A Path Forward in Uncertain Times

Webinar Series:
Issues Facing Public Company Boards

What's Next?
A Path Forward in Uncertain Times

Moderator:

Rick Kline

Partner, Silicon Valley
Tech / Life Sciences

Panelists:

Deborah Birnbach

Partner, Boston
Sec White Collar &
Business Litigation

Lynda Galligan

Partner, Silicon Valley
Tech / Life Sciences

Joseph Johnson

Partner, Boston
Tech / Life Sciences

Danielle Lauzon

Partner, Boston
Tech / Life Sciences

Maggie Wong

Partner, San Francisco
Tech / Life Sciences

Board Of Directors Oversight and Role in Disclosures

The Intersection of Fiduciary Oversight Duties and Securities Law Disclosure Obligations

Deborah Birnbach

Fiduciary Oversight and Securities Law Disclosure Obligations

- Fiduciary Duties
  - Duty of Care: to inform yourself of all material information reasonably available before making a business decision
  - Duty of Loyalty: to put interests of corporation above the director's own self-interest; to operate in good faith and avoid bad faith through gross negligence; showing of bad faith on part of fiduciary requires an "extreme set of facts to establish that disinterested directors were intentionally disregarding their duties or that the decision… [was] so far beyond the bounds of reasonable judgment that it seems essentially inexplicable on any ground other than bad faith."
- Section 10(b) of Securities Exchange Act of 1934 and Rule 10b-5
  - Unlawful to make any untrue statement of a **material** fact or to omit to state a **material** fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading
- Directors' Oversight Duties in the Wake of Clovis Oncology
- Managing Disclosure Obligations - Best Practices

Big Picture: Why is Clovis Making Waves in Boardrooms?

- *Clovis* appears to represent a refinement of the *Caremark* standard for Board of Director oversight of the mission-critical operations of a company subject to external regulations, particularly for life sciences or other regulated companies
  - "When a company operates in an environment where externally imposed regulations govern its 'mission critical' operations, the board's oversight function must be more rigorously exercised."
  - "The careful observer is one whose gaze is fixed on the company's mission critical regulatory issues."
- In letting a case survive an initial motion to dismiss the complaint, court found that shareholder plaintiff stated a claim for breach of fiduciary duty
- There was a reasonable inference that Clovis' directors consciously ignored red flags that management was publicly reporting data from clinical trials in a manner that was inconsistent with the clinical trial protocol and FDA guidance

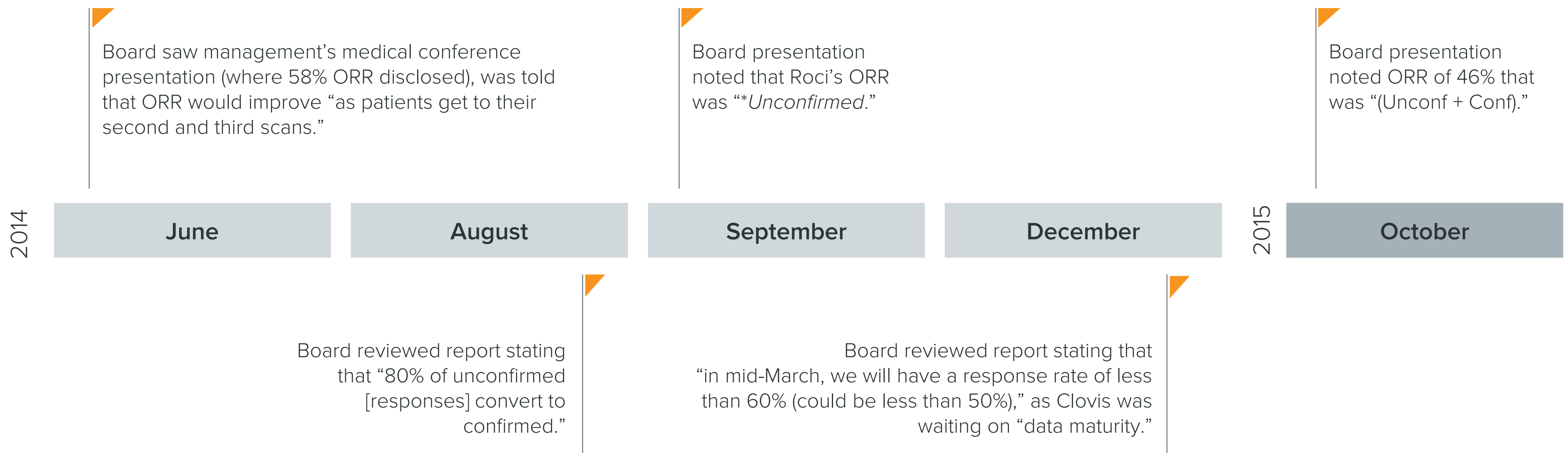
Clovis Was Developing Roci, A Lung Cancer Drug

- Roci would be an alternative to the front-line treatment for lung cancer
  - FDA granted breakthrough therapy designation in May 2014
  - Estimated $3 billion annual market
- Astra Zeneca was developing a competitor drug
  - Clovis's CEO on an earnings call: "We are in a race. They are a very able competitor with an active drug."
- Roci's clinical trial, where success was measured by the objective response rate (ORR), which is the percentage of patients who experience clinically meaningful tumor shrinkage when treated with the drug
- Trial standards called Response Evaluation Criteria in Solid Tumors (RECIST)
  - "Confirmation of response is required for trials with response primary endpoint."
  - "Complete or partial responses may be claimed only if criteria for each are met at a subsequent time point as specified in the protocol (generally 4 weeks later)."
- Clinical trial protocol required confirmation scans to be performed 4-6 weeks after an initial response

Clovis Reports ORR Key Number Without Disclosing That Calculation Includes Unconfirmed Responses

- Between May 2014 and April 2016, Clovis management publicly reported an ORR of *approximately 60%*
- Clovis relied on the 60% ORR to raise $316 million in a secondary offering in July 2015
  - "*At the recommended dose of 500mg BID, an overall response rate, or ORR, of 60 percent* and a disease control rate, or DCR, of 90 percent was observed, and across all doses a 53 percent ORR and 85 percent DCR was observed in heavily pretreated, centrally confirmed tissue T790M-postitive patients."
- The 60% ORR also kept Clovis on pace with Astra Zeneca, which was reporting a similar ORR for its drug.
- Roci's **final confirmed ORR** - the only one that mattered for the clinical trial's success or failure turned out to be closer to **30%**.

