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## I. GOVERNANCE AND DISCLOSURE IMPLICATIONS FOR PUBLIC COMPANIES

By [Robert Kimball](#), [Sarah Morgan](#), [Sarah Fortt](#), [Joanna Enns](#) and [Katherine Frank](#)

The COVID-19 pandemic and related economic crisis present many complex governance and disclosure issues for boards of directors and their management teams to consider. The following discussion summarizes some of the most important issues our clients are facing as the situation rapidly changes.

### What's the Plan?: Key Considerations for Management and the Board in Navigating the COVID-19 Crisis

Even in times of unprecedented crisis, the fiduciary duties of care and loyalty guide boards of directors to exercise oversight and disclosure responsibilities by understanding the critical risks facing the company as the pandemic evolves and management's proposals to address and mitigate those risks. Given the constant stream of new developments in the COVID-19 pandemic, it is critical that emerging risks to the company be identified and managed quickly.

- Of utmost importance are the company's **employee safety and business continuity plans**. Specific guidance on employee safety can be found in sections **V. Mitigating the Risks of a Remote Workforce**; **VI. Ensuring Employee Safety and Considering Employee Privacy**; and **VII. Reductions in Force and Workforce Management in a Downturn**. The company should consider contingencies, such as working with a remote or skeleton workforce, and additional safety issues, such as whether a deep clean of office and workspaces is appropriate.
- The board and management should also consider **production, supply chain and other business disruption and any protection the company may have**. This involves review and assessment of the company's major contracts with customers, suppliers and other vendors and their force majeure clauses, as well as the company's insurance policies and their protections. Additional information on these topics can be found in sections **IX. Insurance Coverage During the Outbreak** and **XII. Implications for Federal Contractors**.
- **Keeping open lines of communication with all levels of government and staying up to speed on all governmental actions** that may affect business operations or provide assistance to the company and its employees in each jurisdiction in which the company operates is also critical.
  - o Management should prepare, coordinate and communicate with local and state authorities to understand any pending shutdown of operations or sites, any quarantine affecting the company's workforce, changes to the business operations, and any assistance programs that may be available to a company or its employees, and regularly communicate the same to the board. Ever-changing local responses to the pandemic can dramatically alter a company's contingency plans. Participating early in those discussions in the applicable jurisdictions can provide the opportunity to help shape the government's actions and better prepare the company to quickly respond to the same.
  - o Management and the board should understand the assistance programs and other actions developed at a federal level and how they will apply to the company

and its employees. See [Federal Government Provides Guidance on Essential Businesses During COVID-19 Outbreak](#) for more information on federal actions to date.

- Management and the board need to **make a clear assessment of the company's capital resources and liquidity position under multiple different scenarios** and sensitivity analyses. What are the levers the company can pull in various scenarios and the short-term and long-term effect of such actions? Review of the company's credit facilities and debt instruments is warranted to understand more fully the **liquidity implications** of the COVID-19 pandemic and related market effects on the company. See section **XI. Credit/Financing Implications** for more information. In addition, if a company is concerned it may be insolvent in the near future if present circumstances persist, the board should be refreshed on its fiduciary duties and related considerations in a distressed environment. See **Understanding Your Fiduciary Duties** in section **II. Considerations for Distressed Public Companies**.
- The board should work with management to plan for **potential illness of board members or members of the c-suite**, including who takes over if a c-suite executive is unable to work, and whether and how to disclose these changes. For each scenario, the plan should cover the same basic topics of who, what, and when:
  - o **Who?** Who takes over if someone is unable to work? (Companies should pay particular attention to how emergency succession plans may play politically inside the company.)
  - o **What?** What is the scope of that person's responsibilities, duties, and powers?
  - o **When?** When (and how) should the company communicate this to employees, stockholders, and the public?

For additional information, see [My CEO Just Tested Positive, Now What?](#)

- Management and the board should prepare for **increased cybersecurity and data risks** as more employees work from home. For additional detail on some of these issues and how to promote sound information security practices, see [COVID-19 Places Company Information at Risk](#).
- Management and the board should **consider whether the company is vulnerable to stockholder activism in current markets and take appropriate pre-cautionary measures** including consulting with advisors, monitoring its stock-watch program, and preparing a "pill on the shelf" to use if necessary. For additional information, see section **X. Shareholder Activism Considerations in a Distressed Environment**.
- Management and the board should **understand the effect of COVID-19 and related market distress on any pending or future M&A processes**, if applicable, as well as understand other potential strategic transactions, such as a take private. For additional information see section **III. Implications for M&A Negotiations and Agreements**; and **My Board and I Just Got a Letter From My Largest Stockholder Who Wants to Buy Out the Public and Take the Company Private. Now What?** in section **II. Considerations for Distressed Public Companies**.

- Management and the board should **consider whether to adjust or delay executive compensation decisions** to ensure the company’s compensation remains appropriately aligned with the current environment, including by consulting with outside counsel and compensation advisors about the topic. For additional information, see section **XIII. Executive Compensation Considerations**.

Many companies have established a dedicated task force reporting to the CEO or board with representatives from all major business lines and covering all the areas identified in this checklist. A task force or committee can help the company to prioritize, summarize, assess and manage COVID-19 and distressed market-related issues and regularly report on those to the board. The task force can also assist in coordinating communications across multiple constituencies and stakeholders. All companies should have a clear and consistent communications strategy with respect to the issues raised by the COVID-19 pandemic—one that proactively addresses issues but takes into account the fact that all of a company’s actions and communications related to the crisis may be scrutinized in the future by regulators or be the subject of future stockholder actions. See ***Heightened Risk of Stock-Drop Litigation*** later in this section.

### **What’s the Story?: Disclosure Implications**

As company operations and market conditions develop in response to COVID-19, companies must consider whether their disclosures are adequate and complete in light of desired communications to investors or other considerations. Most companies have already filed their Form 10-K and would typically wait until the next Form 10-Q or next earnings release to disclose any material changes from information previously disclosed unless they have some particular reason or duty to disclose updated information. Nevertheless, because the spread of COVID-19 and related economic consequences have significantly affected businesses worldwide, many companies are considering revisions they may need to make to forward-looking statements, risk factors, MD&A and other items in their next filing and whether interim disclosures may be necessary. Companies must also consider whether financial and other consequences of COVID-19 and related market distress or interim actions in response to COVID-19 trigger a Form 8-K disclosure obligation.

In addition to potential SEC sanctions for failure to comply with disclosure obligations, in times of great disruption in the stock market, investors will inevitably seek to recoup losses by filing stock-drop lawsuits. Plaintiffs’ attorneys will closely monitor company disclosure and any statements directors and officers make about the COVID-19 outbreak, so extreme caution should be used when preparing disclosure or company statements going forward.

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*In the SEC’s [March 4 release](#), SEC Chairman Clayton reminded “all companies to provide investors with insight regarding their assessment of, and plans for addressing, material risks to their business and operations resulting from the coronavirus to the fullest extent practicable to keep investors and markets informed of material developments.”*

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## Key disclosure considerations:

- **Selective disclosure of material non-public information (MNPI).** Normal anti-fraud rules and Regulation FD apply even in a pandemic. Many companies are making interim disclosures in order to be able to communicate with investors without Regulation FD concerns and to cleanse the company and employees who may be privy to MNPI for purposes of stock buyback programs or any open trading windows. The SEC cautioned against trading where a company has become aware of a COVID-19 related risk that would be material to investors or selective disclosure of that information in a [March 25, 2020 statement](#), and also noted, that, “[d]epending on a company’s particular circumstances, it should consider whether it may need to revisit, refresh, or update previous disclosure to the extent that the information becomes materially inaccurate.”
- **Guidance.** Given the high levels of uncertainty around the full extent of the effects of COVID-19, many companies have issued a Form 8-K or press release withdrawing guidance altogether and are not issuing further guidance in the near term.
- **Assumptions, sensitivities and accounting measures.** Financial and accounting and audit teams are considering the effect of COVID-19 developments on impairment analysis, counterparty credit risk, covenant compliance, and other financial and accounting measures and sensitivity analyses to assess what updates will be required and whether interim disclosures are necessary.
- **Internal controls and disclosure controls and procedures.** Companies should consider how remote working arrangements or closure of company facilities is affecting the company’s ability to maintain internal controls over financial reporting and disclosure controls and procedures and whether disclosure of any past or anticipated changes to these controls or systems is warranted.
- **Proxy statement considerations.** Companies should consider whether COVID-19 developments may affect the following proxy statement disclosures:
  - o Does the company plan to move to a virtual meeting or retain flexibility to move to a virtual meeting at a later date? See ***Shall We Meet?: Virtual Annual Meetings*** later in this section.
  - o Is disclosure regarding board oversight of any material COVID-19 or other current market-related risks warranted in the board oversight section?
  - o Will executive compensation decisions be delayed or action taken to adjust existing compensation and awards? See section **XIII. Executive Compensation Considerations**.
  - o Are the shares of stock available under the company’s current equity incentive plans sufficient if awards are made at depressed stock prices, or should the company consider including a proposal to increase the authorized number of plan shares?
- **SEC relief for filing deadlines:** Consider whether your company is eligible for an extended timeline for filing most reports under the Exchange Act. The SEC has provided conditional relief for certain reporting companies that are unable to meet their filing

requirements due to the COVID-19 outbreak. The SEC release also offers targeted relief on a case-by-case basis to companies facing unique reporting compliance challenges as a result of COVID-19. For additional guidance regarding the SEC's conditional relief, see [SEC Offers Filing Extensions Amid Coronavirus Pandemic](#).

- o **SEC disclosure guidance.** On March 25, 2020, the SEC issued [disclosure guidance](#) for public companies affected by COVID-19, which provides additional detailed guidance regarding disclosure considerations, insider trading, financial reporting, non-gaap measures and other topics. With respect to assessing COVID-19's impact and related material disclosure obligations, the SEC provided the following illustrative (but not exhaustive) list of questions that each company will need to carefully assess:

*“Assessing the evolving effects of COVID-19 and related risks will be a facts and circumstances analysis. Disclosure about these risks and effects, including how the company and management are responding to them, should be specific to a company's situation. As companies assess COVID-19-related effects and consider their disclosure obligations, questions to consider with respect to their present and future operations include:*

- *How has COVID-19 impacted your financial condition and results of operations? In light of changing trends and the overall economic outlook, how do you expect COVID-19 to impact your future operating results and near-and-long-term financial condition? Do you expect that COVID-19 will impact future operations differently than how it affected the current period?*
- *How has COVID-19 impacted your capital and financial resources, including your overall liquidity position and outlook? Has your cost of or access to capital and funding sources, such as revolving credit facilities or other sources changed, or is it reasonably likely to change? Have your sources or uses of cash otherwise been materially impacted? Is there a material uncertainty about your ongoing ability to meet the covenants of your credit agreements? If a material liquidity deficiency has been identified, what course of action has the company taken or proposed to take to remedy the deficiency? Consider the requirement to disclose known trends and uncertainties as it relates to your ability to service your debt or other financial obligations, access the debt markets, including commercial paper or other short-term financing arrangements, maturity mismatches between borrowing sources and the assets funded by those sources, changes in terms requested by counterparties, changes in the valuation of collateral, and counterparty or customer risk. Do you expect to disclose or incur any material COVID-19-related contingencies?*
- *How do you expect COVID-19 to affect assets on your balance sheet and your ability to timely account for those assets? For example, will there be significant changes in judgments in determining the fair-value of assets measured in accordance with U.S. GAAP or IFRS?*
- *Do you anticipate any material impairments (e.g., with respect to goodwill, intangible assets, long-lived assets, right of use assets, investment securities), increases in allowances for credit losses, restructuring charges, other expenses, or changes in accounting judgments that have had or are reasonably likely to have a material impact on your financial statements?*

- *Have COVID-19-related circumstances such as remote work arrangements adversely affected your ability to maintain operations, including financial reporting systems, internal control over financial reporting and disclosure controls and procedures? If so, what changes in your controls have occurred during the current period that materially affect or are reasonably likely to materially affect your internal control over financial reporting? What challenges do you anticipate in your ability to maintain these systems and controls?*
- *Have you experienced challenges in implementing your business continuity plans or do you foresee requiring material expenditures to do so? Do you face any material resource constraints in implementing these plans?*
- *Do you expect COVID-19 to materially affect the demand for your products or services?*
- *Do you anticipate a material adverse impact of COVID-19 on your supply chain or the methods used to distribute your products or services? Do you expect the anticipated impact of COVID-19 to materially change the relationship between costs and revenues?*
- *Will your operations be materially impacted by any constraints or other impacts on your human capital resources and productivity?*
- *Are travel restrictions and border closures expected to have a material impact on your ability to operate and achieve your business goals?*

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- **Considerations for Non-GAAP Measures.** The [March 25th release](#) also provided detailed guidance regarding the presentation of any non-GAAP financial measure or performance metric to adjust for or explain the impact of COVID-19.
    - o The company should explain why the measure or metric useful and how it helps investors assess the impact of COVID-19 on the company's financial position and results of operations.
    - o In instances where a GAAP financial measure is not available at the time of the earnings release because the measure may be impacted by COVID-19-related adjustments that may require additional information and analysis to complete:
      - o The Division would not object to companies reconciling a non-GAAP financial measure to preliminary GAAP results that either include provisional amount(s) based on a reasonable estimate, or a range of reasonably estimable GAAP results.
        - o For example, under this position, if a company intends to disclose on an earnings call its earnings before interest, taxes, depreciation and amortization (EBITDA), it could reconcile that measure to either its GAAP earnings, a reasonable estimate of its GAAP earnings that includes a provisional amount, or its reasonable estimate of a range of GAAP earnings. The provisional amount or range should reflect a reasonable estimate of COVID-19 related charges not yet finalized, such as impairment charges.

- o If a company presents non-GAAP financial measures that are reconciled to provisional amount(s) or an estimated range of GAAP financial measures in reliance on the above position, it should:
  - o limit the measures in its presentation to those non-GAAP financial measures it is using to report financial results to the Board of Directors, and
  - o explain, to the extent practicable, why the line item(s) or accounting is incomplete, and what additional information or analysis may be needed to complete the accounting
- o A non-GAAP financial measure should not be disclosed more prominently than the most directly comparable GAAP financial measure or range of GAAP measures.
- o Where GAAP financial statements are required, such as filings on Form 10-K or 10-Q, companies should reconcile to GAAP results and not include provisional amounts or a range of estimated results.

