

The Guide to Not-for-Profit Governance 2013

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NOT-FOR-PROFIT GOVERNANCE AND “BEST PRACTICES”

Not-for-profit organizations play a significant role in our society by undertaking and providing funding for projects that benefit the greater good. They provide services and grants in a wide variety of areas that are of importance to the community, including supporting hospitals, educational institutions, museums and organizations dedicated to assisting those in need. A not-for-profit organization may not be formed for financial gain and generally cannot provide profits or excessive benefits for its owners, insiders, donors or others outside the charitable class or objective for which the not-for-profit organization is formed and intended to serve. The mission of a not-for-profit organization sets forth the purpose for which the organization was formed and granted special legal not-for-profit status. This mission drives the activities carried out by the organization; the board of directors is responsible for governing the not-for-profit to carry out this mission. The assets of a not-for-profit organization are intended to benefit the public good and are restricted by law toward that use alone. Thus, given the prohibition against use of not-for-profit assets for anything other than the intended charitable objective, the founders, owners and managers of a not-for-profit will have less control over a not-for-profit corporation than if they established a for-profit corporation and had conventional rights of equity owners or for-profit management.

Effective governance, with its corollaries, transparency and accountability, leads to increased public trust in the organization and a greater willingness by the public to donate funds and services. Effective governance also provides protection from regulatory intrusion.

This outline (i) summarizes steps a not-for-profit organization may wish to consider taking to ensure that it is accountable, transparent and effectively governed by an active and engaged board and (ii) serves as an introduction to the source materials included in this volume.

Boards of for-profit organizations have worked to restore public confidence and increase investment in the wake of a number of highly public governance failures. The steps taken by boards of for-profit organizations – including those required by reforms embodied in the Sarbanes-Oxley Act of 2002 (“Sarbanes-Oxley”) and related rules and regulations – have led to increased board engagement. Boards of not-for-profit organizations may wish to adapt certain measures that have become “best practices.” Although not required by law, many states – including the State of New York – have proposed similar requirements for not-for-profit organizations.

A summary of statutory and case law applicable to not-for-profit organizations in the State of New York, as well as liabilities imposed by the Internal Revenue Service (the “IRS”), are set forth at **Tab 2**.

I. ROLE OF THE BOARD AND FIDUCIARY DUTIES – AN OVERVIEW

The role of the board of directors of a not-for-profit organization is similar to the role of a for-profit board. In both cases, the organizations are tasked with managing other people’s money and in both cases they are judged by their success in doing so. Yet, there is a very key

difference: in the for-profit context, shareholders are able to hold corporate directors and officers accountable, whereas in the not-for-profit context there is no private mechanism by which the organization can be held accountable when it fails to act in furtherance of its mission. Although governmental entities (such as the relevant State Attorney General and the IRS) play an important role in policing and monitoring not-for-profit activities, there is no private right of action available against officers and directors to ensure accountability. The not-for-profit board is required to fill this void, by ensuring that the organization acts in accordance with its mission through meaningful oversight of operations and policy guidance in a way that assures integrity and effective management but without leading to board involvement in the organization's day-to-day activities.

The basic duties of directors of not-for-profit and for-profit organizations are virtually the same, even though the organizations are typically governed by different laws and have different constituent relations. Directors of not-for-profit organizations are required to discharge their duties in accordance with the following basic fiduciary duties, which are discussed in more detail at **Tab 2**:

- ***Duty of care:*** Act in good faith, with the care an ordinarily prudent person in a like position would exercise under similar circumstances;
- ***Duty of loyalty:*** Act in good faith in a manner the director reasonably believes to be in the best interests of the organization; and
- ***Duty of obedience:*** Act within the organization's purposes and ensure that the mission is pursued.

Breaches of fiduciary duty are enforced by the Attorney General. Enforcement actions can result in significant personal liability for directors; however, not-for-profit organizations may wish to minimize the risk of liability through indemnification and/or directors' and officers' insurance. For a discussion of indemnification and insurance, and examples of enforcement actions, see **Tab 2** and **Tab 16**.

II. BASIC FUNCTIONS OF A NOT-FOR-PROFIT BOARD

The board of a not-for-profit organization is responsible for directing the affairs of the organization in accordance with its mission. In practice, the board delegates responsibility for managing the day-to-day activities of the organization to managers; however, fiduciary duties cannot be delegated and, therefore, the board retains oversight responsibility for matters that have been delegated. Board service should not be viewed as just an honor – the oversight responsibilities of directors are real, and failure to discharge these legal duties can have unwelcome consequences for the organization and its board members.

The primary functions of the not-for-profit board typically include the following:

- Selecting, monitoring, evaluating, compensating and – if necessary – replacing the CEO;

- Defining and reevaluating from time-to-time the long-term strategy by which the organization fulfills its mission and monitoring the performance of the organization in implementing the strategy;
- Approving budgets, financial plans and financial statements; reviewing and approving material capital allocations and expenditures; monitoring and ensuring the integrity of the organization's financial reporting processes, internal control systems and audit; hiring the independent auditor (if any) and assuring itself of the auditor's independence;
- Balancing constituency interests in a manner that is consistent with the mission;
- Understanding the organization's risk profile and reviewing and overseeing the organization's management of risks;
- Ensuring compliance with all applicable laws, regulations, policies and ethical standards of the organization (including laws and regulations enforced by the IRS, as well as the organization's conflict of interest and other policies);
- Assisting in obtaining resources through making personally meaningful financial contributions, fundraising and/or grant-writing; and
- Establishing the composition of the board and its committees, and determining governance practices.

The demands of not-for-profit board service are heavy – board responsibilities are wide-ranging and board service is part-time (and usually voluntary). The board of a not-for-profit organization should consider implementing board processes and structures that can assist directors to more efficiently and effectively fulfill these responsibilities; however, in doing so, the board should bear in mind that board practices should address the unique needs and circumstances of the particular not-for-profit organization – one size does not fit all.

The board should look for governance “best practices” that embody pragmatic solutions that will work given the particular needs and circumstances of the organization, including organizational structure, size, activities, life-cycle stage and funding mechanisms. The goal of “best practice” is to promote active oversight and objective and informed judgment by the board. An effective board acts as an independent mechanism of oversight as to the activities of the managers to whom the board has delegated authority. This is necessary to promote the accountable functioning of the organization, including the responsible use of assets that have been entrusted to the organization by others. Board effectiveness can be enhanced by considering the following guiding principles that are common to effective not-for-profit boards.

III. COMMON GUIDING PRINCIPLES FOR EFFECTIVE BOARDS

A. *Mission*

Board accountability begins with the charitable, educational or social mission of the not-for-profit organization. The mission is the reason why the organization exists and has been granted legal status as a not-for-profit by the State and tax-exempt status by the IRS. The mission should be the not-for-profit organization's "polestar" in that it provides a measure of success and guides the organization's conduct. (This can be compared to the for-profit world "polestar" of maximizing shareholder value through the efficient production of goods and services.)

The board is charged with ensuring that managers further the mission, without wasting assets or engaging in self-dealing. Therefore, as a starting point, the board needs to:

- Understand the entity's mission, as stated in its governing documents;
- Develop, with management, a strategy for carrying out that mission; and
- Monitor and assess management's efforts to carry out that strategy in line with the mission.

B. *Clear Delineation of Responsibility and Authority and the Line Between Oversight and Management*

All directors need to understand the role of the board as an entity, as well as their individual duties as fiduciaries and the distinct role of management. The role of the board is one of oversight – directors "direct" – while the role of management is to carry out the day-to-day activities of the organization – managers "manage." Often members of a not-for-profit board cross the line between oversight and management by becoming overly engaged in the operating activities of the entity, such as the day-to-day work required to fulfill programmatic goals. Board involvement in operating activities can lead to tensions between the board and management/staff. Boards should consider the extent to which their involvement in operating – as opposed to strategic – activities benefits or hinders the ability of management to perform.

The board may wish to consider defining the respective roles of the board and management with respect to strategic and operational activities in a formal "delegation of authority" that addresses the specific matters reserved to the CEO and those reserved to the board. For example, the board typically delegates the execution of policies and strategic objectives to management. Creating a formal delegation of authority can also help the board identify and communicate expectations about what issues are worthy of board consideration and in what time frame decisions are expected to be made.

C. *Monitoring and Measuring Performance*

Active board oversight requires that management performance be evaluated against the specific operational goals that the board has determined will further the agreed strategy in line with the organization's mission. The board should then define with management the specific benchmarks (both long-term and short-term) that would indicate successful performance and monitor results

achieved by management against those benchmarks. If performance goals are not being met, the board should consider where adjustment may be necessary. For example, improving performance may call for adjusting the strategy and replacing management where necessary. Management changes are inevitable and the board should ensure that a succession plan for key executives is in place.

The board should utilize its evaluation of management performance in designing and implementing an executive compensation scheme that will compensate executives fairly and includes appropriate incentives for performance. Although not typical, in some cases it may be appropriate to compensate directors for their service on the board of the not-for-profit organization.

D. “Following the Money”

Overseeing the finances of the not-for-profit organization is a critical part of the board’s role. Fulfilling this oversight responsibility begins with ensuring that the organization has an effective Chief Financial Officer or equivalent (such as a bookkeeper or outside accounting firm). Recruiting such a person can be challenging, particularly as not-for-profit salaries are generally lower than in the for-profit sector. The board should establish open lines of communication with the CFO to facilitate the exchange of information. The board should work with the CFO in developing and approving budgets and financial plans, and should test management assumptions that may be embedded within budgetary analysis. The board is also responsible for monitoring and ensuring the integrity of the organization’s financial reporting processes (including recordkeeping), internal control systems and audit, and should hire an independent auditor if necessary.

E. Determining Board Focus and Information Needs

The board’s ability to govern effectively depends on how it focuses its time and attention and the information it has available to it. The board should take charge of its own agenda by identifying, articulating, prioritizing and scheduling the issues that the board will address. Usually, board attention – and therefore the board’s agenda – is best focused on “following the money,” setting strategic direction and long-term goals, monitoring management’s progress and results to achieve those goals, and ensuring satisfactory compliance with ethical standards and the law.

Board meetings should be structured to make the best use of board time. Meetings should be scheduled well in advance – for example, via an annualized schedule to address foreseeable issues – with additional meetings called when board review with respect to other issues is required. Board meetings should balance management presentations with discussion among directors and with management. Appropriate reports and analyses furnished in advance facilitate discussion at the meeting.

An effective board requires accurate, relevant and timely information relating to the organization and the context in which it operates. The board should identify what information it needs and work with management to ensure that it obtains such information. Information should be distributed in advance of meetings to enable directors to review the material and reflect on it.

In addition, the board of a not-for-profit organization might find it helpful to adopt governance guidelines it applies in fulfilling its responsibilities, including board functions and processes, as well as the organization's expectations of directors. Such guidelines should be specific and tailored to the needs and circumstances of the particular not-for-profit organization. Various factors unique to each not-for-profit organization, including, without limitation, organizational structure, activities, life-cycle stage, funding mechanisms and applicable legal requirements, may affect the provisions that should be addressed. The board sets the tone by adopting a governing style that emphasizes: adherence to codes and principles of conduct and ethics; strategic leadership rather than a focus on administrative detail; prospective focus on achieving mission based on current and anticipated facts; anticipation and preparedness rather than reactivity; collegiality, with respect for diverse viewpoints, and not divisiveness; and consensus building, as opposed to "majority rule."

F. Board Size and Composition

Size and composition influence the ability of a board to be effective. Most decision-making groups function best with between seven and ten members. Not-for-profit boards are often much larger, due to their fundraising nature. If downsizing is not practical, a very large board may wish to consider whether there are ways to facilitate efficient decision-making through the use of committees; for example by creating an executive committee or advisory board that has authority to make decisions on behalf of the board where appropriate. Note that not-for-profit organizations that are required to file Form 990s with the IRS are required to disclose the composition and scope of an executive committee or similar committee with broad authority to act on behalf of the board – see **Tab 4**.

Board candidates should be selected with a set of criteria in mind that are specific to the needs of the particular not-for-profit organization. The board (through a nominating committee, if there is one) should engage in a review of the composition of the board as a whole periodically, including the balance of independence, business specialization, technical skills, diversity, fundraising ability and/or willingness to make personally meaningful gifts, geographic representation and other desired qualities that directors bring to the board (such as integrity and sound judgment) – bearing in mind that a board is more than the sum of its parts and that the right mix of competencies will change as the organization evolves and its circumstances change – and refresh the board where necessary.

It has been observed that board member disengagement harms the organization in a number of ways, and that selection and identification of potential board members should involve a process of looking past a short-term ability to secure funds, and should look to the long-term positive or negative impact on the organization that the particular candidate will have. The board should be comprised of directors who are committed to the organization's mission. Directors should ensure that they are interested in and understand the activities of the organization, the environment in which it exists and the challenges and risks it faces. They should learn about the structure of the organization by reviewing its governing documents, policies and minutes of board and committee meetings from the past year, as well as any literature produced as part of the organization's programs. Directors should seek out information from management where required to gain this understanding.

G. Board Independence

Independence is the foundation for objective judgment. The board should be comprised and organized in a manner that encourages directors to be engaged and to form and express objective judgments about issues involving inherent conflicts with management, such as:

- Evaluation of management performance and compensation, and succession planning;
- Approving the organization's financial objectives and major plans, strategies and actions;
- Oversight of audit, accounting, financial reporting and risk management; and
- Determination of board composition and governance processes.

The board should include a number of persons who lack material business relationships to the entity and also lack material business and family relationships to senior management and key constituents. Note that not-for-profit organizations that are required to file Form 990s with the IRS are required to disclose the number of directors who are considered "independent" in accordance with IRS tests, as well as whether any directors have family or business relationships with officers, directors, trustees or key employees of the organization – see ***Tab 4***.

H. Board Leadership

The board needs effective and focused leadership. An effective board leader is one who is capable of developing a strong but independent working relationship with management and in guiding the board to consensus after free and open discussion of viewpoints. An independent board leader is especially important for:

- Organizing the board agenda with input from management and helping to identify the board's information needs;
- Leading board discussions of management performance and compensation in sessions at which management is not present ("executive sessions"); and
- Encouraging frank but collegial discussions both at the board level and as between the board and management.

The board should not be led by management, either in name or in spirit.

I. Policies and Guidelines

The board plays a key role in setting the tone of the organization by establishing policies and guidelines that set forth expectations for behavior within the organization and by assessing whether senior management is promoting an appropriate ethical culture within the organization. These policies should include the following:

- **Board Guidelines:** Board guidelines set forth expectations of directors, which may include board functions, processes and structures, as well as requirements to make personally meaningful gifts and/or contribute to fundraising efforts.
- **Conflict of Interest Policy:** The conflict of interest policy assists directors, officers and others in the organization in identifying, evaluating and resolving conflicts of interest. A conflict of interest arises where a board member, management or other decision-maker has an outside interest or relationship that conflicts or may conflict with his or her ability to act strictly in the interests of the organization. For example, a board member is said to be conflicted where the not-for-profit organization is considering a commercial transaction with another company in which the board member has a financial interest.

The policy should define conflicts of interest and should require that the organization's officers, directors, trustees, and key employees disclose or annually update their interests that could give rise to conflicts of interest (usually by completing a "Questionnaire Concerning Conflicts of Interest and Affirmation re: Organization Policies"). The conflict of interest policy should also include practices for monitoring proposed or ongoing transactions and dealing with potential or actual conflicts, whether discovered before or after the transaction has occurred. The conflict of interest policy should specify the committee or other body that determines whether a conflict exists and the body that reviews actual conflicts (typically the audit committee or the full board). Persons with a conflict should be prohibited from participating in the deliberations and other decisions regarding the conflict. A sample policy is provided by the IRS on Appendix A to the Instructions to Form 1023. Note that not-for-profit organizations that are required to file Form 990s with the IRS are required to disclose whether they have adopted a conflict of interest policy that meets certain requirements – see **Tab 4**.

- **Code of Business Conduct and Ethics:** This code applies to the board, management and employees and requires fulfillment of responsibilities in a manner that furthers the mission of the organization and complies with law, regulations, ethical standards and policies adopted by the organization.
- **Whistleblower Policy:** The whistleblower policy should contain procedures to receive, investigate and take appropriate action regarding fraud or non-compliance with law or organizational policy, and to protect whistleblowers against retaliation. Such procedures are encouraged to be implemented by not-for-profit organizations so as to ensure compliance with applicable provisions of Sarbanes-Oxley – see **Tab 2**. The policy should encourage staff and volunteers to come forward with credible information regarding illegal practices or violations of organizational policies, law, regulations and/or ethical standards, and specify that the organization will protect the individual from retaliation, and identify those staff, board members or outside parties to whom such information can be reported. Note that not-for-profit organizations that are required to file Form 990s with the IRS are required to disclose whether they have adopted whistleblowing procedures that meet certain requirements – see **Tab 4**.

- **Document Retention and Destruction Policy:** The document retention and destruction policy ensures that documents are retained pursuant to applicable laws and that documents that may be relevant to legal proceedings or governmental investigations are not destroyed. Such procedures are encouraged to be implemented by not-for-profit organizations so as to reduce the risk that documents will be inappropriately destroyed – see **Tab 2**. The policy should identify the record retention responsibilities of staff, volunteers and board members for maintaining and documenting the storage and destruction of the organization’s documents and records. Note that not-for-profit organizations that are required to file Form 990s with the IRS are required to disclose whether they have adopted a document retention and destruction policy that meets certain requirements – see **Tab 4**.
- **Other Policies:** If the organization participates in significant grant programs or joint ventures it should adopt policies governing those activities as well.

