

From the Lawyers ...

Legal Duties of an International School Board of Governors

Many international schools are incorporated as U.S. non-profit corporations headquartered in the state of Delaware. As such they are subject to all state and federal laws applying to non-profit corporations. As the governing body of the organization, a nonprofit's board of governors is also subject to the same laws, regardless of the member's nationality. A board member, whether he or she is a U.S. citizen or citizen of another country, can be sued in the U.S. if he or she violates the laws governing his legal duties as a board member.

To help minimize this possibility, each board member must know and understand what his or her legal duties are. In particular, there are three fundamental legal duties that all board members must follow. These three duties, commonly known as "fiduciary duties," apply to everything that the board of governors does: duty of care, duty of loyalty and duty of obedience. Board members must keep these duties in mind when making decisions or taking action for the organization. If they fail to do so, they could be held liable for any consequences of their actions.

Duty of Care

In general the duty of care requires that a board member: (1) act in good faith; (2) act in the manner a board member reasonably believes to be in the best interest of the organization; (3) become sufficiently informed to carry out his/her decision making and oversight functions; and (4) exercise the same care that a person in the same position would reasonably believe was to be in the best interests of the organization under the circumstances.

A board member may violate this duty by nonfeasance – failing to act, or misfeasance – committing bad acts.

To meet the reasonable care standard, board members must take an active and informed role in decision making. They should be sure to attend board meetings on a regular basis and be actively involved in those meetings. They are required to make informed business decisions by considering all material information reasonably available to them, including adequately reviewing key transaction documents. In evaluating information provided to them by management, board members are expected to review the information critically and not accept it blindly. Board members must ask questions about matters that are unclear or if they think they need more information. Board members are not required to possess any particular expertise, but they should obtain the assistance of outside consultants if evaluation of a subject requires special expertise and knowledge that they do not possess.

While they can rely, in part, on recommendations and information provided by others (including committees, outside professionals and knowledgeable staff members), they must make independent decisions based on that information and not simply conform to a decision made by someone else without undertaking personal analysis and critical thought.

Duty of Loyalty

All board members owe a duty of loyalty to the organization. The duty of loyalty requires a board member to keep the best interests of the organization in mind at all times when making decisions on behalf of the organization. Their position of trust and confidence may not be used to further their own interests financially or otherwise. This duty raises four main issues for discussion: 1) conflict of interest; 2) self-dealing transactions; 3) corporate opportunity; 4) confidentiality.

Conflict of Interest. A conflict of interest exists when a board member has a personal material interest in a proposed transaction to which the corporation may be a party. A conflict of interest may exist in the following examples:

- Employment agreement between the school and a board member or a member of the board member's family.
- Provision of a service by the school to a board member, a member of the board member's family or an entity affiliated with a board member.
- Provision of a service by a board member, his family or affiliated entity to the school.

Conflicts of interest are neither unusual nor generally prohibited under state law. In fact, transactions involving a conflict of interest may sometimes be in the best interest of the school. For example, it may be perfectly appropriate for a board to approve a transaction with a board member in which the board member is providing the school with some goods, service or facility at below market rates.

From a legal perspective, it is the manner in which conflicts of interest (even ones that are favorable to the school) are handled by the board member and the board that may determine whether the board member's duty of loyalty has been breached and whether the transaction may be rendered void. For example, in the case of a proposed transaction between the organization and a board member (or if the board member has another significant interest), the interest must be disclosed and the transaction should be approved by a majority of the non-interested board members.

Similarly, if a board member is torn between his employer's interests and the interests of the school, the board member must disclose this conflict and should excuse himself from any decision related to that conflict.

Likewise, board members may feel a conflict between their role as a board member and their role as a parent of a student at the school. If a board member believes he cannot be objective and make a decision in the best interests of the school generally when deciding on a given issue because of his role as a parent of a student, he must disclose the conflict and excuse himself from the decision.

The board should be aware that even a perceived conflict of interest may harm the school's reputation and thus should be avoided. Accordingly, the school should enter into such transactions cautiously when the board members believe that it could be viewed negatively if brought to light by the media. For all these reasons, a conflict of interest policy is highly recommended.

Self-dealing transactions. A self-dealing transaction is one involving the organization and a board member or in which a board member has a financial interest. The board should not approve such a transaction unless it can be established that it entered into the transaction for the organization's own benefit, that the transaction was fair and reasonable to the organization at the time it entered into the transaction, that the material facts concerning the transaction and the board member's interest in the transaction were fully disclosed or known to the board or board committee, and that the board or board committee authorized or approved such transaction in good faith by a majority vote not counting the vote of the interested board member.

Corporate opportunity. The corporate opportunity doctrine prohibits a corporate fiduciary (including a board member) from seizing an opportunity for himself or herself if: (i) the organization is financially able to undertake it; (ii) it is within the organization's line of business and is of practical advantage to the organization; and (iii) the organization is interested, or has a reasonable expectancy, in the opportunity.

