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KEYNOTE REFLECTIONS: THE PUBLIC GOVERNANCE DUTY[1]

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[1] Copyright © 2015 by Steven L. Schwarcz. These Keynote Reflections are based on, and excerpted from, the article *Excessive Corporate Risk-Taking and the Decline of Personal Blame*. The full and original article will appear in Volume 65, Issue 2, of the *Emory Law Journal*, available at 65 EMORY L.J. (forthcoming Dec. 2015) and also available at http://ssrn.com/abstract=2553511.

I. INTRODUCTION

There has been real frustration with the SEC and other government agencies for not holding individuals responsible for the excessive risk-taking that was a principal cause of the 2008 to 2009 global financial crisis (Financial Crisis) and its associated banking failures.[2] Enforcement has focused instead on the financial firms themselves.[3]

But being managed by individuals, firms themselves are the second-best targets of deterrence. Targeting managers in their personal capacity is thus widely viewed as a greater, and perhaps a more optimal, deterrent than firm-level liability.[4] Better deterrence is critical because insufficient deterrence could sow the seeds—as may already be occurring—for future systemic meltdowns. Targeting managers in their personal capacity can also help to increase accountability and fairness.

Moreover, firm-level liability can impose significant externalities on third parties. The prosecution of Arthur

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[2] *See, e.g.*, *Ted Kaufman: Wall Street Prosecutions Never Made a Priority, Frontline*, PBS (Jan. 22, 2013, 9:41 PM), *available at* http://www.pbs.org/wgbh/pages/frontline/business-economyfinancial-crisis/untouchables/ted-kaufman-wall-street-prosections-never-made-a-priority/ (expressing frustration and disappointment with his own political party that there were no prosecutions for the misconduct leading to the Financial Crisis).

[3] In August 2012, for example, the U.S. Department of Justice determined that it had no basis to prosecute Goldman Sachs employees in regard to allegations in the Levin-Coburn report that Goldman Sachs made large profits from marketing CDO Securities backed by subprime mortgage loans as safe investments to clients, while betting against the same securities. *See* Dominique Debucquoy-Dodley, *No "Viable Basis" to Prosecute Goldman, Justice Department Says*, CNN (Aug. 10, 2012, 7:13 AM), http://www.cnn.com/2012/08/09/business/goldman-justice-department/. Goldman Sachs nonetheless paid $550 million is settlement of civil claims with regard to the activity in question. Phil Mattingly et al., *U.S. Agencies Probing Goldman Findings After Senate Referral*, BLOOMBERG (May 4, 2011, 12:01 AM), http://www.bloomberg.com/news/articles/2011-05-03/Levin-report-accusing-goldman-of-deception-referred-to-u-s-justice-sec.

[4] *See* Cedric Argenton & Eric Van Damme, *Optimal Deterrence of Illegal Behavior Under Imperfect Corporate Governance* 26 (Tilburg L. & Econ. Ctr., Working Paper No. 2014-053, 2014), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2540155 (arguing that personal liability is needed in addition to firm-level liability to reach the optimal level of deterring corporate moral hazard).

Andersen, for example, caused tens of thousands of employees to lose their jobs.[5] Firm-level liability can also hurt innocent stockholders and creditors, who will suffer a loss in the value of their securities.

II. SYSTEMIC RISK IS COMPLICATING WHAT RISK-TAKING IS EXCESSIVE

To understand why post-financial crisis prosecution has focused so heavily on firm-level liability and not personal liability, I have been examining changes that may be impeding the imposition of personal liability for excessive corporate risk-taking.[6] One of the most important changes, which I would like to speak about today, is that systemic risk is complicating the very concept of "excessive" risk-taking.

Our increasingly competitive and complex global economy requires firms to take ever greater risks to innovate and create economic value. Because unsophisticated attempts to curtail corporate risk-taking could inadvertently destroy that value,[7] it is critical to be able to distinguish appropriate from excessive risk-taking.

