

## Global Financial Crisis Advisory: Navigating the Current Financial Crisis

10/31/2008

### Topics Identified in This Alert

Are you a takeover target?

Is it time to consider repurchasing some stock?

Are your cash reserves and liquid investments safe?

Are your employee stock options underwater?

Are you contemplating a reduction in workforce?

Under pressure from short sellers?

Is the government calling?

Directors: Do you know where your fiduciary duties lie in troubled times?

The ongoing financial crisis continues to have a profound effect on the U.S. and global economy. Frozen credit markets, tumbling stock prices, the rising costs of raw materials, and consumer uneasiness, among other things, have combined to create a toxic environment in virtually all business sectors. Management teams and boards of directors are challenged each day by new problems and pressures.

Our clients are not immune to the effects of this unprecedented global crisis. We have been working with many of them daily, assisting them in taking the steps and making the critical decisions that will enable them to ride out the current storm and, perhaps, emerge stronger when the economy settles. The following are just some of the issues with respect to which we have provided support and counsel to our clients.

### Our stock has hit an all time low. We may be subject to an unsolicited offer or takeover attempt.

With stock prices at historic lows, many companies may become attractive acquisition candidates for larger, better capitalized companies in their respective industries. Yet a sale of the company at a bargain price may not be in the best interests of stockholders.

Stockholder rights plans and other protective measures are designed to enable a company's board of directors to evaluate and respond to an unsolicited acquisition overture without duress. However, protective measures taken in response to a specific acquisition proposal may be invalidated by courts. Therefore, it is best to implement appropriate protections before a potential acquiror makes an offer. It is also prudent to educate management and the board as to the proper procedures to follow if a potential acquiror calls.

### We are considering repurchasing some of our stock. What should we be thinking about?

There are myriad corporate and regulatory issues to consider when planning a stock repurchase program. A company must have adequate surplus available in order to repurchase its shares. A repurchase program that impairs a company's capital could lead to personal liability for the directors approving it. Loan agreements and other documents may contain restrictions on the repurchase of securities. Several securities laws, including Rule 10b-18 and Regulation M under the Securities Exchange Act of 1934, and the rules and regulations of the company's principal trading markets, are brought into play. Adopting proper procedures for implementing a repurchase program is therefore critical to its success. Other issues, such as the program's impact on the company's public float and stock exchange or stock market listing, must also be considered.

### Are our cash reserves and other liquid assets safe?

There has been a lot published regarding the safety of various investments and accounts held at various financial institutions. When shares of the Reserve Privacy Fund, a large money market fund, recently "broke the buck" and began trading below the standard \$1 per share, the federal government stepped in to guarantee amounts held in money market funds on September 19, 2008. Not everyone understood that amounts transferred into such funds after September 19th would not be protected. It is also important in the current environment to understand the differences between holding securities in one's own name as opposed to street name, the limits of protection afforded by the FDIC and SIPC, the use of multiple accounts to expand insurance limits, and other forms of protection that may be available.

### All of our employee stock options are currently underwater which is having a serious impact on the morale of our work force. Is there anything we can do?

Many of our clients are beginning to explore ways to continue to motivate employees through changes to outstanding equity compensation arrangements, from amending provisions of outstanding stock options to reduce their exercise prices to swapping underwater stock options for new equity incentives. Boards will need to review their fiduciary obligations when considering changes and be mindful of stockholder perception. Companies need to review their stock plans and the terms of their outstanding grants to determine what can be done and whether stockholder approval will be required. In addition, companies will need to be mindful of the various laws, rules, and regulations governing these arrangements such as tax laws, securities laws (including whether any exchange would be deemed an issuer tender offer requiring the filing and review by the SEC of a Schedule TO under Rule 13e-4 under the Securities Exchange Act of 1934), and the corporate governance rules of the company's principal trading market. The expense under the accounting rules associated with any changes must also be considered. Lastly, any changes that are made must be disclosed timely and accurately in a company's public filings.

### The downturn in the economy has resulted in a significant decline in our business, requiring a reduction in our work force. What issues must we consider in effecting the necessary layoffs?

A reduction in force may be unavoidable but compliance with federal and state employment laws is not. Employers considering a reduction in force should consult counsel regarding the application of the Worker Adjustment Restraining and Notification Act (WARN), which applies to employers with 100 or more employees. WARN may require that certain advance notice be provided to employees before a reduction in force may take place. In addition, employers must be mindful of the impact of federal and state antidiscrimination laws on layoff decisions. In addition, employers struggling to meet payroll and provide benefits should consult counsel regarding the legal limitations and requirements with respect to payroll obligations, as those obligations may impose personal liability on officers and directors in certain states. The earlier employment and benefits counsel is involved in the reduction and closure process, the better we are able to assist an employer in implementing the process and mitigating any liability that may arise along the way.

### Our stock has been under pressure from short sellers. Is there anything we can do?

Short selling, the practice of selling a financial instrument that the seller does not own with the intent of later purchasing it at a lower price, can have a significant adverse impact on the market price of a company's stock, particularly one with a limited public float and trading volume. Short selling may be employed when investors believe the stock of a particular company is overpriced. It may also be employed, however, to drive down the price of a thinly traded stock so the short seller can profit when purchasing the shares at the depressed price.

Companies subject to excessive short selling have employed several measures in response, including threatening and pursuing legal action, requesting that authorities investigate the activities of short sellers, and taking various steps designed to make borrowing shares to fill short positions more difficult. Care must be taken, however, not to send the wrong signals to the market, which could inadvertently prompt further selling of the company's stock.

For more information on short selling, see our previous alert, *Global Financial Crisis Advisory: SEC Extends Emergency Short-Sale Restrictions and Reporting Requirements*.

## Several companies in our industry have become targets of governmental investigations. What should we do if a government agency knocks on our door?

Well before the government comes knocking, companies should have protocols in place for handling a subpoena or other government request, including identifying the appropriate person within the organization to notify about the request. That person should immediately coordinate with outside counsel experienced in governmental investigations to liaise with the government investigators to determine the corporation's status in, and the nature and focus of, the investigation. Outside counsel will also advise on document retention and, if appropriate, begin its own investigation to identify and address any problems or vulnerabilities the company may have, enabling the company to put its best foot forward with the government.

## I am a director of a company that is experiencing some difficulty. Is there any change in my obligations under these circumstances? Do I have adequate protections in place to shield me from liability?

The directors of a financially sound company have fiduciary duties to the company's stockholders. However, as the company approaches the "zone of insolvency," the directors' duties shift and the directors become responsible for preserving the company's assets for the benefit of creditors. It is important to understand these disparate duties, including when they arise. Directors who are allied with certain investors in the company who may be willing to inject additional capital in order to keep the company afloat must also understand the various conflicts of interest that are likely to arise and how they are best dealt with. Finally, the time may be ripe to review the various protections in place for the directors and officers (*i.e.*, certificate of incorporation and by-law provisions, indemnification agreements, and directors' and officers' liability insurance policies) to determine their adequacy under present circumstances.

## Conclusion

The landscape is changing daily, giving rise to new issues and challenges. We have formed interdisciplinary teams of attorneys to assist our clients in addressing the changes in regulatory framework and market conditions in order to turn challenge into opportunity.

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