The Delaware Supreme Court Does Not Scream for Ice Cream: Director Oversight Liability Following *Marchand v. Barnhill*

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TABLE OF CONTENTS

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I. INTRODUCTION

For nearly six years, Blue Bell Creameries' management ignored food safety compliance concerns at all three of the ice cream maker's manufacturing plants.[1] These compliance issues eventually culminated in a listeria outbreak, a recall of all of the company's products, and the death of three customers.[2] Shareholders subsequently brought a derivative action seeking to hold the board of directors liable for failing to implement a system to oversee food safety.[3] The Delaware Supreme Court's decision in *Blue Bell* was the first to confront a *Caremark* claim and determine that the complaint had plead sufficient facts to support a claim that the directors were personally liable for breaching their oversight duty.[4] This striking conclusion was a result of horrifying facts, carefully crafted reasoning, and an arguably expansive view of oversight liability.

Part II of this note will give an overview of director oversight liability beginning with *Caremark*, the Chancery Court decision whose name now represents the entire category of board oversight claims. Part III will discuss the *Blue Bell* case in detail. Part IV will analyze the court's reasoning and propose some doctrinal and practical implications of the decision.

II. LEGAL BACKGROUND

Directors owe their corporation both the duty of care and the duty of loyalty. The directors' duty of care requires them to act in good faith in the best interests of the corporation with the care that a reasonably prudent person would exercise.[5] The common law business judgment rule protects

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1. Marchand v. Barnhill (*Blue Bell*), 212 A.3d 805, 811–13 (Del. 2019).
2. *Id.* at 813–14.
3. *Id.* at 809, 815–16.
4. *See id.* at 824; Elizabeth Pollman, *Corporate Oversight and Disobedience*, 72 VAND. L. REV. 2013, 2024 (2019). *Blue Bell* is one of four cases that have reached the Delaware Supreme Court directly on a *Caremark* claim and the only one in which the claim was allowed to proceed beyond the pleading stage. *See* City of Birmingham Ret. & Relief Sys. v. Good, 177 A.3d 47, 51 (Del. 2017) (affirming the lower court's dismissal on a motion to dismiss because "the plaintiffs did not sufficiently allege that the directors faced a substantial likelihood of personal liability for a *Caremark* violation"); Wood v. Baum, 953 A.2d 136, 143 (Del. 2008) (affirming a dismissal on a motion to dismiss because the complaint did not plead with particularity that the directors knowingly engaged in illegal conduct, that there were any red flags before the board, or that "the defendants otherwise consciously and in bad faith ignored the improprieties alleged in the complaint"); Stone v. Ritter, 911 A.2d 362, 373 (Del. 2006) (affirming a dismissal on a motion to dismiss because the board "exercised oversight by relying on periodic reports" and the board cannot be held personally liable for failures of employees).
5. *See, e.g.*, MODEL BUS. CORP. ACT § 8.30(a)–(b) (AM. BAR ASS'N 2016); *see also, e.g.*, DEL. CODE ANN. tit. 8 § 102(b)(7) (2020) (authorizing corporations with a certificate of incorporation to exculpate directors from monetary damage liability for a

directors by requiring plaintiffs alleging a breach of the duty of care to rebut a presumption of the directors' good faith.[6] Directors may breach their duty of loyalty to the corporation by acting in their own self-interest rather than in the interests of the corporation—by engaging in transactions that involve conflicts of interest, self-dealing, or other suspect motivations —by willfully violating the law, or by failing to properly monitor or oversee the corporation.[7]

breach of the duty of care—gross negligence); *id.* § 141(e) (stating that only directors who rely in good faith on corporate books and records or reports from corporate officers or certain advisors are fully protected against shareholder claims); *id.* § 145(a) (stating that only directors who act in good faith are entitled to indemnification of legal expenses). As part of their duty of care, directors must also refrain from conducting transactions that constitute corporate waste, a claim which is rare and requires the plaintiff to show that "the exchange was 'so one sided that no business person of ordinary, sound judgment could conclude that the corporation has received adequate consideration.'" *In re* Walt Disney Co. Derivative Litig. (*Disney*), 906 A.2d 27, 74 (Del. 2006) (quoting Brehm v. Eisner, 746 A.2d 244, 263 (Del. 2000)).

6. *See, e.g.*, *Disney*, 906 A.2d at 52 ("Our law presumes that 'in making a business decision the directors of a corporation acted on an informed basis, in good faith, and in the honest belief that the action taken was in the best interests of the company.'" (quoting Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984), *overruled by Brehm*, 746 A.2d at 254)); *In re* Caremark Int'l Inc. Derivative Litig. (*Caremark*), 698 A.2d 959, 967 (Del. Ch. 1996) ("[W]hether a judge or jury considering the matter after the fact, believes a decision substantively wrong, or degrees of wrong extending through 'stupid' to 'egregious' or 'irrational', provides no ground for director liability, so long as the court determines that the process employed was either rational or employed in a *good faith* effort to advance corporate interests.").

7. *See, e.g.*, Guttman v. Huang, 823 A.2d 492, 506 n.34 (Del. Ch. 2003) (considering a violation of the law to be a violation of the duty of loyalty); *Caremark*, 698 A.2d at 967 (distinguishing between self-interested transactions and improper monitoring). The *Caremark* court treated the duty to monitor as part of the duty of care as distinguished from the duty of loyalty issues mentioned above. *Caremark*, 698 A.2d at 967. However, later decisions have considered director oversight liability to be a form of a breach of the duty of loyalty. *See, e.g.*, *Guttman*, 823 A.2d at 506 ("Although the *Caremark* decision is rightly seen as a prod towards the greater exercise of care by directors in monitoring their corporations' compliance with legal standards, by its plain and intentional terms, the opinion articulates a standard for liability for failures of oversight that requires a showing that the directors breached their duty of loyalty by failing to attend to their duties in good faith."); *Stone*, 911 A.2d at 370 ("Where directors fail to act in the face of a known duty to act, thereby demonstrating a conscious disregard for their responsibilities, they breach their duty of loyalty by failing to discharge that fiduciary obligation in good faith.").

A. Oversight Liability: Caremark *and Its Progeny*

1. Caremark

Director oversight liability, the type of liability at issue in *Blue Bell*, owes its roots to the *Caremark* decision.[8] *Caremark* was a Delaware Court of Chancery decision involving a health care company's compliance with laws prohibiting kickbacks for referrals of Medicare and Medicaid patients.[9] Multiple government agencies, including the Department of Justice, investigated Caremark's referral practices, eventually leading to multiple grand jury indictments and five stockholder derivative actions based on employee violations of the referral laws.[10] Throughout this period, Caremark maintained and updated an internal guide to govern employees' contracts with physicians and hospitals, hired outside auditors to review Caremark's compliance policies, and took other measures to assure compliance with the law.[11] Caremark's board of directors received information of these measures through management reports, through meetings called in response to the investigations, and through reports received through the board's Audit and Ethics Committee.[12] As part of a settlement with federal and state government entities, Caremark paid criminal fines and civil damages, but no officers or directors were charged.[13]

The court addressed the following issue: "what is the board's responsibility with respect to the organization and monitoring of the enterprise to assure that the corporation functions within the law to achieve its purposes?"[14] To answer that question, the court turned to the Delaware Supreme Court's 1963 decision in *Graham v. Allis-Chalmers Manufacturing Co.*[15] and developments since the *Graham* decision.[16] The court recounted the holding

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8. *See, e.g.*, *Stone*, 911 A.2d at 364 (acknowledging that director oversight liability claims are often referred to simply as "*Caremark* claim[s]").

9. *See Caremark*, 698 A.2d at 961–62.

10. *Id.* at 962–64.

11. *Id.* at 963.

12. *See id.* at 963–64.