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## COVID-19

### SEC Disclosure Checkup

- Risk Factors
- MD&A
- Accounting
- Forward-Looking Statement Disclaimers
- Guidance
- Proxy Considerations

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## Key events that may require immediate disclosure under Form 8-K

- **Material amendment or waiver to material contract.** If an issuer has entered into a material amendment or waiver to a material contract, such as a credit facility waiver, disclosure will be required under Item 1.01 of Form 8-K.
- **Termination of a material agreement.** If a material agreement is terminated due to *force majeure* or for similar reasons, disclosure may be required under Item 1.02 of Form 8-K. See section **IV. Force Majeure Provisions in Light of the Coronavirus**.
- **Government aid, revolver drawdowns or other new financial obligations.** Creation of a direct financial obligation or an obligation under an off-balance sheet arrangement requires disclosure under Item 2.03 of Form 8-K. Entry into a new loan, including government aid in the form of a loan, or a significant draw on an existing revolving credit facility may trigger disclosure if material.
- **Ratings downgrade, margin calls, redetermination, events of default or other triggering event with material consequences.** Item 2.04 of Form 8-K requires



disclosure if a triggering event occurs that increases or accelerates an existing financial obligation and if the consequences of the event are material to the issuer.

- **Layoffs or other employment actions.** Major layoffs or other employment termination actions pursuant to a plan of termination may require disclosure of the details of the termination and an estimate of the related costs under Items 2.05 or 5.02 of Form 8-K.
- **Material impairment charge.** A definitive determination of a material impairment charge, including impairment to securities or goodwill, must be disclosed under Item 2.06 of Form 8-K. Note that no filing is required if the determination is made in connection with the preparation, review or audit of financial statements required to be included in the next periodic report.
- **CEO illness.** Illness of the CEO or another senior executive may be reportable under Item 5.02 of Form 8-K if he or she is unable to perform his or her duties. See [My CEO Just Tested Positive, Now What?](#)
- **Listing deficiencies:** Notice of delisting or failure to comply with a continued listing standard triggers reporting obligations under Item 3.01 of Form 8-K. See ***Help! I'm About to be Delisted! What Are My Options?*** In section **II. Considerations for Distressed Public Companies**.
- **Other material disclosure to be incorporated by reference into existing registration statements:** If the company has existing resale or other registration statements that may be used prior to the next Exchange Act report and the company has issued press releases containing material updates to business operations or other information included in the company's Form 10-K, consider filing those press releases under, or including language from them in, Item 8.01 of Form 8-K to incorporate them by reference into active registration statements.

## Heightened Risk of Stock-Drop Litigation

By [Craig Zieminski](#)

SEC sanctions are not the only potential consequence of disclosure missteps. Enterprising plaintiffs' attorneys have already begun seeking to take advantage of the stock market declines that have accompanied the COVID-19 outbreak by filing class action lawsuits alleging that these declines were caused, not by an unforeseeable public health crisis, but by the revelation that prior statements made by the company's directors and officers were fraudulent. While the COVID-19 health crisis is certainly unprecedented, such "stock-drop lawsuits" are not. They follow a familiar formula and will be subject to familiar arguments on both sides at the pivotal motion to dismiss stage.

One such lawsuit, brought against Norwegian Cruise Line, its CEO, and its CFO, challenges a series of statements made by the company in February 2020 about the company's commitment to guest and crew safety and its financial resilience and prospects. The complaint alleges that these statements were revealed to be false or misleading in March 2020 when an article was published in the *Miami New Times* indicating that Norwegian had downplayed COVID-19 in marketing statements and that bookings were slowing as a result of the outbreak. At least one other lawsuit alleging violations of Section 10(b) of the Exchange Act related to COVID-19 has already been filed, and many more are likely to file suit in the months ahead. While each such

lawsuit will pose unique challenges and risks to the named defendants, there are several common themes directors and officers should keep in mind when preparing for a possible defense to such a lawsuit:

- Plaintiffs must identify an actual misstatement, not a mere business downturn or even mismanagement.
- Liability must be based on a statement that was misleading when made, not merely a statement that became misleading in light of subsequent events.
- Plaintiffs cannot base their claims on mere “sales talk” or generally positive “puffery” about the company or its prospects.
- Statements about company-wide policies and programs are not automatically rendered misleading by the existence of discrete incidents at odds with the policies or programs.

In an attempt to bolster their complaints, plaintiffs inevitably allege that defendants in stock-drop lawsuits engaged in a “cover-up” and that any subsequent stock declines the company experiences can be attributed to the revelation of the truth that the purported cover-up concealed. To minimize the risk of such claims, public companies and their directors and officers should exercise extreme caution in making any statements about the COVID-19 outbreak, its effect on the company, or the company’s prospects for a recovery from any related business downturn. Where such statements are necessary, it is best to stick to well-established facts and to highlight the uncertainty of any statements of opinion.

For additional information about key disclosure and litigation considerations, see [SEC Disclosures Amidst Coronavirus](#) and [First Coronavirus Stock-Drop Securities Class Action Lawsuits Filed: Are You Prepared for a Resurgence of These Types of Cases?](#).

### **Can I Buy?: Stock Repurchase Programs**

In light of the significantly reduced stock prices resulting from the COVID-19 outbreak, many companies are considering whether to initiate or increase a stock repurchase program. **Companies considering a repurchase program should consider the best program for their situation and their company, including whether conservation of cash should be a higher priority.** Companies that may seek government assistance because of COVID-19 challenges should also be aware that both political parties appear to share the view that stock buybacks are inappropriate for a company seeking that assistance.

One of the most common choices is the **open market repurchase plan**. Companies may repurchase stock on the open market, typically pursuant to a repurchase plan that complies with Rule 10b-18, which provides a nonexclusive safe harbor for issuer repurchases against allegations of market manipulation so long as certain broker, timing, price and volume conditions are met:

- **Broker or Dealer.** Purchases by the company and its affiliated purchasers must be made through only one broker or dealer on any single day.
- **Timing.** Generally, purchases cannot constitute the opening purchases of the day or be made during the 10 or 30 minutes before the scheduled close of trading on the

applicable stock exchange, depending on the size of the public float and average daily trading volume of the company.

- **Price.** The price may not exceed the highest independent bid or the last independent transaction price for the stock, whichever is higher, on the applicable stock exchange.
- **Volume.** Other than one block purchase each week, daily purchases may not exceed 25% of the average worldwide daily trading volume for the four calendar weeks preceding the week of the trade.

Rule 10b-18 does not provide a safe harbor against illegal insider trading, and a company should not repurchase stock under a discretionary open market repurchase plan if it has not disclosed all material non-public information.

If a company does not possess material non-public information, it can also protect itself by implementing a **Rule 10b5-1 repurchase plan**. Using a Rule 10b5-1 repurchase plan, companies relinquish direct control over their transactions, allowing them to repurchase stock even while they have material nonpublic information by providing an affirmative defense to illegal insider trading. Under Rule 10b5-1, the relevant plan must (1) be adopted when the company is not in possession of material, non-public information, (2) be written, (3) either provide a formula for repurchases or delegate authority to make repurchases to an unaffiliated third party, (4) be entered into in good faith and not as part of a plan or scheme to evade anti-fraud provisions, and (5) not be influenced by the company to alter or deviate from the plan, and the company may not enter into a corresponding or hedging transaction or position with respect to the securities. Rule 10b5-1 repurchase plans should also be structured to require compliance with Rule 10b-18.

A company may also elect to repurchase stock through one or more **privately negotiated transactions** or through an **accelerated stock repurchase plan** (ASR). An ASR offers a potential method to reduce the number of outstanding shares of stock more quickly than an open-market repurchase program.

A company should announce a repurchase program before commencing repurchases and consider whether it has duties to disclose material non-public information, including duties to update prior information, at the time of commencement or during the program. A company will be required to report its repurchase activity in each Annual Report on Form 10-K and Quarterly Report on Form 10-Q. In any repurchase program, the board and management should consider whether the company has sufficient surplus or other financial requirements under applicable state law, the consequences under credit agreements or other agreements, and whether to allow sales by insiders during the repurchase program. Finally, a company should consider whether a 10b5-1 repurchase plan, including an ASR, limits the company's flexibility to cease repurchases in order to conserve cash in this volatile market. The company's decision to terminate a Rule 10b5-1 repurchase plan before its stated termination may affect the availability of the affirmative defense afforded by Rule 10b5-1.

### **Shall We Meet?: Virtual Annual Meetings**

As proxy season and the coronavirus pandemic collide, travel restrictions, quarantines and health concerns are complicating many public companies' plans for their annual stockholder meetings. Companies that have already called their traditional physical annual meeting are considering options to switch to a virtual-only stockholder meeting (VSM) or to a hybrid meeting.

More recently, companies calling their annual meetings have also announced that they are retaining flexibility to switch to a VSM or hybrid meeting or to adjourn the meeting until a later date if necessary. Currently, we believe most public companies that are finalizing their notice of annual meeting are switching to a VSM, while other companies are planning to postpone their annual meeting. As shelter-in-place and similar restrictive orders are becoming more common across the country, most companies should plan to hold fully virtual meetings or postpone their annual meetings until a physical meeting is safe and permissible.

VSM providers are trying to scale up to meet the increased demand for VSMs, but they are subject to staffing and technology limitations. Companies desiring to hold a VSM should reach out as soon as possible to reserve their preferred meeting date and start the VSM process. VSM providers will need **at least 20-30 days** to set up the meeting. If the initial proxy materials have already been distributed by a different service provider, the VSM provider may need to mail new access codes to all stockholders.

The following table outlines the key benefits and challenges of each of these options. See [Taking the Meeting Out of Annual Meetings: Exploring Virtual Meeting Options in the Age of Coronavirus](#) for a more in-depth description of the technical details regarding the VSM, hybrid and flex options, and for answers to some frequently asked questions about VSMs.

	<b>Benefits</b>	<b>Challenges</b>
<b>Holding a VSM:</b> <i>all parties and presenters participate remotely</i>	<ul style="list-style-type: none"> <li>• No need to reassess or change venue last minute</li> <li>• No additional filing or notice needed</li> <li>• No travel required</li> </ul>	<ul style="list-style-type: none"> <li>• Less tech-savvy stockholders, directors or others may have difficulty participating and voting; training may be required</li> <li>• Traditionally a less-favored approach among investors, although this year appears to be an exception if stockholders have the same rights and opportunities to participate as they would in a physical meeting</li> <li>• Additional logistical considerations and technology costs</li> <li>• May not be permitted by state law or bylaws</li> <li>• May have tax implications for companies operating in, or with directors participating from,</li> </ul>

	Benefits	Challenges
<p><b>Holding a hybrid meeting:</b> <i>company hosts physical annual meeting with virtual feed; stockholders can attend and presenters may present remotely or in person</i></p>	<ul style="list-style-type: none"> <li>• More flexibility to make last minute decisions regarding location of presenters</li> <li>• Option to cancel physical meeting at later date if necessary</li> <li>• No additional filing or notice needed if virtual component is included in original notice and physical meeting not cancelled</li> <li>• Stockholders can participate via preferred medium</li> </ul>	<p>jurisdictions that rely on the location of the meeting as a factor in determining tax residency</p> <ul style="list-style-type: none"> <li>• Somebody must be present at physical meeting</li> <li>• Cost and logistics of setting up both physical meeting and VSM</li> <li>• May not be permitted by state law or bylaws</li> </ul>
<p><b>Holding a traditional meeting at a physical location:</b> <i>plan for physical meeting and maintain flexibility for contingencies listed below; this may be the only option for companies that have already filed their proxy statement</i></p>	<ul style="list-style-type: none"> <li>• Standard meeting preparations</li> <li>• No extra costs or complications if COVID-19 subsides before meeting date</li> <li>• Familiar for stockholders, directors and company</li> </ul>	<ul style="list-style-type: none"> <li>• Need to continually monitor situation and make a decision at least a month before meeting date</li> <li>• If the company decides to change to a VSM or hybrid meeting, second notice and supplemental proxy filing (and potentially physical mailing) may be required</li> <li>• Coordination of multiple vendors may increase cost and required additional mailing</li> </ul>
<ul style="list-style-type: none"> <li>• Planning to hold a physical meeting and</li> </ul>	<ul style="list-style-type: none"> <li>• Ability for all parties (including presenters) to participate remotely</li> </ul>	<ul style="list-style-type: none"> <li>• All of the challenges of holding a VSM, plus:</li> </ul>

<b>Benefits</b>		<b>Challenges</b>
retaining flexibility to switch to a VSM		<ul style="list-style-type: none"> <li>o Potentially higher cost to switch to VSM last minute</li> <li>o Second notice and supplemental proxy filing required; physical mailing may be required</li> </ul>
<ul style="list-style-type: none"> <li>• Planning to hold a physical meeting and retaining flexibility to switch to a hybrid meeting</li> </ul>	<ul style="list-style-type: none"> <li>• Ability for parties to participate in preferred medium</li> </ul>	<ul style="list-style-type: none"> <li>• All of the challenges of holding a hybrid meeting, plus: <ul style="list-style-type: none"> <li>o Potentially higher cost to add a virtual option last minute</li> <li>o May require second notice and supplemental proxy filing</li> </ul> </li> </ul>
<ul style="list-style-type: none"> <li>• Commencing the meeting at a physical location only to adjourn it to a later time/location</li> </ul>	<ul style="list-style-type: none"> <li>• No need to set up virtual meeting (unless the adjourned meeting is held as a VSM)</li> <li>• Can make a last minute decision and may be able to delay until COVID-19 subsides</li> </ul>	<ul style="list-style-type: none"> <li>• Somebody must be present at physical meeting to adjourn it</li> <li>• Costs and logistics of hosting annual meeting twice</li> <li>• Additional filing and notice may be required for adjourned meeting</li> <li>• Additional timing considerations for adjourned meeting</li> </ul>
<ul style="list-style-type: none"> <li>• Planning to hold a physical meeting and subsequently postponing the meeting until a later date</li> </ul>	<ul style="list-style-type: none"> <li>• No need to set up virtual meeting (unless the postponed meeting is held as a VSM)</li> <li>• Can make a last minute decision and may be able</li> </ul>	<ul style="list-style-type: none"> <li>• Second notice and supplemental proxy filing required; physical mailing may be required</li> </ul>

Benefits	Challenges
to delay until COVID-19 subsides	<ul style="list-style-type: none"> <li>• Costs and logistics of planning annual meeting twice</li> <li>• Potential stockholder action if meeting is delayed too long</li> </ul>
<p><b>Postpone annual meeting until later in the year:</b>  <i>wait to file proxy statement until later in the year, ideally after COVID-19 restrictions are lifted</i></p>	<ul style="list-style-type: none"> <li>• May be able to delay until COVID-19 subsides</li> <li>• If VSM required later in the year, vendors will have more availability</li> <li>• Need to file Form 10-K/A within 120 days of year end (if definitive proxy statement not filed by then)</li> <li>• Potential stockholder action if meeting is delayed too long</li> </ul>

## II. CONSIDERATIONS FOR DISTRESSED PUBLIC COMPANIES

The COVID-19 pandemic and related economic crisis have pushed many companies into distressed situations. The following discussion summarizes some considerations for distressed public companies facing potential delisting, privatization, insolvency or bankruptcy.