J. Committee Structure & Operations

Appropriate structure and use of board committees can enhance the efficiency and effectiveness of the board. Board committees may be particularly useful with respect to board responsibilities that may involve a conflict of interest for management; such committees should – where possible – be comprised of directors who are independent from management and should be provided for in the organization’s bylaws. Key board committees include:

- **Audit Committee:** This committee is responsible for hiring and assuring the independence of the independent auditor (if any), and providing oversight of (a) the audit, review or compilation of financial statements, (b) internal controls and related processes designed to assure the reliability of financial data, and (c) risk management processes. Note that not-for-profit organizations that are required to file Form 990s with the IRS are required to disclose whether they have an audit committee that meets certain requirements – see **Tab 4**.
- **Compensation Committee:** This committee is responsible for determining and reviewing the compensation of the CEO and other senior managers in accordance with objective, documented and comparable information, and for ensuring that compensation is tied to the achievement of predetermined performance goals that are keyed to mission-related accomplishments. Note that not-for-profit organizations that are required to file Form 990s with the IRS are required to disclose whether their process for determining compensation of certain persons included, among other things, review and approval by independent persons – see **Tab 4**.
- **Nominating and Governance Committee:** This committee is responsible for nominating board candidates, ensuring that the size, leadership and composition of the board are appropriate, and overseeing governance structures and policies (including committee structure, conflict of interest and other policies, and bylaws).

However, whether a not-for-profit organization would find it useful to establish a particular committee will depend on the needs and circumstances of the organization. For example, an organization with significant financial resources or complex financial arrangements may benefit significantly by establishing an audit committee. In contrast, a small organization with simple financial structures may decide that it would be efficient and effective to entrust responsibility for ensuring the integrity of financial reporting to the entire board. (In either case, some members of the board should be financially literate and at least one director should be sophisticated concerning financial reporting and accounting.)

Committee charters help set forth the responsibilities of each committee and clarify whether decisional authority is delegated to the committee or whether the committee is to undertake the background work and make recommendations to the board for board approval.

As discussed above, not-for-profits with large boards may find it useful to organize an executive committee to take on a number of tasks that might otherwise fall to the full board, but can be achieved more efficiently in a smaller group. Additionally, boards of not-for-profit organizations often have a large number of committees that focus on operational or program aspects; for example, strategic planning, finance, fundraising and public relations. Care should be taken that Board committees do not unduly proliferate and result in the board becoming over-engaged in operational matters and hampering management's ability to perform effectively.

K. Board Health and Evaluation

The board should regularly evaluate its performance and seek to continually improve (see **Tab 14**). The board of a not-for-profit organization may wish to consider evaluating its effectiveness against BoardSource's "Twelve Principles of Governance that Power Exceptional Boards":¹

1	Constructive Partnership	Exceptional boards govern in constructive partnership with the chief executive, recognizing that the effectiveness of the board and chief executive are interdependent.
2	Mission Driven	Exceptional boards shape and uphold the mission, articulate a compelling vision, and ensure the congruence between decisions and core values.
3	Strategic Thinking	Exceptional boards allocate time to what matters most and continuously engage in strategic thinking to hone the organization's direction.
4	Culture of Inquiry	Exceptional boards institutionalize a culture of inquiry, mutual respect, and constructive debate that leads to sound and shared decision making.
5	Independent-mindedness	Exceptional boards are independent-minded. When making decisions, board members put the interests of the organization above all else.

¹ BoardSource, *The Source: Twelve Principles of Governance That Power Exceptional Boards* (2005).

6	Ethos of Transparency	Exceptional boards promote an ethos of transparency by ensuring that donors, stakeholders, and interested members of the public have access to appropriate and accurate information regarding finances, operations, and results.
7	Compliance with Integrity	Exceptional boards promote strong ethical values and disciplined compliance by establishing appropriate mechanisms for active oversight.
8	Sustaining Resources	Exceptional boards link bold visions and ambitious plans to financial support, expertise, and networks of influence.
9	Results-Oriented	Exceptional boards are results-oriented. They measure the organization's advancement towards mission and evaluate the performance of major programs and services.
10	Intentional Board Practices	Exceptional boards intentionally structure themselves to fulfill essential governance duties and to support organizational priorities.
11	Continuous Learning	Exceptional boards embrace the qualities of a continuous learning organization, evaluating their own performance and assessing the value they add to the organization.
12	Revitalization	Exceptional boards energize themselves through planned turnover, thoughtful recruitment, and inclusiveness.

L. Other Governance Practices

- ***Minutes and Records:*** Boards and their committees should ensure that minutes of their meetings, and actions taken by written consent, are contemporaneously documented. Minutes/records should detail or summarize the deliberative process undertaken by the board and committees as they address organizational issues in the proper discharge of their fiduciary duties; in this way, the minutes/records serve not only as important reminders as to what has been decided and why, but also serve as evidence as to how the board and committees fulfilled their fiduciary duties.
- ***Financial Statements:*** Directors are stewards of a not-for-profit organization's financial and other resources. The board should ensure that financial resources are used to further charitable purposes and that the organization's funds are appropriately accounted for by regularly receiving and reviewing up-to-date financial statements and any auditor's letters or finance and audit committee reports.

Smaller organizations may prepare financial statements without any involvement of outside accountants or auditors. Others use outside accountants to prepare compiled or reviewed financial statements, while others obtain audited financial statements. State law may impose audit requirements on certain charities. Many organizations that receive funds from the U.S. Government are required to undergo one or more audits as set forth in the Single Audit Act and OMB Circular A-133. However, even if an audit is not required, a charity with substantial assets

or revenue should consider obtaining an audit of its financial statements by an independent auditor.

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M. Related Materials

Outline of Director Duties and Liabilities at ***Tab 2***.

IRS Form 990 Memorandum at ***Tab 4***.

Sample Board Guidelines at ***Tab 5***.

Sample Conflict of Interest Policy at ***Tab 6***.

Sample Code of Conduct and Ethics at ***Tab 7***.

Sample Whistleblower Policy at ***Tab 8***.

Sample Committee Charters at ***Tabs 9-13***.

Issues and Concerns for Directors of Troubled Not-For-Profit Organizations at ***Tab 16***.

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DUTIES AND LIABILITIES OF DIRECTORS OF NOT-FOR-PROFIT ORGANIZATIONS¹

I. BACKGROUND FOR NOT-FOR-PROFIT ORGANIZATIONS

A tax-exempt not-for-profit organization is defined by its inability to distribute its profits to those who control it or to its directors or officers.² A not-for-profit corporation is organized “exclusively for a purpose or purposes, not for pecuniary profit or financial gain,” and “no part of the assets, income or profit of which is distributable to, or inures to the benefit of, its members, directors or officers except to the extent permitted under this statute.”³ The distinguishing characteristic is not a lack of profits, but the prohibition on pecuniary gain, and it is that prohibition – rather than statutory type of the not-for-profit corporation⁴ – that informs many of the liabilities and duties of its directors and officers.⁵

A. Role and Purpose of the Board of Directors in Not-For-Profit Corporations

Not-for-profit organizations are governed by a board of directors that has management powers.⁶ The board typically delegates responsibility for the day-to-day management of the organization to a management team appointed by the board. In addition, the New York Not-For-Profit Corporation Law (“N-PCL”) § 701 allows incorporators to diminish the management powers of the board by vesting more power in management in the certificate of incorporation. Nonetheless, the board remains liable for breaches of its duties, even if it does not retain management powers.⁷ This is important because:

- Most members of not-for-profit boards are volunteers and, as such, may incorrectly assume that they have few legal responsibilities; and
- Not-for-profit board members often operate on a part-time schedule and do not devote much time to their directorships.

B. Enforcement of Duties and Liabilities

The N-PCL identifies the following persons as potential enforcers of director and officer duties and liabilities:

- The Attorney General;⁸
- The corporation itself;⁹ or
- On behalf of the corporation: any director or officer;¹⁰ a receiver, trustee in bankruptcy or judgment creditor;¹¹ or a member of the corporation, in limited derivative cases.¹²

This can be contrasted to for-profit corporations, which have shareholders or owners capable of enforcing director and officer duties and liabilities.¹³

1. *The Attorney General.*

Recently, in the not-for-profit arena, the Attorney General has been the primary enforcement agent.¹⁴ The Attorney General may sue not-for-profit directors and officers for a breach of fiduciary duty under several statutory provisions:¹⁵

- N-PCL § 112 (power to initiate an action or special proceedings against directors or officers);
- N-PCL § 720 (power to initiate suits against directors and officers seeking certain types of relief); and
- N-PCL § 719 (liability of directors in certain cases).

In addition, the Attorney General has authority under the N-PCL to regulate fundamental changes and to play a role in overseeing major developments and transactions at a not-for-profit corporation which require court approval, such as:

- Amendments to certificates of incorporation that change an organization's purpose;¹⁶
- Sale, lease, exchange or other disposition of all or substantially all the assets of the organization;¹⁷
- Dissolution;¹⁸ and
- Mergers and consolidations.¹⁹

This oversight can lead to an investigation of whether directors and officers have satisfactorily discharged their duties in deciding to dispose of some or all of the organization's assets.

- *Manhattan Eye, Ear & Throat Hospital and Memorial Sloan Kettering Cancer Center et al. v. Eliot Spitzer*. "Since as a type B, i.e., charitable, corporation, Manhattan Eye, Ear & Throat Hospital ("MEETH") does not have shareholders, the Attorney General, acting as *parens patriae*, is statutorily involved whenever such a charity seeks to dispose of all, or substantially all, of its assets, as MEETH resolved to do."²⁰

The Attorney General may seek a wide array of remedies for director and officer misconduct and breaches of fiduciary duty under the N-PCL²¹ including:

- Payment of restitution by the director or officer;
- Removal of the director or officer;
- Voiding of a transaction in which a director or officer took part and which was deemed to be self-interested;

- Other injunctive relief; and
 - Dissolution of the organization.²²
2. *The Internal Revenue Service (“IRS”).*

The IRS has an important role to play in policing not-for-profit organizations and their directors and officers, using intermediate sanctions or revocation of tax exempt status as a means of encouraging not-for-profit directors and officers to fulfill their fiduciary duties.²³

- *Kamehameha Schools* (an educational not-for-profit corporation whose board violated its directorial duties). The IRS, instead of simply imposing sanctions, cooperated with the Hawaii Attorney General in formulating an agreement²⁴ with Kamehameha mandating implementation of a new governance regime and on the payment of a fine imposed by the Hawaii Attorney General.²⁵
3. *Cooperative Prosecution.*

A not-for-profit organization whose directors are accused of violating their duties may face cooperative prosecution by several entities, including the Attorney General, the IRS, and any other regulatory body that has oversight of the offending corporation. For example:

- *Kamehameha Schools* – the IRS deferred to the Hawaii Attorney General in deciding what sanctions to apply.²⁶
- *Committee to Save Adelphi v. Diamandopoulos, et al.*²⁷ – the Board of Regents of the State of New York and the New York Attorney General instituted simultaneous actions. Although the Board of Regents and the New York Attorney General did not act in concert, cooperation among various regulators is likely to be seen more frequently in the future.

C. Liability of Directors, Officers and Trustees to Third Parties

The liabilities of directors, officers and trustees to third parties are governed by N-PCL § 720-a.

- *Standard.* Gross negligence or intentional conduct.
 - A director may be liable to persons other than the corporation, association, organization or trust on whose board the director serves on the basis of the director’s conduct in the execution of the office, if the director does not receive compensation for such service and such conduct, with respect to the person asserting liability, constituted gross negligence or was intended to cause the resulting harm.²⁸

- As a result of such a rigorous standard, directors and officers are rarely liable to third parties based on their corporate actions.

II. DUTIES OF NOT-FOR-PROFIT DIRECTORS AND OFFICERS

Directors and officers are fiduciaries of the not-for-profit organizations²⁹ they manage. The N-PCL and judicial authorities have defined three broad duties: the duties of care, loyalty and obedience.

- N-PCL § 720: An action may be brought against one or more directors or officers to compel the defendant to account for his official conduct in the following cases:
 - The neglect of, or failure to perform, or other violation of his duties in the management and disposition of corporate assets committed to his charge; and
 - The acquisition by himself, transfer to others, loss or waste of corporate assets due to any neglect of, or failure to perform, or other violation of his duties.³⁰

A. *The Duty of Care*

The duty of care for not-for-profit directors and officers is set out in N-PCL § 717:

Directors and officers shall discharge the duties of their respective positions in [(1)] good faith and [(2)] with the care an ordinarily prudent person in a like position would exercise under similar circumstances.

The duty of care is closely modeled on the New York Business Corporation Law (“BCL”) for-profit model, and the legal expectation and legislative presumption is that courts will apply the standards uniformly.³¹ In general, most commentators have found that, at the very least, the duty of care requires directors to:

- Be attentive to the fiscal affairs of the organization;
- Conscientiously apprise themselves of the affairs and important matters of the corporation;
- Create and enforce “internal information systems;” and
- “Serve as a check or veto on management.”³²

1. *Good Faith.*

Good faith is a subjective standard that has been defined as “acting honestly; not to act, or cause the corporation to act, in an unlawful way; purporting to rely upon information

that a director knows to be untrue will not be considered acting in good faith.”³³ Good faith has been equated with “rules of conscientious fairness, morality and honesty in purpose”³⁴ and requires “the exercise of an honest judgment and an honest and unbiased consideration of any fact or circumstances affecting the general interest of the corporation.”³⁵ The good faith standard mandates an objective review of facts and circumstances in an effort to ascertain the defendant’s state of mind before making a deliberation of whether the defendant’s actions were taken in good faith.³⁶

2. *Care.*

The Nonprofit Organization Committee of the American Bar Association’s Guidebook for Directors of Nonprofit Corporations (the “ABA Guidebook”) defines the second part of the duty of care as follows:

Care – Expressing the need to pay attention and to act diligently and reasonably;

Ordinarily Prudent Person – incorporating the basic attributes of common sense, practical wisdom, and informed judgment;

Under Similar Circumstances – recognizing that the nature and extent of the oversight will vary, depending upon the corporation concerned and the factual situation presented.³⁷

3. *Application of the Duty of Care.*

The director’s duty of care applies both to his or her decision-making function and to his or her oversight function.³⁸

- Decision-making depends on the facts and circumstances at a certain point in time.
- The director’s oversight function, by contrast, involves “ongoing monitoring of the corporation’s business and affairs over a period of time.”³⁹

Within the for-profit context, “It is the directors’ duty to make necessary inquiries” where “suspicions are aroused or should be aroused.”⁴⁰ However, “directors are not required to ferret out wrongdoing absent a specific warning or other obvious “red flag.”⁴¹ Therefore, “directors may depend on the presumption of regularity absent knowing or notice to the contrary.”⁴²

This standard appears to apply to not-for-profit corporations as well. In the following cases, directors were liable for breaches of the fiduciary duty of care because they failed to respond to blatant violations or irregularities in the governance of their organizations:

- *United States v. William Aramony et al.*⁴³ See below for further discussion.

- *Vacco v. Diamandopoulos*.⁴⁴ See below for further discussion.
- 4. *Applications of the Duty of Care to Investment Decisions.*

Not-for-profit organizations are likely to face increased scrutiny by the Attorney General and the IRS into investment performance and investment decisions and general compliance with the Uniform Prudent Management of Institutional Funds Act (“UPMIFA”) rules, as codified by New York.⁴⁵ These rules impose a statutory duty of care, expenditure rules for endowments and rules required for delegation of investment management. In the exercise of its investment authority, the administration of assets received for specific purposes and the delegation of investment management decisions, the board should consider the following:

- *Reasonable Costs.* A not-for-profit organization should incur only those investment fees and costs which are appropriate and reasonable in relation to its assets, purposes and the skills available to it.⁴⁶
- *Investment Factors.* The board should consider the following factors when managing and investing funds: (a) general economic conditions; (b) the possible effect of inflation or deflation; (c) expected tax consequences; (d) the role that each investment or course of action plays within the overall investment portfolio of the fund; (e) the expected total return from income and the appreciation of investments; (f) other resources of the organization; (g) the needs of the organization to make distributions and to preserve capital; and (h) an asset’s special relationship or special value, if any, to the purposes of the organization.⁴⁷
- *Investment Strategy and Policy.* Investment decisions should not be made in isolation but in the context of an overall investment strategy having risk and return objectives reasonably suited to the organization.⁴⁸ Not-for-profit organizations should have a written investment policy setting forth guidelines on investments and delegation of management and investment functions in accordance with applicable law.⁴⁹ A not-for-profit organization should make reasonable efforts to verify facts relevant to the management and investment of its fund.⁵⁰
- *Diversification.* Not-for-profit organizations should diversify their investments unless the organization prudently determines that the purposes of its investments are better served without diversification because of special circumstances.⁵¹ Decisions to not diversify should be reviewed at least annually.⁵²
- *Timing of Investment Decisions.* Not-for-profit organizations should carry out decisions concerning the retention or disposition of property or to rebalance a portfolio promptly, unless there is a good reason not to.⁵³

- *Delegation of Management and Investment Functions.* Not-for-profit organizations should: (i) carefully carry out decisions concerning the selection, retention or termination of investment advisors including assessing any conflicts of interest or other factors affecting their independence; (ii) carefully monitor an investment advisors' performance and compliance; and (iii) provide that each contract delegating authority to an investment advisor should be terminable upon no more than 60 days notice.⁵⁴
5. *Reliance on Information under the Duty of Care.*

N-PCL § 717(b): "In discharging their duties, directors and officers, when acting in good faith, may rely on information, opinions, reports or statements including financial statements and other financial data, in each case prepared or presented by:"⁵⁵