13. *Id.* at 965. The shareholder derivative claims also resulted in a settlement agreement. *Id.* at 966. Among other guarantees, the settlement agreement required the Caremark board to meet semi-annually to discuss changes to healthcare regulations, to establish a new committee that meets at least four times a year and reports compliance to the board twice a year, and to receive reports from "compliance officers" to the committee twice a year. *See id.* The court's job was to determine whether to approve this settlement. *See id.* at 960. In deciding whether the settlement was fair to both parties and the absent shareholders, the court had to evaluate the strength of the plaintiffs' claim and the legal standard governing the directors' obligation to monitor corporate performance. *Id.* at 961.

14. *Id.* at 968–69.

15. 188 A.2d 125 (Del. 1963).

16. *Caremark*, 698 A.2d at 969–70. The court also turned to trends in criminal enforcement of corporate compliance, noting recent changes in criminal penalties for

in *Graham*: "absent cause for suspicion there is no duty upon the directors to install and operate a corporate system of espionage to ferret out wrongdoing which they have no reason to suspect exists."[17] Rejecting a broader interpretation of this holding—"that a corporate board has no responsibility to assure that appropriate information and reporting systems are established by management"—the *Caremark* court decided that in the modern context, the *Graham* decision means that "absent grounds to suspect deception, neither corporate boards nor senior officers can be charged with wrongdoing simply for assuming the integrity of employees and the honesty of their dealings on the company's behalf."[18] The court reached this conclusion after considering the Delaware Supreme Court's recent decisions, which emphasized the seriousness of the board's role and the necessity of information in the board's monitoring role.[19]

The *Caremark* court then analyzed the plaintiffs' claims in light of its conclusion that

> a director's obligation includes a duty to attempt in good faith to assure that a corporate information and reporting system, which the board concludes is adequate, exists, and that failure to do so under some circumstances may, in theory at least, render a director liable for losses caused by non-compliance with applicable legal standards.[20]

The court held that although there was a violation of law by Caremark employees, the directors' failure to learn of these violations was not a breach of their fiduciary duty because they made a good faith attempt to make themselves informed of the relevant facts.[21]

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violations of health and safety regulations, which created an incentive for corporations to "have in place compliance programs to detect violations of law, promptly to report violations to appropriate public officials when discovered, and to take prompt, voluntary remedial efforts." *Id.* at 969.

17. *Id.* (quoting *Graham*, 188 A.2d at 130).
18. *Id.* at 969–70.
19. *Id.* at 970.
20. *Id.* at 969.
21. *Id.* at 971–72.

2. Stone v. Ritter*: The Delaware Supreme Court Adopts the* Caremark *Standard*

Stone was the first case after *Caremark* in which the Delaware Supreme Court had the opportunity to directly address director oversight liability.[22] In so doing, the court approved of *Caremark*'s interpretation of the court's holding in *Graham* and approved of the standard for director liability articulated in *Caremark*.[23] The *Stone* court ultimately articulated the standard for oversight liability:

> We hold that Caremark articulates the necessary conditions predicate for director oversight liability: (a) the directors utterly failed to implement any reporting or information system or controls; or (b) having implemented such a system or controls, consciously failed to monitor or oversee its operations thus disabling themselves from being informed of risks or problems requiring their attention. In either case, imposition of liability requires a showing that the directors knew that they were not discharging their fiduciary obligations. Where directors fail to act in the face of a known duty to act, thereby demonstrating a conscious disregard for their responsibilities, they breach their duty of loyalty by failing to discharge that fiduciary obligation in good faith.[24]

Stone involved a bank and its parent company that were liable for fines and civil penalties as a result of employee violations of anti-money laundering regulations.[25] Of significance, as part of its assessment of the company's compliance procedures, the Financial Crimes Enforcement Network (FinCEN) determined that the compliance program "'lacked adequate board and management oversight,' and that 'reporting to management for the purposes of monitoring and oversight of compliance activities was materially deficient.'"[26] However, an independent auditor found that the company had in place several mechanisms to ensure board oversight of anti-money laundering compliance, including a Suspicious Activity Oversight Committee that met quarterly, an officer and multiple departments in charge of compliance, annual presentations by the officer to the board, and board involvement in the amendment of compliance policies.[27]

The *Stone* court held that the plaintiffs' claim for oversight liability lacked basis.[28] In so holding, the court noted that "a claim that directors

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22. *See* Eric J. Pan, *A Board's Duty to Monitor*, 54 N.Y.L. SCH. L. REV. 717, 726 (2009–2010); Geoffrey Christopher Rapp, *Institutional Control and Corporate Governance*, 2015 BYU L. REV. 985, 992.
23. *See* Stone v. Ritter, 911 A.2d 362, 367–69 (Del. 2006).
24. *Id.* at 370 (first citing Guttman v. Huang, 823 A.2d 492, 506 (Del. Ch. 2003); then citing *In re* Walt Disney Co. Derivative Litig., 906 A.2d 27, 67 (Del. 2006)).
25. *See id.* at 365.
26. *Id.* at 366.
27. *Id.* at 371–72.
28. *Id.* at 373.

are subject to personal liability for employee failures is 'possibly the most difficult theory in corporation law upon which a plaintiff might hope to win a judgment.'"[29] The independent auditor's report showed that the board was involved in setting policies, delegated compliance to employees, and relied on periodic reports.[30] Therefore, although the employees failed to properly report compliance issues to the board, the directors could not be personally liable for these failures.[31]

B. Oversight Liability Today

Stone's articulation of the test for oversight liability still stands today. The *Blue Bell* court invoked it.[32] Directors must consciously disregard their duty to act by either failing to implement a reporting system entirely or failing to monitor that system.[33]

A director's failure to act in good faith is a necessary component of director oversight liability, a point emphasized in *Caremark* and *Stone*.[34] The *Caremark* court held that "only a sustained or systematic failure of the board to exercise oversight—such as an utter failure to attempt to assure a reasonable information and reporting system exits—will establish the lack of good faith that is a necessary condition to liability."[35] The *Stone* court approved of this test and noted that it was consistent with the court's

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29. *Id.* at 372 (quoting *In re* Caremark Int'l Inc. Derivative Litig. (*Caremark*), 698 A.2d 959, 967 (Del. Ch. 1996)).

30. *Id.* at 372–73.

31. *Id.* at 373.

32. *See* Marchand v. Barnhill (*Blue Bell*), 212 A.3d 805, 821 (Del. 2019) (citing *Stone*, 911 A.2d at 370–72). The *Blue Bell* court summarized the standard for oversight liability by quoting *Stone*:

> Bad faith is established, under *Caremark*, when "the directors completely fail to implement any reporting or information system or controls, or . . . having implemented such a system or controls, consciously fail to monitor or oversee its operations thus disabling themselves from being informed of risks or problems requiring their attention." In short, to satisfy their duty of loyalty, directors must make a good faith effort to implement an oversight system and then monitor it.

Id. at 821 (alteration in original) (quoting *Stone*, 911 A.2d at 370).

33. *Id.* (citing *Stone*, 911 A.2d at 370–72).

34. *Stone*, 911 A.2d at 370 ("[A] showing of bad faith conduct, in the sense described in *Disney* and *Caremark*, is essential to establish director oversight liability."); *Caremark*, 698 A.2d at 970 ("[A] director's obligation includes a duty to attempt in good faith to assure that a corporate information and reporting system, which the board concludes is adequate, exists, and that failure to do so under some circumstances may, in theory at least, render a director liable for losses caused by non-compliance with applicable legal standards.").

