





PORTFOLIO COMPANY BOARD MEMBER ROLE & DUTIES

AGENDA

- 
- **Role and Duties of Board Members**
 - Fiduciary Duties
 - Personal Liability & Indemnification
 - Antitrust Concerns
 - **Dual-Hat Liability**
 - Identifying Conflicts
 - Addressing Conflicts

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Role and Duties of Board Members

- The board oversees the company's business and affairs and provides oversight to a company's management team
- In discharging their responsibilities to shareholders, board members must satisfy their fiduciary duties to the company
- The same fiduciary duties apply whether a company has publicly-traded securities or is privately held



Fiduciary Duties

- Fiduciary duties may be waived entirely for LLCs, but not for corporations
- Unless expressly waived in an LLC agreement, board members owe fiduciary **duties of care, loyalty, and confidentiality** to the company and its shareholders

1. Duty of Care

Make informed business decisions in good faith and with due care



2. Duty of Loyalty

Place the company's interests first and act in good faith



3. Duty of Confidentiality

Keep company information confidential and use it only for the company's benefit



Duty of Care

- The board must act on an informed basis after due consideration of relevant materials and deliberation
- The board is entitled to rely on reports and opinions from management and experts that it believes to be competent, but must make its own conclusions
- Delaware law typically applies the deferential business judgment rule to determine whether board members have satisfied their duty of care
- Courts will focus on a board's process



Duty of Loyalty

- Board members must act in good faith:
 - Honest belief that action taken is in the company's best interests; and
 - No ulterior motives or self-interest
- Delaware courts will apply a more onerous “entire fairness” standard when the board's duty of loyalty is challenged
- To satisfy entire fairness, the company must show that the transaction was the product of fair dealing and fair price



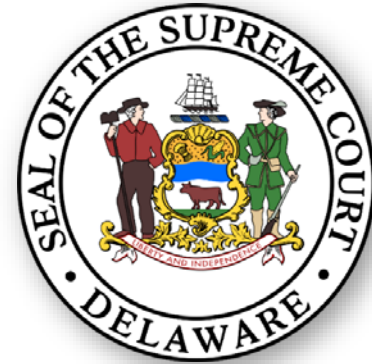
Duty of Confidentiality

- Board members must keep company information confidential and use it only for the company's benefit
- A board member's duty of confidentiality is within the scope of his or her duty of loyalty
- Companies generally have confidentiality policies, which determine the scope of a board member's duties



Fiduciary Duties in Business Combination Context


- Delaware courts generally apply an enhanced fiduciary duty standard to transactions involving business combinations (e.g., merger)
- Delaware courts will substantively review both the board's process and the price obtained in any resulting transaction



Fiduciary Duties in Insolvency Context

- Be mindful of fiduciary duties where portfolio companies have liquidity or solvency issues
 - Especially important in COVID-19 environment
- Board members owe the same fiduciary duties in the insolvency context, but should consider taking the following steps:
 - Document the basis or reasoning for any decisions;
 - Require management and advisors to give detailed presentations that explore all available options; and
 - Consider forming a special committee to consider any transactions with insiders

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Personal Liability

- Company charters generally exculpate board members from personal monetary liability for certain conduct, such as breaches of the duty of care
- Under Delaware law, board members cannot be exculpated for certain acts, including:
 - Bad faith conduct;
 - Breaches of the duty of loyalty; and
 - Transaction involving receipt of an improper benefit




Indemnification & Insurance

- Companies generally provide additional indemnification coverage for the cost of certain claims, as well as legal fees, settlement costs, and/or damages
 - This often includes advancement of expenses
- A company's D&O insurance policy may provide an additional source of funds to satisfy indemnification claims
- Important to know the company's indemnification and insurance agreements, and what claims are and are not covered

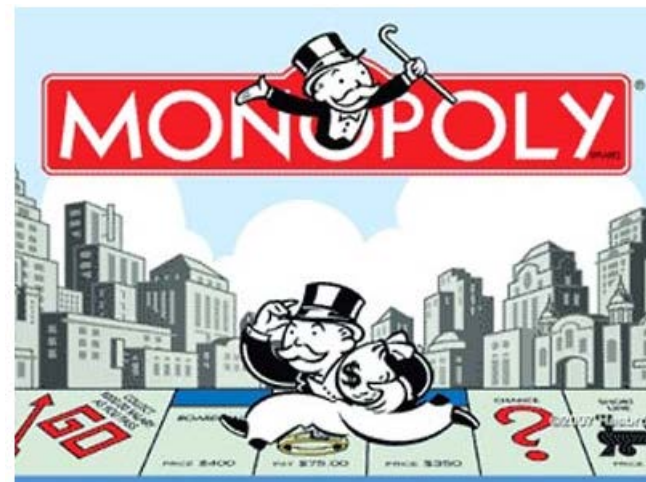


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Clayton Act and Interlocking Directorates


- Antitrust enforcement agencies monitor companies that share common board members
- Clayton Act § 8 prohibits any “person” from simultaneously serving as a board member or officer of two competing “corporations”
- Principal remedies:
 - Force the overlapping “person” to resign from one of the two boards; or
 - Restructure transaction to avoid § 8 violation



Prudent Practices

- Exercise caution regarding sharing competitively sensitive information between “corporations”
- Do not allow individuals who serve in an oversight role (whether as management or on board) to review another company’s competitively sensitive information

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Dual-Hat Board Member Liability

- Board designees ***owe fiduciary duties to both the firm and the companies*** on whose boards they serve
- Generally, a board designee can share information if (1) the firm and portfolio company are ***not in adverse positions***, and (2) the disclosure ***does not harm the source*** of the information
 - **Example:** Confidential information of one portfolio company should not be used to assist another portfolio company in evaluating strategic alternatives where such use could be to the detriment of the source of information

Question 1: Does a Conflict Exist?

