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How Informed Boards Can Reduce Risk!

“THE ONLY CERTAINTIES IN LIFE ARE ‘DEATH AND TAXES’...THAT’S AN OLD SAW WE’VE HEARD BEFORE. BUT IF YOU’RE IN THE PRIVATE CLUB INDUSTRY, THERE’S THE POSSIBILITY OF MUCH MORE.

In today’s litigious society, private clubs also face the real possibility of a lawsuit, whether or not it’s between clubs and existing or prospective members, between clubs and suppliers or anyone else who has felt harmed by the actions of a private club or clubs.

“The risks are real because of today’s litigious environment,” says Randy Addison of Addison Law. The risks can come from:

- Member suspensions / terminations
- Employee issues
- Refunds/resignation lists
- Claims regarding governance / operating outside authority of Bylaws
- Securities claims

“It is imperative general managers takes ownership of the club by enforcing job descriptions, rules and regulations and governing protocols. When the GM is reluctant to correct a volunteer leader there is no enforcement and the courts will throw out all the rules and reinstate the club’s liability.” ~ Tarun Kapoor

- Negligence / accident claims
- Losing tax exempt status, and
- Contract disputes many of which are not covered by insurance.

“The question is: What doesn’t create a liability at a club?” queries Jeff Magoon, senior director of risk management, CMAA.

“If you think about it, a club has multiple businesses under one roof. It takes a special talent to manage a club and the

staff. Most club facilities have a restaurant, a bar, landscaping, maintenance, catering, retail shops (golf, tennis, etc.), administration office, aquatic facility, youth programs, fitness, spa and the list goes on.

“When you consider all of the different liability exposures that exist at a club, it is unlike any other business. The biggest liability at a club is the unknown or the unanticipated liability,” Magoon explained.

So how do clubs, their boards of directors and members reduce the risk...the exposure? In a nutshell, prevention is the key to 1) controlling costs 2) avoiding liability.

Really, it’s pretty clear what private equity clubs and their boards need to do. Board members need to know what their roles and responsibilities are today. They need a strong educational package based on an orientation program. They need to incorporate the club’s institutional memory (minutes, financials, details of capital projects), and the club’s culture, and make sure it all translates into the club’s operation,

mission, vision, strategic plans, bylaws, and training manuals and guidelines for management and staff.

Directors, committee chairs and other club officers are charged with the task of controlling liability, controlling costs and enhancing the member experience at their club. It’s a worthy objective and the basic reason for a club, but ultimately it raises myriad legal issues and concerns.

While the threat of litigation today is real, “any action

involves both risk and return," suggests Gregg Patterson, general manager of the Beach Club of Santa Monica, CA.

"Whenever the decisions, there are intended and unintended consequences – 'some good and some bad.' My job as GM is to anticipate as many of these outcomes as possible to accelerate the 'good' and mitigate the 'bad,'" Patterson explained. That's the practical side of management.

Where does it all start? With a proper orientation for board members (where as many as one third of board members can change each year) is essential because a club depends upon its board for long-term guidance, leadership and policymaking.

This education is essential helping board members understand and meet the requirements of their fiduciary duties, thus mitigating or preventing costly legal fights.

"Every club needs to have a risk analysis done in order to develop a risk management plan that includes education, training, and better tools that make it easy for staff to implement better practices. The club's plan should be reviewed and updated every year," Magoon added.

Perhaps the most overriding principle guiding a director should be "fiduciary duty." A fiduciary is the highest standard of duty the law imposes in any relationship. This rela-

tionship is founded on trust placed by one person in the integrity and fidelity of another.

Directors must discharge their director duties, including duties as a member of a committee, "in good faith" and "in a manner the director 'reasonably believes to be in the best interests of the club.'" This is central to the mandate of "duty of loyalty."

There are a couple of red flags along the way that may affect a director's participation on the board of directors including:

Conflict-of-interest: Does the director have any current potential conflicts between their business or personal lives and the needs of the club?

Too many directorships: Does the director already serve on too many boards that will preclude the person from devoting the time necessary to the club's board?

So to reiterate, clubs and their boards must create an environment of prevention, because it's incumbent on the board to operate the club within the boundaries of the club's bylaws.

Directors, committee members and club officers and management may contend they've 'never been sued' or that they have Directors and Officers Liability Insurance, to cover the club in the event of a lawsuit. But no doubt, some clubs may

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find themselves in precarious legal positions, even if they do have pertinent insurance coverage.

"Every action therefore lies somewhere on the 'risk spectrum' in terms of what can happen, what the ramifications will be and what sort of return I might expect from the risk taken. My job is to frame those outcomes and those risks in practical terms," explains Patterson.

He 'views risk' through his own experiential filter and contends that every individual (board member and gm) does the same.

"Perhaps it's the world I grew up in, in the early 1950s in rural Maine. But the fact is that I'm risk tolerant in my own life. I fly airplanes, ride motorcycles, bicycle to work, travel

"Board orientation is critical for new board members to review the board's duties and responsibilities as new board members come in with experience from their business background that is not always consistent with the private club board duties," explained Addison.