Fiduciary Duty Lawsuit Alleged Board of Directors Ignored Red Flags that ORR Calculation Included Unconfirmed Responses



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The Fallout

- November 16, 2015: Stock price falls 70% from $99.43 to $30.24
- November 19, 2015: Four federal securities class actions filed against Clovis and officers
- April 12, 2016: FDA's Oncological Drug Advisory Committee (ODAC) votes 12-1 to delay action on Roci's NDA until Clovis could show a more favorable risk / benefit profile
  - ODAC concluded that Roci failed to show any clinically meaningful advantage over available therapies, especially over Astra Zeneca 's drug
  - Clovis ends development of Roci
- May 31, 2016 & December 15, 2016: Clovis stockholders submit Section 220 demand for books and records that yields approximately 3,000 pages of documents. Strong weapon
- February 9, 2017: Colorado federal court largely denies motion to dismiss consolidated federal securities class action
- March 23, 2017: Derivative complaint filed in Delaware against Clovis' directors
- October 26, 2017: $142 million in cash and shares settlement of securities class action
- September 18, 2018: SEC files complaint against Clovis and CEO / CFO, resulting in more than $20 million in civil penalties against Clovis and penalties / disgorgement for officers
- November 19, 2018: Delaware plaintiffs move to amend derivative complaint to incorporate SEC enforcement action

Directors’ Duty of Oversight

- Directors of Delaware corporations have a duty to oversee and monitor the company’s viability, legal compliance, and financial performance
- Not a separate fiduciary duty - associated with the duty of loyalty because liability is only imposed if directors fail to “attend to their duties in good faith.” A “showing of bad faith is a *necessary condition* to director oversight liability.”
- Directors do not get the benefit of exculpation charter provisions for breaches of the duty of oversight
- Decades ago, the Delaware Supreme Court tipped the scales in favor of directors when it ruled that directors can assume the “honesty and integrity of their subordinates” and have “no duty… to install and operate a corporate system of espionage to ferret out wrongdoing which they have no reason to suspect exists.”
- In the 1996 *Caremark* decision, the Court of Chancery narrowed that deferential view by finding that directors do have a duty to “attempt in good faith to assure that a corporate information and reporting system, which the Board of Director’s concludes is adequate, exists”-giving rise to the so-called “*Caremark* claim.”

The Standard for Caremark Claims

- *Caremark* claims are among the hardest to plead and prove: Directors must have known that they were not discharging their fiduciary obligations-"possibly the most difficult theory in corporation law upon which a plaintiff might hope to win a judgment."
- Plaintiffs can support a *Caremark* claim under one of two prongs:
  - The directors utterly failed to implement any reporting or information system or controls; or
  - Having implemented such a system of controls, the directors consciously failed to monitor or oversee the company's operations, thus disabling themselves from being informed of risks or problems requiring their attention
- Directors will not be liable solely because an oversight mechanism fails, or a reporting system is ineffective; rather, plaintiffs must plead and prove bad faith, which arises only when the Board of Director's consciously disregards its responsibility to look for or monitor risks

Marchand v. Barnhill: Failure to Implement Reporting System

- Reasonable inference that directors of Blue Bell ice cream company facing *listeria* outbreak at manufacturing facilities did not "make a good faith effort-*i.e.*, try-to put in place a reasonable board-level system of monitoring and reporting"
- Delaware Supreme Court credited complaint's allegations of the lack of reporting system before the *listeria* outbreak:
  - No board committee that addressed food safety;
  - No regular process or protocols that required management to keep the Board of Directors apprised of food safety compliance practices, risks, or reports;
  - No schedule for the board to consider on a regular basis any key food safety risks;
  - No suggestion that there was any regular discussion of food safety issues;
  - During a key period leading up to the deaths of three customers, management received reports that contained red, or at least yellow, flags, and the board minutes from the relevant period revealed no evidence that these were disclosed to the board; and
  - The board was given certain favorable information about food safety by management, but was not given important reports that presented a much different picture

Clovis: No Viable Caremark Claim Under Prong 1, But…

- Clovis' directors accused of breach of fiduciary duty for failure to oversee the Roci clinical trial and by allowing Clovis to mislead the market regarding Roci's efficacy
- "It is difficult to conceive how Plaintiffs would prove the Board had no reporting or information system or controls."
  - Board's Nominating and Corporate Governance Committee "specifically charged" with "providing general compliance oversight… with respect to… federal health care program requirements and FDA requirements."
  - "The Board… reviewed detailed information regarding [Roci's] TIGER-X trial at each Board meeting."

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Clovis: Viable Caremark Claim Under Prong 2

- Delaware Court of Chancery interpreted *Marchand* as imposing a heightened duty to oversee mission-critical risks facing highly regulated companies
  - "As *Marchand* makes clear, when a company operates in an environment where externally imposed regulations govern its 'mission critical' operations, the board's oversight function must be more rigorously exercised."
  - "As *Marchand* makes clear, the careful observer is one whose gaze is fixed on the company's mission critical regulatory issues."

Clovis: Viable Caremark Claim Under Prong 2 (contd.)