35. *Caremark*, 698 A.2d at 971.

prior decision in *Disney*.[36] In its analysis of situations where directors act in bad faith,[37] the *Disney* court gave one example as "where the fiduciary intentionally fails to act in the face of a known duty to act, demonstrating a conscious disregard for his duties,"[38] the type of conduct that the *Stone* court recognized as a "'necessary condition' for director oversight liability."[39] Therefore, the failure to act in good faith, as emphasized by the *Stone* court's holding above, is "essential to establish director oversight liability."[40]

As the Delaware Supreme Court itself has noted, claims for director oversight liability are often unsuccessful and for good reason.[41] In addition to the good faith requirement, the difficulty in pleading and proving oversight liability claims stems from the fact that directors rely heavily on management to run the company and are not expected to be directly involved in many of the decisions that management makes.[42] Having a demanding test, however, is beneficial to shareholders because it is lenient enough to encourage qualified people to serve on the board, yet strong enough to encourage those board members to act in the interests of the corporation.[43] A stringent pleading standard also protects directors from liability when they make decisions to pursue risky investments that ultimately benefit the shareholders.[44]

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36. *Stone*, 911 A.2d at 369 (citing *In re* Walt Disney Co. Derivative Litig. (*Disney*), 906 A.2d 27, 66–67, 67 n.111 (Del. 2006).

37. There is no meaningful difference between the lack of good faith and the presence of bad faith in the fiduciary duty of loyalty context, and courts often use them interchangeably. *See, e.g.*, Lyondell Chem. Co. v. Ryan, 970 A.2d 235, 240 (Del. 2009) (adopting the *Stone* court's test for oversight liability and equating lack of good faith with bad faith); *Disney*, 906 A.2d at 62–68 (discussing the difference between bad faith and subjective bad faith—intentional or knowing misconduct—but adopting a definition that equates the failure to act in good faith with bad faith); *Stone*, 911 A.2d. at 369–70.

38. *Disney*, 906 A.2d at 67 (quoting *In re* Walt Disney Co. Derivative Litig., 907 A.2d 693, 755 (Del. Ch. 2005), *aff'd*, 906 A.2d 27 (Del. 2006)). As *Stone* noted, the *Disney* court cited to *Caremark* approvingly in its analysis of bad faith following this example. *Stone*, 911 A.2d at 369 (citing *Disney*, 906 A.2d at 67 n.111).

39. *Stone*, 911 A.2d at 369 (quoting *Caremark*, 698 A.2d at 971).

40. *Id.* at 370.

41. *See, e.g.*, Marchand v. Barnhill (*Blue Bell*), 212 A.3d 805, 820 (Del. 2019) ("*Caremark* claims are difficult to plead and ultimately to prove out."); *Stone*, 911 A.2d at 372 ("[A] claim that directors are subject to personal liability for employee failures is 'possibly the most difficult theory in corporation law upon which a plaintiff might hope to win a judgment.'" (quoting *Caremark*, 698 A.2d at 967)); *see also* Guttman v. Huang, 823 A.2d 492, 505–06 (Del. Ch. 2003) ("A *Caremark* claim is a difficult one to prove.").

42. *See Stone*, 911 A.2d at 372 ("Delaware courts have recognized that 'most of the decisions that a corporation, acting through its human agents, makes are, of course, not the subject of director attention.'" (quoting *Caremark*, 698 A.2d at 967–68)).

43. *Caremark*, 698 A.2d at 971.

44. *See* Gagliardi v. Trifoods Int'l, Inc., 683 A.2d 1049, 1052 (Del. Ch. 1996). The court called this the "rational acceptance of corporate risk" and emphasized that because shareholders can diversity their portfolios, it is in their interest that corporate boards are not risk averse, but instead "accept for the corporation the highest risk

Twenty-three years after the creation of oversight liability by *Caremark*, and thirteen years after the Delaware Supreme Court's affirmation of the prerequisites of oversight liability in *Stone*, the court addressed and, for the first time, allowed to proceed beyond the pleading stage an oversight liability claim in *Blue Bell*.[45]

III. THE CASE: *MARCHAND V. BARNHILL (BLUE BELL)*

The Delaware Supreme Court's en banc decision in *Blue Bell* involved claims against Blue Bell's management for failing to properly respond to food safety concerns and against the board for failing to implement a reporting system to inform itself of food safety compliance.[46] The court addressed both counts in turn, but this note focuses only on the case as it relates to the allegations against the board.[47]

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adjusted returns available that are above the firm's cost of capital." *Id.* However, a lower pleading standard, such as negligence, that allows directors to be held derivatively liable if these risky investments do not work out will discourage directors from taking any risks in the first place. *Id.*

45. *Caremark* was first decided in 1996, *Stone* reached the Delaware Supreme Court in 2006, and *Blue Bell* was decided in 2019. *See generally Blue Bell*, 212 A.3d 805; *Stone*, 911 A.2d 362; *Caremark*, 698 A.2d 959.

46. *See Blue Bell*, 212 A.3d at 809, 815–16.

47. While this note does not delve into the court's analysis of the claim against Blue Bell's management, it does not by doing so disregard this analysis as uninteresting or unimportant. The dismissal of the claim against management relied on whether demand on the board would have been futile—"whether a majority of [the b]oard could [not] impartially consider a demand." *Id.* at 807–08 (quoting Marchand v. Barnhill, C.A. No. 2017-0586-JRS, 2018 WL 4657159, at *16 (Del. Ch. Sept. 27, 2018), *rev'd*, 212 A.3d 805 (Del. 2019)). Two tests may be used to determine demand futility:

> The *Aronson* test applies to claims involving a contested transaction *i.e.*, where it is alleged that the directors made a conscious business decision in breach of their fiduciary duties. That test requires that the plaintiff allege particularized facts creating a reason to doubt that "(1) the directors are disinterested and independent or that (2) the challenged transaction was otherwise the product of a valid exercise of business judgment." . . . The second (*Rales*) test applies where the subject of a derivative suit is not a business decision of the Board but rather a violation of the Board's oversight duties. The *Rales* test requires that the plaintiff allege particularized facts establishing a reason to doubt that "the board of directors could have properly exercised its independent and disinterested business judgment in responding to a demand."

Wood v. Baum, 953 A.2d 136, 140 (Del. 2008) (first quoting Aronson v. Lewis, 473 A.2d 805, 814 (Del. 1984), *overruled in part by* Brehm v. Eisner, 746 A.2d 244 (Del. 2000); then quoting Rales v. Blasband, 634 A.2d 927, 934 (Del. 1993), *abrogated in part by* Hamilton Partners, L.P. v. Englard, 11 A.3d 1180 (Del. Ch. 2010).

A. Factual Background[48]

Blue Bell Creameries USA, Inc. (Blue Bell) is an ice cream manufacturer and producer that suffered a deadly listeria outbreak.[49] Food safety regulations at both the federal and state levels require Blue Bell to prevent and monitor possible contamination hazards.[50] Between 2009 and 2015, multiple regulators, including the federal Food and Drug Administration (FDA), Texas Department of State Health, and Alabama Department of Health, as well as independent laboratories, identified contamination concerns at all three of Blue Bell's manufacturing plants.[51] Starting in February of 2015, Blue Bell recalled some of its products following positive test results for listeria at one of its facilities and by April had recalled all of its products.[52] The Center for Disease Control and Prevention identified two of Blue Bell's plants as the cause of a listeria outbreak that killed three adults and sickened five others.[53] An FDA inspection following the recall

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The issue in *Blue Bell* was whether one particular board member, W.J. Rankin, would have been able to act impartially when considering a demand to sue two officers, and the court adopted the *Rales* test to analyze this issue. *Blue Bell*, 212 A.3d at 808, 818. The court emphasized the role that the Kruse family had played in mentoring and otherwise supporting Rankin and his career when deciding that it was fairly inferable that he would not have been able to act impartially when deciding whether to sue Paul Kruse. *Id.* at 818–19.

