A NEW *CAREMARK* ERA: CAUSES AND CONSEQUENCES

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ABSTRACT

*What role does corporate law play in holding directors accountable for compliance failures? Until recently, the answer has been "very little." The prevalent standard for director oversight duties (*Caremark *duties) was set high, effectively demanding that plaintiffs show scienter without having access to discovery. As a result, derivative actions over directors' failure of oversight were routinely dismissed at the pleading stage, and many commentators considered* Caremark *duties largely irrelevant. Yet starting in June 2019, a string of successful* Caremark *cases have signaled a new era of enhanced oversight duties. This Article contributes to our understanding of the new* Caremark *era along three dimensions. First, the Article delineates the contours of the shift in Delaware courts' approach to oversight duties. The courts now increasingly apply the "mission critical compliance" exception to justify enhanced duties, and lower the threshold for receiving information in order to investigate potential failure-of-oversight claims. Second, the Article identifies the drivers of this "new* Caremark *era," with special emphasis on the role of a seemingly disparate development in shareholders' right to information from the company. Shareholders now enjoy much better pre-filing discovery powers, which they can utilize to plead with particularity facts about how the board never even discussed a critical compliance issue, or how they knew about critical problems but chose to ignore them. Armed with these newfound pre-filing investigatory tools, shareholders can overcome what once seemed insuperable pleading hurdles. Finally, the Article evaluates the desirability of the new* Caremark *era, spotlighting its likely positive effects on information flows inside companies and the ability of the market to discipline corporate misbehavior (better reputational discipline), as well as the ways in which it nicely compensates for the blind spots of other enforcement mechanisms.*

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INTRODUCTION

Compliance has become a key corporate governance issue across the globe.[1] Companies pour hundreds of billions of dollars into internal compliance programs meant to prevent and detect wrongdoing by their employees.[2] Regulators are constantly attempting to gauge the effectiveness

1. Stavros Gadinis & Amelia Miazad, *The Hidden Power of Compliance*, 103 MINN. L. REV. 2135, 2146 (2019); Robert C. Bird & Stephen Kim Park, *Organic Corporate Governance*, 59 B.C. L. REV. 21, 44–45 (2018) (compiling references). "Compliance" here is defined as the set of internal processes firms employ in order to ensure that their behavior falls in line with applicable laws. *See* Sean J. Griffith, *Corporate Governance in an Era of Compliance*, 57 WM. & MARY L. REV. 2075, 2082 (2016). Recently there have been calls to broaden the scope so that these internal processes would also ensure meeting broader societal expectations. *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. (forthcoming 2021), https://scholarship.law.upenn.edu/cgi/viewcontent.cgi?article=3198&context=faculty_scholarship [https://perma.cc/F6Y2-6PR8].

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

of such internal compliance programs. Yet until recently, corporate law played a seemingly very limited role. The prevalent standard for director oversight duties (*Caremark* duties[3]) was set high, effectively demanding that plaintiffs show scienter without having access to discovery. As a result, derivative actions over directors' failure of oversight were routinely dismissed at the pleading stage, and many commentators considered *Caremark* duties largely irrelevant.

Against this background, it was noteworthy when, within thirteen months in 2019–2020, four *Caremark* claims succeeded in surviving the motion to dismiss (*Marchand*, *Clovis*, *Hughes*, and *Chou*). Practitioners immediately took notice, and started debating the meaning of the string of successful cases. Does it signify a meaningful trend of a "stricter *Caremark* era,"[4] or is it merely a rare coincidence of cases with extremely egregious facts?[5] And if there is, indeed, a resurgence in director oversight duties, why now? What changed around 2019 that sparked the resurgence?

The answers, this Article suggests, are (1) "yes," and (2) "section 220." Yes, there is a trend of revamped director oversight duties. And this trend is here to stay, partly because it is driven by a seemingly disparate development in shareholders' rights to information from the company, nestled in D.G.C.L. § 220.[6]

Section 220 grants shareholders a qualified right to inspect the company's books and records. In recent years Delaware courts have liberalized their interpretation of section 220 requirements: both in terms of whether to provide internal documents (the "proper purpose" requirement), and in terms of what internal documents to provide (the "permissible scope" requirement). The courts now order provision of not just formal documents such as board minutes, but also informal electronic communications such as private emails or LinkedIn messages between directors. Armed with such newfound pre-filing discovery powers, shareholders and their attorneys can use the internal documents to plead with particularity facts that implicate directors' mental state and awareness, thereby overcoming the once-insuperable *Caremark* pleading hurdle. Plaintiffs can now more easily show that the board never even discussed a critical compliance issue, or knew about critical problems but chose to ignore them.

Indeed, section 220 actions—that is, litigation over what documents shareholders can get in order to investigate potential failure of oversight—should be considered themselves a part of the new *Caremark* era. Within

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3. Named after one of Delaware's most iconic cases. *See In re* Caremark Int'l Inc. Derivative Litig., 698 A.2d 959 (Del. Ch. 1996), *adopted by* Stone v. Ritter, 911 A.2d 362, 365 (Del. 2006).

4. *Infra* note 35 and accompanying text.

5. *Infra* note 38 and accompanying text.

6. *See* DEL. CODE ANN. tit. 8, § 220 (2021).

the past year, plaintiffs have succeeded in getting internal documents, including sometimes emails, to investigate failures of oversight on the part of Facebook's directors in the Cambridge Analytica scandal, or AmerisourceBergen's directors in the opioid crisis, to name two examples. In other words, the trend is bigger than the *Marchand*-*Clovis*-*Hughes*-*Chou* quadfecta.

What changed is therefore not necessarily the standard for oversight liability, which is still a high bar,[7] but rather shareholders' ability to establish the facts and hold directors accountable. In a separate project I show how the expansion of section 220 has revamped judicial oversight of deal negotiations;[8] here I focus on how it has revamped director oversight duties as well. To be sure, there exist other factors contributing to the new *Caremark* era, beyond the increased emphasis on pre-filing investigations. Notably, Delaware courts have been carving a constantly-growing exception to the deferential standard, in the form of "mission critical compliance": in situations where meeting certain regulatory demands is critical to the firm's success, directors should be especially alert to yellow and red flags, and proactively monitor compliance. The combination of the courts' increased willingness to scrutinize directors' conduct in this context and plaintiffs' increased ability to document directors' conduct is likely to continue generating successful *Caremark* claims going forward.

Yet it is one thing to say that plaintiffs are now more likely to succeed in failure-of-oversight claims, and another to say that the new turn in *Caremark* litigation is desirable from a societal perspective. For one, the expansion of pre-filing discovery comes with its own set of costs, such as potentially bringing back the dreaded fishing expeditions through the backdoor.[9] And, critics may claim, thus far it has produced no meaningful benefits: success in section 220 actions or the motion to dismiss does not mean that these cases will ultimately be decided in favor of the plaintiffs. We therefore cannot conclude that the new *Caremark* era will generate more compensation for shareholders or better deterrence, the argument goes. In fact, such an objection misconstrues how Delaware corporate law works (deters). In corporate law, in general, corporate decision-makers practically

7. For a recent iteration of the high standard, namely, particularized allegations of bad faith, see Richardson v. Clark, C.A. No. 2019-1015-SG (Del. Ch., Dec. 31, 2020) (clarifying that when directors truly try to remedy a compliance problem but fail, it would not constitute a breach of their *Caremark* duty).

8. Roy Shapira, *Corporate Law, Retooled: How Books and Records Revamped Judicial Oversight*, 42 CARDOZO L. REV. (forthcoming 2021), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3600935 [https://perma.cc/G5YM-M3A5].

9. "Fishing expedition" here denotes the concern that parties may bombard each other with requests to find information that may or may not exist, needlessly raising the costs of litigation in the process. *See* Alexandra D. Lahav, *A Proposal to End Discovery Abuse*, 71 VAND. L. REV. 2037, 2039 (2018).

never pay out of pocket for their misbehavior.[10] Yet deterrence cannot be measured solely on the basis of sanctions imposed in verdicts coming after a full trial.

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. 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. As this Article details, the new *Caremark* cases created a wave of law firm memos calling on boards to place compliance issues on the agenda and make sure deliberations are being properly recorded. 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). This Article illustrates how the expansion of section 220 has dramatically increased these non-legal costs for failure of oversight, thereby ramping up deterrence. In all, while it is still too early to empirically assess the costs and benefits of the new mode of *Caremark* litigation, this Article provides several indications that suggest it will, indeed, prove desirable.

The Article proceeds in three parts. Part I sets the stage by delineating the ebbs and flows of director oversight standards over the years, culminating in their recent resurgence. Part II explains why two important new developments in Delaware law, namely, director oversight duties and shareholder information rights, are intertwined. The resurgence of inspection rights led to a resurgence of oversight duties. Part III evaluates some of the consequences of the section 220 turn in *Caremark* litigation, such as an increased emphasis on documentation and upward flows of information inside organizations. I then conclude by extrapolating lessons from the recent development in director oversight duties to offer big-picture observations on how Delaware corporate law works when it is at its best.

I. NEW TRENDS IN OVERSIGHT LIABILITY

The 1996 *Caremark* decision reinvented director oversight duties.[11] Prior to *Caremark*, directors' duties were merely reactive: as long as the

10. *See infra* note 135 and accompanying text.

11. *In re* Caremark Int'l Inc. Derivative Litig., 698 A.2d 959 (Del. Ch. 1996). The case revolved around illegal kickbacks to physicians, which ended up costing the company around $250 million in civil fines. *Id.* at 960–61. On the iconic stature of *Caremark* as one of the most important corporate governance decisions, see Todd Haugh, Caremark*'s Behavioral Legacy*, 90 TEMP. L. REV. 611, 612 (2018) ("[F]ew cases loom larger in the realm of corporate governance."). There exists a voluminous literature on the *Caremark* decision and its aftermath. I provide here only a bare bones summary, as context for the Article's main claims regarding the 2019–2020 developments in oversight liability.

company's employees did not flag a problem, directors could assume everything was fine.[12] *Caremark* institutes an affirmative duty to be proactive: directors have to install a system that monitors compliance issues and reports them back. Even *Caremark*'s critics agree that, at a minimum, it raised awareness and increased the urgency of compliance issues in boardrooms.[13]

Yet many legal scholars claim that *Caremark* did little more than raise attention, ultimately failing to bring about a substantive improvement in board oversight.[14] The oft-mentioned culprit is the very high threshold for plaintiffs to prove failure of oversight. Plaintiffs have to show bad faith, namely, that the directors *consciously* disregarded their duties.[15] Practically speaking, such a threshold translated to a high likelihood of early dismissals of *Caremark* claims.[16] Plaintiffs had a very hard time convincing the courts that demand on the board should be excused because the board faces a substantial likelihood of personal liability:[17] in order to do so, they had to plead particularized facts about directors' mental state and awareness,[18] which are hard to come by without access to discovery. In other words, without access to internal documents, it is hard to show what directors knew about the problem, when they knew it, and whether they could have done more to stop it.

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12. Graham v. Allis-Chalmers Mfg. Co., 188 A.2d 125 (Del. 1963). The case revolved around criminal price-fixing.

13. *See, e.g.*, Donald C. Langevoort, Commentary, Caremark *and Compliance: A Twenty-Year Lookback*, 90 TEMP. L. REV. 727, 729 (2018); Brian R. Cheffins, *Delaware and the Transformation of Corporate Governance*, 40 DEL. J. CORP. L. 1, 47 (2015) (noting *Caremark* helped spur the rise of the multi-billion compliance industry as we have come to know it); Miriam Hechler Baer, *Governing Corporate Compliance*, 50 B.C. L. REV. 949, 967 n.117 (2009).

14. *See, e.g.*, Anne Tucker Nees, *Who's the Boss? Unmasking Oversight Liability Within the Corporate Power Puzzle*, 35 DEL. J. CORP. L. 199, 215–16 (2010); Mercer Bullard, Caremark*'s Irrelevance*, 10 BERKELEY BUS. L.J. 15 (2013).

15. *See* Stone v. Ritter, 911 A.2d 362, 370 (Del. 2006); *see also* Jennifer Arlen, *The Story of* Allis-Chalmers*,* Caremark*, and* Stone*: Directors' Evolving Duty to Monitor*, *in* CORPORATE LAW STORIES 323, 326 (J. Mark Ramseyer ed., 2009). Indeed, the *Caremark* decision itself famously acknowledges that a "*Caremark*" claim is one of the most difficult for plaintiffs to win. *Caremark*, 698 A.2d at 967, 971.

16. *See* Elizabeth Pollman, *Corporate Oversight and Disobedience*, 72 VAND. L. REV. 2013, 2032 (2019); *see also* Paul E. McGreal, Caremark *in the Arc of Compliance History*, 90 TEMP. L. REV. 647, 676 n.238 (2018) (compiling references); Ezra Wasserman Mitchell, Caremark*'s Hidden Promise*, 51 LOY. L.A. L. REV. 239, 241–42 (2018) (same).

17. To bring a derivative claim, the plaintiff first has to make a demand on the company's board to pursue that claim. To survive the demand-requirement stage, plaintiffs practically need to convince the courts that a demand is futile because the company's board cannot be trusted to make the right decision—because directors themselves face a significant threat of personal liability, for example. Aronson v. Lewis, 473 A.2d 805, 811–12 (Del. 1984), *overruled in part by* Brehm v. Eisner, 746 A.2d 244, 253 (Del. 2000); Rales v. Blasband, 634 A.2d 927, 930 (Del. 1993).