- Critical conclusion of court → "ORR was the crucible in which Roci's safety and efficacy were to be tested. Roci was Clovis' mission critical product. And the Board knew, upon completion of the… trial, the FDA would consider only confirmed responses when determining whether to approve Roci's [New Drug Application] per the agency's own regulations. *As pled, these regulations, and the reporting requirements of the RECIST protocol, were not nuanced. The Board was comprised of experts and the RECIST criteria are well-known in the pharmaceutical industry.* Moreover, given the degree to which Clovis relied upon ORR when raising capital, it is reasonable to infer the Board would have understood the concept and would have appreciated the distinction between confirmed and unconfirmed responses. The inference of Board knowledge is further enhanced by the fact the Board knew that even after FDA approval, physicians (i.e., future prescribers) would evaluate Roci based on ORR."
- Court rejected fact-based arguments raised by defendants at motion to dismiss stage, including:

Best Practices for Boards of Directors

- Identify categories of risks that are “mission critical” at least annually, update to Board of Director or committee regarding the status of any identified priority risk mitigation
- Evaluate protocols and procedures to ensure information flow to directors about mission-critical risks
  - Regular agenda items (at full board meeting or at a standing committee that reports back to the Board of Directors)
  - Set expectations for management, include non-executive employees with expertise at board meetings and regular presentation items and / or pre-read materials on key risk areas
- Consider Board of Directors expertise - adequate background to assess mission-critical risks
- Encourage director engagement through questions or discussions
- Assess documentation of Board of Directors discussions (a Section 220 books and records demand is an effective tool for plaintiffs), including director engagement, informal discussions between meetings noted in next meeting minutes, consider level of detail of discussion topics
- Review board materials with counsel in real time (the written record will be scrutinized after-the-fact by plaintiffs’ attorneys and courts)

Executive Compensation

Lynda Galligan

Executive Compensation Considerations

- Rethinking Compensation Programs Generally
  - Compensation Philosophy
  - Compensation Mix
- Performance Metrics for Cash Bonus Plan and Performance-Based Equity
  - Alternatives for 2020
  - Metric setting going forward
- Succession Planning
- Executive Retention Considerations
  - Increasing vs Declining Equity Values
  - Unintended Consequences
- Disclosure Implications
- Compensation Planning for Potential M&A

Shareholder Activism + Poison Pills

Joseph Johnson

A Brave New World

- The Impact of COVID-19 Pandemic on Public Companies
  - The extreme market volatility and share price dislocation resulting from the COVID-19 pandemic has changed the corporate landscape
  - M&A activity is down over 50% year over year and previously announced deals are being terminated at levels reminiscent to the Great Recession
- Short Term Landscape
  - Other than activist campaigns underway prior to the COVID-19 pandemic, activist activity is expected to be low due to both logistical and optical reasons
  - Activists will be challenged to gain the attention and support of investors for long term activist thesis
- Long Term Landscape
  - Activism and unsolicited M&A will be at all-time highs
  - While the reasons for market turbulence today are different than in the 2008 financial crisis, the return of activism and hostile M&A activity may follow a similar trend. Following the 2008 financial crisis the number of proxy fights and unsolicited M&A transactions increased by almost 50%
  - As one prominent activist advisor notes, *"once the dust settles and market valuations reflect reality, underperforming companies will be exposed, creating major opportunities for activism. In the short term, investors should position themselves opportunistically to take advantage of this future potential."*
  - Or more aptly as that preeminent M&A advisor William Shakespeare said "Cry Havoc and Let Loose the Dogs of War."

Gender Diversity is a Key Issue

- Many large investors have indicated that they will vote against or withhold their votes from directors due to a lack of gender diversity. For example, BlackRock has publicly stated that it expects to see at least two women directors on every board and reported that in 2019 it had voted against 52 Russell 1000 companies that did not satisfy this criteria. State Street Global Advisors (SSGA) advised that it will vote against all members of the nominating and / or governance committee that fail to take action to increase the number of women on their Board of Directors and reported that by early March 2019 it had voted against more than 400 companies for failure to demonstrate progress on Board diversity in the previous year
- CalPERS engaged more than 500 US companies in the Russell 3000 index regarding lack of Board of Directors diversity and adopted a Board Diversity & Inclusion voting enhancement to hold directors at these companies accountable for failure to improve diversity on their boards or diversity and inclusion disclosures. CalPERS reported that through May 2018 it withheld votes or voted against 271 directors at 85 companies as a result of board diversity concerns
- California recently enacted a law that requires publicly traded companies headquartered in California (including those incorporated in Delaware and other states to have at least:
  - Two women on the board of Directors by December 31, 2021 for companies with ≤ 5 directors
  - Three woman on the board of Directors by December 31, 2021 for companies with 6+ directors

(penalties for noncompliance are $100K in the first year of violation and $300K for every subsequent year)

Gender Diversity is a Key Issue

- **ISS**: Beginning in 2020 for companies in either the Russell 3000 or S&P 1500 indices, ISS issued negative vote recommendations against nominating committee chairs if the board does not include at least one female director or make disclosure of mitigating factors or plan for addressing the lack of female representation. Board diversity is tracked in ISS QualityScore ratings
- **Glass Lewis**: Beginning in 2019, Glass Lewis issued negative vote recommendations against nominating committee chairs if the board does not include at least one female director or disclosure of a cogent explanation and / or plan for addressing the lack of female representation
- Companies that ignore gender diversity do so at their peril. This is a key issue for institutional investors whether or not there is an activist threat. Stockholders will expect boards to have considered this issue and developed a strategy for achieving gender diversity
- Investors will continue to focus on this issue in the future and companies will be expected to have developed a long-term plan of how they will address this issue in the future, and additionally will be expected in the future to have gender diversity in board leadership positions
- Companies are expected to provide public disclosure regarding these considerations and strategies

The Activist Playbook

Activists Typically Follow Well-Established Escalation Strategy

- Activists generally travel together. The wolfpack follows the lead activist into the stock
- Significant turnover of shareholder base following activist announcement of stake. With stock price increase following activist announcement, historic investors exit the stock and are replaced by "event driven" investors
- Activists use the media (and social media) to communicate their case / intentions and put pressure on the company

Increasing Active / Hostile

Accumulation of Stake

- Slowly accumulate initial stake to establish "toehold" without moving price.
- Often accomplished through derivatives to avoid public disclosure required by HSR and SEC rules
- Once public disclosure of stake is made, the activist converts derivatives into actual shares

