

Serving as a Director of A Not-for-Profit Corporation

Submitted by Joshua Mintz ¹ for the Georgetown Not for Profit Conference April 19, 2024

This memorandum provides general guidance to staff of a private foundation or other grant making organization who are asked to serve on a board of another not-for-profit organization.² It addresses legal parameters and practical considerations of board service.

Being a director of a not-for-profit organization can be personally fulfilling and provide valuable assistance to the not-for-profit organization. It can also further your professional development by enlarging your network and providing additional work-related experience. It requires, however, a commitment of time and effort, and often an expectation of financial contribution to the organization. If things go wrong, it can also damage your reputation if the board is seen as asleep at the switch or, worse, complicit in the wrongdoing. Consequently, care must be taken before accepting a board seat. The following are some considerations.

Be Clear About Why You Would Accept

Before agreeing to serve on a board, be clear in your own mind why you would serve: Professional development or networking opportunity; a felt need to contribute to a cause; a favor to a friend; the belief you can help the organization to accomplish its mission; the mission resonates with you or your values align with the organization; or other reasons.

Understand the Commitments: Time and Financial

You should also understand upfront the time commitment and whether it would detract from your job responsibilities or create potential conflicts with your duties at your primary organization.

Do Your Due Diligence

Before joining a board of directors, you should undertake due diligence on the organization and the board sufficient to understand the financial condition, mission, leadership, and future opportunities and risks. This includes review of at least the following matters or documents:

¹ Joshua Mintz is the Vice President, General Counsel and Secretary of the John D. and Catherine T. MacArthur Foundation. The views expressed herein are the personal views of the author and should not be ascribed to the MacArthur Foundation

² Additional resources regarding board service can be found at BoardSource and the Bridgespan Group:

https://www.bridgespan.org/insights/library/boards/nonprofit-board-resource-center?utm_campaign=leadership&utm_source=twitter&utm_medium=social&utm_content=cool; see also <http://www.nonprofitlawblog.com/trouble-nonprofit-boards/>.

- Articles of incorporation and bylaws (and consider Form 1023).
- The organization's financial condition, including its assets and liabilities, statement of cash flow and amount of any endowment, loans outstanding, pledges of support, related party transactions, and contingent liabilities.
- The organization's tax return (990 or 990-PF).
- Structure of staff and compensation of highest paid persons.
- Key policies (conflicts of interest, whistleblower, sexual harassment).
- Business plan of the organization, including present funding and the expectation of future fundraising, and the ability to continue as a going concern.
- Board members, terms, and structure, including the number and type of committees and the overall board culture.
- Philosophy of the board regarding its role vis-a-vis management.
- How the board selects the chairman, her role, and the expected tenure.
- The chief executive, her philosophy, and expected tenure.
- Plans for succession of the chief executive.
- Process for reviewing and compensating the chief executive.
- Website or other printed materials describing the organization.
- Whether the organization has directors' and officers' insurance.
- Whether the mission aligns with your interest and skills.
- Your expected role, including whether you are expected to provide donations or additional services.
- Length of your expected tenure and the time commitment during your service.
- Whether the position is compensated (unlikely).
- Availability of directors' and officers' liability insurance.
- Consider any red flags that this review raises.

Understand the Legal Duties of a Director

Before (and after) accepting a board seat, you should also understand your legal duties and obligations.

Directors of not-for-profit corporations have fiduciary duties similar to the directors of for-profit companies. Generally, a director is expected to discharge his or her duties (i) in good faith, (ii) with the care that an ordinarily prudent person in a like position would exercise under similar circumstances, and (iii) in a manner the director reasonably believes to be in the best interests of the corporation.

This standard is generally understood to encompass the following duties: A duty of care and a duty of loyalty. Many not-for-profit commentators also suggest that there is a separate duty of obedience, which is a duty to be faithful to the organization's mission and conform the organization's activities to its charter and applicable law. In for-profit companies, the duties run generally to the corporation and its shareholders; in the case of not-for-profits, the duties run directly to the corporation and derivatively to the general public.

The duty of care requires directors to use that amount of care which an ordinarily careful and prudent person would use in similar circumstances and consider “all material information reasonably available” in making business decisions.³ A breach of the duty of care can arise from a board decision that is made in a negligent manner, as well as a board’s failure to act to prevent loss to the corporation. Courts in Delaware have focused increased attention on a corporate board’s duty to oversee and monitor the corporation and the conduct of its affairs by management. This means taking steps to stay informed and doing the requisite homework.

The duty of loyalty requires directors to act in good faith and solely in the best interests of the corporation. A director should seek to avoid conflicts of interest and, if actual or potential conflicts are present, to disclose the nature of the conflict and abstain from voting on the matter. Decisions made by directors should be independent such that any decision is based on the corporate merits of the subject before the board rather than extraneous considerations or influence. Also, implicit in the duty of loyalty is an obligation of each director to maintain the confidentiality of information the corporation treats as confidential and information regarding the board’s deliberations.

