

Monthly Newsletter

May 2020

Upcoming Events

May 6

PDA Director Training and Referral Program: How Will it Help Me?
May 6, 2020 - 12:00 PM - 1:00 PM
WEBINAR

May 7

Audit Committee Best Practices
May 7, 2020 - 12:00 PM - 1:00 PM
WEBINAR

May 12

The Board's Compliance Oversight Role
May 12, 2020 - 12:00 PM - 1:00 PM
WEBINAR

May 13

Rightsize without Layoffs
May 13, 2020 - 12:00 PM - 1:00 PM
WEBINAR

May 14

CARES Act PPP Funding Poses Complex Financial, Legal and Moral Issues: What Directors, Company Owners and Executives Should Know
May 14, 2020 - 12:00 PM - 1:00 PM
WEBINAR

May 19

Governance in the Zone of Insolvency: Guidelines for Effective Governance in Distress
May 19, 2020 - 2:00 PM - 3:30 PM
WEBINAR

Register Now for These and Other PDA Events

Sponsors

Chicago

Gold: Bank of America, Diligent, Directors & Boards, Private Company Director

Silver: Ernst & Young LLP, Grant Thornton, PNC Bank, Tucker Ellis LLP, U.S. Bank Private Wealth Management, Willis Towers Watson

Bronze: BMO Harris Bank, Board Prospects, Executive Coaching Connections, Northern Trust, Perkins Coie, Seyfarth Shaw, Sugar Felsenthal Grais & Helsinger LLP, Wintrust

Detroit

Gold: Bank of America

Silver: Butzel Long, Plante Moran

Bronze: Amherst Partners, Clayton & McKervey, Dickinson Wright, Jaffe Counsel

Media: DBusiness Magazine

Charlotte

Gold: Bank of America

Silver: EY

Bronze: GreerWalker

Nashville

KraftCPAs PLLC, PNC Bank



Jonathan Friedland, a partner with Sugar Felsenthal Grais & Helsinger LLP, regularly helps financially distressed businesses and their boards navigate out of trouble. He is also expert at helping buyers of distressed businesses. Jonathan is rated AV® Preeminent™ by Martindale-Hubbell, 10/10 by AVVO, and enjoys several other similar distinctions. He spent an earlier part of his career at Kirkland & Ellis, first as an associate and then as a partner. He is lead author of the 1,800+ page [Strategic Alternatives For And Against Distressed Businesses](#) and the 2,000+ page [Commercial Bankruptcy Litigation](#). Jonathan clerked for a federal judge before entering private practice and served for several years as an Adjunct Professor of Strategic Management at the University of Chicago's Graduate School of Business, and as the first visiting professor at the Clayton School of Entrepreneurial Law at the University of Tennessee College of Law. Jonathan is also founder and publisher of [FinancialPoise™](#).

Don't Shoot the Messenger, But Your Company May Be Insolvent. What Do You Do Now?

A company on whose board of directors you sit, perhaps financially strong just a couple of months ago, may now be hanging on by a thread. What do you do?

The First Thing Not to Do if Your Company is Financially Distressed

First, what you should not do: resign; do not resign out of some misplaced knee-jerk on the assumption that by so doing you will relieve yourself of potential liability. The ordinary principles governing fiduciary duties apply whether a company is solvent or not: essentially, a director has a duty of loyalty and a duty of care to the company. And, simply stated, it is not that difficult in practice to discharge both duties.¹

Leaving aside the moral obligation you may have not to abandon a company when it needs you most, doing so just as things become discernably bad is not typically the best strategy to sidestep potential liability. If mistakes were made on your watch for which you bear some responsibility, leaving is not going to make a difference. In fact, leaving only eliminates any chance that you

can be part of a solution that ameliorates the problem. For these reasons, one seldom sees an experienced private equity professional, for example, resigning from the board of a financially distressed portfolio company, even one filing chapter 11.

