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Top 10 Topics for Directors in 2020: Economic Downturn

Jan 22, 2020

Reading Time : **3 min**

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To prepare for these challenges, directors should be familiar with general legal and practical principles associated with operating in a low liquidity environment.

Evaluate Evolving Conditions

Directors should ensure that informational systems and controls are reviewed and established to ensure that management provides timely, accurate and complete financial and operational information to board members. Corporate directors should carefully review any information provided by management and insist upon clear and unambiguous answers to any questions raised by such review and consider whether the timing and content of board updates should be modified to address the evolving situation.

Any early signs of financial distress should be addressed with appropriate operational and reporting changes, and may merit an evaluation of available restructuring options with independent advisors.

Understand Fiduciary Duties

While directors are undoubtedly aware of their fiduciary duties, they should also consider that a weak economic environment may enlarge the group of stakeholders with standing (and motivation) to bring a derivative claim for breach of fiduciary duty.

In Delaware, for example, creditors gain standing to bring such a claim when a company becomes insolvent as judged by the company's balance sheet. Against the backdrop of such suits and the shifting group of stakeholders to whom corporate directors may become responsible, they should rely on external counsel to provide advice on the scope of their duties.

An important defense against allegations of breached fiduciary duty lies in scheduling regular board meetings and keeping well-developed records showing the board's consideration of various alternatives and input from advisors.

Review Access to Capital and Existing Restrictions

To decrease the likelihood of a liquidity crunch or crisis, corporate directors should understand the contractual restrictions imposed on their business's ability to raise capital. These include limitations arising from lending agreements or agreements with shareholders.

Further, debt covenants under financing documents should be continually reviewed to provide warning signs regarding defaults or thin cushions, and/or to prompt early negotiations in the event of changing financial conditions.

Retain Independent Advisors

Retaining experienced, independent advisors in advance of a financial emergency can help preserve enterprise value and prevent worst-case scenarios. Restructuring attorneys, turnaround advisors and financial advisors each have a role in navigating complicated financial situations and creating or evaluating potential restructuring plans.

Review Terms of D&O Insurance

Working with knowledgeable subject matter experts, corporate directors should carefully review their directors and officers (D&O) insurance policies to identify provisions which may be implicated by financial distress or a potential restructuring.

Side A coverage, which provides direct coverage for individual directors and officers when the company is legally unable or unwilling to indemnify them, may be reviewed to:

- Identify whether Side A payments have priority over payments under Side B (reimbursement to a company for indemnity payments it makes on behalf of directors or officers) or Side C (payments to the company for securities claims) coverages
- Ensure that any proceeds related to Side A coverage are explicitly the property of the covered director

- Confirm that such coverage will not be impacted or rescinded by a potential restructuring transaction.

It's also a good idea for corporate directors to examine the coverage exceptions to insured-versus-insured (IvI) exclusions to determine whether potential suits commenced in connection with a restructuring transaction would be subject to the exclusion (and thus exempted from coverage). And corporate directors should consider seeking appropriate tail coverage in the event of a restructuring transaction that may trigger the termination of a D&O policy.

Plan an Orderly Restructuring

Transactions that impact a company's capital structure can take a variety of forms and should be specifically tailored to fit a business' needs and circumstances. Whether implemented as an out-ofcourt transaction (such as a debt-for-equity exchange or capital commitment transaction) or a Chapter 11 filing (prepackaged, pre-arranged or otherwise), restructuring transactions can take significant time and resources to plan, negotiate and implement.

Out-of-court negotiations with creditors and stakeholders can be contentious and complicated, while in-court deliberations will be subject to public and judicial scrutiny. As a practical matter, corporate directors should plan for restructuring transactions to take several months to complete. This timeframe, in the context of immediate capital needs and possibly worsening financial situations, makes early preparation and a clear, orderly process essential to maintaining control throughout a restructuring transaction.