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The Duties of Directors for Overseeing Business Risks During a Pandemic

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The Duties of Directors for Overseeing Business Risks During a Pandemic

The COVID-19 pandemic has had tremendous impact on the global economy. In light of this impact, members of the boards of directors of Delaware companies may have concerns about their exposure for the business decisions they make today in the shareholder suits that may be filed tomorrow. Such concerns should be readily assuaged.

Within the framework provided by Delaware law, directors continue to have broad flexibility in how they guide their organizations through the current global crisis. The decisions directors make are subject to the full protection of the business judgment rule. To the extent that plaintiff firms may attempt to impute liability to directors for how they oversee the business risks posed by the pandemic, such attempts should resoundingly fail.

Directors' Protections Pursuant to Delaware Law

The fundamental precept of Delaware law is that the board of directors manages the business and affairs of a Delaware corporation.

The business judgment rule is an extension of this fundamental precept. The rule presumes that directors act on an informed basis, in good faith, and in the best interests of the corporation and its stockholders. If a stockholder plaintiff is unable to plead and prove facts overcoming this presumption, then the business judgment rule requires a court to defer to the judgment of the directors even if the court were to disagree with their decision.

Adding further protection, stockholders of almost every Delaware public corporation have adopted charter provisions exculpating directors from monetary liability for conduct falling short of either a breach of the duty of loyalty or bad faith.

The Significant Distinction Between Legal Risks and Business Risks for Director Liability

Despite the protection afforded to directors by Delaware law, opportunistic investors may nonetheless seek to recover from directors for corporate losses incurred during the COVID-19 pandemic. One possible avenue that such investors may pursue is a claim based on an alleged failure of oversight.



With the recent decisions in *Marchand v. Barnhill*,¹ *In re Clovis Oncology, Inc. Derivative Litigation*,² and *Inter-Marketing Group USA, Inc. v. Armstrong*,³ new attention has been given to the duties of directors to oversee a company's legal compliance. Despite the finding of potential director liability in these cases, an oversight claim remains one of the most difficult claims in all of corporate law for a plaintiff to plead and prove. To succeed, a plaintiff must prove facts showing that directors knew they were failing to fulfill their oversight duties. Such an oversight claim thus requires facts demonstrating an utter failure by directors to implement reasonable board-level reporting controls or, if such a system of controls is in place, a conscious abdication by directors of their duty to oversee the company's "mission critical" legal risks.

While the case law for the duty of oversight is firmly rooted in a failure to oversee legal risks, plaintiff firms occasionally attempt to expand such claims to the oversight of business risk. Such attempts often fail. Indeed, the Court of Chancery in *In re Citigroup Inc. Shareholder Derivative Litigation* noted that "[t]he mere fact that a corporation takes on business risk and suffers losses, even catastrophic losses, does not evidence misconduct, and without more, is not a basis for personal director liability in a shareholder derivative action."⁴ Accordingly, "[t]o impose oversight liability on directors for failure to monitor 'excessive' risk would involve courts in conducting hindsight evaluations of decisions at the heart of the business judgment of directors."⁵

Identifying and applying the difference between director liability for a failure of oversight of legal risks, as in *Marchand*, *Clovis*, and *Inter-Marketing*, and the absence of liability for the oversight of business risk, as in *Citigroup*, will be significant for resolving future stockholder claims related to the pandemic.

For Most Corporations, the COVID-19 Pandemic Presents Business Risks

As a once-in-a-century event, the COVID-19 pandemic presents a singular and novel set of challenges that are predominately business risks.

The business risks presented by the pandemic are numerous. Directors have confronted decisions related to adapting their business strategy to national and global developments as they happen in real time, to obtaining financing or access to the capital markets, to maintaining employee headcount, and to maintaining key customer relationships. Claims arising from how a board oversees and responds to these and other business risks should therefore fall squarely within the analysis of *Citigroup* and the protection of the business judgment rule.

Considerations for Directors in Overseeing the Business Risks of COVID-19

While the business judgment rule should foreclose liability for many stockholder claims arising from the COVID-19 pandemic, directors nonetheless should follow best practices in fulfilling their duties. Fortunately, Delaware case law provides a useful road map. In fulfilling their duties, directors should:

- Gather reasonably available information material to the business decision at hand.
 - Directors should consider the amount of information needed to make an informed decision. In fact, a decision about how directors inform themselves is itself protected by the business judgment rule.



- Devote sufficient time to deliberate.
 - Many issues presented by the COVID-19 pandemic require immediate attention. Directors should act prudently in deciding the amount of deliberation needed in light of these exigent circumstances.
- Consult with the company’s officers, employees, and external advisors.
 - Internal experts will have valuable insights for what steps a company is capable of taking. External advisors can fill the gap to provide expertise for the unique challenges presented by the pandemic. Directors are protected for their good faith reliance on the opinions and reports of these internal and external experts.
- Screen for potential director conflicts with respect to the contemplated corporate action.
 - Director conflicts can arise from either financial considerations or social relationships with interested parties. Experienced counsel can screen for these potential conflicts.
- Act in good faith and in the best interests of the corporation and, ultimately, its stockholders.
 - While Delaware law recognizes that stockholders are the ultimate beneficiaries of their fiduciary duties, directors can consider stakeholder interests in making decisions related to the long-term viability and success of the corporation. These considerations can include how to best maintain an experienced work force, how to support the community, and whether to retool corporate facilities to address market needs during the COVID-19 pandemic.
- With the aid of management, directors should understand whether the COVID-19 pandemic gives rise to “mission critical” legal risks for the corporation.
 - If so, directors should ensure themselves that reasonable controls are in place to inform the board of compliance issues should they materialize. If such issues materialize, the board should work with management to resolve any compliance concerns.
- Consider temporary amendments to corporate bylaws to prevent opportunistic raids that could harm the business.
 - Undoubtedly there will be commercial actors or activist firms that will seek to exploit opportunities created by the COVID-19 pandemic. If a board believes there is a real threat of a highly disruptive raid when corporate efforts would be better suited to surviving the pandemic, the temporary adoption of prophylactics such as enhanced advance notice bylaws, a stockholder rights plan, and additional requirements on the calling of special stockholder meetings may be warranted.
- Adopt bylaw provisions providing for stockholder claims to be litigated in the courts of Delaware.
 - It is inevitable that there will be some stockholder litigation challenging the decisions directors make during this crisis. A corporation and its stockholders will benefit from having the most experienced courts resolve this litigation.



While the COVID-19 pandemic is unprecedented, directors should take comfort that the same principles of Delaware law that have guided and protected their decisions remain in full effect. While acting within those principles, directors can protect their organizations, their stockholders, and themselves from parties that would seek to exploit the current uncertainty plaguing the global economy.



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¹ 212 A.3d 805 (Del. 2019).

² 2019 WL 4850188 (Del. Ch. Oct. 1, 2019).

³ 2020 WL 756965 (Del. Ch. Jan. 31, 2020).

⁴ 964 A.2d 106, 130 (Del. Ch. 2009).

⁵ *Id.* at 131.; *see also Corp. Risk Holdings LLC v. Rowlands*, 2018 WL 9517195, at *7 (S.D.N.Y. Sept. 28, 2018) (“While Plaintiff may be correct that the Board mismanaged business risk . . . , such a claim does not satisfy the ‘exacting’ standard for liability under *Caremark*—a standard that becomes yet more exacting when, as here, the claims involve a failure to monitor business risk, as opposed to legal risk.”).

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