
**MBOH BOARD MEMBERS
SUMMARY OF LEGAL DUTIES**

BACKGROUND

The Montana Board of Housing is best described as a *municipal "corporation."* The duties of directors of all corporations are imposed both by state laws and by federal securities laws. Most people are familiar with the duties of a director of a *private* for-profit corporation, such as IBM or Citicorp. The duties of the MBOH board members are rooted in the same legal principles, but are not as well defined because directors of municipal corporations are rarely the object of personal lawsuits (because most lawsuits against directors of corporations arise from disgruntled stockholders, and municipal corporations such as the MBOH do not issue stock).

DUTIES

General

All directors of corporations, whether the director of a for-profit private company like IBM, a nonprofit company like Habitat For Humanity or a municipal corporation like the MBOH, are "fiduciaries" for the corporation and its purposes. That means that a director has a duty to act for the benefit of the corporation and its purposes, and must subordinate the director's own personal interests to those of the corporation. A fiduciary duty is the *highest standard of duty* imposed by law, the same as that of a trustee or guardian.

When considering the duties of corporate directors, it is very important to understand those duties in light of the purpose of the corporation. For-profit corporations have one purpose—to maximize their value for the benefit of their stockholders, pure and simple. Not so simple are non-profit corporations and municipal corporations because they often have multiple purposes, and no stockholders to enforce them. The purposes of non-profit corporations are set out in their articles of incorporation, and in virtually all states the state attorney general is authorized by law to assure that those purposes are followed. The purposes of municipal corporations, such as the MBOH, are usually set forth in the law creating them, and generally no one is directed to assure that they are followed; however, theoretically through the *political* process the actions of directors are monitored. The MBOH's statutorily specified purposes are to finance decent, safe and sanitary housing for lower income persons and families. [Note that the MBOH does not have a statutory purpose of making a profit, although it is supposed to be self-supporting.] In addition, in its various indentures the MBOH has *contractually* agreed to various financial covenants, including promises to prudently manage programs supporting various bond issues.

State laws impose two primary duties on directors—a duty of DUE CARE and a duty of LOYALTY. In addition, because the MBOH issues bonds, the federal securities laws impose a third major duty—a duty of DISCLOSURE.

Duty of Due Care

The duty of DUE CARE is a very broad duty which requires that a director exercise ordinary and reasonable care in the performance of the director's office. This requires that a director act in good faith and act honestly.

In particular, the duty of DUE CARE requires that a director:

(a) Be sure all *specific obligations* listed in the enabling legislation are carried out, such as keeping minutes of board meetings, electing officers, meeting periodically, filing reports, adopting rules and regulations for programs, and so on. These are often called "ministerial obligations," and courts are pretty rigid about making sure these are complied with.

(b) Adopt *appropriate programmatic policies* to be sure that the MBOH's purposes are carried out. These are often referred to as "discretionary duties" and courts will give directors substantial latitude in the type of policies adopted and their content.

(c) Employ competent *staff*.

(d) Generally *supervise and monitor* MBOH operations (such as making sure the staff prepares regular reports on various programs and operations). But a director should **NOT** try to operate the day-to-day business or micromanage operations. In fact, under the law, a director has no authority with respect to actual day-to-day operations unless so authorized by a board resolution; management (staff) is vested with those powers. For example, a director cannot contractually bind the MBOH absent an authorizing resolution, but the executive director usually *can*.

(e) Adopt *reasonable management policies* such as personnel policies, compensation, anti-discrimination policies, hiring policies, and investment policies (which in recent years would include restrictions on investments in derivatives and/or leveraging). This also includes such things as a board audit committee to review financial matters and budgets and a management review committee to periodically review at least senior management.

(f) *Be informed and exercise independent judgement*. This means that a director should read and be familiar with board materials, including the MBOH act and its rules and regulations and its written policies. Directors should attend meetings, and participate in board discussions and decisions. (As one court said, a director cannot protect himself behind a paper shield bearing the motto "dummy director.") However, in the ordinary course of business, a director may act in reliance on information and reports received from regular sources whom the director reasonably regards as trustworthy, such as staff and retained professionals.