- When potential conflicts arise concerning prospective transactions and board designees, ***ask:***
 - Are there conflicting fiduciary duties?
 - Are there existing fund restrictions?
 - Are there antitrust concerns?

Interests are *not* typically in conflict

■ Duties to Company

- Act in the best interest of the company
- Duty of Confidentiality to company
- Duty of Care to company
- Duty of Loyalty (no self-dealing) to company

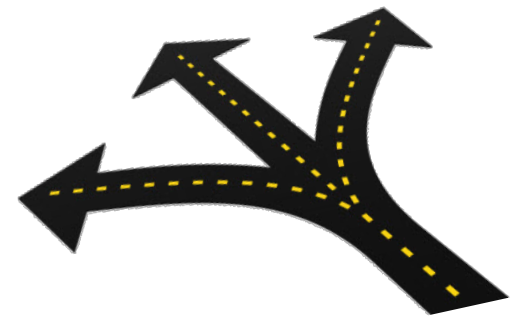
■ Duties to Sponsor

- Act in the best interest of firm
- Duty of Confidentiality to firm
- Duty of Care to firm
- Duty of Loyalty (no self-dealing) to firm


Competing Loyalties and Divergent Interests

- **Circumstances in which loyalties may divide:**

- Information Sharing – Both Ways
 - Sponsor information may benefit portfolio company, but it is confidential and disclosure may harm sponsor
 - Portfolio company information may benefit sponsor, but it is confidential and disclosure may harm portfolio company
- Opportunities
 - Potential sponsor investment in a competitor
 - Sponsor portfolio company mergers
- Insolvency

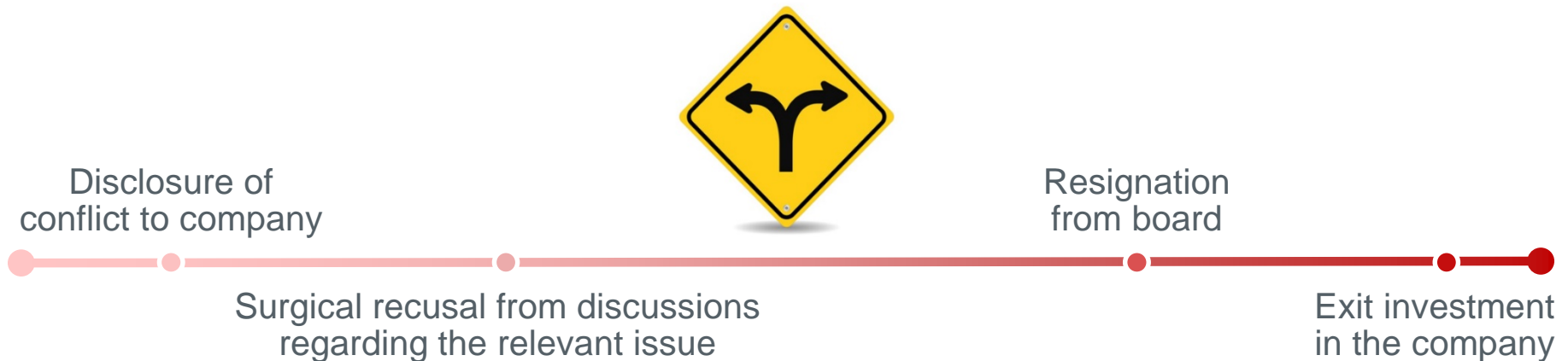


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 - **Addressing Conflicts**

Interests Diverge: What Then?

- Prompt and full **disclosure** to the sponsor and the company of the conflict would typically be curative
- BUT, sometimes disclosure runs afoul of **duty of confidentiality** to either the company or the sponsor
- Spectrum of possible curative actions:



Best Practices for Managing Confidentiality

- **Educate board designees** on confidentiality and associated risks
- **Review confidentiality agreements** to determine if they restrict the use of information or the sharing itself
- **Develop a record** because courts take a fact-intensive approach to evaluating overlapping duties that create conflicts
- **Limit information shared** and avoid information sharing for purposes other than matters relevant to service as a board member (or evaluation of investment in portfolio company)
- **Build walls**
- **Create entirely separate deal teams** or establish separate junior members
- **Create silos** to avoid sharing information and documents
- **Scrub board materials** and ask portfolio company to manage information flow to prevent receipt of information that would create conflict