Legal Duties of Nonprofit Board Members

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Nonprofit officers, directors, committee members, and others involved in the nonprofit's governance structure are often unclear as to their roles and responsibilities. And for good reason – some rights and obligations are determined by law, others by the nonprofit's articles of incorporation and bylaws, and still others by written policies and procedures or more informal arrangements. This article is designed to clarify the delegation of duties, explain the fiduciary duties imposed by law on nonprofit officers and directors, and suggest ways to protect volunteer leaders from personal liability.

Roles and Responsibilities.

The *board of directors* is the governing body of the nonprofit, responsible for the ultimate direction of the management of the affairs of the organization. The board is responsible for *policymaking*, while employees (and to a certain extent, officers) are responsible for executing *day-to-day management* to implement board-made policy. However, the ultimate legal responsibility for the actions (and inactions) of the nonprofit rests with the board. (Note that the term "directors" is synonymous with "board members.")

The board can act legally only by consensus (majority vote of a quorum in most cases) and only at a *duly constituted and conducted meeting*, or by *unanimous written consent* (in

most states, boards cannot act by mail or electronic ballot). The board may delegate authority to act on its behalf to others such as committees, but, in such cases, the board is still legally responsible for any actions taken by the committees or persons to whom it delegates authority. An *individual* board member has no individual management authority simply by virtue of being a member of the board. However, the board may delegate additional authority to a board member such as when it appoints board members to committees. In a similar fashion, an *officer* has only the management authority specifically delegated in the bylaws or by the board (although the delegated authority can be general and broad).

Committees have no management authority except for that delegated to them by the bylaws or by the board. Note that most state nonprofit corporation law delineate between *committees of the board* (which usually need to be comprised solely of board members and which can exercise the board's fiduciary authority) and *other committees* (which do not need to be comprised solely of board members but which cannot exercise the board's fiduciary authority). Furthermore, even for committees of the board, under most state nonprofit corporation statutes, certain functions may not be delegated by the board to committees. For example, in many states, the board may not delegate to committees the power to elect officers, fill vacancies on the board or any of its committees, amend the bylaws, or approve a plan of merger, consolidation or dissolution, or a substantial transfer of assets.

Employees have no management authority except that specifically delegated to them in the bylaws or by the board. For example, most nonprofits' bylaws delegate to the chief staff executive the responsibility for the day-to-day operations of the nonprofit's office(s), including the responsibility to hire, train, supervise, and terminate the professional staff of the nonprofit, as well as the responsibility for all staffing and salary administration within guidelines established by the board.

Members (where the nonprofit corporation has members) have no management authority, as such authority is held by the board of directors. However, state nonprofit corporation laws generally reserve to members the right to approve certain major corporate transactions, such as mergers, consolidations, dissolutions, and substantial transfers of assets, as well as the authority to amend the nonprofit's articles of incorporation. If members elect board members, many state statutes reserve the right to remove such directors to the members that elected them. Under some nonprofits' bylaws, certain matters, such as the amendment of the bylaws or the election of officers and directors, must be submitted to the membership for a vote. However, most other matters generally are not submitted to the full membership, but rather are handled by the board, one or more

of its committees, or the officers or employees of the nonprofit. Any rights not allocated to the members or others by statute or the nonprofit's governing documents default to the board.

Fiduciary Duty.

Those in positions of responsibility and authority in the governance structure of a nonprofit – both volunteers who serve without compensation and employed staff – owe fiduciary duties to the organization, including duties of care, loyalty and obedience. In short, this means they are required to act *reasonably, prudently and in the best interests of the organization*, to a*void negligence and fraud*, and to *avoid conflicts of interest*. In the event that the fiduciary duties of care, loyalty or obedience are breached, the individual breaching the duty is potentially liable to the nonprofit for any damages caused to the nonprofit as a result of the breach. This fiduciary duty is a duty to the nonprofit as a whole; even those who only serve on a particular committee or task force owe the fiduciary obligation to the entire nonprofit. Breaches of fiduciary duties also can be enforced by the state Attorney General of the nonprofit's state of incorporation.

1. Duty of Care. This duty is very broad, requiring officers and directors to exercise *ordinary and reasonable care* in the performance of their duties, exhibiting honesty and good faith. Officers and directors must act in a manner which they believe to be *in the best interests of the nonprofit*, and with such care, including reasonable inquiry, as an ordinarily prudent person in a like position would use under similar circumstances. The "business judgement rule" protects officers and directors from personal liability for actions made in poor judgment as long as there is a reasonable basis to indicate that the action was undertaken with due care and in good faith.

2. Duty of Loyalty. This is a duty of faithfulness to the nonprofit. This means that officers and directors must give undivided allegiance to the nonprofit when making decisions affecting the nonprofit. In other words, officers and directors cannot put personal interests above the interests of the nonprofit. Personal interests may include outside business, professional or financial interests, interests arising from involvement in other organizations, and the interests of family members, among others. Officers and directors should be careful to disclose even potential conflicts of interest to the board of directors, and should recuse themselves from deliberation and voting on matters in which they have personal interests. For pervasive and continuing conflicts – such as a director of the nonprofit concurrently serving on the board of a competing nonprofit – resignation from the individual's nonprofit leadership post or from the outside conflicting responsibility may be required. Officers and directors can have business dealings with the nonprofit, but such

transactions must be subject to considerable scrutiny. In such event, officers and directors must fully disclose any personal interests to the board of directors, the terms of any transaction must be fair to the nonprofit, and the transaction must be approved by the disinterested members of the Board. In addition, state nonprofit corporation statutes frequently provide specific procedures for dealing with transactions in which officers or directors have conflicts of interest. Finally, the duty of loyalty imposes an obligation to protect any confidential information obtained while serving the nonprofit.

