



G U N D E R S O N   D E T T M E R

LATE STAGE TRANSITION TO IPO –  
CORPORATE GOVERNANCE

May 11, 2023

We represent *what's next.*



# *Board Basics – Director Fiduciary Duties*

Overview

# Standards for Director Conduct

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- DGCL – The business and affairs of every corporation shall be managed by or under the direction of a board of directors
- Day-to-day operation of the business delegated to management
- Board must oversee management’s conduct of the business without usurping management’s role
  - Oversight role
  - Approval of high-level items / significant transactions
  - Advisor to management

# Fiduciary Duties

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- In discharging their responsibility to manage the affairs of a corporation, directors must act in good faith and in a manner reasonably believed to be in the best interests of the corporation
- **Duty of Care** – duty to act with the care that an ordinary prudent person in a like position would use under similar circumstances
  - Deliberative process to become informed and remain engaged
- **Duty of Loyalty** – duty to act in good faith with honesty and integrity and lack of self-dealing, fraud or conflict of interest
  - interests on both sides of a potential transaction,
  - personal benefit disproportional or unique from other stockholders, and
  - conflicting fiduciary duty to other constituents



# *Board Effectiveness Best Practices*

Practical Tips

# Board Basics

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## **AN EFFECTIVE CORPORATE BOARD:**

- Creates an open and engaging boardroom atmosphere
- Maximizes the value of the board's time commitment by establishing clear roles and responsibilities within an appropriate structure
- Determines the information the board needs and ensures it is delivered in a timely manner
- Dedicates time to strategic issues
- Creates a transparent, explicit and accountable executive pay process
- Actively engages in CEO succession planning
- Assesses the strength of the company's management talent
- Monitors the company's enterprise risk management system

# Board (and Committee) Meeting Basics

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- Set a thoughtful agenda (work with CEO/Chairman ahead of the meeting)
- Prepare board materials thoughtfully
  - what metrics are you reporting to the board, are you overloading them?
- Send board materials to the board at least a week ahead of time
- Be thoughtful as to the creation and retention of documents, including notes and emails
  - Documents may be discoverable in litigation or government investigation
- Duty of confidentiality – continues after resignation
- Privileged communications – must be made for the purpose of seeking legal advice. A communication is not privileged simply because it is made by or to a lawyer and because a lawyer is copied on an email
- Make executive sessions a regular practice



# *Board Oversight of Risk Management*

Trends & Best Practices



# Risk Management

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## A BUSINESS & OPERATIONAL TOPIC FOR MANAGEMENT

- ERM matrix
- Risk management policies, procedures and response plans (training, testing)
- Integration of risk management into strategic decision-making
- “Tone at the top”

## A GOVERNANCE TOPIC FOR BOARD OVERSIGHT

- Active, engaged board (including committee) oversight of corporate risk
- Cadence of periodic updates (assessments, incidents, mitigation)
- Appropriate records of board oversight

# Caremark & Board Oversight of Risk

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*Caremark* (1996) – risk oversight responsibilities imposed by directors' fiduciary duties

Directors may be held liable for breach of loyalty if directors have:

- utterly failed to implement any reporting system or controls, and
- consciously failed to monitor such a system

# Caremark & Bd. Oversight of Risk (Cont'd)

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## *Marchand v. Barnhill (Blue Bell Creameries) (2019)*

- Blue Bell suffered listeria outbreak in early 2015, causing three deaths and company recall, shut down of production, and lay offs of 1/3 of its work force
- Shareholders alleged breach of fiduciary duty of oversight
- Delaware Supreme Court agreed that plaintiffs' allegations properly stated a claim against the directors for breach of their fiduciary duties because:
  - (1) no board committee that addressed food safety existed;
  - (2) no regular process or protocols that required management to keep the board apprised of food safety compliance practices and risks;
  - (3) no schedule for the board to consider on a regular basis if any key food safety risks existed;
  - (4) board minutes revealed no evidence that any of the reports containing red or yellow flags regarding food safety were disclosed to the board; and
  - (5) board meeting minutes were devoid of any suggestion that there was any regular discussion of food safety issues

# Caremark & Bd. Oversight of Risk (Cont'd)

*In Re The Boeing Company Derivative Litigation (2021)*

- Caremark claim against directors of the Boeing Company in shareholder suit against board after 2 crashes of 737 MAX aircrafts
- Court concluded that complaint described a board that “complete[ly] fail[ed] to establish a reporting system for airplane safety,” noting:
  - The first crash “was a red flag . . . that the Board should have heeded but instead ignored”
  - There was no board committee assigned the specific task of overseeing airplane safety (Boeing’s audit committee was responsible for overseeing legal/regulatory compliance but was alleged to have “primarily focused on financial risks” and the committee charter didn’t mention safety as part of its mandate); instead, the Company had a Safety Review Board run by employees
  - Board minutes showed airplane safety was not addressed as part of board’s yearly updates on compliance or otherwise regularly on agenda
  - Board didn’t have a way to receive internal reports or complaints about safety

# Cybersecurity

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## March 2023 – Blackbaud SEC Enforcement Action

- In May 2020, Blackbaud discovered a ransomware attack on its systems; Blackbaud hired third-party vendor to coordinate ransom payment in exchange for attacker's promise to delete the data
- In July 2020, Blackbaud announced the incident on its website and notified affected customers, claiming the attacker did not access bank account information or SSNs
- SEC alleged that July 2020 statements were later learned by Blackbaud to be untrue and Blackbaud's 10-Q after the attack misleadingly mischaracterized the risks from the attack
- SEC order regarding failure of disclosure controls/procedures included \$3M fine