18. Wood v. Baum, 953 A.2d 136, 141–43 (Del. 2008); *In re* Citigroup Inc. S'holder Derivative Litig., 964 A.2d 106, 125 (Del. Ch. 2009).

The parade of early dismissals of *Caremark* claims led to a parade of law review articles bemoaning *Caremark*'s lack of bite.[19] Scholars criticized *Caremark* for practically insulating boards from oversight liability, being "irrelevant,"[20] a "toothless tiger,"[21] and "an empty triumph of form over substance."[22]

Against this background, it was notable when, in June 2019, Delaware's Supreme Court reversed the Court of Chancery's dismissal of the Blue Bell case, *Marchand v. Barnhill*.[23] *Marchand* revolved around a food safety crisis: Blue Bell, one of the largest ice-cream manufacturers in the U.S., had a line of ice-cream products contaminated with listeria, causing three deaths and massive recalls.[24] Shareholders brought a claim of failure of oversight, which the Chancery routinely dismissed for not being able to link the bad outcomes at the company level to bad intentions on the directors' part. Yet the Delaware Supreme Court had a different reading: for then-Chief Justice Strine, the fact that the plaintiffs showed that the board of a food-manufacturing company never even discussed food safety issues indicated a possible utter failure of compliance,[25] thereby justifying denying the motion to dismiss.[26]

Coming on the heels of *Marchand* was the October 2019 *Clovis* case,[27] involving a pharmaceutical company whose fate rested on the successful development of a promising drug for lung cancer therapy. When the drug's trial did not go as hoped, the company failed to accurately report to the regulator and the market the true efficacy of the drug. The Court denied the company's motion to dismiss, reasoning that for a "monoline" company

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19. *See, e.g.*, Megan W. Shaner, *The (Un)Enforcement of Corporate Officers' Duties*, 48 U.C. DAVIS L. REV. 271, 307 (2014) (compiling references); Claire A. Hill & Brett H. McDonnell, *Reconsidering Board Oversight Duties After the Financial Crisis*, 2013 U. ILL. L. REV. 859 (arguing 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 (2011). *But see* 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 (2008).

20. Bullard, *supra* note 14, at 44.

21. Nees, *supra* note 14, at 216.

22. Charles M. Elson & Christopher J. Gyves, In re Caremark*: Good Intentions, Unintended Consequences*, 39 WAKE FOREST L. REV. 691, 692 (2004); *see also* McGreal, *supra* note 16, at 648 (arguing that *Caremark*'s development stalled, leaving it a "largely symbolic" duty).

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

24. *Id.* at 812–13, 822.

25. Whether the board failed to implement a monitoring and reporting system is the first prong of the *Caremark* inquiry. The second is whether the board consciously ignored damning information that such a monitoring system, once implemented, generated. Stone v. Ritter, 911 A.2d 362, 370 (Del. 2006).

26. *Marchand*, 212 A.3d at 824.

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

(similarly to Blue Bell) operating in a "highly regulated industry,"[28] meeting FDA protocols is "mission critical," which calls for heightened oversight scrutiny.[29] Indications of problems in that context thus count as quintessential red flags that directors should never have ignored.[30]

In April 2020 came yet another successful *Caremark* case, *Hughes v. Hu*.[31] There, an auto parts company had persistently struggled to meet the legal requirements for financial reporting and related-party transactions, and the shareholder plaintiff sought damages from directors and officers for their pervasive oversight failures.[32] The court denied the motion to dismiss, reasoning that even though the company "had the trappings of oversight,"[33] the mere existence of audit committees and departments charged with compliance is not enough to rebut a *Caremark* claim, when evidence indicates that these institutions met only sporadically and consistently ignored clear indications of irregularities.[34]

This trifecta of successful *Caremark* cases quickly attracted the attention of practitioners and academics alike. Law firms sent memos to their clients, warning them of a potential "stricter *Caremark* era" that is upon us.[35] Scholars who were bemoaning *Caremark*'s lack of bite now edited their papers to describe the new development as potentially signifying a desirable change of direction.[36] But while commentators agreed that these new *Caremark* cases are worthy of attention, they seemingly could not agree on whether the cases represent a meaningful trend or not. Some quipped that

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28. *Id.* at *1.

29. *Id.* at *12–13. The emphasis on "mission critical compliance" follows the lead of *Marchand*, 212 A.3d at 822.

30. *Clovis*, 2019 WL 4850188, at *2. In other words, while the *Marchand* court emphasized *Caremark*'s first prong, the *Clovis* court emphasized *Caremark*'s second prong.

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

32. *Id.* at *1.

33. *Id.* at *16.

34. *Id.* at *14–17.

35. Francis Pileggi, *Directors May Face Oversight Liability for Not Properly Monitoring Key Drug's Clinical Trial*, DEL. CORP. & COM. LITIG. BLOG (Oct. 16, 2019), https://www.delawarelitigation.com/2019/10/articles/chancery-court-updates/directors-may-face-oversight-liability-for-not-properly-monitoring-key-drugs-clinical-trial/ [https://perma.cc/UET8-ZWTY]; *see also* Roger Cooper, Jared Gerber, Vanessa Richardson & David Wagner, *Cleary Gottlieb Offers 2019 Mid-Year Developments in Securities and M&A Litigation*, CLS BLUE SKY BLOG (Aug. 27, 2019), https://clsbluesky.law.columbia.edu/2019/08/27/cleary-gottlieb-offers-2019-mid-year-developments-in-securities-and-ma-litigation/ [https://perma.cc/7DUR-DH6D] (treating *Marchand* as a reminder that Caremark claims "still have teeth," after all). For more on practitioners' reactions to the new *Caremark* cases see Shapira, *supra* note 8 (manuscript at 27 n.141) (compiling examples); Robert C. Bird, Caremark *Compliance for the Next Twenty-Five Years*, 58 AM. BUS. L.J. (forthcoming 2021), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3566279 [https://perma.cc/9ZZW-GHF4] (analyzing more systematically thirty such memorandums).

36. *See* John Armour, Jeffrey Gordon & Geeyoung Min, *Taking Compliance Seriously*, 37 YALE J. ON REGUL. 1, 12 (2020); Pollman, *supra* note 16.

"once is a happenstance, two is a coincidence, and three is enemy action,"[37] while others suggested that three is not a trend,[38] choosing to highlight instead the egregious circumstances in these cases that make them less applicable going forward.

While the debate was still raging, the trifecta turned into a quadfecta. In August 2020, another *Caremark* claim survived the motion to dismiss, in *Teamsters Local 443 v. Chou*.[39] There, the AmerisourceBergen Company (ABC) had one of its subsidiaries embroiled in a criminal investigation into cancer drug repackaging. The subsidiary was pooling overfills from oncology vials, which were not intended for patient use, and repackaging them into syringes that they then sold and distributed. This behavior violated multiple laws and regulations, eventually costing ABC hundreds of millions in criminal and civil fines. The court found pleading-stage indications for several red flags that were ignored by ABC's directors: an outside law firm flagged a lack of monitoring of the particular subsidiary in question, the Subsidiary's former COO filed a qui tam action invoking the violations in question, and the DOJ issued a subpoena regarding the matter.[40] Throughout the opinion, the court seemingly departs from the conventional understanding of *Caremark*, according to which some compliance is enough compliance.[41] Not anymore, apparently: the fact that the board hired an outside law firm to flag areas of weaknesses, and then heard reports from the chief compliance officer about efforts to ramp up compliance in these areas, is not enough, the court insisted, given that there is no documentation of the board demanding updates and progress reports.[42] In other words, it is not enough to make sure that risks are disclosed to the board; the board has to follow up and attempt to rectify these risks. The fact that the board heard

37. Professor Bainbridge, channeling his inner Ian Fleming. Stephen Bainbridge, *Is* Caremark *Still the Hardest Claim for Plaintiffs to Win in Corporate Law?*, PROFESSORBAINBRIDGE.COM (May 3, 2020), https://www.professorbainbridge.com/professorbainbridgecom/2020/05/is-caremark-still-the-hardest-claim-for-plaintiffs-to-win-in-corporate-law.html [https://perma.cc/5DSD-CT22].

38. Nicholas D. Mozal & David A. Seal, *Three Is Not a Trend: Another* Caremark *Claim Survives a Motion to Dismiss, But Does Not Reflect a Change In The Law*, HARV. L. SCH. F. ON CORP. GOVERNANCE (May 27, 2020), https://corpgov.law.harvard.edu/2020/05/27/three-is-not-a-trend-another-caremark-claim-survives-a-motion-to-dismiss-but-does-not-reflect-a-change-in-the-law/ [https://perma.cc/35WJ-VRHU]; *see also* Meredith Kotler, Pamela Marcogliese & Marques Tracy, *Recent Delaware Court of Chancery Decision Sustains Another* Caremark *Claim at the Pleading Stage*, HARV. L. SCH. F. ON CORP. GOVERNANCE (May 25, 2020), https://corpgov.law.harvard.edu/2020/05/25/recent-delaware-court-of-chancery-decision-sustains-another-caremark-claim-at-the-pleading-stage/ [https://perma.cc/W9SR-4MGM] ("It remains unlikely that these recent decisions signal some change in the law, but rather reflect allegations of unique or extreme examples of certain corporate behavior.").

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

40. *Id.* at *19–24.

41. *See* Langevoort, *supra* note 13, at 729–30 (suggesting *Caremark* demands "almost nothing beyond asking that *some* compliance system exists").

42. *Chou*, 2020 WL 5028065, at *10.

recommendations on how to deal with the qui tam suit was also deemed not enough, given that there is no indication that they did something about the underlying issue. And the fact that board minutes did not contain a discussion of the DOJ subpoena (even though the board signed a Form 10-K disclosure recognizing the subpoena) is held against them as an indication of, again, not doing enough.[43]

Importantly, The *Chou* court reiterates and further extends the basis for the previous three successful cases. Following *Marchand* and *Clovis*, *Chou* implies an enhanced oversight duty for "mission critical" risks. But recall that *Marchand* and *Clovis* referred to "mission critical compliance" in the context of monoline companies, whose fate rests on meeting the regulatory requirements for a single product. The *Chou* court extends the application of such enhanced oversight duties to the context of a giant drug company, for violations that occur in one of its many subsidiaries, and involve only a tiny fraction of the company's overall revenues ($14 million).[44] Following *Chou*, one could provocatively maintain that *everything is regulatory mission critical* these days.[45]

And like *Hughes*, *Chou* uses any document that was *not* produced by the defendants against them.[46] If in the past one could claim that lack of documentation evidences that directors were not aware of the problem (and so no pleading-stage indication of bad faith exists), after *Chou* it becomes clear that lack of documentation can evidence lack of needed follow-ups and actions on part of the board to remedy potential oversight issues. *Chou* further implies that directors would be held aware of any piece of information included in company's disclosures and documents that they execute (such as Form 10-K).[47]

In a little over a year, then, four *Caremark* claims survived the motion to dismiss. Do these cases represent a meaningful shift in oversight liability, or are they merely a coincidence of several cases with rare circumstances? And if we are indeed witnessing a new trend, why now? What changed around 2019 that facilitated the purported change in oversight liability?

II. CAUSES: THE RISE OF SHAREHOLDER INSPECTION RIGHTS

My answer to the above-mentioned question is: yes, there is a systematic change in failure-of-oversight litigation. A new *Caremark* era. And the main

43. *Id.* at *24.
44. *Id.* at *5.
45. Indeed, we will later see that law firms are now advising their clients that the revamped *Caremark* duties may apply also to how the board handles cybersecurity risks or the challenges that come with COVID-19. *See infra* note 141 and accompanying text.
46. *Chou*, 2020 WL 5028065, at *2.
47. *See id.* at *21.

reason I think that this trend is here to stay is that it is connected to and driven by a seemingly disparate development in shareholders' right to information from the company. Success in *Caremark* litigation has always hinged on plaintiffs' ability to conduct thorough *pre-filing* investigations, so as to be able to link the directors to the trauma that the company suffered. One way for shareholders to investigate potential failures of oversight is to utilize their right, nestled in D.G.C.L. § 220, to inspect the company's "books and records."[48] Shareholders' inspection rights include internal company documents such as board materials and intra-company communications.[49] And in recent years, the courts have liberalized their interpretation of section 220, now allowing shareholders to gain access to more internal documents, including even informal electronic communications via emails and private LinkedIn messages.[50] Armed with this increasingly potent investigatory tool, shareholders can now plead with particularity facts indicating that red flags were flown in the directors' faces, thereby surviving the once-insuperable *Caremark* pleading hurdle.

This Part fleshes out the link between the two seemingly disparate developments in inspection rights and oversight liability. Section A explains why shareholder litigation in general has long put a premium on pre-filing investigations. Section B applies the general argument to the specific failure-of-oversight context, showing how *Caremark* claims that succeed tend to be those relying heavily on evidence extracted from prior section 220 requests. Section C details the recent liberalization of section 220 requirements, as it pertains to director oversight duties. Section D then acknowledges that not everything is related to section 220, delineating other (non-exclusive) factors that contribute to the new *Caremark* era.