Corporate Opportunities Doctrine. The duty of loyalty specifically prohibits competition by a nonprofit officer or director with the nonprofit itself. While officers and directors generally may engage in the same "line of business" or areas of endeavor as the nonprofit, it must be done in good faith and without injury to the nonprofit. One form of competition that is not permitted, however, is appropriating "corporate opportunities." A corporate opportunity is a prospect, idea or investment that is related to the activities or programs of the nonprofit and that the individual knows, or should know, may be in the best interests of the nonprofit to accept or pursue. A nonprofit officer or director may take advantage of a corporate opportunity independently of the nonprofit *only* after it has been offered to, and rejected by, the nonprofit.

3. Duty of Obedience. This duty requires officers and directors to act in accordance with the organization's articles of incorporation, bylaws, policies, and other governing documents – including the mission and purposes of the organization expressed in those documents – as well as all applicable laws and regulations.

Reliance on experts. Unless an officer or director has knowledge that makes reliance unwarranted, an officer or director, in performing his or her duties to the organization, may rely on written or oral information, opinions, reports, or statements prepared or presented by: (i) officers or employees of the nonprofit whom the officer or director believes in good faith to be reliable and competent in the matters presented; (ii) legal counsel, public accountants, or other persons as to matters which the officer or director believes in good faith to be within the person's professional or expert competence; or (iii) in the case of reliance by directors, a committee of the board on which the director does not serve if the director believes in good faith that the committee merits confidence.

Willful ignorance and intentional wrongdoing. Directors cannot remain willfully ignorant of the affairs of the nonprofit. A director appointed as treasurer, for example, with limited knowledge of finance cannot simply rely on the representations and reports of staff or auditors that "all is well" with the nonprofit's finances. Moreover, officers and directors acting *outside of or abusing* their authority as officers and directors may be subject to

personal liability arising from such actions. Furthermore, officers or directors who, in the course of the nonprofit's work, *intentionally* cause injury or damage to persons or property may be personally liable, even though the activity was carried out on behalf of the nonprofit.

Reducing Personal Liability Risk.

Nonprofit officers and directors can help minimize their risk of personal liability by doing the following:

- Being thoroughly and completely prepared before making decisions.
- Becoming actively involved in deliberations during board meetings, commenting as appropriate, and making inquiries and asking questions where prudent and when such a need is indicated by the circumstances.
- Making decisions deliberately and without undue haste or pressure.
- Where there are dissenting votes or abstentions, insisting that meeting minutes accurately reflect such votes on actions taken at meetings.
- Requesting that legal consultation be sought on any matter that has unclear legal ramifications.
- Requesting that the nonprofit's accountants assess and evaluate any matter that has significant financial ramifications.
- Obtaining and carefully reviewing both audited and unaudited periodic financial reports of the nonprofit.
- Attending the nonprofit's meetings and reading the nonprofit's publications carefully to keep fully apprised of the organization's policies and activities.
- Reviewing from time to time the nonprofit's articles of incorporation, bylaws, policies, and other governing documents.
- Avoiding completely any conflicts of interest that may be harmful to the organization and fully disclosing any potential conflicts at the outset.

Liability Protection.

If preventive risk management fails, the liability of nonprofit officers and directors often can be limited – but not fully eliminated – through indemnification by the nonprofit, directors and officers liability insurance purchased by the nonprofit, and federal and state volunteer protection laws.

Apparent Authority.

In the landmark 1982 case, *American Society of Mechanical Engineers v. Hydrolevel*, the U.S. Supreme Court determined that a nonprofit can be held liable for the actions of its officers, directors and other volunteers (including actions which bind the nonprofit financially), even when the nonprofit does not know about, approve of, or benefit from those actions, as long as the volunteer reasonably *appears* to outsiders to be acting with the nonprofit's approval (i.e., with its "apparent authority"). The U.S. Supreme Court made clear that nonprofits are to be held strictly liable for the activities of volunteers that have even the apparent authority of the nonprofit. Even if a nonprofit volunteer does not, in fact, have authority to act in a particular manner on behalf of the nonprofit, the law will nevertheless hold the nonprofit liable if third parties reasonably *believe* that the volunteer had such authority. The law thus requires a nonprofit to take reasonable steps to ensure that the scope of its agents' (e.g., officers, directors and committee members') authority is clear to third parties, and that agents are not able to hold themselves out to third parties as having authority beyond that which has been vested in them by the nonprofit – for example, by being permitted to use an email address being able to utilize an email address containing the nonprofit's domain, having business cards from the nonprofit, or having access to nonprofit's letterhead

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Calif Legislative Information Corp. Code - Corp
On Atty General's 8215
Website

CORPORATIONS CODE - CORP

TITLE 1. CORPORATIONS [100 - 14631] *(Title 1 enacted by Stats. 1947, Ch. 1038.)*

DIVISION 2. NONPROFIT CORPORATION LAW [5000 - 10841] *(Heading of Division 2 amended by Stats. 1978, Ch. 567.)*

PART 3. NONPROFIT MUTUAL BENEFIT CORPORATIONS [7110 - 8910] *(Part 3 added by Stats. 1978, Ch. 567.)*

CHAPTER 12. Required Filings by Corporation or Its Agent [8210 - 8217] *(Chapter 12 added by Stats. 1978, Ch. 567.)*

8215. Any officers, directors, employees or agents of a corporation who do any of the following are liable jointly and severally for all the damages resulting therefrom to the corporation or any person injured thereby who relied thereupon or to both:

(a) Make, issue, deliver or publish any prospectus, report, circular, certificate, financial statement, balance sheet, public notice or document respecting the corporation or its memberships, assets, liabilities, capital, dividends, business, earnings or accounts which is false in any material respect, knowing it to be false, or participate in the making, issuance, delivery or publication thereof with knowledge that the same is false in a material respect.

(b) Make or cause to be made in the books, minutes, records or accounts of a corporation any entry which is false in any material particular knowing such entry is false.

(c) Remove, erase, alter or cancel any entry in any books or records of the corporation, with intent to deceive.

(Added by Stats. 1978, Ch. 567.)