Until the Financial Crisis, it seemed relatively easy to make that distinction by taking into account the consequences of corporate risk-taking. Most observers assumed that a firm's failure would primarily, if not exclusively, harm its investors. Accordingly, corporate risk-taking was assessed—and therefore "excessive" risk-taking was implicitly defined—by its potential

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[5] Robert Hennelly, *Has General Motors Learned Its $900 Million Lesson?*, CBS NEWS (Sept. 18, 2015, 3:48 PM), http://www.cbsnews.com/news/has-general-motors-learned-its-lesson/.

[6] *See generally* Schwarcz, *supra* note 1.

[7] *See* Eduardo Porter, *Recession's True Cost Is Still Being Tallied*, N.Y. TIMES (Jan. 21, 2014), http://www.nytimes.com/2014/01/22/business/economy/thecost-of-the-financial-crisis-is-still-being-tallied.html (observing that regulations that require financial institutions to increase capital cushions to buffer against risks and potential losses have been criticized for cutting into global economic output and reducing jobs).

impact on those investors, typically focusing on the tension between risk-seeking shareholders and more risk-averse creditors.[8]

In most circumstances, the interests of shareholders would trump those of creditors,[9] who, nonetheless, could try to bargain to protect their (risk-averse) interests through contractual covenants in their loan agreements. The responsibilities of a firm's managers, who run the firm as agents for the investors, to engage in corporate risk-taking were therefore primarily driven by shareholder interests. Moreover, the enforcement of those responsibilities was delegated to privately enforced rights, through such means as shareholder derivative suits.

Systemic risk—in this context, the risk that a financial firm's failure will impact other financial firms or markets, resulting in a domino-type collapse that ultimately harms the real economy—is complicating corporate risk-taking, creating ambiguity about what amount of risk-taking is excessive and confusing even corporate law experts about when risk-taking that causes a firm to fail should be penalized as excessive.[10]

The substantive source of confusion is that the failure of a "systemically important" firm can harm not only its investors but also, by triggering a systemic collapse, the public at large. Current law does not require firms to fully internalize that cost. As a result, a firm may well decide to engage in a transaction that is expected to be profitable—thereby favorable to its investors and thus appropriate corporate risk-taking under existing corporate

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[8] *See, e.g.*, Steven L. Schwarcz, *Rethinking a Corporations Obligations to Creditors*, 17 CARDOZO L. REV. 647, 679 (1996). Shareholders tend to be risk-seeking because they typically benefit fully from an increase in a firm's value but only are harmed by a decrease. Creditors tend to be more risk-averse because they typically do not benefit from an increase in a firm's value and are harmed by a fall in the firm's value that causes insolvency. *Id.* at 674.

[9] *See id.* at 665 ("In general, directors of a solvent corporation owe fiduciary obligations solely to shareholders.").

[10] Wulf A. Kaal & Richard W. Painter, *Initial Reflections on an Evolving Standard: Constraints on Risk Taking by Directors and Officers in Germany and the United States*, 40 SETON HALL L. REV. 1433, 1438, 1441, 1465 (2010) (observing the controversy over "whether there is any such thing as excessive risk, and if so, how excessive risk is to be defined").

governance law—even though doing so could increase systemic risk, since much of the harm from a resulting systemic collapse would be externalized onto other market participants, as well as onto ordinary citizens impacted by an economic collapse.[11]

Nobody is speaking for the public's interest in avoiding systemic harm when firms engage in corporate risk-taking. That voice needs to be heard.

III. WHAT SHOULD BE DONE?

I have separately examined various ways to impose personal liability in order to control and internalize the costs of excessive corporate risk-taking.[12] I am also separately considering the extent to which imposing personal liability should supplement, or substitute for, other ways of regulating control of that risk-taking.[13] Today's talk focuses on imposing a public governance duty, assuming, arguendo, that should at least supplement other ways of regulating excessive risk-taking.