- One or more officers or employees of the corporation, whom the director believes to be reliable and competent in the matters presented;⁵⁶
- Counsel, public accountants or other persons as to matters that the directors or officers believe to be within such person's professional or expert competence;⁵⁷ or
- A committee of the board upon which they do not serve, duly designated in accordance with a provision of the certificate of incorporation or the bylaws, as to matters within its designated authority, which committee the directors or officers believe to merit confidence, so long as in so relying they shall be acting in good faith and with [the requisite] degree of care."⁵⁸

"Persons who so perform their duties shall have no liability by reason of being or having been directors or officers of the corporation."⁵⁹

Competence vs. Confidence

For reliance to be defensible it must be placed upon experts who are competent in their fields; competence generally implies expertise.⁶⁰

When relying on an "expert" opinion, diligence requires that the board investigate the expert's qualifications and ascertain his competence. The director must review the material and follow up with any questions presented by that material. "If all a director knows about a report is the conclusion, he is not acting in good faith or with the required diligence."⁶¹ Moreover, if a director has some expertise in a particular field, he is held to a higher standard while evaluating information presented to the board, even though other board members would only be subject to a layman's standard in order to satisfy the duty of care.⁶²

Conversely, in the case of a committee composed of the organization's board members, a reasonable belief that the committee members will act in good faith and in a disinterested manner is sufficient to satisfy the due care standard.⁶³

6. *The Business Judgment Rule.*

The business judgment rule protects director decision-making by limiting the scope of judicial review. The business judgment rule creates a presumption that the decision being challenged was made by “disinterested and independent directors on an informed basis and with a good faith belief that the decision will serve the best interests of the corporation.”⁶⁴ If the party challenging the decision does not overcome the presumption, then the business judgment rule prohibits the court from examining the merits of the underlying business decision.⁶⁵ The business judgment rule has never been codified in New York, and therefore is not found in the BCL or the N-PCL. However, New York’s highest court has accepted its use in for-profit cases⁶⁶ and in the not-for-profit arena.⁶⁷

- *Consumer Union of U.S., Inc.* (challenging legislation allowing for the conversion of defendant from a not-for-profit to a for-profit corporation, and directing that certain organization assets be used for various public health and charitable purposes). Plaintiffs alleged that the board breached its fiduciary duties by deciding to convert and by encouraging politician-legislators to decide how its assets should be used after conversion. Noting that the legislation supersedes all inconsistent common-law and statutory duties, the court made the point that even if this was not the case, “the business judgment rule...bars plaintiff’s claim.”⁶⁸
- *William J. Higgins v. NYSE*⁶⁹ (challenging the proposed merger of the NYSE and Archipelago). Plaintiff alleged breaches of the fiduciary duty of loyalty, due care and good faith by the NYSE’s board and CEO. The court in *Higgins* cited *Consumer Union* as authority for the applicability of the business judgment rule to board decisions of not-for-profit organizations.⁷⁰
- *Eliot Spitzer, as Attorney General of the State of New York v. Schussel et al.*, (alleging a breach of fiduciary duty by defendant directors for a number of self dealing transactions). The Court recognized the business judgment rule but held that where there is a “showing of that a breach of fiduciary duty occurred, including evidence of bad faith and self dealing, or decision affected by inherent conflicts of interest, judiciary inquiry is triggered.”⁷¹

New York courts have also applied the business judgment rule in cases involving residential cooperative boards, religious corporations and educational institutions regulated by the New York State Board of Regents.⁷²

- *40 West 67th Street, Respondent, v. Pullman; Levandusky v. One Fifth Avenue Apartment Corp.* (boards of residential cooperatives).⁷³
- *Scheuer Family Foundation, Inc., v. 61 Associates*⁷⁴ (allegations that the directors and investment manager negligently managed the foundation’s assets and that the directors engaged in self-dealing). The New York

Supreme Court did not apply the business judgment rule because the defendants did not proceed with the “disinterested independence” requirement of the rule.⁷⁵

7. *N-PCL § 719: Liability of Directors in Certain Cases.*

N-PCL § 719 sets forward certain situations relating to financial decision-making/fiscal management in which directors can be jointly and severally liable to the corporation.

- **Cash or Property Distributions.** Any distribution of the corporation’s cash or property to members, directors or officers, other than a distribution permitted under N-PCL § 515, can create liability. Dividends are prohibited, but certain distributions of cash or property are authorized.⁷⁶
- **Security Redemptions.** Any redemption of capital certificates, such as bonds or security interests, member’s capital contributions, or subventions, must follow statutory prescriptions.⁷⁷
- **Interest Payments.** Payment of fixed or contingent periodic sums to the holder of subvention certificates or of interest to the holders or beneficiaries of bonds to the extent such payment is contrary to N-PCL §§ 504 or 506.⁷⁸
- **Dissolution and Distribution of Assets.** Dissolution must be accomplished according to statute. A failure to pay for all known liabilities of the corporation could create liability. Dissolution is covered in N-PCL Article 10 and Article 11. See **Tab 16**.
- **Corporate Loans.** Corporate loans to directors and officers are in most cases illegal and in general excluded. They are discussed in detail below.⁷⁹

If a director is present at a meeting where an action is taken that does not comply with the statutes listed above, *concurrence is assumed unless dissent is recorded*. If a director is not present, he is assumed to concur unless dissent is delivered or sent by registered mail or filed in the minutes of the proceedings, within a reasonable time after learning of such action.⁸⁰ In addition, a director against whom a claim is successfully made is entitled to contribution from other concurring directors.⁸¹

8. *Loans to Directors.*

- N-PCL § 716 prohibits loans from a not-for-profit corporation to its directors or officers, or to any corporation or firm in which one or more of its directors or officers hold a substantial financial interest.⁸²
 - A loan that violates § 716 is considered a violation of the director’s duty to the corporation.⁸³

- Exceptions:
 - Loans through the purchase of bonds, debentures or similar obligations of the type customarily sold in public offerings or through ordinary deposit of funds in a bank.
 - Loans between two Type B (charitable) organizations. However, directors should inform themselves of any potential conflicts of interest, such as a director who serves on both boards.
 - Loans to non-officer employees of not-for-profits.⁸⁴

B. The Duty of Loyalty

The duty of loyalty requires the undivided loyalty of directors to the interests of the not-for-profit corporation's mission and basic well-being. According to the ABA Guidebook:

The duty of loyalty requires directors to exercise their powers in good faith and in the best interests of the corporation, rather in their own interests or the interest of another entity or person.⁸⁵

In effect, "the duty of loyalty is thus transgressed when a corporate fiduciary . . . uses his or her corporate office . . . to promote, advance or effectuate a transaction between the corporation and such person (or an entity in which the fiduciary has a substantial economic interest, directly or indirectly) and that transaction is not substantively fair to the corporation."⁸⁶

The following are classic examples of situations that implicate the duty of loyalty:

- A director appearing on both sides of a transaction;
- A director receiving a personal benefit from a transaction;⁸⁷ or
- A director usurping or appropriating a financial opportunity for his own personal gain.

Although there is no specific mention of this duty in the N-PCL beyond § 717(a)'s exhortation to discharge duties in good faith, the duty of loyalty has been recognized by New York courts.⁸⁸

- *American Baptist Churches of Metropolitan New York v. Galloway*⁸⁹ (by creating a competing company to exploit, for personal gain, corporate opportunity created for the not-for-profit, the defendant director breached his duty of loyalty).⁹⁰

1. *N-PCL § 715 – Director and Officer Interested Transactions.*

N-PCL § 715 regulates self-interested transactions by directors and officers and creates a “safe harbor” for certain interested transactions. A corporation may not subsequently void or cancel a contract or transaction between the corporation and an entity in which a director has a substantial financial or personal interest, if:

- There has been “good faith disclosure” of the material facts as to the conflicting interests, or if that interest is known to the board or members entitled to vote; and
- If the transaction is authorized by a vote of the disinterested members or by the board (or committee) without counting the vote(s) of such interested director or officer.⁹¹

“However, if there was no such disclosure or knowledge, or if the vote of such interested director or officer was necessary for the authorization of such contract or transaction at a meeting of the board or committee at which it was authorized, the corporation may avoid the contract or transaction unless the party or parties thereto shall establish affirmatively that the contract or transaction was fair and reasonable to the corporation at the time it was authorized by the board, a committee or the members.”⁹²

2. *Key Cases: Adelphi and United Way.*

*Committee to Save Adelphi v. Diamandopoulos*⁹³

The board of trustees of Adelphi University breached its duty of care in fixing the salary and additional compensation of the University President, Dr. George Diamandopoulos, from 1987 to 1995. Specifically, Diamandopoulos received raises of approximately \$30,000 per year starting from \$95,000 in 1985, so that by 1996 his base salary was \$330,750. In addition to the base salary, Diamandopoulos received a life insurance policy of \$1.25 million, an annual \$60,000 contribution to Diamandopoulos’ pension fund, a contribution to a sabbatical year salary at one sixth of his base salary which was approximately \$55,000, an option to buy an apartment in New York City for \$905,000 (a 17% discount from the price at which Adelphi acquired it ten months earlier), free rent worth \$36,000 at a house near Adelphi, operating costs for the two residences at approximately \$100,000, and other perks. By 1996, the estimated total compensation when all of these factors were taken into account was \$837,113.

Except for one year, the full board of trustees did not review or approve the President’s compensation. The salary and additional compensation was set by a three-member ad-hoc committee, without explanation of Diamandopoulos’ contributions or an evaluation of how his performance rated against the academic goals of the University, and the committee did not consider salaries of presidents at comparable institutions.

The Board of Regents concluded that Diamandopoulos’ salary was not commensurate with the work he performed for Adelphi University, as mandated by N-PCL § 202(a)(12). The Board of Regents found that the trustees breached their duty of care by failing to take

the necessary steps to inform themselves of the compensation decisions, and for awarding Diamandopoulos compensation between 1993 and 1996 that was greater than the value of the services he performed. The Regents removed eighteen of nineteen trustees for breaching their fiduciary duty of care. Finally, the Board of Regents found that Diamandopoulos breached his duty of loyalty by accepting the excessive payments.

Committee to Save Adelphi also provides an example of self-dealing. One trustee, Ernesta Procope, received personal benefits from University insurance contracts. Procope owned and operated E.G. Bowman, Inc., a licensed broker of insurance policies. In 1986, the University's insurer threatened to cancel its coverage. The board of trustees formed a committee, chaired by Procope on account of her expertise in the insurance industry, which was charged with finding a new insurer for Adelphi. Rather than conducting an arms-length search for a new insurer, Procope installed E.G. Bowman as the insurance broker for the University. Diamandopoulos personally authorized the use of Procope's company, and explained to the board of trustees that its services were free of charge when in fact, Diamandopoulos arranged for E.G. Bowman to receive fees of \$1,227,949 in 1987. These terms were never disclosed to the board of trustees and thus the guidelines set forth in N-PCL § 715 for implementation of interested director transactions were not followed. Finally, this arrangement occurred while Procope was on the committee responsible for setting Diamandopoulos' compensation.⁹⁴ Although the arrangement that E.G. Bowman brokered may have been fair, the fact that Procope purposefully used her directorship for personal gain, and did not put the University's needs first by searching for the best available option, created a breach of the duty of loyalty for which she was found liable.

The Board of Regents found that both Diamandopoulos and Procope violated the duties of care and loyalty on several accounts. In the criminal counterpart to the Board of Regents decision, the Attorney General in the State of New York sued the removed trustees for damages relating to their breaches of the duties of care and loyalty.⁹⁵ There was no cooperation between the Attorney General and the Board of Regents in sanctioning the former trustees or the University. However, the New York Supreme Court did incorporate the Board of Regent's investigation, findings, and judgment in its decision. The Attorney General sought damages from the trustees who benefited from the improper payments and interested transactions, as well as from those who allowed the payments. The ousted trustees settled the criminal action by paying \$1.23 million to the University and assuming \$400,000 in legal fees, and Diamandopoulos paid approximately \$750,000 in damages to the University.⁹⁶

*The United Way and William Aramony*⁹⁷

William Aramony, the CEO of the United Way of America, and other United Way officials, were found to have engaged in self-dealing, and to have breached their fiduciary duties of care and loyalty. Aramony used company funds for chauffeur service, to buy personal gifts, take vacations and monthly flights to Florida, and to pay his girlfriend a salary despite that fact that she worked only one or two days a month. Aramony arranged these payments through Thomas Merlo, the CFO hired by Aramony, by paying him large bonuses. These bonuses were not based on work performed; rather, they were vehicles

through which the executives were able to appropriate company funds for private use. In one instance, Merlo received a bonus of \$300,000, and subsequently allocated \$89,000 to Aramony's girlfriend.⁹⁸ In addition, Aramony bought a condominium in Florida with United Way funds for \$125,000, funded through Steven Paulachak, another Aramony appointee in control of a subsidiary of United Way, ostensibly for use for company functions, but which was in fact for personal use.

The CFO purchased annuity funds in the name of the United Way then, using his position, caused them to be transferred to himself as annuitant. In two such schemes, he was able to defraud the United Way out of approximately \$500,000.

The Chief Executive of PUI, a subsidiary of United Way, transferred PUI funds to Aramony, facilitated Aramony's use of corporate funds for private matters, and filed fraudulent tax returns to cover up these transactions.

The court found that all three officials had violated their duties of care and loyalty, and had engaged in a "virtual roadmap for what to avoid in not-for-profit governance."⁹⁹ Additionally, the court found that the United Way board of directors breached its fiduciary duty of care by not staying sufficiently apprised of the organization's affairs, noting the following in its decision:

- There were only two board meetings per year and to prepare for those meetings, board members reviewed briefing books created by Aramony that did not contain substantial financial or strategic analysis of the organization or of any of its planned initiatives;
- Directors did not seek to investigate the company's practices or to insist on greater disclosure by management; and
- The board of directors did not investigate whether certain spin-offs were necessary or even financially viable and beneficial.

Concurrent with the convictions above, the board's conduct became the subject of an investigation by the New York Attorney General and was resolved in an out-of-court settlement in which the board was required to institute oversight procedures and to become more informed about the workings of the business.¹⁰⁰

3. *Compensation of Directors and Officers.*

N-PCL § 202(a)(12) sets the standard for appropriate compensation for officers and directors.

"Each corporation, subject to any limitations provided in this chapter or any other statute or its certificate of incorporation, shall have power in furtherance of its corporate purposes . . . [t]o elect or appoint officers, employees and other agents of the corporation, define their duties, fix their reasonable compensation and the reasonable compensation of directors . . . [s]uch compensation

shall be *commensurate* with services performed.” (emphasis added)¹⁰¹

Commentators and courts have focused on the “commensurate” language in the statute. Given the not-for-profit ethos of charitable organizations, “[t]he clear implication is that legislators are less tolerant of excessive executive compensation in the nonprofit arena than they are in the business community.”¹⁰² Therefore, it is important for boards to exercise diligence in setting and reviewing compensation schemes.

Furthermore, the IRS recently imposed stricter disclosure requirements on executive pay. Any organization filing a Form 990 must list all of its current officers, directors, and trustees, regardless of whether any compensation was paid to such individuals. The organization must also list up to 20 current employees who satisfy the definition of key employee (persons with certain responsibilities and reportable compensation greater than \$150,000 from the organization and related organizations), and its five current highest compensated employees with reportable compensation of at least \$100,000 from the organization and related organizations who are not officers, directors, trustees, or key employees of the organization.¹⁰³

C. *The Duty of Obedience*

The duty of obedience concerns a director’s obligation to ensure that the mission of the corporation is upheld and perpetuated. This duty is not stated explicitly in the N-PCL, and is not codified in any statute relating to not-for-profit organizations, but does find support in N-PCL §§ 201-202, and 402(a)(2), which require a not-for-profit organization to have a purpose in order to incorporate. The duty of obedience would be at issue in the following circumstances:

- Diversion of corporate resources away from the stated purpose, no matter how worthy the use, is not legally justifiable and exposes the director to liability for breaching the duty of obedience.¹⁰⁴
- In the context of a merger or sale of its assets, the organization must present a verified position to the requisite supreme or county court setting forth “[t]hat the consideration and the terms of the sale, lease, exchange or other disposition of the assets of the corporation are fair and reasonable to the corporation, *and that the purposes of the corporation*, or the interests of its members will be promoted thereby.” (emphasis added)¹⁰⁵
 - *Manhattan Eye, Ear and Throat Hospital v. Spitzer*. The trustees of the hospital sought court approval to sell the hospital facilities and the land to a cancer hospital and real estate developer. As part of this sale, the hospital would close certain programs that were mandated by its corporate purpose. Noting that the board failed or refused to consider other sale alternatives that would have allowed the hospital to continue as a specialty hospital in its chosen fields, the court found the board breached its duty of obedience, holding

that “the proposed use of the assets involves a new and fundamentally different corporate purpose.”¹⁰⁶

- *Agudist Council of Greater New York v. Imperial Sales Company*¹⁰⁷ (a synagogue’s sale of its property housing a senior center was invalidated because preservation of a service for seniors was an explicit organizational purpose).
- However, *In the Matter of the Application of Sculpture Center, Inc.*, the New York Supreme Court allowed the sale of a building belonging to the Friends of the Sculpture Center, as the proceeds were only to be used to buy a larger building in a different location, thus preserving the organization’s purpose.¹⁰⁸

Compliance with Applicable Laws

The duty of obedience also mandates that directors and officers ensure that the organization complies with applicable laws, including compliance with:

- Civil rights statutes;
- Sales tax laws;
- Internal Revenue Code (“IRC”) restrictions on self-dealing and taxable expenditures:
 - For example, federal withholding and employment taxes.¹⁰⁹ Although not-for-profit corporations do not pay taxes on gross income, they are responsible to the IRS for other disbursements, and a failure to comply with these regulations will result in directors and officers breaching the duty of obedience and exposing the corporation to liability under IRC § 6672; and
- Applicable environmental or antitrust statutes.

