Clients&FriendsMemo

Caremark and "Mission-Critical" ESG Company Operations

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I. Introduction

Companies are increasing pressure to address environmental, social, and governance ("ESG") issues. ESG topics have taken center stage in boardrooms, with regulatory agencies, and in the media.[1] For example, BlackRock CEO Larry Fink recently reiterated his support for "stakeholder capitalism," emphasizing that "[a]s stewards of our clients' capital, we ask businesses to demonstrate how they're going to deliver on their responsibility to shareholders, including through sound environmental, social, and governance practices and policies."[2] During 2021, the Securities and Exchange Commission asked "staff to evaluate [its] disclosure rules with an eye toward facilitating the disclosure of consistent, comparable, and reliable information on climate change" and welcomed public comment on the matter.[3] In Europe, 60 organizations representing EUR 8.5 trillion in assets – including Allianz, Deloitte, Deutsche Bank, Nasdaq, and PwC – signed an open letter to the European Union encouraging regulators to promote "high-quality ESG standards[.]"[4] And in Asia, Goldman Sachs "more than tripled" its ESG investments in an effort to respond to client needs to reduce greenhouse gas emissions.[5]

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1 *See*, *e.g*., *Thomas Ball, et al*., "Was the Exxon Fight a Bellwether?" Harvard Law School Forum on Corporate Governance (July 24, 2021); Al Barbarino, Top SEC Official Suggests More ESG Enforcement is Coming, Law360, July 13, 2021, https://www.law360.com/articles/1402762/top-sec-official-suggests-more-esg-enforcement-is-coming; Dawn Lim and Geoffrey Rogow, BlackRock at Odds With Warren Buffett's Berkshire Hathaway Over Disclosures, *Wall Street Journal*, May 6, 2021, https://www.wsj.com/articles/blackrock-at-odds-with-warren-buffetts-berkshire-hathaway-over-disclosures-11620306010.

2 Laurence Fink, "*The power of Capitalism*," BlackRock (Jan. 17, 2022), https://www.blackrock.com/corporate/investor-relations/larry-fink-ceo-letter.

3 Acting Chair Allison Herren Lee, "*Public Input Welcomed on Climate Change Disclosures*," U.S. Securities and Exchange Commission (Mar. 15, 2021), https://www.sec.gov/news/public-statement/lee-climate-change-disclosures.

4 60 Organizations Release Open Letter for EU to Act on ESG, World Economic Forum (Oct. 25, 2021), https://www.weforum.org/agenda/2021/10/57-organizations-release-open-letter-for-eu-to-act-on-esg/.

5 Cathy Chan, "*Goldman Triples Asia ESG Investments as Bets Start Paying Off*," Bloomberg (Dec. 16, 2021), https://www.bloomberg.com/news/articles/2021-12-17/goldman-triples-asia-esg-investments-as-bets-start-paying-off.

With that backdrop, it is no surprise that stockholder complaints over boards' handling of various ESG-related issues are making their way to the courtroom. Over the last few years, Delaware – whose law governs in many stockholder actions – has revitalized the viability of actions pleading director liability under the Court of Chancery's landmark decision in *In re Caremark Int'l Derivative Litigation*. There, the court expressly recognized the potential for directors to be held liable for breaching their fiduciary duties to a company for oversight failures where they did not implement or monitor internal control systems and the company faced subsequent lawsuits or regulatory penalties.[6] In *Caremark*, the board of a health care company allegedly failed to monitor the company's obligations under the federal Anti-Referral Payments Law, as well as various state laws, to prevent arrangements where an employee would compensate a health care provider in exchange for patient referrals.[7] Subsequent caselaw has since delineated two options for a plaintiff to successfully plead a "*Caremark* claim." In a "prong one" argument, a plaintiff can survive a motion to dismiss by pleading that the "directors utterly failed to implement any reporting or information system or controls."[8] In a "prong two" argument, a plaintiff can plead that even though the directors did implement "such a system or controls . . . [they] consciously failed to monitor or oversee its operations thus disabling themselves from being informed of risks or problems requiring their attention."[9] Historically, the "oversight" requirement of *Caremark* applied to financial-related controls and has been "difficult to plead and ultimately to prove out."[10] Now, Delaware courts have breathed new life into the doctrine, rejecting motions to dismiss in situations where a board of directors failed to conduct proper oversight of any aspect of a company's business, financial or otherwise, that is "mission-critical" to the company. And, these cases often have involved ESG-related *Caremark* claims addressing public health, pharmaceutical efficacy, environmental destruction, airplane safety, and workplace sexual harassment.

