The Path Ahead: Corporate Law Current Trends and Forecasts for 2010

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The authors describe what they expect to see in the months and year ahead in connection with issues ranging from shareholder activism and executive compensation to corporate finance and securities law liabilities.

In the midst of arguably the most severe global economic crisis since the Great Depression, 2009 has been a highly eventful year in the area of corporate law. The current times herald a new era of more expansive regulation of U.S. public companies and increased powers for public company shareholders in areas historically reserved to management. The full impact of these developments remains to be seen, in part because some of the most far-reaching reforms have not yet been implemented through final federal regulation or legislation. Nevertheless, there are certain proposed legislative and regulatory initiatives and other trends that promise to significantly alter the U.S. public company landscape in the years ahead.

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SHAREHOLDER ACTIVISM

Proxy Access Looms on Horizon

The issue of proxy access looms over public companies, as the SEC is expected to enact some form of its proposed rules in early 2010 (which rules will not be effective for the 2010 proxy season for companies with a fiscal year that ends on December 31). The SEC's proposed rules would empower activist shareholders by permitting candidates constituting up to 25 percent of the board of directors to be nominated through the company's proxy materials, shifting much of the cost of a dissident proxy contest away from activists and onto companies. To have such access, shareholders would have to meet stock ownership requirements of one percent, three percent or five percent, depending upon the size of the company's public float. The SEC's proposed rules also include an amendment to current SEC rules that would require companies to include in their proxy materials shareholder proposals that would amend the company's governing documents to provide for proxy access.

The proposed rules were adopted by a 3-2 vote of the SEC commissioners, and the debate over proxy access continues to be heated. Opponents of the proposed rules believe that the SEC should enable shareholders to bring the issue of proxy access before shareholders through the company's proxy materials (which shareholders are currently prevented from doing under SEC rules), but leave the details of ownership thresholds and other eligibility requirements to be decided by the companies and their shareholders under state corporate law. This kind of state-by-state, company-by-company approach would be consistent with changes to the Delaware corporation law earlier this year that clarified that proxy access and related eligibility requirements are appropriate issues for companies and their shareholders to cover in corporate bylaws.

At a minimum, it seems apparent that the SEC will adopt final rules that will allow shareholders to include proposals in company proxy materials to amend the company's governing documents to set forth proxy access rules and requirements. We also believe there is a significant chance that the SEC will mandate proxy access for all public companies, although criticisms of certain aspects of the proposed proxy access rules in the SEC

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comment process may result in certain changes from the proposed rules.

Although some commentators have advocated otherwise, we generally believe it premature for public companies to adopt proxy access-related amendments to their bylaws in advance of the adoption of final SEC proxy access rules. Because of the uncertainty regarding what will be included in the final rules and when such rules would be effective, any endeavor to amend a public company's bylaws in advance of the adoption of final SEC rules runs a significant risk that company time and expense will be wasted on bylaw amendments that will need to be revised again, perhaps materially, based on what is included in the final rules. Nevertheless, we believe it advisable for public companies to consider how they might react to various scenarios regarding what may be included in the final rules.

End of Broker Discretionary Voting for Uncontested Director Elections

Effective for the 2010 proxy season, brokers will no longer be able to vote in uncontested director elections at their discretion in the absence of specific instructions from beneficial shareholders. Historically, a significant majority of shares held by retail holders (who tend to vote in favor of management) are not voted unless prompted by active solicitation efforts. Therefore, companies with a significant retail shareholder base (more often, NASDAQ companies) may need to engage in more active solicitation efforts to counter the anticipated reduction in the size of the retail vote. This change is expected to be especially problematic for companies that have adopted a majority voting standard for director elections, as the anticipated reduction in the size of the retail vote will make it more difficult for directors to receive the requisite majority vote. Further, in those cases where the only matter being voted on at a company's annual meeting is the election of directors, obtaining a quorum of the company's shareholder may be more difficult.

