Biotechnology Entrepreneurship Boot Camp

Biotechnology
Innovation Organization

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Building and working with the Board

It’s not rules and regulations. It’s how people work together.

How to Create an Effective Board

- Every director individually, and the board acting together, has a fiduciary duty to act in the best interest of the corporation and its stockholders
- Three important questions. In relation to the BOD,
  - Who owns and controls a corporation?
  - What is a fiduciary and a fiduciary duty?
  - What about all the Delaware Corporations?

Who owns and controls a corporation?

- All states have state-enacted laws built on a corporate model that separate ownership from control.
- The owners of a corporation are its shareholders and the shareholders, operating under state laws where they incorporated, are charged with electing and removing directors.
- The BOD is responsible for taking charge and control of the operations and assets of the corporation on behalf of the shareholders. It is common practice for the BOD of a corporation to delegate the daily business operations to one or more executives routinely known as "management."
- The shareholders elect the BOD. The BOD appoints management. The BOD is responsible to the shareholders and management is responsible to the BOD.
- Of note, courts regularly find that management has a joint responsibility and accountability to both the BOD and shareholders of a corporation.
- At the basic level, shareholders own, directors control, and management runs a corporation.

What is a fiduciary and a fiduciary duty?

- *A fiduciary* is a person to whom property or power is entrusted for the benefit of another. Fiduciaries are vested with special privileges and responsibilities while acting for the benefit of others.
- In general, a *fiduciary duty* pertains to the relationship and obligation between fiduciaries and the people they serve and to whom their obligation is owed. Directors and BODs are fiduciaries.
  - The directors by virtue of their legitimate election are vested with special privileges and responsibilities while acting for the benefit of others.
- Being a fiduciary and having a fiduciary duty implies a position of great trust, requiring any number of qualities and duties including good faith, trustworthiness, and confidence.
  - It requires a very high level of care in managing the assets, money and operations of another.
- Two fiduciary duties of directors are widely recognized:

  *The duty of care
  *The duty of loyalty
- The duties of care and loyalty stem from the common law of various states and are subject to ongoing reviews and interpretations by the courts.
- The *duty of care* means that directors be careful, informed and use their own independent judgment.
- The *duty of loyalty* means that directors use their authority only in the best interest of the corporation and never in their own personal interest or the interest of some other party.

What About All of Those Delaware Corporations?

- In the US, a corporation comes into being under the authority of a state of incorporation, with the choice of the state being made by those persons filing the application for incorporation.
- The general corporate laws for a state of incorporation—along with shareholder-approved governing documents including articles of incorporation and by-laws—establish the general contract, obligations, and relationships among the shareholders, directors, and other parties to company operations.
  - The state of Delaware and its specialized business-oriented court system are preeminent thought leaders in corporate and fiduciary duty law.
  - ➢ Many states look to Delaware law to guide them in developing and applying laws that govern non-Delaware corporations.
  - The importance of Delaware law is especially notable for large publicly-traded companies as more than 50 of all publicly traded U.S. corporations and more than 60% of the Fortune 500 are incorporated in Delaware.
  - Delaware has a prosperous business, with its renowned court system that is well supported by its state legislature.
  - ➢ The law in all 50 states tells us that the board oversees a company's operations with language similar to that found in the General Corporation Law of Delaware shown in Figure 2.1 from Title 8, Chapter 1, Subsection 141 on Directors and Officers.

What about Director Liability?

- For most prospective directors, director liability is the one question/and concern that surfaces and causes anxiety.
- The best answer and protection any director can rely upon in fulfilling their duties is a simple concept known as the Business Judgment Rule.
- The Business Judgment Rule provides directors with a shield of liability protection.
  - It is a principle well-established in case law that courts follow where they decline to substitute their judgment for that of directors and management.
  - If the actions of a board of directors produce a bad result, even a mind-boggling string of bad results, courts consistently decline to second-guess directors.
- This is why we see major corporations, such as Hewlett-Packard (HP) and Disney, winning cases in which their boards have been accused of failing to do their duties.
- Examples:
  - A suit in which HP directors were accused of failing to properly oversee CEO succession and acquisitions.
  - Another where Disney directors allegedly squandered $140 million with a severance package given to executive Michael Ovitz after just one year of service.

What is the Role of the Board of Directors?

The board of directors (BOD), including the CEO, has very defined roles and responsibilities within the business organization.

- The role of the board of directors to hire the CEO or general manager of the business and assess the overall direction and strategy of the business.
- The CEO is responsible for hiring all of the other employees and overseeing the day-to-day operation of the business.
- Problems can arise when these guidelines are not followed.
- Conflict occurs when the directors interfere in the day-to-day operation of the business.
  - Equally, management is not responsible for the overall policy decisions of the business.
- The board of directors selects officers for the board.
  - The major office is the president or chair of the board.
  - Next is the vice-president or vice-chair who serves in the absence of the chair. These positions are filled by board members.
  - Next is the secretary and treasurer or combined secretary/treasurer.
    - ➢ These positions have very specific activities and may be filled by someone who is serving on the BOD or appointing someone who is not a member of the BOD.
    - ➢ The selection process is often based on who is willing and/or most qualified, although seniority may come into play.

What are the major responsibilities of the BOD?

- Recruit, supervise, retain, evaluate and compensate the manager.
- Provide direction for the organization.
- Establish a policy-based governance system.
- Govern the organization and the relationship with the CEO.
- Fiduciary duty to protect the organization’s assets and member’s investment.
- Monitor and control function.

What is Governance and What are Governance Models?

