Benjamin, *supra* note 36, at 376. Benjamin also notes that climate litigation can adversely affect credit ratings, the cost of debt, and other financing costs. *Id.* (citing Matteo P. Arena, *Corporate Litigation and Debt*, 87 J. BANKING & FIN. 202, 203 (2018)).

48. *See* Penn, *supra* note 1 and accompanying text.

49. David Hasemyer, *Fossil Fuels on Trial: Where the Major Climate Change Lawsuits Stand Today*, INSIDE CLIMATE NEWS (Jan. 17, 2020), https://insideclimatenews.org/news/17012020/climate-change-fossil-fuel-company-lawsuits-timeline-exxon-children-california-cities-attorney-general.

50. Benjamin, *supra* note 36, at 325.

51. *See* Richard Heede, *Tracing Anthropogenic Carbon Dioxide and Methane Emissions to Fossil Fuel and Cement Producers, 1854–2010*, 122 CLIMATIC CHANGE 229, 238 (2014); B. Ekwurzel, J. Boneham, M.W. Dalton, R. Heede, R.J. Mera, M.R. Allen & P.C. Frumhoff, *The Rise in Global Atmospheric CO2 Surface Temperature, and Sea Level from Emissions Traced to Major Carbon Producers*, 144 CLIMATIC CHANGE 579, 585 (2017).

harms increases,[52] firms contributing to global warming will face higher litigation risks.

Despite the threat of significant losses related to climate risks, U.S. corporations are not sufficiently accounting for and incorporating the short-, medium-, or long-term risks of climate change into their business models.[53] This may be due in part to the fact that long-term risks, particularly statistical "tail risks"—those that are relatively unlikely to occur but could have catastrophic consequences—are difficult for financial markets to assess and value in financial terms.[54]

B. INTEREST IN DIRECTOR RESPONSIBILITY

As climate risks have become more salient, interest in the responsibility of boards of directors to understand and plan for climate risks has increased. Board responsibility for risk management in general has increased in the last two decades. It includes enterprise risk management and difficult-to-assess financial risks.[55] The role of the board in risk management depends on the nature of the company, the industry, and whether special circumstances, such as an external or internal crisis, are present.[56]

In 2017, the Financial Stability Board's Task Force on Climate-Related Financial Disclosures made one of its core disclosure recommendations the disclosure of the extent and nature of the board's oversight of climate-related risks.[57] In response to the growing global interest in the obligations of corporate directors with respect to climate risks, the World Economic Forum ("WEF") created the Climate Governance Initiative ("The Initiative") in 2019 to ensure that climate risks and opportunities are centrally embedded in company strategies.[58] The Initiative has established guiding principles for climate

52. Attribution science relies on observational records to determine changes in probability or magnitude of climate-related events and uses model simulations to compare the manifestation of an event in worlds with and without human-caused climate change. Nathaniel L. Bindoff et al., *Detection and Attribution of Climate Change: From Global to Regional (Supplementary Material)*, *in* CLIMATE CHANGE 2013: THE PHYSICAL SCIENCE BASIS 867, 869 (Thomas F. Stocker et al. eds., 2013).

53. Benjamin, *supra* note 36, at 367; *see also* Allie Goldstein, Will R. Turner, Jillian Gladstone & David G. Hole, *The Private Sector's Climate Change Risk and Adaptation Blind Spots*, 9 NATURE CLIMATE CHANGE 18, 18 (2018) (noting the imbalance between the short-term financial decisionmaking and long-term impacts of climate change).

54. Benjamin, *supra* note 36, at 366.

55. Ellie Mulholland, Sarah Barker, Cynthia Williams & Robert G. Eccles, *Climate Change and Directors' Duties: Closing the Gap Between Legal Obligation and Enforcement Practice*, *in* THE HANDBOOK OF BOARD GOVERNANCE 1, 7 (Richard Leblanc ed., 2d ed. 2020).

56. CORNELIS A. DE KLUYVER, CORPORATE GOVERNANCE 56 (Saylor Found. 2012).

57. *See* TASK FORCE ON CLIMATE-RELATED FIN. DISCLOSURES, *supra* note 41, at 14.

58. WORLD ECON. F., HOW TO SET UP EFFECTIVE CLIMATE GOVERNANCE ON CORPORATE BOARDS: GUIDING PRINCIPLES AND QUESTIONS 6 (2019), https://www3.weforum.org/docs/WEF_Creating_effective_climate_governance_on_corporate_boards.pdf [hereinafter WEF, EFFECTIVE CLIMATE GOVERNANCE]; WORLD ECON. F., INTEGRATED CORPORATE GOVERNANCE: A PRACTICAL GUIDE TO STAKEHOLDER CAPITALISM FOR BOARDS OF DIRECTORS 6 (2020), https://www3.weforum.org/docs/WEF_Integrated_Corporate_Governance_2020.pdf.

governance on boards, intended to ensure board accountability and familiarity with climate issues.[59] According to the WEF, management of climate risks is now an inherent part of good corporate governance.[60] The Initiative currently has chapters in Australia, Brazil, Canada, Central America and the Carribean, Chile, Greece, Hong Kong, Malaysia, Mexico, New Zealand, and the United States, as well as across Europe.[61]

Investors are increasingly pressuring boards to pay more attention to climate issues.[62] Major institutional investors are announcing plans to exit investments in companies that are not sufficiently serious about climate change and sustainability.[63] Investors are also pressuring boards through shareholder resolutions requiring board consideration of climate risks.[64] Climate Action 100+ reported 136 climate-related shareholder resolutions in the 2021 proxy season, including fifty-four that were withdrawn following agreement by the companies to take the actions sought.[65]

In May 2021, shareholders supported an ESG activist fund's efforts to unseat two members of the ExxonMobil board in order to push for a more aggressive reframing of its business in light of transition risks for the oil and gas

59. *See* WEF, EFFECTIVE CLIMATE GOVERNANCE, *supra* note 58. The principles encourage boards to (1) gain climate awareness and skills, (2) embed climate considerations into board decisionmaking, and (3) understand and act upon the risks and opportunities that the climate emergency poses to the long-term resilience and success of their companies. *Id.* at 10.

60. *Id.* at 6.

61. *Join a Chapter*, CLIMATE GOVERNANCE INITIATIVE, https://climate-governance.org/join-a-chapter/ (last visited Apr. 1, 2023). The National Association of Corporate Directors announced in April 2021 that it would become the U.S. chapter of the initiative. Press Release, Nat'l Ass'n of Corp. Dirs., NACD Joins the Climate Governance Initiative, A Project Run in Collaboration with the World Economic Forum (Apr. 22, 2021), https://www.prnewswire.com/news-releases/nacd-joins-the-climate-governance-initiative-a-project-run-in-collaboration-with-the-world-economic-forum-301274343.html.

62. *See*, *e.g.*, CERES, RUNNING THE RISK: HOW CORPORATE BOARDS CAN OVERSEE ENVIRONMENTAL SOCIAL AND GOVERNANCE (ESG) ISSUES 5 (2019), https://www.ceres.org/resources/reports/running-risk-how-corporate-boards-can-oversee-environmental-social-and-governance.

63. Mark Olsen, *Corporate Boards Get Wake-Up Call on Climate Change*, INTELLIGIZE (Sept. 15, 2020), https://www.intelligize.com/corporate-boards-get-wake-up-call-on-climate-change (noting that BlackRock is exiting investments in companies with high sustainability-related risks, and that the largest Norwegian private money manager sold $47 million in stock of twenty-one companies after announcing divestment from polluting companies and companies that lobby against the Paris Agreement on climate change).

64. Attracta Mooney, *Big Investors Demand Annual Vote on Companies' Net Zero Plans*, FIN. TIMES (July 29, 2021), https://www.ft.com/content/a1ab86dd-edbc-45f8-a4d0-53f7dc3ccc67 (noting that more than fifty large institutional investors, including JPMorgan Asset Management, BNP Paribas Asset Management, and UBS Asset Management, together managing more than $14 trillion in assets, have called on companies to establish "say on climate" votes).

65. These include agreements by Domino's Pizza, Citigroup, JPMorgan Chase, Cleveland Cliffs, Albemarle Corp., Pentair, and Realty Income Corp. to reduce greenhouse gas emissions, and agreements by CSX, Duke Energy, Entergy, First Energy Corp, and Valero to disclose how corporate lobbying aligns with the goals of the Paris Agreement. Press Release, Climate Action 100+, Investors Seek Greater Climate Action in 2021 Proxy Season (Apr. 2, 2021), https://www.climateaction100.org/news/investors-seek-greater-climate-action-in-2021-proxy-season.

company.[66] In response to increased investor interest in climate risks, American law firms have started minting large numbers of memos to their clients extolling the importance of director attention to climate risk matters.[67]

C. U.S. DIRECTORS AS INATTENTIVE

Despite the strong interest in climate risks among investors and global business forums, the evidence on U.S. board engagement with climate risks is decidedly mixed. Although 74% of the companies in the S&P 100 acknowledge in their public filings that climate change poses a material risk to their enterprises,[68] only 17% charged their boards with overseeing the corporate response to climate change.[69] While a majority of U.S. directors believe climate change should play *some* role in corporate strategy,[70] climate risks do not appear to be a priority for U.S. boards. The National Association of Corporate Directors ("NACD") reports that only 13% of corporate boards participating in its annual survey listed climate change as one of the top-five trends affecting their companies in 2020, up from 6% in 2019.[71] This made climate change the fourteenth-ranked trend in the survey overall.[72] Clearly, climate change risks do not appear to be a priority for most boards.[73]

There are a variety of reasons boards may be reluctant to focus more attention on climate risks. The lack of interest in climate risks persists despite increasing board attention to ESG and sustainability matters more generally.[74]

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66. Christopher M. Matthews, *Activist Wins Exxon Board Seats After Questioning Oil Giant's Climate Strategy*, WALL ST. J., https://www.wsj.com/articles/activist-wins-exxon-board-seats-after-questioning-oil-giants-climate-strategy-11622050087 (May 26, 2021, 6:17 PM).

67. *See, e.g.*, Martin Lipton & William Savitt, *Directors' Duties in an Evolving Risk and Governance Landscape*, HARV. L. SCH. F. ON CORP. GOV. & FIN. REG. (Sept. 19, 2019), https://corpgov.law.harvard.edu/2019/09/19/directors-duties-in-an-evolving-risk-and-governance-landscape/.

68. CERES, RESPONSIBLE POLICY ENGAGEMENT ANALYSIS 2022: HOW COMPANIES ARE—AND ARE NOT—LEADING ON U.S. CLIMATE POLICY 7 (2022), https://www.ceres.org/practicingRPE.

69. *Systematize: Decision-Making for Climate Risks*, CERES, https://www.ceres.org/accelerator/responsible-policy-engagement/database/systematize (last visited Apr. 1, 2023).

70. PricewaterhouseCoopers reports in its 2020 Annual Corporate Directors Survey that 67% of board members surveyed believe that climate change should play a role in forming corporate strategy, up about thirteen percentage points from 2019. PWC GOVERNANCE INSIGHTS CTR., PWC'S 2020 ANNUAL CORPORATE DIRECTORS SURVEY 10 (2020), https://www.corporatecomplianceinsights.com/wp-content/uploads/2020/09/PwC-2020-ACDS-Report.pdf.

71. NAT'L ASS'N OF CORP. DIRS., 2019-2020 NACD PUBLIC COMPANY GOVERNANCE SURVEY 12 (2020), https://corpgov.law.harvard.edu/wp-content/uploads/2020/01/2019-2020-Public-Company-Survey.pdf.

72. *Id.*

73. Only 6% of U.S. corporate directors in one survey selected climate change as a focus area. CERES & KKS ADVISORS, SYSTEMS RULE: HOW BOARD GOVERNANCE CAN DRIVE SUSTAINABILITY PERFORMANCE 18 (2018), https://static1.squarespace.com/static/5143211de4b038607dd318cb/t/5afc5e271ae6cf3092ecd7ed/1526488627169/Systems+Rule_Final.pdf. Only 25% of boards surveyed by the NACD considered climate change to be one of the ESG issues of greatest concern to the company. NAT'L ASS'N OF CORP. DIRS., *supra* note 71, at 28.

74. A 2020 study of S&P 100 proxy statements concluded that 78% of the S&P 100 companies had at least one board committee charged with overseeing environmental sustainability matters. Kellie Huennekens, *ESG Disclosure in 2020 Proxy Statements*, NASDAQ (May 13, 2020, 8:00 AM), https://www.nasdaq.com/articles/esg-

Climate change is not garnering as much attention as other ESG issues, such as diversity and inclusion, which benefit from SEC disclosure requirements and state laws mandating board diversity.[75] One reason may be that director expertise on climate is exceedingly rare.[76] ESG fatigue among corporate boards may also affect attention to climate risks. In 2019, 56% of directors surveyed by PricewaterhouseCoopers ("PwC") felt that investors were focusing too much on ESG issues, twice the percentage with that view in 2018.[77] In addition, the complexity and systemic nature of climate change obscures the relationship between climate and business. Directors have misperceptions about the time horizons for climate risks; they have competing priorities, including cyber risks; and they lack clarity on how their risk-oversight role can evolve to include climate risks.[78] Finally, directors may have inadequate pecuniary and reputational incentives to pay more attention to climate, among other priorities and responsibilities, since the likelihood of personal liability for failing to pay attention to climate-related risks is extremely low.

D. Australian and Canadian Directors as More Attentive

There will certainly be limitations on what can be achieved in terms of director attention to climate risks through stricter standards of duty or heightened risk of liability, but there is reason to believe that the threat of liability or lawsuit may focus boards. As discussed in Part III, Canada and Australia apply significantly stricter standards of conduct and liability to directors' oversight obligations than Delaware. Australia also arguably has the strongest enforcement mechanisms for directors' duties of care among common law countries. As described in Part III.D, leading lawyers in Australia and Canada

disclosure-in-2020-proxy-statements-2020-05-13. On the other hand, in 2018, only 10% of the boards of the top 475 Fortune 2000 companies regularly reviewed sustainability issues at board meetings. Ceres & KKS Advisors, *supra* note 73, at 13.

75. In a March 2021 survey of more than 100 directors from Fortune 1000 companies ranking corporate priorities, 77% of directors said their companies were focused on data privacy and security, 68% reported being focused on board diversity and inclusion, only 31% reported they were focused on climate change, and only 19% expected their companies to disclose a strategy for transitioning to a net-zero business model. *Corporate Board Directors: Latest Findings from PwC's Pulse Survey*, PwC, https://www.pwc.com/us/en/library/pulse-survey/executive-views-2022/corporate-board-directors.html [https://web.archive.org/web/20210329150942/https://www.pwc.com/us/en/library/pulse-survey.html].

76. A 2020 NYU study of the credentials of 1,188 Fortune 100 company directors found that while 29% of directors had ESG credentials, 21% were clustered in "social," with expertise in health and diversity issues, while only 6% had credentials in environmental issues; of those, most had expertise in energy and conservation, with only three (0.2% of the total) directors having expertise in climate. Tensie Whelan, NYU Stern Ctr. for Sustainable Bus., U.S. Corporate Boards Suffer from Inadequate Expertise in Financially Material ESG Matters 3 (2021), https://www.stern.nyu.edu/sites/default/files/assets/documents/U.S.%20Corporate%20Boards%20Suffer%20From%20Inadequate%20%20Expertise%20in%20Financially%20Material%20ESG%20Matters.docx%20%282.13.21%29.pdf; *see also* Pilita Clark, *Too Many Boardrooms Are Climate Incompetent*, Fin. Times (Jan. 30, 2021), https://www.ft.com/content/611522b7-8cf6-4340-bc8a-f4e92782567c.

77. PwC Governance Insights Ctr., PwC's 2019 Annual Corporate Directors Survey 4, 32 (2019).

78. Benjamin, *supra* note 36, at 378–79.

have opined that directors in those countries have an obligation to monitor climate risks to their corporations to avoid corporate harm caused by those risks.

