

The Long-Term Impact of the Pandemic on Corporate Governance: *Recommendations the General Counsel May Share with the Board*

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The pandemic is likely to have lasting, material repercussions for how health care enterprises approach corporate governance. These repercussions are separate and distinct from the board's disaster-response duties that were summoned into application during the height of the health crisis. Rather, they relate to how certain traditional governance principles and practices are expected to change given the lessons and experiences that corporate leadership is gaining over the course of the pandemic.

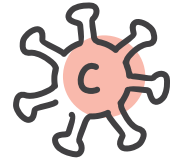
A critical impact of the pandemic is that the law, corporate stakeholders, and public policy will likely expect boards to be responsive in some way to how circumstances have changed, in a good faith man-

ner. Boards will thus be called upon to evaluate the governance impact of pandemic-specific lessons and experiences, and to implement changes believed to be appropriate given the circumstances.

This is not to suggest that all principles of corporate governance will be irrevocably changed by the pandemic. But certain key principles—including those that relate to the board/management dynamic, levels of director engagement, and oversight of particular management functions—are likely to be altered to a significant degree.

The following discussion is intended to highlight the most probable areas in which governance principles and practices are expected to change following the





pandemic, and to suggest ways in which the general counsel may introduce those changes to the governing board.

1. The Board/Management Dynamic. The board and management should be alert to the need for clarity on lines of decision-making authority between them.

The ability of both senior leadership components to execute their duties in times of crisis requires a shared understanding of the basic distinctions between the roles of governance and of management. This is particularly the case as both seek to satisfy enhanced expectations of their conduct created by the crisis.

The Business Roundtable's statement of governance principles¹ ascribe to the board the basic responsibility for oversight of corporate management and business strategies, consistent with the goal of long-term sustainability. It ascribes to management responsibility for establishing, managing, and implementing corporate strategies, including but not limited to the day-to-day operations of the company under board oversight and updating the board on operational status.

But the line separating what is the responsibility of the board, and what is the responsibility of management, tends to blur in times of crisis. The absence of a "bright line" separating their respective duties can be the source of much leadership-level friction. It is vitally important that the parties work diligently to establish understandable lines of authority that assure the sustainability of organizational decisions and avoid confusion.

2. Greater Board Engagement. Boards of health care entities are likely to retain for the foreseeable future a heightened level of engagement with governance responsibilities, and with management.

Disasters, such as the pandemic, call for board involvement beyond that contemplated by basic governance principles. The pandemic presents such fundamental challenges to corporate stability that the organizational response cannot be delegated to executive management as it would be in the normal course, or even with more traditional crises.

A critical impact of the pandemic is that the law, corporate stakeholders, and public policy will likely expect boards to be responsive in some way to how circumstances have changed, in a good faith manner.

It's a level of engagement that will be difficult to withdraw from, at least for the near term. For one reason, commerce can be expected to remain in some uproar until public health concerns have been satisfactorily addressed. The leadership, scrutiny, and perspective offered by the board will remain at a premium. For another reason, the lasting impact of the crisis on industries and individual company business models will take time to realize and address. The board will need to remain at a heightened level of attentiveness to evaluate this change. In addition, it is now clear that boards can stay well involved through a variety of "virtual" means; it is logistically easier to perform their duties.

3. Oversight of Business Resiliency. The obligation to exercise oversight of business resiliency will become a primary board focus going forward.

The evolution of the pandemic to the resumption of sustained economic activity prompts the board to pivot to its unique oversight obligation for business resiliency. This refers to concepts of oversight that focus on long-term business and cultural 'bounce-back' from truly abrupt disruptions of cross-industry, national, or global proportions. It is a critical board obligation under the circumstances, but one that nevertheless should be exercised with discretion to avoid unnecessary conflict with management.

Business resiliency is an essential part of the board's risk oversight function. It is grounded in the obligation to periodically review management's plans to recover from catastrophe and disaster, including such tasks as business continuity, physical security, cybersecurity, and crisis management.

Ultimately, this responsibility encompasses several basic categories: whether there is a plan for getting the organization back on its feet; which corporate officers are designated to lead the effort; whether outside advisors are to be consulted; what are the features of the plan; when is it to be initiated; and whether it addresses workforce health, safety, and support.

4. Enterprise Risk Management. One of the most significant governance implications of the pandemic may be its impact on the role and function of the board's enterprise risk management (ERM) committee.