### Help! I'm About to be Delisted! What Are My Options?

By [Robert Kimball](#), [Sarah Morgan](#), [Sarah Fortt](#), [Joanna Enns](#) and [Katherine Frank](#)

The extreme decline in U.S. and global equities markets generally and in energy stocks in particular has resulted in stock prices and market capitalizations for many companies falling below the requirements for continued listing on the national securities exchanges.

- **New York Stock Exchange.** The NYSE continued listing standards include stock price and market capitalization floors that, if reached, could result in immediate suspension of trading for listed securities, as well as other minimum levels that, if sustained, could ultimately result in delisting from the NYSE. The SEC has granted [relief](#) from automatic delisting when a company falls below the NYSE's \$15 million market capitalization floor until June 30, 2020. The NYSE has also indicated that it is exercising flexibility on the "abnormally low share price" standard during this time and will continue to work with the SEC on other potential relief.
- **Nasdaq Stock Market.** The Nasdaq continued listing standards do not currently have market or financial triggers that could result in immediate suspension of trading. However, recent market conditions and financial challenges could lead to deficiencies in continued listing standards (such as minimum price or market value) that, if sustained, could result in delisting. In January 2020, Nasdaq filed a proposal with the SEC to add an "abnormally low" price concept similar to the NYSE's, as well as a provision limiting the cure period for companies with a low share price and history of significant reverse stock splits. In light of the unprecedented market conditions, we understand Nasdaq may consider delaying effectiveness of this rule if approved by the SEC in the near term.

The following chart outlines the NYSE and Nasdaq continued listing standards most likely to be directly affected by current market conditions and identifies the relevant cure periods, if any. Note that both exchanges have other financial, disclosure and corporate governance continued listing standards that, if not maintained, could lead to delisting from the relevant exchange.

### NYSE

Continued Listing Standard	Deficiency Trigger	Cure Period?
<b>\$1.00 Average Share Price</b>	Average closing price below \$1.00 per share over any consecutive 30 trading-day period	<b>Cure Period:</b> 6 months to cure <sup>1</sup> <b>Cure:</b> Closing price of \$1.00 at the end of any calendar month + average closing price at least \$1.00 over prior 30 trading-day period



<b>Continued Listing Standard</b>	<b>Deficiency Trigger</b>	<b>Cure Period?</b>
<b>\$50 Million Market Capitalization</b>	Market capitalization below \$50 million over a consecutive 30 trading-day period in which stockholders' equity is also below \$50 million	<b>Cure Period:</b> No specific period <b>Cure:</b> Company must submit a business plan to cure within 18 months; if plan is accepted, must demonstrate compliance for two quarters to cure
<b>Abnormally Low Share Price</b>	Stock trades at \$0.16 or below at any time	<b>Cure Period:</b> None <sup>2</sup> <b>Result:</b> Trading suspended intraday or end of day
<b>\$15 Million Market Capitalization</b>	Stock trades below \$15 million market cap over a consecutive 30 trading-day period	<b>Cure Period:</b> None <sup>3</sup> <b>Result:</b> Trading suspended as of the following trading day

<sup>1</sup> Depending of timing of deficiency, may be extended to the next stockholder meeting if stockholder approval required to effect the cure.

<sup>2</sup> The NYSE has indicated that it is exercising flexibility on this standard during the current market crisis.

<sup>3</sup> On March 20, 2020, the SEC approved a temporary suspension of the market capitalization standard beginning March 4, 2020, until June 30, 2020. Any new events of noncompliance will be determined based on a consecutive 30 trading-day period commencing on or after July 1, 2020.

## Nasdaq

<b>Continued Listing Standard</b>	<b>Deficiency Trigger</b>	<b>Cure Period?</b>
<b>Bid Price</b>	Closing price remains below \$1.00 for 30 consecutive trading days	<b>Cure Period:</b> 180 days to cure (may extend 180 additional days) <b>Cure:</b> Closing price at least \$1.00 for 10 consecutive trading days within cure period

Continued Listing Standard	Deficiency Trigger	Cure Period?
<b>Market Value of Listed Securities</b>	Market value of listed securities below \$5 or \$15 million (depending on market and standard) for 30 consecutive trading days	<b>Cure Period:</b> 180 days to cure <b>Cure:</b> In compliance for 10 consecutive trading days within cure period (may be extended up to 20 days)
<b>Market Value of Publicly Held Shares</b>	Market value of publicly held shares below \$5 or \$15 million (depending on market and standard) for 30 consecutive trading days	<b>Cure Period:</b> 180 days to cure <b>Cure:</b> In compliance for 10 consecutive trading days within cure period

As a company approaches potential suspension and delisting from an exchange, several options may be available to avoid delisting or to mitigate the consequences of delisting.

- **Wait and See.** Given both the NYSE's and Nasdaq's willingness to work with companies affected by COVID-19 and the current economic volatility, companies facing suspension or delisting for share price or market capitalization deficiencies may be able to watch the market for a few weeks or months to see whether it recovers. NYSE-listed companies near the automatic suspension thresholds may wish to discuss options and flexibility with their NYSE analyst.
- **Transfer to a Lower Level Exchange.** For companies that do not anticipate a meaningful increase in stock price in the near future, transferring to the NYSE American or Nasdaq Capital Market, which have lower continued listing standards, may be a practical option:
  - o **NYSE American.** NYSE-listed companies with a declining share price may consider transferring to NYSE American, which does not require companies to maintain a minimum share price, other than staying above a \$0.06 floor. However, NYSE American requires a minimum \$2.00 or \$3.00 stock price at the time of the transfer, so NYSE-listed companies would need to transition before nearing the \$1.00 threshold or execute a reverse stock split to meet the standard. In addition, NYSE American requires companies to maintain a \$50 million market capitalization or \$50 million in total assets and revenue, along with other market and liquidity measures, which may limit this option for companies that are experiencing other financial distress in the current conditions.
  - o **Nasdaq Capital Market.** Companies listed on the Nasdaq Global Select Market and Global Market have the option to apply to switch to the Nasdaq Capital Market if they are unable to cure a bid price deficiency during the 180 day cure period. Although Nasdaq waives the minimum bid price requirement for companies switching to Nasdaq Capital Market during a bid price deficiency,

companies would need to have a \$35 million market capitalization and meet the other initial listing standards at the time of transfer. In addition, switching to Nasdaq Capital Market would not remove the \$1.00 bid price requirement for continued listing, but would simply provide companies with an additional 180 days to cure the deficiency. Companies nearing the threshold of the market value standards of Nasdaq Global Select Market and Global Market may also consider switching to Nasdaq Capital Market, which has a lower continued listing standard. Such companies would need to meet the continued listing standards of the Nasdaq Capital Market at the time of transfer, including maintaining a \$1 million market value of publicly held shares and either \$2.5 million of stockholders' equity, \$35 million market value of listed securities or \$500,000 net income from continuing operations, along with other requirements.

- **Reverse Stock Split (for stock price deficiency).** For companies that are otherwise in compliance with continued listing standards, the most typical cure for a stock price deficiency is to execute a reverse stock split. Depending on the current stock price and timing of the 2020 annual meeting, companies nearing a stock price deficiency may consider discussing with their listing exchange whether authorization for a reverse stock split should be included in the 2020 annual meeting proxy statement, could be delayed to 2021, or should be sought at a special meeting. While a reverse stock split will increase stock price, it will not cure violations of all standards, including the minimum market capitalization standards. Note also that paying cash in lieu of fractional shares in a reverse stock split may result in taxable gain to the stockholder.
- **Trade on the OTC.** If the NYSE or Nasdaq suspends trading of a company's common stock, trades in the company's common stock would typically begin to be reported in the OTC Pink on the trading day following the date of suspension. Companies may apply to be admitted to one of the higher OTC tiers (OTCQX or OTCQB). Unless the company prefers to simply allow for trading of its common stock on the OTC Pink, it is advisable to submit an application and to pay the requisite application fee at least two weeks prior to the suspension of trading so the company can consummate the admission to the OTCQX or OTCQB the next trading day following suspension. Trading on the OTC Pink market and then attempting to be admitted to the OTCQX or OTCQB could prove challenging if there is downward pressure on the trading price of a stock as a result of inclusion in the OTC Pink.
- **Going Dark.** A final option may be the voluntary delisting of a public company's stock from its listing exchange and terminating/suspending its SEC reporting obligations ("going dark"). Going dark is much different than going private and may be able to be accomplished without a stockholder vote, stockholder fairness opinion, cash-out and other significant costs. Only some companies will qualify for this option (e.g., fewer than 300 holders, or total assets not exceeding \$10 million as of the last day of each of the three prior fiscal years and the class of equity securities was held of record by fewer than 500 persons). Note that (a) a company that has an active registration statement and has filed a Form 10-K for fiscal year 2019 cannot cease SEC reporting until it has filed its Form 10-K for fiscal year 2020, and (b) if a company terminates/suspends its SEC reporting obligations, it is more complicated and time-consuming to relist its stock later.

Companies entering the suspension and delisting process will also need to consider disclosure requirements to avoid further continued listing standard deficiencies and securities law

violations (such as Form 8-K and press releases and filing of Forms 25 and 15). The mitigation and transfer options previously outlined are also subject to disclosure requirements under continued listing standards and SEC rules.

## **My Board and I Just Got a Letter From My Largest Stockholder Who Wants to Buy Out the Public and Take the Company Private. Now What?**

By [Stephen Gill](#) and [Lande Spottswood](#)

In any declining market, going private transaction proposals are likely to increase. The most obvious reason is that significant or controlling stockholders<sup>4</sup> may see this as an opportunity to buy the company cheaply, hunker down and ride out the current environment. Such potential for opportunism does beg the question “Why would selling now be in the best interest of my stockholders?” But there are also a number of reasons that could lead a reasonable director to conclude “because I have no better options.” For example, the precipitous decline in equity values universally (and more dramatically in certain industries) creates uncertainty as to whether and to what extent equity values will return to levels seen prior to the pandemic at any time in the near to medium term (if at all). Allowing the significant stockholder to bear that risk while providing an opportunity for the public stockholders to sell at a premium to the current (albeit depressed) price may be a reasonable decision under the circumstances, particularly for companies facing near- or medium-term distress.

However, transactions with significant stockholders present conflicts that must be managed from the outset to best protect directors’ decisions from scrutiny in stockholder litigation:

- to the extent these transactions involve a controlling acquirer, they are viewed as conflicted transactions that implicate the highest level of judicial scrutiny, known as “Entire Fairness,” absent complying with specific judicially prescribed procedural safe harbors from the very outset of discussions; and
- even if the acquiring stockholder is not deemed a “controlling” stockholder, the conflicts presented by a transaction may warrant the adoption of procedural protections, such as the recusal of directors appointed by such stockholder from certain board discussions, the formation of an independent committee, and/or the imposition of clear communications channels between the potential acquirer and representatives of the company.

Also, because of concerns for minority stockholders, the SEC requires additional disclosure in comparison with unconflicted M&A transactions. Moreover, for sponsors and other significant stockholders considering such a proposal, they need to be aware of their disclosure obligations with respect to any take private transaction, the timing of this disclosure and the likelihood of litigation related to the disclosure so that parties can avoid premature disclosure of a potential transaction and ensure materials are prepared with an eye towards publicly disclosing later. See ***Disclosure Obligations for Significant Stockholders*** later in this section.

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<sup>4</sup> This section will focus on offers from significant or controlling stockholders. It is also possible that a third party or an unaffiliated stockholder may use the occasion of depressed stock prices and market uncertainty to make a takeover proposal. For brevity, we will focus on transactions with significant or controlling stockholders in this article. But in those other circumstances, enhanced scrutiny of the board’s action is also likely to apply.

### *Satisfying Entire Fairness*

Unlike the default Business Judgment Rule, in which courts are deferential to board decisions in the absence of conflicts or recklessness, transactions with controlling stockholders, as well as transactions in which a majority of the board of directors have a material conflict, are generally subjected to Entire Fairness. Under this standard of review, the courts require the proponents of a transaction to prove both fair dealing (*i.e.*, a fair process) and a fair price. This is a substantial burden. As one court put it, “the standard of entire fairness [is] so exacting, the determination of [this] standard of judicial review frequently is determinative of the outcome of derivative litigation.” Even where a proponent is able to demonstrate entire fairness, the case is so fact intensive that (again unlike Business Judgment Rule cases) early dismissal is not common, thus driving up litigation costs.

Delaware courts have recognized two prophylactic measures that do not alter the standard of review, but do shift the burden of proof from the proponents to stockholders challenging the transaction in court. These are:

- Approval by a properly functioning special committee composed of independent and disinterested directors (Special Committee Approval); and
- Approval by a fully informed and uncoerced majority of the unaffiliated stockholders (Majority of the Minority Approval).

Under fairly recent Delaware case law, if, among other things, a controlling stockholder making a buyout offer conditions its offer at the outset on both Special Committee Approval and Majority of the Minority Approval, then the Business Judgment Rule Standard of Review is reinstated, thereby increasing the likelihood of dismissal at the pleading stage.

