

**Hypothetical for
Maine Association of Community Banks
Community Bank Directors' College
October 20, 2009**

Vandolay Industries, a leading kayak manufacturer headquartered in Wisconsin, has been negotiating for several weeks with a local distributor, Kramer Kayaks, to establish Kramer as its principal northeast distributor. George is extremely excited about the project. The founder and president of Vandolay Industries, Art Vandolay, is an old college friend of George's, and it was George who, as a recently elected outside director of Kramer Kayaks, brought the opportunity to Kramer. The deal is contingent on the ability of Vandolay to establish and quickly get up and running a new warehouse and distribution center in Maine. Time is of the essence.

Art calls George to tell him that he has found the perfect location for the distribution center project at an abandoned industrial site in Brewer. He asks for guidance as to where he might go for local financing. George, who also is a long time member of Second National Bank of Maine's board of directors, naturally suggests the Bank. George arranges a meeting between Art and the Bank's senior loan officer and the two quickly hammer out terms for a financing. The proposed loan is large and promises to lead to a very handsome new customer relationship for the Bank. Art's only stated condition is that the loan must be "fast-tracked." The loan officer assures Art that will not be a problem. After a quick meeting with the Bank's president and board chair, a special Board meeting is called to consider approval of the loan.

At the Board meeting, George advocates persuasively for approval, pointing out that this is a "plum" loan and will significantly enhance the Bank's commercial loan portfolio. The only question raised relates to the environmental risk associated with the industrial property which is to serve as the Bank's principal collateral. The loan officer explains that, given Vandolay's timetable, there is no time to commission a formal environmental site assessment, as would be the Bank's normal policy. He indicates, however, that Vandolay has filled out an environmental questionnaire which does not suggest any environmental issues. Two of the nine Bank board members present express concern. George seeks to minimize this "technical problem" and emphasizes the importance to the Bank of the potential relationship with Vandolay and the risk of losing that relationship if the Bank is not sufficiently responsive.

As the discussion proceeds, another board member, Elaine Bennis, becomes increasingly uncomfortable. As the CFO of Kramer Kayaks, she is aware of the ongoing negotiations between Vandolay and Kramer, as well as George's election to the board of Kramer, and she is concerned that George has not disclosed the existence of those negotiations to the Board. On the other hand, Elaine also is acutely aware of the fact that she is an officer of Kramer, to which she owes a fiduciary duty, and she is concerned that raising the issue of George's apparent conflict of interest could jeopardize approval of the loan and, consequently, could kill the deal between Vandolay and Kramer.

After a short discussion, a vote is taken to approve the loan. George and five other directors vote in favor. The two directors who had raised concerns vote against. Elaine abstains saying that she has a potential conflict of interest. She does not elaborate.

The loan closes as does the distribution deal between Vandolay Industries and Kramer Kayaks. Six months later, while the project site is being rehabilitated, an old hazardous waste dump is discovered. The project, and the relationship between the Bank and Vandolay Industries, unravels. Vandolay defaults on the loan, and the Bank ultimately takes a significant write-off. A group of concerned Bank shareholders subsequently bring a shareholder derivative action against all members of the Board for breaching their fiduciary duties to the Bank. All of the Board members request that the Bank indemnify them against all of these claims.