

Responsibilities of a Nonprofit Director

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RESPONSIBILITIES OF A NONPROFIT DIRECTOR

Most state nonprofit corporation statutes vest the management of a nonprofit corporation's affairs in its board of directors. The purpose of this article is to inform nonprofit board members of the duties, responsibilities and liabilities that arise out of their service as directors. It is intended as an overview of general concepts and standards. Board members should consult the articles and bylaws of their nonprofit corporation as well as the nonprofit corporation act of their state for their specific responsibilities.

The information is presented in five sections. The first is a general discussion of board governance and composition. The second describes the duty of loyalty and standard of care required of directors. The third deals with attendance at meetings, transactions with the organization and conflicts of interest, and making public statements regarding the organization. The fourth and fifth sections discuss a director's liability and right to indemnification.

I. BOARD GOVERNANCE AND COMPOSITION

The affairs of most nonprofit corporations are managed by its board of directors composed of uncompensated, volunteer leaders. Although the board has the power to delegate authority, the ultimate responsibility for the governance of the corporation resides with the board of directors.

Directors should be aware that the organization's assets are dedicated to the purposes set out in the organization's articles of incorporation and must be treated as a trust. Directors are fiduciaries and their status as fiduciaries is analogous to that of trustees of a trust, though the actual standard of care required is slightly less strict. Directors must protect the interest of the organization and refrain from doing anything to cause injury to the organization or to deny it the advantage of their skills and abilities.

The board of directors acts only as a group at duly-convened meetings at which a quorum is present—i.e., participates in person, by video conference or telephonically—or without a meeting by unanimous written consent of all the directors, provided the directors at a duly-convened meeting would have had the power to take such action.

The bylaws typically state the number of directors required to have a quorum. For purposes of calculating the quorum, the organization considers the number of individuals elected to and serving as directors at the time of any meeting. Vacancies or directorships which could have been but have not been filled are not considered when determining the quorum. Unless the articles or bylaws specifically provide for it, directors may not vote by proxy.

No individual director, as such, has the power to control, make decisions for or act on behalf of the organization. An informal consensus of the directors is not valid unless approved (before action is taken) or ratified (after action is taken) by the board. When a quorum participates in a meeting, action by the board usually requires only a simple majority vote of the

directors present, though a greater vote may be required by Robert's Rules of Order or other controlling authority, such as the state nonprofit corporation act, the articles of incorporation or the bylaws.

A director may resign from the board of directors at any time by delivering written notice to the chair of the board or to the secretary. Resignation is effective upon receipt of the notice or at such future time as is stated in the notice. A director may be removed from office at a meeting specially called for that purpose with or without cause by such vote as would suffice for his or her election.

II. DUTIES AND RESPONSIBILITIES OF DIRECTORS

The obligations of directors can be divided into three broad categories: (a) a duty of loyalty; (b) a duty of care; and (c) duty of obedience.

A. Duty of Loyalty

The duty of loyalty requires directors to put the interest of the organization above any individual interests. It incorporates the basic principle of corporate law that directors must not use their position for personal profit or other personal advantage. Directors must (1) avoid conflicts of interest, (2) ensure that any dealing between themselves and the organization is fair, (3) avoid preempting any business opportunity available to the organization, and (4) maintain the confidentiality of information made available to them as directors until such time as that information has become a matter of public record or common knowledge.

Directorship is a responsibility, not just an honor. A director may make a valuable contribution through relevant inquiry and focused discussion of proposals initiated by management. However, lack of objectivity and putting personal status and aspirations ahead of the needs of the organization may result in the misdirection of board activity. Directors should be prepared to oppose, if necessary, the position of dominant members of the board. An individual should seek to become, or consent to be, a director only if he or she is sufficiently qualified and is prepared to devote the attention and effort necessary to fulfill the substantial responsibilities involved.

B. Duty of Care

The duty of care requires directors to perform their duties, including service as a member of any committee, in good faith, in a manner they reasonably believe to be in the best interest of the organization, and with the care an ordinarily prudent person in a like position would use under similar circumstances.

The directors' primary responsibility is to maintain vigilance over corporate transactions. The board of directors is not expected to operate the organization, but it is responsible for providing oversight of the operation of the organization. Actual operation of the organization is

the function of the president (or the executive director or other chief executive officer) and the staff.

Directors must, of course, pay attention to the affairs of the organization. In general, this obligation can be met by (1) regular attendance at meetings of the board and any committees of which they are a member and (2) reviewing information regarding matters requiring board action. (Since a great deal of material may be supplied to the directors for their general information, special attention should be given to the budget and other communications directed to them by the president or secretary, to materials supplied to any committee they are on, and to agenda materials prepared for meetings.) Directors should also try to be informed on important issues related to the organization's mission.

