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# Contractual Duties to Conduct a Business in Accordance With 'Sound Business Practices'

**By Gabriel Herrmann and Lee R. Crain**

The Delaware Court of Chancery's decision in *Wenske v. Blue Bell Creameries*, C.A. No. 2017-0699-JRS (July 6, 2018) (Slights, V.C.), highlights an interesting practical challenge faced by parties seeking to impose oversight obligations on a manager charged with operating a business in accordance with sound industry business practices. While a competent manager with relevant industry experience presumably would know such practices when he sees them, giving concrete form to a contractual standard of care that calls for adherence to such practices is a more complex task—one that inevitably requires consideration of sources beyond the contract's four corners. Parties that choose to define their obligations by reference to such industry standards might therefore consider specifying in their contracts the particular sources that will define the relevant standards, or designating industry-qualified experts to make such determinations when needed.

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*Blue Bell* addressed a motion to dismiss a derivative action brought by the limited partners in Blue Bell Creameries L.P., an ice cream manufacturer structured as a Delaware limited partnership, against the company's general partner (BBGP), the general partner's parent (BBUSA), and several individuals. Blue Bell's limited partnership agreement (LPA) vested BBGP with exclusive authority to manage the business, and provided that BBGP "shall use its best efforts to conduct [Blue Bell's] business in a good and businesslike manner, and in accordance with sound business practices in the industry."

As the plaintiffs alleged, Blue Bell was the country's third-largest ice cream manufacturer. But in early 2015, state and federal regulators repeatedly discovered Listeria contamination in Blue Bell's products. Several people contracted listeriosis as a result—three died—and the fallout led to a meltdown of Blue Bell's business, including a production shutdown and product recall, extensive layoffs, government fines, civil settlements and a criminal investigation.

Blue Bell's limited partners sued, asserting a claim against BBGP alleging that it breached its obligation to run the business "in accordance with sound business practices" (as well as claims against BBUSA and the individual defendants that the court dismissed).

The plaintiffs contended that "sound" dairy-industry "business practices" required "properly cleaning and sanitizing [production] plant surfaces, adequately testing for contamina[nts] such as Listeria … and determining and correcting the cause [of bacterial contamination] if discovered." Although the LPA did not specify any particular sources or materials intended to define that standard, plaintiffs cited several sources supporting their position, including various laws and regulations, as well as food-safety guidelines issued by two industry organizations, the Dairy Practices Council (DPC) and International Dairy Foods Association (IDFA).

Defendants moved to dismiss, arguing that the LPA's contractual standard of care could not be read to incorporate extrinsic sources such as DPC and IDFA guidelines and, thus, that deviation from those guidelines would not breach the LPA. They also asserted that the LPA's absence of guidance as to what constitutes "sound business practices" rendered plaintiffs' interpretation "impossible to enforce and therefore unreasonable." Finally, defendants cited another LPA provision that, they contended, modified the standard of care to require only a "good faith effort" to adhere to applicable industry practices.

The court rejected defendants' contentions and held that plaintiffs had stated a viable claim that BBGP breached its obligation to conduct the business "in accordance with sound business practices in the industry." Reasoning that "sound" business practices are those that are "based on thorough knowledge of and experience with the dairy industry" or "agree with accepted views within that industry," the court concluded that the LPA's directive regarding "sound business practices in the industry" may "reasonably be understood to encompass" the range of sources "referenced in the complaint"—including "practices recommended in DPC and IDFA guidelines."

