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The Memorandum

COVID-19 and M&A: How the Pandemic May Change the Road Ahead

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The coronavirus disease 2019 ("COVID-19") pandemic continues to have dramatic effects on daily life across the globe. Businesses face a variety of challenges, including unprecedented market conditions, supply chain issues, liquidity concerns and dilemmas over how best to protect their customers and employees. Moreover, some businesses are confronting existential crises as the changes caused by COVID-19 have sped up what might have otherwise been more gradual evolutions.

While some businesses are facing difficult choices including bankruptcy, restructuring and asset sales, others are racing to respond to skyrocketing demand or to add new products. In this period of uncertainty, the difference between businesses that suffer, survive or thrive depends in part on the circumstances that they found themselves in at the beginning of the crisis, but also on their ability to adapt to rapidly changing conditions.

While deal activity substantially slowed upon the emergence of the pandemic, businesses and financial sponsors have once again begun to pursue transactions. In many instances, parties have now re-engaged on transactions that were put on hold for some months and in other instances, with equity markets having stabilized at high levels, potential sellers are willing to consider offers that provide a full valuation.

At this point in time, dealmakers should consider the opportunities and perils arising from the pandemic, with an eye towards forging creative solutions where needed. This article examines considerations for businesses, including:

- Recent deal volume developments.
- Transaction disruptions and renegotiations.
- Changes ahead for M&A.
- How the pandemic may affect unsolicited acquisition proposals and shareholder activist approaches.

Recent Deal Volume Developments

Global M&A activity fell 28% in the first quarter of 2020 to its lowest level since 2016 as the effects of the pandemic began to be felt. April and May had even steeper declines in both global M&A activity and in U.S. deal activity. However, there have been dramatic increases in deal volume in both June and July to levels comparable to monthly deal volumes in the fourth quarter of 2019 and August has gotten off to an equally strong start. Further worth noting is that these transactions have not been limited to the range of distressed activity that at one point was expected to be dominating the market. Instead, they have included a significant number of transactions that had for the most part been the kinds of strategic transactions and private equity acquisitions that would have been expected prior to the COVID-19 crisis.

With respect to deal volume through the remainder of 2020, according to a survey by the M&A Leadership Council, 26% of respondents acknowledged their anticipated future deal volume for Q2-4 2020 is expected to be substantially reduced. However, the survey also noted that 23% of respondents reported either "no impact in 2020 forecast deal volume" or their intent to "accelerate" deal volume during the remainder of 2020 based on the "increased number of opportunistic targets or more palatable valuations brought about by the crisis."

Transaction Disruptions and Renegotiations

Some businesses continue to have pending transactions that were signed pre-crisis. Perhaps the most intriguing outcome from the pandemic is how most of these agreements have held up during the pandemic and not been susceptible to termination or renegotiation as a result of the pandemic. These pre-pandemic agreements were examined to see how their provisions would be interpreted in light of COVID-19. On the whole, with some notable exceptions, these agreements have not been readily terminated or renegotiated by buyers. Some businesses with agreements may still decide to pursue litigation as a negotiation posture if the parties' positions have hardened or try to find a basis to renegotiate or terminate the agreement. For the most part, however, at this stage of the dislocation from the pandemic, most deals have proceeded to closing based on existing transaction terms.

EARLY PANDEMIC DEAL LITIGATION

Some deals were drafted as the pandemic spread and drafters choose to include pandemic-specific provisions. However, even with the addition of specific language, it is still uncertain how courts will interpret both standard provisions and pandemic-specific ones as the limited amount of pandemic-related litigation filters its way through the court system. Unsurprisingly, a number of lawsuits have been filed in Delaware Chancery Court. Many are still in their preliminary stages and it is still too soon to tell how the courts will ultimately resolve these issues.

In one recent example, Sycamore Partners, a private equity firm, commenced litigation in April 2020 against L Brands, Inc. seeking to terminate its affiliate's obligation to acquire a 55% interest in Victoria's Secret and PINK for approximately $525 million. *SP VS Buyer LP v. L Brands, Inc.*, No. 2020-0297 (Del. Ch. Ct.).