A. IMPOSING A PUBLIC GOVERNANCE DUTY

Because corporate risk-taking can impact the public in addition to impacting investors, one way of controlling excessive risk-taking would be to require the managers of a systemically important firm to run the firm as agents, not merely for the investors, but also for the public. To that extent, such managers would not only have a

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[11] This could be described as a type of "tragedy of the commons," insofar as market participants suffer from the actions of other market participants. Robert T. Miller, *Oversight Liability for Risk Management Failures at Financial Firms*, 84 S. CAL. L. REV. 47, 110 (2010). But it also is a more standard externality insofar as non-market participants (i.e., the ordinary citizens impacted by an economic collapse) suffer from the actions of market participants. Steven L. Schwarcz, *Controlling Financial Chaos: The Power and Limits of Law*, 2012 WIS. L. REV. 815, 821.

[12] *See generally* Schwarcz, *supra* note 1.

[13] Steven L. Schwarcz, *Misalignment: Corporate Risk-Taking and Public Duty* (Duke Law Sch. Pub. L. & Legal Theory, Series No. 2015-40, 2015), http://www.ssrn.com/abstract=2644375.

private corporate governance duty to investors but also a public corporate governance duty to society (public governance duty) not to engage in excessive risk-taking that could harm the public.[14] Managers who breach this public governance duty should then be—just as managers who breach their private governance duty to investors already are—subject to personal liability for breach of their principal-agent relationship.

This reformulation of corporate governance law raises several practical questions about how a firm's managers should perform their public governance duty:

- How should managers assess the potential impact on the public of corporate risk-taking?
- How should managers balance public costs and private benefits when deciding whether the firm should engage in a given risk-taking activity?
- Who should actually sue to impose personal liability on managers who breach their public governance duty by engaging their firms in excessive risk-taking?

Consider these questions in turn.

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[14] *Cf.* John Carney, *Big-Bank Board Game Puts Shareholders in Second Place*, WALL ST. J. (Apr. 5, 2015, 1:36 PM) (noting a speech by U.S. Federal Reserve Governor Daniel Tarullo suggesting that "corporate governance would need to change to broaden the scope of boards' fiduciary duties to reflect macroprudential [, i.e., systemic,] regulatory objectives"). The nation of Iceland has actually enacted legislation that appears to require, at least in principle, the managers of at least certain systemically important firms to "operate[ ] . . . [their firms] in the interests of . . . shareholders . . . and the entire economy." Act on Financial Undertakings (Act. No. 161/2002) (Ice.) (unofficial English translation), *available at* http://eng.atvinnuvegaraduneyti.is/laws-and-regulations/nr/nr/7366. The Dean of the University of Iceland's law faculty believes this law "puts clear constraints on the directors and managers" of those firms and "underlines the difference between" those firms "and other companies that usually have the only purpose of increasing shareholder value." E-mail from Professor Eyvindur G. Gunnarsson, Dean, Faculty of Law, Univ. of Ice., to author (Feb. 14, 2015, 6:28 PM) (on file with author).

B. ASSESSING THE POTENTIAL IMPACT ON THE PUBLIC

How should managers assess the potential impact on the public of corporate risk-taking? As with any other type of corporate action, it is difficult, *ex ante*, to precisely predict *ex post* consequences. That difficulty would likely be even greater when predicting consequences to the public, not merely to the firm and its investors.

In the traditional corporate governance context, managerial decisions—including risk-taking decisions—are protected to some extent by the business judgment rule, which presumes that managers should not be personally liable for harm caused by negligent decisions made in good faith and without conflicts of interest—and, in some articulations of the business judgment rule, also without gross negligence.[15] On its face, at least, the business judgment rule should apply to managers trying to predict consequences to the public of corporate risk-taking. But given those public consequences, should the business judgment rule be modified to make it easier to impose personal liability for excessive risk-taking that causes systemic harm?

