

A Reassessment of the Role of Good Faith in Personal Liability Before and After *Stone v Ritter*

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Abstract

The paper explores the role of good faith within the traditional theory of fiduciary duty in the lead-up of the Delaware Supreme Court's *Stone ex-rel. AmSouth Bancorporation v. Ritter* decision. The enforcement of the director's liability is discussed concerning the doctrinal controversies concerning *inter alia*, the reach of the exculpation statute passed after the *Smith v Van Gorkon* holding. The paper also analyzes the conditions that a Plaintiff must survive a motion to dismiss a claim of director liability; the appropriate standard of review for alleged duty of liability breaches, and the role of good faith within the overall triad of traditional fiduciary responsibilities. Over a decade after this landmark case was decided, there is value in reconsidering whether the *Stone* judgment lived up to the promise of the *Caremark* holding and its reformulation of good faith as a judicial device for evaluating director liability in contexts that not do easily fit with the traditional doctrines of duty of care and loyalty.

Keywords: good faith, personal liability, fiduciary duty.

This paper incorporates three key types of analysis; descriptive, doctrinal, and qualitative. The paper begins with a descriptive analysis of the fiduciary duty of directors whether duty of care or loyalty duty and how historically courts looked in good faith of the directors before and after *Van Gorkom*. It re-examines how the 2006 *Stone v Ritter* holding affirmed the correctness of the *Aronson* test and how The *Stone* decision has solidified its status as a landmark decision.

The doctrinal analysis reviews the relevant cases, laws, statutes, and policies that one must understand how the 2006 *Stone v Ritter* holding affirmed the correctness of the *Aronson* test and how the *Stone* decision has solidified its status as a landmark decision, and application on other related cases.

Literature Review

The Relation Between Good Faith, Duty of Care, and the Duty of Loyalty

Before delving into evaluating the rationale behind the *Stone* decision, it's crucial to acknowledge the evolving nature of Delaware General Corporate Law regarding its distinct treatment of breaches of loyalty versus breaches of the duty of care over the decades. In its broadest way, the legal framework on fiduciary duty was born out of the need to protect shareholders from absorbing very high costs e.g. from excessive payouts and by obliging corporate executives to act not in their self-interest but in the larger interests of the company. These principles find legal expression in the traditional foundations of fiduciary duty: the duty of loyalty and the duty of care. Valasco

explains: The duty of care requires diligence. Directors are expected to do a good job in managing the company. They breach this duty when they are negligent (or grossly negligent). The duty of loyalty is concerned with conflicts of interest. Directors are expected to act in the interests of the corporation and its shareholders, rather than in their interests. They breach this duty, *inter alia*, when they engage in unfair self-dealing.¹

According to Delaware Corporation Law, the courts have applied the standard of gross negligence when assessing the existence of a breach of the duty of care.² The duty of loyalty adheres to distinct legal criteria, mandating that directors fulfill their obligations in a manner aligned with the best interests of the corporation and its shareholders.⁷ Extending from this, a director may be deemed to have violated this mandate if a conflict of interest arises that promotes self-interest or otherwise deprives shareholders of the advantage of an impartial decision-making entity.⁸

Several cases have dealt with the limits and reach of director liability, creating a maze of judicial discussion on, *inter alia*, the survivability of a claim faced with a director's motion to dismiss *de novo* judicial review as well into the substance, mainly in the area of corporate waste and self-dealing (concerning how the law should be applied to a particular complaint).

The term "good faith" has a long history in Delaware fiduciary law and courts have widely referenced this concept in association with the established duties of loyalty and care. In the 50's, courts harnessed the tests of good faith and fairness to conduct a 'hard look' review into soundness or reasonableness of business decisions. The case of *Smith v. Van Gorkom* marked the pinnacle of this heightened level of judicial examination into director conduct.⁹ In the 1985 decision, directors of the Trans Union Corporation were held personally accountable for selling their company to a third party in a sale process that the company's shareholders (the Plaintiffs) contended was rushed and

inadequately conducted. In this context, the *Van Gorkom* decision witnessed the Court departing from the conventional standard of mere rationality established by the Supreme Court, opting instead for a more rigorous scrutiny now occasionally termed as an intermediate or proportionality review.³

