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Cooley U: Board Basics

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Forming the Corporation's Board of Directors

- A Board of Directors is a Legal Requirement for All Corporations
 - DE – One Director is Enough
 - CA – Three Directors are Generally Required Once Stock is Issued
 - Directors Do Not Need to be Stockholders
- Corporate Bylaws Set Parameters for Board & Directors
 - Size of the Board; How it is Set
 - Qualifications (not common)
 - Quorum
 - Filling Vacancies
 - Removal Procedures
 - How Action is Taken (more on this later)
 - Committees (more on this later)

How Directors Join and Leave the Board

- Initial Director(s) Most-Typically Appointed by the Sole Incorporator
- Then: Directors and/or Stockholders (depending on what bylaws say) Fill Vacancies Created by Resignations, Removals, Additional Directorships
- Directors Serve Until:
 - the [Next] Annual Meeting of Stockholders;
 - and Until His/Her Replacement is Duly Elected and Qualified;
 - or Until His/Her Earlier Resignation or Removal.
- Removal Requires Stockholder Action
- Voting Agreements Among the Corporation, Founders and Investors Most Typically Specify Board Membership (designation rights, voting agreement)
- Certificate/Articles of Incorporation Can Specify Specific Class/Series Voting for Directors
- FAQs/Follow-up Points
 - Must We Have an Annual Stockholder Meeting?
 - When/How are Stockholders Involved in these Processes?

How the Board Takes Action

- Meeting
 - Bylaws Set Notice Requirements (typically ~48 hours; can be waived)
 - Bylaws Set Quorum Requirements (typically majority)
 - Majority of Directors at the Meeting Can Take Action
 - Bylaws/Law Set Means of Meeting:
 - In-Person, Always Permitted
 - Does Not Need to Occur in State of Incorporation
 - Telephonic Nearly Always Permitted (all directors must be able to hear and be heard)
- Written Consent Must be Unanimous
- Typically One Director = One Vote
- FAQs/Follow-up Points
 - A Director may not “proxy” or delegate their vote.

What Does the Board Approve?

- Hiring CEO & senior management
- Appointing corporate officers (different than titles)
- Amendments to the certificate of incorporation or bylaws
- Equity grants (stock, options or warrants)
- Formation of subsidiary
- A sale of the company or any other transaction resulting in a change of control
- Items that are “material” to the business (as opposed to day-to-day)
 - Materiality will change as the company grows
 - Borrowing or lending money
 - An annual plan or large capital expenditure
 - Bonus or compensation programs
 - Selection of auditors

Chairman of the Board

- Role of the Chairman = Set the Agenda, Run the Meeting
 - Desired but Not Necessary to Have Chair Appointed
 - Frequently Chair is CEO for Early-Stage Corporations
 - Typically Chair is NOT the CEO for Public or Large Private Corporations

- FAQs/Follow-up Points
 - What is an “Executive Chairman”?

Meetings and Agenda

- At Least Once Per Year; 4-8 Times Per Year is Common
- Advisable to Schedule in Advance for the Whole Year
- Set An Agenda & Manage the Time Carefully
- Typical Agenda Items
 - Corporate Housekeeping (e.g. approve minutes (more on these later))
 - Business Overview (can include detailed updates by executives responsible for particular business unit such as sales, product development)
 - Financial Review
 - Executive Session (usually includes option grants, if any)
- Create a Board “Deck” and Circulate in Advance – Nothing Discussed at the Meeting Should be Brand New Information for Directors; Manage “Bad News”
- FAQs/Follow-up Points
 - What Formalities Are Required?

Who Attends Board Meetings and Where

- Who Attends:
 - All Board Members
 - Key Members of Executive Team (some depending on the agenda)
 - Outside Counsel
 - Board Observers, if any
- Location: Large-Enough Room and Privacy from Employees (borrow space from investor, outside counsel, etc.)
- Considerations: Confidentiality; Sensitive Matters; Need to Know

- FAQs/Follow-up Points
 - Why Should I Have Outside Counsel at Board Meetings?

Minutes and Record Keeping

- It is Important to Keep Good Corporate Records
 - Deal/Financing Diligence
 - Legal Opinions
 - Legal Requirement
- Corporate Records Should be in the “Minute Book”
 - Charter and Bylaws
 - Board Minutes (signed by the secretary) and Actions by Written Consent
 - Stockholder Meeting Minutes and Actions by Written Consent
- Audience for *Official* Minutes
 - Potential Investors and Acquirers
 - Litigants
- Keep the Minutes Formal, Accurate and High-level; Do Not Include Sensitive Information
- Other Key Records = Personnel, IP, Leases, Debt, Commercial, Financings, Options, Etc.

Committees

- Role of Committees = Handle Delegated Board–Level Matters Without Having to Involve the Full Board; Particularly Used Where Conflicts Exist
- Committee Membership is Limited to Members of the Board (others may attend meetings)
- DE Committee Can Be 1 or More Directors; CA Committee Can Be 2 or More Directors
- Most Common Committees = Audit & Compensation
- Other Committees: Nominating and Corporate Governance (most Public Corporations have this), Financing Committee, Non-Executive Stock Option Committee & Committees Set Up for Specific Transaction or Issue
- Certain Actions Cannot Be Delegated
 - DE: Actions that Require Stockholder Approval & Amending Bylaws
 - CA: Actions that Require Stockholder Approval, Filling Vacancies on the Board or Committees, Fixing Director Compensation, Amending Bylaws, Certain Distributions, Appointment Of Committees

Fiduciary Duties of Directors

- Duty of Loyalty
 - Act Solely for the Benefit of the Corporation and its Stockholders
 - Refrain from Conflicts of Interest
- Duty of Care
 - Be Informed
 - Act Reasonably
 - Act Responsibly After Consideration of Relevant Materials and Information and After Appropriate Deliberation (get input from advisors)
- Other Duties: Confidentiality, Corporate Opportunity, Candor
- Business Judgment Rule: Directors are Presumed to Have Acted in Good Faith and in the Interest of the Corporation
- Interested Transactions
- Procedural Considerations: Independent Directors; Disclosure of Conflicts; Recusal of Directors; Clear Record Keeping; Use Advisors; Stockholder Approval

Fiduciary Duties of Directors Cont.

- Breaches of Fiduciary Duties (i.e. breach of duty of loyalty):
 - Personal Liability for Damages
 - Injunctions
 - Loss of Indemnification (more on this later)
 - Loss of D&O Insurance Protection (more on this later)
 - Court Costs, Legal Expenses, Awards, Damages, Time and Money
- Duty to Stockholders Shifts to Duty to Creditors in the Case of Insolvency

Indemnification of Directors and D&O Insurance

- Certificate/Articles of Incorporation and Bylaws Typically Include Indemnification Provisions for Directors and Officers
- Many Corporations Also Adopt Indemnification Agreements with Directors and Officers; Include More Details of Procedures and Coverage
- D&O Insurance is a Good Idea for Early-Stage Corporations and a Must-Have for VC-Backed, Later-Stage and Public Corporations
 - Covers Directors' and Officers' Personal Liability for Corporate Actions

Board Composition: Who and When to Recruit

- The Role of the Board
 - Day-to-day operations typically handled by management, but the Board is ultimately responsible for management and oversight of the company
 - Frequency of meetings, involvement in operations, compensation of Board members is highly dependent upon the stage of the company
- Pre-Funding
 - Primarily founders, but looking for mentorship
- Post-Funding
 - Investors will be involved, it is important to have an independent voice
- Pre-Public/Public
 - Public company requirements