In deciding so, the court downplayed the significance of Rankin's decision to vote against Paul Kruse to separate the CEO and Chairman positions, and emphasized instead that "the nature of the decision at issue must be considered in determining whether a director is independent." *Id.* at 819. Citing cases that seem to share this sentiment, the court stated that the decision to sue officers is much more serious than the decision to vote against them. *See id.* at 819 & n.95. The notion that director independence is measured differently depending on the subject matter at issue is interesting in itself. However, the court's characterization of Rankin's vote also raises some questions. The court said that Rankin "had voted differently from Paul Kruse on a proposal," but this characterization does not fully encompass the significance of this vote. *Id.* at 819. The vote had to do with separating the CEO, President, and Chairman of the Board positions so that different people held each position rather than Paul Kruse holding each. Marchand v. Barnhill, C.A. No. 2017-0586-JRS, 2018 WL 4657159, at *15 (Del. Ch. Sept. 27, 2018), *rev'd*, 212 A.3d 805 (Del. 2019). After this proposal was passed and Paul Kruse threatened to resign, Rankin was one of only two people that voted against the rest of the board on a proposal to reunify the positions. *Id.* Therefore, the event was much more than Rankin voting "differently" than Paul Kruse—he was voting *against* him on a decision central to Paul Kruse's continued employment with the company.

48. I summarize the facts as the court stated them; the court relied on "the plaintiff's complaint, documents incorporated by reference into the complaint, and the Court of Chancery's opinion based on these same documents." *Blue Bell*, 212 A.3d at 809 n.13.

49. *Id*. at 807.

50. *Id.* at 810.

51. *Id.* at 811–14.

52. *Id.* at 813–14.

53. *Id.* at 814.

found contamination and compliance issues similar to the ones discovered in years prior, indicating that Blue Bell had failed to properly address years of compliance deficiencies.[54] Members of management, including the CEO and the Vice President of Operations who both sat on Blue Bell's board, were aware of the continuing compliance deficiencies.[55] Employee interviews further supported the contention that management ignored and contributed to compliance concerns.[56]

During this period, the board was largely unaware and uninformed of compliance issues.[57] According to the Delaware Supreme Court, the board did not have a food safety committee, a process to specifically devote board meeting time to food safety issues, or a protocol or expectation of reporting by management to the board.[58] Board meeting minutes from 2014 do not reflect that the board specifically discussed listeria-related issues at the plants; the only references to food safety were general references to discussions of plant operations, a good report from the Texas Commission on Environmental Quality, and a positive report from a third-party sanitation auditor.[59] The first time the board directly discussed the listeria problem was two days after the first recall in February 2015, when the board received information of regulators' involvement in the recall.[60] The board met again, two days after an increased recall in March, and adopted a resolution encouraging management to solve the problem.[61]

B. Procedural History

The Court of Chancery concluded that the plaintiff had failed to properly allege either claim—against management or the board—and dismissed the

54. *See id.* at 814–15.
55. *See id.* at 811 ("Paul Kruse, Blue Bell's President and CEO, and his cousin, Paul Bridges, were responsible for the three plants Blue Bell operated in Texas, Oklahoma, and Alabama. The complaint alleges that, despite being responsible for overseeing plant operations, Paul Kruse and Bridges failed to respond to signs of trouble in the run up to the *listeria* outbreak."); Marchand v. Barnhill, C.A. No. 2017-0586-JRS, 2018 WL 4657159, at *3 (Del. Ch. Sept. 27, 2018), *rev'd*, 212 A.3d 805 (Del. 2019).
56. *Blue Bell*, 212 A.3d at 815.
57. *Id.* at 812–14.
58. *Id.* at 813.
59. *Id.* at 812–13.
60. *Id.* at 813–14.
61. *Id.* at 814.

complaint.[62] As for the *Caremark* claim, the court analyzed whether the plaintiff had alleged a claim under either prong of the oversight liability test: utter failure to implement any system of controls or conscious failure to monitor an implemented system.[63] The court found that although the plaintiff's argument principally relied on the board's failure to implement a reporting system, the plaintiff failed to plead particularized facts that the board "'utterly' failed to adopt or implement *any* reporting and compliance systems," and thus did not plead a valid claim under the first prong.[64] Rather, the court concluded that what the plaintiff "really attempts to challenge is not the *existence* of monitoring and reporting controls, but the *effectiveness* of monitoring and reporting controls in particular instances."[65] The court also found that the plaintiff did not plead a claim under the second prong because the plaintiff failed to allege that the board acted in bad faith by knowing of and consciously ignoring red flags; the plaintiff did not even allege that the board was aware of any red flags.[66]

C. Analysis and Conclusion

The Delaware Supreme Court ultimately held that "the complaint alleges particularized facts that support a reasonable inference that the Blue Bell board failed to implement any system to monitor Blue Bell's food safety performance or compliance" and that the "board's 'utter failure to attempt to assure a reasonable information and reporting system exists' is an act of bad faith in breach of the duty of loyalty."[67] The court summarized its reasoning as follows:

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62. Marchand v. Barnhill, C.A. No. 2017-0586-JRS, 2018 WL 4657159, at *2 (Del. Ch. Sept. 27, 2018), *rev'd*, 212 A.3d 805 (Del. 2019). The court also explained why a heightened pleading standard applied in this case. When stockholders bring derivative suits on behalf of a corporation, such as this one, they must make a demand on that corporation's board to pursue the claim or show that such a demand would be futile and should be excused. DEL. CH. CT. R. 23.1(a); *Marchand*, 2018 WL 4657159, at *11 (citing Beam v. Stewart, 845 A.2d 1040, 1044 (Del. 2004)). When plaintiffs choose the latter, they must meet "stringent requirements of factual particularity that differ substantially from the permissive notice pleadings" that are normally permitted at this stage in litigation. *Marchand*, 2018 WL 4657159, at *11 (quoting Brehm v. Eisner, 746 A.2d 244, 254 (Del. 2000)). The analysis of demand futility thus leads to an analysis of the merits of the claim.

63. *Marchand*, 2018 WL 4657159, at *16 (citing Stone v. Ritter, 911 A.2d 362, 370 (Del. 2006)).

64. *Id.* at *17–18.

65. *Id.* at *18.

66. *Id.* at *18–19.

67. Marchand v. Barnhill (*Blue Bell*), 212 A.3d 805, 809 (Del. 2019) (quoting *In re* Caremark Int'l Inc. Derivative Litig. (*Caremark*), 698 A.2d 959, 971 (Del. Ch. 1996)).

> As a monoline company that makes a single product—ice cream—Blue Bell can only thrive if its consumers enjoyed its products and were confident that its products were safe to eat. That is, one of Blue Bell's central compliance issues is food safety. Despite this fact, the complaint alleges that Blue Bell's board had no committee overseeing food safety, no full board-level process to address food safety issues, and no protocol by which the board was expected to be advised of food safety reports and developments. Consistent with this dearth of any board-level effort at monitoring, the complaint pleads particular facts supporting an inference that during a crucial period when yellow and red flags about food safety were presented to management, there was no equivalent reporting to the board and the board was not presented with any material information about food safety. Thus, the complaint alleges specific facts that create a reasonable inference that the directors consciously failed "to attempt to assure a reasonable information and reporting system existed."[68]

In coming to its conclusion, the court emphasized evidence that pointed to the lack of formal monitoring systems, to management's failure to report to the board, and thus, purportedly, to the nonexistence of an attempt at a board-level monitoring system.[69] Such evidence included meeting minutes and other books and records that, in the court's view, supported the plaintiff's following allegations: the board did not establish a formal food safety committee; no regular schedule or process required management to report to the board or required the board to consider food safety risks; board minutes did not reflect management's disclosure of red or yellow flags; the board was given favorable, but not negative information about food safety; and food safety issues were not regularly discussed at board meetings.[70] The court also placed weight on the fact that contamination compliance failures "might have been rectified had any reasonable reporting system that required management to relay food safety information to the board on an ongoing basis been in place."[71]

