Corporate Governance and Compliance and Board Interactions (Part 6)

By Daniel A. Cotter | October 12, 2016

You began by reviewing the governing documents and now understand how your start-up is organized, what form of entity it is, how the start-up was originally capitalized, and the capital position and needs of your start-up. You have addressed your organization's intellectual property and can now turn to corporate governance and board interactions.

CORPORATE GOVERNANCE

Corporate governance is the set of internal policies pursuant to which a company is controlled and directed, delegating certain functions to each of the stakeholders (board of directors, shareholders, and others). The National Association of Securities Dealers Automated Quotations ("NASDAQ"), the second largest stock exchange in the world behind the New York Stock Exchange ("NYSE"), lists a number of corporate governance requirements that every NASDAQ-listed company must meet.

The NASDAQ "requirements include rules relating to a Company's board of directors, including audit committees and Independent Director oversight of executive compensation and the director nomination process [and] code of conduct." The NYSE has similar corporate governance requirements.

Review the requirements for an audit committee, a compensation committee and a nominating committee, and consider adopting such charters even if there are no immediate plans to go public.

In the wake of various corporate scandals that resulted in the collapse of companies such as Enron and MCI Worldcom, Congress passed the Sarbanes-Oxley Act ("SOX"), which was signed into law by President George W. Bush on July 30, 2002. The intent of Congress in passing SOX was to restore public confidence in corporate governance. While SOX was directed primarily at publicly-listed companies, certain provisions of SOX also apply to privately-held companies. For example, Section 802(a) of SOX prohibits any company from destroying evidence while a Federal investigation or bankruptcy is pending.

Other than certain provisions of SOX, private companies have no explicit requirements relating to formal corporate governance programs. However, you might consider adopting NASDAQ requirements well before considering an initial public offering - your start-up will have to do so if it plans to go public, and it also is good practice to have a strong corporate governance program in place. (If you seek private equity, sophisticated investors likely will demand evidence of sound corporate governance before investing.)

In addition, in a recent Inside Counsel article, 'Commonsense Corporate Governance Principles' for Private Companies, author Ellen Grady recommends that private companies implement certain concepts from the *Commonsense Principles of Corporate Governance* that leaders of 13 prominent public companies published this past July. You should review the article and the Principles and consider implementing some or all of the Principles that might be of benefit to your start-up.

In addition, you should review and consider

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implementing the corporate governance requirements of NASDAQ with respect to board independence and committee charters. As Grady notes, good governance and "effective oversight… may serve to increase long-term value."

To be effective, your senior management team must embrace and set the tone of any corporate governance and compliance program. Support for the program cannot be mere "lip service" or carried out in a "check the box" mindset. In 2003, United States Deputy Attorney General Larry Thompson issued a memo, "Principles of Federal Prosecution of Business Organizations" (the "Thompson Memo"), which listed a number of factors Federal prosecutors should consider when deciding whether to criminally charge a corporation.

One factor listed was "the existence and adequacy of the corporation's compliance program," which was changed in 2007 by Deputy Attorney General Paul J. McNulty to add the word "pre-existing" before "compliance."

An effective pre-existing compliance and governance program may reduce the company's exposure to criminal prosecution if your start-up finds itself in such a difficult circumstance.

CONSIDER YOUR CYBER PROGRAM

You should include cybersecurity and privacy as part of the overall corporate governance program you implement or improve at your start-up. Large cybersecurity attacks in a variety of industries, including the recently-reported data breach at Yahoo!, likely portend more attempts by cybercriminals to attack companies' security and systems.

You should review what your start-up is doing to reduce the risk that it will be the victim of a cybersecurity breach. Failure to do so can put your company at risk of major financial harm as well as damage to corporate goodwill and reputation.

YOUR INTERACTION AND BOARD RELATIONS

You or someone in your law department will likely have the "corporate secretary" title in addition to your legal roles and responsibilities. You likely have drafted charters for the audit, nominating and compensation committees.

As corporate secretary, your responsibility is to work with senior management and the board of directors to draft the agendas and prepare the minutes for the committee and general board meetings. Your level of interaction with the committee chairs and the board in general will depend on the culture of the company and the direction of the CEO or managing partner.

The extent to which you will participate in the actual committee and board meetings will also depend on the expectations of the committee chairs and chairperson. Try to sit down with committee chairs and chairperson and discuss their expectations and preferences for agenda setting, for minute drafting, and for interactions.

Each board member has different idiosyncrasies and preferences; understanding what they expect will help you perform exceptionally in your dealings with the board.

You must remember at all times that you represent the company itself and not any individual officer or director. While you might report to a CEO or other executive, and have certain responsibilities to the board, your client at all times is the entity. You may have to remind the board or executive of this responsibility at times.

Implementing a solid corporate governance and compliance program will benefit you and your start-up. While a formal process is not required as a private company, it is best practice to have a strong corporate governance and compliance program in place and will allow your start-up to more readily file an IPO and become publicly traded. Such a program will also provide an efficient framework for board meetings and board structure.

Reviewing each of the six elements outlined in this nuts and bolts series, should provide you with a better understanding of the broad range of issues that you oversee and also a solid outline of steps you can take with your start-up to make it a more effective organization.

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