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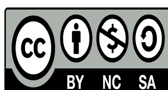

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DIRECTORS' LIABILITY FOR ESG FACTORS UNDER *CAREMARK* CLAIMS[1]

A RESPONSABILIDADE CIVIL DOS CONSELHEIROS DE ADMINISTRAÇÃO DE SOCIEDADES ANÔNIMAS POR FALHAS NA GESTÃO DE FATORES ESG À LUZ DA TEORIA *CAREMARK*

Giovanna Rennó Duque*

Abstract: ESG investing has grown substantially during the past few years, and it is continuing to gain traction in markets today; correspondingly, lawyers, scholars, and regulators are debating the consequences of this trend on corporate and securities law. Although there is enough reason to believe that, in the coming years, Courts will be faced with the question of whether directors may be held liable for failing to oversee ESG factors, and if so, under which circumstances, very few authors have tried to answer this question. It is proposed in this Essay that, when dealing with ESG-related claims, Courts should resort to the same test and standards developed under *Caremark* and its progeny. Therefore, directors may be held liable for breaching their duty to oversee legal and business risks related to ESG (in the latter case, subject to a much higher burden on the plaintiffs), while remaining shielded from liability for failing to address ESG opportunities, in line with the business judgment rule.

Keywords: ESG. Board of Directors. Fiduciary Duties. Caremark Claims. Civil Liability.

Resumo: Os investimentos ESG cresceram exponencialmente nos últimos anos, e continuam a ganhar relevância no mercado de capitais; consequentemente, advogados, acadêmicos do Direito e reguladores começam a debater as implicações dessa tendência para o Direito Societário e do Mercado de Capitais. Apesar de haver mo-

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1 Artigo recebido em 25.11.2022 e aceito em 27.11.2022.

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tivos suficientes para acreditar que, nos próximos anos, os Tribunais serão provocados a analisar se os conselheiros de administração de sociedades anônimas podem ser civilmente responsabilizados por eventuais falhas na gestão de fatores ESG e, em caso positivo, em quais circunstâncias tal responsabilização pode ser determinada, poucos autores se debruçaram sobre esse assunto até a presente data. Propõe-se, neste trabalho, que, ao lidar com demandas relacionadas a fatores ESG, os Tribunais devem recorrer aos mesmos testes e *standards* desenvolvidos no precedente *Caremark* e na jurisprudência que se consolidou após tal decisão. Portanto, conselheiros de administração podem ser responsabilizados por violarem o dever de fiscalizar riscos jurídicos e de negócios relacionados a fatores ESG (sendo que, no segundo caso, o ônus da prova do requerente é substancialmente superior); por outro lado, não podem responder por eventual falha em endereçar oportunidades de negócios relacionadas a fatores ESG, em linha com a teoria da *business judgment rule*.

Palavras-chave: ESG. Conselho de Administração. Deveres Fiduciários, Teoria Caremark. Responsabilidade Civil.

Sumário: Introdução. 1. ESG Factors: Risks, Opportunitties and Materialitty. 2. The board's duty of oversight under *caremark* and its progeny. 3. *Caremark* claims involving ESG factors. Conclusion.

Introduction.

The acronym ESG stands for "environmental, social, and governance". These 3 words were first put together by the United Nations Secretary General Kofi Annan back in 2004, when he wrote to over 50 CEOs of major financial institutions urging them "to develop guidelines and recommendations on how to better integrate environmental, social and corporate governance issues in asset management, securities brokerage services and associated research functions".[2-3]

2 MACEY, Jonathan R. *ESG Investing: Why Here? Why Now?,* 15 nov. 2021. Disponível em:

But institutional investors have long resisted doing so, under the rationale that the fiduciary duties they owed to asset owners precluded them from adding "ethical considerations" to their investment decisions.[4]

Corporation directors faced the same dilemma, as illustrated by the longstanding scholarly debate on the purpose of corporations. Although the stakeholder theory advocated that corporations should seek not only profit but also the interests of their employees, consumers, and the community in which they are involved,[5] the shareholder-primacy approach is the one that has generally prevailed. Under this approach, corporate law is meant to serve the interests of stockholders, and thus the directors' job is purely to increase shareholder value.[6]

However, this debate seems to have become anachronic. In fact, in the past few years, various studies have suggested that there is a positive correlation between ESG and greater business and stock price performance, as well as lower cost of capital.[7] In other words, taking

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https://clsbluesky.law.columbia.edu/2021/11/15/esg-investing-why-here-why-now/#_ftn2. Aceso em: 4 fev. 2022.

3 UNITED NATIONS. *Who Cares Wins*, 2004. Disponível em: https://www.scribd.com/fullscreen/16876740?access_key=key-16pe23pd759qalbnx2pv. Acesso em: 4 fev. 2022.

4 CFA Society of the UK. *Certificate in ESG investing official training manual*, at 10 (1st ed. 2019).

5 For a summary of this corporate law debate, see STRINE, Leo E. *et al.*, Caremark and ESG, Perfect Together*:* A Practical Approach to Implementing an Integrated, Efficient, and Effective Caremark and EESG Strategy. *Iowa Law Review*, Iowa City, v. 106, n. 1885, p. 1889-1905, 2021. Disponível em: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3664021. Aceso em: 4 fev. 2022.

6 See FRIEDMAN, Milton. *The Social Responsibility Of Business Is to Increase Its Profits*. 1970. Disponível em: https://www.nytimes.com/1970/09/13/archives/a-friedman-doctrine-the-social-responsibility-of-business-is-to.html. Acesso em: 4 fev. 2022.

7 See DB Climate Change Advisors, *Sustainable Investing:* Establishing Long-Term Value and Performance. 2012. Disponível em: https://churchinvestment.org/wp-content/uploads/2015/04/DB-Advisors-Sustainable_Investing_2012.pdf. Acesso em: 5 fev. 2022;

into consideration stakeholder interests effectively increases shareholder value. Accordingly, in 2019, the Business Roundtable issued a statement updating the purpose of a corporation to "promote an economy that serves all Americans", arguing that addressing stakeholder interests would help ensure long-term value for shareholders.[8-9]

A study conducted by McKinsey & Company has shown that ESG-value creation may happen in 5 different ways. First, ESG contributes to top-line growth by allowing companies to enter new markets or expand their shares in previous existing ones (for instance, by getting them to attract more customers that seek sustainable products). Second, it helps corporations reduce operational costs (by leading to a reduction in energy consumption, for example). Third, it reduces state intervention and fine application (such as for damages caused to the environment). Fourth, it increases productivity (e.g., increasing employee motivation and talent attraction). Fifth and lastly, it enhances investment and asset optimization (by allowing corporations to allocate capital to more sustainable and promising projects in the long term and preventing them from investing in stranded assets).[10-11]

CLARK, Gordon L.; FEINER, Andreas; VIEHS, Michael, *From the Stockholder to the Stakeholder:* How Sustainability Can Drive Financial Outperformance, 5 mar. 2015. Disponível em: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2508281. Acesso em: 4 fev. 2022; FRIEDE, Gunnar; BUSCH, Timo; BASSEN, Alexander. ESG and financial performance: aggregated evidence from more than 2000 empirical studies. *Journal of sustainable Finance & Investment*, London, v. 5, n. 4, p. 210-233, nov. 2004. Disponível em: http://dx.doi.org/10.1080/20430795.2015.1118917. Acesso em: 5 fev. 2022.

8 BUSINESS ROUNDTABLE. *Business Roundtable Redefines the Purpose of a Corporation to Promote 'An Economy That Serves All Americans'*. ago. 2019. Disponível em: https://www.businessroundtable.org/business-roundtable-redefines-the-purpose-of-a-corporation-to-promote-an-economy-that-serves-all-americans/. Disponível em: 4 fev. 2022.

9 Similarly, in the investing context, the Principles for Responsible Investment – PRI group stated that: "As institutional investors, we have a duty to act in the best long-term interests of our beneficiaries. In this fiduciary role, we believe that environmental, social, and corporate governance (ESG) issues can affect the performance of investment portfolios". Principles for Responsible Investment, *Signatories' Commitment*. Disponível em: https://www.unpri.org/about-us/what-are-the-principles-for-responsible-investment. Acesso em: 16 fev. 2022.

