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KEY GOVERNANCE ACTION ITEMS IN RESPONSE TO COVID-19

To Our Clients and Friends:

As public companies wrestle with the continuing and evolving impact of COVID-19, there are several key corporate governance matters that public companies and their boards of directors should consider in the short term.

1. **Ensure board continuity:** Boards should consider whether to take action now to adopt emergency bylaws and/or appoint executive committees in order to ensure the continued ability of the board to operate in the months ahead.
 - Emergency Bylaws. The corporate laws of many states include provisions that apply in the event of an emergency to ensure that the board can continue to function. Some of these provisions require board action while others are self-executing. For example:
 - Section 110(a) of the General Corporation Law of the State of Delaware (the “DGCL”) authorizes boards of companies incorporated in Delaware to adopt emergency bylaws that apply in the event that specific types of emergencies^[1] prevent a quorum of the board or a standing committee. The emergency bylaws can provide flexibility regarding who can call board or committee meetings, permit a lower quorum and allow officers to serve as directors for certain meetings.
 - In addition, other parts of DGCL Section 110 apply regardless of whether the board has acted. For example, DGCL Section 110(f) states that, unless otherwise provided in emergency bylaws, notice of any board meeting during an emergency may only be given to the directors that it is feasible to reach and by means that are feasible at the time. DGCL Section 110(g) also provides that to the extent necessary to achieve a quorum at any board meeting during an emergency, the company’s officers who are present shall (unless otherwise set forth in the emergency bylaws) be deemed directors for the meeting.
 - Importantly, DGCL Section 110(d) states, “No officer, director or employee acting in accordance with any emergency bylaws shall be liable except for wilful misconduct.”
 - Executive Committees. Another method to provide for board continuity is to create (or reconsider if previously created) an executive committee of the board comprised of a few members of the board with the remaining directors designated as alternates. This increases the likelihood that the executive committee will be able to continue to function even if several directors are

unreachable and unable to participate. While it is important for the board in creating or reconsidering an executive committee to give the committee all of the powers and authority of the board that it is permitted to delegate, there are limits. For example, DGCL Section 141(c) places certain limits on board committees depending on the applicable DGCL provision and, in some instances, whether such rights were expressly delegated to the executive committee. Moreover, Delaware corporations should confirm whether the bylaws authorize committees to appoint alternate members, which provides added flexibility. Section 141(c) of the DGCL authorizes the board to appoint alternate committee members, but committees may appoint alternates only if expressly permitted in the bylaws.

- **Practical Considerations:** As an initial matter, companies should determine whether their bylaws already include emergency bylaws and authorize committees to appoint alternates as well as review the resolutions used to create any existing executive committee to determine whether alternates are designated and the extent of the committee's authority. Boards also should consider which approach is preferable, considering (among other things) that there may be limits on the authority of an executive committee and that emergency bylaws create flexibility to adjust the quorums for the board and its committees, allow officers to fill board seats and, as discussed above, provide individuals acting pursuant to emergency bylaws greater protection from liability. While reviewing the bylaws in light of these issues, companies should also review the notice requirements for board and committee meetings and assess whether any changes are appropriate (consistent with state law) to enhance the board's flexibility. As a matter of good corporate governance, even if a company has adopted one or both of these measures, it often will remain appropriate to invite all directors or committee members to any meetings so that directors remain informed and ready to act as needed.

2. **Reinforce emergency executive succession plan:** A key duty of the board is to engage in succession planning for the CEO and management team, both for the long term and in the case of an emergency. Given COVID-19, it is important for boards to act now to review and confirm their emergency succession plan.^[2] Specifically, boards should:

- **Confirm expected successors in an emergency.** Discuss who should step in as CEO if needed and who is their replacement and understand, with input from the CEO, who are the replacements for each member of the executive team, preferably identifying at least two potential successors for each.
- **Communicate with the emergency CEO successors.** Inform the potential emergency CEO successors of their expected role in the event of the unexpected loss or incapacity of the CEO so that the relevant person can act until the board can formally appoint them as the new or interim CEO.
- **Discuss the factors that would trigger implementation.** Consider and discuss the various scenarios that may require implementation of the emergency succession plan (g., CEO hospitalization). Companies should review their bylaws to confirm whether they address officer succession events and impose any formalities on the process.

