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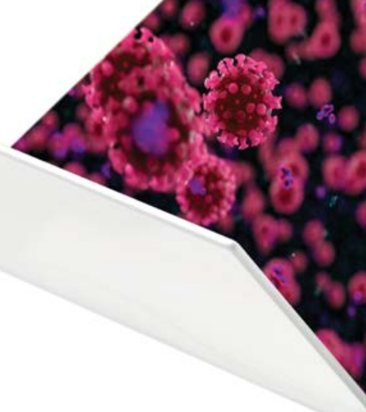

Practical insights for boards of directors in the time of COVID-19

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Introduction

The COVID-19 pandemic has created unprecedented uncertainty for all participants in the United States and global economy. To stem the spread of COVID-19, many local and national governments have issued significant restrictions on public activity, including travel restrictions, social distancing mandates, stay at home orders and other containment policies, which have caused many businesses to adjust their operations or close their doors. As governments begin to ease restrictions and businesses begin to re-open their physical locations, a different set of considerations for companies has emerged. While companies continue to focus on the safety and well-being of employees, customers, suppliers and other stakeholders during this time, the decisions to be made regarding how and when to re-open and bring employees back to work are complex and often involve balancing the needs of different stakeholders.

In such times, the board of directors of a public company plays a critical role in overseeing management and guiding the company through the disruption and uncertainty. Many companies will face litigation related to COVID-19, whether merited or not. Therefore, ensuring that the board of directors has the necessary information to fulfill its fiduciary duties, including its oversight responsibilities, and properly documenting board actions are even more important in the current environment.

This article will first briefly overview directors' fiduciary duties in the context of COVID-19 and then outline a number of practical tips and recommendations, including:

- The potential use of a committee to spearhead the board's oversight of COVID-19-related issues;

- Strategies for keeping the board informed, including regular and special meetings, informal updates, written materials, and the use of outside legal and subject matter experts; and

- Tips for robust documentation of board activity, including drafting minutes that highlight the directors' active participation and include the appropriate amount of detail without waiving legal privileges.

The board's fiduciary duties

The members of a board of directors owe fiduciary duties to the company and its shareholders. The exact scope and nature of these fiduciary duties vary from jurisdiction to jurisdiction. In general, however, directors owe fiduciary duties of care and loyalty. Directors fulfill these duties in a variety of ways, including by attending regular and special board meetings, reviewing materials provided prior to and during those meetings, and engaging in dialogue with management. Based on that information, directors must make decisions with the good faith belief that the courses of action are in the best interest of the company and its shareholders. However, directors cannot rely passively on information provided to them by management. Directors also have a duty to ensure that there are processes in place to monitor issues that are important to the company. Ensuring that such processes are in place is part of a director's duty of oversight, which is particularly important in the current environment.

The duty of oversight is part of the duty of loyalty and generally requires a board of directors to (1) have in place systems or controls sufficient for proper oversight of the company's business, and (2) properly monitor those systems or controls. The duty of oversight has been in the spotlight recently due to several Delaware[1] court decisions to deny motions to dismiss claims against boards of directors for failure to exercise proper oversight. These failures of oversight claims are known as *Caremark* claims[2] and, until recently, were widely referred to as "the most difficult theory in corporation law upon which a plaintiff might hope to win a judgment."[3]

Last year, in *Marchand v. Barnhill*, the Delaware Supreme Court reversed a Court of Chancery decision dismissing a *Caremark* claim against Blue Bell Creameries, finding that the plaintiff sufficiently alleged that the board failed to implement procedures to effectively oversee the company's food safety compliance.[4] The Delaware Supreme Court found that food safety was a "mission critical" issue for Blue Bell, a one-product company. Yet according to the plaintiff's allegations, Blue Bell lacked a committee dedicated to food safety, a process through which the board of directors could address food safety, and a procedure through which the board was regularly advised of food safety issues.

Relying on *Marchand*, the Court of Chancery subsequently denied a motion to dismiss an oversight claim in *In re Clovis Oncology, Inc. Derivative Litigation*.[5] There, the plaintiffs alleged that Clovis Oncology failed to implement procedures sufficient to allow the board of directors (1) to monitor the FDA-approval process, and (2) to detect management misstatements regarding clinical trial results. The Court of Chancery concluded that while the board did have procedures in place to oversee clinical trials, the board ignored numerous red flags indicating that the information the board received from management was not correct.

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1 This article focuses on current developments in Delaware law due to the significant number of corporations that are incorporated in Delaware and the focus of the Delaware courts on business issues. While many other jurisdictions look to Delaware law for guiding principles, companies incorporated outside of Delaware always should first look to the controlling law in their jurisdiction of incorporation.