A. Corporate Law Puts a Premium on Pre-Filing Investigations

A fundamental challenge in any litigation is how to separate the meritorious from the meritless claims. More accurately, the challenge is *when* to do the screening. Screening cases early reduces the "direct costs" of the process (and the chilling effects that come with them), as in saving the costs of going through discovery and trial.[51] At the same time, screening early increases the "error costs": if you set the pleading bar high (as in requiring a showing of scienter), screening early may mean dismissing too many meritorious claims; if you set the bar low, screening early may mean

48. DEL. CODE ANN. tit. 8, § 220 (2021).
49. *Id.*
50. *E.g.*, KT4 Partners LLC v. Palantir Techs. Inc., 203 A.3d 738 (Del. 2019).
51. For a concise summary of economic analysis of civil procedure, see Daniel Klerman, *The Economics of Civil Procedure*, 11 ANN. REV. L. & SOC. SCI. 353 (2015).

spending too many resources on meritless claims. In American shareholder litigation (both in federal and in state courts), the screening is done early and aggressively, prior to discovery.[52] The motion to dismiss has become the main event: most shareholder litigation cases face one, and many such motions succeed.[53]

Opting for early screening with a high pleading bar can be justified by pointing to two key differences between shareholder litigation and other types of litigation: asymmetries in discovery costs and agency problems. Unlike in other types of litigation, in shareholder litigation the costs of discovery fall mainly on one side, namely, the defendants' side.[54] And because shareholder litigation is usually representative litigation (derivative or class actions), there are also more severe agency problems: the representative may conduct litigation in ways that impose costs rather than benefits on the other, passive shareholders.[55] As a result, shareholder litigation is more susceptible to strike suits and quick settlements that benefit no one but the attorneys.[56] In other words, the choice of early screening with a high pleading bar is meant to combat the worry that plaintiff attorneys will rush to file suits without investigating the merits and use the discovery costs as leverage to extract quick rents from defendants.[57]

At the same time, such early screening increases the "false negative" errors of dismissing meritorious claims, in a context where the costs of false negatives are huge: breaches of duties in corporate and securities laws can cause potential harms in the billions of dollars.[58] A key challenge for courts is therefore how not to overscreen, that is, how to maintain deterrence. Delaware courts have traditionally answered the early screening challenge with a combination of (1) assuring the availability of high-quality information even at an early stage, and (2) having expert judges who could evaluate the strength of cases based on partial information.[59]

52. *See* Lawrence A. Hamermesh & Michael L. Wachter, *The Importance of Being Dismissive: The Efficiency Role of Pleading Stage Evaluation of Shareholder Litigation*, 42 J. CORP. L. 597, 600 (2017).

53. *Cf.* Stephen J. Choi & A. C. Pritchard, *The Supreme Court's Impact on Securities Class Actions: An Empirical Assessment of* Tellabs, 28 J.L. ECON. & ORG. 850, 851 (2012) (on shareholder securities litigation); Jessica Erickson, *The Lost Lessons of Shareholder Derivative Suits*, 77 WASH. & LEE L. REV. 1131 (2020) (on shareholder derivative actions).

54. *See* Shapira, *supra* note 8 (manuscript at 10); Hamermesh & Wachter, *supra* note 52, at 602.

55. Hamermesh & Wachter, *supra* note 52, at 605.

56. Gagliardi v. Trifoods Int'l, Inc., 683 A.2d 1049, 1054 (Del. Ch. 1996).

57. Jessica Erickson, *Corporate Misconduct and the Perfect Storm of Shareholder Litigation*, 84 NOTRE DAME L. REV. 75, 93 (2008). For Delaware courts' criticism of "fast filers," see *In re* Cox Commc'ns, Inc. S'holders Litig., 879 A.2d 604, 608 (Del. Ch. 2005); *In re* Revlon, Inc. S'holders Litig., 990 A.2d 940, 959–60 (Del. Ch. 2010); John Armour, Bernard Black & Brian Cheffins, *Delaware's Balancing Act*, 87 IND. L.J. 1345, 1368 (2012) (compiling examples).

58. Lynn A. Stout, *Type I Error, Type II Error, and the Private Securities Litigation Reform Act*, 38 ARIZ. L. REV. 711, 713 (1996) (asserting costs of fraud outweigh costs of litigation in our context).

59. This is the main thesis in Hamermesh & Wachter, *supra* note 52.

Nowhere is this shareholder litigation dynamic—trying to combat fast-filers while assuring availability of high-quality information—more pronounced than in *Caremark* litigation. Delaware courts have long expressed their disdain for those who hasten to file a complaint shortly after a regulator announces an enforcement action against the company, without bothering to properly investigate first.[60] Indeed, one relatively unnoticed aspect of the otherwise endlessly analyzed *Caremark* opinion is that Chancellor Allen struck down the proposed attorney fee as too high. Allen reasoned that the attorney merely piggybacked on prior regulatory enforcement actions, without adding much to the preexisting mix of information or remedies.[61]

Concomitantly, the courts have long admonished plaintiffs to use all the tools at hand to investigate before filing a *Caremark* claim, and in particular to utilize their rights to inspect the company's books and records under section 220.[62] The Court of Chancery went as far as adopting a presumption of *in*adequate representation for those who file *Caremark* claims without utilizing section 220 first.[63] While Delaware's Supreme Court has thus far refused to adopt such a sweeping approach,[64] it has nevertheless recognized the problem, and offered a plethora of more nuanced approaches.[65] In all, the courts seem to agree that in failure-of-oversight claims, rushing to file makes little sense: the claim is about something that has already happened, and there is a real need to investigate thoroughly, as the claim invokes scienter.[66]

The ebbs and flows of oversight cases should therefore be viewed (also) through the lens of Delaware courts trying to combat file-first-investigate-

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60. Armour, Black & Cheffins, *supra* note 57, at 1375.

61. *In re* Caremark Int'l Inc. Derivative Litig., 698 A.2d 959, 972 (Del. Ch. 1996). Perhaps nowhere is this criticism more pronounced than in the *Citigroup* case, where the court denounced the mode of filing *Caremark* claims based on "general ipse dixit syllogisms" and the hope that "the Court [would] accept the conclusion that since the Company suffered large losses, and since a properly functioning risk management system would have avoided such losses, the directors must have breached their fiduciary duties in allowing such losses." *In re* Citigroup Inc. S'holder Derivative Litig., 964 A.2d 106, 128–29 (Del. Ch. 2009).

62. *See* Wood v. Baum, 953 A.2d 136, 143–44 (Del. 2008).

63. La. Mun. Police Emps.' Ret. Sys. v. Pyott, 46 A.3d 313, 335–36 (Del. Ch. 2012) (*Pyott I*); South v. Baker, 62 A.3d 1, 22–24 (Del. Ch. 2012); Cal. State Tchrs.' Ret. Sys. v. Alvarez, 179 A.3d 824, 853 (Del. 2018). To be sure, a presumption of inadequacy is just that: a presumption. It can be rebutted, for example, if the plaintiff shows that she did conduct thorough pre-filing investigations, albeit by means other than section 220.

64. Pyott v. La. Mun. Police Emps.' Ret. Sys., 74 A.3d 612 (Del. 2013) (*Pyott II*); *cf.* King v. VeriFone Holdings, Inc., 12 A.3d 1140, 1150–52 (Del. 2011).

65. Such as denying lead plaintiff status, limiting the ability of the fast filer to amend her complaint, and so on. *See King*, 12 A.3d at 1151–52.

66. As V.C. Laster succinctly put it: unlike with claims about other business decisions, with *Caremark* claims "the connection to the board is neither readily apparent nor reasonably inferable from the occurrence of the corporate trauma." *Baker*, 62 A.3d at 23.

later derivative suits that do not serve the best interests of shareholders. The recent *Hughes* case provides an illustration. We saw earlier that several commentators suggested not reading much into the *Hughes* decision, because it rested on extremely egregious facts—a rare, clear-cut case of utter failure of oversight. Yet such a reading of *Hughes* ignores the fact that the Southern District of New York quickly dismissed a lawsuit based on the exact same underlying misbehavior.[67] One important factor that led to the different fates of the S.D.N.Y. lawsuit and the Delaware lawsuit is pre-filing investigations.[68] The S.D.N.Y. plaintiff filed only three days after the public announcement of irregularities, in March 2017.[69] The Delaware plaintiff, by contrast, prepared a thorough section 220 request and filed it in May 2017, and then for over a year fought the company over access to documents that could help to link the company's top decision-makers to the reported irregularities.[70] When he exhausted all his pre-filing investigation possibilities, the Delaware plaintiff filed in February 2019 a detailed 116-page complaint.[71] The thorough, well-documented complaint allowed the court to make reasonable pleading-stage inferences about what directors knew, when, and what they did not do to stop the pervasive problems.

The *Hughes* lawsuit thus succeeded not just because of the egregious facts about corporate misbehavior, but also because the plaintiff did an important service by fully fleshing out the directors' and executives' role in not stopping such misbehavior. As the next Section shows, this is a recurring pattern in successful *Caremark* claims.

B. Pre-Filing Investigations Determine the Fate of Caremark Claims

Legal scholars have long attempted to identify the determinants of successful *Caremark* claims. Some focus on the type of misbehavior in question (cases that succeed are about disobedience rather than about taking bad business risks), while others focus on the type of companies in question (cases that succeed concern companies operating in heavily regulated industries).[72] I propose here a different (non-exclusive) factor to focus on, namely, the extent to which plaintiffs and their attorneys conducted thorough pre-filing investigations. When outside shareholders succeed in

67. Mozal & Seal, *supra* note 38.

68. To be sure, this is not the only factor that matters, if only because the pleading standards in federal securities cases are different than those in state corporate law cases. *See* the 1995 Private Securities Litigation Reform Act (PSLRA), 15 U.S.C. §§ 77z-l(b), 78u-4(b)(3)(B), as interpreted in Tellabs, Inc. v. Makor Issues & Rights, Ltd., 551 U.S. 308, 314, 324 (2007).

69. *In re* Kandi Techs. Grp., Inc. Sec. Litig., No. 17 Civ. 1944, 2019 WL 4918649, at *3 (S.D.N.Y. Oct. 4, 2019).

70. Hughes v. Hu, No. 2019-0112-JTL, 2020 WL 1987029, at *9 (Del. Ch. Apr. 27, 2020).

71. *Id.* at *9.

72. For a recent thorough analysis see Pollman, *supra* note 16.

extracting internal board communications, they exponentially increase their chances of finding evidence implicating scienter. To illustrate, one need simply look at the procedural history of *Caremark* cases that survived motions to dismiss. Most of them rested on prior section 220 litigation, which allowed plaintiffs to locate pleading-stage indications in one of two categories: (1) locating damning information that was reported to the directors, who ignored it; or (2) indicating a dearth of documentation of board-level discussion of a critical issue, which is damning in and of itself.

The Blue Bell (*Marchand*) case fits the latter category, namely, dearth of documentation. Following the listeria outbreak, shareholders filed a section 220 request, and combed through the company's board minutes, observing that the minutes never contained a discussion of food safety issues.[73] Other internal Blue Bell documents showed that discussions and warnings of food safety problems existed in house, but the information never flowed up to the board level.[74] This was enough to convince the Supreme Court to deny the motion to dismiss.[75] A similar theme appears in three cases involving China-based companies that entered U.S. public markets through reverse mergers. In 2013, the *China Agritech*[76] and *Fuqi*[77] cases survived the motion to dismiss, based on "the glaring absence from the production of books and records that the Company should have readily possessed and provided."[78] China Agritech was required in a section 220 action to produce its audit committee minutes and failed to produce *any*;[79] Fuqi failed to meet plaintiffs' demands for books and records and defunded its audit committee to prevent further investigation.[80] The 2020 *Hughes* decision stated that defendants' failure to produce exculpating documents doomed their motion to dismiss.[81] For example, the company was ordered in prior section 220 action to produce all the board minutes from 2009–2017 that address a certain thorny issue, yet the first minutes they provided were from 2014.[82] This allowed the court to infer that the board never even addressed the thorny issue from 2009–2014.[83]

73. Marchand v. Barnhill, 212 A.3d 805, 817 (Del. 2019).
74. *Id.*
75. *Id.*
76. *In re* China Agritech, Inc. S'holder Derivative Litig., No. 7163-VCL, 2013 WL 2181514 (Del. Ch. May 21, 2013).
77. Rich *ex rel.* Fuqi Int'l, Inc. v. Yu Kwai Chong, 66 A.3d 963 (Del. Ch. 2013).
78. *China Agritech*, 2013 WL 2181514, at *1.
79. *Id.* at *19.
80. *Rich*, 66 A.3d at 979; Kelly v. Fuqi Int'l, Inc., No. 6797-VCG, 2013 WL 1150257, at *3 (Del. Ch. Jan. 2, 2013).
81. *See* Hughes v. Hu, No. 2019-0112-JTL, 2020 WL 1987029, at *2 (Del. Ch. Apr. 27, 2020)
82. *Id.* at *2.
83. *Id.*

Clovis represents the other category, namely, smoking-gun indications that red flags were flown in the directors' face, and ignored. There, shareholders used section 220 to show that directors received indications that the company was violating FDA protocols, yet repeatedly ignored them.[84] There was a clear mismatch between the (damning) information the board received in house and the (rosy) information the company disclosed to the public. A similar pattern emerged in the *Pyott I*[85] case, which revolved around Allergan paying $600 million in fines for violating off-label drug marketing regulations regarding Botox. Plaintiffs obtained, via section 220, materials prepared for the board, allowing the court to cite specific bullet points from board presentations as indications that directors had to know about plans to ramp up Botox sales via off-label usages.[86] In an earlier case, *Saito*, plaintiffs used section 220 to receive documents implicating directors' awareness of fraudulent accounting schemes.[87]

The upshot is clear: a shareholder who wishes to successfully plead a failure-of-oversight claim has to effectively utilize her inspection rights prior to filing. A diligent use of shareholder's inspection rights can yield internal documents that link the board to the trauma, indicating that directors either knew about the problem but did nothing to stop it, or completely ignored a critical issue. Still, the question remains: why now? The fact that utilizing inspection rights is key to successful *Caremark* litigation is not new; Delaware courts have been telling plaintiffs that for over two decades. Let us move to examine what changed in recent years that made the string of successful *Caremark* claims possible.