After the deal was signed, Sycamore alleged that L Brands had taken several steps to respond to the pandemic, including closing stores, furloughing employees, cutting executive pay, refusing to receive new merchandise and failing to pay April rents at brick-and-mortar stores. Sycamore argued that these actions had damaged the business, were in breach of the agreement and that accordingly it should not be obligated to close. Sycamore argued that that the agreement required L Brands to operate the business in the ordinary course consistent with past practice until the deal closes, along with not changing its cash management policies or practices. However, due to the pandemic, how courts will interpret provisions like these is uncertain.

For example, there are several possible interpretations for the ordinary course of business covenant including:

- How the target operated immediately before the pandemic began;
- How the target operated in response to the 2008 financial crisis; or
- How other businesses have responded to the pandemic.

Additionally, it is possible that courts could consider the steps that the buyer itself has taken in response to the pandemic.

In the Victoria's Secret deal litigation, the parties' agreement also included a material adverse effect ("MAE") clause with a pandemic carve-out, although the carve-out did not apply to the entire MAE clause. Sycamore argued that the first portion of the MAE clause (unaffected by the pandemic carve-out) permitted it to terminate if there was any state of facts that would prevent or "materially impede the performance" of the agreement by L Brands. Shortly after Sycamore commenced its lawsuit, L Brands countersued. The litigation then abruptly ended in early May 2020, when the parties confirmed a mutual agreement to terminate their transaction agreement. The parties announced an agreement to settle all pending litigation and mutually release all claims. Neither party was required to pay a termination fee or other consideration.

Some have speculated that the litigation ended because of the equity commitment letter ("ECL"). The ECL provided that if L Brands sought any remedy against the buyer under the purchase agreement other than specific performance, the ECL terminated automatically. When L Brands countersued they sought either specific performance or monetary damages, and Sycamore filed a second complaint alleging that this caused the ECL to terminate automatically. Sellers should take care to ensure that the ECLs or other financing commitments supporting a buyer's financing for a transaction are not in conflict with their purchase agreements. An ECL should permit any negotiated/agreed on remedies to be brought under and in accordance with the purchase agreement simultaneously, as well as claims to enforce the ECL. Of course, the purchase agreement should provide that only one remedy can actually be granted.

RENEGOTIATION AND AMENDED TRANSACTION AGREEMENTS

In light of the pandemic, buyers and sellers in some instances have negotiated amended transaction agreements that provide for new closing conditions to save deals threatened by changed circumstances. In response to the pandemic, businesses in various sectors are cutting their expenditures and drawing down on their revolving credit facilities to add cash to their balance sheets. Some companies are choosing to borrow all available funds under their credit lines. Typically, drawing down on revolvers was an option for distressed companies ahead of a restructuring, but it became a regular occurrence in response to the pandemic as companies realized the potential long term impacts of COVID.

In one recent instance, a buyer consented to a target's draw down of its entire $500 million revolving credit facility. The parties to this amended transaction agreement, BorgWarner and Delphi Technologies PLC, also provided for new closing conditions requiring that, at the time of the closing, the total amount of Delphi Technologies' outstanding revolver borrowings not exceed $225 million, and net of its cash balances not exceed $115 million, and its net debt-to-adjusted EBITDA ratio not exceed a specified threshold. The parties also agreed to a revised exchange ratio pursuant to which Delphi Technologies' stockholders will receive a 5% reduction in the share exchange ratio (0.4307 shares of buyer common stock for each target company share).

Changes Ahead for M&A

As mentioned above, some businesses will see an increase in opportunities for strategic partnerships as they navigate the uncertainty caused by the pandemic. Businesses considering and negotiating acquisition agreements should evaluate how this uncertainty will affect their agreements, particularly with regards to their underlying assumptions, as these may have shifted. For instance, a buyer should carefully consider its assumptions regarding both its own future performance as well as the target's.