Public Announcement of Stake

- Announce position through filing a 13D
- Depending on investment strategy, the 13D includes a presentation / letter to the board explaining investment rationale
- Request meeting with Lead Outside Director / board

Public Campaign

- Solicit support of other shareholders
- Public disclosure of letters or "white paper" further explaining investment thesis and / or attack "entrenchment" / nonaction by the Board

Proxy Fight

- Submission of nominees to replace existing directors
- Proxy contest to elect activist nominees

GOODWIN

Steps After an Initial 13D Filing Designed to Increase Pressure on Management and the Board of Directors

- Continue to accumulate shares
- Increase intensity of engagement with the Company
- Encourage current shareholders to support activist agenda
  - Cultivate sell-side commentary in favor of expanded capital return
  - Develop and cultivate relationships with top institutional shareholders
- Encourage other like-minded shareholders, including activist funds, to enter the stock
  - 13D filing will trigger significant churn in the shareholder base
  - Activist may have numerous "followers" in the activist fund community
- Continue to publicly attack the Company's performance or failure to take action in response to activist's demands
  - Directly or indirectly through media briefings, social media and sellside analyst notes
- Publicly issue white paper or presentation highlighting their thesis
  - Letter implies detailed presentation is already complete
- Seek Board of Directors change by nominating directors at next annual meeting

Considerations When Meeting an Activist

Rules of the Road

Objectives & Considerations

- Demonstrate a company's willingness to engage in constructive discussions with shareholders
- Convey that a company's Board and management team are committed to creating long-term shareholder value
- Convey confidence in a company's strategic plan and management's ability to execute that plan
- Gain a better understanding of the activist objectives and thesis regarding a company
- Correct any significant misperceptions the activist may have about a company
- Avoid offering any information or sound bites that could potentially be used against a company, especially if taken out of context

Potential Questions to Ask

- What is your current (in shares and derivatives)? Do you expect to increase your investment
- What informed your views on a company?
- Have you spoken to other companies in our space? What is your view on the sector and our peers? Who do you define as our peer group?
- What is your approach to investments like this? What is your typical holding period for this kind of investment?
- What are the key financial returns, operating metrics, etc., you focus on when evaluating companies? What do see as the key drivers of success in the industry?
- What is your view of the industry in terms of current opportunities and risks? What about specifically for a company?
- Where do you see the industry in a year? Five years?
- What are the financial assumptions underlying your investment thesis? How did you come to these assumptions?
- Have you discussed your investment with any of our other shareholders?
- What else should we know about your views?

Considerations When Meeting an Activist (cont.)

Key Do's and Don'ts - Remember that Nothing is "Off-the-Record"

WHAT TO DO OR SAY...	WHAT NOT TO DO OR SAY...
Listen carefully. Create a record of willingness to engage in constructive discussions	Do not say anything you would not want to see in a subsequent SEC filing and / or letter to shareholders. Anything you say can and will be used against you in the court of public opinion
Ask questions whenever appropriate. It's one way to show a willingness to engage, while potentially learning a lot	Do not provide material, non-public information (e.g., future plans for strategic actions)
Keep a neutral tone and an open mind. Drawing hard lines in the sand at this point will not serve the Company well	Do not provide commentary or your personal opinion about a potential board decision or proposed action
Frame responses in terms that are consistent with the Company's focus on shareholder value and listening to all investors	Do not give timelines for specific objectives or make any firm Commitments
When pressed, fall back on responses you feel comfortable with (and have rehearsed) from earnings calls and typical investor meetings	Do not speculate or respond to hypothetical scenarios
If asked about items such as governance or board representation, indicate that those decisions are the domain of the board and that you will relay discussions on these topics back to the appropriate parties	Do not promise future meetings with the board or management. Respond by saying, "We will bring your concerns to the rest of the board."
If any specific proposals or suggestions are made, or a subsequent meeting with board members is requested, respond by saying that you will escalate the proposal or request in a timely manner	Do not reveal timing of board meetings or information about how the board operates
Control the timing of next steps. Do not commit to any particular timetable for a response or provide the schedule of the next board meeting (commit only to conveying their proposals back to the board • "I hear your views and will be sure that the board is aware of them." • "I will pass that on to the board." • "I will get back to you as soon as practicable."	Do not use language, provide commentary, or state anything definitive regarding any proposals (at least at this time)
Adhere to Regulation FD in all communications. You can only discuss information that is already in the public record, so avoid discussing future plans, financial estimates, board meeting dates, etc.	Do not say that you agree with all or part of their thesis or proposal
	Do not say: "Our company is not for sale."

Considerations When Meeting an Activist (cont.)

Illustrative Opening and Closing Remarks, as well Transition Phrases to use During Meeting

Opening Remarks

- We appreciate the opportunity to speak today
- We value feedback from shareholders and welcome constructive dialogue
- Since you requested the meeting, we'll turn it over to you. Where would you like to start?

Transition Phrases (to be used as needed throughout meeting)

- We are focused every day on enhancing the value of a Company
- Can you help us understand why you think this?
- I'd like to hear what leads you to that conclusion…
- I'd to better understand your views…
- The way we look at that is…[on material items, keep to previously publicly disclosed information]
- We appreciate your perspective on that; we'll be sure that it is shared with the full board…
- If asked about board-related decisions: It is not appropriate for us to get ahead of the full board, but we will make sure to share your thoughts with them…

Closing Remarks

- Thanks for taking the time to speak with us today
- Our focus remains on doing what we believe is in the best interests of the Company and all company shareholders
- If appropriate: I will pass along your perspective to the full board
- We appreciate the discussion and hope to maintain a constructive dialogue with you
- If Asked About Next Steps / Another Call / Meeting: We'll circle up over here and will be sure to get back to you

Engagement Roles Involving Live Activist Situations

Management

In most situations, the CEO is the primary point of contact

- Often times, the head of IR will be part of the discussion as well

Board of Directors

Not typical for Board of Directors to be engaged in detailed dialogue with activists for a variety of reasons initially - as the relationship progresses the Lead Independent Director (and sometimes others) may be involved

