Revisiting Term Limits: To Limit or Not to Limit—That Is the (Term) Question

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Effective governance planning includes a periodic evaluation of the merits of term limits and mandatory retirement rules. This is particularly important during periods of enormous organizational challenge, in which experienced board leadership is at a premium.

It is useful to anticipate the interest in unlimited terms of service, which often arises during such tumultuous times. In considering the term limit question, boards will need to balance the potentially competing goals of retaining seasoned leaders and assuring independent oversight.

In any evaluation, deference should first be made to the relevant provisions, if any, of state non-profit corporation law. Most non-profit corporation laws allow for directors to be elected to successive terms, deferring to organizational bylaws whether to contain specific limits on the number of successive or total terms served. Some state laws provide a default term (e.g., one year) if the articles of incorporation or bylaws fail to specify terms for board members. Other states limit the length of an individual term without specifically providing for term limits (the maximum length of a single term varying depending upon whether it is a membership corporation). Under each of these various approaches, a director may be elected to serve more than one term unless the organization’s articles of incorporation or bylaws provide to the contrary.

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In the absence of state law guidance, the board’s term limit evaluation should be guided by a “facts and circumstances” approach. The discussion should be grounded in an appropriate application of its conflict-of-interest policy. While all serving board members would automatically have some self-interest simply by virtue of their position, the goal of the conflicts review would be to protect the process from extraordinary bias (e.g., the perspective and/or vote of board members at the end of their maximum term).

In conducting the “facts and circumstances” evaluation, the board should consider the evenhanded treatment of the issue provided by the Panel on the Nonprofit Sector’s influential Principles for Good Governance and Ethical Practice: A Guide for Charities and Foundations. Principle #17 provides that a non-profit board “should establish clear policies and procedures addressing the length of terms and the number of consecutive terms a board member may serve” — without formally recommending the use of term limits. In so doing, the principle articulates the benefits of both approaches (i.e., term limits and no term limits).

The term limit arguments — both pro and con — are well established. The arguments in favor of term limits are centered on the benefits associated with mandatory director rotation — delivering valuable change and positive transformation (e.g., new energy and perspectives) to the board. These arguments seek to protect against the oversight risks arising from entrenchment or excessive familiarity with executive management. (These are legitimate oversight concerns — the risk that long-standing board members may be less willing to exercise constructive skepticism due to a lack of independence.) Term limits also offer a discreet way to effect removal of loyal board members without risking the embarrassment of non-reappointment. Advocates of term limits view staggered director terms as a means of preserving a balance between new and experienced directors.

The arguments against term limits are centered on the risks associated with depriving the organization (and management) of seasoned, experienced directors — especially during times of organizational challenge or transformation. The recent economic recession offers an excellent example of an external challenge that might prompt board interest in retaining experienced directors. Boards may also seek to retain directors beyond specific terms to facilitate the implementation of major corporate initiatives commenced during their regular term.

There is also concern that by reducing the collective experience level and institutional knowledge of the board, it may become inappropriately reliant on senior management, from an oversight perspective. The less familiarity the board collectively has with the institution, the industry sector, or the pressures it faces, the greater the risk that it will be reluctant to exercise constructive skepticism. Opponents of term limits prefer to rely on active board evaluation and nomination procedures as a more effective means of achieving desired board turnover.

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Possible transitional service on an affiliated advisory board offers a supplemental process for boards that do not limit the terms of board service. A possible compromise adopted by many non-profit boards is the use of a mandatory “stand-down” requirement. This approach allows a board member to become eligible for additional board service after a required pause, or stand-down, of one or two years after concluding a specified term of service. For example, directors are eligible to serve a maximum number of three consecutive terms but may serve an unlimited number of nonconsecutive terms. The ultimate question is what constitutes a reasonable length of cumulative service.
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service by a board member. For this question, there is no specific guidance. Yet, it is fair to say that the longer the length of cumulative service (e.g., in excess of 20 years) the greater the risk of a director being presumed non-independent by a charity regulator. Care should be given to assure that such a “stand-down” does not serve as a subterfuge to allow an individual to essentially serve in perpetuity, with periodic limited “vacations” from board service. Board service is not an endowed right.

The matter of term limits for non-profit board service is one for which there is no “right answer” under current law and governance principles. While the practice of limiting board service to a set number of consecutive certain-year terms may be gaining in organizational popularity, it is by no means a recognized non-profit sector best practice. Indeed, the current transitional environment for non-profits is prompting many boards to evaluate how best to retain valuable board experience. What is important from the perspective of effective governance is that the matters receive vigorous board consideration on a periodic basis.

Specific mandatory retirement provisions are similarly not best practice in the non-profit sector, despite their continued prevalence in public companies. This is principally due to the increasing recognition that a director’s age bears no meaningful relationship to the board service contributions he/she may have to offer. Growing in popularity though are “change in status” rules. These are provisions that require a director to tender his/her resignation when the director’s principal occupation or business/professional association changes substantially. The board may elect to accept or decline the tender, based upon its evaluation of whether the new occupation (or retirement, as the case may be) is consistent with the reasons prompting the director’s initial appointment.

Some proactive non-profits expand the use of “change in status” rules to address situations in which issues affecting ethical fitness to serve (e.g., material violations of law or professional ethics) are alleged or determined.

Periodic board consideration of the merits of term limits is a useful governance practice. In the absence of any relevant state law or precise best practice, boards should be guided by the fundamental need to preserve effective and informed oversight of executive management, and organizational pursuit of mission.

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