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EXECUTIVE COMPENSATION

Executive Compensation Legislative Initiatives

Over the past year, the global recession and market downturn have acted as catalysts with respect to corporate governance reform initiatives, and one of the areas seeing significant reforms is executive compensation. Notably, executive compensation reform proposals stem from an array of sources: federal and state legislators, the SEC, national securities exchanges and shareholder activists, to name a few.

One of the most prominent pieces of reform legislation is the Corporate and Financial Institution Compensation Fairness Act of 2009, which was proposed by the House Committee on Financial Services Chairman Barney Frank (D-MA) and passed in the House of Representatives on July 31, 2009. Among other requirements, the Act would require public companies to give shareholders a non-binding, advisory say-on-pay vote on executive compensation for named executive officers at the company's annual meeting. In addition, the Act would require a separate shareholder vote to approve certain "golden parachute" arrangements in proxy solicitation materials for any meeting where shareholders are asked to approve certain business combinations or sale of assets transactions.

The Act would also require enhanced or new independence standards for compensation committees, compensation consultants and other similar advisors of compensation committees. Furthermore, compensation committees would have the sole, discretionary authority to retain and obtain the advice of independent compensation consultants, outside counsel and other independent advisers, and would be directly responsible for their appointment, compensation and oversight. The SEC has also proposed rule amendments that would require companies to provide additional disclosure about compensation consultant relationships and fees.

We believe it likely that some form of say-on-pay will become law, although it is difficult to predict how Congressman Frank's legislation will progress through Congress this fall given the crowded congressional calendar. Even if this Act is signed into law this fall, it appears that say-on-pay will not be effective until after the 2010 proxy season based on the current language in the legislation.

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Navigating the Executive Compensation Waters

Boards of directors and compensation committees are charged with the difficult task of navigating through all of the recent reform initiatives to ensure that their compensation policies and practices are on the proper tack. This difficulty is only exacerbated by the inherent uncertainties in handicapping the legislative and administrative processes. However, boards of directors and compensation committees should keep in mind a couple of points with respect to their company's compensation policies and practices. First, notwithstanding all the new legislative proposals, directors should not, and need not, be deterred from making pay decisions they determine to be appropriate and in the best interest of their companies. To this end, the business judgment rule is a strong ally: directors who act on an informed and rational basis, in good faith and not in their personal self-interest, having the advice of an independent consultant and legal counsel in approving their compensation programs, need not fear being second guessed by the courts. Second, statements made by, and actions taken by, government officials or shareholder activist groups expressing approval or disapproval of certain forms or amounts of compensation do not set the standard for "reasonableness" under the law. In other words, aspirational "best practices" are not synonymous with legal requirements.

CORPORATE GOVERNANCE

Public Companies Will Remain Under Pressure to Adapt to Corporate Governance "Best Practices"

The year to come may prove to be a watershed period for corporate governance reform, one that will require vigilance among senior management and directors. Public companies will continue to be under pressure from shareholder activists to adopt various corporate governance "best practices," such as repealing classified boards, implementing majority voting for director elections, and having an independent chairman. The adoption of certain of these practices has been more prevalent among large-cap companies than smaller public companies. For example, a significant majority of mid-cap and small-cap companies continue to have pure plurality

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voting, while a sizeable majority of S&P 500 companies have adopted some version of majority voting. Nevertheless, in the current environment, public companies of all sizes will remain under pressure to adapt to these current trends, both from shareholder activists and proxy advisory services and, possibly, by governmental fiat.