C. What Changed? The Liberation of Section 220

Pre-filing investigations have become more effective in recent years. Some of the recent success is due to plaintiff attorneys' learning curve and the Court of Chancery's consistent admonitions to utilize section 220 prior to filing. Some may be attributed to the increased availability of information from online sources. But here I want to highlight another significant factor,

84. *In re* Clovis Oncology, Inc. Derivative Litig., No. 2017-0222-JRS, 2019 WL 4850188, at *6 n.76 (Del. Ch. Oct. 1, 2019).

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

86. *Id.* at 353. The following V.C. Laster quote perfectly illustrates this Section's argument: "Critically, the Complaint does not merely allege that this misconduct took place. Unlike the parade of hastily filed *Caremark* complaints that Delaware courts have dismissed, and like those rare *Caremark* complaints that prior decisions have found adequate, the Complaint supports these allegations with references to internal Allergan books and records that [plaintiffs] obtained using Section 220." *Id.*

87. Saito v. McCall, No. 17132-NC, 2004 Del. Ch. LEXIS 205 (Dec. 20, 2004). For the prior history of the *Saito* case, which shows the reliance on section 220 documents, see Saito v. McKesson HBOC, Inc., No. 18553, 2002 Del. Ch. LEXIS 125 (Oct. 25, 2002).

which I view as critical to the continued resurgence of *Caremark* litigation: a series of court decisions that liberalized section 220's requirements.

Shareholders' right to inspect the company's books and records is qualified. To gain access to internal company documents, shareholders have to show "proper purpose," and even then they can request only specific documents that fall within the permissible scope.[88] In practice, companies commonly do not acquiesce to shareholders' section 220 demands: they refuse to provide all or part of the documents, or provide only heavily redacted documents.[89] The demanding shareholder then often files a section 220 action with the court, whose decision hinges on the interpretation of the two prongs: purpose and scope.[90] In recent years, the courts have liberalized their interpretation of both prongs.[91]

Much of the impetus for liberalizing section 220 came from a separate development in deal litigation, on which I elaborated elsewhere:[92] decisions such as *Corwin*[93] and *M.F.W.*[94] put the onus on an informed shareholder vote on the deal, thereby making it necessary to allow aggrieved shareholders to examine ex post whether all material information was provided to them ex ante. The courts responded to that development by allowing shareholders to use section 220 to effectively plead around the *Corwin* or *MFW* defenses. Importantly for our purposes here, the section-220 liberalization did not stop at deal litigation: it now accommodates robust pre-filing investigations also in the context of failure-of-oversight claims, thereby enhancing the bite of *Caremark* duties.

1. Proper Purpose

A proper purpose for inspecting the company's books and records is one that is "reasonably related to such person's interest as a stockholder."[95] Investigating corporate wrongdoing qualifies as such.[96] Yet merely

88. Section 220 also contains other, more technical requirements, such as (1) being a stockholder, and (2) complying with formalistic requirements as to how the request has to be submitted (a written demand under oath). DEL. CODE ANN. tit. 8, § 220(b)–(c) (2021).

89. Pettry v. Gilead Scis., Inc., No. 2020-0132-KSJM, 2020 WL 6870461, at *61 (Del. Ch. Nov. 24, 2020).

90. *See* Shapira, *supra* note 8.

91. *Id.*

92. *Id.* The two developments are intertwined. To illustrate, when the *Hughes* and *Chou* courts denied the motion to dismiss based on defendants' failure to provide in prior section 220 action documentation of their actions, they referred to a recent notable decision in the context of deal litigation: *Morrison v. Berry*, 191 A.3d 268 (Del. 2018). *See* Teamsters Loc. 443 Health Servs. & Ins. Plan v. Chou, No. 2019-0816-SG, 2020 WL 5028065, at *24 n.314 (Del. Ch. Aug. 24, 2020); Hughes v. Hu, No. 2019-0112-JTL, 2020 WL 1987029, at *2 (Del. Ch. Apr. 27, 2020).

93. Corwin v. KKR Fin. Holdings LLC, 125 A.3d 304, 306 (Del. 2015).

94. Kahn v. M & F Worldwide Corp., 88 A.3d 635 (Del. 2014).

95. § 220(b).

96. Seinfeld v. Verizon Commc'ns, Inc., 909 A.2d 117, 121 (Del. 2006).

throwing accusations and speculations against the wall and seeing if they stick does not suffice. The demanding shareholder rather has to show a *credible basis* for her allegations before she gains access to internal documents. Instead of general allegations, the shareholder has to show *some* evidence from which the court may infer a possible breach of fiduciary duty.[97] How much is "some," exactly? Recent court decisions clarify that in our context, "some" could mean very little.

Consider, for example, the 2019 *Facebook* section 220 litigation.[98] When investigative reporters revealed the Cambridge Analytica scandal, showing that Facebook had been monetizing users' data without their consent, the company's stock price dropped dramatically.[99] Shareholders sought to investigate a potential failure to monitor privacy breaches and filed a section 220 action to inspect internal communications of Facebook's top managers in the light of privacy issues.[100] The company fought back, claiming that one cannot inspect books merely for curiosity's sake. Shareholders' chances of turning the section 220 request into a successful *Caremark* claim were slim, it argued, and it was highly unlikely that the company would benefit (get compensated by its directors) due to shareholders' inspection requests. In other words, the defendants claimed that section 220 is available only for investigating *actionable* wrongdoing. The court insisted that while plaintiffs' chances of winning a *Caremark* claim on the merits are indeed low, this, in itself, should not alter the minimal burden governing section 220 requests.[101] The court further reiterated that hearsay, such as journalistic reporting on the scandal, could suffice to meet the minimal, credible-basis standard.[102]

A related, potentially more impactful clarification comes from the 2020 *AmerisourceBergen* section 220 litigation.[103] AmerisourceBergen is a large wholesale distributor of opioid pain medication, which became embroiled

97. *Id.* at 123–25.

98. *In re* Facebook, Inc. Section 220 Litig., No. 2018-0661-JRS, 2019 WL 2320842 (Del. Ch. May 30, 2019).

99. *Id.* at *1.

100. Specifically, Facebook was under an FTC consent decree, putting it on notice regarding how it treats user privacy. *Id.* at *2. The shareholders demanded books and records to investigate whether Facebook's business model was in fact predicated on ignoring the FTC consent decree and monetizing user data. *Id.* at *1–2. The discussion throughout this Article on the resurgence of oversight duties corresponds with another recent debate on the ability and desirability of holding Big-Tech companies as "information fiduciaries." *See* Andrew F. Tuch, *A General Defense of Information Fiduciaries*, 98 WASH. U. L. REV. 1897, 1917 n.110 (2021).

101. *Facebook*, 2019 WL 2320842, at *2.

102. *Id.* at *2 n.10.

103. Lebanon Cnty. Emps.' Ret. Fund v. AmerisourceBergen Corp., No. 2019-0527-JTL, 2020 WL 132752 (Del. Ch. Jan. 13, 2020). Note that this is not the August 2020 case of *Chou*, which involved different violations by the same company, albeit on a much smaller scale.

in regulatory investigations of the opioid crisis.[104] Institutional investors demanded access to the company's books and records, but the company denied their request in its entirety.[105] In court, the company cited prior rulings, according to which only *non-exculpated* wrongdoing is proper purpose.[106] Since the defendant directors were protected by a 102(b)(7) exculpatory clause, and shareholder plaintiffs could not point to particular indications of bad faith (because all they had at that stage was access to public materials), shareholders could not inspect the company's books, or so the argument went.[107] The Court of Chancery rejected the claim, clarifying that limiting inspection rights only to non-exculpated wrongdoing is both bad law (misunderstanding prior precedent) and bad policy (disincentivizing genuine efforts to hold managers accountable).[108] Instead, the court maintained, any credible suspicion of wrongdoing at the company level (regardless of whether the directors were exculpated) could be deemed proper purpose for inspection.[109]

Most recently, after the first drafts of this Article were already circulated, two additional decisions further cemented the liberal approach to ordering provision of documents pre-suit in *Caremark* cases. In November 2020, the *Gilead Sciences* court not only approvingly relied on *AmerisourceBergen* to grant a section 220 request on the basis of allegations from other lawsuits and government investigations, but also, importantly, granted leave for plaintiffs to move for their expenses.[110] The court reasoned that the prevalent strategy by companies—to aggressively litigate section 220 demands and obstruct plaintiffs from employing it as a quick and easy pre-filing investigatory tool—calls for fee shifting.[111] Then, in, December 2020, Delaware's Supreme Court affirmed all the Court of Chancery's determinations in *AmerisourceBergen*, putting a final stamp of approval on

104. *Id.* at *1.

105. *Id.* at *6.

106. *Id.* at *19–23.

107. *Id.*

108. *Id.* Part of the court's reasoning was that shareholders can seek to inspect their company's books and records, not solely for the purpose of subsequently filing a *Caremark* lawsuit. They can use the information they receive for other purposes, such as when voting on remuneration or reelection of those who supposedly failed them. *Id.* at *11. For the assertion that prior precedent is more limited than the defendants argued it to be, see *id.* at *13–14 (citing, among others, Se. Pa. Transp. Auth. v. Abbvie Inc., No. 10374-VCG, 2015 WL 1753033, at *11 (Del. Ch. Apr. 15, 2015)).

109. *Id.* at *19.

110. Pettry v. Gilead Scis., Inc., No. 2020-0132-KSJM, 2020 WL 6870461, at *29–30 (Del. Ch. Nov. 24, 2020). The case revolved around multiple alleged violations in the context of development, sale, and market of HIV drugs. *Id.* at *1.

111. *Id.* at *2 & n.6 (citing James D. Cox, Kenneth J. Martin & Randall S. Thomas, *The Paradox of Delaware's 'Tools at Hand' Doctrine: An Empirical Investigation*, 75 BUS. LAW 2123 (2020)).

the new, more liberal approach to section 220.[112] Importantly, the Supreme Court affirmed that a demanding shareholder does not have to establish that the wrongdoing-in-question is actionable in order to gain access to internal company documents.

The abovementioned examples join other decisions in non-*Caremark* contexts[113] to signal a broader interpretation of the proper purpose requirement. Yet meeting the proper purpose requirement is only half the battle. The other half is the "permissible scope" question: what types of documents can a shareholder inspect in order to achieve her stated purpose?

2. Permissible Scope

A shareholder requesting access to internal company documents bears the burden of showing that each document is necessary and essential for meeting her stated purpose.[114] "Necessary and essential" here means only those documents that address the crux of the purpose and contain information that cannot be found elsewhere. The courts have emphasized that shareholders cannot use section 220 as a wide-ranging fishing expedition, but rather need to request specific documents with "rifled precision."[115] Yet here as well, we are witnessing a clear trend of liberalization.

Perhaps the most practically important issue in corporate litigation nowadays (and not just in *Caremark* litigation) concerns access to electronic forms of internal communications.[116] Recent court decisions have clarified that electronically stored information, including emails and text messages, is now fair game in section 220 actions. Shareholders' inspection rights apply not just to classic, hard-copy company "books and records," such as board minutes, but also to informal modes of communications, such as emails exchanged among the company's directors and between them and other company officials or third-party advisors. As long as the messages implicate a company issue, shareholders are entitled to inspect them, regardless of the medium.[117] In that respect, the current trend in interpreting "scope" more broadly parallels the one in interpreting "purpose": it facilitates robust pre-filing investigations.

112. AmerisourceBergen Corp. v. Lebanon Cnty. Emps.' Ret. Fund, 243 A.3d 417, 437 (Del. 2020) (explaining shareholders "need not demonstrate that the alleged mismanagement or wrongdoing is actionable" to gain access to internal documents).

113. For elaboration on the expansion of inspection rights in the context of M&A litigation see Shapira, *supra* note 8.

114. Saito v. McKesson HBOC, Inc., 806 A.2d 113, 116 (Del. 2002).

115. *Id.* at 117 n.10 (quoting Brehm v. Eisner, 746 A.2d 244, 266 (Del. 2000)).

116. Joel Edan Friedlander, *Vindicating the Duty of Loyalty: Using Data Points of Successful Stockholder Litigation as a Tool for Reform*, 72 BUS. LAW. 623, 648 (2017).

