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Analyzing the Post-Marchand "Expansion" of Mission Critical Risks: Cybersecurity, Climate Change, and Caremark

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ANALYZING THE POST-*MARCHAND* "EXPANSION" OF MISSION CRITICAL RISKS: CYBERSECURITY, CLIMATE CHANGE, AND *CAREMARK*

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INTRODUCTION

We are currently seeing an environment in which the public is holding corporations to a higher standard and has rising expectations about the role of corporations in today's society.[1] Large corporations are under attack, and stakeholders and shareholders alike are pressing corporations about their *social* responsibility, in addition to their corporate governance responsibility.[2] *In re Caremark International Inc. Derivative Litigation* established the standard for director oversight liability under Delaware law.[3] A *Caremark* claim seeking to hold directors liable for failure to exercise oversight is "possibly the most difficult theory in corporation law upon which a plaintiff might hope to win a judgment."[4] Consequently, a corporate board's risk of exposure to oversight liability was limited. In the twenty-year period following the Delaware Court of Chancery's decision in *Caremark*, oversight claims made against a corporate board never survived a motion to dismiss.[5]

Things changed in 2019. In *Marchand v. Barnhill*, the Delaware Supreme Court reversed the Court of Chancery's dismissal of a shareholder derivative suit alleging *Caremark* claims against Blue Bell Creameries USA, Inc.'s ("Blue Bell") board of directors.[6] The supreme court's reason for allowing the *Caremark* claim to proceed was based on the board's failure to exercise oversight on "essential and mission critical" risk categories.[7] Specifically, the board of Blue Bell—an ice cream company—failed to comply with the "most central consumer safety and legal compliance issue facing the company."[8]

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1. Holly Gregory, *Board Oversight: Key Focus Areas for 2022*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Jan. 5, 2022), https://corpgov.law.harvard.edu/2022/01/05/board-oversight-key-focus-areas-for-2022/ [https://perma.cc/79AT-WQTF].
2. *Id.*
3. 698 A.2d 959 (Del. Ch. 1996).
4. *Id.* at 967.
5. *See* Bonnie David, Ryan Lindsay & Edward Micheletti, *The Risk of Overlooking Oversight: Recent Caremark Decisions from the Court of Chancery Indicate Closer Judicial Scrutiny and Potential Increased Traction for Oversight Claims*, JDSUPRA (Dec. 17, 2021), https://www.jdsupra.com/legalnews/the-risk-of-overlooking-oversight-4652994/ [https://perma.cc/B5BF-SQVG] ("[*Caremark*] claims have been few and far between and, when such claims were brought, they rarely survived motions to dismiss.").
6. 212 A.3d 805 (Del. 2019).
7. *Id.* at 824.
8. *Id.*

When the supreme court handed down its decision in *Marchand*, the corporate legal community was turned upside down.[9] For the first time, a *Caremark* claim had survived a motion to dismiss, and shareholders were able to proceed with their derivative lawsuit against the Blue Bell board of directors for allegedly breaching their duty of oversight.[10] People wondered whether the *Marchand* decision signaled a change in the law regarding oversight and whether directors could be liable for a *Caremark* claim in a way that had not been thought possible before.[11]

This Comment undertakes the task of defining the scope of "essential and mission critical" risk categories in the context of directors' duty of oversight. Although director oversight liability under *Caremark* seemed like an impossible standard, Delaware jurisprudence suggests a growing trend in *Caremark* claims surviving a motion to dismiss.[12] Indeed, "within thirteen months in 2019–2020, four *Caremark* claims succeeded in surviving the motion to dismiss (*Marchand, Clovis*, *Hughes*, and *Chou*)."[13] As of December 15, 2021, "five of 17 *Caremark* claims raised in the Court of Chancery have survived a motion to dismiss—an approximately 30% success rate. It remains to be seen whether the Delaware courts will continue to sustain *Caremark* oversight claims with increased frequency."[14]

Recent cases involving *Caremark* claims reiterate the importance of boards exercising oversight on "mission critical" risk categories in particular.[15] Some commentators argue that the number of *Caremark* claims surviving a motion to dismiss is not indicative of any change in the standard for director oversight liability, nor is it "a lowering of the pleading requirement for oversight claims."[16]

9. Gregory A. Markel, Daphne Morduchowitz & Matthew C. Catalano, *A Director's Duty of Oversight after* Marchand *in "Caremark" Case*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Jan. 23, 2022), https://corpgov.law.harvard.edu/2022/01/23/a-directors-duty-of-oversight-after-marchand-in-caremark-case/ [perma.cc/6SPL-NPN3].

10. *See Marchand*, 212 A.3d at 805.

11. *See, e.g.*, Markel et al., *supra* note 9 (noting that many were concerned over the *Marchand* decision being indicative of a change in law that would effectively increase liability for corporate boards).

12. *See* Roy Shapira, *A New* Caremark *Era: Causes and Consequences*, 98 WASH. U. L. REV. 1857 (2021).

13. *Id.* at 1859.

14. David et al., *supra* note 5.

15. *See, e.g.*, *In re* Boeing Co. Derivative Litig., No. 2019-0907, 2021 Del. Ch. LEXIS 197, at *89 (Sept. 7, 2021).

16. Markel et al., *supra* note 9.

Others have gone even further—suggesting that failure to exercise oversight by a corporation's board of directors should encompass areas such as cybersecurity;[17] environmental, social, and governance ("ESG") issues;[18] and human rights due diligence ("HRDD").[19] This Comment argues that the characterization of risks as "mission critical," which directors must regard according to their duty of oversight, are those which encompass three factors: (1) the risk is of primary importance to the defendant directors' company; (2) the company facing the risk is highly regulated; and (3) the damage caused by the risk is particularly egregious (for example, the risk implicates great safety concerns and/or results in casualty). In order to assess the type of oversight liability that boards may be exposed to following *Marchand*, this Comment examines how these factors apply across the board versus how these factors apply in cases involving company-specific risks. Companies are already obligated to tailor their oversight mechanisms to the company's business to address company-specific or industry-specific risks, in other words, traditional or typical areas of risk.[20] In doing so, this Comment focuses on non-traditional risk categories that boards may now have to consider in the current environment of heightened board scrutiny.[21]

This Comment, which proceeds in three Parts, proposes that emerging and atypical areas of risk in the context of directors' fiduciary duty of oversight—specifically, cybersecurity and climate change—are not "mission critical" for most corporations. The directors of such corporations, therefore, are unlikely to face oversight liability for failure to address cybersecurity and climate change risks. In other words, it is unlikely that a *Caremark* claim, in this scenario, would survive a motion to dismiss. Ultimately, the standard for director oversight liability under *Caremark* has not changed post-*Marchand*.

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17. *Id.*

18. PRICEWATERHOUSECOOPERS, ESG OVERSIGHT: THE CORPORATE DIRECTOR'S GUIDE 2–3 (2021), https://www.pwc.com/us/en/services/governance-insights-center/esg-guidebook-layout-final.pdf [https://perma.cc/N6FJ-QWYV].

19. *See* David Hess, *The Management and Oversight of Human Rights Due Diligence*, 58 AM. BUS. L.J. 751, 785 (2021) (discussing the "emerging debate on whether [HRDD] legislation should create new fiduciary duties for directors").

20. KATHERINE L. HENDERSON, BRAD D. SORRELS & LINDSAY K. FACCENDA, WILSON SONSINI, "BAD" V. "BAD-FAITH" OVERSIGHT: NAVIGATING THE RISKS OF POTENTIAL OVERSIGHT LIABILITY FOLLOWING *MARCHAND V. BARNHILL* 2 (2021), https://www.wsgr.com/a/web/euJtU199phKqUbgXY9XuMn/bad-v-bad-faith.pdf [https://perma.cc/SC75-PK9Z].

21. *See infra* note 72 and accompanying text.

In Part I, this Comment introduces the duty of oversight, as defined by the Delaware Supreme Court in *Caremark*. Next, this Comment looks at *Marchand* and explores its impact on the doctrine in light of subsequent shareholder derivative suits involving *Caremark* claims. In Part II, this Comment describes the current state of directors' oversight duties and the correspond risks to which directors must pay attention. This Comment then discusses categories of risk that shareholders and stakeholders are invested in, and thus may require attention by the board. This Comment narrowly focuses on two notable categories of risk that have been the subject of discussion regarding increased oversight obligations by directors: cybersecurity and climate change. Part III then proposes that "mission critical" risks, for the purpose of *Caremark* liability, are narrowly defined and may be encompassed by three factors, which are pulled from trends arising out of *Caremark* litigation, starting with *Marchand*. This Comment then applies that argument to cybersecurity risks and climate change risks. In so doing, this Comment notes certain features of risk management that boards should consider when identifying risk categories that require oversight. Lastly, this Comment concludes by discussing what the future of director oversight liability may look like if the expectations of boards of directors continue to expand into other areas of risk, and what boards can ultimately do to protect themselves against future *Caremark* claims.

