

**CORONAVIRUS RESOURCE CENTER**

# COVID-19 and Private Equity: Portfolio Company and Fund Governance Practices in the Time of COVID

April 8, 2020

The COVID-19 pandemic is forcing fund managers and portfolio companies to make fast and hard decisions that must not only work during the crisis but stand up to scrutiny after the pandemic subsides. On April 2, 2020, Debevoise's Private Equity Group held its second COVID-19 briefing, focusing on how good governance today can minimize litigation headaches tomorrow.

To access the on-demand recording of the presentation, please [click here](#). Highlights include the following:

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## Corporate Governance

Natasha Labovitz

### Perfect Conditions for Second Guessing

The COVID-19 pandemic combines financial distress, time pressure, rapidly changing conditions and imperfect information. Once things return to normal, however, appreciation of the difficulty of making decisions under these conditions will quickly subside, replaced by second-guessing and litigation. That private equity funds are perceived as deep-pocketed sources of recovery only makes matters worse. Having a target on your back makes defensive corporate governance all the more essential.

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## Regulatory Environment

Robert B. Kaplan and Julie M. Riewe

### Keep Your Guard Up

In its communications since the crisis hit, the SEC has struck a fairly sympathetic tone toward market participants. However, this does not preclude it from taking a tougher stance later and applying it retroactively. Indeed, SEC actions during and after the 2008 financial crisis show that the agency is highly cognizant of, and vigilant toward, the opportunities for rule-skirting presented by upheaval. The following are particularly likely to draw scrutiny after the pandemic subsides:

**Liquidity events.** In the race to shore up liquidity positions, cash tends to become especially fungible. Managers may see it as advantageous to have one fund or SMA satisfy the redemption request of another, to instigate transactions between one portfolio company and another, or to make loans from one fund to another (or from a fund to a manager). In these cross-transactions, be scrupulous in adhering to governance checks and balances, including obtaining LPAC approvals, making proper notifications and obtaining fairness opinions.

**Redemptions.** Adhere closely to fund documents to ensure redemptions are not made preferentially, particularly if the decision is made to exercise a gate provision, which frequently draws investor ire.

**Valuation.** The current environment presents significant challenges for valuing assets and reporting performance. While the SEC rarely pursues cases involving valuations per se, it will focus on adherence to disclosed valuation methodologies, whether managers followed existing policies and procedures, and any misrepresentations or omissions in communications with LPs. Managers contemplating departure from standard procedures in this area should obtain any necessary consents and maintain transparency with investors.

**MNPI.** The SEC's co-directors of enforcement have explicitly cautioned against the misuse of material non-public information during the current volatile period, when non-public information has even more potential value than usual. For public companies, this means heightened attention to Regulation FD compliance. As discussed further below, fund managers need to be mindful of the risk of selective disclosure at a time when investors are clamoring for real-time information regarding performance and other metrics.

## Document Mindfully

Documenting decisions made during the crisis and the rationale behind them, especially if under exigent circumstances, will be protective in the event of after-the-fact questioning.

## Maintain Communications Hygiene

Be aware that communications may be discoverable. Consider how emails sent in the heat of the crisis will sound when read by a regulator or in a courtroom two years from now.

## For SEC Exams and Enforcement, It's Business (not quite) as Usual

The SEC has consciously maintained a “business as usual” face, and indeed, WFH conditions during the pandemic are particularly favorable for agency staff to bring intense scrutiny to their review of production documents. At the same time, some testimony is being postponed indefinitely (with some being done remotely by VTC or phone), and needed flexibility is generally being shown regarding return dates for document productions and written submissions. With the SEC’s September 30 fiscal year end fast approaching, however, the agency is already facing tough decisions about which enforcement investigations to prioritize and finish and which to let go given the disruption presented by the pandemic.

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## Material Non-Public Information (MNPI)

Jonathan R. Tuttle

### The Pandemic Doesn't Change the Basics

As much as the pandemic has upended markets, insider trading laws still hold—including for information that pre-dates the crisis. Remember that as a subspecies of the broader Section 10(b) securities anti-fraud provisions, MNPI rules apply to both public and non-public companies. For someone in possession of MNPI, the legal obligation to avoid insider trading liability generally boils down to two options: Disclose the material or abstain from trading.

### Handle Minority Investors With Care

When considering transactions such as rationalizing the capital structure, sponsors should remember that some minority investors will not have the same access to information that a sponsor does. Mitigate trading liability risk by, for example, getting the issuer to provide a release from NDAs so that information can be shared, or where

that isn't feasible, securing consent from the issuer to the transaction. Big boy letters can also be used to minimize civil liability risks in private, non-market-based transactions with minority investors or others because they eliminate reliance, but the SEC is not required to prove reliance and big boy letters are not generally a defense to an SEC inquiry. (Big boy letters can also be useful in non-securities bank-debt transactions.)

### **Know the Long Reach of Confidentiality**

In addition to the duty of confidentiality to the issuer, managers may have similar obligations to third parties, as in the case of material provided by a third party during due diligence conducted on behalf of a portfolio company contemplating an acquisition. Make sure that NDAs are clear regarding the existence of such duties and how such third-party information can and can't be used.

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## **Fiduciary Duties**

Shannon Rose Selden and Sidney P. Levinson

### **Back to Basics: Duties of Care and Loyalty**

Directors typically owe fiduciary duties to the Company on whose Board they serve and its shareholders. The duty of care requires fiduciaries to keep themselves informed about the affairs of the Company and to seek out and use all reasonably available information when making decisions; that can be more difficult in a challenging and changing environment, but it is no less important. Directors should seek out information and ask questions when making decisions even in exigent circumstances. The duty of loyalty requires directors to place the interest of the Company ahead of their own interest, and those of other parties; disclosing conflicts, exercising independent judgment, and making decisions in good faith and in the best interest of the Company are key.

### **Wearing Multiple Hats is Tougher in a Storm**

An investment professional who sits as a company director may owe duties both to a fund and its investors and to the company and its shareholders. Even in good times, those who serve as fiduciaries for multiple entities must be wary of conflicts and careful to ensure that when they act as a fiduciary, they are putting the interests of the organization on whose behalf they are acting first. In periods of financial distress, it is particularly important for fiduciaries to be attuned to the possibility of diverging interests, and aware of their role(s). It may also be appropriate to consider whether adding an independent director would be beneficial, and in fact, the appointment of

independent directors in restructuring matters has become more prevalent in recent years.

### **Process is Important**

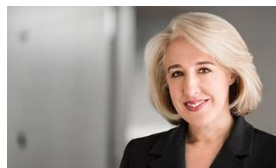
It can be challenging for fiduciaries to manage conflicts and stay informed when situations are changing constantly and information is imperfect—but process is important. In the face of uncertainty, stay engaged in decision making and be scrupulous about not signing off on anything you don't understand, regardless of the urgency. Identify and disclose conflicts of interest. Make sure to exercise independent judgment and to make decisions in good faith and in the best interests of the entity for which you are acting. Where practicable, a contemporaneous marketing process (whether to obtain financing or investment, to sell assets or any other transaction), properly conducted, can provide valuable support for any decisions that are later attacked in hindsight.

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For more information regarding the coronavirus, please visit our [Coronavirus Resource Center](#).

Please do not hesitate to contact us with any questions.

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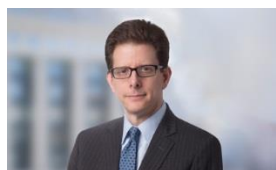


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