This article addresses Delaware courts' recent application of *Caremark* claims to ESG issues, and how stockholders are using—and will likely continue to use—*Caremark* to hold directors legally accountable for failures relating to their obligations to monitor "mission-critical" ESG aspects of a company. *Caremark* claims have a high pleading standard, described as "possibly the most difficult theory in corporation law upon which a plaintiff might hope to win a judgment."[11] Therefore, plaintiffs asserting *Caremark* claims, including novel ESG-related challenges, face an uphill battle. But Delaware courts lately have not dismissed such claims out of hand. Companies and their counsel should take stock of areas where plaintiffs may pursue such claims in the ESG context, and

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[6] *In re Caremark Int'l Inc. Derivative Litig.*, 698 A.2d 959 (Del. Ch. 1996).

[7] *Id.*

[8] *In re Boeing Co. Derivative Litig.*, No. CV 2019-0907-MTZ, 2021 WL 4059934, at *24 (Del. Ch. Sept. 7, 2021).

[9] *Id.*

[10] *Marchand v. Barnhill*, 212 A.3d 805, 820 (Del. 2019).

[11] *Id.* at 820.

take steps to shore up their internal controls and ensure they are adequately monitored, with any issues that arise promptly and appropriately addressed.

II. *Caremark's* Application to ESG Issues

Following the Delaware Supreme Court's 2019 decision in *Marchand v. Barnhill* challenging the board of directors' oversight of the safety of an ice cream company's ice cream production, Delaware courts have sustained, on motions to dismiss, *Caremark* claims alleging a variety of financial and non-financial problems where a board failed to properly oversee operations that are "mission-critical" to the company. In both *In re Clovis* and *Teamsters v. Chou*, plaintiffs successfully alleged that the boards of pharmaceutical companies failed to follow health and safety regulations imposed by the Food and Drug Administration (the "FDA"). *Inter-Marketing Group* addressed the obligation of the board of an oil company to oversee its pipeline operations and prevent oil spills. In *In re Boeing*, plaintiffs adequately pleaded that the board did not properly oversee the safety of its airline fleet and otherwise ignored public events demonstrating that a portion of its planes were unfit to fly. Lastly, this section discusses a derivative claim filed in January 2022 against McDonald's, which alleges that the company's inability to properly address reports of sexual harassment damaged a critical aspect of the company: its workforce and its workplace practices.

A. *Marchand v. Barnhill*

The case that initiated the revitalization of *Caremark* is *Marchand v. Barnhill*,[12] in which the Delaware Supreme Court reversed the Court of Chancery's dismissal of a derivative action that asserted, among other allegations, a *Caremark* claim relating to the alleged failure of the board of directors of Blue Bell Creameries USA Inc. ("Blue Bell") to provide effective oversight of the health and safety conditions of the company's ice cream production. In 2015, Blue Bell manufacturing facilities in a number of locations dealt with a *listeria* outbreak,[13] causing the company to recall its product line, temporarily shut down its manufacturing plants and eventually lay off over a third of its workforce. A stockholder brought a derivative action alleging breaches of the duty of care and loyalty against management and directors, contending that they "knowingly disregard[ed] contamination risks and fail[ed] to oversee the safety of Blue Bell's food-making operations."[14] The Court of Chancery dismissed the complaint because it found, among other things, that the plaintiff failed to plead the requisite particularized facts required under *Caremark* to show that Blue Bell neglected to adopt or implement appropriate compliance or reporting systems.

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[12] *Id.*

[13] *Listeria* is a "life-threatening bacteria." *Id.* at *808. Three people died as a result of the *listeria* outbreak at Blue Bell's manufacturers. *Id.* at *814.

[14] *Id.* at *807.

The Delaware Supreme Court reversed, stating that "[u]nder *Caremark*, a director may be held liable if she acts in bad faith in the sense that she made no good faith effort to ensure that the company had in place any 'system of controls.'"[15] Finding that the "complaint supports an inference that no system of board-level compliance monitoring and reporting existed at Blue Bell," the Court cited the following allegations:

1. no board committee existed to address food safety;
2. no regular process or protocols existed to require management to apprise the board of food safety compliance practices, risks, or reports;
3. no schedule existed for the board to consider key food safety risks on a regular basis;
4. management received reports containing what could be considered red, or at least yellow, flags, but the board minutes from the relevant period revealed no evidence that these reports were disclosed to the board;
5. the board was provided certain favorable information about food safety, but was not provided important reports containing adverse information; and
6. the board meetings were otherwise devoid of any suggestion that there was regular discussion of food safety issues.[16]

The board countered these facts by noting that Blue Bell did have "in place certain manuals for employees regarding safety practices . . . commissioned audits from time to time . . . [and] that the government regularly inspected Blue Bell's facilities." But key to the Delaware Supreme Court's analysis is that while Blue Bell on the whole may have "nominally complied with FDA regulations," this "does not imply that the *board* implemented a system to monitor food safety *at the board level*."[17] Indeed, *Caremark* imposes an obligation on the board to "make a good faith effort" to establish a board level monitoring system about a company's "central compliance risks" and what is "essential and mission critical" to its operations – for Blue Bell, this was ensuring the health and safety conditions of its ice cream manufacturing operations.