I. BACKGROUND

This Comment begins by introducing the duty of oversight, as it has come to be defined by Delaware case law, beginning with the Delaware Court of Chancery's decision in *Caremark*. It then briefly discusses *Stone v. Ritter*, the case in which the Delaware Supreme Court adopted the *Caremark* standard, and describes what a *Caremark* claim consists of. Next, this Part turns to *Marchand v. Barnhill*, which is recognized as the first time a *Caremark* claim survived a motion to dismiss. Finally, this Part introduces three cases following *Marchand* that also survived a motion to dismiss—*In re Clovis Oncology Derivative Litigation*, *Inter-Marketing Group USA, Inc. v. Armstrong*, and *In re Boeing Co. Derivative Litigation*—in order to assess the scope of "mission critical" risks.

A. *Defining Director Oversight Liability:* Caremark *Claims*

Directors of Delaware corporations are subject to the fiduciary duties of care and loyalty, which include the subsidiary duties of good faith, oversight, and disclosure. "A half century ago, Delaware corporate law placed no duty on a board of directors to implement a system for monitoring the company's regulatory compliance, absent cause for suspicion of wrongdoing."[22] Since then, the duty of oversight has continuously evolved, starting with the landmark case *In re Caremark International Derivative Litigation*,[23] from which the term "*Caremark* claim" is derived.[24] The decision by the *Caremark* court was "the first to recognize a director's fiduciary duty to oversee a corporation's compliance and ethics program, which instantly raised the visibility and urgency of compliance and ethics in the board room."[25]

Caremark involved a shareholder derivative lawsuit brought against the board of directors of Caremark International, Inc. ("Caremark") after an extensive federal investigation resulting from alleged violations by Caremark employees of federal and state laws and regulations applicable to health care providers.[26] The shareholders claimed that Caremark's directors, in neglecting to effect sufficient internal control systems, breached their fiduciary duties and cost the company approximately $250 million in criminal fines and civil penalties.[27]

In *Caremark*, the Delaware Court of Chancery articulated a standard of liability with respect to a board of directors' oversight failures, explaining that such oversight duties stem from a director's duty to act in good faith and be "reasonably informed concerning the corporation."[28] In order to fulfill its obligation to be reasonably informed, the *Caremark* court concluded that the board must "attempt in good faith to assure that a corporate information and

22. Elizabeth Pollman, *The Evolution of Delaware's Corporate Oversight Doctrine*, REGUL. REV. (Oct. 5, 2020), https://www.theregreview.org/2020/10/05/pollman-evolution-delaware-corporate-oversight-doctrine/ [https://perma.cc/3W45-2TRB].

23. 698 A.2d 959 (Del. Ch. 1996).

24. Pollman, *supra* note 22.

25. Paul E. McGreal, Caremark *in the Arc of Compliance History*, 90 TEMP. L. REV. 647, 648 (2018).

26. *Caremark*, 698 A.2d at 960.

27. *Id.* at 960–61; Jim DeLoach, Caremark*: Even the Highest Standard Can Be Met*, CORP. COMPLIANCE INSIGHTS (Dec. 23, 2020), https://www.corporatecomplianceinsights.com/caremark-highest-standard-boards/ [https://perma.cc/XBV8-2P8C].

28. Markel et al., *supra* note 9 (quoting *Caremark*, 698 A.2d at 970).

reporting system, which the board concludes is adequate, exists."[29] The court then articulated a high pleading standard for director oversight liability, which requires "a sustained or systematic failure of the board to exercise oversight—such as an utter failure to attempt to assure a reasonable information and reporting system exists."[30]

Ten years later, the Delaware Supreme Court expressly endorsed the *Caremark* standard in *Stone v. Ritter*, stating that "*Caremark* articulates the necessary conditions predicate for director oversight liability."[31] The supreme court also clarified that establishing director oversight liability requires a showing of bad faith conduct and, accordingly, the fiduciary duty violated by such conduct is the *duty of loyalty*.[32] Since the duties articulated in *Caremark* were no longer categorized under the fiduciary duty of care, directors could not be exculpated for a breach of such duty, and it would now be possible to hold them liable for *Caremark* claims.[33]

To successfully plead a *Caremark* claim, a plaintiff must show that one of two conditions is met in order to establish a violation of the duty of oversight.[34] Under the first *Caremark* prong, a plaintiff can allege that directors "utterly failed to implement any reporting

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29. *Caremark*, 698 A.2d at 970.

30. *Id.* at 971; *see also* Markel et al., *supra* note 9 (noting that the Court of Chancery contemplated other examples of a systematic failure that could meet *Caremark*'s high pleading standard, such as instituting an "obviously unreasonable or inadequate system, or to implement a system of reporting and then fail to monitor the reported risks").

31. 911 A.2d 362, 364, 370 (Del. 2006) (affirming the Chancery Court's dismissal of what it characterized as a "classic *Caremark* claim").

32. *Id.* at 370 (clarifying that fiduciary liability under *Caremark* does not arise from directors' duty of care as previously understood). In its opinion, the Delaware Supreme Court also confirmed that the duty of good faith is not an independent fiduciary duty and, thus, the violation of the duty of good faith cannot directly result in liability. However, directors may be *indirectly* liable—only a sustained or systematic failure of director oversight can overcome the presumption that the directors acted in bad faith and are therefore liable for breaching their duty of loyalty. The supreme court recognized that this is a "demanding test of liability," but noted that this high standard is for the benefit of both shareholders and directors. *Id.* at 372 (quoting *Caremark*, 698 A.2d at 971).

33. Under section 102(b)(7) of the Delaware General Corporation Law, a corporation's certificate of incorporation may include an "exculpation clause" which allows it to eliminate the personal liability of directors from all duty of care violations. DEL. CODE. ANN. tit. 8, § 102(b)(7) (1953).

34. Briana Seyarto Flores, *Defining a "Good Faith" Director: Key Takeaways from Recent Court Rulings on Corporate Board Oversight*, NAT'L L. REV. (Feb. 2, 2022), https://www.natlawreview.com/article/defining-good-faith-director-key-takeaways-recent-court-rulings-corporate-board [https://perma.cc/W9L4-BYRH]; Meghan Roll, Note, *The Delaware Supreme Court Does Not Scream for Ice Cream: Director Oversight Liability Following* Marchand v. Barnhill, 57 SAN DIEGO L. REV. 809, 815 (2020) ("*Stone*'s articulation of the test for oversight liability still stands today.").

or information system or controls."[35] Under the second prong, a plaintiff can allege that directors, having implemented such a system or controls, "consciously failed to monitor or oversee its operations thus disabling themselves from being informed of risks or problems requiring their attention."[36] Under either prong, a plaintiff must be able to demonstrate that directors knowingly violated their fiduciary obligations to hold them liable for such a claim—a standard which is notoriously difficult to meet.[37] That being said, it came as a shock when the Delaware Supreme Court allowed a *Caremark* claim to proceed in *Marchand v. Barnhill*.[38]

B. Marchand v. Barnhill

Marchand v. Barnhill involved a shareholder derivative lawsuit against the board of directors of Blue Bell after the company suffered a listeria outbreak in its factories in early 2015.[39] As a result of the listeria outbreak, three people died after consuming contaminated products, and Blue Bell had to "recall all of its products, shut down production at all of its plants, and lay off over a third of its workforce."[40]

Here, the Delaware Supreme Court again upheld the *Caremark* standard but, unlike in *Stone*, refused to dismiss the *Caremark* claim.[41] The supreme court relied on the first *Caremark* prong and

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35. *Stone*, 911 A.2d at 370.

36. *Id.*

37. *Id.*; *see* Shapira, *supra* note 12, at 1863 (discussing criticism of *Caremark* for "practically insulating boards from oversight liability, being 'irrelevant,' a 'toothless tiger,' and 'an empty triumph of form over substance'") (footnotes omitted) (quoting Mercer Bullard, Caremark's *Irrelevance*, 10 BERKELEY BUS. L.J. 15, 44 (2013); Anne Tucker Nees, *Who's the Boss? Unmasking Oversight Liability Within the Corporate Power Puzzle*, 40 DEL. J. CORP. L. 199, 216 (2010); Charles M. Elson & Christopher J. Gyves, In re Caremark: *Good Intentions, Unintended Consequences*, 39 WAKE FOREST L. REV. 691, 692 (2004)). Furthermore, duty of oversight claims are often brought in the context of shareholder derivative lawsuits. Under Delaware law, such lawsuits are governed by Court of Chancery Rule 23.1, which requires a shareholder to plead "particularized facts" showing that demand on a corporation's board would be futile. DEL. CH. R. 23.1(a). The challenge of pleading particularized factual allegations, "[c]oupled with a general philosophy of deference to corporate governance decisions pursuant to the business judgment rule, [makes] a *Caremark* claim . . . one of the hardest theories for plaintiffs to successfully allege." Flores, *supra* note 34.