10 MCKINSEY & COMPANY. *Five ways that ESG creates value*, 2019. Disponível em:

As a result of these findings and the increasing demand on the part of consumers and individual investors that corporations contribute to a more sustainable and socially responsible society,[12] ESG investing has grown substantially. In fact, sustainable investing assets already correspond to 35.9% of the assets under management in the world, amounting to more than USD 35.3 trillion in dollars, as of 2020.[13] However, it seems like lawyers, regulators, and directors are still struggling to understand the exact impact of this ESG movement on their daily work.

In the regulatory sphere, some jurisdictions in the past years have been changing their rules to mandate that corporations publish information regarding ESG.[14] For example, the Brazilian Securities and Exchange Commission has recently enacted Resolution n. 59/2021, which mandates that publicly held corporations must clarify, among other ESG-related information, whether they publish any reports on their ESG approach and, in the affirmative, explain how they assess materiality. In the United States, although Regulation S-K does

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https://www.mckinsey.com/business-functions/strategy-and-corporate-finance/our-insights/five-ways-that-esg-creates-value. Acesso em: 8 jan. 2022.

11 Stranded assets are the ones that suffer premature devaluation or turn into liabilities. This may happen for a variety of reasons, but it is expected that ESG factors significantly increase the number of stranded assets, especially due to climate change in carbon-intensive industries. See LLOYD'S. *Stranded Assets:* the transition to a low carbon economy, 2017. Disponível em: https://assets.lloyds.com/assets/pdf-stranded-assets/1/pdf_stranded-assets.pdf. Acesso em: 4 fev. 2022.

12 Research shows that individual investors are increasingly interested in sustainable investing, especially among millennials. See MORGAN Stanley Institute for Sustainable Investing. *Sustainable Signals:* New Data from the Individual Investor, 2017. Disponível em: https://www.morganstanley.com/pub/content/dam/msdotcom/ideas/sustainable-signals/pdf/Sustainable_Signals_Whitepaper.pdf. Acesso em: 5 fev. 2022.

13 GLOBAL SUSTAINABLE INVESTMENT ALLIANCE. *Global Sustainable Investment Review 2020*, 2021. Disponível em: http://www.gsi-alliance.org/wp-content/uploads/2021/08/GSIR-20201.pdf. Acesso em: 4 fev. 2022.

14 BRAZILIAN Securities and Exchange Commission, Resolution n. 59/2021, Annex A, item 1.9.

not specifically require corporations to disclose their ESG approach, item 105 does mandate that they disclose "material" risk factors, which include ESG material risk factors.[15-16]

For board members, in turn, it seems that there is still a large amount of hesitation and misunderstanding about what it means exactly to address ESG concerns and what is the best way to do so. Therefore, it is reasonable to conclude that, in the coming years, lawyers and Courts will be faced with the question of whether directors may be held liable for failing to oversee ESG factors, and if so, under which circumstances. This is especially the case in light of recent decisions by the Court of Chancery of Delaware which, for the first time, upheld *Caremark* claims (although so far only in the pleading stage).[17]

This Essay proceeds in 4 parts. Section II explains what the most common ESG factors are, how they can be classified into risks and opportunities, and how their materiality can be assessed by corporations and investors in their disclosures and decision-making processes. Section III provides an overview of caselaw on the duty of oversight. Section IV analyzes the circumstances in which directors may be held liable for failing to oversee ESG factors, building on the caselaw outlined in Section III and the concepts of risks and opportunities developed in Section II. Section V concludes.

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15 Regulation S-K, 17 CFR § 229.105.

16 As has been explained (and criticized) by Commissioner Allison Herren Lee: "[T]he Commission takes the position that it does not need to require or specify these types of disclosures [ESG disclosures] because our principles-based disclosure regime is on the job and will produce any disclosures on these topics that are material. Investors are asked to trust that each individual company has gauged materiality on these complex issues with flawless precision and objectivity". LEE, Allison Herren Lee. *Regulation S-K and ESG Disclosures*: An Unsustainable Silence, 2020. Disponível em: https://www.sec.gov/news/public-statement/lee-regulation-s-k-2020-08-26. Acesso em: 8 jan. 2022.

17 See Section III *infra*.

1. ESG factors: risks, opportunities, and materiality.

What exactly are ESG factors? Several (truly, endless) elements may be regarded as such, so long as they have some impact on environmental, social, or governance matters. Environmental factors are the ones that pertain to the natural world, such as climate change, greenhouse gas emission, waste management, resource depletion, water scarcity, and the use of renewable energies. Social factors are issues that arise out of the corporation's relationship with its employees, consumers/clients, and society in general. They include occupational health and safety concerns, talent attraction and retention, human rights protection, product safety, customer privacy, and stakeholder opposition. Lastly, governance factors regard how corporations are run and what their officers, managers, and shareholders' rights and responsibilities are; typical governance matters are board structure and diversity, management compensation, succession planning, compliance with laws and regulations (including those about bribery and corruption), and corporate reporting and transparency.[18]

This is a rather "artificial" classification, for some situations may entail, at once, environmental, social, and governance concerns. For example, a hydroelectric corporation that engages in legal deforestation to build a new plant may face protests from the local community that eventually prevent it from continuing its operations. Shareholders might believe that the company is failing to properly address the matter and, in response, make sure to appoint a new board member experienced in crisis management to try to better navigate the problem. In this case, one single (and perfectly legal) corporate decision – to legally deforest an area in order to build a new plant – would have raised environmental (resource depletion), social (stakeholder opposition), and governance (board diversity) issues.

As mentioned in Section I above, there is significant evidence that ESG plays an important role in enterprise value creation. To bet-

18 CFA SOCIETY OF THE UK, *Op. Cit.*

ter understand how this happens, it is useful to think about ESG factors as both risks and opportunities.

According to the Committee of Sponsoring Organizations of the Treadway Commission ("COSO"),[19] risks are events that might negatively impact a corporation, preventing value creation or eroding the existing one.[20] ESG risk factors thus create value if they are successfully managed in a way to avoid a negative outcome. For instance, an oil company is (or at least should be) aware that its operations may lead to environmental accidents, such as an oil spill into the ocean. If such an event occurs, the company may face huge fines, harming its profitability.[21] So, environmental factors impose a risk to this company, which it could mitigate by adopting a clear policy on how to conduct deep-water drilling,[22] thus avoiding fines and preserving enterprise value.

Opportunities are defined by the COSO as "the possibility that an event will occur and positively affect the achievement of objectives, supporting value creation or preservation".[23] Hence, ESG factors are opportunities if they have the potential to create value not by

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19 As stated in its website: THE COMMITTEE OF SPONSORING ORGANIZATIONS. *'The Committee of Sponsoring Organizations' (COSO) mission is to help organizations improve performance by developing thought leadership that enhances internal control, risk management, governance and fraud deterrence*. 2022. Disponível em: https://www.coso.org/pages/aboutus.aspx. Acesso em: 17 fev. 2022).

20 COSO. *Enterprise Risk Management — Integrated Framework*, 2004. Disponível em: https://www.coso.org/Publications/ERM/COSO_ERM_ExecutiveSummary.pdf . Acesso em: 14 jan. 2022, at 2.

21 The Gulf of Mexico oil spill caused in 2010 by the British company BP entailed a fine of almost $20 billion dollars, one of the largest corporate fines of all times. See Dominic Rushe, *BP set to pay largest environmental fine in US history for Gulf oil spill*, THE GUARDIAN, Jul. 2, 2015, theguardian.com/environment/2015/jul/02/bp-will-pay-largest-environmental-fine-in-us-history-for-gulf-oil-spill (visited on Jan. 8, 2022).

22 For an analysis of the BP accident and how management could have addressed the oil spill risk, see WATKINS, Michael D. *How BP Could Have Avoided Disaster*, jun. 2010. Disponível em: https://hbr.org/2010/06/global-strategy-local-policies. Acesso em: 13 jan. 2022.