"The board's confidentiality policy is critical to keep the board on a functional united basis because of the potential of non-board member factions in the club.

"Comprehensive D&O Insurance is very important and should be reviewed carefully as different D&O policies may not cover all activities of the board members. Proper indemnification provisions in the club bylaws are also very important to protect the board.

"The board is the governing body for an equity club. As a member of the board, an individual must abide by the club

"I'm saddened by the risk aversion that characterizes our age and the litigious thinking that make it so. It's easier to 'cover all the bases' do nothing and know that 'we're protected.' But doing so diminishes the club experience for our member community. The balance I search for between risk and return is covered by my own 'experiential risk' filter," ~ Gregg Patterson

solo in Third World countries, load ammunition and shoot guns, and am therefore more tolerant in my professional life than others with different life experiences.

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"The reality of insurance liability lingers despite the fact that the club represents members with shared values.

"We're in a litigious society and it's important to cover one's derriere. We invest in instruments that cover our backsides. Insurance is big since it limits the downside of any outcome. Cash is king. We have solid cash reserves to cover deductibles and 'unforeseen' encounters that are covered by our insurance package. Our exposure to 'unforeseens' is very, very small as long as what we do is legal.

"Illegal stuff means that we enter a particular adventure 'bare' and that excites neither the boards nor me. Legal is good for a number of different reasons," Patterson emphasized.

bylaws and owes the club certain duties and responsibilities arising from the board positions," Addison said.

"In particular, all board members must exercise their business responsibilities in accordance with the 'business judgment rule', which states that a director of a corporation is insulated from liability for a business decision made in good faith if he is not interested in the subject of the business judgment, is informed with respect to the subject of the business judgment to the extent he reasonably believes to be appropriate under the circumstances, and rationally believes that the business judgment is in the best interests of the club."

Additionally, each board member owes a duty of loyalty to the club they serve. Directors must perform their board duties with an undivided loyalty to the club and may not use their official position, information they receive about the club while acting in that official position or property of the club, in a manner that allows them to secure a financial benefit for themselves or their family or relatives.

"In other words, a board member should avoid any 'conflict of interest' and not use his or her position to secure lucrative service contracts for related parties without full and

absolute disclosure to the board,” Addison explained.

Another liability issue focuses on the specifics of board operations, including the functioning of committees and the necessity of having board members chair the committees.

“A board member should chair every committee,” recommends Dick Kopplin, president, Kopplin Kuebler of Scottsdale, AZ.

“This allows for clear communications from the board to the committees and back to the board. The club committees are the feedback mechanism for the board and general manager. Even more importantly, they serve as the ‘process handlers’ for issues within a club.

“The work of the club should be done at the committee level, not at the board level. Some attorneys have said they would have real concerns about committees not chaired by board members. With all the litigation occurring over a wide range of issues, it makes sense to ensure that the flow of authority for any club decision flows from the board through the committees.

“The most effective way to ensure this process happens in an orderly manner is to have the committees chaired by board members,” Kopplin concluded.

How real is the liability risk to private clubs today and what creates a liability for a club? There are several factors.

“Golf and country clubs have a very real liability risk in numerous facets of their business. The most significant is liquor liability,” explained Rob Mulhern, senior vice president, Preferred Club Program.

“This is significant because when the club serves the alcoholic beverages, they (the club) are solely responsible for the patrons’ activities even after they leave the golf or country club. They are also susceptible to liability losses through the use of golf carts.

“Most clubs allow members and guests the opportunity to operate golf carts on their premises without any training, and most clubs allow carts without waivers of liability or written contracts. This makes a club susceptible to a loss when carts are not operated properly and leaves them open to liability suits,” he added.

There are of course, some specific measures clubs can take.

“An important way to prevent liability is to use contracts and legal review from in-house counsel for all third party contractors. You want to have third party contractors hold the club harmless,” Mulhern stressed.

“Utilize your in-house counsel to help develop the bylaws and internal procedures to help avoid third party liability claims coming from susceptible areas of the club’s operations. This includes contracts and legal review for sub-contractors and vendors coming on the premises, and securing certificates of insurance.

“Review your bylaws and procedures as they relate to important liability areas, including cart operation by mem-

bers and guests and the serving of liquor throughout the club,” Mulhern added.

“All clubs that have a board of directors should buy D&O and EPLI coverage to protect the board and the clubs, including the executive officers of the club, for possible claims. This usually is not an expensive endeavor.”

D&O Liability provides financial protection for directors, typically volunteers, and also covers the executive officers and directors of the club from third party liability in the event they are sued in conjunction with the performance of their authorized duties, as related to the club.

“All clubs should include EPLI coverage, which covers them for any employment errors and omission. We recommend purchasing a minimum of \$2 million \$5 million of limits. Also, some programs will include the D&O and EPLI coverage within the umbrella coverage,” Mulhern explained.

“D& O insurance policies have different exclusions that need to be reviewed carefully along with the amount of coverage,” added attorney Addison. “Certificates of insurance should be obtained each year and provided to board members for their independent review.”