38. 212 A.3d 805, 809 (Del. 2019); *see also* Shapira, *supra* note 12, at 1863.

39. 212 A.3d at 807.

40. *Id.*

41. *Caremark* requires "that a board make a good faith effort to put in place a reasonable system of monitoring and reporting about the corporation's central compliance risks," which in Blue Bell's case was food safety. *Marchand*, 212 A.3d at 824. In reversing the Delaware Court of Chancery's dismissal of the *Caremark* claim, the Delaware Supreme Court

found that the complaint supported a reasonable inference that the Blue Bell board breached its duty of oversight.[42] In its holding that the allegations of total absence of board-level oversight of food safety compliance and monitoring gave rise to a *Caremark* claim, the supreme court reinforced the necessity for directors to understand, inform themselves about, and document the company's most significant risks or, in other words, the company's "mission critical" risks.[43] Here, the board's "utter failure to attempt to assure a reasonable information and reporting system exists," according to the *Marchand* court, is an act of bad faith in breach of the duty of loyalty.[44]

In its analysis, the Delaware Supreme Court emphasized two issues—whether the corporation is monoline and whether it is heavily regulated—to consider when evaluating claims against directors for an oversight failure, both of which were present in *Marchand*.[45] The supreme court was particularly concerned with the fact that Blue Bell—a "monoline company" that has a single good as its only product—did not have a supervisory structure in place to oversee food safety and compliance for its sole product line.[46] And because Blue Bell was operating in the food industry, a "heavily regulated industry" bound by United States Federal Drug Administration ("FDA") requirements and state regulations, these protocols were especially important.[47] Since "food safety was essential and mission critical" for Blue Bell the court found that the complaint pled facts supporting a fair inference that the board had violated its duty under *Caremark*, specifically under its first prong.[48]

The *Marchand* court's denial of the Blue Bell board's motion to dismiss "disrupted corporate law with the first successful '*Care-*

concluded that the plaintiff "ha[d] met his onerous pleading burden and [was] entitled to discovery to prove out his claim." *Id.*

42. *Id.* at 809.

43. Christian Matarese, Siobhan Namazi & Neil Steiner, *Delaware Supreme Court Reverses Dismissal of Caremark Claim, Finding Lack of Board-Level Oversight and Director Independence*, JDSUPRA (July 1, 2019), https://www.jdsupra.com/legalnews/delaware-supreme-court-reverses-17103/ [https://perma.cc/99HG-8SGX].

44. *Marchand*, 212 A.3d at 809 (quoting *In re Caremark Int'l Inc. Derivative Litig.*, 698 A.2d 959, 971 (Del. Ch. 1996)).

45. Katherine M. King, Note, Marchand v. Barnhill*'s Impact on the Duty of Oversight: New Factors to Assess Directors' Liability for Breaching the Duty of Oversight*, 62 B.C. L. REV. 1925, 1925 (2021).

46. *Marchand*, 212 A.3d at 809.

47. *Id.* at 810.

48. *Id.* at 824.

mark claim.'"[49] The Delaware Supreme Court's landmark decision in *Marchand v. Barnhill* marked the beginning of a series of cases in which Delaware courts refused to dismiss shareholder derivative actions alleging oversight breaches.[50] *Marchand* also left practitioners and in-house counsel with a few guideposts—including whether a company is monoline and/or highly regulated—to shape their oversight practices and clarified what Delaware courts would focus on when assessing a *Caremark* claim.[51]

C. *Post-*Marchand *Litigation of* Caremark *Claims*

In October 2019, four months after *Marchand*, the Delaware Court of Chancery, under *Caremark*'s second prong, denied Clovis Oncology, Inc.'s motion to dismiss an oversight claim.[52] *In re Clovis Oncology, Inc. Derivative Litigation* was a shareholder derivative lawsuit in which the shareholder plaintiffs alleged that Clovis's board breached their fiduciary duties by failing to oversee the clinical trial of Rociletinib, the company's lung cancer drug, and then allowing the company to mislead the market regarding the drug's efficacy by using unconfirmed data on tumor shrinkage.[53]

Like *Marchand*, the *Clovis* case "intimated that high expectations will be placed on directors when it comes to the monitoring of highly regulated operations, particularly of 'mission critical' products."[54] Clovis was characterized as a monoline biopharmaceutical company with no products, no sales revenue, and only a single promising drug in its pipeline.[55] Because protocols and related regulations, imposed by the FDA, governing Clovis's clinical trial were

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49. King, *supra* note 45, at 1926.

50. Hille R. Sheppard, Elizabeth Y. Austin & Thomas H. Collier, *Best Practices for Minute-Taking: Three Lessons from Recent Caremark Decisions*, SIDLEY (Mar. 2, 2022), https://ma-litigation.sidley.com/2022/03/best-practices-for-minute-taking-three-lessons-from-recent-caremark-decisions/ [https://perma.cc/U49Z-7WNR].

51. HENDERSON ET AL., *supra* note 20, at 2.

52. *In re* Clovis Oncology, Inc. Derivative Litig., No. 2017-0222, 2019 Del. Ch. LEXIS 1293, at *32–33, *38 (Oct. 1, 2019).

53. 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/ [http://perma.cc/3UQA-JJB3].

54. HENDERSON ET AL., *supra* note 20, at 4.

55. Peter J. Walsh, Jr. & Nicholas D. Mozal, *Observations on* Clovis Oncology, Inc. *Derivative Litigation*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Oct. 14, 2019), https://corpgov.law.harvard.edu/2019/10/14/observations-on-clovis-oncology-inc-derivative-litigation/ [http://perma.cc/PG4G-SAKZ].

"mission critical regulatory issues" for its "mission critical product," the Delaware Court of Chancery was satisfied that, at the pleadings stage, the plaintiff shareholders had adequately pled that the board consciously ignored red flags by failing to correct the Company's reporting.[56]

Likewise, in January 2020, the Delaware Court of Chancery allowed another *Caremark* claim to proceed under its second prong in *Inter-Marketing Group United States v. Armstrong*.[57] *Inter-Marketing Group* involved a shareholder derivative lawsuit brought by a Plains unitholder, which alleged that a failure to implement or properly oversee a pipeline integrity reporting system resulted in a Plains pipeline rupturing and spilling 3,400 barrels of oil into an environmentally-sensitive part of the West Coast.[58] Like *Marchand*, critical safety concerns were implicated in the *Inter-Marketing Group* case and—although there were no casualties—the Court of Chancery declined to dismiss the complaint.[59]

More recently, in 2021, the Delaware Court of Chancery permitted a *Caremark* claim to proceed against Boeing's board after two fatal plane crashes involving the company's 737 MAX airplanes—the first in 2018 involving Lion Air, and the second in 2019 involving Ethiopian Airlines.[60] In the case of *In re Boeing Co. Derivative Litigation*, Vice Chancellor Zurn ruled that the case against Boeing's directors could proceed, coming to the conclusion that the company's directors faced a substantial likelihood of oversight liability for Boeing's loses under both *Caremark* prongs.[61] In denying Boeing's motion to dismiss, the Delaware Court of Chancery concluded that the complaint sufficiently pled that the board had "failed to establish a reporting system" for airplane safety.[62] In addition, the court stated that the complaint had adequately pled that the first of the two plane crashes "was a red flag . . . that the Board should have heeded but instead ignored," and that "the

56. *Clovis*, 2019 Del. Ch. LEXIS 1293, at *30–31.

57. No. 2017-0030, 2020 Del. Ch. LEXIS 391, at *34–36 (Jan. 31, 2020) (denying motion to dismiss under *Caremark*'s second prong).

58. Kotler et al., *supra* note 53.

59. *Inter-Mktg. Grp.*, 2020 Del. Ch. LEXIS 391, at *34–37; HENDERSON ET AL., *supra* note 20, at 5.

60. *In re* Boeing Co. Derivative Litig., No. 2019-0907, 2021 Del. Ch. LEXIS 197, at *4 (Sept. 7, 2021).

61. *Id.* at *2–4.

62. *Id.* at *85–86.

