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# *Boeing* Decision Underscores Need for Board Oversight of "Mission Critical" Product Safety Risks – And Documentation Demonstrating This Oversight

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*The Delaware Court of Chancery's recent decision denying a motion to dismiss in* In re The Boeing Company Derivative Litigation*, 2021 WL 4059934 (Del. Ch. Sept. 7, 2021), reminds directors and their counsellors of the importance of board and board committee level oversight and monitoring of "mission critical" product safety risks – in this case airplane safety. Perhaps even more important for litigation purposes, the Boeing decision also reminds directors and their counsellors of the importance of documenting these efforts in a manner that can be produced to stockholders making demands for books and records under Section 220 of the Delaware General Corporation Law.*

The *Boeing* decision addressed derivative claims by stockholders of The Boeing Company against members of Boeing's board of directors alleging oversight failures following October 2018 Lion Air and March 2019 Ethiopian Airlines crashes of Boeing 737 MAX airplanes that killed everyone on board. Investigations revealed that the 737 MAX tended to pitch up due to its engine placement; that a new software program designed to adjust the plane downward depended on a single faulty sensor and therefore activated too readily; and that the software program was insufficiently explained to pilots and regulators. In both crashes, the software directed the plane down. The crashes caused Boeing and its stockholders to lose billions in value.

As is now customary in Delaware courts, stockholders sought books and records pursuant to Section 220 before filing suit. Plaintiffs obtained 44,100 documents totaling over 630,000 pages, and used these board-level documents to allege that Boeing's board of directors failed in its oversight duties both before and after the crashes. Plaintiffs' complaint and the court's decision focused on what the documents showed the board and its committees did and did not do – or at least did not document doing – with respect to oversight of safety issues. The court stated that "[i]t is reasonable to infer that exculpatory information not reflected in the document production does not exist."

Oversight claims – known as *Caremark* claims, a moniker coined after *In re Caremark International Inc. Derivative Litigation*, 698 A.2d 959 (Del. Ch. 1996) – require, at the pleading stage, particularized facts showing either that

(1) "the directors utterly failed to implement any reporting or information system or controls," or (2) "having implemented such a system or controls, [the directors] consciously failed to monitor or oversee its operations thus disabling themselves from being informed of risks or problems requiring their attention." As first observed in *Caremark*, a claim that corporate fiduciaries have breached their duties to stockholders by failing to monitor corporate affairs is "possibly the most difficult theory in corporation law upon which a plaintiff might hope to win a judgment" – a maxim that has been repeated many times, and that was described in *Boeing* as "among the hoariest of Chancery clichés." "*Caremark* does not demand omniscience," and directors need only "make a good faith effort to implement an oversight system and then monitor it." As noted in *Boeing*, "Delaware courts routinely reject the conclusory allegation that because illegal behavior occurred, internal controls must have been deficient, and the board must have known so."

*Boeing*, however, illustrates the unusual – but, as noted below, increasingly common – case involving oversight of safety issues where allegations succeeded under *Caremark* (and, in this case, under both of *Caremark*'s alternative prongs).

*Caremark Prong One: "the directors utterly failed to implement any reporting or information system or controls."* The court emphasized that "[d]irectors may use their business judgment to 'design context- and industry-specific approaches tailored to their companies' businesses and resources" but "must make a good faith effort – i.e., try – to put in place a reasonable board-level system of monitoring and reporting" in a manner "designed to ensure reasonable reporting and information systems exist that would allow directors to know about and prevent wrongdoing that could cause losses for the Company."

The court focused on the Delaware Supreme Court's 2019 decision in *Marchand v. Barnhill*, 212 A.3d 805 (Del. 2019), which distinguished the situation at hand – food safety (and Blue Bell Creameries' distribution of ice cream tainted by listeria) – from traditional *Caremark* cases focusing on oversight systems monitoring financial wrongdoing like accounting fraud. The court described food safety as the "most central safety and legal compliance issue facing" Blue Bell and an area in which the board's oversight function therefore "must be more rigorously exercised" with "a sensitivity to compliance issues intrinsically critical to the company." The *Marchand* court concluded, based on the documents that Blue Bell produced in response to a Section 220 books and records inspection demand in that case, that

- no board committee that addressed food safety existed;
- no regular process or protocols that required management to keep the board apprised of food safety compliance practices, risks, or reports existed;
- no schedule for the board to consider on a regular basis, such as quarterly or biannually, any key food safety risks existed;
- during a key period leading up to the deaths of three customers, management received reports that contained what could be considered red, or at least yellow, flags, and the board minutes of the relevant period revealed no evidence that these were disclosed to the board;
- the board was given certain favorable information about food safety by management, but was not given important reports that presented a much different picture; and
- the board meetings are devoid of any suggestion that there was any regular discussion of food safety issues.

The court stated in *Boeing* that, like food safety in *Marchand*, airplane safety was "'mission-critical' to Boeing's business." The court stated, based on the documents Boeing produced in response to plaintiffs' Section 220 demand, that Boeing's board had no committee charged with direct responsibility to monitor airplane safety, and that the audit committee, while charged with risk oversight, focused on financial risks – as evidenced by yearly report the audit committee received on Boeing's compliance risk management process that contained nothing on airplane safety. The court noted that "[t]his stood in

contrast to many other companies in the aviation space whose business relies on the safety and flightworthiness of airplanes," pointing to "board-level safety committees and control at Southwest Airlines, Delta Airlines, United Airlines, JetBlue, Spirit Airlines, and Alaska Airlines."

