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What's on Your Mind?

Join Our Continuing Peer-to-Peer Exchange Exploring the Latest Corporate Governance Trends

Private Company Corporate Governance Best Practices

November 14, 2012

9:15 a.m. – 10:30 a.m.

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Private Company Corporate Governance Best Practices

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Overview

- Board Responsibilities
- Pitfalls for Private Equity Portfolio Boards
- Protective Measures
- Sarbanes-Oxley

Board Responsibilities

Board Responsibilities

- Board of Directors is Responsible for Overseeing the Business and Affairs of Its Company
 - Approving Leases, Contracts or Other Material Agreements
 - Approving Fundamental Operating Financial and Corporate Plans, Strategies and Objectives
 - Authorizing Sale of Company Assets and Other Strategic Transactions

Board Responsibilities

- **Overseeing the Business and Affairs of Its Company** *(continued)*
 - Evaluating Performance of the Company and its Management
 - Selecting, Evaluating and Fixing Compensation of Corporate Officers
 - Reviewing and Approving Management Plans
 - Adopting Policies of Corporate Conduct

Board Responsibilities

- **Evaluating the Overall Effectiveness of the Board Itself**
 - How Well the Board Carries Out Its Functions
 - How Well Prepared the Directors Are to Fulfill Their Obligations

Board Responsibilities

- The Directors Owe Certain Fiduciary Duties to Their Company
 - Duty of Care
 - Duty of Loyalty

Board Responsibilities

- Duty of Care:
 - Requires Directors to Keep Themselves Informed About the Affairs of the Company and be Assured that They Have All Reasonably Available Information When Making Decisions
 - Directors are Expected to Act on an Informed Basis, in Good Faith, with the Care an Ordinary Prudent Person in a Like Position Would Exercise and in a Manner the Directors Believe to be in the Best Interests of the Company

Board Responsibilities

■ Duty of Loyalty

- Requires Directors to Uphold Their Fiduciary Duties to the Company and its Stockholders by Placing the Company's Interests Ahead of Their Own
- Directors Should Not Use Their Corporate Position to Make a Personal Profit or Gain or for Other Personal Advantage
- Two Specific Considerations:
 - Conflict of Interests
 - Corporate Opportunity

Board Responsibilities

■ Business Judgment Rule

- Qualifies the Duty of Care
- Protects Disinterested Directors from Personal Liability to the Company and Its Shareholders, even if a Corporate Decision the Director Approved Turns Out to be Unwise or Unsuccessful

Board Responsibilities

- Business Judgment Rule *(continued)*
 - A Court Generally Will Not Substitute Its Judgment for that of a Director, if the Director:
 - Acted in Good Faith
 - Was Reasonably Well Informed; and
 - Rationally Believed the Action Taken Was in the Best Interests of the Company

Pitfalls For Private Equity Portfolio Board

Pitfalls For Private Equity Portfolio Board

- Being Too Involved vs. Not Being Involved Enough
 - Avoid Managing Portfolio Company's Day-to-Day Operations
 - Remain Actively Involved in Board Activities

Pitfalls For Private Equity Portfolio Board

- Conflicts of Interests
 - Between Private Equity Firm's Interests and Portfolio Company's Interests
 - Acquisition Decisions
 - Executive Compensation
 - Management Fees and Other Arrangements
 - Valuation and Terms of Additional Financing Provided By Private Equity Firm
 - Between the Various Discrete Funds Managed in Parallel by The Private Fund Manager

Pitfalls For Private Equity Portfolio Board

- Conflicts of Interests (*continued*)
 - Between Various Portfolio Company's Interests
 - Acquisition Decisions
 - Commercial Transactions Between Different Companies Represented by a Director

Pitfalls For Private Equity Portfolio Board

- Blurring the Line Between Private Equity Firm and Portfolio Board – Piercing the Corporate Veil
 - Using Portfolio Company as a Façade for the Operation of the Corporate Parent or Related Company
 - Failure to Keep Separate Corporate Records for Portfolio Company and Private Equity Firm
 - Failure to Adhere to Corporate Formalities
 - Board Meetings
 - Authorizing Resolutions
 - Electing Directors