Board was aware or should have been aware that its response to the Lion Air Crash fell short."[63]

Following *Marchand* and the number of post-*Marchand* cases that survived a motion to dismiss, corporate law observers were left "wondering if the Delaware courts are ushering in a new era of more 'muscular' oversight doctrine."[64] *Marchand*, *Clovis*, *Inter-Marketing Group*, and *Boeing*—as well as other cases involving *Caremark* claims post-*Marchand* that advanced past the pleading stage—have all involved "unique fact patterns, with allegations accepted as true for purposes of a motion to dismiss."[65] In the cases discussed in this Section, the defendant companies were all monoline companies operating in highly regulated sectors.[66] In each case, the plaintiff alleged failures of board oversight of "mission critical" systems or risks: food safety, clinical drug trials, oil pipeline integrity, and airplane safety, respectively.[67] While the Delaware Supreme Court's decision in *Marchand* ostensibly "signaled a new plaintiff-friendly shift in jurisprudence on oversight liability," subsequent cases have not necessarily demonstrated a lower pleading standard for *Caremark* claims.[68]

Under Delaware law and *Caremark* jurisprudence, the onus of identifying and monitoring risk and compliance is on the board of directors, especially in regard to *mission-critical* risks.[69] The duty of oversight for directors includes "the *continual* inquiry . . . into whether the board's delegation of authority to management is reasonable, and whether the board has received sufficient and accurate information from management to make that determination."[70]

According to the Delaware Supreme Court in *Marchand*, board oversight should focus on key risks facing the company, such as "compliance issue[s] intrinsically critical to the company's business operation."[71] Despite initial concerns, neither *Marchand* nor its progeny changed how courts evaluate a *Caremark* claim—notwith-

63. *Id.* at *91–92.

64. Pollman, *supra* note 22; *see generally* Shapira, *supra* note 12 (arguing that a string of successful *Caremark* cases, post-*Marchand*, have signaled a new era of enhanced oversight duties).

65. Kotler et al., *supra* note 53.

66. *Id.*

67. *Id.*

68. HENDERSON ET AL., *supra* note 20, at 2–3.

69. Gregory, *supra* note 1.

70. *Id.* (emphasis added).

71. Marchand v. Barnhill, 212 A.3d 805, 822 (Del. 2019).

standing future decisions which may expand the scope of the *Caremark* standard.[72] After all, Delaware courts continue to reiterate that a *Caremark* claim is "possibly the most difficult theory in corporation law upon which a plaintiff might hope to win a judgment."[73] Yet, in the context of advising boards on how to avoid oversight liability, it is important to consider the possibility of future decisions expanding the scope of the *Caremark* standard—as it relates to a broader category of mission-critical risks—in light of our current "atmosphere of heightened scrutiny of board oversight."[74]

As these cases, and other successfully pled *Caremark* cases, demonstrate, Delaware courts have continued to uphold the "mission critical" language of *Marchand* in order to determine more egregious violations and failures of corporate compliance systems and director oversight.[75] It is important for companies to identify "mission critical" risks and, in effect, for boards to exercise their duty of oversight in addressing such risks.

II. AREAS OF RISK IN MODERN CORPORATE GOVERNANCE

Part II discusses the areas of risk in the context of modern corporate governance and the expanding role of board of directors regarding issues such as cybersecurity and climate change in today's business environment. This Part defines cybersecurity and climate change issues and how these issues implicate risk and risk-management in the context of board oversight.

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72. *See Delaware Supreme Court Reinforces Directors' Oversight Obligations on Mission-Critical Subjects*, JONES DAY: INSIGHTS (Aug. 2019), https://www.jonesday.com/en/insights/2019/08/delaware-court-reinforces-directors-oversight [https://perma.cc/NG6H-G29V].

73. *In re* Boeing Co. Derivative Litig., No. 2019-0907, 2021 Del. Ch. LEXIS 197, at *65 (Sept. 7, 2021) (quoting *In re* Caremark Int'l Derivative Litig., 698 A.2d 959, 967 (Del. Ch. 1996)).

74. Gregory, *supra* note 1 ("Ensuring that directors are well-positioned to satisfy their oversight responsibility requires periodic assessment of board agenda priorities and the related structures, processes, and controls that are in place to ensure that the board is well-informed on a timely basis of matters requiring attention."). Note, however, that this "atmosphere of heightened scrutiny" is in reference to the general public, rather than Delaware courts. However, this Comment argues that this could ultimately trickle down to Delaware courts' analyses of *Caremark* claims in the future. *See infra* CONCLUSION.

75. Eisele Ibarra, Note, *Tighten the Line for* Caremark *Claims*, 20 FLA. ST. U. BUS. REV. 115, 123 (2021).

A. *Post*-Marchand *Duty of Oversight and Additional Risk Categories for Boards' Consideration*

Today, boards function in a complex and dynamic business setting in which stakeholder expectations and demands for board attention are expanding and corporations are facing increased pressure on multiple fronts, all in an atmosphere of heightened scrutiny of board oversight.[76] Moreover, the challenges that companies face are evolving rapidly—not only do issues like cybersecurity and climate change, for example, pose strategic risks to corporations of all sizes and in every industry, but stakeholder expectations regarding how businesses plan to mitigate those risks are also in flux.[77] This has resulted in an uncertain landscape that must be navigated with care by leaders within a corporation, including directors.[78]

According to a 2016 Global Board of Directors Survey, "sixty percent (60%) of directors say that there is a gap between the expectations placed on boards and the reality of the board's ability to oversee a company . . . ."[79] Julie Hembrock Daum, head of Spencer Stuart's North American Board Practice, says that "[t]hese expectations are coming from multiple stakeholders—investors, consumers, regulatory bodies, the media—in a climate of unprecedented demands for transparency and accountability."[80] *Marchand* and subsequent cases finding complaints to have sufficiently pled *Caremark* allegations may dovetail with the ever-increasing role of cybersecurity and ESG in corporate policy and strategy. Boards of directors may be required to oversee corporate conduct with an eye towards how the company's financial health intersects with and relies upon the company's commitment to examining disruptive digital transformations taking place in their industries, as well as its commitment to sustainability, transparency, and regulatory

76. Gregory, *supra* note 1.

77. PRICEWATERHOUSECOOPERS, BOARD EFFECTIVENESS: A SURVEY OF THE C-SUITE 12 (2021), https://www.pwc.com/us/en/services/governance-insights-center/library/board-effectiveness-and-performance-improvement.html [https://perma.cc/NZ85-WZMC].

78. Gregory, *supra* note 1.

79. WomenCorporateDirectors Educ. & Dev. Found., Inc., *Are Expectations on Board Members Too High? Most Directors Think So*, CISION: PR NEWSWIRE (Oct. 20, 2016, 9:30 AM), https://www.prnewswire.com/news-releases/are-expectations-on-board-members-too-high-most-directors-think-so-300347936.html [https://perma.cc/V96A-WRUL].

80. *Id.*

compliance.[81] These issues have acquired new urgency, and ensuring that directors are properly positioned to satisfy their duty of oversight requires periodic assessment of board agenda priority and the related structures, processes, and controls that are in place to ensure that the board is well-informed on a timely basis of matters requiring their attention.[82]

B. *Defining Cybersecurity and Environment, Social, and Governance ("ESG") Risks*

The typical areas of risk that are commonly associated with directors' duty of oversight include the "strategic initiatives, financial performance and the integrity of financial statements and accounting and financial reporting processes, risk management, and compliance."[83] Generally speaking, these "typical" areas of risk are largely focused on a corporation's financial- or profitability-related risks, which makes sense given the role that directors play in the successful leadership of a corporation.[84] However, we are currently witnessing a trend of increasing attention on corporate compliance that goes beyond finances and profit, thus implicating directors' fiduciary duties of compliance oversight.[85]

The subjects or risk categories that necessitate director oversight will differ based on the evolving needs of a particular corporation; however, some commentators argue that directors across the board are now responsible for overseeing "virtually any subject that an investor, stakeholder, or other party raises as being potentially material to a company and, therefore, needing board attention."[86] Corporations and their boards are paying greater attention to issues, such as cybersecurity and climate change, that were once considered inapplicable to most companies and, thus, did not

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81. Flores, *supra* note 34; *Great Expectations: The Digital Transformation in Today's Board Room*, DILITRUST (2022), https://www.dilitrust.com/en/blog/great-expectations-the-digital-transformation-in-todays-board-room/ [https://perma.cc/42F9-HVSH].

82. Gregory, *supra* note 1.

83. *Id.*

84. *See id.*

85. *See* discussion *supra* Section II.A; Robert Biskup, Krista Parsons & Robert Lamm, *Board Oversight of Corporate Compliance: Is it Time for a Refresh*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Oct. 15, 2019), https://corpgov.law.harvard.edu/2019/10/15/board-oversight-of-corporate-compliance-is-it-time-for-a-refresh/ [https://perma.cc/E2E8-FB4L].

