

IN RE MCDONALD'S II
OPINION DISMISSING BAD FAITH CLAIMS AGAINST DIRECTOR
DEFENDANTS

SUMMARY AUTHORED BY LAURA GIARDINA

C.A. No. 2021-0324-JTL

Court of Chancery of the State of Delaware

Key Takeaway: *In order to survive a motion to dismiss a prong-two Caremark claim, a plaintiff must show that a defendant both had knowledge of red flags and consciously failed to respond—mere evidence of a bad business decision is not enough to show bad faith.*

Bonus Takeaway: *“Mission critical risks” are not required for Red flag Caremark claims and they are an example of—not the standard for—evaluating breaches in information systems claims.¹*

Following Vice Chancellor J. Travis Laster’s January 26, 2023 *McDonald’s* Opinion providing that corporate officers owe the same duty of oversight as corporate directors (“*McDonald’s I*”),² the director defendants moved to dismiss the remaining claims for breach of oversight, waste, and other fiduciary duties under Court of Chancery Rule 12(b)(6). As in *McDonald’s I*, this Opinion, colloquially termed *McDonald’s II*, analyzed the duty of oversight as articulated in *In re Caremark Int’l Inc. Deriv. Litg.*³ (“*Caremark*”) and applied Delaware’s business judgment rule in evaluating the claims for breach of fiduciary duty and waste. Vice Chancellor Laster granted the motion to dismiss, and in a separate order issued the same day, dismissed the breach of oversight claim against the corporate officers under Court of Chancery Rule 23.1.⁴

¹ Vice Chancellor Laster addressed the recent trend of litigants focusing on mission critical risks as a “talismatic” requirement for *Caremark* claims. *In re McDonald’s Corp. S’holder Deriv. Litig. (McDonalds II)*, 47 Del. J. Corp. L. 705, 705 (2023). The Opinion clarifies that , “a [r]ed-[f]lags [c]laim is not dependent on the signal relating to an essential or mission critical risk.” *Id.* at 709. It goes on to state—in dicta—that the standard for evaluating information systems claims is whether a board put systems in place to monitor “central compliance risks,” which may be broader than “mission critical” ones. *Id.* at 705–08.

² See Shira R. Freiman, *In re McDonald’s Corp. S’holder Deriv. Litig. Case Summary*, 47 DEL. J. CORP. L. 331, 331–32 (2023).

³ See 698 A.2d 959 (Del. Ch. 1996).

⁴ See *In re McDonald’s Corp. S’holder Deriv. Litig.*, C.A. No. 2021-0324-JTL (Del. Ch. Mar. 1, 2023) (Order).

Plaintiffs must do more than just point to bad business decisions to survive a motion to dismiss prong-two *Caremark*, or “Red-Flags” claim. Rather, plaintiffs must show that defendants knew of red flags and failed to respond. Failure to respond is a “bad faith response,” where defendants consciously disregard their duty to address the misconduct.

Mere evidence of bad business decisions is insufficient to overcome the presumption of good faith under Delaware's business judgment rule. This rule presumes “directors. . . acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interest of the company.” Pleadings must rebut the presumption that a defendant’s decisions had no “rationally conceivable basis.” As to waste, “committing waste is an act of bad faith.” Accordingly, waste claims are subject to the business judgment rule analysis and are a “means of pleading that [a] director[] acted in bad faith.”

In *McDonald’s*, the plaintiffs articulated multiple bad business decisions against the director defendants, including: 1) ignoring company-wide sexual misconduct 2) agreeing to \$47,534,341 in compensation for CEO Steve Easterbrook's separation agreement, and 3) trying to claw back separation compensation through additional litigation. The director defendants were put on ample notice of the culture of sexual misconduct, but “[f]iduciaries cannot guarantee success, particularly when fixing a sadly recurring issue like sexual harassment. What they have to do is make a good faith effort.” The director defendants launched company-wide initiatives and updated McDonald's Enterprise Risk Management system to identify “Respectful Workplace” as a new risk theme once they were made aware of the situation. These business decisions failed, and the problems persisted. However, these business decisions enumerated by the plaintiffs neither illustrated a conscious disregard for red -flags, nor rose to the level of rationally inconceivable actions. Instead, the plaintiffs demonstrated that the decisions failed to change the culture around sexual misconduct, which did not constitute bad faith.

Vice Chancellor Laster determined that bad *business decisions* are not dispositive of bad *faith*. The plaintiffs did not plead facts showing a conscious disregard of red flags or rationally inconceivable decisions to remedy the rampant sexual misconduct at McDonald’s, and thus the court granted the motion to dismiss.