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Introduction

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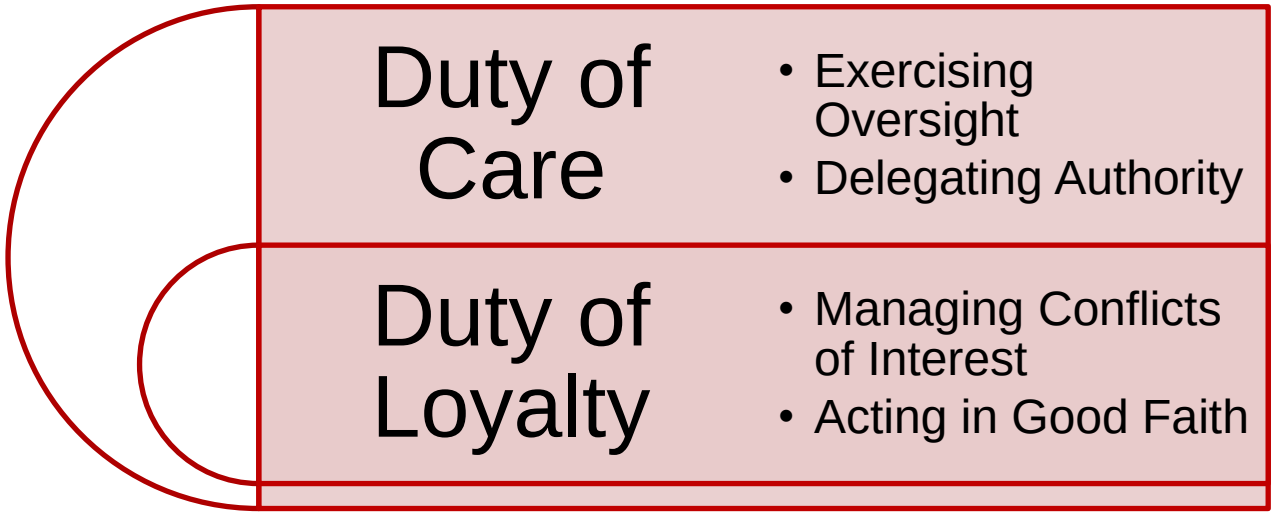
The New Board Table Is a Standing Desk:

Navigating Today's Risks and Rewards Serving as a Board Member

Overview


Duty of Care
• Exercising Oversight
• Delegating Authority
Duty of Loyalty
• Managing Conflicts of Interest
• Acting in Good Faith


Compensation
Corporate Disclosures
ESG

Hypothetical 1: The Emergency Financing

Duty of Care

- Standard in Delaware is gross negligence
- Board must be informed of all material information reasonably available when making decisions
- No *per se* duty to maximize profits, but actions must be related to rational business purpose
- Corporation can exculpate directors for breaches of this duty
  - As of 2022, corporations can also exculpate officers, but for direct claims only

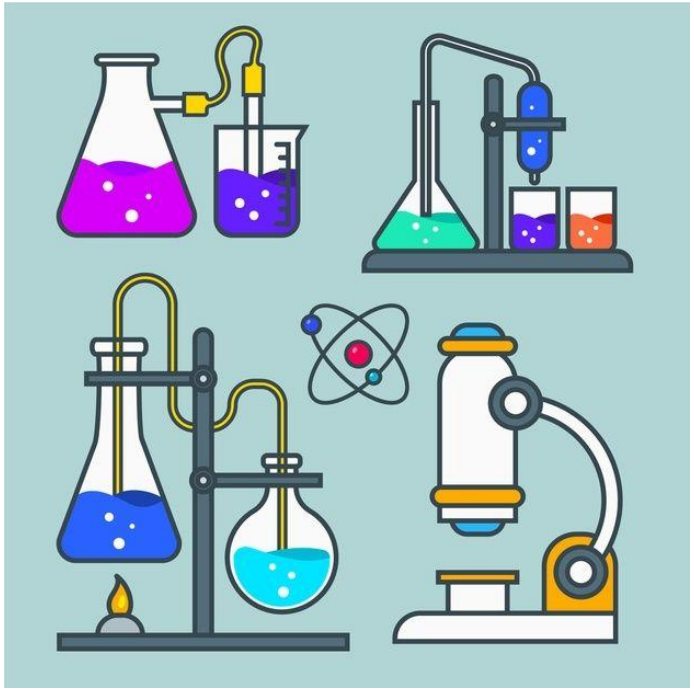
Business Judgment Rule

- Directors' business decisions generally protected by the business judgment rule
- Presumes disinterested/independent directors:
  - Are informed
  - Act in good faith
  - Act in the best interest of the corporation

Duty of Care – Best Practices

- Don’t be an empty chair (or Zoom square)
- Ignorance of complex/novel areas no excuse; directors expected to “do their homework”
- While courts will not second-guess business decisions, make sure record reflects the board explored all options