86. Marc S. Gerber, Kenton J. King, & Peter A. Atkins, *Directors' Oversight Role Today: Increased Expectations, Responsibility and Accountability—A Macro View*, SKADDEN (Apr. 22, 2021), https://www.skadden.com/insights/publications/2021/04/directors-oversight-role-today [https://perma.cc/ES7E-WKQW].

necessarily require board attention.[87] In considering the potential for liability, boards should individually assess whether these broadly applicable issues are within their responsibility:

> Pressure from investors and others, in various forms and with increasing intensity, has been and continues to be applied to boards to address these issues promptly and more effectively. The failure by a board to deal with any such identified subject, or a board's perceived inadequacy in doing so, often leads to questions being raised about the board's performance of its oversight function.[88]

Some corporate directors claim they have too much liability exposure for a company's operations and, as a result, view the position as being too much of a risk, especially when considering the expanding role of directors towards issues such as climate change and cybersecurity.[89] Nevertheless, today's corporate boards must "proactively anticipate change and address the risks and opportunities associated with key trends shaping the current and future business context," from a business strategy standpoint, as well as a legal one.[90]

In discussions of emerging and atypical risks, i.e., risks other than the financial risks that are traditionally associated with exercising oversight as a director, cybersecurity poses an area of growing concern for companies.[91] The National Institute of Standards and Technology defines cybersecurity as the "[p]revention of damage to, protection of, and restoration of computers, electronic communications systems, electronic communications services, wire communication, and electronic communication, including information contained therein, to ensure its availability, integrity, authentication, confidentiality, and nonrepudiation."[92] At the outset of

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87. See *id.* (arguing that the range of issues which require board attention is broader than ever before).

88. *Id.* (summarizing that "directors remain the targets when investors or others look to hold companies responsible and accountable for perceived missteps relating to a constantly growing range of oversight subjects, many of which not long ago would have surprised public company boards of directors as being their responsibility").

89. *See* Steven Davidoff Solomon, *Despite Worries, Serving at the Top Carries Little Risk*, N.Y. TIMES DEALBOOK (June 7, 2011, 5:58 PM), https://archive.nytimes.com/dealbook.nytimes.com/2011/06/07/despite-worries-serving-at-the-top-carries-little-risk/ [https://perma.cc/VDA2-3YSF].

90. EY CTR. FOR BD. MATTERS, SIX PRIORITIES FOR BOARDS IN 2021 7 (2020), https://assets.ey.com/content/dam/ey-sites/ey-com/en_us/topics/cbm/ey-cbm-six-priorities-for-boards-in-2021.pdf [https://perma.cc/CU7D-BXH8]. From a legal standpoint, anticipating and preparing for risk could mitigate oversight liability. *See* HENDERSON ET AL., *supra* note 20, at 7.

91. Markel et al., *supra* note 9 (discussing cybersecurity oversight obligations).

92. *Cybersecurity*, NAT'L INST. STANDARDS & TECHS., https://csrc.nist.gov/glossary/term/cybersecurity [http://perma.cc/6G9D-22V7].

2022, cybersecurity was an especially timely issue.[93] When it comes to identifying and managing cybersecurity risks, financial regulators, such as the U.S. Securities and Exchange Commission ("SEC"), now expect greater oversight from companies and their boards of directors than ever before.[94] In a global board survey conducted by McKinsey & Company, participants rated cybersecurity among their top four priorities.[95] Post-pandemic trends—such as advancements in information technology ("IT"), digital transformations by a growing number of corporations, and the shift towards remote or hybrid work environments—coupled with the evolution of threat actors has resulted in a riskier, more complex cyber landscape.[96] Furthermore, these threat actors are employing tactics that are "new and more sophisticated," which adds another layer of complexity to an area of risk that is already complex and technical.[97] Accordingly, cyber risk management by corporations must go beyond the mere prevention of data breaches and should take various, advanced cyber risks into consideration.[98]

In 2021, the three biggest cybersecurity risks were (1) the software supply chain, (2) ransomware and phishing attacks, and (3) mobile security and remote devices.[99] However, cybersecurity risks can take various forms, such as "loss of access to business-critical data and IT infrastructure, successful consumer class action law-

93. Chris Olson, *Content Was the Biggest Cybersecurity Oversight of 2021*, FORBES (Mar. 24, 2022, 6:30 AM), https://www.forbes.com/sites/forbestechcouncil/2022/03/24/content-was-the-biggest-cybersecurity-oversight-of-2021/ [http://perma.cc/5V5M-KK2N].

94. James Rundle, *New U.S. Financial Cyber Rules Focus on Board Oversight*, WALL ST. J. PRO: CYBERSECURITY (Mar. 16, 2022, 5:30 AM), https://www.wsj.com/articles/new-u-s-financial-cyber-rules-focus-on-board-oversight-11647423003 [https://perma.cc/SW95-LMD7]; *see also* J.D. Bridges & Daniel G, Berick, *Boards Under Fire*, ASS'N OF CORP. COUNS. DOCKET (Feb. 6, 2023), https://docket.acc.com/boards-under-fire [https://perma.cc/WPU7-9AM6].

95. Frithjof Lund, Wolf Richter & John Noble, *Boards and Cybersecurity*, MCKINSEY & CO. (Feb. 2, 2021), https://www.mckinsey.com/business-functions/strategy-and-corporate-finance/our-insights/boards-and-cybersecurity [http://perma.cc/B6X5-V9GJ] (discussing reasons why boards should prepare for the rising cybersecurity threat).

96. *See* Olson, *supra* note 93 (describing long- and short-term effects of cybersecurity risks, including "the global cost of cybercrime [being] projected to reach $10.5 trillion by 2025"); Sean Joyce & Catie Hall, *Overseeing Cyber Risk*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Feb. 24, 2022), https://corpgov.law.harvard.edu/2022/02/24/overseeing-cyber-risk-2/ [https://perma.cc/R3XG-86S2]; *What is Digital Transformation?*, SALESFORCE, https://www.salesforce.com/products/platform/what-is-digital-transformation/ [https://perma.cc/W8GF-PAVK] (defining "digital transformation" as a way that businesses can adapt to the digital age).

97. Joyce & Hall, *supra* note 96.

98. *See id.*

99. Olson, *supra* note 93.

suits, regulatory liability, or loss of commercial counterparties, or liability to those counterparties."[100] Although boards are generally concerned about cybersecurity risk, it is largely viewed as an exclusively IT-related issue.[101] However, as previously mentioned in the context of oversight, shareholders and stakeholders have growing expectations for directors, which includes cyber risk management: companies, including those with a well-organized risk management program, are increasingly susceptible to cyber breaches and attacks in the current cyber landscape.[102] Almost every company experiences cyber risk in some capacity, and it is a challenge that should, at least, be *addressed* by the company's board.[103] After all, cyber threats are becoming so frequent that they are an "almost weekly" occurrence.[104] Despite the frequency of these threats, a majority of board members do not identify as cyber experts—according to PwC's 2021 Annual Corporate Directors Survey, "[o]nly 33% of directors say they think their board understands the company's cybersecurity vulnerabilities very well," despite the fact that understanding and overseeing such significant risk may fall under directors' fiduciary duties.[105] Therefore, "[d]irectors need active engagement with leadership, access to expertise, and robust information and reporting from management."[106]

Another emerging and atypical area of risk is ESG risk. "As once-radical concepts of social investing and sustainability-as-strategy become more mainstream, many corporate boards are shifting their focus to understanding and implementing environmental, social, and governance (ESG) frameworks and metrics."[107]

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100. Robert S. Velevis & Christina M. Claxton, *Caremark's Comeback Includes Potential Director Liability in Connection with Data Breaches,* SIDLEY (Jan. 26, 2022), https://datamatters.sidley.com/caremarks-comeback-includes-potential-director-liability-in-connection-with-data-breaches [https://perma.cc/6XG8-G7GK].

101. Dan Burke & Teresa Milano, *Board of Directors: Prioritize Your Cyber Risk*, JDSUPRA (Jan. 4, 2022), https://www.jdsupra.com/legalnews/board-of-directors-prioritize-your-5863010/ [https://perma.cc/F2YF-Z72U] (claiming that "all boards need to put cyber risk front and center as part of their corporate governance" in order to "ease director liability").

102. Joyce & Hall, *supra* note 96 ("[S]takeholders demand that companies do everything in their power to protect consumer data, and to also recover quickly from a breach or critical disruption.").

103. *See id.*

104. *Id.*

105. *Id.* (citing PRICEWATERHOUSECOOPERS, PWC'S 2021 ANNUAL CORPORATE DIRECTORS SURVEY 27 (2021), https://www.pwc.com/us/en/services/governance-insights-center/assets/pwc-2021-annual-corporate-directors-survey.pdf [https://perma.cc/4JTC-C29H]).

106. *Id.*

107. Caroline Davis Schoenecker, *Boards Face Rising Complexity of ESG Oversight Role*, WALL ST. J. Pro: SUSTAINABLE BUS. (Nov. 17, 2021, 3:00 PM), https://deloitte.wsj.com/article

Although ESG is often associated with public company disclosures and sustainable investing, ESG issues encompass a broad area of risk including, but not limited to: (1) risks to corporate reputation; (2) risks to project financing; (3) legal liability risks; (4) risks associated with lack of diversity, equity, and inclusion; (5) risks based on lobbying; (6) risks from lack of corporate ESG coordination; and (7) risks associated with lost opportunities.[108] One particular area of risk included within the ESG framework is climate change risk.

