

Director Service Contracts

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Overview

- ▶ What is a Director Service Contract?
- ▶ Why would a corporation use Director Service Contracts?
- ▶ How does a corporation introduce Director Service Contracts?

What is a Director Service Contract?

- A director service contract is an agreement between the corporation and individual directors that provides how the director will be compensated for their service and outlines the duties and responsibilities that the director promises to uphold.

The contract is an enforceable exchange of promises

- ▶ The corporation promises to pay the director a monthly stipend or fee per meeting.

and

- ▶ The director promises to fulfill their fiduciary duty, comply with a code of conduct, and fulfill other obligations that may be included in the agreement.

Why would a corporation use a director service contract?

- ▶ The process of entering into the director service contract can serve as a good orientation to the director's roles and duties;
- ▶ The director service contract can serve as a good resource for directors with questions about their role and duties;
- ▶ The director service contract can clarify and impose important obligations on director conduct; and
- ▶ The director service contract can set forth contractual remedies that are advantageous for the corporation in situations where a director fails to perform their role or fulfill their duty.

Difficulties that can flow from director conduct

- ▶ Disruptive conflicts with other board members,
- ▶ Disparaging public remarks about the corporation,
- ▶ Refusal to respond to reasonable inquiries about corporate matters,
- ▶ Access to and release of sensitive confidential information, and
- ▶ Actions which expose the corporation to liability.

Substantive provisions of director service contracts

- ▶ Articulation of fiduciary duty
- ▶ Policy on treatment of confidential information
- ▶ Policy on conflicts of interest
- ▶ Policy on treatment of employees
- ▶ Policy on public statements about the corporation
- ▶ Other standards of conduct

Director Access to Information

- By statute, directors have very broad rights to access corporate information.
- In the director service contract, the director can agree that for certain violations, the corporation can limit the type of information they can receive and limit the decisions they can participate in.

Requiring directors to cooperate with investigations

- Without a director service contract, a director may take the position that they do not need to cooperate with corporate investigations.
- With a director service contract, the director can promise that they will be candid with the corporation and respond to reasonable inquiries from the corporation.

Without a director service contract, what can you do about a problem?

- ▶ Talk to the director;
- ▶ Censure them, publicly or privately;
- ▶ Remove them from committee assignments;
- ▶ Stop paying them;
- ▶ Exclude them from the board solicited proxy;
- ▶ Call for a shareholder vote for removal; or
- ▶ Sue them in superior court seeking an order removing them from office and damages.

For serious problems, these remedies can be inadequate

- ▶ A lawsuit:
 - ▶ May take years,
 - ▶ Is a distraction to the board and management,
 - ▶ Presents certain public relations problems,
 - ▶ Opens the corporation to discovery,
 - ▶ Can be expensive, and
 - ▶ Is uncertain.
- ▶ A shareholder vote:
 - ▶ Is a distraction to the board, management, and shareholders,
 - ▶ Requires a public airing of dirty laundry,
 - ▶ Takes time, and
 - ▶ Is uncertain.

The contractual remedies can be better alternatives

- ▶ Alaska Statute § 10.06.463 provides that the superior court may remove a director from office “for fraudulent or dishonest acts, gross neglect of duty, or gross abuse of authority or discretion with reference to the corporation”
- ▶ Through a Director Service Contract, a director can agree:
 - ▶ That a breach of the contract meets the statutory standard,
 - ▶ That they will tender a resignation under certain circumstances, and
 - ▶ That the corporation is entitled to a preliminary injunction as a remedy.

Summary of why a corporation would use the director service contract

- ▶ Going through the document is a good orientation for new directors and a good review for experienced directors;
- ▶ When an issue arises, or someone has a question, a carefully drafted director service contract is a good resource;
- ▶ If the corporation needs to limit access to information, restrict participation in decision making, or obtain information through investigation, the director service contract gives it a contractual basis to take these actions; and
- ▶ The contractual remedies are superior to the default legal rules.

How to introduce a director service contract?

- ▀ Stated another way, what if one or more directors refuses to sign?

Actions the board can take

- Restrict access to the board solicited proxy to persons who agree to enter into the director service contract
 - If you don't sign our contract, you can't be on the board solicited proxy
- Make director compensation contingent upon entering into and complying with the director service contract
 - If you don't sign our contract, you won't get paid

What would a roll out look like?

- Incorporate your existing board policies and procedures and codes of conduct into a director service contract,
- Explain the new contract to the board and obtain their approval,
- Pass a resolution that makes pay contingent upon entering into the director service contract, and
- At the next election cycle require applicants for the board solicited proxy to promise to enter into the agreement (or get them to enter into the agreement) in advance of listing their name on the board solicited proxy.

What does maintenance of the program look like

- ▶ After each annual meeting, go through the agreement with the newly elected directors, providing them with a good orientation to their duties and roles;
- ▶ After each annual meeting, you can have experienced directors renew their commitment;
- ▶ The agreement can be modified by the board in the same way that the board can modify its policies and procedures and codes of conduct; and
- ▶ Use good judgment in enforcing the agreement.

Overall objective

- ▶ The objective of the director service contract is to make sure all of your directors are working for, not against, the corporation.

Questions?

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