Recent surveys of directors in Australia and Canada indicate that directors in those countries are paying close attention to climate risks, ranking them among the highest priorities for their boards and their national governments.[79] A recent survey of the directors of Australian companies conducted by American and Australian academics provides additional empirical evidence that including climate risks in directors' duty of care has become uncontroversial in Australia.[80] The survey also found that directors in both Australia and the United States said that if litigation, regulatory investigation, or shareholder reaction to a potential breach of a duty to manage climate risks emerges, the pressure on directors to ensure they are fulfilling obligations would increase significantly.[81]

II. CLIMATE RISK AND DELAWARE DUTIES

So why are Delaware directors so much less attentive to climate risks than their counterparts in other common law jurisdictions? The story begins with the fact that the standard for director attentiveness in Delaware is bifurcated between the duties of care and loyalty, depending on whether directors are actively making decisions or passively failing to do so. In making decisions, Delaware directors are subject to claims that they breached their duty of care by making decisions without adequate consideration of climate risks and opportunities. In passively failing to act, they are subject to claims that they breached their duty of loyalty by failing to establish or adequately monitor corporate information systems designed to inform them of the climate risks faced by the corporation (*Caremark* claims). Both types of claims, however, are extremely difficult to maintain beyond a motion to dismiss.

79. Colin Brinsden, *Directors Want More Done on Climate Change*, W. AUSTRALIAN (Apr. 29, 2021, 10:33 AM), https://thewest.com.au/politics/directors-want-more-done-on-climate-change-c-2719979 (stating that Australian directors nominated climate change as the number one issue for the federal government to address in the April 2021 biannual Director Sentiment Index published by the Australian Institute of Company Directors; more than three-quarters of respondents were in support of establishing five-year emissions reduction targets to provide a clear pathway to the longer-term net-zero goal, and a majority considered climate change a material risk to their organization). Canada's Institute of Corporate Directors reported in its Spring 2021 Director Lens Survey that Canadian directors chose climate change as the second-highest challenge for Canada in the next ten to fifteen years. INST. OF CORP. DIRS., DIRECTOR LENS SURVEY: SPRING 2021, at 11 (2021), https://www.icd.ca/ICD/media/documents/ICD-Director-Lens-Survey-Spring-2021-EN_2.pdf. They also collectively ranked climate change the fourth-highest challenge for their organization, after human capital issues, technology change, and access to capital. *Id.*

80. Brett McDonnell, Hari M. Osofsky, Jacqueline Peel & Anita Foerster, *Green Boardrooms?*, 53 CONN. L. REV. 335, 393–98 (2021).

81. *Id.* at 393, 397 (quoting one U.S. source as saying that "the risk of a lawsuit gets everyone's attention in a way that I think can trump anything else in terms of focus").

A. CLIMATE RISK AND DELAWARE DUTY OF CARE

1. *Duty of Care*

In making decisions on behalf of the corporation, the directors of a Delaware corporation are required to act with the care that an ordinarily careful and prudent person would use in similar circumstances.[82] They are required to consider "all material information reasonably available" to them in making decisions.[83] If climate risks are material to a particular decision to be made by the directors of a Delaware corporation, ignoring them in the decisionmaking process constitutes a breach of the duty of care; risks that are not material, however, may be ignored.[84]

Although Delaware courts expect directors to act with the ordinary care expected of a reasonably prudent fiduciary—a negligence standard—the standard of review for liability is purposely set at the more lenient "gross negligence" level to encourage directors to act without undue inhibition.[85] This is a high standard, implicating reckless indifference to the interests of the corporation.[86] In other words, the normative standard of conduct and the judicial standard of review for liability are distinct.[87]

2. *Procedural Hurdles*

At present, the duty of care serves as a poor inducement for more attentive director decisionmaking in Delaware, since there are important procedural

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

83. Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984); *In re* Citigroup Inc. S'holder Derivative Litig., 964 A.2d 106, 122 (Del. Ch. 2009). In this context, the term "material" means "relevant and of a magnitude to be important to directors in carrying out their fiduciary duty of care in decisionmaking." Brehm v. Eisner, 746 A.2d 244, 259 n.49 (Del. 2000).

84. REGNER, *supra* note 12, at 5.

85. William T. Allen, Jack B. Jacobs & Leo E. Strine, Jr., *Realigning the Standard of Review of Director Due Care with Delaware Public Policy: A Critique of* Van Gorkom *and Its Progeny as a Standard of Review Problem*, 96 NW. U. L. REV. 449, 449–50 (2002) ("The gross negligence standard is consistent with Delaware's long-standing policy of deferring to business decisions made by well-motivated fiduciaries. . . . [I]ntruding on the protected space that the business judgment rule accords [findings of liability for duty of care violations] . . . create[s] disincentives for businesses to engage in the risk-taking that is fundamental to a capitalist economy . . . [and] prolongs litigation without offsetting social utility.").

86. *In re* Walt Disney Co. Derivative Litig., 907 A.2d 693, 750 & n.429 (Del. Ch. 2005) (asserting that gross negligence for duty of care purposes means "reckless indifference to or a deliberate disregard of the whole body of stockholders' [interests] or actions which are without the bounds of reason").

87. Allen, Jacobs, and Strine argue that divergence between the standards of conduct and review are attributable to fairness and public policy considerations articulated by Melvin Eisenberg: (1) directors must often make decisions in an environment of imperfect (that is, limited or incomplete) information; (2) the risk of liability under the applicable standard of conduct for assuming a given corporate role may dwarf the incentives for assuming the role; (3) if the risk of liability is disproportionate to the directors' incentives for service, directors may avoid making economically valuable decisions that might subject them to litigation risk; (4) courts are ill-equipped to determine after the fact whether a particular business decision was reasonable in the circumstances confronting the corporation; and (5) institutional and prudential considerations sometimes counsel judicial deference to the corporate decisionmaker. Allen et al., *supra* note 85, at 451–52 (citing Melvin Aron Eisenberg, *The Divergence of Standards of Conduct and Standards of Review in Corporate Law*, 62 FORDHAM L. REV. 437, 437–38 (1993)).

hurdles that make it virtually impossible for a duty of care claim to survive a motion to dismiss[88]: demand requirements,[89] the business judgment rule,[90] and exculpation clauses in corporate charters.[91] As a result, not only are financial penalties for inattentive decisions unlikely, but it is also unlikely that directors will experience reputational or other costs, since courts cannot serve as neutral third-party arbiters of director behavior when cases are dismissed on the pleadings.

It is important to recognize, of course, that the protections for directors in Delaware operate in a highly litigious environment.[92] In some cases, the damages for negligent actions can be so large as to be personally ruinous for directors.[93] Delaware courts are aware of the imbalance between risk and reward for directors and have pointed that out as a basis for rules shielding directors from liability for duty of care violations.[94] Without the protection of judicial rules, exculpation, indemnification, or insurance, directors might refuse to serve

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88. Miller, *supra* note 22, at 104.

89. Because directors have the statutory right and obligation to manage the affairs of the corporation, Delaware law permits shareholders to sue on behalf of the corporation only if they can show that (1) directors have wrongfully refused a shareholder demand to institute the lawsuit, or that (2) demand is excused because the directors are incapable of making an impartial decision about whether to institute the litigation. United Food & Com. Workers Union v. Zuckerberg, 262 A.3d 1034, 1047 (Del. 2021). In deciding whether demand can be excused, Delaware courts determine whether, at the time of the demand, a majority of directors could exercise independent and disinterested judgment regarding a demand by reviewing, for each director:

> (i) whether the director received a material personal benefit from the alleged misconduct that is the subject of the litigation demand, (ii) whether the director would face a substantial likelihood of liability on any of the claims that are the subject of the litigation demand, and (iii) whether the director lacks independence from someone who received a material personal benefit from the alleged misconduct that is the subject of the litigation demand or who would face a substantial likelihood of liability on any of the claims that are the subject of the litigation demand.

Id. at 1058.

90. The business judgment rule is applied by Delaware courts as a rebuttable presumption that directors made an informed decision, in good faith and in the honest belief the decision was in the best interest of the corporation. Smith v. Van Gorkom, 488 A.2d 858, 872 (Del. 1985), *overruled on other grounds by* Gantler v. Stephens, 965 A.2d 695 (Del. 2009). Duty of care cases against directors are dismissed on the pleadings if shareholders cannot adduce sufficient evidence that directors were interested, uninformed, or acted in bad faith to rebut the presumption in their complaint. Gantler v. Stephens, 965 A.2d 695, 706 (Del. 2009).

91. The Delaware legislature explicitly permitted corporate charter clauses exculpating directors from liability for duty of care violations through a 1986 amendment to the Delaware General Corporation Law ("DGCL") adding section 102(b)(7). Most Delaware corporations include such an exculpation provision in their charters. REGNER, *supra* note 12, at 8. Delaware courts dismiss cases seeking only monetary damages for breaches of the duty of care when nonexculpated claims cannot be proven. Malpiede v. Townson, 780 A.2d 1075, 1095 (Del. 2001) ("Our jurisprudence since the adoption of the statute has consistently stood for the proposition that a Section 102(b)(7) charter provision bars a claim that is found to state only a due care violation."). Because of DGCL section 102(b)(7), most shareholder litigation in recent years has focused on duty of loyalty claims (including claims alleging breaches of good faith). Randy J. Holland, *Delaware Directors' Fiduciary Duties: The Focus on Loyalty*, 11 U. PA. J. BUS. L. 675, 693 (2009).

92. This is a significant difference with the regimes enforcing directors' duties in Australia, Canada, and the United Kingdom. Hill & Conaglen, *supra* note 8, at 320–21.

93. Spamann, *supra* note 24, at 339; Stuart R. Cohn, *Demise of the Director's Duty of Care: Judicial Avoidance of Standards and Sanctions Through the Business Judgment Rule*, 62 TEX. L. REV. 591, 595 (1983).

94. *See, e.g.*, Gagliardi v. Trifoods Int'l, Inc., 683 A.2d 1049, 1052–53 (Del. Ch. 1996).

if they must bear the entire loss suffered by the corporation through their inattention.[95]

B. CLIMATE RISK AND RISK OVERSIGHT: *CAREMARK*

When a board decides without sufficiently considering attendant risks, that act is reviewed under the duty of care standard and the business judgment rule, as described above. But what if directors haven't acted when they should have, such as failing to adequately monitor risks to the corporation, including risks related to climate change?

Delaware courts have historically reviewed failures to adequately monitor risks to the corporation under the duty of care, determining that directors can be liable only if they ignore "red flags";[96] but in the last twenty-five years, Delaware courts have reviewed such failures to monitor under the duty of loyalty.[97] While this eliminates some of the procedural hurdles to liability described above, it establishes extremely high substantive standards of liability that have been difficult for Delaware plaintiffs to overcome.

1. Oversight Liability

Prior to *Caremark*, directors' oversight duties were reactive—as long as there were no red flags drawing directors' attention to employee malfeasance, they could assume that all was fine.[98] The 1996 *Caremark* case suggested directors have an affirmative duty to be informed about "material acts, events or conditions within the corporation,"[99] and to attempt *in good faith* to establish corporate information-gathering and reporting systems.[100] Such systems should provide management and the board with information about the corporation's "compliance with law and its business performance," so that they may satisfy their responsibility to be informed.[101] However, the *Caremark* court established an extremely high standard of review for liability, stating that directors can only be liable for a "sustained or systematic failure of the board to exercise

95. This is, in fact, what happened when, following the *Van Gorkom* decision, directors' and officers' insurance became so expensive or unavailable that directors began to resign from companies that did not have adequate insurance. Allen et al., *supra* note 85; Roberta Romano, *Corporate Governance in the Aftermath of the Insurance Crisis*, 39 EMORY L.J. 1155, 1159 (1990).

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

97. The case law for oversight liability has primarily developed through motion practice pursuant to motions to dismiss for failure to state a claim or failure to make a presuit demand on the board pursuant to Delaware Rule 23.1. *See* Elizabeth Pollman, *Corporate Oversight and Disobedience*, 72 VAND. L. REV. 2013, 2031 (2019) ("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." (footnotes omitted)).

98. *Graham*, 188 A.2d at 130; Shapira, *supra* note 10, at 1862.

99. *See In re* Caremark Int'l Inc. Derivative Litig., 698 A.2d 959, 969 (Del. Ch. 1996).

100. *Id.* at 970.

101. *Id.*

oversight[] such as an utter failure to attempt to assure a reasonable information and reporting system exists."[102]

The Delaware Supreme Court endorsed the *Caremark* standard for oversight liability in the 2006 *Stone ex rel. AmSouth Bancorp. v. Ritter* case, stating that directors would be liable if:

> (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. In either case, imposition of liability requires a showing that the directors knew that they were not discharging their fiduciary obligations.[103]

2. *Shift from Duty of Care to Duty of Loyalty*

While *Caremark* and *Stone* established a clear standard of liability for inactive inattention (as opposed to active inattention in connection with making a corporate decision), they also changed the relevant duty applying to inactive inattention from a duty of care to a duty of loyalty. Altering the applicable duty significantly changed the evidentiary requirements and prospects for overcoming a motion to dismiss in such cases, which could affect directors' incentives to be appropriately attentive to their responsibilities.[104]

Although the *Caremark* case involved a duty of care claim, and Chancellor Allen treated the claim as such, he got the ball rolling toward duty of loyalty treatment of oversight duties with the way he framed the obligation. Allen explicitly rejected a negligence-based standard for assessing director due care and the "reasonable person" standard adopted in other common law countries, stating: "[O]ne wonders on what moral basis might shareholders attack a *good faith* business decision of a director as 'unreasonable' or 'irrational.'"[105] Instead, Allen focused on whether directors exercised *effort* in good faith, as opposed to their objective level of attention or "informedness."[106] He asked whether directors made a *good faith effort* to be informed, not whether they were *actually*

102. *Id.* at 971.

103. 911 A.2d 362, 370 (Del. 2006) (emphasis added).

104. *Caremark* and *Stone* moved oversight responsibility from due care, a negligence standard, to loyalty, a scienter standard that requires shareholders to provide evidence permitting an inference that directors *knew* they were not fulfilling their duties to the corporation in failing to establish or monitor corporate information systems. *See Caremark*, 698 A.2d at 971; *Stone*, 911 A.2d at 370. That is often a difficult standard to satisfy. On the other hand, unlike duty of care violations, duty of loyalty violations are not exculpable under DGCL section 102(b)(7), so they will not be dismissed for failure to state a claim the way duty of care claims seeking only monetary damages would be. *Stone*, 911 A.2d at 367. Thus, the shift of oversight responsibility from care to loyalty is a two-edged sword.

105. *Caremark*, 698 A.2d at 968. Allen made a frontal assault on the negligence standard for assessing director attentiveness, clearly concerned that such a standard invites after-the-fact review of substantive decisions, which would discourage corporate risk-taking. *Id.* at 967–68 ("The vocabulary of negligence while often employed, is not well-suited to judicial review of board attentiveness . . . ." (citations omitted)).

106. *Id.* at 967–68.

informed of all reasonably available material information.[107] Allen appears to have taken the view that directors should not be held liable for negligence, but should only be liable when they fail to perform their duties in good faith.[108]

Then Vice Chancellor Strine explicitly moved *Caremark* from a duty of care analysis to a duty of loyalty analysis in *Guttman v. Huang*.[109] Anticipating the Delaware Supreme Court's subsequent location of good faith in the duty of loyalty, Strine stated that "by its plain and intentional terms," *Caremark* "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."[110] Strine explained the move in his subsequent opinion in *Desimone v. Barrows*.[111] *Stone* confirmed *Guttman*'s reframing of *Caremark* as a duty of loyalty standard.[112] Noting the *Caremark* opinion's references to good faith, the *Stone* decision stated that lack of good faith is a "necessary condition" for director liability for oversight failures and went on to establish that failure to exercise good faith is a breach of the duty of loyalty, not a breach of the duty of care.[113] Thus, under Delaware law, oversight failures became breaches of the duty of loyalty, requiring intentional malfeasance, rather than breaches of the duty of care.

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107. *Id.* at 967 ("[C]ompliance with a director's duty of care can never appropriately be judicially determined by reference to *the content of the board decision* that leads to a corporate loss, apart from consideration of the good faith *or* rationality of the process employed."). Bayless Manning presaged this position in a 1984 article in which he suggested that directors' duty of oversight should be limited to making good faith efforts to establish and monitor corporate information systems designed to report the information they and management need to make informed judgments. Manning, *supra* note 31, at 1484, 1499. While focusing on the presence or absence of directors' *efforts* to obtain information about material risks may be an appropriate basis for judging directors' exposure to liability, it does not necessarily follow that the standard of liability should be conscious disregard of duties rather than negligence. Insufficient effort may cause great harm and should be discouraged, regardless of whether it is conscious.

