LEE BRUDER ASSOCIATES

The Three Legal Responsibilities of a Nonprofit Board of Directors[1]

The standard of care has moved away from fiduciary (trustee) care to that of providing oversight of an on-going business entity. Case law precedent has made the responsibilities of being on a nonprofit board essentially the same as being on a corporate board of directors.

The corporate standard is:

One serves "in good faith,"
Acts with prudent care and,
In the best interest of the organization

This standard protects against decisions deemed, through hindsight, to be poor decisions.

Common law brings to us three areas of legal responsibility of nonprofit board members.

<u>The Duty of Care</u>

The duty of care describes the level of competence that is expected of a board member, and is commonly expressed as the duty of "care that an ordinarily prudent person would exercise in a like position and under similar circumstances." This means that a board member owes the duty to exercise reasonable care when he or she makes a decision as a steward of the organization. It does not mean that you have to be perfect or that you cannot make a mistake rather, that you have exercised reasonable caution in making decisions. Ways in which the duty of care may be exercised include:

- Be informed (the duty to learn about the organization, its vision, mission and initiatives; learn about the organization's programs; read materials.)

- Attend meetings and functions (a simple way of becoming and staying informed). A failure to attend in and of itself may be considered a failure to carry out one's fiduciary responsibilities. Meetings can be conducted in-person or through phone conference. The law hasn't caught up with technology so, the legality of Internet conferences is not clear in the law. Non-attendance may, or may not be protection against board of directors' wrongful action charges. It will, in part, depend on the individual judge/court. To be truly protected your objection should be recorded by a vote.

- Be familiar with the financial status of the organization (duty to be informed).

- Information flow - To cause the organization to create and offer reports that keep the Board of Directors informed in a timely and accurate manner.

- Make informed decisions. Did we seek out information? Did we ask questions and deliberate? Did I participate in discussions/deliberations?

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[1] Compiled from: 1.) *The Legal Obligations of Nonprofit Boards: A Guidebook for Board Members* by Jacqueline Covey Leifer and Michael Glomb; National Center for Nonprofit Boards, publishers. 2.) BoardSource, 3.) Presentation Drew Landry 1/19/06, Keene, NH

Supporting Elements:

- Reliance on others – allows for the fact that a board must rely on others for information. Examples include internal reports and financial statements, legal council, auditor, and committees of the board - as long as the information expected is within the purview of that committee.

  Note: Board committees are held to a heightened standard of care because of members' exposure to (and the expectation that members will possess) a more in-depth knowledge of a particular area of the organization's functioning.

- Business judgment rule is a standard that encourages businesses to be entrepreneurial versus clinging to the status quo. This standard supports the risk-taking that is necessary for growth and success. For example, review of fiduciary duty as it relates to management of investments focuses on the process (how the investments were managed) rather than the performance of the investments themselves.

Duty of Loyalty

The duty of loyalty is a standard of faithfulness; a board member must give undivided allegiance when making decisions affecting the organization. This means that a board member must never use information gained as a member of the board for personal gain, but must act in the best interests of the organization. It means putting one's personal and professional interests aside for the good of the organization. One good way of exercising duty of loyalty is having a conflict of interest policy in place.

Conflicts of interest policy should include:

- Immediate disclosure of even the appearance of a conflict
- Abstaining from a vote and from participating in the discussion; may go so far as removing self from the room while the topic is being discussed. However, it is permissible for the individual to offer factual information to the board.

Duty of Obedience

A basis for this rule lies in the public's trust that the organization will manage donated funds to fulfill the organization's mission. The duty of obedience requires board members to adhere to the organization's by-laws, to comply with state and federal laws, and to be faithful to the organization's mission. They are not permitted to act in a way that is inconsistent with the central goals of the organization.

New Thinking on Legal Duties

"In addition to the above three traditional duties, boards have an obligation to ensure that their organization is appropriately transparent in its operations. For most nonprofits, this entails the filing of IRS form 990 or 990-PF and other appropriate[2]" tax return information. Federal law requires this information be made available to the public.

Exercising this responsibility:

- File required documents on time with the appropriate agency
- Many nonprofits are posting these and other documents such as by-laws on their websites

[2] From Chuck V. Loring *Boards that Excel*, 8/6/ 2010, Boardsource presentation for the NH Center for Nonprofits