Hypothetical 2 – The Concerning Test Results



Board's Duty to Monitor and Oversee Corporate Risk

- *In re Caremark International Inc. Derivative Litigation*, 698 A.2d 959 (Del. Ch. 1996)
- Directors liable where they:
  - Utterly failed to implement any reporting system or information system or controls; ***or***
  - Consciously failed to monitor or oversee a reporting system thereby disabling themselves from being informed of risks or problems requiring their attention.
- Historically, *Caremark* could not be used to second-guess a Board's business decisions, including those involving risk.
  - Most claims did not survive a motion to dismiss.
- But have recently "bloomed like dandelions after a warm spring rain." *Constr. Indus. Laborers Pension Fund v. Bingle*, 2022 WL 4102492, at *1 (Del. Ch. Sept. 6, 2022)

Takeaways- *Caremark*

- Enhanced scrutiny
- Greater inspection rights
- Shift in corporate law and how it treats societal interests (ESG)

Practice Points - *Caremark*

- Retain relevant experts and consultants to provide periodic updates on new developments
- Appoint standing board committee to monitor specific risks
- Demonstrate clear pattern of routine board engagement
- Receive regular reports from management on mission critical components of the business
- Stay engaged and display leadership if there is a materialization of a risk
  - When areas of risk identified, ensure that there are individuals/committee(s) explicitly responsible for monitoring
- Develop a business culture that makes mission critical risks a priority

Recent Developments – *Caremark* Claims Dismissed

- *Fisher v. Sanborn*, 2021 WL 1197577 (Del. Ch. Mar. 30, 2021)
  - Board did not consciously overlook or fail to address red flags regarding company's illegal deception of borrowers. Issuance of subpoena or launch of regulatory investigation insufficient to establish that the directors knew or should have known the corporation was violating the law.
- *Pettry v. Smith*, 2021 WL 2644475 (Del. Ch. June 28, 2021)
  - Board did not consciously disregard its duty to address company's unlawful practice of shipping illegal cigarettes subject to ongoing enforcement actions.
  - The board decided in good faith to let the litigation play out prior to making any determinations regarding the remediation of the underlying alleged misconduct.
- *Firemen's Ret. Sys. of St. Louis v. Sorenson*, 2021 WL 4593777 (Del. Ch. Oct. 5, 2021).
  - Board had outside consultants/auditors to improve its cybersecurity and red flag reports were delivered by management to the board.
  - Pleading non-compliance with non-binding industry standards, like the Payment Card Industry Data Security Standard, is not the same as pleading that directors knowingly permitted a company to violate the law.
- *City of Detroit Police and Retirement Sys. v. Hamrock*, 2021 WL 877720 (Del. Ch. June 30, 2022)
  - Board established a reporting system for "mission critical" risks—safety at the site of energy holding company.
  - The board formed a committee to oversee and report on safety policies, practices, and performance. This committee met five times a year, received extensive reports from senior executives, and regularly reported on safety risks to the full board.
- *Construction Industry Laborers Pension Fund v. Mike Bingle*, 2022 WL 4102492 (Del. Ch. Sept. 6, 2022)
  - Board adequately oversaw risk to cybersecurity of criminal attack despite company falling victim to Russian hackers.
  - Board did not allow the company itself to violate law, ensured that the company had at least a minimal reporting system about corporate risk, including cybersecurity, and did not ignore sufficient red flags of cyber threats to imply a conscious disregard of a known duty.

Recent Developments – Viable *Caremark* Claims

- *Marchand v. Barnhill*, 212 A.3d 805, 824 (Del. 2019).
  - Board of an ice cream company failed to establish a board-level compliance reporting system for food safety.
- *In re Clovis Oncology, Inc. Deriv. Litig.*, 2019 WL 4850188 (Del. Ch. Oct. 1, 2019)
  - Board of a drug manufacturer "consciously ignored red flags that revealed a mission critical failure to comply with [a clinical trial] protocol and associated FDA regulations," despite the fact that Clovis was a "monoline company [that] operates in a highly regulated industry."
- *Hughes v. Hu*, 2020 WL 1987029 (Decl. Ch. Apr. 27, 2020)
  - Board, acting through Audit Committee, failed to provide meaningful oversight over Company's financial statements and system of financial controls as illustrated by "chronic deficiencies" in internal controls over financial reporting.
- *Teamsters Local 443 Health Services & Insurance Plan v. Chou*, 2020 WL 5028065 (Decl. Ch. Aug. 24, 2020)
  - Board of a pharmaceutical sourcing and distribution company ignored red flags and allowed a "woefully inadequate reporting system with respect to the business line in which [its subsidiary] operated."
- *In re Boeing Company Deriv. Litig.*, 2021 WL 4059934 (Del. Ch. Sept. 7, 2021)
  - Board had no reporting system in place to monitor safety updates from management and made statements that demonstrated they knew they should have processes in place to receive safety information given that airplane safety was "essential and mission critical" to Boeing's business.
  - Board ignored red flags, failing to treat the 737 MAX crashes as a safety issue and instead treating it as a PR/legal issue

Hypothetical 3 – The “Sustainable” Product

Sources of ESG-Related Litigation Risks in the U.S.