Let The Good Deed Go Unpunished: Avoiding Nonprofit Board Liability

By Zachary S. Kester, Executive Director and Robert Miller, Program Officer, Charitable Allies

Savvy businesspeople know that the best way to protect personal interests from liability is through incorporating their for-profit business. Incorporating offers many of the same protections for nonprofit organizations.

However, errors and omissions of the Board of Directors ("Board") or Officers can still leave a risk of liability to both the nonprofit and its individual Directors, or Officers. Nonprofit Directors are passionate about causes and serving the community, but they often lack the required knowledge to understand their obligations under the law. Such Directors are doing a good deed by volunteering to sit on the Board; but the consequences of inattention can "punish" their otherwise "good deeds."

Understanding Board Responsibilities

The Directors failure to fully understand the law and risks associated with failing to act in accordance with their responsibilities as a Director could leave the nonprofit and its Directors open to liability.

Directors of nonprofit corporations are fiduciaries, meaning they hold positions that require trust, confidence, the and exercise of good faith and candor. They also have a duty to act for the benefit of others in connection with their undertakings for the nonprofit organization. Specifically, Directors can be held personally liable based on three fiduciary duties: the duty of care, the duty of loyalty, and the duty of obedience. Unfortunately, many board members seem to be unaware of their fiduciary responsibilities for the organization for which they volunteer. Fortunately, however, Directors can only be held responsible for breaches of fiduciary duties if the breach is due to recklessness or willful misconduct.

The Duty of Care

The duty of care requires a Director to exercise the same care that an ordinary, prudent person would exercise under similar circumstances. Generally, this duty is also understood to include informed decision-making and attentiveness. Informed decision-making means knowing the law and the corresponding requirements for the nonprofit organization, keeping tabs on its daily activities, and then, basing decisions on that knowledge. Devoting the necessary attention to the organization requires the Directors to act in a competent manner and spend the time required to care for the organization as needed.

...the Board must ensure that it is regularly reviewing the articles and bylaws and updating them as necessary...

One major way that the duty of care is violated is by the Board's failure to keep all of the nonprofit's documents, i.e. the articles of incorporation/organization and the bylaws, updated and current. This means that the Board must ensure that it is regularly reviewing the

Location *

City

State

What service are you looking for? *

Nonprofit Start...

Can you answer the "who, what, when, where, and how" of your charitable program in order to adequately complete the form required by the IRS? *

○ **Not yet**

○ **Yes, I can answer these**

What can we help with? *

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articles and bylaws and updating them as necessary to keep up with the current workings of the organization.

The biggest trap for duty of care violations though, often relates to employment practices. Of the nonprofit organizations who filed a claim on their D&O insurance in the last 10 years, over 85 percent of those claims were employment related, and some sources estimate it to be even as high as 94 percent!

The Duty of Loyalty

The duty of loyalty requires Directors to act in good faith and pursue an organization's best interests. This includes full disclosure of any issues that could cause, or be perceived to cause, a conflict of interest and recusing oneself from all discussions, both formal and informal, related to such conflict. It also requires Directors not to take opportunities away from the nonprofit for their own personal gain and to protect the organization's confidential information.

The biggest issue with this duty is conflict of interest transactions. However, that does not mean that a Director is in violation of this duty when they act in a way that benefits themselves so long as it also appropriately benefits the nonprofit. Additionally, a breach of this duty in this way can be avoided by showing approval of a majority of the disinterested Directors or showing that the transaction was inherently fair.

The Duty of Obedience

Lastly, the duty of obedience forbids acts outside the scope of the organization's rules, policies, mission statement, articles of incorporation, and bylaws. In addition, the Board must comply with state and federal laws. Directors are supposed to follow the rules of the organization as laid out in the various corporate documents as well as the state and federal laws applicable, but sometimes that is easier said than done. In part this is due to the sheer number and complicated nature of the potential applicable rules, a few of which are discussed in more detail below.

One major issue with the duty of obedience is ensuring that the funds of the nonprofit are used to fulfill the organization's stated mission, which can include paying rent, employees' salaries, or executing the program to serve the community. If they are not used in that way, then there is a risk that the nonprofit might lose its tax-exempt status.

Another common issue is the Board's failure to abide by its own articles or bylaws. Directors must be sure to become familiar with the rules of the organization itself and follow them whenever applicable. Failing to follow the articles or bylaws of the organization can lead to consequences for the organization itself and its board members.

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There are two specific laws with which most Directors should be familiar that are described in more detail directly below.

Understanding Board Responsibilities: Volunteer Protection Act of 1997

In addition to the above general fiduciary responsibilities, the Board is also subject to special laws that govern their actions. The Volunteer Protection Act of 1997 (VPA) covers all 501(c)(3) organizations and their volunteers (including uncompensated directors) from liability, unless there is willful or criminal misconduct, gross negligence, or reckless conduct. Where reckless conduct has been described as an intentional act done with reckless disregard of the natural and probable consequence of injury to a known person under the circumstances or, alternatively, as an omission or failure to act when the actor has actual knowledge of the natural and probable consequence of injury and his opportunity to avoid the risk. Notably, the "reckless" standard is the same as in most states' Nonprofit Corporations Acts.

Even though the Act provides some protection for the nonprofit organizations and their volunteers, it does require Directors to make sure their organization stays compliant with IRS guidelines and maintains its tax-exempt status.

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Easily done, right? Yet one of the most common pitfalls for nonprofits is failure to file a Form 990 in a timely manner. That misstep, if occurring for three consecutive years, leads to auto-revocation of a nonprofit organization's tax-exempt status – and potential loss of protection under the Volunteer Protection Act. Any number of other acts or omission can constitute recklessness as well.

Understanding Board Responsibilities: Uniform Prudent Management of Institutional Funds Act

Additionally, many nonprofit organizations and their Boards are subject to the UPMIFA, or the Uniform Prudent Management of Institutional Funds Act. The UPMIFA provides guidance on investment decisions and endowment expenditures for nonprofit and charitable organizations.