Accordingly, the Court held that the plaintiff adequately pleaded a *Caremark* claim for the mission-critical aspect of food safety to Blue Bell's operations. The case is currently stayed by agreement of the parties while a special committee of the board conducts an internal investigation.[18]

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[15] *Id.* at *822.

[16] *Id.*

[17] (emphasis in original). *Id.*

[18] Letter to Vice Chancellor Slights, *Marchand v. Barnhill, et al.*, C.A. No. 2017-0586-JRS, BL-104 (Sept. 27, 2019). That investigation has since been "delayed" while the former president of Blue Bell stands trial for charges related to the *listeria* outbreak. (*Id.*, BL-126).

B. *In re Clovis*

In re Clovis[19] addressed a motion to dismiss a derivative action alleging that the board of a pharmaceutical company, Clovis Oncology, Inc. ("Clovis"), failed to exercise proper oversight of the company's compliance with FDA regulatory standards for safety and efficacy when conducting a clinical trial to bring a pharmaceutical to market. Drawing on the Delaware Supreme Court's "explication of *Caremark* [claims] in *Marchand*,"[20] Vice Chancellor Slights denied a motion to dismiss the derivative action because the prospective pharmaceutical was "intrinsically critical to [Clovis]'s business operation" and the board "ignored multiple warning signs" that the trial was being mismanaged.[21]

Clovis was, at the time, an "upstart biopharmaceutical compan[y]" with "no products on the market and . . . no sales revenues[,]" but had developed a "promising" treatment for lung cancer.[22] Clovis entered the drug into clinical trials to obtain FDA approval, which required the company to follow certain trial protocols to measure success of the treatment.[23] The company was also aware that a rival entity had entered a similar treatment into clinical trials. "Mindful of the race to market," Clovis' management issued interim reports of its trial based on data of "unconfirmed" responses which, upon final analysis, had overstated the drug's efficacy.[24] Meanwhile, management presented analyses to the board showing that management "was not vigilantly following" trial protocol but, with "hands on their ears to muffle the alarms," the board signed an annual report that "reaffirmed previous, inflated" results of the drug's efficacy.[25] Only after the FDA "emphasized that it would credit only confirmed responses" in its efficacy analysis and "insisted Clovis comply" with proper trial protocol did Clovis issue a press release informing the public of the drug's accurate efficacy. Clovis' stock price "immediately dropped 70%, wiping out more than $1 billion in market capitalization."[26]

The Court found that plaintiffs successfully pleaded the requisite particularized facts to support the second prong of *Caremark*, including that the board was aware that its clinical trial guidelines conflicted with those of industry practice and that the board knew management was reporting

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

[20] *Id.* at *9.

[21] *Id.*

[22] *Id.* at *1 and *4.

[23] *Id.* at 4.

[24] *Id.* at *5-6.

[25] *Id.* at *7.

[26] *Id.* at *8.

inaccurate trial results but did nothing to ensure compliance with the FDA required trial protocols.[27] The Court concluded that, in drawing the required reasonable inferences in plaintiffs' favor at this stage of the proceedings, plaintiffs sufficiently pleaded that the board ignored red flags addressing the company's "mission critical regulatory issues."[28]

The court stayed the proceedings to allow for a special board committee to conduct an internal investigation.[29] Following the conclusion of its investigation, the special committee filed a motion to terminate this litigation on December 16, 2020.[30] Discovery is now ongoing.[31]

C. *Teamsters Local v. Chou*

In another derivative action addressing FDA health and safety regulations, the Court of Chancery considered in *Teamsters Local v. Chou*[32] a board's failure to monitor a pharmaceutical company's packaging and distribution of oncology medication. In doing so, the Court of Chancery reiterated that a *Caremark* claim will survive a motion to dismiss where the board failed to exercise effective oversight of a "mission critical" component of its operations. But where *Marchand* and *In re Clovis* each addressed a "monoline company" – a company whose revenue derives primarily from a single type of business operation – the Court of Chancery in *Teamsters* noted that the "concept of mission critical compliance risk" is still applicable to even a "relatively more complex corporation" than Blue Bell Creameries or Clovis.

