CHOATE

Top Ten

TOP TEN TAKEAWAYS

Periscopes Up: Managing Your Company In Turbulent Economic Waters

On November 6, Choate and Ernst & Young hosted "Periscopes Up: Managing Your Company in Turbulent Economic Waters." We presented three panels addressing the very real challenges companies are facing in today's economic environment: internal risk management, credit market exposure and completing an M&A deal in an uncertain environment. Our panelists included senior representatives from Bank of America, Polaris Venture Partners, Ernst & Young and Duff & Phelps, as well as partners from Choate's Public Company and Finance & Restructuring Groups. Below is a list of ten key takeaways from the program and a hyperlink to a video of the seminar, which we invite you to view for additional insights.

1. **Risk oversight is an essential element of fiduciary duty:** Directors must ensure that controls are in place to identify company-specific risks and be prepared to take action when red flags go up. Failure to do so may result in a breach of duty of care.

2. **Heightened sensitivities in 2008 audit:** Year-end audits will focus intensely on counter-party risk (customers, vendors, lenders, lessors, freight forwarders, etc.) and asset impairment (inventory and goodwill). Information flow and transparency will be critical to a successful audit process. In addition, early and proactive management of counter-party risk and working capital resources is essential to ensuring operating results.

3. **Falling stock valuations lead to increased asset impairments:** When market capitalization falls below book value, asset impairment assessments are triggered. In practice, companies may have a "grace period" to defer impairment charges until market volatility subsides. In any event, board-approved projections are essential input to impairment assessments.

4. **Compensation needs to be reconsidered:** Falling stock prices have eviscerated incentives in existing equity awards, and deteriorating corporate performance has made many existing incentive metrics irrelevant. Companies must re-tool their approach to incentive compensation to reflect the near-term and longer-term environment.

5. **Corporate defaults are on their way up:** Approximately one year ago, credit defaults were at the lowest level since the Great Depression. To date, there has been some increase in corporate defaults, but the indicators suggest that will soon grow as lenders become less reluctant to exercise remedies and potentially realize losses. With the recent injection of government capital and ongoing consolidation in the banking industry, lenders will likely act more forcefully in coming months.

6. **Communication with lenders has never been more important:** Proactive, thoughtful communication with lenders will be crucial in navigating through this near perfect storm of the mortgage crisis, stock market volatility and the seizure of the credit markets. Lenders have never liked surprises less.

7. **M&A buying opportunities exist:** Strategic buyers who have sufficient cash balances so as to not require external financing are being presented with good acquisition opportunities. Highly leveraged management buyouts are difficult to execute. Lean companies with proven sales models continue to be attractive. Targets are cutting costs and using more variable pay with lower base salaries for sales professionals.

8. **Simultaneous sign and close of M&A deals is increasingly common:** Given the uncertainty in the debt markets, more deals are being structured to provide for a simultaneous sign and close.

9. **MAC out is rare:** Delaware courts continue to hold that a material adverse change (MAC) condition to close to an M&A deal is an exceptionally high standard, with the buyer having the burden of proof unless otherwise specified in the purchase agreement. As a result, buyers may be required to close deals despite deteriorating economic conditions and reduced target financial prospects.

10. **Internal communications are discoverable:** Business people considering avoiding or retrading a deal should bear in mind that all of their internal communications -- and communications with the other party – will be discoverable, with the exception of attorney-client privileged communication. Rule of thumb: don’t speak, write or otherwise communicate anything that you would not want a judge or jury to hear.

In-Depth Videos

To watch the complete sessions online, select from the following links:

Session 1: Internal Risk Management with:
- William B. Asher, Jr., Choate
- Craig E. Hallenbeck, Ernst & Young
- Michael Lynch, Duff & Phelps

Session 2: Credit Market Exposure with:
- Kevin P. Cronin, Bank of America
- Doug R. Gooding, Choate
- John F. Ventola, Choate

Session 3: M&A Transactions with:
- Mark D. Cahill, Choate
- Charles J. Johnson, Choate
- Jason Trevison, Polaris Venture Partners

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