According to the McGuireWoods Nonprofit & Tax-Exempt Organizations Group, this legislation adds to the standard of care required to be exercised by the Directors when dealing with investment issues. Under this law, nonprofit Directors must consider the whole investment portfolio, the economic circumstances at the time, the organization's charitable purposes, and the charitable purposes of the fund, if applicable. Additionally, it requires a Board to exercise prudence in cost management by allowing only appropriate and reasonable costs, to investigate the information it uses to make investment decisions, and it requires any Director with special skills or

expertise to use such skills or expertise in making investment decisions.

Overall, nonprofit Directors have a number of responsibilities with regards to their fiduciary duties to the nonprofit. These duties include the duties of care, loyalty, and obedience. Additionally, Directors must be cognizant of any special laws and regulations that pertain to nonprofits generally or to nonprofits in their industry specifically, and require them to act in some way to prevent liability.

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Minimizing Potential Liability

So how can nonprofits properly deal with potential liability issues involving their Board?

Board Member Education

While educating your Directors about their roles and responsibilities, good governance, and any other issues relevant to the Directors along with ensuring to the best of your ability that you choose the right Directors can help a great deal in decreasing personal liability for the Directors. There will however still be a risk that a Director or the Board as a whole will violate one of their fiduciary duties and incur liability. Therefore, it is important to obtain liability insurance to cover those times when violations do occur. But this is not as simple as it sounds.

Liability Insurance

Insurance certainly is a necessary and prudent part of risk management for a nonprofit organization and this includes an

appropriately-sized D&O liability policy.

Essentially, there are three types of insurance that nonprofits need to be aware of when making their decision: (1) A-side, which covers claims for direct payments to a director for defense costs and liability damages if directors do not have indemnification rights or indemnification is useless due to financial condition of nonprofit; (2) B-side, which reimburses the nonprofit for indemnity payouts to directors and officers; and (3) C-side, which covers the organization itself for wrongful acts.

However, when choosing policies and insurance carriers, beware of common exclusions that might affect your organization. Common exclusions that we have encountered include: (1) an organization, its Officers, and/or Directors may not make a claim on its own policy (which is unlike auto insurance, for example); (2) employment practices are excluded and generally require a separate rider; (3) exclusions for damages incurred under a written contract (such as breaches of leases or liability for nonpayment of certain creditors where the liability was incurred as a result of a written contract); (4) claims for breached duty of loyalty (i.e., conflict of interest or self-dealing transactions); (5) taxes and penalties; (6) intentional conduct of Directors or Officers; (7) environmental claims; and (8) intellectual property-related damages. Before finalizing your insurance purchase, ask your insurance agent to assess your policy for these exclusions and "plug the holes" for you where possible.

According to Travelers, nearly twice as many D&O claims are made on insurance policies by nonprofit organizations as are made by their public or private counterparts. And in a recent study, up to 63 percent of nonprofit organizations reported a D&O claim in the past 10 years.

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Additionally, insurance companies are going to

look closely at your Board's practices before agreeing to cover the organization. Therefore, if your organization's tax-exempt status has been revoked, the insurance company finds that the Board has not followed best practices and policies in its operation and oversight of the nonprofit, or the organization was less than forthright on its D&O insurance application, then that insurance policy may not be much more than an expensive piece of paper. So, not only is insurance a way to deal with potential Director liability, but it can also be affected by your Directors' failure to fulfill their responsibilities.

In the end, attaining insurance for your nonprofit is important, but it will not be able solve all of the problems with Director and/or Board liability, especially if the insurance company decides not to pay on the claim. It is important that you and your Board understand all of the responsibilities and duties that a Board has in order to ensure that you comply with them to the best of your ability.

Overall, Director and/or Board liability can be a major issue for nonprofits which might require legal help to resolve, so do not let your good deed be punished by failing to exercise the appropriate care and caution with your nonprofit's Board in the same way you did with all other aspects of bringing your nonprofit organization to life.

*Attorney **Zac Kester** provides generalist and strategic nonprofit legal and consulting services. He holds a Master of Laws, a post-law school advanced degree, in which he studied the unique needs of tax-exempt nonprofit organizations. His legal and consulting career has focused on nonprofit organizations.*

With highly experienced legal and training personnel, Charitable Allies provides all manner of legal and educational services for boards, officers, management and staff of myriad charities throughout the sector. From basic one-time questions about a single matter to training for boards and officers to complex reorganization or merger of

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alteration or removal of records may result in an enforcement action by the Attorney General or a district attorney.[15]

OFFICERS' DUTIES

As indicated above, officers sometimes are not members of the board of directors. Officers may be paid employees, and have titles such as chief executive officer, chief financial officer, secretary, chief operating officer, vice president, or executive director. Regardless of titles, officers are ultimately those who participate in the management of the corporation, and have some discretionary authority in managing the corporation's affairs.[16]

Officers stand in a fiduciary relationship with the corporation. Hence, they must scrupulously protect the interests of the corporation, exercise their powers in good faith and with best efforts, and refrain from doing anything that harms the corporation. For instance, officers cannot use their positions to further their private interests, or otherwise secure any personal advantage against the corporation.[17] In fact, officers who breach their fiduciary duty to the corporation may be liable for any damage their actions or inaction caused.

Directors are required to perform with the level of care that an ordinarily prudent person in a like position would use under similar circumstances. This includes making reasonable inquiries as needed.

DIRECTORS' DUTY OF CARE

Directors also act as fiduciaries. For instance, each director owes a duty of care to its nonprofit corporation and the corporation's charitable beneficiaries. For public benefit corporations, directors are required to perform with the level of care that an ordinarily prudent person in a like position would use under similar circumstances. This includes making reasonable inquiries as needed.[18]

To ensure the duty of care is met, a director should review the corporation's articles of incorporation and bylaws to better understand the corporation's mission, and the expected roles and responsibilities of

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[15] (E.g., Corp. Code, §§ 6215-6216, 6812.)

[16] (*GAB Business Services, Inc. v. Lindsey & Newsom Claim Services, Inc.* (2000) 83 Cal.App.4th 409, 420-421, disapproved on another ground in *Reeves v. Hanlon* (2004) 33 Cal.4th 1140.)