Climate change is defined as "a phenomenon that occurs from the accumulation of greenhouse gases, such as carbon dioxide, nitrous oxide and methane, in the atmosphere."[109] Human activity has resulted in volumes of greenhouse gas emissions that are significantly higher than the natural baseline and, as a result, heat trapped within the Earth's atmosphere is causing global average temperatures to rise.[110] Climate change risk is of particular importance in discussions regarding corporate governance and social responsibility, and it has been at the forefront of ESG issues over the past few years.[111]

In anticipation of the 2022 proxy season, shareholders have filed a record number of shareholder proposals, and climate-related proposals comprise the largest share (20%) of the 567 shareholder resolutions filed as of March 31, 2022.[112] In addition to shareholders, corporations are also raising concerns regarding the issue of climate change and the resulting risk—according to Deloitte Global's

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s/boards-face-rising-complexity-of-esg-oversight-role-01637170602 [https://perma.cc/EL5C-78AF].

108. Samuel L. Brown et al., *Environmental, Social and Corporate Governance: What Are the Risks, Really?*, NAT'L L. REV. (Mar. 31, 2021), https://www.natlawreview.com/article/environmental-social-and-corporate-governance-what-are-risks-really [https://perma.cc/YZ57-4ZHC].

109. SARAH BARKER, CYNTHIA WILLIAMS, & ALEX COOPER, FIDUCIARY DUTIES AND CLIMATE CHANGE IN THE UNITED STATES 2 (2021), https://ccli.ubc.ca/wp-content/uploads/2021/12/Fiduciary-duties-and-climate-change-in-the-United-States.pdf [https://perma.cc/57FM-XZJC].

110. *Id.*

111. DONNELLEY FIN. SOLS., BOARD OVERSIGHT OF ESG—NOW! 2 (2020), https://www.dfinsolutions.com/sites/default/files/documents/2020-10/Board%20Oversight%20of%20ESG%20Now.pdf [https://perma.cc/LK9A-YL6R].

112. Karin Rives, *Climate Resolutions Top 'Unprecedented' Number of Shareholder Proposals in 2022*, S&P GLOBAL (Apr. 4, 2022), https://www.spglobal.com/marketintelligence/en/news-insights/latest-news-headlines/climate-resolutions-top-unprecedented-number-of-shareholder-proposals-in-2022-69641049 [https://perma.cc/W9UY-KCWK] (discussing the "totally unprecedented" growth in volume of shareholder proposals in 2022, as compared to 2021). Executives with PricewaterhouseCoopers LLP and Broadridge Financial Solutions Inc. wrote that "[c]limate change is the top issue to watch in the 2022 proxy season." *Id.*

2021 Climate Check report, over 80% of corporate executives are concerned about climate change.[113] Climate change creates a wide range of risks for businesses, including disrupted supply chains, rising insurance costs, and labor challenges.[114] "Climate change and extreme weather events [caused by climate change] such as hurricanes, floods, and fires . . . have a direct impact on 70% of all economic sectors worldwide."[115] According to a Deloitte Global report, "[c]limate-related events are already affecting more than 1 in 4 organizations worldwide . . . ."[116] Given the far-reaching effects of climate change, in general and on corporations, climate risk may fall within the board of directors' duty of oversight.

Going forward, companies and their boards "must bear in mind that scrutiny of board oversight of ESG and the overall handling of the risk function are more challenging and critical today than ever before."[117] Such heightened scrutiny will have "important implications both for company and board practices, as well as for company disclosures about these practices."[118] For the purpose of this Comment, the relevant issue with regard to these emerging and atypical risks (cybersecurity and climate change) is whether they are "mission critical," such that a board's failure to regard them would be considered a breach of its fiduciary duty of oversight.

III. CYBERSECURITY AND CLIMATE CHANGE (ESG) RISKS ARE UNLIKELY TO BE INTERPRETED BY DELAWARE COURTS AS "MISSION CRITICAL"

The definition of "mission critical," as related to risks that the board must adequately consider as part of their duty of oversight is a limited one. In an attempt to articulate the limited scope of mission critical risks, this Part identifies three factors related to such risks that Delaware courts have focused on when allowing a

113. Deloitte, *Organizations Are Feeling the Pain of Climate Change: Here Are Five Ways its Affecting Their Business*, FORBES (Apr. 16, 2021, 12:26 PM), https://www.forbes.com/sites/deloitte/2021/04/16/organizations-are-feeling-the-pain-of-climate-change-here-are-five-ways-its-affecting-their-business/ [https://perma.cc/4THY-P7JD] (suggesting that executives are concerned because "most global organizations are already starting to feel [climate change's] negative impacts").

114. *Id.*

115. *Id.* (suggesting that executives are concerned because "most global organizations are already starting to feel [climate change's] negative impacts").

116. *Id.*

117. DONNELLEY FIN. SOLS., *supra* note 111, at 2.

118. *Id.*

Caremark claim to proceed against a board of directors post-*Marchand*. These factors demonstrate that the categories of risk that boards must consider in order to avoid oversight liability is narrow and fact-specific. In other words, *Marchand* and its progeny do not indicate a change in the standard of review, nor does it expand the areas of risks (beyond those that are traditionally subject to board oversight) that boards *must* consider when providing oversight. Next, this Part analyzes cybersecurity risks using these three factors and argues that cybersecurity risks are unlikely to be interpreted by Delaware courts as "mission critical" broadly. Finally, this Part analyzes climate change risks according to three factors and concludes that climate change is also unlikely to be interpreted by Delaware courts as "mission critical".

A. *Limited Scope of "Mission Critical"*

Marchand and its progeny make very clear that *Caremark* remains a very high bar in terms of its pleading standard. Scholars also support this notion—arguing that *Marchand* does not indicate any change to the standard of review or pleading requirement for a *Caremark* claim.[119] As Chancellor Allen first observed in *Caremark*, and "as since emphasized by [Delaware courts] many times, *perhaps to redundance*, the claim that corporate fiduciaries have breached their duties to stockholders by failing to monitor corporate affairs is 'possibly the most difficult theory in corporate law upon which a plaintiff might hope to win a judgment.'"[120]

The cases following *Marchand* have not necessarily evidenced a significant departure from previous *Caremark* case law—instead, they indicate that Delaware courts will undertake a fact-specific inquiry in assessing oversight claims and that the inquiry remains highly contextual. On the other hand, *Marchand* and its progeny have revealed what appears to be trends—which can be organized into three different factors relating to the "mission critical" risk at issue—that consistently appear in Delaware courts' inquiries into

119. 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/9MRN-V76Y]; *see also* Markel et al., *supra* note 9.

120. *In re* Boeing Co. Derivative Litig., No. 2019-090, 2021 Del. Ch. LEXIS 197, at *65 (Sept. 7, 2021) (quoting *In re* Caremark Int'l Co. Derivative Litig., 698 A.2d 959, 967 (Del. Ch. 1996)) (emphasis added).

Caremark claims and may provide guidance as to the likelihood of having to litigate these claims past the motion to dismiss.[121]

There are three factors that have remained consistent amongst *Caremark* cases that have survived motions to dismiss. These three factors derive from the "mission critical" language that has been echoed in cases following *Marchand*.[122] The combined presence of these factors gives rise to the reasonable inference that the board faced a substantial likelihood of liability thereby allowing a *Caremark* claim to proceed past the motion to dismiss stage. The three factors related to "mission critical" risks are: (1) the risk is of primary importance to the defendant directors' company; (2) the company facing the risk is highly regulated; and (3) the damage caused by the risk is particularly egregious.

The first factor is whether the risk at issue is of primary importance to the defendant directors' company, which is related to the consideration raised in *Marchand* as to whether the company is monoline. In monoline companies, directors will be expected to closely monitor the company's sole product, but this expectation is not limited if, for example, a company sells more than one product. In *Teamsters Local 443 Health Services & Insurance Plan v. Chou*, the Delaware Court of Chancery allowed the *Caremark* claim, under the second prong, to proceed against the board of directors of ABC's pharmacy business—as compared to ABC's business as a whole—based on the allegations that the board ignored red flags and failed to monitor compliance and safety.[123] The defendants' argument that, since the pharmacy was a small part of ABC's overall business, the *Caremark* claims should be dismissed was rejected by the court because the "concept of mission critical" was still in play.[124] Importantly, "even though the pharmacy business represented a small portion of the company's overall revenue, compliance with FDA regulations is and was a primary regulatory concern for the company and its pharmacy business."[125]

121. *See* HENDERSON ET AL., *supra* note 20, at 7.

122. *See, e.g.*, *In re* Clovis Oncology Inc. Derivative Litig., No. 2017-0222, 2019 Del. Ch. LEXIS 1293, at *28 (Oct. 1, 2019); *Boeing*, 2021 Del. Ch. LEXIS 197, at *71–72 (discussing the significance of mission critical risks to a board's duty of oversight).