2 The landmark 1996 Court of Chancery decision *In re Caremark Int'l Inc. Derivative Litigation* held that directors are responsible for overseeing that the company has in place information and reporting systems reasonably designed to provide the board and senior management with timely, accurate information sufficient to support informed judgments about compliance risk. 698 A.2d 959 (Del. Ch. 1996). Since *Caremark*, plaintiffs have brought claims alleging that the directors failed to exercise adequate oversight in response to a variety of corporate compliance issues. However, until recently, it has been rare for a *Caremark* claim to survive a motion to dismiss.

3 *In re Caremark*, 698 A.2d at 967.

4 212 A.3d 805, 808-09 (Del. 2019).

5 C.A. No. 2017-0222-JRS, 2019 WL 4850188 (Del. Ch. Oct. 1, 2019).

Applying *Marchand* and *Clovis* in the context of a publicly-traded limited partnership, the Court of Chancery again denied a motion to dismiss a *Caremark* claim in *Inter-Marketing Group USA, Inc. v. Armstrong*.[6] There, an oil pipeline company suffered a catastrophic leak of 3,400 barrels of oil, resulting in environmental clean-up exposure, securities fraud litigation, reputational harm and criminal convictions. The Court of Chancery determined that pipeline integrity and maintenance was mission critical, and that the plaintiff adequately alleged that the board failed to implement a process to specifically monitor the risks relating to pipeline safety.

Last month, the Court of Chancery again denied a motion to dismiss a *Caremark* claim in *Hughes v. Hu*.[7] There, the Court of Chancery found that the plaintiff adequately alleged that the directors who served on the audit committee failed to oversee the company's financial statements and related party transactions, which allegedly led to the need for the company to restate its financial statements. The plaintiff alleged, among other things, that the audit committee held an insufficient number of meetings – typically once per year for only one hour – and often missed important issues that later needed to be addressed through action by written consent.

Fulfilling fiduciary duties in the age of COVID-19

The core nature of the duty of oversight (and the duties of care and loyalty more generally) is not changed by the COVID-19 pandemic. However, the pandemic has presented a number of unique challenges, many of which are unprecedented and require companies to balance financial, safety, personnel, and other key issues. Due to the slowdown of the world economy and the closing of nearly all non-essential businesses, companies are facing significant operational and financial challenges, with many adjusting or rescinding earnings guidance and announcing lower-than-expected financial results. As portions of the economy re-open, companies must determine how to safely bring employees back to work and, in some cases, re-open their doors to customers. The volatility and uncertainty caused by the COVID-19 pandemic necessitates that the directors have timely and accurate information regarding key corporate risks and business performance and are promptly informed of significant issues or challenges, especially with respect to matters that are "mission critical."

To ensure that directors are fulfilling their fiduciary duties during the COVID-19 pandemic, we recommend that every board revisit the company's risk management processes to determine whether any adjustments need to be made. Companies may want to consider the following options and determine whether adopting one or more of the recommendations might allow the board of directors to fulfill its fiduciary duties more thoroughly, quickly, and efficiently.

Consider the use of committees

Every company will be uniquely impacted by COVID-19 based on the company's size, industry, financial condition, and other factors. One structural issue that a board of directors should consider from time to time during the COVID-19 crisis is whether the formation of a new committee would benefit the company. A newly formed committee dedicated to the oversight of COVID-19-related issues may help provide enhanced oversight of the company's response to the constantly evolving and unique challenges presented by the pandemic. In addition, use of a newly formed committee would allow directors whose experience and specific expertise best qualify them to address these unique challenges to focus on COVID-19 issues.

6 C.A. No. 2017-0030-TMR (Del. Ch. Jan. 31, 2020).

7 C.A. No. 2019-0112-JTL, 2020 WL 1987029 (Del. Ch. Apr. 27, 2020).

As an alternative to a newly formed committee, oversight responsibilities for COVID-19 issues may be delegated to one or more existing committees. For some companies, it may make sense to delegate to committees already overseeing the impacted areas. For example, a company might charge the audit committee or other appropriate committee with oversight of the financial impact of COVID-19 or cybersecurity issues created by COVID-19. To ensure proper oversight of a company's response to the pandemic, the board also should confirm that existing committees with responsibility for overseeing and managing certain pre-pandemic risks are considering how those risks are being exacerbated by COVID-19.

Even if a new committee is formed or primary oversight of a specific subject matter is delegated to an existing committee, all directors must fulfill their duty of oversight even if they do not serve on the specific committee dedicated to the particular matter. For this reason, it is important that committees regularly report out to the full board.