The business community responded to *Van Gorkom* with concerns of unwarranted judicial interference in business decisions, fearing that the decision would establish a dangerous precedent for enhanced personal liability for routine decision-making and financial transactions.⁴ From a legal standpoint, the increasing intensity and scope of the emerging standard of review seemed to directly contradict the Business Judgment Rule, as outlined in the liability-limiting ruling of the Delaware Supreme Court in *Graham v. Allis-Chalmers*.⁵ The rule embodies a "cardinal principle" of Delaware Corporation Law, under which directors, rather than shareholders, are entrusted with the management of the corporation's business and affairs,⁶ judges should defer to them on matters concerning the soundness or correctness of a decision or transaction unless some gross irregularity or criminality is present. Others urged that the Court's willingness to circumvent traditional standards would likely produce adverse economic, as well as legal, consequences.

To evade liability in subsequent derivative suits, directors might encounter escalating pressures to adopt a risk-averse approach, potentially leading to excessive expenditures on oversight.⁷

The legislative response to the growing fears of liability 'creep' was to pass an exculpation Statute that would expressly cabin the scope of personality liability for care, while opening a window of opportunity for good faith-related actions.⁸ Section 102(b)(7) of the General Corporation Law seems to permit Delaware corporations to modify their certificates of incorporation to shield directors from liability for breaches of care, while still allowing for the

potential of liability if breaches of loyalty or good faith occur.⁹ The reference to good faith in section 102(b)(7) as a possible exception to any provision exculpating directors from personal liability is as follows:

A provision eliminating or limiting the personal liability of a director to the corporation or its stockholders for monetary damages for breach of fiduciary duty as a director provided that such provision shall not eliminate or limit the liability of a director: (i) For any breach of the director's duty of loyalty to the corporation or its stockholders; (ii) for acts or omissions not in good faith or which involve intentional misconduct or a knowing violation of law... (iv) for any transaction from which the director derived an improper personal benefit.¹⁰

The Statute represents a clear attempt to reverse, or negate, the over-broad reach of the *Van Gorkam* decision. Delaware law also upright various procedural hurdles to a claim. Under the Delaware Chancery Court Rule.¹⁸ It is the board of directors who must initiate a derivative suit, based on the reasoning that the action is being pursued on behalf of the corporation. Consequently, a plaintiff must possess standing as a stockholder of the corporation at the time of the transaction about which the plaintiff is lodging a complaint.¹¹

The most challenging hurdle for a shareholder plaintiff to overcome is often the Demand Requirement.²⁰ In *Aronson v. Lewis*, the Court of Chancery set forth two threshold tests that must be satisfied before a derivative action can proceed under Delaware law.²¹ The shareholder must either demonstrate that the directors improperly declined to initiate a lawsuit, despite the shareholder's prior request for them to do so, or provide factual evidence indicating that making such a demand on the directors would have been futile.¹² The procedural barrier that this imposes on pending and future claims has led some to reject the Demand tests as 'an arbitrary requirement that is not necessarily tied to the economic harm caused by a breach of fiduciary duty.'¹³

However arbitrary or exhausting the procedural hurdles to mounting a successful claim may be, it is clear that the Demand Requirement is closely linked to the substantive limits of personal liability.¹⁴ The foremost limiting principle is embodied by the Business Judgment Rule, defined in Aronson as "a presumption that in making a business decision the directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company."¹⁵ This definition has become the cornerstone for the liability-limiting standard of review applied to alleged breaches of the duty of care, establishing a presumption of deference to the decisions of the Board, or even a policy of non-review.¹⁶ According to traditional theory, judicial review is typically precluded if any alleged lapse in due care can be attributed to a rational business purpose.²⁷ A determination of liability for a breach of duty of care has typically been confined to instances of gross negligence. Due to this limitation, shareholders often find it challenging to challenge the presumption in favor of the Business Judgment rule.¹⁷

