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# Experience Counts: Finding the Right Independent Directors

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# Experience Counts: Finding the Right Independent Directors

During major business transactions such as joint ventures, asset securitizations, and large commercial real estate deals, lenders often require corporate borrowers to hold their assets in “special purpose entities” or “SPEs” (also known as “special purpose vehicles” or “SPVs”). These entities are considered “bankruptcy remote”—in other words, they are designed to shield assets in the event that the parent company declares bankruptcy.

As an added layer of protection during high-value deals, lenders often require the boards of these SPEs to appoint at least one member with no ties to or interest whatsoever in the parent company. During votes, these “independent directors,” through their veto power, serve as a buffer against the possibility of the board of a solvent entity filing for bankruptcy.

In the past, the independent director’s role was uncomplicated. Companies hired independent directors to fulfill their lenders’ requirements with little consideration as to how capable they were. Whether the directors had experience in the realms of corporate governance, finance, and bankruptcy proceedings generally was an afterthought.

The economic turmoil of the past half-decade, though, has shined a light on the independent director’s role. With capital for financing often in short supply in recent years, independent directors—whose votes are typically needed in any instance of sale, merger, or filing for bankruptcy—are now of major importance. Today’s independent directors need to possess an understanding not only of the complexities of corporate governance, including fiduciary duties, but of bankruptcy processes as well.

The question is: Where can you find these people?

## Directors for hire

Several service companies now provide independent directors on a contract basis. But it can be hard to know just what you’re getting for your money when you hire their directors.

For instance, not all service providers offer directors with the experience it takes to manage complex situations, and the consequences of hiring a subpar director can be severe. Faulty discharge of an independent director’s duties can leave a company and its board of directors vulnerable to lawsuits, and—in situations that do end in bankruptcy—can render a company’s reorganization and emergence much more costly and time-consuming.

## Questions to ask

When it’s time for your firm to hire independent directors on your client’s behalf, there are several questions you should ask the service provider: How experienced are you in providing these services? Does your company have enough independent directors on staff to cover the number of entities involved? Do you provide for a director’s replacement if he or she becomes unable to perform their duties?

## Case Study: AREA Property Partners

**Background**

In 2007, at the height of the real estate boom, AREA Property Partners, a New York–based global real estate investment manager, acquired a portfolio of 13 upscale hotel properties from Eagle Hospitality Properties Trust.

AREA Property Partners purchased the properties—located throughout the U.S. and Puerto Rico—as part of a joint venture. Financing for the deal was secured from Bear Stearns Commercial Mortgage. The debt was structured among a dozen mortgage borrowers, a dozen operating lessees, five tiers of mezzanine debt, and one borrower located in Puerto Rico. Each level in the structure required two unique individuals to serve as independent directors, for a grand total of 16.

**The challenge**

By March 2008, the bottom had fallen out of the market and a failing Bear Stearns was bought by JPMorgan Chase. Bear Stearns' assets—which now included the AREA joint venture's loans—became part of Maiden Lane LLC, a financial vehicle established by the Federal Reserve Bank of New York for the purpose of "unwinding" those distressed assets.

In September 2011, the Maiden Lane debt came due. Until then, the joint venture had managed to keep up with its debt-service payments, but it was increasingly clear that it would not be able to repay the full $606 million it owed. AREA Property Partners' general counsel at the time, Keith Kooper, began to consider the possibility of a Chapter 11 bankruptcy filing.

**The solution**

Kooper knew that AREA Property Partners, given the tough situation it faced, needed the best-available governance for its entities, so he began researching firms with experience in providing independent directors that could match their needs. His search brought him to CSC. "We'd used CSC Trust's escrow services in the past, so I knew CSC provided an Independent Director Service as well," Kooper says. "We knew that CSC would provide the class of service we needed and the experience to back it up."

In March 2012, AREA Property Partners signed an engagement letter with CSC. Next, it replaced the joint venture's existing 16 independent directors with an equal number from CSC—each hand-selected for his or her level of education, business and real estate backgrounds, and, most critically, their experience on other boards in dealing with distressed assets.

**The result**

CSC's independent directors quickly brought stability and good judgment to the board at a decisive moment. In May 2012, the joint venture's Maiden Lane debt was purchased at a discount by a major private equity firm. The joint venture then entered into negotiations with the new lender for a result that satisfied the needs of all parties involved.

The following criteria are important and only grow more so during a "distress event":

1. Experience. How many times have the company's independent directors been asked to vote on a "material event," i.e., something that can affect value of the asset held by the company? How many times have they authorized a bankruptcy filing for an SPE?
2. Outside support. Does the independent director service have regular outside advisors it can quickly engage if an unusual situation arises, such as a vote on a material event? If so, who are they?
3. Established protocol. Does the independent director service have a protocol for dealing with votes on material events such as potential bankruptcies, etc.?
4. Added value. Is the independent director service supported with form documents, best-practices tip sheets, regular webinars, and other procedural and training tools that enable their clients to use the service more effectively and reduce costs?
5. Scalability. Does the independent director provider have enough savvy directors to meet the needs of the most complex structures and complex transactions? Can they handle the most difficult situations in a nimble, effective manner?

By applying a little common sense and asking the right questions of independent director service providers up front, you can not only help your clients fulfill their governance requirements, you can help them avoid risk, headaches, and unwanted expenditures in the course of their most critical deals.

## Independent Director Services from CSC

Corporation Service Company® (CSC®) is recognized by lenders and rating agencies nationwide as a leading provider of independent directors/managers for Special Purpose Entities used in structured finance, credit, and securitization transactions. CSC has provided independent directors to the commercial real estate industry for 20 years, with more than 8,000 appointments on file. CSC is a privately owned company and not affiliated with any bank or real estate company.

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