The court followed its mandate to accept the plaintiff's allegations and draw reasonable inferences from them.[72] It decided that it was reasonable to infer from the facts as alleged in the complaint that the "board has undertaken no efforts to make sure it is informed of a compliance issue

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68. *Id.* at 809 (citing *Caremark*, 698 A.2d at 971).
69. *Id.* at 822.
70. *Id*.
71. *Id.* This statement by itself exemplifies the court's contrived reasoning. *See infra* Section IV.A.
72. *See, e.g.*, *Blue Bell*, 212 A.3d at 818 (citing Del. Cty. Emps. Ret. Fund v. Sanchez, 124 A.3d 1017, 1022 (Del. 2015) ("In that consideration, it cannot be ignored that although the plaintiff is bound to plead particularized facts in pleading a derivative complaint, so too is the court bound to draw all inferences from those particularized facts in favor of the plaintiff, not the defendant, when dismissal of a derivative complaint is sought.")).

intrinsically critical to the company's business operation."[73] The court went beyond saying just that the compliance system or the board's efforts were not reasonable; it said "that no board-level system of monitoring or reporting on food safety existed."[74] It summarily rejected Blue Bell's argument that, because there was a management-level compliance system in place, it could be implied that there was also a board-level monitoring system.[75] The fact that management regularly reported operational issues to the board was also of little significance; the court dismissed this as a general and discretionary procedure.[76]

IV. IMPLICATIONS

The *Blue Bell* court's articulation of the standard for oversight liability and choice to draw certain inferences from the pleadings confuses the existence and effectiveness of a monitoring system, oversimplifies the good faith inquiry, and emphasizes formalities in place of substantive compliance. In doing so, the decision sends mixed messages to corporations.

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73. *Id.* at 822.
74. *Id.* at 824.
75. *Id.* at 823. The court stated:

> At best, Blue Bell's compliance with these requirements shows only that management was following, in a nominal way, certain standard requirements of state and federal law. It does not rationally suggest that the board implemented a reporting system to monitor food safety or Blue Bell's operational performance. The mundane reality that Blue Bell is in a highly regulated industry and complied with some of the applicable regulations does not foreclose any pleading-stage inference that the directors' lack of attentiveness rose to the level of bad faith indifference required to state a *Caremark* claim.

Id. Notice that the court described the inference that could be drawn in the plaintiff's favor from this evidence in the context of the board's lack of *attentiveness* not the board's *efforts* to put a monitoring system in place. While the industry's level of regulation, by itself, may not have foreclosed the possibility of bad faith, other factors, such as the fact that the board did receive reports, only received positive rather than negative reports until it was too late, and included members that were also officers, were relevant to the determination of whether it would be reasonable to infer that the board did not even *try* to implement a monitoring system. These issues are discussed in *infra* Part IV.

This analysis should also be compared to *Stone*, where the court took notice of the board's involvement in policy manuals and audits as evidence that the board instituted a reasonable reporting system. *See* Stone v. Ritter, 911 A.2d 362, 372–73 (Del. 2006); *see also Blue Bell*, 212 A.3d at 822–23 ("[T]he company had in place certain manuals for employees regarding safety practices and commissioned audits from time to time."). The *Blue Bell* court may not have had the benefit of a third-party report reflecting that the board approved policies, delegated compliance, and "exercised oversight by relying on periodic reports," but the absence of this information implied only that the board's involvement was unknown or ineffective, not nonexistent. *See Stone*, 911 A.2d at 372–73 (Del. 2006).

76. *Blue Bell*, 212 A.3d at 823–24.

A. Does the Monitoring System Need to Be Effective?

Despite its insistence to the contrary, the court conflated a nonexistent reporting system with an ineffective one. The rule articulated by *Caremark* and adopted by *Stone* placed liability on directors who either "(a) utterly failed to implement any reporting or information system or controls; or (b) having implemented such a system or controls, consciously failed to monitor or oversee its operations thus disabling themselves from being informed of risks or problems requiring their attention."[77] An ineffective reporting system, without more, is not a basis for a *Caremark* claim.[78] However, because the court was constrained by the complaint, which alleged that no monitoring system existed,[79] it was forced to fit what might

77. *Stone*, 911 A.2d at 370.

78. *See, e.g.*, Marchand v. Barnhill, C.A. No. 2017-0586-JRS, 2018 WL 4657159 at *19 (Del. Ch. Sept. 27, 2018), *rev'd*, 212 A.3d 805 (Del. 2019). "[A]llegations that 'there ultimately may have been failures by employees to report deficiencies to the Board [provide] no basis for an oversight claim seeking to hold the directors personally liable for such failures by the employees.'" *Id.* at *19 n.198 (quoting *Stone*, 911 A.2d at 373). "[A] director cannot be put on 'inquiry notice by something he or she never saw or heard.'" *Id.* (quoting *In re* Citigroup Inc. S'holders Litig., No. 19827, 2003 WL 21384599, at *2 (Del. Ch. June 5, 2003), *aff'd sub nom.* Rabinovitz v. Shapiro, 839 A.2d 666 (Del. 2003)). "[B]ad faith means 'the directors were conscious of the fact that they were not doing their jobs, and that they ignored red flags indicating misconduct in defiance of their duties' and that it is not enough to plead that 'some hypothetical, especially zealous, board might have discovered and stopped the conduct complained of' in order to impose oversight liability." *Id.* (quoting David B. Shaev Profit Sharing Account v. Armstrong, No. Civ.A. 1449-N, 2006 WL 391931, at *5 (Del. Ch. Feb. 13, 2006), *aff'd*, 911 A.2d 802 (Del. 2006)). The court in *In re General Motors* "conclud[ed] that the complaint did not allege particularized facts showing 'that the Board had knowledge that General Motors' system was inadequate or that the Board consciously remained uninformed on this issue.'" *Id.* (quoting *In re* Gen. Motors Co. Derivative Litig., C.A. No. 9627-VCG, 2015 WL 3958724, at *14 (Del. Ch. June 26, 2015), *aff'd*, 133 A.3d 971 (Del. 2016)).

79. *See* Verified Stockholder Derivative Action Complaint at 2, Marchand v. Barnhill, C.A. No. 2017-0586-JRS, 2018 WL 4657159 (Del. Ch. Sept. 27, 2018) [hereinafter Complaint] ("[T]he Board of Directors willfully failed to exercise its fundamental authority and duty to govern Company management and *establish standards and controls for Company compliance*, in breach of the directors' fiduciary duty of loyalty to the company." (emphasis added)); *see also Blue Bell*, 212 A.3d at 811 ("[T]he complaint alleges that management turned a blind eye to red and yellow flags that were waved in front of it by regulators and its own tests, and the board—by failing to implement any system to monitor the company's food safety compliance programs—was unaware of any problems until it was too late."); *Marchand*, 2018 WL 4657159, at *17–19 (noting that the plaintiff relied primarily on a "first prong" theory of liability and that the court was "unable to discern whether Plaintiff actually intends to advance a second-prong *Caremark* claim"). The complaint repeatedly referred to liability based on a "willful failure to govern management" by failing to "establish

otherwise have been considered an ineffective system into a box that only allowed room for the inference that a monitoring system was completely nonexistent.

Much of the evidence that the court cited lends more naturally to an inference that an ineffective monitoring system was in place rather than an inference that no monitoring system existed. For example, the complaint alleged that before the listeria outbreak, management was aware of reports that should have alerted them to the severity of the compliance issues but still failed to report any of this information to the board.[80] In fact, during this period, management reported only positive information about food safety to the board and withheld negative reports.[81] The board met to discuss the issue just two days after both the initial product recall and the extended recall.[82] Together, this evidence lends to a reasonable inference that management, in its discretion, chose to withhold concerning information from the board until it was unavoidable; it does not necessarily follow that the board failed to *try* to implement a system by which they *expected* management to regularly report this type of information.