- Activists typically try to get management on their side and prefer constructive engagement as opposed to a more hostile approach of asking to speak with Lead Independent Director / other Directors
- Reg. FD issues
- Should the Campaign go to a proxy contest the board will ultimately become very involved in shareholder / proxy advisor solicitation process

Critical for company to speak with **one voice** in order to show the activist(s) there is “no daylight” between management and board and minimize weaknesses / points for attack

Activist Outreach to Board Member

Guidelines for Directors if Approached

- General posture should be “listen-only” mode with an eye to ending the conversation quickly - keep tone polite and courteous
- Suggest activist reach out directly to IR and immediately inform the board of the interaction
- Assume any response or discussion, even if private, will be made public

Director Talking Points

- Thanks very much for reaching out
- As I hope you can appreciate, we have a standard process by which we engage with our shareholders, and it wouldn’t be appropriate for me to get into further detail right now
- We’re open to hearing the views and perspectives of our shareholders and factor them into our decision making process
- Let me take down your contact information and I’ll make sure that the appropriate person gets in touch
- If I’m sorry, I’m attending to a personal matter at the moment. Let me take down your contact information and I’ll have the appropriate person get back to you

Board of Directors Meeting with Activist - Potential Response Options

- Demonstrate that the Board of Directors and management are fully aligned and convey confidence in a company's strategic and financial plan
- Reinforce that a company:
  - Regularly reviews its strategy in the context of the current operating environment
  - Remains laser focused on shareholder value creation
  - Values shareholder engagement and is open to feedback
- If asked about governance or board representation, indicate that you will relay any discussions on these topics to the full Board of Directors
- Avoid providing any information about timing of board meetings or how the board operates
- If any specific proposals or suggestions are made, or a subsequent meeting is requested, respond by saying you'll take it back to the full board and will get back to them in a timely manner
- Avoid providing sound bites that can be used against the board and / or management

How to win an Activist Fight

TOP 10 THINGS TO DO	TOP 10 THINGS NOT TO DO
Take the high road. Be dispassionate, focus on company's strengths and only use objective facts to undermine the dissident's position	Be defensive or engage in personal attacks. Do not do things that are emotionally satisfying, but may lose votes
Maintain tight team communications. Internal and advisory teams speak with one voice, maintain tight confidentiality, and ensure frequent updates to keep all team members abreast of developments	Create the perception that management dominates the company or the board is not fully engaged
Define your core messages. Shareholders are most focused on company performance, so set clear proof points on strategy, operational and financial success and use them relentlessly	Appear closed to alternatives or refuse to interact with the dissident
Be measured in your response. Not every argument requires a rebuttal; too many messages may distract from your core strengths	Assume that shareholders or the media will see through spurious arguments made by the dissident
Be proactive. Identify and address potential vulnerabilities and consider counterstrategies along strategic, operational and governance axes	Rely on too broad of a set of messages or respond to every attack from the dissident
Keep your shareholders close. Maintain periodic contact, determine leverage points and processes within institutional investors, and determine whether shareholders are willing to go "on the record" on the behalf	Undertake fundamental strategic (e.g., acquisitions) or financial actions (e.g., equity financings) that are not mission critical during the fight
Be prepared for rapid response to escalation. Prepare relevant PRs, legal filings, and fight presentations to rapidly repel potential attacks, as appropriate	Change governance provisions or take other "tactical" actions that are viewed to disadvantage the dissident
Emphasize board independence and good corporate governance. Bring independent director(s) to investor and ISS meetings during proxy fights and strike a balance between competent and involved Board	Undertake fundamental changes to placate the dissident that are inconsistent with long-term strategic, operational or financial objectives of the company
Show a record of engagement. Do not ignore the dissident and be open to discussions. Maintain polite, back channel dialogue	Be inflexible in the face of shareholder dissent or new dissident attacks
Be nimble. Be prepared to adjust your approach based on shareholder feedback	Assume that a negative recommendation from proxy advisory firms is dispositive

Guiding Principles…

“If it feels really good, then it’s probably a bad idea”

“Everything must be viewed through the lens of:
“Does this win me a vote or lose me a vote?”
ALL shareholders are voters - not just the activist”

“Everything you say can and will be used against you in the court of public opinion”

Names to Watch for: The “WOLFPACK”

- Ancora Advisors LLC
- Barington Companies Investors
- Basswood Capital Mgmt
- Biglari Capital Corp.
- Blue Harbour
- Bulldog Investors
- Cannell Capital
- Carlson Capital
- Clinton Group
- Clover Partners
- Crescendo Group
- Discovery Group
- Eminence Capital
- Engaged Capital
- Engine Capital Mgmt
- Franklin Mutual Advisers
- FrontFour Capital Group
- GAMCO Investors
- Gilead Capital
- Glenview Capital Mgmt
- Highland Capital Mgmt
- JCP Investment Mgmt
- Karpus Investment Mgmt
- Land & Building Investment Mgmt
- Legion Partners
- Lone Star Value Mgmt
- Lucus Advisors
- Marathon Partners
- Marcato Capital
- Millennium Mgmt
- Neuberger Berman
- Northern Right Capital
- Osmium Partners
- Owl Creek Asset Mgmt
- PL Capital Advisors
- Potomac Capital Mgmt
- Privet Fund Mgmt
- Raging Capital Mgmt
- Red Mountain Capital Partners
- Saba Capital Mgmt
- Sandell Asset Mgmt
- Sarissa Capital
- Snow Park Capital
- Southeastern Asset Mgm
- Steel Partners
- Stilwell Value LLP
- TCI Fund Mgmt
- Tenzing Global Investors
- Veteri Place Corp
- VIEX Capital Advisors
- Voce Capital
- Western Investment
- Wynnefield Capital Mgmt

Shareholder Rights Plan Overview Amid COVID-19

Shareholder Rights Plans - Key Considerations

- Once the COVID-19 pandemic subsides, hostile takeover bids are likely to be at an all-time high
  - In this brave new world all companies are vulnerable to activist attacks and hostile takeover bids. Accordingly, Boards of Directors should review their existing takeover protections and understand their relevant fiduciary duties if they become subject to an activist attack or hostile takeover bid
- Shareholder Rights Plans continue to be effective tools to provide leverage and time to Boards of Directors to protect the long term interest of shareholders
  - A Shareholder Rights Plan is one of the few takeover defenses that can be implemented by board action (without shareholder approval at adoption) to protect against hostile takeover bids and creeping control acquisitions by activists and others
  - Significant levels of hostile activity and the threat of market accumulations by raiders and activists (including through total return swaps and other derivative technologies), combined with gaps in the regulatory reporting structures, have reaffirmed the efficacy of shareholder rights plans. Delaware courts have consistently upheld the adoption of rights plan in the face of takeover and activist threats

Shareholder Rights Plans - Key Considerations (cont.)