Against this backdrop, the passing of the exculpation Statute brought new concerns that the statute had swung too far in the opposite pole of the liability spectrum, shifting the dial from substantial review of due care to substantial deference to the presumption of avoided liability. This shift would pose its own set of challenges, potentially leading to a situation where directors become excessively passive, influenced by both Delaware's robust business judgment rule and a business culture that promotes minimal interference by directors with the CEO.¹⁸ This notion of director independence is also the principal reason why breach of care claims do generally not prevail in director liability cases.³⁰

Furthermore, the express reference to good faith in the Delaware Statute did not settle the interpretative controversy in connection with the scope and application of good faith in director fiduciary duties. In cases leading up to the *Stone*

v Ritter case.¹⁹ The Delaware Supreme Court has established directors' fiduciary duties as a triad, explicitly acknowledging the duty to act in good faith alongside the fundamental duties of care and loyalty.³² But what was not clear was whether a breach of good faith was sufficient, on its terms, to give rise to liability. On the one hand, there was judicial and scholarly support for the idea that good faith, as with the other exceptions expressly provided for under section 102(b)(7), should be taken as necessary, but ancillary, consideration when evaluating whether a duty of loyalty had been breached.²⁰ If this interpretation was taken to be correct, bad faith in director oversight liability cases would not suffice to establish direct liability. Others held a contrary perspective, contending that good faith and loyalty, while interconnected, should be regarded as distinct exceptions under section 102(b)(7).²¹ On this reading, good faith constituted a free-standing duty for subjecting directors to personal liability.

The *Caremark* standard had a defining influence on the development of fiduciary law in years to come but its aspiration to inject new vitality in good faith as a bridging principle has arguably fallen short. The *Caremark* decision was structured to give rise to a duty on directors to act in good faith by ensuring the existence of a process-relating reporting and compliance system, without going as far as to imply that bad faith alone would impute liability.³⁵ Instead, the Chancellor deployed the language of a director having "utterly failed" to monitor or oversee business operations under its control. Following *Caremark*, several cases would apply these standards to cases involving director conduct such as the duty to exercise due care in decisions involving executive compensation or the process-related failure to satisfy the duty of loyalty by implementing adequate reporting controls.²²

Despite paying lip service to good faith, several high-profile post-*Caremark* cases end up reaching a similar conclusion: good faith was to be viewed as a mere process-related variant of

the duty of loyalty, with virtually no bearing on now near obsolete doctrine of the breached duty of care. The apparent reason for this shift is that, unlike the stringent standards applied to the duty of care, the duty of loyalty has the flexibility to be interpreted expansively in evolving case law. More than a decade after the decision, the Supreme Court in *Stone* would once and for all solidify this doctrinal shift. Among its distinguishing features, the Delaware Supreme Court in *Stone* would both approve of and retreat from, the *Caremark* standard. Finally settling the question of whether good faith represented a separate duty, the entire concept was now subsumed under the Court's rendering a more expansive duty of loyalty.²³ Cast in a critical light, the incorporation of good faith in what an increasingly indeterminate formulation of the duty of loyalty was would set in motion a judicial hollowing out of good faith in contexts involving director misconduct or recklessness. In the post-*Stone* era, the standard used to determine bad faith can sometimes appear, simultaneously, vague and exacting. Simplified to a procedural demand, a complaint is viable only if it demonstrates that a director consciously and entirely neglected their duties within the scope of the duty of loyalty.

The next section will therefore examine the most important judicial decision to address the scope and limits of good faith in the lead-up to the *Stone* holding.

Stone v Ritter: A Turning Point?

In the 2006 *Stone v. Ritter* ruling, the case centered on a derivative claim filed by the shareholders of AmSouth Bancorporation (AmSouth) against its directors, prompted by investigations conducted by the US Federal Reserve into a Ponzi scheme linked to AmSouth.²⁴ The Financial Crime Enforcement Network (FinCen) found that AmSouth acted based on misrepresentations made by the instigators of the Ponzi scheme and duly failed to file a "Suspicious Activity Report" under the Bank Secrecy Act. 40 While the US Attorney's Office did not explicitly attribute fault to any