In 2001, AmerisourceBergen Corporation ("ABC") acquired an oncology supply pharmaceutical company (the "Pharmacy") that sold single-dose, pre-filled syringes of oncology medication to treat immunocompromised patients. The process involved removing FDA-approved medications from their original glass vials and then "repackaging" them into single-dose syringes.[33] After removing the doses from the original FDA packaging, a small amount – known as "overfill" – remained. Medication manufacturers include "overfill" intentionally so as to avoid error in the administration of doses and to ensure there is a full amount of doses in each shipment. Normally, overfill "is not

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27 *Id.* at *13-14. The Court of Chancery rejected plaintiff's claims under *Caremark*'s first prong, noting that plaintiffs acknowledged the board had committees dedicated to "compliance oversight . . . with respect to Federal health care program requirements and FDA requirements." *Id.* at 13.

28 *Id.* at *13.

29 Order Extending the Stay, *In re Clovis Oncology, Inc. Derivative Litigation*, C.A. No. 2017-0222-JRS, BL-220 (Nov. 13, 2020).

30 Motion to Terminate, *In re Clovis Oncology, Inc. Derivative Litigation*, C.A. No. 2017-0222-JRS, BL-226 (Dec. 16, 2020).

31 *See In re Clovis Oncology, Inc. Derivative Litigation*, C.A. No. 2017-0222-JRS, BL-248 (Aug. 10, 2021).

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

33 *Id.* at *4.

intended for patient use."[34] Here though, the Pharmacy combined the small remaining "overfill" from different original glass vials to create extra doses. Throughout this entire process, neither the Pharmacy nor the facility that housed the single-dose vial program was properly registered with the FDA.[35]

Vice Chancellor Glasscock addressed the claims under a *Caremark* "prong two" analysis,[36] finding that ABC operated in a highly regulated industry in which laws and regulations addressing the safety of its medications are "the most central" concerns facing the company.[37] Accordingly, when such laws or regulations are at issue, a board of directors "must actively exercise its oversight duties."[38] Here, plaintiffs successfully alleged that the board consciously ignored the following red flags:

1. A request from the CEO for a capital expenditure program at the facility "whose sole business was to fill and distribute pre-filled syringes" did not "address any compliance or safety issues" related to the expenditure program and the board "did not consider or discuss" any relevant regulatory or compliance issues.[39]
2. A report solicited by a board director and conducted by a law firm to "undertake the assessment of the adequacy" of the company's regulatory compliance system and "recommend improvements"[40] showed that ABC's "mission critical compliance mechanisms . . . had substantial gaps." This "creat[ed] a void in which illegal activity [at the Pharmacy] could occur undetected."[41] The report put the board "on notice of gaps in . . . compliance" and yet the board took no remedial action.[42]
3. ABC's former Chief Operating Officer had raised concerns both internally and in a *qui tam* suit filed under seal in federal court regarding compliance failures, which were later disclosed in ABC's public filings, but the board of directors never took remedial action.[43]

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34 *Id.*

35 *Id*. at *5.

36 Determining that the claims could survive under *Caremark* prong two, the Court of Chancery did not undertake a *Caremark* prong one analysis. Vice Chancellor Glasscock briefly observed that the facts pled indicated that ABC "had a woefully inadequate compliance system" which reflected a "lax approach (at best) to compliance at ABC." *Id*. at *26.

37 *Id.* at *18.

38 *Id.*

39 *Id.* at *10.

40 *Id.*

41 *Id.* at *20.

42 *Id.*

43 *Id.* at *13.

4. The company received a subpoena from federal prosecutors regarding what ABC "believe[d] could be related to [the] qui tam action" but the board minutes did not reflect any discussion related to the subpoena.[44]

Following the Court's denial of the motion to dismiss, the parties agreed to temporarily stay the litigation to allow a special board committee to conduct an internal investigation.[45] After concluding its investigation, the special committee filed a motion to dismiss on September 22, 2021.[46] Discovery is now ongoing.[47]

D. *Inter-Marketing Group USA, Inc. v. Armstrong*

In *Inter-Marketing Group USA, Inc. v. Armstrong*,[48] the Court of Chancery addressed a motion to dismiss a derivative suit alleging *Caremark* claims resulting from an environmentally "disastrous oil spill."[49] In 2015, a pipeline operated by Plains All American Pipeline, L.P. corroded and then "ruptured and spilled 3,400 barrels of oil into an environmentally sensitive part of the west coast."[50] The total cost of the clean-up effort was $257 million.[51] Plaintiff alleged, under a *Caremark* prong one analysis, that there was no board-level system in place to monitor, "detect, report, and respond to [pipeline corrosion],"[52] or otherwise address its "mission-critical objective of maintaining pipeline integrity."[53]

The Court of Chancery first stated that while this case "concerns a master limited partnership," Plaintiff's claim "resembles oversight liability claims litigated" under *Caremark*.[54] The Court of Chancery recognized that a general partner's contractual obligations to act in "the best interests" of the company "imposes duties identical to those identified in *Caremark*."[55] Since the parties applied

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44 *Id.* at *24.

