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Board Oversight of "Mission-Critical" Regulatory Issues

In *In re The Boeing Company Derivative Litigation*, the Delaware Court of Chancery declined to dismiss claims that the board members breached their duty of oversight by failing to establish an effective airplane safety monitoring system and follow up on related red flags. Although the litigation is still pending, the opinion by Vice Chancellor Zurn reiterates the importance of board oversight of "mission-critical" regulatory issues and gives guidance as to possible board processes, such as assigning responsibility to a committee specifically in its charter documents or including such matters as part of the regular board agenda (as opposed to *ad hoc* reports by management), and, in either case, ensuring that management reports convey a full picture of such matters. In addition, boards should actively follow up on red flags relating to the failure of a mission-critical company issue and be willing to question management's assessment.

Background

The litigation arose from the crashes in October 2018 and March 2019 of two Boeing 737 MAX airplanes, alleged management and board compliance deficiencies related to airplane safety issues, and criminal, regulatory and civil liability stemming therefrom. Plaintiffs asserted that the Boeing board breached their duty of oversight (so-called *Caremark* claims), among others. The directors moved to dismiss based on the plaintiffs' failure to make a pre-suit demand on the board. The court declined to dismiss the claims, ruling that demand was excused because if the facts alleged by the plaintiffs were true (and the Court of Chancery was required for purposes of the motion to dismiss to assume they were true), then the directors would face a substantial likelihood of liability on the *Caremark* claims for failing to establish an internal system of board-level reporting regarding airplane safety compliance issues and for not focusing on "red flags" regarding the 737 MAX after the first crash occurred. It is important to note that the litigation is in the very earliest stages and it is not uncommon for plaintiffs' claims against directors to survive a motion to dismiss based on alleged facts that later turn out to be unsupported by the evidence.

Takeaways

Although the *Boeing* case is pending and no factual findings have been made at this stage, the court's reasoning on this preliminary motion provides helpful guidance and considerations on a board's *Caremark* duties, including the following:

- *Boards may consider documenting explicitly how mission-critical compliance issues are overseen by the board*. As the court noted, boards continue to have significant leeway in how they choose to satisfy their *Caremark* obligations, including whether to delegate these responsibilities to a committee or retain oversight at board level. However, a well-documented, structured process with respect to compliance matters is viewed as important by the courts, especially for purposes of possible dismissal. First, in order to comply with their oversight duties, a board might impose some rigor to identifying what, if any, mission-critical compliance issues exist for the company. Then, once a mission-critical item is identified, the board's chosen process for handling such matters can be appropriately documented, e.g., by explicit reference in a committee charter (if delegated), including these issues as regular board or committee meeting agenda items and reflecting related discussion in the committee or board minutes. Similar documentation and process should be considered if an incident occurs on a mission-critical topic.

- *Boards should consider taking steps to ensure that management apprises the board of these mission-critical issues in a holistic manner*. Boards might expect that management reports on mission-critical issues on a consistent basis and be willing to press management for further information. Intermittent, management-initiated communications to the board may not be sufficient to comply with the board's oversight duties. For example, in *Boeing*, the court was critical of the alleged fact that the board only received management-initiated updates that were not "safety-centric" and instead focused on the company's production and revenue strategy. In addition, boards should consider pressing management, as appropriate, for further information and not passively accept management's assurances and opinions on key compliance issues.

- *Where a board's reporting system reveals red flags, best practices may include following up and questioning management's assessment.* Even where there are extensive reporting systems and controls in place, a board should ensure that red flag compliance issues are adequately reported to the board and an adequate response is implemented. For example, the *Boeing* court criticized the board's alleged response to red flags concerning the first crash, noting that the directors allegedly focused on the crash as an "anomaly" and attended to its public relations and litigation consequences without first investigating whether there were internal safety compliance failures that contributed to the crash and, if so, how to remedy those failures.

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This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Questions concerning issues addressed in this memorandum should be directed to:

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