In a traditional context (i.e., without regard to systemic risk), at least two scholars have considered and rejected arguments to weaken the business judgment rule for excessive risk-taking. Professor Christine Hurt has rejected any such weakening of the rule as imprudent and, insofar as the exercise of managerial business judgment is inappropriate for court review, unmanageable.[16] She also has said that it would be inconsistent with corporate law principles to impose personal liability for poor managerial judgment. It should be up to shareholders, she has argued, to evaluate corporate risk through their investment

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[15] Christine Hurt, *The Duty to Manage Risk*, 39 J. CORP. L. 253, 258–59 (2014).
[16] *Id.* at 259–60, 289–91.

decisions, not through litigation.[17] Professor Robert Miller has adopted similar arguments in rejecting any such weakening of the business judgment rule.[18]

To the extent those arguments assume that shareholders evaluate risk through their investment decisions, the arguments are irrelevant to the question of imposing personal liability for excessive risk-taking that causes public harm. A firm's shareholders would have no incentive—and thus are highly unlikely no matter what the liability standard—to sue managers for engaging in excessively systemically risky actions. To the contrary, shareholders generally want their firms to take potentially profitable risks, regardless of the possible systemic impact.

Nonetheless, the inappropriate-for-court-review part of those arguments should have merit no matter who, a shareholder or a government prosecutor, is attempting to impose personal liability. It generally would be impractical for a judge, who typically lacks business experience, to review business management decisions.

For two reasons, however, I believe that the public interest requires some weakening of the business judgment rule. Members of the public, unlike shareholders, cannot mitigate their harm by voting to replace managers or selling stock. Even more significantly, public harm breaches one of the basic assumptions of the business judgment rule's application—that there be no conflict

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[17] *Id.* at 258 ("[S]hareholders can sell shares of companies that are poorly managed, and companies can fire poorly performing managers; imposing liability through a shareholder suit is the least efficient way to discipline management.").

[18] Miller, *supra* note 11, at 103 ("Legally, any meaningful expansion of Caremark liability would amount to a revolution in Delaware law tantamount to repealing the business judgment rule, a result that would be so obviously inefficient as to be incontrovertibly out of the question. Economically, even apart from the inefficiencies involved in repealing the business judgment rule, the desired expansion of Caremark to control so-called excessive risk taking would be misguided because the kinds of excessive risk taking that expanded oversight liability are not the kinds of excessive risk taking that may have contributed to the financial crisis.").

of interest.[19] The interest of a manager who holds significant shares or interests in shares, or whose compensation or retention is dependent on share price, is aligned with the firm's shareholders, not with that of the public. To that extent, the manager would have a conflict of interest.[20]

Managers who are conflicted in that way should not be given quite the same absolute deference that the business judgment rule gives non-conflicted managers. I therefore argue that the rule should not protect conflicted managers who are grossly negligent—that is, who fail to use even slight care.

Technically, this approach does not even change the business judgment rule; it merely applies the gross negligence standard that is articulated as part of that rule, though rarely utilized with any rigor. And because courts routinely review whether other types of actions are grossly negligent,[21] they should not find it inappropriate or impractical to review corporate risk-taking actions under a gross negligence standard. As a practical matter, furthermore, managers who follow a reasonable procedure to balance public costs and private benefits—perhaps one akin to the procedure next discussed—should be protected.[22]

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[19] Rachel E. Schwartz, *The Clawback Provision of Sarbanes-Oxley: An Underutilized Incentive to Keep the Corporate House Clean*, 64 BUS. LAW. 1, 31 n.202 (2008) ("Of course, deference, in the form of the business judgment rule, is given to management decisions in the absence of a conflict of interest between managers and shareholders." (citing Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984))).

[20] I recognize that courts applying the business judgment rule usually look for conflicts of interest between managers, on the one hand, and the firm and its shareholders, on the other hand. Logically, however, if, as this Article argues, the managers should also have a duty to the public, then the notion of conflicts should be broadened to include conflicts between managers, on the one hand, and the public, on the other hand.

[21] *See, e.g.*, John Schwartz, *Judge's Ruling on Gulf Oil Spill Lowers Ceiling on the Fine BP is Facing*, N.Y. TIMES (Jan. 15, 2015), http://www.nytimes.com/2015/01/16/business/energy-environmen/judge-sets-toppenalty-for-bp-in-deepwater-horizon-spill-at-nearly-14-billion.html?_r=0 (observing that Judge Carl J. Barbier of the Federal District Court in New Orleans found BP grossly negligent in causing the 2010 Gulf of Mexico oil spill).