From one perspective, the pandemic may serve to elevate that committee to a role of greater significance, potentially on a par with that of the audit committee. From a related perspective, it may prompt significant board contemplation of the level of oversight expected from that committee.

The catalyst for such change is grounded in five interconnected factors: (i) the broad-based application of ERM-focused board committees; (ii) the nature and scope of the pandemic; (iii) the environment of "second guessing" on risk preparedness likely to emerge from the pandemic; (iv) the extent to which the *Caremark*² oversight standard has evolved over the past year; and (v) the lessons on risk identification disaster response that individual corporations are certain to take from the pandemic.

COVID-19 has validated the need for a vital ERM function. Perhaps more significant is the extent to which it has confirmed that cataclysmic disasters can indeed occur and may henceforth be given greater consideration in the ERM risk identification process. These factors will, in turn, place a premium on close board evaluation on the effectiveness of the current ERM program.

5. Quality and Patient Safety. A much greater level of system-wide board collaboration with management on quality of care and patient safety concerns can be expected.

The pandemic has shone a spotlight on the vital role of the board in supporting management to ensure that both that emergency preparedness and response

efforts are fully coordinated, and that the impacts of a large-scale effort are analyzed from the perspective of those who are ultimately responsible for the operation of the health care enterprise.

In the past, governing boards may have considered "operational" subjects like quality of care, infection prevention, and shifts in regulatory compliance as solely the province of management and staff. Going forward, the effects of the national health emergency and the lasting influence it will have on health care operations indicate these areas are appropriate for board-level review and decision making. Oversight and inquiry to ensure that management and health care leaders have pressure-tested their plans, and considered the effect on the organization as a whole, is well within the scope of the governing board.

By way of example, the exigencies of the pandemic and the attendant stresses due to lack of health care equipment, staff, and resources have brought to the fore complex issues like rationing care and development of "crisis standards of care." Board involvement in vetting and adopting care protocols or care priorities developed by the organization is important, as the potential risks—legal, ethical, and reputational—rest squarely with the organization.

6. Executive Compensation. Compensation Committees (and CEOs) will focus on greater discretion in executive pay programs, and on finding a new balance between salary and performance components.

Indeed, the lessons of the pandemic suggest that the Compensation Committee will need to address a variety of important and sometimes unique compensation concepts that may prompt a long-term expansion of its agenda.

For example, the Committee and the CEO will want to reach a new understanding on CEO emergency powers to change executive compensation during a crisis. From a talent development perspective (and to avoid losing key executives before or during a crisis), the Committee will want to review the overall retention effect of executive programs and determine when retention will be weakest.

Employee health and safety will become a more important element of the board's workforce culture oversight responsibilities.

Boards may recalibrate the compliance function (and their oversight of that function), to address new risks and to seek efficiencies.

A key pandemic lesson is the benefit of having an appropriate level of Compensation Committee discretion built into all executive compensation and benefit arrangements. This includes the flexibility in a crisis not to pay something, or to pay it later, as well as the flexibility to pay something different or additional when extraordinary circumstances intervene.

Long-standing executive pay or benefit programs should be taken off auto pilot and given a fresh look. This includes reviewing supplemental retirement plans to understand all costs under a wider range of financial scenarios, to assess long-term affordability, and to add discretion to suspend new benefits during a crisis.

Executives will be expected to conduct their work outside the traditional office setting. A mobile leadership model will have implications for paid time-off programs, productivity, availability, and performance evaluation.

With many organizations coming out of a period of executive pay reductions, and likely an absence of incentive pay awards, the Committee will wrestle with how to restore executive compensation. The Committee will have to decide whether lost amounts are restored, whether pay increases will be through salary or greater incentive opportunity, and whether restored base salaries will at least make the organization competitive for key leadership talent.

7. Scenario-based Technology Planning. More rigorous board oversight will be exercised over long-term access to key technology, equipment, and personnel.

The health care economy has long relied on the availability and effectiveness of both technology and the technicians who operate and maintain it. The pandemic and its collateral impact on technology's adaptability has shaken that reliance with significant resulting risk implications for physician groups, providers, and similar health care enterprises.

Going forward, boards will be expected to assure that management has in place an effective emergency technology plan. Such a plan would be designed to address events and scenarios in which technology, equipment, personnel, or some combination thereof becomes unavailable, and to build a map of probabilities. Based

on each emergency type, the plan would confront an operating model without historically available technology and assure access to both an off-site backup technology, and to additional technical support. Such a plan would anticipate how long the organization can effectively operate under emergency conditions. It should also identify necessary steps to obtain and implement replacement technology, equipment, and personnel—and both the time frame and cost of doing so.

