



### **Directors' Oversight Duties**

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**1) Cannot knowingly cause company to commit crimes; must terminate crimes directors learn about**  
Business Judgement Rule never applies

**2) Duty to ensure firm has information and reporting system to detect and inform the board about legal violations**

**3) Duty to act in good faith to respond to red flags that crimes are being committed**

### **Burden of proof?**

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- \* Standard of liability is did Directors act in bad faith in violating their duties**
- \* Met if a director knowingly violates one of the duties above.**
- \* Judgment of bad faith=> no indemnification/insurance**
- \* Result: Dir will file for summary judgement**
  - If lose they settle
  - Facts/pleadings read in light most favorable to plaintiff
  - Plaintiff doesn't need to prove it. Just need facts that could support finding dir's breached the duty

### **Silence is not Golden**

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**Dela Ch Ct has consistently held that P. survives summary judgment if the board minutes provide no evidence that the directors learned about the risk or acted on the red flag**

## Caremark

Recently held to apply to officers as well as directors

McDonalds

## Dela 220 Books and Records

**Shareholders right to access books and records for proper purpose**

**Proper purpose includes**

Shareholder has credible basis that has valid Caremark claim against the board/officer

Shareholder has credible basis of mismanagement  
Regulatory settlement, news story, massive employee walkouts about sexual harassment likely to provide credible basis

**Shareholder can get**

Formal corporate materials: board minutes

Informal: Emails btw board, officers relating to issue

## Duty not to knowingly violate law

- 1) Walmart owns pharmacies; sells opioids
- 2) Had settled with DEA based on DEA's view firm failed to comply with obligation to control opioid prescriptions
- 2) Directors informed company not yet in compliance moving ahead but not there
- 3) No evidence directors prioritized fixing violations
- 4) Introduced a management incentive plan: bonuses for employees if > 190,000 prescriptions
- 5) Provided < 50% budget told need to fix problem
- 6) Did not implement needed computer system
- 7) preferred CCOs who balanced compliance & profit
- 8) Firm hit with Sanctions

## Ct Allowed the claim to go ahead

**Motion to dismiss complaint: Evidence light most favorable to plaintiff.**

**Plaintiff's allegations supported claim that:**

**Directors knew company was not in compliance with its legal obligations**

**Evidence acted to undermine compliance**

Incentive plan

**Not implement several needed fixes**

**No evidence of active board action to fix problem**

One reason: company redacted a lot of the board minutes given to plaintiff on attorney-client grounds

Ct. says it can treat lack of evidence of action as evidence of inaction

## Directors' Oversight Duties

### 2) Duty to ensure firm has information and reporting system to detect and inform the board about legal violations

Standard case: Business Judgement Rule

If board implements a compliance program and has policies and procedures to ensure some information reaches the board, board has discretion to decide what reaches the board

### 3) Duty to act in good faith to respond to red flags that crimes are being committed

Standard cases: Business Judgement Rule

Board has discretion in how to respond: including delegating to management in good faith

## Caremark Liability: Bad Faith

### Prong 1

the directors completely fail to implement any reporting or information system or controls

### Prong 2

Board consciously failed to monitor or oversee reporting or information system, or failed to respond appropriately to evidence of legal violation

**and board inaction was a proximate cause of harm to firm.**

## Mission Critical Risks

### 2) Duty to ensure firm has information and reporting system to detect and inform the board about legal violations

Board must ensure that the board as a whole or a committee has ownership of the risk, policies and procedures are set up to inform the board/committee about the risk, and the board/committee makes sure it is informed

### 3) Duty to act in good faith to respond to red flags that crimes are being committed

Board must exercise active oversight over the investigation  
Cannot delegate complete to management.  
Must exercise active oversight

## Mission Critical Risks

### Characteristics so far...

- 1) very important to financial health firm
- 2) Source risk heavily regulated b/c creates risk of death /serious injury  
Regulation includes a duty to report problems

### Examples

- 1) Food safety (listeria) for ice cream company
- 2) risk of noncompliance with Drug testing protocols for company with one drug
- 3) Airplane safety for airplane manufacturer