Both the Shareholder Bill of Rights Act of 2009, introduced by Senator Charles Schumer (D-NY) in the Senate, and the Shareholder Empowerment Act of 2009, introduced in the House, seek to impose major reform with respect to the corporate governance of public companies and to significantly federalize corporate law in the United States. Although there are some differences between the proposed bills, both pieces of legislation would mandate proxy access, would require majority voting for directors of exchange-listed companies, would require that the chairman of exchange-listed companies be independent, and would require an annual non-binding advisory shareholder vote regarding executive compensation. The Senate bill would also require exchange-listed companies to hold annual director elections (effectively eliminating staggered boards) and would require exchange-listed companies to create a separate risk management committee comprised solely of independent directors. Senator Schumer's bill would also give the SEC the authority to exempt certain public companies from the application of certain requirements of his bill based on company size or other criteria the SEC deems appropriate. Although these bills may not have support to pass as stand-alone legislation in their current form (even if certain components of these bills, such as say-on-pay, may have widespread support), the final outcome of this legislation is difficult to predict, as the bills could be modified, or incorporated into omnibus congressional legislation, in a manner that increases their chances of passage.

Proposed Expansion of SEC Disclosure Rules Related to Directors

The SEC has proposed amendments that would expand the proxy disclosure requirements regarding the specific qualifications of directors and nominees for director in light of the company's business and structure. In addition, these proposed rules would require companies to describe their

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leadership structure and their board's role in risk management. Companies would be required to disclose whether the same person serves as both principal executive officer and chairman of the board, and if so, whether the company has a lead independent director.

FIDUCIARY DUTIES

Delaware Courts Remain Protective of Business Judgment Rule

2009 has been an active year for litigation focused on the fiduciary duties of public company directors, including litigation relating to executive compensation and in the mergers and acquisitions context. In particular, courts considered corporate oversight and corporate waste in the corporate governance context (including the widely publicized *AIG* and *Citigroup* decisions), and provided important clarification on *Revlon* duties and director liability for breaches of their duties of care and loyalty (including "disclosure" and "good faith") in a transactional context. In these decisions, the Delaware Courts remained protective of the "business judgment rule" and maintained a high bar to finding directors personally liable for a breach of their duty of loyalty (or "bad faith") in these contexts — emphasizing the importance of ensuring that companies incorporated under Delaware law eliminate in their certificate of incorporation the liability of their directors to the maximum extent permitted under Delaware law for breach of their duty of care.

Continued Focus on Executive Compensation and Risk Management Advisable in 2010

Over the next year, we expect more fiduciary duty decisions in the area of corporate oversight, including in the compensation arena (and a possible tightening of the corporate waste doctrine) — the latter resulting from increasing shareholder dissatisfaction with executive compensation and severance and perceived disconnects between pay and performance. Now, more than ever, boards (and compensation committees) should be mindful of their fiduciary duties and oversight responsibilities.

In addition, "risk management" is also high on the reformist agenda

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of activist shareholders, shareholder advisory groups such as RiskMetrics, the SEC and Congress. This focus on risk management could trigger an increase in shareholder litigation targeting perceived poor risk management controls. Facing considerable "external" pressures in the current political and shareholder environment, the courts may permit a possible creeping of less deferential oversight liability standards to risk management oversight — thereby encroaching on the protective cloak of the business judgment rule, an action thus far resisted by the Delaware courts (including in the *Citigroup* decision earlier this year). Accordingly, if not already in process, we recommend boards review their approach to overseeing the risk management controls of their company and the related monitoring process.

M&A TRENDS AND DEVELOPMENTS

The Current State of M&A

Despite the recent upturn in the U.S. equities market, mergers and acquisitions activity in the United States remains depressed compared to recent years (U.S. deal volume in the second quarter of 2009 was lower than any quarter, other than the fourth quarter of 2008, since the third quarter of 2003). Lack of available credit, diminished liquidity, and uncertainty and pessimism about the economy have all contributed to this downturn. The widespread perception that many U.S. public companies have been undervalued following the sharp decline in the U.S. stock market in 2008 and the first quarter of 2009 has resulted in average deal premiums for public company acquisitions in 2008 and 2009 being significantly above their average levels from 2002-2007 but has not spurred a general increase in mergers and acquisitions activity. Moreover, the recent rebound in the U.S. stock market has not resulted in significantly increased deal volume, in contrast to the recent historical trend of increased deal volume being closely correlated with stock market upturns.

