Private Directors Association Certificate Course

Case Studies Package

PRIVATE DIRECTORS ASSOCIATION®
Creating Value Through Board Excellence

Instructions

There are **three case studies** included right after this page.

As part of this course, you are required to read and prepare for each case study **prior to your mentoring session.**

Additionally, there are several other case studies attached to this package as well. These case studies are for your use and are **not mandatory** assignments.

Revitalizing a Dysfunctional Board

By: Bruce D. Werner

PRIVATE DIRECTORS
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Creating Value Through Board Excellence

PDA University

Case Study

Revitalizing a Dysfunctional board

By: Bruce D. Werner

Background

A global technology company had enjoyed 35 years of growth and prosperity. The organization included dozens of offices around the world. Many of its clients were household names. A single owner had built the company, along with a few loyal lieutenants, into a $500-million-revenue business. But the business revolved around the owner, who was a true entrepreneur. The same owner had failed to do any succession planning. So, when he died unexpectedly, the business became a rudderless ship. The equity passed to a trust for the benefit of the owner's minor children. The trustee was the owner's estate attorney, who had no practical business experience and was quickly overwhelmed.

You, along with another successful business entrepreneur are on the Board. You met the owner at the country club 15 years ago and he asked you to join the Board. The Board has met almost once a year for the last 15 years.

Situation

When the owner died, competitors spread rumors of financial problems to undermine the company's stellar reputation. Employees worried about the company's health, and competitors were starting to lure key employees.

The business had been undermanaged for many years. Due to the strong personality of the owner, most of the management team was passive. They knew how to take orders, but not how to give them. They thrived on stability and avoided change.

Overall, the company had a strong, unified culture, with most, if not all, of the staff dedicated to their mission. They were quick to point out "how things have always been done here"

The bylaws were written 35 years ago for a single-member LLC. They were antiquated and grossly insufficient for the current and future situation.

Since it had a single owner, the company had minimal D&O insurance, and had minimal other coverages to save expense.

Legally, the trustee was the sole director. There was no designated successor CEO. The long-term CFO, who was effectively a partner with the owner, stepped in as CEO to fill the void. However, he did not like to talk to customers or employees, he sat in his office and worked on numbers. He also went to great lengths to avoid questions from the trustee and others.

Unfortunately, the CFO had also recently had severe heart issues, and needed to modify his work schedule accordingly.

The banks were looking for reassurances that the company would be stable.

There were two business units. The largest, by revenue, was the least somewhat profitable, but in a shrinking market. The second business had strong margins, and significant growth opportunities. The future was here. These business managers were in demand and were receiving offers from competitors. They expressed concern on where the business, overall, was headed, as they considered their personal situations.

Questions

- What are the key questions that should be asked to fully understand the situation?
- Who is in charge? What is their authority to act?
- Who is owed duties of care and loyalty?
- What should be done to establish reasonable governance and oversight, and who should make it happen?
- Someone suggested an outside CEO should be hired, but that process might take a year. Who runs the business until then?
- How would you deal with the rest of the management team?
- What do you tell customers, employees, banks, and suppliers?

The Board's Role in Handling Ethics Issues

By: Dennis Kessler

The Board's Role in Handling Ethics Issues

Case Study (scenario #1) by Dennis Kessler

Deliverable:

Discuss the company profile highlights, the Ethics issue and develop a recommended action plan for the Independent Directors, the Board and Management.

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Company Profile:

Midwest based manufacturing company.
$500 million in sales – 70% domestic
Excellent peer group performance
Mature industry – organic growth/year of 3-4%
Continually achieve annual plans the last 2 years
Business unit leaders (5 BU's) have long term tenure with the Company.
Strategic plan developed by CEO/CFO.
Seasoned Board and CEO in place – have worked together the last 3+ years.
Non-executive Chair and CEO roles are split.
Company is a partial ESOP with the Chairman's widowed sister-in-law owning the majority of shares.
Chairman is 3rd generation.
Board is a Fiduciary Board with three family members (Chair, sister-in-law, and Chair's son), three non-family management (CEO, CFO and BU President), and three Independent Directors.
The Company has a strong Ethics policy that is reviewed and signed annually by all senior management staff.