The court also stated that had a reporting system been in place that required reports from management at specified time intervals, the consequences of the outbreak *might* have been avoided.[83] Notably, these compliance failures might also have been rectified had management done a better job at reporting them to the board. This seems to be more of an observation on

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standards and controls for Company compliance." Complaint, *supra*, at 2, 41. The complaint alluded vaguely to a "failure of controls" and an "inadequacy of procedures" but attributed the problem to the board's support of management and "blatantly evident lack of adequate oversight and reporting" "despite the obvious existential threat to the Company due to management's failure to operate the Company safely." *Id.* at 41–42, 47. Therefore, it appears that the plaintiff attempted to claim that management's compliance procedures were ineffective and the board's oversight system was nonexistent. The Appellant's Opening Brief also made clear that it was the lack of a board-level system, not its ineffectiveness, that the plaintiff challenged. Appellant's Opening Brief at 22–23, Marchand v. Barnhill (*Blue Bell*), 212 A.3d 805 (Del. 2019) (No. 533,2018).

80. *Blue Bell*, 212 A.3d at 822.

81. *Id.*

82. *Id.* at 813–14.

83. *Id.* at 822. The statement assumes that a particular result followed because of a failure of the board, but assuming the opposite—that the same consequence would have resulted had the board had a proper monitoring system in place—contradicts this statement's value. Assuming the court had concluded that the board had proper oversight mechanisms in place, the board would still have had the same absence of knowledge, and if the board had knowledge of the circumstances, the business judgment rule would have applied to any decision the board subsequently made. *See, e.g.*, *In re* Caremark Int'l Inc. Derivative Litig. (*Caremark*), 698 A.2d 959, 967 (Del. Ch. 1996) (noting that a board decision that was allegedly "ill advised or 'negligent' . . . will typically be subject to review under the director-protective business judgment rule, assuming the decision made was the product of a *process* that was *either* deliberately considered in good faith or was otherwise rational").

the board's lack of knowledge and its subsequent consequences rather than on the board's attempt to acquire knowledge. The board did not have the requisite knowledge either because the board failed to attempt to implement a system or because management was ineffective at complying with a poorly implemented system, two plausible assumptions that can reasonably be drawn from a *might* statement like this. Despite the court's mandate that it must draw all reasonable inferences in favor of the plaintiff, it is a stretch to say that the fact that consequences *might* have been different, had the board had a proper system in place, is evidence that the board *did not* have a proper system in place.

Some of the court's reasoning appears to be either a Freudian slip or an intentional blurring of the distinction made in *Stone* between the failure to implement a system and the conscious failure to monitor one. In concluding that a management-level compliance system was not evidence of a board-level monitoring system, the court said that this evidence "does not foreclose any pleading-stage inference that the directors' lack of attentiveness rose to the level of bad faith indifference required to state a *Caremark* claim."[84] By using lack of *attentiveness* as a measure of bad faith, the court contradicted its own holding that bad faith lies in the lack of *effort* in establishing a reporting system[85] and alluded to a measure of bad faith that is more appropriately used in conjunction with a failure to *oversee*—or pay attention to—a reporting system already in place.[86] It is difficult to imagine how a director can be inattentive to something that does not exist.

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84. *Blue Bell*, 212 A.3d at 823.

85. *See id.* at 821 ("[T]he board must make a good faith effort—*i.e.*, try—to put in place a reasonable board-level system of monitoring and reporting." (citing Stone v. Ritter, 911 A.2d 362, 370 (Del. 2006))).

86. *See Stone*, 911 A.2d at 370 (setting forth the two types of oversight liability). In fact, at least one lower court interpreting *Blue Bell* has similarly confused the two types of bad faith established by *Stone*. *See* Lebanon Cty. Emps.' Ret. Fund v. Amerisourcebergen Corp., C.A. No. 2019-0527-JTL, 2020 WL 132752 (Del. Ch. Jan. 13, 2020). As part of its discussion of director liability stemming from either the failure to implement a monitoring system or to oversee such a system, the court cited *Blue Bell* in support of the latter. *Id.* at *20–21. The court quoted a portion of the *Blue Bell* opinion discussing the type of bad faith resulting from failure to implement a monitoring system to explain liability for failure to oversee a monitoring system already in place. *See id.* at *20 (quoting *Blue Bell*, 212 A.3d at 822). The full quote from *Blue Bell* reads:

> [T]he complaint supports an inference that no system of board-level compliance monitoring and reporting existed at Blue Bell. Although *Caremark* is a tough standard for plaintiffs to meet, the plaintiff has met it here. When a plaintiff can plead an inference that a board has undertaken no efforts to make sure it is informed of a compliance issue intrinsically critical to the company's business

Ultimately, the court's reasoning was contrived to meet its desired end. The court at best placed too little weight on, and at worst ignored, the significance of evidence that leads to an inference that an ineffective system existed. Its reasoning confused nonexistence with ineffectiveness and implied that evidence of one can lead to inferences of the other.

B. Form or Substance: What Matters More to Oversight Liability?

In the eyes of the court, a board may only exemplify its efforts to establish a monitoring system by observing formalities.[87] The court found that the complaint alleged that the board did not have a food safety committee, a specific portion of board meetings devoted to food safety, or an expectation of consistent and mandatory reporting from management.[88] From this, the court inferred that the board "had made no effort at all to implement a board-level system of mandatory reporting of any kind."[89]

This emphasis on formalities was not necessarily new. As the court pointed out, "plaintiffs usually lose because they must concede the existence of board-level systems of monitoring and oversight such as a relevant committee, a regular protocol requiring board-level reports about the relevant risks, or the board's use of third-party monitors, auditors, or consultants."[90] *Caremark* itself involved a board that had a formal ethics committee that used outside auditors.[91] *Stone* also involved an oversight committee that oversaw the particular compliance programs at issue.[92]

> operation, then that supports an inference that the board has not made the good faith effort that *Caremark* requires.

Blue Bell, 212 A.3d at 822.

87. *See Blue Bell*, 212 A.3d at 809 ("[T]he complaint alleges that Blue Bell's board had no committee overseeing food safety, no full board-level process to address food safety issues, and no protocol by which the board was expected to be advised of food safety reports and developments. Consistent with this dearth of any board-level effort at monitoring, . . . the complaint alleges specific facts that create a reasonable inference that the directors consciously failed 'to attempt to assure a reasonable information and reporting system existed.'" (quoting *Caremark*, 698 A.2d at 971)).

88. *Id.* at 813.

89. *Id.*

90. *Id.* at 823. For several examples cited by the court in support of this contention, see *id.* at 823 n.112. Lower courts have adopted this insistence on formalities in the wake of the *Blue Bell* opinion. *See In re* Lendingclub Corp. Derivative Litig., C.A. No. 1298-VCM, 2019 WL 5678578, at *9 n.59 (Del. Ch. Oct. 31, 2019) (acknowledging that Plaintiff's complaint recognized the existence of multiple committees and an independent auditor, thereby constituting a formal monitoring system); Rojas v. Ellison, C.A. No. 2018-0755-AGB, 2019 WL 3408812, at *9 (Del. Ch. July 29, 2019) (concluding that the board's audit committee was evidence of a board-level monitoring system).

91. *See Caremark*, 698 A.2d at 963.

92. *Stone*, 911 A.2d at 371.

