

Where Was the Board?
Thomas A. Tupitza, Esq.
October 18, 2018

Where Was the Board?

presented by
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OVERVIEW

- Role of the board: to govern, not manage (“noses in, hands out”)
- Conscience, critic, coach, cheerleader, counselor

OVERVIEW

- Policy Governance (John Carver)
 - Ends (what results, for whom, at what cost)
 - Executive Limitations
 - Board-CEO Linkage
 - Governance Process

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OVERVIEW

- Fiduciary Duties of Directors and Officers:
 - Duty of Care and the Business Judgment Rule
 - Duty of Loyalty
- Other Duties of the Board:
 - Stewardship of Charitable Purposes and Charitable Assets
 - Oversight of Organizational Compliance and Risk Management

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**Where Was the Board?
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OVERVIEW

- Governance Best Practices:
 - Board-CEO Relationship
 - Committees
 - Governance Committee
 - Meetings
 - Minutes

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OVERVIEW

- Protection Against Personal Liability:
 - Immunity
 - Indemnification
 - Insurance

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DUTIES

DUTY OF CARE

- A director shall perform his or her duties as a director, committee member, or officer:
 - in good faith
 - in a manner reasonably believed to be in the best interests of the organization
 - with such care, including reasonable inquiry, skill and diligence, as a person of ordinary prudence would use in similar circumstances

DUTY OF CARE (cont.)

- A director may consider:
 - the effects of any action on any or all affected groups, including members, employees, suppliers, customers and creditors of the organization and on the community in which the organization is located, and all other pertinent factors

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DUTY OF CARE (cont.)

- A director may rely on information and opinions presented by:
 - officers or employees reasonably believed to be reliable and competent
 - lawyers, accountants, other professionals and experts within their areas of competence
 - committees, within their designated authority, if the director reasonably believes that they merit confidence

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BUSINESS JUDGMENT RULE

- Acts of board, committees and individual directors are presumed to be in best interests of the organization except in cases of:
 - breach of fiduciary duty
 - lack of good faith
 - self-dealing

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BUSINESS JUDGMENT RULE

- Affirmative steps to support presumption:
 - attend and participate in all board and committee meetings
 - be familiar with articles of incorporation, bylaws, other relevant documents
 - insist that materials be distributed in advance; review them
 - ask questions, use independent judgment

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DUTY OF LOYALTY

- A director must act in the best interests of the organization, not in self-interest or to advance other conflicting interests
 - issues:
 - confidentiality
 - corporate opportunities
 - conflicts of interest

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CONFIDENTIALITY

- Information presented in board meetings is confidential unless otherwise specified
- Ordinarily, the organization (and board, if separate statement is appropriate) should have only one spokesperson

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CORPORATE OPPORTUNITIES

- Business opportunities of which the director becomes aware and which may be of benefit to the organization must be presented first to the organization
- Director may be required to disgorge profits earned in violation of this duty

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CONFLICTS OF INTEREST

- A contract or transaction between the organization and a director or officer is not void or voidable solely for that reason if:
 - all material facts about the contract or transaction are disclosed before the vote and a majority of other directors vote to approve (even if less than a quorum)
 - or
 - the contract or transaction is fair to the organization at the time it is approved

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CONFLICTS OF INTEREST (cont.)

- avoid appearance of conflicts as well as actual conflicts
- require that interested parties leave the room during discussions and votes
- record disclosures, recusals and abstentions in minutes
- require completion of annual questionnaire disclosing relationships with vendors and competitors

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INTERMEDIATE SANCTIONS

- Excise tax imposed on “excess benefit transactions” involving “disqualified persons”
 - penalty equal to 25% of excess benefit amount may be imposed on the disqualified person
 - additional 200% penalty may be imposed if excess benefit amount not returned after tax imposed

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EXCESS BENEFIT TRANSACTION

- Fair market value of benefit provided to disqualified person exceeds fair market value of property or services received by the organization (includes excessive compensation)

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DISQUALIFIED PERSON

- Anyone in a position to exercise substantial influence over the organization during the previous 5 years:
 - voting board members
 - presidents, treasurers, CEOs, COOs, CFOs
 - family members of the above
 - entities controlled by the above (35% control)

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ORGANIZATION MANAGERS

- Penalty of 10% of excess benefit (up to \$10,000 per transaction) may be imposed on “organization managers” who knowingly participate in the transaction:
 - officers, directors, trustees, committee members

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REBUTTABLE PRESUMPTION OF REASONABLENESS

- Transaction (including compensation) approved by disinterested directors or committee, without disqualified person present
- Prior review of and reliance on appropriate comparability data
- Adequate contemporaneous documentation of basis for determination

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EXCISE TAX ON EXECUTIVE COMPENSATION

- Tax Cuts and Jobs Act of 2017 imposes 21% excise tax on excessive compensation:
 - amount over \$1 million in tax year
 - amount of any parachute payment over 3x average annual comp for most recent 5 years

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OTHER DUTIES OF THE BOARD

- Stewardship of charitable purposes and charitable assets
 - role of Attorney General and Orphans' Court
 - changing purposes
 - modifying specific gift restrictions
 - cy pres
 - deviation
 - fundamental transactions (dissolution, merger, change of control)

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OTHER DUTIES OF THE BOARD

- Oversight of organizational compliance and risk management:
 - HR policies
 - insurance
 - 990 and tax compliance
 - gift solicitation compliance and gift acceptance policy
 - investment and endowment spending policies
 - audit
 - lobbying and political activity

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GOVERNANCE BEST PRACTICES



BOARD-CEO RELATIONSHIP

- Constructive partnership, interdependence
- Selection, support, evaluation
- Communication, role clarity, conflict resolution
- Board Chair-CEO relationship is key (set expectations regarding communication)

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COMMITTEES

- No committee shall have power to:
 - submit to members any action requiring approval of members:
 - fill vacancies on the board
 - adopt, amend or repeal bylaws
 - amend or repeal any resolution of the board that by its terms is amendable or repealable only by the board
 - take action on matters committed by the bylaws or resolution to another committee

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COMMITTEES (cont.)