[22] That would effectively conform the business judgment rule's application to a duty of process care, the standard commonly used in the United States.

C. BALANCING PUBLIC COSTS AND PRIVATE BENEFITS

How should managers balance public costs and private benefits when deciding whether the firm should engage in a given risk-taking activity? I have considered a somewhat parallel question in the context of examining how managers of a firm in the "vicinity of insolvency," who then run the firm as agents not only for the shareholders but also for the creditors, should balance their *ex ante* assessment of costs to creditors and benefits to shareholders when deciding whether the firm should engage in a given risk-taking activity.[23] In that context, I argued that "where non-comparable commodities of benefit and harm to different parties are being weighed, the benefit may have to considerably outweigh the harm . . . to be justified."[24]

That approach follows a cost-benefit balancing that includes a semi-strong form of the precautionary principle. Precautionary principles are applied when balancing the costs and benefits of activities that can pose great harm—which in our case would be systemic harm. The "considerably outweigh" requirement not only shifts the burden to prove that the risk-taking activity should be permitted to the proponent of that activity but also requires a margin of safety.[25] This same approach could be used to balance the public costs and private benefits of corporate risk-taking.

Using this approach, excessive corporate risk-taking should mean risk-taking for which the private benefits to investors are not expected to considerably outweigh any systemic costs to the public. Managers who engage systemically important firms in such risk-taking would have violated their public governance duty and thus should be subject to personal liability. The managers

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[23] Schwarcz, *supra* note 8, at 669–77.

[24] *Id.* at 676–77.

[25] *See generally* Cass R. Sunstein, *Beyond the Precautionary Principle*, 151 U. PA. L. REV. 1003 (2003) (discussing an use of a precautionary principle that includes provision for a margin of safety in regulatory efforts).

nonetheless should be protected by the business judgment rule if they acted in good faith and without gross negligence.

One might ask why a normative analysis should ever weigh costs and benefits to different parties—in our case, a firm's investors and the public. One answer is that public policymaking—and indeed the very notion of cost-benefit analysis—relies on the Kaldor-Hicks concept of efficiency, under which a public project is regarded as efficient if its overall benefits exceed its overall costs regardless of who bears the costs and who gets the benefits.[26] Admittedly, Kaldor-Hicks efficiency implicitly assumes that the distribution of benefits and costs is not controlled by the party—in our case, a firm's managers—also controlling the decision whether to engage in the project.[27] But those managers do not completely control the distribution of benefits; the public usually benefits, at least indirectly, from corporate risk-taking that benefits investors.

Next consider expected value examples of how that weighing of costs and benefits could be done. Assume a systemically important firm is considering engaging in a risky project that could be profitable. The firm's managers value in good faith the following outcomes. They also perform at least a minimally appropriate inquiry to reach their valuations. That would enable them to be protected by the business judgment rule if, in retrospect, they made incorrect valuations.

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[26] RICHARD A. POSNER, ECONOMIC ANALYSIS OF LAW § 1.2 (6th ed. 2003).

[27] ROBIN PAUL MALLOY, LAW IN A MARKET CONTEXT 190–91 (2004). Kaldor-Hicks efficiency aims to maximize society's aggregate utility. *Id.* Legal reasoning concerning non-voluntary or non-consensual transactions employs the Kaldor-Hicks test as a hypothetical efficiency standard in considering "what rules and institutional mechanisms might best advance social welfare." *Id.* at 191. Additionally "[w]hen a right is protected by a liability rule it is subject to Kaldor-Hicks efficiency analysis and can be subject to a forced exchange if social utility can be enhanced." *Id.*

Expected value of the project to investors (usually the shareholders)
[(X% chance of project being successful) x $\$Y$ profit from that success] – [(1-X% chance of project being unsuccessful) x $\$W$ loss from that failure]

Expected value of the project's systemic costs
[(1-X% chance of project being unsuccessful) x F% chance of firm failing as a result of the project being unsuccessful x $\$Z$ resulting systemic costs][28]

What values should management use? Most of these values would be pure business judgments about which the firm's managers should have sufficient information, or at least much more information than third parties. For example, those managers should have much more information than third parties about valuing X%, the chance of the project being successful; $\$Y$, the profit from that success; $\$W$, the loss from the project's failure; and F%, the chance of the firm failing as a result of the project's failure (i.e., effectively as a result of the $\$W$ loss).

