

The Duties and Responsibilities of Corporate Directors: A Primer

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GENERAL

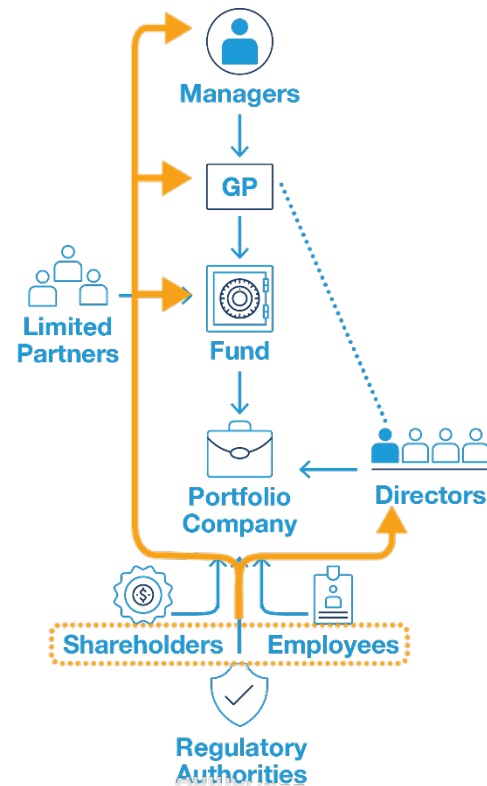
- Duties of directors are governed by corporate law of the Company's state of incorporation (here, Delaware).
- Under Delaware law, business and affairs of Company are managed by or under direction of Board of Directors. In this capacity, members of Board serve as fiduciaries of the Company and its stockholders.
- Basic obligation of the Board (including its committees) is constant throughout: to act without conflict of interest, in good faith and on an informed and deliberative basis, to identify, protect and advance the best interests of the Company and its stockholders.
 - Company should hold regular board meetings and maintain appropriate minutes and records.

FIDUCIARY DUTIES

- Directors of a Delaware corporation owe three duties to the corporation and its stockholders:
 - Duty of care;
 - Duty of loyalty; and
 - Duty of good faith
- In practice, these duties may overlap.
- These duties apply generally to all Board conduct.

FIDUCIARY DUTIES (cont'd)

A directorship
creates risk
throughout the entire
investment structure



DUAL FIDUCIARIES

- Directors may owe fiduciary duties to more than one entity, including a portfolio company and the fund.
 - While Delaware law does not prohibit directors serving in dual roles, directors should be mindful of circumstances where the portfolio company's and the fund's interests conflict or diverge.
 - In such circumstances, proper disclosure of the directors' conflict and/or a vote of disinterested directors or a special committee may be appropriate and/or required.
- Sharing of portfolio company information with the fund can result in situations that will require careful consideration.

ATTORNEY CLIENT PRIVILEGE, INDEMNIFICATION & INSURANCE

- Attorney Client Privilege
 - Whether a director's communications with a portfolio company's attorney will be considered privileged depends on situation-specific facts and circumstances.
- Indemnification and Insurance
 - Directors should ensure that a portfolio company's D&O insurance properly complements the fund's D&O insurance.

STANDARDS OF REVIEW

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- Courts review directors' discharge of their fiduciary duties under different standards of review, depending on the situation:
 - Business Judgment Rule
 - Entire Fairness
 - Enhanced Scrutiny
- Applicable standard could potentially impact the outcome of litigation.

BUSINESS JUDGMENT RULE

- To determine if directors have satisfied their fiduciary duties, courts generally apply the business judgment rule:
 - The business judgment rule is a judicial presumption that directors make decisions in good faith, based on reasonable investigation and after careful consideration of all material factors reasonably available, in a manner reasonably believed to be in shareholders' best interests.
- If directors act in this manner, they are presumed to have satisfied their duties without “second-guessing” by courts.
- The presumption of the business judgment rule imposes a burden on plaintiff to show that the directors did not act in a manner consistent with their fiduciary duties.