108. *Caremark*, 698 A.2d at 968 ("[T]he core element of any corporate law duty of care inquiry [is] whether there was good faith effort to be informed and exercise judgment. . . . Where a director *in fact exercises a good faith effort to be informed and to exercise appropriate judgment*, he or she should be deemed to satisfy fully the duty of attention."). Allen explained and justified this view in an article written a couple of years after the *Caremark* decision. William T. Allen, *The Corporate Director's Fiduciary Duty of Care and the Business Judgment Rule Under U.S. Corporate Law*, *in* COMPARATIVE CORPORATE GOVERNANCE: THE STATE OF THE ART AND EMERGING RESEARCH 307, 327 (Klaus J. Hopt et al. eds., 1998). It is also a theme of a work he coauthored with Justices Strine and Jacobs. *See* Allen et al., *supra* note 85.

109. 823 A.2d 492, 506 (Del. Ch. 2003).

110. *Id.* at 506 ("[T]he [*Caremark*] 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."); *see also* Bainbridge, *Enterprise Risk Management*, *supra* note 22, at 975 ("In *Guttman*, . . . Vice Chancellor Strine ripped the *Caremark* claim from its original home in the duty of care and reinvented it as a duty of loyalty . . . .").

111. 924 A.2d 908, 935 (Del. Ch. 2007) ("For reasons Caremark well-explained, to hold directors liable for a failure in monitoring, the directors have to have acted with a state of mind consistent with a conscious decision to breach their duty of care. *Caremark* . . . plainly held that director liability for failure to monitor required a finding that the directors acted with the state of mind traditionally used to define the mindset of a disloyal director—bad faith . . . . ").

112. Bainbridge, *Enterprise Risk Management*, *supra* note 22, at 975.

113. Stone *ex rel.* AmSouth Bancorp. v. Ritter, 911 A.2d 362, 364, 370 (Del. 2006).

3. Focus on Legal, Accounting, and Safety Compliance

Caremark claims have mostly been dismissed.[114] The *Caremark* claims that have survived motions to dismiss have involved failures in legal or accounting compliance, in some cases including ethical or legal lapses by the directors themselves.[115] In fact, the vast majority of *Caremark* cases, whether dismissed or not, have involved claims regarding legal compliance and accounting failures. There have been *Caremark* claims asserting violations of environmental regulations,[116] product safety violations,[117] consumer financial fraud,[118] employee rights and safety regulations,[119] and pharmaceutical marketing and safety regulations.[120] There have also been some cases involving failure to monitor financial reporting, which is also subject to extensive regulation.[121]

Law firms and scholars have generally averred that *Caremark* liability for oversight failures is available *only* in the context of legal compliance and accounting failures.[122] More recently, some have argued that *Caremark* liability

114. *See* Pollman, *supra* note 97, at 2032; Paul E. McGreal, Caremark *in the Arc of Compliance History*, 90 TEMP. L. REV. 647, 676 n.238 (2018) (listing dismissals).

115. *See, e.g.*, cases cited *supra* note 11; *see also* La. Mun. Police Emps.' Ret. Sys. v. Pyott, 46 A.3d 313, 358–59 (Del. Ch. 2012), *rev'd on other grounds*, 74 A.3d 612 (Del. 2013); *In re* Massey Energy Co., No. 5430-VCS, 2011 WL 2176479, at *20–21 (Del. Ch. May 31, 2011); Am. Int'l Grp., Inc. Consolidated Derivative Litig., 965 A.2d 763, 779 (Del. Ch. 2009).

116. *See, e.g.*, Inter-Mktg. Grp. USA, Inc. *ex rel.* Plains All Am. Pipeline, L.P. v. Armstrong, No. 2017-0030, 2020 WL 756965, at *10–15 (Del. Ch. Jan. 31, 2020) (involving liabilities resulting from an oil spill); City of Birmingham Ret. & Relief Sys. v. Good, 177 A.3d 47, 50 (Del. 2017) (involving "nine misdemeanor criminal violations of the Federal Clean Water Act").

117. *See*, *e.g.*, *In re* Boeing Co. Derivative Litig., No. 2019-0907, 2021 WL 4059934, at *2 (Del. Ch. Sept. 7, 2021); *In re* Gen. Motors Co. Derivative Litig., No. 9627-VCG, 2015 WL 3958724, at *1 (Del. Ch. June 26, 2015) (involving faulty ignition switches leading to personal injury and death to drivers), *aff'd*, 133 A.3d 971 (Del. 2016).

118. *See, e.g.*, Rojas *ex rel*. J.C. Penney Co. v. Ellison, No. 2018-0755, 2019 WL 3408812, at *1 (Del. Ch. July 29, 2019) (involving price-comparison advertising); Shaev v. Baker, No. 16-cv-05541, 2017 WL 1735573, at *9–15 (N.D. Cal. May 4, 2017) (Wells Fargo's account fraud scandal).

119. *See In re Massey Energy Co.*, 2011 WL 2176479, at *l8–21 (involving a *Caremark* claim based on mine safety violations).

120. *See, e.g.*, *In re* Clovis Oncology, Inc. Derivative Litig., No. 2017-0222, 2019 WL 4850188, at *10 (Del. Ch. Oct. 1, 2019) (involving alleged failure to oversee misconduct in seeking approval of new pharmaceutical product from the Food and Drug Administration).

121. Hughes v. Hu, No. 2019-0112, 2020 WL 1987029, at *1 (Del. Ch. Apr. 27, 2020); Teamsters Local 443 Health Servs. & Ins. Plan v. Chou, No. 2019-0816, 2020 WL 5028065, at *1 (Del. Ch. Aug. 24, 2020).

122. *See, e.g.*, REGNER, *supra* note 12, at 8; Miller, *supra* note 22, at 82–83; Strine et al., *supra* note 22, at 1887. Strine, Smith, and Steel characterize the *Caremark* duty as a duty to "implement and monitor compliance programs to ensure that the company honors its legal obligations." Strine et al., *supra* note 22, at 1887. They argue that the duty is "rooted in the much older requirement that corporations conduct only lawful business by lawful means." *Id.* They call this the "first principle of corporate law: corporations may only conduct lawful business by lawful means." *Id.* at 1893 & n.23 (citing DEL. CODE ANN. tit. 8, § 101(b) (2023) ("A corporation may be incorporated or organized under this chapter to conduct or promote any lawful business or purposes . . . .")); *In re* Facebook, Inc. Section 220 Litig., No. 2018-0661, 2019 WL 2320842, at *14 (Del. Ch. May 30, 2019) ("The legal academy has observed that Delaware courts are more inclined to find *Caremark* oversight liability at the board level when the company operates in the midst of obligations imposed upon it by positive law yet fails to implement compliance systems, or fails to monitor existing compliance systems, such that a violation of law and resulting liability occurs.").

is available when directors fail to monitor mission-critical risks such as product safety.[123] But in those situations, product safety is typically regulated, so such failures are likely to involve legal compliance failures.[124]

4. *Skepticism About Liability for Risk Management Failures*

The Delaware courts have been skeptical about applying *Caremark* liability to enterprise risk management failures as opposed to legal and accounting compliance failures. While they have never said that *Caremark* does not apply to enterprise risks, the courts have pointedly noted, in several cases, that they have never definitely accepted the application of *Caremark* liability to risk management failures.[125] In an October 2021 decision rejecting a claim based on harm to the corporation arising from alleged failures to monitor unregulated cybersecurity risks, the Delaware Chancery Court stated that there has never been a successful *Caremark* claim focused solely on risk management failures unrelated to legal compliance.[126] The court did not rule on whether oversight liability applies to nonregulated cybersecurity risk, however, because it concluded that directors had established and monitored information and reporting systems on cyber risks, satisfying both prongs of *Caremark*.[127]

The most well-known articulation of skepticism over extending *Caremark* liability to inadequate oversight of enterprise risks is Chancellor Chandler's decision in the 2009 case *In re Citigroup Inc. Shareholder Derivative Litigation*.[128] There, Chandler refused to impose liability on Citigroup directors for inadequate monitoring of subprime business risks prior to the 2007 to 2009

123. Paul E. Kalb & Holly J. Gregory, *Boeing Case Highlights Risk for Health, Life Sciences Boards*, SIDLEY: ENHANCED SCRUTINY (Oct. 8, 2021), https://ma-litigation.sidley.com/2021/10/boeing-case-highlights-risk-for-health-life-sciences-boards/; Cynthia A. Williams, Fiduciary Obligations and Climate Change (Aug. 2022) (unpublished manuscript), https://bpb-us-w2.wpmucdn.com/sites.udel.edu/dist/8/12944/files/2022/08/2021-Ceres-RT_U.S.-Fiduciary-Duty-analysis-for-the-Weinberg-Center_.pdf.

124. Indeed, *Marchand v. Barnhill*, which involved product safety, discussed product safety as a compliance issue, not as a separate basis for *Caremark* liability. 212 A.3d 805, 809 (Del. 2019) ("[O]ne of Bluebell's central compliance issues is food safety."); *id.* at 822 ("[N]o system of board-level compliance monitoring and reporting existed at Blue Bell."); *id.* at 824 ("[N]o reasonable compliance system and protocols were established as to the obviously most central consumer safety and legal compliance issue facing the company.").

125. Often, courts refer to enterprise risks as "business risks," implying that such matters are subject to the business judgment of directors. *See, e.g.*, Okla. Firefighters Pension & Ret. Sys. v. Corbat, No. 12151-VCG, 2017 WL 6452240, at *18 (Del. Ch. Dec. 18, 2017) ("[F]ailure to monitor or properly limit *business* risk[] [is] a theory of director liability that this Court has never definitively accepted.").

126. Firemen's Ret. Sys. *ex rel* Marriott Int'l, Inc. v. Sorenson, No. 2019-0965, 2021 WL 4593777, at *12 (Del. Ch., Oct. 5, 2021) ("Delaware courts have not broadened a board's *Caremark* duties to include monitoring risk in the context of business decisions.").

127. *Id.* at *12–13; *see also* Constr. Indus. Laborers Pension Fund v. Bingle, No. 2021-0940, 2022 WL 4102492, at *7 (Del. Ch. Sept. 6, 2022) (stating that no case in Delaware previously imposed oversight liability based solely on a failure to monitor business risk, and that while failure to monitor cybersecurity risk absent violations of positive laws or regulations could potentially form a *Caremark* claim, dismissal was warranted where plaintiffs failed to establish an inference of scienter).

128. *In re* Citigroup Inc. S'holder Derivative Litig., 964 A.2d 106, 131 (Del. Ch. 2009).

financial crisis, stating that to do so would involve the court in reviewing business decisions in contravention of the business judgment rule.[129]

In *Citigroup*, Chancellor Chandler characterized plaintiffs' claims as alleging a failure to monitor Citigroup's *business risk*, specifically its exposure to the subprime mortgage market.[130] Chandler concluded that plaintiffs were hoping the court would "accept the conclusion since the Company suffered large losses, and [that] since a properly functioning risk management system would have avoided such losses, the directors must have breached their fiduciary duties in allowing such losses."[131] Although he left open the possibility that risk management failures might, in an extreme case, suffice to establish a *Caremark* claim for oversight failure,[132] Chandler concluded with a lengthy criticism of the effort to hold directors accountable for risk management failures, suggesting that such claims could eviscerate the business judgment rule.[133] Since the *Citigroup* decision, no Delaware Chancery decision has denied dismissal of a case based on business risk oversight failures.[134]

C. Delaware Duties and Climate Risk

As noted in the previous Subpart, there has been tremendous interest among activists, investors, and some regulators in the duties of corporate directors with respect to climate risks and opportunities. Reflecting this interest, the UNPRI commissioned and publicly distributed an opinion from the highly regarded New York law firm, Debevoise & Plimpton LLP, regarding the duty of directors of Delaware companies to consider ESG issues, including climate risk.[135] The opinion acknowledges that Delaware directors must consider all material information reasonably available in connection with making any

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129. *Id.* ("Instead of alleging facts that could demonstrate bad faith on the part of the directors, by presenting the Court with the so called 'red flags,' plaintiffs are inviting the Court to engage in the exact kind of judicial second guessing that is proscribed by the business judgment rule.").

130. *Id.* at 124 ("[P]laintiff's theory essentially amounts to a claim that the director defendants should be personally liable to the Company because they failed to fully recognize the risk posed by subprime securities."). The *Citigroup* case may be an example of bad facts (or poorly pled cases) making bad law. The plaintiffs did not allege absence of a system to monitor risks, failure to monitor the system, or disregard of red flags *generated by* a system. *Id*. at 106. The red flags identified by the plaintiffs in the *Citigroup* case were entirely *external* to Citigroup. *Id*. at 115. The plaintiffs also failed to plead facts establishing scienter, so their complaint did not state a claim under *Caremark* and *Stone*. Robert T. Miller, *The Board's Duty To Monitor After* Citigroup, 12 U. Pa. J. Bus. L. 1153, 1160 (2010).

131. *Citigroup*, 964 A.2d at 128.

132. *Id.* at 126 ("While it might be possible for a plaintiff to meet the burden under some set of facts, plaintiffs in this case have failed to state a *Caremark* claim sufficient to excuse demand based on a theory that the directors did not fulfill their oversight obligations by failing to monitor the business risk of the company.").

133. *Id.* at 131 ("To impose oversight liability on directors for failure to monitor 'excessive' risk would involve courts in conducting hindsight evaluations of decisions at the heart of the business judgment of directors.").

134. *See supra* Part II.B.3.

135. *See Guidance for Private Equity Signatories: US Directors' Duties and ESG*, Principles for Responsible Inv. (Sept. 30, 2020), https://www.unpri.org/private-equity/guidance-for-private-equity-signatories-us-directors-duties-and-esg/6522.article.

decision on behalf of a corporation—including ESG factors presenting material risks or opportunities to the corporation—unless they are not material.[136]

With respect to *Caremark* oversight duties, however, the Debevoise lawyers opined that these are limited to systems monitoring legal compliance.[137] They stated that while ESG matters that have been reduced to legal obligations—such as environmental compliance, worker safety, antibribery, and supply chain integrity—would be covered by *Caremark* duties, such duties otherwise "do[] not . . . answer the question of how directors ought to think about ESG factors that have not been reduced to legal obligations."[138] In other words, Debevoise took the position that directors of Delaware corporations have an obligation to obtain and consider information about unregulated climate risks only when it is material to making a corporate decision.[139] Failing to monitor climate risks would not be a violation of directors' fiduciary duties.

III. Climate Risk and Duties in Other Common Law Countries

The duties of directors of corporations in other major common law jurisdictions, Australia, Canada, and the United Kingdom, are different from the duties of Delaware directors in several ways that bear on the prospects of liability for failure to consider or monitor for climate risks. The primary differences are: (1) the duties are now codified in statutory provisions;[140] (2) director failure to consider risks in making decisions is subject to a negligence standard, rather than gross negligence; (3) director failure to monitor risks is also subject to a negligence standard, rather than a bad faith scienter standard; (4) the business judgment rule is applied differently and is a less formidable barrier to lawsuits against directors; (5) exculpation of directors from liability for negligence is prohibited; and (6) Australia utilizes public, as well as private, enforcement of directors' duties, and its regulator, the Australian Securities and Investments Commission ("ASIC"), has been active bringing cases.[141]

136. Regner, *supra* note 12, at 5 (citing Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984)). Regner notes that directors have wide discretion in determining what is material to the corporation. *Id*.

137. *Id.* at 4.

138. *Id.*

139. *Id.* at 6 (citing Del. Code Ann. tit. 8, § 141(e) (2023)) (arguing that directors are permitted to and typically do rely on the corporation's management to identify risks and opportunities).

140. *Corporations Act 2001* (Cth), ch 2D div 1 ss 180–184 (Austl.); Canada Business Corporations Act, R.S.C. 1985, c. C-44 s. 122; Companies Act 2006 c. 46, §§ 172, 174 (UK). Australia common law duties apply concurrently. *Corporations Act 2001* (Cth), s 185 (Austl.).