The corollary states that a fiduciary may take a corporate opportunity if: (i) the opportunity is presented to the fiduciary in his individual and not organizational capacity; (ii) the opportunity is not essential to the organization; (iii) the organization holds no interest or expectancy in the opportunity; and (iv) the fiduciary has not wrongfully employed the resources of the organization pursuing or exploiting the opportunity.

Accordingly, if a board member learns of an opportunity that may be of interest to both the organization and the board member personally, the board member should first offer the opportunity to the organization and allow the organization sufficient time and the first right to exploit the opportunity before taking advantage of the transaction in his or her individual capacity.

Confidentiality. A board member should keep the organization's private information confidential. In addition, a board member should exercise reasonable diligence to keep such information confidential. Note that the strategic plans of an organization may contain confidential information not meant to be disclosed to the general public allowing some other person or entity to exploit the information to the disadvantage of the organization.

Duty of Obedience

The duty of obedience, which is sometimes considered part of the duty of due care, requires board members to be faithful to the organization's mission. Their actions must be consistent with the organization's mission statement, Articles of Incorporation, bylaws, tax-exemption documentation and policy and procedure manuals. The organization's central goals must guide all board decisions. In addition, board members must also comply with all applicable laws and regulations.

To ensure obedience to the organization's mission, board members must be knowledgeable about and comfortable with the mission. Before joining a board, potential members must familiarize themselves with the mission statement, organizing documents, and programs. These documents should also be revisited on a regular basis, to guard against "mission drift" (or to revise the mission statement when appropriate).

Board members must also become familiar with the basic laws and regulations affecting the organization (tax-exemption, fundraising, employment, etc.), and have a strategy in place for complying with them. While this strategy may involve the use of experts and staff members, the ultimate responsibility for compliance rests with the board of board members.

Business Judgment Rule

Related to its fiduciary duties is the business judgment rule.

The Board generally has the power and duty to make business decisions for the organization. These decisions include establishing and overseeing the organization's long-term plans and strategies, and the

hiring and firing of the school Director. Delaware law affords board members making such decisions a set of presumptions—known as the "business judgment rule"—that, so long as a majority of the board members have no conflicting interest (see "duty of loyalty" above) in the decision, their decision will not later be second-guessed by a court if it is undertaken with due care and in good faith. The business judgment rule applies even if the business decision later turns out to have been unwise.

Keep in mind, however, if a majority of the Board, has a conflicting interest in a transaction challenged in court, the board's decision may not be protected by the business judgment rule. Rather, Delaware courts generally will require the board members to demonstrate that a self-dealing transaction was entirely fair to the corporation.

Likewise, the Board will not be protected from what the courts term a “sustained and systematic failure of the board to exercise oversight.” For example, if the Board knew laws were being violated, but took no steps to prevent or remedy the situation, and that failure to take any action for an inordinate amount of time resulted in substantial organizational losses, establishing a lack of good faith, a Board’s decision to not act may be deemed not to have been made in good faith and be contrary to the best interests of the organization.

How to Minimize the Risk of Violating the Fiduciary Duties

The following summarizes important principles board members should keep in mind when analyzing a proposed decision to help reduce the risk of violating the fiduciary duties.

- 1. Deliberate Decision-Making.** Courts accord greater deference to decisions made with deliberation. Board members should not be hurried and specific board action should not be made in haste.
- 2. Board Preparation.** Documents and background information should be circulated before board members make any final decisions. Board members must use reasonable diligence in considering material information about a proposal.
- 3. Active Involvement by the Board.** Board members should regularly attend and participate in board meetings. Board members should probe to obtain information and assure themselves that those making presentations have done their homework. Board members should take sufficient time to resolve all of their questions.
- 4. Consultation With and Reliance Upon Others.** Board members should consult knowledgeable management officials and other advisors, as appropriate. Board members generally are entitled to rely in good faith on reports, opinions or other advice of officers or of outside experts, who the board members reasonably believe are qualified to provide such advice. Board members should read materials provided to them as thoroughly as possible and should raise any questions about the materials.
- 5. Establishment of a Record.** Board members should establish a record showing an inquiry into the basis for, and completeness of, reports provided by officers and other experts or advisors upon whom the board members rely. Board members should insure that the minutes are sufficiently detailed to establish an accurate record that the procedural and substantive points have been addressed.
- 6. Consider Substantive Factors of a Decision.** Courts have required that board members give appropriate attention to the material factors of the decision, such as the reasonableness of the money

being paid; the future effects of a proposed decision; relevant employee and operational issues; and the long-term enhancement of the organization to be gained by such a decision.

7. Disclose Any and All Existing or Potential Conflicts of Interest. As soon as an existing or potential conflict of interest arises, the board member should disclose it to the board in accordance with school policy and procedure. Upon learning of the conflict or potential conflict, the board should then act in accordance with the school policy and determine how the situation should be handled.