A Short & Practical Primer on Fiduciary Duties of Corporate Directors

While neither the extent of a director's fiduciary duties nor the way courts judge whether those duties were fulfilled change as a result of the insolvency of a company, something important does change: the constituencies to whom fiduciary duties are owed change. You already know this on some level (at least you better, if you serve on any company board), but to refresh:

1. Directors owe fiduciary duties only to a solvent company's equity holders.
2. Directors owe fiduciary duties only to an insolvent company's creditors.
3. Writing more precisely, in both cases above, directors owe fiduciary duties to the company, and since the company's

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residual (a/k/a beneficial or equitable) owners are its equity holders when the company is solvent and its creditors when the company is insolvent, we (attorneys and courts) tend to write and speak in shorthand, in terms of duties being owed directly to whoever the company's residual owners are.

- Since the question of solvency is often very hard to answer, some courts developed a legal fiction referred to as the "zone of insolvency," which is (was, since the theory is largely dead now) the gray area in which a company is right on the thin line between solvency and insolvency. Tons of cases and commentaries were written on the subject (and how a director's fiduciary duty expanded to include creditors when a company was not clearly solvent or insolvent), until the most influential courts decided to discard the theory altogether. The bottom-line: courts decided this way because they wanted to protect directors from having to have two masters (i.e. equity and creditors) in the gray zone.
- Instead, the general rule now is that corporate directors need to do what is best for the company (i.e. the enterprise) itself, regardless of who the residual owners of the enterprise may be.
- All the above is incredibly abbreviated. Courts differ in their views. Facts matter. And the law continues to evolve.²

- Why you should "just say no"
- Why you should hope for the best and how to plan for the worst

¹Some courts and commentators refer to other fiduciary duties, but those other duties are best viewed as subsets or examples of these two main duties. My statement, "it is not that difficult in practice to discharge both duties," could easily be interpreted as too cavalier and, to be clear, it assumes that a director is experienced, attentive, and well advised.

My use of the words "not that difficult" should not be confused to suggest the contrary or that fulfilling one's duties doesn't take hard work. It does. What I mean is that the principles are well understood. Also, unique times may call for unique action. For example, no one should be able to fault a company's failure to screen workers for COVID-19 back in November 2019. Not to do so today, however, may be a different story. See *In Marchand v. Barnhill*, 212 A.3d 805 (Del. 2019), where the Delaware Supreme Court suggested the board of directors had heightened oversight responsibilities in times of a health crisis. The court found that a board of a company dealing with a listeria outbreak that had a significant impact on the company's operations "failed to implement any system to monitor [the company's] food safety performance or compliance."

²Read more about directors' fiduciary duties in an insolvent company in "Shades of Gray: Recent Developments That Impact Advising Directors and Officers in The Twilight Zone of Insolvency."

PDA Members:
To learn more about the topics discussed in this article, register for Opportunity Amidst Crisis

Co-produced by the PDA, this three hour on-line symposium is for business owners, corporate directors and officers, private equity professionals, and others seeking to learn the ins and outs of dealing with a financially distressed company – whether running one, buying one, or trying to get paid by one. Registrants will also receive on-demand access to watch at their leisure.

June 23rd from 9:00am to 12:00pm CT.

Register today! "Seating" is Limited!

Use discount code **PDA2020** and pay only \$49.99.

Register Now

Keep reading this article on PDA's **Body of Knowledge**, and learn:

- Why insolvency is in the eye of the beholder
- The specific issues you need to consider given the existential threat that COVID-19 poses to the business
- Specific actions the company should take with respect to these issues
- Why you should not be too quick to throw in the towel

Helpful Links

PDA Website

Become a Member

Find a Director

Director Development

PDA Body of Knowledge

Board of Directors

- Chairman** – Joseph S. Poehling
- CEO** – Kenneth B. Hoganson
- COO** – Dennis Kessler
- Corporate Secretary** – Paul Marcela
- Director** – Cindy Burrell
- Director** – Don Delves
- Director** – Phil Grybas
- Director** – Sara Hamilton
- Director** – Eileen Kamerick
- Director** – Mathias J. Klein, III
- Director** – Lawrence M. Molinari
- Director** – Helga Reidel
- Director** – Roy Verstraete
- Director** – Dave Watkins

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