

Webinar Takeaways

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Governance in the Zone of Insolvency: Guidelines for Effective Governance in Distress



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Questions and Answers:

1. **In order to conduct its duties, a Board needs reliable, actionable information. What is the Board's obligation to inform itself concerning company operations and related reporting? If management fails to provide this reporting on a timely and accurate basis, what is the risk to the Board, and how should the Board manage this risk?**
 - a. The board has a fiduciary duty to be informed.
 - b. The information that the board receives must be timely, relevant and effective.
 - c. The board should not step into the shoes of management but it should also not be passive. It is important to seek out information.
 - d. Ask for specific financial information especially those things that are indicators of distress.
 - e. Use your intuition. If you suspect that things are not right, then they probably are not.
2. **Is there liability for directors if they take the first answer when they ask for information? In other words, does the board have a duty to investigate?**
 - a. This falls under the director's duty of care.
 - b. The board should not sit around wondering if they are going to be sued. They should take active steps to increase the value of the company and part of doing that is understanding the true financial situation at the company.
3. **In a distressed situation, there's the concept of "insolvency" which may assume a static, though negative state of financial wherewithal, and then there's the concept of "deepening insolvency" where the insolvency is getting worse – debt is increasing and possibilities of**
 - c. Keep asking questions until you get the right answer
 - d. You might get information between meetings or in conversations outside of the boardroom and you should seek to.

recovery for various interests are deteriorating. Can you comment on the difference in Board exposure to liability in each case?

- a. 6 or 7 years ago, deepening insolvency became a topic of discussion in insolvency cases. That said, some states recognize deepening insolvency as a cause of action whereas others do not.
 - b. First, it is important for directors to understand that the company is insolvent by asking for and getting the right information.
 - c. When a company becomes insolvent, duties shift from shareholders to creditors.
 - d. The board should seek to maximize the value of the business even if it is insolvent. In some cases, the best way to do that is to liquidate whereas in other cases the best way is to continue to operate while understanding that directors' duties have shifted to creditors.
 - e. Do not pursue a "Hail Mary" strategy when the company is insolvent. That said, it can be difficult to decide if something is a "Hail Mary".
- 4. What should a director do as soon as they suspect that the company is distressed?**
- a. Hire legal counsel with restructuring experience, a litigation arm, and a corporate finance arm. You might need all of those services during the course of the restructuring/turnaround.
 - b. Hire a financial advisor to advise on strategic options.
 - c. Boards often wait too long to bring in professionals (attorneys, turnaround professionals, financial advisors). They should hire professionals as soon as they realize that they might need them.
 - d. Look for signs from management that do not sit right (e.g. the CFO asks the CEO before answering questions)
 - e. Remember that bad news does not get better with time.
 - f. Turnaround professionals should report directly to the board.
 - g. The turnaround professionals should not communicate through management.
- h. The board may want to bring on a Chief Restructuring Officer (CRO) because that person becomes the contact between management and the board. The CRO should report to the board.
 - i. There are 2 types of CRO. The first is more of a traffic cop. The second serves as CEO.
 - j. If you think that you might need a CRO, you probably do.
 - k. The CRO should be a restructuring professional, not an industry expert.
- 5. Should a director resign if the company is insolvent?**
- a. If you resign, you will be blamed for problems and outcomes.
 - b. Take legal advice before deciding what to do.
 - c. Make sure that you understand your D&O policy.
 - d. As an aside, the CRO should also be covered by the D&O policy.
 - e. If you stay, you might get a release of claims.
 - f. If the company is in chapter 11, your decisions are protected by the judge.
 - g. Keep in mind that there will be significantly increased work. There will, for example, be more frequent meetings and calls.
- 6. Does the board fail in its duty of care by not hiring a CRO or by not firing the CEO?**
- a. Two examples were given. One by Mitch Arden and the other by Paul Ferdinands.
- 7. What other things should a Board always do in a distressed situation?**
- a. Understand what are the strategic alternatives
 - b. Document everything
 - c. Might want to hire an attorney to take minutes
 - d. Monthly board meetings (at least)
 - e. Appoint a special committee made up of independent directors to oversee the turnaround
 - f. Understand that restructurings are expensive but the board has to understand that the cost is necessary to show the board was trying to maximize the value of the company.
- g. Understand the liquidity runway (how much liquidity do you have)
 - h. Create a 13 week rolling cash flow
 - i. You might want to hire a new independent director with turnaround experience to add to a special committee
 - j. The special committee might need legal advice or other advisors
- 8. Should a company use more than a 13 week rolling cash flow? 26 weeks for example?**
- a. Accuracy is key. It is hard to predict more than 13 weeks.
 - b. Be conservative with cash flow information.
 - c. To be clear, this is a 13 week *rolling* [emphasis added] cash flow
- 9. Are there differences between public and private scenarios?**
- a. In a private situation, directors may be more conflicted.
 - b. Directors' duties are the same.
 - c. Shareholder lawsuits are more common in public scenarios.
- 10. What do you do if the CEO/ CFO does not have restructuring experience?**
- a. This happens all of the time.
 - b. Appoint a CRO or financial advisor.
 - c. It is important to have experienced turnaround people involved because you only know what to do if you have done it before.
- 11. Can you talk about how the board should guide management in regard to conversations with the secured lender?**
- a. Restructuring professionals can help here.
 - b. Third party professionals can be the bad guy when management cannot.
 - c. Credibility is the key and third parties can establish credibility.
 - d. Restructuring professionals will know how to communicate with the bank because they do that all the time.