CORPORATE GOVERNANCE

Analysis

Director Oversight in the Context of COVID-19

In their Corporate Governance column, David A. Katz and Laura A. McIntosh discuss a number of considerations that need to be addressed by directors and senior management teams working together as they fulfill their oversight responsibilities during the COVID-19 pandemic.

By David A. Katz and Laura A. McIntosh | March 25, 2020 at 12:45 PM

David A. Katz and Laura McIntosh. Courtesy photos

The challenges facing America during the ongoing COVID-19 pandemic are unprecedented. As directors of public companies work to fulfill their oversight responsibilities during this difficult time, there are a number of considerations that need to be addressed by directors and senior management teams working together.

Though it is the job of management to develop and implement the corporation's response to the crisis, directors should not hesitate to reach out proactively to request information or ask to schedule a virtual board meeting to receive updates from management as needed under the circumstances. Similarly, management teams may want to consider scheduling regular board updates to keep the board informed of management's response to the crisis. In its oversight role, the board should do its best to ensure that management is prioritizing the safety and well-being of the company's employees as well as those who depend upon the company for essential services. Board members must be careful, however, not to usurp or interfere with management's handling of the day-to-day operations of the company.

It is crucial for the board to understand the risks to the company and its various stakeholders arising from the pandemic as well as from the widespread economic shutdown that is of uncertain duration. The board can then have the opportunity as a group to discuss at regular intervals—or more frequently as needed—management's strategies for minimizing and mitigating these risks, which will be constantly developing

as the crisis unfolds. The physical health and financial health of corporate stakeholders are intertwined in this crisis. As it confronts this dual threat, management should review with the board the viability of the enterprise from short-, medium-, and long-term perspectives in order to ascertain that corporate strategies are in place, with the board being updated as needed, to maintain that viability.

The board should work with management to understand the company's external obligations, including debt instruments and regulatory requirements, along with the timelines for company action and any changes thereto. Debt obligations may include bank and bond financings, lines of credit, availability of revolvers, and key covenant terms. Regulatory obligations may include reporting requirements, deadlines for certain actions, and industry-specific requirements or company-specific obligations. In particular, management should discuss with the board whether any contractual obligations under existing debt instruments, or any newly applicable reporting requirements, could foreseeably arise as a result of material changes to the company's business and financial position during the COVID-19 crisis.

Liquidity will be a critical concern for many American businesses in the coming weeks and months. The board should be made aware of any near-term liquidity needs that may arise as a result of the crisis and oversee management's efforts to secure liquidity needs. A number of companies, with the support of their boards, have drawn down their bank lines in order to maximize the availability of cash during this difficult time. The board should actively debate the merits of doing so, while discussing with management the potential signals this step could send to customers, regulators and investors. As part of its review, the board should work with management to evaluate the company's current and future dividend and stock buyback policy as well as capital allocation and liquidity generally.

The board should review compensation plans and work with management to consider whether changes are required, particularly with respect to equity arrangements, unforeseen employee cash needs, and mission-critical personnel. Given the significant erosion in stock prices, the board, together with its compensation consultant and senior management, should consider whether alternative arrangements are appropriate in the current circumstances.

The board and management should work closely together to understand any potential strategic threats and opportunities that may emerge as a result of the global financial and economic turmoil that is expected over the coming months. The board should oversee management's response to activist attacks or other actions by those seeking to take advantage of the current situation in order to promote their own agenda. The management team and the board should also consider the threat of unsolicited potential takeovers to the extent a company's stock price has declined significantly. Management may wish to use this opportunity to update the board on takeover tactics and potential responses, including reviewing the potential utility of a shareholder rights plan (also known as a poison pill). While the decision to implement a shareholders rights plan will be case-specific, there is a significant benefit to having a poison pill "on the shelf" so that it can be timely adopted under appropriate circumstances.

Management should also brief the board regarding potential opportunities for transactions that may become available due to changed market circumstances. In times of crisis, there are often opportunities to pursue transactions that may fundamentally reshape a company's industry and trajectory. There may be opportunities for companies with greater liquidity and flexibility to acquire businesses that are struggling to survive. It is to be hoped that a number of acquisitions in coming months will not only make strategic sense for the acquiring entities but also preserve the target businesses as ongoing concerns, to the benefit of stakeholders and beyond.

Federal legislation intended to mitigate the widespread damage to American business is likely to be passed and implemented on a highly accelerated timetable. Once the legislation is finalized, management should brief the board as to the legislation's expected effect on the company and its competitors in the

relevant industry. The implementation of this legislation creates another set of uncertainties, particularly given the scale of the federal government's intervention across the national economy, and the board should receive updated briefings as needed. To the extent that a company chooses to avail itself of government resources, the board and management need to understand any limitations that will be placed on the company as a result. For example, limits on executive compensation, stock buybacks, or dividends may be the cost of receiving government assistance in the COVID-19 crisis.

The decisions facing companies at this time are terribly difficult and painful. It will be crucial for the board and the management team to maintain an atmosphere of respect and shared concern in order to promote effective decision-making in this period of great stress. The board should be careful to resist any temptation to usurp the role of management in running the company's day-to-day business and addressing the challenges resulting from the COVID-19 pandemic. Corporate America finds itself now in uncharted territory, and the ramifications of the crisis and the nationwide response are unknowable factors. While there may be substantial second-guessing once the COVID-19 crisis is past, directors should take comfort that the business judgment rule applies to board decisions regardless of how they appear in hindsight. The board is called to fulfill its oversight role to the best of its ability. Directors who act on an informed basis, in good faith, and in the honest belief that their decisions are in the company's best interests will continue to have the protection of the business judgment rule.

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