- While the number of companies with rights plans had declined prior to COVID-19, given the disruptive effect of the pandemic on companies market capitalizations, many boards are considering whether to either adopt a shareholder rights plan or put one “on the shelf.”
  - 64 companies have adopted poison pills in 2020 through June 17, compared with 18 in the whole of 2019 and 15 in 2018.[2]
  - Fifteen of the 64 pills adopted in 2020 were NOL pills
  - Of the 49 non-NOL pills:
    - All but six have a duration of 12 months or less - consistent with ISS guidance
    - Forty-one were adopted without an imminent threat from an activist or unsolicited bidder
    - Trigger thresholds: 2%(1); 2.25%(1); 4.9%(2); 5% (1); 10% (12); 15% (9); 20% (4); 5%/20%(1); 10%/12% (1); 10%/15% (2); 10%/20% (12); 15%/20% (2); and 32% (1)

Shareholder Rights Plans - Key Considerations (cont.)

- Many companies that do not have a Shareholder Rights Plan in place have rights plans documents prepared and "on the shelf"
  - The Shareholder Rights Plan is one of the few takeover defenses that can be implemented by board action (without shareholder approval at adoption)
  - Decisions regarding the adoption of the rights plan that are dependent on economic circumstances, such as exercise price, are deferred until the plan is taken down from the "shelf."
  - In the event of a specific takeover threat, the board meets with management and financial and legal advisors to determine whether it is appropriate to formally adopt the shareholder rights plan, which plan would typically expire at the Company's next annual meeting unless approved by shareholders
  - This approach affords the board the opportunity to adopt a shareholder rights plan quickly in the face of a specific takeover threat
  - Having a plan on the shelf does not involve any public disclosures and are much less likely to implicate ISS voting policies
  - Companies that have a Shareholder Rights Plan "on the shelf" are still vulnerable to stealth accumulations by activists and raiders
  - Vigilant stock watch monitoring is required to ensure the company will have sufficient notice to adopt a rights plan (prior to a substantial and rapid accumulation)
- The Company should evaluate any decision regarding a Shareholder Rights Plan in the context of its valuation, governance profile, other structural protections and an assessment of its vulnerabilities

Shareholder Rights Plans - Other Considerations

A Shareholder Rights Plan can help a board enhance shareholder value

A Shareholder Rights Plan is not intended to and will not prevent a hostile takeover of a company, nor does it eliminate the obligation of the directors to exercise their fiduciary duties

Advantages

- Helps preserve the board's flexibility and provides time to evaluate alternatives, consider the relevant constituencies and maximize value for the company and all shareholders
- Deters market accumulations by any person seeking to acquire a position of substantial influence or control without paying shareholders a full and fair price
- Reduces the risk of coercive two-tiered, front-end loaded or partial offers that may not offer full and fair value to all shareholders
- Encourages an otherwise hostile acquiror to negotiate with company since rights would cause substantial dilution to acquiror
- Board can implement this common takeover defense without a shareholder vote knowing that it has been endorsed by the courts

Considerations

- May be negatively viewed by press and shareholders
- ISS policies could trigger a withhold vote recommendation, depending on the plans features, timing and other factors
- Could invite shareholder resolutions seeking redemption of (or shareholder approval of) the rights plan

Shareholder Rights Plans - Overview

US-Incorporated Poison Pills in Force at Year End

Year End	# Companies
2001	2,218
2002	2,220
2003	2,114
2004	1,980
2005	1,852
2006	1,617
2007	1,394
2008	1,206
2009	1,037
2010	869
2011	734
2012	611
2013	537
2014	462
2015	369
2016	313
2017	270
2018	200
2019	171

Companies May Adopt a Shareholder Rights Plan in Response to an Unsolicited Bid

- Generally under Delaware's business judgment rule, a court will presume that directors have discharged their fiduciary duties to act in the best interests of the corporation and its shareholders
- If a court determines that a board has adopted a poison pill to avoid an unsolicited change in control, then the court will apply the more nuanced test set forth in the Delaware Supreme Court's decision in **Unocal Corp. vs. Mesa Petroleum**
- Adopting a shareholder rights plan is valid under Unocal if:
  - The board has an objectively reasonable belief of a threat to the corporate policy and effectiveness of the company (a reasonableness test)
  - The terms of the shareholder rights plan are a proportional response to the threat (a proportionality test)
- As the Delaware Supreme Court clarified in **Unitrin, Inc. v. American General Corp.**, a proportional response:
  - Cannot be preclusive or coercive
  - Must be within the range of reasonable responses to the threat

Companies May Adopt a Shareholder Rights Plan in the Face of an Activist Threat

In **Third Point vs. Sotheby's**, a Delaware chancery court upheld the board's adoption of a Rights Plan in the face of an activist threat

- The Delaware court determined that the enhanced level of scrutiny set forth in the Delaware Supreme Court's decision in **Unocal Corp. vs. Mesa Petroleum** would be used to determine whether the board's adoption of the rights plan was valid
- In this context, under the **Unocal** standard, the board was required to prove that:
  - The board found that the activist "presented an objectively reasonable and legally cognizable threat" to the company ("a demonstration that the Board of Directors had a reasonable grounds for believing that a danger to corporate policy and effectiveness existed"); and
  - The adoption of a Rights Plan with a 10%/20% flip in trigger was reasonable in relation to the threat posed