23 COSO, *Op. Cit.*

avoiding negative outcomes, but by contributing to positive ones, thus allowing the company to capitalize on them. For example, an automobile company can lawfully produce only fuel cars; but, if it also starts producing electric ones, it will get to both benefit the environment and enter a new and (possibly) increasingly profitable market. From this perspective, environmental factors may entail opportunities to an automobile corporation.

One may apply the distinction between ESG risk and opportunity factors into the 5 categories of value creation identified in the McKinsey & Company's study (mentioned in Section I above).[24] Under this framework, the issues that must be managed for a corporation to avoid state intervention or fine application are risk factors – because they create value by preventing a negative outcome. Conversely, the elements that facilitate top-line growth, operational cost reduction, productivity increase, and investment and asset optimization are opportunity factors – because they create value by affecting the achievement of positive and profitable outcomes.[25]

Still, some types of ESG risks cannot be framed into these 5 categories of value creation. For example, as mentioned in Section I above, talent attraction and retention are considered as part of the "S" prong of ESG. Suppose that a corporation has not adopted training programs for people in leadership positions; the turnover ratio in its strategic positions remains very high, and there is evidence that the corporation is at a competitive disadvantage vis-à-vis its competitors as a result.

It seems clear that, in the example outlined above, talent attraction and retention fall within the concept of an ESG risk factor

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24 MCKINSEY & COMPANY, *Op. Cit.*

25 It was pointed out in the McKinsey & Company study that: "As with each of the five links to ESG value creation, the first step to realizing value [through costs reduction] begins with recognizing the opportunity". MCKINSEY & COMPANY, *Op. Cit.* It is proposed in this Essay, however, that not all categories of ESG factors involve identifying an opportunity, since some of them – namely, reduction of state intervention and fine application – entail risks, not opportunities.

because a social matter has a negative impact on enterprise value creation. But such impact is not related to either a state intervention or a fine; rather, it derives from a decision about how to conduct the corporation's business. It follows that one may classify ESG risk factors into legal or business risks depending on whether they are related, respectively, to obligations imposed by laws or regulations, on the one hand, or to business decisions, on the other hand.

In practice, however, it might not be all that simple to distinguish whether we are facing a business risk or an opportunity. For example, for a consumer goods company, it might be mission critical for sales to have a good reputation, including about sustainability issues. If a company fails to take any initiatives to appear to the market as an environmentally conscious corporation, is it missing an opportunity or poorly managing a risk?

As previously mentioned, there are endless issues that may be regarded as risk or opportunity ESG factors. Therefore, corporations must be able to determine which of these factors they should carefully address and disclose as part of their ESG reporting. To do so, corporations must carry out a "materiality" assessment,[26] i.e., they must identify the factors that impact enterprise value creation. In short, ESG materiality is a very important concept, and it is one similar to the materiality concept used for financial reporting purposes.[27-28]

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26 As previously mentioned, in the United States, although Regulation S-K does not specifically require corporations to disclosure their ESG approach, its item 105 does oblige them to disclosure "material" risk factors, which include ESG material risk factors (Regulation S-K, 17 CFR § 229.105). In fact, as has been explained (and criticized) by Commissioner Allison Herren Lee: "[T]he Commission takes the position that it does not need to require or specify these types of disclosures [ESG disclosures] because our principles-based disclosure regime is on the job and will produce any disclosures on these topics that are material. Investors are asked to trust that each individual company has gauged materiality on these complex issues with flawless precision and objectivity". LEE, Allison Herren. *Regulation S-K and ESG Disclosures:* An Unsustainable Silence. 2020. Disponível em: https://www.sec.gov/news/public-statement/lee-regulation-s-k-2020-08-26. Acesso em: 8 jan. 2022. So, to comply with regulations, companies must be able to identify material ESG factors.

27 SASB *et al. Statement of Intent to Work Together Towards Comprehensive Corporate Report-*

Some institutions have created frameworks for identifying material ESG factors by sector,[29] helping corporations disclose comparable and reliable information. One of the most famous initiatives in this regard is the Sustainability Accounting Standards Board – SASB, which points out material environmental, social, and leadership and governance matters by industry "intended for use in communications to investors".[30] In line with the concept of materiality outlined above, SASB considers as material ESG issues the ones most likely to "impact the financial condition or operating performance" of the companies in a given sector.[31-32]

Similarly, in November 2021, the International Financial Reporting Standards – IFRS announced the creation of the International

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ing. 2020. Disponével em: https://29kjwb3armds2g3gi4lq2sx1-wpengine.netdna-ssl.com/wp-content/uploads/Statement-of-Intent-to-Work-Together-Towards-Comprehensive-Corporate-Reporting.pdf. Acesso em: 8 jan. 2022, at 4.

28 There are different types of ESG disclosure, which might serve (i) a broad range of users and objectives, or (ii) users whose primary objective is economic decision making. In the first case, the materiality assessment of the ESG factors will not be strictly related to their financial impact, but also to their importance to the corporation's stakeholders. *Id.*

29 As pointed out by the ESG research provider MSCI: "Environmental, social, and governance risks and opportunities are posed by large scale trends (e.g. climate change, resource scarcity, demographic shifts) as well as by the nature of the company's operations. Companies in the same industry generally face the same major risks and opportunities, though individual exposure can vary". MSCI. *Msci Esg Ratings Methodology*, 2020. Disponível em: https://www.msci.com/documents/1296102/21901542/MSCI+ESG+Ratings+Methodology+-+Exec+Summary+Nov+2020.pdf. Acesso em: 13 jan. 2022. at 3.

30 SASB. *Understanding SASB Standards*. Disponível em: https://www.sasb.org/implementation-primer/understanding-sasb-standards/. Acesso em: 8 jan. 2022.

31 *Idem.*

32 Other initiatives include the CDP, the Climate Disclosure Standards Board – CDSB, the Global Reporting Initiative – GRI, and the International Integrated Reporting Council IIRC. In 2020, these 5 organizations (including the SASB) issued a Statement of Intent to Work Together Towards Comprehensive Corporate Reporting, in which they have stressed that the combination of their frameworks "can provide the basis for progress towards a comprehensive corporate reporting system that would enable companies to provide more complete and comparable information to their different stakeholders". SASB *et al.*, *Op. Cit.*, note 26, at 305-318.

Sustainability Standards Board – ISSB, with the purpose of delivering "a comprehensive global baseline of sustainability-related disclosure standards".[33] As pointed out by commentators, this initiative "could help drastically simplify reporting for issuers and may even inform the SEC's likely rulemaking around ESG disclosure".[34]

It is also worth noting that ESG-oriented investors must also be able to establish how they will integrate ESG-related information into their investment analysis and decision-making processes. For that, they usually use the services of ESG research providers, such as MSCI and Sustainalytics, which have put in place their own approach for determining materiality.[35] Despite conceptual differences, these research providers also look to the financial impact of the ESG factors to determine their materiality.[36-37]

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33 IFRS. *About the International Sustainability Standards Board*. Disponível em: https://www.ifrs.org/groups/international-sustainability-standards-board/. Disponível em: 11 mar. 2022.

34 FLYNN, Dorothy; GUMBS, Keir. *Corporate Governance Trends in 2022 and Beyond*. 28 fev. 2022. Disponível em: https://corpgov.law.harvard.edu/2022/02/28/corporate-governance-trends-in-2022-and-beyond/?utm_content=buffer792e0&utm_medium=social&utm_source=linkedin.com&utm_campaign=buffer. Acesso em: 11 mar. 2022.