It should be noted that historically, offerors almost ubiquitously chose to rely on Special Committee Approval over Majority of the Minority Approval because of the uncertainty of placing the fate of the transaction in the hands of a minority of stockholders, or at least enticed some of the stockholders to seek to obtain a price bump by waging a “vote no” campaign. Now that the invocation of both protective measures can result in significantly lower litigation risk and cost, a significant stockholder seeking to take a company private needs to weigh the litigation enhancing benefits against that same risk.

Companies (and significant stockholders who may be interested in pursuing a going private offer) should also examine the make-up of their board to determine whether there are a sufficient number of directors who are not only independent for purposes of stock exchange rules, but also independent of the significant stockholder. The courts are highly skeptical of committees of one.

### *Rule 13e-3 Transactions and Increased Disclosure*

A purchase of an equity security (whether via tender, merger or even open market purchases) by the target company or an affiliate of the target that has a reasonable likelihood or purpose of causing the public equity to be eligible for termination from registration or reporting obligations under the Exchange Act or being delisted from a national securities exchange is considered a 13e-3 transaction. In addition to a customary proxy statement, the target and each affiliate must file a Schedule 13e-3 that discloses additional information, including:

- The **purposes** of the transaction, including a reasonably detailed discussion of the benefits and detriments of the transaction to the target, its affiliates and unaffiliated stockholders, and a description of any alternatives considered and why they were rejected;
- The **fairness** of the transaction, including whether each person (including the buyer) believes that the transaction is fair to unaffiliated stockholders, as well as a discussion of the material factors upon which this belief is based, and the weight assigned to each factor; and
- **Reports, opinions, appraisals and negotiations** from outside parties that are “materially related” to the transaction. The SEC takes a very broad view of what encompasses this, including preliminary board books and investment banker presentations.

#### *Disclosure Obligations for Significant Stockholders*

Section 13 of the Exchange Act requires significant stockholders considering making a going private offer, to update their disclosures in their Schedule 13D if they materially change their intention with respect to their investment in a public company. In 2015, the SEC brought a series of enforcement actions against controlling stockholders who failed to promptly update their 13Ds after taking what the SEC viewed as substantial steps towards making a going private offer. This creates an understandable tension between compliance with Section 13 and a desire to not prematurely disclose preliminary plans (which can complicate or even prevent a transaction). These are fact-intensive questions beyond the scope of this brochure, but early involvement of legal counsel is warranted.

#### **Principal Reduction Transactions**

By [James Longhofer](#), [Brett Santoli](#), [David Stone](#), [David Wicklund](#), and [Daniel Spelkin](#)

As the market disruption and turmoil have many term loans and bonds trading significantly below par value, many companies are considering various liability management processes to reduce their outstanding indebtedness and overall interest expense burden.

- Open market debt repurchases. Opportunistic repurchasing of deeply discounted term loans or bonds by issuers can be a useful deleveraging tool for issuers with the available cash. With respect to term loans, it may be possible to structure repurchases to take advantage of cash that might otherwise be swept to pay down loans at par pursuant to excess cash flow sweeps. Such repurchases can be executed quickly with minimal documentation, at varying prices and times, and are typically not pre-announced. Consult your counsel to structure such repurchases to (i) avoid tender offer rules, (ii) address issues regarding disclosure of material non-public information and the potential utility of “big-boy” letters, and (iii) take into consideration potential tax implications to the issuer (as discussed below).
- Cash Tender Offer. Cash tender offers by issuers to bondholders provide for more participation by bondholders in a single transaction and greater principal reduction than an extended bond repurchase program. Tender offers for bonds utilize a variety of structures with respect to the number of series for which tenders are sought, series priority, pricing structure and participation caps. Tender offers may also be coupled with

consent solicitations to amend indenture covenants if necessary or desirable. However, unlike open market repurchases, tender offers require greater preparation and documentation, are announced via press release, are typically required to be held open for 20 business days (although there are exceptions) and are subject to certain SEC regulations. As with open market purchases, consult your counsel to discuss potential tax implications to the issuer (as discussed below).

- Non-Cash Exchange Transactions. Non-cash exchanges are of particular interest to distressed issuers seeking to reduce principal and negative carry without reducing liquidity. Consideration for such transactions can include common stock, unsecured debt, secured debt and loan interests. Certain recent exchanges have involved notes issued by bankruptcy remote special purpose vehicles. These transactions fit broadly into two categories: (i) private exchanges which are not subject to tender offer rules and (ii) “public” exchange offers which are subject to tender offer rules. The structure of any such exchange is highly dependent on the issuer’s capital structure and any restrictions in various debt instruments and other documents. Consult counsel to help you develop a structure that may be advantageous.
- Tax considerations. An issuer will recognize cancellation of indebtedness income to the extent it or a related party repurchases the issuer’s debt at a discount. In a related party debt repurchase, the debt may be treated as reissued for tax purposes with original issue discount, resulting in interest deductions for the issuer (subject to applicable limitations on interest deductions) and original issue discount income to the purchaser. In addition, an issuer may recognize cancellation of indebtedness income on non-cash exchange transactions. Consult your tax advisor regarding potential tax implications with respect to principal reduction transactions.

## Understanding Your Fiduciary Duties

By [Paul Heath](#), [David Meyer](#), [Lauren Kanzer](#), [Jessica Peet](#), and [Emily Tomlinson](#)

Officers and directors can expect their actions to receive greater scrutiny during times of financial distress than in times of prosperity. Therefore, it is important for officers and directors of companies facing distress to remain particularly mindful of these duties when evaluating proposed courses of action.

- How Director and Officer Duties Evolve as a Company Approaches Insolvency
  - o As a company approaches insolvency, the nature of officer and director duties does not change. However, the beneficiaries of these duties may change, as creditors, not just equity holders, are residual stakeholders of insolvent companies. This change affects both who can bring fiduciary duty claims and director and officer decision-making:
    - o **Who Can Sue?** When a company is solvent, only shareholders have standing to bring a derivative action on behalf of the company against officers and directors for breach of fiduciary duties. However, when a company is insolvent, its creditors may gain standing to bring a derivative action on behalf of the company for breach of fiduciary duties.

- o **Risky Business.** Directors and officers are not required to eliminate business risk. However, a chosen course of action must be reasonably achievable and periodically reassessed as events develop. Directors and officers should be wary of transactions that equate to a “Hail Mary” pass for the direct benefit of one group of stakeholders. A difficult strategy that would benefit only equity holders, if successful, but imposes a significant risk of loss to other stakeholders if unsuccessful will likely be the subject of significant scrutiny if the strategy fails.
- **Best Practices for Directors and Officers of Distressed Companies**
  - o **Meet Regularly and Document Deliberations.** Conduct regular meetings with management and outside advisors, ensure necessary information is shared, and develop a common understanding of key deadlines and facts. More frequent meetings should be held as the company’s financial distress becomes more acute. Document the bases or reasoning underlying director and officer decision-making, including the pros and cons of a particular transaction or decision.
  - o **Obtain Professional Advice.** Legal counsel, financial advisors, and others can assist in analyzing strategic alternatives, including the achievability of a potential course of action.
  - o **Preserve Attorney-Client Privilege.** Decisions made in a time of distress may be the subject of future litigation, particularly if a chapter 11 filing becomes necessary. Make counsel’s role and involvement clear, and ensure appropriate engagement mechanics are in place to establish attorney-client privilege.
  - o **Evaluate Business Plan and Alternatives.** Carefully consider assumptions and underlying data upon which the business plan is based. Be prepared to consider alternatives and, if necessary, pursue multiple alternatives simultaneously.
  - o **Maximize Enterprise Value.** Take actions that maximize the value of the entire enterprise rather than the interests of a particular stakeholder.
- **Five Common Mistakes:**
  - o **Moving Too Fast.** Take appropriate steps before executing transactions, which can preserve value and minimize litigation exposure.
  - o **Careless Communications.** Assume **every** written communication, including e-mails and other communications (e.g., text messages), may be produced in a potential litigation. Be aware of tone and whether jokes or code names could sound nefarious to an outsider. When in doubt, pick up the phone.
  - o **Casually Opining on Financial Performance.** Words like solvency are terms of art with significant meaning in a litigation context.
  - o **Abandoning Guard Rails.** Once a risk mitigation protocol is established, ensure subsequent decisions follow the same protocol.



- o ***Forgetting to Ask for Advice.*** Consult counsel regularly as you evaluate options as decisions, facts, and law may change in connection with each proposed course of action.

### III. IMPLICATIONS FOR M&A NEGOTIATIONS AND AGREEMENTS

By [Caroline Phillips](#)

#### Does the COVID-19 Outbreak Constitute a Material Adverse Effect?

**MAE.** In any M&A transaction, a significant deterioration in the target's business between signing and closing may upset the fundamental bargain struck between a seller and a buyer. M&A agreements typically address this risk through highly negotiated "material adverse effect" or "material adverse change" (MAE) clauses which may entitle a buyer to walk away from its obligations to close if the clause is triggered. With the outbreak of the coronavirus (COVID-19), many clients are asking whether the effects of the outbreak or the worsening of COVID-19 would constitute an MAE. If you are currently negotiating an M&A agreement, careful consideration should be given to drafting the MAE definition in light of these evolving developments.

MAE definitions in M&A agreements serve several purposes. They can be used to limit the scope of the seller's representations and warranties as well as provide a standard for bringing down those representations and warranties as of the closing. They can also set the parameters for the buyer's right to terminate the M&A agreement prior to closing or for the failure of a condition to the buyer's obligation to close.

The typical MAE definition includes "any change, development, effect, circumstance or state of facts that have had, or would reasonably be expected to have, a material adverse effect on the business, assets, financial condition or results of operations of the business to be acquired." An MAE definition typically excludes various economic, market, industry, political and other general categories of risk, but only to the extent such effects do not disproportionately adversely affect the target's business relative to other businesses in the same industry and, in some cases, within a specified geographic area. In some cases, the disproportionate adverse effect must be material (not defined).

It has been largely left to the courts to determine whether or not an MAE has occurred. Until *Akorn, Inc. v. Fresenius KABI AG*, C.A. No. 2018-0300-JTL (Del. Ch. Oct. 1, 2018), no Delaware court had ruled in favor of a buyer attempting to invoke an MAE clause. The determination whether an MAE has occurred is a highly fact-specific inquiry tested against the language of the MAE definition. In *Akorn*, the Delaware Chancery Court stated: "A buyer faces a heavy burden when it attempts to invoke a material adverse effect clause in order to avoid its obligation to close . . . A short-term hiccup in earnings should not suffice . . . the effect should substantially threaten the overall earnings potential of the target in a durationally-significant manner." The court noted that a duration of significance would likely be years rather than months.

In light of *Akorn*, it is probably too soon to tell whether the effects of COVID-19 will be durationally significant enough to constitute an MAE. Any such determination will depend on the facts giving rise to the alleged material adverse effect on the target's business as well as the language of the subject MAE definition.

We are seeing MAE definitions now exclude events such as the COVID-19 outbreak, or the worsening thereof, to the extent the effects are not disproportionate or materially disproportionate to the target's business relative to other participants in the industry. Some examples of such exclusions are:

- Any global health conditions (including any epidemic, pandemic, or disease outbreak (such as COVID-19 )), and any material worsening of such conditions
- Any epidemic, pandemic or other health crisis (including COVID-19)
- Any outbreak of disease
- Any global public health emergency (as declared by the World Health Organization)

We anticipate such exclusions will become customary going forward.

**Acquisition Financing.** If a buyer has arranged for debt financing to fund the purchase price, the debt papers will contain an MAE clause which typically uses the same MAE definition as in the related M&A agreement. However, buyers may still be at risk that the lenders will claim an MAE has occurred and refuse to fund the debt financing at the closing of the M&A transaction. In such a situation, the buyer would have to prove that an MAE has occurred, and any such claim by the lenders is not necessarily determinative that an MAE has in fact occurred for purposes of the M&A agreement. If a buyer is unsuccessful in asserting an MAE has occurred, it may be required to pay the seller a reverse break fee to terminate the M&A agreement.

### **Other Impacts of the COVID-19 Outbreak on M&A Transactions**

**Timing.** In certain jurisdictions and in industries particularly affected by the COVID-19 outbreak, some deals are on pause as the parties evaluate the effects of the outbreak. This is likely to lead to price renegotiations and, in some cases, termination of negotiations if buyers are unsure whether they are overpaying for an asset.

**Process.** Travel restrictions are limiting in-person meetings, management presentations and site visits although conducting due diligence through electronic data rooms may continue uninterrupted so long as personnel are available to upload and manage content and recipients are able to access the site. Meetings are more often conducted through conference calls or videoconferences.

**Due Diligence.** Buyers' due diligence on the target's business is likely to become more robust in the areas of insurance coverage, emergency preparedness, IT systems for remote working arrangements, ensuring remote employees' productivity, privacy and other business continuity measures. Buyers will also want to scrutinize the target's ability to perform under its key commercial contracts as well as the risk of its counterparty's failure to perform or its counterparty's reliance on force majeure clauses for nonperformance. Buyers will also need to consider the exposure of the target's business to jurisdictions where the effects or worsening of the COVID-19 outbreak are more acute.

**Reps and Warranties.** Buyers may also seek additional representations and warranties about the target's business relating to the impact of COVID-19 (including the diligence items above), and we anticipate the typical negotiations over materiality and knowledge qualifiers. Sellers may attempt to ringence representations and warranties related to the effects of COVID-19 so as to minimize a buyer's post-closing claim that the outbreak resulted in a breach of more general representations and warranties. Sellers will likely attempt to disclose as much as possible in the disclosure schedules about the potential impacts of COVID-19, which of course are largely unknown and evolving.

**Interim Covenants.** Affirmative operating covenants obligating sellers to maintain intact their business organizations and relationships or keep available the services of their employees may need to be modified to accommodate the impact or potential impact of COVID-19. Alternatively, buyers may push to require that sellers use specified measures to maintain business continuity during this period.

**“Ordinary Course of Business.”** Any use of “ordinary course of business” qualifiers in representations and warranties or in interim covenants is likely to be heavily negotiated to take into account extraordinary measures implemented in the target’s business or workplace as a result or in anticipation of the outbreak or worsening of COVID-19.