- Composition of committees (non-board members?)
- Ex officio members (specify whether voting power)
- Executive Committee (keep and distribute minutes)

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GOVERNANCE COMMITTEE

- Board member selection
- Orientation
- Education
- Succession
- Evaluation
- Periodic review of articles and bylaws

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SELECTION

- Expectations of board members
- Developing a pool
- Matrix: skills, experience, diversity
- Independence (at least a majority without employment or business relationship)
- Advisory Boards / committee service
- Interviews of potential board members
- Nomination process for organizations with members

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ORIENTATION

- Culture: history, mission, vision, values
- Legal and fiduciary duties
- Strategic plan
- Structure: board, staff
- Financial tutorial
- Facilities
- Board manual / directory / minutes
- Board software
- Mentors

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EDUCATION

- Articles, publications of interest
- Educational sessions at board meetings
- Retreats
- External resources: NPP, industry organizations

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SUCCESSION

- Committee assignments / rotation
- Terms / term limits
- Officer succession
- Emeritus members

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EVALUATION

- Meeting evaluation
- Collective board evaluation (combine with CEO evaluation?)
- Self-evaluation
- Individual conversations
- Evaluation of members (attendance)

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REMOVAL

- Unless bylaws otherwise provide, only:
 - by members without cause
 - by board upon judicial declaration of unsound mind
 - conviction of felony by court for fraudulent or dishonest acts or gross abuse of authority

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MEETINGS

- Elements of effective meetings:
 - Preparation
 - Dashboard reporting
 - Consent agenda
 - Strategic focus
 - Adequate time for discussion
 - Everyone participates
 - Regular executive sessions

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MEETINGS (cont.)

- For special meetings, notices should specify general nature of business to be transacted
- Quorum requirements (majority of directors in office unless otherwise specified)
- Approve action items, not reports
- Conference calls and unanimous written consent
- Proxies not permissible for directors

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MINUTES

- Emphasize actions, not discussion
- Specify authorities relied on
- Attach or clearly identify documents referred to
- Avoid imprecision, inflammatory phrases, unnecessary names
- Name directors who voted against or abstained
- Don't get hung up on "who seconded the motion"

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MINUTES (cont.)

- a director who is present at a meeting is presumed to have assented unless dissent is entered in minutes or filed in writing with the Secretary before or immediately after adjournment of the meeting (does not apply if director voted in favor)
- may assert that dissent was incorrectly omitted, if so notify Secretary in writing promptly upon receipt of minutes

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PROTECTION AGAINST PERSONAL LIABILITY



IMMUNITY UNDER PA LAW

- Pa. “Little League” and “Good Samaritan” laws:
No uncompensated officer, director or trustee shall be liable for civil damages as a result of any act or omission unless his or her conduct fell substantially below ordinary standards of care and he or she knew or had reason to know that the act or omission created a substantial risk of harm
- Federal Volunteer Protection Act of 1997



IMMUNITY UNDER PA LAW

- Under Pa. law, if a bylaw amendment so provides, a director shall not be personally liable for monetary damage for any action taken unless:
 - the director has breached or failed to perform statutory duty of care; and
 - the breach or failure to perform constitutes self-dealing, willful misconduct or recklessness

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IMMUNITY UNDER PA LAW

- Exceptions:
 - criminal offenses
 - liabilities for the payment of taxes pursuant to federal, state or local law

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INDEMNIFICATION UNDER PA LAW

- Applicable to any person who is or is threatened to be made a party to any civil, criminal, investigative or administrative proceeding because he/she is/was a “representative” of the organization
- Covers attorneys’ fees, judgments, fines, settlement amounts

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INDEMNIFICATION UNDER PA LAW (cont.)

- May be provided if representative acted in good faith and in a manner he/she reasonably believed to be in the best interests of the organization, and had no reasonable cause to believe conduct was unlawful, and
 - board authorizes it by majority vote of disinterested directors; or
 - independent legal counsel approves it in writing; or
 - court orders it; or
 - bylaws require it

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INDEMNIFICATION UNDER PA LAW (cont.)

- May not be provided where a court determines that the breach constituted willful misconduct or recklessness
- Must be provided if representative is successful on the merits in defense of the action

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INSURANCE

- Directors' and officers' insurance may provide protection against personal liability even if indemnification is not permissible

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INSURANCE (cont.)

- Typical exclusions:
 - dishonest, fraudulent or criminal conduct
 - suits by one director against another
 - libel or slander
 - personal gain
 - bodily injury or property damage
 - environmental issues

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Thank You!

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