III. LIABILITIES IMPOSED BY THE IRS: INTERMEDIATE SANCTIONS

A. Background

IRC § 501(c)(3) proscribes any private inurement or benefit as a condition of tax-exempt status.

- Private inurement and benefit occurs when an officer or director profits financially or receives an improper advantage from the corporation’s actions or existence.¹¹⁰

On January 23, 2002,¹¹¹ the IRS enacted IRC § 4958 creating intermediate sanctions, a mechanism short of revocation of exempt status to punish those who benefit or inure at the

expense of their organizations. However, the imposition of intermediate sanctions does not preclude a revocation of tax-exempt status if the IRS deems it necessary.¹¹²

B. Excess Benefit Transactions

IRC § 4958 defines violations that inure or cause benefit to certain disqualified persons as “excess benefit transactions,” and imposes a two-tiered excise tax on individuals who profit from those transactions.

- An “excess benefit transaction” is a transaction in which an economic benefit is provided by an applicable tax-exempt organization, directly or indirectly, to a “disqualified person” where the value of the economic benefit provided exceeds the value of the consideration (including the performance of services) that is received.¹¹³

The following may be seen as excess benefit transactions:

- Certain sales of property;
- Unreasonable compensation;¹¹⁴
- Direct and indirect compensation or enrichment (through a controlled intermediary);¹¹⁵ and
- Certain gifts by sponsors or other entities in a transaction to directors or officers.

C. Definition of Disqualified Persons

The IRC defines “disqualified persons” to mean:

- A person who was, at any time during the five-year period ending on the date of such transaction, in a position to exercise substantial influence over the affairs of the organization;
- A member of the family of such an individual; or
- A person who controls at least 35% of the transacting or benefiting entity.¹¹⁶

Treasury Regulation 53.4958-3(c) defines “substantial influence” to mean:

- Any person who is a member of the organization’s governing body, presidents, CEOs, treasurers, CFOs and any other individual regardless of title who either “has ultimate responsibility for implementing the decisions of the governing body or for supervising the management” or “has ultimate responsibility for managing the finances of the organization;”¹¹⁷ or

- Certain other persons can have “substantial influence,” depending on specific facts and circumstances, such as whether the person is a founder or a significant contributor to the organization.¹¹⁸

D. Taxes on Disqualified Persons and Managers Who Engage in Excess Benefit Transactions

A “disqualified person” who engages in an excess benefit transaction is liable for excise taxes under IRC § 4958 as follows:

- An initial tax of 25% of the excess benefit; and
- If the excess benefit is not returned within a reasonable time, then the IRS may levy an additional tax of 200% of the excess benefit on the offending individual.¹¹⁹

Additionally, a manager who does not fall within the disqualified person definition can still be taxed, albeit at a lower rate, if that manager is deemed to have knowingly participated in an excess benefit transaction.¹²⁰ A manager may be deemed to have “knowingly participated” if the manager had actual knowledge that the transaction would be an excess benefit transaction and either affirmatively approved the transaction or did not oppose the transaction.¹²¹ A manager who knowingly participates in an excess benefit transaction and where such participation was willful and/or not the result of reasonable cause (such as reliance upon a written opinion of counsel) will be taxed at 10% of the excess benefit.¹²²

1. *Exceptions to the Disqualified Persons Rule:*

- ***The “First Bite” Exception.*** IRC § 4958 does not apply to payments that are made pursuant to fixed, objective terms specified in a contract before the person was in a position to exercise substantial influence.¹²³ Once the person has achieved substantial influence, any future payments are reviewable.¹²⁴
- ***Reliance on a Professional Opinion Exception.*** A manager’s participation in a prohibited transaction will ordinarily not be considered “knowing” if, after “full disclosure of the factual situation to an appropriate professional, the organization manager relies on a reasoned written opinion of that professional with respect to elements of the transaction within the professional’s expertise.”¹²⁵ “Appropriate professionals” would include legal counsel (including in-house legal counsel) or certified public accountants or certified public accounting firms with expertise regarding the relevant tax matters.¹²⁶
- ***“Safe Harbor” Rebuttable Presumption.*** The organization, by taking certain steps, can create a rebuttable presumption that certain compensation agreements or property transfers were reasonable.¹²⁷

- **Advance Decision.** The board or a committee composed entirely of individuals who do not have a conflict of interest with respect to the transaction must make an advance decision regarding the transaction.¹²⁸
- **Comparability Data.** The decision-making body must obtain and rely upon appropriate comparability data in making its decision.¹²⁹ Appropriate data may include:¹³⁰
 - Appraisals;
 - Other offers;
 - Availability of similar services in the geographic area of the organization; and
 - Comparable compensation schemes.
- **Disinterested Participation.** Disqualified persons cannot participate in the discussion or the vote, but may be present to answer questions (although they may not be present during any debate or vote).¹³¹
- **Document the Decision.** The board or committee must document the basis for its decision within 60 days of the action taken, or before their next meeting.¹³² Documentation must include:
 - Terms of the transaction and date approved;
 - Members of the board or committee present when the transaction was approved, and those who voted on it;
 - Comparability data relied upon and how it was obtained;
 - Actions taken with respect to consideration of the transaction by a board or committee member who has a conflict of interest with respect to the transaction; and
 - The basis for determining the compensation or payment if the board or committee determines that what is reasonable or fair market value is higher or lower than the range of comparable data obtained.

However, if the organization reimburses excise taxes, pays personal expenses, offers to engage in transactions not at fair market value, or pays insurance premiums for excise tax liability for the individual, such payments are generally considered excess benefits unless they are included in the person's compensation package, which, in turn, is subject to the reasonableness requirement.¹³³

E. Recent Applications of Intermediate Sanctions

*Michael T. Caracci et al., v. Commissioner of IRS*¹³⁴

The Tax Court determined that the conversion of a chain of nursing homes from not-for-profit to for-profit entities by the founders of the company constituted an excess benefit transaction because the value of the not-for-profits surpassed the consideration paid. This resulted in an unfair enrichment of the main shareholders, the founders, of the for-profit entities by an approximate total of \$37 million each. The Tax Court upheld the penalties imposed by the IRS¹³⁵ and did not act to revoke the exempt status of the original not-for-profits that it deemed dormant. This decision shows that intermediate sanctions “have teeth,” and that it is likely that the IRS will endeavor to use them before seeking total disqualification of exempt status.¹³⁶ IRS Director of Exempt Organizations has confirmed that the IRS “has other intermediate sanctions cases in the pipeline.”¹³⁷

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The settlement imposed intermediate sanctions of only \$40,000 per trustee even though the IRS had originally sought \$6.5 million.¹³⁸ However, contingent to that settlement was the agreement that the organization would pay a \$25 million fine to the state. Additionally, by the terms of the settlement, it was agreed that the implicated trustees would resign and that the organization would follow operational parameters presented in the Closing Agreement in order to retain its exempt status.¹³⁹

IV. INDEMNIFICATION AND INSURANCE FOR NOT-FOR-PROFIT DIRECTORS AND OFFICERS

A. Indemnification

N-PCL §§ 721-726 provide the statutory framework for indemnification where directors act:

- In good faith;
- For a purpose that he reasonably believed to be in, or, in the case of service of any other corporation...not opposed to, the best interests of the corporation; and
- In criminal actions or proceedings... had no reasonable cause to believe that his conduct was unlawful.¹⁴⁰

Directors and officers *must* be indemnified if they have succeeded in defending a civil or criminal action or proceeding.¹⁴¹ The N-PCL allows a not-for-profit corporation to provide indemnification rights and requirements beyond those mandated by statute in the certificate of incorporation or in the bylaws as long as the additional indemnification provisions are not contrary to the indemnification requirements of the N-PCL.¹⁴²

A corporation is prohibited from indemnifying a director where it has been established by an adverse final judgment that his acts “were committed in bad faith or were the result of active and

deliberate dishonesty and were material to the cause of action so adjudicated, or that he personally gained in fact a financial profit or other advantage to which he was not legally entitled.”¹⁴³

B. Insurance

Indemnification provisions in the bylaws or certificate of incorporation provide protection only if, and to the extent, the organization has the financial capability to make indemnification payments. Many organizations purchase indemnity insurance to reassure potential directors that their costs will be covered in case of a claim.¹⁴⁴ According to the N-PCL¹⁴⁵ a not-for-profit corporation can obtain insurance to:

- Reimburse itself for any indemnification costs;
- Indemnify directors and officers for those costs allowed by the New York indemnification provisions; and
- Indemnify directors and officers for those costs that may not be allowed under the indemnification provisions,¹⁴⁶ provided that such a contract includes the required deductible and co-insurance payments.¹⁴⁷

V. OTHER CONSIDERATIONS

A. Volunteer Protection Act of 1997¹⁴⁸

The Volunteer Protection Act provides liability protection for volunteers of not-for-profit organizations for acts or omission on behalf of the organization if:

- The volunteer was acting within the scope of the volunteer’s responsibilities at the time of the act or omission;
- If appropriate or required, the volunteer was properly licensed, certified, or authorized by the appropriate authorities for the activities or practice in the State in which the harm occurred;
- The harm was not caused by willful or criminal misconduct, gross negligence, reckless misconduct, or a conscious, flagrant indifference to the rights or safety of the individual harmed; and
- The harm was not caused by the operating of a vehicle for which the State requires the operator or owner to possess a license or maintain insurance.¹⁴⁹

This Act preempts State law to the extent that such laws are inconsistent. However, State laws conditioning limited liability for volunteers cannot be inconsistent with this Act. For example, State law may require not-for-profit organizations to adhere to risk management procedures or to maintain insurance or other financially secure financial sources for recovery by individuals who suffer harm as a result of actions taken by a volunteer. For more information see **Tab 15**.

B. Whistleblower Protection

Section 1107 of the Sarbanes-Oxley Act of 2002 makes it a criminal offense, punishable by fines and/or up to 10 years of prison, for anyone, including not-for-profit organizations, to “knowingly, with the intent to retaliate” take any action harmful to an employee for providing information relating to the commission or possible commission of a federal offense.¹⁵⁰ To this end, not-for-profits should implement procedures for the communication of concerns or complaints regarding corporate financial or accounting practices, as well as for the appropriate evaluation and response to such communications. Additionally, not-for-profits may choose to provide protections for employees against harassment, discharge or other adverse actions for providing information.

C. Record Retention

Section 1102 of the Sarbanes-Oxley Act of 2002 mandates penalties for obstruction of justice caused by the destruction of documents that are, or are anticipated to become, subject to any kind of official proceeding or federal agency investigation.¹⁵¹ Criminal sanctions apply to all persons and entities, including not-for-profit organizations. Hence, not-for-profits would be well-served by having a document retention policy in place for the preservation of documents that are identified as potentially subject to known, and reasonably anticipated, investigations by governmental agencies.

ENDNOTES

¹ With the exception of Section III, which discusses certain aspects of U.S. Federal income tax law, this document contains a limited general discussion of director and officer liability arising under the not-for-profit law of the state of New York. Non-profit organizations that are organized in other states are subject to different applicable law. Furthermore, the Federal income tax law discussion contained in Section III regarding the intermediate sanctions regime is relevant only to exempt organizations that are either public charities or social welfare organizations, and is not intended to cover the many tax-related issues that confront not-for-profit organizations. For a more complete discussion of the fundamental tax law considerations applicable to not-for-profit organizations, see **Tab 4**.

² IRC § 501(c)(3).

³ N-PCL § 102(a)(5).

⁴ N-PCL § 201(b). There are different types of not-for-profit corporations. **Type A** is a corporation formed for non-business purposes including, but not limited to: civic, patriotic, political, social, fraternal, athletic, agricultural, horticultural, animal husbandry and for a professional, commercial, trade or service organization. **Type B** is a corporation formed for non-business purposes including but not limited to: charitable, educational, religious, scientific, literary, cultural or for the prevention of cruelty to children or animals. **Type C** is a corporation formed for a lawful business purpose to achieve a lawful public or quasi-public objective. **Type D** is a corporation that is formed under other corporate law of the state.

⁵ Bjorklund, Fishman and Kurtz, *New York Nonprofit Law and Practice: With Tax Analysis* (Charlottesville, VA: Michie Law Publishers 1997) at 393.

⁶ *Id.* at 330.

⁷ N-PCL § 701(b), and Bjorklund, *supra* note 5, at 337.

⁸ N-PCL § 720(b).

⁹ *Id.*

¹⁰ N-PCL § 720(b)(1).

¹¹ N-PCL § 720(b)(2).

¹² N-PCL § 720(b)(3). In certain cases a member may bring a derivative suit under N-PCL § 623.

¹³ *In the Matter of Herbert H. Lehman College Foundation, Inc. v. Ricardo R. Fernandez et al.* (“Lehman”), 292 A.D.2d 227, 228 (N.Y. Sup. Ct. 2002) (“directors of a not-for-profit corporation do not act on behalf of shareholders who control the corporation’s certificate of incorporation, and its board. They act on behalf of beneficiaries who have no direct voice in governing the corporation and must depend on the State to represent and protect their interests.”).

¹⁴ Three major cases in which the Attorney General has taken action as the enforcement agent are: *The People of the State of New York, by Eliot Spitzer v. Richard A. Grasso, Kenneth G. Langone, and the New York Stock Exchange* (“Grasso”), 2006 N.Y. Slip Op 26095 (Sup. Ct. N.Y. 2006) (motion to discuss four of the six claims denied), *rev’d*, 836 N.Y.S.2d 40 (N.Y. App. Div. 1st Dep’t May, 8, 2007); *Vacco, as Attorney General of the State of New York v. Peter Diamandopoulos et al.*, 715 N.Y.S.2d 269 (1998), Index No. 401253/97 (Sup. Ct. N.Y. Cty., March 24, 1997 complaint); *Manhattan Eye, Ear & Throat Hospital and Memorial Sloan Kettering Cancer Center et al. v. Eliot Spitzer, as Attorney General of the State of New York* (“MEETH”), 715 N.Y.S.2d 575, 1999. These cases are discussed in detail in Section II.

¹⁵ Elizabeth M. Guggenheimer, *Fiduciary Duties of Directors and Officers of Not-for-Profit Organizations: An Overview for Volunteer Attorneys*, Lawyers Alliance for New York, March 2000, at 14.

¹⁶ N-PCL § 804. See *Lehman*, *supra* note 13 (“By thus diluting the influence of the College and its president on the governance of the Foundation, in effect transforming the Foundation into an independent entity unaccountable to the College, the bylaw amendments changed the Foundation’s powers and purpose as enumerated in its certificate of incorporation. There can be no doubt that any like amendment to the certificate would require judicial approval on notice to the Attorney General.”).

¹⁷ N-PCL §§ 510, 511.

¹⁸ N-PCL Articles 10 and 11.

¹⁹ N-PCL § 907.

²⁰ *MEETH*, *supra* note 14, citing N-PCL § 511.

²¹ N-PCL § 112.

²² Guggenheimer, *supra* note 15, at 14.

²³ Michael A. Shea, *Closing Agreement Shows IRS Position on the ‘Straight and Narrow’ of Organization Management*, 12 Journal of Taxation of Exempt Organizations 24, July/August 2000. Although the IRC sections promulgating intermediate sanctions were adopted in official and finalized form in January 2002, the IRS enacted them in proposed form in 1996, and they have been applied in cases since they were first published.

²⁴ *Id.*

²⁵ *Id.*

²⁶ *Id.*

²⁷ *Committee to Save Adelphi v. Diamandopoulos* (Board of Regents of the University of the State of New York Decision Feb. 5, 1997).

²⁸ N-PCL § 720-a.

²⁹ *Scheuer Family Foundation, Inc. v. 61 Associates*, 179 A.D.2d 65, N.Y.S.2d 662 (1st Dept. 1992).

³⁰ N-PCL §§ 720(a)(1)(A) and 720(a)(1)(B).

³¹ Bjorklund, *supra* note 5, at 375.

³² *Id.* at 393.

³³ Nonprofit Organization Committee, *Guidebook for Directors of Nonprofit Organizations – Third Edition*, American Bar Association, at 7 (2012) (“ABA Guidebook”).

³⁴ Bjorklund, *supra* note 5, at 375.

³⁵ *Kavanaugh v. Kavanaugh Knitting Co.*, 226 N.Y. 185, 198, 123 N.E. 148 (1919).

³⁶ Bjorklund, *supra* note 5, at 376.

³⁷ *ABA Guidebook*, *supra* note 33, at 26.

³⁸ Block, Barton & Radin, *The Business Judgment Rule: Fiduciary Duties of Corporate Directors*, at 2 quoting Model Bus. Corp. Act Annotated § 8.30(a), (b) (5th ed. 2002).

³⁹ Model Bus. Corp. Act Annotated § 8.31 Official Comment at 8-56 (4th ed. 2007).

⁴⁰ *Hoye v. Meek*, 795 F.2d 893, 896 (10th Cir. 1986).

⁴¹ Block, *supra* note 38, at 127.

⁴² Model Bus. Corp. Act Annotated § 8.30 Official Comment at 8-37 (4th ed. 2007).

⁴³ *United States v. William Aramony, et al.*, 88 F.3d 1369 (1996).

⁴⁴ *Vacco v. Diamandopoulos*, *supra* note 14. Vacco was the New York Attorney General who brought the criminal component to the Board of Regents case against the trustees of Adelphi University.

⁴⁵ UPMIFA has been codified in New York at N-PCL §§ 550-558 (“NYPMIFA”). Also see N-PCL §§ 512-514, 522 regarding investment authority, delegation of investment management and use of restricted funds. For additional information on NYPMIFA see “A Practical Guide to the New York Prudent Management of Institutional Funds Act” available at http://www.charitiesnys.com/nypmifa_new.html UPMIFA has been codified in Delaware at 12 Del. Code §§ 4701 - 4710.