35 CFA Society Of The UK, *Op. Cit.*

36 MSCI assesses ESG materiality as follows: "A risk is material to an industry when it is likely that companies in a given industry will incur substantial costs in connection with it (for example: regulatory ban on a key chemical input requiring reformulation). An opportunity is material to an industry when it is likely that companies in a given industry could capitalize on it for profit (for example: opportunities in clean technology for the LED lighting industry)". MSCI, *Op. Cit.*

37 According to Sustainalytics, an ESG factor is considered material if: "An issue is considered to be material within the ESG Risk Ratings if its presence or absence in financial reporting is likely to influence the decisions made by a reasonable investor. To be considered relevant in the ESG Risk Ratings, an issue must have a potentially substantial impact on the economic value of a company and, hence, its financial risk- and return profile from an investment perspective". SUSTAINALYTICS. *ESG Risk Ratings* – Methodology Abstract. 2021. https://connect.sustainalytics.com/hubfs/INV/Methodology/Sustainalytics_ESG%20Ratings_Methodology%20Abstract.pdf. Acesso em: 13 jan. 2022.

2. The board's duty of oversight under *Caremark* and its progeny.

In *Graham*, members of the board of directors of a Delaware corporation had been accused of breaching their fiduciary duties by failing to prevent the company's employees from engaging in antitrust violations.[38] The Supreme Court of Delaware rejected the plaintiffs' claims, stating that "absent cause for suspicion there is no duty upon the directors to install and operate a corporate system of espionage to ferret out wrongdoing which they have no reason to suspect exists".[39] In other words, in the absence of "red flags" pointing to these actions, the board had no liability for losses that the corporation had incurred because of law violations by its employees.

This understanding began to change in 1996 with *Caremark*. In this case, a corporation, Caremark, had been charged with a $250 million fine due to violations of laws and regulations applicable to the health care industry. The plaintiffs claimed that the members of Caremark's board of directors had breached their duty of care by failing to take measures to prevent these violations from occurring.[40]

In dictum, the Court of Chancery of Delaware recognized that a board of directors has the obligation to make sure that there are adequate reporting systems in place that allow it to receive sufficient information "to reach informed judgments concerning both the corporation's compliance with law and its business performance".[41] It distinguished *Graham*, arguing that directors could be held liable for ignoring the existence of wrongdoing within the corporation only

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38 DELAWARE. Supreme Court of Delaware. Graham v. Allis-Chalmers Mfg. Co. *188 A.2d 125* (Del. 1963), 24 jan. 1963.

39 *Idem*, at 130.

40 DELAWARE. Court of Chancery of Delaware. In re Caremark Int'l. *698 A.2d 959* (Del. Ch. 1996), 25 set. 1996

41 *Ibidem*, at 970.

when (i) there was a systematic failure to oversee, (ii) the directors knew or should have known that violations of the law were occurring, (iii) they had failed to take good faith steps to prevent or remedy such violations, and (iv) this failure resulted in losses to the corporation.[42]

The Court noted, however, that "the level of detail that is appropriate for such an information system is a question of business judgment", and that "[t]he theory here advanced [directors' liability for a breach of the duty of oversight] is possibly the most difficult theory in corporation law upon which a plaintiff might hope to win a judgment".[43] Accordingly, it found that in the case at hand there was no evidence that the defendants had systematically breached their duty of oversight, since the corporation had information systems that demonstrated the directors' good faith attempt to be sufficiently informed.[44]

In the *Gutmann* case, the Court of Chancery dismissed the claim against directors who had been accused of breaching their duty of oversight after the corporation had to restate its financial information for failing to comply with the applicable accounting standards[45]. In its reasoning, the Court remarked that, although the *Caremark* decision "is rightly seen as a prod towards the greater exercise of care by directors in monitoring their corporations' compliance with legal standards", the opinion required that plaintiffs showed that the directors had violated their duty of loyalty by failing to act in good faith.[46]

But it was only with the *Stone* decision that Delaware jurisprudence unequivocally established that the duty of oversight falls under

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42 *Ibidem*, at 971.

43 *Ibidem*, at 970, 967.

44 *Ibidem*.

45 DELAWARE. Court of Chancery of Delaware. Guttman v. Jen-Hsun Huang. *823 A.2d 492 (Del. Ch. 2003)*, 23 abr. 2003.

46 *Ibidem*, at 970, 506.

the duty of loyalty, the violation of which is not exculpated by Section 102(b)(7) of Delaware General Corporate Law.[47] Because of this development – and others explained below –, commentators usually refer to *Stone* as the precedent in which the Supreme Court of Delaware upheld and further clarified the duty of oversight doctrine first articulated in *Caremark* 10 years earlier.[48]

Stone was a derivative suit in which the directors of a bank were accused of breaching their duty of oversight after the company was fined $50 million to resolve investigations about its failure to report suspicious activities to the competent regulators. Similar to the ruling in *Caremark*, the Supreme Court dismissed the claim for failure to make demand, finding that the plaintiffs had not pled with particularity facts raising a reasonable doubt that the directors acted in good faith in exercising their oversight responsibilities.[49]

Despite having dismissed the claim, the Supreme Court in *Stone* developed 4 important concepts for analyzing alleged breaches of the duty of oversight: (i) in light of the Supreme Court's decision in *Disney*, it made clear that *Caremark* claims are about failing to act in good faith, understood here as a conscious disregard of the directors' duties to act;[50-51] (ii) it established that good faith is not an inde-

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47 DELAWARE. Supreme Court of Delaware. Stone v. Ritter. *911 A.2d 362 (Del. 2006)*, 6 nov. 2006. For a criticism of the "marriage" between good faith and oversight, see BAINBRIDGE, Stephen M. *et al.* The Convergence of Good Faith and Oversight. *UCLA L. Rev*, Los Angeles, n. 55, v. 559, p. 559-596, 2008. Disponível em: https://www.uclalawreview.org/pdf/55-3-1.pdf. Acesso em: 5 fev. 2022.

48 See HILL, Claire A.; McDonnell, Brett. Essay: Stone v. Ritter and the Expanding Duty of Loyalty. *Minnesota Legal Studies Research Paper*, n. 35, v. 7, p. [S. l.], 22 ago. 2007. https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1008930. Acesso em: 5 fev. 2022; POLLMAN, Elizabeth. Corporate Oversight and Disobedience. *U Of Penn, Inst For Law & Econ Research Paper*, Philadelphia, n. 20, v. 05, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3474337. Acesso em: 5 fev. 2022.

49 DELAWARE. Supreme Court of Delaware. Stone v. Ritter. *911 A.2d 362 (Del. 2006)*, 6 nov. 2006.

50 In *Disney*, the Supreme Court upheld that there are 3 categories of the concept of acting in

pendent fiduciary duty, but rather a subsidiary element of the duty of loyalty;[52] (iii) it held that, when the corporation already had reporting systems in place, there would only be a breach of the duty of oversight if the directors knowingly overlooked "red flags" indicating that those systems were inadequate to provide them with sufficient information;[53] and (iv) it clarified that liability for breaching the duty of oversight (regardless of whether the corporation already had reporting systems in place or not) depends on the scienter element, i.e., the directors must have been aware that they were failing to discharge their fiduciary obligations.[54-55]

Delaware Court decisions have indeed been granting a great degree of deference to boards that have put in place reporting systems, consistent with the holdings in *Caremark* and *Stone* (according

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bad faith, the third of which leads to unexculpated conduct under Delaware General Corporate Law Section 102(b)(7): "That leaves the third category of fiduciary conduct, which falls in between the first two categories of (1) conduct motivated by subjective bad intent and (2) conduct resulting from gross negligence. This third category is what the Chancellor's definition of bad faith – intentional dereliction of duty, a conscious disregard for one's responsibilities-is intended to capture." Supreme Court of Delaware. *Brehm v. Eisner (In re Walt Disney Co. Derivative Litig.)*, 906 A.2d 27 (Del. 2006), at 99-100. For a scholarly study on the duty of good faith, see STRINE JR., Leo E.; HAMERMESH, Lawrence A.; BALOTTI, R. Franklin; GORRIS, Jeffrey M. Loyalty's Core Demand: The Defining Role of Good Faith in Corporation Law. *Geo. L. Rev*, v. 98, n. 629, p. [S. l.], 2010.

