

What are the legal considerations for serving on a Board of Directors?

There are three legal principles that must be kept in mind when considering a position on the Board of Directors:

Duty of Care. This requires the director to use good judgment and reasonable care when making policy and decisions on behalf of interests of the organization.

Duty of Loyalty. Directors need to be faithful to the organization, putting it ahead of their own interests.

Duty of Obedience. Directors and leaders must comply with all federal, state and local laws as well as any governing documents of the organization. These include bylaws, articles of incorporation, and policies.

Indemnification

Some organizations indemnify their directors against any and all financial liability for serving on the Board of Directors. Included in this indemnification can be actual settlement amounts. The indemnification is generally incorporated in the bylaws.

Indemnification is granted, however, only if the director acted in good faith and in the best interests of the organization. If the director acted in bad faith, or otherwise liable, then the defense legal fees and any settled amounts may be borne by the director and not the organization.

States may allow indemnification and others may require it, especially for non-profit organizations. A director should check the state in question as laws may vary state-to-state. Indemnification is mandated by some states should the director successfully defend a legal claim.

The expense of the indemnification is usually funded by the organization, and not the individual director. Some insurance carriers offer coverage for indemnification, and directors are encouraged to investigate this avenue to make certain they are covered.

In addition, a director should have a written outline of the coverages and the extent of how they are covered.

Next, the indemnification is good only to the extent that the organization has the wherewithal to pay legal fees and other expenses should a claim be filed.

Antitrust Considerations

Boards of Directors and other individuals who act on behalf of the organization, and who violate the antitrust laws, could be sued by the federal government or people who believe they have been harmed.

It is very important that organizations, and particularly non-profit organizations, have “antitrust guidelines” that specifically outline and detail what activities and behavior are not permitted. These guidelines prohibit:

1. Restraint of trade, whether a code of conduct or ethics
2. Exclusion or expulsion of membership for competitors
3. Standards or certification programs that harm competitors
4. Price-fixing discussions

Directors and others from organizations, including volunteers in non-profit groups, have been held personally liable for antitrust violations by the courts. Some have paid huge fines; others have served time in jail.

This is a serious area and directors must be aware of the consequences. Even if there is no direct antitrust involvement by the individual, the director can be charged with mismanagement or negligence by allowing the conduct to occur or continue. Directors must be alert to what makes up antitrust behavior, recognize it and then take appropriate action to discontinue the activities without delay.

Conflicts of Interest

Conflicts of interest often arise when the director has a relationship, personal interest or situation that may appear to influence or actually influence the judgment, decision or action of that director. The relationship may be personal, professional or business related. It may be real or just perceived.

Boards and directors must take extra steps to avoid actual conflicts of interest and even the mere appearance.

An example of a conflict of interest could be a director serving on one organization, and then getting elected to a competitive organization. Another example could be a director who may be an employee of a business either doing business, or hoping to do business with the organization.

There are many situations that may arise that can be the cause of a conflict. People change jobs, move to other areas, get married or divorced, work for different causes and have wide circles of friends and family. Conflicts of interest can arise when changes occur in directors’ personal or professional lives. They need to understand that when change occurs, it may affect their standing on the Board of Directors of the organization. It is the Board’s responsibility to educate its members about dealing with conflicts of interest.

It is important that whether the conflict is real or just perceived, it is the responsibility of the director to disclose it to the Board of Directors. Further, the director has to decide and inform the Board how the conflict will be resolved. The director should explain that participation or discussion on the issue may be a conflict of interest and therefore the director should be exempted or excused from any further discussions.

The Board decides the level or impact of the conflict. They may recuse the director in specific discussions or votes. The director may be asked to leave the meeting room. In some cases, in the conflict of interest is deemed serious or major, the director may be asked to resign from the Board.

In any event, the Board needs to be careful and thorough when dealing with conflicts of interest. The Board must also be sensitive to those conflicts and the resultant consequences.

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