⁴⁶ N-PCL § 552(c)(1); 12 Del. Code § 4703(c)(1).

⁴⁷ N-PCL § 552(e)(1); 12 Del. Code § 4703(c)(2)(b)(1).

⁴⁸ N-PCL § 552(e)(2); 12 Del. Code § 4703(c)(2)(b)(2).

⁴⁹ N-PCL § 552(f) (this requirement to have a written investment policy is a requirement of NYPMIFA that is not in the UPMIFA).

⁵⁰ N-PCL § 552(c)(2).

⁵¹ N-PCL § 552(e)(4); 12 Del. Code § 4703(c)(2)(b)(4).

⁵² N-PCL § 552(e)(4) (this requirement to review decisions to not diversify is a requirement of NYPMIFA that is not in the UPMIFA).

⁵³ N-PCL § 552(e)(5); 12 Del. Code § 4703(c)(2)(b)(5).

⁵⁴ N-PCL §§ 514 and 554 (the requirement that contracts be terminable upon no more than 60 days notice is a requirement of NYPMIFA that is not in the UPMIFA); 12 Del. Code § 4705.

⁵⁵ N-PCL § 717(b).

⁵⁶ N-PCL § 717(b)(1).

⁵⁷ N-PCL § 717(b)(2).

⁵⁸ N-PCL § 717(b)(3).

⁵⁹ N-PCL § 717.

⁶⁰ Bjorklund, *supra* note 5, at 392.

⁶¹ *Id.*, quoting *Davidowitz v. Edelman*, 153 Misc. 2d 853, 583 N.Y.S.2d 340 (Sup. Ct., Kings Cty. 1992).

⁶² *Id.*

⁶³ *Davidowitz v. Edelman*, *supra* note 61, at 857.

⁶⁴ Block, *supra* note 38.

⁶⁵ *Id.*, quoting *Federal Deposit Ins. Corp. v. Stahl*, 89 F.3d 1510, 1517 (11th Cir. 1996).

⁶⁶ Bjorklund, *supra* note 5, at 384. In *Auerbach v. Bennett*, the Court of Appeals applied the federal standard encapsulated above to New York business corporations. *Auerbach v. Bennett*, 47 N.Y.2d 619, 419 N.Y.S.2d 920, 393 N.E.2d 994 (1979).

⁶⁷ *Consumer Union of U.S., Inc. et al. v. The State of New York, Empire HealthChoice, Inc. et al.*, 5 N.Y.3d 327, 840 N.E.2d 68 (2005).

⁶⁸ *Id.* at 360, 118.

⁶⁹ *William J. Higgins v. New York Stock Exchange*, 806 N.Y.S. 2d 339 (N.Y. Sup. Ct. 2005).

⁷⁰ *Id.* at 357.

⁷¹ *Spitzer v. Schussel*, N.Y.S. 2d 74 (N.Y. App. Div. Sept. 11, 2007).

⁷² *Morris v. Scribner*, 69 N.Y.2d 418, 515 N.Y.S.2d 424 (1987); *Committee to Save Adelphi v. Diamandopoulos*, (Board of Regents of the University of the State of New York Decision Feb. 5, 1997).

⁷³ *40 West 67th Street, Respondent v. Pullman*, 760 N.Y.S.2d 745, 747, 100 N.Y.2d 147, 790 N.E.2d 1174 (2003) citing *Levandusky v. One Fifth Avenue Apartment Corp.*, 554 N.Y.S.2d 807, 810, 75 N.Y.2d 530, 553 N.E.2d 1317 (1990).

⁷⁴ *Scheuer Family Foundation*, *supra* note 29.

⁷⁵ *Id.*

⁷⁶ N-PCL § 515. Distributions would be allowed to members in the case of corporate dissolution or liquidation.

⁷⁷ N-PCL §§ 502, 504 and 506.

⁷⁸ N-PCL §§ 504 and 506.

⁷⁹ N-PCL § 716.

⁸⁰ N-PCL § 719(b).

⁸¹ N-PCL § 719(c).

⁸² N-PCL § 716.

⁸³ *Id.*

⁸⁴ Bjorklund, *supra* note 5, at 413.

⁸⁵ ABA Guidebook, *supra* note 33, at 43.

⁸⁶ Block, *supra* note 38, at 263, quoting *Solash v. Telex Corp.*, [1987-1988 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 93,608 at 97,727 (Del. Ch. Jan. 19, 1988).

⁸⁷ *Id.*, citing *Cinerama Inc. v. Technicolor Inc.*, 663 A.2d 1134 (Del. Ch. 1994), *aff'd*, 663 A.2d 1156 (Del. 1995).

⁸⁸ *Guth v. Loft, Inc.*, 23 Del. Ch. 255, 5 A.2d 503, 511 (Del. 1939).

⁸⁹ *American Baptist Churches et al. v. Eric Galloway et al.*, 271 A.D.2d 92, 710 N.Y.S.2d 12 (N.Y. App. Div. (2000)).

⁹⁰ *Id.*

⁹¹ N-PCL § 715(a)(1) and N-PCL § 715(a)(2). Interested officers and directors can be present at the meeting approving the interested transaction and they can be counted in ascertaining a quorum for that meeting. N-PCL § 715(c).

⁹² N-PCL § 715(b).

⁹³ *Committee to Save Adelphi v. Diamandopoulos*, *supra* note 27.

⁹⁴ *Id.* at 25.

⁹⁵ *Vacco v. Diamandopoulos*, *supra* note 14.

⁹⁶ Halbfinger, *Lawsuits Over Ouster of Adelphi Chief Are Settled*, N.Y. Times, Nov. 18, 1998, at B1.

⁹⁷ *United States v. William Aramony, et al.*, 88 F.3d 1369 (1996); *Aramony v. United Way of America*, 28 F. Supp. 2d 147 (S.D.N.Y. 1998), *aff'd, rev'd and remanded in part* 191 F.3d 140 (2d Cir. 1999); *United States v. Aramony*, 166 F.3d 655 (4th Cir. 1999), *cert. denied* 526 U.S. 1146 (1999). A large part of this case law revolves around Aramony's efforts to receive several million dollars from a Replacement Benefit Plan that did not contain a "bad boy" clause canceling the payments if Aramony was convicted of a crime. The breaches of his duties and the fines assessed were not at issue in the appeals.

⁹⁸ *United States v. Aramony*, *supra* note 43, at 1374.

⁹⁹ Pamela A. Mann, *Advising Nonprofit Organizations*, Practising Law Institute, at 28 (2002).

¹⁰⁰ *Vacco v. Aramony*, N.Y.L.J., Aug. 7, 1998, p. 21 (Sup. Ct. N.Y. County July 13, 1998).

¹⁰¹ N-PCL § 202(a)(12).

¹⁰² White, Kantrowitz and Slutsky, *White on New York Corporations*, 14th ed., ¶ 202.04 (2005). See Grasso, *supra* note 14, at 30 (the Attorney General alleged that a majority of the Board did not effectively vote to approve Mr. Grasso's salary and additional compensation, as the Board was presented with allegedly inaccurate and incomplete information).

¹⁰³ Form 990, *Return of Organization Exempt from Income Tax*, Part VII (2010 Form 990).

¹⁰⁴ Bjorklund, *supra* note 5, at 414.

¹⁰⁵ N-PCL § 511(a)(6).

¹⁰⁶ *MEETH*, *supra* note 14, at 154.

¹⁰⁷ *Agudist Council of Greater New York v. Imperial Sales Company*, 158 A.D.2d 683, 551 N.Y.S.2d 955, 1990.

¹⁰⁸ *In the Matter of the Application of Sculpture Center, Inc.*, 2001 N.Y. Slip Op 40368U, 2001 N.Y. Misc. Lexis 1019.

¹⁰⁹ IRC §§ 3401-3403, 3509.

¹¹⁰ Bruce R. Hopkins, *The Law of Tax-Exempt Organizations*, 485 (8th Ed. 2003).

¹¹¹ As stated previously, intermediate sanctions were first enacted in proposed form in July, 1996.

¹¹² Treas. Reg. § 53.4958-8(a).

¹¹³ IRC § 4958(c)(1)(A).

¹¹⁴ See Stephanie Strom, *I.R.S. Finds Tax Errors in Reports of Nonprofits*, N.Y. TIMES, Mar. 1, 2007, at A15. Having completed its two-year investigation of executive compensation at nonprofit organizations, the IRS imposed more than \$20 million in penalties on 40 individuals at 25 organizations which substantially overcompensated executives and more could be imposed still.

¹¹⁵ Treas. Reg. § 53.4958-4(a)(2).

¹¹⁶ IRC § 4958(f)(1).

¹¹⁷ Treas. Reg. § 53.4958-3(c).

¹¹⁸ Treas. Reg. § 53.4958-3(e)(2), (3). Section 501(C)(3) organizations and certain § 501(c)(4) organizations are not deemed “disqualified.” Treas. Reg. § 53.4958-3(d).

¹¹⁹ IRC § 4958(a), (b).

¹²⁰ IRC § 4958(a)(2).

¹²¹ Treas. Reg. §§ 53.4958-1(d)(4)(iii), 53.4958-1(d)(3).

¹²² IRC § 4958(a)(2).

¹²³ Treas. Reg. § 53.4958-4(a)(3).

¹²⁴ 66 Fed. Reg. 2,144, 2,150 (2001); see Treas. Reg. § 53.4958-4(a)(3)(vii) example 4.

¹²⁵ Jeffrey L. Carmichael, *Building Bridges: Closing the Gap Between the Self-Dealing and Excess Benefit Transaction Rules*, 36 Exempt Org. Tax Rev. 373, at 380, quoting Treas. Reg. § 53.4958-1(d)(4)(iii).

¹²⁶ *Id.*

¹²⁷ Treas. Reg. § 53.4958-6.

¹²⁸ Treas. Reg. § 53.4958-6(a)(1).

¹²⁹ Treas. Reg. § 53.4958-6(a)(2). *See also*, Stephanie Strom, *I.R.S. Finds Tax Errors in Reports of Nonprofits*, N.Y. TIMES, Mar. 1, 2007, at A15. Having completed its two-year investigation of executive compensation at nonprofit organizations, the IRS imposed penalties at organizations that failed to use comparable figures or otherwise failed to justify executive pay levels. Mr. Miller, the commissioner in charge of the I.R.S. division overseeing tax-exempt entities, noted however “That shouldn’t be read to mean that high compensation wasn’t paid in the other cases...it means that in some cases where we found high compensation – and we did find it – the organization has done a good job of using comparables and establishing a procedure to determine it.”

¹³⁰ Treas. Reg. § 53.4958-6(c)(2).

¹³¹ Treas. Reg. § 53.4958-6(c)(1)(ii).

¹³² Treas. Reg. § 53.4958-6(c)(3)(ii).

¹³³ Sarah J. Schmidt, *Avoiding the Snares of Intermediate Sanctions*, 14 Nonprofit World No. 6 at 18, November/December 1996.

¹³⁴ *Michael T. Caracci, et al. v. Commissioner of Internal Revenue*, 118 T.C. 379 (2002).

¹³⁵ *Id.*

¹³⁶ Fred Stokeld, *IRS Gets Partial Win in First Big Intermediate Sanctions Case*, 37 Exempt Organization Tax Review 10, July 2002.

¹³⁷ Carmichael, *supra* note 125, at 382.

¹³⁸ Evelyn Brody, *Troubling Lessons from the Bishop Estate Settlement For Administering the New Intermediate Sanctions Regime*, 32 Exempt Org. Tax Rev. 431, June 2001.

¹³⁹ Shea, *supra* note 23, at 19-21.

¹⁴⁰ N-PCL § 722(a).

¹⁴¹ N-PCL §§ 723 and 722(a).

¹⁴² N-PCL § 721.

¹⁴³ N-PCL § 721.

¹⁴⁴ Bjorklund, *supra* note 5, at 456.

¹⁴⁵ N-PCL § 726(a).

¹⁴⁶ For instance, fines and penalties where there has been an adverse judgment in a derivative action.

¹⁴⁷ N-PCL § 726(a). An insurance policy issued directly to a director or officer (rather than to a corporation) is not subject to retention and co-insurance requirements.

¹⁴⁸ 42 USC 14501 *et seq.*

¹⁴⁹ 42 USC 14503.

¹⁵⁰ 18 USC 1513(e).

¹⁵¹ 18 USC 1512(c).

May 2013

ANNUAL REPORTING REQUIREMENTS AND PUBLIC INFORMATION REGARDING NOT-FOR-PROFIT ORGANIZATIONS

Board members of not-for-profit organizations should be aware of the reporting obligations that apply to their entity, such as those mandated by the Internal Revenue Service and the New York State Attorney General. Board members should also be aware of the publicly available information regarding their organization. Listed below is a summary of certain annual reporting requirements and publicly available information regarding not-for-profit organizations. Additional reports and filings may be required, for example, when an organization amends its charter or bylaws. Note that each organization is unique and must determine whether any other reporting or filing obligations are applicable to it.

I. CERTAIN ANNUAL REPORTING REQUIREMENTS

The following are descriptions of certain annual reporting requirements for not-for-profit organizations that are incorporated in the State of New York.

A. *IRS Form 990*

Form 990 is an annual reporting return that certain federally tax-exempt organizations must file with the IRS. It provides information on the filing organization's mission, programs and finances, and governance, management and disclosure practices. With some exceptions, organizations that are required to file Form 990 include federally tax-exempt not-for-profit organizations that have gross receipts greater than or equal to \$200,000 and total assets greater than or equal to \$500,000 and all 501(c)(3) private foundations, regardless of income.¹ In general, organizations that are not required to file Form 990 include most faith-based organizations. Not-for-profit organizations (other than private foundations) with gross receipts less than \$200,000, or total assets less than \$500,000 are entitled to file a simplified form called Form 990-EZ, in lieu of Form 990. An exempt organization whose annual gross receipts are normally \$50,000 or less may instead file Form 990-N ("e-postcard") which requires disclosure of only the most basic information about the organization.

It appears that merely filing a Form 990-N ("e-postcard") is not sufficient to ensure that a small exempt organization will be included on the IRS's published list of exempt organizations (Publication 78), which inclusion can confer certain fundraising advantages. Instead, e-postcard filers are searchable through a separate database on the IRS website. Consequently, it is recommended that even these small exempt organizations file a Form 990 (or Form 990-EZ) in order to ensure that they continue to be included in Publication 78. The IRS maintains two separate lists of exempt organizations, which are both available online. The searchable Publication 78 database, including the Auto-Revocation List and the Form 990-N filing list, are

¹ Private Foundations file form 990-PF.

available at <http://apps.irs.gov/app/eos>. The downloadable “master file” list is available at <http://www.irs.gov/taxstats/charitablestats/article/0,,id=97186,00.html>.

Failure to file the applicable version of Form 990 for three consecutive years leads to an automatic revocation of an organization’s tax-exempt status. See the Instructions for the Form 990 for information on how to complete the Form 990 and what fees and attachments are required, available at <http://www.irs.gov/pub/irs-pdf/i990.pdf>. For more information on Form 990, see **Tab 4**.

***B. New York State Annual Filing for Charitable Organizations:
Form CHAR500***

With some exceptions (dependent upon the amount and nature of solicitations), registered charitable or other not-for-profit organizations that have filed a Form CHAR410 (Registration Statement for Charitable Organizations) are required to annually file a Form CHAR500 (Annual Filing for Charitable Organizations) to the Charities Bureau of the New York State Attorney General. Registration is required of charitable and other not-for-profit organizations that (i) solicit contributions from New York State (including residents, foundations, corporations, government agencies and other entities) (pursuant to Article 7-A of the Executive Law) and/or (ii) are incorporated, are formed or otherwise conduct activity in New York State (pursuant to Section 8-1.4 of the Estates, Powers and Trusts Law). Depending on the organization’s finances during the year, it may be required to submit a filing fee and attachments, such as an IRS Form 990 and an accountant’s audit or review. See the Instructions for the Form CHAR500 for information on how to complete the Form CHAR 500 and what fees and attachments are required, available at http://www.charitiesnys.com/charindex_new.jsp#filing.

II. PUBLIC INFORMATION REGARDING NOT-FOR-PROFIT ORGANIZATIONS

There are many organizations and publications which rank or rate not-for-profit organizations based on established standards, criteria or processes. Many of these organizations provide their findings, as well as IRS Form 990s filed by not-for-profit organizations, free-of-charge to the public. Below is a sample list of such organizations and publications.

A. Organizations

- American Institute of Philanthropy (AIP): AIP is a charity watchdog service whose purpose is “to help donors make informed giving decisions.” Its website provides information about the charities which it rates as well as its method for rating charities. <http://www.charitywatch.org>
- Better Business Bureau (BBB) Wise Giving Alliance (WGA): The WGA reports on nationally soliciting charitable organizations that are the subject of donor inquiries. The BBB Wise Giving Alliance “helps donors make informed decisions and advances high standards of conduct among

organizations that solicit contributions from the public.”
<http://www.bbb.org/us/Wise-Giving/>.

- Charity Navigator: Charity Navigator provides information on charities and evaluates the financial health of these charities. Charity Navigator aims “to advance a more efficient and responsive philanthropic marketplace, by evaluating the financial health of over 5,500 of America’s largest charities.” <http://www.charitynavigator.org>
- GuideStar. GuideStar gathers and publicizes information about nonprofit organizations. GuideStar believes that “the best possible decisions are made when donors, funders, researchers, educators, professional service providers, governing agencies, and the media use the quality information” that GuideStar provides. <http://www2.guidestar.org>

B. Publications

- Chronicle of Philanthropy: <http://www.philanthropy.com>
- NonProfit Times: <http://www.nptimes.com>

May 2013

FUNDAMENTAL TAX LAW CONSIDERATIONS FOR THE NOT-FOR-PROFIT ORGANIZATION

The following outlines significant tax-law considerations generally relevant to NFP organizations. Given the scope and the nuances of tax-law, it is not possible to, and the following is not an attempt to, answer questions that are specific to a particular organization or to a particular set of facts or circumstances. Thus, the following outline should serve merely as a starting point, a resource that can help to educate and alert an NFP board member or executive as to the very significant tax-law considerations that affect every aspect of the organization's conduct.