[17] (*Bancroft-Whitney Co. v. Glen* (1966) 64 Cal.2d 327, 345; *Pigeon Point Ranch, Inc. v. Perot* (1963) 59 Cal.2d 227, 233, overruled on another ground in *Kowis v. Howard*, (1992) 3 Cal.4th 888; *GAB Business Services, Inc., supra,* 83 Cal.App.4th at pp. 416-417, disapproved on another ground in *Reeves v. Hanlon* (2004) 33 Cal.4th 1140; *Burt v. Irvine Co.* (1965) 237 Cal.App.2d 828, 850; *Daniel Orifice Fitting Co. v. Whalen* (1962) 198 Cal.App.2d 791, 797, 800.)

[18] (Corp. Code, § 5231, subd. (a).)

When there are paid staff in place, rather than steer the boat by managing day-to-day operations, board members provide *foresight, oversight, and insight*: think of them as up in the crow's nest scanning the horizon for signs of storms or rainbows to explore, perhaps with a pot of gold at the end! Yes, board members - your role as stewards of the nonprofits DOES involve fundraising. And...at the National Council of Nonprofits we are big promoters of the important role board members play as advocates for the nonprofit's mission.

Did you know?

- The vast majority of board members for charitable nonprofits serve as volunteers without any compensation.
- Arguably the most important policy for a board to adopt is a policy addressing conflicts of interest.
- A common question: Should your nonprofit's CEO also be a board member? Yes, according to BoardSource, the national leader on nonprofit governance practices: "The chief executive's input in board meeting deliberation is instrumental and invaluable for informed decision making. However, to avoid actual or perceived conflicts of interest, questions concerning accountability, or blurring the line between oversight and execution, chief executives should be non-voting members of the board, unless not permitted by law." See Recommended Governance Practices from BoardSource,"LP7".
- There's a difference between "board of directors" and "trustees"? (CharityLawyer)

The basics

What's the role of the board of directors of a nonprofit corporation? ¿Cuáles son las responsabilidades legales de una junta directiva sin fines de lucro?

Just as for any corporation, the board of directors of a nonprofit has three primary legal duties known as the "duty of care," "duty of loyalty," and "duty of obedience."

1. **Duty of Care**: Take care of the nonprofit by ensuring prudent use of all assets, including facility, people, and good will;
2. **Duty of Loyalty**: Ensure that the nonprofit's activities and transactions are, first and foremost, advancing its mission; Recognize and disclose conflicts of interest; Make decisions that are in the best interest of the nonprofit corporation; *not in the best interest of the individual board member* (or any other individual or for-profit entity).

3. **Duty of Obedience**: Ensure that the nonprofit obeys applicable laws and regulations; follows its own bylaws; and that the nonprofit adheres to its stated corporate purposes/mission.

However, a board of directors does not exist solely to fulfill legal duties and serve as a fiduciary of the organization's assets. Board members also play very significant roles providing guidance to nonprofits by contributing to the organization's culture, strategic focus, effectiveness, and financial sustainability, as well as serving as ambassadors and advocates. Beyond fulfilling legal duties, board members can be important resources for the organization in multiple ways.

Practice Pointers

We encourage all nonprofit board members to subscribe to our free monthly newsletters to stay up-to-date with issues that are popping up around the country, affecting the operations of charitable nonprofits, and in addition to be aware of these useful resources:

- How does your board compare with others? Leading With Intent offers benchmarks from a national study (BoardSource).
- Help board members get comfortable with their important role as advocates.
- Evaluating the performance of the executive director is one of the most-likely-to-be-avoided but most important roles that a board can play in supporting a nonprofit's sustainability. (Minnesota Council of Nonprofits). This article from the LEAP Ambassadors community explores the challenges, discusses creative approaches, and lists helpful resources.
- Boards and CEOs: Building strong board/CEO relationships (Maine Association of Nonprofits)
- Yes, the role of board members DOES include helping to raise money for the nonprofit! Help board members understand that this usually includes making a personal contribution. (BoardSource)
- Navigate governance challenges with our Tip sheet for candid conversations for boards.

CHAPTER 10 ATTORNEY GENERAL'S ROLE WITH CHARITIES

In This Chapter

- Overview
- Charitable Trusts Section
- Scope of Investigations
- Investigation Processes
- Frequently Asked Questions

OVERVIEW

The Attorney General has primary responsibility for supervising charities and charitable trusts in California.[1] This involves protecting charitable assets and donations, and ensuring compliance with trust documents, articles of incorporation, and other governing documents of a charitable organization. In doing so, the Attorney General investigates charities, charitable trusts, and fundraising professionals, and brings enforcement actions, as discussed below and in Chapter 11 and Chapter 12.

CHARITABLE TRUSTS SECTION

Within the Department of Justice, the Attorney General has a specialized unit, the Charitable Trusts Section, which carries out his regulatory and law enforcement program. The Charitable Trusts Section is comprised of the Registry of Charitable Trusts and a Legal and Audits Unit.

Registry of Charitable Trusts

The Registry of Charitable Trusts (Registry) is responsible for administering the registration and reporting requirements set forth in the Supervision of Trustees and Fundraisers for Charitable Purposes Act (Gov. Code, § 12580 et seq.) and its regulations. The Registry does this through its various programs: Initial Registration, Registration Renewals, Delinquency, Dissolution, Commercial Fundraising, Raffles, Complaints, and Administrative. The Registry also maintains a searchable database for the public to research registered charitable organizations and fundraising professionals.

The registration and reporting requirements the Registry administers, discussed in Chapter 6, Chapter 9, and Chapter 12, advance and promote the Attorney General's oversight over charities and fundraising professionals. For instance, Registry staff reviews forms filed by charities and fundraising professionals, and based on this review, makes referrals to the Legal and Audits Unit. The Registry also receives complaints from

[1] (Gov. Code, § 12598, subd. (a).)

the public about charity mismanagement, fraud, diversion of assets, and fundraising or reporting violations. All complaints are reviewed and researched by Registry staff and referred to the Legal and Audits Unit.

