

Taking a directorship

What to be aware of when agreeing to serve on a corporate board of directors

Business leaders are usually pleased if they are asked to serve on a business's board of directors.

They should be. Being asked to serve on a board of directors is a recognition that a business leader has achieved success and that he or she has valuable insights into how a business can be profitable. Nonetheless, business leaders should recognize that serving on a corporation's board carries with it very real responsibilities and risks, says Tim Miller, a partner at Novack and Macey LLP.

"If a board member fails to take the responsibilities of board membership seriously, and instead treats board memberships as an 'honor' without responsibilities, or as a chance to periodically play a round of golf with colleagues, it can lead to serious repercussions," says Miller.

Smart Business spoke with Miller about how to protect yourself should you agree to serve on a board.

What are some potential repercussions of failing to take seriously the responsibilities of being a board member?

A director could be sued for millions of dollars in damages. There are actions filed every day in this country in which stockholders allege that a director breached his or her duties and that this breach cost a company millions of dollars.

Ironically, such suits are filed even when a company is successful; sometimes these suits allege that the company should have been more successful. Even if such a case is meritless, it can cost a lot of time and money in attorneys' fees to defeat it.

In other cases, governmental entities can seek civil or criminal penalties against directors.

Don't most corporations indemnify board members against losses from such suits?

Yes, most companies agree to indemnify board members against loss suffered by reason of serving as a board member. But if a board member is found to have not acted in good faith, he or she may lose the right to indemnification. And if a corporation becomes insolvent, its promise to indemnify its directors is not worth very much.

Even if a corporation is insolvent, doesn't insurance protect board members?

Insurance may protect a corporate direc-



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tor. But insurance policies are usually written with exclusions that may leave a director uninsured against particular types of suits.

For example, many policies have an 'insured v. insured' exception. If the stock of an insolvent corporation is sold, new management may decide to sue the directors who controlled the company when it became insolvent. In such a situation, the suit may not be insured. Moreover, penalties are usually not insured against.

All of this means that somebody who agrees to serve as a corporate director should try to do the job he or she has agreed to accept.

What duties does a board member have?

A director's duties differ depending on the state where a business is incorporated, but usually directors are said to owe duties of care and loyalty.

What is the duty of care?

Just as it sounds, the duty of care requires directors to carefully act on behalf of the corporation. As the standard is usually formulated, the duty of care requires that the directors exercise the same degree of care that a prudent person would exercise in the management of his or her own business.

Among other things, this means that directors should attend board meetings, inform

themselves of facts necessary to make decisions, exercise their judgment and make prudent decisions.

One of the more important aspects of the duty of care is that a director should make certain that he or she has adequate information to decide matters that come before the board. For example, if asked to approve of a corporation going into a new business, the director should make sure that he or she understands enough to make an informed decision about whether it is wise for the corporation to take such a significant step.

Frequently, rosy forecasts of future profits can distract from the need to be fully informed of risks before making a decision. A director may need to question management, test the assumptions underlying projections, consider what will happen if something goes wrong and ask how risks can be mitigated to make a reasoned decision.

In other words, a director should act as though the consequences of a decision is his or her responsibility — because it is.

What does the duty of loyalty involve?

The duty of loyalty requires that directors act in the best interests of the corporation — not their own best interests. Thus, for example, if a director learns of a business opportunity, he or she may need to refer it to the corporation and not exploit it for the director's own benefit.

The duty of loyalty also means that, in situations in which matters are brought before the board and a director has a conflict of interest, he or she should recuse him or herself from the decision. For example, if the corporation is going to retain another business in which a director is interested, the director should disclose the conflict and should not vote on that matter. Indeed, the director should attempt to cause the minutes to reflect that he or she has not participated in a decision that could benefit him or her.

Does all of this mean that somebody should turn down a directorship if offered?

No. It means that those offered a directorship should think very seriously about what being a director means and should not accept the role unless they are willing to take it very seriously. <<

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