Understanding Your Other Responsibilities

Beyond your legal duties, being a director of a not-for-profit organization also carries additional responsibilities. These include:

- Devoting sufficient time to the role as is required based on the circumstances. In times of crisis, this can be considerably more than initially contemplated.
- Taking time to understand the organization, its mission, financial condition and other issues.
- Reading the board materials provided and coming to board meetings prepared to engage.
- Being collegial with other board members and the CEO, yet also not being afraid to ask hard questions. A silent board member who does not engage and acquiesces to the wishes of the CEO when she does not agree is not performing her duties.
- Being respectful of staff and staying within a board role.
- Not seeking personal benefit or benefit to other organizations with whom you may be affiliated.

³ *In re Walt Disney Co, Derivative Litig.*, 907 A.2d 693, 749 (Del. Ch. 2005) (quoting *Graham v. Allis-Chalmers Mfg. Co.*, 188 A.2d 125, 130 (Del. 1963) and *Brehm v. Eisner*, 746 A.2d 244, 259 (Del. 2000)), aff’d, 906 A.2d 27, 55 (Del. 2006).

Issues That Can Arise

Conflicts with Your Role as an Employee of your organization

If you serve on a board of a not-for-profit corporation you need to understand, in advance, what, if any, relationship the corporation has or could have with your organization. This can be particularly important if the organization is or wishes to be a grantee of your organization.

In cases like this, you need to be alert to potential conflicts. As a director of the organization, you have duties to the organization. As an employee of your organization, you have duties to your organization. Circumstances could arise, therefore, where you have confidential information that you are precluded from sharing with one organization or the other that could be important to the other organization. This can arise, for example, where the organization is facing unexpected financial difficulties or discovers improper activities that could affect a funder's willingness to continue to fund the organization.

In such cases, you cannot serve two organizations. If these duties cannot be reconciled, you may have to resign from your position as a director of the organization. And, depending on your position, potentially do more if you are aware of information suggesting illegal activity.

Confidentiality

As a director of an organization, you have a duty of confidentiality. Circumstances can arise, however, where you receive information that might reflect illegal activity that has occurred such as fraud or the possibility that action is contemplated that would constitute a fraud or an illegal act. In such cases, you have to consider whether to resign or, in extreme cases, to inform the board and the CEO that you will have to report the activity to appropriate persons.

Above the Decks

A board's role is to provide oversight of the operations, finances, governance, and strategic development; it is not to engage in operational matters. While this concept is easily expressed, in practice there can be gray areas. When in doubt whether to engage on matters, you should speak with the board chairman to try to reach consensus on the appropriate action.

Potential Liability⁴

In general, uncompensated directors of not-for-profit organizations in Illinois are protected against claims by third parties. See Illinois Statutes 108.70(a) of the Illinois Not for Profit Corporation Act. This protection, however, may not be absolute in certain circumstances where a conflict of interest may be present or where the director's conduct is willful or wanton (that could include recklessness). Liability

⁴ This is not intended to cover all potential liabilities that could arise. It suggests, however, that a potential director should understand potential personal liability exposure before agreeing to serve.

could also arise for the failure of the organization to withhold and pay federal or state taxes. Consequently, as indicated earlier, you should know whether the organization has directors' and officers' insurance or otherwise would provide indemnification to you. In the private foundation context, a board member can have liability under the self-dealing or excess business holding rules of the Internal Revenue Code.

Differences of Views with Other Directors or the Chair

You may not always agree with positions of other directors or how the chairman is running the meetings or engaging with other directors. How you attempt to resolve those issues can make a big difference to your board tenure, whether the work is enjoyable and to the fulfillment of your duties.

Abstention

You should only abstain from voting on a matter when you have a conflict of interest. It is your responsibility to obtain the information sufficient to make a decision whether to vote yay or nay on a matter. If you feel you do not have sufficient information, you should inform management of that view. My view is that, if the matter is nevertheless presented for approval, you should vote no rather than abstain.

Conclusion

Serving as a director of a not-for-profit organization can benefit the organization and your professional development. It is critical, however, that you not lightly accept such an invitation and understand fully the opportunities and challenges. If you have questions, consult with your counsel.

Process for Addressing Service on Boards and Other Entities by Staff: One Suggested Approach

Submitted by Joshua Mintz¹ for the Georgetown Not for Profit Conference April 19, 2024

Not for profit organizations, particularly grant making foundations, often face the question of whether to allow Staff to serve on outside boards, advisory committees, and similar structures and if so what process or rules should be followed. Each organization may approach this question differently with different presumptions and rules depending on the organization's culture, history, policies, and values.

