

## **DUTIES AND RIGHTS OF DIRECTORS AND OFFICERS OF NON-PROFIT CORPORATIONS**

### A. Duties of Directors and Officers to the Organization

Although directors and officers of non-profit corporations historically have been referred to as “trustees” and were subjected to a fiduciary standard of care, case law and statute over the last twenty years have clarified that the standard of care applicable to directors and officers of non-profit corporations is closer to the standard applied to directors and officers of for-profit corporations. Accord, Stern v. Lucy National Training School, 381 F.Supp. 1003(D.D.C. 1974). Thus, while case law often refers to directors and officers of non-profit corporations as serving in a fiduciary capacity with respect to the corporation and its members, the fiduciary obligations imposed on directors and officers essentially fall into the two broad categories that are applicable to directors and officers of for-profit corporations - the duty of loyalty and the duty of care. See generally, American Bar Association Section of Business Law, Guidebook for Directors of Nonprofit Corporations (1993).

#### *1. Duty of Loyalty.*

a. “By assuming his office, the corporate director commits allegiance to the enterprise and acknowledges that the best interest of the corporation and its shareholders must prevail over any individual interest of his own. The basic principle to be observed is that the director shall not use his corporation position to make a personal profit or gain other personal . . . .” American Bar Association Committee on Corporate Law, The Corporate Director’s Guidebook, 33 Bus. Law. 1591, 1599-1600, (1978).

b. Directors are said to be fiduciaries of the corporation. Smith v. Van Gorkom, 488 A.2d 858, 872 (Del. 1985). Courts

have recognized, however, that “if directors were held to the same standard as ordinary fiduciaries, the corporation could not conduct business.” Panter v. Marshall Field & Co., 646 F.2d 271, 294 (7<sup>th</sup> Cir.), cert. denied, 454 U.S. 1092 (1981).

A director may not have any personal interest in the challenged decision. A director cannot “appear on both sides of the transaction nor expect to derive any personal financial benefit from it in the sense of self-dealing, as opposed to a benefit which devolves upon the corporation or all stockholders generally.” Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984). If a plaintiff establishes that a director had such personal interest, the director must demonstrate that the transaction was to the corporation, unless the material facts of the transaction and the director’s interest were disclosed or know and property approved, authorized or ratified.

c. Examples of breach of the duty of loyalty (conflicts of interest and self-dealing):

- 1) Breaching confidentiality.
- 2) Competing with corporation. Guth v. Loft, Inc., 5 A.2d 503 (Del. 1939).
- 3) Appropriating corporate opportunity. Mile-O-Mo Fishing Club, Inc. v. Noble, 62 Ill.App.2d 50, 210 N.E. 2d 12 (1965).
- 4) Conflicts of interest. Romanik v. Lurie Home Supply Center, Inc. 105 Ill. App.3d 1118, 435 N.E. 2d 712 (1982). Globe Woolen v. Utica Gas & Elec., 121 N.E. 378 (N.Y. 1918).
- 5) Corporation lends money to a director or a director’s affiliate.

6) Improper payments, gratuities.

*2. Duty of Care.*

a. “In addition to owing a duty of loyalty to the corporation, the corporate director also assumes a duty to act carefully in fulfilling the important task of monitoring and directing the activities of corporate management.” American Bar Association Committee on Corporate Laws, The Corporate Director’s Guidebook, 33 Bus. Law. 1591, 1599-1600 (1978).

b. Standard of Care

1) Some states have a statutory formulation.

2) Common Law: Generally described as “the same degree of care and prudence that men prompted by self-interest generally exercise in their own affairs.” Hun v. Cary, 82 N.Y. 222, 223 (1880); Litwin v. Allen, 25 N.Y.S.2d 667 (1940).

3) Model Act: The Revised Model Non-Profit Corporation Act provides that a director should discharge duties in good faith, with the care an ordinarily prudent person in a like position would exercise in similar circumstances, and in a manner reasonably believed to be in the corporation’s best interests.

c. Duty of Care includes duty of attention, which requires the directors to:

1) Attend meetings.

2) Review adequate information concerning action taken by the Board.

- 3) Generally oversee the corporation's business.
- 4) Adopt and prescribe major policies. Bates v. Dresser, 251 U.S. 524, 64 L.ED. 388, 40 S.Ct. 247 (1920); Graham v. Allis-Chalmers Mfg. Co., 188 A.2d 125 (Del. 1963).

d. Application of the "Business Judgment Rule"

- 1) The Business Judgment Rule encourages and protects deliberative decisions that are:
  - a) informed and made on the basis of reasonable inquiry;
  - b) made in good faith and without a disabling conflict of interest; and
  - c) made on a rational basis.
- 2) Application of the Rule presumes that judgment has been exercised. Thus, the Rule "has no role where directors have either abdicated their functions, or absent a conscious decision failed to act." Aronson v. Lewis, 473 A.2d at 813.
- 3) The Rule does not apply to cases involving a conflict of interest. Alison v. General Motors Corp., 604 F. Supp. 106 (D. Del. 1985).
- 4) The Rule applies only to informed decisions; directors must inform themselves of all information reasonably available to them and relevant to their decision. Smith v. Vank Gorkom, 488 A.2d at 872-75. The proper standard for determining whether a business judgment was informed is gross negligence. Id.; see also, Treco, Inc. v. Land of Lincoln Savings and Loan, 749 F.2d 374 (7<sup>th</sup> Cir.

1984); Panter v. Marshall Field & Co., 646 F2d 271 (7<sup>th</sup> Cir.) cert. denied, 454 U.S. 1092 (1982).

3. *State law Statutory duties to the Organization or its creditors:*

- a. Organization activities: adopt bylaws, adopt corporate policies regard personnel, etc.
- b. Ongoing activities: adopt budgets, select officers; review corporate personnel, etc.
- c. Permissible distributions prior to dissolution.
- d. Creditors of a dissolved corporation; claims can be barred with proper notice.
- e. Doing business after dissolution: directors can be liable to creditors.

B. Duties of Directors and Officers to Members

Generally, a Director or Officer does not face liability to members of a non-profit organization, provided the above duties are fulfilled. This is because generally a non-profit member does not have a financial interest in the organization. While a member might, under unusual circumstances claim a derivative status to sue on behalf of the organization, this is a rare case. A director who faithfully performs his or her duty to the organization has little or no personal exposure to members.