Background:

One of the Independent Directors received a call from a lawyer friend saying that one of his clients is a supplier to the company and wanted to remain anonymous. The client reported that one of the senior management people has been demanding and receiving kickbacks for the last several years.

The Board's Role in Driving Long-term Value Creation

The Board's Role
in Driving Long-term Value Creation

Case Study

Deliverable:

Discuss the company profile highlights, develop 3-4 agenda items for the next Board meeting.

Company Profile:

Midwest based manufacturing company
$500 million in sales – 70% domestic
Low 3rd Quartile peer group performance
Mature industry – organic growth/year of 3-4%
Missed annual plans the last 2 years – no bonuses paid
Business unit leaders (5 BU's) have long term tenure with the Company
    3 BU's are marginal. Mgmt ownership of the numbers is weak
Last 2 acquisitions didn't work out –"1-time" write-offs taken
Strategic plan developed by CEO/CFO
Seasoned Board and CEO in place – have worked together the last 3+ years
Non-executive Chair and CEO roles are split.
Several institutional investors own most of the stock. No investor owns more than 25% of the equity. They have lost patience with poor performance and want a new plan.
CEO owns 5% of the stock. Mgmt has equity incentives.

Background:

The Chairman has called a special Board meeting to discuss their expectations. He's developing the agenda for the meeting and has asked you to weigh in on the top 3-4 topics the Company needs to address.

Admittedly the Chairman is troubled by the Company's performance. He views this as a "wake up" call for the Company.

Other Case Studies

The Board's Role
in Quality and Patient Safety
A Case Study

Background:
Since 2006, the Institute for Healthcare Improvement's (IHI) Boards on Board initiative has recommended that Boards allocate as much time to discussing patient safety and quality as they spend reviewing financial performance. Building trust and confidence in today's hospital Board Rooms is all about transparency—discussing the hard issues and answering the tough questions honestly.

This hospital Board included independent members who were experts in their respective fields (banking, law, insurance, philanthropy, finance, etc.), including a recently appointed Registered Nurse who brought expertise on health care delivery, quality and patient safety issues that other Board members lacked. The Board also included as a voting member the President of the Medical Staff, representing the interests of hospital's medical staff, a structure of growing concern to governance experts due to its inherent conflict of interest.

Situation:
It is a role and duty of the Board to ask questions about the quality of the care provided by the medical staff. One responsibility of a Medical Staff Affairs Committee (often known now as Quality and Safety on more progressive Boards) is to re-appoint physicians to the medical staff so they may continue to admit patients. Committee members receive applications for 300 medical staff members covering a 3-year reappointment period. Each application includes verification of current licensure and board certification(s), proof of malpractice insurance and current liability claims, lists any sentinel events (a patient safety event that results in death, permanent harm, or severe temporary harm), patient satisfaction survey results, and a list of any incident reports (a formal recording of the facts related to a workplace accident, injury, patient safety event, error or near miss.)

The RN Board member was also considered to be what's known as a health care "insider"—an expert who knows when hospital management is not being forthright when sharing a patient's story, its quality reports or other care quality data. During the meeting this Board member asked for a clarification related to management's presentation of the incident reports: "I need clarification on how the incident reports are listed. It seems odd and rather unusual that over a 3-year period for 300 physicians there were no incident reports listed for anyone." Reply from the chief medical officer: "That's management's purview, I review each incident report and determine those that are appropriate for Board review."

Questions:
What do you think is the governance issue here?
What would you have done next?
What do you think was running through my mind?
What should the board do?
What questions would you ask?
How do you advise and govern without usurping the CEO? (nose in fingers out)?
Should the board do anything different from the normal routine such as form a subcommittee or task force or meet regularly about this issue?

Private Directors Association
Cohort Board Scenario
Succession Planning

Company Overview:
100 year old private, family owned business.

- Company is profitable, but increased competition, technology and market dynamics have led to a decline in revenue and profitability and the company realizes that changes need to be made in order remain competitive and grow the business into the future.

- The Chairman/CEO is ready to retire from the company and the board. He does not believe there is a 4th generation family member who is ready to be CEO.

- The two 4th generation family members with executive roles in the company both believe they should be the next CEO.

