



NATIONAL DIRECTORS INSTITUTE

Best Practices in Private Company Corporate Governance

November 15, 2019

Panelists / Moderators

- **Erick Harris**
Blue Vista Capital Management
- **Jörg Schneewind**
Appvion
- **Zaldwaynaka Scott**
Chicago State University
- **David Zyer**
OCA Ventures
- **Steven Cade (co-moderator)**
Foley & Lardner LLP
- **Christopher Rasmussen (co-moderator)**
Foley & Lardner LLP

Overview

- Board Responsibilities
- Recent Judicial Developments
- Takeaways for Directors
- Protective Measures
- Trending Topics
 - Transitioning Founder-Driven Culture to a Board-Driven Culture
 - Succession Planning
 - Diversity
 - Competing Interests of Board Members
 - Importance of Committees

Board Responsibilities

Board Responsibilities

- “The business and affairs of every corporation organized under this chapter shall be managed by or under the direction of a board of directors....” (DGCL §141(a))
- Board of directors is responsible for overseeing the business and affairs of the company
 - Approving leases, contracts, or other material agreements
 - Approving fundamental operating financial and corporate plans, strategies, and objectives
 - Authorizing sale of company assets and other strategic transactions

Board Responsibilities

- **Overseeing the Business and Affairs of the Company**
(continued)
 - Evaluating performance of the company and its management
 - Selecting, evaluating, and fixing compensation of corporate officers
 - Reviewing and approving management plans
 - Adopting policies of corporate conduct

Board Responsibilities

- Directors do not run day-to-day operations, but they are ultimately responsible for the management of the corporation
- Evaluating the overall effectiveness of the board itself
 - How well the board carries out its functions
 - How well prepared the directors are to fulfill their obligations
- The directors owe certain fiduciary duties to the company
 - Duty of Care
 - Duty of Loyalty

Board Responsibilities

- Duty of Care

- Requires directors to keep themselves informed about the affairs of the company and be assured that they have all reasonably available information when making decisions
- Directors are expected to act on an informed basis, in good faith, with the care of an ordinary prudent person in a like position would exercise and in a manner the directors believe to be in the best interests of the company
- Rely on the advice of experts if helpful
- Non-delegation: the Duty of Care cannot be delegated to other decision-makers

Board Responsibilities

- Duty of Loyalty
 - Requires directors to uphold their fiduciary duties to the company and its stockholders by placing the company's interests ahead of their own
 - Directors should not use their corporate position to make a personal profit or gain or for other personal advantage
 - Two specific considerations:
 - Conflicts of Interest
 - Corporate Opportunity

Board Responsibilities

- Business Judgment Rule
 - Qualifies the Duty of Care
 - Protects disinterested directors from personal liability to the company and its shareholders even if a corporate decision the director approved turns out to be unwise or unsuccessful
 - A court generally will not substitute its judgment for that of a director, if the director:
 - Acted in good faith;
 - Was reasonably well informed; and
 - Rationally believed the action taken was in the best interests of the company

Recent Judicial Developments

Recent Judicial Developments

- *Marchand v. Barnhill* (Del.Jun.19, 2019): Delaware Supreme Court Allows Shareholder Suit Against Directors to Proceed Alleging Breach of Duty of Loyalty
- In 2015, Blue Bell Creameries, a large manufacturer of ice cream, experienced a *listeria* outbreak, which infected its products and led to the death of three people. A stockholder sued derivatively, alleging, among other things, that the directors breached their fiduciary duty of loyalty.
- Held: A board’s “utter failure to attempt to assure a reasonable information and reporting system exists is an act of bad faith in breach of the duty of loyalty.”
- Takeaways: (1) boards should ensure that reporting systems are in place for the most substantial risks facing the company; (2) meeting minutes should reflect considerations by the board of key compliance issues; and (3) board should ensure an appropriate plan for significant risks.