Nor was the court's conclusion altered by another LPA provision stating that "any standard of care and duty imposed by this agreement or under … any applicable law … shall be modified, waived or limited, to the extent permitted by law, as required to permit [BBGP] to act under this agreement … and to make any decision under the authority prescribed in this agreement, so long as the action is reasonably believed by [BBGP] to be in, or not inconsistent with, [Blue Bell's] best interests." Citing *Brinckerhoff v. Enbridge Energy*, 159 A.3d 242 (Del. 2017), the court noted that such a clause "'unconditionally eliminates all common law standards of care and fiduciary duties, and substitutes a contractual good faith standard of care,'" but further observed that that "contractual good faith standard … only 'operates in the spaces of the LPA without express standards.'" BBGP's obligation to "'use its best efforts to conduct the business … in accordance with sound business practices in the industry,'" the court concluded, is one that "fully occupies the space" for purposes of articulating the relevant standard of care and, as such, is not modified by the contractual good-faith standard embodied in the latter clause.

Thus, the court sustained on the pleadings plaintiffs' effort to define the relevant standard by reference to the laws, regulations and industry guidelines cited in the complaint. But it noted that its preliminary ruling in that regard ultimately concerned a factual issue that may require further proceedings, and extensive fact-finding, to resolve; the court observed that "the content of 'sound business practices in the [dairy] industry' presents a question of fact" and declined to "express [any] view regarding whether [that standard] is susceptible of other reasonable interpretations (and, thus, ambiguous)."

The court's reference to the factual nature of assessing an industry's "sound business practices" highlights one potential unintended consequence of contractually defining by reference to industry practices the standard of care for overseeing a business. Contracting parties typically prefer contractual standards that provide certainty and clarity regarding the scope of

the parties' rights and obligations. But it is difficult to predict ex ante what a fact-finder in a case like *Blue Bell* might ultimately conclude on a full record about whether to incorporate any particular extrinsic source into a contractual definition of "sound business practices," (or even how other courts might approach the question on the pleadings). While applicable legal requirements likely reflect reasonable operating standards in many instances, industry guidelines may present greater interpretive challenges: they might emanate from multiple sources, enjoy varying degrees of perceived authoritativeness, contain biased or spurious information, and/or impose conflicting standards. Compliance with legal requirements may itself impose differing standards on businesses subject to multiple regulatory regimes. In practice, then, it may not be clear to a manager exactly which industry sources must be followed to ensure adherence to "sound business practices." Answering that question may well necessitate a trial on the merits following years of costly discovery.

To avoid such concerns, parties wishing to structure contractual governance provisions to afford greater certainty in articulating applicable standards of care might consider incorporating contractual language that identifies the specific extrinsic sources deemed authoritative for defining the standard of care, that excludes undesirable sources from consideration, or that otherwise provides ex ante guidance for identifying authoritative sources. Alternatively, parties might consider dispute-resolution provisions delegating to specialists with industry-specific expertise, rather than generalist courts and juries, the task of determining which particular extrinsic sources are authoritative.

Such considerations are particularly germane to the organizational agreements of alternative entities like Blue Bell's limited partnership. As the court noted in denying BBGP's motion to dismiss, "a manager's act or omission may not be applicable under equitable fiduciary standards applicable in the corporate context but may be actionable in the alternative entity context when measured under a heightened contractual standard." While the business judgment rule, exculpatory provisions under General Corporation Law Section 102(b)(7), and the *Caremark* doctrine typically combine to "place an extremely high burden" on claims against *corporate* managers concerning the "duty of oversight," those "impediments either do not exist as a matter of law or can be eliminated by contract" as applied to alternative entities, whose managers' oversight obligations "depend upon what the parties say about those standards in the operative entity agreement." Indeed, the *Blue Bell* plaintiffs' derivative claim was allowed to proceed to discovery absent a pre-suit demand despite several exculpatory LPA provisions that—although deemed inapplicable by the court—arguably suggest that the parties intended to preserve some of the deferential principles that typically apply to corporate oversight claims.

Thus, parties structuring alternative entities that do not intend, by articulating an express contractual standard of care, to apply a "heightened contractual standard" for review of derivative claims alleging oversight failures should consider incorporating additional contractual provisions to clarify whether they intend to waive or, alternatively, preserve the traditional "impediments" that apply to such claims in the corporate context.

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