

Ethikos Volume 37, Number 2. April 01, 2023

Leadership oversight of compliance and ethics programs

by Rebecca Walker

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In its seminal 1996 decision of *In re Caremark Int'l Inc. Derivative Litigation*, the Delaware chancery court held that directors have a fiduciary duty to oversee a company's compliance systems.^[1] The parameters of that duty have been explored in a number of recent cases. In January 2023, in the case of *In re McDonald's Corporation Stockholder Derivative Litigation*, the Delaware courts, for the first time, directly addressed the question of whether the *Caremark* oversight duties also apply to a company's officers.^[2] (Spoiler alert—the court answered that question with a resounding “yes.”) It is a detailed and interesting decision—one well worth exploring for the court's discussion of both (1) an officer's duty to oversee a compliance program and (2) the *Caremark* line of cases.

This article will first provide a quick overview of the *McDonald's* case to set the stage, then offer a brief (but important) review of *Caremark* and its progeny. We will then take a closer look at *McDonald's* and its implications for compliance programs. As a bonus, we also consider two interesting procedural aspects of shareholder derivative litigation with which compliance professionals may want to be familiar.

McDonald's Derivative Litigation

The *McDonald's* case is a shareholder derivative action against McDonald's directors and certain officers, including the company's former chief people officer (CPO). The case alleges that the directors and officers failed to satisfy their fiduciary duty to oversee the McDonald's compliance program considering pervasive sexual harassment concerns at the company—including sexual harassment allegedly perpetrated by the CPO. The decision we are concerned with relates only to the claims against the CPO, who was an officer but not a director of McDonald's. The CPO argued the court should dismiss the claims against him on the grounds that officers do not have a fiduciary duty to oversee a company's compliance program akin to a director's *Caremark* duties. The court disagreed, holding that corporate officers do, in fact, have a fiduciary duty to oversee a company's compliance systems.

***Caremark* and its line of cases**

To fully appreciate the *McDonald's* decision, it is essential to undertake a brief refresh of *Caremark* and its progeny. The *Caremark* court held that directors of a corporation have a dual obligation of compliance oversight:

- To ensure that information and reporting systems exist that are sufficient to provide “senior management and to the board itself timely, accurate information sufficient to allow management and the board, each within its scope, to reach informed judgments concerning . . . the corporation's compliance with law;” and
- To appropriately respond to red flags indicating serious potential non-compliance.^[3]

However, the court in *Caremark* also made clear that the standard for liability in *Caremark* cases is high. Despite this high bar, in several recent cases, Delaware courts have permitted *Caremark* claims to proceed and created

guidance for companies seeking to ensure effective board oversight practices.

In 2019, the Delaware Supreme Court decided *Marchand v. Barnhill*, a case concerning a listeria outbreak at Blue Bell Creameries.^[4] The Delaware Supreme Court focused its analysis not on that board's general compliance oversight systems but instead on the board's oversight of compliance systems in the company's most significant risk area given its line of business (food safety). The court thus highlighted the importance of a board's oversight of compliance systems directed at those risk areas that are "intrinsically critical to the company," as well as general compliance oversight.

In 2021, the Delaware Chancery Court decided *In re Boeing Company Derivative Litigation*, a derivative suit stemming from the 2018 and 2019 crashes of the Boeing 737 MAX airplane.^[5] As in *Marchand v. Barnhill*, the *Boeing* court focused on the board's failure to implement and monitor compliance systems in that company's mission-critical risk area (airplane safety) in holding that the suit should be allowed to proceed. Both *Boeing* and *Marchand* thus highlight the importance of the board's oversight of both general compliance and compliance systems in mission-critical risk areas.

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