TOP TAKEAWAYS

Private Equity Portfolio Corporate Governance

1. A company can be much more valuable from a PE fund perspective if it takes steps to be ready for that outside capital before an acquisition or investment by stepping up its corporate governance. Funds are looking for a company that has identified the risks and put in place the proper systems and processes to deal with those risks, and want to see a willingness to move from a founder-directed decision-making process to a collaborative, collective model and a set framework for what the company wants to accomplish over the next twelve months.

2. A PE Fund director can help a company upgrade their corporate governance by, for example, finding a decent CFO, ensuring separation or delegation of duties of the board members and executives, or implementing stricter governance principles – more and more private companies are moving towards implementing stricter Sarbanes-Oxley principles such as engaging an outside auditor or requiring CFO certification of financials. Ultimately these stronger governance practices will make the company more attractive to potential future public company acquirers since it would be easier to mesh to two sets of financial controls.

3. Outside directors are a useful tool to enhance corporate governance. Typically the PE fund will have the right to appoint the majority of directors, so an outside director will likely be a minority voice on the board but can contribute important industry expertise and improve the company's production/distribution efforts or introduce the company to new customers and industry players. An outside director can give weight to the board of a client-facing business - for example, in a healthcare business having an industry-leading physician as a director gives gravitas to the board. An outside director can also serve as a tiebreaker or mediator of sorts between fractions, or serve as a counselor to management, without a real vested interest, particularly when determining how much money to keep in versus how much to take out.

4. When looking for an outside director or industry experts, it is important to analyze the needs of the company and what the company is lacking or what business channels and markets the company is trying to open and look in the right place for an outside director. CEOs need to be open to the idea of finding fresh talent, and be aware of any issues with a potential director's prior commitments, including any non-competes that may limit a potential expert from joining the board. It may be useful to install an interim CEO or CFO and use his or her expertise while searching for a permanent executive – and leverage the interim's experience and expertise when transitioning to the permanent officer.

5. Typically, the PE fund effectively owns the company and has a majority of the board seats - funds and fund directors need to be vigilant and ensure proper safeguards against conflicts of interests in these situations. The fund may have a 3-5 year exit in mind, but they also have a duty to minority shareholders, and the director has his or her own fiduciary duties. If the company is insolvent, there are also duties to creditors. Know what the LLC agreement

or bylaws say about your fiduciary duties, and be sure the governing documents disclaim the corporate opportunity doctrine for funds to avoid the situation where a minority shareholder brings a claim against the company that the director's fund acquired a company under a different vehicle when it should have been an add-on acquisition. Lawyers can help structure what decisions should be made by the board versus the fund as a shareholder.

6. Good funds will also have their own policies of running companies as separate entities, creating conflict walls, and making introductions to vendors or experts, but remaining hands-off on the decision making process. It is important to ensure the decision to exercise a right as a shareholder is made by someone at the fund who is not on the board of directors, especially in the context of a distressed company and dealing with creditors.

7. Indemnification provisions in the governing and investment documents are important, but are only as good as the prospects of the company. More importantly, there should be a solid D&O insurance policy in place to protect the directors – bad actors and actions are not covered, so be sure the managers and board are not negligent in their actions. Also have a tail policy of at least 6 years in place when departing a company's board. Any potential acquirer of the company should be on board with a tail policy as well to protect the company.

8. In certain situations it is more appropriate or advantageous to serve as a board observer rather than have a voting seat on the board. As a board observer, the investor can be in the room during important board sessions, has access to management, and will be "in the know" as to whether the company is implementing the strategy the fund invested in. The observer can report back to its limited partners in confidence. An observer or board advisor can be a useful tool for the company as well – they can point out when the board or company begins to stray from its short term or 5 year plan and remind the board about other groups' interests and issues (lenders, and other creditors employees, WARN Act compliance).

For more information on Private Equity Portfolio Corporate Governance, please feel free to contact the moderator directly:

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