However, the *Blue Bell* court gave little credit to the fact that an informal equivalent of a committee existed on Blue Bell's board. Two members of management, Paul Kruse, President and CEO, and Greg Bridges, Vice President of Operations, both sat on Blue Bell's board[93] and they both "'provided regular reports regarding Blue Bell operations to the . . . Board,' including reports about audits of Blue Bell's facilities."[94] Kruse and Bridges were the two most senior officers responsible for company operations and were the two people most responsible for food safety compliance.[95] A board's trust in a subset of its directors does not lead to an inference that the board as a whole acted in bad faith, and reliance on two board members intimately involved in operations cannot be reasonably seen as the full board taking "no efforts to make sure it is informed of a compliance issue intrinsically critical to the company's business operation."[96]

The court also gave little significance to the fact that the board likely expected a certain level of reporting from management on food safety issues. It can reasonably be inferred that the board expected management to report on food safety regularly, just as the board expected reports on operations regularly,[97] because food safety was a "compliance issue intrinsically critical to the company's business operation."[98] Based on the same facts, the Court of Chancery concluded that there was "consistent reporting by

93. Marchand v. Barnhill, C.A. No. 2017-0586-JRS, 2018 WL 4657159, at *3 (Del. Ch. Sept. 27, 2018), *rev'd*, 212 A.3d 805 (Del. 2019). Richard Dickson, another Blue Bell director, also served as sales manager and plant manager of the Oklahoma plant before becoming the company's President in 2017. Complaint, *supra* note 79, at 7. Presumably, as a manager involved in plant operations, he also had some knowledge of at least some of the compliance issues and had the opportunity to report them to the full board. However, the complaint focused on Kruse and Bridges, who "knowingly disregarded contamination risk and safety compliance and continued the Company's production and distribution of ice cream." *Id.* at 39.

94. *Blue Bell*, 212 A.3d at 817 (quoting *Marchand*, 2018 WL 4657159, at *17).

95. Appellant's Opening Brief, *supra* note 79, at 12.

96. *Blue Bell*, 212 A.3d at 822.

97. *See id.* at 823–24.

98. *Id.* at 822 (discussing evidence of board-level efforts regarding "what has to be one of the most central issues at the company: whether it is ensuring that the only product it makes—ice cream—is safe to eat"); *see also id.* at 824 (discussing food safety as "the obviously most central consumer safety and legal compliance issue facing the company"). The court itself even lumped together food safety and operations. *See, e.g.*, *id.* at 823 (Blue Bell's compliance with food safety regulations "does not rationally suggest that the board implemented a reporting system to monitor food safety or Blue Bell's operational performance.").

senior management to Blue Bell's board on operations."[99] Therefore, contrary to the Delaware Supreme Court's assertion that "it is inferable that there was no expectation of reporting to the board of any kind,"[100] the board likely reasonably expected Kruse and Bridges to report food safety concerns to it as consistently as they reported other operational concerns, especially when these two most senior members of management in effect constituted a board committee.[101]

The court's insistence on formalities in the context of director oversight liability downplays the significance that good faith has in the equation. When a director's good faith, and thus their liability, is measured in terms of how expensive of a lawyer they hired to organize the board's structure rather than by the substance of their efforts to oversee the corporation, good faith loses its significance. Insistence on formalities has its place in corporate law, but a more flexible and realistic standard might be more appropriate when dealing with issues that deserve a more deferential touch.[102]

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99. *Id.* at 817.

100. *Id.* at 813.

101. The appellant specifically conceded that Kruse and Bridges provided reports to the board on a monthly basis yet failed to mention any of the food safety compliance issues. Appellant's Opening Brief, *supra* note 79, at 35. Considering that these two members of management were aware of the growing compliance concerns for a matter of years, Kruse and Bridges had ample opportunity to report these issues to the *rest* of the board. Their failure to do so reflected not only on their failures as officers, but also on their failures as board members. Perhaps the real issue was not the board's failure to designate a committee in charge of monitoring food safety, but rather its failure to place board members that were not management on this committee. The board exercised its discretion in trusting compliance oversight to the de facto committee, and it was this committee's ineffectiveness in reporting to the entire board that kept the board unaware of the compliance issues. Thus, although a de facto committee existed as an oversight mechanism, this committee was simply ineffective.

102. For example, Delaware rejects the de facto merger doctrine—in which the target company's assets are sold to the acquiring company and then the target company is dissolved—and considers the sale and dissolution to be two separate transactions that do not require the same protections that a merger would. *See, e.g.*, Hariton v. Arco Elecs., Inc., 188 A.2d 123, 125 (Del. 1963). *But see* Orzeck v. Englehart, 195 A.2d 375, 378 (Del. 1963) (noting that the de facto merger doctrine may be recognized to protect shareholders when corporations fail to comply with statutes governing asset sales). The court recognized that Delaware has two separate statutes governing asset sales and mergers that are independently significant even if they have the same end result. *Orzeck*, 195 A.2d at 378. Therefore, a reorganization can proceed under either statute without being governed by the requirements of the other. *See id.* In this reorganization context, it is the formalities of the reorganization that determine the governing law, so an emphasis on formalities is appropriate to ensure certainty and discourage litigation. *See Hariton*, 188 A.2d at 125. However, in the context of fiduciary duty, where directors are afforded great deference, shareholders may be best served by a more flexible standard that allows for a case-by-case consideration of good faith.

C. How Important Is the Good Faith Inquiry?

What if the court had the opportunity to decide whether the complaint sufficiently alleged that the directors consciously failed to oversee a monitoring system already implemented? The court could not point to the fact that the monitoring system was ineffective but, instead, would have to hold the directors liable by relying on evidence of the directors' bad faith, showing their conscious disregard of their known duty to monitor the reporting system.[103] The result the court would have reached is obviously just speculation. Even so, the court's analysis was curiously light on evidence of the directors' bad faith, efforts, and intentions.[104] The evidence recited by the court does not seem to establish that the board, rather than the

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103. *See Blue Bell*, 212 A.3d at 808 ("[T]he Court of Chancery reasoned that 'what Plaintiff really attempts to challenge is not the existence of monitoring and reporting controls, but the effectiveness of monitoring and reporting controls in particular instances,' and 'this is not a valid theory under . . . *Caremark*.'" (quoting Marchand v. Barnhill, C.A. No. 2017-0586-JRS, 2018 WL 4657159, at *18 (Del. Ch. Sept. 27, 2018), *aff'd*, 212 A.3d 805 (Del. 2019))); Stone v. Ritter, 911 A.2d 362, 370 (Del. 2006) (setting forth the two mutually exclusive bases for oversight liability). The Delaware Supreme Court seemed to accept the Court of Chancery's holding that an effectiveness argument was not a valid basis for *Caremark* liability because it cited the lower court's holding in this respect twice without comment. *See Blue Bell*, 212 A.3d at 808, 817. The court then went on to emphasize that it was the existence, not effectiveness, of the reporting system that was in question. *Id.* at 821.

104. Bad faith was only discussed when the court drew the inference that "the directors' lack of attentiveness rose to the level of bad faith indifference" and "that no reasonable compliance system and protocols were established." *Id.* at 823–24. This is true despite the fact that the court framed the ultimate issue of the case as "whether the complaint pleads facts supporting a reasonable inference that the board did not undertake *good faith efforts* to put a board-level system of monitoring and reporting in place." *Id.* at 821 (emphasis added). Perhaps the court was implying that if it can be inferred that the reporting system is entirely nonexistent, then it can be inferred that the directors did not sufficiently *try* to put a system in place.