How to keep the board informed

Given the need for directors to be informed and kept up to date on key company matters, it is important for a company to have a thoughtful and reliable process in place for keeping the board of directors informed and for the company to follow that process vigilantly. During normal operations, it may be sufficient for a board and its committees to hold a few regular and special meetings each year, with communication between management and the board in between board meetings limited to specific updates on major acquisitions, financings, and other significant corporate developments.

In light of uncertainties created by COVID-19 and the transition to modified operating environments for many companies, every company should consider whether to increase the frequency with which management and the board communicate and whether to alter the manner in which the board is kept informed. Considerations include:

- **Regular board meetings**: A company should continue to hold all regular board meetings it would usually hold notwithstanding COVID-19. These meetings should be held telephonically or by videoconference where in-person attendance is not possible. The meetings should be treated by all attendees as seriously as an in-person meeting would be and attendees should be encouraged to make sure they are in a location with as few distractions as possible.

- **Special board meetings**: The scope and intensity of COVID-19's impact on companies is changing frequently. If the company determines to update the board of directors in between regularly scheduled board meetings, the best practice is to schedule a formal board meeting, even if all members of the board cannot attend. Often, the number of board meetings on a given matter is a more persuasive fact to demonstrate that the board of directors satisfied its fiduciary duties, including its oversight responsibilities, than the number of informal update calls. In addition, the number of board meetings will be disclosed in the next annual proxy statement and can be an important factor in securing the incumbent directors' reelection. These special board meetings should be scheduled as needed and may vary in length based on the topics on the agenda, but should at least allow sufficient time for (1) an update from management on key issues and risks, and (2) questions from the directors.

- **Informal board update calls**: Directors (both inside and outside) have numerous demands on their time. A public company must disclose which of their directors attended fewer than 75% of the aggregate number of board and committee meetings each year in their annual proxy statements.[8] If an incumbent director falls below the 75% attendance threshold, the reelection of the director may become challenging. Therefore, it is important for companies to make every effort to accommodate each director's schedule. To increase attendance, consider scheduling special board meetings at regular intervals (for example, at the same time every week or month). However, if a majority of board members cannot attend a board meeting, consider whether it would be better to hold an informal update call than delay relaying information to the board of directors.

- **Written materials**: Written materials provided to the board of directors are an effective tool in making sure the entire board is fully informed. Companies should issue written updates to the board of directors as needed, especially on topics already covered at a prior meeting or during a prior update call. Directors and management should discuss the frequency and appropriate content of such materials, including the consistent presentation of data or key performance indicators. These updates should be drafted in consultation with company counsel to ensure the preservation of any applicable legal privilege. Management and counsel also should make themselves available to speak with any director who might have a question about the written update.

- **Outside advisors**: Outside legal, financial, technical or other advisors may need to be retained and made available to the board of directors. For example, a company may seek guidance from outside advisors regarding financial planning, including the possible need for extensions on debt maturities, additional liquidity, or other financial restructuring. A company might also seek outside legal advice on the various government actions and legal developments in response to the pandemic, such as COVID-19 relief packages being passed by Congress as well as state and local government restrictions. It may be helpful to invite outside advisors to the board meetings to allow for the direct presentation of information from experts and also allow directors to ask questions of the advisors.[9] Depending on the situation, it may be advisable to have advisors engaged by and reporting directly to the board rather than to management.

Documenting the board's work

Board and committee minutes are the primary means for the board to establish a record that the board fulfilled its fiduciary duties, including its oversight responsibilities. Minutes (as well as board and committee materials) should reflect the full scope of information provided to the board of directors as well as the topics discussed. The goal of minutes should be to create a balanced record demonstrating diligent oversight by the board, while recognizing that those minutes could be produced in litigation or pursuant to a books and records demand. In addition, minutes should be drafted, reviewed, and finalized in a timely fashion so that the company's minutes for the board and all committees are up to date if the need arises to use or produce those minutes.

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8 *See* Item 407 of Regulation S-K.

9 Delaware law, like most states, encourages directors to rely in good faith on expert advisers for advice, information, and specialized expertise. *See* 8 Del. Code § 141(e) ("A member of the board of directors, or a member of any committee designated by the board of directors, shall, in the performance of such member's duties, be fully protected in relying in good faith upon the records of the corporation and upon such information, opinions, reports or statements presented to the corporation by any of the corporation's officers or employees, or committees of the board of directors, or by any other person as to matters the member reasonably believes are within such other person's professional or expert competence and who has been selected with reasonable care by or on behalf of the corporation.").