141. The Commonwealth Climate and Law Initiative ("CCLI"), established by Oxford University and ClientEarth, has done extensive work examining the legal obligations of directors in common law countries to consider, manage, and report on climate change–related risk, and the circumstances in which they may be liable for failing to do so. *Overview of Commonwealth Climate and Law Initiative*, Commonwealth Climate & L. Initiative, https://ccli.ouce.ox.ac.uk/overview/ (last visited Apr. 1, 2023). Affiliates have prepared country papers examining the duties of directors with respect to climate in several common law countries that have been instructive for this project. *See generally, e.g.*, Sarah Barker, Commonwealth Climate & L. Initiative,

A. DUTY OF CARE IN AUSTRALIA, CANADA, AND THE UNITED KINGDOM

While courts in Delaware have developed separate standards of review for director action and inaction, courts in Australia, Canada, and the United Kingdom apply one unified standard of review to the entire continuum of directors' obligation of attention to corporate affairs. Courts in Australia, Canada, and the United Kingdom also seem to expect more proactive oversight of enterprise risks by boards of directors than Delaware courts.[142]

Economic arguments in favor of limiting liability for duty of care violations have been less influential in Australia and the United Kingdom than in the United States.[143] In contrast with Delaware, where the standard of liability has effectively moved from gross negligence to no liability for exculpable offenses, the standard of liability in Australia and the United Kingdom has moved the other way: from gross negligence to a stricter standard of liability, more akin to simple negligence.[144]

Prior to the 1990s, the leading case on directors' duty of care in Australia and the United Kingdom was the 1925 case *In re City Equitable Fire Insurance Co.*,[145] which established a very low subjective standard of care, sometimes referred to as the "amiable lunatic" standard,[146] requiring a director to exert no "greater degree of skill than may reasonably be expected from a person of his knowledge and experience."[147] This standard was abandoned in the United Kingdom in a series of cases in the 1990s that established a more demanding objective test that is now reflected in section 174 of the Companies Act of 2006.[148] A similar trend arose in Australian case law in the 1990s as courts dealt

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DIRECTORS' LIABILITY AND CLIMATE RISK: AUSTRALIA – COUNTRY PAPER (2018), https://commonwealthclimatelaw.org/wp-content/uploads/2022/05/CCLI-Australia-Paper-Final.pdf [hereinafter CCLI AU]; JANIS SARRA & CYNTHIA WILLIAMS, COMMONWEALTH CLIMATE & L. INITIATIVE, DIRECTORS' LIABILITY AND CLIMATE RISK: CANADA – COUNTRY PAPER (2018), https://commonwealthclimatelaw.org/wp-content/uploads/2022/05/CCLI-Canada-Paper-Final.pdf [hereinafter CCLI CA]; ALEXIA STAKER & ALICE GARTON, COMMONWEALTH CLIMATE & L. INITIATIVE, DIRECTORS' LIABILITY AND CLIMATE RISK: UNITED KINGDOM – COUNTRY PAPER (2018), https://commonwealthclimatelaw.org/wp-content/uploads/2022/05/CCLI-Canada-Paper-Final.pdf [hereinafter CCLI UK]; SARAH BARKER & ELLIE MULHOLLAND, COMMONWEALTH CLIMATE & L. INITIATIVE, DIRECTORS' LIABILITY AND CLIMATE RISK: COMPARATIVE PAPER – AUSTRALIA, CANADA, SOUTH AFRICA, AND THE UNITED KINGDOM (2019), https://ccli.ouce.ox.ac.uk/wp-content/uploads/2019/10/CCLI-Directors%E2%80%99-Liability-and-Climate-Risk-Comparative-Paper-October-2019-vFINAL.pdf.

142. Sarah Barker, *Directors' Personal Liability for Corporate Inaction on Climate Change*, GOVERNANCE DIRECTIONS, Feb. 2015, at 21–23; CCLI AU, *supra* note 141, at 23, 56; CCLI CA, *supra* note 141, at 12; CCLI UK, *supra* note 141, at 38–39.

143. Hill & Conaglen, *supra* note 8, at 322.

144. *Id.*

145. *In re* City Equitable Fire Ins. Co. [1925] Ch 407, at 428 (Eng.).

146. Hill & Conaglen, *supra* note 8, at 322 (citing DAVID KERSHAW, COMPANY LAW IN CONTEXT: TEXT AND MATERIALS (Oxford Univ. Press 2009)); B.A.K. Rider, *Amiable Lunatics and the Rule in* Foss v. Harbottle, 37 CAMBRIDGE L.J. 270, 285 (1978).

147. *In re* City Equitable Fire Ins. Co. [1925] Ch 407, at 428 (Eng.).

148. According to Hill and Conaglen, following the collapse of Barings Bank in 1995 and many other financial institutions during the 2007 to 2009 financial crisis, Australia and the United Kingdom recognized that managerial incompetence can cause massive corporate losses and may constitute a greater risk to society than duty of loyalty breaches. Hill & Conaglen, *supra* note 8, at 322–23.

with a number of cases based on harm caused to financial institutions by inadequately supervised traders losing money on foreign exchanges and other trades.[149]

Moreover, in each jurisdiction, the courts apply an objective reasonableness test to determine whether directors have been negligent in their attention to corporate affairs. Australian courts consider whether the director has taken "all *reasonable* steps to be in a position to guide and manage the company."[150] This involves an inquiry into what directors *should have known*.[151] To determine reasonableness, Australian courts balance the magnitude of the risk and probability that it will arise against the expense, difficulty, and inconvenience of countermeasures, and the director's conflicting responsibilities.[152] Acting, or failing to act, in good faith is not enough where directors fail to make relevant inquiries, raise matters that ought to have been raised, or "join the dots."[153]

Canada also has a reasonableness standard of review for the duty of care. The Canada Business Corporations Act requires directors to "exercise the care, diligence and skill that a *reasonably prudent person* would exercise in *comparable circumstances*."[154] The Supreme Court of Canada has reiterated this objective standard and noted that Canadian courts will defer to the reasonable business judgment of directors who have been duly diligent in their oversight of their corporation.[155] Provided that directors are duly diligent, do not have conflicts of interest, and make decisions within a range of reasonableness, courts will defer to directors' business judgment.[156] Thus, courts in Canada are perceived to be capable of determining whether the appropriate degree of prudence and diligence was brought to bear in reaching a decision.[157] The question is whether the directors' decision was reasonable—if their decision was

149. *Id.* at 323 (citing *Daniels v Anderson* (1995) 37 NSWLR 438 (Austl.) ("*AWA Appeal*" decision)).

150. To satisfy their duty of care, directors must proactively acquire and maintain an "irreducible" core of knowledge and understanding of the fundamentals of their corporation, monitor corporate affairs and policies, and "take a diligent and intelligent interest in the information available to them or which they might appropriately demand from the executives or other employees and agents of the company." *ASIC v Healey* [2011] FCA 717 ¶¶ 16–20 (Austl.).

151. *Id.* ¶ 16 (stating that the duty of care is a "core, irreducible requirement" of the directors "to be involved in the . . . company and . . . to be in a position to guide and monitor"); Hill & Conaglen, *supra* note 8, at 324.

152. *E.g.*, *ASIC v Ingleby* (2012) 91 ACSR 66, 69 (Austl.); *ASIC v Rich* (2009) 75 ACSR 1 ¶¶ 7231, 7236 (Austl.); *ASIC v Vines* (2005) 55 ACSR 617 (Austl.).

153. CCLI AU, *supra* note 141, at 18 (citing *ASIC v Ingleby* (2012) 91 ACSR 66 (Austl.); *ASIC v Lindberg* (2012) 91 ACSR 640 (Austl.); *Shafron v ASIC* (2012) 286 ALR 612 (Austl.)).

154. Canada Business Corporations Act, R.S.C. 1985, c. C-44 s 122(1).

155. People's Dep't Stores Inc. v. Wise, [2004] 3 S.C.R. 461, 491–92 (Can.); BCE Inc. v. 1976 Debentureholders, [2008] 3 S.C.R 560, paras. 36–38 (Can.).

156. [2004] 3 S.C.R. at 491–92.

157. Janis Sarra, *Fiduciary Obligations in Business and Investment: Implications of Climate Change* 17 (Commonwealth Climate & L. Initiative Working Paper Series, 2018), https://commons.allard.ubc.ca/cgi/viewcontent.cgi?article=1483&context=fac_pubs.

within a range of reasonableness, courts should not substitute their own opinion, even if the reasonableness of the decision is challenged in hindsight.[158]

The standard of care in the United Kingdom also focuses on the reasonableness of the decisionmaking process. The duty of competence and attentiveness (or care, skill, and diligence) does not require a commercially advantageous financial outcome, but a robust decisionmaking process.[159] The decisionmaking process must include awareness and oversight of compliance with relevant regulations.[160]

B. PROCEDURAL HURDLES IN AUSTRALIA, CANADA, AND THE UNITED KINGDOM

In addition to lower standards of liability, the other common law countries also have lower procedural barriers to lawsuits against directors than Delaware. They have arguably less onerous derivative lawsuit requirements, they apply the business judgment rule less aggressively, and they prohibit exculpation of directors.[161] That said, the risk of directors being sued for damages is extremely low, at least in Canada and the United Kingdom.[162] One reason for this may be that shareholders in other common law countries have significantly greater power over corporate affairs than shareholders in Delaware.[163] Another reason may be alternative hurdles to shareholder lawsuits that have proven effective: prohibition of class actions and contingency fees, and the implementation of a "loser pays" system in Canada and the United Kingdom.[164]

1. Derivative Lawsuit Requirements

In Australia, Canada, and the United Kingdom, shareholders must obtain court permission to bring a derivative lawsuit to enforce directors' duties, but courts do not require an inquiry into whether the directors can be trusted to

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158. CCLI CA, *supra* note 141, at 12.

159. *See, e.g.*, Re Cont'l Assurance Co. of London PLC [2007] 2 BCLC 287, [399] (Eng.)

160. Brumder v. Motornet Serv. & Repairs Ltd. [2013] EWCA (Civ) 195 (Eng.) (holding that failure to be aware of obligations of car garage company under health and safety regulations led to liability).

161. *See* sources cited *supra* note 142.

162. Directors of UK public companies have virtually no risk of being sued for damages for breach of their duties as directors. John Armour, Bernard Black, Brian Cheffins & Richard Nolan, *Private Enforcement of Corporate Law: An Empirical Comparison of the United Kingdom and the United States*, 6 J. EMPIRICAL LEGAL STUD. 687, 690 (2009) ("[C]hances of a director of a publicly traded U.K. company being sued under corporate law are virtually nil.").

163. Shareholders have significantly greater power under the corporation laws of Australia, Canada, and the United Kingdom to call special meetings, remove directors, and unilaterally amend corporate charters, than shareholders of Delaware corporations. These shareholder powers may substitute, to some extent, for active enforcement of directors' duties. *See generally* CHRISTOPHER M. BRUNER, CORPORATE GOVERNANCE IN THE COMMON-LAW WORLD: THE POLITICAL FOUNDATIONS OF SHAREHOLDER POWER (Cambridge Univ. Press 2013).

164. Armour et. al., *supra* note 162, at 692; Hill & Conaglen, *supra* note 8, at 313.

consider the suit themselves.[165] In Australia, shareholders must prove only that the lawsuit is brought in good faith and is in the best interests of the company.[166]

In Canada, judges have discretion, where it is in the best interest of the corporation, to grant shareholders (and other aggrieved parties) leave to sue directors derivatively on a company's behalf.[167] A proper complainant includes "any person who, in the discretion of the court, is a proper person to make an application."[168] This could include stakeholders, in addition to shareholders, if, for example, the survival of a corporation affects the economic security of a community (e.g., one-industry towns).[169]

In the United Kingdom, derivative claims are governed by the Companies Act 2006.[170] UK courts consider whether the lawsuit has been brought in good faith and whether a person fulfilling the directors' duty to act in the best interests of the corporation would bring the lawsuit.[171] This will often boil down to a question of whether it is in the financial interest of the company to bring the claim, which will depend on the size of the alleged loss due to the breach.[172]

2. Application of Business Judgment Review

Australian courts were traditionally reluctant to secondguess the merits of directors' decisions.[173] However, as noted above, Australian courts began to adopt a stricter stance toward directors' duty of care following financial scandals in the late 1990s.[174] In 2000, in partial response to the *AWA Appeal* decision, the Australian Parliament adopted a new statutory defense with components similar to Delaware's business judgment rule.[175] However, unlike Delaware's judicial rule, the Australian statute does not operate as a rebuttable presumption.[176] Australian courts have decided that the terms of the statute impose the burden of

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165. *See* CCLI AU, *supra* note 141, at 48–50; CCLI CA, *supra* note 141, at 27; CCLI UK, *supra* note 141, at 12.

166. CCLI AU, *supra* note 141, at 48–50.

167. Canada Business Corporations Act, R.S.C. 1985, c C-44, s 239.

168. *Id.* s 238(d) (defining a complaintant as including "any person who, in the discretion of the court, is a proper person to make an application" under the statute).

169. CCLI CA, *supra* note 141, at 12.

170. Companies Act 2006, c. 46, §§ 260–263 (UK).

171. CCLI UK, *supra* note 141, at 12.

172. *Id.*

173. Hill & Conaglen, *supra* note 8, at 325 (citing *Harlowe's Nominees Pty Ltd. v. Woodside (Lakes Entrance) Oil Co.* (1968) 121 CLR 483, 493 (Austl.)).

174. *Id.* at 322–23; Mark Byrne, *Directors To Hide from a Sea of Liabilities in a New Safe Harbour*, 22 AUST. J. CORP. L. 255, 258 (2008).

175. Hill & Conaglen, *supra* note 8, at 325. The statutory business judgment rule, section 180(2) of the Corporations Act, was modeled on the American Law Institute's description of the business judgment rule. *Id.* at 325–26 (citing PRINCIPLES OF CORPORATE GOVERNANCE § 4.01 (AM. LAW INST. 1994)). Under the statute, a director establishes compliance with the duty of care if the director (1) acts with good faith for a proper purpose, (2) does not have a material personal interest in the matter (i.e., the director is disinterested), (3) is adequately informed, and (4) rationally believes the decision is in the best interests of the corporation. *Corporations Act 2001* (Cth), ch 2D div 1 s 180(2)(a)–(d) (Austl.).

176. *See Corporations Act 2001* (Cth), ch 2D div 1 s 180(2) (Austl.).

proof on director defendants, rather than operating as a presumption that must be rebutted by shareholder plaintiffs.[177] Thus, they have applied the rule as a defense to a finding of due care violations that must be proven by defendant directors. In practice, the defense has been unsuccessful in nearly all cases where a violation has been found.[178]

Canada has a common law business judgment rule that accords deference to board decisions. It provides that directors will not be held liable for a breach of the duty of due care and diligence where they have actively exercised their judgment (rather than omitting consideration of the relevant issue), otherwise acted honestly and free from any material conflict of interest, were reasonably informed, and can demonstrate they held a rational belief that their conduct was in the best interests of the company, or within a range of reasonable available options.[179] However, because this standard only applies when the director's action is within a range of reasonableness, judges retain considerable discretion to review board decisions.[180]

The business judgment rule is an "alien concept" under UK law.[181] However, UK courts have traditionally been reluctant to hold directors liable for honest mistakes of judgment,[182] and recent UK cases have retained a noninterventionist approach, so the result is similar to the application of the business judgment rule by Delaware courts.[183]

3. *Prohibition of Exculpation*

In the early twentieth century, Australian and UK companies could and often did include exculpatory clauses in their charters without statutory authorization.[184] Such provisions appear to have been common in the charters of

177. *See, e.g.*, *ASIC v Rich* (2009) 75 ACSR 1, ¶ 7269 (Austl.). Subsequent cases have concurred with the *ASIC v Rich* judgment. *See e.g.*, *ASIC v Fortescue Metals Grp. Ltd.* (2011) 274 ALR 731, ¶ 197 (Austl.).