- Private ESG-related litigation generally arises in consumer protection or fraud claims under federal or state laws and anti-fraud provisions in Section 10(b) of the Securities Exchange Act.
- There also has been an enhanced regulatory focus on ESG-related topics at both the state and federal levels.

Securities Fraud Claims	Consumer Protection & Unfair Competition	Deceptive & Unfair Practices
• Issuers and fund managers are under heightened scrutiny regarding ESG-related claims and products. • Issuers will need a robust data tool to evaluate disclosures / claims to ensure such disclosures / claims are consistent with actual practice.	• Sustainability claims have been brought under state consumer protection laws, focusing on product labeling, alleging that such labels include misleading or false statements. • This subcategory of litigation follows "an increase in public access to information about companies' [ESG] performance, which can then be compared against statements and commitments."	• Litigation has focused on misrepresentations about product content and/or attributes • Claims here focus on whether products claiming to be sustainable (including production processes) actually are

Directors' Involvement in Company Statements – Risks and Benefits

- **Being active is a good thing - but there is risk**
- **Potential liability for securities fraud if company statements are false or misleading**
  - While directors will normally be insured or indemnified, there are reputational risks
- **Some types of documents (SEC filings or registration statements) directors will be expected to sign**
  - Others might be prepared disseminated without director involvement

Janus Capital Group, Inc. v. First Derivative Traders, 564 U.S. 135 (2011)

- **Landmark Supreme Court case holding that only a "maker" of a statement can be primarily liable for securities fraud under Rule 10b-5(b)**
  - Supreme Court in *Lorenzo* later expanded "scheme" liability to those who disseminate a misrepresentation
- **Maker is someone with "authority over the content of the statement and whether and how to communicate it."**
  - Significantly narrowed primary liability to avoid implicitly creating a theory of "aiding and abetting" liability

Section 20(a) Control Person Liability

- Liability for those who exercise “actual power or control” over a primary violator (usually the company itself)
- Directors face an uphill battle in overcoming 20(a) claims especially at the motion to dismiss stage because director status serves as a “red light”
- Unlike primary liability, not *per se* tied to control over statements, but one factor that is considered

Company Statements – Best Practices

- **When asked to provide feedback or revisions to a company statement, consider:**
  - Whether you have first-hand knowledge of the representations being made or are able to independently confirm them
  - Whether the statements contain opinions or projections and, if so, whose opinions or projections they are
  - Risk-reward calculation of involving yourself in the statement

Duty of Loyalty

- Act in good faith for the benefit of the corporation / its shareholders
  - Do not consciously disregard duties, knowingly violate law, or act for any purpose other than advancing the best interest of the corporation
  - Actual or constructive knowledge required
- Corporate opportunity doctrine
  - Can't take business opportunity presented to or otherwise belonging to the corporation

Breach of Duty of Loyalty – Conflict of Interest

- Actual Conflict of Interest:
  - Applies in:
    - Conflicted-board transactions: Majority of directors who approved transaction were not disinterested and independent
    - Controlling-stockholder transactions
    - Fraud on the board
  - "Entire Fairness" Standard of Review requires fair dealing and fair price
  - No exculpation if director acted in self-interest or bad faith or lacked independence from a conflicted party

Breach of Duty of Loyalty – Conflict of Interest

- Potential Conflict of Interest:
  - Applies in:
    - Anti-takeover defensive measures
    - Sale of control (but not dissolution)
    - Corporate elections
    - Enforcement of advance notice by-law provisions
  - “Enhanced Scrutiny” Standard of Review, specific elements depending on the circumstance

Breach of Duty of Loyalty – Conflict of Interest

- Best Practices:
  - Examine existing procedures
  - Err on the side of disclosure
  - Create new procedures if existing procedures are inadequate
- Potential ways to cure conflict:
  - Form a special committee of independent and disinterested directors to make a decision or
  - Get a majority of fully informed, disinterested shareholders to ratify a decision

Option Based Compensation

- Provides employees with the right to purchase employer stock at a specified price for a certain price
- Attractive compensation scheme because of the way that “at the money” option awards are booked as a company expense
- Spring-loaded options—where a company grants stock options or other awards shortly before it announces market-moving information—are increasingly awarded by public companies but raise increased regulatory scrutiny

Spring-Loaded Options

- Spring-loading is not insider trading (both sides to the trade have the same information)
- Because spring-loading is not unlawful, there can be no liability for failing to disclose it
- Open question whether spring-loaded options are a deceptive or manipulative practice
- Non-routine spring-loaded option grants merit “particular scrutiny”
  - November 29, 2021 Guidance Staff Accounting Bullet No. 120

Compensation – Recent Developments

- **2022 Final Clawback Rules - Recovery of Erroneously Awarded Compensation**
  - Adds new Rule 10D-1 under the Securities Exchange Act of 1934
  - Listed issuers must now (1) adopt and comply with a written clawback policy, which provides for the recovery of "erroneously awarded" incentive-based compensation received by its current or former executive officers; and (2) disclose clawback policy in accordance with SEC rules.
- **2022 Amendments to Rule 10b5-1 Trading Plans**
  - More difficult now to assert affirmative defense based on Rule 10b5-1 trading plans

Questions?

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