Pitfalls For Private Equity Portfolio Board

- Inappropriate Disclosure of Material, Non-public Information – Violation of Regulation FD
- Inappropriate Use of Material, Non-public Information – Insider Trading

Pitfalls For Private Equity Portfolio Board

- Changing Fiduciary Duties in the “Zone of Insolvency”
 - Duties Change When Portfolio Company Nears Insolvency
 - Duties Run to Company’s Creditors
 - Ordinary, Routine Corporate Decisions Become Subject to Additional Scrutiny

Protective Measures

Protective Measures

- Document Decision Making and Corporate Approval Process Carefully
 - Board Minutes
 - Must be More than Mark-up of Last Year's Minutes
 - Balance Between No Record of Deliberations and Keeping Transcripts
 - Reflect Substance and Process of Meeting

Protective Measures

- Use Independent Directors
 - Conflicts of Interests
 - Executive Compensation
- Use Outside Experts
 - Mergers/Acquisitions
 - Executive Compensation
 - Other Substantial Transactions

Protective Measures

- Know Where Your Duties Lie
 - When Acting as Partner/Manager of Private Equity Firm
 - When Acting as Director of Portfolio Company
 - When Serving on Multiple Boards Simultaneously
 - When Portfolio Company is in “Zone of Insolvency”

Protective Measures

- Avoid “Deputization” Issues
 - Look Out for Interests of All Shareholders, Rather than Serving on the Board as a Representative or “Deputy” of the Private Equity Firm
 - Carefully Consider the Kinds of Communication You Have with Colleagues at the Private Equity Firm – Avoid the Appearance of Deputization

Protective Measures

- Time and Effort
 - Ensure You Have Adequate Time to Fulfill Your Obligations
 - Attending Meetings
 - Communication Between Meetings
 - Reviewing Materials
 - Carefully Considering Decisions
 - Put Forth the Time and Effort Required
 - Experts Estimate between 150-200 hours annually

Protective Measures

- Process
 - The Legal System Will Judge You Based on the Soundness of the Process You Undertook
 - Whether Independent Directors Approved Related-Party Transactions
 - How Many Meetings the Board Held to Discuss an Issue
 - How Much Time the Board Spent Discussing Certain Issues

Protective Measures

- Process *(continued)*
 - What Materials Were Reviewed
 - Whether the Board Received Required Materials Sufficiently in Advance of Board Meetings
 - How Many Questions the Directors Asked

Protective Measures

- Specific Concerns
 - Piercing the Corporate Veil
 - Maintain Corporate Records Appropriately
 - Follow Corporate Formalities
 - Ensure Directors and Officers Act on Behalf of the Company They are Serving
 - Management's Failure to Raise Issues
 - Create a Whistle-Blower System for Employees

Protective Measures

- Specific Concerns (*continued*)
 - Regulation FD
 - Create and Follow Certain Procedures for Disclosing to Others Within the Private Equity Firm, Information You May Learn as Director of a Portfolio Company
 - Adhere to Such Procedures in Every Instance

Protective Measures

- Specific Concerns *(continued)*
 - Insider Trading
 - Create and Follow Certain Procedures to Ensure that Partners and Employees of Private Equity Firm Do Not Intentionally or Accidentally Decide to Buy or Sell Shares of Public Portfolio Company's Stock While Possessing Material, Non-Public Information
 - Adhere to Such Procedures in Every Instance

Sarbanes-Oxley

Sarbanes-Oxley

- Why Adhere to Sarbanes-Oxley (“SOX”)?
 - Risk Management
 - May be Required in Future
 - By Public Companies Doing Business with Private Companies
 - By Law

Sarbanes-Oxley

- Why Adhere to SOX? (*continued*)
 - Importance to Exit Strategy
 - Going Public
 - Sales to Third Parties

Questions?

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