

What Duties Are Owed By Directors to a Not-For-Profit Organization?

Submitted By: Karla C. Steele, Attorney Califf & Harper, P.C.

As seen in the February 2011 Quad City Times Business Journal



It is estimated that more than 1,300 not-for-profit organizations exist in the Quad Cities alone. A common misperception is that a member of a not-for-profit organization's board of directors (a "director") is insulated from any personal liability due to the fact that the organization is incorporated. The truth, however, is that a director could be held personally liable if she violates her fiduciary duties. Directors have three primary fiduciary responsibilities – the duties of care, loyalty, and obedience.

First, a director owes the corporation a DUTY OF CARE, which requires the director to participate in the activities of governance, provide operational and policy oversight, and exercise a reasonable level of care when making decisions. A director must discharge duties (1) in good faith; (2) with the care that an ordinarily prudent person in a like position would exercise; and (3) in a manner the director believes to be in the best interests of the corporation.

Examples of activities furthering this duty include the following:

1. Participating in board and committee meetings;
2. Becoming familiar with the business and strategic plans and with the organization's purpose as stated to the IRS;
3. Reviewing the budget, fundraising results, and audited financial statements;
4. Raising questions to clarify facts and forming independent judgments about decisions to be made.

Directors are generally not liable for their decisions – even if later such decisions prove to be unwise – *so long as* those decisions were informed and made in good faith without any conflict of interest. A director may rely on information provided by the organization's staff, legal counsel, and other advisors, unless she has reason to believe the information is incorrect.

Second, a director owes the corporation a DUTY OF LOYALTY, which focuses on conflicts of interest, disclosure of conflicts, and confidentiality, and requires the director to place the interests of the organization above her own and above the interests of another organization with which she may be affiliated. Issues arise in many contexts, because many individuals serve on more than one board and are also employed by a separate corporation.

Examples of breach of this duty include the following:

- Voting on a matter in a way that benefits the director or another organization affiliated with her or her family member, or in which she or a family member has an interest, at the expense of the organization;
- Using information obtained as a director for personal benefit or for the benefit of third parties;
- Failing to disclose to the board all conflicts of interest and to abstain from voting.

Third, a director owes the corporation the DUTY OF OBEDIENCE, which requires the director to ensure the organization carries out its mission as defined in its governing documents and that the organization complies with applicable laws.

Examples of breach of this duty are the following:

- Failing to modify activities to comply with changes in laws
- Changing the organization's purpose or activities to those outside the scope authorized by the organization's documents or to those in violation of the law

Directors who breach this duty could cause the organization to lose its tax-exempt status if it operates in a way that is contrary to the purpose stated to the IRS or if it fails to serve the public good.

In conclusion, directors owe fiduciary duties to the corporation – mainly the duties of care, loyalty, and obedience. This article is intended to provide a general discussion of the main fiduciary duties but not intended to constitute individual advice on a specific issue. For specific advice, please contact an attorney.