Exempt Organization Fiduciary Responsibilities

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Agenda

- Directors and Officers ("D&O") – The Basics
- Fiduciary Responsibilities of Directors and Officers
- Duty of Care
- Duty of Loyalty
- Duty of Obedience
- Directors and Officers Insurance and Indemnification
- Practice Points

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Learning Objectives

- Identify and describe the duties of care, loyalty, and obedience
- List the three primary areas of possible enforcement actions that can be taken against directors and officers
- Explain how to avoid personal liability
- Design and implement policies and procedures to ensure compliance with the duties of care, loyalty, and obedience

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Directors and Officers ("D&O") – The Basics

- State and federal law changes over the years (no more absolute "charitable immunity")
- D&O of nonprofits are basically held to same standard of conduct as for-profit businesses
- D&O are responsible for overseeing programs, finances, employees, and the mission/vision of the nonprofit they serve
- Ideally D&O receive some orientation to their responsibilities and legal duties; however, many D&O are unaware of their legal duties or the harm that a breach of their duty can cause to their organization or themselves

Fiduciary Responsibilities of Directors and Officers

A. A fiduciary duty is simply a duty to act for someone else's benefit, while subordinating one's personal interests to that of the other person.

B. The duties are grounded in equity (fairness) and common law and many have been subsequently codified in state nonprofit statutes.

Fiduciary Responsibilities of Directors and Officers, continued

C. The elements of a breach of a fiduciary duty claim are:

1. Existence of a duty;
2. Breach of that duty; and
3. Injury to the principle or benefit to the fiduciary.

Fiduciary Responsibilities of Directors and Officers, continued

D. Understanding what constitutes a breach is important. A breach of fiduciary duty is the main source of personal liability exposure for D&O.

E. For example, trustee-vs-corporate D&O; both owe fiduciary duties but they vary in what may be deemed a breach or failure.

F. For example, a trustee can be liable for ordinary negligence (a relatively low standard) while a corporate D&O can be liable for gross negligence (a higher standard).

Fiduciary Responsibilities of Directors and Officers, continued

G. Three sources of enforcement generally:

1. corporate members, officers and directors may bring suit against wayward directors;

2. the state Attorney General's office has a wide range of powers; and

3. the taxing authority of federal, state and local governments (laws pertaining to excessive compensation, side-dealing, employer tax withholding, etc. can implicate personal liability by directors) and taxing authorities can pursue the personal assets of errant directors with taxes, penalties and interest.

Fiduciary Responsibilities of Directors and Officers, continued

H. However, personal and corporate liability can be avoided with careful adherence to fiduciary duties.

I. Nonprofit fiduciary duties (with some minor exceptions related to particular state laws) play out in the duties of care, loyalty, and obedience.

Fiduciary Duties

A. Duty of Care

B. Duty of Loyalty

C. Duty of Obedience

Duty of Care

D&O must exercise reasonable diligence or good faith and ordinary or due care in the best interest of the organization.

A. D&O must stay informed about activities and finances; regularly attend meetings; examine and evaluate records and understand the organization's governing documents.

B. When a decision is complex the D&O should engage subject matter experts and professional advisors. (D&O can delegate certain decision or activities but not oversight/ governance responsibility.)

Duty of Care, continued

C. Generally, the duty of care is evaluated according to the "business judgment rule" where they are presumed to be making decisions on an informed basis and in good faith unless there is a showing of gross negligence or willful misconduct (basically, this is just a restatement of the duty of care).

