



DELAWARE COURT'S McDONALD'S OPINION: ANOTHER STEP IN CAREMARK'S INGESTION OF ALL CORPORATE LAW

by Stephen A. Bainbridge

In *In re McDonald's Corp. Stockholder Deriv. Litig.*,¹ Delaware Vice Chancellor Travis Laster ruled that the oversight duties the 1996 *Caremark*² decision imposed on corporate directors also apply to corporate officers. The decision exacerbates my longstanding concern that the scope of *Caremark* liability just keeps growing and growing.

At this point, I pause to ask readers unfamiliar with *Caremark* to visit my home blog, ProfessorBainbridge.com and read "[After Boeing, Caremark is no longer 'the most difficult theory in corporation law upon which a plaintiff might hope to win a judgment'](#)." That post will provide necessary background on *Caremark*'s growth.³

First, *Caremark* was wrong from the outset. In the original *Caremark* decision, the unique procedural posture of the case, which was such that it would not be appealed, gave Chancellor Allen an opportunity to write "an opinion filled almost entirely with dicta" that "drastically expanded directors' oversight liability."⁴ In doing so, Allen misinterpreted binding Delaware Supreme Court precedent and ignored the important policy justifications underlying that precedent.

Second, *Caremark* was further mangled by subsequent decisions. The underlying fiduciary duty was changed from that of care to loyalty, with multiple adverse effects. In recent years, moreover, there has been a steady expansion of *Caremark* liability. Even though the risk of actual liability probably remains low, there is substantial risk that changing perceptions of that risk induces directors to take excessive precautions.

The "[explosive](#)" *McDonald's* decision likely will accelerate that trend.

In brief, the allegations are that McDonald's chief Human Resources executive (Fairhurst) ignored red flags about a culture of sexual harassment in certain McDonald's locations and that Fairhurst himself committed sexual harassment.

The plaintiffs have sued Fairhurst for breach of the duty of oversight, and they also have sued Fairhurst for breaching his duty of loyalty by engaging personally in acts of sexual harassment.

¹ 2021-0324-JTL, 2023 WL 387292 (Del. Ch. Jan. 26, 2023).

² *Caremark International Inc. Derivative Litigation*, 698 A.2d 959 (Del. Ch. 1996).

³ For those wishing still more on why *Caremark* was wrong from the outset and has grown into a massive mistake, I refer you to Stephen A. Bainbridge, [Don't Compound the Caremark Mistake by Extending it to ESG Oversight](#), 77 Bus. Law. 651 (2022).

⁴ Todd Haugh, [Caremark's Behavioral Legacy](#), 90 Temp. L. Rev. 611, 618 (2018).

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The opinion is long with an exhaustive history of *Caremark's* evolution. But three paragraphs capture the gist:

This decision clarifies that corporate officers owe a duty of oversight. The same policies that motivated Chancellor Allen to recognize the duty of oversight for directors [in *In re Caremark International Inc. Derivative Litigation*] apply equally, if not to a greater degree, to officers. The Delaware Supreme Court has held that under Delaware law, corporate officers owe the same fiduciary duties as corporate directors, which logically includes a duty of oversight. Academic authorities and federal decisions have concluded that officers have a duty of oversight.

The fact that corporate directors owe a duty of oversight does not foreclose officers from owing a similar duty. Just as a junior manager with supervisory duties can report to a senior manager with supervisory duties, so too can an officer with a duty of oversight report to a board of directors with a duty of oversight. And just as a senior manager with supervisory duties can hold a junior manager accountable for failing to fulfill the junior manager's supervisory duties, so too can a board with a duty of oversight hold an officer accountable for failing to fulfill the officer-level duty.

Although the duty of oversight applies equally to officers, its context-driven application will differ. Some officers, like the CEO, have a company-wide remit. Other officers have particular areas of responsibility, and the officer's duty to make a good faith effort to establish an information system only applies within that area. An officer's duty to address and report upward about red flags also generally applies within the officer's area, although a particularly egregious red flag might require an officer to say something even if it fell outside the officer's domain. As with the director's duty of oversight, establishing a breach of the officer's duty of oversight requires pleading and later proving disloyal conduct that takes the form of bad faith.

VC Laster seemingly was determined to make that arguably unprecedented jump (he devotes a lot of the opinion to the question of whether it had precedents), as he rewrote the plaintiffs' complaint for them. Plaintiffs had alleged Fairhurst breached his duty of care, which Laster acknowledged was "insufficient" to trigger *Caremark* liability, which requires a showing that the defendant acted in bad faith and thereby breached his duty of loyalty. Because Delaware has adopted notice pleading, the question "is whether the complaint contained a short, plain statement of facts sufficient to support a claim against Fairhurst for breach of the duty of oversight," which VA Laster concluded it had done.

There is a certain logic to Laster's conclusion. After all, in general, Delaware law holds that officers have the same fiduciary duties as directors.

But at every step along the way there has been a certain logic to the expansion of *Caremark*, which raises the question of whether at some point we have to wonder if we want *Caremark* to swallow the whole of corporate law.

Caremark started out as a logical consequence of *Smith v. Van Gorkom*. Directors must make informed decisions, which means they must ensure there are systems in place to provide them with the information necessary to making a fully informed decision. Most of what directors do, however, consists of supervision and oversight not discrete decision making. So, it was logical to say that directors needed to ensure the corporation had information and reporting systems sufficient to ensure their monitoring efforts would detect wrongdoing at lower levels of the corporation.