I. SAFEGUARDING AND SPENDING THE ASSETS OF AN NFP – AN OVERVIEW

A. *Not-for-Profit is Not the Same as Tax-Exempt*

1. State Not-For-Profit Corporation Law – The NFP entity is formed under, exists by reason of, and derives its organic legal rights and obligations from state law.
2. Most states have a special statute applicable to NFP's. In some jurisdictions, like Delaware, there is not a separate statutory framework specifically and exclusively applicable to NFP's; rather, general corporate law applies to the NFP corporation.
3. Meaning of “Not for Profit” – The defining state law feature of an NFP organization is that there exists no person who can, through ownership or control of the entity, derive a profit from the organization. “Not for profit” does not, however, mean that the organization is precluded by state corporate law from conducting an activity that generates a profit, even an activity designed to do so.
4. Meaning of “Tax Exempt” – Classification of an entity as “tax exempt” generally refers to the exclusion it enjoys from paying income and other taxes under US federal, state and local tax statutes. Often (but not always), tax-exempt organizations are those to which donations may be made on a tax-deductible basis.
5. Typically, the not-for-profit character of an organization is only one of many requirements for the organization to seek, attain and retain tax-exempt status under the various tax statutes.

B. Planning & Supervising NFP Activities & Operations – The NFP Board and Management Must Consider the Organization’s Activities Through the Following Prism:

1. Are we “on mission”? The guiding principle, the “polestar,” of every action (or inaction) taken by an NFP is its “mission” as enunciated in its governing documents.
2. “Mission” is not necessarily what a given board member (or even the entire board) or manager believes to be the organization’s goals; rather, “mission” is defined by the organization’s governing documents, subject to being amended or updated in accordance with the provisions within those governing documents.
3. What does our charter say? The organization’s conduct must at all times and in every way comport with the guidelines and limitations established under its organic documents.
4. What have we “promised” our donors? Often, if not always, donors to an NFP expect that the funds will be applied in a certain way. Sometimes specific promises are made as part of the fundraising effort, and sometimes no express promise is made other than the implicit assurance that the funds will be applied in accordance with the organizational mission. In many situations, the lines are not clearly drawn. In all cases, the NFP must be ever mindful of valid donor expectations as it deliberates application of organizational assets.
5. What did we tell the IRS when we sought tax exemption? The process by which the NFP seeks tax-exempt status is one in which many representations are made to the IRS (or other taxing authority) regarding virtually (if not actually) every aspect of the organization’s operations. To the extent that, at some later time, the NFP strays from the factual representations made to the taxing authority, it can place its tax-exempt status in jeopardy.
6. Will we jeopardize our exempt status or subject ourselves to tax law penalty? Merely remaining in strict or technical compliance with the representations made to the taxing authorities when first seeking exempt status is no guaranty of anything. Commercial (and other) activities conducted by an NFP can result in the organization losing its exempt status and also can expose both the organization and its members and officers to penalties under the tax law.

C. NFP Assets Must Be Safeguarded and Properly Spent

1. State Law – Generally under governing state law, the assets of an NFP are held in trust for the public.
 - It's All About Mission – The NFP's assets are not in any way the property or domain of the major donor, the founder or the visionary; while these people often are given a say or even a controlling say in the application of NFP assets, those decisions must be guided by the overriding principle that the NFP assets are dedicated to the NFP's mission and held by the NFP in trust for the achievement of that mission.
2. Tax Law – The assets of the tax-exempt NFP must be applied in furtherance of its tax-exempt objectives. The tax law, in its insistence on and enforcement of this principle, provides (at least) three express prohibitions (discussed in greater detail in the succeeding portions of this outline) regarding the use and application of organizational assets:
 - no Private Inurement
 - no Private Benefit
 - no Excess Benefit Transactions
3. When do these tax-law constraints arise? Any act, decision, or arrangement that involves the assets of the NFP implicates these tax law constraints. Thus, these constraints arise in just about every deliberation undertaken and every decision made by the NFP board and its management.

II. THE TAX-EXEMPT NFP – PRIVATE INUREMENT

A. *Private Inurement – Statutory Construct*

1. Section 501(c)(3) describes an organization “. . . organized and operated exclusively for . . . charitable . . . purposes, . . . *no part of the net earnings of which inures to the benefit of any private shareholder or individual.*”
2. Thus, the tax statute absolutely prohibits so-called “private inurement,” the realization by certain people associated with the organization of any benefit as a result of their association.
3. Private inurement constraint applies to many types of tax-exempt entities, including:
 - Section 501(c)(3) Charities
 - Section 501(c)(4) Social Welfare Organizations
 - Section 501(c)(6) Trade Associations

B. *Private Inurement vs. Private Benefit*

1. Aside from the “private inurement” constraint, the tax law also includes an additional prohibition against the NFP affording a “private benefit.”
2. While the proscription against Private Inurement focuses on “insiders,” the proscription against Private Benefit is concerned with anyone (outside the charitable class). Thus, even if someone is not an “insider,” generally the tax-exempt NFP may not provide benefit to that person unless the provision of that benefit is consistent with and in furtherance of its exempt objectives.
 - Private Benefit a Product of Tax Regulations: The “private benefit” concept grows out of the regulatory interpretation and application of the statutory requirement that the organization be “exclusively charitable.”
 - For purposes of the “private benefit” constraint, the tax law permits a certain level of benefit – “incidental.”
3. Practical Difference Between Private Inurement and Private Benefit: Scrutiny and Sympathy – When a tax-exempt NFP provides a benefit to a person outside the charitable class, the taxing authority tends to afford greater latitude if that person is not an “insider.”

C. Private Inurement – Dealing With Insiders

1. Prohibition Covers Any Asset – Real, personal, tangible, intangible.
2. The Meaning of “Insider”: You know one when you see one.
 - Someone who exercises control and/or has influence
 - Derive Meaning of “Insider” from Excess Benefit Transaction Rules – As discussed below, the tax law contains an entire subset of constraints, the so-called intermediate sanctions, that contain an elaborately defined “insider” concept; to what extent will that definition apply to or inform the meaning of “insider” for purposes of the “private inurement” constraint?
 - The First Contract: One Bite at the Apple – Although a senior executive or executive director, once hired, can be expected to be treated as an “insider” for purposes of this rule, before he/she is hired (assuming no other relationship) there should not be “insider” status. Thus, the first contract with the executive is made with a non-”insider”; watch out, however, when it comes time to amend or renew that first contract!
3. Any Amount of Benefit to “Insider” Prohibited.
 - Practice vs. Theory – Technically, the tax law allows for no benefit, regardless of how little, to be afforded an “insider.” As a practical matter, however, the taxing authorities are, understandably, reluctant to revoke tax-exempt status from otherwise “good” organizations, and, consequently, cannot enforce this rule in such a stringent manner.

D. Private Inurement – Value For Value Permitted

1. The private inurement rule prohibits any value or benefit paid or afforded to an “insider.” This constraint, however, does not proscribe the tax-exempt organization from paying or providing value to an “insider” (or any person) if the NFP is getting full value in return.
2. Reasonable Compensation for Services – Thus, the private inurement prohibition does not proscribe compensation so long as it is reasonable and necessary for the services rendered in exchange.
3. Fair Price for Property – Similarly, a tax-exempt NFP may pay value to an insider in exchange for property, so long as the property received by the NFP is (at least) equal in value to the consideration paid.

4. Private Foundations Subject to Greater Constraints: The Self Dealing Rule – Although tax-exempt organizations generally are thus permitted to enter into commercially reasonable and fair transactions, whether in a compensatory or other setting, organizations classified under the tax law as “private foundations” are subject to a number of additional, more limiting constraints, including with respect to “self-dealing.” In the case of “private foundations,” the meaning of proscribed “self-dealing” is quite expansive and covers many situations that would otherwise be recognized as reasonable and arm’s-length, indeed even to certain arrangements clearly favorable for the organization.

E. Situations Giving Rise to Private Inurement (for “insiders”) or Potential Inurement

1. The private inurement constraint must be considered in connection with every relationship or interaction between the tax-exempt NFP and any of its directors, officers or other “insiders.”
2. NFP boards and managers often fail to appreciate and focus on the many situations in which the private inurement constraint may apply. The following is an illustrative list of situations that have the potential to raise the private inurement issue:
 - Excessive Compensation
 - Low-Interest Loans
 - Free Use of Assets
 - Rent-Free Use of Premises
 - “Extra” Bonus, Severance, Reimbursements, Perquisites
 - Payment of Legal Fees
 - Portfolio Management and Other Consultant Fees
 - Fundraising Commissions
 - Promoting the Business/Reputation of Insider
 - Advancing Insider’s Political/Social Agenda
 - Activity “Overly Commercial”
 - Commercial Joint Ventures

F. Avoiding Inurement – Best Practices

1. Board Must Set the “Tone” – Organizational culture and day-to-day conduct of “rank and file” is significantly affected by signals emanating from the Board. The Board should establish a culture of scrupulousness regarding the oversight and application of organizational assets.
2. Monitor Every Use of Organizational Funds/Assets.
3. “Test” All Transactions Against Mission/Exempt Purpose.
4. Adopt and Follow Written Procedures.
 - Board Guidelines/Policies
 - Conflicts Policy
5. Follow Process for Every Insider Transaction.
 - Obtain Comparables and Perform Diligent Analysis – Assure commercial terms of arrangement are “arm’s-length” (or better for the NFP)
 - Transaction and all its elements considered, deliberated and approved by an independent committee/body
 - Contemporaneous Minutes – Written memorialization of the processes and deliberations undertaken by the independent committee
 - Documentation – Written agreement incorporating every element of the agreement reached with an “insider”
 - Transparency/Disclosure – Form 990

III. EXCESS BENEFIT TRANSACTIONS – THE INTERMEDIATE SANCTIONS

A. Tax Law Imposes Monetary Penalties on Insiders and Board Members/Managers Involved in an “Excess Benefit Transaction”

- Applies to Section 501(c)(3) and Section 501(c)(4) Organizations
- Organizations treated under the tax law as “private foundations” are not covered by these rules, and are instead covered by a different (and long-standing) set of potential excise taxes

B. The Intermediate Sanctions Target a Specific Abuse: “Excess” Value Provided by the Tax-Exempt Organization to an “Insider”

- Too much compensation
- Too high a price for property (of any sort)
- Direct or Indirect – These sanctions can apply to situations even where the web of relationships and/or arrangements is complex and fuzzy, if a benefit (even if indirectly) has been provided to an “insider”

C. These Sanctions Were Enacted in 1996 as a Response to the Inadequacy of the Then Available IRS Tools to Combat Abuses

- As noted above, while the Private Inurement rule technically proscribes the tax-exempt NFP from affording any benefit to an “Insider,” for many practical reasons the taxing authority cannot strictly enforce the prohibition and revoke exempt status
- The Intermediate Sanctions supplement and overlap with Private Inurement rules
- IRS has two weapons: Revocation of exempt status and imposition of Intermediate Sanctions

D. Excess Benefit Transactions – The Penalties

1. Penalty Imposed on Recipient “Insider.”
 - Initially 25%, and increasing to 200% of uncured excess benefit
 - Cure and abatement provisions are provided
2. Additional Penalty Imposed on Organization Decision Maker.
 - 10% of excess benefit up to \$20,000 (per excess benefit transaction)

- Applies to organization officers, directors, and others
- Imposed on organization managers who knowingly participated
 - Exception if participation not willful AND reasonable cause
 - “Participation” can be by action or inaction
 - Joint/several liability if more than one participating manager

E. Excess Benefit Transactions –Who Is an “Insider”?

1. “Disqualified Person” – “Any person who was in a position to exercise *substantial influence* over the affairs” of the organization.
 - Five-year lookback from date of transaction
2. Board Member, CEO, Managing Director, COO, CFO, Treasurer.
3. Family members; 35% controlled entities.
4. Facts/Circumstances Determination of “Substantial Influence.”
 - Relevant Factors:
 - Founder
 - Substantial contributor
 - Employee entitled to revenue-based compensation
 - ◆ Exception for employee below specified amount
 - Exception for New Hire Based on Fixed Compensation – Similar to the “first bite at the apple” described earlier in connection with “private inurement,” the tax law does not apply the “intermediate sanctions” to a first-time arrangement with an executive, even though the executive becomes or may become an “insider” as a result of the new arrangement. This exception is specifically defined, and organizations must beware if the arrangement provides any discretionary compensation, as well as if/when the arrangement is renewed or amended.

F. Excess Benefit Transactions – Rebuttable Presumption

1. If certain requirements are met, the tax law allows a rebuttable presumption that a contractual arrangement with an “insider” does not run afoul of these rules
 - Contract terms must be pre-approved by independent committee
 - The decision on contract terms must be based on appropriate data/comparables
 - There must be contemporaneous written documentation of the decision process and the agreement
2. The presumption that the contractual arrangement will not be subject to the intermediate sanctions, where established, is rebuttable by the IRS

IV. JOINT VENTURES WITH NON-EXEMPT PARTNERS ... WHEN DO THE TAX ISSUES ARISE?

A. What Is a “Joint Venture”?

1. Joint venture includes any arrangement by which the profit from an activity is shared between an exempt organization and a third party.

B. Prototypical Case – Partnership or Joint Venture with Third Party

C. Tax Law Focus on “Substance”: Even a “Simple” Contract Can Be a “Joint Venture”

- For example, a “royalty” arrangement pursuant to which the exempt organization shares the profits from an activity with a third party, or
- A compensatory arrangement in which a service provider shares in the profit derived from a given activity

D. NFP Motivations in Fashioning Profit Sharing Arrangements:

- Attract employees
- Exploit and maximize NFP assets – *e.g.*, intellectual property
- Raise capital to support charitable activity
- Facilitate/enable charitable goals – *e.g.*, medical research

E. Joint Ventures with Non-Exempt Partners – The Stakes

1. Tax Exempt Status.
 - Activity Attribution – When an exempt organization has an interest in certain types of entities or businesses, the very activity conducted by the entity or business can be treated, under and for purposes of the tax law, as conducted directly by the exempt organization. Depending on the nature and scope of the activity so attributed, the organization’s exempt status can thereby be placed in jeopardy
 - Private Benefit – In a context where assets are deployed in a venture and some portion of the venture profit inures to the benefit of a third party, it is possible that the exempt organization will run afoul of the prohibition against private benefit (described above)

2. Unrelated Business Income Tax (UBIT) – The exempt organization’s portion of income or profit derived from a joint venture can be characterized as “unrelated business taxable income” and subject to tax.
3. Private Foundation Excise Taxes – Where a “private foundation” engages in a joint venture, it must also analyze the various prohibitions/excise taxes specifically applicable to it under the tax law, including those regarding:
 - Self-dealing
 - Excess business holdings
 - Jeopardy investments

F. Joint Ventures with Non-Exempt Partners – Protecting Tax-Exempt Status

1. Trap for Both the Unwary and the Wary? – The tax law relating to joint ventures between an exempt organization and any third party are, in many respects, confused, confusing and unsettled, and can be treacherous. The types of potential arrangements that could, at least in theory and often in practice, be cast as a “joint venture” are many and varied, and not always very obvious.
2. Situations to Beware of? To some extent, it is misleading to attempt to list those commercial/financial/economic arrangements with respect to which an NFP needs to be tax law wary. Surely, any form of partnership, limited liability company or other form of venture with a third party should be considered under these tax law principles. As noted earlier, however, the NFP must remain sensitive to these issues with respect to any other form of commercial relationship in which there is some element or variation of sharing of profits or success of a venture or activity.
3. If an NFP enters a joint venture relationship, what must it do? There is no generic answer to this question. As a general proposition, it is useful to appreciate that (at least as things stand today) in situations where an exempt organization has a significant interest in a joint venture that is not conducted inside a taxable corporation, the IRS places critical weight on the stated (and contractually/legally binding) objectives of the venture and on the governance and control over the venture’s conduct.
4. When in Doubt, a Prudent Approach – As noted, often it is and remains unclear whether these tax law principles are implicated. The prudent NFP Board or manager, therefore, is on the lookout for and careful with any profit sharing activity/arrangement. In these situations, often the NFP is well-advised to consider and, perhaps, adhere to the following guidelines:

- Joint venture organizing documents should establish primary/overriding charitable/exempt objective
- NFP should be provided with overriding control
- If third party management company is involved, ideally it should be one that is not affiliated with the non-exempt partner
- All joint venture contracts should be at arm's-length/fair

V. IMPROVING THE WORLD: POLITICS, ADVOCACY, LOBBYING

A. Participating in Political Campaigns

1. A section 501(c)(3) organization may not participate or intervene, directly or indirectly, in any political campaign on behalf of or in opposition to any candidate for public office.
2. The prohibition is absolute. Violation of it can result in revocation of exempt status.

B. Who Is a Candidate for Public Office?

1. A candidate for public office is any individual who has offered him/herself or has been proposed by others, as a contestant for an elective public office, whether federal, state or local.

C. What Activities Constitute Prohibited Participation or Intervention in a Political Campaign?

1. Such prohibited activities include, but are not limited to, the publication or distribution of written statements or the making of oral statements on behalf of or in opposition to a candidate.
2. Whether the activities of an organization or its members or officers have engaged in prohibited political activities depends upon all of the facts and circumstances. Organizations often struggle to find the line between permitted conduct – such as advocacy or education concerning important social issues – and prohibited involvement in political campaigns. There simply is no bright line that tells the NFP how far it may go. The extent to which specific NFP conduct may be found to run afoul of this absolute prohibition can depend, in large measure, on the factual/situational context.

