

A Podcast Series in Collaboration With PLUS

In the Boardroom with Resnick and Fuller

Episode 4

Featuring Stephanie Resnick and John Fuller

PLUS: Welcome to this PLUS podcast, “In the Boardroom with Resnick and Fuller.” As a reminder, the information and opinions expressed by our speakers today are their own and do not necessarily represent the view of their employers, or PLUS. The contents of these materials may not be relied upon as legal advice.

Today, in Episode Four, we discuss how corporate boards and officers should respond to negative financial news, and specifically, the speculation that a recession in 2023 appears inevitable. Stephanie and John look at this topic through the lens of the liability risks that a recession and talk of a recession pose for directors and officers.

First, using the comparison of the COVID pandemic, they explore how company leaders and decision makers might be faulted for failing to prepare for a recession. That leads to a discussion of how boards should communicate with shareholders about recession concerns. Finally, they talk about how a recession can disrupt a company's prior decisions and existing commitments on a variety of issues, such as ESG, recruiting and compensation.

Stephanie Resnick is a partner at Fox Rothschild, a national law firm, and is co-chair of the firm's Directors' and Officers' Liability and Corporate Governance Practice Group. For 14 years, Stephanie has been ranked by Chambers USA as a leading litigator in Pennsylvania. She is known for taking the lead in high stakes, bet-the-company litigation and defending corporate boards and officers in complex and protracted litigation.

Stephanie is a former managing partner of Fox's Philadelphia office and a past chair of its nationwide Litigation Department.

Fuller is also a partner at Fox Rothschild and is the other co-chair of the firm's Directors' and Officers' Liability and Corporate Governance Practice Group. John has extensive experience defending directors and officers of public and private corporations in claims stemming from the discharge of their duties and management decision.

Since 2015, Stephanie and John have been co-authoring articles on topics of interest to corporate boards and directors for a variety of publications, including *Corporate Compliance Insights*, *The Legal Intelligencer* and the *Wiley Board Leadership Journal*. I'll now turn it over to John to get us started.

Fuller: We're here today to talk about pending, if not inevitable recession. As much discussion as there is about a possible recession, there's just as much about what people should be doing to prepare. What we want to do today, as we have in prior episodes of this podcast, is to really look at things not just from

a corporate structure, not from an individual's viewpoint, but really from a position of potential liability and what directors and officers should be focused on as we prepare for and then likely move into a recession.

A couple of areas we're going to talk about today are: how directors and officers can take demonstrable steps in their preparation; how boards should go about communicating with shareholders leading up to and through potential recession; and how issues such as recruitment or ESG, which may not normally require direct board oversight, should be on the board's radar as we think about the crisis presented by a recession.

So with respect to preparation, during the COVID-19 pandemic, we saw shareholder actions, which allege that directors and officers had failed to adequately prepare for the pandemic and its impact on their business. It's impossible to imagine how COVID would unfold and how it exactly would impact different businesses and at different times, near a still ongoing basis.

Now, nevertheless, despite the innate uncertainty, shareholders still pointed to things such as lack of supply chain resiliency and business interruption preparedness as purportedly knowable risks that boards failed to appreciate and properly address. We have to think that this concept of preparedness in and of itself may well form the basis of shareholder claims if and when a recession comes.

And, Stephanie, my first sort of question for the day and get your thoughts on is what do you think boards can do to bolster their preparations as we look towards a recession?

Resnick: Thanks John. Well, first I want to address your comment about liability during the pandemic, because I think it is very unfair that directors and officers were put in a position where they had to really be readers of crystal balls to determine what was going to happen during the pandemic.

It was never, never contemplated that the pandemic would be as long and as devastating, from an economic standpoint, with regard to supply chain issues, talent issues and the like. So, I just want to put my comments within the context of that. I think that we will need to treat a recession as a special event, just like a pandemic ... almost like a crisis.

And, what we need to do is really pay very strict attention to the economics of the company and what the company is doing to essentially focus on the issue of the recession. And the recession is going to shine a light on weaknesses and unproductive aspects of the business. So it's very, very important to understand how this is going to factor into the company's operations. Depending on the size of the company, this may mean forming a special committee to identify and analyze specific risks that a recession poses to the company. Smaller companies should consider making time in their board agenda to discuss these issues.