51 DELAWARE. Supreme Court of Delaware. Stone v. Ritter. *911 A.2d 362 (Del. 2006)*, 6 nov. 2006. At 369-370.

52 *Idem.*

53 *Idem.*

54 *Idem.*

55 Considering these elements, the Supreme Court so summarized the requisites for successfully stating a Caremark claim: "We hold that Caremark articulates the necessary conditions predicate for director oversight liability: (a) the directors utterly failed to implement any reporting or information system or controls; or (b) having implemented such a system or controls, consciously failed to monitor or oversee its operations thus disabling themselves from being informed of risks or problems requiring their attention. In either case, imposition of liability requires a showing that the directors knew that they were not discharging their fiduciary obligations". *Idem*, at 370.

to which, as mentioned, the level of detail of these existing systems is a matter of business judgment and, consequently, directors are allowed to trust their adequacy unless there are red flags pointing otherwise). The Courts have thus routinely dismissed claims that failed to establish "a sufficient connection between the corporate trauma and the board" and were based simply on conclusory allegations that the control systems must have been deficient because illegal behavior occurred.[56]

For example, in the *Gutmann* case mentioned above, the Court of Chancery pointed out that the corporation had an audit committee and that there had been no allegations that such committee "met only sporadically and devoted patently inadequate time to its work, or that the audit committee had clear notice of serious accounting irregularities and simply chose to ignore them".[57] Therefore, it concluded that the plaintiffs failed to plead with particularity that the corporation's financial compliance systems were inadequate.

Likewise, in *General Motors*, the background issue was that the corporation incurred losses as a result of liability for injuries and deaths caused by safety defects in some of its cars models. Plaintiffs argued that demand was futile because the directors faced a substantial likelihood of liability for breaching their duty of oversight.[58] The Court of Chancery, in a decision affirmed on its own basis and reasons by the Supreme Court,[59] dismissed the claim holding that General Motors had systems in place to report safety information to regu-

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56 DELAWARE. Court of Chancery of Delaware. Desimone v. Barrows. *924 A.2d 908* (Del. Ch. 2007); DELAWARE. Court of Chancery of Delaware. La. Mun. Police Emples. Ret. Sys. v. Pyott. *46 A.3d 313* (Del. Ch. 2012).

57 DELAWARE. Court of Chancery of Delaware. Guttman v. Jen-Hsun Huang. *823 A.2d 492 (Del. Ch. 2003)*. At 507.

58 DELAWARE. Court of Chancery of Delaware. In re GM Co. Derivative Litig. *2015 Del. Ch. LEXIS 179* (Ch. June 26, 2015).

59 DELAWARE. Supreme Court of Delaware. In re GM Co. Derivative Litig. *133 A.3d 971* (Del. 2016).

lators, the general counsel, and the board, and that plaintiffs had failed to plead with particularity that there were red flags concerning the adequacy of these systems and that the board had ignored them. In effect, the Court emphatically noted that "GM had a system for reporting risk to the Board, but in the Plaintiffs' view, it should have been a better system". Therefore, it ruled that this did not amount to pleading with particularity that the directors had failed to act in good faith.[60]

In 2019, the Supreme Court of Delaware upheld a *Caremark* claim for the very first time (although so far only in the pleading stage).[61] As in *General Motors*, the matter involved product safety defects: in *Marchand*, a listeria outbreak occurred in ice cream plants and led to the death of some of Blue Bell Creameries' clients. Although recognizing that caselaw does, and must, give deference to existing control systems, the Supreme Court explained that boards must at least "make a good faith effort—i.e., try—to put in place a reasonable board-level system of monitoring and reporting".[62] The Court further stressed that the fact that a corporation operates in a heavily regulated industry and so complies with some of the applicable regulations does not, *per se*, demonstrate any attempt at the board level to be sufficiently informed about a compliance issue "intrinsically critical to the company's business operation".[63]

Analyzing the case at hand, the Supreme Court noted that management had already received information concerning the listeria problem, but that such information never reached the board. It pointed out that, although Blue Bell was a monoline company – and so food safety was undisputedly a "central compliance issue" for the

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60 DELAWARE. Court of Chancery of Delaware. *In re GM Co. Derivative Litig.*, 2015 Del. Ch. LEXIS 179 (Ch. June 26, 2015), at 46-51.

61 DELAWARE. Supreme Court of Delaware. *Marchand v. Barnhill*, 212 A.3d 805 (Del. 2019).

62 *Idem*, at 821.

63 *Idem*, at 823, 822.

corporation –, the "board had no committee overseeing food safety, no full board-level process to address food safety issues, and no protocol by which the board was expected to be advised of food safety reports and developments".[64]

Since *Marchand*, the Court of Chancery has issued 4 important decisions holding that plaintiffs pled with particularity facts raising a reasonable doubt that the defendants acted in good faith (all in the pleading stage, as previously mentioned). For example, in *Clovis*, a pharmaceutical company had a promising drug under development, but clinical trial studies later indicated that it would not be approved by the FDA. The plaintiffs claimed that the directors had failed to oversee the clinical trial, thus allowing the corporation to mislead the market concerning the drug's efficacy. In denying defendants' motion to dismiss, the Court pointed out that red flags concerning the drug had been ignored by the board despite the drug in question being a "mission critical" product of the corporation.[65] In the same manner, in *Inter-Marketing Group*, the corporation owned various pipelines and one of them leaked, provoking an oil spill. The Court denied defendants' motion to dismiss, holding that plaintiffs pled with particularity that the board had not received any reports on pipeline integrity, despite the fact that the corporation was "one of North America's largest energy pipeline operators [and that] its primary operational emphasis [was] on pipeline integrity and maintenance".[66]

In *Hughes*, the company had persistently struggled with its financial reporting system; despite having declared in 2014 that it had remediated problems related to a lack of oversight of its audit committee and internal control for related-party transactions, it announced in 2017 that it had to restate its financial statements due to

64 *Idem*, at 809.

65 DELAWARE. Court of Chancery of Delaware. *In re Clovis Oncology, Inc. Derivative Litig.*, 2019 Del. Ch. LEXIS 1293 (Ch. Oct. 1, 2019).

66 DELAWARE. Court of Chancery of Delaware. *Inter-Marketing Grp. United States v. Armstrong*, No. 2017-0030-TMR, 2020 Del. Ch. LEXIS 391 (Ch. Jan. 31, 2020), at 26.

these same problems.[68] The Court of Chancery highlighted that it had found in *Gutmann*, in dictum, that the existence of an audit committee does not provide an absolute protection against *Caremark* claims.[69] It further held that, in the case at hand, the audit committee had chronic deficiencies because its members (i) lacked expertise to oversee the corporation's financial reports, (ii) met only sporadically, (iii) did not devote enough time to its work, (iv) and entirely deferred to management even though there were clear signs that it was not capable of accurately reporting on related-party transactions. Therefore, the Court concluded that, contrary to the plaintiffs' allegations, the case in *Hughes* did not relate to the degree of efficiency of the existing control systems, as in *General Motors*, but rather to a lack of any good faith attempts to put in place a board-level control system, as in Marchand.[70]

Finally, in *Boeing*, losses were incurred due to the Lion Air and Ethiopian Airlines' airplane crashes, which revealed safety defects in Boeing's 737 MAX model. The record indicated that, as in *Marchand*, (i) the company operated in a heavily regulated industry; (ii) Boeing's employees were aware of issues with the 737 MAX and had reported them to senior management, but the board remained uninformed about the problem; and (iii) airplane safety was "mission critical" to the corporation's line of business. Regardless, (i) there was no committee in charge of handling airplane safety specifically, (ii) this issue was not a regular agenda item at board meetings, and (iii) the board had no protocols in place for receiving internal information about airplane safety. Therefore, the Court dismissed the directors-defendants' motion to dismiss for failure to make demand.[71]

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68 DELAWARE. Court of Chancery of Delaware. *Hughes v. Xiaoming Hu*, No. 2019-0112-JTL, 2020 Del. Ch. LEXIS 162 (Ch. Apr. 27, 2020).

69 *Idem*, at 40.

70 Idem, at 47.

71 DELAWARE. Court of Chancery of Delaware. *In re Boeing Co. Derivative Litig.*, No. 2019-0907-MTZ, 2021 Del. Ch. LEXIS 197 (Ch. Sep. 7, 2021).

