NONPROFIT CORPORATIONS: BOARD AUTHORITY AND FIDUCIARY DUTIES

By Jonathan A. Grissom

Persons serving on boards of directors of nonprofit corporations are often unaware of the authority held by the board and the duties each director owes to the organization they serve. Pursuant to the California Corporations Code (the "Code"), the board of directors exercises, or directs the exercise of, all corporate powers, subject to member approval where required.[1]

While the board's authority may be absolute, it is tempered by the fact that all decisions are made collectively by all members of the board. In addition, all decisions of the members of the board are made in light of four primary fiduciary duties owed by all directors to the organizations they serve.

Those duties are as follows: (1) the duty of care; (2) the duty of inquiry; (3) the duty of loyalty; and (4) the duty to follow investment standards.

1. The Duty of Care.

The standard of conduct for directors of non-profit public benefit corporations is set forth in Code §5231(a), which provides as follows: "A director shall perform the duties of a director, including duties as a member of any committee of the board upon which the director may serve, in good faith, in a manner such director believes to be in the best interests of the corporation, and with such care, including reasonable inquiry, as an ordinarily prudent person in a like position would use under similar circumstances."

2. Duty of Inquiry.

The director's obligation to make reasonable inquiry is derived from Code §5231. This duty provides that directors cannot close their eyes to the activities of the organization and, if they are put on notice by the presence of suspicious circumstances, they may be required to make such reasonable inquiry as an ordinarily prudent person would make under similar circumstances.

In fulfilling their duty of inquiry, directors may obtain the services of and rely upon opinions, reports or other information prepared or presented by any of the following:

A. One or more officers or employees of the corporation whom the directors believe to be reliable and competent in the matters presented;

B. Counsel, independent accountants, or other persons on matters which the director believes to be within such person's professional or expert competence; and

C. A committee of the Board upon which the director does not serve, as to matters within the committee's designated authority, which committee the director believes to merit confidence.

If a director has a reason to doubt information that he/she is being supplied, the director owes a fiduciary duty to inquire further into those matters. Such duty may be exercised by the board through the retention of experts to assist the directors in verifying the information supplied, obtaining additional information, and analyzing the matters to which the information pertains.

3. Duty of Loyalty.

Directors must act in a manner that they believe to be in the best interest of the corporation.[2] Where the organization does not have members, such as in the case of public benefit corporations, the directors must strive to advance the organization's charitable purposes. The duty of loyalty includes a duty to avoid conflicts of interest between the directors individually and the corporation.

4. Duty to Follow Investment Standards.

This fiduciary duty applies to investment assets held by public benefit corporations, the assets of which are held in charitable trust. Code §5240 sets forth the applicable standards as follows:

A. Avoid speculation, looking instead to the permanent disposition of the funds, considering the probable income, as well as the probable safety of the corporation's capital;

B. Comply with additional standards, if any, imposed by the corporation's articles, bylaws, or the express terms of an instrument or agreement pursuant to which the assets were contributed to the corporation; and

C. In carrying out their investment duties, a director must comply with the duties of due care and reasonable inquiry, may rely upon others, and may delegate its investment powers as permitted by Code §5210.

In addition to the duties mentioned above, directors of applicable organizations are obligated to use funds and assets, including but not limited to endowment funds, in accordance with the provisions of the Uniform Management of Institutional Funds Act ("UMIFA").[3]

Directors of nonprofit and religious organizations are encouraged to learn more about the duties under which they operate and the standards to which they are held.

---

1 Code §§5120, 7210, 9210.

2 Code §§5231, 7231, 9241.

3 California Probate Code §§18500 et seq.