When drafting minutes, the following practice tips should be considered:

- **Scope**: The minutes should demonstrate the full scope of information that the board received, both concerning "good news" as well as challenges facing the company.
- **Active participation:** Often minutes are drafted in a way that makes it appear as if the directors were passively receiving information from management – when most often, that is not the case. The minutes should note when directors asked questions, discussed a topic, or requested follow-up information to be presented at the next meeting or during an update call.
- **Limit executive sessions**: Because the primary purpose of minutes is to assist the board in establishing a record of its actions, the existence of such discussions should not be hidden behind a blanket statement that the board entered executive session, without any mention that critical compliance issues were discussed during that session. Where possible, compliance and risk management should be discussed in the regular portions of the applicable board or committee meeting. The minutes (and relevant board or committee materials) should demonstrate that compliance and risk information in specific categories was disclosed to the board, and that the board discussed the information as applicable. The minutes should serve as a high-level summary, not a ledger of statistics and details or a verbatim record.

Consider the possibility of a books and record demand

Having properly drafted minutes is critical given the increasing use of books and records demands. Over the past years, the Delaware Court of Chancery has encouraged potential plaintiffs to make a demand for books and records prior to initiating a derivative lawsuit against a company.[10] At the same time, the Court of Chancery has been increasing the scope and type of documents a shareholder can receive as well. For example, many shareholders have requested and received e-mail and other electronic communications.[11] This has included internal company e-mail as well as e-mail and text messages exchanged between directors. It is helpful to remind directors that e-mails and even text messages on their personal devices about company issues may be deemed "corporate records" subject to production in a books and records demand.

In addition, the Court of Chancery has confirmed that a shareholder does not need to identify the use for the documents, only that he or she has a proper purpose in requesting them.[12] In a recent case, the Court of Chancery rejected the company's argument that the request was improper because the shareholders intended to use the documents for litigation.[13]

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[10] *See, e.g., King v. VeriFone Holdings, Inc.*, 12 A.3d 1140, 1145 (Del. 2011) ("Delaware courts have strongly encouraged stockholder-plaintiffs to utilize Section 220 before filing a derivative action, in order to satisfy the heightened demand futility pleading requirements of Court of Chancery Rule 23.1.").

[11] *See, e.g., Schnatter v. Papa John's Int'l, Inc.*, C.A. No. 2018-0542-AGB (Del. Ch. Jan. 15, 2019); *In re UnitedHealth Grp. Inc. Section 220 Litig.*, C.A. No. 2017-0681-TMR (Del. Ch. Feb. 28, 2018); *Inter-Local Pension Fund GCC/IBT v. Calgon Carbon Corp.*, C.A. No. 2017-0910-MTZ (Del. Ch. Jan. 25, 2019); *KT4 Partners LLC v. Palantir Techs. Inc.*, 203 A.3d 738 (Del. 2019); *In re Facebook Section 220 Litig.*, C.A. No. 2018-0661-JRS (Del. Ch. May 30, 2019); *Bucks Cty. Emps.' Ret. Fund v. CBS Corp.*, C.A. No. 2019-0820-JRS (Del. Ch. Nov. 25, 2019).

[12] *See Lebanon Cty. Emps.' Ret. Fund and Teamsters Local 443 Health Servs. & Ins. Plan v. AmerisourceBergen Corp.*, C.A. No. 2019-0527-JTL, 2020 WL 132752 (Del. Ch. Jan. 13, 2020).

[13] *Id.*

Finally, the Delaware Courts have clarified that a confidentiality agreement is not a given in books and records litigation, but can be required after balancing the rights of a shareholder to inspect documents against the company's need for confidentiality.[14] As noted above, when drafting corporate records like minutes of board and committee meetings, companies should always balance the need for a detailed record against the possibility that materials could be made public.

Conclusion

To date, COVID-19 has presented companies with a number of unique and unprecedented challenges and will likely continue to do so as the global community wrestles with containment of the pandemic. Companies and their boards of directors should consider whether current processes need to be modified in light of these unique and unprecedented challenges to ensure that the board is fully informed and a proper record of the board fulfilling its fiduciary duties is created. Using a combination of all available communication methods – in-person, video, telephonic, and written – will help keep the board up to date on all pertinent issues facing the company, and diligent record keeping will ensure that the directors' conduct is properly documented. Taking these steps will best position the company for success, both in assisting the board in exercising its business judgment as well as in any litigation.

Disclaimer: This article provided by Hogan Lovells for educational and informational purposes only and is not intended and should not be construed as legal advice.

14 *See, e.g.*, *Tiger v. Boast Apparel, Inc.*, 214 A.3d 933 (Del. 2019).

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