**“Business Day.”** The definition of “business day,” which customarily excludes days on which banks in certain locations are closed, may need to be modified for locations that are subject to a shelter in place or other non-essential business restrictions if wire transfer functions are still available.

**Rep and Warranty Insurance.** COVID-19 has quickly become a key feature of rep and warranty insurance underwriting. We are seeing caveats in non-binding indications that underwriting diligence will include an investigation on the potential impact of COVID-19 and that, depending on the impact of COVID-19 on the target’s business, the underwriters may require an exclusion for business interruption or other losses arising out of or relating to COVID-19. We can expect underwriters, like buyers, to be keenly focused on MAE and force majeure language in the target’s contracts and the impact on termination rights. Parties relying on representation and warranty insurance should be prepared to accept policy exclusions relating to COVID-19. Parties should try to limit these exclusions to specified jurisdictions where COVID-19 is known to have had detrimental effects and to specified consequences to prevent underwriters from using a broad exclusion to avoid legitimate, unrelated claims. Parties should not expect to rely on the product to cover any downside risks related to COVID-19.

**D&O Insurance.** We are seeing a significant increase in the cost of D&O tail policy premiums together with extended negotiations with D&O policy underwriters. Parties should factor these costs into any M&A agreement that requires such a tail policy.

**Time Periods.** Time periods for completing matters specified in an M&A agreement, such as purchase price adjustment calculations, may be impacted if companies are unable to prepare or review closing statements and related information on the time frames specified in the M&A agreement. Consider adding extension periods for completion of these matters if either party is anticipated to be adversely affected by COVID-19. Parties may wish to contemplate extensions to “drop-dead” or “outside” dates for this same reason as well as for any delays anticipated in obtaining regulatory approvals or third-party consents.

**Anti-sandbagging Clauses.** Lastly, clauses addressing the impact of a party’s knowledge on its ability to bring an indemnity claim may exclude claims related to the impact of COVID-19 because it is a known risk.

## **Additional Resources**

[Does the COVID-19 Outbreak Constitute a Material Adverse Effect? Plus Other Impacts on M&A Transactions](#)

## IV. FORCE MAJEURE PROVISIONS IN LIGHT OF THE CORONAVIRUS

By [Phillip Dye](#), [Eamon Nolan](#) and [Louise Woods](#)

Companies across all industries are addressing concerns about their own ability, or that of their suppliers and other key stakeholders, to perform contractual obligations in light of the increasingly paralyzing impact of COVID-19. We are seeing and assisting companies conducting a review of commercial, vendor and supply contracts to ascertain what obligations are likely to be impacted and whether they are entitled to any performance or (less probably) payment relief, as well as assessing what similar entitlements counterparties may have. The exact nature and potential risk exposure in the event COVID-19 affects a party's ability to perform, and the potential relief and exposure under existing force majeure provisions in the relevant agreements, will vary by agreement and jurisdiction. Sometimes, the contracts will be silent, and parties will need to consider whether any statutory or common law (e.g. impossibility or frustration) remedies are available. Often, the evaluation of the risk exposure and available remedies will involve a multi-jurisdictional analysis, and care should be taken in responding to force majeure claims as the contractual and commercial puzzle may not be straightforward.

There are several key elements of any force majeure (FM) review including analyzing the following:

- Whether concept of epidemic or pandemic identified as an included or excluded event.
- Whether the concept of change in laws identified as an included or excluded event.
- Whether there is any timing component as to when the event needs to have occurred.
- Whether upstream or downstream events directly affecting suppliers or purchasers but not directly affecting the relevant company are included.
- Whether the relevant parties have mitigation obligations.
- Whether the relevant parties have affirmative notice obligations to invoke FM.
- Whether the relevant FM event was reasonably foreseeable at the time the contract was entered into, or at the time the FM event took place.
- Whether the relevant FM event was reasonably beyond the party's control at the time the contract was entered into, or at the time the FM event took place.
- What law governs the contract and whether there are any statutory FM rights under that governing law in addition to the contractual provisions (including whether concepts such as impossibility or frustration may be invoked).
- Where is your counterparty physically located and what are the circumstances affecting that jurisdiction?

The consequences of incorrectly invoking force majeure may result in contractual termination, loss of entitlements or relief, or damages obligations (liquidated or general) so parties should seek advice before invoking their FM clauses or if a counterparty has invoked FM against them.

Finally, despite the observed disruptions, new contracts are being entered into on a daily basis and careful consideration should be given to the way owners, offtakers, constructors, suppliers and other commercial participants approach the negotiation and drafting of new force majeure provisions in the current environment. Parties need to conduct thorough due diligence on the impact that COVID-19 will likely have on their potential counterparties' ability to perform new contracts, by understanding their counterparties' supply chain and labor constraints.

#### **Additional Resources**

- [Six Things to Consider Before the Coronavirus Impacts Environmental Compliance](#)
- [Routes to Relief on Both Sides of the Atlantic – Frustration and Force Majeure under US and English Law](#)
- [Solar Project Development, Force Majeure and the Coronavirus](#)

## V. MITIGATING THE RISKS OF A REMOTE WORKFORCE

By [Christopher Bacon](#), [Sean Becker](#), [Vanessa Griffith](#), and [Jeffrey Johnston](#)

A remote work force presents a number of cybersecurity and information risks. Many companies are setting up remote access tools as quickly as possible, and the necessary controls may be overlooked. And many employees will be working remotely for the first time, and may not be familiar with or understand how company policy applies to remote access. Cybercriminals will be looking to take advantage of this uncertain environment and play upon the public's fears. Given these risks, companies can take a number of steps to mitigate these risks:

- Review internal policies with regard to cybersecurity and remote access. As appropriate, circulate those policies – or summaries — to employees and remind them what the company expects.
- Offer employees training on working remotely. Make sure they know how to contact IT with questions or issues.
- Regularly remind employees to be vigilant for phishing attacks; there are multiple reports of phishing attacks looking to exploit public fears related to COVID-19. Remind them to be suspicious of emails from people they do not know or that they were not expecting. And be particularly suspicious of emails asking them to enter their network credentials.
- Be on guard for wire transfer and gift card scams and put in place additional controls to confirm financial transactions in a remote environment.
- Make sure your remote access tools are encrypted and require two-factor authentication.
- Be wary of where your data is going. Consider whether you can effectively prohibit the use of unencrypted thumb drives, webmail and cloud storage that the company doesn't control; these can be an avenue to data loss and a vector for malware.
- Consider what materials your employees are now printing out or viewing from home and thus potentially making accessible to others. Implement policies that lessen the risk of inadvertent disclosure of sensitive information.

### **The Laws Don't Change Just Because Your Employees Are At Home**

Employers also need to be mindful that wage laws continue to apply, even if employees aren't punching a time clock at a company site or performing their work from the office. Non-exempt employees need to be paid for all hours worked, and employers need to make sure that they have a time tracking system – whether web-based or otherwise – that provides for the accurate tracking of employee hours. Exempt employees still need to be provided (with very limited exceptions) their full salary for any workweeks in which they perform work – even if they were unable to work for some of the days in that workweek due to coronavirus-related or other disruptions. Although salary deductions for exempt employees may be possible for absences of one or more full days occasioned by sickness if the deduction is made in accordance with a bona fide plan, policy or practice of providing compensation for loss of salary occasioned by that sickness, employers will need to be sure that they can properly make such a deduction before doing so.

Other employment laws also still apply even though employees aren't working from the office. Employers will still need to consider requests for accommodation from employees who may have a disability – including whether it would be reasonable for an employer to make adjustments to facilitate telecommuting or pay for changes to an individual's personal, home office. If an employee is injured during working hours, but while at home, fact-specific analyses will be required to determine if workers' compensation benefits are available. If employees are now working from a home that is in a state different from the office to which they used to report, employers will need to consider whether new state laws apply, and whether they need to make adjustments as a result.

## **Expanded FMLA and Sick Leave Obligations for Some Employers**

New federal legislation now requires certain employers to provide paid sick leave and paid family and medical leave due to absences caused by the coronavirus. Employers will need to carefully monitor whether new or existing leaves qualify for these benefits, and it will be important to follow still-developing regulatory guidance regarding how these benefits (or potential exemptions from having to provide these benefits) apply to particular situations.

***Which employers and employees are subject to the new leave requirements?*** Employers with less than 500 employees are required to provide the new leaves. However, the law allows the Secretary of Labor to exempt employers with fewer than 50 employees if compliance with the Act would jeopardize the viability of such businesses as a going concern. The Secretary of Labor may also exclude certain health care providers and emergency responders from employees eligible for leave under the Act.

***What is the new family leave requirement?*** Employers must now provide up to 12 weeks of paid leave to any employee who is unable to work because they have to take care of a child whose school or place of care has closed as a result of COVID-19. Employees on that leave must be paid at a rate equal to two-thirds their usual rate of pay; however, that amount is capped at a maximum of \$200 per day. Note that the first 10 days of this leave may be unpaid, but benefits under the "sick leave" benefits described below should be available to affected employees for that period.

***What new sick leave benefits need to be provided?*** Covered employers are required to provide two weeks of paid sick leave to employees who have been employed for at least 30 days and who need to take leave to: (i) comply with a government quarantine or isolation order; (ii) self-quarantine on advice of a health care provider; (iii) obtain a medical diagnosis after experiencing symptoms related to COVID-19; (iv) care for an individual who is subject to any of the preceding circumstances; or (v) care for a child whose school or place of care has been closed as a result of COVID-19. Full-time employees taking this leave are entitled to up to 80 hours of paid leave at their regular rate of pay. Part-time employees are entitled to pay measured by the number of hours they work, on average, over a two-week period. However, paid sick leave is capped at \$511 per day for any employee.

***Who ultimately pays for these benefits?*** While employers will bear the initial costs, the federal government will reimburse employers in the form of a payroll tax credit. Employers are eligible for a refundable tax credit of 100% of qualified sick leave wages paid and family leave wages paid against their employer-side tax liability. The amount of qualified family leave wages taken into account for each employee is capped at \$200 per day and \$10,000 for all calendar quarters. The Act does not impose an aggregate limit on the amount of paid sick leave wages taken into account.



***Does the law require anything else besides paid leave?*** With respect to those employees who are entitled to extended FMLA leave – e.g., parents who cannot work because they are caring for a child whose school has closed – employers will have a duty to restore the employee to their former position, or make reasonable efforts to find an equivalent position if the former position no longer exists, unless the employer has fewer than 25 employees. Employers will also be required to post a model notice regarding the new paid sick leave law that the Secretary of Labor will make available.

***How long will these requirements last?*** As of now, the benefits are scheduled to sunset on December 31, 2020.

### **Additional Resources**

- [Congress Adopts “Phase Two” Coronavirus Relief Bill](#)
- [My CEO Just Tested Positive, Now What?](#)
- [Your Company’s Coronavirus Checklist: 7 Questions Employers Should Ask About Their Emergency Plans](#)
- [A Coronavirus Readiness Checklist for the Workplace](#)
- [Dealing with the Coronavirus in the Workplace](#)

## VI. ENSURING EMPLOYEE SAFETY AND CONSIDERING EMPLOYEE PRIVACY

By [Sean Becker](#), [Peter Goetschel](#), [Phileda Tennant](#), and [Tom Wilson](#)

At all times, employers are subject to the general duty clause of the Occupational Safety and Health Act of 1970, which requires that they provide a workplace “free from recognized hazards likely to cause death or serious harm.” The Occupational Safety and Health Administration (OSHA) has issued guidance that considers this standard in light of the COVID-19 pandemic, and highlighted the importance of advanced planning and having a workforce disease preparedness plan in place.

Among other things, OSHA recommends that employers identify COVID-19 exposure risk factors in the workforce, including whether workers regularly interact with affected individuals or a company has locations in an area experiencing community transmission of the virus. The extent of personal protective equipment that an employer may need to provide will be affected by those risk factors. OSHA has also advised that employers implement basic infection prevention techniques – some as basic as providing hand-washing reminders and some as detailed as instituting remote work programs or flexible shifts. The implementation of telework policies, office closures, and cancellations of large group meetings are all consistent with this directive.

OSHA’s guidance also underscores how important it is for employers to develop a contingency plan for the possibility that a COVID-19 outbreak occurs in their area, or that potentially contagious employees have been in the workplace. Those plans should consider employee notice protocols, office sanitation resources, social distancing controls, and business continuity plans.

Although restrictions on making medical-related inquiries of employees (including asking about COVID-19 exposure and requiring temperature checks that could be indicative of that exposure) may lessen in the wake of a pandemic, employers still need to be mindful of employees’ privacy concerns and that sharing medical information can violate federal and/or state laws. Companies therefore need to think about how they will balance disclosure obligations with privacy concerns, put protocols in place to make any employee inquiries in a discreet manner, and limit the dissemination of medical information.

### Additional Resources

- [How to Ask About COVID-19: Privacy Considerations](#)
- [Coronavirus Health & Safety Guidance: OSHA Gives New Direction to Employers](#)

## VII. REDUCTIONS IN FORCE AND WORKFORCE MANAGEMENT IN A DOWNTURN

By [Sean Becker](#), [Brian Bloom](#), [Alex Bluebond](#), and [Vanessa Griffith](#)

Employers are facing difficult decisions regarding workforce management in light of employee illnesses, government-mandated shutdowns, and other business impacts from the COVID-19 crisis. Employers do have options in this regard, however undesirable they may be, and a summary of the key legal considerations associated with these options follows.

- Reduced Pay; Reduced Hours – Absent a contractual arrangement to the contrary, employers are generally free to reduce employees' hours and pay, provided the change is prospective and clearly communicated. For non-exempt employees, this is enough – workers in this category need be paid only for work performed.

The situation is more complex, but still manageable for exempt employees. Exempt employees are paid a salary, and must be paid that entire salary for each workweek in which *any* work is performed (with some exceptions unlikely to be applicable here). Accordingly, although an employer may reduce an employee's salary (as long as it is above the FLSA-mandated minimum), it may not dock the pay of exempt employees for periods of less than a week. Employers must be careful not to disguise what could be viewed as improper pay docking by adjusting exempt employees' salary on a weekly or other frequent basis designed to conform to actual hours worked as this is arguably inconsistent with the "salary basis" test.

