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# The Role of an Advisory Board for a Startup

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Many startup companies utilize advisory boards with industry recognition to bring credibility to their ventures and to make introductions, or to bring individuals with particular skill sets to advise on certain issues. This can be an attractive solution for a startup with a limited budget and no independent board. It is important, however, to properly structure the advisory board in order to gain the benefits of board members without creating potential issues for the company in future.

The most important legal difference between an advisory board member and a member of the board of directors of a corporation (or manager of a limited liability company) is that a member of the board of directors owes fiduciary duties to the company, whereas an advisory board member does not. These duties are imposed both by statute and in common law, and include the duty of loyalty and the duty of care. The duty of care requires each director to participate in the decisions of the board and to be informed as to the data relevant to such decisions. The duty of loyalty requires directors to exercise their powers in the interest of the company, rather than in their own interest or in the interest of another entity or person. Encompassed within the duty of loyalty are the duty to disclose and address potential conflicts of interest, the duty not to engage in a transaction a board member reasonably should know may be of interest to the company without first offering the opportunity to the corporation (known as "appropriation of a corporate opportunity"), and the duty to keep information about the company's legitimate activities confidential unless the information is already known by the public or is of public record.

The fiduciary duties (and corresponding potential liability exposure) make enticing valuable stakeholders to join a company's board of directors more and more difficult. Given the recent litigation and regulatory actions involving corporate boards of directors, many would-be board members are opting not to serve in those roles. Those same candidates may, however, be willing to serve on an advisory board, since liability exposure from serving on an advisory board would be minimal.

In order for an advisory board member to provide valuable advice to the company, it is important for the company to share confidential information with the advisory board member, and for the advisory board member to be able to receive any relevant information that the adviser deems necessary in order to offer his or her recommendations to the company. Before this occurs, however, it is imperative that a written agreement be put into place to address the fact that advisory board members do not, inherent in their title, owe fiduciary duties to the

company.

The most important issue to be addressed in an advisory board agreement is confidentiality. The adviser should confirm that, like a member of the board of directors, the adviser will not disclose the company's confidential information or otherwise use it to the adviser's own advantage. If a company shares confidential information with an adviser (or other third party) without entering into a confidentiality agreement, the status of the confidential information will be jeopardized as a protectable trade secret. As standard practice, the company should enter into confidentiality agreements with all advisers and other third parties who are given access to the company's confidential information.

Before engaging the adviser, the company should confirm that none of the adviser's other activities conflict with the company's interests, including any engagements with competitors. Given that advisory board members are generally engaged within the company's industry, it is important to vet this, and to determine any potential conflicts up front. Otherwise, the adviser could be involved with other projects that are in conflict with the company. While this may seem like an obvious point, the adviser may not recognize a conflict until he or she is more intimately involved with the company's business. A representation regarding conflicts in the advisory board agreement with the requirement that the adviser list his or her other activities will help to focus this discussion before it is too late.

It should be made clear that all intellectual property created in connection with the adviser's work in the company will be owned by and otherwise assigned to the company. This is crucial, since the adviser will not be an employee of the company. Accordingly, without a written agreement specifically addressing the ownership by the company of intellectual property, any intellectual property created by the adviser would otherwise be deemed owned by the adviser.

The position of the adviser in connection with both the company and the board of directors should be spelled out so that the adviser does not unintentionally act without authority. The advisory board should generally be used as a sounding board for nonbinding recommendations, rather than as a decision-making body, and, as such, the power of the advisory board member (or lack thereof) should be made clear. When making introductions to the company, the adviser should properly indicate his or her role as an advisory board member, rather than an officer, director or employee of the company.

Given that the role of the adviser is generally more specific than a member of the board of directors, both the time commitment—advisory board meetings, phone consultations, and other participation in company issues—and the term of the adviser's position should be included in the advisory board agreement. In addition, the advisory board agreement should have a specific term that is terminable at the will of the company.

An adviser's compensation, which tracks the anticipated time commitment and term, should be included in the written advisory board agreement. This is particularly important, because most advisers receive stock options, restricted stock or other forms of equity in compensation for their services. If the details of an adviser's compensation are not addressed, and issues like vesting, other restrictions and tax considerations are not covered, an adviser may end up with a claim for more compensation than was originally contemplated, which would negatively affect the founders' equity position in the company.

Finally, the role between the advisory board and the board of directors should be delineated, so that the duties of the board of directors are not usurped. Meetings of the board of directors

should be separate and distinct from advisory board meetings (although they can overlap). The duties of the board to oversee the management of the company should not be delegated to the advisory board.

If the legal and structural issues that would otherwise make an advisory board a potential risk are addressed through a comprehensive advisory board agreement and clear communication on the advisory board's roles and responsibilities, an advisory board can serve as a successful tool to enhance a startup company's ability to grow with the assistance of leaders in the company's industry.

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