Company Structure:
CEO – 3rd generation family member and shareholder; ready to retire
COO – non-family member; non-shareholder
CFO – non-family member; non-shareholder
VP Sales – 4th generation family member and shareholder
VP Manufacturing – 4th generation family member and shareholder

Board Composition:
Chairman – CEO of the company and plans to retire from the board and company
Board director – 4th family member and shareholder; does not work at the company
Board director – 3rd generation family member and shareholder; does not work at the company
Board director – 4th generation family member and shareholder; retired from company
Independent director #1 – Financial background
Independent director #2 – Marketing background
Independent director #3 – Technology background

Situation:
Company does not have a succession plan. Succession is a "hot button" issue within the company. You are one of the independent directors on the board. Th succession issue is on the agenda for the next board meeting.

Develop a framework for dealing with the following:
- What issues need to be addressed?
- How should those issues be addressed?
- How should communications be handled?
- Who should deliver the messaging and how should it be delivered?

May 2021
PDA University
Case Study
Remo Picchietti

Modena S.r.L., was founded in northern Italy in the year 1897 by carpenter Giacomo Natalino as a manufacturer of wooden parts for wagons, wheels, and farming equipment. During and immediately after WWII, the family business, then being run by the third generation, pivoted into steel and aluminum frames and parts serving the fledgling automotive industry. Its customers included Italian car makers Abarth, Alfa Romeo, Ferrari, Fiat, Lamborghini, Lancia, and Maserati.

In 1962, Giovanni Natalino, the third-generation owner of Modena, sent his younger brother, Pellegrino, to Michigan in the United States to open a factory to provide its Italian design and manufacturing capabilities under contract to Ford Motor and other US car makers.

Today, the family business, with 9,000 employees and facilities in more than a dozen countries serving the global automotive industry, is being led by 58-year-old, fifth-generation leader Francesca Natalino-Santi. The company is still owned and controlled by approximately 75 descendants of founder Giacomo Natalino. Its global headquarters is still in Modena, Italy but most of its senior executives are in its US Headquarters near Charleston, South Carolina (which is also home to sixth-generation leader heir-apparent, Emilia Santi-McCormack).

The company's 125th anniversary will be celebrated in the year 2022. Francesca hopes to celebrate the company's quasquicentennial (along with the end of the global pandemic), with a three-day extravaganza at the Grand Hotel Tremezzo on Lake Como in the Lombardy region of Italy. Francesca wants to host not only family, but close customers, suppliers, and Italian dignitaries.

Emilia, now serving as the company's COO, reporting to Francesca, is responsible for, among many other things with the business, its social responsibility and global sustainability efforts. In fact, Emilia commissioned a study to measure the impact such an event would have on the globe (carbon emissions, etc.). She was staggered at the data. To Emilia, a large party sends the wrong signal to its global constituents and is contrary to her efforts to position the company for the next 125 years as a leader in social responsibility.

Francesca feels that Emilia is not appreciating the family history and culture. She believes in her family leading efforts for societal reforms but disagrees with potential strategies such as limiting or eliminating air travel.

Emilia feels that Francesca is "old school' and not in tune with today's business and societal challenges. In fact, small family disruptions have erupted between the fifth and sixth generations, primarily over what the company's position should be on the global social responsibility issues.

Due to the logistics of hosting such a gala, a decision needs to be made within 60 days.

You have been an outside, fiduciary board member for just under one year. Therefore, you are still learning the personalities and positions of generations five and six (including the fact that Emilia has the full support of all G6 family members).

1. What is the main, underlying issue (it might not be just about a party)?
2. What are the possible answers to the question?
3. What is your recommendation as to how to settle the debate?

Additional questions to consider in your evaluation:

1. What should the board do?
2. What questions would you ask?
3. What information would you ask for?
4. What are the board's fiduciary responsibilities with respect to this issue?
5. How do you advise and govern without usurping the CEO? (nose in, fingers out)?
6. Should the board do anything different from the normal routine such as form a subcommittee or taskforce or meet regularly about this issue?

PDA Case Study

By Mark Richards

Deliverable:

You are hired as the Chair and CEO of this company. The two independent directors tell you they are concerned about the current direction of the company and board independence. The other two independent directors indicate they are considering stepping down from the board. Discuss the company profile and possible concerns. Identify the potential corporate governance issues and other board issues from the given information. What needs to be done here?