178. *See, e.g.*, *ASIC v Rich* (2009) 75 ACSR 1, ¶ 2721 (Austl.); *ASIC v Mariner Corp. Ltd*. (2015) 327 ALR 95, ¶ 495 (Austl.); *see also* Jenifer Varzaly, *Protecting the Authority of Directors: An Empirical Analysis of the Statutory Business Judgment Rule*, 12 J. CORP. L. STUD. 429, 458 (2012) (noting that the BJR did not provide an effective defense in any of the fourteen cases alleging breach of the duty of care brought against directors in Australia from 2000 to 2012).

179. BCE Inc. v. 1976 Debentureholders, [2008] 3 S.C.R 560, paras 36–38 (Can.); People's Dep't Stores Ltd. v. Wise, [2004] 3 S.C.R. 461, 491–92 (Can.).

180. *See* CCLI CA, note 141, at 32; Sarra, *supra* note 157, at 10, 33.

181. Hill & Conaglen, *supra* note 8, at 325.

182. Mullholland et. al., *supra* note 55, at 349 ("Although there is no express business judgment rule in the UK, in practice courts are reluctant to intervene where a director has acted in good faith." (citing Howard Smith Ltd. v Ampol Petrol. Ltd. [1974] AC 82 (PC)).

183. Hill & Conaglen, *supra* note 8, at 325. UK courts justify a noninterventionist stance on the grounds of avoiding hindsight bias. *Id*. (citing Regentcrest PLC v. Cohen [2001] BCC 494, [127]; Re Sherborne Assocs. Ltd. [1995] BCC 40, [50]; Re Brian D. Pierson (Contractors) Ltd. [1999] BCC 25, [50]; *see also* Re Cont'l Assurance Co. of London PLC [2007] 2 BCLC 287, [399]).

184. Hill & Conaglen, *supra* note 8, at 328. The only restriction in UK common law was that directors could not be indemnified against liability for fraud. IAN AUSTIN & BOB RAMSAY, PRINCIPLES OF CORPORATIONS LAW ch. 8.400 (16th ed. 2015).

UK companies in the early twentieth century.[185] Following review by a government commission, in 1928 the United Kingdom passed a law prohibiting exculpation of directors from liability for breaches of their fiduciary duties, including for negligence.[186] The government commission drafting the law stated:

> We consider that this type of article gives a quite unjustifiable protection to directors. Under it a director may with impunity be guilty of the grossest negligence provided that he does not consciously do anything which he recognizes to be improper.[187]

Thus, unlike their Delaware counterparts, UK companies cannot exculpate their directors for breaches of the duty of care.

The modern Australian Corporations Act prohibits both exculpation and indemnification of directors.[188] Furthermore, shareholders cannot ratify a breach of directors' statutory duties.[189] Canada similarly prohibits firms incorporated under its federal corporations law from including exculpation provisions in their corporate charters, but permits indemnification and insurance.[190]

4. *Public Enforcement in Australia*

Like Delaware, Canada and the United Kingdom rely primarily on private enforcement of directors' duties.[191] Unlike other common law jurisdictions, Australia has a public enforcement mechanism to enforce the duties of directors of public companies.[192] In 1993, Australia adopted a statutory civil-penalty regime to complement its United Kingdom–like private enforcement model.[193] Reckless or intentionally dishonest violations may be prosecuted criminally.[194] Scholars have called for the adoption of a public mechanism to enforce directors'

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185. Hill & Conaglen, *supra* note 8, at 328 (citing BOARD OF TRADE, REPORT OF THE COMPANY LAW AMENDMENT COMMITTEE 1925-1926, 1926, [Cmd.] 2657, at 46 (UK)).

186. Companies Act 1928, 18 & 19 Geo. 5 c. 45, s. 78(1) (UK). The modern version of the law states: "[A]ny provision that purports to exempt a director (to any extent) from any liability that would otherwise attach to him in connection with any negligence, default, breach of duty or breach of trust in relation to the company is void." Companies Act 2006, c. 46, § 232(1) (UK).

187. BOARD OF TRADE, REPORT OF THE COMPANY LAW AMENDMENT COMMITTEE 1925-1926, 1926, [Cmd.] 2657, at 46 (UK)).

188. The Australian Corporations Act states:

> A company . . . must not exempt a person . . . from a liability to the company incurred as an officer or auditor of the company. . . . Anything that purports to indemnify or insure a person against a liability, or exempt them from liability, is void to the extent that it contravenes section 199A . . . ."

Corporations Act 2001 (Cth), ch 2D.2 div 1 ss 199A–199C (Austl.).

189. Hill & Conaglen, *supra* note 8, at 315.

190. Canada Business Corporations Act, R.S.C. 1985, c. C-11, s. 122(3); Brian R. Cheffins & Bernard S. Black, *Outside Director Liability Across Countries*, 84 TEX. L. REV. 1385, 1443, 1447–48 (2006).

191. Hill & Conaglen, *supra* note 8, at 312–13; Cheffins & Black, *supra* note 190, at 1444; William Kaplan & Bruce Elwood, *The Derivative Action: A Shareholder's "Bleak House"?*, 36 U. BRIT. COLUM. L. REV. 443, 464–68 (2003).

192. Hill & Conaglen, *supra* note 8, at 312.

193. *Id.* at 314.

194. *Id.*

duties in the United Kingdom[195] and the United States,[196] but neither Parliament, Congress, nor the states have adopted such a system.

Australian courts have concluded that there is a public interest in enforcing the duties of directors.[197] The majority of civil penalty applications brought by ASIC relate to the statutory duty of care under section 180(1) of the Corporations Act.[198] ASIC has had a high rate of success in its civil-penalty duty of care cases against corporate directors.[199] Data on ASIC's choice of civil penalties for violations of fiduciary duties by directors—focused primarily on pecuniary penalties and disqualification orders—suggest that the government's primary enforcement objective is to achieve "maximum voluntary compliance" rather than to obtain compensation for shareholder losses.[200]

Criminal enforcement of directors' duties was more prevalent than civil enforcement from 2005 to 2014.[201] Criminal enforcement was responsible in 81% of the matters in which liability was established and covered 61% of defendants found liable.[202] Prison sentences and disqualification orders each accounted for one-third of the penalties issued, while 18% of sanctions were civil pecuniary fines, and only 2% were criminal fines.[203] The fines were generally much lower than the maximum $200,000 penalty, with the median financial penalty for one breach being $25,000.[204] The government established liability in 88% of civil, and 89% of criminal, cases.[205]

195. *See* Andrew Keay, *The Public Enforcement of Directors' Duties: A Normative Inquiry*, 43 COMMON L. WORLD REV. 89, 118 (2014) (arguing that the United Kingdom should adopt a public enforcement regime given that private enforcement is effectively nonexistent). *See generally* Andrew Keay & Michelle Welsh, *Enforcing Breaches of Directors' Duties by a Public Body and Antipodean Experiences*, 15 J. CORP. L. STUD. 255 (2015) (arguing that the United Kingdom should adopt a public civil enforcement regime for directors' duties).

196. Renee M. Jones & Michelle Welsh, *Toward a Public Enforcement Model for Directors' Duty of Oversight*, 45 VAND. J. TRANSNAT'L L. 343, 403 (2012).

197. *ASIC v Cassimatis* (2016) 336 ALR 209 (Austl.).

198. Hill & Conaglen, *supra* note 8, at 324.

199. Keay & Welsh, *supra* note 195, at 269–74 (noting that ASIC has successfully brought both disqualification and pecuniary penalty proceedings in numerous cases); Jasper Hedges & Ian Ramsay, *Has the Introduction of Civil Penalties Increased the Speed and Success Rate of Directors' Duties Cases?*, 34 COMP. & SEC. L.J. 549, 552–53 (2016); Michelle Welsh, *Realising the Public Potential of Corporate Law: Twenty Years of Civil Penalty Enforcement in Australia*, 42 FED. L. REV. 217, 233–34 (2014); Greg Golding, *Tightening the Screws on Directors: Care, Delegation and Reliance*, 35 U. NEW S. WALES L.J. 226, 273–74, 287–89 (2012).

200. Hill & Conaglen, *supra* note 8, at 315.

201. Jasper Hedges, Helen Bird, George Gilligan, Andrew Godwin & Ian Ramsay, *An Empirical Analysis of Public Enforcement of Directors' Duties in Australia: Preliminary Findings* 2, 18 (Ctr. for Int'l Fin. & Regul., Working Paper No. 105, 2016).

202. *Id.* at 2.

203. *Id.*

204. *Id.*

205. *Id.*

C. Climate Risks and Duties in Australia, Canada, and the United Kingdom

The differences in the standards of liability for director oversight of enterprise risks between Delaware and the common law countries described above make themselves felt when leading lawyers articulate directors' duties with respect to climate risks. In striking contrast with the understated opinion of Debevoise described in Part II.C, leading lawyers in Australia, Canada, and the United Kingdom have all opined that directors of companies in those countries could be liable for inadequate oversight of climate risks.

One of the leading barristers in Australia opined in 2016 that Australian courts will consider whether a director *should have known* of danger to the corporation from climate change, assessed against the standard of a reasonable person, by reference to the prevailing state of knowledge publicized at the time.[206] Moreover, he concluded that

> [i]t is likely to be only a matter of time before we see litigation against a director who has failed to perceive, disclose or take steps in relation to a foreseeable climate-related risk that can be demonstrated to have caused harm to a company (including, perhaps, reputational harm).[207]

One of the leading corporate governance experts in Canada, Carol Hansell,[208] delivered an opinion on the obligations of directors of Canadian corporations in June 2020.[209] Hansell opined that directors "must inform themselves of the risk that climate change poses to the corporation and how that risk is being managed," and should "be satisfied that the corporation is addressing climate change risk appropriately" by directing management to prepare reports on such risks and considering reports from external sources as necessary.[210] She also noted that "well-publicized socio-economic implications

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206. Noel Hutley SC & Sebastian Hartford-Davis, Ctr. for Pol'y Dev. & the Future Bus. Council, Memorandum of Opinion: Climate Change and Directors' Duties ¶ 51 (2016).

207. *Id.* In March 2019, Hutley and Hartford-Davis supplemented their 2016 opinion with an additional opinion that a "profound and accelerating shift in the way that Australian regulators, firms and the public perceive climate risk . . . elevated the standard of care that would be expected of a reasonable director" in discharging their duty of care. Additionally, it would be "increasingly difficult . . . for directors of companies of scale to pretend that climate change will *not* intersect with the interests of their firms," as a result of which exposure of individual directors to liability was increasing exponentially. Noel Hutley SC & Sebastian Hartford-Davis, Supplementary Memorandum of Opinion: Climate Change and Directors' Duties ¶ 4 (2019).

208. Hansell was previously Chair of the Province of Ontario's Business Law Advisory Committee and Chair of the Corporate Governance Committee of the Section of Business Law of the American Bar Association. *Carol Hansell, Senior Partner*, Hansell McLaughlin Advisory Grp., https://www.hanselladvisory.com/team-member/carol-hansell/ (last visited Apr. 1, 2023).

209. Hansell LLP, Putting Climate Change Risk on the Boardroom Table 1 (2020), https://www.hanselladvisory.com/content/uploads/Climate-Change-Risk-on-the-Boardroom-Table-00094165xD4A96.pdf.

210. *Id*. at 22, 24. Hansell also noted that Canadian courts have taken judicial notice of the existence of climate change and its impact, so that litigants would not have to prove that climate change risk exists. *Id.* at 6. Hansell cited *Reference re Greenhouse Gas Pollution Pricing Act*, [2019] 436 D.L.R. 1 (Can. Ont. C.A.);

of climate change risk support the argument that a reasonably prudent person in circumstances comparable to those facing directors today would address the climate change risk facing the corporation and its business."[211]

Finally, one of the justices of the UK Supreme Court noted in a speech in 2019 that general fiduciary and duty of care obligations may require directors to consider climate-related risks and to make efforts to reduce the contributions of their corporations to climate change.[212] Similarly, in 2019, the Bank of England, Financial Conduct Authority, and Financial Reporting Council issued a joint statement urging corporate directors to consider climate change risks to their companies. They called climate change "one of the defining issues of our time," and urged companies to "consider the likely consequence of climate change on their business decisions, in addition to meeting their responsibility to consider the company's impact on the environment."[213]

IV. INCLUDING CLIMATE RISK IN *CAREMARK*

As noted in Part I.C and I.D, American directors, collectively, are paying significantly less attention to the climate risks to their corporations than their Australian and Canadian counterparts. As described in Parts II and III, Delaware directors are subject to very different standards of liability and enforcement with respect to their oversight duties than their brethren in Australia, Canada, and the United Kingdom. Those differences have led to strikingly different opinions from leading lawyers in those jurisdictions regarding the prospects of director liability for failure to monitor climate risks to their corporations. While correlation is not equivalent to causation, it seems reasonable to infer that *Caremark* has failed to encourage Delaware directors to be sufficiently attentive to one of the greatest risks of harm to their corporations in the twenty-first century.[214] That is unlikely to change unless the Delaware judiciary clearly recognizes oversight responsibility for climate risks as falling under its *Caremark* jurisprudence. If Delaware courts do not take steps to do so, they may produce pressure for more federal regulation of corporate governance, such as

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Reference re Greenhouse Gas Pollution Pricing Act, [2019] 440 D.L.R. 398 (Can. Sask. C.A.); and *Reference re Greenhouse Gas Pollution Pricing Act*, [2020] 455 D.L.R. 1 (Can. Alta. C.A.), in which various provincial courts of appeals took different positions on the ability of the Canadian federal government to regulate GHGs, but all agreed on the risks created by climate change. The Supreme Court of Canada found the legislation constitutional in April 2021. Reference re Greenhouse Gas Pollution Pricing Act, [2021] S.C.C. 11 (Can.).

211. HANSELL LLP, *supra* note 209, at 14.

212. Lord Sales, Just. of the Sup. Ct., Directors' Duties and Climate Change: Keeping Pace with Environmental Challenges (unpublished manuscript) (Aug. 27 2019) (on file with author).

213. Press Release, Bank of England, Financial Conduct Auth., Fin. Reporting Council & the Pensions Regul., Joint Statement on Climate Change (July 2, 2019).

214. From the shareholder's perspective, it matters not whether material harm to the corporation is caused by directors' failure to monitor compliance with the law or directors' failure to monitor other operational risks. The harm to the corporation is the same. The only difference is that the corporation is not allowed to break the law, but it is allowed to ignore risks to itself. But from the shareholder's perspective, that is a difference without meaning.

establishing an SEC or stock exchange requirement for risk management committees at the board level.[215]

There are at least three ways Delaware courts could clarify their *Caremark* jurisprudence to improve directors' incentives to be attentive to climate risks: First, they could confirm that *Caremark* applies to compliance with laws that already require attention to climate risks. Second, they could clarify that *Caremark* applies to failures to monitor significant risks to the business other than legal compliance risks. Third, they could reconfirm that the duty to monitor is, after all, a matter of the duty of care, subject to a gross negligence standard of liability, and that only the most egregious failures to monitor—those involving a knowing failure to satisfy the duty of care—establish nonexculpable breaches of the duty of loyalty. Part IV discusses each of these options. First, however, it is important to discuss how judicial signals impact directors' incentives and behavior.

A. Director Incentives and Judicial Signals

As discussed in Part III.B.4, the prospect of liability for breaching the duty of care is not insignificant in Australia. However, the difference in director attention to climate risks in the United States and other common law countries is not necessarily a story about deterrence or nudging through liability. Despite differences in the standards of conduct and liability for directors, historically, the likelihood of out-of-pocket liability for directors in Australia, Canada, and the United Kingdom, as well as Delaware, has uniformly been exceedingly low.[216] Various procedural rules either discourage litigation altogether or make it difficult to have the merits of claims considered, while indemnification or insurance often covers costs when a breach is found on the merits. But deterrence cannot be measured only by sanctions imposed after trial.[217] Paying settlements following the failure of a motion to dismiss and making efforts ex ante to avoid the risks and costs of litigation are important incentives for better fiduciary behavior.[218]

215. *See, e.g.*, William B. Chandler III & Leo E. Strine, Jr., *The New Federalism of the American Corporate Governance System: Preliminary Reflections of Two Residents of One Small State*, 152 U. PA. L. REV. 953, 1005 (2003). However, Delaware courts are also stuck in a delicate balancing act between encouraging companies to incorporate elsewhere if they invite too much litigation and losing their status as the preferred venue for corporate litigation if they establish litigation rules that are too strict. John Armour, Bernard Black & Brian Cheffins, *Delaware's Balancing Act*, 87 IND. L.J. 1345, 1348 (2012).

