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Governance Litigation and the COVID-19 Pandemic

The pandemic has created massive business disruption, and weeks or months of further market dislocation and volatility seem certain. Equally certain is that stockholder lawsuits will appear as (or perhaps even before) the disruption begins to resolve. Delaware's *Caremark* doctrine—which requires directors to monitor the corporation's compliance with the law and to address indications of non-compliance—has become a preferred vehicle for stockholder plaintiffs seeking to bring representative litigation in response to corporate trauma. We accordingly expect an increase in *Caremark* litigation this year, with plaintiffs blaming a failure of board oversight for corporate losses resulting from the pandemic.

For reasons we have previously addressed, we do not think *Caremark* should or will be extended to permit liability in these circumstances, and we continue to believe that *Caremark* exposure remains exceedingly limited for any attentive and well-advised board. *Caremark* liability attaches only when a board "utterly fails" to monitor corporate risk or intentionally ignores a "red flag" that a risk has ripened. The doctrine is not designed—and has never been permitted—to be invoked simply because a company finds itself in financial distress. To the contrary, it originated as a means of policing the rare instances in which a board consciously fails to institute an effective compliance system or disregards indications that the corporation is violating the law. What is more, recent lessons in *Caremark* case law teach that boards must be vigilant with respect to key, identifiable "enterprise risks." We do not think the courts are likely to credit an unforeseen global trauma such as the COVID-19 pandemic as a company-specific enterprise risk that required, *ex ante*, a board-level monitoring function.

There is no one-size-fits-all governance approach to addressing the crisis—each board's response must be bespoke—but there are general rules to blunt opportunistic litigation. To be sure of *Caremark* protection, boards should always pay special attention to "hot-button" issues; the present pandemic certainly qualifies. As directors address the crisis, they should consider COVID-19 and its operational consequences systematically, from an enterprise risk perspective, with appropriate advice from advisors and managers, while taking care to memorialize their pandemic-related discussions and actions in ways that can become part of a pleadings-stage litigation record. Boards can thus ensure not only that they are addressing the substantive oversight obligations *Caremark* imposes, but also that they will be best-positioned to defend the likely litigation fallout.

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