The Registry's complaint form (Form CT-9) is available on the Attorney General's Charities website or by writing to the Registry and requesting the form. The Registry of Charitable Trusts address is P.O. Box 903447, Sacramento, CA 94203-4470. A completed complaint form and any attachments should also be mailed to this address.

Legal and Audits Unit

The Legal and Audits Unit is comprised of attorneys, investigative auditors, and legal assistants. The Unit is tasked with several responsibilities, such as:

- Performing investigations, also referenced as audits, to determine if directors, officers, or trustees are carrying out their authorized charitable purposes in a lawful manner.[2] This can involve different areas of concern, as discussed below;
- Reviewing and investigating various nonprofit corporate transactions, discussed below and in Chapter 11;
- Bringing enforcement actions to stop violations of the law, recover charitable assets due to fiscal abuse, and obtain other remedies; and
- Defending and protecting gifts made to unnamed charitable beneficiaries in a will or trust (see Chapter 12).

SCOPE OF INVESTIGATIONS

The investigations of the Charitable Trusts Section's Legal and Audits Unit include the following areas of concern:

- Illegal or improper use of charitable funds;
- Diversion or loss of charitable assets;
- Losses arising out of speculative investments or the failure to diversify investments leading to insignificant gains;
- Excessive compensation, including salaries, pensions, benefits, insurance, travel, entertainment, legal and other professional fees;
- Breaches of fiduciary duties;
- Misleading, deceptive, or coercive charitable solicitations and fundraising practices;

[2] (E.g., Corp. Code, § 5250; Gov. Code, §§ 12588, 12598.)

- Improper or false statements in reports or filings, including the annual registration reports, renewal reports, and informational returns filed with the Registry;
- Self-dealing transactions;
- Improper loans of charity assets;
- Amendments to the articles of incorporation of public benefit corporations;
- Dissolutions;
- Sales of charitable assets at an unfair price;
- Mergers; and
- Conversion of a public benefit corporation to for-profit status.

The Legal and Audits Unit is also tasked to review transactions which require the Attorney General's consent or notice. For instance, a California public benefit corporation must obtain prior written consent from the Attorney General before converting into or merging with a for-profit corporation or mutual benefit corporation. Likewise, California law requires a public benefit corporation that operates or controls a "health facility" to provide written notice to and obtain the written consent of the Attorney General prior to any sale or transfer of ownership or control of a material amount of its assets to a for-profit corporation, mutual benefit corporation, or another public benefit corporation.[3] For more information, see Chapter 11.

There are also some matters the Legal and Audits Unit typically does not investigate. For instance, the Legal and Audits Unit does not become involved in disputes between charities and third parties over contracts or torts.

Moreover, the Legal and Audits Unit generally does not get involved in matters pertaining to internal board disputes, contested elections, and disagreements between directors and members over policies and procedures. However, this may not be the case if a complaint also raises concern that there has been a significant loss of charitable assets.

Also, although the Attorney General has oversight over California mutual benefit corporations,[4] the Legal and Audits Unit may decline to take action because members, directors, and officers have standing to address many corporate law violations involving mutual benefit

[3] (Corp. Code, §§ 5914-5925.)
[4] (Corp. Code, §§ 7240, 8712.)

corporations. And oftentimes, these types of complaints do not involve a loss of charitable assets.

INVESTIGATION PROCEDURES

As for what triggers a Charitable Trusts Section investigation, the Attorney General receives leads or complaints from many sources including other government agencies, directors, officers, agents, charity employees, media reports, donors, and consumers or users of services. However, even without a complaint, an investigation can occur at any time to ensure compliance with the laws the Charitable Trusts Section enforces.

When the Charitable Trusts Section receives complaints, they may be made confidentially or anonymously. To protect both the complainants and the targets of the complaints, the Attorney General does not discuss pending investigations, or confirm or deny the existence of complaints received.

The failure to respond and produce records can lead to the suspension of registration and assessment of penalties.

Frequently, the Legal and Audits Unit sends a written request to a charity or fundraising professional to investigate a complaint. It is important to fully cooperate with the investigation process. The failure to respond and produce records can lead to the suspension of registration and assessment of penalties.[5] A suspended registrant (as well as a delinquent or a revoked registrant) is not in good standing, and is prohibited from engaging in conduct for which registration is required – including solicitations for charitable purposes.[6]

During the audit process, Legal and Audits Unit auditors and attorneys may interview directors, officers, and other interested parties such as complainants, volunteers, current and past employees, bookkeepers, and accountants. Records may be subpoenaed from third parties. Donors may be contacted to confirm the complaint's allegations, or to investigate improper solicitation practices. Depending on the investigation's complexity and other work, it can take between six months to a few years to complete the audit.

In many cases, problems identified in the investigation may be resolved informally. If the parties are unable to reach a satisfactory resolution informally, or if the violations are more serious, the Attorney General may bring a formal enforcement action. Enforcement actions may seek the recovery of charitable funds including lost income and interest, the

[5] (Gov. Code, §§ 12591.1, subd. (c), 12598, subd. (e)(1); Cal. Code Regs., tit. 11, §§ 315, 999.9.)
[6] (Cal. Code Regs., tit. 11, § 999.9.4.)

DAVIS-STIRLING ACT

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Civil Code § 5100. Elections that Require Secret Balloting.

(a)

(1) Notwithstanding any other law or provision of the governing documents, elections regarding assessments legally requiring a vote, election and removal of directors, amendments to the governing documents, or the grant of exclusive use of common area pursuant to Section 4600 shall be held by secret ballot in accordance with the procedures set forth in this article.

(2) An association shall hold an election for a seat on the board of directors in accordance with the procedures set forth in this article at the expiration of the corresponding director's term and at least once every four years.

(b) This article also governs an election on any topic that is expressly identified in the operating rules as being governed by this article.

