

Updates From Delaware

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Officers' Duty of Oversight

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Oversight Duties Extend to Officers

In re McDonald's Corporation Stockholder Derivative Litigation, 289 A.3d 343 (Del. Ch. 2023)

- McDonald's stockholders brought suit alleging that the company's Chief People Officer ("CPO"):
 - breached his fiduciary duty of oversight by allowing a corporate culture to develop that condoned sexual harassment and misconduct; and
 - breached his fiduciary duty of loyalty by engaging personally in acts of sexual harassment.
- The Court denied the officer's motion to dismiss and rejected the argument that Delaware law does not recognize an oversight claim against corporate officers:

"This decision clarifies that corporate officers owe a duty of oversight."

- Like directors, officers owe a "context-driven" duty to:
 - (i) implement "information systems and controls," and
 - (ii) "identify red-flags and either address them or report upward."

Scope of Officers' Duty of Oversight

"Although the CEO and Chief Compliance Officer likely will have company-wide oversight portfolios, **other officers generally have a more constrained area of authority.**"*

Officers' Information Systems Duty

- "With a constrained area of responsibility comes a constrained version of the duty that supports an Information-Systems Claim."
- **The Court provided examples:**
 - The CFO "is responsible for financial oversight and for making a good faith effort to establish reasonable information systems to cover that area."
 - The CLO "is responsible for legal oversight and for making a good faith effort to establish reasonable information systems to cover that area."

Officers' Duty to Address or Report Red Flags

- Similarly, "officers generally only will be responsible for addressing or reporting red flags within their areas of responsibility, although one can imagine possible exceptions."

* Emphasis in quotations is added by presenter unless otherwise specified.

McDonald's Corporation Stockholder Derivative Litigation

“If a red flag is *sufficiently prominent*, for example, then any officer might have a duty to report upward about it.”

For example, “[a]n officer who receives credible information indicating that the corporation is **violating the law** cannot turn a blind eye and dismiss the issue as *‘not in my area.’*”

Officer Red-Flags Claim

To plead a “**red-flags claim**” that will survive a Rule 12(b)(6) motion, a plaintiff must plead facts supporting an inference that the fiduciary:

- knew of evidence of corporate misconduct; and
 - consciously failed to take action in response.
- **The bad faith requirement for director duty of oversight claims applies to officer claims:**

“This decision concludes that oversight liability for officers requires a showing of bad faith.”

 - » “The pled facts must support an inference that the failure to take action was sufficiently **sustained, systematic**, or **striking** to constitute action in **bad faith**. A claim that a fiduciary had notice of serious misconduct and simply brushed it off or otherwise failed to investigate states a claim for breach of duty.”

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