- Reinforce the role of the board’s independent leadership. Discuss designating the independent director in a leadership role (g., lead independent director or board chair) as point person for discussing if and when to trigger the CEO emergency succession plan in consultation with the board. Boards should also consider and document the role of the CEO and other executives in implementing emergency succession actions below the CEO level.
 - Consider SEC disclosure of COVID-19 illnesses. In this context, boards may need to discuss whether and when to disclose a COVID-19-related illness of an executive officer. Although not necessarily a reportable event under Form 8-K, if an executive takes a leave of absence due to the illness, or can no longer perform his or her duties, disclosure under Item 5.02 of Form 8-K may be warranted. However, disclosure may be prudent, even without a leave of absence, if, under the circumstances, the company considers the illness of the executive to be a significant development in the company’s business requiring public disclosure. Companies should carefully review Form 8-K disclosure requirements in the event that an interim or replacement officer (even if temporary) has been appointed.[3]
3. **Consider if updates are needed to delegations of authority:** Companies typically use delegations of authority to establish the specific authority given by the board to management in various areas, such as acquisitions, financing arrangements, variances from previously approved operating plans and budgets, and employee compensation matters. Given the evolving and often dramatic economic and business impacts related to COVID-19, companies should review these delegations of authority and consider whether the nature and scope of these delegations remain appropriate so that management has the flexibility to pivot as needed and the board can continue to play an appropriate oversight role.
4. **Evaluate how best to fulfill the board’s oversight role and directors’ fiduciary duties:** Boards need to carefully balance performance of their oversight responsibilities with not unnecessarily burdening management teams that are already fully engaged. Boards should be shifting gears and spending more time overseeing issues and risks in response to the current situation, including emergency succession (discussed above), enhanced cybersecurity protections, liquidity concerns (g., if customers are delayed in paying bills), and staffing and the operation of workplace safety and work-from-home policies. This may mean delaying nonessential presentations, and moving from full- or multiple-day board and committee meetings to more frequent, shorter meetings. Other practices may also be useful in helping to keep the board informed in light of the rapidly occurring developments related to COVID-19, such as more frequent between-meeting communications with the board and having the board chairman check in individually with directors. The goal should be to ensure that the board is receiving regular reports on, and devoting appropriate time and attention to, the most critical challenges and risks facing the company, including those posed by COVID-19, and that the board’s efforts are appropriately documented. This will enable the board to fulfill its “Caremark” duties (so named for the seminal *Caremark*[4] case in which the Delaware Chancery Court articulated the oversight and monitoring responsibilities of a corporation’s boards of directors under Delaware law). A more recent application of this case—the Delaware Supreme Court’s 2019 decision in *Marchand v. Barnhill*[5]—underscores the importance of diligent monitoring when a company faces events or risks that are intrinsically critical to its business operations. Finally,

directors should be mindful that in times of true crisis, a director’s fiduciary duties permit—and indeed, may even compel – the board to prioritize the interests of a range of stakeholders, because a company’s survival may depend on it. In this regard, Former Chief Justice of the Delaware Supreme Court Leo Strine recently wrote that during a national crisis, “the corporation’s obligations to its workers, its regular contractors, service providers, and lenders, and others with a legal and ethical claim to being paid comes above its duty to stockholders. Corporate leaders have the discretion to use their business judgment to best enable the corporation to weather this unprecedented storm, to honor its duties to those who have made the deepest commitment to the company’s success (that is, its employees), and to secure the solvency and long-term health of the business.”[6]