It should definitely be an agenda item at every meeting, and special attention should be given to issues such as supply chain disruptions, what will happen to cash flow if consumer demand drops, and what levers can the company pull, especially if interest rates continue to climb. Even if there is still tremendous uncertainty, identifying the potential risk is a good first step to communicating and setting expectations with respect to the shareholders. John, do you agree with that?

Fuller: I absolutely agree, and I think where you ended is kind of a perfect segueway to what else we talk about, is this idea of demonstrable preparation. Some of the things you hit on go to that, making sure that discussion of these topics is in the board agenda and is reflected in the minutes and that the board, again, seeing this from a liability standpoint, can say, yes, we were looking at this, we were setting aside time, and we can show that we were working on this problem, this impending crisis.

Resnick: And I just want to accentuate a point. The worst thing a company could do is just ignore it. Ignore the fact that we're going through a recession. If special attention is made to addressing the issue head on, I believe that that will avoid liability because certain issues will be addressed in a special way to account for this.

Fuller: I absolutely agree. And so taking those preparations internally, some of those may be, sort of, broadcast externally or to shareholders, but that first part of the preparedness, making sure it's well documented. The next part of that, as you were saying, is the communication, and so this is another area where, looking back at the COVID-19 pandemic, we saw generated shareholder claims. And again, as a recession, as you said, should be treated like a special event, like a crisis, what we saw during the pandemic is that there was this pressure, with the uncertainty, to make sure that there were silver linings in external communications. To make sure that there was some positive outlook, when really there was utter chaos, and no one knew what was coming. Boards need to resist that urge. And maybe management is often in control of that, especially in circumstances where you may use a PR firm or someone else to sort of help give some positive spin to things that appear on the website or other press releases and things like that.

But because we saw it as such as fertile ground for claims during the pandemic, this is a place where the board needs to know what's going out the door and needs to not just rely on how positive the spin is because there could ultimately be accountability for the board if there's uncertainty and, I guess it becomes sort of a question of accuracy and how much accuracy is the board responsible for.

And Stephanie, what are your thoughts?

Resnick: You know, you talked about communication. I think that really the issues should be grouped together as communications and transparency, and they go hand in hand in terms of communicating from the board to the shareholders. And if shareholders are aware of the situation and are aware of the problem and have been fully informed about what is going on, there is certainly going to be less likelihood that a suit would follow or claim would follow, because you're essentially, from a company perspective, becoming a partner with the shareholder and saying, "Hey, these are some of the issues that we're facing in this recession. The recession is beyond our control, but this is the impact to our business, and this is how we're going to try and address it together."

And they will – they being the shareholders – will have to understand that you can't just change a recession if you're a company, but you've got to deal with the impact of a recession on your bottom line in so many different respects. And that includes talent, that includes supply chain issues, that includes timeliness of delivery of product if you're a manufacturer or if you are distributor. It's those sorts of things that you would need to address that would be atypical in a normal environment, but typical in a recession, much like the pandemic. Although I think that in a recession, there will be more layoffs, and there really will be an emphasis to take a deep dive into the business' productivity.

Fuller: So one of the things that certainly comes with the recession is, it seems on its face advisable to reduce expenses, try to deal with things without perhaps getting outside professionals and things at all. What's your take on sort of spending money from a board's perspective? When is that advisable? When do you think the first line of defense should be just to try to deal with things in-house and save money?

Resnick: John, that's an excellent question, because clearly a board is going to be reluctant to spend additional money on consultants or experts when there's been a downturn in the markets, but sometimes it makes sense to get a consultancy agreement for a financial expert, for instance. That way the board has essentially isolated itself from any complaints that the board didn't take any action, that the board didn't do anything, that there were certain things that the board should have done. However, there are some common themes apart from hiring an expert or consultant that you just said that I want to reiterate

Expenses. That's the first item on the list. Somehow, during a recession, the company is going to need to tighten its belt to deal with expenses. Second: talent. Talent in a recession ... your first thought is that, oh, there's going to be an abundance of individuals to have as employees because everyone is going to be laying off employees.