The exception, however, is the value for $\$Z$, the systemic costs if the firm fails. Government financial regulators are likely to know much more about valuing $\$Z$ than the firm's managers. That valuation should therefore be a public policy choice.

As a policy matter, there could be several possible ways of valuing $\$Z$. One approach would be to assume that the firm actually fails, with a systemically negative impact to the real economy. That would yield an indeterminate but potentially huge number for $\$Z$. But that valuation approach could be misleading

[28] This equation has been simplified. The full equation would be [(1-X% chance of project being unsuccessful) x F% chance of firm failing as a result of the project being unsuccessful x $\$Z$ resulting systemic costs] + [(X% chance of project being successful) x A% chance of firm failing as a result of the project being successful x $\$B$ resulting systemic costs]. However, A%, the chance of the firm failing as a result of the project being successful, is likely to be zero.

for at least two reasons. First, the failure of any given firm, no matter how large, would be unlikely by itself to be the sole cause of a major financial crisis; even Lehman Brothers' failure did not, by itself, cause the Financial Crisis.[29] Second, at least in the United States, the "living will" requirement under the Dodd-Frank Act is intended to minimize the systemic consequences of any given systemically important firm's failure.[30]

A more plausible way to value *$Z* would be to estimate the costs of the firm's failure to its immediate counterparties. The rationale for this approach is that first-order systemic consequences are much more likely to result from a systemically important firm's failure than a full-blown financial collapse.[31] Such a cost estimate was done for the possible failure of Long-Term Capital Management (LTCM), a large hedge fund whose losses in the Russian bond market brought it close to default.[32] Analysts at JP

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[29] *See* Edward J. Estrada, *The Immediate and Lasting Impacts of the 2008 Economic Collapse—Lehman Brothers, General Motors, and the Secured Credits Markets*, 45 U. RICH. L. REV. 1111, 1115 (2011) (listing the collapse of Lehman Brothers as one of many factors contributing to the global financial crisis).

[30] Jennifer Meyerowitz et al., *A Dodd-Frank Living Wills Primer: What You Need to Know Now*, 31-AUG. AM. BANKR. INST. J. 34, 34 (2012) ("As part of the goal to remove the risks to the financial system posed by 'too big to fail' institutions, § 165(d) of the Dodd-Frank Act requires 'systemically important financial institutions' to create 'living wills' to facilitate 'rapid and orderly resolution, in the event of material financial distress or failure.' " (internal quotations omitted)).

[31] This is especially true after the implementation of Dodd-Frank, which seeks to avoid systemic disruptions in the event of a failed institution. As former FDIC Chair Sheila Blair explained, "[T]he FDIC has come up with a viable strategy for resolving a large complex financial institution . . . . The FDIC will take control of a holding company and put creditors and shareholders into a receivership where they, not taxpayers, will absorb any losses. This will allow the subsidiaries to remain operational, avoiding systemic disruptions, as the overall entity is unwound over time. Mike Konczal, *Sheila Blair: Dodd-Frank Really Did End Taxpayer Bailouts*, WASH. POST (May 18, 2013), https://www.washingtonpost.com/news/wonk/wp/2013/05/18/sheila-bair-dodd-frank-really-did-end-taxpayer-bailouts/.

[32] *Cf.* Cheryl D. Block, *Measuring the True Cost of Government Bailout*, 88 WASH. U. L. REV. 149, 164 (2010) (observing that the Federal Reserve Bank facilitated "private market solutions" by bringing "private lenders and investors together to work out a rescue plan for Long Term Capital Management" (LTCM)); Steven L. Schwarcz, *Systemic Risk*, 97 GEO. L.J. 193, 201 (2008).