45 Order Granting Motion to Stay, *Teamsters Loc. 443 Health Servs. & Ins. Plan v. Chou*, No. CV 2019-0816-SG, BL-124 (Del. Ch. Nov. 10, 2020).

46 Motion to Dismiss, *Teamsters Loc. 443 Health Servs. & Ins. Plan v. Chou*, No. CV 2019-0816-SG, BL-145 (Del. Ch. Sept. 22, 2021).

47 *See Teamsters Loc. 443 Health Servs. & Ins. Plan v. Chou*, No. CV 2019-0816-SG, BL-151 (Del. Ch. Nov. 15, 2021).

48 *Inter-Mktg. Grp. USA, Inc. on Behalf of Plains All Am. Pipeline, L.P. v. Armstrong*, No. CV 2017-0030-TMR, 2020 WL 756965 (Del. Ch. Jan. 31, 2020).

49 *Id.* at *1.

50 *Id.*

51 *Id.*

52 *Id.* at *11.

53 *Id.* at *15.

54 *Id.* at *10.

55 *Id.*

a *Caremark* analysis in both their briefing and oral argument, the Court also analyzed the "contract-based oversight liability claims using *Caremark's* established framework."[56]

While the Court found that the board did have an established audit committee, the complaint adequately pled that the board "never discussed pipeline integrity" and the evidence further "supports the inference . . . that the audit committee failed to perform its duties."[57] True, the board did receive reports regarding general pipeline activity. But defendants never adequately responded to plaintiff's "assertion that the reports were devoid of substance" and that the board "never reviewed pipeline integrity policy and procedure."[58] Here, like in *Marchand*, "no system of board-level compliance monitoring and reporting existed."[59] Accordingly, Chancery denied the motion to dismiss.

The parties are now engaged in discovery proceedings.[60]

E. *In re Boeing*

In re Boeing[61] addressed a motion to dismiss a derivative action arising from two crashes of Boeing's 737 MAX airplanes: (1) the October 2018 crash of a plane departing from Indonesia (the "Lion Air Crash") and (2) the March 2019 failure of an airline taking off from Ethiopia (the "Ethiopian Airlines Crash"). The two incidents resulted in the loss of hundreds of lives. Plaintiffs alleged in their complaint that the board of directors "complete[ly] fail[ed] to establish[] a reporting system for airplane safety, or . . . turn[ed] a blind eye to a red flag representing airplane safety problems."[62] Finding that airplane safety "was essential and mission critical to Boeing's business, and [was] externally regulated,"[63] and that the board otherwise "acted in bad faith by consciously disregarding its duty to address" airline safety,"[64] Vice Chancellor Zurn drew upon *Marchand*, *In re Clovis*, and *Teamsters* to deny the motion to dismiss under both *Caremark* prong one and prong two analyses.

The Court of Chancery first addressed *Caremark* prong one, finding that airplane safety "'was essential and mission critical' to Boeing's business[.]"[65] Accordingly, the board of directors was

56 *Id.*

57 *Id.* at *13.

58 *Id.* at *14.

59 *Id.* at *13.

60 *See Inter-Marketing Group USA, Inc. v. Armstrong*, C.A. No. 2017-0030-PAF, BL-137 (Del. Ch. Jan, 22, 2021).

61 *In re Boeing Co. Derivative Litig.*, No. CV 2019-0907-MTZ, 2021 WL 4059934 (Del. Ch. Sept. 7, 2021).

62 *Id.* at *1.

63 *Id.* at *26.

64 *Id.* at *33.