Company Profile:

100% ESOP-owned, over 100-year-old Midwest-based, capital-intensive manufacturing company with 2000 employees with most being ESOP plan participants

$800 million in sales with 30% ex-US and 5 facilities located in the US and UK

Balance sheet is highly-leveraged (>5x) due to ESOP-buyout

70% of sales into mature, declining market where they are the world leader

30% of sales into global, growing market that is technology driven

Company invented the products for both markets and lead the market with most major innovations

The annual strategic plan is prepared by the CEO and management team for board review

Over 80 different "new product development" projects are being "pushed" by R&D in an attempt to offset the main business decline at an annual cost of almost $20 million.

CEO has the following direct reports: CFO, VP Marketing, SVP HR, GC and 3 BU GMs

Company has a Code of Conduct, Secrecy and Confidentiality, and Governance policies in place; none have been reviewed or updated since written

Fiduciary board comprised of CEO/Chair, CFO, VP HR and 4 outside independent directors. All are long service board members and employees except the new CEO/Chair

Two standing committees currently exist and include compensation and audit both staffed with only independent directors

Independent ESOP Trustee and valuation firm monitor board and manage twice annual ESOP valuation process. The valuation report is not requested by management or the board.

Board and committee charters exist as well as annual planning calendars for board and each committee. The charters have not been reviewed or updated since written.

No board or management succession plans exist

No enterprise risk evaluations are prepared

No onboarding materials are prepared

A D&O policy exists but no one besides the CFO has seen or reviewed it.

Background:

Historically, the board culture was dictatorial. For example, it was reported in one board meeting the CEO/Chair told the board they already had 3 “yes” votes for a significant acquisition and were looking for one more to close the deal. Recently, the existing Chair/CEO decided they wanted to retire and gave notice and resigned after 20 years of service. No succession plan existed so the board was left to conduct a search for a new CEO, and decided the replacement will also carry the Board Chair title. One of the independent directors is also an ESOP consultant that the company has periodically retained for advisory services. Of the four existing independent directors, all are retired and have been for many years except one.

Questions:

What questions would you ask?

What information would you ask for?

Should the board do anything differently?

Identify some of the governance issues here?

How would you prioritize the issues?

What needs to be done here?

CASE STUDY
For Private Directors Association
MACATAWA OIL

Author: Janeen Judah.   V1/Aug21

Transparency and Board/Management Dynamics

Disclaimer – Any similarity to any real people or companies is unintentional.

1. Company Introduction

Macatawa Oil is a Midland-based, private independent oil producer founded by Grandpa in 1967. Grandpa grew up poor on a farm in Arkansas but learned business by watching his grandfather trade livestock. Grandpa worked his way through the University of Arkansas with the GI Bill and several jobs, graduating with a degree in geology. Grandpa started his career in west Texas as a wellsite geologist and scout. After getting laid off from his employer, he struck out on his own, buying stripper[1] wells, working them over, selling them then starting again. Grandpa built Macatawa Oil from scratch and now enjoys the good life, complete with homes in Midland and northern Arkansas (including its own water-skiing lake), a yacht in the Bahamas and is the managing owner of the Tennessee Titans football team. Grandpa is still very much involved in the management of Macatawa Oil and very visible to investors as the CEO and board Chair.

Sonny (G2) is Grandpa's only son (there is also a G2 daughter, Missy). Sonny attended an elite private boarding school in the northeast, followed by Princeton. He worked as a landman[2] for 2 years for one of Grandpa's oilfield friends, then off to the University of Texas at Austin for his MBA. Sonny immediately joined the family business, focusing primarily on the financial and deal side. Sonny is now the President of Macatawa Oil, after spending many years as CFO.

Sonny also brough new capital into the company when he married Sonita, a trust fund heiress from one of Texas' legendary oil families, that he met at a fraternity party in Austin. Sonita brought not only her own trust funds and capital, but also funding from some of her siblings and cousins, who have all profited well from Grandpa & Sonny's excellent management. Sonny has two daughters (G3), neither of which are interested in active involvement in the company.

Trey (G3) is Sonny's nephew (Missy's son) and is the heir apparent. Trey has followed a similar trajectory to his uncle with an undergraduate degree in finance from UT Austin, two years as an analyst at a Houston energy private equity company, then a Harvard MBA. Trey is currently the Vice President for Business Development (the 'deal guy'), with a plan to take over as CFO when the current non-family CFO, Bean, retires in 5 years.