It is worth noting that, even though the Court of Chancery briefly stated in *Caremark* that the corporations' reporting systems should allow the board to have sufficient information to reach conclusions about its "compliance with law and its business performance", the Court did stress that a breach of the duty of oversight depended on the directors' knowledge (either proved or presumed) about law violations.[72] Similarly, in *Gutmann*, the Court stressed that the decision in *Caremark* had the effect of enhancing "corporations' compliance with legal standards".[73-74] Accordingly, all the *Caremark* Claims mentioned above were based on damages incurred by the companies and their shareholders due to violations of laws or regulations (including accounting rules); in order words, they all involved the board's failure to monitor legal risks.

In *Citigroup*, plaintiffs alleged that the directors had breached their duty of oversight by failing to properly monitor the company's exposure to the subprime lending market, which led it to incur substantial losses (especially because of put options contained in the collateralized debt obligations that Citigroup issued)[75]. As pointed out by the Court of Chancery, those losses were directly related to the com-

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72 DELAWARE. Court of Chancery of Delaware. *In re Caremark Int'l*, 698 A.2d 959 (Del. Ch. 1996), at 970, 971.

73 DELAWARE. Court of Chancery of Delaware. *Guttman v. Jen-Hsun Huang*, 823 A.2d 492 (Del. Ch. 2003), at 505.

74 Commentators stress that one of the major impacts on the *Caremark* decision was to lead corporations to design and enforce compliance programs aiming at (i) assuring that information concerning the corporation's legal risks are drawn to the board's attention, and (ii) promoting organizational commitment to integrity at all the corporate levels. See BIRD, Robert C. Caremark Compliance for the Next Twenty-Five Years. *American Business Law Journal*, n. 58, v. 1, p. 86–102. Disponível em: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3566279. Acesso em: 4 fev. 2022; LANGEVOORT, Donald C. Commentary, Caremark and Compliance: A Twenty-Year Lookback. *Temple Law Review*, Philadelphia, v. 90, p. 727-742, 2018. Disponível em: https://scholarship.law.georgetown.edu/cgi/viewcontent.cgi?article=3058&context=facpub. Acesso em: 4 fev. 2022.

75 DELAWARE. Court of Chancery of Delaware. *In re Citigroup Inc. S'holder Derivative Litig.*, 964 A.2d 106 (Del. Ch. 2009).

pany's line of business, and so plaintiffs were seeking to hold the directors liable for supposedly failing to monitor not legal, but business risk.[76]

The Court highlighted that business decisions are protected by the business judgment rule, which presumption can be rebutted only by the difficult burden of showing the board's gross negligence.[77] It further stressed that directors' oversight duties had been designed to ensure that systems were put in place to allow the board to know about and prevent wrongdoings within the company, and that "[t]here are significant differences between failing to oversee employee fraudulent or criminal conduct and failing to recognize the extent of a [c]ompany's business risk".[78] Still, the Court recognized that, under some circumstances, a plaintiff can show that the directors "consciously disregarded an obligation to be reasonably informed about the business and its risks", in which case a *Caremark* claim could be successful, emphasizing that the burden in this case would be even higher than the one required for rebutting the business judgment rule.[79]

The Court of Chancery ruled that such high burden had not been met by plaintiffs in the case at hand because Citibank had procedures in place designed to monitor risk, and there had been no "red flags" indicating that those control systems were inadequate. But the understanding that the failure to oversee business risks may, at least in theory, give rise to liability under *Caremark* has been reaffirmed by the Court in later decisions, with the caveat that it is unclear under which circumstances this might occur in practice.[80]

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76 *Ibidem*, at 123-124.

77 *Ibidem*, at 125.

78 *Ibidem*, at 131.

79 *Ibidem*., at 125-126.

80 See DELAWARE. Court of Chancery of Delaware. *In re Facebook, Inc. Section 220 Litig*., 2019 Del. Ch. LEXIS 197 (Ch. May 30, 2019); Court of Chancery of Delaware. *In re Goldman Sachs*

What conclusions can we draw from the decisions outlined above? It is hard to say (at least for now) that in the past few years Delaware Courts have blatantly changed the law; rather, in the cases in which they have sustained *Caremark* claims in the pleading stage, they have repeatedly stated that those claims are very hard to prove. *Marchand*, *Boeing*, *Clovis*, *Inter-Marketing Group*, and *Hughes*, however, all involved extreme circumstances.[81] For example, in the first two cases, the corporations were monoline, and still the board failed to have any reporting system in place to monitor regulatory aspects directly related to their line of business. In *Hughes*, there was proof that the members of the audit committee lacked expertise in financial reporting, did not meet regularly and consistently ignored "red flags" that management could not properly report related-party transactions.

These cases provide insight into the elements that are likely to be taken into consideration by the Courts in refusing to grant deference to boards regarding the design and implementation of reporting systems. First, the fact that a company operating in a highly regulated industry complies with some rules applicable to its activities does not necessarily entail a board-level effort to monitor compliance. Second, failure to monitor risks that are "mission critical" to the corporation's business raises reasonable doubt that the directors acted in good faith.

Grp., Inc. S'holder Litig., Civil Action No. 5215-VCG, 2011 Del. Ch. LEXIS 151 (Ch. Oct. 12, 2011); Court of Chancery of Delaware. *Asbestos Workers Local 42 Pension Fund v. Bammann*, No. 9772-VCG, 2015 Del. Ch. LEXIS 142 (Ch. May 21, 2015).

81 KOTLER, Meredith; MARCOGLIESE, Pamela; TRACY, Marques. *Recent Delaware Court of Chancery Decision Sustains Another Caremark Claim at the Pleading Stage*. 25 mai. 2020. Disponível em: https://corpgov.law.harvard.edu/2020/05/25/recent-delaware-court-of-chancery-decision-sustains-another-caremark-claim-at-the-pleading-stage/. Acesso em: 21 jan. 2022; MARC LANE, *Representing Corporate Officers And Directors And Llc Managers*. 2022. At 1-36.5. Disponível em: https://books.google.com/books?id=5lOEDwAAQBAJ&pg=SA1-PA35-IA6&lpg=SA1-PA35-IA6&dq=has+delaware+changed+oversight+law+in+marchand&source=bl&ots=CBkaSkyB9b&sig=ACfU3U3nDFk-7UpA_NrE_5GIQQoUs2SOCQ&hl=pt-BR&sa=X&ved=2ahUKEwiN8tuZqr_2AhXwkYkEHaXICI0Q6AF6BAg1EAM#v=onepage&q=has%20delaware%20changed%20oversight%20law%20in%20marchand&f=false. Acesso em: 11 mar. 2022.

As in Courts holdings to date, in monoline corporations, issues directly related to the company's only line of business are mission critical. But this seems to be quite a vague concept, and it might be unclear in many situations whether the issue at hand is mission critical or not, especially in non-monoline companies. Under this perspective, it might be fair to conclude that directors now face a greater likelihood of liability under the *Caremark* doctrine than they did in the past.[82]

In any case, to this day, all decisions where Delaware Courts found that plaintiffs had alleged with particularity a breach of the duty of oversight concerned the monitoring of the corporations' legal risks. As pointed out by commentators, risk management and legal compliance are not different in "kind", but they are different in "degree", because the former is intertwined with risk taking, which falls within the protection of the business judgment rule.[83] Therefore, although the Court of Chancery admitted in the *Citigroup* decision that it is theoretically possible to file a successful *Caremark* claim related to the oversight of business risk,[84] in order to actually succeed in these claims, plaintiffs would probably have to prove that the board had no risk management program in place whatsoever, or that it blatantly failed to act in response to "red flags".

3. *Caremark* claims involving ESG factors.

After having analyzed how ESG factors play a role in enter-

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82 Arguing that, although there has not been a "black letter" change in the law, the risk of Caremark liability for directors are higher since 2019, see PACE, H. Justin; TRAUMAN, Lawrence J. Mission Critical: Caremark, Blue Bell, and Director Responsibility for Cybersecurity Governance. *Wisconsin Law Review*, Madison, v. 2022, n. 4, p. [S. l.], 2022. Disponível em: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3938128. 11 mar. 2022.