Although there have been some signs that the deal market is reviving at the national level within the last couple of weeks, most observers are not predicting a significant increase in mergers and acquisitions activity until 2010. We generally agree with this prevailing wisdom. Although the worst of the credit crisis appears to have passed, the inability of companies to ob-

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tain credit on terms comparable to recent years will continue to have a negative impact on deal volume for as long as negative credit conditions persist. Moreover, cash availability continues to be a significant issue among a large segment of U.S. companies, as many companies struggle to meet debt covenants and others use cash for purposes such as buying back debt.

Nevertheless, among companies that have the liquidity and willingness to engage in acquisitions, opportunities abound — particularly for strategic buyers. As the number of prospective buyers has decreased, so too has the asking price of many target companies — EBITDA multiples have generally declined in 2008 and 2009 compared to recent years. Moreover, stock may become a more attractive acquisition currency for prospective acquirers if the recent stock market rebound does not reverse itself (the percentage of all-stock deals declined significantly in 2008 and the first half of 2009 compared to recent years). Finally, although the deal market has not witnessed as much of a pro-buyer sea change regarding deal terms such as indemnification baskets and caps as one might have expected in this economic climate, in many cases buyers will be able to take advantage of the current environment to negotiate more favorable legal terms in acquisition agreements than they could have in recent years.

Unsolicited Activity Remains High

Unsolicited and hostile takeover activity remains at historically high levels as a percentage of total deal activity, despite the difficult financing conditions. The sharp decline in the U.S. stock market in 2008 and the first quarter of 2009 has left many U.S. public companies with market capitalizations that have been widely perceived as undervalued, even after giving effect to the recent positive movement in the stock market. Moreover, the decline in recent years of defensive measures such as shareholder rights plans and classified boards has left many companies more vulnerable to unsolicited activity. Although the recent rebound in the stock market may temper unsolicited and hostile activity to a degree, the market capitalization of most public companies remains far below their level at the peak of the market in October 2007, and public companies are advised to remain vigilant and to monitor their vulnerabilities and defensive profile on an ongoing basis.

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DISTRESSED M&A

Distressed Transactions Will Remain Prevalent, Present Opportunities for Buyers

The general upheaval caused by the financial crisis and the consequent disappearance of readily available credit has been responsible for not only the considerable number of high-profile bankruptcies in 2008 and 2009, but also much larger, if less visible, numbers of private companies that find themselves with limited sources of capital available to fund operations during the downturn. Faced with such limited prospects, an increasing number of such companies have been forced into reorganizations and sales, presenting potential bargain acquisition opportunities for buyers even in a market where general M&A activity has declined sharply. Overall, the number of bankruptcy-related mergers and acquisitions through August 2009 was 65 percent higher than over the same time period in 2008.

Courts dealing with the increased number of distressed transactions, including in the recent high-profile decision of the Second Circuit Court of Appeals upholding the transfer of the assets of Chrysler to Fiat in a U.S. Treasury-backed transaction, have continued to affirm the broad discretion of bankruptcy courts to tailor Section 363 auction sales and other types of transactions in ways that suit each individual distressed target's circumstances. At the same time, acquirers have continued to explore new ways of effecting distressed acquisitions quickly and with minimal risk to the underlying business, such as through "pre-packaged" reorganization plans and by coupling bids in 363 auctions with debtor-in-possession financing that allows the business to remain intact while the 363 process is overseen by the bankruptcy court.

The trend toward larger numbers of companies finding themselves in distress seems likely to continue into 2010 as credit markets are expected to remain tight and as additional covenant-light debt instruments that were put in place prior to the beginning of the financial crisis expire, leaving many companies with few, if any, choices to replace them. Hedge funds, an increasing player in distressed acquisitions over the past year, will likely

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continue to seek potential bargains through both individual distressed acquisitions and the establishment of "opportunity funds" with an investment strategy focused on distressed targets. Buyers with cash available to move quickly and a willingness to be creative in managing risks and structuring acquisitions are likely continue to find significant numbers of distressed targets available for low multiples and in many cases eager to deal.

