IN RE MCDONALD'S CORP. S'HOLDER DERIV. LITIG.

CORPORATE OFFICER FIDUCIARY DUTY OF OVERSIGHT[1]
SUMMARY AUTHORED BY SHIRA R. FREIMAN

C.A. No. 2021-0324-JTL

Court of Chancery of the State of Delaware

January 26, 2023

Key Takeaway: *Delaware decisional law now explicitly provides that corporate officers owe the same fiduciary duty of oversight as corporate directors.*

In *In re McDonald's*, stockholders of the McDonald's Corporation ("McDonald's") filed derivative action against David Fairhurst, the Executive Vice President and Global Chief People Officer of McDonald's, for breach of fiduciary duties including the duty of oversight. Fairhurst moved to dismiss the oversight claim under Court of Chancery Rule 12(b)(6), contending that there is no duty of oversight for corporate officers comparable to that owed by corporate directors as articulated in *In re Caremark Int'l Inc. Deriv. Litig.*[2] ("*Caremark*"). Vice Chancellor J. Travis Laster denied the motion and found the plaintiffs' allegations stated claims upon which relief can be granted.

Though no Delaware case has explicitly stated that corporate officers have a fiduciary duty of oversight, Vice Chancellor Laster reasoned that "diverse authorities indicate that officers owe a fiduciary duty of oversight as to matters within their areas of responsibility." Reflecting on the precedent set forth by *Graham v. Allis-Chalmers Mfg. Co.*,[3] the landmark *Caremark* decision asserted a fiduciary duty of oversight onto corporate directors. The case was expanded upon in *Stone v. Ritter*[4] to identify two types of *Caremark* claims, when: 1) the directors utterly failed to implement any reporting or information system or controls;[5] or 2) having implemented such a system or controls, the

[1] Vice Chancellor Laster's Opinion addresses alleged fiduciary duty breaches of oversight, care, and loyalty against defendant David Fairhurst. This Case Summary focuses on Fairhurst's motion to dismiss the breach of oversight claim.

[2] *See* 698 A.2d 959 (Del. Ch. 1996).

[3] *See* 188 A.2d 125 (Del. 1963).

[4] *See* 911 A.2d 362 (Del. 2006).

[5] Claims falling under this standard are often referred to in practice as "prong one *Caremark*" or "Information-Systems" Claims.

directors consciously failed to monitor or oversee their operations, in turn disabling the directors from being informed of circumstances or incidents requiring their attention.[6] Though not explicitly referencing *Caremark* or the fiduciary duty of oversight, the Delaware Supreme Court later held in *Gantler v. Stephens* that "the fiduciary duties of officers are the same as those of directors."[7] This same school of thought has been acknowledged and expanded upon in bankruptcy courts, agency law, and other scholarly works.

Defendant Fairhurst is alleged by the plaintiffs to have known about evidence of sexual misconduct permeating throughout McDonald's, and to have consciously disregarded his duty to address said misconduct. This is effectively a Red-Flags *Caremark* claim. Specifically, the plaintiffs alleged that "Fairhurst permitted a toxic culture to develop at [McDonald's] that turned a blind eye to sexual harassment and misconduct." Fairhurst himself allegedly engaged in acts of sexual harassment in December 2016 and November 2018, which, taken in consideration with city-wide company walkouts, EEOC complaints, and a plethora of other events, "support Fairhurst's knowledge of red flags" and personal engagement in bad faith conduct. Notably, Vice Chancellor Laster explained that, like directors, "officers generally only will be responsible for addressing or reporting red flags within their areas of responsibility. . . ." with purported exceptions for red flags that are "sufficiently prominent," which may then carry "a duty to report upward. . . ." The standard of liability for corporate officers remains actions of bad faith, and thus disloyalty.

With the *McDonald's* Opinion, corporate officers are now explicitly subject to the fiduciary duty of oversight. The plaintiffs properly pled a claim against Fairhurst for breaching this duty, so the 12(b)(6) motion was denied.[8]

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[6] Conversely, claims falling under this standard are often deemed "prong two *Caremark*" or "Red-Flags" Claims, though they technically derive from *Allis-Chalmers.*

For Red-Flags Claim allegations to survive a 12(b)(6) motion to dismiss, a plaintiff must: 1) plead facts supporting an inference that the fiduciary knew of evidence of corporate misconduct; and 2) plead facts supporting an inference that the fiduciary "consciously failed to take action in response." *McDonald's*, C.A. No. 2021-0324-JTL at 54. The pled facts must support an inference that failing to act was "sufficiently sustained, systematic, or striking to constitute action in bad faith." *Id.* Claims that a fiduciary had notice of "serious misconduct" and brushing it off or otherwise failing to investigate suffices to state a claim. *Id.* (citing *Lebanon Cnty. Empls.' Ret. Fund v. AmerisourceBergen Corp.*, 2020 WL 132752, at *20 (Del. Ch. Jan. 13, 2020)).

[7] *See* 965 A.2d 695, 709 (Del. 2009).

[8] Of note, Vice Chancellor Laster also found an actionable claim of the breach of loyalty stemming from Defendant Fairhurst's alleged personal acts of sexual harassment.