Directors should use common sense, practical wisdom and their informed judgment in fulfilling their responsibilities. The nature and extent of the role played by an individual director will, as a matter of law, vary depending on the special background and qualifications of the director. For example, if a director has experience in financial affairs, he or she is expected to bring that experience to bear in making decisions as a director and may be expected to exercise greater skill with regard to financial matters than a director who has no special experience in that area. This does not mean the director with special qualifications has special duties; merely that in the exercise of duties which are common to all of the directors, directors with special skills and experience must utilize those special skills and experience in reaching decisions. Thus, for example, a director inexperienced in financial affairs might accept and act on a financial report without liability even if the report turned out to be erroneous while another director who has more knowledge or expertise in financial affairs might be found negligent in failing to note the errors in the report and bringing those errors to the attention of the full board.

The board can usually fulfill its responsibility by reviewing periodic reports from its president and staff. In general, directors are not personally responsible for the actions or omissions of the president and the staff if the president and staff have been prudently selected. However, the board of directors is required to take corrective action in the event that the president or staff takes action which is not in the organization's best interest. Directors may rely upon financial statements presented to them as correct by appropriate officers of the organization or as set forth in reports or statements made by or certified by the organization's independent certified public accountants. A director is obligated to study and understand to the best of the director's ability the organization's financial condition and to review submitted materials. If a director has knowledge that such materials are inaccurate or incomplete but goes ahead and relies upon them, he or she is not exercising good faith. A director must make some reasonable, critical inquiry as to whether there is any basis to disbelieve information that is being presented.

A director has the right to inspect all the books and records of the organization and to receive reports from its officers, employees and agents. Such requests for information or inspection should be directed to the president. Refusal to honor a director's reasonable request for information should be reported to the chair. In a severe situation, a director may have an obligation to bring certain matters to the attention of state regulatory agencies or officials; but, before taking such extreme action, a director should first discuss the matter with the chair, the president, or the organization's legal counsel.

Legal action may be brought against a director if the duty of care is not exercised, and a director may be held personally responsible for any harm caused as a result. Directors may ask the advice and informative guidance of others, but, in the end, must use their own judgments in coming to a final decision. As a fiduciary, a director must exercise power for the benefit of the organization and all its members, not for only some of them, with full honesty and reasonable efficiency.

C. Duty of Obedience

Directors are obliged to follow the organization's articles of incorporation, bylaws, state law, and any policies that have been adopted by the board. Directors can meet this duty by being familiar with the articles, bylaws, and policies of the organization. They should seek legal advice when appropriate before taking action as a board.

D. Guidelines

To fulfill their duties and responsibilities, individual directors should adhere diligently to the following guidelines:

1. Attend meetings of the board of directors consistently and attentively, and ensure that such meetings are held regularly and as frequently as necessary.
2. Carefully review and understand the organization's articles of incorporation and the bylaws to see that they are followed.
3. Be familiar with the facilities, personnel and programs of the organization and view those facilities and activities firsthand from time to time.
4. Maintain the confidentiality of information made available to them as directors, at least until such time as the information has become a matter of public record or common knowledge.
5. Review the agenda and appropriate supporting material distributed prior to each board meeting and take time in advance of the meeting to prepare for the meeting.
6. Safeguard and ensure the protection of the organization's assets and be certain that sufficient assets are maintained for the timely fulfillment of the organization's obligations and objectives. A director should also be concerned with the adequacy and type of the organization's funding.
7. Be concerned with the orientation, composition and continuity of the board, and perpetuate a sound board by regular elections and, when appropriate, filling interim vacancies.

8. Obtain sufficient information about proposals put before the board to enable an informed judgment to be made and acted on.
9. Obtain and review information from outside sources, which deal not only with the organization but also with other nonprofit corporations with business and activities in related areas.

Finally, in addition to the foregoing, individual directors should be satisfied that the board, as a whole, adheres to the following guidelines:

1. Ensures that there are no improper distributions of cash or other property to officers, directors or members.
2. Approves important financial and business policy decisions of the organization and ensures that annual and interim reports are filed as required by law.
3. Participates in establishing the basic objectives and broad policies of the organization and ensures that these objectives are being met and the policies are being maintained.
4. Selects the president of the organization, approves his or her actions when appropriate and provides for the audit of his or her performance.
5. Delegates the power to sign contracts, open bank accounts, sign checks and engage in other activities as may be required in the course of the organization's activities.
6. Ensures that an effective system for reporting to the board on present and future developments is established and maintained.
7. Ensures that a written record of each board meeting is kept, distributed in a timely fashion and ratified at the following meeting.
8. Exercises oversight with regard to the management of employee benefit plans.