216. Cheffins & Black, *supra* note 190; Bernard Black, Brian Cheffins & Michael Klausner, *Outside Director Liability*, 58 STAN. L. REV. 1055, 1074–75 (2006); John Armour, Bernard Black, Brian Cheffins & Richard Nolan, *Private Enforcement of Corporate Law: An Empirical Comparison of the United Kingdom and the United States*, 6 J. EMP. LEGAL STUD. 687, 701, 709–10 (2009). As noted in Part III.B.4, however, in more recent years financial penalties have been levied on corporate directors in Australia in several cases through public enforcement of fiduciary duties.

217. Shapira, *supra* note 10, at 1861 ("[D]eterrence cannot be measured solely on the basis of sanctions imposed in verdicts coming after full trial.").

218. *Id.* ("Corporate law's impact on oversight rather comes from paying settlements ex post and, pertinently, planning how to avoid the risks and costs of litigation ex ante."); *id.* at 1880–81.

More importantly, directors are influenced not only by financial concerns, but also by intangible interests, such as their reputations. Reputation is an important incentive for corporate directors and an important aspect of how directors' duty incentives actually operate. Litigation can be a very useful signal for reputation purposes, in addition to financial interests.[219] Directors may be influenced by the emotional and reputational costs that legal standards permitting litigation against them create.[220] They prefer to avoid the distraction and potential reputational harm of being sued for breaches of their duties, much less a finding of fault, even if they do not have to pay damages themselves.[221] Allen, Jacobs, and Strine acknowledge that directors are concerned about their reputations and are likely to act in a manner so as to avoid having their actions enjoined by a court, even if they are not subject to monetary damages.[222]

Litigation is an important means of revealing and diffusing information about corporate wrongdoing that can affect director incentives.[223] Directors are inclined to follow the standards established by courts and communicated to them by law firms, and Delaware courts are aware of their role in guiding director conduct.[224] An important function of Delaware jurisprudence is to "nudge" Delaware fiduciaries toward better behavior and best practices through narratives of good and bad behavior, even in the absence of sanctions.[225] Directors' behavior is also affected by input from lawyers and concerns about reputation and stress,[226] including concerns about the emotional and reputational costs of being sued for nonfeasance.[227]

The process of litigation can produce unflattering information about the actions or inactions of executives that can adversely affect their reputations (and

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219. ROY SHAPIRA, LAW AND REPUTATION: HOW THE LEGAL SYSTEM SHAPES BEHAVIOR BY PRODUCING INFORMATION (Cambridge Univ. Press 2020) [hereinafter SHAPIRA, LAW AND REPUTATION]; Roy Shapira, *A Reputational Theory of Corporate Law*, 26 STAN. L. & POL'Y REV. 1, 1 (2015) [hereinafter Shapira, *Reputational Theory*].

220. Shapira, *supra* note 10, at 1861 ("[Law can also impose] (uninsurable) non-legal costs, such as emotional costs (stress, embarrassment) and reputational costs (having details about your misbehavior dug out and made public for all market participants to see)."); *see also* Donald C. Langevoort, *The Human Nature of Corporate Boards: Law, Norms, and the Unintended Consequences of Independence and Accountability*, 89 GEO. L.J. 797, 823 (2001).

221. *See* Langevoort, *supra* note 220, at 819; Shapira, *supra* note 10, at 1881.

222. Allen, Jacobs & Strine, *supra* note 85, at 451 n.10 ("Directors are reputationally sensitive and likely will try to avoid making decisions that could be enjoined by a court . . . . It is commonsensical to think that directors of public companies will likewise be disquieted at the prospect of reading in the *Wall Street Journal* that a court has enjoined their actions as imprudent.").

223. *Id.*; *cf.* SHAPIRA, LAW AND REPUTATION, *supra* note 219, at 35–74.

224. Edward B. Rock, *Saints and Sinners: How Does Delaware Corporate Law Work?*, 44 UCLA L. REV. 1009, 1017 (1997).

225. *Id.*; *see also* Margaret M. Blair & Lynn A. Stout, *Trust, Trustworthiness, and the Behavioral Foundations of Corporate Law*, 149 U. PA. L. REV. 1735, 1735 (2001).

226. Shapira, *supra* note 10, at 1861 ("Part of the law's effect on behavior comes from the memos that legal advisors send their clients, explaining how they should behave going forward.").

227. *Id.* ("Another part of the law's effect on behavior comes from imposing (uninsurable) non-legal costs, such as emotional costs (stress, embarrassment) and reputational costs (having details about your misbehavior dug out and made public for all other market participants to see).").

therefore, their personal value) in the market.[228] Reputational sanctions include "the aggregate of diminished business opportunities" for "violating market norms."[229] *Caremark* actions are particularly susceptible to reputational consequences.[230] Stakeholders may be less willing to do business with defendant directors or companies who have been subject to judicial scolding.[231] In order to impact reputational preferences, however, cases must receive some third-party adjudication as a signal of the veracity of the adverse reputational claims against the alleged wrongdoer. When judges dismiss cases for failure to state a claim, as Delaware judges currently do in *Caremark* cases alleging failure to monitor business risks with no legal compliance breaches, they eliminate the possibility of imposing reputational costs upon directors' oversight failures. Thus, it is important for the Delaware judiciary to recognize a *Caremark* oversight duty with respect to climate risks, which can cause catastrophic corporate losses if they are not properly monitored.

B. Climate Risk and Legal Compliance

Since the 2019 *Marchand* decision and subsequent Chancery Court decisions rejecting motions to dismiss *Caremark* claims, former Delaware Supreme Court justices, practitioners, and scholars have hailed the *Caremark* decision as a "dynamic driver of modern day oversight and compliance requirements."[232] Some have suggested that to fully comply with their *Caremark* obligations, boards should also monitor ESG risks.[233] However, this usually assumes that ESG risks are covered by legal compliance obligations. Strine, Smith, and Steel argue that the ESG issues most salient to a company are likely to be similar to the legal regimes (or legal compliance issues) most salient to the company.[234] Certainly, some positive law obligations, such as workplace safety rules and obligations to protect customer information, may require corporations to be cognizant of how climate risks, such as physical risks arising from natural disasters, can make their compliance obligations more difficult to satisfy.[235] There will be substantial risks, however, that will not implicate existing regulatory obligations.

228. Shapira, *Reputational Theory*, *supra* note 219, at 3.

229. Shapira, *supra* note 10, at 1884. Shapira contends that in order for reputational sanctions to be meaningful, damning information must be widely diffused, credible, and attributed to deep-seated problems in the company that may resurface in the future. *Caremark* investigations are meaningful because they reveal information about "who knew what when," which the reputation literature considers "highly indicative of [a] company's future behavior." *Id.* at 1886.

230. Claire A. Hill, Caremark *as Soft Law*, 90 TEMP. L. REV. 681, 688 (2019) (stating that legal and reputational sanctions affect each other in the context of *Caremark* cases).

231. Shapira, *supra* note 10, at 1887–88.

232. Veasey & Holland, *supra* note 22, at 1.

233. *Id.* at 15 (citing Strine, Smith, and Steel for the idea that the board's oversight responsibilities require it to establish and monitor programs relating to ESG matters).

234. Strine et al., *supra* note 22, at 1909.

235. Susan S. Kuo & Benjamin Means, *Climate Change Compliance*, 28 IOWA L. REV. 2135, 2136 (2022).

Cynthia Williams argues that, at least as to public reporting companies, the SEC's disclosure requirements establish a legal obligation for directors of such companies to establish systems to gather and report information on climate risks.[236] Williams notes that under Regulation S-K, which establishes the line-item disclosure obligations of public companies in connection with annual reports and offerings of securities, companies are required to disclose material risks to the corporation.[237] The SEC has issued guidance noting that climate risks material to a company's financial condition or results of operations must be disclosed.[238] The directors of public companies arguably have an obligation to at least consider whether it is necessary to establish an information and reporting system with respect to climate risks in order to determine whether such risks are material, and therefore reportable by the company. The initial decision as to whether climate risks present material risks to a company is at the discretion of the company's management. Such internal materiality judgments, however, are ultimately reviewable by courts in connection with securities fraud litigation under the *Basic, Inc. v. Levinson* standard, which considers whether the information would be deemed significant to a voting or investing decision of a reasonable investor.[239]

The problem with relying on securities disclosure requirements as a source of legal compliance under *Caremark* is that such requirements could be used as a justification for requiring establishment of information and reporting systems with respect to any and all matters that potentially create a material risk to the company. Perhaps that is precisely how the oversight obligations of *Caremark* should be read. However, the cases in which the Delaware courts have so far acknowledged an obligation to establish information and reporting systems have been limited to cases in which such systems are necessary to track compliance with proscriptive legal restrictions. Recognizing a *Caremark* obligation with respect to complying with public company disclosure requirements would extend the obligation to a potentially expansive universe of positive legal obligations.

C. APPLYING *CAREMARK* TO NONCOMPLIANCE RISKS

Delaware courts could also increase director attentiveness to climate risks by clarifying that the *Caremark* obligations to establish and monitor corporate information and reporting systems apply to noncompliance enterprise risks as well as compliance risks. While the salience of legal compliance in the *Caremark* oversight standard is understandable given that corporations are

236. Williams, *supra* note 21, at 1893.
237. *Id*. at 1911.
238. SEC Commission Guidance Regarding Disclosure Related to Climate Change, 17 C.F.R. pts. 211, 231, 241 (2010).
239. Basic, Inc. v. Levinson, 485 U.S. 224, 224 (1988).

required to follow the law,[240] the failure to manage certain enterprise risks, such as climate risks, could lead to more significant economic harm to the corporation than legal compliance failures.[241] Furthermore, as Stephen Bainbridge has noted, there is "no doctrinal [or policy] reason that *Caremark* claims should not lie in cases in which the corporation suffered losses, not due to a failure to comply with applicable laws, but rather due to lax risk management."[242] Bainbridge cogently argues that "[t]he necessity for the board to ensure that it is provided with sufficient information to carry out its obligations . . . seems just as relevant to risk management as to legal and accounting compliance."[243]

In fact, expanding *Caremark* to cover climate risks and other material ESG risks is consistent with one of the central arguments of the *Caremark* case. In *Caremark*, Chancellor Allen argued that standards for legal compliance systems, government expectations, and the responsibility of directors for such systems had evolved since the *Graham v. Allis-Chalmers* decision was decided in the 1960s. Similarly, since the *Caremark* decision, standards for enterprise risk management have evolved to require more involvement from directors.[244] The most recent iterations of the leading enterprise risk management frameworks, such as the COSO Enterprise Risk Management Framework, have incorporated the management of ESG risks into their frameworks.[245] The American Bar Association's Corporate Director's Guidebook advises that "[r]isk management and legal compliance are critical components of the board's responsibility for oversight of the corporation's business and affairs," giving risk management equal footing with legal compliance among the board's responsibilities.[246] Despite these expert judgements regarding the importance of risk oversight, less than half of the companies participating in the NACD's annual survey have a board committee responsible for supervising enterprise risks; of those that do, two-thirds make enterprise risk one of the responsibilities of the audit

240. A fundamental principle of Delaware law is that corporations are to engage only in lawful activity. DEL. CODE ANN. tit. 8, § 101(b) (2023). *See generally* Elizabeth Pollman, *Corporate Disobedience*, 68 DUKE L.J. 709 (2019).

241. The PG&E experience is one salient example. *See supra* notes 1–2 and accompanying text.

242. Bainbridge, *Enterprise Risk Management*, *supra* note 22, at 968. In fact, as Bainbridge notes, the *Caremark* opinion suggests directors should establish information systems to monitor business matters as well as legal compliance. *Id*. (citing *In re* Caremark Int'l Inc. Derivative Litig., 698 A.2d 959, 970 (Del. Ch. 1996)).

243. *Id.* at 980. On the other hand, Bainbridge states that legal compliance and risk management are sufficiently different "in degree" that Delaware courts should apply a stricter standard of liability to risk management failures than to legal compliance failures. *Id.* at 986 ("[C]ourts should be especially willing to accept any board effort to supervise risk management as adequate to satisfy their *Caremark* obligations.").

244. Betty Simkins & Steven A. Ramirez, *Enterprise-Wide Risk Management and Corporate Governance*, 39 LOY. U. CHI. L.J. 571, 577–86 (2008) (describing the history of business risk management and the development of the enterprise risk management concept).

245. COMM. OF SPONSORING ORGS. OF THE TREADWAY COMM'N & WORLD BUS. COUNCIL FOR SUSTAINABLE DEV., ENTERPRISE RISK MANAGEMENT: APPLYING ENTERPRISE RISK MANAGEMENT TO ENVIRONMENTAL, SOCIAL AND GOVERNANCE-RELATED RISKS, EXECUTIVE SUMMARY 10 (2018).

246. ABA BUS. L. SECTION, CORPORATE DIRECTOR'S GUIDEBOOK 35 (7th ed. 2020).

committee, which is typically busy reviewing financial reporting matters.[247] Strine, Smith, and Steel argue that most boards of directors should have a risk management, compliance, and EESG committee.[248]

One reason to increase the incentives for directors to manage climate risks is that they are difficult to manage, so directors may otherwise ignore or seek to avoid them. Evaluating low-probability but high-impact risks, such as climate-induced natural disasters, is challenging because the outcomes associated with those risks do not follow a normal distribution of risks.[249] The distributions for such risks are typically described as being long-tailed, meaning that there are a large number of potentially high-intensity risks that have increasingly attenuated probabilities of occurring, or fat-tailed, meaning that there is a higher-than-normal likelihood of certain low-probability but high-intensity risks occurring.[250] There is evidence that uncertainties associated with risks characterized by fat- and long-tailed distributions has led to lax and undisciplined management of the risks, making them undermanaged.[251]

The chief challenge to including risk management monitoring in *Caremark*'s oversight standard is the close relationship between risk management, risk-taking, and business judgment.[252] As discussed in Part II.B.1.d, the *Citigroup* case expressed concerns about eviscerating the business judgment rule if directors could be liable for inadequate consideration of business risks. Concurring with the concerns Chancellor Chandler aired in his *Citigroup* opinion, Stephen Bainbridge and Robert T. Miller argue that decisions about the nature, scope, and content of risk management systems are inherently business judgments tied to a company's appetite for risk.[253] Substantive review of those choices would involve courts in secondguessing business judgments that should be protected by the business judgment rule.[254] But these concerns are overly cautious. Fundamentally, the application of *Caremark* oversight liability to business risks is more a question of whether directors have gathered adequate

247. On the other hand, few boards in the United States have a committee dedicated to reviewing enterprise risks. *See* NAT'L ASS'N OF CORP. DIRS., *supra* note 71, at 18 (reporting that only 16% of boards locate risk management in a risk committee, while 31% of boards locate enterprise risk management in the audit committee, and 51% of boards report that the full board is responsible for risk management); *id.* at 25 (noting that 63% of boards locate compliance responsibilities in the audit committee).

248. Strine et al., *supra* note 22, at 1918–19.

249. Susan Schmidt Bies, *Keynote Address*, 8 FORDHAM J. CORP. & FIN. L. 81, 88 (2003).

250. Bainbridge, *Enterprise Risk Management*, *supra* note 22, at 971–72.

251. *Id.* at 972 (citing Thomas L. Barton et al., *Managing an Unthinkable Event*, FIN. EXEC., Dec. 1, 2008).

252. The Committee of Sponsoring Organizations of the Treadway Commission, the leading authority on corporate risk management, has defined enterprise risk management as the process by which directors and officers define an optimal balance between a firm's "growth and return goals and related risks." COMM. OF SPONSORING ORGS. OF THE TREADWAY COMM'N, ENTERPRISE RISK MANAGEMENT - INTEGRATED FRAMEWORK: EXECUTIVE SUMMARY 1 (2004), http://www.coso.org/Publications/ERM/COSOERMExecutiveSummary.pdf; *see also* GREGORY MONAHAN, ENTERPRISE RISK MANAGEMENT: A METHODOLOGY FOR ACHIEVING STRATEGIC OBJECTIVES 12 (2008) ("[E]nterprise risk management is defined as a methodology for managing risks associated with strategic objectives of an organization.").