Sotheby's Analysis and Decision

- Prong 1: Threat to the Company
  - In **Sotheby's**, the court noted that the activist "presented a multitude of threats to the company."
  - The court focused on the potential for the activist to acquire "creeping control" (i.e., activists or group of activists gain effective control of the company without paying a control premium)
  - The court concluded that based on the facts, there was sufficient evidence that the activists possessed a legally cognizable threat and the board satisfied the first prong of the **Unocal** test
- Prong 2: Reasonableness of the Response
  - The **Sotheby's** court then determined that the adoption of a Rights Plan with a 10%/20% flip in trigger was reasonable in relation to the threat posed by the activist
  - The court noted "the reasonableness of a board's response is evaluated in the context of the specific threat identified - the specific nature of the threat sets the parameters for the range of permissible defensive tactics at any given time. When evaluating whether a defensive measure falls within the range of reasonableness, the role of the court is to decide whether the directors made a reasonable decision not a perfect decision. Courts applying enhanced scrutiny under **Unocal** should not substitute their business judgment for that of the directors and if, on balance, a board selected one of several reasonable alternatives, a court should not second-guess that choice."

Key Decision Points Relating to Shareholder Rights Plan Adoption

Key Features to be Considered

- Timing of adoption
- Term / duration
- Trigger threshold
  - Percentage (10-20%)
  - Definitions of beneficial ownership (including options / derivatives)
  - Bifurcated trigger
- Exercise price
- Sufficient number of authorized shares
- Exchange feature
- Whether to submit the pill to a shareholder vote
- "Grandfathering" provision
  - Consider carving out large existing shareholders

Key Benchmarking Exercises

- Term / duration - determine the length of time that rights plan will stay in place
  - Based on duration of recent precedent adoptions
  - Generally, shareholder rights plans adopted in the face of a takeover offer have an expiration date of one year or less
- Trigger threshold - determine the proper threshold at which a plan will dilute an unsolicited acquiror
- Exercise price - determine the appropriate price for exercising the rights granted under the plan
  - Based on exercise price as a multiple of current stock price for precedent adoptions
  - Customarily range from three to five times current market price

ISS and Institutional Investor Voting Policies

- ISS and many institutional investors have policies generally requiring "withhold votes" against directors of companies that adopt a Shareholder Rights Plan:
  - With a term **over 12 months**
  - With a term of **12 months or less**, depending on a number of factors including:
    - The date of the Shareholder Rights Plan's adoption relative to the date of the next meeting of shareholders (i.e., whether the company had time to put the pill on the ballot for shareholder ratification given the circumstances)
    - Rationale for adoption, existing governance structure and practices, and the company's "track record of accountability" to shareholders
- ISS has stated that **"A severe stock price decline as a result of the COVID-19 pandemic is likely to be considered valid justification in most cases for adopting a pill of less than one year in duration; however, boards should provide detailed disclosure regarding their choice of duration, or on any decisions to delay or avoid putting plans to a shareholder vote beyond that period**. The triggers for such plans will continue to be closely assessed within the context of the rationale provided and the length of the plan adopted, among other factors."

Public Company M&A

Deborah Birnbach + Danielle Lauzon

Deal Trends

- Pandemic-related bargains did not drive volume over last five months
- M&A activity continues but there has been a slowdown in H1 2020. According to Refinitiv, for US M&A activity:
  - 69% decrease in deal value vs. H1 2019
  - 9% decrease in deal volume vs. H1 2019
- Capital markets remain strong, particularly in life sciences, providing alternative strategic opportunities for companies – IPOs, PIPEs
- General view that there is a “temporary pause” and that deal volume expected to increase late 2020 / early 2021 as prices and markets stabilize, if they stabilize
- Opportunities remain for buyers with internal M&A capabilities with cash on hand, sufficient access to debt or a healthy stock price

Typical MAE / MAC Clauses Pre-Pandemic

- Allocating risk between the buyer and the seller during the period leading up to closing is normally a business and industry-specific negotiation
  - "Any event, development or condition occurring that has had, or would be reasonably expected to have, a material adverse effect on the business, financial condition or results of operations of the company and its subsidiaries, taken as a whole"
- Parties typically negotiate exclusions or carve-outs for industry-wide risks, acts of God, natural disasters, terrorism, economic downturns, transaction litigation, etc.

Proving an MAE is Very Difficult

- Transaction terminations based on the occurrence of an MAE are rare
- Buyers bear heavy burden to prove long-term business-specific effects on performance
- No Delaware court had upheld a buyer's termination of an M&A agreement on the basis that an MAE had occurred until the 2018 *Akorn v. Fresenius* decision
- *Akorn* does not change the standard for proving MAEs
  - Bad facts: Loss of a key contract and delays in product launches, combined with whistleblower letters to buyer about quality control defects and falsified data to FDA
  - While court found approximate 20% decrease in target's value amounted to an MAE, it cautioned not to "fixate on particular percentage as establishing a bright-line test"
  - Buyers need to establish a "durationally significant," "dramatic, unexpected, and company-specific downturn"

Does COVID-19 Give Rise to an MAE?