123. No. 2019-0816, 2020 Del. Ch. LEXIS 274, at *6 (Aug. 24, 2020).

124. HENDERSON ET AL., *supra* note 20, at 5.

125. *Id.* (citing *Teamsters Local 443 Health Servs. & Ins. Plan*, 2020 Del. Ch. LEXIS 274, at *5–6).

The second factor is whether the company facing the risk is highly regulated. In other words, does the corporation operate in a highly regulated area or is it subject to externally imposed regulations? Where companies operate in highly regulated areas, they will be expected to have information and reporting systems that are tailored to the company's area of operations and designed to ensure compliance with those regulations.[126] The board's oversight function must also be more rigorously exercised when a company operates in an environment or industry where externally imposed regulations govern its primary operations.[127] In *Clovis* and *Marchand*, Clovis and Blue Bell, respectively, were subject to externally imposed regulations regarding drug and food safety by the FDA.[128] Similarly, Boeing was subject to externally imposed regulations regarding airplane safety by the U.S. Federal Aviation Administration.[129] In each of the three cases, the company facing the risk at issue was highly regulated by external, federal regulatory agencies.

The third factor is whether the damage caused by the risk is particularly egregious. "Particularly egregious," as used here, means the risk results in casualties and/or implicates great safety concerns. While the facts in *Boeing* and *Marchand* were extremely egregious, since there were casualties resulting from a failure by the board to exercise their duty of oversight,[130] the facts do not always need to be as extreme. For example, the court denied a motion to dismiss in *Inter-Marketing Group* due to critical safety risks resulting from an oil spill which did not result in any casualties.[131]

B. *Cybersecurity Risks for Most Corporations are Unlikely to be Interpreted by Delaware Courts as a "Mission Critical" Risk in a* Caremark *Analysis*

To assess whether cybersecurity risks would be interpreted as a "mission critical" risk in a *Caremark* analysis, courts should turn

126. *Id.* at 7.

127. *Clovis*, 2019 Del. Ch. LEXIS 1293, at *28.

128. *Id.* at *2; Marchand v. Barnhill, 212 A.3d 805, 807 (Del. 2019).

129. *In re* Boeing Co. Derivative Litig., No. 2019-0907, 2021 Del. Ch. LEXIS 197, at *10, *65 (Sept. 7, 2021).

130. *See generally id.* at *31, *44 (noting the death of 346 passengers in two airplane crashes); *Marchand*, 212 A.3d at 807 (noting the death of three customers).

131. *See, e.g.*, Inter-Mktg Grp. USA, Inc., 2017-0030, 2020 Del. Ch. LEXIS 391, *1–3 (Jan. 31, 2020).

to the three-factor test articulated in the previous section. Starting with the first factor, a court must ask whether the cybersecurity risk is of primary importance to companies across the board—rather than focusing exclusively on, for example, a technology company—such that any company not properly addressing these risks would be in breach of their duty of oversight. "Cybersecurity poses an area of increasing risks for companies" and, due to the "progressive sophistication of cyber criminals in disrupting operations to extort payment, cybersecurity is likely to be considered a significant risk for *most* businesses."[132] However, it would be a reach to say that cybersecurity risk is of *primary* importance to companies *across the board*. While board oversight of cybersecurity risks and risk mitigation policies are important for most companies and their directors, it is unlikely that disregarding cybersecurity risks, in general, can expose directors to *Caremark* liability.[133]

In *Firemen's Retirement System of St. Louis v. Sorenson*, the Delaware Court of Chancery specifically addressed the issue of cybersecurity risks in a duty of oversight case which was ultimately dismissed—despite the fact that the cyberattack in this case resulted in one of the largest data breaches in history, during which the personally identifiable information of up to 500 million Marriott hotel guests was exposed.[134] However, the court did acknow-ledge that cybersecurity is "an area of consequential risk that spans modern business sectors" and that "corporate harms presented by noncompliance with cybersecurity safeguards increasingly call upon directors to ensure that companies have appropriate oversight systems in place."[135]

Nevertheless, the court dismissed the suit against Marriott's board based on its conclusion that the growing risks posed by cybersecurity threats do not lower the high threshold that a plaintiff must meet to plead an oversight claim under either the first or second prong of *Caremark*.[136] Even though Marriot's board had consistently ranked cybersecurity as a primary risk facing the company, due to their online booking system, the plaintiffs were unable to show that the board "utterly failed" to implement *any* reporting

132. Markel et al., *supra* note 9 (emphasis added).

133. *See id.* (citing Firemen's Ret. Sys. v. Sorenson, No. 2019-0965, 2021 Del. Ch. LEXIS 234, at *1–3 (July 7, 2021)).

134. 2021 Del. Ch. LEXIS 234, at *12.

135. *Id.* at *27–28.

136. *Id.* at *28.

system or internal controls to address the risk of a data breach, as required in showing the bad faith necessary for *Caremark* liability.[137] Thus, cybersecurity risks fail the first factor of the three-factor test articulated in the previous section.

This may be susceptible to change if, for example, advancements in technology make it more accessible to all corporations, such that cybersecurity would become mission critical—perhaps by way of increased regulatory control, which is relevant to the second factor's consideration of subjectivity to external regulation. In fact, the SEC issued a cyber regulation proposal titled "Cybersecurity Risk Management, Strategy, Governance, and Incident Disclosure," which would affect a wide range of corporations—from small companies to large multinationals.[138] Betsy Atkins, an expert in corporate governance and business trends, believes that not excluding companies based on size is understandable, given that "virtually all companies are connected by the internet and most supply chains include small dealers, distributors and manufacturers."[139] While cybersecurity risks have greater potential to impact companies, on a more general scale, regulation in the form of mandatory disclosure, alone, is not enough to satisfy this factor.

In *Clovis*, for example, the board was allegedly aware of additional clinical trial violations and side effects but had not tempered its disclosure to the market accordingly, which was meaningless for FDA approval.[140] Allowing the *Caremark* claim to proceed was not predicated on the issue of disclosure but, rather, the failure to receive FDA approval due, in part, to violation of the SEC's disclosure rules.[141] As to this point, the Delaware Court of Chancery found it appropriate to "distinguish the board's oversight of the company's *management of business risk* that is inherent in its business plan from the board's oversight of the company's *compliance*

137. *Id.* at *29–30.

138. Betsy Atkins, *Cybersecurity and the Role of the Board*, FORBES (Mar. 18, 2022, 4:28 PM), https://www.forbes.com/sites/betsyatkins/2022/03/18/cybersecurity-and-the-role-of-the-board/?sh=4b6522e172b3 [https://perma.cc/2E3Z-HYW8] (commenting on the impact of the SEC's cyber regulation proposal in navigating board oversight duties related to cyber risk).

139. *Id.* (commenting how "the breaches of larger companies often originate from their less vigilant or resource challenged smaller companies that are part of their supply chain, or their distribution dealer and distributor network").

140. *In re* Clovis Oncology, Inc. Derivative Litig., No. 2017-0222, 2019 Del. Ch. LEXIS 1293, at *17 (Oct. 1, 2019).

141. *Id.* at *30–31 (explaining how pharmaceutical trial reporting requirements impacted FDA approval).

with positive law—including regulatory mandates."[142] The SEC's cybersecurity proposal would implicate a wider range of public companies to external regulation of their cybersecurity risks;[143] and it would require directors' oversight of cybersecurity risks, among other things.[144] As a consequence of the proposal's oversight requirement, directors face greater exposure to potential oversight liability, at least in theory. In *Clovis*, the court highlighted the significance of director oversight in the face of regulatory compliance:

> Delaware courts have been more inclined to find *Caremark* oversight liability at the board level when a company operates in the midst of obligations imposed upon it by positive law yet fails to implement compliance systems, or fails to monitor existing compliance systems, such that a violation of law, and resulting liability, occurs.[145]

Clovis was not just subject to mandatory disclosure rules, but also subject to regulatory control by the FDA as the agency which oversees biopharmaceutical companies.[146] The effect of failing to adhere to FDA guidelines was the termination of Clovis's drug study and a decline in the company's stock price, which the plaintiffs were able to successfully argue was in breach of the board's duty of oversight.[147]

To satisfy the third factor, cybersecurity risk must result in harm that is "particularly egregious." Although cybersecurity risks can implicate great safety concerns, it is unlikely that cybersecurity-related safety concerns would suffice to be considered particularly egregious in the context of a *Caremark* claim without the presence of the additional two factors. After all, the Delaware Court of Chancery ended up dismissing a *Caremark* claim arising from one of the largest data breaches, which one could argue implicates great safety concerns given the overwhelming exposure of potentially identifiable information.[148] For these reasons, cyber-

142. *Id.* at *27.

143. *See* Cybersecurity Risk Management, Strategy, Governance, and Incident Disclosure by Public Companies, 87 Fed. Reg. 16,590 (proposed Mar. 9, 2022) (to be codified at 17 C.F.R. pts. 229, 232, 239, 240, 249) (proposing amendments to enhance and standardize cybersecurity-related disclosures).

