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Delaware and *Caremark*: An Update

Recent Delaware decisions have reminded boards of directors of the obligation to make a good faith effort to put in place a compliance system designed to help ensure that their companies operate within the bounds of the law and that their products, services, and operations do not cause harm to consumers, community members, or the environment. That duty — famously associated with the Delaware Court of Chancery’s 1996 decision in [Caremark](#) — is a core responsibility of independent directors, working in concert with company management, that requires them to make a good faith effort to identify the key compliance risks the company poses to others and faces itself, and to put in place a reasonable oversight structure to address them.

In 2019, the Delaware Supreme Court’s decision in [Marchand](#) reminded boards that although the *Caremark* standard only requires a good faith effort to put in place and attend to a reasonable compliance structure, a plaintiff could state a claim against directors by pleading facts suggesting that the board failed to make any effort to ensure that a board-level system of oversight was in place to address a mission critical risk. In that case, the company’s sole business was to make ice cream and there was no board-level process for monitoring the safety of its products, which caused the death and illness of consumers in a listeria outbreak. Just last year, the Court of Chancery issued a high profile decision in the [Boeing case](#), applying *Marchand* in the face of detailed fact pleadings suggesting that the company had no board-level process for overseeing the company’s effort to ensure the safety of its aircraft.

In those and other cases, the increasing use of books and records demands by plaintiffs to plead their claims has been illustrated. Because the Delaware courts have long made clear — including in *Marchand* and *Boeing* — that *Caremark* requires a good faith effort by the board, not perfection, and that the board will only face liability if the evidence demonstrates that a board has not made a good faith effort to fulfill its duties, plaintiffs have sought books and records to sustain their difficult burden to plead a viable claim. When these books and records do not reflect that a company had in place a board structure that attended to core business and legal risks, the plaintiffs cite to that lack of effort in an effort to plead a complaint that cannot be dismissed on motion.

For these reasons, we have urged that companies ensure that their board-level committee structures address all mission critical risks and that the board’s efforts in holding meetings and receiving information in aid of its monitoring responsibilities are well documented. Taking these steps are beneficial on several levels. Most important, tone and involvement at the top on important compliance matters helps companies best position themselves to function safely and lawfully. Because managing complex business entities invariably involves risks, these actions are also helpful in the event that something goes wrong despite the company’s good faith efforts at prevention. A documented board-level compliance system makes it much more difficult for a plaintiff to plead a viable *Caremark* claim. With increased attention to these subjects, two-thirds of the *Caremark* cases filed after *Marchand* have been dismissed on motion.

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In a recent decision, Chancellor McCormick of the Court of Chancery underscored the utility of thoughtful consideration of board risk management and compliance structures. [*City of Detroit Police and Retirement Sys. v. Hamrock*, C.A. No. 2021-0370-KSJM \(June 30, 2022\)](#). The decision addressed a *Caremark* claim against the board of a natural gas company, NiSource, in the wake of a horrific explosion that occurred during the replacement of an old cast-iron pipe that resulted in one death, multiple injuries, and devastation to a small community.

Despite the mission critical nature of the safety issue — which was undisputed — the claim was dismissed. Important to that result was the fact that the company had a board-level committee specifically charged with addressing the core risks posed by its business — including the risks of explosion. Although the company’s compliance efforts did not prevent the tragedy that inspired the suit, the record that the committee met regularly, received reports on related safety issues, and was actively engaged in attempting to have the company improve its safety practices was critical to the court’s ruling that the plaintiffs had not met their burden to plead bad faith. Importantly, the books and records provided to the plaintiffs documented that the board was active in addressing the key safety issues involved in running a natural gas business.

As important, the *Hamrock* opinion, consistent with *Caremark* and *Marchand*, focused on whether the plaintiffs had met their burden to plead an absence of board effort amounting to bad faith, and not whether the board could be faulted for any form of negligence. The opinion specifically rejected the plaintiffs’ claim that board-level discussion on two occasions was too infrequent, holding that the record was sufficient to demonstrate plaintiffs’ failure to meet “the high ‘utter failure’ standard, even as understood through the refined lens of *Marchand* and *Boeing*.” And the court held that the board’s knowledge of “general risks” arising out of noncompliance with pipeline safety regulations in other parts of the company’s business was not a sufficient “red flag” of a “specific corporate trauma” to constitute a basis for *Caremark* liability.

Hamrock underscores that even in a very difficult and sad situation, directors face a very limited risk of personal liability if they use their business judgment and work with management to put in place and attend in good faith to a sound compliance structure that addresses the company’s central risks, and documents its efforts in doing so. In that regard, our comprehensive memorandum, *Risk Management and the Board of Directors*, is available [here](#).

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