The complaint relied on alleged evidence of the board's failure to establish a reporting system to monitor management's food safety compliance and only contained conclusory allegations that the board "willfully failed to govern management" and establish a system of controls. Complaint, *supra* note 79, at 40–41. The main evidence of intent was against Kruse and Bridges, members of the board and of management, in their knowing disregard of the risk of contamination. *Id.* at 39–40. However, the complaint alleged the board willfully disregarded their duties simply by trusting management when there was a reason, unbeknownst to the board, not to. *See id.* at 47. If the board as a whole was unaware of any of these risks and the officer-directors kept the board in the dark of these risks, this fact alone does not lead to an inference that the board acted knowing that they were disregarding their duties. If anything, it just shows that the board was naïve to put their trust in the officer-directors.

officer-directors in charge of compliance, acted in bad faith.[105] The court also gave little significance to the speediness with which the board responded when it received news of the recalls—it met only two days after each recall.[106] Trusting that other board members with better access to information would fulfill their fiduciary duty does not "demonstrate[e] a conscious disregard for their responsibilities" on the part of the rest of the board.[107] The board did not ignore any red flags before it and "'[r]ed flags' are only useful when they are either waived in one's face or displayed so that they are visible to the careful observer."[108] The officers aware of the red flags hid them from the board until it was too late, and "[i]n the absence of red flags, good faith in the context of oversight must be measured by the directors' actions 'to assure a reasonable information and reporting system exists' and not by second-guessing after the occurrence of employee conduct that results in an unintended adverse outcome."[109] And, as previously discussed, the court ignored allegations in the complaint that lead to an inference that an

105. It is important to note that a board of directors relies heavily on the officers and management to properly report to the board. *Caremark* endorsed the proposition that "absent grounds to suspect deception, neither corporate boards nor senior officers can be charged with wrongdoing simply for assuming the integrity of employees and the honesty of their dealings on the company's behalf." *In re* Caremark Int'l Inc. Derivative Litig. (*Caremark*), 698 A.2d 959, 969 (Del. Ch. 1996). *Stone* also emphasized that when board members delegate compliance responsibility to certain employees or departments and then rely on periodic reports from those employees, "there is no basis for an oversight claim seeking to hold the directors personally liable for" "failures by employees to report deficiencies to the Board." Stone v. Ritter, 911 A.2d 362, 373 (Del. 2006). The *Blue Bell* court, on the other hand, insisted that instead of delegating compliance to management, the board should have held "more frequent emergency board meetings to receive constant updates on the troubling fact that life-threatening bacteria was found in its products." *Blue Bell*, 212 A.3d at 814. How exactly was the board supposed to know to hold these board meetings when there were no red flags alerting the board to the existence of this bacteria and when management only fed the board positive results? Even after the partial recall when the board first became aware of the listeria problems, the board was presumably acting on knowledge of the outbreak but not of management's track record of suppressing compliance failures, so trusting management to come up with a proper solution would not have been unreasonable.

Ultimately, it was the discretion placed with Kruse and Bridges that led to Blue Bell's demise. Considering that both were members of the board, it was not just the discretion given to management that caused Blue Bell's downfall, as the plaintiff alleged, but the trust given to these two board members. *See* Appellant's Opening Brief, *supra* note 79, at 35. Therefore, there was evidence that Kruse and Bridges acted in bad faith by intentionally withholding compliance issues from the rest of the board, but there was no evidence to suggest that the rest of the board acted in bad faith by ignoring any red flags, because the potential red flags were withheld from them by those who were most familiar.

106. *See Blue Bell*, 212 A.3d at 813–14.

107. *See Stone*, 911 A.2d at 370.

108. *See In re* Citigroup Inc. S'holders Litig., No. 19827, 2003 WL 21384599, at *2 (Del. Ch. June 5, 2003).

109. *See Stone*, 911 A.2d at 373 (quoting *Caremark*, 698 A.2d at 971).

informal reporting system did exist. But because it did not have occasion to address the issue, the court did not decisively conclude whether there was any basis for a claim that the Blue Bell directors did not make a good faith effort to monitor a reporting system that was in place, regardless of how informal that reporting system was. A showing of a *formal* oversight system should not be necessary to establish good faith even if it is sufficient to do so.

Instead, the court's decision essentially creates a presumption that directors act in bad faith whenever it can be *inferred* that a reporting system did not exist. The court's holding nearly said this, but with an eye to the efforts of the directors in establishing that system: "When a plaintiff can plead an inference that a board has undertaken *no efforts* to make sure it is informed of a compliance issue intrinsically critical to the company's business operation, then that supports an inference that the board has not made the good faith *effort* that Caremark requires."[110] The fact that the court's analysis then turned to evidence of an inference of the nonexistence of a monitoring system, rather than of director efforts to establish a monitoring system, is what creates this presumption.[111] The court circumvented the requirement that the plaintiff plead lack of good faith—lack of effort—and allowed a complaint that pled enough facts for the court to infer that it was possible that a monitoring system did not exist to suffice. More is required; the plaintiff must show that the board did not even attempt in good faith to establish that system.

D. Practical Implications: Changes Companies Can Make to Ensure Their Board Has Done Enough to Avoid Liability

The court makes it clear that a corporation's adherence to the formalities laid out in the opinion is practically determinative of an oversight liability

110. *Blue Bell*, 212 A.3d at 822 (emphasis added).

111. *See, e.g.*, *id.* at 809 ("[T]he complaint pleads particular facts supporting an inference that during a crucial period when yellow and red flags about food safety were presented to management, there was no equivalent reporting to the board and the board was not presented with any material information about food safety. Thus, the complaint alleges specific facts that create a reasonable inference that the directors consciously failed 'to attempt to assure a reasonable information and reporting system existed.'" (quoting *Caremark*, 698 A.2d at 971)); *id.* at 813 (reciting the pleaded facts of an absence of a board food safety committee, of a specific portion of meetings devoted to food safety, and of a formal protocol of mandatory reports from management, then drawing inferences that the board did not expect reporting from management and thus that the board did not make any effort to implement mandatory reporting).

claim. Corporations should therefore be sure that the board has a committee that oversees, a board-level process that addresses, and a clear protocol for management to report on the companies' central compliance issues.[112] The board level process should, at the very least biannually, devote a specific portion of board meeting time to discussing the central compliance issues.[113] The board should also ensure that there is a clear, mandatory requirement that management report material compliance developments to the board.[114]

V. CONCLUSION

The Court of Chancery looked at the same factors highlighted by the Supreme Court—a highly regulated industry, ongoing third-party audits and tests, and management's reports on operations—and found that a board-level monitoring system did exist. Comparing these two competing interpretations of the evidence and conclusions about the inferences that can be drawn therefrom shows why the plaintiff did not meet the heightened burden of pleading particularized facts of bad faith that is necessary to establish demand futility.[115] More information was needed for the courts to properly characterize the board's good faith or lack thereof, but the pleadings did not supply or even allege this information. The Delaware Supreme Court's decision to allow the litigation to move forward rested on reasoning that was entirely one-sided and designed to adapt itself to a desirable result. Ultimately, the court ignored the role of bad faith in an oversight liability claim, confused its inference that a monitoring system did not exist with injections of evidence that pointed more directly to an ineffective system, and measured human intentions by their adherence to formalities rather than by the substance of their actions. Simply put, the court was too generous with its inferences and failed to give necessary deference to the Blue Bell board before concluding that they had acted in bad faith.[116]

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112. *See, e.g.*, *id.* at 809, 817, 822–23; *In re* Clovis Oncology, Inc. Derivative Litig., C.A. No. 2017-0222-JRS, 2019 WL 4850188, at *13 (Del. Ch. Oct. 1, 2019) (interpreting *Blue Bell* to mean that "when a company operates in an environment where externally imposed regulations govern its 'mission critical' operations, the board's oversight function must be more rigorously exercised" (quoting *Blue Bell*, 212 A.3d at 824)).

113. *See Blue Bell*, 212 A.3d at 813, 822.

114. *See id.* at 809, 813, 822.

115. *See, e.g.*, City of Birmingham Ret. & Relief Sys. v. Good, 177 A.3d 47, 55–56 (Del. 2017) (emphasizing how difficult it is to prove bad faith and that the inferences made must be objectively reasonable).

116. *See Blue Bell*, 212 A.3d at 821 ("[O]ur case law gives deference to boards and has dismissed *Caremark* cases even when illegal or harmful company activities escaped detection, when the plaintiffs have been unable to plead that the board failed to make the required good faith effort to put a reasonable compliance and reporting system in place.").