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Creating Value Through Board Excellence
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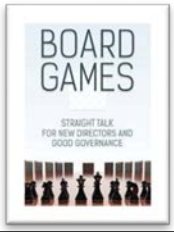

Private Directors Association™
Recommended Reading:
Board Games: Straight Talk for New Directors and Good Governance
By John T. Montford and Joseph Daniel McCool
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Private Directors Association™ Newsletter August 2017

Fiduciary and Advisory Boards, Understanding The Differences

Upcoming Events

Second Annual PDA Golf Outing
August 8, 2017
Starts 11:30 AM
Rolling Green Country Club
Arlington Heights, IL 60004

ESOPS as a Viable Liquidity Option for Sale or Succession
September 27, 2017
Starts 5:00 PM
McDermott, Will & Emery
444 West Lake Street
Chicago, IL, 60606

Chicago Evening Event
October 18, 2017
Starts 5:00 PM
Seyfarth Shaw
Willis Tower
233 South Wacker Drive
Chicago, IL, 60606

Register Now

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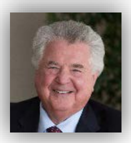

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There are two types of Boards, "a Fiduciary Board" and an "Advisory Board."

All Companies Must Have a Fiduciary Board

A corporation is required, by law, to have a Fiduciary Board of Directors. A limited liability company (LLC) will typically provide for management in some form in its operating agreement, which is often similar to a corporate board. The legal mandate sets out the responsibilities of the "Fiduciary" Board and are often further defined in the charter, the corporation's by-laws, or the LLC's operating agreement.

The Board's responsibilities typically include, but are not limited to, areas such as:

- Selecting the company's officers responsible for operating the company consistent with the Board's stated policies,
- Approving distributions to equity holders, and
- Otherwise overseeing the company's plans and policies.

There are often other responsibilities, but these are three of the most common.

Fiduciary Board members are elected by and serve the Shareholders, whom they seek to please. This is often carried to extremes when the Boards are exclusively family members. To be clear, in many closely held businesses, the Fiduciary Board is often a rubber stamp for the officers running the business, because the Boards often consist of the same, related or individuals who are or feel subordinate to the owner(s). In some companies, the Board does not even formally meet, but the members just sign off on the minutes regarding corporate action needing Board approval and Board meetings. These Boards typically are not constituted or operated to add value to the company.

Fiduciary Boards in privately-held businesses are all too frequently "rubber stamps," because they often consist only of owners, family members, and direct reports.

In a closely held business, the Fiduciary Board typically includes only family or subservient members. It is also not uncommon for these Boards to consist of only family members working in the business or non-family members, like professionals who serve the business at the pleasure of the officers working in the business. So, while such professionals are outsiders, they also often have a formal, long standing relationship with the individuals controlling the business.

With other types of private companies, there are varied levels of ownership representation on the Board that are typically spelled out in the company's shareholder agreement or operating agreement. **However, it is unusual to have outside independent directors who only owe their loyalty to the business and not to the individuals who are operating the enterprise.**

Electing independent board members to a Fiduciary Board or appointing independent advisors to an Advisory Board is often a hallmark of a company where ownership has realized the benefit of bringing independence to its boardroom(s).

CONTINUED Page | 2

Private Directors Association™ Newsletter August 2017

Fiduciary and Advisory Boards, Understanding The Differences

What then is an Advisory Board?

In contrast to the Fiduciary Board, there is no law that governs the creation of an Advisory Board. These Boards are often formed for the purpose of providing non-binding independent, experienced advice to the company's leadership. While the Advisory Board may be asked to provide recommendations regarding the three areas described above and others, they may also be tasked to focus on operations, relating to very specific issues and topics the company faces from time to time. When a specific item or items are identified, it is not uncommon to seek out persons with specific expertise to join the Advisory Board to address that item or items as well as on-going issues the company faces from time to time.

Fiduciary Board Versus Advisory Board Authority

The Fiduciary Board has the legal authority to require action on the part of the company and the company's leaders. The Advisory Board, in contrast, can only make Recommendations, but does not have any authority to require any action. The Fiduciary Board may have legal liability for acts and omissions. While the Advisory Board does not have statutory authority, they may still have some level of legal liability, which is usually governed by a written agreement with the Advisory Board members. Typically, those agreements relate to confidentiality, compensation, and other items. Either type of Board embodies the concept of authority, either actual or implied, to hold those responsible for operating the company accountable.

So why is this relevant to owners and advisors to private companies?

First, irrespective of which type of Board we are working with, we need to be clear about the actual responsibilities of the Board and its members. Once those responsibilities are established, what are the legal ramifications for those serving as Board members as well as the company and its owners?

When we are working to create and or enhance Advisory Boards, we need to be clear about the distinction between making recommendations without having the legal authority to put in place operating policies and procedures for the company, compared to Fiduciary Boards, which have the legal authority to enforce their policies and procedures.

In the situation where both Fiduciary Boards and Advisory Boards are active the respective members need to be very clear as to where their respective responsibilities and accountabilities of each start and end.

Boards, whether Advisory or Fiduciary, can and should be important tools to help any company thrive and grow. The most important decision business owners can make for the future of their business is to introduce independence into the boardroom, whether Advisory or Fiduciary. But to do so owners need not fear "jumping off a cliff without a parachute".

PDA's mission is to help owners learn how to properly engage with their Boards, Advisory and Fiduciary, and to get the most out of them in the long term best interest of their companies. PDA's process is one of discovery through caring and dedicated mentorship in the service of the company, its Shareholder(s) and its Board(s).

The Private Directors Association™ (PDA) is dedicated to helping private companies form and work with more effective Boards and helping them find qualified members for their Boards. Let PDA help you and your company get to the next level, by understanding how to work with independent board members and create one or more boards for your company.

Body of Knowledge Topic: Board Operations