But what sort of wrongdoing? *Caremark* started out as dealing with law and accounting compliance. In an important decision that the Delaware courts seem to have forgotten, former Chancellor William Chandler explained that it was essential to keep *Caremark* within those boundaries:

To the extent the Court allows shareholder plaintiffs to succeed on a theory that a director is liable for a failure to monitor business risk, the Court risks undermining the well settled policy of Delaware law by inviting Courts to perform a hindsight evaluation of the reasonableness or prudence of directors' business decisions.⁵

As a result, [Delaware courts long](#) "routinely dismissed *Caremark* claims at the motion to dismiss stage, even in the face of substantial 'corporate traumas.'"

Granted, as I have acknowledged elsewhere, there was a certain logic to expanding *Caremark* to business risks.⁶ In general, however, even the recent cases most aggressively pushing the boundaries between legal and business—such as [Marchand and Boeing](#)—have involved failures of board oversight of mission critical risks in areas that posed significant risk of harm to the public, such as food and drug safety.

I do not wish to minimize the toxic nature of the culture allegedly created at McDonald's during Fairhurst's tenure. Nor do I wish to minimize the trauma suffered by its victims.

But there are significant differences between this case and even cases like *Marchand* and *Boeing*:

- It involves an officer rather than the board.
- At least by 2018, the board was aware of the problems and was dealing with them.
- There is no allegation of pervasive criminal conduct, especially by the people that Fairhurst was charged with supervising. (Presumably, Fairhurst has no *Caremark* duty to supervise himself).
- The problem is not a lack of supervision or oversight, but rather one of inaction in the face of a known problem. The decision of how to handle sexual harassment is a business decision. Fairhurst and the McDonald's C-suite handled the decision poorly but that's not what *Caremark* is supposed to be about.
- As appalling as Fairhurst and the CEO's conduct undoubtedly was, it never posed the sort of existential threats that were involved in *Marchand* and *Boeing*.

In *Marchand*, the regulatory violations were not just important: "Food safety was the 'most central safety and legal compliance issue facing the company.'"⁷

The *Marchand* court observed that Blue Bell (an ice cream manufacturer) was a mono-line business for which "food safety was essential and mission critical."⁸ But despite the critical nature of food safety, the *Marchand* board's oversight failures allowed listeria to "engulf" the company. As a result, the board had "to recall all of its products, shut down production at all of its plants, and lay off over a third of its workforce. ... Less consequentially, but nonetheless important for this litigation, stockholders also suffered losses because, after the operational shutdown, Blue Bell suffered a liquidity crisis that forced it to accept a dilutive private equity investment."

⁵ *In re Citigroup Inc. Shareholder Derivative Litig.*, 964 A.2d 106, 126 (Del. Ch. 2009).

⁶ See Stephen M. Bainbridge, *Caremark and Enterprise Risk Management*, 34 J. Corp. L. 967 (2009).

⁷ *In re Boeing Co. Derivative Litig.*, WL 4059934, at *26 (Del. Ch. Sept. 7, 2021) (describing *Marchand*).

⁸ *Marchand v. Barnhill*, 212 A.3d 805, 824 (Del. 2019).

There is simply no suggestion anywhere in the *McDonald's* opinion that the problems posed an existential problem of comparable magnitude as the problems Blue Bell faced.

Turning to *Boeing*, just as food safety posed existential concerns in *Marchand*, airplane safety “was essential and mission critical” to Boeing’s business, and “externally regulated.” The oversight failures had devastating consequences:

- “The crashes caused the Company and its investors to lose billions of dollars in value.”
- “The 737 MAX fleet was grounded for twenty months”
- “In 2020, Boeing estimated that it had incurred non-litigation costs of \$20 billion, and litigation-related costs in excess of \$2.5 billion.”
- “And in January 2021, Boeing consented to the filing of a criminal information charging the Company with conspiracy to defraud the United States and thereby incurring billions of dollars in penalties.”

Maybe there was a certain logic to dealing with such existential trauma under *Caremark*. But the *McDonald's* misconduct simply doesn’t rise to the same level.

In sum, *Caremark* has now grown to encompass what amounts to Human Resources mismanagement. What should have been a matter of employment law (and punished severely thereunder) has become a matter of the most controversial doctrine in corporate law.

Despite the length of VC Laster’s *Caremark* analysis, there is a potentially even more explosive aspect of the opinion. In his conclusion, VC Laster addressed the separate question of whether Fairhurst’s own personal misconduct constituted a breach of his fiduciary duties. Laster concluded that:

When Fairhurst engaged in sexual harassment, he was not acting subjectively to further the best interests of the Company. He therefore was acting in bad faith. The allegations against Fairhurst accordingly support a claim for breach of the duty of loyalty.

VC Laster thereby transformed sexual harassment—and who knows how much more of employment and civil rights law—into cognizable corporate law claims.

To be sure, VC Laster anticipated just such a complaint:

Some might ask whether the Court of Chancery should be hearing sexual harassment claims and worry that recognizing such a claim will open the floodgates to employment-style litigation. ...

... Like an oversight claim, a claim for breach of duty based on the officer’s own acts of sexual harassment is derivative, so all of the protections associated with derivative claims apply.

But so what? Is Laster saying that if Fairhurst had moved to dismiss for failure to make a demand on the board per Rule 23.1 that Fairhurst would have won?

I do not see a firebreak between Laster’s decision and “employment-style litigation.” But I do see a slippery slope.