CORPORATE FINANCE

A Thaw in the IPO Market?

We expect the pace of IPO filings to increase during the remainder of 2009 and in 2010 (as of September 4th, there had been 21 U.S. initial public offerings in 2009, compared to 50 last year). Early IPO preparations are essential for a successful IPO, and many newly public companies underestimate the level of market scrutiny that accompanies an IPO. Newly-listed companies must meet market and analyst expectations immediately. Companies considering an IPO should start planning now for any time-consuming organizational changes. These changes can include strategic planning, building a management team, drafting corporate and organizational documents that are required of public companies, and establishing the internal control, financial and accounting systems required of public companies. A strong infrastructure will facilitate regulatory compliance, protect against risk exposure and provide accurate guidance to forecast financial results, all of which are fundamental for success as a public company.

At-The-Market Offerings Increasing in Popularity

Despite the recent trend in IPO filings, the market is still extremely volatile, which has limited some of the more traditional capital raising methods for many public companies. Public companies are increasingly seeking alternative sources of economic capital. An "at-the-market" offering ("ATM") is one type of offering structure that can permit public companies to quickly and discreetly raise capital while avoiding the potential downward pressure on stock prices that typically accompanies

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the announcement of a traditional follow-on offering. By establishing an ATM offering program, an exchange-listed company can, over a period of time, sell newly-issued shares into the trading market through a designated broker-dealer at prevailing market prices, rather than at a fixed price in a single takedown.

ATM offerings have become more popular over the past two years in part because of the elimination of various procedural hurdles in connection with the 2005 Securities Act Reform regulations. An ATM program will not replace traditional offerings but instead allows public companies to raise incremental capital on an as-needed basis.

The public offering market has also seen a rise in "stealth" or overnight public offerings, in which an issuer with an effective shelf registration statement or that is able to file an automatically effective shelf registration statement, sells securities in a fast-moving transaction without the benefit of a traditional two to three week road show. These transactions, which are completed on an accelerated basis, seek to limit an issuer's exposure to market risk that often accompanies a more traditional process involving a road show.

INVESTOR RELATIONS/EARNINGS RELEASES

Current Economic Distress Accelerating Trends Relating to Earnings Guidance

The current recession and ongoing volatility in the financial markets has accelerated the trend over the past several years of public companies discontinuing, suspending or modifying the practice of issuing earnings-per-share ("EPS") guidance, especially with respect to quarterly EPS guidance. Due to the increased difficulty of predicting results of operations in the current economic climate, many public companies are shifting from providing quarterly EPS guidance to providing annual forecasts or eliminating the practice of giving EPS guidance altogether. Instead, some companies are replacing annual and quarterly EPS guidance with other, less specific, forward-looking financial metrics and even non-financial disclosures regarding results and trends, with an emphasis on long-term strategic goals and plans. Other companies are only providing guidance for

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specific line items which management can forecast with confidence. We expect these trends to continue for the foreseeable future until the economy stabilizes and recovers and results of operations become more easily predictable.

Companies deciding whether to discontinue or suspend earnings guidance should consider a number of issues, including the announcement of suspension or discontinuation of guidance, metrics that will be provided in lieu of EPS, and Regulation FD considerations. Decisions regarding the frequency and nature of a company's earnings forecasts should be made on an individualized basis and in consultation with the company's management, audit committee, accountants and legal counsel.

PERIODIC AND CURRENT REPORTING

XBRL: Deadlines Draw Nearer for Smaller Public Companies

SEC reporting rules adopted in December 2008 will soon transform how reporting companies disclose financial data. The rules will require reporting companies to file certain financial data in the *eXtensible Business Reporting Language* ("XBRL") format. XBRL is an international standard for encoding financial statements in a manner that can be read, interpreted and analyzed by computer software. Applicability of the XBRL rules is being phased-in over three years based on company size.

