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How to Remove an 'Unfit' Director

By Michael W. Peregrine – December 7, 2012

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Michael Thomas/Associated Press

Lance Armstrong voluntarily resigned from the board of the Livestrong charity, which he founded.

Lance Armstrong has had a rough couple of months. But to a certain extent, Mr. Armstrong's loss is corporate governance's gain.

His recent resignation from the board of the Livestrong charity, which he founded, is a valuable reminder that boards should have in place a protocol dealing with "fitness to serve" issues for officers and directors.

Such a protocol will serve to confront, and resolve, those sticky situations — legal, financial or personal — that tarnish a board's fiduciary credibility. By all accounts, Mr. Armstrong resigned on his own, citing the best interests of the charity and his continuing legal problems. He wasn't pushed.

There have been several other recent circumstances in which high-profile board members have resigned amid controversy: the former Certified Financial Planners Board of Standards chairman, Alan Goldfarb; and a former director at the Financial Industry Regulatory Authority, Joel Blumenschein; to name two.

But not every director facing a tough controversy "does the right thing"; sometimes, a director will resist efforts to resign.

A "fitness to serve" protocol is a self-enforcing mechanism that facilitates a resignation in circumstances that reflect negatively on the director and on the corporation. But adopting such a protocol can be a real challenge.

That's because it requires the board to make some tough decisions. The protocol will have to address what kinds of events should lead to a resignation and whether the board can have discretion to override the policy if warranted.

Such a protocol can also be a deterrent for qualified director candidates. And of course, the decisions about what does and does not constitute a breach of the guidelines can be subjective.

However, the board's main duty should be to protecting the reputation of the organization. And to make sure that happens, the board needs to have some guidelines in place.

What exactly should a board be worried about? Anything involving an officer or director that raises concerns about that person's qualifications and integrity. Circumstances that could harm the company's reputation or the board's ability to lead. The board must make a call on where to draw the line.

Let's put aside the "no-brainer" circumstances that involve criminal conviction, or a ruling of breach of fiduciary duty. An effective "fitness to serve" protocol should extend to a director facing harsh regulatory penalties or professional ethics sanctions. It may even capture a board member's service on a different company that has faced severe legal or regulatory sanctions.

The protocol should also address what should occur if a director is the target of a regulatory or internal investigation (as was the case with Mr. Goldfarb and Mr. Blumenschein) or has been named a defendant in litigation. While nothing is yet proven, the allegations are public and can often keep board members facing the charges from carrying out their fiduciary duties.

This can be a tougher call, particularly when trying to determine how serious a charge must be to warrant a director's removal or forced resignation. For example, it may affect the board member's access to directors and officers liability insurance — known as the "D&O" coverage and indemnification protection provided by the company. Yet, the resignation of implicated board members may be perceived favorably by interested regulators.

But there are risks, too; especially in the context of high-stakes litigation or government prosecution. The "fitness removal" could appear prejudicial. The company's "white collar" team should be consulted in that instance.

The next lower threshold of concern involves violations of the code of corporate conduct or controversial personal conduct, like extramarital affairs or other inappropriate relationships. These actions can place the board on a much more slippery slope, but they're realistic concerns — we see them every day in the news, on the Internet and (unfortunately) on Comedy Central. And it does not hurt to clarify up front what the board considers to be unacceptable behavior.

Whatever thresholds are set, the board can implement a protocol in several ways. The board could require an advance resignation in which the director agrees to step down at the request of the governance committee. All board members may be required to have a clause in their contracts involving "fitness to serve" conditions. The board could adopt a policy that requires resignation upon the occurrence of the specific event, or an obligation to provide notification upon such an event — followed by efforts by board leadership to encourage the director's resignation.

To outsiders, it may seem easy for boards to remove a director at will if serious questions arise about conduct.But clear policies can help when a director is not ready to resign willingly. Some directors are not immediately convinced of the need to step aside.

Some board members — out of loyalty or friendship — may have a difficult time voting to remove a director, especially if that person has had a long record of service to an organization (as Mr. Armstrong had with Livestrong).

The removal process can be full of highly public tension, rancor and even litigation. But because issues of conduct seem to be arising with greater frequency, the smart governance play is to confront the fitness issue in the abstract, before it becomes a reality.