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COVID-19

Corporate Governance Considerations in Response to COVID-19 Outbreak

The COVID-19 pandemic and its aftermath will heighten focus on corporate governance and the role of a talented management team and an engaged board as companies forge a path through the uncertain times ahead. Strong oversight, coordination and leadership will be critical in managing a fluid and complex situation impacting a company's business, operations, prospects, employees, stockholders, other stakeholders and government/regulatory relationships. Among various other challenges, we expect that boards and management will be called upon to:

- i. understand, adapt to and reduce COVID-19-related risks;
- ii. protect the health and safety of employees, other stakeholders and the broader public;
- iii. implement and refine best practices in a constantly changing environment;
- iv. reassess short- and long-term business plans and strategy, liquidity, debt and available financing, capital allocation, dividend policy and share buybacks;
- v. reevaluate M&A strategy and activity (including potential acquisitions);
- vi. coordinate and communicate with governments, regulatory agencies and other companies and parties within and outside a company's industry;
- vii. evaluate employee work and compensation/benefit arrangements;
- viii. maintain an open and constructive dialogue, both among board members and between the board and management; and
- ix. communicate and engage with employees, stockholders and other stakeholders regarding the pandemic and ordinary course matters.

Further, the declines in the equity values of most public companies accompanying the pandemic increases the risk of hostile takeovers and shareholder activist activity. By way of example, the 2008 financial crisis was followed by significant increases in the number of hostile offers, proxy fights, activism and event-driven

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investing. As a result, companies should remain current on investor buying activities, pay attention to market rumors, monitor their securities for unusual accumulations or trading between hedge funds, and be prepared to deal with potential hostile acquirors and activists should a threat emerge. Proactive steps include a company working with its proxy solicitor to monitor investor activity, coordinating with its bankers regarding potential acquirors/activists and strategy, and discussing with its outside counsel related considerations, tactics, board duties, and preparedness plans.

It is especially important for a company's board and management to stay informed so that it is well positioned to take swift, targeted action that will benefit the company and all of its stockholders. Early detection and advance planning are key to protecting a company's stockholders and long-term business strategy from coercive tactics that leverage undervalued equity. In particular, time is of the essence in an activist or hostile acquisition situation regardless of the actions a company's board ultimately decides to take. Compared to the activist campaigns of prior years, recent activist campaigns typically have a much shorter timeline. In some instances, investors have been able to amass significant stakes before a board could put a rights plan (commonly known as a poison pill) in place or take other responsive action.

A rights plan (i) prevents a bidder or others from accumulating a substantial position in the company for so long as the plan is in effect, (ii) enhances a board's negotiating leverage and (iii) provides time to seek out and consider alternatives if a board decides to do so, thereby increasing the likelihood that any resulting transaction is in the best interests of the target company and its stockholders. Though few companies now maintain an active rights plan, most companies have the ability to adopt a plan if and when a specific threat arises. Further, many boards have considered potential plans well in advance of their implementation so that they can, should the need arise, quickly take a rights plan "off the shelf".

Companies with reduced market valuations are particularly vulnerable to hostile bids or large accumulations not only because it is less costly for the insurgent to accumulate a substantial stake, but also because antitrust filings required by the HSR Act and Schedule 13D filings become less effective as early warning mechanisms as a result of the companies' smaller market cap. In recent years the threshold for making an HSR filing has been viewed as an early warning or limitation on certain types of accumulations. However, given the recent decline in equity values, this threshold, currently set at \$94 million in voting securities and tied to the absolute dollar value of the acquiror's stake, rather than relative ownership interest, may prove less of an impediment (for many experienced investors this does not present any immediate obstacle as generally the use of derivatives allows them to push off an HSR filing). Similarly, while a person or group acquiring more than 5% of a company's shares is required to file a Schedule 13D disclosing the size of their position and intent, activists have taken advantage of the ten-day window before their initial Schedule 13D filing is due to acquire stock beyond the 5% level, and aggressive stake builders might use cash settled derivatives to increase their economic position before creating a Schedule 13D filing obligation. Consequently, investors may be able to acquire very substantial positions in a target company without filing

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under the HSR Act or on Schedule 13D. This increases the importance of active monitoring and advance preparation such that a target company is not caught unaware.

Moreover, companies should be aware that the recent volatility may lead to an increase in index rebalancing (though certain rebalancing, including quarterly for the Dow and S&P 500, has been delayed due to COVID-19). This activity in a company's shares presents the opportunity for activists to cloak accumulation through block purchases from index funds without driving up share price (particularly for smaller market cap companies with more illiquid stock). Both the company's investor relations team and proxy advisor should put in place measures to prepare for and mitigate this possibility – particularly, as noted above, since HSR and Schedule 13D filings may not provide a company with adequate advance warning.

COVID-19 will continue to place a focus on each company's leadership and corporate governance, its response to the pandemic, and its ability to preserve and drive long-term value. Given the current market turbulence and reduced equity values, companies must also remain vigilant in monitoring investor activity and preparing for potential hostile acquirors and activists, and, should a threat emerge, consider adopting a poison pill (including taking one "off the shelf") or other defensive measures to preserve shareholder value. Conversely, this market volatility will also present new opportunities to evaluate and pursue potential value-enhancing transactions, which companies should monitor and be prepared to execute.

We are available to discuss any of the foregoing at your convenience and provide assistance in this uncertain time.

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