## Oct. 2022 – former Uber security chief found guilty of covering up 2016 breach

- Authorized rewarding hacker \$100K under Uber's bounty program despite hacker not being eligible under program's T&Cs; had hackers sign NDA falsely stating they had not obtained or stored any data during the intrusion; concealed the breach from the FTC and others within the company

# Cybersecurity (cont'd)

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SEC proposed cybersecurity framework requires companies to disclose:

- Specified disclosure of **information about material cybersecurity incidents** within 4 business days of determining an incident is material
- **A company's policies and procedures**, if any, for identifying and managing cybersecurity risks, including whether and how the company considers cybersecurity risks as part of its business strategy, financial planning and capital allocation
- **A company's cybersecurity governance**, including the board of directors' oversight role with respect to cybersecurity risk
- **Management's role, and relevant expertise, in assessing and managing cybersecurity risks** and implementing related policies, procedures and strategies
- Whether **any board members have expertise in cybersecurity** and, if so, their names and a detailed description of the nature of their expertise



# *Transitioning to a Public Company*

Key Corporate Governance Topics

# Public Company Requirements

## Size

- At IPO closing, boards of emerging growth companies usually average approximately 7 persons

## Board composition

- NYSE/Nasdaq listing rules require majority of board to be “independent directors” within 12 months of IPO closing
- Lead Independent Director or Chairperson

## Board committees

- Audit (at least 3 directors; heightened independence and financial tests)
- Compensation (at least 2 directors; heightened independence tests)
- Nominating (at least 2 independent directors)

## Other board composition considerations

- Nasdaq’s Board Diversity Rule, which was approved by the SEC on August 6, 2021, requires that most Nasdaq-listed operating companies (1) publicly disclose board-level diversity statistics using a standardized template, and (2) have, or explain why they do not have, at least two diverse directors



# The Private to Public Company Transition

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- Over time, both prior to and after the IPO, VC investors leave the board and are replaced with independent directors
- Characteristics sought in public company directors change from those sought in private company directors
  - Private company directors tend to be founders, angel/VC investors or close confidants of founders
  - Public company directors tend to be sought for broader:
    - Knowledge—of the company and its industry
    - Skills—including leadership ability, character and collegiality
    - Experience—including service as an officer or director of a public company
    - Relationships—including with entities that are strategic to the company (customers, suppliers, government, potential acquirers, etc.) and other potential public company directors
    - Ability to serve on board committees, particularly audit and compensation, because of financial expertise or experience evaluating public company executive compensation
    - Diversity of thought, experience and expertise as well as diversity of gender, race and ethnicity
      - Diversity has become an increasingly important issue for regulators, legislators, institutional investors, proxy advisory firms such as ISS and Glass Lewis, advocacy organizations and other key stakeholders

# Board Matters Ahead of IPO

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- Evaluate independence of each director
- Consider expanding board to increase independence and add additional expertise, including financial, public company and industry expertise
- Consider establishing audit and compensation committees with private company charters
- Review board and committee meeting procedures
  - E.g., agendas, distribution of materials in advance, inclusion of appropriate advisors and good recordkeeping
  - Consider implementing board management software

# Public Company Governance Strategies

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- Board and committee self-evaluations
- Director skills matrix and interlocks
- Board refreshment
- Executive succession planning
- Corporate governance guidelines



# *ESG Topics*

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For the Company and the Board

# ESG Reporting Trends

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- For public companies, disclosures to date are mostly voluntary with a few mandatory topics
  - Human capital management
  - Conflict minerals
  - Material effects of environmental regulations compliance
  - 2022 proposed SEC rules would require mandatory standardized climate disclosures (final rules anticipated this fall)
- Motivation / pressure for ESG action and reporting variable
  - Public companies: shareholder proposals, shareholder activism, institutional investors and proxy advisors, regulatory requirements (e.g., SEC, stock exchanges)
  - All companies: customers (e.g., RFPs), employees, investors, federal or state law (e.g., EEOC reporting)
- Practice mixed on level of voluntary disclosure being provided by companies

# ESG Policies & Reporting Topics

- ESG is broad in scope and is expanding and evolving
- No two companies will address ESG the same way



## Environmental

- Climate change (resilience v. de-carbonization)
- Supply chain management
- Natural resource use
- Waste
- Pollution
- Green products or services



## Social

- Diversity, equity and inclusion
- Human capital management (talent, working conditions, employee relations)
- Cybersecurity and privacy
- Human rights
- Modern slavery
- Child labor
- Community impact and safety



## Governance

- Bribery and corruption
- Executive pay
- Board diversity and structure
- Political lobbying and donations
- Whistleblower policies
- Conflict of interest policies

# ESG Governance Best Practices

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Consider who internally at the company is responsible for ESG reporting and messaging

Consider what you will report externally and where

- What does the trend line look like over time

**Disclosure best practices**

- Materiality assessment, material misstatements and omissions, disclosure controls and procedures, policies formalizing practices, backed up statements, forward-looking statement safe harbors and aspirational statements, consistency
- Consider third-party reporting frameworks—many choices (SASB, GRI, TCFD)

**Think about ESG and the Board**

- Oversight (full board or committees), reporting and structure (e.g., diversity)

# Questions?



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