Private Equity Portfolio Company Corporate Governance

1. **A Working Board is a Strong Start:** Set expectations for the Board's regular interactions with managers and create clear guidelines for when the Board must be consulted. This is an opportunity to provide immediate value and a straightforward way to set the stage for effective, efficient governance.

    - Key metrics and goals are important discussion points that quickly highlight performance, but Boards must make time for in-depth discussion of business issues. More communication fosters stronger working relationships and common understanding.
    - Investment agreements and company by-laws are effective vehicles for assigning and clarifying authority within the organization.
    - Non-financial performance metrics can serve a critical role in the long-term value of a portfolio company. Updating the Board on issues such as diversity, environmental impact, and community engagement can help portfolio companies remain relevant and responsible market players.

2. **Formalities Matter:** It is important to maintain formality in the boardroom. Key factors include: (i) recording meeting minutes; (ii) engaging outside counsel to sit in on Board meetings and assist if legal questions arise or if Board members need to be reminded of fiduciary duty obligations; and (iii) establishing committees, as necessary.

    - Executive committees can be a means of keeping Boards agile and delegating limited decision-making authority to a smaller leadership group.
    - Closely-held companies without a Board are excellent candidates for establishing an Advisory Board. These help establish the rhythm of regular Board meetings, more formal reporting and oversight controls.

3. **Have The Right People In The Room:** The right mix of expertise on the Board can foster uninhibited discussions and fresh ideas.

    - Ensure Board seats are filled with a blend of company leadership (i.e. CEO) and highly experienced industry professionals who can provide insight or crucial introductions.
    - Keep Board size manageable. While there is no magic number for Board size, limiting to between 5 and 7 directors reduces scheduling conflicts and encourages active participation.
    - Observer rights are an effective way to engage smaller investors without sacrificing control.

4. **Know Your Team:** Board members should foster personal relationships outside of the boardroom in order to maintain trust, effective communication and cohesion among a group of people with different backgrounds and different interests. This takes ongoing effort to accomplish. The failure to build and maintain strong relationships among the Board members could lead to tensions among the Board during difficult times.

    - Pre-Board meeting dinners or events can be well-justified expenses. They offer an opportunity to interact informally, learn about the management team, and set the tone for the meeting to come.
    - A tag-team approach to Board management is an effective way to lead. Placing a senior private equity fund member as the chairman of the Board provides

experience, expertise, and well-developed judgment to the Board. Combining this with a junior member Board seat responsible for the day-to-day responsibilities of Board membership – like regular management interactions and agenda setting – ensures that expertise is combined with a strong understanding of the company's current position.

5. **Remember Your Duties:** Fiduciary duties are owed to the shareholders of the company as a whole, other than in a "zone of insolvency" situation where the duties shift to the company's creditors.

   - Board members should always think about what "hat" they are wearing before acting. Courts have held that dual fiduciaries will be held to the same exacting standard for all companies in which they hold Board seats.

   - If there is a conflict of interest, the best course of action is to disclose the conflict and withdraw from the vote.

6. **Dueling Fiduciary Duties:** Engaging outside (or independent) directors is one way to mitigate risks associated with dueling fiduciary duties of private equity partners that sit on Boards of their portfolio companies.

   - A well-functioning committee of independent directors is critical in the event that a business decision is challenged.

   - Ensuring independence can be challenging if the independent director is sourced by the private equity fund and relies on successive nominations by the fund. Careful planning to ensure the independent director avoids conflicting interest (e.g. material stock ownership, employment by an interested party) is important to maintaining independence.

7. **Compliance Oversight is Critical and Changing:** Waiting passively for senior management to advise the Board of potential legal compliance problems or other material threats to the business is not enough.

   - Take proactive measures. Ensure that management responsible for compliance regularly attends Board meetings. Define primary risk areas for the portfolio company's business and make these issues regularly-scheduled topics for Board discussion. Set aside time to ask questions on the agenda, and include ethics/compliance content in Board training materials.

   - Reevaluate regularly, as compliance programs are not "one-size-fits-all". A company that has experienced a compliance breakdown has different needs than a company with a long record of compliance, and risk-exposure changes over time.

8. **Understand Your Insurance**: Director and officer policies are important means of addressing the risk of settlements/judgments arising from shareholder actions as well as investigations.

   - Make sure you understand significant exclusions in your policy.

   - Have your policy reviewed by an outside professional to determine the scope of items that may not be covered under the policy.