253. Bainbridge, *Don't Compound* Caremark, *supra* note 22, at 948; Miller, *supra* note 22, at 110.

254. Bainbridge, *Enterprise Risk Management*, *supra* note 22, at 984; Miller, *supra* note 22, at 87, 103.

information about risks to the enterprise than of whether they are making sound business decisions about which risks to accept. Failing to be properly informed about risks is not the same as making a business decision about the proper level of risk-taking; uninformed decisions and inadequate oversight of risks are not, and should not, be protected by the business judgment rule.

Applying *Caremark* to risk management does not require secondguessing business decisions about how much and what kinds of risks to take. Rather, *Caremark* requires only that directors establish and monitor systems to gather information about all material risks to the corporation. Miller contends that decisions about which data to utilize in assessing risks are also business decisions subject to the business judgment rule.[255] While Miller may be correct as to weighing and assessing various risks through a risk management information system, it strains the scope of the business judgment rule to suggest that the question of which risks should be included in the information-gathering system in the first place should be subject to the rule. Under current Delaware law, application of the business judgment rule can be rebutted by evidence that directors failed to consider reasonably available material information in making a decision.[256] Similarly, the business judgment rule should be rebutted by evidence that directors failed to include material risks to the corporation in the scope of an information system designed to permit directors to fulfill their duty to exercise oversight by monitoring "the corporation's operational viability, legal compliance and financial performance."[257]

In the continuum of attentiveness, a decision about which risks to monitor, as opposed to how to respond to such risks, is more like a decision about which information to consider in making a business decision, which has historically been a basis for rebutting the business judgment rule and excusing presuit demand on the directors in shareholder derivative actions to enforce directors' duties.[258] Just as a failure to consider material information reasonably available in connection with a business decision is cause for rebutting the business judgment rule, a complete failure to establish or subsequently monitor an information-gathering system for a material risk to the corporation should be

255. Miller, *supra* note 22, at 81.

256. Miller seems to believe that inadequate information should not be a basis for rebutting the business judgment rule because decisions about what and how much information to consider in making a decision should also be subject to the rule. *Id.* at 85 & n.163. Former Chancellor Allen and Bayless Manning may have shared that view. *See* Allen, *supra* note 85, at 120; Manning, *supra* note 31, at 1480.

257. Marchand v. Barnhill, 212 A.3d 805, 809 (Del. 2019). *Caremark* cases frequently note that the purpose of information systems is to inform directors about risks to the corporation. In *Stone*, the Delaware Supreme Court stated that directors may not disable themselves "from being informed of risks or problems requiring their attention." Stone *ex rel.* AmSouth Bancorp. v. Ritter, 911 A.2d 362, 370 (Del. 2006).

258. Brehm v. Eisner, 746 A.2d 244, 259 (Del. 2000) ("Pre-suit demand will be excused in a derivative suit only if . . . particularized facts in the complaint create a reasonable doubt that the informational component of the directors' decisionmaking process, *measured by concepts of gross negligence*, included consideration of all material information reasonably available.").

amenable to judicial review and director liability.[259] In other words, courts would not be evaluating the reasonableness of risk management decisions, but rather whether certain risks that have been completely ignored are sufficiently material such that they should not have been ignored.[260]

Nonetheless, Delaware courts may be less comfortable making judgments about whether certain risks should be included in a corporate information and reporting system than they are deciding whether certain information is material to a board's decision in a given context (the foundation of gross negligence review under *Van Gorkom*), or whether certain legal compliance issues should be included in a corporate information and reporting system. The question is why, and I believe it comes down to a question of judicial effectiveness, legitimacy, and the problem of expertise. After discussing this challenge, I explore three ways Delaware judges can "borrow" expertise in making *Caremark* decisions about risk management by relying on (1) corporate expertise, (2) third-party expertise, and (3) social consensus.

1. Judicial Effectiveness, Legitimacy, and Expertise

While the prospect of litigation can create valuable incentives affecting director behavior, litigation signals will not be effective (or considered legitimate) unless the standards of liability are clear and applied consistently.[261] Holger Spamann argues that third-party evaluations, particularly those of respected individuals such as judges, can be potent signals to incentivize value-enhancing actions by officers and directors.[262] However, the reliability, and therefore value, of the liability signal depends on the extent to which judges have

259. Miller acknowledges that judicial review of the adequacy of information and reporting systems might be analogized to the obligation to be informed of reasonably available material facts under the duty of care (or for rebuttal of the business judgment rule) before making business decisions. He argues, however, that decisions about which information and reporting systems are cost-justified are "vastly more complex than the question of which information is cost justified for the board to gather before making a particular, discrete business decision." Miller, *supra* note 22, at 106. The initial question of what risks should be included in the system in the first place, however, is simpler and cheaper than the questions about which systems for managing risks are cost-justified.

260. As noted by Miller, critics of the *Citigroup* decision seemed to be suggesting that corporate boards were accepting too much risk and should have had lower risk tolerance levels for their firms in order to protect the economy from systemic risks created by overly high risk tolerance levels (something that is not really covered by oversight liability). With respect to climate risks, it is more an issue of whether boards are considering the risks at all (something that *is* covered by oversight liability), as opposed to whether they are setting risk tolerance levels too high, which is arguably a business decision. *Id.* at 98.

261. Holger Spamann argues persuasively that properly calibrated *partial* liability would unambiguously improve the incentives of directors and managers. Spamann, *supra* note 24, at 338, 341–45. This is a readily available alternative to complete exculpation. Prior to the passage of the DGCL section 102(b)(7) exculpation provision in the early 1980s, the American Law Institute proposed to include a cap on a director's liability equal to one year's director's fees for outside directors and one year's salary for officers. The proposal was not included in the final version of the Delaware law.

262. *Id.* at 343–44. Spamann notes that the value of the liability signal may be partially or fully offset by the costs of litigation. *Id.* at 355.

the ability to render clear, consistent judgments.[263] In other words, the cost-benefit tradeoff of a liability regime is more favorable when the judicial signal is more precise and less subject to "noise."[264] The legitimacy of judicially administered incentives also depends on jurisprudential stability, continuity, and adherence to precedent.[265] Thus, it is important for both the effectiveness of litigation incentives and the authority of the judiciary that judges apply clear liability standards in a consistent and reliable manner.

Applying clear standards in a consistent manner requires expertise. One popular measure of expertise used in the social science literature is the Cochran-Weiss-Shanteau ("CWS") measure. CWS measures expertise as the ratio of discrimination divided by inconsistency, where discrimination is the ability to differentiate between similar, but not identical, cases, and consistency is the ability to repeat judgments in similar situations.[266] As discrimination increases and inconsistency decreases, the ratio increases, and the level of expertise is likely to be higher.[267] This method has successfully distinguished between experts (audit partners) and novices (accounting students) in the application of a set group of norms (accounting standards).[268] For present purposes, the point is that to make clear and consistent judgments, judges need to either be experts or be able to apply (through expert witnesses or otherwise) a clear set of normative standards. It will be difficult to be both discriminating and consistent in making judgments about idiosyncratic matters.

Spamann notes that it is difficult for judges to render reliably clear and consistent judgments on directors' business decisions because each business situation is complex and unique, and there will seldom be agreed industry standards of what makes a reasonable decision.[269] Bayless Manning, like Spamann, is skeptical of relying on common conceptions of prudence as a basis

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263. *Id.* at 340. Spamann argues that the benefits of litigation, resulting in "noisy" judicial evaluations of business decisions that lack precision and predictability, do not outweigh the significant costs (both monetary and in terms of director distraction), particularly in light of the relative precision of stock price signals coupled with performance pay and other governance mechanisms.

264. *Id. See generally* DANIEL KAHNEMAN, OLIVIER SIBONY & CASS R. SUNSTEIN, NOISE: A FLAW IN HUMAN JUDGMENT (2021).

265. Linda Hamilton Krieger & Susan T. Fiske, *Behavioral Realism in Employment Discrimination Law: Implicit Bias and Disparate Treatment*, 94 CALIF. L. REV. 997, 1024 (2006).

266. Shanteau et al., *supra* note 23, at 255–56. Weather forecasters and accounting auditors have high levels of consistency in their judgments, both individually and as a profession. Clinical psychologists and stockbrokers have relatively low levels of consistency. *Id.*

267. *Id.* at 258.

268. *Id.* at 259.

269. Spamann, *supra* note 24, at 365. Spamann notes that with respect to other negligence judgments by courts, such as medical malpractice, there are usually fairly objective industry standards in place by which to measure the actions of the defendant. In the case of business decisions, however, it will often be true that no two business situations are alike (unless they involve fairly standardized, frequently repeated decisions, such as a decision sell a company), and valuation issues will often be very challenging; as a result, business expert witnesses cannot support judicial evaluations nearly as well as medical expert witnesses, for example. *Id.* at 357.

for judicial decisionmaking in the business context.[270] Both Spamann and Manning argue that this makes review of business decisions very different from review of other sources of liability in which the prudent person (or prudent professional) standard of conduct applies, such as auto accidents, where there is societal consensus regarding prudent driving, or medical malpractice, where there are agreed professional standards that can be applied. While we talk of the "reasonable man" in torts, that language is less useful in business precisely because business circumstances are so idiosyncratic. Delaware judges have generally agreed.[271]

As Spamann acknowledges,[272] however, the first prong of the *Caremark* standard, whether directors have established a system to monitor risks to the corporation, is easily amenable to judicial evaluation. Either an information system has been established, or it has not. The second prong of the test, whether directors monitored the results produced by the information system, is also a straightforward, process-oriented inquiry that can be adjudicated with a high degree of reliability. Either directors paid attention to reports, or they didn't.

A third inquiry that has been part of Delaware directors' standard of liability for oversight failures since before the *Caremark* decision is whether directors have ignored "red flags" generated by a corporate information and reporting system. This inquiry involves substantive decisions by the judge about what constitutes a red flag, and is therefore more suspect from a discrimination and consistency perspective, depending on what is being measured. When the question is whether information about legal compliance lapses constitutes a red flag, judges can apply their experience reviewing claims of legal violations to determine what constitutes a red flag. When the question is whether information about risks to corporate assets constitute a red flag, judges have less expertise to apply, and it may be more difficult for them to make consistent and reliable decisions without reference to the opinions of risk experts internal or external to the corporation.

What neither Spamann nor Delaware courts discuss, however, is how to decide whether a particular subject deserves to be covered in a corporate information and reporting system in the first place. As noted in Part IV.C, defenders of the business judgment rule argue that such decisions are fundamentally business decisions of the directors, protected from judicial secondguessing by the rule. However, Delaware courts seem to have concluded,

270. Manning, *supra* note 31, at 1493–94 ("We do not have any common standard or experience as to what directors do; and what they do varies from company to company, from situation to situation, and from time to time. . . . The whole concept of negligence and of 'reasonable man' presupposes as a predicate a clear conception of *what* the person is doing, and a community understanding of a standard of normalcy about *how* he should do it. *Both those pieces are missing in the case of the work of corporate directors.*").

271. Allen et al., *supra* note 85, at 454 ("Unlike automobile accident cases, it may be hard for judges to differentiate bad business decisions from good business decisions that turn out badly.").

272. Spamann, *supra* note 24, at 361–62 (arguing that judicial evaluations of standardized actions, such as the establishment of monitoring systems, are likely to be less noisy and more valuable as incentive signals to directors than evaluations of idiosyncratic decisions).

without saying so explicitly, that directors do not get to decide whether certain legal compliance matters should be covered in an information and reporting system. If a company is required to comply with certain statutes and regulations in carrying out its business, compliance with those laws should be part of the information and reporting system established by the directors. That may be because Delaware law "does not charter law breakers."[273] On the other hand, it could also be due to the fact that judges have more confidence in their own expertise with respect to assessing whether directors have failed to make a good faith effort to monitor compliance with laws than they do with respect to assessing whether directors have made a good faith effort to monitor enterprise risks.

If climate risk is treated as an enterprise risk management problem rather than a legal compliance problem, judges will need experts (inside or outside the company), or a body of norms, to rely upon in determining whether a board breached its *Caremark* duties by failing to monitor the risk. Relying on such experts or norms will increase the discrimination and consistency of their opinions. That will in turn diminish the noisiness and increase the signal value of their decisions. There are at least three sources of expertise judges could rely on: (1) corporate judgments, (2) third-party risk experts, and (3) social consensus.

2. Relying on Director Judgments

One option Delaware courts could take is to recognize *Caremark* obligations for climate risks when the directors of a corporation identify such risks as material to the corporation. This would apply any time the directors refer to climate risks as material risks in their public filings. It could also apply in situations in which directors identify climate risks as significant risks in sustainability reports or other public statements, or even in internal documents. In any of those situations, Delaware judges would be relying on the internal expertise of the directors with respect to that corporation as to whether climate risk is material. Once the materiality decision has been made, Delaware judges could reliably and consistently conclude that information and reporting systems covering such material risks should be established and monitored. Judges would not be secondguessing decisions of the directors as to idiosyncratic business matters because the directors have already made the materiality judgment. Essentially, judges would be relying on the internal expertise of management and directors. The downside of this approach is that it is entirely in the discretion of the management and directors of the corporation, which may result in material harms due to climate risk occurring in the absence of a system to gather and report information regarding such risks, giving shareholders little comfort that their investments will not be unduly diminished.

273. *See In re* Massey Energy Co., No. 5430-VCS, 2011 WL 2176479, at *20 (Del. Ch. May 31, 2011); *see also supra* notes 122, 240 and accompanying text.

3. Relying on Third-Party Experts

The courts can also turn to expert views to determine which risks are material to which corporations. One set of external experts on such matters is COSO, as noted above. The big four accounting firms are also developing expertise on ESG reporting and auditing, and would likely be in a position to provide expertise on which risks are most material to a given corporation. The Value Reporting Foundation, formerly the Sustainability Accounting Standards Board, has developed a materiality matrix for material sustainability issues applying to different industries.

Stephen Bainbridge worries that deferring to experts as to which ESG matters should be included in a corporation's *Caremark* oversight obligations would improvidently deprive directors of discretion over important corporate decisions.[274] While it is true that directors would lose some discretion if courts relied on third-party experts, the erosion of discretion in this context would be limited to establishing which risks should be monitored, not how risks should be managed.

4. Relying on Social Consensus

Finally, Delaware judges could rely on social consensus as a source of expertise in determining which risks are material to corporations. This appears to be the approach accepted by courts in Australia and Canada, where they review director decisions regarding oversight of risks for reasonableness, assessing it from the perspective of what a reasonable person in a similar position would do under the circumstances. As discussed in the opinions of leading lawyers in those jurisdictions, reasonableness is judged in part based on social consensus over the materiality and foreseeability of certain risks. The wisdom of the crowd may offer comparatively greater discrimination and consistency—that is, expertise—than director choices in the context of enterprise risks, such as climate risks, that involve cognitive biases and systemic harms for the economy.

Corporate managers have a tendency to systematically underestimate the likelihood of encountering low-probability adverse events.[275] Optimism bias, in which individuals are unrealistically optimistic about the outcomes of certain events, encourages decisionmakers to overestimate positive outcomes and underestimate negative ones, discouraging them from considering complete probability distributions for risks and causing them to discount the likelihood of negative events occurring.[276] Availability bias concentrates the decisionmaker's mind on more recent or particularly salient experiences, discounting older and

274. Bainbridge, *Don't Compound* Caremark, *supra* note 22, at 32–33.

275. Iman Anabtawi & Steven L. Schwarcz, *Regulating Systemic Risk: Towards An Analytical Framework*, 86 NOTRE DAME L. REV. 1349, 1354 (2011).

