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Caremark: It's Not Just for Boards Anymore

The Delaware Court of Chancery last week held that corporate officers may be held liable for breach of "the duty of oversight." *In re McDonald's Corp. S'holder Derivative Litig.*, C.A. No. 2021-0324-JTL (Del. Ch. Jan. 25, 2023). Never before had oversight claims been applied to officers rather than directors.

At issue were allegations that McDonald's chief human resources officer was answerable in fiduciary breach for having failed to properly respond to evidence of sexual harassment at the company. The court had little trouble sustaining those claims in light of allegations that the officer himself had engaged multiple times in sexual harassment of employees. More generally, the court ruled that officers, like directors, owe *Caremark* duties—the duty to implement appropriate corporate controls, and the duty to react when "red flags" indicate those controls are not working.

The ruling, while not compelled by precedent or logically inevitable, is unsurprising given previous decisions indicating that the duties of officers largely mirror the duties of directors. And the decision importantly suggests principles to limit the scope of officer-oversight claims. The court made clear that a *Caremark* claim can be based only on knowing, bad-faith breaches of the duty of loyalty, so that negligent or even grossly negligent oversight failures will not state a claim. The court also emphasized that an officer's oversight obligations will typically extend only to matters within the officer's sphere of responsibility.

Notwithstanding these limiting principles, corporate defendants should brace for a wave of officer-oversight litigation, as the plaintiffs' bar explores the boundaries of the new doctrine. *Caremark* litigation has been on the rise for several years. Last week's decision should be expected to accelerate that trend.

But as we have recently emphasized, boards have powerful tools at hand to prepare for such litigation before it happens. Those same tools—including company-calibrated risk-management protocols, innovative board committee architecture reflecting the company's risk profile, and faithful record-keeping—will continue to be the best preventive medicine at the board level. Similar bespoke solutions can and should now be addressed at the level of the officer corps, to ensure compliance with best practices and reduce litigation risk. With effective preparation, *Caremark* exposure remains entirely manageable.

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