144. Press Release, Sec. & Exch. Comm'n, SEC Proposes Rules on Cybersecurity Risk Management, Strategy, Governance, and Incident Disclosure by Public Companies (Mar. 9, 2022), https://www.sec.gov/news/press-release/2022-39 [https://perma.cc/W5TE-9UPS].

145. *Clovis*, 2019 Del. Ch. LEXIS 1293, at *27–28 (quoting *In re* Facebook, Inc. Section 220 Litig., No 2018-0661, 2019 Del. Ch. LEXIS 197, at *38 (May 30, 2019)).

146. *Id.* at *3.

147. HENDERSON ET AL., *supra* note 20, at 3.

148. *See supra* notes 134–37 and accompanying text.

security risks for most corporations are unlikely to be interpreted by Delaware courts as a "mission critical" risk in a *Caremark* analysis.

C. *Climate Change Risks for Most Corporations are Very Unlikely to be Interpreted by Delaware Courts as a "Mission Critical" Risk in a* Caremark *Analysis*

Some commentators argue that "the risks posed by climate change to the economy have the potential to be so far-reaching that climate change is, in effect, a systemic risk. As such, [corporate law-related] regulation aimed at curbing climate change must incorporate its systemic risk nature."[149] In order to assess whether climate change risks would be interpreted as a "mission critical" risk across the board, courts conducting a *Caremark* analysis should turn to the previously articulated three-factor test. Starting with the first factor, courts should ask whether climate change risk is of primary importance to companies across the board—rather than focusing exclusively on, for example, a company within the energy and commodities sector—such that any company not properly addressing these risks would be in breach of their duty of oversight. In contrast, other commentators argue that relatively few companies consider "compliance with 'climate change' or 'greenhouse gas emissions' laws" as a primary purpose of their business.[150] According to this argument, the category of companies for which climate change risks are pivotal to the company's operations may be limited to "companies in emissions-intensive industries such as mining, chemicals, manufacturing, livestock, cement, fertilizer, or energy, where laws purporting to limit, price or require reporting of greenhouse gas emission pollution will impose direct, material obligations on their operations or their value chain."[151] Therefore, climate change risks are of primary importance to these companies, in particular, but not across the board. In effect, climate change risks fail the first factor.

While it is unlikely that climate change would today be considered a "mission critical" risk for companies according to *Caremark*

149. Barnali Choudhury, *Climate Change as Systemic Risk*, 18 BERKELEY BUS. L. J. 52, 56 (2021) (arguing that climate change should be viewed as a systemic risk because it can cause "wide-scale, enormous adverse impacts on the economy").

150. BARKER ET AL., *supra* note 109, at 6.

151. *Id.*

standards, this may be subject to change based on considerations regarding the second factor. The second factor asks whether the company facing the climate change risk is highly regulated. The SEC has recently proposed new climate change disclosure rules that could, in effect, require boards to exercise their duty of oversight in the context of mission critical risks or, at least, elevate the urgency to implement some level of oversight related to a corporation's sustainability practices.[152] Unlike cybersecurity risks, however, the nature of the regulations relating to climate change risk will differ depending on the company in question—meaning it will not apply across the board—and, as discussed in the previous Section, the fact that companies must abide by mandatory disclosure rules does not mean that said company is highly regulated.[153] Accordingly, climate change risks fail the second factor as well.

In order to satisfy the third factor, climate change risk must result in harm that is "particularly egregious." Climate change, as it is now understood, "pose[s] material risks across both the real economy and the financial system across short, medium, and long-term horizons . . . [and it] presents at least three types of foreseeable financial harm for corporations and financial systems—physical, economic transition, and liability."[154] According to the January 2021 World Economic Forum's Global Risks Report, "climate-related impacts comprise five of the top six risks facing the global economy."[155] Although climate change does result in harm that is particularly egregious, in the sense that it implicates great safety concerns and can also result in casualty, this factor—without the presence of the other two factors—may simply mean that climate change is harmful. In determining oversight liability under *Caremark*, courts are concerned with the resulting harm of the board's failure to oversee climate change risks—not the harm associated with climate change risks themselves. For these reasons, climate

152. David Cifrino & Jacob Hollinger, *SEC Proposes Landmark Standardized Disclosure Rules on Climate-Related Risks*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Apr. 8, 2022), https://corpgov.law.harvard.edu/2022/04/08/sec-proposes-landmark-standardized-disclosure-rules-on-climate-related-risks/ [https://perma.cc/NEE5-7NLF].

153. *But see* BARKER ET AL., *supra* note 109, at 6–7 ("Accordingly, it may be argued that climate change-related information communicated to the board regarding the company's financial position, *in so far as this relates to information previously disclosed or which would need to be disclosed to the market*, may warrant scrutiny as *Caremark* climate red flags.") (emphasis added). Although this argument is sound, I believe this *Caremark* scrutiny is based primarily on the board's duty to oversee traditional risk categories, such as those relating to a company's finances, rather than the climate change risk itself.

154. *Id.* at 2–4.

155. *Id.* at 2.

change risks for most corporations are very unlikely to be interpreted by Delaware courts as "mission critical" risks in a *Caremark* analysis.

CONCLUSION

Delaware 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."[156] Under existing Delaware case law, it is unlikely that Delaware courts would identify cybersecurity and climate change risks as being "mission critical," across the board, to the extent that it would implicate *Caremark*. However, it is clear that these two issues are important to shareholders and stakeholders alike. Corporations are increasingly directing their attention towards atypical issues, such as cybersecurity and climate change. Given the highly specific and fact-based inquiry that Delaware courts engage in when analyzing *Caremark* claims, these risks are not yet integral enough to corporate governance, across the board, such that all corporations within Delaware's jurisdiction, and their directors, must prepare to oversee them. That being said, directors should remain vigilant when it comes to identifying areas of risk as they emerge.

Despite the great deference afforded to Delaware directors under *Caremark* and its progeny, *Marchand* and subsequent *Caremark* cases suggest that Delaware courts are becoming increasingly concerned with corporations' industry- and business-specific compliance measures. Although cybersecurity and climate change risks may not be "mission critical" for most companies, thereby requiring director oversight of such risks, directors should still "identify 'mission critical' operations or critical products, and tailor oversight systems to make sure that issues pertaining to those operations or products are closely monitored and reported to the board."[157] Additionally, directors may elect to receive regular updates with regard to any regulations that govern such mission critical operations and establish procedures that will ensure proper compliance with those regulations, especially in light of the SEC's

156. Shapira, *supra* note 12, at 1857.
157. HENDERSON ET AL., *supra* note 20, at 7–8; *see also supra* Part III.

recent proposals regarding required disclosures related to both cybersecurity risks and climate change risks.[158]

To navigate areas of atypical risk, legal and compliance experts have posed a number of suggestions for corporations and their boards of directors. Establishing and maintaining an information and reporting system is a common suggestion, which would help ensure that issues are communicated to the board.[159] Additionally, "[d]irectors should take efforts to ensure that there is a regular cadence of reporting to the board on . . . oversight and compliance generally," as relying solely on information communicated by management does not preclude liability.[160]

Reports to directors should include, among other things, any changes or developments in the positive law, i.e., statutes, regulatory mandates, etc., related to the corporation's central issues.[161] Another suggestion for directors is to "revisit the company's compliance efforts and particular risk profile at least annually" in order to make a determination as to what they consider to be a "mission critical" risk.[162]

Cybersecurity and climate change risks are arguably not "mission critical" for purposes of general director oversight liability, except for specific categories of corporations, but that is certainly subject to change. If the SEC's proposals regarding cybersecurity and climate change are any indication, then these risks may become "mission critical" across the board. For now, corporations and their board of directors should be mindful of their "mission critical" risks, which may or may not include atypical risks such as cybersecurity and climate change risks, depending on the legal and regulatory landscape at that point in time. In doing so, directors can

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158. HENDERSON ET AL., *supra* note 20, at 7–8.

159. *See, e.g.*, *id.*; Gail Weinstein, Warren S. de Wied & Philip 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/8LB6-XBH9].

160. HENDERSON ET AL., *supra* note 20, at 7–8; *see also* Marchand v. Barnhill, 212 A.3d 805, 824 (Del. 2019) ("[T]he Blue Bell directors just argue that because Blue Bell management, in its discretion, discussed general operations with the board, a *Caremark* claim is not stated. But if that were the case, then *Caremark* would be a chimera.").

161. Wied & Richter, *supra* note 159, *see also In re Clovis Oncology, Inc. Derivative Litig.*, No. 2017-0222, 2019 Del. Ch. LEXIS 1293, at *27–28 (Oct. 1, 2019) (discussing the significance of director oversight in regard to compliance with positive law).

162. *Id.*

reduce their potential for breaching their duty of oversight and, in effect, their potential for *Caremark* liability.

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