5. **Evaluate impacts on internal controls and internal audit function:** Companies should consider the impacts of COVID-19 on their internal controls and internal audit function. In a recent statement, SEC Chairman Jay Clayton reminded companies that how they plan and respond to unfolding COVID-19 developments can be material to investment decisions and therefore may require disclosures about companies’ assessment of material risks related to COVID-19 and plans for addressing these risks. In light of this, Chairman Clayton “urge[d] companies to work with their audit committees and auditors to ensure that their financial reporting, auditing and review processes are as robust as practicable in light of the circumstances in meeting the applicable requirements.”[7] Changes to internal controls, and the implementation of new controls, may be warranted, and changes must be disclosed in Forms 10-Q and Form 10-K to the extent those changes have materially affected, or are reasonably likely to materially affect, the company’s internal controls. Companies also should consider the possibility that personnel or information critical to the effective operation of certain controls may be unavailable and that the development of alternative controls may be necessary. With respect to the internal audit function, companies may wish to revisit the internal audit plan and determine whether it is appropriate to shift priorities reflected in the plan and whether it is feasible to conduct planned audits without in-person access to certain locations. As companies continue to respond to COVID-19, internal audit can also play an important role in evaluating and making recommendations on issues such as emerging risks and business continuity plans.
6. **Consider how to proceed with the annual shareholders meeting:** A significant number of companies expected to hold annual meetings of shareholders in the coming months now will hold virtual meetings in order to comply with government orders limiting the size of gatherings and to protect the health and safety of those who attend. While the SEC has provided relief for companies with respect to the proxy rules, companies also must consider the laws of the states in which they are incorporated.
 - Restrictions on Virtual Meetings. Some jurisdictions continue to prohibit or restrict the ability to hold virtual meetings, and some companies may not be in a position to rely upon emergency relief granted to facilitate virtual meetings.[8] As a result, some companies will need to choose between convening (or adjourning) in-person meetings with limited attendance in order to facilitate votes on key matters, and postponing the meeting for what could be a significant period of time due to COVID-19 and thus potentially incurring the costs of redistributing proxy materials.

- Holding Virtual Meetings. Companies that determine to hold a virtual meeting should carefully evaluate, among other things, the experience and workload of key virtual meeting providers and how to balance structuring the meeting agenda to complete the formal portion of the meeting quickly in case there are technological challenges with providing a forum for shareholders to engage with the company. Companies in this situation should address contingency plans for various scenarios, such as arranging in advance appropriate delegations or substitutions if the meeting chair or the designated proxyholders are unavailable. Finally, directors should strive to “attend” the virtual shareholder meeting to the extent feasible.
 - Pivoting to Virtual Meetings. Companies that distributed proxy materials discussing the possibility of virtual meetings will need to decide whether to pivot to a virtual meeting several weeks in advance of the meeting in order to notify the virtual meeting provider, address state law notice requirements for record holders informing them of the change in location (if necessary—for example, if the website address for the meeting was not included in the initial materials) and issue a press release.^[9] While not addressing or resolving state law concerns, the SEC’s recent guidance^[10] for conducting annual meetings in light of COVID-19 addresses securities law issues for a company changing the meeting location from a physical location to a virtual one. The guidance provides that under the federal securities laws, a company that determines to change the date, time or location of its annual meeting after having mailed its definitive proxy materials may do so without needing to mail additional soliciting materials or amend its proxy materials if it issues a press release announcing such change, files the announcement as additional soliciting material on EDGAR, and takes all reasonable steps necessary to inform other intermediaries in the proxy process and relevant market participants of such change. With respect to companies opting to pivot to a virtual meeting, the SEC staff noted that it expects companies to timely notify shareholders and market participants of any plans to conduct a virtual meeting and to clearly disclose logistical details of the virtual meeting, including how shareholders can remotely access, participate in and vote at such meeting.
7. **(Re)examine incentive arrangements:** Boards should bear in mind existing compensatory programs for senior management and employees and consider whether they provide the proper incentives in light of COVID-19. For example, establishing long-term goals based on total shareholder return (TSR) at a time of extreme stock price volatility may not create adequate incentives, and some executive compensation decisions may be better delayed until situations improve or at least stabilize. Moreover, companies should consider whether to disclose decisions by executive teams to reduce their compensation. Some boards have also considered whether to reduce their cash compensation to set the appropriate “tone at the top.”