- The effects of COVID-19 may implicate the general market exception that parties typically include in MAE definitions
- Question becomes:
  – Will COVID-19 cause a ***long-term*** disruption to operations or impairment to the value of the target's business?
  – Did the effects of COVID-19 have a ***disproportionate effect*** on the target's business as compared to other companies in the same industry?
- No court has answered these fact-specific questions yet

Themes from COVID-19 / MAE Cases Filed to Date

- Strategic delay (*Juweel Investors Ltd. v. Carlyle Roundtrip, L.P.*)
- Duration of business closures (*Level 4 Yoga, LLC v. CorePower Yoga, LLC & CorePower Yoga Franchising LLC*)
- Proving disproportionate effects on retail business (*Bed Bath & Beyond, Inc. v. 1-800-Flowers.com*)
- "Ordinary course" during a pandemic (*SP VS Buyer LP v. L Brands, Inc.*)
- Buyer's knowledge of COVID-19 risks at the time agreement executed (*Forescout Technologies, Inc. v. Ferrari Group Holdings, L.P.*)
- Creative plaintiffs' lawyers (*Local 464A United Food and Commercial Workers Union v. Darcy Antonellis*)

Takeaways for Merger Agreements

- MAE / MAC definition
  - Sellers should seek to include a specific “pandemic” or “coronavirus” carve-out
  - Buyers should seek to clarify that disproportionate impacts from COVID-19 would be included in the MAE / MAC and would not be qualified by knowledge or disclosure
- Interim operating covenants
  - What flexibility is needed between signing and closing to deal with COVID-19?
  - “Ordinary course of business” definition
    - Consistent with past practice vs. commercially reasonable efforts
- COVID-19 specific closing conditions or termination rights
  - Specific COVID-19 warranties brought down as a closing condition
  - Termination right if target’s financial health falls below a certain threshold
- Consider drop dead dates, timing for obtaining antitrust and other regulatory approvals

What’s Next?
A Path Forward in Uncertain Times

Public Company Fundraising Transactions

Rick Kline + Maggie Wong

Public Company Financing Transactions

- Overview of Market Trends
- Registered Direct Offerings
- At-the-Market Offerings
- Bought Deals and Block Trades
- PIPE Transactions
- Convertible Note Offerings

Market Trends

- Market volatility presents greater challenges for executing on traditionally marketed underwritten offerings
- Most follow-on offerings are shelf takedowns and are either pre-marketed (wall-crossed) offerings (“CMPOs”) or marketed on an accelerated basis
  - Some shelf takedowns are structured as registered direct offerings with no public marketing at all
  - Bought deals are underwritten offerings that can be executed with minimal issuer marketing
- Companies subject to “baby shelf” rules are limited as to the amount they can raise through shelf takedowns
- PIPE transactions can be a useful alternative means of fundraising for companies subject to the baby shelf rules, subject to NASDAQ rules on private placements
- At-the-market offerings also allow issuers to raise capital with minimal market impact
- There has been significant market demand for convertible note offerings through 1H 2020

Registered Direct Offerings

- Securities registered pursuant to an effective shelf registration statement on Form S-3 and Rule 415 under the Securities Act
- Can be conducted as "best efforts" offering through a placement agent or as an underwritten offering
  - In both cases, the securities are marketed to a small, targeted group of institutional investors, thus minimizing market risk
- Key Considerations
  - Placement agent has same liability as in a firm commitment underwritten offering; thus same level of diligence (legal opinions, negative assurance and comfort) required
  - Nasdaq may view registered direct offerings as private placements, thus must consider Nasdaq rules
  - Subject to SEC "baby shelf" rules

At-the-Market ("ATM") Offerings

- Offering of securities into existing trading market at publicly available bid prices, often anonymously through electronic exchanges
  - Issuer can direct sales agent to place shares at a minimum price and can specify amount and duration of sales
  - Placement fees generally are lower and impact on stock price is typically more modest, as the number of shares sold in any single offering is not considered significant relative to public float or daily trading volume
- Key Considerations
  - Agent has statutory "underwriter" liability, thus subject to similar diligence and documentation requirements as underwritten offerings but with varied timing for delivery
  - Regulation M: if the security is not actively traded then Agent cannot be in the market during restricted period, which could reduce some benefits of the program for non-actively traded securities
  - Issuer cannot sell under ATM program while in possession of material, nonpublic information or if prospectus contains a material misstatement or omission

Bought Deals and Block Trades

- In a bought deal, underwriters agree to purchase securities at a fixed price (or pre-negotiated pricing formula) without any prior marketing
  - Typically launched after market with all bought securities resold before market opens the next day
  - Given tight execution timeline, generally only feasible for issuers that have or can file an effective WKSI shelf
  - Subject to same diligence and issuer disclosure requirements as other underwritten offerings
- Larger, one-off block trades negotiated with select identified parties may be conducted under an ATM program
  - Allows for efficient execution because sales agent is current on diligence
  - Need to ensure that "plan of distribution" for ATM program contemplates block trades in privately negotiated transactions
  - Additional disclosure (through a prospectus supplement) may be necessary if deal is large relative to overall size of ATM program, is priced at a significant discount or involves special facts and circumstances that could be considered material

PIPE Transactions

- Private placement of securities at a fixed price and amount, conditioned upon filing and effectiveness of a resale registration statement subsequent to closing (to permit prompt resale by investors)
- Placement agent not subject to underwriter liability but will conduct some level of diligence to comply with FINRA guidelines; investors generally will not want MNPI as it would limit their ability to trade in the issuer's shares after closing
- Key Considerations
  - Generally structured to comply with Section 4(a)(2) exemption and Rule 506(b) under Regulation D with sales to accredited investors only
  - Communications are subject to Regulation FD; thus need to ensure MNPI is not shared unless appropriate confidentiality measures are in place
  - Subject to Nasdaq rules requiring shareholder approval for 20% issuances at less than "Minimum Price"
    - "Minimum Price" defined as the lower of: (i) the closing price immediately preceding the signing of the binding agreement; or (ii) the average closing price of the common stock for the five trading days immediately preceding the signing of the binding agreement

Convertible Note Offerings

- A convertible note is a debt security that is convertible by the holder into exchange traded equity of the issuer; typically convertible into common stock at a conversion price that exceeds the common stock trading price on the day the deal is priced
  - Benefits relative to straight debt include lower interest rate, fewer covenants
- Can be conducted as registered offering or, more often, as private placement under Rule 144A
  - Documentation includes indentures, underwriting or purchase agreement
  - Diligence (including opinions, negative assurance and comfort) comparable to underwritten equity offerings
- Key Considerations
  - Important to understand accounting treatment
  - For 144A offerings, securities are restricted subject to legend removal after one year
  - 144A requires conversion price be at least 10% higher and for investors to be qualified institutional buyers ("QIBs")
  - Subject to Nasdaq 20% rule

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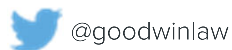

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