D. IRS Guidance to Help Distinguish Between Prohibited and Permitted Political Activities

The IRS has issued authoritative guidance describing varying factual scenarios, intended to explain the difference between prohibited and permitted political activities. It is useful to consider these issues as divided into 7 classes of activities:

1. Voter Education and Registration and Get-Out-the-Vote Drives – These activities are permitted if conducted in a non-partisan manner. For example, activities designed to encourage voter registration by all eligible voters regardless of their position on candidates or issues is permitted; on the other hand, activities designed to encourage voter registration only by those likely to vote for a particular candidate would be prohibited.

2. Individual Activities by Leaders – Leaders of Section 501(c)(3) organizations may advocate the election of particular candidates but may not do so at official functions of the organization or in official publications of the organization. In all cases, care should be taken to make clear that views expressed in an “individual” capacity are not those of, or, in effect, being advanced by, the organization.
3. Candidate Appearances – Inviting political candidates to speak at organizational functions is permitted if all candidates are given an equal opportunity to participate.
4. Candidate Appearances When Speaking as Non-Candidate – Candidates may appear or speak at organization events in a non-candidate capacity. Factors the IRS will take into account in determining whether this test is met include: whether the individual is chosen to speak solely for reasons other than his/her candidacy; whether he/she speaks in a non-candidate capacity; whether mention is made of his/her candidacy or the election; whether any campaign activity occurs in connection with the appearance; whether a nonpartisan atmosphere is maintained; and whether the organization clearly indicates the capacity in which he/she is appearing and does not mention the individual’s candidacy or the upcoming election in communications announcing the appearance. Experience shows that this candidate appearance test is not sufficiently objective to prevent serious disagreements over its application in particular situations.
5. Issue Advocacy – Section 501(c)(3) organizations may take positions on public policy issues, including issues on which candidates for public office disagree. They may not do so, however, in a manner that functions as political campaign intervention, such as by identifying the issue with a particular candidate. This issue, too, can become quite murky.
6. Business Activity – Business activity that could be prohibited intervention in a political campaign includes selling or renting of mailing lists or office space and the acceptance of paid advertising. Such activities will generally not be treated as prohibited intervention if the good, service or facility is available to candidates on an equal basis and if the fee charged is the organization’s normal fee.
7. Web sites – A link on a Section 501(c)(3)’s web site to a candidate’s web site or to material on another person’s web site that endorses a political candidate may constitute prohibited intervention. Factors to consider include: whether links are provided to the web sites of all candidates for a particular office; and whether there is a non-political reason for a link to another web site that may include, among other material, an endorsement of a particular candidate.

E. Lobbying For/Against Legislation

1. A section 501(c)(3) organization may not carry on propaganda or other activities, or otherwise attempt to influence legislation *as any substantial part of its activities*. Violation of this prohibition can result in loss of tax exempt status.
2. What is “lobbying”?
 - Contacting or urging the public to contact legislators for the purpose of proposing, supporting or opposing legislation.
 - Advocating the adoption or rejection of legislation.
 - “Legislation” is any bill that has been introduced or a draft bill that may be introduced in any legislative body.
3. What is “substantial”?
 - There are no clear guidelines in the tax law. It is safe to say that “substantial” in this context means something less than the majority of an organization’s activities; indeed, it clearly means something considerably less. But how much less is not clear. Consequently, where an exempt organization otherwise restricted from “lobbying” does or expects to do more than an insignificant amount of “lobbying,” reliance on this test is risky.

F. The Expenditure Test – An Objective Guideline For Determining Allowable Lobbying

1. The Section 501(h) Election – Recognizing that many exempt organizations needed greater certainty regarding the amount of “lobbying” they could conduct while still retaining their exempt status, Congress (in 1976) enacted a provision that permits an organization, upon making an election, to undertake “lobbying” activity up to specifically defined dollar thresholds.
2. Section 501(h) permits a section 501(c)(3) organization to elect an objective “expenditure test” in place of the subjective “substantial part test.”
3. May All Section 501(c)(3) Organizations Elect the Expenditure Test? No – The expenditure test election is not available to churches, associations of churches or a member of an affiliated group of charities that includes as one of its members a church or association of churches.
4. What Does the Expenditure Test Do? It lays out specific limits on how much money a charity can spend for lobbying based on its exempt purpose

expenditures. The rules distinguish between different forms of lobbying and spell out the amount of expenditures permitted for each type. Under this test, there are no limits on lobbying activities that do not require expenditures, including, for example, unreimbursed activities of volunteers.

5. For purposes of the expenditure test, the meaning of prescribed or limited “lobbying” is set out and excludes certain activity/conduct that otherwise might be thought of as “lobbying.”
6. Penalties for Exceeding Expenditure Test Limits – A Section 501(c)(3) organization that elects the expenditure test will not lose its tax exempt status unless it normally makes lobbying expenditures that are more than 150% of the permitted amount. Exceeding the limits can result in a 25% excess tax on the excess lobbying expenditures.

G. Reporting Lobbying Expenditures

1. Section 501(c)(3) organizations must report lobbying expenditures to the IRS.
 - Enhanced Form 990 (annual tax return) requires detail regarding organizational lobbying expenditures
2. More detailed reporting is required of organizations that do not make the Section 501(h) election.

H. Private Foundations And Lobbying

1. Organizations treated under the tax law as “private foundations” are prohibited from any lobbying and can incur severe tax penalties for doing so.
2. Private Foundations may make general support grants to publicly supported charities that lobby so long as the grant is not ear-marked for lobbying.

VI. THE FORM 990 TAX RETURN – DISCHARGING YOUR RESPONSIBILITY AND ANTICIPATING A SHIFTING LANDSCAPE

A. Overview of Form 990 – Annual Tax Return

1. Form 990 – In 2008, the IRS meaningfully revamped Form 990, the tax return filed annually by most (but not all) exempt organizations. The revised Form 990 demands considerably greater disclosure as to virtually every aspect of the organization’s activity and conduct than the prior version of the Form 990.
2. Form 990 Demands Significant Disclosure –In certain respects, the Form 990, given the scope and detail of information required, has been described as something of an analogue to the Form 10K, the audited GAAP financials, and/or the Annual Report of publicly-traded for-profit corporations.
 - In most cases, the new Form demands only disclosure, and does not purport to be changing in any respect the tax law requirements previously and still applicable to exempt organizations.
 - Expanded disclosure does, however, result in greater transparency (and reduced anonymity).

B. IRS Purposes in Making Revisions to Form 990

1. The IRS has indicated that the old (pre-2008) Form 990 “fail[ed] to meet the Service’s tax compliance interests, or the transparency and accountability needs of the states, the public, and local communities served by the organization.”
 - Thus, the IRS admittedly expanded the scope of the Form to serve non-tax reporting and non-federal purposes
2. New sections of the Form require more disclosure regarding the following areas, considered by the IRS to be “Hot Spots,” in order to curtail abuses:
 - Organizational Governance
 - Compensation
 - Fundraising Activities
 - Related Organizations
3. Goal of the IRS is to strongly encourage, by disclosure, the implementation of “good corporate governance” policies and provide the IRS the ability to better identify abusive transactions.

C. Form 990 Mandates Enhanced Disclosure Regarding Governance and Compensation – These Sometimes Sensitive and Sometimes Neglected Matters Can No Longer “Fly Below the Radar”

1. Organizational Governance – Revised Form Asks for More Detail.
 - Organization is required to disclose whether it has policies relating to:
 - Conflicts of Interest
 - Whistleblower
 - Document Retention and Destruction
 - Compensation Review
 - Evaluations of Joint Ventures and Investments in Taxable Entities
 - Must disclose whether the board has reviewed the completed Form 990 prior to filing, the process used to have the board review the form, and the process used to make the governing documents, conflict of interest policy, and financial statements available to the public.
 - While adoption of these policies is not mandatory (yet), the decision to adopt some or all of them is a “critical tax compliance consideration” that relates to the private benefit, excess benefit, and private inurement prohibitions
2. Compensation – Enhanced Disclosure Required.
 - Required for **all** 501(c) organizations with employees compensated in excess of \$100,000 (not just 501(c)(3) organizations)
 - More detailed information required
 - “Key Employees” is now a separate category from highly paid employees; also, disclosure is required for certain former officers, directors, trustees and key employees.
 - New Questionnaire regarding details of compensation and benefits (e.g., first class travel, companion travel, social club dues, compensation based on revenue).

- Compensation Details Required – Base compensation, bonus/incentives, deferred compensation, and nontaxable benefits.

D. Form 990 Mandates Other Areas of Operational Transparency

1. Fundraising Activities – Enhanced disclosure required for amounts paid to professional fundraisers and amounts received from fundraising events.
2. Foreign Operations – Organizations with revenues or expenses exceeding specified threshold amounts are required to provide information about foreign activities, including a listing of grants to foreign organizations and individuals.
3. Related Parties and Organizations
 - Disclosure of “excess benefit transactions,” loans, grants, and business transaction with “interested persons”
 - All Form 990-filing NFPs, not just 501(c)(3) and (c)(4), must disclose loans, grants and business transactions with interested parties
4. Increased Financial Transparency – An organization must disclose if its separate or consolidated financial statements for the tax year include a footnote that addresses the organization’s liability for uncertain tax positions under Fin 48. If so, the substance of the Fin 48 footnotes must be disclosed verbatim.

E. Other Significant Changes

1. Political Campaign and Lobbying activities
 - Political Campaign activity disclosure required by all 501(c) tax-exempt organizations, not just those exempt under Section 501(c)(3).
 - Disclosure of any funds contributed to other organizations for Section 527 function activities.
2. Non-Cash Contributions – IRS intends to focus on valuation issues.

F. Form 990 - Potential Pitfalls and Consequences

1. Many governance practices are not required by federal tax law . . . but:

- IRS view is that “good governance and accountability practices provide safeguards that *the organization’s assets will be used consistently with its exempt purposes*”
 - If issues of private inurement or non-tax-exempt purposes arise, the IRS may use the lack of policies as a factor in reaching a determination and choosing a course of action with respect to the issue
 - Lack of good corporate governance may lead to increased likelihood of audit
2. Disclosures made on the Form 990 could, in extreme cases, lead to loss of tax-exempt status, for example:
 - If new disclosures indicate charitable purpose is not being fulfilled
 - If activities such as lobbying and political contributions go beyond allowable limits
 3. Disclosures made on the Form 990 could lead to increase in actual tax liability. Disclosures create more transparency for UBTI related activities.
 4. Failure to file Form 990, Form 990-EZ, or Form 990-N for three consecutive years leads to an automatic revocation of exempt status.

G. The Form 990 – What NFPs Should Do

1. Review the organization’s by-laws and adopt “good governance procedures.” For example, NFP’s should consider adopting written policies regarding:
 - Conflicts of interest
 - Whistleblower
 - Document retention and destruction
 - Compensation
 - Joint Ventures
2. Review Financial and Data Reporting Systems – The Form and Schedules require more detailed information; NFP’s should confirm that their internal systems can generate the required data.
3. Review Compensation of Executives, Key Employees, and Board members – Given that more information will be disclosed AND available to the public, NFP’s should focus on their compensation policies and

processes and assure that the required disclosure will not adversely affect them among any of their constituencies. Also, NFP's should recognize and anticipate that the enhanced disclosure may necessitate a significant additional expenditure of time and effort for organizations with complicated compensation arrangements and/or other activities that may give rise to compliance concerns or scrutiny.

4. Re-evaluate Fundraising Activities – If disclosing fundraising costs in greater details would have an adverse effect, an organization may consider changing its fundraising models or policies.
5. Evaluate organization's adherence with federal and state tax rules in anticipation of the greater transparency for taxing authorities to determine taxable activities.

VII. NFP GOVERNANCE – WHAT THE IRS WANTS, WHAT THE IRS EXPECTS, AND WHAT THE IRS DEMANDS

A. IRS Involvement in Governance Issues

1. Background.

- On February 7, 2007, the IRS posted on its web site a discussion draft entitled “Good Governance Practices for 501(c)(3) Organizations”
- On June 7, 2007, the IRS released a draft new Form 990, which contained a section on governance topics
- The IRS’s attempt to create governance guidelines prompted significant public discussion, much of which was directed at the question of whether this was an arena best left to the states
- On December 20, 2007, the IRS released its new Form 990, which contains a revised governance section
- After the release of the new Form 990, the IRS removed its governance discussion draft from its web site

B. Current IRS Position

1. *“Despite the absence of explicit statutory provisions setting forth clear governance standards . . . we are not interlopers trying to regulate an area that is beyond our sphere. . . . The effects of good or bad nonprofit governance cut across virtually everything we see and do in our work. It impacts whether the organization is operated to further exempt purposes and public, rather than private, interests. It dictates whether the organization’s executives are compensated fairly or excessively. It influences whether the organization makes informed and fair decisions regarding its investments or its fund raising practices, or allows others to take unfair advantage. . . . It is no longer a question of whether IRS has a role to play, but what that role will be.”* Steven Miller, Commissioner of the IRS’s Tax-Exempt and Government-Entities Division, speaking at a Georgetown University conference on April 23, 2008.
2. In addition to the Form 990 information, the IRS has a paper entitled “Governance and Related Topics – 501(c)(3) Organizations” on its web site (linked through the portion of its web site dealing with the Life Cycle of 501(c)(3) organizations).
3. On December 3, 2009, the IRS released a “check sheet” that will be used by examination agents “to capture data about governance practices and the related internal controls of organizations being examined.”

4. IRS View on NFP Mission.
 - The IRS believes a charity should have a mission statement and that it should be reviewed regularly
 - Form 990, Part I, Line 1 requires a description of the mission statement
5. IRS View Regarding Organizational Documents of NFP.
 - A charity must have organizational documents that provide the framework for its governance and management
 - Copies of a charity's organizational documents must be submitted to the IRS in connection with its application for tax-exempt status
 - Form 990 requires the organization to report significant changes to its organizational documents
6. IRS View Regarding Governing Body of NFP.
 - The IRS believes that the board of a charity should include individuals who are knowledgeable and informed
 - The IRS believes that a board should include independent members
 - Form 990 asks a fair amount of detailed questions about the board
 - The IRS's belief as to the desirability of independent board members has not (yet) been incorporated in any regulation or administrative rule
7. IRS View Regarding NFP Governance and Management Policies.
 - The IRS will look to see if a charity has implemented policies relating to executive compensation, conflicts of interest, investments, fundraising, documenting governance decisions, document retention and destruction and whistleblower claims
 - Again, these concepts are not (yet) incorporated in any regulation or administrative rule
8. IRS View Regarding Financial Statements and Form 990 Reporting.
 - The IRS encourages the NFP board to ensure that financial resources are used to further charitable purposes and that the organization's funds/assets are appropriately accounted for

9. Transparency and Accountability – The Internal Revenue Code requires a tax-exempt charity to make its Form 1023 (the application for tax-exempt status filed by an organization when first seeking tax-exempt status), Form 990 and Form 990T available for public inspection.

INTERNAL REVENUE SERVICE CIRCULAR 230 NOTICE: TO ENSURE COMPLIANCE WITH REQUIREMENTS IMPOSED BY THE IRS, WE INFORM YOU THAT ANY U.S. TAX ADVICE CONTAINED IN THIS MEMORANDUM (INCLUDING ANY ATTACHMENTS) IS NOT INTENDED OR WRITTEN TO BE USED, AND CANNOT BE USED, FOR THE PURPOSE OF (I) AVOIDING PENALTIES UNDER THE INTERNAL REVENUE CODE OR (II) PROMOTING, MARKETING OR RECOMMENDING TO ANOTHER PARTY ANY TRANSACTION OR MATTER ADDRESSED HEREIN.

May 2013

IRS FORM 990

The Internal Revenue Service (the “IRS”) redesigned and revised Form 990, the annual tax return filed by most public charities and other exempt organizations, in 2008.¹ The revised Form 990 requires considerably expanded disclosure, including with respect to corporate governance, finances, compensation, joint venture transactions, fund-raising/donors, lobbying/advocacy, and more. The revisions were designed to help the IRS identify misuse of organization resources, enhance transparency, improve corporate governance practices, and prevent problems from conflicts of interest. This memorandum provides a general overview of some of the most important governance, policy and practical issues to address to prepare for the revised Form 990, but does not cover all the changes to the form.

Even though specific governance, management, and disclosure policies and procedures generally are not required under the federal tax rules, the IRS considers certain policies and procedures, as well as an active and independent board, important elements of an organization’s governance facilitating or even assuring improved tax compliance and protecting against misuse of organization resources. The IRS has observed that the absence of appropriate policies and procedures may lead to opportunities for excessive compensation, excess benefit transactions, private inurement, operation for non-exempt purposes, or other activities inconsistent with exempt status and thus may indicate to the IRS a need for further inquiry.

Whether a particular policy, procedure, or practice should be adopted by an organization depends on the organization’s particular circumstances, including its size, culture, type, structure, and activities. Accordingly, it is important that each organization consider the governance policies and practices that are most appropriate for that organization in assuring sound operations and compliance with tax law and its exempt purpose.