65 *Id.* at *26.

required to "rigorously exercise its oversight function," but failed to do so in the following five instances:

1. The board had "no committee charged with direct responsibility to monitor airplane safety." The board of directors did have an audit committee, but it was focused on general management of risk, particularly financial risks, without any specific responsibility involving aviation failures.[66]
2. The board did not otherwise "monitor, discuss, or address safety on a regular basis," nor did the board regularly allocate meeting time to discuss airplane safety until after the Ethiopia Crash.[67]
3. The board had "no regular process or protocols requiring management to apprise the board of airplane safety." Instead, the board "only received ad hoc management reports" regarding safety.[68]
4. Management saw "red, or at least yellow, flags but that information never reached the board."[69]
5. The record supports an "explicit finding" of the requisite scienter. The board of directors itself confirmed in its own words that it should have put procedures in place to discuss safety information, but had failed to do so.[70]

Turning to *Caremark* prong two, Vice Chancellor Zurn found that the board must have been aware of the occurrence of the Lion Air Crash, a highly publicized newsworthy event, and yet waited a full week to request information about the disaster from management. Moreover, the board then held an "optional" call to address the Lion Air Crash, did not list it as an agenda item until the regular board meeting in December 2018, and then resolved to delay an internal investigation until after a regulatory investigation was completed.[71] The board abided by management's position that the 737 MAX was safe, the crash was an "anomaly" and should be treated as a public relations issue and litigation risk – but not as a safety issue threatening the entirety of the fleet of 737 MAX airplanes.[72] Accordingly, the Court found that plaintiffs adequately alleged that the board "acted in

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66 *Id.* at *26-27.

67 *Id.* at *27.

68 *Id.* at *28-29.

69 *Id.* at *31.

70 *Id.* at *32.

71 *Id.* at *34.

72 *Id.*

bad faith by consciously disregarding its duty to address" its obligations to address airline safety before the Ethiopian Airlines Crash.[73]

The Parties have since entered into a settlement agreement for $237.5 million[74] and have submitted a proposed final judgment to the Court of Chancery for approval.[75]

F. *In re McDonald's*

In a pending derivative action[76] against the McDonald's board of directors filed in late January 2022, a shareholder brought claims against the board of directors for breaches of its fiduciary obligations for "allowing a culture of harassment . . . to flourish" at the company's headquarters and restaurants throughout the United States.[77]

The complaint details how the McDonald's board "created an environment in which the 'Superstar Harasser' problem would flourish."[78] In 2015, the board selected a new CEO who "set an improper tone from the top" by creating a "party atmosphere" where male employees – including senior corporate executives" – "routinely" made female employees "feel uncomfortable."[79] The complaint alleges that the board was "indifferen[t]" to the CEO's behavior.[80] In 2018, the board "failed once again" to address reports of sexual misconduct that alleged that the McDonald's executive in charge of "cur[ing] gender representation gaps" had "harassed and grabbed a McDonald's employee . . . at a *human resources event*."[81] Throughout the company, "sexual misconduct became rampant" and there "were near constant revelations about sexual harassment

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73 *Id.* at *33.

74 Stipulation and Agreement of Compromise, Settlement, and Release, *In re the Boeing Company Derivative Litigation*, No. 2019-0907-MTZ, BL-363 (Del. Ch. Nov. 5, 2021).

75 [Proposed] Order and Final Judgment, *In re the Boeing Company Derivative Litigation*, No. 2019-0907-MTZ, BL-381 (Del. Ch. Jan. 24, 2022).

76 Verified Consolidated Stockholder Derivative Complaint, *In re McDonald's Corporation Stockholder Derivative Litigation*, No. 2021-0324-JRS, BL-83 (Del. Ch. Jan. 28, 2022).

77 *Id.* at 4.

78 *Id.* at 3-4. "Superstar Harasser" refers to a report issued by the an Equal Employment Opportunity Commission's Select Task Force on Harassment in the Workplace, which highlighted the problem of the "Superstar Harasser." These are "high-ranking and privileged individuals within a company [who] develop a 'self-view that they are above the rules[.]'" *Id.* at 2-3.

79 *Id.* at 5.

80 *Id.* at 4.

81 (emphasis in original). *Id.* at 5-6.

. . . at McDonald's restaurants."[82] But, the board did not respond or otherwise take action to "arrest this trend."[83]

The complaint appears to lay out claims under *Caremark*. Plaintiffs allege that the board engaged in "bad faith" conduct because it knew of the harassing behavior by McDonald's executives but instead kept the information secret, took no action to stop the harassment, and instead doled out a "lavish severance package" for these executives to "quietly leave the company."[84] Directors "knew" or were "notified" that these executives had violated company policy and yet allowed them to continue their inappropriate behavior.[85] Broadly, the directors "brush[ed] aside instances of sexual misconduct in the C-suite."[86] Additionally, the complaint alleges that the board held the power to regulate the workplace environment at its franchise restaurants and address reports of misconduct and harassing behavior, but failed to implement sexual harassment policies, procedures, and trainings.[87]

Seemingly drawing on *Marchand* and its progeny, plaintiffs here plead that McDonald's has acknowledged that the company's "workforce and workplace practices are *critical* to its success" but the board "accepted misconduct among its highest-ranking executives."[88] While the Court of Chancery has yet to issue an opinion in response to a likely motion to dismiss, this case should be watched closely to see if it builds off of *Marchand* to further delineate what is considered a mission-critical aspect of a company.