Companies subject to the XBRL rules must electronically identify items in their financial statements and reports with specific XBRL "tags." This tagging is intended to make the reports interactive and readable by software, enabling investors to compare, analyze and interpret data more easily. Initially, XBRL data must be included in a separate exhibit filed with the SEC and posted to the filer's website.

Reporting companies must begin to file XBRL financial statements in their first quarterly report on Form 10-Q for a fiscal quarter ending on or after June 15, 2009, 2010 or 2011, depending on the company's filing status and market capitalization as follows:

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Company Size	*Effective Date*
Large accelerated filers using U.S. GAAP with a public equity float *greater* than $5 billion	June 15, 2009
Large accelerated filers using U.S. GAAP with a public equity float *less* than $5 billion	June 15, 2010
All other U.S. GAAP filers and all filers that use Financial Reporting Standards.	June 15, 2011

Compliance with the XBRL rules will require reporting companies to prepare well in advance of the applicable phase-in date. First and foremost, reporting companies will need to decide whether to outsource the XBRL financial reporting transition to a third party vendor or devote internal resources to compliance. Outsourcing the function to a third party vendor will result in additional cost which should be factored into the budgeting process for 2010 and 2011 for those reporting companies not yet required to comply with the rules. Using internal resources and XBRL tagging software to tag the financials without the assistance of a third party vendor will require additional employee hours and contribute to increased compliance costs. Whether a reporting company outsources the tagging process to a third party vendor or retains the responsibility in-house, compliance with the XBRL rules will result in additional cost and will require reporting companies to allow for additional time in preparing quarterly and annual reports.

SECURITIES LAWS LIABILITIES/SEC PRIORITIES AND ENFORCEMENT/INSIDER TRADING

SEC Division of Enforcement Expands Enforcement Initiatives

The SEC's Division of Enforcement is boldly going where no Division of Enforcement has gone before. Unfortunately, that means that the regulated community must remain tuned-in to find out what new or expanded liability awaits.

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In May 2009, the SEC began blazing new ground by filing its first enforcement action alleging insider trading in credit default swaps. In doing so, the SEC broadened its application of well-established laws regarding insider trading in stocks and applied them to credit default swaps.

To the chagrin of some seemingly innocent individuals, other "firsts" quickly followed. With July came the SEC's first use of the "clawback" provision of Sarbanes-Oxley against an individual not accused of wrongdoing, and the first action involving the books and records and internal controls provision of the Foreign Corrupt Practices Act against individual executives who were not alleged to have knowledge of any misconduct. The fall of 2009 has continued to reflect the Division's increased focus on insider trading cases with the October 16, 2009 announcement that the SEC had charged billionaire Raj Rajaratnam and his New York-based hedge fund advisory firm Galleon Management LP with engaging in a massive insider trading scheme that generated more than $25 million in illicit gains.

With Director Robert Khuzami's marching orders for the Division of Enforcement to be more *strategic*, *swifter*, *smarter*, and more *successful*, organizational restructuring of the Division is beginning to take shape. New specialty groups are being formed to address pressing regulatory concerns, and resources are being redeployed in an effort to operate more effectively and nimbly. Focus appears to be shifting to proactive front-line investigations and away from delayed and reactive responses. A newly created Office of Market Intelligence will act as the center for monitoring complaints and tips. The SEC also appears to be reaching out to individuals, offering them incentives to cooperate in investigations that have only been offered to corporations in the past.

FINANCIAL INSTITUTIONS

Heightened Regulatory Focus Expected to Continue Into 2010

The first nine months of 2009 have been a tumultuous time for the financial services industry. From increased regulatory oversight to mounting asset quality concerns, financial institutions and their managers and directors are facing challenges not seen in almost 20 years. The latest tightening of regulatory oversight can be seen in the Federal Deposit In-

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surance Corporation's recent Financial Institution Letter extending the "de novo" period for examinations, capital and other requirements from three to seven years. Citing "recent experience" and describing how depository institutions insured less than seven years are over represented on the list of institutions that failed during 2008 and 2009 (83 such institutions had failed in 2009 through August 28, 2009), the FDIC will keep these institutions (including existing institutions formed prior to the issuance of the FIL, but which are not yet seven years old) on a 12-month examination cycle for the full seven year period. The FDIC must also approve material changes to these institutions' business plans during the seven year period.