Note that reductions in hours and compensation may allow the affected employees to obtain unemployment compensation.

- Leaves of Absence and Furloughs – Employers can place employees on short-term leaves of absence during which the employees are not paid but remain employed, and (subject to applicable plan terms) entitled to medical benefits provided they continue to pay their share of the monthly premium. Non-exempt workers may be furloughed for any period of time – days, weeks, months – that meets the employer's needs. Exempt workers may also be furloughed, but the minimum period of leave must be only a week (and, it must be a week that coincides with the employer's workweek) or the employee is entitled to full salary for the week. Also as noted, furloughs may trigger the right to unemployment benefits.
- Reductions in Force – A layoff generally severs the employment relationship, even when the layoff is anticipated to be short in duration. Where the layoff involves a large group of employees, the federal Worker Adjustment and Retraining Notification Act (WARN) or similar state laws may be implicated. In general terms, these laws require employers to provide advance notice of mass layoffs both to the workforce and the local government. WARN-style laws may also be triggered by furloughs and other schedule adjustments. For example, WARN defines a "job loss" to include a reduction in hours of work of more than 50% during each month of any six-month period. Note, however, actions short of termination (such as temporary layoffs or reductions in hours) are counted as a job loss only where the change continues for more than six months. Finally, even though employers may be excused from the advance notice requirement under one of WARN's exceptions, they may be obligated to provide it as soon as possible.

A final cautionary note – all of these options must take into account and comply with any contractual arrangements between the employer and individual employees or unions.

## Retirement and Nonqualified Deferred Compensation Plan Matters

There are several issues that an employer may encounter relating to retirement and nonqualified deferred compensation plans as the consequences of COVID-19 and the economic downturn become more widespread. These include:

- Partial Plan Terminations – Employers should take into consideration the partial termination rules that are applicable to their qualified retirement plans when considering a reduction in the workforce. A partial plan termination could occur as a result of one or more rounds of layoffs, depending on the magnitude of the layoffs and other facts and circumstances. If a partial termination occurs, then affected employees (e.g., generally those who had a severance from employment during the applicable period) must be 100% vested in their account balance or accrued benefit, to the extent funded.
- Reducing or Suspending Employer Matching or Nonelective Contributions – Employers may consider reducing or suspending employer matching or nonelective contributions temporarily, but any such reduction or suspension must not violate plan provisions or applicable law. For a safe-harbor 401(k) plan, employer matching or nonelective contributions may be reduced or suspended mid-year only if the employer is operating at an economic loss for the plan year or the safe harbor notice for the plan includes certain information indicating that the plan could be amended to reduce or suspend safe harbor contributions. In order to reduce or suspend safe-harbor contributions during a plan year, employees must receive at least 30-days advance notice of the change, and certain other requirements must be satisfied.
- Hardship Withdrawals – Due to increased financial difficulties that employees may experience, it is likely that some of those employees may seek access to their retirement savings through hardship withdrawal requests. Many plans limit such withdrawals to the safe harbor reasons provided by the IRS, which include, among other things, certain expenses for medical care, payment of tuition and other educational expenses, payments necessary to prevent the eviction of the employee from his or her principal residence or foreclosure on the mortgage for that residence, and expenses and losses incurred by the employee as a result of a disaster declared by FEMA. As of March 23, 2020, FEMA has declared a disaster for the states of New York, California and Washington in connection with the COVID-19 pandemic. Plan administrators should monitor FEMA disaster declarations as more are likely to occur.
- Applicable Deadlines – Unless and until relief is provided by the IRS and the Department of Labor, deadlines relating to retirement plans continue to apply. These deadlines may include Form 5500 filing obligations, the time permitted for depositing contributions into the plan's trust account, and quarterly minimum funding contributions to pension plans.
- Nonqualified Deferred Compensation Plans – For many traditional deferred compensation plans, payment of account balances is provided upon a specified date or a separation from service (or the earlier of those two events). However, in the current environment, employees may desire to have earlier access to their balances for several reasons, including addressing their own personal financial issues and concerns relating to the employer's financial situation and ability to pay those benefits in the future. The ability to accelerate payment of such benefits is extremely limited due to the anti-acceleration rules included in Section 409A of the Internal Revenue Code. Accelerated payments may be permitted in the case of an unforeseeable emergency, however very

stringent requirements must be satisfied in order to receive such a payment. Plan termination may be an option, but it comes with its own set of restrictions, potentially including a required delay of at least 12 months prior to processing the termination distributions. If an employer has concerns relating to an employee voluntarily leaving employment to obtain access to his or her nonqualified deferred compensation plan benefits, implementation of a retention program could be considered as an alternative.

#### **Additional Resources**

- [Advance Planning for Furloughs or Layoff](#)
- [New Coronavirus Law Mandates Paid Leave for Certain Employees](#)

## VIII. UPDATE ON CORONAVIRUS RELIEF LEGISLATION

By [Adrienne Goins](#)

Late on Wednesday, March 25, 2020, the U.S. Senate passed a massive coronavirus relief bill estimated at \$2.2 trillion. The House of Representatives plans to pass the bill by voice vote on Friday, March 27. President Trump says he will sign the bill immediately. This legislative effort is the largest emergency stimulus package in American history.

*The V&E Coronavirus Task Force is continuing to monitor developments in Congress and will provide in-depth analysis of the relief package when it is finalized by separate client alert. This information was current as of the date and time of this publication.*

### Loans and Other Assistance

The bill creates a \$500 billion lending program through the Treasury Department with loans and loan guarantees for companies, states and cities. By far, the largest share – \$454 billion – is for loans to businesses, cities and states.

- The bill includes about \$50 billion for passenger airlines and \$8 billion for cargo airlines. The amounts will be provided as grants, loans and loan guarantees. Airlines also receive a reprieve from paying excise taxes on ticket prices, fuel and cargo taxes. Half of the funds are required to be used to pay employees.
- It includes \$17 billion for firms important to national security. This category reportedly includes Boeing and General Electric. The concept of “national security,” though not defined in the bill, is likely to draw on the Department of Homeland Security’s list of critical infrastructure sectors.

The bill requires strict oversight of the business loans, with restrictions on stock buybacks and executive compensation. An inspector general and accountability committee will oversee how the loans are made.

The final bill does not include specific relief for oil and gas companies, though such firms can seek assistance where they qualify. The bill also does not include an extension of tax breaks for renewable energy firms.

The bill provides over \$350 billion in additional loans and grants specifically to help small companies deal with immediate costs. The parameters of this program are being clarified and will be addressed in a separate client alert.

The bill provides more than \$150 billion in assistance to hospitals, doctors, nurses and community health centers. This amount includes \$100 billion in grants for hospitals and health systems; \$10 billion for the Indian Health Service; and billions more for personal protective equipment for health care workers, testing supplies, increased workforce training, construction of new facilities to house patients, an increase of the Strategic National Stockpile (pharmaceuticals and medical supplies), medical research into COVID-19, and Medicare payment increases to hospitals and providers.

The bill includes about \$50 billion for several programs to assist the agricultural sector. Colleges, universities, states and local school districts will receive \$30 billion in education funding. Public transit agencies will receive \$25 billion.

### **Direct Payments to Americans and Unemployment Assistance**

The bill would provide \$367 billion in additional loans and grants specifically to help small companies deal with immediate payroll costs. This program is designed to help small businesses bridge expenses for up to ten weeks. Firms will not be required to repay up to eight weeks' worth of assistance if they refrain from laying off employees, or if they rehire employees they have already laid off by June. At least some of this assistance will come in the form of a worker retention payroll tax credit.

### **Additional Programs and Assistance**

The bill provides additional funding to several important federal programs:

- The Defense Department receives \$10.5 billion, including \$1.5 billion for deployment of up to 20,000 National Guard members to help state coronavirus response teams and \$415 million for research and development of vaccines and medicine.
- The Federal Communications Commission receives \$200 million for telemedicine focused on reaching remote, rural patients.

The bill includes significant increases in food assistance and child nutrition programs.

## IX. INSURANCE COVERAGE DURING THE OUTBREAK

By [Michael Charlson](#)

Risk management and mitigation is an important corporate function generally, and the odd confluence of events around COVID-19 make it even more so. Companies, with help from their counsel and insurance brokers, should examine the scope of coverage available under their various insurance policies and ensure coverages are current and any claims perfected. While there are many different types of insurance with terms potentially relevant to losses associated with COVID-19, four coverage types in particular may be significant.

### Directors' and Officers' (D&O) Liability

Although it is early in this crisis, there already have been class action lawsuits filed against corporate directors and officers over allegedly material misrepresentations relating to the company's business and risk factors. More suits in the securities and corporate governance arena are a near certainty. To ensure that a company and its people are appropriately protected, robust D&O coverage is essential.

As with any insurance, D&O insurance policies are contracts, with terms controlled primarily by the policy language. Making matters more difficult is that D&O insurance policies are highly customized so that the terms and conditions in the policy can vary substantially. Quite apart from the current situation, to understand the scope of coverage, including potential gaps and coverage extensions, it is generally important to have a lawyer or insurance broker experienced with D&O insurance review the policy language. In the current context, there are some particular issues that a company should focus upon.

- **Timely renewal.** The insurance market has tightened considerably in recent years, and even more so in recent weeks. Clients may find themselves surprised at the premium increases being demanded as part of program renewals currently, and while there are ways to mitigate those increases – higher self-insured retentions, lower limits for the insurance tower, and modification of terms and conditions to a state less favorable to the insured are all examples – these sorts of issues can take time to consider, negotiate and price. If the company is approaching a policy renewal, plenty of time should be given to the company's insurance broker and counsel to obtain a renewal proposal, or proposals, and to afford all concerned reasonable time for considering the proposals and alternatives.

In this regard, it is important to remember that D&O insurance policies are so-called "claims made" policies. This means that D&O insurance responds only to Claims (as defined in the policy) actually made during the policy term. Having a policy lapse can result in a temporal gap in coverage, and it could be difficult to convince even an incumbent carrier that has not bound coverage as of the renewal to make the later renewal retroactive to the expiring policy's end date. It may be impossible to get a new carrier in an insurance tower to do so.

With the premium increases some carriers are seeking, it may be tempting for a company to consider changing insurance carriers, particularly at the primary layer. Doing so has its own set of issues. Perhaps most important, a company needs to be sure that a new insurer will cover claims that may relate to wrongful acts that happened before the policy term began – a date sometimes called the



“pending or prior” date or the “continuity” date. In the current market, it may be difficult to convince a new carrier to extend these dates back beyond the policy term, or they may agree to do so only with company agreement to exclude from coverage large issues that could provoke a claim. To avoid a coverage gap, then, a company may need to consider exercising the extended reporting period normally provided for in the expiring policy – though that exercise itself can be expensive and needs to be factored into the overall coverage program. These are additional reasons why a company should be working with their brokers to begin the renewal process early and to involve experienced professionals in the process.

- **Potentially helpful sublimits.** Many D&O policies have provisions that afford first-dollar, but limited, coverage for extraordinary expense (not limited to attorneys’ fees) associated with so-called corporate “crises.” These crises, normally defined by the policy terms, can include a host of unexpected corporate events – for example, substantial earnings or revenue shortfalls, the modification or withdrawal of financial guidance, the reduction or suspension of dividends or distributions – that often lead to Claims, but that may necessitate the retention of counsel, public relations firms or other professionals to on the front end, including crafting appropriate disclosures and other defensive responses, before a Claim is actually made. Crisis Fund sublimits can help pay for some of these expenses (although they do deplete the policy limits otherwise available to respond to a Claim once asserted).

In some insurance programs, these sublimits are replicated up the insurance tower and “drop down” to give the insured company access to larger pools of first-dollar coverage. Normally, excess insurance policies are not implicated in a covered loss until the insurance below the excess policy has fully expended its coverage limit. But with a drop-down sublimit, the excess policy is implicated as soon as the lower layer has expended its sublimit.

- **Discovery tail policies.** Discovery tails or extended reporting periods enable a company to remain covered for alleged wrongful acts that occur during an insurance policy term but where a Claim is not actually made until the policy term has expired. These tails can mean very useful protection, but advance planning is often necessary. These are a few examples where they can come into play.
  - o **M&A or other Change-in-Control Transactions.** M&A transactions, including transactions involving the sale of a substantial set of a company’s assets, can result in coverage gaps. It is essential for companies to be aware of change-in-control provisions in D&O policies to avoid these gaps.
  - o **Bankruptcy.** In distressed situations where a company may need to file for protection under the Bankruptcy Code, a prepaid discovery tail can be important protection. Placing insurance to primarily protect directors and officers after a bankruptcy filing can be difficult, not only because the company often lacks funds, but also because courts can view the expenditure as not benefitting the bankruptcy estate. As a result, these tail coverages need to be put in place pre-filing, and the earlier in time the better – with agreed-upon triggers that convert a D&O policy to run-off mode.

- o **Change of Carrier.** As noted, changing insurance carriers can result in a coverage gap depending on the terms of the new policy. In these situations, a coverage gap may be plugged or mitigated by exercising the extended reporting period provided for in the existing policy. These provisions will extend by a year the period during which a Claim must be noticed (but only for acts that pre-dated the end of the policy term), and these features are priced in advance, in some cases with pricing that may appear favorable.

### **Errors & Omissions (E&O) Coverage**

For companies that provide services, E&O coverage may prove significant when COVID-19 and related governmental mandates render it difficult or impossible to provide those services. As with all insurance, the policy language controls, but it is important to keep the potential for coverage in mind and to review the issues with a qualified professional.

### **Business Interruption (BI) Coverage**

Many companies have insurance policies that include limited coverage for unexpected interruptions in the insured business operations – generally as part of their commercial property policies. Events surrounding COVID-19 would appear to meet this threshold.

BI coverage is subject to a wide range of exclusions and limitations. Moreover, the business loss typically must be linked with business disruptions at particular properties that are covered under the primary insurance. Sometimes coverage exists only with respect to interruptions that relate to particular products being produced for particular customers, or for disruptions caused by failures of specific vendors to provide particular raw materials. The point is that these policies are again governed by the particular policy language, which can vary significantly from policy to policy owing to differential needs of the insured companies and their business operations. The details matter. Even policy exclusions limiting coverage for disruptions caused by contagions or pandemics may or may not apply because losses may stem from many different causes. It depends on the policy language taken as a whole, and on the circumstances of the loss. These situations need to be assessed by experienced coverage counsel.