individual Director in the resulting report, it did conclude that AM's anti-money laundering mechanism 'lacked adequate board and management oversight' and that the 'monitoring and oversight of compliance activities was materially deficient.'²⁵ As part of a deferred prosecution agreement, AmSouth was required to pay \$40 million in fines and \$10 million in civil penalties. AmSouth shareholders did not initially file a demand upon the directors, by the Delaware Chancery Court Rule but would later initiate a derivative suit to recover their losses.⁴² In their pleadings, the Plaintiffs acknowledged that the Board was not aware of the violations of the Bank Secrecy Act and that no "red flags" were triggered that should have altered the Director's practices of fraud and criminality.⁴³ Nonetheless, the Shareholders maintained that the Director had 'utterly failed' to institute the 'statutorily required monitoring, reporting or information controls that would have enabled them to learn of problems requiring their attention.'²⁵ The defendants subsequently filed a motion to dismiss the complaint, arguing that the cause of action did not meet Delaware's statutory Demand Requirements.²⁷ The Court invoked the two-second prong test applied in Aranson to plaintiffs to assess whether the pleaded facts proved demand futility. Asserting the futility of a demand on the Director, the Shareholders contended that because the Directors faced a "substantial likelihood of liability", they were unlikely to pursue an action that implicated their own failings and economic liability.²⁸ The court dismissed this argument because the plaintiff's factual allegations did not support the assertion that directors declined to meet demand out of self-interest, understood as gaining a personal benefit from their alleged failure.²⁹ The Court of Chancery ruled in favor of the defendant and dismissed the action.

The Delaware Supreme Court presided over a de novo review of the trial court (Court of Chancery's) dismissal.³⁰ Affirming the Trial Court's holding, the Delaware Supreme Court affirmed the correctness of the Aronson test for

determining demand futility, noting that AmSouth's incorporation certificate exempted directors from liability for breach of due care.⁴⁹ With the exceptions expressly provided for under section 102(b)(7) in mind, the Delaware Supreme Court proceeded to consider whether the Board's conduct may nonetheless meet the threshold of a breach of the duty of loyalty.³¹

The Stone Court proceeded to examine the substance of the plaintiff's pleadings. The crux of the shareholder's derivative claim was that the directors had failed to make the requisite good-faith efforts to fulfill their fiduciary duties. Framing their pleading as a complaint about the Defendant's failure to perform adequate levels of oversights, the Plaintiff's argument rested on the allegation that the Company Board had 'consciously and intentionally disregarded their responsibilities' once they had become aware of deficiencies in the Corporation's (statutorily mandated) information and reporting systems.⁵¹ The Court went on to the Plaintiff's (the shareholders) assertion that a failure to implement compliance and reporting controls involved a business process and was thus not materially related to the rationality of a decision or transaction, thereby escaping the ordinary application of the Business Judgement Rule.³²

Drawing heavily from the Caremark decision, the Court of Chancery reaffirmed that when directors utilize a rational process and take into account all materially available information, their decision will generally be upheld. The action was consequently dismissed before being reviewed, and affirmed, by the Delaware Supreme Court.

Clearing a seemingly expansive interpretation of 102(b)(7) of the Delaware law, the Supreme Court clarified the Trial Court's reasoning by stating that the duty of loyalty could be correctly construed as encompassing any cases 'where the fiduciary fails to act in good faith.'³³ Specifically, the Supreme Court went significantly beyond previous decisions to determine that the duty of loyalty was not exclusively confined to cases involving fiduciary

conflicts of interest.³⁴ In bolstering its rationale, the *Stone* Court cited the earlier *Guttman* decision, which asserted that a director cannot demonstrate loyalty to the corporation unless she genuinely believes in good faith that her actions are in the best interest of the corporation.³⁵

Taking another stride, the Supreme Court drew on the *Disney* case to confirm that a lack of good faith can be inferred when a fiduciary consciously refrains from acting despite being aware of a duty to act.⁵⁷ The Supreme Court in *Stone* took the additional step of determining that since demonstrating bad faith conduct, as outlined in *Disney* and *Caremark*, is crucial to establish director oversight liability, it logically follows that any bad faith conduct in director oversight must be considered a relevant factor when assessing a claim of a breach of the duty of loyalty.³⁶ However, the Supreme Court affirmed the Trial Court's dismissal, referring to the insufficiency of the Plaintiff's factual pleadings. On the material issues, both Courts concluded that the Plaintiff had failed to demonstrate that the board's prior knowledge of i.) deficiencies in AmSouth's compliance control systems; ii) that these inadequacies would not rise to the level of criminality and that iii) that board had prior knowledge of criminality but 'chose to do nothing about problems it allegedly knew existed.'³⁷ Correspondingly, the Supreme Court affirmed the Trial Court's finding that the complaint was not exempt from the usual application of the demands requirement and should have sought to raise its objections with the board.³⁸