Recent Judicial Developments

- *In re Clovis Oncology, Inc.* (Del. Oct. 1, 2019): the Delaware Chancery Court provided further perspective on directors' potential liability for breaches of the duty of oversight
- Plaintiffs alleged that the company misrepresented to investors and others the level of confirmed responses in a clinical trial of a lung cancer drug, which the FDA later declined to approve.
- Held: Boards not only must be able to demonstrate that they have made good faith efforts to put in place an oversight system, but that also that they *monitor* the system – especially when a company operates in a highly regulated industry.
- Takeaways: (1) the importance of board level efforts to oversee compliance with governing law and regulatory mandates, particularly in situations where compliance issues are critical; and (2) how stockholders are using books and records demands under 8 *Del. C.* § 220 to pursue fiduciary claims focused on those same compliance issues.

Takeaways for Directors

Takeaways for Directors

- Duties of loyalty and care are alive and well in the Delaware courts
- A board must both implement a reporting and controls system and monitor its functioning
- The board should document the company's key risks and insure the management reporting system produces actionable information regarding such risks
- Boards should document reporting and control systems and consideration of key risks in board minutes

Protective Measures

Protective Measures

- Document decision making and corporate approval process carefully
 - Board minutes
 - Must be more than a mark-up of last year's minutes
 - Balance between no record of deliberations and keeping transcripts
 - Reflect substance and process of meeting

Protective Measures

- Use Independent Directors
 - Conflicts of Interest
 - Executive Compensation
- Use Outside Experts
 - Mergers/Acquisitions
 - Executive Compensation
 - Other Substantial Transactions

Protective Measures

- Know where your duties lie:
 - When acting as partner/manager of private equity firm
 - When acting as director of portfolio company
 - When serving on multiple boards simultaneously
 - When company is in “zone of insolvency”

Protective Measures

- Avoid “Deputization” Issues
 - Look out for interests of all shareholders, rather than serving on the board as a representative or “deputy” of the private equity firm
 - Carefully consider the kinds of communication you have with colleagues at the private equity/VC firm – avoid the appearance of deputization

Protective Measures

- Time and Effort
 - Ensure you have adequate time to fulfill your obligations
 - Attending meetings
 - Communication between meetings
 - Carefully considering decisions
 - Put forth the time and effort required
 - Experts estimate between 150-200 hours annually

Protective Measures

- Process

- The legal system will judge you based on the soundness of the process you undertook
 - Whether independent directors approved related-party transactions
 - How many meetings the board held to discuss an issue
 - How much time the board spent discussing certain issues
 - What materials were reviewed
 - Whether the board received required materials sufficiently in advance of board meetings
 - How many questions the directors asked

Protective Measures

- Specific Concerns
 - Piercing the Corporate Veil
 - Maintain corporate records appropriately
 - Follow corporate formalities
 - Ensure directors and officers act on behalf of the company they are serving
 - Management's Failure to Raise Issues
 - Create a whistle-blower system for employees

Protective Measures

- Specific Concerns (*continued*)
 - Insider Trading
 - Create and follow certain procedures to ensure that partners and employees of private equity firm do not intentionally or accidentally decide to buy or sell shares of public portfolio company's stock while possessing material, non-public information
 - Adhere to such procedures in every instance

Trending Topics

Trending Topics

1. Transitioning from a Founder-Driven Culture to a Board-Driven Culture
 - Set expectations
 - Establish clear roles and communication practices
 - Venture capital firms should work especially closely with founders
 - Balance the founders' happiness with the board's plan

Trending Topics

2. Succession Planning

- It is never too early to have a plan
- Invest in leadership development
- Venture capital firms and founders can work together to create a plan that is right for the company
- Know the culture and incorporate that understanding into a succession plan

Trending Topics

3. Diversity

- Investors expect board diversity (of both background and experience)
- A diverse board helps create a successful company culture
- Filling in the gaps (industry, management, etc.)

Trending Topics

4. Competing interests between different board members
 - Board member vs. company (*e.g.* appropriating/usurping corporate opportunities)
 - Board member's duty of loyalty to shareholders
 - Venture capital shareholders vs. founders vs. other investors

Trending Topics

5. Importance of Committees

- Get organized: create an agenda and outline the duties, responsibilities and expectations of the committee
- Increase accountability
- Divide and conquer and maximize efficiency
- Tap the specific talents, skills and knowledge of individual board
- Heightened importance for family companies/founder driven companies

Questions/Discussion