83 BAINBRIDGE, Stephen M. Caremark and Enterprise Risk Management. *UCLA School Of Law, Law-Econ Research Paper*, Los Angeles, n. 09-08, v. 31, p. [S. l.], 2009. Disponível em: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1364500. Acesso em: 4 fev. 2022.

84 Court of Chancery of Delaware. *In re Citigroup Inc. S'holder Derivative Litig.*, 964 A.2d 106 (Del. Ch. 2009), at 125-126.

prise value creation and how their materiality can be assessed, as well as caselaw on directors' duty of oversight, we now turn to the main question of this Essay: can *Caremark* claims for failure to oversee ESG factors succeed under Delaware law?

Some commentators argue that *Caremark* claims involving ESG risks that are not the subject of legal regulation should not succeed because (i) "ESG oversight is difficult and beyond the skill set of typical corporate boards",[85] and (ii) "extending Caremark to the ESG context would effectively create a legal mandate that directors try to balance profit against environmental and social issues".[86] According to this line of thinking, ESG comprises such a variety of topics that it would be unreasonable to expect that any board would have the necessary expertise to deal with all of them; this circumstance, in addition to the fact that Delaware Courts have recently upheld some *Caremark* claims in the pleading stage, would lead to an increase in the directors' perceived risk, thus pushing many people away from boardrooms. These commentators further argue that many ESG concerns remain merely aspirational, and so corporate efforts to manage those concerns should be only voluntary.[87]

Other authors maintain that ESG "is best understood as an extension of the board's duty to implement and monitor a compliance program under *Caremark*", and so suggest that boards delegate compliance and ESG oversight to the same committee.[88] To this effect, they argue, for example, that compliance programs that address environmental risks better position the corporation to meet the environmental prong of ESG. In sum, ESG factors would allegedly overlap

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85 BAINBRIDGE Stephen M. Don't Compound the Caremark Mistake by Extending it to ESG Oversight; *UCLA School Of Law, Law-Econ Research Paper*, Los Angeles, n. 21-10, v. 24, p. [S. l.], 2021. Disponível em: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3899528. Acesso em: 4 fev. 2022.

86 *Ibidem,* at 30.

87 *Idem,* at 36.

88 STRINE, Leo E. *et al.*, *Op. Cit.*

with compliance duties that have long been a focus of *Caremark* claims.[89]

A third line of reasoning differentiates compliance and ESG issues, arguing that the former is narrower than the latter: compliance programs are essentially backwards looking because they target legal risks based on statutory and regulatory concepts of appropriate conduct, whereas ESG information gathering efforts also focus on business risks from a variety of sources (whether or not they are legally punishable), as well as on potential social and environmental benefits.[90] These commentators further argue that, because addressing ESG concerns helps corporations create safeguards against downside risks, boards that act in bad faith and completely disregard these concerns should be subjected to liability, in line with Caremark.[91] *They claim, however, that prong 2 of the Caremark test, as clarified in Stone*, should not apply to ESG matters; in other words, directors would have no obligation to act upon ESG information when "considering whether to support a sustainability initiative, or whether to take ESG into account as one of the factors determining their ultimate choice on a business quandary before them".[92]

To better answer the question of whether *Caremark* claims regarding ESG oversight may succeed under Delaware law, one must bear in mind that ESG factors may entail either legal risks, business risks, or opportunities, as detailed in Section II. It seems that all 3 lines

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89 *Ibidem.*, at 1905-1907.

90 GADINIS, Stavros; MIAZAD, Amelia. Corporate Law and Social Risk. *Vand. L. Rev.* n. 1401, v. 73, p. 1431-1432, 2020. Disponivel em: https://cdn.vanderbilt.edu/vu-wp0/wp-content/uploads/sites/278/2020/10/19130846/Corporate-Law-and-Social-Risk.pdf. Acesso em: 4 fev. 2022).; POLLMAN Elizabeth. Corporate Social Responsibility, ESG, and Compliance. *Loyola Law School, Los Angeles Legal Studies Research Paper*, Chicago, No. 2019-35, v. 8, p. [S. l.], 2019. Disponível em: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3479723. Acesso em: 4 fev. 2022.

91 GADINIS, Stavros; MIAZAD, Amelia. *Op. Cit.*, at 1466-1467.

92 *Ibidem.*, at 1468.

of thinking mentioned above have failed to properly apply these concepts to their analysis, and so do not offer the best understanding of how *Caremark* and ESG should intertwine. It is proposed in this Essay, instead, that directors may be held liable for breaching their duty to oversee ESG legal and business risks (in the latter case, subject to a much higher burden on the plaintiffs), but that they must be shielded from liability for failing to address ESG opportunities, in line with the business judgment rule.

The first conclusion – that *Caremark* claims may succeed due to a failure to oversee ESG legal risks – seems the least controversial. In these situations, ESG concerns have already been addressed by statutes or regulations, and so legal compliance and ESG directly overlap. It is not necessary to put one's imagination to work here; there are real-life examples of *Caremark* cases that involved ESG matters. For instance, *Inter-Marketing Grp.* concerned the board's failure to oversee a pipeline integrity reporting system, whereas *Marchand* and *Boeing* concerned the violation of product safety regulations. In the first case, the company's business was to operate pipelines, which are quite likely to provoke environmental accidents. In other words, this corporation faces a risk that falls within the "E" prong of ESG, and governmental authorities have responded to this risk by imposing certain regulations. Environmental compliance was thus an ESG legal risk for Inter-Marketing Group, and the directors' failure to oversee such risk might lead (as it did in this case) to their liability under *Caremark*. In *Marchand* and *Boeing*, the products sold by the companies in question – ice cream and airplanes, respectively – had the potential to create great harm to their consumers. Product safety was thus a risk to these corporations, one that falls within the "S" prong of ESG, and to which governmental authorities have responded by imposing certain regulations, turning product safety into an ESG legal risk factor. To the extent that corporate reporting and transparency is included in the "G" prong of ESG, the audit committee members' lack of expertise and violation of the applicable accounting rules in *Hughes* can also be viewed as a *Caremark* claim that involved ESG legal risks.

But, contrary to what some authors have implied,[93] this does not encompass the entire concept of ESG. Rather, ESG may also entail business risks, consistent with the definition proposed in Section II and the example given therein about the absence of talent attraction and retention policies.

As detailed above, the Court of Chancery in *Citigroup* has expressly stated that *Caremark* claims related to the oversight of business risks might succeed (although there is still no precedent upholding such a claim). The specificity of these cases is that the plaintiffs' burden will be much higher, given that the Courts cannot risk waiving the protection granted by the business judgment rule.[94]

Applied to our previous example in Section II, the directors could only be held liable for failing to oversee talent attraction and retention policies in highly unusual circumstances. For instance, this could be the case if the board had been presented with evidence that the corporation was struggling to find hires for very strategic positions and that the absence of attraction and retention policies was directly impacting its competitive advantage.[95]

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93 STRINE, Leo E. *et al.*, *Op. Cit.*

94 Court of Chancery of Delaware. *In re Citigroup Inc. S'holder Derivative Litig.*, 964 A.2d 106 (Del. Ch. 2009), at 125-126.

95 In *Zucker v. Andreessen*, the plaintiffs presented, among others, a Caremark claim after the CEO of Hewlett–Packard Company was fired, and the company struggled to find a new CEO in the absence of a well-established succession plan. The court dismissed this claim on the grounds that the plaintiffs had failed to plea with particularity that demand was futile, stressing that: "In reaching this conclusion, the Court has no need to address whether the duty of care requires directors to adopt succession plans, and it expresses no view on that issue. Rather, the limited holding of the Court's analysis as to Count II of the Complaint is that there can be no substantial threat of personal liability predicated on bad faith disregard of a known duty to implement a succession plan because the Complaint fails to allege a basis from which the existence of such a known duty reasonably could be inferred". This seems to indicate that, under specific circumstances, the board might have the duty to put in place a succession plan. Court of Chancery of Delaware. *Zucker v. Andreessen*, No. 6014-VCP, 2012 Del. Ch. LEXIS 135 (Ch. June 21, 2012), at 40-41.