As we look ahead to the remainder of 2009 and the first half of 2010, we expect to see a continued heightened focus from regulators, both state and federal, on asset quality and capital during this exam cycle. With this, we expect to see continued increased provisioning expense and more financial institutions being placed under formal enforcement actions. We also expect that the remainder of 2009 and the first half of 2010 will see financial institutions exploring a number of capital raising alternatives as they seek to shore up capital levels during these difficult economic conditions.

TRANSACTIONAL TAX

Recent Decision May Cause Companies to Revisit What Documentation is Provided to Outside Auditors

As a result of the recent decision by the U.S. First Circuit Court of Appeals in *U.S. v. Textron Inc.*, companies should exercise extreme caution in supplying their outside auditors with documents that are otherwise protected under the attorney-client privilege. It long has been settled law that sharing such documents with outside auditors spoils the attorney-client privilege. Nevertheless, prior to the *Textron* decision, such documents often were protected from disclosure to an adversary (including the IRS) under the work product privilege. After the *Textron* decision, relying on the work product privilege to protect such documents could prove perilous.

The tax accrual work papers at issue in *Textron* were prepared by outside lawyers and others in Textron's tax department and contained analysis and estimates of potential tax liabilities if the IRS were to challenge cer-

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tain positions taken by Textron. The tax work papers were requested by Textron's outside auditors in connection with its audit of Textron's annual financial statements. The IRS requested the tax work papers in connection with its audit of Textron. While the IRS generally has adopted a policy of restraint in requesting tax accrual work papers, it requested Textron's tax work papers after discovering a potentially abusive transaction on audit. The First Circuit Court of Appeals ultimately granted the IRS access to Textron's tax work papers.

Accordingly, if a company shares attorney-client privilege protected tax documents with a third party, including an independent auditor, the IRS may have the ability to force this company to turn over such tax documents. Such tax documents often provide a roadmap of the weaknesses of certain tax positions, and as such, could provide the IRS with a significant advantage during an audit or other tax controversy proceeding.

JOINT VENTURES

Considerations in Dealing with Joint Venture Partners That Are Financially Distressed

The specter of distressed business partners in the current economic climate puts stress on joint venture relationships. Jointly owned business entities and their owners should approach certain legal issues in light of the financial stability of all owners and should engage in contingency planning for the security of the joint venture's business.

Important considerations for joint venture entities and owners in the current climate are:

- Analyzing the joint venture's agreements with third parties for issues that could be triggered by a weakness of an owner or "affiliate" as it may be defined in third party agreements. A common example of an agreement that raises this concern is a debt agreement under which default is triggered by the insolvency of an "affiliate" or the failure of an "affiliate" to pay its debts as they become due. Clients may need assistance negotiating waivers or amendments to third party agreements to alleviate these issues.

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- Assessing the financial strength of joint owners and their ability to meet ongoing obligations to the joint venture, whether to contribute capital, provide financing support, or provide supplies or services. Companies that depend on joint owners for cash or operating needs should develop back-up plans for owner defaults and may want to seek liens or security interests or negotiate special offset, buy-out or other rights against owners in light of particular risks.
- Proceeding with care against joint owners that are insolvent or have filed for protection under bankruptcy laws. Companies should seek legal advice concerning the bankruptcy court's automatic stay requirements and enforcement of joint venture remedies, which involve a complex and developing area of the law. Companies and partners should be aware that funds which a partner contributed to the venture may be recoverable in bankruptcy, and that joint venture agreements may be treated as executory contracts, which may be assumed, rejected or even assigned in bankruptcy, depending on the facts and the legal analysis applied by bankruptcy courts, which may differ depending on the court that hears a case.

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