

# Tips for Directors & Officers to Limit Personal Liability

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The current economic crisis has resulted in increased scrutiny of the actions of directors and officers, which may lead to increased director and officer liability. If you serve as a company director or officer, here are some tips for limiting your personal liability.

## 1. Know your fiduciary duties

**Duty of Care:** Directors and officers must act in good faith, with the care an ordinarily prudent person in a like position would exercise under the circumstances and in a manner the director reasonably believes to be in the best interest of the corporation. In discharging their duty of care, directors may rely on information, opinions, reports and statements of management and other experts.

**Duty of Loyalty:** The duty of loyalty requires a director to put the corporation's interests ahead of his or her own. The duty is breached when a director diverts corporate assets, opportunities, or information for personal gain.

A recent court decision proclaimed that officers have the same duties as directors.

## 2. Benefit from the business judgment rule presumption

The business judgment rule is a presumption by courts and state statutes that in making a business decision, not involving self-interest, the directors and officers of a corporation acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company and its shareholders and with the care that a person in a like position

would reasonably believe appropriate under the circumstances. It acts as a protection for the business decisions of directors.

The court will not use the business judgment rule to shield directors from their own gross negligence, self-dealing or acting in bad faith. To avail yourself of the benefits of the presumption of the business judgment rule you should take an active role and pay attention to the affairs of a corporation.

Although it is not clear whether a court will apply the business judgment rule to actions of officers, as mentioned above, a recent court decision proclaimed that officers have the same duties as directors.

## 3. Document corporate actions appropriately

It is important for the board to properly document how it complies with corporate governance documents and the decisions it makes and the basis for arriving at the decisions. The minutes of meetings should include a description of the actions taken, make clear how the directors were informed, highlight questions and discussions showing the diligence of the directors, and discuss the deliberation and consideration of the actions taken by the board, all in an appropriate amount of detail for the specific issue being addressed.



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## 4. Disclose conflicts of interest and refrain from voting.

A conflict-of-interest transaction is any transaction: (i) between the corporation and a director; (ii) between the corporation and another entity in which a director has a

material financial interest or in which a director is a general partner; or (iii) between the corporation and another entity of which the director is a director, officer, or trustee, if the transaction is or should be considered by the board of directors of the corporation. A conflict-of-interest transaction must be approved by a majority of the disinterested directors or shareholders entitled to vote on the transaction after the material facts of the transaction and the director's interest were disclosed or must be fair to the corporation.

Be sure to disclose your conflicts and refrain from voting.

## 5. Maximize indemnification protections

The articles of incorporation and bylaws should contain indemnification provisions for directors and officers. They will define in what circumstances the corporation will indemnify the directors for litigation expenses and costs. It is important to understand the extent of the indemnification provisions in these organizational documents and ensure that you have the maximum protections allowed

by law. Supplement indemnification provisions by formal contracts between the directors or officers and the corporation.

## 6. Understand the limits of your D&O insurance

Director and officer (D&O) insurance protects directors and officers from liability arising from actions relating to their corporate positions. Each policy contains different provisions, exclusions and coverage limitations. It is important to know your policy – its coverage and its limitations and exclusions. Most policies are on a "claims made" basis, covering claims made against directors and officers during a policy period. To cover claims made after the policy period, a "tail" policy will need to be purchased.

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*If you have questions or would like more information about how to limit the possibility of personal liability you should contact your legal counsel.*

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