Duty of Care, continued

D. Example – Gift Acceptance Policy

1. For nonprofits engaged in fundraising, directors should develop and periodically review a gift acceptance policy
2. D&O and staff:
   - Should not benefit personally from fees related to gifts received
   - Should not participate in any activity which could be deemed a conflict of interest (closely related to the duty of loyalty as well as Internal Revenue Code and Treasury regulations)
3. The policy should:
   - Discuss finder's fees or other prohibited private benefit payments
   - Consider the different types of gift vehicles and whether or not restricted gifts will be accepted
   - Consider policies concerning acceptance of real estate (inspection and environmental evaluation)

Duty of Loyalty

A. Prohibits D&O from using their position of trust for personal advantage at the expense of the nonprofit.

B. The most common transactions that breach this duty are:

1. transactions involving conflict of interest or interested transactions (contract between corporation and director; 1023 and Form 990 questionnaires),
2. misuse of the organization's information or opportunities (D&O must disclose and offer the opportunity to the nonprofit), and
3. misappropriation of assets (private inurement and excess benefit transactions).

Duty of Loyalty, continued

C. Example – Conflict of Interest Policy; Annual Conflict of Interest Disclosure

D. "Disclose, Discuss, Decide by Disinterested Directors and Document"

Duty of Obedience

Duty to remain faithful to and pursue the goals of the organization and avoid *ultra vires* or illegal or unauthorized acts. Practically, this means the D&O must follow the governing documents, laws applicable to the organization, and restrictions imposed by donors and ensure the organization satisfies reporting and regulatory requirements.

Directors and Officers Insurance and Indemnification

A. Important protections against personal liability for D&O

B. Doesn't protect against fraud, criminal activity, or a director's improper receipt of a public benefit

Practice Points

A. Articles of Incorporation
(legally superior to bylaws; on file with the state)

B. Bylaws

C. Policies

D. Board Processes

E. Job Descriptions/Charters

F. Board Meeting Agendas/Minutes

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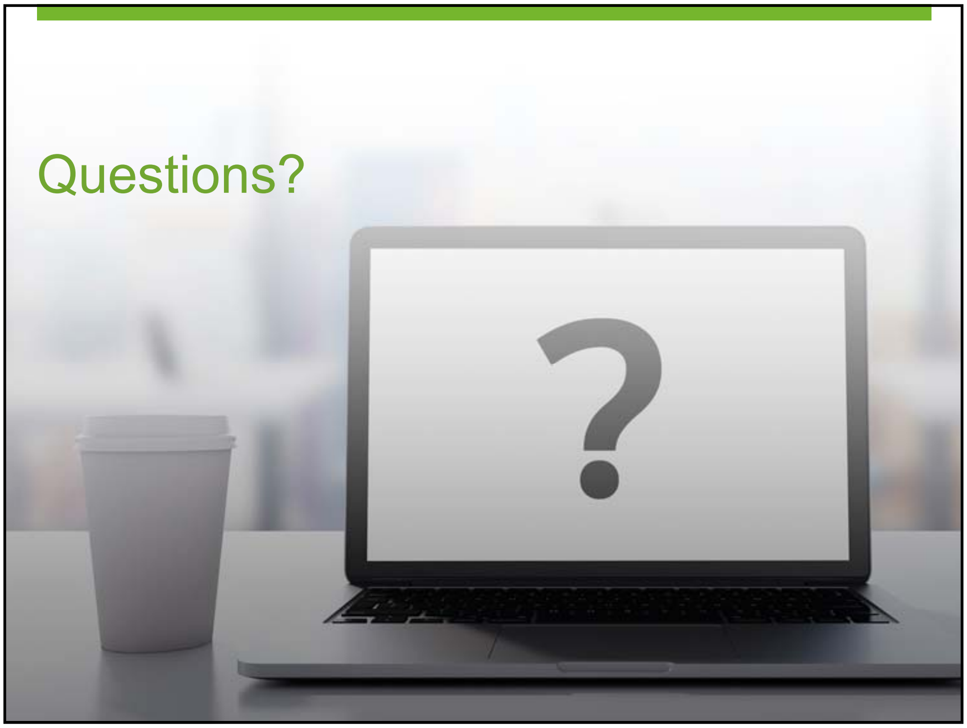

Thank you.

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