LITIGATION MINUTE: THE "G": GOVERNANCE ISSUES KEEP THE BOARD FROM GETTING BORED

ESG IN LITIGATION SERIES: PART THREE OF EIGHT

Date: 21 June 2022

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WHAT YOU NEED TO KNOW IN A MINUTE OR LESS

Class actions alleging the board of directors breached its fiduciary duties have become increasingly prevalent, as shareholders seek to hold companies liable for operations management, even across multiple corporate layers. These cases implicate governance factors, the “G” in “ESG,” which are focused on executive compensation, shareholder rights, and how a company is managed and holds itself accountable, such as through audits and internal controls.

Here is how this trend has developed in environmental, social, and governance (ESG) class actions.

Does the Board Even Care(*mark*)?

One of the most prevalent types of governance ESG class actions are shareholder derivative claims for breach of directors' oversight duties, typically called *Caremark* claims, after the seminal case *In re Caremark Int'l Derivative Litig.*, 698 A.2d 959 (Del. Ch. 1996). *Caremark* generally requires directors to (1) make a good-faith effort to ensure information and reporting systems are in place to prevent the corporation from violating the law, and (2) once such reporting systems are in place, to monitor or oversee their operation.[1] Because *Caremark* requires plaintiffs to plead particularized facts demonstrating bad faith (i.e., that a board either failed to implement a board-level information system or that it was alerted of misconduct and consciously disregarded the duty to address it), *Caremark* claims are difficult to prevail on.[2]

However, class action plaintiffs' lawyers have found some recent success. For example, a major company in the aerospace industry recently reached a US$237.5 million settlement for claims alleging the board's failure to monitor aircraft safety.[3] And *Caremark* claims against a major ice cream manufacturer recently survived a motion to dismiss based on an alleged failure to oversee food safety tied to a listeria outbreak that resulted in three deaths.[4]

To guard against *Caremark* claims, companies should maintain a detailed record of the board's oversight and compliance efforts, especially for operations that (1) could allow for embezzlement or other asset diversion; (2) deal with safety; and (3) that drive revenue. The board should also receive regularly comprehensive reports from the company's compliance officer to ensure that appropriate systems are in place and functioning well.

Everything the Light Touches is a Target

A number of claims have been filed that seek to bring claims against parent corporations for events or conduct that occurred at a direct or indirect subsidiary. These claims generally are based on allegations that the parent company owes a direct duty of care because large, international companies have group environment, health, and safety (EHS) policies.

For example, a large consumer goods company faced claims that it placed members of a Kenyan minority tribe at risk by bringing them together to work at a tea plantation, following a violent attack after local elections. And a multinational banking and financial services corporation faced a putative class action alleging fraud based on widespread money laundering at a former branch in Estonia.

To provide additional protection against such claims, companies should consider their corporate structures with an eye toward assessing whether there are operations that should be subsidiaries or spun off. Further, companies should evaluate whether the necessary resources and expertise are provided to local operations and subsidiaries, as appropriate. To reduce risk, companies can look to limit centralized services (other than oversight) and limit involvement in day-to-day local and subsidiary operations as much as reasonably possible.

FOOTNOTES

[1] *In re Citigroup Inc. S'holder Derivative Litig.*, 964 A.2d 106, 123–24 (Del. Ch. 2009).

[2] *Stone ex rel. AmSouth Bancorporation v. Ritter*, 911 A.2d 362, 370 (Del. 2006).

[3] For more on this case, see this U.S. Litigation and Dispute Resolution Alert published by our colleagues: Approval of US$237.5 Million Settlement in Boeing Derivative Action Demonstrates Impact of Section 220 Demand in ESG Litigation.

[4] See *Marchand v. Barnhill*, 212 A.3d 805 (Del. 2019).

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