III. ATTENDANCE AT MEETINGS, TRANSACTIONS WITH THE ORGANIZATION, AND PUBLIC STATEMENTS

A. Attendance at Meetings

The primary obligation of board members is to attend and participate in the meetings of the board. Directors who are unable to attend meetings of the board should explain their absence in a letter addressed to the president or secretary. Some boards adopt a policy which provides that if a director is absent from a certain number of consecutive regular meetings for reasons which the board finds to be insufficient, the director's resignation shall be deemed to have been tendered and accepted.

Agenda materials should be sent to directors at in advance of each meeting with sufficient time for the directors to read and reflect on the material presented. Directors should study the agenda materials and be prepared to act in what they see as the best interest of the organization.

B. Transactions with the organization and Conflicts of Interest

Since a director is a fiduciary and must act for the benefit of the organization, not for personal gain, a director normally should not have any personal interest in transactions of the organization. Because of this, most boards adopt a conflict of interest policy. Directors should be asked each year to review and sign a copy of the Conflict of Interest Policy.

A director must exercise care not to preempt corporate opportunities. A director will be in breach of his or her duties to the organization if he or she "misappropriates" for personal use or gain any opportunity that should have been utilized by the organization. This includes misappropriating an opportunity for another organization. Whether an opportunity is the organization's or is within the legitimate scope of the director's individual interests depends upon all of the facts and circumstances. An opportunity should not be used by a director if the organization has a right to or interest in the opportunity as would be the case where the funds, personnel or facilities of the organization have been used to develop a particular opportunity. A director who is unsure whether a corporate opportunity is being appropriated for personal use should consult with the chair or the organization's legal counsel and, if necessary, seek a board resolution determining that the organization has no interest in the opportunity before proceeding to use it.

Though it would be an unusual situation, an organization may from time to time, because of different financial interests and occupations of directors, want to engage in a transaction with a director or with an organization in which a director has a direct or indirect financial interest. Such transactions are not illegal, but they present various legal problems and should be thoroughly reviewed in advance with the organization's legal counsel.

C. Public Statements

The complexities of modern public relations, the complex interrelationships of various issues, and the importance of consistent policy expression suggest that, whenever possible, directors should contact the president before making any public statements as a director of the organization. Typically board members are not authorized to make public statements on behalf of the organization. Board members should be mindful that when they are a member of a board, what they may consider to be their personal comments will, if made publicly, most likely be attributed to the organization.

IV. A DIRECTOR'S LIABILITY

A director who behaves fairly and honorably and who, acting in good faith, is diligent in discharging his or her duties is not likely to be subjected to personal liability. Courts recognize

that business judgment inevitably involves risk evaluation and that directors are not normally committed to full-time involvement in the affairs of the organization. Courts further recognize that directors must make important decisions which, in retrospect, may prove to be erroneous. If it turns out the decision of the board was a mistake, the question of whether or not the directors have been careless is decided in terms of the facts as they were or reasonably appeared to be when the decision was made and not in terms of 20-20 hindsight.

Directors are generally protected from honest mistakes if they (1) exercised their good-faith judgement without carelessness, (2) acted within the power granted to the organization by state law and the organization's articles of incorporation and bylaws, and (3) executed such judgment after due consideration of what they reasonably believed to be the relevant facts. If, however, a director violates his or her duty of loyalty to the organization, a court may hold the director responsible for such willful neglect.

A director who votes for or concurs in an improper action of the board of directors may be jointly (with the other directors) and severally (individually) liable. Making sure that the written record indicates good faith is one method of protection. When a matter in which any doubt regarding personal conduct of a director may arise, a director should insist that his or her views and acts be reflected in the minutes.

The absence of a director at a board meeting usually does not excuse the director from personal liability for actions taken at the meeting. If the director is absent from a board meeting, he or she is responsible for obtaining the minutes of the meeting, and if he or she objects to any action taken, promptly dissent, preferably in writing, to the entire board. If this is not done, the director may be deemed to have acquiesced in the action.

V. RIGHT TO INDEMNIFICATION

The bylaws of the organization sometimes authorize the organization, under certain circumstances, to indemnify its officers and directors for costs and expenses incurred by them as a result of legal proceedings brought by a third party. The right to indemnification is governed by statute, however, and the organization may indemnify its officers and directors only to the extent permitted by the state law. A bylaw or agreement which extends this right is unenforceable. In the absence of any right to indemnification in the organization's bylaws or an agreement entered into between the organization and each board member, a board member's right to indemnification is dependent on state law.

Many organizations also maintain a fairly broad coverage association professional liability insurance policy that includes directors and officers liability coverage. Board members may also want to consult with their personal insurance agent to see if a homeowner's umbrella liability policy provides any coverage for their actions as a nonprofit board member.

VI. CONCLUSION

Increased regulation of nonprofit organizations at the state and federal level and increased media attention to the failures and poor choices made by a few boards in recent years have raised the stakes for all nonprofit board members. Those who understand what is expected of them will improve their chances for success and the likelihood that their board service will be a valuable and rewarding experience.