III. The Limits of *Caremark*

While courts have been willing to expand *Caremark* in some instances, the next two cases discussed below emphasize that *Caremark* claims remain difficult to plead. In *Richardson*, Vice Chancellor Glasscock dismissed claims that the board of directors did not properly oversee compliance with a deferred prosecutorial agreement and compliance with anti-money laundering ("AML") laws. In *Fisher*, Chancellor Bouchard dismissed claims that the board of directors failed to exercise proper oversight of the company's compliance with consumer protection laws. While the Court of Chancery granted motions to dismiss in each of these two cases, the Court faithfully applied *Marchand*.

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[82] *Id.* at 48.

[83] *Id.*

[84] *Id.* at 70.

[85] *Id.* at 70-71.

[86] *Id.* at 70.

[87] *Id.* at 73.

[88] (emphasis added). *Id.* at 17-18.

A. *Richardson v. Clark*

In *Richardson v. Clark*,[89] the Court of Chancery addressed a motion to dismiss a derivate suit brought by a shareholder of MoneyGram International, Inc. ("MoneyGram"), a company that facilitates the transfer of payments among businesses and individuals. The derivative suit claimed that the board failed to ensure that the company properly follow AML laws and a deferred prosecution agreement ("DPA") with the United States Department of Justice ("DOJ").

In 2012, MoneyGram had entered into a DPA with the DOJ and the U.S. Attorney's Office for the Middle District of Pennsylvania, stemming from accusations that MoneyGram had "fail[ed] to maintain effective AML procedures" and otherwise aided and abetted wire fraud.[90] As part of the DPA, MoneyGram was required to adopt certain AML compliance restrictions and provide $100 million in restitution payments for its users who were victims of fraud. But, as Vice Chancellor Glasscock stated, despite MoneyGram "taking these and other steps," fraud complaints from users actually increased.[91] As the DPA was set to expire in 2017, the DOJ found that MoneyGram had violated its requirements and imposed an amended DPA that required MoneyGram to abide by additional compliance requirements as well as contribute another $125 million in restitution payments.

Despite these allegations, the Court of Chancery dismissed plaintiff's complaint in its entirety, finding that plaintiff had failed to show the requisite particularized facts under *Caremark* that the board engaged in "bad faith" in its oversight responsibilities.[92] The Court found that, based on the allegations in the complaint, the directors had "ensured that a system of oversight and control was in place with regard to fraud and money laundering," including by spending "nearly $250 million on remedial measures over several years" and taking "numerous actions to improve anti-fraud and AML controls and to reduce the number of fraud complaints."[93] While these efforts ultimately failed, fraud complaints increased, and the DOJ imposed an amended DPA, the court found that plaintiff failed to plead that the board of directors did "nothing."[94] In fact, according to the complaint, the directors did the opposite. They implemented AML software and, after being made aware of problems with this technology, "scrapped [it] in favor of more efficient software."[95] As Vice Chancellor Glasscock wrote, a "failed attempt is not itself indicative of a bad-faith attempt."[96]

89 *Richardson as Tr. of Richardson Living Tr. v. Clark*, No. CV 2019-1015-SG, 2020 WL 7861335 (Del. Ch. Dec. 31, 2020).

90 *Id.* at *5.

91 *Id.* at *6.

92 *Id.* at *2.

93 *Id.* at *9.

94 *Id.* at *11.

95 *Id.* at *10.

96 *Id.* at *9.

Plaintiff also pled that the board of directors “affirmatively concealed” deficiencies with the AML software in its reports to the DOJ – in essence, plaintiff alleged that the board of directors did not issue proper disclosures when it wrote to the DOJ that it had “substantially completed” its obligations under the DPA after it replaced the failed AML software. But Vice Chancellor Glasscock disagreed, stating that merely “misrepresent[ing] problems with [the AML software] to the DOJ” did not rise to the level of “bad faith[.]”[97]

Vice Chancellor Glasscock highlighted the distinction between this case and his opinion in *Teamsters*. The key to analyzing these types of *Caremark* cases is whether the board of directors’ “*inaction* exhibited conscious disregard of their duty to act.”[98] In *Teamsters,* “no remedial action was alleged to have been taken” and the board “did nothing to correct the underlying mission critical compliance shortcomings.”[99] By contrast, here, plaintiff alleged that the board of directors took action but that action was “insufficient.”[100] Indeed, the DOJ itself “concede[d] that MoneyGram had made progress toward full compliance with the DPA during its term.”[101]