The "rules" adopted by an organization on participation on outside activities such as board membership or participation on committees or task forces can be driven by different policies of an organization, including, depending on the organization: conflicts of interest, volunteer activities, paid work outside the organization and similar policies.

The rules and process adopted by an organization has implications for potential liability of the staff member and the organization, indemnification and insurance coverage, reimbursement of expenses, and the organization's reputation. It is important therefore for each organization to carefully consider the process and policies it wishes to follow to address these issues, to document the approach and to follow such policies.

This paper describes one possible approach for a grant making organization to consider for a process to address a staff member's participation on outside boards, task forces, advisory committees, and similar activities.² It presumes that some board service by staff will be permitted although some organizations may desire a presumption against such service or, in some cases, outright prohibition. It does not purport to address all the issues that may arise nor to presume that this is the only approach. Organizations should also always address in a conflict-of-interest policy or the rules addressing service on boards circumstances where a staff member's spouse or other family member is serving on the board of a grantee or other party with whom the organization may do business.

As always, consultation with legal counsel is an important part of a sound policy approach.

A General Process

Prior Permission. Before an employee agrees to serve on a board, outside committee, task force or similar role for an organization or with respect to an issue that is reasonably likely to intersect with the Organization's work, he/she should first obtain the approval of his/her supervisor and the head of the

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² This paper does not address the participation by foundation staff on Limited Partnership Advisory Committees in investments made by the foundation. There are myriad issues to consider in that context which are beyond the scope of this paper

area. Depending on the nature of the service and management level of the staff and the organizational culture, it is often useful to obtain the President's approval as well. The employee should check with his/her supervisor periodically (including when a term as a director is to be extended) to determine that continued service makes sense given workloads and other relevant factors.

Personal or Organization-Related. A determination should be made whether the outside activity is done in a personal capacity or as part of the employee's duties to the Organization. In most cases, service on an outside board, task force, etc. is undertaken in an employee's personal capacity. This can have important implications depending on the organization's policies. For example, expenses associated with the cost of the service should be borne by the employee of acting in a personal capacity and not the Organization and the employee is not typically indemnified by the Organization for his/her activity. It also means that the employee needs to manage his/her time in accordance with the Organization's policies on personal time.

Analysis By Legal Counsel. Service by Organization staff on certain outside boards can raise conflicts of interest and other issues. For those reasons, when the service involves a board of a grantee or potential grantee, or a task force or committee that could impact or involves areas of the Organization's work, it is advisable to have legal counsel (either the General Counsel of the organization if there is one or an outside counsel) to provide a memo to the President and applicable Head of the area regarding actual or potential conflicts, potential legal issues and/or optic issues that could arise. This memo should include any suggested limitations on the role and how to address and mitigate conflicts should they arise. The decision on whether the role should be accepted is ultimately the responsibility of the President or Head of the area informed by the legal memorandum.

No Participation in Grant Process. It is best practice to ensure that an employee who serves on the board of a grantee or is otherwise affiliated be precluded from working on any grant or other transaction involving the grantee. Service on a task force or on a committee of a grantee will not automatically exclude an employee from working on a grant to the grantee; however, the facts and circumstances should be considered to determine the best approach to support transparency and fairness in decision-making.

Board Service at the Request of the Organization. On limited occasions, an Organization may conclude that service on a board, advisory committee or a task force is in furtherance of the Organization's business and an employee should serve on behalf of or at the request of the Organization. This should require the approval of the President, the head of the department/program area, and the general counsel and must be evidenced by a written memorandum that provides the request and the rationale for the decision. An employee serving on behalf of the Organization may have his/her expenses paid by the Organization. Some Organizations may also decide that an employee serving in this capacity may also continue to work on a grant or a transaction with the affiliated entity unless circumstances suggest a different approach. There may still be, however, conflicts that could arise because the employee will have conflicting duties to the Organization and the entity on whose board the employee sits. Consequently, in such event the legal counsel and Managing Director for the area should be consulted before work on a grant proceeds.

Sector Service. There are also limited instances where an employee serves on the board of a membership organization or a committee in which the Organization is a member. Depending on the organization's approach this type of service may be viewed as "service to the field" for the Organization and, consequently, the Organization might reimburse the reasonable business expenses associated with the service.

Affinity Groups. Service on affinity groups can be viewed similarly to sector service described above. Consequently, expenses associated with these types of service may be reimbursed by the Organization. Before accepting service on an affinity group, however, an employee should obtain the approval of the area based on a conclusion that the service furthers the work of the Organization or is important to the Organization's contribution to the field. The duration of services should also be periodically reviewed with the employee's supervisor.

Listing Affiliations. It is a good practice for staff of an organization to report all affiliations of whatever type, business or personal, for inclusion on a conflicts of interest report. Depending on the structure of an organization, this report should be used to ensure that conflicts of interest are identified prior to a transaction being approved.