117. *See* Shapira, *supra* note 8 (manuscript at 16) (compiling examples).

To illustrate, we need simply recast our previous examples: in *Facebook*, Mark Zuckerberg and Sheryl Sandberg, among others, were ordered to produce emails relating to data privacy issues.[118] In *AmerisourceBergen*, Vice Chancellor Laster opted for a staggered approach: first, ordering the provision of formal board-level materials, to allow outside shareholders to get a sense of what materials directors formally received and considered.[119] Then, pertinently, he allowed shareholders to depose directors and potentially extend the scope of inspection further, to less formal materials that would evidence directors' deliberations and knowledge, such as emails and other electronic messages with the company's officials.[120]

It is hard to overstate the importance of expanding the scope of section 220 to informal, electronic communications.[121] Formal documents such as board minutes are usually drafted after the fact, by paper-trail-generating lawyers. Informal electronic communications in social media and emails are done in real time and are usually less carefully edited. Applied to oversight liability litigation, such extended scope increases plaintiffs' chances of finding smoking-gun indications of red flags that were flown in the directors' faces.

Beyond illustrating the liberalization of section 220, *Facebook* and *AmerisourceBergen* also suggest that when debating whether there is a "new *Caremark* era" or not, we should look beyond the *Blue Bell-Clovis-Hughes-Chou* quadfecta. When we evaluate the trend, we should also factor in successful section 220 actions filed in preparation for potential subsequent *Caremark* litigation. Much like successful merit-based *Caremark* litigation, successful section 220 litigation often imposes costs on defendants in ways that make them internalize the costs of failures of oversight. A successful section 220 not only increases the expected legal sanction down the road. It also, pertinently, imposes non-legal costs, such as the emotional drainage of going through depositions (as in *AmerisourceBergen*) or the reputational damage that comes from media coverage of the section 220 dispute (as in *Facebook*).[122] In other words, section 220 litigation over investigation of potential failures of oversight can yield similar consequences to actual *Caremark* litigation.

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118. *In re* Facebook, Inc. Section 220 Litig., No. 2018-0661-JRS, 2019 WL 2320842, at *18 n.185 (Del. Ch. May 30, 2019).

119. Lebanon Cnty. Emps.' Ret. Fund v. AmerisourceBergen Corp., No. 2019-0527-JTL, 2020 WL 132752, at *66-67 (Del. Ch. Jan. 13, 2020)

120. *Id.*

121. For the practitioner's viewpoint see Friedlander, *supra* note 116; Joel Edan Friedlander, *Confronting the Problem of Fraud on the Board*, 75 BUS. LAW. 1441, 1472–76 (2020).

122. *See infra* Section III.B.

D. Other Causes Besides the Rise of Shareholder Inspection Rights

Thus far we have seen that the new *Caremark* era consists of enhanced duties for overseeing critical regulatory risks (as in *Marchand*, *Clovis*, and *Chou*), and lower evidentiary thresholds for requesting internal documents and allowing for provision of even formal e-communications (as in *Facebook* and *AmerisourceBergen*). Before we switch to evaluating the desirability of such developments in Part III below, let us dedicate this Section to discussing other potential drivers of the resurgence of oversight duties, besides the increased emphasis on pre-filing investigations.

Indeed, the recent liberalization of section 220 cannot fully explain the wave of successful *Caremark* cases. Recall that in *Blue Bell* and in *Hughes*, for example, the court denied the motion to dismiss not based on documents extracted via section 220, but rather based on the documents that were *not* provided.[123] And in *Clovis* and *Chou*, most of the pleading-stage inferences about red flags were made using board-level documents: the type of traditional documents that were long available via section 220, rather than the type of smoking-gun emails that have recently won claims in the deal negotiation context.[124] One could therefore claim that regardless of how the courts now interpret the permissible scope of inspection rights, these *Caremark* claims could have succeeded even under a more stringent interpretation that does not allow the production of informal communications.

It is thus important to reiterate: I do not claim that the expansion of the permissible scope prong of section 220 is the sole driver of the new *Caremark* era. My claim is rather broader and more modest: the increased *emphasis* on pre-filing investigations increases the chances that a *Caremark* claim will survive the motion to dismiss. The courts' constant admonitions and tinkering started paying dividends, in that plaintiffs now increasingly turn to and make better use of their inspection rights.[125] And once the plaintiff fully utilizes her inspection rights and submits a detailed complaint, the court is more willing to draw inferences against the defendants, such as holding lack of documentation against them, as an indication for ignoring red flags.[126] In all, Delaware corporate law has become more pre-filing-

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123. *See supra* Part I.

124. *See supra* Part I. A classic example from the deal negotiation context is Morrison v. Berry, 191 A.3d 268 (Del. 2018). On *Morrison*'s impact, see Shapira, *supra* note 8.

125. One could also surmise that the increased emphasis on thorough pre-filing investigations has led to better screening of low-quality plaintiff attorneys, such that nowadays the successful *Caremark* claims are brought by better representatives of shareholder interests.

126. Expanding the permissible scope does have its own impact, but we would typically find this impact much earlier, in section 220 litigation: if shareholders gain access to directors' emails, that, in itself, is where deterrence can come from (and defendants would be likely to push for early settlement).

investigations friendly, which bodes well for plaintiffs' chances in *Caremark* cases.

To further clarify, I do not see my section-220 explanation as the sole driver of the resurgence in oversight duties. The new *Caremark* era is not only about better pre-filing investigations. There exist other, non-mutually-exclusive drivers. One potential driver is what Gadinis and Miazad recently referred to as "the hidden power" of compliance officers.[127] The proliferation of compliance personnel within organizations, and the credible threat of liability that they face, have gradually increased the chances that these compliance officers will report to the board on thorny aspects of the company's compliance. This, in turn, increases the chances of locating red flags after the fact and holding directors accountable for ignoring them in real time. In other words, nowadays there exists more robust evidentiary records on compliance issues within organizations, which in turn opens a clearer path for director liability.[128]

Another potential driver of the resurgence of director oversight duties is the increased societal demands that corporations face these days, calling on them to treat their stakeholders and society at large better. Former Chief Justice Strine has recently alluded to how these rising "ESG" demands coincide with *Caremark* duties.[129] There exist two conduits from rising societal demands to a recalibration of Delaware corporate law (here, oversight duties). First, the courts may believe that the environment that corporations operate in these days necessitates that directors devote more time and effort to monitor compliance risks, if only because the expected regulatory and reputational sanctions for ignoring compliance have grown. In other words, the argument could be that an increased emphasis on oversight is more and more in the best interests of shareholders. Indeed, a similar reasoning was the impetus for the 1996 *Caremark* decision, where Chancellor Allen noted that the then-recently-passed sentencing guidelines have made the oversight role of the board all the more important.[130] A second conduit from rising societal and regulatory demands to a change in corporate law doctrine is Delaware courts' need to maintain legitimacy and stem federal intervention.[131] Others have made a similar argument—namely, that Delaware courts are attuned to potential public backlashes over salient corporate governance problems—in the past, such as in early 2000s,

127. *See* Gadinis & Miazad, *supra* note 1, at 2139.
128. *Id.*
129. *See* Strine et al., *supra* note 1. ESG stands for Environmental, Social, and Governance factors.
130. *In re* Caremark Int'l Inc. Derivative Litig., 698 A.2d 959, 969–70 (Del. Ch. 1996).
131. *See* Pollman, *supra* note 16, at 2030.

when public attention was focused on excessive executive pay and Delaware handed down its famous *Disney* decision.[132]

Whatever the other drivers of the recent trend in oversight duties are, the expansion of shareholders' inspection rights is likely to ensure that the trend is here to stay. If we think that more indications of red flags exist in house these days, or that courts are more willing to scrutinize failure of oversight, then arming plaintiffs and their attorneys with better pre-filing investigatory tools is bound to lead to more successful *Caremark* claims in the near future. The question then becomes: is that a good thing?

III. CONSEQUENCES: FACILITATING BETTER INTERNAL AND EXTERNAL ENFORCEMENT

It is one thing to recognize that more *Caremark* claims survive the motion to dismiss these days, and another to conclude that such a development is desirable from a societal perspective. For one, we saw that some of the development in oversight duties is related to the expansion of pre-filing discovery. And the expansion of pre-filing discovery comes with its own set of thorny issues. Section 220 actions consume sizeable resources of the demanding shareholder, the company, and the courts.[133] Beyond the direct costs, expanded section 220 actions also carry the risk of a chilling effect by subjecting companies to "excessive and disruptive, and perhaps nefarious, inquiries."[134] One could also question the benefits arising from the new *Caremark* cases: success in section 220 actions or motions to dismiss does not mean that these cases will ultimately be decided in favor of the plaintiffs. We therefore cannot jump to the conclusion that these new cases would generate better deterrence—or so the argument goes.

In fact, such an objection misconstrues how Delaware corporate law works (deters). In corporate law, in general, corporate decision-makers practically never pay out of pocket for their misbehavior.[135] Yet deterrence

132. Disney v. Walt Disney Co., 857 A.2d 444 (Del. Ch. 2004). Sean J. Griffith, *Good Faith Business Judgment: A Theory of Rhetoric in Corporate Law Jurisprudence*, 55 DUKE L.J. 1, 16–18 (2005). It is perhaps not a coincidence that it was Chief Justice Strine who signaled the new *Caremark* era in his *Marchand* opinion, given that Strine has been a staunch advocate of the need for companies to respond to what he terms EESG demands in his off-the-bench writing. *See, e.g.*, Leo E. Strine, Jr., *Who Bleeds When the Wolves Bite: A Flesh-and-Blood Perspective on Hedge Fund Activism and Our Strange Corporate Governance System*, 126 YALE L.J. 1870 (2017); Strine et al., *supra* note 1.

133. *See generally* Cox et al., *supra* note 111 (providing empirical evidence on the growth in complexity and duration of section 220 litigation).

134. Donnelly v. Keryx Biopharmaceuticals, Inc., No. 2018-0892-SG, 2019 WL 5446015, at *3 (Del. Ch. Oct. 24, 2019).

135. Bernard Black, Brian Cheffins & Michael Klausner, *Outside Director Liability*, 58 STAN. L. REV. 1055, 1055 (2006); Margaret M. Blair & Lynn A. Stout, *Trust, Trustworthiness, and the Behavioral Foundations of Corporate Law*, 149 U. PA. L. REV. 1735, 1791 (2001) (noting directors are more likely to get struck by lightning than pay damages for breaching their fiduciary duties).

cannot be measured solely on the basis of sanctions imposed in verdicts coming after a full trial. Deterrence here rather comes from paying settlements ex post and planning how to avoid the risks and costs of litigation ex ante.

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. As Section A details, the new *Caremark* cases created a wave of law firm memos calling on boards to place compliance issues on the agenda and make sure deliberations are being properly recorded. Another part of the law's effect on behavior is through imposing (uninsurable) non-legal costs, such as the emotional costs (stress, embarrassment) and the reputational costs (having details about your misbehavior dug out and made public, for all other market participants to see).[136] Section B illustrates how the expansion of section 220 has dramatically increased these non-legal costs for failure of oversight, thereby ramping up deterrence. At the same time, I should not overstate my claim: even in the most optimistic reading of the new *Caremark* era, private, corporate-law litigation plays only a small part in the larger compliance puzzle, and it cannot fix all the major problems. Accordingly, Section C clarifies my more modest claim: the revamped, section 220-driven mode of *Caremark* litigation, however imperfect, balances some of the flaws of the other institutions that combat corporate illegality.

A. Facilitating Better Paper Trails

After each of the abovementioned new *Caremark* decisions, the large law firms sent memos to their clients, imploring directors to (1) start working harder on implementing and conducting periodic reviews of a well-integrated legal compliance program, and (2) make sure that proper documentation exists and that the board minutes demonstrate that the board received appropriate information about the key issues the company faces.[137] For example, following *Marchand*, law firms advised boards to "establish systems so that management provides them with an adequate picture of

136. *See, e.g.*, 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).

137. *See* Gail Weinstein, Warren S. de Wied & Phillip Richter, Caremark *Liability for Regulatory Compliance Oversight*, HARV. L. SCH. F. ON CORP. GOVERNANCE (July 8, 2019), https://corpgov.law.harvard.edu/2019/07/08/caremark-liability-for-regulatory-compliance-oversight/ [https://perma.cc/8WEN-CASQ]; Louis L. Goldberg, Joseph A. Hall, John B. Meade, Bryan B. Rooney & Andrew Ditchfield, *Davis Polk Discusses Recent Delaware Decisions on Director Oversight*, CLS BLUE SKY BLOG (Dec. 2, 2019), https://clsbluesky.law.columbia.edu/2019/12/02/davis-polk-discusses-recent-delaware-decisions-on-director-oversight/ [https://perma.cc/YA6E-R6E3].

compliance risks."[138] Following *Hughes*, law firms highlighted the fact that the court would draw "plaintiff-friendly, pleadings-stage inferences . . . based on what was—and more importantly, *what was not*—included in the corporate board minutes regarding the topics in dispute,"[139] and accordingly concluded that boards should strive to keep more robust documentation of board discussions and company records.[140] In fact, legal advisors are now using the new *Caremark* cases to admonish their clients to create better reporting systems and documentation not just in the context of monitoring illegalities, but also in the context of monitoring the company's response to COVID-19-related challenges, or to cybersecurity threats.[141]

The key question is whether such an increased emphasis on record-keeping would contribute to reducing the social costs of corporate misbehavior. The answer depends on the extent to which better paper trails produce real salutary effects. A skeptic may argue that a company can have fantastic paper trails merely as window dressing, without actual improvement in the underlying behavior. Yet from this vantage point, focusing on a well-documented process is a staple of corporate law and is also good policy. Research on decision-making shows that robust documentation can generate real positive effects, such as assuring an issue is not neglected, or elevating the level of deliberation.[142]

Specifically in the context of oversight, academic studies on how to better evaluate the effectiveness of compliance programs suggest focusing

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138. Jason J. Mendro, Andrew S. Tulumello & Jason H. Hilborn, *Recent Application of* Caremark*: Oversight Liability*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Aug. 16, 2019), https://corpgov.law.harvard.edu/2019/08/16/recent-application-of-caremark-oversight-liability/ [https://perma.cc/ZTR4-NWFF].

