COVID-19 Directors’ Duties of Oversight: Reporting and Monitoring

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Boards of directors have a duty to exercise oversight and to monitor the company’s operational viability, legal compliance and financial performance during this COVID-19 pandemic.\[1\] Lessons learned from a listeria outbreak instruct directors to execute their duty of oversight by adopting a reporting and monitoring system sufficient to ensure the board remains informed about fundamental business issues involving public health, safety, and business performance overall during the COVID-19 pandemic.

**Fiduciary Duties and the Business Judgment Rule**

Officers and directors owe fiduciary duties of loyalty and care.\[2\] Under the duty of loyalty, directors are required to act in the best interest of the corporation and the stockholders by acting honestly and in good faith.\[3\] Under the duty of care, directors must make a good faith effort to be informed and exercise judgment when making decisions on behalf of the corporation.\[4\] Traditionally, these fiduciary duties were limited to stockholders of the company, however, under Delaware law, directors may—and should—also consider the long-term interests of other stakeholders, including employees, clients, suppliers, communities, and the environment, even if doing so may result in short-term losses for the stockholders,\[5\] except where the company is undergoing a cash sale, in which case, the stockholders’ short-term interests take priority.\[6\]
When evaluating claims for breach of fiduciary duties, Delaware courts will generally presume that “in making a business decision, the directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company.”[7] As such, plaintiffs will often have the burden of proof. Nonetheless, Delaware courts have consistently emphasized and enforced directors’ fiduciary duties, and in light of the COVID-19 pandemic, it is crucial that directors pay close attention to their duty of care in the oversight context. Specifically, directors should ensure they: (i) establish a reporting system, if one does not exist; and (ii) monitor such reporting system.

Step 1: Reporting System

In Marchand, the Delaware Supreme Court held that the company’s directors failed to adopt a reporting and monitoring system sufficient to ensure they remained informed specifically about food safety issues.[8] Although the facts of the Marchand case focus on food safety caused by the sale of listeria-contaminated ice cream, heed the lesson. The Marchand opinion suggests a Caremark breach[9] may be inferred if regular reports to the board contain no information on an “intrinsically critical” compliance issue, especially involving public health and safety. The court pointed out that although management received reports concerning the growth of listeria in the ice cream plants, board minutes did not make any references to listeria or the frequent positive tests reported, indicating that the directors were not informed of the then-current situation.[10] The court also noted that after two years of evidence that listeria was growing, the directors finally discussed the issue for the first time, but rather than adopting an oversight system, the directors simply left the company’s response to management.[11] Consequently, the court found that the directors did not meet their fiduciary obligations by failing to establish a reporting system at the board level.

Step 2: Monitoring the System

The Marchand opinion also indicates that even where a company is complying with applicable law and regulations, e.g., Food and Drug Administration, such compliance does not imply that the board has implemented a monitoring system at the board level.[12] In other words, Delaware courts will evaluate (i) what systems the board implements, aside from mandatory regulations, in order to stay informed and ensure that the company is operating safely in light of the circumstances, particularly in connection with public health concerns; and (ii) whether the board has made a good faith effort to monitor the system implemented.

In addition to adopting a reporting system, directors must communicate with management regularly and monitor the COVID-19 pandemic closely. For instance, if the reporting committee informs the board of concerns related to employees’ health due to the pandemic, the board must play close attention to the committee’s recommendations and regularly check on the progress or changes to the committee’s recommendations. Similarly, directors must be aware of mandatory shutdowns and similar requests by the government, and ensure compliance across the company. Furthermore, if the board realizes that the reporting system is failing, directors
must make a good faith effort to replace the current reporting system.

**In summary, as the Court of Chancery of Delaware recently explained:**

Directors cannot take an ostrich-like approach to their fiduciary obligations, and so they must take active steps to oversee the operations of the corporation and become informed about the risks confronting the company. ... Directors must attempt in good faith to assure that a corporate information and reporting system, which the board concludes is adequate, exists. The resulting information and reporting systems must be reasonably designed to provide to senior management and to the board itself timely, accurate information sufficient to allow management and the board, each within its scope, to reach informed judgments concerning both the corporation’s compliance with law and its business performance (emphasis added).[13]

**Takeaway**

Although management is on the front line during the COVID-19 pandemic, it is crucial to understand that directors may be held liable under Caremark for: (i) utterly failing to implement any reporting or information system or controls at the board level; or (ii) having implemented such systems, failing to monitor or oversee operations. Good faith efforts – not 100% success rate – is what is required of the directors and officers.[14]

**Recommendations**

- Ensure the company has implemented COVID-19 reporting systems at the board level.
- Form a board committee, if appropriate, to oversee COVID-19 concerns and potential impact on the company.
- Schedule board or committee meetings with management on a regular basis to discuss critical COVID-19 issues, especially compliance issues involving public health and safety.
- Ensure there are regular protocols in place that require management to keep the board or committee informed of risks and safety concerns related to COVID-19.
- Monitor the COVID-19 reporting system and pay close attention to any red flags that may indicate the system in place is not working properly.
- Replace reporting and monitoring systems if current systems are failing.
- Maintain appropriate meeting minutes that document the board’s oversight activities (i.e., reporting and monitoring).
- When considering long-term shareholder value, take into account the interests of the company’s stakeholders in a holistic view. However, if the company is for sale, the focus should be on the stockholders’ short-term gains.

As you are aware, things are changing quickly and there is no clear-cut authority or bright-line rules. This is not an unequivocal statement of the law, but instead represents our best interpretation of where things currently stand. This article does not address the potential impacts of the numerous other local, state and federal orders that have been issued in response to the COVID-19 pandemic, including,
without limitation, potential liability should an employee become ill, requirements regarding family leave, sick pay and other issues.

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[3] The Delaware Supreme Court characterized “good faith” as part of the duty of loyalty in the Stone case: “the requirement to act in good faith is . . . a condition of the fundamental duty of loyalty.” Stone at 370.


[5] For example, a board of directors may decide to raise employee wages although such raises may result in lower short-term profits for stockholders because of the expected long-term value, including the company’s reputation, hiring and retaining talent, etc. See, e.g., TW Services, Inc. Shareholders Litigation, 1989 Del. Ch. LEXIS 19, *20-21, Fed. Sec. L. Rep. (CCH) P94,334 (“[Directors] may find it prudent (and are authorized) to make decisions that are expected to promote corporate (and shareholder) long run interests, even if short run share value can be expected to be negatively affected, and thus directors in pursuit of long run corporate (and shareholder) value may be sensitive to the claims of other ‘corporate constituencies.’”).

[6] In Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., the Delaware Supreme Court held that when a Delaware corporation is sold for cash, the directors become “defenders of the corporate bastion to auctioneers charged with getting the best price for the stockholders.” 506 A.2d 173, 182 (Del. 1986).


[9] A Caremark breach occurs when directors fail to exercise a good faith judgment in the oversight context. More specifically, a Caremark claim will likely succeed if the board fails to: (i) implement a reporting system; and/or (ii) monitor the reporting system. Caremark at 959.


In *Stone*, the court held that although the lack of internal controls resulted in a huge fine for the company, the board had reasonable reporting systems in place. For example, the board “dedicated considerable resources to the [] compliance program and put into place numerous procedures and systems to attempt to ensure compliance.” In addition, the board established departments and committees to oversee the company’s compliance with certain regulations and to report violations to management and the board. In light of the board’s actions, the court ruled in favor of the directors. Stone at 371.

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