HOW TO GET VALUE FROM THIS DEMO

- Use chat to submit questions
- Yes, you’ll get the slides and video
- We’re recording, so come back and listen again
- Contact Heather Krejci with questions: hkrejci@angelcapitalassociation.org

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ANGEL CAPITAL ASSOCIATION TODAY

World’s largest association of active accredited angel investors - www.angelcapitalassociation.org

Mission: fuel the success of the accredited angel investor community through advocacy, education, data and connection building

14,000+ investors across North America

Data Analytics

Gold Standard Education

Advocacy in DC

Great Connections
OUR SPEAKER: RON WEISSMAN

- Board Member, Angel Capital Association
- Band of Angels, Berkeley Angel Network
- VC at Apax Partners (17 years)
- 40+ boards as Chairman, Director or Observer here and abroad
- Senior executive at NeXT (reporting to Steve Jobs)
- CMO, Turnaround of the Year (Verity)
- Mentored and/or invested in 60 companies
- Angel outreach: Australia, New Zealand, Hong Kong, Italy, Chile, Germany, Armenia, Republic of Georgia, US White House
- Author of multiple works on the Italian Renaissance
“And the Board of Directors voted to wish you a speedy recovery, 3 to 4 with 2 abstentions.”
GOALS

• Understand startup company Board basics
• Understand Director’s legal duties and obligations
• Maximize Director effectiveness
• The CEO’s role, challenges and relationship with the Board
• Stay out of trouble!
• All in the context of life after Series Seed and Series A
WHAT YOU’LL LEARN ABOUT TODAY

• Zombies!
• Why good Board meetings are like nuclear arms treaties
• NIFO!
• The problem with Board observers
• The RED Zone
AGENDA

• Introduction: Board Basics
• Building a Board
• Governance
• Best Practices in Working With Your Board
AGENDA

• Introduction: Board Basics
  • Role and Duties of the Board
  • Changing Board Role as Company Matures

• Building a Board

• Governance

• Best Practices in Working With Your Board
DEFINITION

*Board of Directors*: a group of persons elected by the shareholders to jointly govern the affairs of a corporation.

“By demanding to nominate directors you shareholders act as if you own the place.”
HOW ARE BOARDS ESTABLISHED?

• C Corporations* are required to have a Board
  • Specific rules differ by state

• Formed via Company Charter / Articles of Incorporation filed with state
  • Company name, stock, officers, directors, by-laws

• Changes to Articles of Incorporation: usually occur as a result of new financing rounds

• Financing rounds are the easiest time to mandate better governance

• Best practice: Directors should familiarize themselves with Articles (including by-laws), Investor Rights Agreement, last round’s final term sheet, company’s current cap table

* C Corporation: Any corporation that is taxed separately from its owners.
DUTIES OF THE BOARD*

1. Determine the Company’s Mission, Purpose & Risks
2. Hire & Fire the CEO
3. Support the CEO, Review His or Her Performance
4. Ensure Effective Organizational Planning
5. Ensure Adequate Resources

* From BoardSource – with additions
ROLE OF THE BOARD CHANGES OVER TIME

(Next three slides)

- Ensure High Integrity Corporate Governance
- Hire/Review CEO, Approve Exec Hires
- Approve Strategic Plans
- Monitor Performance Against Plan
- Ensure Audit / Hire Audit Firm
- Hire Law Firm
- Exec Compensation & Stock Option Grants
- Ensure Shareholder Communications
ROLE OF THE BOARD CHANGES OVER TIME

All of the above plus…
• Approve Significant Contracts
• Interim Crisis Management or Interim Operating Roles
• Manage Debt & Equity Financing
• Approve Dividends & Structure Changes
• Protect IP
• Ensure Regulatory Compliance
• Nominating Committee & 360° Bd Review
• Approve Acquisitions
• Exit Planning
All of the above plus…
• Hire Investment Bank
• Approve M&A
• Prepare/Execute IPO
• Ensure Wind down / Liquidation / ABC Process
## TAKING VENTURE CAPITAL CHANGES BOARD DYNAMICS

<table>
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<th>Angel/Series Seed</th>
<th>Venture Series A, B, C, ...</th>
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<td>Metrics and milestones</td>
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<td>CEO is still co-equal</td>
<td>Power shifts to investors</td>
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<td><strong>Board</strong></td>
<td>3 to 5 person</td>
<td>5 to 7 person</td>
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<td>Ideas, Product, Engineering, Hiring</td>
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<td><strong>Honeymoon</strong></td>
<td><strong>Danger Zone!</strong></td>
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REMINDER:

MOST IMPORTANT TASKS FOR AN ANGEL DIRECTOR

• Never run out of cash
• Hire/Fire the CEO
• Sell the company

Source: John Huston
Introduction: Board Basics

Building a Board
- Building and Running a Board
- Composition
- Effective Meetings
- Board Committees