The Impact of *Stone* Decision

The *Stone* decision has cemented its status as a landmark decision albeit one that is characterized more by judicial restraint than the Supreme Court's daring effort to update the law. Beyond expanding the duty of loyalty. It is certainly true that the *Stone* Court purported to definitively settle the status of good faith as a free-standing duty. What is less obvious is whether this doctrinal shift should be taken as a positive development. In one sense, the *Stone*

decision establishes a precedent for a broader interpretation of the duty of loyalty beyond the traditional sphere of conflicts of interest. In another sense, the *Stone* Court achieved this by leaving the duty of due care largely untouched and, implicitly, placing good faith in due care and waste cases outside the sphere of judicial review.³⁹ As noted in the introductory section, prior to *Stone*, the Delaware Support Court had referred to the duty of care, loyalty, and good faith as a triad of duties, in an affirmation of the interdependencies between these elements. In many respects, therefore, the *Stone* Court reversed, or at least rolled back, on the rhetoric of previous Courts, and since *Caremark* first set out to develop a workable theory of personal liability for bad faith. Instead of posting a triad of duties, *Stone* reaffirms the existence of the two traditional duties- care and loyalty, with good faith, collapsed into loyalty absent much consideration of what, if anything, distinguishes these concepts.

It is reasonable that the *Stone* Court's central motivation stemmed from its unwillingness to stray too distantly from the plain meaning of Section 102 (b)(7), in ways that may open up the floodgates to a tide of derivative suits. In so far as the ultimate legacy of *Stone* is to locate good faith within the exclusive realm of loyalty, the Decision further reinforces the sense of narrowing down or demotion of due care liability.⁴⁰ This demotion is problematic given how strongly the *Stone* Court came to rely on the *Caremark* structure. Thus, by appropriating the standard of an "utter failure" as a fundamentally procedural standard, one with a high bar, the *Stone* Court may be seen to have relied on a false analogy between the two cases. After all, the *Caremark* decision concerned, exclusively, an alleged breach of due care, the opposite of how the *Stone* court would come to frame the legal issues under its review.⁴¹

As the next section will demonstrate, the *Stone* holding has precipitated a broader judicial pattern of uncoupling the duty of loyalty from the traditional sphere of due care. While the attempt

to shoehorn good faith into one doctrinal category, and not the other, can be described as a problem of legal form, there are wider substantive impacts to consider. In its most negative light, the Stone holding has only served to solidify the presumption that a bad faith act will not survive an action for dismissal in all but the most extreme cases.

Post Stone: A Challenging Trajectory

The *Ryan v. Lyondell Chemical* decision of 2009 seemed to consolidate the precedential value of the Stone decision but went even further to quash any lingering hopes that good faith's independent liability function.⁴² The facts of the Lyondell case concerned the director's decision to sell the company over a week at a premium. In their pleadings, the shareholders alleged that in doing so, the Board had failed to secure the best price in the sale transaction, in violation of their fiduciary duty to act in the best interests of the company.⁴³ While the 2008 Bridgeport case, handed down in 2008, endeavored to expand the reach of director liability after Stone expanded the duty of loyalty, the Delaware Supreme Court's decision in the Lyondell rule bucked this trend, by further reining in the scope for personal liability. The Supreme Court began by reversing the Court of Chancery's decision to refuse the directors' motion for summary judgment.