Even where there is coverage, proving the magnitude of the loss is also critical, and insureds should expect pushback from their carriers. Because losses can result from multiple causes, it is very important that insureds document their losses thoroughly, and give prompt notice of their claim. Again, coverage counsel and the insurance broker can assist.

### **Comprehensive General Liability (CGL)**

Among many things, CGL policies offer protection against third-party claims for damages arising from COVID-19. For example, a person who sues having allegedly been infected after visiting a business or purchasing a product carrying the virus would be a third-party claim under most CGL policies.

## X. SHAREHOLDER ACTIVISM CONSIDERATIONS IN A DISTRESSED ENVIRONMENT

By [Lawrence Elbaum](#) and [Brett Peace](#)

- **Proxy Fights Continue Despite the Market Volatility**
  - o Of the 43 proxy campaigns that were announced this year before March 1, 2020, 30 continue to move forward – with many activists further building their stakes and ramping up their campaigns.<sup>5</sup>
  - o Since March 1, 2020, 8 additional proxy campaigns have been announced and are proceeding.<sup>5</sup>
  - o Boards should continue to prepare for proxy contests and be mindful of future campaigns that will likely follow the current depressed market conditions – activists may allege that boards and management teams were caught off-guard by the downturn and should have been better prepared from an operational standpoint.
  
- **Shareholder Engagement**
  - o With recent market volatility resulting from both COVID-19 and depressed commodity prices, continued shareholder engagement remains crucial.
  - o Board members can play a central role in shareholder engagement in order to support their management teams, which may have limited capacity to perform the traditional shareholder engagement function as a result of the increased demands market conditions have placed on management.
  
- **Consider Preserving Shareholder Value with a Rights Plan (a/k/a “Poison Pill”) that is Tailored to the Particular Concerns Facing the Company**
  - o The poison pill is a defensive measure that, upon triggering, creates a deterrent for any activist (or unwelcome acquiror or hostile bidder) by giving all other shareholders the right to buy shares in the company at a substantial discount. If the activist purchases shares beyond a threshold predetermined by the board, or if a shareholder who already owns shares beyond the threshold purchases additional shares, then the poison pill is triggered and the activist’s ownership interests in the company are substantially diluted.
  - o Companies facing volatile market conditions should consider preparing a rights plan to keep on the shelf, ready for future adoption by the board. While a rights plan does not, and is not intended to, prevent a proxy contest or takeover, it is designed to provide the board with time to consider alternatives and leverage to ensure that the interests of all shareholders are considered. Rights plans that are not yet adopted do not need to be disclosed while they remain on the shelf.
    - o A rights plan can slow opportunistic shareholders seeking to gain control without paying all shareholders an appropriate control premium. They are

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<sup>5</sup> Source: FactSet Research Systems Inc.

especially relevant when market conditions result in depressed share prices and, as a result, high volume trading might permit a shareholder to quickly gain a significant position in the company's stock.

- o If a company is concerned about safeguarding valuable net operating losses (NOLs) and other tax carryforwards, an "NOL Rights Plan" or "NOL Poison Pill" can be tailored to reduce the likelihood that changes in the company's investor base, particularly during high volume selloffs, would limit the company's future use of its tax benefits, which would significantly impair their value. A company with significant NOLs should consult its independent auditor and tax advisor about an Internal Revenue Code Section 382 study to determine how at risk its NOLs are due to trading in the company's stock.

- **Annual Meetings**

- o In a year in which annual meetings are far more likely to be held either in part or entirely through a virtual platform, contested elections, in particular, may give rise to litigation because (i) physical shares may not be present and (ii) the inspector of elections may not be physically present to collect proxies and inspect them.
- o Additionally, a board may have less certainty in advance of a contested election if the meeting is held in part or entirely through a virtual platform because shareholders can more easily attend virtual meetings – and can therefore delay their voting and even change their votes at the last minute.
- o Many national jurisdictions impose a tax residency test by reference not only to where the relevant company is incorporated, but also the jurisdiction from which it is centrally managed and controlled or has its place of effective management. This is generally where the key strategic decisions of the company are carried out. If a majority of a company's directors dial-in to important board meetings from a foreign country (e.g., not the country of incorporation), there is a risk that the company could inadvertently be treated as tax resident in that foreign country, and subject to that country's tax on its worldwide profits. The analysis depends on the peculiar facts of each situation and can be quite nuanced, so we recommend obtaining tax advice if this is a concern.

- **Insurance Coverage for Activism Preparation and Defense Costs**

- o The coronavirus pandemic, volatility in the energy industry, and other factors may have triggered coverage under many insurance policies for liability and damages incurred in managing through global health concerns and unstable economic conditions.
- o Many primary director and officer (D&O) liability insurance policies provide coverage of up to \$100,000 with no deductible when companies are facing so-called "Crisis" events.
  - o For example, a leading insurer in the D&O industry, which is one of the most common underwriters of primary D&O policies, recognizes 13 specific events that constitute a covered "Crisis," including negative

earnings, loss of major contracts, director and officer resignations, product recalls and unsolicited takeover bids.

- o If a company experiences one of these “Crisis” events, this insurer will cover a company’s expenses up to \$100,000 with no deductible to hire a crisis management firm, such as a public relations, investor relations or law firm, to help develop strategic communications plans with shareholders and other constituencies.
- o Other leading insurance carriers offer companies similar “Crisis” coverage as described above.
- o There might also be coverage, subject to exceptions and deductibles, under business interruption insurance policies for loss of business due to the coronavirus.
- o Many companies overlook their policies while managing a crisis, oftentimes giving notice after incurring significant expenses without their insurance carriers’ knowledge and consent. This can create significant hurdles in obtaining coverage.
- o Companies should carefully review all of their insurance policies and consider whether it is appropriate to give notice of claims or circumstances that could give rise to a claim in the future.

## XI. CREDIT/FINANCING IMPLICATIONS

By [Guy Gribov](#), [James Longhofer](#), [Brett Santoli](#), [David Wicklund](#), and [Caitlin Snelson](#)

### Debt Considerations

As global credit markets struggle to cope with the ramifications of the COVID-19 pandemic and the concurrent precipitous decline in oil prices, borrowers are forced to grapple with numerous issues with respect to outstanding debt facilities.

### **Accessing Loans Under Your Existing Credit Facility**

For many companies, a credit facility providing for revolving loans is a vital source of ongoing liquidity. Inability to access that liquidity can be catastrophic. Here are some things to consider in connection with your liquidity facility:

- Draw Conditions. Evaluate your liquidity facility to determine what conditions your company needs to satisfy in order to continue borrowing.
  - o *No default or event of default*. Nearly all credit facilities will require there be no default or event of default at the time of a borrowing. Consider whether there are any existing defaults a lender could assert as a defense to honoring a borrowing request (see more about defaults below). The no-default condition will become critical if you believe you may not be able to satisfy a financial covenant in the future or if you believe you may get a “going concern” or other qualification from your auditors. A so-called “defensive draw” (see more about that below) may be warranted in those circumstances.
  - o *Repeating or “bringing-down” representations and warranties*. Nearly all credit facilities will require the representations and warranties be brought down at the time of each borrowing. Review your representations and warranties with counsel to determine whether there are any that might be difficult to make today, or you anticipate struggling to make in the future. Particular attention should be paid to solvency representations and material adverse effect or material adverse change representations. For a deep dive on “MAE” in credit facilities, please see [COVID-19: Does the Current Crisis Threaten Borrower Access to Credit Facilities?](#)
  - o *Pro forma compliance with financial covenants*. Some credit facilities will require *pro forma* compliance with financial covenants as a condition to draw.
  - o *Anti-cash hoarding*. Some credit facilities contain anti-cash hoarding provisions which aim to restrict defensive draws. See below for more on anti-cash hoarding provisions.
- Reserve-Based Loan Borrowing Base Redeterminations. With oil prices at 20-plus year lows, you should anticipate that the borrowing base in your reserve-based loan facility (RBL) will be redetermined downward this Spring season.
  - o *Dialogue with lenders*. Borrowing base redeterminations are usually conducted amidst a good deal of dialogue between the borrower and the agent bank. Your RBL lenders should tell you what to expect with the spring redetermination. If

your facility is syndicated, consider with your lead bank which lenders in the syndicate might be operating under unusually tight constraints or policy limitations regarding their RBL portfolio.

- o “*Wild Cards.*” RBL lenders customarily have the ability to request additional interim (or “wild card”) borrowing base redeterminations between the scheduled spring and fall redeterminations.
- o *Overdrawn as a result of redetermination.* If a redetermination leaves your company overdrawn, the deficiency will need to be repaid. RBLs usually require repayment of any such deficiency in a lump sum or in 5 or 6 equal monthly installments (at the borrower’s option) or, in most RBLs, additional collateral may be added to increase the borrowing base and eliminate the deficiency.
- o *Consult with counsel.* Consult with your finance counsel who can help you understand the particulars of your redetermination mechanics, including the timing of effectiveness of a new borrowing base, requirements and strategies to resolve any resulting deficiency, and the lenders’ ability to institute, and mechanics governing, wild card redeterminations.
- Asset-Based Loan Borrowing Base Redeterminations. Companies in oilfield services or compression services often have asset-based revolving loan (ABL) facilities governed by an accounts receivable and inventory borrowing base calculated monthly or weekly using a detailed fixed formula. You should anticipate the possibility of a decline in your borrowing base as market conditions deteriorate. Consult with counsel as to whether any of the following may apply.
  - o *Reserves.* Despite the characteristically detailed borrowing base formula, ABL facilities typically give the administrative agent “permitted discretion” to establish broad reserves to address various contingencies. Consult with counsel as to whether specific facts could result in a reserve to your ABL borrowing base.
  - o *Cash dominion.* Many ABL facilities give the lenders dominion over the borrower’s cash (including the right to apply the entire amount of such cash to prepay the loans) if facility availability is below a certain target amount. A reduction in the ABL borrowing base could trigger such a provision. Consult with counsel regarding any cash dominion triggers in your facility.
  - o *Financial covenants.* Many ABL facilities contain springing financial covenants, such as fixed charge coverage ratios, triggered by facility availability being reduced below a target amount. A reduction in the ABL borrowing base could trigger such a springing financial covenant. Consult with counsel regarding springing financial covenants in your ABL facility.
- Defensive Draws. Borrowers make a “defensive” draw when they draw on a line of credit in anticipation of that line being reduced or otherwise unavailable in the future. Under current market conditions, some borrowers are considering defensive draws on their revolving credit facilities. A defensive draw can be a useful tactic in the right circumstances, but it can also be provocative and should only be done after careful consideration of the ramifications and available alternatives. You should consult with counsel before consummating a defensive draw.

- Anti-cash hoarding provisions. As noted above, some revolving credit facilities contain anti-cash hoarding provisions. These usually take two forms, (i) a condition to drawing that the borrower has no more than a certain amount of cash on hand after giving effect to such drawing and (ii) a covenant requiring the borrower to apply excess cash on hand to pay down its revolving loans. The purpose of anti-cash hoarding provisions is to reduce the risk to lenders of defensive draws. Under current market conditions, borrowers should expect to see anti-cash hoarding provisions added to their new money loans. Furthermore, borrowers seeking amendments to their existing facilities will see anti-cash hoarding provisions added to those amendments. Counsel can help you better understand the intricacies of such provisions as well as available formulations providing for appropriate flexibility for your context.

### Potential Events of Default Under Existing Facilities

As markets continue to deteriorate, borrowers will need to monitor their credit facilities for defaults and potential defaults.

- Financial covenants. Unless your credit facility is “covenant lite,” it contains one or more financial covenants. Financial covenants commonly found in credit facilities include debt-to-EBITDA tests (or “leverage tests”), interest coverage ratios, debt service coverage ratios, asset coverage tests, current ratios, fixed charge coverage ratios and loan to value ratios. You should be carefully reviewing and monitoring your financial covenants to anticipate any potential future defaults. The earlier a future potential financial covenant problem is identified, the more time you will have to develop a path forward with your lenders.
  - o *How and when tested.* Consider when and how your financial covenants are tested. Are they tested quarterly, monthly or at all times? Are they tested on twelve-month trailing basis looking backward at historical results? Are they tested on a last quarter annualized basis, looking only at the last quarter of results?
  - o *EBITDA/net income.* Consider available add-backs to EBITDA and exclusions from consolidated net income contained in your credit facility. Add-backs for extraordinary, non-recurring or unusual losses/costs/expenses can be helpful. The treatment of proceeds of business interruption insurance might be relevant. If you are looking to monetize hedges, check whether those proceeds are excluded from net income.
  - o *Net debt tests.* Some leverage tests allow the borrower to reduce the debt side of the ratio by all or a portion unrestricted cash held by the borrower.
  - o *Asset coverage tests.* For upstream companies, consider whether any asset coverage test applicable to you uses commodity prices reflected in the latest reserve report or more recent commodity prices.
  - o *Can I cure my financial covenant default?* It is commonplace for the credit facilities of portfolio companies of private equity sponsors to contain an equity cure provision. The typical equity cure provision permits a sponsor to inject equity into a company after quarter-close and add those amounts to EBITDA retroactively to cure the applicable financial covenant. In the absence of such an



equity cure provision or some other more bespoke provision, financial covenants are not cured by the subsequent improvement in a company's performance.

- o *What happens if I think I will default my financial covenant?* If you are forecasting a financial covenant default, get ahead of it as soon as possible. Consult with counsel and financial advisors to determine the best path forward. Once the relevant measurement period ends, you may no longer be able to draw a revolving line if you believe your financials will demonstrate a financial covenant default.
- Annual audit. Concurrent with annual financial statements, companies are usually required to deliver audit opinions that are without a qualification as to "going concern." Some credit facilities permit such "going concern" qualifications to the extent arising from narrow circumstances such as impending debt maturities or prospective financial covenant defaults. You should evaluate any audit concerns with your auditors and other advisors.
- Material adverse effect/material adverse change. Some credit facilities contain an event of default upon the occurrence of a material adverse effect or material adverse change has occurred. For a deep dive on "MAE" in credit facilities, please see [COVID-19: Does the Current Crisis Threaten Borrower Access to Credit Facilities?](#)
- Notice of default. Most credit facilities require borrowers to give lenders notice of the occurrence of a default or event of default.

