Anticipating the Unanticipated

Director Caremark duties during fast-moving, global events.

BY DOUG RAYMOND

As we have been painfully reminded by recent events, life can come at you fast, and systemic shocks and unanticipated challenges will stress even the best-organized companies. As individuals, families and businesses have struggled to respond to the COVID-19 pandemic, many boards of directors have been working double shifts to keep ahead of the fast-changing situation and oversee the changes in business and operations that are required. While some have argued that this crisis was not foreseeable, in the wake of the Ebola epidemic and the H1N1 (swine flu) virus, most experts were not surprised. And, while at the time of this writing the conclusion of the COVID-19 pandemic and its ultimate impact on corporate America are unknown, the obligations of boards in addressing these threats are clear. The board must work to anticipate likely risks and develop appropriate contingency plans to protect the business and its stakeholders against such risks, to the extent possible. Under the line of cases beginning with the Delaware Chancery Court's decision in *In re Caremark International Inc. Derivative Litigation*, the court set the standard for directors' oversight of the corporation's compliance programs and operations, requiring directors to make a "good faith effort" to implement an oversight system and monitor it.

Two more recent Delaware cases — *Marchand v. Barnhill* and *In re Clovis Oncology, Inc. Derivative Litigation* — are instructive in considering how Caremark duties apply to fast-moving, global events such as the COVID-19 pandemic. First, *Marchand* illustrated that a lack of risk assessment or reporting systems for "mission critical" business matters could constitute a breach of a director's duty of loyalty under Caremark. Second, *Clovis* clarified that even if reporting systems for "mission critical" business matters exist, failure to properly monitor such systems could result in liability, particularly if directors ignore "red flags."

The COVID-19 pandemic has provided a unique perspective, as it has impacted almost every business, comprehensively demonstrated where companies are most vulnerable, and highlighted differences in how they have responded. Some companies closed their doors almost immediately, moving to fully remote operations. Many others, unable to operate with a remote workforce, remained open, but often with different ways of addressing the concerns of their customers and employees.

These different approaches were often adopted ad hoc, without meaningful board oversight, as the impact of the pandemic moved more quickly than the usual timeframe for corporate response. As a consequence, many boards will be criticized for having failed to adequately anticipate the potential for an Asian-sourced pandemic that not only impacted supply chains and domestic production capacity,

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but also ultimately disrupted demand for products and upset the financial and credit markets. Other boards will be challenged for their failure to establish sufficiently safe environments for customers and employees.

Once businesses emerge from the present crisis, boards should engage in meaningful self-examination and consider how their risk monitoring and assessment systems can be improved to better manage other unexpected risks. In learning from this, directors should enhance the reporting processes and risk assessment protocols that extend across the organization to learn from experience and plan for a comprehensive approach to future risks.

Directors should actively and holistically seek to anticipate the possible risks to the corporation, and in particular the multiple impacts that a single or related series of risks could have. The directors should also consider what other unlikely risks may become more possible, including, notably, the risks to businesses posed by climate change, which has the potential to affect companies in numerous ways simultaneously. Boards should in particular pay close attention to how such risks could affect their mission-critical business processes and vulnerabilities, and should analyze the possible second- and third-order impacts. In order to proactively prepare their businesses to respond to the next global event, boards should engage in thoughtful discussions regarding these challenges.

As the COVID-19 pandemic has demonstrated, unexpected risk can strike at the core of a business with great speed and little warning, forcing boards to react quickly, often without the opportunity to meaningfully reflect on potential consequences of their actions. In order for boards to meet their obligations in times of heightened threat and resist reactive practices, boards should attempt more diligently than before to anticipate risks before they develop and create appropriate contingency plans. Although the next crisis may not yet have been identified, when it does arise, whether it is global or limited to just one corporation, the board should be prepared and alert, having made every effort not to be surprised. ■

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