Businesses need to carefully consider the risks related to the pandemic and intentionally allocate them in their agreements. M&A that involves distressed businesses presents different risks than transactions with non-distressed targets. Often, buyers in distressed deals cannot use otherwise standard contractual protections, such as indemnification provisions, and deterioration in the target's business, including delays in satisfying ordinary course payables, make it challenging to both value the business and implement contractual provisions, such as working capital or purchase price adjustments, meant to preserve such value for the benefit of the buyer. However, depending on how the transaction is structured, buyers may find that the protections afforded by the bankruptcy code provide better protection against the assumption of unwanted liabilities than the usual protections seen in non-distressed deals. The pandemic has led to a rash of distressed deals, including in the retail and energy sectors.

In terms of valuation, sellers may seek to characterize earnings decreases from the pandemic as short lived, while buyers may view them as durable. Some of the broader trends that predated the pandemic appear to have been accelerated, including the demise of some well-known retail brands that were already on shaky ground in some instances. So far, a number of well-known retailers have filed for Chapter 11, including J.Crew, Neiman Marcus and Brooks Brothers.

M&A will likely change in a number of ways due to the pandemic, including with respect to:

- Due diligence.
- Purchase price adjustments.
- Interim operating covenants.
- Use of buyer stock as consideration.
- Earnout provisions.

- Pandemic-related exclusions from representation and warranty insurance.
- MAE clauses with pandemic-specific language.

DUE DILIGENCE

Pre-pandemic due diligence sought to identify a target's legal, operational and other risks. Buyers would address these risks using certain standard remedies and risk-allocation devices. However, going forward, dealmaking is unlikely to be able to rely on these standard solutions to the same degree. The extent of the impact of the pandemic on deals relates directly to the impact of the pandemic on the industry in question. For example, deals involving the retail industry have been greatly impacted, and careful due diligence is even more critical, but the impact on technology deals has been marginal in some cases. To align their practices with these new circumstances, buyers should:

- **Perform a self-assessment.** Buyers should closely examine their current due diligence processes to identify weaknesses and areas for improvement. In particular, buyers should focus on whether their processes need to be updated to account for the pandemic. Buyers should also consider whether to upgrade their M&A operating processes, playbooks, software solutions, skills and resources to effectively operate in remote working conditions.
- **Identify the target's key risks.** Buyers should consider how core fundamentals, competitive pressure or other internal or external factors have impacted the target's revenues and profits and separate those factors from any caused by the pandemic.
- **Consider the target's current and potential location issues.** Buyers should examine whether a target has exposure in geographic areas that are highly affected by COVID-19, or are likely to become so. This requires an on-going evaluation as the pandemic has begun to spread again in areas where it had initially appeared to be under control, such as Hong Kong and in parts of Europe and the United States. The evaluation should look at how the pandemic is affecting the target's operations and its ability to function, both now and in the future. The buyer should also examine the location of the target's key counterparties, suppliers and customers.
- **Evaluate the target's supply chain risk.** Buyers should analyze a target's supply chain, the level of disruption to the supply chain caused by the pandemic, in addition to the availability and cost of alternative sources.
- **Assess the target's earnings and look for deceptive practices.** Prior to the pandemic, channel stuffing would occasionally occur when businesses would try to avoid falling short of their sales targets. However, due to the pandemic, there is an increased risk that targets may engage in channel stuffing or other deceptive practices. Buyers should take this into consideration and not assume without proof that a target's earnings are reliable. Certain activities can indicate that channel stuffing has occurred. For example, a target may offer distributors or retailers incentives (such as discounts, rebates or extended payment terms) to buy quantities in excess of their current needs. Alternatively, a target may pressure

distributors or retailers into accepting excess product. For example, the target may agree to waive termination clauses which allow it to terminate the relationship if the distributor fails to meet certain depletion targets.

