

June 20, 2019

Delaware Supreme Court Reverses Dismissal of Bad Faith Claim Against Directors

The Court Finds Bad Faith Adequately Pled by Allegations That Company Had No Board Level System for Monitoring or Reporting on Food Safety Issues

In a decision issued yesterday in *Marchand v. Barnhill et al.*, No. 533, 2018 (Del. June 19, 2019), the Delaware Supreme Court reversed the dismissal of a stockholder derivative lawsuit against the members of the board of directors and two officers of Blue Bell Creameries USA, Inc., a leading manufacturer of ice cream products. The lawsuit arose out of a serious food contamination incident in 2015 that resulted in widespread product recalls and was linked to three deaths. The Delaware Supreme Court, applying the “duty to monitor” doctrine enunciated in *In re Caremark International, Inc. Derivative Litigation*, 698 A.2d 959 (Del. Ch. 1996), and noting the very high hurdle to claims under it, nonetheless ruled that the plaintiff had adequately alleged the requisite bad faith by the members of the Blue Bell board. Plaintiff did so by using information obtained in a Section 220 books and records demand to show facts supporting their contention that the Company did not have in place “a reasonable board-level system of monitoring and reporting” with respect to food safety, which the Court deemed to be “a compliance issue intrinsically critical to the company’s business.” After concluding that “food safety was essential and mission critical” to Blue Bell’s business, the Supreme Court ruled that bad faith was adequately pled by alleging “that no board-level system of monitoring or reporting on food safety existed.” The Court thus declined to dismiss a claim that the directors breached their duty of loyalty, potentially exposing directors to non-exculpated (and potentially not indemnifiable) monetary damages.

In light of the *Blue Bell* decision, boards of directors should review carefully their board processes and procedures to ensure that “reasonable compliance system and protocols” are in place with respect to “safety and legal compliance” and other regulatory and business threats that may pose significant risks for their particular company. Equally important, boards should document the procedures followed to

SULLIVAN & CROMWELL LLP

identify significant risks, including advice from management, counsel and other advisors, as well as the processes and procedures implemented to provide for board reporting and appropriate supervision of these risks, and maintain written records of the implementation of these processes and procedures in practice. The principal basis upon which the Court in *Blue Bell* found the record to support the complete failure to impose any board-level “system of controls” with respect to food safety was the absence of any written board procedures or documented discussion on the topic, and the lack of any mention of food safety in board minutes in periods before the food contamination outbreak, despite previous food safety issues that allegedly had arisen in previous years, including positive tests for *listeria* in Company facilities beginning in 2013. The *Blue Bell* decision makes clear that oversight with respect to these kinds of issues is a board-level responsibility, and goes beyond mere compliance with laws. The Delaware court opined that “the fact that Blue Bell nominally complied with FDA regulations does not imply that the board implemented a system to monitor food safety at the board level.”

“In short,” the Delaware Supreme Court ruled, “to satisfy their duty of loyalty, directors must make a good faith effort to implement an oversight system and then monitor it.” While “routine regulatory requirements, although important, are not typically directed at the board,” companies should ensure that they have written processes and procedures in place for the board to be timely informed about, and to monitor regularly, compliance, safety and business developments that are important to the company, or may be viewed as critical to the company in hindsight.¹

This decision, while only on a motion to dismiss, illustrates the continued importance of the *Caremark* doctrine as a strand of Delaware law governing the conduct of directors. While the burden for withstanding a motion to dismiss a *Caremark* claim is high, and the theory remains “possibly the most difficult theory in corporation law upon which a plaintiff might hope to win a judgment,”² it can be met. *Caremark* is an important tool in the Delaware jurisprudential arsenal for enforcing what Delaware courts view as reasonable director conduct, and when applied sends a powerful message because of the potential it creates for personal director liability.

* * *

Copyright © Sullivan & Cromwell LLP 2019

¹ The full text of the *Blue Bell* decision can be found here.
<https://courts.delaware.gov/Opinions/Download.aspx?id=291200>

² *Caremark*, 698 A.2d at 967.

SULLIVAN & CROMWELL LLP

ABOUT SULLIVAN & CROMWELL LLP

Sullivan & Cromwell LLP is a global law firm that advises on major domestic and cross-border M&A, finance, corporate and real estate transactions, significant litigation and corporate investigations, and complex restructuring, regulatory, tax and estate planning matters. Founded in 1879, Sullivan & Cromwell LLP has more than 875 lawyers on four continents, with four offices in the United States, including its headquarters in New York, four offices in Europe, two in Australia and three in Asia.

CONTACTING SULLIVAN & CROMWELL LLP

This publication is provided by Sullivan & Cromwell LLP as a service to clients and colleagues. The information contained in this publication should not be construed as legal advice. Questions regarding the matters discussed in this publication may be directed to any of our lawyers listed below, or to any other Sullivan & Cromwell LLP lawyer with whom you have consulted in the past on similar matters. If you have not received this publication directly from us, you may obtain a copy of any past or future publications by sending an e-mail to SCPublications@sullcrom.com.

CONTACTS

New York

Audra D. Cohen	+1-212-558-3275	cohen@nullcrom.com
H. Rodgin Cohen	+1-212-558-3534	cohenhr@nullcrom.com
Scott B. Crofton	+1-212-558-4682	croftons@nullcrom.com
Mitchell S. Eitel	+1-212-558-4960	eitelm@nullcrom.com
Brian T. Frawley	+1-212-558-4983	frawleyb@nullcrom.com
Joseph B. Frumkin	+1-212-558-4101	frumkinj@nullcrom.com
C. Andrew Gerlach	+1-212-558-4789	gerlacha@nullcrom.com
Brian E. Hamilton	+1-212-558-4801	hamiltonb@nullcrom.com
John L. Hardiman	+1-212-558-4070	hardimani@nullcrom.com
Matthew G. Hurd	+1-212-558-3122	hurdm@nullcrom.com
Stephen M. Kotran	+1-212-558-4963	kotrans@nullcrom.com
Keith A. Pagnani	+1-212-558-4397	pagnanik@nullcrom.com
George J. Sampas	+1-212-558-4945	sampasg@nullcrom.com
Melissa Sawyer	+1-212-558-4243	sawyerm@nullcrom.com
Matthew A. Schwartz	+1-212-558-4197	schwartzmatthew@nullcrom.com
Krishna Veeraraghavan	+1-212-558-7931	veeraraghavank@nullcrom.com

Washington, D.C.

Janet T. Geldzahler	+1-202-956-7515	geldzahlerj@nullcrom.com
Christopher Michael Viapiano	+1-202-956-6985	viapianoc@nullcrom.com

Los Angeles

Eric M. Krautheimer	+1-310-712-6678	krautheimere@nullcrom.com
Alison S. Ressler	+1-310-712-6630	resslera@nullcrom.com
Robert A. Sacks	+1-310-712-6640	sacksr@nullcrom.com

Palo Alto

Brendan P. Cullen	+1-650-461-5650	cullenb@nullcrom.com
-------------------	-----------------	--