But that's not really the case. As we've seen from the pandemic, people work differently now. And, employees and recruitment of employees could become an issue, which ultimately can affect the supply chain and distribution and bottom line. So, you have to really look at the talent piece in addition to just expenses and how those will be managed.

Fuller: No, I absolutely agree. And I think that's one of these things we're seeing is, perhaps it's not always, talent is not always on the board's plate. Obviously you have managers dealing with that. But I think particularly in the context where we are now, as you said, work has changed. We're in a period now where there is very low unemployment, fierce competition and people are using compensation as sort of the traditional way to attract talent. But we then have to sort of bring into the mix, and this is where I think it can really start to impact the board, is looking at policies relating to talent and the workforce.

But we have to think about how they may ultimately impact productivity. So, talking about work from home, but maybe more aptly, now is there a mandatory work from office policy, a parental leave, some of these other non-monetary policies, which the board should have some insight because if productivity drops, you can't attract the right talent and you can't just offer more money because of the recession.

We need to look at how that whole package, that whole compensation package, is going to potentially affect the company's ability to hire and retain people. So I think, Stephanie, I totally agree that talent is one of those issues like expenses that you need to look at. There are not, in a recession, that many ways to affect your bottom line. And again, we've seen from COVID, that preparedness, that ability to retain, that loss of talent, those types of things, were fodder for shareholder actions, and we have to assume that everybody's going to try to bring these again.

You know, another issue we want to bring up in terms of a place where the board may need to have additional oversight is ESG factors, which of course, over the last few years, environmental, social, governmental issues have risen to the top of actually too many boards' agendas. Something to be

thoughtful of in this pending recession, which may not have been present in prior fiscal cycles, is whether your company has made commitments regarding ESG.

And now some companies came out, and we've talked about this at length, Stephanie, about sort of what was appropriate for different companies. Some have come out and at the very least, articulated that these ESG issues do have an impact on the bottom line and that the board is potentially resolving to address them, perhaps hiring new departments or creating new titles and new focus on these issues. Some companies have gone further and put out quantitative commitments to where they will be, and with a pending recession, and as you talked about expenses and these sort of first layer ways to constrict, it may be tempting to put some of these ESG concerns back in an aspirational posture. But particularly where you've now announced that there's an effect on the bottom line, or that you are going to hit certain targets and that is going to be the basis of lawsuits, in our estimation.

Do you agree with that?

Resnick: I do. And I also think a recession could be an opportunity for the board and the CEO and COO to come together to really look at the policies in place and look at how they're operating and how they're doing business. And it's a good opportunity to kind of do a recheck and make sure that in all areas of operation, the board and the officers are comfortable with the way in which each part of the organization is running. Again, it's almost like a little reorganization. You might have to run a little tighter. And the board should definitely make an effort to try and do that. And again, a financial consultant who does modeling, depending upon the size of the company ... I mean, we are not suggesting that a small company should do this, but you know, in a larger company, it may make sense to get a consultant and talk about how you can more efficiently run your business.

But again, it's a lot of speculation, and as I've held fast to those pandemic claims, I really don't think that boards and officers and directors have crystal balls, and it's very hard to predict the downturn of an economic market. But once we're there, or we're on our way there, you just have to make an effort to address the points and kind of do a recheck. I think that's the safest way to avoid liability.

Fuller: I couldn't agree more. And the way you said it before as well, that you're sort of all in this together, to be a partner with the shareholders and the board and management is a great sort of driving and direct line through all of these points: the preparedness, taking a hard look at what needs to be done, being transparent and communicating that, dealing with all of these issues because there shouldn't be an adversarial, this is an outside crisis. It's an outside external pressure on the business as a whole. As you said, to work together. And with that being your driving force, to recheck, maybe you do slim some areas down. You look at what's not working, but this is a time to come together and prepare together and be transparent. So I couldn't agree more.

PLUS Staff: Thank you, John and Stephanie, for sharing your insights with PLUS, and thank you for listening to this PLUS podcast.

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