In its deliberation, the Supreme Court concluded that as only a potential care claim existed and was shielded under section 102(b)(7) exculpatory provision, there was no legal foundation on which to hold the directors liable.⁴⁴

In substance, the Vice Chancellor concluded that the protections granted under the liability limiting clause in Lyondell's company charter, as well as the traditional cabining of substantive due care, could only be overcome if Defendant had "knowingly and completely failed" to undertake his or her responsibilities.⁴⁵ In this regard, the Lyondell Court looked to clarify and limit the application of Stone. The Court went a step further to establish that mere "unexplained inaction" would not be adequate grounds to hold

a director accountable for breaching a fiduciary duty,⁴⁶ noting that "there is a vast difference between an inadequate or flawed effort to carry out fiduciary duties and a conscious disregard for those duties".⁴⁷

In addition to significantly narrowing the scope of director liability, the Lyondell decision highlights the inconsistency with which Courts have interpreted section 102(b) (Bridgeport was handed down a year earlier). While the holding in Lyondell appears to have prevailed in granting directors sweeping statutory protections, in the final analysis, most cases following Stone converge in their assessment of the appropriate liability standard: a director may be held liable if they breach their duty of loyalty (a knowing and utter failure to fulfill their responsibilities). Taken such, the Lyondell decision is not fundamentally at odds with the holding in Bridgeport, since the Delaware Court seems to have generally conditioned liability on the presence of hypothetical examples of egregious bad faiths. This standard appears to set an extremely high threshold, limiting liability to cases where an "extreme set of facts" demonstrate that the director "completely failed" to perform a particular action or otherwise "utterly failed to attempt" to maintain and implement appropriate controls. Very little opportunity is left for an expanded conception of good faith outside this process-orientated conception of the 'bad faith equals breach of loyalty' formula.

In 2009, the Delaware Court of Chancery handed down another influential decision against the backdrop of the 2008 financial crisis. The *In Re Citigroup Inc. Shareholder Derivative Litigation* decision earned its reputation as a test case for pending or future derivative suits alleging director oversight liability, corporate waste, bad faith, and unjust enrichment for compensation. In their pleadings, the Plaintiffs claimed that the Defendants had violated their fiduciary duties by inadequately supervising and controlling the Company's risk exposure in the subprime mortgage market, despite the presence

of public information indicating deteriorating conditions in the subprime and credit markets.⁷⁴ The Plaintiffs then argued that the existence of these “red flags” should have alerted the Defendants to possible loss risks and compelled them to take action to mitigate shareholder exposures.⁴⁸

On the substance, the Court relied on *Lewis v. Vogelstein*, stating that the Business Judgment Rule could only be theoretically overcome in the context of a claim of corporate waste if the “exchange of corporate assets for consideration so disproportionately small as to lie beyond the range at which any reasonable person might be willing to trade.”⁴⁹ Subject to the test set forth under the *Disney* ruling, for such a claim to succeed Defendant must bear the burden of demonstrating that no “business person of ordinary, sound judgment could conclude that the corporation has received adequate consideration.”⁵⁰

Regarding the procedural aspects of a purported breach of loyalty demonstrated by bad faith, the Citigroup Court endorsed the oversight liability standard articulated in *Stone*, which entails either a) a total failure to establish reporting or information systems, or b) having established such systems or controls, effectively “disabling themselves from being informed of risks or problems requiring their attention”.⁵¹ In a significant development, the Court leaned on the preceding *Rales* decision to establish the relevant legal standard for the failure of the duty of disclosure.⁵²

The Court elucidated that the Company was obliged to disclose any documents that could implicate their liability, including awareness of any public statements that were false or misleading. The Court indicated that any factual allegations supporting these disclosure failures would suffice to fulfill the Plaintiff’s requirement to demonstrate that a disclosure violation was committed in bad faith, knowingly, or intentionally. Before assessing whether the Plaintiff’s pleadings satisfied this threshold, the Citigroup Court distinguished the case before it

from traditional *Caremark* claims involving alleged violations of law or employee misconduct. By contrast, the Plaintiffs in this case were alleging bad faith oversight in the management of business risk.⁵³

Ultimately, the Citigroup Court upheld the director’s motion of dismissal on the basis of the Court’s theory of personal liability, namely that a claim of a breach of loyalty or care could stand in respect of future losses “which no director could reasonably anticipate.”⁵⁴ The Court concluded that the plaintiff’s factual allegations were insufficient to demonstrate bad faith.