[1] DGCL Section 110 states that emergency bylaws can be operative “during any emergency resulting from an attack on the United States or on a locality in which the corporation conducts its business or customarily holds meetings of its board of directors or its stockholders, or during any nuclear or atomic disaster, or during the existence of any catastrophe, or other similar emergency condition.”

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[2] Under DGCL Section 110(b), either before or during an emergency, the board of directors may provide and modify lines of succession “in the event that during such emergency any or all officers or agents of the corporation shall for any reason be rendered incapable of discharging their duties.”

[3] *See* SEC Compliance and Disclosure Interpretation 217.02, stating, “When a principal financial officer temporarily turns his or her duties over to another person, a company must file a Form 8-K under Item 5.02(b) to report that the original principal financial officer has temporarily stepped down and under Item 5.02(c) to report that the replacement principal financial officer has been appointed. If the original principal financial officer returns to the position, then the company must file a Form 8-K under Item 5.02(b) to report the departure of the temporary principal financial officer and under Item 5.02(c) to report the ‘re-appointment’ of the original principal financial officer.” *See also* SEC Compliance and Disclosure Interpretation 217.04, providing that Item 5.02(b) of Form 8-K does not require a registrant to report the death of a director or listed officer.

[4] *In re Caremark Int’l Inc. Deriv. Litig.*, 698 A.2d 959 (Del. Ch. 1996).

[5] *Marchand v. Barnhill*, 2019 WL 2509617 (Del. June 18, 2019).

[6] Leo Strine, *Remembering What Comes First is More Important Than Ever*, Financial Times (Mar. 27, 2020).

[7] *Available at* <https://www.sec.gov/news/press-release/2020-53>.

[8] Although California law requires all shareholders to consent to the holding of virtual meetings, the governor issued an executive order suspending those requirements, dated March 30, 2020, *available at* <https://www.gov.ca.gov/wp-content/uploads/2020/03/3.30.20-N-40-20.pdf>. Other states that allow only hybrid meetings (physical and electronic) have acted to permit virtual-only meetings during the COVID-19 crisis. For example, several governors have issued executive orders to temporarily permit virtual-only meetings: Connecticut, dated March 21, 2020 (*available at* <https://portal.ct.gov/-/media/Office-of-the-Governor/Executive-Orders/Lamont-Executive-Orders/Executive-Order-No-71.pdf?la=en>), Georgia, dated March 20, 2020 (*available at* <https://gov.georgia.gov/document/2020-executive-order/03202002/download>), Massachusetts, dated March 30, 2020 (*available at* <https://www.mass.gov/doc/virtual-shareholder-meeting-order/download>), New York, dated March 20, 2020 (*available at* https://www.governor.ny.gov/sites/governor.ny.gov/files/atoms/files/EO_202.8.pdf) and North Carolina, dated April 1, 2020 (*available at* <https://files.nc.gov/governor/documents/files/EO125-Authorizing-Encouraging-Remote-Shareholder-Meetings.pdf>). *See also* the legislation enacted in New Jersey (*available at* https://www.njleg.state.nj.us/2020/Bills/A4000/3861_I1.HTM).

[9] An emergency order signed by the Delaware governor on April 6, 2020, states that a public company can provide notice of a change from a physical to a virtual meeting by filing a notice with the SEC and issuing a press release that is posted on the company’s website provided that the change was due to the public health threat caused by COVID-19 and that the company distributed proxy materials in advance of the Order notifying shareholders of the physical meeting. *See* Tenth Modification of the Declaration

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of A State of Emergency for the State of Delaware Due to a Public Health Threat, *available at* <https://governor.delaware.gov/health-soe/tenth-state-of-emergency/>.

[10] *See Staff Guidance for Conducting Annual Meetings in Light of COVID-19 Concerns, available at* <https://www.sec.gov/ocr/staff-guidance-conducting-annual-meetings-light-covid-19-concerns?auHash=zrsDVFen7QmUL6Xou7EIHyo4Y6IfrRTjW3KPSVukQs>.



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