B. *Fisher v. Sanborn*

In *Fisher v. Sanborn*,[102] the Court of Chancery addressed a motion to dismiss a derivative complaint alleging that the board of LendingClub Corporation (“LendingClub”) had failed to oversee the company’s compliance with consumer protection laws. The claims stemmed from a Federal Trade Commission (“FTC”) suit against the company alleging that LendingClub “had engaged in unfair and deceptive practices with consumers.”[103] The Court of Chancery dismissed the complaint, finding that plaintiff had failed to alleged the “particularized facts” required under *Caremark*.[104]

In May 2016, the company disclosed that the board of directors had conducted an internal investigation that revealed “material weaknesses in [its] internal control over financial reporting.”[105] In that same month, LendingClub also received a Civil Investigative Demand (“CID”) from the FTC. The board’s risk committee was made aware of the CID by at least mid-September 2016 and, in November of that year, the company disclosed this information in a Form 10-Q.

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97 *Id.* at *10.

98 (emphasis in original). *Id.* at *11.

99 *Id.*

100 *Id.*

101 *Id.*

102 *Fisher on Behalf of LendingClub Corp. v. Sanborn*, No. CV 2019-0631-AGB, 2021 WL 1197577 (Del. Ch. Mar. 30, 2021).

103 *Id.* at *1.

104 *Id.* at *1.

105 *Id.* at *2.

Addressing the first prong of *Caremark*, Chancellor Bouchard stated that to be successful in its motion to dismiss, the board "must make a good faith effort – *i.e.*, try – to put in place a reasonable board-level system of monitoring and reporting."[106] The Court distinguished the facts here from *Marchand*, noting that plaintiff had acknowledged that LendingClub had "board-level reporting systems in place," namely an audit committee and a separate risk committee to monitor the company's policies regarding "operational, technology, security, legal, and compliance risk[.]"[107] Indeed, Chancellor Bouchard explicitly noted that the "facts here do not come close to the allegations [in *Marchand*] indicating a lack of board-level systems or controls."[108] Instead, Chancery found that "it reasonably cannot be said" that LendingClub's directors "made no good to faith effort to 'try'" to "monitor[] compliance with consumer protection laws."[109]

The Court also found that plaintiff failed to adequately plead the second *Caremark* prong. While plaintiff pointed to two purported red flags – the launch of the FTC investigation in May 2016 and presentations to the board showing an increasing number of customer complaints – Chancellor Bouchard found that the "issuance of a subpoena or the launch of a regulatory investigation does not 'necessarily demonstrate that a corporation's directors knew or should have known that the corporation was violating the law.'"[110]

Accordingly, Chancellor Bouchard dismissed the complaint in its entirety.

IV. Conclusion

Each of the discussed cases finding in favor of *Caremark* claims focus on ESG issues instead of financial oversight: plaintiffs adequately pleaded claims that a board failed to monitor the safety of food production, comply with pharmaceutical regulations, safeguard the environment, and protect its customers from airplane disasters. Another pending case would further apply *Caremark* to find a board obligation to implement controls that ensure a harassment-free workplace.

With stockholders' increasing focus on ESG issues, *Caremark* may be one way in which stockholders seek to invoke change or otherwise hold companies accountable. It is likely that stockholders will bring further claims regarding ESG-related issues, such as compliance with safety regulations, environmental metrics, discrimination and harassment, pay inequality, or other issues that can be considered "mission-critical" to a company. As a result, directors may wish to consider the following takeaways to ensure that appropriate control systems are implemented and monitored

106 *Id.* at *10.

107 *Id.*

108 *Id.* at *11.

109 *Id.*

110 *Id.* at *12.

by the board, and that committees are established to oversee and regularly report on newly created or amended ESG policies or commitments.

1. Directors – particularly those of monoline companies – should identify what is "mission-critical" to their company's operations.
2. Directors should create committees with specific responsibilities to oversee these "mission-critical" operations and submit regular reports to the board regarding these operations.
3. Should a "mission-critical" compliance issue be raised by a committee, directors must take good faith action to rectify the problem.
4. Courts may also consider highly publicized newsworthy or small, but accumulating, individual red flags when analyzing the requisite knowledge under *Caremark* "prong two." Accordingly, directors should take notice of public events or a series or pattern of small red flags and take appropriate action.
5. Good faith remedial actions – even those that are ultimately unsuccessful in addressing the underlying issue – can shield a board of directors from liability.

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