At best, the pleadings could only support a claim that the directors had made poor business decisions, and as a result, they were shielded under the protection of the Business Judgment rule.⁵⁵ Notably the Court noted another decision rendered in the same year in *American International Group, Inc. Consolidated Derivative Litigation*.⁵⁶ This case involved allegations of fraud and illegality. Distinguishing between the two cases, the Citigroup Court underscored that personal liability for the failure to anticipate the future and assess business risk adequately differed in nature from a failure to oversee fraud and criminal activities, including the implementation of appropriate controls to prevent such illegality, which formed the basis of the Plaintiff’s claim in *Stone*.⁵⁷

In other aspects of its judgment, however, the Court left the door open to certain narrow circumstances under which liability could be found. Such circumstances may have been explicated more fully had the plaintiff’s factual allegations implicated broader questions of duty of oversight in novel contexts outside the sphere of fraudulent and criminal actions. Overall, there is no escaping the cautious tone struck by the Court, both in the care it took to distinguish actions involving criminal fraud and more routine allegations of director oversight and in the emphasis, it placed on the need to curb judicial interference in the marketplace. This judicial interference, it was strongly suggested,

was best moderated by cabining substantive review of care.

In the final analysis, the Citigroup decision gave further credence to the bright line dividing process/substance claims in *Stone* and *Caremark*, respectively.⁵⁸ A process failure could, in theory, meet the threshold of a breach, if supported by evidence of bad faith intent, under *Stone*'s formulation of the duty of loyalty. At the same time, the prevailing standard of rationality-based review would continue to stand for duty of care claims involving allegations of corporate waste, with little space for good faith considerations outside the most flagrant examples of self-dealing, criminality and acts of gross negligence.

Conclusion

The analysis of *Stone*, and the later cases of *Lyondell* and *Citigroup*, points to a resurgent and largely process-centered focus on the duty of loyalty, and a gradual retreat from the duty of care.⁵⁹ Yet, the *Stone* Court's expansion of the loyalty doctrine to avert bad faith in the oversight and control of business decisions does not appear to have significantly improved a Plaintiff's chances of prevailing in director oversight cases either. While there has been plenty of handwringing in the post-*Stone* era over the presence of bad faith as a substantiating, though subsidiary, cause for loyalty-related liability, the case law indicates that the Delaware Courts will almost always favor director independence. This has forced some scholars to conclude that 'good faith has not changed the space for director liability in any measurable way.'⁶⁰

While it might seem like an overarching critique, it does highlight an expanding gap between judicial attitudes and the theoretical foundations of the doctrine of fiduciary duty: directors are obligated to act in the best interests of the company.⁶¹

The *Disney* and *Citigroup* decisions may have secured some small victories for shareholders, by affirming that, at the very least,

they should be able to expect honest communication from directors, transparently and in good faith.⁶² Professor Pan, nonetheless, argues that *Citigroup*'s decision rests on 'an overly narrow interpretation of the duty to monitor,' that has to go further in 'strengthening the fiduciary duty to monitor' so that the Board 'make the effort to collect the right type of information about the corporation.'⁶³ I would argue that this requirement should stand regardless of whether the demand requirement has been met. Moreover, there is no apparent legal or policy rationale why a breach of fiduciary duty should not be established in instances where directors neglect to take reasonable measures to supervise activities that could lead to significant losses for the company. This principle should arguably stand regardless of whether this activity was internal (such as employee fraud) or external (public disclosures of market risk or money-laundering-related compliance risks).

On the broader trajectory of corporate law in this sphere, it is also not self-evidently persuasive that Courts should abandon all hopes to reform corporate law in the areas of substantive due care and waste. Viewed optimistically, the *Citigroup* decision could potentially create an avenue for shareholders to pursue future claims concerning egregiously excessive executive compensation and severance packages under the doctrine of corporate waste. Ten years later, derivative suits pursued under waste theory still encounter considerable obstacles, despite heightened public scrutiny surrounding the magnitude of executive compensation. It is difficult therefore to avoid the conclusion the early idealism of the *Caremark* decision – the hope that good faith may bridge the gap between intensive substantive review and statutory deference to director liability – has faded with each respective case. The derivative suit has all but disappeared.