In short, there should be no difference between the duty to oversee (legal or business) risks related to ESG in particular and (legal or business) risks in general. When dealing with ESG-related claims, Courts should simply resort to the same test and standards developed under *Caremark* and its progeny, including the "mission-critical" assessment necessary to identify the issues that should be addressed, and the obligation to act upon "red-flags" under prong 2 of the test. Therefore, directors should not be held liable for failing to oversee any and all ESG-risk factors, but only those so intrinsically related to the success of the company's business that the directors could not have failed to oversee them had they been acting in good faith.

In this regard, it must be highlighted that the "mission-critical" standard used by the Courts to analyze a *Caremark* claim is not identical to the "materiality" assessment used for disclosure purposes. As mentioned in Section II above, the latter is similar to the concept of materiality applicable to financial reporting purposes, and so encompasses all ESG factors that might substantially impact shareholder value creation. The "mission critical" standard developed under *Marchand* and later cases seems to be much narrower, concerning risks directly related to the corporation's main (or only) line of business. It follows that some ESG factors might be material enough for the corporation to disclose them as part of its ESG efforts, but not enough for directors to be held liable for a failure to oversee them. But figuring out exactly how to determine which issues are "mission critical" in a non-monoline corporation seems to be a question to which the answer is unclear to date, as previously commented.

Having discussed directors' liability for ESG legal and business risks, one must also tackle the issue of ESG opportunities. This issue has a different history, and (at least in theory) a rather simpler one.

In fact, it seems to be crystal-clear that, under the board-centric model of Delaware law, directors cannot be told which businesses the corporation should invest in. For example, there cannot be any *Caremark* liability for the directors of an automobile company

that fails to invest in electric cars, even if all signs point to the conclusion that this environment-friendly move is also the best business strategy. Deciding whether or not to explore an ESG opportunity is a matter of pure business judgment, and the only available measures for discontented shareholders are voting the board out or divesting from the company.

In practice, however, and as mentioned in Section II, it might not be all that simple to distinguish whether we are facing a business risk or an opportunity, as "managing risks" and "taking risks" are intimately intertwined.[96] This fact, in addition to the vagueness of the "mission critical" concept, reinforces the significance of directors being held liable for failing to oversee business risks (either ESG related or not) only under highly unusual circumstances.

There is a final interesting issue regarding *Caremark* claims and ESG. As mentioned in Section I, ESG investing is already a major (and increasingly growing) market, and the decision in *Hughes* might be read as suggesting that putting in place adequate internal controls over financial reporting is mission critical to any publicly held corporation. It is thus possible that, under some circumstances, the board's failure to oversee the accuracy of the corporation's ESG reporting leads to its liability under *Caremark*.

Conclusion.

As mentioned in the introductory Section of this Essay, ESG is becoming increasingly important. In fact, ESG assets already correspond to a significant part of the assets under management in the world, and scholars, lawyers, and regulators are largely discussing the implications of this trend on corporate and securities law. Still, a lot remains unclear in relation to boards addressing ESG matters and the legal consequences of doing or failing to do so.

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96 BAINBRIDGE Stephen M., *Op. Cit*, at 31.

Although there is enough reason to believe that, in the coming years, lawyers and Courts will be faced with the question of whether, and if so, under which circumstances, directors may be held liable for failing to oversee ESG factors, very few authors have tried to answer this question. As argued in this Essay, all the approaches proposed so far fail to properly apply the concepts of legal risks, business risks, and opportunities detailed in Section II, and thus do not offer the best understanding of how *Caremark* and ESG should intertwine.

The first conclusion that might be drawn from this Essay is that it makes little sense to discuss whether *Caremark* claims apply to ESG factors in general. In fact, many *Caremark* cases, including the ones that have succeeded in the pleading stage (such as *Inter-Marketing Grp.*, *Marchand*, *Boeing*, and *Hughes*), are about the board's failure to comply with legal rules that are ESG-related. This is precisely what the second scholarly approach mentioned in Section IV advocates: ESG and compliance overlap.[97]

Although this conclusion is not inaccurate, it does not encompass the entire concept of ESG, and so it would be minimalistic to state that ESG and compliance are the exact same thing. Rather, as also mentioned, ESG may entail not only legal risks, but also business risks and opportunities. Thus, the real question seems to be whether *Caremark* claims also comprise ESG business risks and opportunities.

The first scholarly approach mentioned in Section IV, i.e., that Courts should not extend the *Caremark* doctrine to ESG risks that are not subject to legal regulation, draws on 2 presumptions: (i) that boards cannot have expertise in all ESG matters, and (ii) that addressing ESG would force the directors to choose between profit-seeking and stakeholder considerations, which would not be consistent with Delaware law.[98] These underlying presumptions, however, do not seem to be precise.

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97 STRINE, Leo E. *et al. Op. Cit.*

98 BAINBRIDGE, Stephen M. *Op. Cit.*

First, there is little doubt that ESG does comprise a lot of different issues, and so a big corporation may be exposed to some degree to so many of them that it would be unfeasible to have board members experienced in all such issues. But this is also true of any other aspect of the company's operation, whether it involves ESG concerns or not. In other words, no one expects boards to have members who are experts in any and all possible matters in which the corporation might be involved,[99] and the same reasoning should apply to ESG factors. Therefore, to comply with their duty of oversight, boards must have members experienced in and address those ESG risk factors that are "mission critical" to the corporation.

The argument that "extending" *Caremark* to ESG oversight would go against Delaware law by imposing on the board the obligation to balance profit against environmental and social issues is baseless if one establishes that liability in these cases can only follow when ESG factors should have been managed as safeguards against downside (legal or business) risk that is mission critical to the corporation. Analyzed under this perspective, failure to oversee ESG factors destroys shareholder value, as corroborated by various studies, and the legal framework applicable to these claims does not differ from that applicable to any other *Caremark* claim.

The third approach mentioned in Section IV is the one that gets closer to the one proposed in this Essay. According to this line of reasoning, addressing ESG matters helps corporations create safeguards against downside risks; therefore, if directors act in bad faith and completely disregard these matters, they should be subject to liability, consistent with *Caremark*. But prong 2 of the *Caremark* test should not apply to ESG matters, i.e., directors should have no obligation to consider ESG information as a factor influencing their decision.[100]

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99 See TILCSIK, András; ALMANDOZ, Juan. *When Having Too Many Experts on the Board Backfires*. 29 ago. 2016). Disponível em: https://hbr.org/2016/08/when-having-too-many-experts-on-the-board-backfires. Acesso em: 5 fev. 2022.

100 GADINIS, Stavros; MIAZAD, Amelia. *Op. Cit.*

This approach seems to place all types of ESG factors under the same rule, whether they consist in legal risks, business risks, or opportunities. In the latter case, there is no doubt that boards have no obligation to act upon ESG information, as they cannot be told how to run the corporations under Delaware law; in other words, both prongs 1 and 2 of the *Caremark* test do not apply in the opportunities sphere. There should be no difference, however, between the duty to oversee (legal or business) risks related to ESG in particular and (legal or business) risks in general, including in regard to prong 2 of *Caremark*.

In summary, it is proposed in this Essay that, when dealing with ESG-related claims, Courts should resort to the same test and standards developed under *Caremark* and its progeny, including the "mission critical" assessment necessary to identify the issues that should be addressed, and the obligation to act upon "red flags" under prong 2 of the test. Therefore, directors might be held liable for breaching their duty to oversee ESG legal and business risks, but they must be shielded from liability for failing to address ESG opportunities, in line with the business judgment rule. Because "managing risks" and "taking risks" are intimately intertwined, and it might be hard to establish what is "mission critical" in non-monoline corporations, directors may be held liable for failing to oversee ESG business risks only under extreme circumstances.