(g) Protect any confidential information obtained as a director.

In other words, a director should follow prudent business practices, recognizing that the MBOH's business is *financial* in nature and targeted to financing *affordable housing*.

Duty of Loyalty

The second major state law duty is a duty of *LOYALTY* to the organization. This means a director has a duty to avoid conflicts of interests and provide undivided allegiance to the MBOH's purposes, even though by statute a director may be a representative of a particular group (such as lenders, labor or builders).

In particular, a director should

(a) **NOT** participate in making a decision if the director has a conflict of interest, and generally should abstain not only from voting but also from the discussion, and should declare the conflict so all know of it, unless otherwise permitted by statute. *Conflicts are not illegal— but how a director handles them may be.*

(b) Ensure that the best interests of the MBOH are followed when the possibility of insider transactions surface (as well as complying with federal securities laws if securities transactions are involved).

(c) **NOT** take personal advantage of opportunities available to the MBOH. This means avoiding not only personal advantage, but also avoid providing advantages to another organization, even if it is another municipal corporation or a non-profit organization. This is the root of all the recent focus on *ETHICS*. Most states now have ethics laws, many state housing agencies have adopted ethics rules, and the SEC has tried to indirectly force its own version of ethics rules on directors by imposing gift and political contribution rules on investment bankers.

Duty of Disclosure

Federal anti-fraud securities laws are special. It has long been accepted that if a municipal corporation (such as the MBOH) issues securities (i.e., bonds), when selling the securities the MBOH is obligated to disclose to potential investors any “material” information—i.e., information that a reasonable investor would consider important in deciding whether to invest in the bonds. That is the reason for the official statement—it is the written means by which the MBOH satisfies this “disclosure” requirement.

In the 1995 Orange County, California debacle, the SEC for the first time officially took the position that *individual* board members of the issuer also have a *personal* disclosure duty under the federal securities laws. This is particularly relevant because in the Private Securities Litigation Reform Act passed in 1995, private securities law class actions were restricted but the SEC’s authority to bring both civil and criminal actions against corporations and individuals was expanded (and SEC officials have publicly stated that the SEC intends to use those powers).

In its *Orange County* report, the SEC said that when authorizing the issuance of securities, board members with *personal knowledge* of information that is material must take reasonable steps to be sure that information is disclosed. Reasonable steps include telling the staff and retained professionals. This rule apparently applies to information the director *actually knew* or *should have known* if the director carried out his duties.

A couple of examples applicable to MBOH might be helpful.

If a director knows that the developer of a multi-family project to be financed with bonds has severe financial problems but doesn’t take steps to ensure that the information is properly considered in the disclosure process, the director may be personally liable. If the director didn’t actually know that particular developer was involved in the project because the director never read the board materials distributed about the project, the director may still be liable for recklessly disregarding his duty of due care to be informed.

A similar situation could occur if a director knows or should have known of a troubled originator/servicer in a single family program.

The federal securities laws do not require that a director become a securities law seer. However, they do require that a director act prudently, and if a director has concerns he should contact his staff or retained professionals to make sure all material information is disclosed. In Orange County the SEC pointed out that the directors either had information about significant problems, or should have received reports with that information, *but never contacted their staff or retained professionals* about whether the information should have been disclosed.

SUMMARY

In conclusion, the primary duties of a MBOH director fall into three categories: the state law duties of **DUE CARE** and **LOYALTY**, and the federal securities law duty of **DISCLOSURE** in securities offerings. If a director makes sure he is informed and that the MBOH follows prudent business practices, the duty of **DUE CARE** should be satisfied. Properly addressing conflicts will usually suffice for satisfying the duty of **LOYALTY**. Simply informing the staff or MBOH professionals of possible disclosure matters should satisfy a director's duty of **DISCLOSURE**. Fortunately, unlike the directors of stock issuing corporations, an MBOH director's violations of state law duties will rarely give rise to even an allegation of personal liability, and so far the SEC has seriously discussed personal liability only in truly outrageous securities situations, such as Orange County.