(c) The provisions of this article apply to both incorporated and unincorporated associations, notwithstanding any contrary provision of the governing documents.

(d) The procedures set forth in this article shall apply to votes cast directly by the membership, but do not apply to votes cast by delegates or other elected representatives.

(e) In the event of a conflict between this article and the provisions of the Nonprofit Mutual Benefit Corporation Law (Part 3 (commencing with Section 7110) of Division 2 of Title 1 of the Corporations Code) relating to elections, the provisions of this article shall prevail.

(f) Directors shall not be required to be elected pursuant to this article if the governing documents provide that one member from each separate interest is a director.

(Amended by Stats. 2021, Ch. 517, Sec 1. Effective January, 1 2022.)

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SECRET BALLOTS REQUIRED

Elections Requiring Secrecy. As required by Civil Code § 5100(a), the following matters must be voted by secret ballot, regardless of any provision to the contrary in an association's governing documents:

- special assessments over 5% (see exceptions) or regular assessments over 20% (see Civ. Code § 5605),
- election and removal of directors,
- amendments to the governing documents (see exception), and
- grant of exclusive use of common area property (see exceptions).

Member surveys do not require a secret ballot.

No Identifiers on Ballots. To preserve confidentiality, voters may not be identified by name, address, or lot, parcel, or unit number on ballots. The ballot itself is not signed by the voter, but is inserted into an envelope that is sealed. (Civ. Code § 5115(c)(1).) If the owner inadvertently signs the ballot, it does not invalidate the ballot.

Signed Outer Envelope. This envelope is inserted into a second envelope that is sealed. The upper left hand corner of the second envelope must contain the voter's name and a separate interest identifier such as an address, lot, parcel or unit number that entitles him/her to vote. The envelope must also be signed by the voter. (Civ. Code § 5115(c)(1).) The statute states that owners "shall sign" his/her name. Accordingly, a typed name by itself is not sufficient. Typed names can be fraudulently applied to the envelope by anyone. A handwritten signature is distinctive and difficult to forge. In addition, signatures should be in ink so they cannot be erased. The signature must be an owner of the property, i.e., a member, not non-member spouses. Failing to sign the outer envelope voids the ballot.

Identity Theft. For those who are concerned that signing the envelope may lead to identity theft, see Signature Identity Theft.

Valid Owner Address. An illegible or invalid owner address also invalidates the ballot. The second envelope is addressed to the Inspector of Elections (See sample envelopes.)

ASSISTANCE: Associations needing legal assistance can contact us.

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BALLOTING REQUIREMENTS & PROCEDURES

Where a matter to be voted on by the association's members requires the use of a secret ballot, the following balloting procedures must be utilized in order to preserve the confidentiality of the vote and to comply with other legal requirements contained in the Davis-Stirling Act:

Ballot with 2 Preaddressed Envelopes

Ballots and two (2) preaddressed envelopes must be mailed by first class mail or delivered by the association to every member not less than thirty (30) days prior to the deadline for voting. Instructions on how a member may return his/her ballot must also be included. (*Civ. Code § 5115(a).*)

- **First Sealed Envelope** – The ballot itself is not signed by the voter, but is inserted into the first envelope that is sealed. (*Civ. Code § 5115(a)(1).*)

- **Second Signed & Sealed Envelope** – the first sealed envelope is inserted into a second envelope that is sealed. In the upper left hand corner of the second envelope, the voter must sign and indicate the voter's name, as well as indicate the address or separate interest identifier that entitles the voter to vote. (*Civ. Code § 5115(a)(1).*) The second envelope is addressed to the association's inspector(s) of elections who ultimately tabulates the votes. (*Civ. Code § 5115(a)(2).*) The envelope may be mailed or delivered by hand to a location specified by the inspector(s) of elections, and the member may request a receipt for delivery. (*Civ. Code § 5115(a)(2).*)

Proposed Governing Document Amendment

If the vote is being conducted to approve amendments of the association's governing documents (i.e., a CC&R amendment), the text of the proposed amendments must be delivered to the members with the ballot. (*Civ. Code § 5115(e).*)

Quorum

If a quorum is required by the governing documents, each ballot received by the inspector(s) of elections must be treated as a member present at a meeting for purposes of establishing quorum. (*Civ. Code § 5115(b).*)

Counting Ballots & Tabulating Votes

Meeting Required – Even if the election is being conducted entirely by mail, all ballots must be counted and tabulated by the association's inspector(s) of elections, or by the designee of the inspector(s) of elections, in public at a properly noticed open board meeting or membership meeting. (*Civ. Code § 5120(a).*) No person, member of the association, or employee of the association's management company may open or otherwise review any ballot prior to the time and place where the ballots are being counted and tabulated. (*Civ. Code § 5120(a).*) The inspector(s) of elections, or the designee of the inspector(s) of elections, may verify the member's information and signature on the outer envelope prior to the meeting where the ballots will be counted. (*Civ. Code § 5120(a).*)

Observing the Counting – Any candidate or member of the association may witness the counting of the ballots and tabulation of the votes. (*Civ. Code § 5120(a).*)

Ballots are Irrevocable

Once a secret ballot is received by the association's inspector(s) of election, the ballot is irrevocable. (*Civ. Code § 5120(a).*)

Reporting Results

Once the votes are counted, the *tabulated results* must: (*Civ. Code § 5120(b).*)

- Be promptly reported to the board;
- Recorded in the minutes of the next board meeting; and
- Be available for review by the association's members.