276. *Id.* at 1366–67.

less salient events and omitting events that have never occurred before.[277] Optimism bias and availability bias prompt individuals to systematically underestimate the likelihood of very rare but potentially devastating risks.[278] When it comes to monitoring risks, managers may also suffer from omission bias, a higher tolerance for risks arising from inaction than for those arising from affirmative acts.[279]

Anabtawi and Schwarcz argue that these biases cause financial firms to charge too little for bearing low-probability risks, which threatens firm integrity, as seen during the 2007 to 2009 financial crisis.[280] In the context of climate risks, similar biases may cause managers to overinvest in assets that do not provide sufficient returns due to transition risks, and to underinvest in deterrence and redundancy with respect to physical risks.[281] If corporate directors do not accurately assess and disclose the exposure of their corporation to climate risk, the market will not accurately price the value of their corporation. This could lead to a large amount of risk in the financial markets and an asset bubble that may burst in a sudden realignment when risks are appropriately accounted for.[282]

It is also possible to take the view that shareholders have a variety of market mechanisms to protect themselves, so it is not necessary or justified to impose liability on directors for poor choices around risk management.[283] If a company goes bankrupt as a result of poor director choices about risk, one can argue that shareholders accepted that risk when they invested. There are two problems with this perspective, however. The first is that there may be inadequate market incentives for directors to overcome these biases and engage in good risk management, particularly with respect to attenuated risks such as climate risks. It is hard for the market to value and reward effective management of tail risks, and managers are incentivized to underreport problems for fear of a negative overreaction from investors.[284] If managers are insulated from downside risks, with significantly more to benefit from outsized gains than they will lose from outsized losses, they can be expected to favor high-risk strategies that have high variances and low or negative expected returns.[285] Compensation plans based on

277. *Id.* at 1367.

278. *Id.*

279. Benjamin, *supra* note 36, at 366.

280. Anabtawi & Schwarcz, *supra* note 274, at 1354 (noting that although low-probability events are susceptible to measurement and prediction, the correlation between low-probability, high-magnitude risks and firm integrity is often missed by managers).

281. Madison Condon, *Market Myopia's Climate Bubble*, 2022 UTAH L. REV. 63, 70–103.

282. *Id.*

283. For a summary of these market mechanisms that arguably protect investors, see, for example, Carl Samuel Bjerre, Note, *Evaluating the New Director Exculpation Statutes*, 73 CORNELL L. REV. 786, 797 (1988).

284. John Armour, Jeffrey Gordon & Geeyoung Min, *Taking Compliance Seriously*, 37 YALE J. ON REGUL. 1, 1–2, 42, 49–59 (2020) (arguing that directors' duties do not sufficiently penalize compliance failures).

285. Anabtawi & Schwarcz, *supra* note 274, at 1365–66; *see also* Lucian A. Bebchuk & Holger Spamann, *Regulating Banker's Pay*, 98 GEO. L.J. 247, 262–63 (2010) (describing the impact of option-based compensation on risk appetite).

stock options designed to encourage risk-taking tend to exacerbate this risk.[286] If directors are also insulated from liability for their risky actions due to lax liability rules, they may be inclined to take too much risk.[287] This may be particularly true with respect to risks, such as climate risks, that are most likely to manifest only after a director has departed from the firm.

The second problem is that failing to properly monitor climate risks may lead to systemic harms that should be avoided. Even if applying *Caremark* to risk management failures is problematic from an optimal-efficiency perspective, it may still be appropriate to apply *Caremark* liability to failures to manage risks, such as climate risks, that have systemic impacts because of the important social costs imposed by such systemic risks, such as the damage caused by fires in California due to PG&E's negligence, that are not borne by the corporation's shareholders or its directors even if the directors are found liable for a *Caremark* breach.[288]

To better align the interests of managers and shareholders in the context of cognitive biases and systemic risks, it is important to incentivize management to avoid such biases and become fully informed. Directors' duties can play an important role in discouraging excessive risk-taking.[289] Shareholders may not be the ideal enforcers of social goods,[290] but as noted in Part I.B, institutional investors have a strong interest in director attention to climate risks, so they may have more incentives to pursue actions against directors who fail to pay attention to climate risks than economic incentives might otherwise suggest.

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286. Options create upside benefits if the value of the firm increases during the life of the option with no downside risk if the value of the firm decreases due to uninformed risk-taking by the managers. Lucian A. Bebchuk, Jesse M. Fried & David I. Walker, *Managerial Power and Rent Extraction in the Design of Executive Compensation*, 69 U. CHI. L. REV. 751, 777 (2002). The risks embedded in managers' decisions remain with the firm, even if managers cash out options and retire. Anabtawi & Schwarcz, *supra* note 274, at 1364.

287. Anabtawi & Schwarcz, *supra* note 274, at 1364.

288. Professors Armour and Gordon have noted that in situations, such as financial institutions, where individual corporations do not internalize all the systemic risks of their actions, directors may engage in excessive risk-taking in making decisions on behalf of the corporation. John Armour & Jeffrey N. Gordon, *Systemic Harms and Shareholder Value*, 6 J. LEGAL ANALYSIS 35, 66 (2014). This could apply equally in the climate context, in which corporate board decisions may not consider all of the risks to both shareholders and other stakeholders, particularly when those risks are aggregated into systemic risks.

289. Anabtawi & Schwarcz, *supra* note 274, at 1385; *see also* Christine Jolls & Cass R. Sunstein, *Debiasing Through Law*, 35 J. LEGAL STUD. 199, 200–01 (2006) (explaining how legal rules can discourage biases and promote more rational behavior).

290. Miller, *supra* note 22, at 119 ("[T]he interest[s] of society here is to prevent financial institutions from taking socially excessive but privately profitable risks. It makes sense to penalize directors for causing their firms to engage in the relevant transactions, but it makes no sense to appoint shareholders as the enforcers, much less the beneficiaries, of such penalties. Shareholders, as the primary beneficiaries of the activities to be suppressed, have quite the wrong incentives as enforcers."). *But see* Roy Shapira & Luigi Zingales, *Is Pollution Value-Maximizing? The* DuPont *Case* 34 (Nat'l Bureau of Econ. Rsch., Working Paper No. 23866, 2017), https://www.nber.org/papers/w23866 [https://perma.cc/E4ME-DJZ9] (arguing that shareholders aren't necessarily incentivized to discipline executives to save expenses by ignoring risks that hurt society but not the corporation itself).

D. Returning Oversight to the Duty of Care

1. *Duty of Care as the Standard for Attentiveness*

While shareholders would be better protected if climate risks were encompassed in directors' *Caremark* oversight duties, it is also desirable to rethink the doctrinal standards of liability applying to those duties. *Caremark* creates an anomalous situation. If directors make a decision without adequate consideration of material risks, their action is reviewed under a gross negligence standard. If, on the other hand, they fail to establish or monitor a system for gathering information about and considering the very same material risks, their failure is reviewed not for gross negligence, but for a more culpable, knowing disregard of their duties. Under the latter standard, shareholder plaintiffs must allege facts permitting an inference that directors *knew* they were not fulfilling their duties to the corporation if the complaint is to survive a motion to dismiss.[291] Stephen Bainbridge argues that it is odd to review failures of oversight under a duty of loyalty rubric, since the duty of loyalty typically involves issues of fairness, while oversight failures involve issues of judgment.[292] This rings true, but I would say that oversight failures involve lack of attentiveness or effort, not lack of judgment.

Application of the duty of loyalty to oversight obligations creates an extremely formidable barrier to director liability and equitable remedies such as injunctions.[293] Some scholars have argued that the large number of dismissals suggest that the *Caremark* standard is too stringent and does not offer sufficient protection.[294] Other scholars have argued that *Caremark* is well crafted, and that oversight liability should not be expanded.[295]

Caremark's requirement that a breach of oversight duties be knowing[296] is particularly nefarious in the context of climate risks, since at least some directors would probably argue that they are not knowingly breaching a duty to the

291. It seems odd that the standard of review for inattention should shift from a negligence standard to a scienter standard depending on whether directors were inattentive in action or inaction. Both are failures to devote sufficient attention to material information about the corporation. One might ask what justifies the different standards applicable to judicial review of board inaction, on the one hand, and board action, on the other? *See, e.g.*, Kohn et al., *supra* note 28.

292. Bainbridge, *Don't Compound* Caremark, *supra* note 22, at 17. Bainbridge also notes that the remedy for duty of loyalty breaches is typically to repay ill-gotten gains from self-interested behavior of the directors or persons to whom they are beholden. *Id.*

293. Miller, *supra* note 22, at 98.

294. *See, e.g.*, Megan W. Shaner, *The (Un)Enforcement of Corporate Officers' Duties*, 48 U.C. DAVIS L. REV. 271, 306–07 (2014) (listing dismissed cases); Claire A. Hill & Brett H. McDonnell, *Reconsidering Board Oversight Duties After the Financial Crisis*, 2013 U. ILL. L. REV. 859, 859 (arguing that board monitoring duties should be expanded); 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).

295. Edward B. Rock & Michael L. Wachter, *Islands of Conscious Power: Law, Norms, and the Self-Governing Corporation*, 149 U. PA. L. REV. 1619, 1675–76 (2001) (arguing that the doctrine's hands-off approach is desirable because it facilitates self-governing); Stephen M. Bainbridge, Star Lopez & Benjamin Oklan, *The Convergence of Good Faith and Oversight*, 55 UCLA L. REV. 559, 559 (2008).

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

company when they consciously ignore or fail to adopt climate risk monitoring systems. Climate science, they might say, is still challenged by some parties in the United States, and climate risks are difficult to predict with confidence. Transition risks are particularly difficult to assess since they arise from changes in regulation or consumer preferences that cannot be anticipated with precision—it is anybody's guess when Congress will pass a carbon tax, for example. Thus, while it might be negligent, or even grossly negligent for directors to deny climate science and the prospective impact of climate risks on their company—as noted by respected legal experts in Australia and Canada[297]—it is less likely to be a knowing breach of directors' duty of loyalty to discount such matters. For how can there be a clear duty with respect to something so uncertain?[298]

Delaware directors' oversight duties, at least with respect to risk management, should be returned to the duty of care, in which the inquiry focuses on whether directors were grossly negligent (or reckless), rather than whether they knew they were breaching their fiduciary duties in failing to establish or monitor a system to gather information about material enterprise risks, including climate risks, which are material for many companies. As discussed above, the choice of which risks are material arguably requires expert input and may be characterized as a business judgment unless specific expert norms apply. The remainder of the *Caremark* inquiry, however, is procedural rather than substantive. It is a factual inquiry about the management of information, not a substantive review of business decisions about risk choices. There is no reason that procedural inquiry cannot be done on a gross negligence basis rather than a scienter-based inquiry into conscious disregard. What the directors do with the information they have received would then be subject to business judgment review.

2. *Assessing Attentiveness in the Flow of Performance*

While the shift from gross negligence to good faith in director liability for inattentiveness that Chancellor Allen engineered through his regular references to good faith in the *Caremark* opinion may have been unfortunate, Allen was correct that courts should focus on the flow of a director's performance of risk-oversight duties rather than on isolated instances of inattention. Allen concluded that directors should be found to have violated their duty only if they demonstrated a *sustained* failure to pay attention to risks.[299] With risk management, in particular, it makes sense to judge directors based on their performance over time as opposed to based on momentary lapses.

297. *See supra* notes 207, 211 and accompanying text.

298. This problem is exacerbated by the *Caremark* jurisprudence—which focuses on legal compliance and criticizes claims based on risk management failures—since it raises further doubts about whether there even *is* a duty of loyalty to monitor enterprise risks, making it even less likely that a director would *knowingly* breach such a duty. You can't consciously disregard a duty that does not clearly exist.

299. *In re* Caremark Int'l Inc. Derivative Litig., 698 A.2d 959, 971 (Del. Ch. 1996).

Bayless Manning argued persuasively in 1984, a full decade before the *Caremark* opinion, that courts should only find violations of directors' duty of attention for significant departures from normal expectations[300]—and then, only based on the *flow* of the director's performance over time.[301] His position was grounded in the observations that "[a]lmost all of what a board does is made up of matters that are brought to it[;] . . . [that] boards cannot take[] and are not expected to take, initiatives";[302] and that the "universe of actions not taken is *always* far greater than the roster of actions taken."[303]

Manning takes the view that the scope of investigation actually undertaken on any given matter will always be less than the scope that could have been undertaken, so the scope of inquiry called for in given circumstances is a business judgment "of the most basic character" and should not be secondguessed unless a director is ignoring the work of the board.[304] This leads to the notion that directors should be judged on their level of attention or inattention over time, as opposed to in a single snapshot. That sensible rule can be utilized as easily in applying a gross negligence standard as in applying a good faith standard.

3. Injunctions for Failure To Monitor Climate Risk

Moving the standard of review for oversight failures to negligence rather than conscious disregard would facilitate lawsuits seeking injunctive or other equitable relief not involving money damages. This would be particularly useful if plaintiffs want to seek an injunction requiring directors to establish an information system to track a corporation's climate risks.

4. Monetary Liability for Bad Faith Violations

Caremark claims currently cannot be exculpated under Delaware General Corporation Law section 102(b)(7). Liability protection through exculpation clauses is often justified on the basis that insufficient protection will cause directors to be overly risk-adverse, leading them to avoid taking risks that could lead to additional value creation for shareholders and the economy.[305] Holger Spamann argues persuasively that complete exclusion of liability for bad

300. Manning, *supra* note 31, at 1480.

301. *Id.* at 1494 ("In the case of a director, the proper referent for his legal duty should be the *flow* of his performance of his directorial functions, not the individual incident.").

302. *Id.* at 1484. Manning also presaged Allen's opinion, arguing that boards have an obligation to ensure that the company has an internal information system "to keep the management informed about what is going on and particularly to provide the accounting data on which to base financial statements," and may not "choose to ignore credible signals of serious trouble in the company." *Id.*

303. *Id.* at 1485.

304. *Id.* at 1486.

305. *See*, *e.g.*, Gagliaridi v. Trifoods Int'l, Inc., 683 A.2d 1049, 1052–53 (Del. Ch. 1996); REINIER KRAAKMAN, JOHN ARMOUR, PAUL DAVIES, LUCA ENRIQUES, HENRY HANSMANN, GERARD HERTIG, KLAUS HOPT, HIDEKI KANDA, MARIANA PARGENDLER, WOLF-GEORG RINGE & EDWARD ROCK, THE ANATOMY OF CORPORATE LAW: A COMPARATIVE AND FUNCTIONAL APPROACH 70 (Oxford Univ. Press 3d ed. 2017).

business decisions can only be justified by high litigation costs, not fear that liability would discourage efficient risk-taking.[306] Liability for breach of the duty of care is a form of negligence liability, not strict liability, which in pure form penalizes boards for failing to take efficient risks that maximize the value of the corporation in the long term.[307] It is only the inability of courts to make decisions based on accurate assessments of the efficiency of the risk-taking efforts that may penalize directors for taking efficient risks.

Shifting the oversight standard of review to gross negligence would lead to exculpation and dismissal of monetary claims under current Delaware precedents for the directors of any corporation that has an exculpatory clause in its certificate of incorporation. This would not prevent shareholders from arguing, in the appropriate case, that monetary damages are justified by director behavior that consciously disregarded the obligation to establish systems to monitor enterprise risks such as climate change.

CONCLUSION

Caremark and its progeny are not doing as much work as they could and should be doing to encourage the directors of Delaware corporations to monitor and mitigate climate risks. Delaware courts have established lower standards of director conduct and higher standards of liability with respect to managing climate risks and other enterprise management risks than those that exist in other common law countries. If shareholders of Delaware companies want the directors of the companies they invest in to be more proactive in considering climate risks, they may need to seek changes in Delaware law to promote more vigilance. Differing levels of director attention and contrasting legal opinions about the prospects of liability for failing to monitor climate risks suggest that *Caremark* jurisprudence has failed to encourage Delaware directors to take their corporations' climate risks corporations seriously. Delaware courts could remedy this problem in a variety of ways described herein.

The discussion in this Article is framed around the rapidly burgeoning challenge of climate change risks, but the analysis may also apply to other enterprise risks of increasing salience, including other ESG concerns such as diversity and human capital issues, which raise both legal and reputational risks,[308] and enterprise risks such as cybersecurity risks. The focus on climate risk is meant to be illustrative rather than exclusive, though it might be argued that climate risks are more likely to lead to catastrophic damage to the enterprise, and society, if inadequately addressed.

306. Spamann, *supra* note 24, at 338, 350–54.

307. *Id.* at 351.

308. *See, e.g.*, DAVID F. LARCKER & BRIAN TAYAN, BLINDSIDED BY SOCIAL RISK: HOW DO COMPANIES SURVIVE A STORM OF THEIR OWN MAKING? 1–2 (2020).

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