The court stated that the documents Boeing produced in response to plaintiffs' Section 220 demand also did not support the conclusion that the board as a whole formally addressed or monitored safety. The court stated that "[t]he Board did not regularly allocate meeting time or devote discussion to airplane safety and quality control," did not "establish a schedule under which it would regularly assess airplane safety to determine whether legitimate safety risks existed," and had "no regular process or protocols requiring management to apprise the Board of airplane safety" and "only received *ad hoc* management reports that conveyed only favorable or strategic information." The court stated that "the reports the Board received throughout the 737 MAX's development and FAA certification were high-level reports focused on the Company's operations and business strategy," not safety. The board "received intermittent, management-initiated communications that mentioned safety in name, but were not safety-centric and instead focused on the Company's production and revenue strategy." And, "when safety was mentioned to the Board, it did not press for further information, but rather passively accepted management's assurances and opinions." The court added that "[t]he lack of Board-level safety monitoring was compounded by Boeing's lack of an internal reporting system by which whistleblowers and employees could bring their safety concerns to the Board's attention."

The court emphasized that, "[f]or mission-critical safety, discretionary management reports that mention safety as part of the Company's overall operations are insufficient to support the inference that the Board expected and received regular reports on product safety." The court stated that "[a]n effective monitoring system is what allows directors to believe that, unless issues or 'red flags' make it to the board through that system, corporate officers and employees are exercising their delegated powers in the corporation's best interest."

*Caremark Prong Two: "having implemented such a system or controls, [the directors] consciously failed to monitor or oversee its operations thus disabling themselves from being informed of risks or problems requiring their attention."* The court also held that plaintiffs stated a claim under the second prong of *Caremark* following the October 2018 Lion Air crash: "the board knew of evidence of corporate misconduct – the proverbial red flag – yet acted in bad faith by consciously disregarding its duty to address that misconduct."

The court stated that "Boeing's safety issues manifested in the Lion Air Crash – an accident the Board could not help but learn about, despite the lack of a Board-level monitoring system" because the crash and its causes were widely reported in the media. The court stated that the documents Boeing produced in response to plaintiffs' Section 220 demand permitted the inference that "[t]he Board did not request any information about it from management, and did not receive any until November 5, 2018, over one week after it happened." The board-level record suggested that the board was told the 737 MAX was safe and that the board "passively accepted that position." A November 12, 2018 Wall Street Journal article reported that the plane has "serious engineering defects that were concealed from regulators and pilots," but the board-level record suggested that the board "did not question management's contrary position." A board call on November 23, 2018 was "optional." The crash "did not appear on the Board's formal agenda until the Board's regularly scheduled December meeting and the board materials documenting that meeting reflected "discussion of restoration of profitability and efficiency, but not product safety." "The Audit Committee devoted slices of five-minute blocks to the crash, through the lens of supply chain, factory disruption, and legal issues – not safety."

Board updates in the months that followed focused on Boeing's image and the crash's impact on production and delivery of 737 MAX planes, not product safety. Monthly dashboard reports addressed production and

cost expectation and challenges, but not safety. At the board's first meeting following its December meeting, in February 2019, the board determined to delay an internal investigation until the conclusion of regulatory investigations. The court stated that the Section 220 record "does not reveal evidence of any director seeking or receiving written information" concerning "Boeing's dealings with the FAA, how it had obtained FAA certification, the required amount of pilot training for the 737 MAX, or about airplane safety generally." Only in April 2019, after the Ethiopian Air crash, and after the FAA grounded the 737 MAX fleet, did Boeing's board build time into its schedule to discuss airplane safety and receive its first presentation – ever – from Boeing officials "leading engineering and safety, respectively, for Boeing's largest segment."

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The *Boeing* decision follows a series of similar decisions denying motions to dismiss in similar product safety spheres: a company that makes a single product – ice cream – that needs to be safe to eat (*Marchand*), regulatory requirements governing an upstart biopharmaceutical company's most promising drug, imperiling FDA approval of the drug (*In re Clovis Oncology, Inc. Derivative Litig.*, 2019 WL 4850188 (Del. Ch. Oct. 1, 2019)), "laws meant to ensure the safety and purity of drugs destined for patients suffering from cancer" (*Teamsters Local 443 Health Servs. & Ins. Plan v. Chou*, 2020 WL 5028065 (Del. Ch. Aug. 24, 2020)), and pipeline integrity at a company transporting through environmentally sensitive regions (*Inter-Mkt'ing Grp. USA v. Armstrong*, 2020 WL 756965 (Del. Ch. Jan. 31, 2020)).

Together, *Boeing*, *Marchand*, *Clovis*, *Teamsters* and *Inter-Mkt'ing* counsel boards and their advisors to review existing compliance and reporting systems to ensure the identification of and proactive oversight over "mission-critical" corporate businesses implicating public health and safety – and documentation of these systems, particularly in board and committee agendas, minutes, and information packages. Where something goes wrong, shareholder plaintiffs will seek – and obtain – agendas, minutes, and board and committee information packages – and argue, often successfully (particularly at the motion to dismiss stage of litigation) that what isn't documented didn't happen. Where peer companies have board-level committees charged with oversight of safety, not having such a such a committee may raise a negative inference. Where the word "safety" is used only in passing in agendas, minutes, and presentations, courts may infer, at least at the motion to dismiss stage of litigation, that "safety" was discussed only in passing. When agendas allot five minute blocks of time to subjects, courts will likewise assume that the subjects were discussed in five minute blocks. And, of course, when a crisis strikes, the board should immediately engage and challenge management in a manner intended to identify the cause and minimize the possibility of recurrence.

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