SPECIAL SITUATIONS

- Funding Rounds and Initial Public Offerings
- Financial Distress
 - While directors generally owe fiduciary duties to the Company and its stockholders, special considerations arise when the Company is in financial distress, is insolvent, or approaches insolvency.
- Special Committees
 - An independent special committee can offer protections to directors reviewing transactions where there may be a conflict, a “change of control,” and other situations.
- Trade Secrets and Intellectual Property

LABOR & EMPLOYMENT

FTC Proposed Ban on Non-compete Agreements

- Jan. 5, 2023: FTC proposes federal rule to ban all non-competes and other forms of agreements that “act” like a non-compete.
- Only stated exception is for the sale of a business where the seller hold 25% of more of the equity.
- Application to LPs is unclear, but at the moment we believe forfeiture-for-competition clauses are unaffected.
- Non-solicitation, confidentiality, and non-disclosure provisions likely unaffected.
- Public comment period closes in March 2023, following which the rule will be finalized and then challenged in court.
- We believe the rule has a fairly low chance of surviving legal challenge.
- This said, non—competes are facing increased scrutiny and regulation nationwide.

FTC Proposed Ban: Takeaways

- Businesses should tighten up confidentiality, non-disclosure, and trade secret agreements and protections.
- Even if the FTC rule does not survive, businesses should ensure that non-compete agreements (in employment agreements, LP agreements, etc.) are as narrowly tailored as possible to protect non-public competitive information.
- Businesses should look to rely on tools other than pure non-competes to protect their assets and disincentivize key employee departures:
 - Forfeiture/claw back agreements
 - Forfeiture tied to leaving, rather than competing
 - Stay incentives
- Businesses with Delaware choice of law provisions in non-compete agreements should keep a close eye on that state's developments.

EXECUTIVE MISCONDUCT

- Directors have liability risk in connection with executive misconduct, discrimination, and sexual harassment.
- The liability theories take different forms, including:
 - Aiding, abetting, permitting, and/or acquiescing.
 - Breach of fiduciary duty for not ensuring proper policies, controls, and training are in place and enforced.
 - Negligent hiring/supervision/retention.
 - Failure to take corrective action in the past, or otherwise “enabling” a culture/environment in which harassment exists.
 - “Shielding” problematic executives from liability, including by authorizing payments to settle past claims.
 - Ignoring “red flags.”

#ME TOO, DEI, AND WORKPLACE EQUITY

- Similar theories have been used to assert liability against directors in connection with #Me Too claims, social justice claims, pay equity claims, and other workplace equity claims.
- These claims arise in both individual and class action lawsuits, as well as shareholder lawsuits.

THE PLAYBOOK TO MINIMIZE RISK

- Understand your culture and history of employee complaints.
 - Where has the company been exposed in the past, and why?
 - Are you confident that measures are in place to identify and remediate issues before they become public?
 - Is there a Board committee with authority over these issues, and a process to be informed of certain complaints?
- Do not “look the other way,” regardless of who is involved.
- Do not try to remediate situations without legal guidance and support.

THE PLAYBOOK TO MINIMIZE RISK (cont'd)

- The Board committee charged with oversight should ensure that:
 - The company is proactive in preventing issues.
 - The company properly handles complaints to minimize damage.
 - The company learns from every incident.
- Review and build out diversity and inclusion efforts.
 - A demonstrated commitment to diversity and inclusion can foster an environment that is less likely to tolerate harassment and discrimination.
- Strive to keep disputes “internal.”
- Have a public relations strategy at the ready.
- Be particularly responsive to claims that are brought directly to the Board, as they often are when the accused is a C-suite executive.

The Duties and Responsibilities of Corporate Directors: A Primer - Summary

SUMMARY

- Regardless of the applicable standard of review, spotlight often is on directors' conduct in a significant corporate transaction.
- Courts look for objective evidence that directors made careful, educated, honest decisions.
- Basic rules:
 - Be informed, well advised and properly motivated.
 - Take your time.
 - Act on basis you honestly believe is in best interests of Company and its stockholders.
 - Examine the premises for proposed action.
 - Ask good questions.

SUMMARY (cont'd)

- Director must:
 - Exercise reasonable diligence in gathering and considering all material information.
 - Understand and weigh risks and any alternative courses of conduct that may be available.
 - Weigh benefits versus harm to Company and stockholders when considering specific courses of action.
 - Secure expert advice (financial advisor/legal advisor), and fully understand experts' findings and basis for findings.
- Process is critical, whether or not heightened standards apply.

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