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Caremark Exposure—And What to Do About It

2022 set another record for lawsuits faulting boards of directors for failing to adequately oversee corporate operations, a third consecutive year of acceleration. Mounting evidence suggests the trend is here to stay. But here's some good news: there is much boards and managers can do to anticipate and thereby de-risk this exposure.

Corporate litigation when things go wrong is of course nothing new. When manufactured products prove to be harmful, or services prove defective, or customers are injured, the class action bar has always responded, demanding payment for alleged tort victims. And so after a 2015 listeria outbreak linked to Blue Bell Creameries' ice cream was linked to three deaths and infections in four states, substantial tort litigation ensued, successfully seeking compensation for the victims from Blue Bell.

In 2019, however, in a case arising from the same tragic facts, the Delaware Supreme Court approved a further avenue for broad-sweeping recovery: a derivative action brought by Blue Bell stockholders seeking damages from Blue Bell's directors for inadequately supervising the company's food safety program. Although the court invoked the traditional "duty to monitor" framework—often called the *Caremark* doctrine after the 1996 decision that conceived it—it reversed the trial court's order dismissing the claim and applied that framework in a way that appeared to liberalize it.

The plaintiffs' bar certainly saw it that way. *Caremark* claims spiked immediately and have continued to mount. As important, since the Blue Bell decision, the courts have sustained these claims far more frequently. *Caremark* claims previously survived a motion to dismiss only very rarely. Now one out of three survive motions to dismiss—acquiring enormous settlement value, without regard to the ultimate merits of the claim or the difficulty of showing any damages to stockholders. As a result, any announcement of adverse corporate news or regulatory exposure should now be expected to trigger not only tort claims from victims, but *Caremark* claims by stockholders.

But effective tools are available to boards to address this risk—both before and after bad news hits the headlines. One key is to ensure the company has an appropriate enterprise risk management and compliance program that is reviewed at the board level. Equally important is to ensure the company addresses "hot button" issues like consumer privacy, cybersecurity, and product, consumer, and employee safety. To manage firm-specific risks, the board should consider bespoke committee architecture and rapid response teams to address potential crises. Likewise essential is skillful engagement with early stockholder inquiries and swift consideration of procedural considerations before litigation commences.

Perhaps most critically: maintain a faithful written record of the board's risk-management efforts, crafted to be producible in litigation. That way, when the plaintiffs come calling, the directors will have a robust record demonstrating their attention to foreseeable risks and supplying a pathway to early dismissal of the claim.

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