Within fifteen (15) days of the election, the board must also give general notice of the tabulated results. (*Civ. Code § 5120(b).*)

Custody of Ballots

The sealed ballots must at all times be in the custody of the association's inspector(s) of election or at a location designated by the inspector(s) of elections until after the tabulation of the vote, and until the time allowed by Civil Code Section 5145 for challenging the election has expired (one year). (*Civ. Code § 5125; See also "Legal Challenge to Election."*) Once that time has expired, the custody of the ballots must be transferred from the inspector(s) of elections to the association. (*Civ. Code § 5125.*) If there is a recount or other challenge to the election process, the inspector(s) of elections must, upon written request, make the ballots available for inspection and review by any member of the association or the member's authorized representative. (*Civ. Code § 5125; See also "Inspection of Ballots."*)

Related Topics

California Code, Civil Code - CIV § 5115

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(a) An association shall provide general notice of the procedure and deadline for submitting a nomination at least 30 days before any deadline for submitting a nomination. Individual notice shall be delivered pursuant to Section 4040 (https://1.next.westlaw.com/Link/Document/FullText?findType=L&originatingContext=document&transitionType=DocumentItem&pubNum=1000200&refType=LQ&originatingDo if individual notice is requested by a member.This subdivision shall only apply to elections of directors and to recall elections.

(b) For elections of directors and for recall elections, an association shall provide general notice of all of the following at least 30 days before the ballots are distributed:

(1) The date and time by which, and the physical address where, ballots are to be returned by mail or handed to the inspector or inspectors of elections.

(2) The date, time, and location of the meeting at which ballots will be counted.

(3) The list of all candidates' names that will appear on the ballot.

(4) Individual notice of the above paragraphs shall be delivered pursuant to Section 4040 (https://1.next.westlaw.com/Link/Document/FullText?findType=L&originatingContext=document&transitionType=DocumentItem&pubNum=1000200&refType=LQ&originatingDoc=Ib3684520531011ecba0eacf1126 if individual notice is requested by a member.

(c) Ballots and two preaddressed envelopes with instructions on how to return ballots shall be mailed by first-class mail or delivered by the association to every member not less than 30 days prior to the deadline for voting. In order to preserve confidentiality, a voter may not be identified by name, address, or lot, parcel, or unit number on the ballot. The association shall use as a model those procedures used by California counties for ensuring confidentiality of vote by mail ballots, including all of the following:

(1) The ballot itself is not signed by the voter, but is inserted into an envelope that is sealed. This envelope is inserted into a second envelope that is sealed. In the upper left-hand corner of the second envelope, the voter shall sign the voter's name, indicate the voter's name, and indicate the address or separate interest identifier that entitles the voter to vote.

(2) The second envelope is addressed to the inspector or inspectors of elections, who will be tallying the votes. The envelope may be mailed or delivered by hand to a location specified by the inspector or inspectors of elections. The member may request a receipt for delivery.

(d) A quorum shall be required only if so stated in the governing documents or other provisions of law. If a quorum is required by the governing documents, each ballot received by the inspector of elections shall be treated as a member present at a meeting for purposes of establishing a quorum.

(e) An association shall allow for cumulative voting using the secret ballot procedures provided in this section, if cumulative voting is provided for in the governing documents.

(f) Except for the meeting to count the votes required in subdivision (a) of Section 5120 (https://1.next.westlaw.com/Link/Document/FullText?findType=L&originatingContext=document&transitionType=DocumentItem&pubNum=1000200&refType=SP&originatingDoc=Ib368ba50531011ecba0eacf11262 an election may be conducted entirely by mail unless otherwise specified in the governing documents.

(g) In an election to approve an amendment of the governing documents, the text of the proposed amendment shall be delivered to the members with the ballot.

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California Code, Civil Code - CIV § 5120

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(a) All votes shall be counted and tabulated by the inspector or inspectors of elections, or the designee of the inspector of elections, in public at a properly noticed open meeting of the board or members. Any candidate or other member of the association may witness the counting and tabulation of the votes. No person, including a member of the association or an employee of the management company, shall open or otherwise review any ballot prior to the time and place at which the ballots are counted and tabulated. The inspector of elections, or the designee of the inspector of elections, may verify the member's information and signature on the outer envelope prior to the meeting at which ballots are tabulated. Once a secret ballot is received by the inspector of elections, it shall be irrevocable.

(b) The tabulated results of the election shall be promptly reported to the board and shall be recorded in the minutes of the next meeting of the board and shall be available for review by members of the association. Within 15 days of the election, the board shall give general notice pursuant to Section 4045 of the tabulated results of the election.

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(a) All votes shall be counted and tabulated by the inspector or inspectors of elections, or the designee of the inspector of elections, in public at a properly noticed open meeting of the board or members. Any candidate or other member of the association may witness the counting and tabulation of the votes. No person, including a member of the association or an employee of the management company, shall open or otherwise review any ballot prior to the time and place at which the ballots are counted and tabulated. The inspector of elections, or the designee of the inspector of elections, may verify the member's information and signature on the outer envelope prior to the meeting at which ballots are tabulated. Once a secret ballot is received by the inspector of elections, it shall be irrevocable.

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INSPECTION OF BALLOTS

Civil Code Section 5125 provides in pertinent part that:

> "If there is a recount or other challenge to the election process, the inspector or inspectors of elections shall, upon written request, make the ballots available for inspection and review by an association member or the member's authorized representative."

This language does not explicitly address whether an association is required to permit the inspection of ballots in the absence of a recount or formal challenge to the election process brought by a member of the association. HOA industry attorneys take varying positions with respect to this issue and whether an association member has a right to inspect the ballots if there is no recount or challenge brought against the association by the member pursuant to Civil Code Section 5145. (*See also "Legal Challenge to Election."*)

"Association Election Materials" as "Association Records"

Civil Code Section 5200 provides an association's members with rights to inspect and *copy* specified "association records." (*See "Records Subject to Inspection."*) Returned ballots, signed voter envelopes, the voter list of names to whom ballots were to be sent, proxies, and the candidate registration list constitute "association election materials" that are "association records" subject to inspection. Signed voter envelopes may be inspected "but may not be copied." (*Civ. Code § 5200(c).*)

Maintain Association Election Materials for 1 Year – An association is required to maintain association election materials for one year after the date of the election. (*Civ. Code § 5200(c).*)

Fees for Inspection

The Davis-Stirling Act does not address whether a member is required to pay any fees associated with the inspection of ballots (i.e., any fees charged by the inspector of election in making the ballots available for inspection).

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