- **Consider whether the pandemic has affected taxes, duties and fees.** Buyers should consider whether any newly adopted federal, state or foreign laws have resulted in new taxes or fees, deferrals of tax or customs duties.
- **Review the privacy implications of remote work.** Remote work arrangements have been widely adopted during the pandemic and can lead to additional cybersecurity risks. A buyer should be alert to the regulatory, licensing, cybersecurity and data privacy implications of these arrangements.
- **Understand the terms of the target's key commercial contracts.** A buyer needs to understand the terms of the target's key commercial contracts, including its (and its counterparties) performance obligations, and ability to suspend, abandon or terminate obligations. A buyer should also examine the *force majeure*, MAE and similar provisions of such contracts.
- **Evaluate reputational issues.** Matters of health, safety, and employee and customer welfare have taken on an increased significance due to the pandemic. These matters should be evaluated carefully as they can enhance or damage a target's value, but also affect a buyer's reputation. Certain industries in particular, such as the airline, hospitality and tourism industry, face heightened concerns that strike at the core of their business models.

PURCHASE PRICE ADJUSTMENTS

Another aspect of M&A that the pandemic may affect is purchase price adjustments. These have typically been used to compensate the buyer if the seller's working capital deviates from the expected level at closing. The expected level is often calculated by examining the target's balances over the last several months. However, the pandemic may cause a particular target to have reduced working capital or to have far more cash on hand than normal if lines of credit were drawn down or new borrowing had taken place. A seller may request an adjustment to the working capital target that takes the pandemic into consideration. Alternatively, a seller may seek a collar or floor to ensure that any adjustments do not reduce the purchase price below an acceptable number.

By contrast, buyers will wish to ensure that the target has adequate levels of working capital and liquidity. If working capital has been reduced, buyers should examine the underlying reasons (for example, reduced accounts payable) and the durability of these reasons. In some industries, customer demand may take a number of years to return to pre-pandemic levels. For example, tourism has been dramatically affected by the pandemic, but once a treatment or vaccine exists, consumer vacation travel will likely rebound. However, business travel may never return to pre-pandemic levels. While in-person meetings may remain the gold standard, after the pandemic some cost-conscious businesses may continue to conduct less business travel. Separately, employees may also be less willing to travel for business having grown accustomed to virtual meetings that they find more convenient.

INTERIM OPERATING COVENANTS

Acquisition agreements typically include interim operating covenants that require the target to conduct the business "in the ordinary course consistent with past practice," during the period between signing and closing. However, as seen in the Victoria's Secret deal litigation, the pandemic can cause the buyer and seller to disagree over how to interpret these covenants. Sellers are likely to argue that any actions taken were justified and in accordance with business necessity, in response to government requirements, or that their actions were the same as their competitors. Buyers, on the other hand, are likely to argue that the sellers' actions deviated from the ordinary course.

Going forward, these ordinary course covenants are likely to be drafted with greater specificity regarding the meaning of "in the ordinary course" and the extent to which any "COVID exception" applies to the affirmative and negative covenants contained in the ordinary course covenant.

As the pandemic continues, a seller may need to respond to sudden challenges, such as new or increased government restrictions or supply chain disruptions. In these cases, buyers and sellers may wish to increase their communication frequency. This may reassure the buyer that the seller will not take unilateral actions that could irreparably damage the value of the business. Subject to antitrust limitations, sellers may also begin to seek covenants requiring the buyer to consult with them in good faith during the interim period regarding operational issues. Sellers may further seek a buyer commitment not to act unreasonably in withholding their consent to operational changes.

BUYER STOCK AS CONSIDERATION

At the initial stages of the pandemic, more traditional sources of debt financing were difficult to obtain. Dealmakers had to become more inventive. Some dealmakers responded by putting up the financing themselves with the expectation that they would refinance when the credit markets opened back up. In recent weeks, it appears that more traditional forms of financing have once again become more available.

As the pandemic continues, buyers with favorable stock price multiples may also wish to consider using their own stock for deal consideration in order to preserve their cash reserves. One advantage of this is that the seller can potentially share in future growth. Additionally, a stock-for-stock deal may help bridge any valuation gap that exists between the buyer and seller. A buyer and seller should determine whether a fixed, floating or hybrid share valuation method will best address potential changes in the buyer's stock price between signing and closing. In determining whether to accept stock as consideration, a seller should carefully consider the buyer's current and future stability as well as potential impacts to the buyer from the pandemic.