All other company management are outsiders, but most of senior management have a long relationship with the family. The other family owners are not interested in active management but vote their proportionate interests in the company at the annual meeting and receive quarterly updates from management. Most family interests are held in a series of trusts and LLCs or Limited Partnerships. To date, most capital has been raised through retained earnings or through Macatawa's Revolving Credit Facility, led by Big Bank.

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[1] Stripper wells are low production, usually end-of-life oil wells.

[2] A Landman handles real estate issues in the oilfield, especially leasing mineral rights & dealing with landowners.

<u>Macatawa Management – Family</u>
Grandpa (G1) – geologist and wildcatter, age 80
Sonny (G2) – business school graduate, ex-banker, 'deal guy', age 55
Trey (G3) – finance undergraduate plus MBA, age 30, current VP Business Development

<u>Non-Family Key Management</u>
Buddy – COO, aged 60, long business & fishing buddy relationship with Grandpa
Lawyer - General Counsel, met Sonny at UT when both were in grad school
Bean - Chief Financial Officer, former Big 4 partner

2. <u>The Deal</u>

Two years ago, Macatawa Oil, as a respected producer in the Permian Basin, was approached by the board of Acme Oil to buy them out. Acme had recently emerged from a bankruptcy and restructuring in which the equity owners were wiped out and the bondholders (3 big NY Private Equity firms) were left with the company. The bondholders wanted out and approached Sonny about a buyout or merger. The Acme assets were excellent and Macatawa agreed – with a part cash/ part equity deal. The Acme acquisition was much larger than anything Macatawa had bought before, so Sonny sold part of the acquisition to SultanCap, the sovereign wealth fund of an oil-rich middle eastern country, who was interested in diversifying their assets into the USA. The bondholders (NYPE) retained 5% each of the deal for their own accounts. The Deal is structured into a Limited Partnership (Macatawa Oil Partners, LP) with owners as follows:

25% - family and management
15% - NY Private Equity Firms (NYPE)
60% - Sultanate Sovereign Wealth Fund (SultanCap)

3. <u>Now for some Governance</u>

SultanCap has a policy of having outside independent directors on the boards of each of their investment companies. SultanCap is amid-term investor, looking to sell or merge their Macatawa investment in 7-10 years. Since this is a condition of SultanCap's investment, Macatawa agreed, though this is the first time they have had outside directors look over their shoulders. SultanCap also requires that the books be audited annually by an outside accounting firm. A Search firm has recruited 3 new independent directors, none of whom have any prior connection to anyone else:

<u>Board of Macatawa Oil Partners, LP:</u>
CEO/ Chair – Grandpa (G1)
President/successor CEO – Sonny (G2)
2 Representatives from Sultanate Sovereign Wealth Fund (SultanCap) – both asset managers
2 from NY Private Equity Firms – energy portfolio manager & a finance specialist
3 Independent Directors:

1) Moe - Qualified Financial Expert & Audit Committee Chair, former CFO
2) Curly - Former Investment Banker & Audit Committee member
3) Larry – Industry expert, engineer with E&P background

Board Committees:

- Audit: Moe (chair), Curly, NYPE finance specialist
- Compensation: Curly (chair), Larry, NYPE energy
- Nomination/Governance: will set up in future

DISCUSSION QUESTIONS

1. Accounting Oversight – SultanCap requires an independent Audit Committee and externally audited financials as a condition of their investment, as does BigBank. Grandpa and Sonny are not used to having outsiders review their finances, and resent having to open the tent, especially on G&A expenses. Bean follows the rules, but also resents the oversight.

- In the Audit Committee meetings, Moe's questions to Bean and the Chief Accounting Officer are often met with "we've got it handled."
- Moe discussed her concerns with Curly over drinks at the airport as they were waiting for their flights after the board meeting. Curly didn't seem to think there is a problem as he 'likes those guys.'
    - If you were a member of the audit committee, how would you handle evasiveness in answering your questions?