## Boeing (Ch Ct Sept 7, 2021)

**Oct. 2018 737 Max manufactured by Boeing Crashed (Lion Air)**

**Second 737 Max crashed in March 2019**

**Problem: 737 Max was a redesign. Boeing added a software system to bring the nose down**

MCAS software prone to activate inappropriately

Boeing misled FAA=> FAA not require needed pilot training

**Board no committee explicitly charged with overseeing safety**

**Board passive after crash; defers to management**

## Dela. Ch. Ct.: Caremark Prong 1

**Board of a company operating in shadow of mission critical regulatory/compliance risk:**

1) Must establish a system to ensure that it gets information about that specific risk

Here airplane safety

2) Must ensure that it actually gets the information

3) Must respond appropriately to yellow/red flags

## Prong 1 failures

**1. No Board Committee with Direct Responsibility for Airplane Safety**

Audit committee charter not mention safety

Audit committee not regularly address safety

CCO report to audit not discuss safety

**2. Board as whole not Oversee Safety**

No Board Meeting Time Set Aside for Safety

Management not required to regularly report on safety

No board procedures for oversight of investigation

**3. Internal Reporting System not designed to enable employees/Whistleblowers to reach the board**

## Scienter

**Boeing: court infers scienter from**

1) Lack any board committee focused on safety

2) No regular process/protocols requirement management to report to board on safety

3) No regular schedule for board to address safety

4) Lack board minutes where safety discussed

5) No evidence red/yellow flags disclosed to board

6) No evidence management conveyed safety information to the board

**Plus: after crash 2 directors email that should discuss safety to show their commitment**

**Publicly tout safety steps never took**

## Prong 2 failures

### After learning about first crash, Boeing board consciously disregarding its duty to address safety risk

- 1) Board not request information from management  
Board accepted CEO assertion MCAS was safe
- 2) Not seek request information after WSJ reported potential problems with MCAS  
Accepted management's claims without question
- 3) Full board not discuss crash for months  
Earlier Board call to discuss 1<sup>st</sup> crash was optional  
Board focused on production not safety

## Implications

### Threat of Liability

Shareholder allowed to proceed to trial in Marchand and Boeing. Settlement likely given existing facts

### Disclosure Directors' Communications

In Facebook and Amerisource Bergen shareholder leveraged Caremark claims to obtain court order requiring firm to disclose management and *directors'* emails relating to commission/oversight of the alleged misconduct

Facebook: Privacy Violations (Cambridge Analytica)

Amerisource Bergen: Illegal marketing/sales opioids

## Take away Messages

### 1) Board cannot allow firm to pursue business plan that would violate the law

If firm currently in violation board should intervene to stop it

### 2) Board should assess company's material regulatory, compliance, safety risks

Which could be subject to Caremark 2.0 duties

### 3) Caremark 2.0

Need to ensure a committee has duty to oversee that risk  
Procedures ensure management reports on the risk  
Committee must report to the board on those risks  
Internal reporting system should enable reports to board  
Committee/Board must set aside time to discuss these vital risks

## Take Away Message

### Board should actively oversee firm's response to misconduct involving these risks

Meet promptly/allocate adequate time

Obtain independent expert advice (not just CEO)

### Minutes should document board's actions

Minutes w/ evidence of action should be produced

### DGCL 220: P. can access board minutes, emails etc. if can establish credible basis for claim of mismanagement or Caremark breach

Redacted minutes => treated as no evidence action

## **McDonalds**

### **Case arising from wide spread sexual harassment**

#### **Applied Caremark to Officers**

- \* Duty not to allow misconduct to continue
- \* Certain officers (like HR) duty to have systems to inform about misconduct
- \* Duty to act in good faith to respond to red flags
  - Investigate in good faith

#### **Implication: May Motivate Officers (CCOs, GCs) to Escalate Red Flags to Board if officers not addressing them**

Boards may have more instances where on notice of problems, triggering their own Caremark duties

**Questions**

**and**

**Thank you**