### **Alternative Sources of Liquidity/Capital**

As credit markets tighten, particularly in the energy sector, there will likely be a surge in desire for alternative forms of capital. Companies will consider asset sales, alternative financing structures and commodity hedge monetizations, among other methods of raising capital. Various de-leveraging and liquidity generating transactions may be restricted by your credit facility or other debt instruments. Consult counsel to work through specific options available under your debt facilities.

- Structured finance. Companies in the upstream space are increasingly looking at potential override and volumetric production payment transactions, acquisition companies, minerals joint ventures, operated and non-operated "DevCos," and other structured financings. These types of structures can enable producers to partially monetize existing assets to finance continued development at the parent level and to source "off balance sheet" capital for minerals and non-operating acquisition opportunities. However, there are fraudulent conveyance and other bankruptcy-related risks attendant to these structures that can make them challenging if commodity prices remain depressed. Consult counsel regarding structures that may be effective for your company and fit within the limitations contained in your existing debt instruments.
- Alternative capital sources. Private equity and other domestic and international funds have large amounts of uncommitted private capital designated for opportunistic investments. Companies are showing renewed interest in convertible preferred, second-lien debt and other parent level financing structures that were popular in 2016-2019.

- o *Preferred equity.* Issuers of preferred equity will be focused on achieving maximum equity credit from ratings agencies, while investors in preferred equity will be focused on downside protection and assuring liquidity. These aims run counter to each other and will result in the need for careful analysis in structuring the terms of the security, as well as close coordination with auditors and the ratings agencies to ensure that the business deal is compliant with accounting and rating agencies objectives.
- o *Second lien and mezzanine debt.* With regard to second lien and mezzanine financings, borrowers will be focused on increasing liquidity and maintaining covenant flexibility, while lenders will be focused on collateral coverage and covenant discipline.
- Commodity hedge monetizations. As commodity hedge positions turn positive, early monetizations of commodity hedges for upstream companies can be an appealing and quick source of liquidity. However, many RBLs have a mechanic for automatic borrowing base reductions triggered by commodity hedge monetizations over a defined threshold (often 5% or 7.5% of the borrowing base) which would reduce the actual incremental liquidity impact. Companies considering this strategy should also consider the possibility of provoking a “wild card” redetermination by lenders looking to reduce their exposure. Finally, unwinding hedges could have an impact on financial covenants that should be considered. In particular, the proceeds of hedge unwinds are frequently excluded from net income, resulting in the unwind having a negative impact on EBITDA-based financial covenants.

## XII. IMPLICATIONS FOR FEDERAL CONTRACTORS

By [David Johnson](#)

Companies in many industries often find themselves in business with the federal government. Energy companies, for example, may be selling natural gas and electricity to federal facilities, providing energy savings services, supplying jet fuel, furnishing renewable power, and privatizing federally owned energy facilities, among other activities. COVID-19's impact on federal contractors and their ability to perform their contracts is inevitable. In the coming days and weeks, a federal agency may curtail access to its facilities and thus, impede a contractor's ability to perform. Or a federal contractor might experience supply chain delays due to the effects of the virus. Or sickness or quarantines could diminish a contractor's own workforce, rendering it unable to meet deadlines. While the threat is likely to generate innumerable scenarios affecting federal contractors, two features of these contracts may be of critical importance to energy industry companies.

- Like many commercial contracts, federal government contracts often contain provisions that excuse performance in emergency situations that are outside the control of the contractor, such as COVID-19. The Federal Acquisition Regulation (FAR), found at 48 C.F.R. Parts 1-52, is applicable to nearly every federal purchase of goods or services with appropriated funds. The FAR contains several clauses that excuse performance delays due to events such as epidemics and quarantines. See, *e.g.*, FAR 52.212-4(f); 52.249-14(a). Other FAR provisions protect contractors from default terminations for failure to perform if the default is beyond the control of the contractor. See, *e.g.*, FAR 52.249-14 and FAR 52.249-8 and -9. Whether a particular FAR clause is included in a federal contract depends on a number of factors, including the type of contract (fixed price versus cost reimbursement) and what the government is purchasing (*e.g.*, commercial items). Contractors engaged with any federal government agency and facing potential impacts from COVID-19 will want to carefully review each contract to determine whether these or other clauses offering relief are in their contracts, and meticulously follow the requirements of any relevant clause.

As the federal government deals with the ever-changing landscape there is wide disparity among agencies on approaches to dealing with interruptions of contract performance. In many cases, contracting officers who are responsible for the administration of government contracts are simply overwhelmed. In such an uncertain environment, contractors are served best by ensuring that they notify contracting officers in writing of any delays that result from COVID-19 and reserve their rights with respect to the effects of any changes in the performance of their contracts that may be attributable to actions or inactions of the contracting officer.

- Finally, important to a subset of government contracts and often found in energy and defense-related and government contracts, is the potential application of the Defense Priorities and Allocations System (DPAS) regulation (15 C.F.R. Part 700) and FAR 52.211-15, the Defense Priority and Allocation Requirements clause to a contract. Often overlooked, a government contract can be identified as subject to DPAS requirements when an innocuous block at the top of the federal standard contract form cover sheet provides "This Contract Is A Rated Order Under DPAS (15 CFR 7900)" and identifies the applicable DPAS rating. Contracts subject to DPAS requirements—which are most often issued by Department of Defense (DoD) entities—can have a major impact on contractors. The purpose of the DPAS requirements is to ensure that DoD's most critical needs are prioritized as necessary to meet required delivery dates. See 15 C.F.R. §

700.3. A company that holds a government contract that is identified as DPAS-rated must assign priority to that contract before fulfilling the requirements of other contracts. The basic consequences of this are twofold:

- o first, the government can require prioritization of performance of its contract to the detriment of the contractor's other customers; and
- o second, because a contractor with a DPAS-rated contract must serve the government as a priority customer, the contractor may experience resulting performance difficulties on its subordinated contracts.

Thus, companies that hold both federal contracts and commercial contracts must be aware if they are performing DPAS-rated contracts, comply with the related clauses and regulations, and proactively manage any potential resulting delays that may result on their commercial contracts.

#### **Additional Resources**

- [Coronavirus's Impact on Federal Contractors](#)

### XIII. EXECUTIVE COMPENSATION CONSIDERATIONS

By [David D'Alessandro](#), [Shane Tucker](#), [Dario Mendoza](#), [Kristy Fields](#), and [Austin Light](#)

With share prices of many companies currently distressed or trading significantly below equity grant prices due to market turbulence, we have been fielding many questions regarding compensation-related items, from what to do if awards have not yet been granted for the 2020 award cycle, to what can be done with awards that have been granted (in 2020 or earlier) but are now completely mismatched to realistic performance outcomes. While a wait-and-see approach may be best in light of quickly evolving conditions, now is the time to begin thinking about these issues and to lay out a game plan for addressing executive compensation matters throughout the course of the year.

It's important to note that conditions are changing rapidly in the current environment from both an economic and legislative standpoint. A company's participation in federal relief efforts could impact executive compensation planning and tax attributes associated with executive compensation awards. Before making any adjustments, companies should consult their executive compensation advisors.

#### Immediate Compensation-Related Action Items

- **If 2020 Incentive Award Grants Have NOT Been Made** – If 2020 annual incentive and equity-based awards have not been granted, consider adjustments to normal terms and processes.
  - o ***Award Timing.*** With uncertainty around the longer-term effects of COVID-19 and other circumstances on the market and individual company circumstances, companies could delay annual awards until there is more market stability. This could include delaying grants entirely, or granting some portion of annual awards now and the remainder over the following three quarters of 2020.
  - o ***Performance Goals.***
    - o **Timing.** Delaying grants may give companies the opportunity to set performance goals more in line with realistic expectations for annual performance.
    - o **Compensation Committee Discretion.** Although proxy advisory firms such as Institutional Shareholder Services (ISS) and Glass Lewis prefer little to no compensation committee discretion to adjust awards, given current market volatility and COVID-19 uncertainty, consider reducing the proportion of hard-wired performance formulas and giving the compensation committee greater discretion to determine performance at the end of the year.
    - o **Adjustments.** Consider building in adjustment provisions to performance-based awards granted in 2020. Providing for specific adjustments in performance goals will set expectations on the part of both the board and executives with respect to particular metrics that may be affected by COVID-19 and market instability, even when those effects are unknown. This approach also reduces the level of discretion granted to the

compensation committee, a change that could be viewed favorably by ISS.

- o **Tax Implications.** Prior to 2018, giving the compensation committee more discretion meant potentially losing a deduction for performance-based compensation. With changes to the tax law, however, most performance-based compensation deductions are limited to \$1 million. This means granting the compensation committee more discretion in setting and adjusting performance will probably not have undesirable tax consequences, and may lend needed flexibility to compensation awards.
- o **Grant Sizing.** Companies that use a formula to determine the size of equity-based awards, such as a pre-determined dollar value divided by closing share price, may consider basing grants on a trailing share price rather than a single day's closing price to smooth out effects of wide swings in the markets. As mentioned above, delaying timing of grants would also allow companies to wait until market swings settle to avoid making grants based on a trading day that may represent a high or a trough in share prices.
- **If 2020 Incentive Award Grants Have Been Made** – It is too soon to tell the magnitude of the effects of COVID-19 and market volatility on company performance; however, companies should consider their options in addressing performance-based compensation that may have been awarded in a completely different market environment.
  - o **Check the Terms of Your Plans.** Begin by investigating how much flexibility existing plans provide in adjusting performance metrics, and whether additional discretion on the part of the compensation committee can be implemented with respect to previously granted awards.
  - o **(Yet Another Reason to) Watch the Market.** As stability returns to the market and companies have more certainty about likely 2020 performance, compensation committees will have more clarity around the necessity – and magnitude – of potential adjustments to performance goals.
  - o **Communicate with Advisors Early and Often.** At this time, companies should initiate communications with external advisors, including compensation consultants and external counsel, to look into their options and keep apprised of how peers are addressing performance-based compensation that no longer matches the reality of the market. As the situation evolves, we will see trends arise in how companies deal with outstanding awards.
- **Shareholder Proposals** – Companies that have not yet distributed a definitive proxy statement for the 2020 annual meeting will want to review their equity incentive plans to determine whether amendments are appropriate. Particularly, if share prices are depressed, more shares will be used to make annual grants of equivalent value to prior years. If share reserves under the company's equity incentive plans need to be replenished, now may be the time to request additional shares. During this process, it would be prudent to review the other equity incentive plan considerations discussed below.

## Incentive Compensation Considerations Going Forward

- **Institutional Investor Pressure** – With current volatility in the stock market, commodities prices, and the economy in general, proxy advisory firms and institutional shareholders may increase pressure on executive pay practices with respect to both the amount of compensation (and its connection to performance) and the method of payment (cash versus equity). Ultimately, boards should make decisions in the best interest of the company. This means that boards, and compensation committees, should use their own discretion to review, implement and administer compensation policies that award appropriate amounts subject to appropriate terms. However, those decisions should be informed by the factors proxy advisory firms take into consideration.
- **Pay-for-Performance Focus**
  - ***Review Pay-outs for Negative Performance.*** Many public companies award pay-outs relative to peers, instead of overall performance. This could lead to pay-outs for executives even when stock prices and shareholder value fall. Investors and their advisors may push back against performance targets that result in pay-out even where absolute performance is negative. Consequently, companies should consider implementing absolute performance targets for awards going forward, rather than targets relative to peer groups. Alternatively, relative performance awards could include a cap on payments where absolute performance is negative. For example, companies could provide awards that will pay-out at the cap instead of maximum level where the company's negative total shareholder return outperforms the peer group.
  - ***Vary Performance Metrics.*** Different metrics can be used in short-term versus long-term goals. For example, if total shareholder return is a component of the company's long-term incentive compensation awards, different criteria could be considered for the company's annual incentive bonus plan.
- **Equity Incentive Plan Considerations**
  - ***Equity Plan Share Reserves.*** Because depressed share prices require the grant of more shares to keep equity compensation on the same level as prior years, companies could consider granting phantom equity awards that are settled in cash, as these awards typically do not count against shares approved for issuance under most equity plans. Obviously, this strategy may pose challenges in a cash constrained environment, and companies need to consider the potential maximum dollar amount that could become payable with respect to such awards. As mentioned above, if timing permits, a company could also consider adding a request for additional shares to their proxy statement for this year's annual meeting.
  - ***Egregious Plan Features.*** A company that is (or is considering) seeking a shareholder vote on an equity incentive plan, including a request for additional shares under an existing plan, will want to consider whether ISS is likely to recommend "for" or "against" the plan. Certain "egregious" plan features (in the view of ISS) continue to result in a nearly automatic "against" vote from ISS on a company's equity plan. These features include: (i) liberal change-in-control definitions (as discussed below); (ii) plans that allow repricing or a cash buyout of

underwater stock options or stock appreciation rights without shareholder approval; (iii) plans that are vehicles for a pay-for-performance disconnect; and (iv) other plan features or company practices that are detrimental to shareholder interest, such as tax gross-ups related to plan awards or reload options.

- **Change in Control** – Given current market volatility and economic uncertainty, companies may increasingly be subject to hostile transactions and/or become attractive takeover targets.
  - o ***Incentive Compensation Plans.*** Companies may want to review the change-in-control definitions used in their compensation plans to ensure they are appropriately structured to fit within their business objectives in this environment. However, keep in mind that equity plans with liberal change-in-control definitions (such as a very low buyout threshold or a change in control that occurs upon signing an agreement for a transaction rather than consummation), coupled with a provision for automatic full vesting upon a change in control, are likely to receive a negative recommendation from ISS.
  - o ***Severance and Related Considerations.*** In addition to reviewing change-in-control definitions, companies may wish to review the consequences of a change in control on employee compensation. Now may be a good time to implement a formal severance policy and review the default treatment of equity-based awards in the event of a change in control.

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***For any Coronavirus-related legal questions, please contact a member of [V&E's Coronavirus Taskforce](#) or visit our [Coronavirus: Preparation & Response](#) site for a list of contacts and additional resources we hope will be helpful.***