Delaware Expands Corporate Officers' Fiduciary Duties to Include a Duty of Oversight

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On January 26, 2023, the Delaware Court of Chancery issued its opinion in *In re McDonald's Corp. Stockholder Derivative Litigation*—a seminal decision in corporate law that will likely have a far-reaching impact on companies across the country.

I. The *McDonald's* Decision

Plaintiffs, stockholders of McDonald's Corporation, sued the former McDonald's Executive Vice President and Global Chief People Officer David Fairhurst, alleging that "he breached his fiduciary duties by allowing a corporate culture to develop that condoned sexual harassment and misconduct." Not only was Fairhurst accused of ignoring "red flags" of sexual harassment, but he was also accused of condoning, and in fact participating in, a “party atmosphere.” Fairhurst moved to dismiss the claim under Federal Rule of Civil Procedure 12(b)(6) for failing to state a claim and arguing that Delaware does not impose a duty of oversight on officers comparable to the duty of oversight for directors as set forth in an earlier Delaware case, *In re Caremark*. The Court disagreed and held—for the first time under Delaware law—that officers, in addition to directors, owe a duty of oversight to the companies they manage. The Court then explained that officers generally have the same fiduciary duties as directors, and, in fact, officers have additional duties as agents who report to the board of directors.

II. What is the Duty of Oversight?

Using the same two factors as the *Caremark* Court, the *McDonald’s* Court explained that an officer’s duty of oversight includes obligations to: (1) “make a good faith effort to ensure that information systems are in place so that the officers receive relevant and timely information that they can provide to the directors,” and (2) “address [red flags] and report upward.” Although the duty is seemingly the same between officers and directors, it is more limited for officers as “officers will generally only be responsible for addressing or reporting red flags within their areas of responsibility.” There may be instances, however, when an officer may still be responsible for reporting red flags outside the scope of his or her duties, such as instances involving “egregious” or “sufficiently prominent” red flags. The limitation on an officer’s duty may also not be applicable to those officers whom have a more expansive scope of responsibility, such as with a Chief Executive Officer.

The *McDonald’s* Court also noted that for an officer to be liable for breach of this new duty, he or she must have acted in “bad faith” by either deliberately failing to make a good faith effort to establish the necessary systems or consciously disregarding the red flags. As in *McDonald’s*, this may look like ignoring complaints, others fearing retaliation for reporting such complaints, and/or engaging in the complained-of behavior.

III. Impact of *McDonald's* Decision

Since other jurisdictions frequently look to Delaware for guidance on corporate law, it is likely that the *McDonald's* Court's recognition of an oversight duty for officers will spread across jurisdictions. Thus, companies and their officers should ensure they are adequately protected for the future by:

- Maintaining adequate reporting systems;
- Providing training to employees, officers, and directors to make certain each is aware of the existence and how to properly use such reporting systems;
- Ensuring that officers have and use a standard method for documenting their responses to "red flags;" and
- Reviewing company policies to ensure adequate anti-harassment and anti-discrimination policies are in place.

Phillips Murrah P.C.'s attorneys will continue to monitor and post about developments on this issue.

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