- A BOD is a collection of people operating as a group.
  - Functioning as a group is something many people are not comfortable with.
  - Each board evolves with its own culture. And board culture is very important.
  - Culture is dictated by the backgrounds of the individuals on the board.

There are several governance models of how a BOD can function.

- Considering and choosing the right model is important because it will influence the success of the business.
- Manager Focus
- Proactive Board
- Geographic Representation
- Community Representation

What Makes Boards Great?

- Conventional Wisdom:
  - Regular Meeting Attendance
  - Equity Involvement
  - Board Member Skills
  - Board Member Age
  - The Past CEO’s Presence
  - Independent Directors
  - Board Size And Committees
  - Audit And Compensation Committees

The Importance of Good Culture

- What sets exemplary boards apart is that the are robust, effective social systems.
- Board members develop:
  - Mutual respect, trust, ability to share difficult information
  - Can challenge one another's conclusions coherently and openly
  - Engage in a spirited give and take which becomes a norm
  - Learn to adjust their own interpretations in response to intelligent questions.
  - Once a plan is agreed upon, the board does not look back
  - Board members do not need ‘back channels’ – information is provided on time

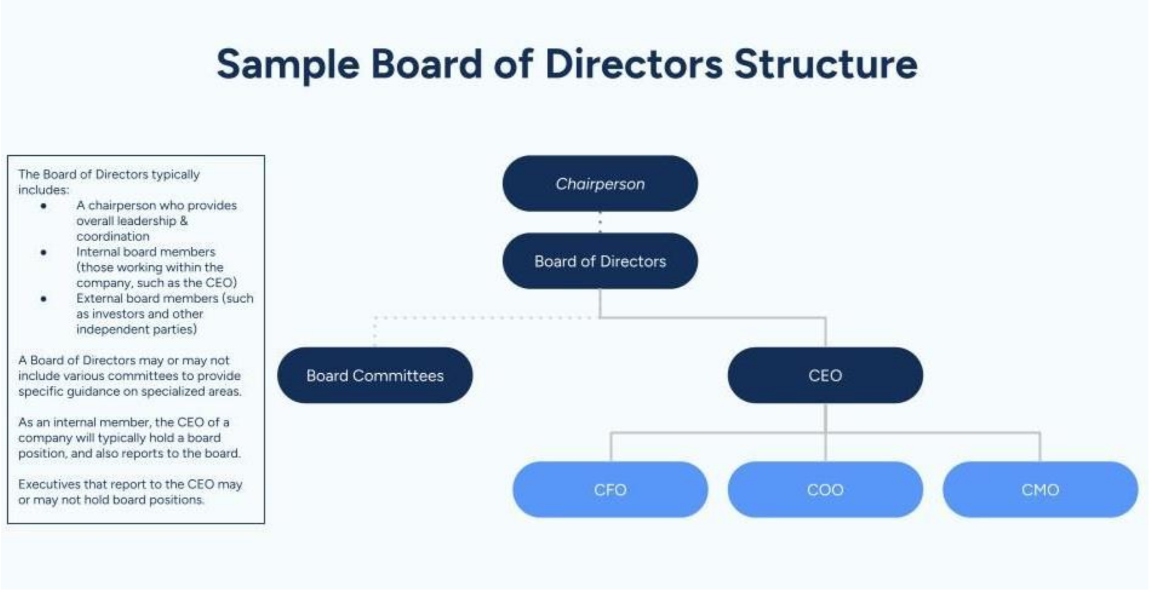
Key Issues in Corporate Governance for 2023

- Risk management
  - Boards are expected to oversee significant and critical risks, and to document their oversight of the strategies, policies and procedures adopted to address those risks.
- Cybersecurity
- Cryptocurrency and blockchain:
- Politicization of ESG, and questions about the “woke” corporation
- Climate disclosure
- Activism preparedness and defense
- D&O exculpation and insurance
- Clayton Act Section 8:
- Executive compensation clawback rules
- Board Diversity

https://corpgov.law.harvard.edu/2022/12/01/thoughts-for-boards-key-issues-in-corporate-governance-for-2023/

What is the Common Structure of a Board of Directors?

- Best practices exist, but there is no set structure for a BOD.
  - The composition and role of the board of directors will depend largely on the industry, stage, funding, and organizational needs.
- Internal members of a BOD are typically individuals who are employed by the organization and have a direct stake in its success.
  - These individuals may include executives, such as the CEO or CFO, or other senior leaders within the organization.
- External members of a BOD are individuals who are not employed by the company or organization.
  - External members may include investors who have funded the company, or independent members.
- Independent board members are often chosen for their expertise in a particular industry or field or for their experience in corporate governance.



https://corporatefinanceinstitute.com/resources/management/board-of-directors/

The Phases of Private Equity Funding

The five stages of Start-up Financing

1. Seed: the first stage of financing where the amount needed is generally modest

- The goal of this stage is to demonstrate the viability of the business

2. Early Stage: companies begin operations but are not yet ready to generate sales

- With this funding, the company completes their clinical trial, builds out their key management, and finalizes their manufacturing processes

3. Growth Stage: starts with passing regulatory requirements, or having clinical or economic evidence to support the commercial sale of the product

- This phase also includes scaling the sales force and building commercial capabilities.

4. Later Stage: the capital provided after commercialization and sales but before an exit such as a merger, acquisition, or initial public offering (IPO)

5. Exit: creating a liquidity event for stockholders; finding a mechanism for stockholders to turn their investments into cash

- Exit should be one of the first thoughts during company formation