2. Family Finances & Operations – Most of the family members' interests in all Macatawa entities (including this LP) are held in a series of trusts to insulate them from greedy ex-spouses & irresponsible children. The family has its own Family Office, housed in the same building as Macatawa Oil on a separate floor, with their own attorneys, accountants and, in some cases, personal assistants/ secretaries to manage their social and travel calendars. Often in the 4th quarter of the year, capital projects are accelerated, or oil production is ramped up or down depending on the family's tax outlook for that year. At the 3Q Board meeting in August, the Board is asked to pull forward capital projects for the LP from next year into this year to generate deductions (intangible drilling costs) for the family in the current year.
    - As an independent board member, what would you think about making investment decisions based on how they affect the family's finances?

3. Family Succession – Grandma died of cancer 7 years ago & Grandpa married a 50-year-old widowed socialite 2 years ago. Stepmom has been urging Grandpa to slow down, enjoy his life more and let Sonny run the business. Grandpa is clearly not up to date on current technologies and business practices but just can't quite let go of his role as CEO. SultanCap and NYPE would like to see Sonny step up as well, but SultanCap would like to put one of their trusted advisers into the LP as CFO and a member of the Audit Committee.

- Do you think Sonny is ready?
- Do you think Grandpa is ready to head to the lake house?
- What about Trey? Should he be the one groomed for succession - or should the company promote from within or hire an outside executive?
- Should SultanCap push hard to get their guy into the Executive Committee? Is it their right?

4. <u>ESG Pressures</u> – Because of ESG and PR (social and traditional media) pressures, Big Bank has decided to no longer bank any fossil fuel companies, so is terminating their relationship with all coal and oil & gas companies. All Macatawa entities are affected, including the LP. Bean must solicit new candidates for the Lead Bank of the syndicate.

- Sonny, Buddy, and the management team decide that the best way to burnish their ESG credentials is to hire a consultant to create a sustainability report. The report will contain metrics Macatawa is already reporting to various agencies, such as OSHA and the state oil regulatory commission. They also want to include photos of their well-maintained operations and highlight the family's large contributions to Ducks Unlimited for wetlands conservation and the Arkansas Parks Board (of which Missy is a commissioner). As a board member, how would you comment on that presentation?
- Trey's Millennial cousins (G3) have no interest in running the company, but definitely want their Trust Fund checks to continue. However, several are vegan, one is a green activist and most want Macatawa to transition away from its Fossil Fuel investments and make a Net Zero by 2050 pledge. Most of the G3 cousins are pressuring Trey to push Grandpa and Sonny out and sell Macatawa out of oil & gas and reinvest the proceeds into wind, solar and batteries. What should Trey do to manage the dissent with his cousins? Should Macatawa get out of the oil business?

5. <u>Philanthropy Pressures</u> – Grandpa is a rabid Arkansas Razorback fan and is the university's #2 donor after the Walton family. The Razorback Foundation has been wooing Grandpa and Stepmom to make a $100 million donation to build a new basketball arena, which will carry his name and have presented a proposal to Grandpa & Stepmom.

- As a board member, are the family's philanthropy plans any of your business?

6. <u>Oil & Gas Reserves Oversight</u> – Big Bank and the banking syndicate require that Macatawa provide audited O&G reserve reports from an outside engineering firm to back up the Reserve Based Lending (RBL). Macatawa has contracted with EngineerCo, a mid-size petroleum engineering consulting firm with longtime ties to the family, to provide the required annual engineering report. Unlike financial reporting, oil and gas reserve reporting is much more subjective and requires expert knowledge of the field to make estimates. Many public oil & gas producers have a board-level Reserves committee that reviews the annual report and work both with staff and the outside engineering consultants to oversee the process.

- Larry, as the lone technical expert on the Board, has asked to see a copy of Macatawa's annual Reserves Report from EngineerCo.
- Larry has also asked Buddy and the Chief Engineer if he can sit in on the all-day report-out meeting with EngineerCo and the company engineers and geologists to review the reserves. Buddy has pushed back, saying 'we're on it.' Should Larry push harder or is this 'fingers in?'
- Larry is at a lunch event for Engineering Society where he runs into an old college friend who used to work for EngineerCo but has recently retired. His friend knows Larry just joined the Macatawa board & mentions that, though he wasn't on the account, that some of the engineers on the Macatawa account thought they were pushed to 'lean forward' on their estimates to cover the RBL. What should Larry do?