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Addison also suggests other measures to keep a private club out of legal trouble.

"A club should follow and update its bylaws and membership agreements regularly and follow approved procedures. The club should operate within the scope and authority of the governing documents."

There should be "good communication to members, and the club should obtain member approval where required," and, there should be a "close relationship with experienced club counsel, legal audits, close supervision of member committees, i.e., disciplinary committee and any conflict of interest issues should be avoided," Addison suggested.

"Every year the risk management plan should be reviewed by the club's leadership and updated accordingly," explained Magoon.

"This can be done internally, by a third party or even their current broker or carrier. I believe it is always a good practice to have a third party give a review, taking into consideration:

Any changes that have been made at the club (remodel, new construction, new hires, etc.)

Any changes in the economy that could create new or additional exposures

Any regulatory or compliance changes, etc."

Bob Lang, an attorney with D'Amato & Lynch, LLP, in New York, who has authored articles on golf and law, says, "One the best ways for private clubs to avoid legal difficulties is to involve both in-house and outside counsel since, among other things, discussions with counsel are privileged.

"That way, unfortunate or poorly thought out comments are not made at board meetings or in discussions, which comments then find their way into pleadings, lawsuits, depositions and testimony," he explained.

"Discussions with counsel present on topics in which legal advice is sought and given, provide the protection and opportunity to have free-ranging discussions which may be privileged, and therefore non-discoverable.

"It is important to remember, however, that the attorney-client privilege belongs to the client, not the attorney, so board members and officers need to remember not to repeat what was discussed with counsel present, and not risk waiving the previously privileged discussion."

PUBLISHER'S FINAL THOUGHTS

Certainly there are key areas of exposure for private clubs today...employment practices, supplier relationships, golf course and clubhouse liabilities, gender-based issues, voting privileges, the lack of D & O insurance, and a host of other 'unforeseen circumstances' that can lead to litigation.

Today, more than ever, there's a need for director education. Some clubs offer little or no director education and orientation for incoming board directors, and unquestionably, this today should be a requirement for any private club.

Board members need indoctrination into the directors' environment to better understand the club's institutional history, culture and bylaws. It all starts with board members understanding their roles and responsibilities.

In fact, a 'director's job description' with a list of duties is a good place to start:



- Establish club policies
- Oversee the fiscal management of the club
- Enact regulations (bylaws, rules, resolutions)
- Adopt budget plans
- Approve membership applications
- Hire the general manager
- Meet prospective new members
- Oversee the administration of policies and enforcement of club regulations
 - Fill vacancies on the board
 - Discipline, suspend, or expel a member when necessary
 - Review and approve programs submitted by club committees
 - Oversee transfer of memberships
 - Attend special meetings
 - Supervise club elections

It's interesting how most clubs have board members (directors) with substantial experience and experience in business matters. Too frequently, however, these individuals abandon their businesslike approach to decision making when they sit on a club's board.

This practice is contrary to a director's legal and moral duty to act like a business person, using the same degree of commitment, attention and care as directors of a for-profit corporation.

Not-for-profit private clubs boards of directors face personal liability for their actions as board members. In performing their duties individuals face greater personal risks than club insurance coverage alone can mitigate. Thus the requirement for, and protection of D & O liability insurance.

The key is knowledgeable governance and sound risk management practices.

Knowledgeable governance starts with a documented orientation process and putting in place a liability loss prevention program. This will help reduce the club's, and also the directors' and officers' liability. This also will help recruit qualified directors and officers and improve the organization's ability to obtain favorable D&O liability insurance coverage.

It's important to understand risk management is not only about buying insurance or winning lawsuits. It's about protecting and conserving the club's resources and providing membership services sensibly. The purpose of risk management is to improve your operations by having risks acknowledged and controlled.

Factual orientation: A formal and accountable orientation program is necessary for new directors. This doesn't mean a tour of the club or the reading of basic orientation information. What proof do you have that they even read what you provided to them?

Accountability is key. And proof they have completed a factual orientation process can prevent misinformed or mis-

used directors, and save time and energy that would be spent on questions, misunderstandings and misconceptions.

Private clubs depend on a constant influx of new volunteers to survive and thrive. It starts with welcoming the new volunteers with open arms, by skillfully managing a factual orientation process.

You are effectively institutionalizing that welcome and making sure that everyone who wants to help will understand what they are doing and why they are doing it.

Finally, the best-written job descriptions for directors will, by their lonesome, be useless. As Tarun Kapoor, BoardRoom Institute's dean of education likes to say, "It is imperative general managers takes ownership of the club by enforcing job descriptions, rules and regulations and governing protocols. When the GM is reluctant to correct a volunteer leader there is no enforcement and the courts will throw out all the rules and reinstate the club's liability."

At least that's the way I see it! **BR**

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If you have comments on this article or suggestions for other topics, please contact John Fornaro at (949) 376-8889, ext. 4 or 105 or via email: johnf@apcd.com

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