Governance

Best Practices in Working With Your Board
EARLY STAGE BOARDS

• Boards defined in current financing round term sheet & closing docs
• Board service is a risk and major obligation, not an honor!
• Early stage Boards can consume hundreds of hours a year
• Don’t confuse a *fiduciary* Board of Directors with advisory boards
BOARD COMPOSITION

Composition defined by Company Charter, modified by future financings

Series Seed Boards
- THREE: 1 founder, 1 preferred shareholder, 1 independent (1:1:1), or
- FIVE: 2:2:1 or 2:1:2

Series A (and probably B)
- THREE: 1:1:1, or
- FIVE: 2:2:1 or 2:1:2

Series C and beyond
  - SEVEN: 2:3:2
  - Strategic investors may serve as observers
ELECTION & BOARD SERVICE

• Board Elected annually by shareholders, generally eligible for re-election
• Investor Series Directors: Nominated by Preferred Investors
• Independent Directors: Nominated by Common and Preferred
• Always have a mechanism for removing Directors
THE ROLE OF THE BOARD CHAIR

• Schedule meetings
• Manage agenda, keep meeting on track
• Oversight of committee work process
• Resolve conflicts
• Mentor an inexperienced CEO
• Best practice: Chair should be independent of management and not CEO
• No cronyism
ROLE OF THE INDEPENDENT DIRECTOR

• Provides Board with deep expertise

• Serves on Independent Director Committee and ensures good governance by providing a disinterested view and “fairness opinion”
SELECTING INDEPENDENT BOARD MEMBERS

- Not aligned with any class of shareholders
- Varieties of expertise:
  - Governance (resolve disputes, understand Board best practices)
  - Financial operations (experience as CFO)
  - Compliance (especially biopharma or financial services)
  - Exits (managing M&A or IPO process plus good network)
- Continued service depends on continued relevance
- Has the time to serve; not on very many Boards
ROLE OF BOARD OBSERVERS

• A non-voting right granted to minority or strategic investors
• Monitors company progress, should listen more than speak
• Has restricted information rights (limited visibility into sales pipeline and business development to avoid conflicts of interest)
• Does not attend “closed door” executive sessions
• NOTE: If too involved, can be subject to the same liability as Directors but without indemnification or D&O insurance
AN EFFECTIVE DIRECTOR

- Understands governance & fiduciary role
- NIFO: Nose In, Fingers Out
- Utilizes specific market or domain experience
  - Understands sector business, metrics and competitive landscape
- Discloses conflicts of interest before joining and as issues arise
- May fill special Board needs or gaps or take a temporary operating role
- Serves as an effective ambassador
- Uses business network to grow the company
ADD VALUE IF YOU WANT TO KEEP YOUR ANGEL BOARD SEAT

• Board seat is critical to protecting Angel rights
• Board seat is critical to understanding the company’s true status
• Your Board seat is vulnerable to Board restructuring at next round UNLESS:
  • You helped recruit the follow-on VC investors
  • You are viewed as a necessary and effective CEO mentor
  • Your industry knowledge and network provide the company with an unfair advantage
  • You are viewed as an experienced Director with significant value-add
  • You (or your angel group) has strong brand, investing, syndication and networking relationships across your entrepreneurial ecosystem
BOARD COMPENSATION

• Early Stage Boards (no cash, if possible)
  • Angels: 0.25% to 0.5% equity for Board service
  • VCs: no compensation
  • Independents and Directors appointed by VCs: 0.25% to 0.5% equity
  • Non-Executive Chair: 0.5% to 1% equity

• Later Stage
  • Equity plus cash compensation (fees per month or per board meeting)
STRUCTURE OF A BOARD MEETING

- Meeting run by Chairman or CEO
- CEO’s report
  - Key operational results, key issues
- CFO: current financials, results vs. annual plan
- Departmental updates
- Strategic issues

- Closed session (Directors only)
  - Approval of minutes, resolutions, stock option grants
  - **Executive session** (outside Directors only--no management)
    - Governance issues
    - Feedback for CEO
BOARD PACKAGE (SENT BEFORE MEETING)

• CEO’s Report
• Standard Financials: Balance Sheet, P&L, Cash Flow
• Operational Dashboard
  • Actuals Against Plan, QTD, YTD, Current Year vs. Last Year
  • Key metrics from business model
• Operational Updates (Sales, Marketing, Product Development, Regulatory Affairs, Support)
• Compliance Issues
• Subcommittee Reports
• Resolutions
• Approval of Prior Board Minutes
• Approval of Option Grants
CEO’S REPORT

- Important news
- High-level summary of recent performance against plan, including metrics and milestones for sales, product development, business development, fundraising and other key functions
- New strategic initiatives
- Update on management hiring
- Update on fundraising
- Update on business environment & competition
- Current company goals and areas of focus
- Experienced Directors should work with new CEO to define what will be in standard report
A GOOD BOARD MEETING

• Accurate view of performance, trends, threats and opportunities affecting long-term shareholder value
• Identifies gaps between actual performance and plan & remediation plans
• Balances view through rear view mirror and windshield
• Deep dive into one substantive issue per meeting:
  • Annual business plan, product development, sales performance, marketing, customer support, regulatory compliance, exit planning
• Has NO surprises
SO, WHAT DOES THIS MEAN IN PRACTICE?