EARNOUTS

An earnout is a contractual provision in a private sale that provides a seller additional compensation in the future if the business achieves certain financial goals, which are usually stated as a percentage of gross sales or earnings.

An earnout can help bridge a valuation gap if a seller seeks a higher price than a buyer is willing to pay. Uncertainty caused by financial or other events usually results in an increase in earnouts being included as a component of purchase price. The pandemic may cause earnouts to be used more frequently in the near term. Whether to use an earnout may depend on:

- The performance period's time frame and whether it is flexible.
- How sensitive the performance metrics are to the pandemic's effects.
- Whether the seller has a strategic plan that can be executed despite the pandemic.
- Whether the earnout structure uses financial or non-financial milestones (for example, regulatory approvals).
- Whether the seller is convinced that the target business will be managed and operated in a such a manner to be able to achieve its future performance milestones and not integrated into the other operations of the buyer.

REPRESENTATION AND WARRANTY INSURANCE

In the past few years, we have seen a rise in the use of representations and warranties insurance policies serving as the primary source of recovery for breaches of representations and warranties in lieu of indemnities from sellers. Many sellers prefer this option instead of offering a traditional indemnification/escrow package. However, many insurers are currently requiring exclusions from coverage to address the effects of COVID-19. Whether the exclusions are narrow or broad appears to depend on the industry involved and the target. Buyers who wish to pursue this approach should obtain several policy quotes, and compare terms and determine if there are any material exclusions. If there are material exclusions, a seller may consider providing a limited special indemnity to address them.

MATERIAL ADVERSE EFFECT CLAUSES

Before the pandemic, some agreement's MAE clauses included epidemics or pandemics as carve-outs. Since the pandemic, sellers have become increasingly focused on including a pandemic carve-out to prevent buyers from backing out on the grounds of COVID-19 or another pandemic. However, even when pandemics are specifically excluded there is often "an exception to the exception" for events that disproportionately impact the target business. A typical MAE clause allocates general market or industry risk to the buyer and company-specific risks to the seller.

We do not expect that there will be a material change in deals being terminated for MAE going forward. Historically, it has been rare for buyers to succeed in terminating a transaction based on an MAE. For example, courts in Delaware have only excused a buyer from closing a transaction due to an MAE once. *Akorn, Inc. v. Fresenius Kabi AG*, No. 2018-0300 (Del. Sup. Ct.). As the *Akorn* court explained, the buyer must show that "there has been an adverse change in the target's business that is consequential to the company's long-term earnings power over a commercially reasonable period, which one would expect to be measured in years rather than months." In any event, it may take a period of time for litigation to develop in this area for it to become possible to reliably predict outcomes.

Changes Ahead for Unsolicited Acquisition Proposals

While some businesses anticipate that the pandemic will create opportunities, others will encounter a variety of threats. The pandemic has weakened some businesses, potentially making them attractive targets for unsolicited acquisition proposals. So far, some federal legislation has been proposed that seeks to prevent predatory investment related to the pandemic. There are also a variety of steps that businesses may wish to consider to prepare to defend against unsolicited acquisition proposals.

PROPOSED FEDERAL LEGISLATION ON PREDATORY INVESTMENT

In April 2020, Senator Elizabeth Warren and Representative Alexandria Ocasio-Cortez announced plans to introduce legislation to impose a moratorium on M&A involving large companies until the Federal Trade Commission ("FTC") "determines that small businesses, workers, and consumers are no longer under severe financial distress." The bill only has one co-sponsor in the Senate and two co-sponsors in the House of Representatives and appears unlikely to gain traction in either House. However, it may offer a glimpse of future legislative developments, depending on the outcome of the 2020 presidential election. The bill, entitled the Pandemic Anti-Monopoly Act, would:

- Apply to companies with more than $100 million in revenue, financial institutions with over $100 million in market capitalization, private equity firms, hedge funds, "companies with an exclusive patent that impacts the crisis, like personal protective equipment" and transactions that must otherwise be reported to the FTC under current law.
- Direct the FTC to establish a legal presumption against M&A that pose a risk to the government's ability to respond to a national emergency.