It remains to be seen whether the judicial attitudes represent a sustained but temporary counterpoint to the breadth of liability proposed

under *Smith v. Van Gorkom*. As societal contexts evolve, such as if there is an increased public demand for stricter controls on director

oversight, the aspirations outlined in *Caremark* may revitalize the potential for director liability based on good faith.

Footnotes:

1. *Stone v. Ritter*, 911 A.2d 362, (Del Supr. Ct. 2006)
2. *Smith v. Van Gorkom*, 488 A.2d 858, 872-73 (Del. 1985)
3. See *In re Caremark Int'l Inc. Deriv. Litig.*, 698 A.2d 959 (Del. Ch. 1996). *Caremark* would come to be the definitive director oversight liability case.
4. Julian Velasco, *The Diminishing Duty of Loyalty*, 75 Washington & Lee Law. Rev. 1035, 1037(2018). Available at: https://scholarship.law.nd.edu/law_faculty_scholarship/1342.
5. *Aronson v. Lewis*, 473 A.2d 805, 812 (Del. 1984).
6. Harold Marsh, Jr., *Are Directors Trustees? Conflict of Interest and Corporate Morality*, 22 Business Law. 35 (1966)
7. *Cinerama, Inc. v. Technicolor, Inc.*, 663 A.2d 1156, 1170 (Del. 1995). See also Andrew D. Appleby and Matthew
8. D. Montaigne, *Three's Company: Stone v. Ritter and the Improper Characterization of Good Faith in the Fiduciary Duty Triad*, 62 Arkansas Law Review 431, 432 (2009)
9. *Smith v. Van Gorkom*, 488 A.2d 858 (Del. 1985) (holding directors personally liable for breaching their duty of care in approving merger of the corporation)
10. *Lewis v. Vogelstein*, 699 A.2d at 337 (Del Ch. 1997).
11. Franklin A. Gevurtz, *Corporation Law* 341 (2d ed. 2010).
12. *Graham v. Allis-Chalmers* decision 188 A.2d 125 (Del. 1963).
13. *Aronson v. Lewis*, 473 A.2d 805, at 811 (Del. 1984).
14. Jennifer Arlen, *The Story of Allis-Chalmers, Caremark, and Stone: The Directors' Evolving Duty to Monitor in Corporate Law Stories*, (J. Mark Ramseyer ed.) (Foundation Press 2009) at 340
15. This section allows corporations to put provisions in their certificates of incorporation that waive personal liability of directors for violations of fiduciary duty. Margaret M. Blair & Lynn A. Stout, *Trust, Trustworthiness, and the Behavioral Foundations of Corporate Law*, 149 University of Pennsylvania Law Review 1735, 1791 (2001)
16. DEL. CODE ANN. tit. 8, § 102(b)(7)
17. Delaware Chancery Court Rule 23.1 states, "The complaint shall also allege with particularity the efforts, if any, made by the plaintiff to obtain the action the plaintiff desires from the directors or comparable authority and the reasons for the plaintiff's failure to obtain the action or for not making the effort." DEL. CT. CH. R. 23.1
18. DEL. CODE ANN. tit. 8, § 327 (West 2017).
19. See DEL. CH. CT. R. 23.1 (2007)
20. *Aronson v. Lewis*, 473 A.2d 805, 812 (Del. 1984). ('[T]he demands requirement... exists [inter alia] ... to provide a safeguard against strike suits.'). id at 811-12
21. Julian Velasco, *The Diminishing Duty of Loyalty*, 75 Washington and Lee University Law Journal. 1035, 1060(2018)
22. *Aronson v. Lewis*, 473 A.2d 805, 811
23. Julian Velasco, *A Defense of the Corporate Law Duty of Care*, 40 Journal of Corporate Law 647 828-29, 828 (2015).
24. *Sinclair Oil Corp. v. Levien*, 280 A.2d 717, 720 (Del. 1971).
25. *Beard v. Elster*, 160 A.2d 731 (Del 1960).
26. Jennifer Arlen, *The Story of Allis-Chalmers, Caremark, and Stone: The Directors' Evolving Duty to Monitor in Corporate Law Stories*, (J. Mark Ramseyer ed.) (Foundation Press 2009) at
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