- Review financials—especially cash—to ensure runway and the integrity of operations
- Monitor current performance against current plan
- Advise on strategy & execution and assist in resolving key issues
- Approve significant transactions constraining company in the future
  - Financing, leases, OEM deals, major contracts, stock options, M&A, litigation
- Disclose conflicts of interest
- Be open to the high-level concerns of any stakeholder
- Question thoughtfully: like arms treaties, Trust but Verify
- What not to do: micro-manage operations
BOARD COMMITTEES

• All companies
  • Audit and Compensation committees
• Maturing companies
  • Nominating and Executive committees
• As needed
  • Exit and Investment committees
  • Independent Directors’ committee

Fun Fact: After the 2000 meltdown, it was discovered that public company compensation committees met 8X more frequently than audit committees!
AGENDA

- Introduction: Board Basics
- Building a Board
- Governance
  - Legal Obligations of Directors
  - Trouble Zones
  - M&A Issues
- Best Practices in Working With Your Board
A **fiduciary** is someone entrusted to manage the assets of others, acting wholly on behalf of those persons without respect to the fiduciary’s personal interests. A **fiduciary** fulfills this duty with the highest **standard of care**.

- **Duty of Loyalty** -- make decisions without regard to interests not broadly shared.
- **Bona Fide** -- Act in good faith in interests of company rather than self interest and without violating the law.
- **Duty of Care** -- make informed decisions (documented in Board minutes).
DIRECTORY’S LEGAL OBLIGATIONS

• **Business Judgement Rule** – Board actions are protected if Directors seriously believe actions are in the best interest of the corporation as a whole (Board minutes are critical)
  - Standard of judgement: “What would a reasonable person do?”
  - Protection depends on evidence of Duty of Care and Duty of Loyalty

• **Entire Fairness** – transactions involving ‘interested parties’ are reviewed in context

• In liquidation, Directors’ duties expand to include creditors
DIRECTOR’S LEGAL OBLIGATIONS DURING M&A

- **Revlon Rules** – In M&A, Directors’ must maximize short-term shareholder value rather than long-term corporate interests and can serve as “auctioneers”
  - **Fiduciary Out**: Directors cannot waive fiduciary duties to shareholders
  - Best practice: Add ‘fiduciary out’ clause to M&A term sheet
- Smart practice: Have your law firm explain in person the “Duties of Directors” memo to all Directors and Officers at start of M&A
DIFFERENT ROLES OF DIRECTORS AND INVESTORS

• **Directors**: fiduciary governance and oversight of the company on behalf of all shareholders

• **Investors**: rights enumerated in the Investors’ Rights Agreement
  - Vote by class (Series A, Series B, etc.) on specified issues
  - Appointing Class or certain other Directors
  - Approve any changes to capital structure or investor rights or economics
  - Rights of first refusal, anti-dilution, co-investment…
  - Approve the sale of the company
DIRECTORS INEVITABLY FACE CONFLICTS OF INTEREST

• Fiduciary duty to the company and all shareholders vs. duty to self, fund or investor class. Increasingly, this obligation can extend to all stakeholders

• Solutions
  • Full Disclosure
  • Affected Director Recusal
  • Use of Independent Director voting and written opinions
DIRECTORS’ LIABILITY

• Business Judgment Rule (Delaware) applies to many situations if you demonstrate Duty of Loyalty & Duty of Care, BUT:
  
• Red Zone / Zone of Insolvency: Directors are personally liable for:
  • Accrued employee wages & vacation pay
  • Federal and state payroll & income taxes
  • 2X penalty for willful failure to pay wages
• Insolvency risk doesn’t override Directors’ obligation to maximize shareholder value
• Delaware generally protects Directors acting in good faith from insolvency creditor law suits
• VCs who have VC supplied D&O coverage may be willing to operate in the Red Zone, leaving non-VC Directors exposed to greater risk

• States have different determinations of Director’s personal liability for unpaid wages and state taxes

