Third in a series —

What is misconduct? *and* Shareholder's responsibilities

This article is in response to a request from one of our readers, Mary Ann Porter ("Su-yook"), for more information on the rights and responsibilities of shareholders in Native corporations. Her desire is to pay closer attention to and take a more active part in her village corporation.

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By Paul Gaskin and Earl Rhodes

WHAT IS MISCONDUCT?

How is a shareholder to know when an action by an officer or director of the corporation is outside the scope of his authority, and possibly illegal? Unless a shareholder is aware that his interests have been compromised, available remedies will go unused and wrongful conduct will continue. In an article entitled "Directors: leaders of the corporations," appearing in the January 31, 1974 Management Report, John Havelock discussed the duties of care and good faith owed by directors of the corporations. While these duties can be described on paper, as a practical matter most breaches of duty are interwoven into complex business operations and cannot be easily identified to permit shareholder action. Most breaches do not appear anywhere on the records or financial statements of the corporation, so that even careful scrutiny of the books will not reveal misconduct.

Usually misconduct is uncovered by chance. Shareholders should be alert to certain warning signals which often accompany misconduct. First, any dramatic or unexplained increase in the living standard of a director or officer should be examined. Second, any excessive trips to locations of doubtful business interest should be questioned. Third, expense accounts and access to corporate facilities such as expensive cars, use of corporate office space for outside dealings, etc., might merit scrutiny. Finally, other boards to which directors belong should be studied for possible conflict of interest.

A frequent case in corporate law involves the use of corporate funds to secure bank loans to third parties who would otherwise not qualify for loans. An example might involve a director, or his friend, who requires $20,000 to modernize a fishing boat in time for the season, and is unable to secure financing from a bank. The director, for himself or his friend, cosigns the bank note in the name of the corporation, with the bank only too willing to accept the security of the corporate assets for an otherwise risky loan. This transaction is clearly a breach of fiduciary duty by the director, but would not be found in the corporate account books unless the loan were defaulted upon by the debtor, in which case repayment to the bank would have to be made out of corporate funds.

Another issue common in corporate law suits questions the commitments a director, board of directors, or interim board can make on behalf of the corporation. A shareholder could hold liable a director who purports to bind the corporation to a course of action which that director has no authority from the board to finalize. Likewise, certain actions cannot be taken by the board without the consent of the shareholders, and a legal action exists if the board makes a commitment properly reserved to the shareholders. Finally, since the interim board has not been elected by the shareholders, it is limited in the contracts it can enter into with third parties. Limitations of the interim boards of village and regional corporations, set up pursuant to the Settlement Act, are found in both the state statutes and in communications from the Secretary of the Interior. If the interim board knowingly makes an unlawful commitment through a contract to a third party who is aware that the commitment may be beyond the legal scope of authority of the interim board, shareholders may choose to: a) hold the directors personally liable for any damages that result, including lost opportunities, b) refuse to ratify contracts entered into prior to the first annual meeting, or c) immediately move to nullify the agreements between the interim board and third parties.

SHAREHOLDER RESPONSIBILITIES

The extent to which shareholders become involved in corporate affairs is voluntary. In some corporations, virtually all daily decisions and long-term plans are made by the board of directors. Other corporations place more of the decision making authority in the hands of the

(Continued on Page Thirteen)

• Shareholder's responsibilities

(Continued from Page Two)

shareholders. This is accomplished through appropriate provisions of the bylaws, which can reserve to the shareholders thr right to vote on any issue determined by the shareholders to warrant their consideration and approval. They types of issues which shareholders generally consider themselves are those which could significantly affect the assets of the corporation, and those which determine the impact activities of the corporation will have on the community of shareholders at large.

Whenever decisions must be made on behlaf of a large group of people of relatively diverse interests, there is always the risk that appointed or elected officials will misjudge the desires of the shareholders on some occasions. There exists also the remote possibility that decisions will be made contrary to the known desires of a majority of shareholders. Frequently, a number of relatively minor decisions when taken together create an economic encumbrance against possibly better alternatives that would have been available to the corporation at a later date.

Whether shareholders should become actively involved in important and complex corporate decisions is debatable. Lack of involvement in corporate affairs requires a greater reliance on "experts" to run the corporation, but excessive reliance on experts limits the potential of shareholders to monitor actions by corporate directors, to redress wrongs committed by them, and to effectively and knowledgeably incorporate shareholder priorities into the decision making structure of the corporation. Hence, while shareholders must allow the directors somewhat of a free hand to run the business affairs of the corporation, a general awareness of the corporation's priorities and long-term plan of operations is essential for every shareholder.