139. Richard L. Renck, *Yet Another Minute About Minutes*, DUANE MORRIS DEL. BUS. L. (May 27, 2020), https://blogs.duanemorris.com/delawarebusinesslaw/2020/05/27/yet-another-minute-about-minutes/?utm_source=Mondaq&utm_medium=syndication&utm_campaign=LinkedIn-integration [https://perma.cc/6EXJ-W4Y3].

140. One could question whether such across-the-board calls from legal advisors actually translate into real-world changes in how companies document their internal deliberations. The practicing attorneys with whom I discussed this question suggested that one marked difference in real-world behavior is the attention of businesspersons to the issue of documentation. As one leading attorney relayed, in the past directors used to leave documentation issues "to the lawyers, but now the non-lawyers have gotten the message too"; they are frequently asking for advice on how to best document discussions about compliance issues. Telephone Interview with Jane Goldstein, Partner, Ropes & Gray (Aug. 24, 2020).

141. *E.g.*, William Savitt, Ryan A. McLeod & Anitha Reddy, *Governance Litigation and the COVID-19 Pandemic*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Apr. 19, 2020), https://corpgov.law.harvard.edu/2020/04/19/governance-litigation-and-the-covid-19-pandemic/ [https://perma.cc/4PFF-6T5B]; Paul Ferrillo, Bob Zukis & Christophe Veltsos, *Boards Should Care More About Recent "*Caremark*" Claims and Cybersecurity*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Sept. 15, 2020), https://corpgov.law.harvard.edu/2020/09/15/boards-should-care-more-about-recent-caremark-claims-and-cybersecurity/ [https://perma.cc/HH74-J8CS].

142. *See* Amir N. Licht, *Stakeholder Impartiality: A New Classic Approach for the Objectives of the Corporation*, *in* FIDUCIARY OBLIGATIONS IN BUSINESS (Arthur B. Laby & Jacob Hale Russell eds., forthcoming 2021).

on what "kinds of data that managers should be collecting to demonstrate that their compliance program is not a mere 'paper' program."[143] This, in a nutshell, is what the new *Caremark* era is all about: investigating and evaluating whether managers collected the right amount and type of data so that their compliance program is not merely cosmetic. Sure, directors and their advisors may be driven by the desire to make the board materials more litigation-proof; but in the process, they nevertheless put compliance on the board agenda and facilitate upward flows of information in the organization.[144]

The emphasis on better record-keeping can also help investigators determine after the fact who knew what when, mitigating the difficulty in holding individuals responsible (that is, mitigating plausible deniability).[145] And the threat of having traces of your shenanigans exposed after the fact may deter you from engaging in shenanigans in the first place.[146]

B. Facilitating Reputational Discipline

A *Caremark* lawsuit based on thorough pre-filing investigations produces quality information on companies' ability and intentions to follow legal and market norms. To the extent that such information becomes public, it generates a positive externality: helping third parties to decide whether they want to keep doing business with the defendant company/businessperson or not. The new mode of *Caremark* litigation may therefore hold the promise of shaping compliance not just directly, through the threat of legal sanctions, but also indirectly, through the threat of *reputational* sanctions.

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143. Soltes, *supra* note 2, at 976.

144. I return to this point in *infra* Section III.0. *Cf.* Armour et al., *supra* note 36, at 31–32.

145. Edward M. Iacobucci, *Corporate Fiduciary Duties and Prudential Regulation of Financial Institutions*, 16 THEORETICAL INQUIRIES L. 183, 203 (2015). Another aspect of the new, section-220 driven *Caremark* litigation is that it can mitigate what Jesse Fried and Ehud Kamar refer to as "law-proof insiders" in China-based companies. *See* Jesse M. Fried & Ehud Kamar, *China and the Rise of Law-Proof Insiders* (Eur. Corp. Governance Inst., Working Paper No. 557/2020, 2020). Fried and Kamar spotlight the difficulties of accessing internal company documents from China-based companies traded in the U.S. *See id.* at 26–29. Yet we saw in *Hughes* (and to some extent in *China Agritech* and *Fuqi*) that the court now supports broad section-220 investigations into these companies, and when insiders do not produce documents, the court holds it against them. *See infra* Section II.0; *see also* Robin Hui Huang & Randall S. Thomas, *The Law and Practice of Shareholder Inspection Rights: A Comparative Analysis of China and the United States*, 53 VAND. J. TRANSNAT'L L. 907 (2020).

146. *Cf.* Érica Gorga & Michael Halberstam, *Litigation Discovery and Corporate Governance: The Missing Story About the "Genius of American Corporate Law"*, 63 EMORY L.J. 1383, 1397–99 (2014) (in the context of discovery in corporate law). Remember, in this context, that inspection rights now extend beyond carefully worded formal board materials into informal electronic communications.

1. Reputation through Litigation: A Short Primer[147]

When bad news about a company breaks, the company's stakeholders may update their beliefs, inferring that the company's "type" is worse than they realized, and reduce their willingness to do business with the company going forward. The aggregate of diminished business opportunities constitutes the reputational sanction for violating market norms. The size of the reputational sanction—how many future business opporunities will be lost—is a function of several conditions. For reputational sanctions to be meaningful, it is not enough that damning information will be *revealed*. The information has to be widely *diffused* so as to reach a critical mass of stakeholders; it has to be perceived by the stakeholders as *credible*, and it has to be *attributed* by the stakeholders to deep-seated problems in the company that are likely to resurface in the future.

In previous projects I showed that litigation affects reputational discpline in each of the abovementioned aspects of reputational sanctions: revelation, attribution, certification, and diffusion of information.[148] Litigation, especially American-style, vests fact-finding powers in private litigants to extract relevant information from their rivals, and may therefore provide market players who follow litigation with information to which they previously could not have been privy.[149] The information coming from litigation can particularly affect stakeholders' attribution: by unearthing inside information about what and when top management knew about the problem, litigation can help stakeholders decide whether the problem is a one-off, honest mistake, or rather indicative of deep-seated flaws that are likely to resurface in the future.[150] Information coming from the courthouse is also usually perceived as credible. And litigation affects the frequency and tenor of media coverage of the issue at hand. It provides journalists with so-called "information subsidies" in the form of pre-packaged, well-documented, libel-proof bits of information about a newsworthy issue.[151] Indeed, information coming from litigation is perhaps the most important source of information for successful investigative reporting nowadays.[152]

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147. For an in-depth discussion of how litigation impacts reputation, see Roy Shapira, *Mandatory Arbitration and the Market for Reputation*, 99 B.U. L. REV. 873, 885–93 (2019).

148. ROY SHAPIRA, LAW AND REPUTATION: HOW THE LEGAL SYSTEM SHAPES BEHAVIOR BY PRODUCING INFORMATION 35–74 (2020).

149. Roy Shapira, *Reputation Through Litigation: How the Legal System Shapes Behavior by Producing Information*, 91 WASH. L. REV. 1193, 1214 (2016).

150. SHAPIRA, *supra* note 148, at 40.

151. *Id.* at 41.

152. *See* Roy Shapira, *Law as Source: How the Legal System Facilitates Investigative Journalism*, 37 YALE L. & POL'Y REV. 153 (2018) (conducting content analysis of prizewinning investigative reports between 1995–2015, and showing that in over half of them "legal sources" were the sine qua non of effective media scrutiny).

2. Reputation through Caremark Litigation

The abovementioned reputation-through-litigation dynamics are in full display in the new version of *Caremark* litigation. Until the last decade, *Caremark* litigation offered very little in terms of relevant information: since most *Caremark* claims piggybacked on the efforts of regulatory enforcement and were dismissed at the pleading stage,[153] they did not provide market players with information they were not already privy to. Nowadays, by contrast, outside shareholders and their attorneys are investigating before filing, and with the help of section 220 they are producing internal company documents to which the market was not privy.[154] Further, the section 220 litigation in itself allows Delaware judges opportunities to comment on the underlying behavior.[155] In that way, the new section 220-driven *Caremark* litigation may spur media scrutiny of the companies and businesspersons involved, thereby facilitating reputational discipline.

To illustrate, let us recast two recent examples: The *Blue Bell* and *Facebook* cases.[156] In Blue Bell's listeria outbreak case, section 220 did not just increase the chances that the defendants would suffer legal sanctions for their alleged failure of oversight; it also had an immediate, significant impact on the defendants' reputation. For a food company, a food-safety crisis with three deaths is a high reputational risk. Yet the company initially seemed to be doing a good job containing the risk, by managing public perception in the wake of the crisis.[157] As one academic study showed, Blue Bell initially managed to control how the event was framed in the media, thereby curtailing the initial reputational fallout.[158] And indeed, soon after the bad news broke in 2015, Blue Bell was already back to being the fifth leading manufacturer in the U.S. in 2016.[159]

Then, plaintiffs filed a section 220 action, which altered how the media covered the event. By culling numerous internal documents, shareholders were able to show that the board ignored issues of food safety. Justice Strine's lucid comments at the pleading stage were quickly picked up by the media, which then went back to covering the listeria debacle and changed its tune, this time highlighting Blue Bell's systemic disregard for food

153. *See supra* Part I.
154. *See supra* Section II.B.
155. *See also* Shapira, *supra* note 8 (manuscript at 31–32).
156. *See supra* notes 23, 98 and accompanying text, respectively.
157. *See* Brandyl Brooks Calley, Courtney Meyers, Courtney Gibson & Erica Irlbeck, *A Comparative Content Analysis of News Stories and Press Releases During the 2015 Blue Bell Ice Cream Recall*, J. OF APPLIED COMMC'NS (2019), https://newprairiepress.org/cgi/viewcontent.cgi?article=2213&context=jac [https://perma.cc/MCK9-KC2S] (testing media reaction to the crisis).
158. *Id.* at 13.
159. *Id.* at 2.

safety.[160] The pre-filing investigations and subsequent *Caremark* litigation turned into a source of media scrutiny and, by extension, a huge reputational risk for Blue Bell.

Another vivid case in point comes from Facebook's section 220 litigation. After investigative reporters initially broke the Cambridge Analytica story in 2018, Facebook and its CEO Mark Zuckerberg went on a public campaign to limit the reputational fallout, communicating a newfound commitment to user privacy.[161] Then, shareholders who wished to investigate failure of oversight by Facebook's board and top executives filed a section 220 action, which brought with it negative media coverage: major business media outlets and tech blogs went back to emphasizing Facebook's apparent "scant regard for users' privacy."[162] Here as well, the section 220 litigation shaped the saliency and tenor of media coverage.

Caremark-type investigations yield information that is highly "reputation-relevant." The emphasis on finding bad faith indications translates into unearthing information on who knew what when – information that is considered in the reputation literature as highly indicative of the company's future behavior. Such bad faith indications can therefore be determinative of stakeholders' decisions to continue doing business with the company or not, that is, determinative of the size of the reputational fallout.[163] To be sure, *Caremark*-type investigations usually do not generate much new information on the alleged underlying corporate misbehavior (such as price-fixing, bribing, or polluting). After all, a

160. *See, e.g.*, Angela Spivey, Andrew Phillips & Alan Pryor, *The Blue Bell Ice Cream Listeria Outbreak and Its Fallout*, FOOD SAFETY NEWS (Aug. 1, 2019), https://www.foodsafetynews.com/2019/08/the-blue-bell-ice-cream-listeria-outbreak-and-its-fallout/ [https://perma.cc/W7YQ-LZUC]; Allen Pusey, *Stockholder Suit Against Blue Bell Revived*, DALL. BUS. J. (June 24, 2019, 10:35 AM), https://www.bizjournals.com/dallas/news/2019/06/24/stockholder-suit-against-blue-bell-revived.html [https://perma.cc/9ZYY-HL97].

161. *See* Julia Carrie Wong, *Mark Zuckerberg Apologises for Facebook's 'Mistakes' over Cambridge Analytica*, THE GUARDIAN (Mar. 22, 2018, 2:53 AM), https://www.theguardian.com/technology/2018/mar/21/mark-zuckerberg-response-facebook-cambridge-analytica [https://perma.cc/UGK4-FSJL]; Julia Carrie Wong, *Zuckerberg Says Facebook Is Pivoting to Privacy After Year of Controversies*, THE GUARDIAN (Mar. 6, 2019, 6:12 PM), https://www.theguardian.com/technology/2019/mar/06/mark-zuckerberg-facebook-privacy-vision#:~:text=Zuckerberg%20says%20Facebook%20is%20pivoting%20to%20privacy%20after%20year%20of%20controversies,-This%20article%20is&text=This%20new%20messaging%20service%20will,a%20certain%20period%20of%20time [https://perma.cc/6G69-LDC9].