In early May 2020, a bill was introduced in the U.S. House of Representatives to expand the authorities and responsibilities of the Committee on Foreign Investment in the U.S. ("CFIUS" or the "Committee") in order to mitigate the perceived threats posed by purported efforts of the Chinese government to acquire sensitive U.S. businesses during the duration of the COVID-19 pandemic. The bill, Restricting Predatory Acquisition During COVID-19 Act, would:

- Temporarily impose a presumptive prohibition on any purchase of a controlling interest by the People's Republic of China and certain of its affiliates in a U.S. business that is considered to be: (1) critical infrastructure; (2) a media or news outlet; or (3) deemed by the President to be culturally significant or otherwise critical to national security.
- Obligate the Committee to review any transaction meeting the foregoing criteria.

- Afford the President the ability to waive these presumptive prohibitions only if it is determined that the prohibition with respect to a particular action is not in the interest of the United States; the purchase price was not significantly affected by the COVID-19 pandemic, and the sale of the company will not allow China additional access to distribute propaganda or alter news and media consumption in the United States.

The bill is particularly novel in that it obligates the Committee and the President to block certain categories of transactions involving China, effectively limiting the range of outcomes and tools (such as through a mitigation agreement) available to CFIUS to address national security concerns. It also emphasizes increased focus in Washington of perceived efforts by foreign state actors to affect U.S. news and media, an industry that has not historically received heightened scrutiny from the Committee. At this time, we have not seen significant traction in Congress with respect to this bill, but we expect to monitor the bill's progress and report on any developments in forthcoming firm publications.

UNSOLICITED ACQUISITION PROPOSALS /ACTIVIST APPROACHES

As one of the effects of the pandemic, a board may find that the company is facing an unsolicited acquisition proposal or interest from an activist shareholder. Boards that believe their company is at risk may wish to consider implementing the following steps:

- Prepare a response team.
- Prepare a response plan.
- Consider whether any conflicts of interest exist.
- Request a structural defense assessment.
- Evaluate the company's existing strategic plans.
- Focus on stockholder engagement.
- Monitor for indicators of hostile or activist intent.

Prepare a Response Team

A company approached by a hostile acquirer or activist will need immediate assistance from experienced advisors, including law firms, investment banks, public relations firms and proxy solicitors. These advisors should be lined up in advance so a company can respond quickly.

Prepare a Response Plan

A board that considers its company to be at risk should have a response plan in place. The plan should be maintained on an ongoing basis to respond to both general changing circumstances as well as the pandemic. The plan should focus on assessing and responding to unsolicited offers and approaches from activist shareholders. It should define the roles and responsibilities of the directors, senior officers and outside advisors.

Consider Conflicts of Interest

In consultation with counsel the board should consider possible director conflicts of interest. The board should also evaluate whether there is any need to form a special committee. In general, to maintain the protection of the business judgement rule, the board (or special committee) must be free from conflict, have become reasonably informed with respect to the activist's proposals or unsolicited offer's financial and legal aspects as well as the company's standalone prospects, act in good faith and use a reasonable process.

Request a Structural Defense Assessment

A board may also wish to have counsel assess the company's structural defenses. Counsel should identify the company's potential vulnerabilities and ways to address them. Counsel and the board should also review the directors' fiduciary duties as they relate to an unsolicited or activist proposal and defensive measures. A holistic assessment should also evaluate whether to include any measures in the company's bylaws that can be changed without stockholder approval.

Prior to the pandemic, some commentators had urged all U.S. public companies to regularly review their defense profile and have a shareholder rights plan (or "poison pill") on the shelf. Such advice continues to make sense during the pandemic, particularly with respect to companies whose stock price has been adversely impacted by the pandemic in a disproportionate manner. Generally, stockholders and proxy advisory firms have disfavored the actual adoption of a poison pill in the absence of a specific threat. However, in response to the pandemic, ISS and Glass Lewis have issued more flexible guidance regarding poison pills that have a duration of no longer than one year, a trigger of not less than 10% and are adopted with a clearly articulated rationale.[1] Companies should assess their defenses and vulnerabilities, consider bylaw changes that can be made unilaterally, and reconsider the poison pill, which has seen some recent developments.