The primary responsibility for scenario-based technology planning will, of course, be that of the management team. Yet with the pandemic's lessons in mind, the board should exercise robust oversight of management's planning (including engaging in mock "tech outages") to help assure organizational preparedness.

8. Oversight of Workforce Culture. Employee health and safety will become a more important element of the board's workforce culture oversight responsibilities.

It is increasingly recognized that boards have a fiduciary responsibility to exercise oversight of corporate culture. This is grounded in the perspective that a positive organizational culture can be a meaningful corporate asset in a variety of ways (e.g., influencing operational performance, talent development, and organizational reputation). One of the recognized iterations of culture is its extension to employee morale, prevention of sexual harassment, and promotion of inclusion in the workforce.

With companies moving to reopen their business locations, culture issues are also extending to the health, safety and morale of the workforce. Employee concerns in this regard, and a general awareness of the safety of the workplace, are likely to remain well after the broad application of a vaccine or other treatment for the virus. The success of the organization's post-pandemic business model may depend in part on the sensitivity it displays to employee virus-related concerns. This sensitivity is likely to expand to general health and safety matters. An informed and engaged board can be a support and guidance resource to management's efforts to address these matters.

9. Oversight of Compliance. Boards may recalibrate the compliance function (and their oversight of that function), to address new risks and to seek efficiencies.



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From a risk perspective, this effort will be driven by the implicit recognition that the post-pandemic era will witness a broadening of governmental authority in general, and an increasingly complex national and international regulatory environment in particular. This can already be seen through requirements relating to accessing federal pandemic relief funds; increasing concerns with the security of information technology, antitrust issues in the labor market, and evolving regulations from the Food and Drug Administration, Centers for Medicare & Medicaid Services, and others.

From a management perspective, boards may see greater efficiencies by moving away from traditional vertical “silo” reporting arrangements for compliance officers, to arrangements that seek targeted accountability for, and greater integration among, the various legal, compliance, and risk functions. Such arrangements are intended to allow for greater collaboration between officers with risk-related responsibilities and to achieve related efficiencies and cost savings without disturbing futility bypass arrangements.

10. Succession Planning. Executive, officer, and director succession planning will require far more consideration at the board level.

For many organizations, leadership succession policies and procedures have been too insufficient or too informal to address the breadth of related succession challenges arising from the pandemic. Going forward, boards are expected to treat succession matters with an enhanced level of attentiveness and formality, which will provide value to the organization.

For example, the Compensation Committee (or a designated executive succession committee) should work with senior leadership to create or update the executive succession plan for key leadership positions. This would likely include addressing emergency vacancies, longer-term successors, developing leadership skills and experience in future leaders, and retention arrangements for key leaders being groomed.

Other unique executive succession issues to be considered include: the return to work of recently retired CEOs and CFOs to support their successors during the crisis environment; having executives share certain tasks and responsibilities; identifying an interim successor if a previously identified successor is not

ready to assume the position; the process for transitioning to the new/interim/emergency CEO; designating an experienced board member to serve as emergency or interim CEO; and more aggressive planning for director succession.

Conclusion

As the pandemic takes its course, health care boards are evolving from a generational disaster for which their organizations have borne a particularly painful burden. In many respects, these boards have been called upon to exercise an unprecedented level of engagement in supporting their organizations. What more could possibly be asked of them?

The ultimate corporate law consideration in play post-pandemic is the expectation that boards will periodically re-evaluate their governance policies and procedures in light of their particular facts and circumstances. This is, essentially the self-analysis, “What have we learned?” “What lessons may we draw from this experience?” “What, if anything, do we need to do differently, or focus on more particularly, going forward?”

There is no “right answer”, no “one-size-fits-all” response. It would be hyperbole to suggest that any clear governance best practices have emerged. The most appropriate approach is for the board to pursue such a self-analysis from a good faith, informed perspective. The above ten points can be a guidepost; a template from which the health care board can come to its own conclusions. The general counsel can be an effective advisor to the board through this process.

The authors’ views do not necessarily represent the views of McDermott Will & Emery or its clients.

Endnotes

1. The Business Roundtable, Principles of Corporate Governance (Aug. 2016), <https://s3.amazonaws.com/brt.org/Principles-of-Corporate-Governance-2016.pdf>.
2. *In re Caremark Int’l Inc. Deriv. Litig.*, 698 A.2d 959, 967 (Del. Ch. 1996).



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