

CLIENT ADVISORY:

FIDUCIARY DUTIES FOR THE BOARD MEMBER OF A NONPROFIT ORGANIZATION

In Rhode Island as in most jurisdictions, board members for nonprofit organizations have broad oversight authority and they have the ability to directly impact policies for governance, financial matters and the strategic planning of their organization. Board members must take this responsibility seriously in today's environment and they should fully understand the nature and scope of the duty before agreeing to serve on a board. As a fiduciary, a board member owes duties of care, loyalty and obedience when acting on the behalf of the organization.

(ii) Ordinary Prudence/Due Diligence - Ordinary prudence means that directors need only act with "common sense and informed judgment." Ordinary prudence does not require a director to have special skills to perform board duties. On the other hand, "diligence" requires that a director take an active interest in the organization's activities, which would necessarily involve a proactive approach to director obligations with oversight responsibility. Simply "rubber stamping" recommendations made by lower levels of management does not satisfy this requirement.

(iii) Best Interests of the Organization - A board member must constantly ask, "Is the decision made in the best interests of the organization?" It is permissible for a director of a nonprofit organization to rely upon the expertise of management and/or outside consultants; however, prudent care requires reasonable inquiry and that a director is well informed when considering and accepting the opinions of others. Those who may be relied upon in providing expertise and recommendations include officers or employees whom the director reasonably believes to be reliable and competent in the matters presented. Advice from legal counsel, accountants or outside consultants may also be relied on provided that the director reasonably believes such advice falls within the attorney, accountant or consultant's professional or expert competence.

It should be noted that board members are afforded some protections as the result of volunteer protection statutes and the common law "business judgment rule." The business judgment rule has evolved over the years through judicial decisions reviewing the business judgments of board members of for-profit and nonprofit corporations alike. The rule creates a rebuttable presumption that the decisions made by a board or its member constituents were in the best interest of that board member's organization. The policy and rationale behind this rule is that boards function best when informed decisions are not continually disrupted by judicial scrutiny, except of course, in cases of egregious board misconduct.



Duty of Care

The duty of care requires that directors discharge their duties: (a) in good faith; (b) with the care of an ordinarily prudent person in a like position would exercise; and (c) with a reasonable belief that the action to be taken is in the best interests of the organization.

(i) Good Faith - The good faith requirement demands honesty and fair dealing and is measured by reviewing objective facts and circumstances.

Duty of Loyalty

The duty of loyalty requires that actions taken by a board member further the organization's goals over personal interests. This duty prohibits a board member from using his or her position, or information gained from occupying such a position, to secure a personal pecuniary benefit. Statutes addressing board member conflicts of interest are also a testament to the importance of fiduciary loyalty. Contracts made on behalf of a nonprofit corporation where a voting board member has a financial interest may be voidable or void. Similarly, at the federal level, the Internal Revenue Service may statutorily issue sanctions in certain transactions between nonprofit organizations and a "disqualified person."

The Internal Revenue Code defines a disqualified person as one who is or was in a position to exercise substantial influence over the affairs of the organization at any time during the five years preceding the transaction. This of course, may include, among others, past or current officers, directors, trustees, highly compensated and/or high level employees, department or project managers, major donors and vendors.

Perhaps one of the best ways to promote board member fulfillment of the fiduciary duty of loyalty is the adoption by a nonprofit of a thoughtful, carefully articulated conflict of interest policy which enumerates (at a minimum):

To whom the policy refers;

- (i) Determinations regarding conflicts;
- (ii) Scope of the activities to be covered;
- (iii) How the policy will be enforced;
- (iv) Training programs for board members, management and staff; and
- (v) Policy review periods.

A successful conflict of interest policy will be specifically tailored to the specific nature of the nonprofit organization and should serve as a guide to be reviewed annually and enforced uniformly.

Duty of Obedience

A third fiduciary duty owed by board members is that of the duty of obedience which requires the board member to comply with both state and federal laws when acting as

a board member. As a practical matter this calls for board member compliance with, among other things, tax, civil rights, and non-discrimination and employment laws. While this certainly does not mean that board members must have a law degree and be an active member of their state's bar, it does suggest that board members should exercise good judgment (duty of care) and seek professional advice when needed.

It may require that a board adopt policies and protocol to ensure legal compliance. The duty of obedience also requires that board members work under and within the confines of their nonprofit's Articles of Incorporation and Bylaws, taking care not to commit or take part in any ultra vires acts. This means that board members must always work towards the mission of their nonprofit and never outside the scope of the organizations powers.

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**GARY R.
PANNONE**
Managing Partner

Gary R. Pannone is the Managing Partner of Pannone Lopes Devereaux & West LLC and has been representing closely held business owners for thirty years. He is an experienced business lawyer specializing in the areas of business formations, corporate restructuring, mergers, acquisitions, corporate compliance and health care. His practice includes the representation of nonprofit organizations with respect to consolidations, mergers and acquisitions.



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PANNONE LOPES DEVEREAUX & WEST LLC

counselors at law