Evaluate the Company's Current Strategic Plan

A board responding to a hostile acquirer or activist needs an up-to-date strategic plan that includes long-term forecasts, in order to evaluate the unsolicited proposal against how the company would independently perform in the future. A board should evaluate the existing strategic plan to determine whether its underlying assumptions should be reassessed due to the pandemic. Ultimately, a board will need to convince its shareholders that the pursuit of the company's long term strategic plan and operational goals will create greater value for shareholders than the activist's platform or hostile acquiror's offer.

Focus on Stockholder Engagement

The success of a company's defense strategy ultimately depends on gaining the support of its stockholders. A board should review its existing relationship with stockholders to determine if any improvements are warranted. If a board already has widespread support for its overall strategy and well-established relationships with large

[1] *See* ISS Global Policy Board, *Impacts of the COVID-19 Pandemic*, April 8, 2020 and Glass Lewis, *Poison Pills and Coronavirus: Understanding Glass Lewis' Contextual Policy Approach*, April 9, 2020.

investors, it is more likely that the board will gain support for a particular defense strategy. The board and management should also be prepared to address any activist criticism of management's response to the pandemic, and take steps to make sure that the company's narrative is credible and cohesive. Although activist campaigns and approaches have declined somewhat during the pandemic, this decrease in activity is not expected to last. Companies that emerge from the pandemic appreciably weaker than their peers will be particularly vulnerable to activist and hostile overtures.

Monitor for Indicators of Hostile Intent or Activist Interest

A company that suspects a potential bidder or activist is making open market purchases should closely monitor trading in its securities. The company can ask its transfer agent to notify it if any one record holder accumulates more than 1% of its shares, or retain a proxy solicitor to monitor activity. Federal government filings may also reveal hostile intent. If a bidder or activist seeking control or influence at the target company acquires 5% or more of a target company's stock, it must disclose its stake, as well as intent, plans and proposals, by filing a Schedule 13D with the SEC within ten days of the acquisition. A bidder or activist will also be required to make a Hart-Scott-Rodino Act premerger notification filing for stock acquisitions in a target company with a value in excess of $94 million, although a buyer can acquire an economic interest above this amount through swaps and other exposures that do not involve acquiring voting securities of the company (and similar structuring is possible to avoid triggering 13D filing obligations).

Consider Strategic Alternatives

Given the effects of the pandemic and the volatility of the market, a company may believe that its stock is significantly undervalued. In this case, consistent with the general fiduciary duties of the board, the company may wish to internally explore strategic alternatives to enhance shareholder value, such as acquisitions or other strategic transactions. Given that "exploring strategic alternatives" is a common platform for activists and the goal of a hostile acquiror, a target company that has preemptively examined such alternatives will be in a stronger position to react to and counter such unsolicited proposals.

A company may also wish to consider stock buybacks, which can be used as a potential response to a hostile offer and also serves as a common investment thesis of shareholder activists. Notably for companies that are evaluating whether to pursue federal stimulus funds, under section 4003 of the Coronavirus Aid, Relief, and Economic Security Act (the "CARES Act"), companies receiving loans, loan guarantees, or investments from the U.S. Treasury generally will not be permitted to repurchase their listed securities. This prohibition exists both during the term of the loan, loan guarantee, or investment and for 12 months after the loan or loan guarantee is no longer outstanding, unless a contractual obligation to repurchase shares was in effect on the date of enactment of the CARES Act.

Apart from the restrictions of the CARES Act, a company should also consider the reputational risks associated with buybacks. Following the 2008 financial crisis, companies were criticized for engaging in stock buybacks and a company may encounter similar criticism given the present economic and social climate. Companies should consider whether the benefits of buybacks outweigh their consequences, which may include lost revenue, destruction of shareholder value, or increased operating, capital or regulatory costs.

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