Morgan estimated that LTCM's failure would have cost its larger bank-creditors $500–$700 million each.[33]

Another plausible way to value *$Z* would be to base it on the estimated cost of a government bailout to avoid a systemic failure. I will use this approach as an example, assuming for illustrative purposes that the firm's bailout cost would be $500 million. I'll also assume that the firm's managers estimate the other values as follows:

> *X%* (the chance of the project being successful) = 80%.
> *$Y* (the profit from that success) = $50 million.
> *$W* (the loss from the project's failure) = $20 million.
> *F%* (the chance of the firm failing as a result of the project's failure) = 10%.

Again, these values are solely illustrative. They rely on no hard empirical data, and a quantitative analysis is no better than its assumptions.

Applying these values to the expected value equations yields the following:

> <u>*Expected value of the project to shareholders*</u>
> = [(80% chance of project being successful) x $50 million profit from that success] – [(20% chance of project being unsuccessful) x $20 million loss from that failure]
> = $36 million
>
> <u>*Expected value of the project's systemic costs*</u>
> = [(20% chance of project being unsuccessful) x 10% chance of firm failing as a result of the project being unsuccessful x $500 million resulting systemic costs]
> = $10 million

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[33] Schwarcz, *supra* note 32, at 237.

If these values are realistic, the $36 million expected value to investors would considerably outweigh the $10 million expected systemic harm to the public. A systemically important firm that undertakes the risky project in question would not therefore be engaging in excessive risk-taking.[34]

Much will depend on valuing *$Z*, the systemic cost if the firm fails. In my example, if *$Z* were estimated at $1.5 billion (rather than $500 million), the expected value of the project's systemic costs would equal $30 million.[35] Managers of a systemically important firm that undertakes the risky project in question might then be charged with excessive risk-taking because the expected value of the private benefit ($36 million) to investors would not considerably outweigh the $30 million expected value of the systemic costs to the public.

D. SUING TO IMPOSE LIABILITY FOR BREACH OF THE PUBLIC GOVERNANCE DUTY

Who should actually sue to impose personal liability on managers who breach their public governance duty? Under existing corporate governance law, shareholder derivative suits are the primary means to impose liability on managers.[36] Shareholders would have no interest, however, in imposing liability on managers of their firm for externalizing systemic harm. Therefore, the government, by default, should have the right to impose that liability.

I also argue that members of the public themselves should be authorized and incentivized to sue. As a precedent, *qui tam* suits

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[34] *Cf. supra* note 22 and accompanying text (explaining that managers who follow a reasonable procedure to balance public costs and private benefits should be protected, thereby effectively conforming the business judgment rule's application to a duty of process care).

[35] As mentioned, the valuation of *$Z* should be a public policy choice. If (as I suggest) that valuation is based on the estimated cost of a government bailout to avoid a systemic failure, the process of designating a firm systemically important could include estimating that cost.

[36] *See supra* note 1.

under the False Claims Act are the primary litigation tool for combating fraud against the federal government. That Act permits private citizens to sue alleged defrauders in the name of the United States government.[37] If the suit is successful or settled, the citizen-plaintiff is entitled to as much as 30% of the award or settlement.[38]

These types of lawsuits raise a standing question; the citizen-plaintiff "suffers no injury" and thus would appear to lack the "injury in fact" required to create Article III standing under the U.S. Constitution.[39] Nonetheless, the Supreme Court has found standing through a somewhat circular argument—that the Act's "partial assignment of the federal government's claim to the [citizen-plaintiff]" provides a sufficient stake in the outcome to create Article III standing.[40]

That same circular argument could justify citizen standing to sue to impose personal liability on managers who breach their public governance duty, if those citizen-plaintiffs were entitled to a percentage of the award or settlement. Moreover, those citizen-plaintiffs would have an additional standing claim: as members of the public, they would be directly harmed by a systemically important firm's collapse.

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[37] David Freeman Engstrom, *Private Enforcement Pathways: Lessons from Qui Tam Litigation*, 114 COLUM. L. REV. 1913, 1944 (2014).

[38] *Id.*

[39] Richard A. Bales, *A Constitutional Defense of Qui Tam*, 2001 WIS. L. REV. 381, 384.

[40] *Id.*