CAREMARK UNFROZEN: DELAWARE SUPREME COURT REVISITS OVERSIGHT CLAIMS

The Delaware Supreme Court recently took the opportunity to revisit *Caremark* with its *en banc* decision in *Marchand v. Barnhill*, No. 533, 2018 (Del. June 19, 2019). In *Marchand*, the Court reversed the dismissal of a stockholder derivative suit and found that the plaintiff sufficiently pled facts demonstrating that the board of directors of Blue Bell Creameries USA, Inc. had not satisfied its duty to exercise oversight over the corporation, which was an act of bad faith in breach of the duty of loyalty.

BACKGROUND

A shareholder of Blue Bell Creameries USA, Inc. ("Blue Bell") brought a derivative suit against company executives and directors after a listeria outbreak allegedly caused the deaths of three consumers and forced the company to issue a total product recall, to shut down certain operations, and to lay off a substantial portion of its workforce.

The plaintiff claimed that Blue Bell's board of directors breached its duty of loyalty under *In re Caremark International Inc. Derivative Litigation*, 698 A.2d 959 (Del. Ch. 1996) by failing to "institute a system of controls and reporting" regarding food safety. *Caremark* requires directors to "make a good faith effort to oversee the company's operations." This includes implementing a "reasonable system of monitoring and reporting about the corporation's central compliance risks" at the board level.

The Court of Chancery initially dismissed the plaintiff's claims, finding that the directors made a good faith effort to monitor food safety. However, the Supreme Court reversed the dismissal, rejecting the board's contention that they made a good faith effort by complying with FDA regulations, commissioning sporadic audits, and promulgating employee manuals regarding food safety practices. The Court made clear that mere

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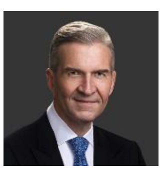
compliance with government regulation is distinct from implementing and monitoring an oversight system. Furthermore, the Court distinguished between the responsibilities of management and board-level reporting.

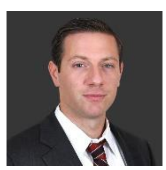
Under *Caremark*, boards must make a good faith effort to oversee a company's business operations. The Court noted that food safety was critical to the success of Blue Bell and the directors had an obligation to monitor the safety of its sole product, ice cream. According to the complaint, however, the Blue Bell directors had failed, among other things, to: (i) have a board committee to review food safety, (ii) establish a regular process requiring management to keep the board apprised of food safety compliance issues, (iii) regularly consider crucial food safety risks, and (iv) include evidence in their board minutes to show that they addressed the "yellow and red flags about food safety." Thus, while acknowledging that *Caremark* claims are difficult to plead and ultimately prove out, the Court found that the plaintiff pled sufficient facts to infer that the directors failed to make a good faith effort to monitor food safety, in breach of their duty of loyalty.

OUR VIEW

Marchand demonstrates the continued vitality of *Caremark* and the importance of board-level corporate oversight. The failure to establish a reasonable system of monitoring and reporting with respect to matters that pose significant risks to a particular company can potentially expose directors to liability for breach of the duty of loyalty. This should be an area of particular concern for directors—as exculpation and indemnification will not be available to protect individual directors in the event that they are ultimately found to be liable for such claims.


GEORGE CASEY
Global Co-Managing Partner
Head of Global M&A
+1 212 848 8787
gcasey@shearman.com


SCOTT PETEPIECE
Head of Global M&A
+1 212 848 8576
spetepiece@shearman.com


RICHARD FISCHETTI
Partner, M&A
+1 212 848 5179
rfischetti@shearman.com


DOREEN LILIENFELD
Global Head of Governance & Advisory
+1 212 848 7171
dlilienfeld@shearman.com


ALAN GOUDISS
Partner, M&A Litigation
+1 212 848 4906
agoudiss@shearman.com


JEFF HOSCHANDER
Partner, Litigation
+1 212 848 7181
jeff.hoschander@shearman.com

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