162. Zak Doffman, *Facebook Loses Court Battle to Keep Internal Privacy Breach Records Private*, FORBES (May 31, 2019, 7:56 PM), https://www.forbes.com/sites/zakdoffman/2019/05/31/facebook-loses-in-court-over-privacy-emails-as-zuckerberg-votes-to-keep-full-control/#47bcac54560c [https://perma.cc/NAV4-CY9U]; *see also* Glyn Moody, *Facebook's Triple Woes over Cambridge Analytica Data Harvesting Scandal*, TECHDIRT (June 6, 2019, 3:42 AM), https://www.techdirt.com/articles/20190605/07294642339/facebooks-triple-woes-over-cambridge-analytica-data-harvesting-scandal.shtml [https://perma.cc/3AYJ-ZWHJ].

163. *Cf.* Claire A. Hill, Caremark *as Soft Law*, 90 TEMP. L. REV. 681 (2018) (noting that *Caremark* litigation is one area where the legal and reputational realms affect each other).

Caremark claim is usually filed after the bad news about the underlying misbehavior has broken, and after regulatory investigations have already generated information on said misbehavior. *Caremark*'s reputational fallout comes rather from its impact on how stakeholders perceive the company's commitment to integrity and a system of internal checks and balances.

Caremark-type investigations also facilitate a more robust market for reputation by separating company- from industry-level reputation. The point can best be illustrated by recasting *AmerisourceBergen*: there, defendants claimed that the ongoing opioid investigation could not be considered an evidentiary basis justifying a section 220 inspection, because the regulatory investigation was directed at the opioid industry as a whole.[164] The court rebutted that "everyone else is doing it" is not a valid argument, and allowed inspection.[165] From a reputational perspective, such company-level investigations are extremely valuable: when regulators target whole industries for certain prevalent misconduct, it may be good for legal enforcement numbers, but it does not affect reputations much.[166] The reason is that stakeholders of company X cannot punish the company for misbehaving if all of the company's competitors face similar allegations (they cannot take their business elsewhere).[167] Private *Caremark* litigation helps in ferreting out who among the industry players fared worse. It allows the media, NGOs, and regulators to scrutinize conduct not at the abstract level of entire industries but rather at the concrete level of individual companies and businesspersons.

Further, the new *Caremark* era affects not just the reputations of specific market players but also the market norms. A key function of Delaware corporate law has always been to facilitate non-legal sanctions. Rather than directly interfere with directors' decisions and impose legal sanctions, Delaware judges produce richly detailed narratives of good and bad corporate behavior.[168] Once the morality tales of corporate saints and sinners become publicly available, they unleash all sorts of non-legal forces. In one version, directors hate to be dressed down in verdicts because it lowers the esteem in which they are held by colleagues and peers (external moral sanctions).[169] In another version, directors who are subjected to

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164. Lebanon Cnty. Emps.' Ret. Fund v. AmerisourceBergen Corp., No. 2019-0527-JTL, 2020 WL 132752, at *10 (Del. Ch. Jan. 13, 2020).

165. *Id.* at *10, *28.

166. SHAPIRA, *supra* note 148, at 111.

167. *Id.*

168. For two representative accounts see Edward B. Rock, *Saints and Sinners: How Does Delaware Corporate Law Work?*, 44 UCLA L. REV. 1009 (1997), and Margaret M. Blair & Lynn A. Stout, *Trust, Trustworthiness, and the Behavioral Foundations of Corporate Law*, 149 U. PA. L. REV. 1735 (2001).

169. *See* Blair & Stout, *supra* note 168, at 1747–49.

judicial scolding suffer not so much from the disesteem of others as from their own sense of guilt (internal moral sanctions).[170] In yet another version, judicial scolding reduces third parties' willingness to do business with the defendant directors or company (reputational sanctions).[171] Yet in the "old" mode of *Caremark* litigation, there were hardly opportunities for Delaware courts to evaluate and opine on directors' oversight conduct.[172]

The "new," section-220-driven version of *Caremark* litigation brings back to life the abovementioned non-legal effects. Section 220 actions and subsequent merit-based litigation give judges the opportunity to provide their version of what and how things happened (thereby affecting reputation), or how things *ought* to have happened (thereby affecting business norms).[173] The media often views such judicial commentary as noteworthy—recall the media coverage of Chief Justice Strine's colorful criticism of *Blue Bell*.[174] The rise of section 220 may therefore restore not just direct deterrence but also indirect deterrence, by facilitating Delaware's ability to shape norms and reputations in the business community.[175]

C. Balancing the Flaws of Regulatory Enforcement and Internal Compliance

I should be careful not to overstate my claim here: perhaps thus far I have sung too zealously the praises of the new *Caremark* era. But in reality, even on the most optimistic reading of recent cases, shareholder litigation probably remains only one small part of the larger corporate compliance puzzle. For various reasons, shareholder litigation is incapable of solving all the major problems on its own.[176] My point here is therefore more

170. *Id.* at 1779–80.

171. Roy Shapira, *A Reputational Theory of Corporate Law*, 26 STAN. L. & POL'Y REV. 1 (2015).

172. Armour et al., *supra* note 36, at 9.

173. Such judicial "preaching" or "storytelling" can help make the too-abstract norm of compliance more concrete, accessible for recall and applicable. *Cf.* Haugh, *supra* note 11, at 643.

174. *See supra* notes 158–160 and accompanying text.

175. One could claim that the purported "reputational benefits" do not flow to shareholders, but rather to other stakeholders and society at large. Once a company was implicated in wrongdoing, the extraction of internal documents that drags the company and its top executives through the mud is not good for shareholders; they would rather have the entire affair over and done with quickly, or so the argument goes. But such an argument, which views the non-legal effects that come with Delaware litigation as bad for shareholders, rests on a narrow, ex post perspective. Ex ante, shareholders as a group may be better off with a regime whereby executives anticipate that their shenanigans will be exposed and their reputation damaged. The non-legal costs of Delaware litigation is thus a feature (deterrence) rather than a bug in the system. Further, in *Caremark* cases specifically, we cannot limit our cost-benefit analysis to the bottom line of a given company in a given point in time: *Caremark* duties are connected to a much more basic corporate law commitment to compliance with laws and regulatory demands, and these cases therefore inherently hinge on broader societal considerations. *See* Langevoort, *supra* note 13, at 731.

176. *Id.* at 741.

modest: the new version of *Caremark* litigation may be imperfect, but its flaws are imperfectly correlated with the other mechanisms for holding companies accountable, such as regulatory enforcement or internal compliance efforts. In other words, the new *Caremark* litigation holds the promise of checking and balancing other enforcement institutions—a "diversified portfolio" approach for enforcement.

1. Problems with Regulatory Enforcement and Compliance

Various regulators are tasked with detecting and punishing corporate misbehavior. Yet regulatory enforcement[177] suffers from several well-documented flaws.[178] For one, the *probability of detecting corporate wrongdoing is small*. Regulators face scarce enforcement resources, and when the regulated entities are large organizations with high levels of complexity, detection becomes extremely difficult.[179]

Even when regulatory enforcers detect corporate wrongdoing, they *rarely succeed in charging top-level decision-makers*.[180] Proving intent and knowledge of individuals is hard given how information is diffused within these large organizations. Top executives, in particular, can insulate themselves from "toxic" information, pushing responsibility for operational decisions down the organizational ladder, while drawing credit for successes up the ladder.[181]

And even when regulatory enforcers are successful in detecting and charging corporate wrongdoing, they *fail to effectively target corporate*

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177. For our purposes, "regulatory enforcement" is defined broadly to encompass any public authority that can impose sanctions on the misbehaving company (agencies, prosecutors, and so on). *See* David Orozco, *Compliance by Fire Alarm: Regulatory Oversight Through Information Feedback Loops*, 46 J. CORP. L. 97, 105 (2020).

178. For a recent account of the many gaps in criminal enforcement of corporate misbehavior see Samuel W. Buell, *The Responsibility Gap in Corporate Crime*, 12 CRIM. L. & PHIL. 471 (2018).

179. Armour et al., *supra* note 36, at 12; Roy Shapira & Luigi Zingales, *Is Pollution Value-Maximizing? The* DuPont *Case* 25 (Nat'l Bureau of Econ. Rsch., Working Paper No. 23866, 2017), https://www.nber.org/papers/w23866 [https://perma.cc/E4ME-DJZ9].

180. *See, e.g.*, Brandon L. Garrett, *The Corporate Criminal as Scapegoat*, 101 VA. L. REV. 1789, 1801–23 (2015) (showing how in DPAs and NPAs, individual officers are rarely prosecuted, and those prosecuted are usually small fish rather than big fish); Eugene Soltes, *The Frequency of Corporate Misconduct: Public Enforcement Versus Private Reality*, 26 J. FIN. CRIME 923, 925 (2019); Dorothy S. Lund & Natasha Sarin, *Corporate Crime and Punishment: An Empirical Study* (Univ. of Pa. Inst. for L. & Econ. Rsch., Working Paper No. 20-13, 2020), https://ssrn.com/abstract=3537245 [https://perma.cc/8EEG-JM3Z].

181. Langevoort, *supra* note 13, at 733 n.30; Roy Shapira, *Amenable Controls: How Companies Influence Laws, Reputation and Morals*, *in* THE CAMBRIDGE HANDBOOK OF CORPORATE LAW, CORPORATE GOVERNANCE AND SUSTAINABILITY 641 (Beate Sjåfjell & Christopher M. Bruner eds., 2020); Miriam H. Baer, *Too Vast to Succeed*, 114 MICH. L. REV. 1109, 1112 (2016) (reviewing BRANDON L. GARRETT, TOO BIG TO JAIL: HOW PROSECUTORS COMPROMISE WITH CORPORATIONS (2014)); GARRETT, *supra*, at 280; Assaf Hamdani & Alon Klement, *Corporate Crime and Deterrence*, 61 STAN. L. REV. 271, 297 (2008).

recidivism. Here the problem stems from the fact that regulatory enforcement is disparate and uncoordinated, as each enforcer has a narrow, circumscribed authority.[182] As a result, the government has "largely failed to sanction corporate repeat offenders as recidivists."[183]

Finally, regulatory enforcement tends to *underproduce information* on corporate wrongdoing. Corporate criminal enforcement shifted from an emphasis on full trials and convictions to an emphasis on deferred- and non-prosecution agreements (DPAs and NPAs, respectively).[184] Civil enforcement by the SEC similarly moved from fighting in courts to filing administratively and settling quickly.[185] An oft-mentioned criticism is that such enforcement through negotiation is too lenient. Yet the common criticism misses the mark: the DOJ or the SEC rarely leaves money on the table; the problem is that they leave information on the table.[186] The misbehaving companies agree to settle quickly and pay nicely, and so the regulators can boast of an increase in total fines collected.[187] In exchange, companies get to limit and control the release of damning information about them to the market. For example, the SEC reportedly allows companies to negotiate the language of the regulator's press release.[188]

All these problems with regulatory enforcement have led to an increased emphasis on internal compliance. Various legal programs now either directly require or indirectly incentivize companies to implement compliance programs.[189] To receive such regulatory credit, the compliance programs must be considered "effective."[190] Yet measuring effectiveness is hard even for the companies themselves, to say nothing of external regulators.[191] And until recently, corporate law did not exactly incentivize directors to innovate and invest in meaningful compliance: as long as they had *some* compliance features, the complaint against them would be readily

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182. Veronica Root, *Coordinating Compliance Incentives*, 102 CORNELL L. REV. 1003, 1054–55 (2017); *see also* Armour et al., *supra* note 36, at 48–49.

183. Root, *supra* note 182, at 1009. For recent corroborating evidence see also Lund & Sarin, *supra* note 180.

184. GARRETT, *supra* note 181.

185. *See* Urska Velikonja, *Securities Settlements in the Shadows*, 126 YALE L.J. F. 124, 129 (2016).

186. SHAPIRA, *supra* note 148, at 110.

187. GARRETT, *supra* note 181, at 292–94 figs. A.1 & A.2 (providing empirical evidence for the increase in fines).

188. SHAPIRA, *supra* note 148, at 111.

189. For example, legal programs could by promise mitigation of penalties or include the requirement as part of negotiated settlements.

190. Geoffrey P. Miller, *An Economic Analysis of Effective Compliance Programs*, *in* RESEARCH HANDBOOK ON CORPORATE CRIME AND FINANCIAL MISDEALING 247 (Jennifer Arlen ed., 2018); U.S. Dep't of Just., Just. Manual § 9-28.800 (2018).