• Protections??
  • D&O Insurance
    • May not cover Red Zone liabilities
  • Charter indemnifications & indemnification agreements
  • Ugly reality – you may be unprotected
  • Best defense: get your corporate law firm with a strong venture-stage practice involved well before you hit the Red Zone
BOARD TROUBLE ZONES

- Balancing adding value and maintaining objectivity
- Not usurping Corporate transactions personally
- Personal Relations with Employees/Executives
- Related Party Transactions
- Financing & M&A:
  - Insider Dealing
  - Independent Directors Committee

- Dissolution/Wind Down:
  - Duties shift to Creditors... and to the state
  - Long-tail liability
  - ABC (Assignment for Benefit of Creditors)
  - VCs and Angels may have different risk profiles
DYSFUNCTIONAL BOARDS

• Lack of alignment between Board and Management
  • First time Directors and/or first time CEOs
  • Liquidation preference distortions-- can be fixed with carve out
• Zombie investors
• A management crisis may force Board to manage the company directly, a last resort, not a standard practice
• Lack of alignment among investors--different economic incentives
• Lack of alignment between common and preferred shareholders
• Over-alignment between independent Director and investors or management
CEO CONFLICTS OF INTEREST

• CEOs are human; have more at stake emotionally and financially than investors—(and are essential to businesses success and exits.)

• Fear of firing: hide or spin bad news

• Undermining executive hires “recommended” by the Board

• Highly dilutive option increases in the absence of commensurate business valuation increased

• Lifestyle CEOs
CEO CONFLICTS OF INTEREST - continued

• M&A
  • Siding with buyers against investors
  • Sweetheart deals for execs joining buyer’s company
  • Maximize management returns at expense of shareholders—“directed carve-outs”
  • Undermining Board-approved exits
  • Not disclosing M&A interest
• Good Boards will ensure that the CEO’s interests are safeguarded so that everyone is playing on the same team.
M&A RESPONSIBILITIES OF DIRECTORS

• Typically, 5-7 years to M&A

• Role of Directors
  • Maximize outcome (Revlon rules) for all shareholders
  • Direct the process: negotiating authority rests with Board, not Management
  • Select an i-banker, law firm
  • Approve the Term Sheet and Definitive Agreement
  • Shareholders vote on the final transaction
  • May need fairness opinion (from independent Directors)
AGENDA

- Introduction
- Building and Running a Board
- Governance
- Best Practices in Working with your Board
DIRECTOR BEST PRACTICES

1. Review Board package before meeting
2. Don’t be a ‘drive by’ Board member
3. Attend in person
4. Always have an executive session
WHAT THE CEO WANTS FROM ITS DIRECTORS

• Engaged and available – takes “midnight phone call”
• Open communications and honest feedback
• Creative experiential problem solver; focuses on solutions
• Opens personal network for strategic partnerships and hires
• Peer comparisons “how do other companies deal with this?”
• A good mentor…. but doesn’t micromanage
• A team player, not a “master of the universe”
• A proactive ambassador for the company
• Acts with integrity and honesty, serves the interests of all shareholders
WHAT DIRECTORS WANT FROM THE CEO

- Views Board engagement as opportunity not nuisance
- Use the Board as a strategic sounding board
- No surprises
- Timely & full disclosure and root cause analysis, not positioning
- Keep a rolling one-year Board calendar
- D&O insurance and Indemnification agreement
- Timely distribution of information and Board materials
- Work to resolve management conflicts of interest
BOTTOM LINE FOR ANGEL DIRECTORS

• Board service is not a merit badge with bragging rights
• Proper governance and Director engagement build resilient companies
• Help the CEO grow as the company grows
• Faithfully execute fiduciary duties
• Address conflicts and trouble early
• If you want to keep your group’s Board seat, focus on adding value
• Be a great ambassador and use your network and experience to grow the company
IN-PERSON STARTUP BOARDS WORKSHOP

**October 16** – Register now to attend the launch of the in-person Startup Boards Workshop. This half-day workshop with Ron Weissman and Bill Payne will be presented in conjunction with the Leadership Workshop in Cincinnati. Learn more -

[https://events.angelcapitalassociation.org/19lw](https://events.angelcapitalassociation.org/19lw)

Bring this workshop to your community!

ACA members interested in bringing this workshop to their hometown should reach out to Heather Krejci –

hkrejci@angelcapitalassociation.org
UPCOMING WEBINARS AND DEMOS

October 9 – Pre-Money Valuations: Do They Matter as Much as Many Angels Think?

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- October 15-16, 2019, ACA Leadership Workshop (*Cincinnati, OH*)
- October 16-17, 2019, ACA Midwest Regional Meeting (*Cincinnati, OH*)
- November 6, 2019, ACA New England Regional Meeting (*Boston, MA*)
- May 12-14, 2020, ACA Summit (*Westminster, CO*)