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

dismissed.[192] As a result, too many programs deteriorated into *cosmetic compliance*—paper programs that seemed fine from the outside but in reality did very little to prevent and detect corporate misbehavior.[193] In other words, these programs functioned merely as window dressing meant to reduce expected legal and reputational sanctions.[194]

There exists a consensus that one of the biggest challenges in internal compliance is to "make sure that relevant information on breaches of the law make[s] it to the top decision makers."[195] Large organizations usually suffer from *information silos*.[196] Even when a company has well-staffed and well-budgeted compliance programs and structures in place, information does not necessarily flow upwards. Damning information may exist inside the organization, but the organization fails to follow through on it. The Wells Fargo phony-accounts scandal is a case in point: several internal company reviews flagged the problematic practices, but the information was too scattered in separate business units.[197]

Relatedly, regulators and academics have expressed worries about how the tone at the top of a company does not reflect a true commitment to compliance.[198] For compliance to be effective, it is not enough that top managers stay apprised of the company's program; they also need to clearly communicate their alignment with the social goals that the program is supposed to advance. The GM faulty ignition switch scandal is a case in point: while the company had a good compliance program and procedures on paper, the tone from the top leadership emphasized controlling costs at all costs, eventually leading to the mass-scale scandal.[199] Part of the problem may stem from managers' own incentives: managers and directors who receive substantial stock-based compensation have incentives to stint on compliance.[200] The market does not adequately reward investment in

192. Armour et al., *supra* note 36, at 9.

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

194. Krawiec, *supra* note 193, at 491. Similar to external regulatory efforts, such internal efforts of compliance suffer from chronic underreporting of the true extent of misconduct.

195. Reinier Kraakman, Eugene Soltes & Karl Hofstetter, Compliance, Compensation and Corporate Wrongdoing 4 n.10 (May 1, 2018) (unpublished manuscript), https://ssrn.com/abstract=3373718 [https://perma.cc/44UC-GMK6].

196. Root Martinez, *supra* note 193, at 283.

197. *Id.*; Orozco, *supra* note 177, at 100 (mentioning also the recent Boeing 737 Max scandal within that category).

198. Alfredo Contreras, Aiyesha Dey & Claire Hill, "*Tone at the Top" and the Communication of Corporate Values: Lost in Translation?*, 43 SEATTLE U. L. REV. 497, 507 n.23, 509–10 (2020) (compiling references).

199. *Id.* at 522–23.

200. Armour et al., *supra* note 36, at 45.

compliance, and managers are incentivized to underreport problems for fear of a negative overreaction by investors.[201]

2. *How the New Caremark Era Can Mitigate These Problems*

Caremark litigation, even in its best version, cannot mitigate all the problems associated with regulatory enforcement or internal compliance. For one, private litigation rests on the incentives of outside shareholders and their attorneys, who may not *want* to discipline corporate disobedience when such disobedience actually benefits them at the expense of society (think for example about pollution that goes under-punished due to regulatory constraints/capture).[202] Further, even when shareholders and their attorneys wish to enforce compliance, they may not be particularly adept at fixing the low probability of detection problem. That is, they are less likely to be the ones detecting misbehavior (this would be left to whistleblowers, investigative reporters, short sellers, and so on.)[203] There are, nevertheless, important areas where *Caremark* litigation, in its revamped form, checks and balances the other systems' flaws. Consider for example how the new *Caremark* era can combat three problems of public enforcement: lack of individual accountability, recidivism, and information underproduction.

Promoting individual accountability. Focusing criminal enforcement on top decision-makers is hard and can also backfire by discouraging top decision-makers from becoming aware of problems inside their organizations.[204] *Caremark* litigation balances this tendency by probing the involvement of top-level corporate decision-makers: if these individuals deliberately avoided damning information to create plausible deniability, such as by keeping discussions of thorny issues off the board agenda, the court may now use it against them as failure of oversight. *Caremark* litigation also helps in checking the tone at the top. Without litigation, it is hard to tell whether top managers set the right compliance tone, as their messages are usually "sanitized . . . by the time they become publicly available."[205] Yet the expanded version of section 220 now allows plaintiffs

201. *Id.* at 38–39.

202. For a real-world case study, see Shapira & Zingales, *supra* note 179. *See also* Pollman, *supra* note 16.

203. Alexander Dyck, Adair Morse & Luigi Zingales, *Who Blows the Whistle on Corporate Fraud?*, 65 J. FIN. 2213, 2213–14 (2010); Amanda M. Rose, *Better Bounty Hunting: How the SEC's New Whistleblower Program Changes the Securities Fraud Class Action Debate*, 108 NW. U. L. REV. 1235, 1258 (2014).

204. *See generally* Assaf Hamdani, *Mens Rea and the Cost of Ignorance*, 93 VA. L. REV. 415 (2007).

205. Contreras et al., *supra* note 198, at 499.

and their attorneys to inspect live and unsanitized electronic communications, thereby making it easier to expose the true tone.[206]

Further, we saw how the new *Caremark* cases led legal advisers and their clients to rethink and refine their record-keeping. Such newfound emphasis on record-keeping can combat the problems of information silos and upward flows of information. When directors are told to create a proper record of efforts to address the issue, it forces them to ask others in the organization to prepare materials for them, which in turn brings thorny issues to the fore. And as Section III.A noted, a better paper trail can help investigators identify culpable top-level individuals after the fact, forcing directors to take ownership of certain aspects of corporate behavior.[207]

Fighting recidivism. When a company has a record of continuing non-compliance, the courts are more willing to let failure-of-oversight claims proceed.[208] To illustrate, contrast the pre-*Caremark* era *Allis-Chalmers* case with the new-*Caremark* era *Facebook* case. The cases share similar factual background: both companies were caught violating consent decrees with the FTC (over price-fixing and user privacy, respectively).[209] Yet while in the *Allis-Chalmers* era directors were let off the hook, today directors and executives of companies under consent decrees are bound to heightened oversight duties. Similarly, in *AmerisourceBergen*, the court made a point of providing plaintiffs with access to documents concerning past regulatory settlements, even though these settlements happened long before the relevant timeframe for the issue at hand.[210] The court reasoned that looking into defendants' past conduct could be useful as an indication of how they tried to game the system by slowly backing away from compliance over time.[211] In that sense, the new *Caremark* litigation contributes to fighting those who systematically attempt to evade the law. The doctrine's emphasis on directors' mental state, coupled with potent investigatory tools, may be the best antidote to evasion efforts.[212]

Fighting information underproduction. Regulatory enforcement often underproduces relevant information. In criminal enforcement, DPAs and

206. *See* DEL. CODE ANN. tit. 8, § 220 (2021).

207. Ann M. Lipton, *Beyond Internal and External: A Taxonomy of Mechanisms for Regulating Corporate Conduct*, 2020 WIS. L. REV. 657, 673; Cary Coglianese & Jennifer Nash, *Compliance Management Systems: Do They Make a Difference?*, *in* CAMBRIDGE HANDBOOK OF COMPLIANCE (Benjamin can Rooj & D. Daniel Sokol eds., 2020).

208. *E.g.*, *In re* Massey Energy Co. Derivative & Class Action Litig., No. 5430-VCS, 2011 WL 2176479, at *21 (Del. Ch. May 31, 2011) ("[W]hen a company has a 'record' as a recidivist, its directors and officers cannot take comfort in the appearance of compliance . . . .").

209. Graham v. Allis-Chalmers Mfg. Co., 188 A.2d 125, 129 (Del. 1963); *In re* Facebook, Inc. Section 220 Litig., No. 2018-0661-JRS, 2019 WL 2320842, at *2–3 (Del. Ch. May 30, 2019).

210. Lebanon Cnty. Emps.' Ret. Fund v. AmerisourceBergen Corp., No. 2019-0527-JTL, 2020 WL 132752, at *28 (Del. Ch. Jan. 13, 2020).

211. *Id.*

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

NPAs order specific companies to improve their behavior going forward, and often also appoint a monitor to oversee the purported improvement, but they do not provide general guidance to other firms on how to handle similar issues.[213] In civil enforcement, regulators such as the SEC maximize the amount of enforcement actions started and fines collected. This often makes them prioritize minor, strict liability-type offenses, and neither-admit-nor-deny settlements that do not help the market distinguish between good and not-so-good market players.[214] The "old" version of *Caremark* litigation, where fast-filed complaints were quickly dismissed, produced very little relevant information not already available to the market from regulatory enforcement. Today, by contrast, plaintiffs extract more relevant inside information, and Delaware judges get more opportunities to provide guidance. Recall, for example, the flurry of legal advice that followed *Blue Bell*'s and *Clovis*' discussion of oversight in the "monoline companies" context.[215]

As of the writing of this Article, a strong case in point is in the making: an institutional investor filed another section 220 action against Facebook, seeking to inspect whether Facebook opted to pay a bigger fine to the FTC in exchange for limiting Mark Zuckerberg's personal liability.[216] This is exactly how section 220 actions, if meritorious, can help curb agency costs and check regulators' behavior.

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In all, there is ample reason to like the new developments in oversight liability litigation. Policymakers attempt to curb corporate illegality through myriad channels, from criminal prosecutions, to encouraging the implementation of internal compliance systems, to enlisting the help of private enforcers such as plaintiff lawyers. Each mechanism suffers from serious flaws, and corporate fiduciary duty litigation is hardly different.[217] Yet instead of overly theorizing how each mechanism works in isolation, we should attempt to capture the interactions— that is, understand how the systems work in tandem. What matters is whether each mechanism's advantages can balance the other mechanisms' blind spots or not. This Part provided indications that the recent trend in *Caremark* litigation represents a step in the right direction in that respect. While I cannot provide an exact

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213. Armour et al., *supra* note 36, at 48; Root Martinez, *supra* note 193, at 260.

214. Shapira, *supra* note 171, at 47–56.

215. *See supra* Part I.

216. Mike Leonard, *Facebook's $5 Billion Fine a Win for Zuckerberg, Suit Says*, BLOOMBERG L. (Feb. 19, 2020, 1:26 PM), https://news.bloomberglaw.com/esg/facebooks-5-billion-fine-let-zuckerberg-off-hook-suit-says?context=article-related [https://perma.cc/824G-BN3R].

217. *E.g.*, Elizabeth Pollman, *Corporate Disobedience*, 68 DUKE L.J. 709, 764–65 (2019); Lipton, *supra* note 207.

cost-benefit estimation (that is ultimately a matter for future empirical research), I can point to several reasons to prima facie favor the trend of enhanced oversight duties we are currently witnessing. For one, unlike other areas of corporate behavior, such as classic business decisions, here the costs of court errors are lower, given the high "normative clarity." There is a roughly-standardized measure of whether companies violated regulations or not, and so the societal costs of court errors in imposing liability are smaller relative to other areas such as scrutinizing business decisions.[218]

One final clarification before we conclude: while this Article has largely sung the praise of the new *Caremark* era, it should not be read as a paean to Delaware corporate law in general. Rather, I am advancing here a claim of how Delaware corporate law functions when it is at its best. In the past, *Caremark* litigation may have reflected the too-deferential-to-managers version of Delaware corporate law. In its revamped mode, by contrast, *Caremark* litigation rests on an ecosystem of expert judges effectively micro-managing the process. Judges stagger the costs of (targeted, pre-filing) discovery, as a function of the information asymmetries and the credibility of the allegations at hand. They make sure that bounty hunters (activist shareholders or plaintiff attorneys) get their bounty only when they contribute to shareholders as a group.[219] And when the system works that way, it generates a positive externality of quality information on corporate behavior, which facilitates a robust market for reputation.[220]

CONCLUSION

Compliance has become a key corporate governance issue. With renewed societal concerns "about whether business entities conduct themselves in a manner that is consistent with society's best interests,"[221] mounting regulatory requirements, and hundreds of billions spent on internal programs, it is crucial to get corporate compliance right. Yet until recently, corporate law played only a limited role in holding directors accountable for compliance failures. And, among many scholars, corporate anti-social behavior was seen as a matter for other laws and regulations, rather than an internal corporate law issue. This state of affairs seems to be

218. Holger Spamann, *Monetary Liability for Breach of the Duty of Care?*, 8 J. LEGAL ANALYSIS 337, 361 (2016); Buell, *supra* note 212, at 666.

219. *Cf.* Holger Spamann, Indirect Investor Protection (2020) (unpublished manuscript) (on file with author).

220. One way to highlight Delaware's mode of oversight liability litigation is to juxtapose it with "*Caremark*" cases in federal securities litigation. There, in a nutshell, state inspection rights are not available, Shapira, *supra* note 8 (manuscript at 7), and the courts maintain that lack of documentations does *not* allow inferring scienter in the pleading stage. Gadinis & Miazad, *supra* note 1, at 2184 & n.270.

221. Strine et al., *supra* note 1 (manuscript at 2).

changing fast, with a string of successful *Caremark* claims signaling enhanced oversight duties.

This Article has contributed to our understanding of the change in director oversight duties along the following three dimensions. First, the Article has delineated the contours of the "new *Caremark* era", identifying certain themes and trends such as increased willingness to activate an enhanced oversight duties mode and increased willingness to allow outside shareholders access to internal corporate documents to meet the once-insuperable pleading hurdle. Second, the Article has located several drivers of the resurgence of oversight duties, emphasizing a seemingly tangential development in shareholders' right to information. Finally, the Article has offered reasons to believe that the new development would prove desirable from a societal perspective: it facilitates upward flows of information inside large organizations, contributes to the ability of the market to discipline misbehaving companies, and balances the blind spots of other enforcement mechanisms. From this vantage point, the new mode of *Caremark* litigation seems to be striking the right balance between deference to business decisions and accountability for failure of oversight.