I. GOVERNANCE ACTION ITEMS

The revised Form 990 asks many new questions about the filing organization’s policies and practices that were in place at the end of the tax year. In short, the IRS is seeking affirmative confirmation that the filing organization has in place each of the policies and practices considered by the IRS to reflect and assure good governance. The consequences of answering negatively to any of these questions are not yet known (and may not be knowable). The IRS will use the information reported on the Form 990 to assess noncompliance and the risk of noncompliance with federal tax law for individual organizations and across the broader exempt sector. It is likely that some negative answers will have no consequence and some will result in further inquiries from the IRS. So that an organization may answer affirmatively to as many of

¹ Note that 501(c)(3) charities sub-categorized as “private foundations” continue to file the Form 990-PF, and do not file the revised Form 990. In addition, depending on certain asset and/or revenue tests, many organizations will be eligible to file the less burdensome Form 990-EZ or Form 990-N. From 2008 to 2010, immediately following the redesign of the Form 990, the thresholds of the asset and revenue tests mentioned above changed annually in order to phase-in the application of the redesigned form to smaller organizations.

these questions as is appropriate, the following practices or policies should be considered for implementation by an organization:

1. *Written Record of all Board Actions.* Every meeting and written action taken by the board (and its committees that act on behalf of the board), should be documented in writing before the next meeting or within 60 days. Typically the documentation should consist of minutes or written consents in the organization's minute book, but this requirement may also be satisfied by emails, or similar writings, so long as the documentation clearly specifies the action taken, when it was taken, and who made the decision. (Part VI, Section A, line 8)
2. *Board Review of Form 990.* An organization must report whether the completed Form 990 was provided to directors prior to filing and must also describe the process for review of the Form 990. Organizations have grappled with the "best" approach to satisfy this IRS request. By way of example, a fairly common approach is for the directors (or a committee thereof) to review and to discuss the Form 990 at a board meeting, with an opportunity to pose questions to management about the information on the Form 990, typically in advance of filing. A copy of the organization's final Form 990 (including required schedules), should be provided to each director, preferably prior to its filing with the IRS. (Part VI, Section B, line 11, and Schedule O) Generally, organizations have not altered their return preparation processes in a way that puts undue responsibility on board members or that places final decision-making authority in the hands of too large a group.
3. *Conflict of Interest Policy.* An organization should have a written conflict of interest policy. The policy should define conflicts of interest to include when a person in a position of authority over the organization, such as an officer, director, or manager, may benefit financially from a decision he or she could make in such capacity, including indirect benefits such as to family members or businesses with which the person is closely associated.

The organization's officers, directors, trustees, and key employees, should disclose or update annually their interests that could give rise to conflicts of interest, such as substantial business or investment holdings, and other transactions or affiliations with businesses and other organizations and those of family members. (Part VI, Section B, line 12a-c)

The conflict of interest policy should also include practices for monitoring proposed or ongoing transactions for conflicts of interest and dealing with potential or actual conflicts, whether discovered before or after the transaction has occurred. The conflict of interest policy should specify the committee or other body that determines whether a conflict exists, and the body that reviews actual conflicts. Persons with a conflict should be

prohibited from participating in the board's deliberations and other decisions regarding the conflict.

4. *Whistleblower Policy.* Most organization's should have a whistleblower policy that encourages staff and volunteers to come forward with credible information on illegal practices or violations of adopted policies of the organization, specifies that the organization will protect the individual from retaliation, and identifies those staff or board members or outside parties to whom such information can be reported. (Part VI, Section B, line 13)
5. *Document Retention Policy.* Most organization's should have a document retention and destruction policy which identifies the record retention responsibilities of staff, volunteers, board members, and outsiders for maintaining and documenting the storage and destruction of the organization's documents and records. (Part VI, Section B, line 14)
6. *Joint Venture Policy.* At this point in time, it is fair to say that few tax-exempt organizations have formal policies governing joint ventures. Ideally, an organization should have in place a process through which planned joint venture² activity is brought to the attention of the appropriate organization personnel, is considered through the prism of applicable tax and other law constraints, and is fashioned and implemented in a manner that comports with the requirements and constraints imposed under law. If the organization invested in, contributed assets to, or otherwise participated in a joint venture or similar arrangement with one or more taxable persons, then the organization should:
(a) adopt a written policy or procedure that requires the organization to negotiate, in its transactions and arrangements with other members of the venture or arrangement, such terms and safeguards as are adequate to ensure that the organization's exempt status is protected, and

² Under the tax law, "joint venture" is broadly defined and includes many economic relationships not conventionally or colloquially referred to or thought of as "joint ventures. A joint venture or similar arrangement means any joint ownership or contractual arrangement through which there is an agreement to jointly undertake a specific business enterprise, investment, or exempt-purpose activity (without regard to (1) whether the organization controls the venture or arrangement, (2) the legal structure of the venture or arrangement, or (3) whether the venture or arrangement is treated as a partnership, association, or corporation for federal income tax purposes). Disregard ventures or arrangements that meet both of the following conditions: (1) 95% or more of the venture's income for its tax year ending with or within the organization's tax year is described in sections 512(b)(1)-(5) (generally, passive investment income including unrelated debt-financed income), and (2) the primary purpose of the organization's contribution to, or investment or participation in, the venture or arrangement is the production of income or appreciation of property.

- b) take steps to safeguard the organization's exempt status with respect to the venture or arrangement.

Some examples of safeguards include the following:

- Control over the venture or arrangement sufficient to ensure that the venture furthers the exempt purpose of the organization.
 - Requirements that the venture or arrangement give priority to exempt purposes over maximizing profits for the other participants.
 - The venture or arrangement not engage in activities that would jeopardize the organization's exemption (such as political intervention or substantial lobbying).
 - All contracts entered into with the organization be on terms that are at arm's length or more favorable to the organization.
7. *Public Availability of Governing Documents and Financial Statements.* The organization should consider making its Form 1023 (Application for Exemption), Form 990, governing documents, conflict of interest policy, and financial statements (whether or not audited) available to the general public, for example by posting them on a website or providing copies upon request. (Part VI, Section C, lines 18, 19)
8. *Audit Committee Charter.* Most organizations should have an audit committee with a charter that specifies that the committee has responsibility for overseeing the compilation, review or audit of its financial statements, and selection of an independent accountant or auditor that compiled, reviewed or audited the financial statements. (Part XII, line 2c)

II. GOVERNANCE, MANAGEMENT AND DISCLOSURE

The IRS has implemented its governance oversight through the revised Form 990 which asks many questions about governance and management. The revised Form 990 requires that organizations disclose the information listed below. Presumably certain types of answers to these questions could trigger further inquiry by the IRS.

1. Whether the organization has an **executive committee** or similar committee with broad authority to act on behalf of the governing body, and if so, its composition and scope. (Part VI, Section A, line 1a)

2. The number of **independent**³ **directors**. (Part VI, Section A, line 1b)
3. Whether any of the organization's **officers, directors, trustees, or key employees, had a family relationship or business relationship** with another of the organization's officers, directors, trustees, or key employees. (Part VI, Section A, line 2, and Schedule O)

To answer the questions on lines 1 and 2 of Part VI (regarding independent directors and business and family relationships among Board members, officers, and key employees) the organization should engage in a reasonable effort to obtain the necessary information to answer these questions. An example of a reasonable effort would be for the organization to distribute a questionnaire annually to each of the organization's officers, directors, trustees, and key employees asking for the information that needs to be reported in response to questions on relationships in lines 1 and 2. The questionnaire could include the name, title, date, and signature of the person reporting information, and contain the Form 990 Glossary definitions of "independent voting member of governing body," "family relationship," "business relationship," and "key employee." The organization may rely on information it obtains in response to such a questionnaire in answering questions on lines 1 and 2.

4. Whether the organization has **delegated to a management company key management duties** that are customarily performed, or supervised, by officers, directors, or key employees. Such management duties include, but are not limited to, hiring, firing, and supervising personnel, planning or executing budgets or financial operations, or supervising exempt operations or unrelated trades or businesses of the organization. Management duties do not include administrative services (such as payroll processing) that do not involve significant managerial decision-making. Management duties also do not include investment management unless the filing organization conducts investment management services for others. (Part VI, Section A, line 3, and Schedule O)

³ Directors are considered "independent" only if all three of the following circumstances apply:

a. The director was not compensated as an officer or other employee of the organization or a related organization.

b. The director did not receive total compensation exceeding \$10,000 during the tax year from the organization (or related organizations) other than reimbursement of expenses or reasonable compensation for services as a director. For example, a person who receives reasonable expense reimbursements and reasonable compensation as a director of the organization does not cease to be independent merely because he or she also receives payments of \$7,500 from the organization for other arrangements.

c. Neither the director, nor any family member of the director, was involved in a loan, grant (*e.g.*, scholarship, award), excess benefit transaction, or certain business transactions involving interested persons, with the organization (whether directly or indirectly through affiliation with another organization). See instructions for transaction required to be reported on Schedule L.

5. Significant **changes to its certificate of incorporation or bylaws**. (Part VI, Section A, line 4, and Schedule O)
6. Any **material diversion of the organization's assets**. A diversion of assets is any unauthorized or improper use of assets (including embezzlement or theft). Diversion does not include transfers for fair market value. A diversion is considered material if the gross dollar amount exceeds the lesser of \$250,000 or 5% of the organization's gross receipts or total assets. (A diversion of assets may in some cases constitute inurement of the organization's net earnings. In the case of section 501 (c)(3) and section 501 (c)(4) organizations, it also may be an excess benefit transaction taxable under section 4958 and reportable on Schedule L). (Part VI, Section A, line 5, and Schedule O)
7. **Loans or grants to any current or former officer, director**, trustee, key employee, highly compensated employee, or other manager. (Part IV, lines 26, 27)
8. Certain types of **fringe benefits** such as first-class or charter travel, travel for companions, tax indemnification and gross-up payments, discretionary spending accounts, housing allowance or payment for business use of personal residence, health or social club dues, bodyguard, chauffeur, financial planner, lawyer, accountant, tax preparer or other personal service providers must be disclosed on a new Schedule J to the Form 990 regardless of whether the items are reported as compensation on a W-2 or 1099. The Organization must also indicate whether it followed a written policy regarding payment or reimbursement of such expenses and if not, it must explain why not. The IRS has stated that the reason for disclosure of these items is to highlight for the IRS potential areas of unreported compensation and arrangements that provide excess benefits to nonprofit executives. An IRS finding of unreported compensation or excess benefit could result in additional taxes and penalties to the executive on the unreported compensation and punitive excise taxes paid by the organization. The Form 990 provides an area for organizations to explain that their use of such benefits is proper and does not result in unreported executive compensation or excess benefits. Additionally, all section 501(c)(3) and (c)(4) organizations must report and explain **compensation contingent** on the revenues or earnings of the organization or any related organization, and **non-fixed payments** (e.g., amounts paid subject to the initial contract exception of the intermediate sanctions provision⁴). (Part IV, line 23 and Schedule J)
9. The Form 990 Part VI requires **disclosure of additional governance items on Schedule O** (Part VI, lines 2-9, 11, 12, 15 and 19):

⁴ See Schedule J instructions and Treas. Reg. § 53.4958-4(a)(3).

- a) whether the organization has members and if they elect the directors;
- b) whether minutes are taken of all board meetings and committees that have board authority;
- c) the process by which the organization reviews its Form 990 and whether it is provided to the board prior to filing;
- d) a description of how the organization monitors and enforces compliance with its conflicts policy, including the process for monitoring proposed or ongoing transactions for conflicts, and the process for dealing with potential or actual conflicts (see instructions for details); and
- e) a description of the process by which the compensation of officers and key employees was determined

III. DISCLOSURE OF DIRECTORS, OFFICERS, AND COMPENSATION AMOUNTS AND PROCEDURES.

The organization must list all of its current officers, directors, and trustees, as those terms are defined in the Form 990 instructions, regardless of whether any compensation was paid to such individuals. The revised Form 990 also requires more disclosure of compensation arrangements and the process used to determine the compensation amounts.

A. Disclosure of Compensation

In addition to current officers, directors, and trustees, the organization must list up to 20 current employees who satisfy the definition of key employee (persons with certain responsibilities and reportable compensation greater than \$150,000 from the organization and related organizations), and its five current highest compensated employees with reportable compensation of at least \$100,000 from the organization and related organizations who are not officers, directors, trustees, or key employees of the organization. The compensation must be reported when it is paid by the organization or from a related organizations (such as, parents, subsidiaries, sibling organizations and other organization that share common control, supporting organizations and supported organizations).

Organizations are required to list the following officers, directors, trustees, and employees of the organization whose reportable compensation from the organization and related organizations exceeded the following thresholds:

Position	Current or former	List on Form 990, Part VII, Section A:	List on Schedule J (Form 990), Part II:
Directors and Trustees	Current	All	If reportable and other compensation > \$150,000 in the aggregate from organization and related organizations (do not report institutional trustees)
	Former	If reportable compensation in capacity as former director or trustee > \$10,000 in the aggregate	If listed on Form 990, Part VII, Section A (do not report institutional trustees)
Officers	Current	All	If reportable and other compensation > \$150,000 in the aggregate from organization and related organizations
	Former	If reportable compensation > \$100,000 in the aggregate from organization and related organizations	If listed on Form 990, Part VII, Section A
Key employees	Current	All	All
	Former	If reportable compensation > \$100,000 in the aggregate from organization and related organizations	If listed on Form 990, Part VII, Section A
Other Five Highest Compensated Employees	Current	If reportable compensation > \$100,000 in the aggregate from organization and related organizations	If reportable and other compensation > \$150,000 in the aggregate from organization and related organizations
	Former	If reportable compensation > \$100,000 in the aggregate from organization and related organizations	If listed on Form 990, Part VII, Section A

“Reportable compensation” generally means compensation reported in Box 5 of the employee’s Form W-2, or in Box 7 of a non-employee’s Form 1099-MISC. “Other compensation” generally means compensation that is not reportable compensation. The instructions to Part VII explain these terms, and also provide a more detailed table listing various types of compensation and where to report them in Part VII or in Schedule J.

B. Compensation Amounts

The organization should ensure that no more than *reasonable compensation* is paid. “Reasonable compensation” is the value that would ordinarily be paid for like services by like enterprises under like circumstances. The tax law generally prohibits, and can subject an organization to loss of exempt status, any excessive compensation arrangement. Unreasonable compensation also could result in an *excess benefit transaction*: a transaction in which specified “insiders” and others thought to hold positions of power/authority, including a current or former manager, receives an economic benefit from the organization which exceeds the value of the consideration (such as performance of services) to the organization. An excess benefit transaction also can occur when a manager embezzles from the organization. Recipients of

excess benefits and the directors or officers who approve the excess benefits are subject to tax penalties.⁵

C. Process for Determining Compensation

The revised Form 990 requires disclosure of whether the organization used a process for determining the compensation of the CEO (or executive director, or other person who is the top management official) and of other officers or key employees that included all of the elements listed below for a rebuttable presumption of reasonable compensation. If the organization did use such a process, then they must describe the process on Schedule O, identify the offices and persons for which the process was used to establish compensation, and state the year in which this process was last used for each such person. (Part VI, Line 15a, b, Schedule J and Schedule O)

D. Rebuttable Presumption of Reasonable Compensation

Fixed payments (but not discretionary bonuses⁶) under a compensation arrangement are presumed to be reasonable if the following three conditions are met:⁷

1. Review and approval of compensation arrangements by the **disinterested members of the board or the compensation committee** (*i.e.*, persons with conflicts were not involved).⁸
2. **Use of data showing comparable compensation** for similarly qualified persons in functionally comparable positions at similarly situated organizations (both taxable and non-taxable). This may include consulting an independent compensation consultant, reviewing Form 990s of other organizations, compensation surveys, actual written offers from similar organizations competing for the executive's services, or other objective external data to establish comparable values for executive compensation. The use of these items are also disclosed on Schedule J.

⁵ A recipient who receives an excess benefit from unreasonable compensation is liable for a 25% (or 200% if not corrected) tax on the excess benefit. Also, organization managers who participate in an excess benefit transaction knowingly, willfully, and without reasonable cause are liable for a 10% tax on the excess benefit (up to \$20,000).

⁶ Nonfixed payments (*e.g.*, a discretionary bonus) may not have a presumption of reasonableness unless there is a specified cap on the amount and the authorized body establishes a rebuttable presumption as to the maximum amount payable under the contract.

⁷ See Part VI line 15 on the Form 990. There is a special safe harbor for small organizations. If the organization has gross receipts of less than \$1 million, appropriate comparability data includes data on compensation paid by three comparable organizations in the same or similar communities for similar services.

⁸ The Nonprofit Sector report recommends that the entire board approve the compensation of the CEO while the compensation committee alone can approve the compensation of other officers.

3. The board or committee **adequately documents its deliberations and the basis for its determination** that the compensation is reasonable in the minutes of the board or the committee. The minutes should include:
 - a) the terms of the compensation arrangement that were found reasonable;
 - b) the comparability data relied upon by the authorized body and how the data was obtained;
 - c) any member of the board or committee who abstained or voted against the arrangement; and
 - d) whether a member of the board or committee having a conflict of interest was recused or took other action.

In some cases, an organization may find it impossible or impracticable to fully implement each step of the rebuttable presumption process described above. In such cases, most organizations should try to implement as many steps as possible, in whole or in part, in order to substantiate the reasonableness of benefits as timely and as well as possible. These requirements for a “rebuttable presumption,” however, may not be appropriate for certain organizations; even so, organizations are well-advised to take any and all steps that *are* reasonable, given their circumstances, to assure proper compensation arrangements. In addition to the steps above, having written documentation of the approved compensation amounts, (*e.g.*, in a written employment agreement, approved budget line item, or board or committee resolution) is helpful to avoid later assertions that a compensation amount is more (or less) than that agreed and that it was determined within the proper framework and procedures.

An important exception to the excess benefit rules and the reasonable compensation requirement is the exception for any fixed payment made pursuant to an initial contract when the contract is both in writing and is with a previously unaffiliated officer or manager.⁹ This is an “exception” because (and assuming) there had been no prior relationship between the organization and the other party. In these cases, however, the organization is well-advised to anticipate the application of these rules, and the need to conform with these rules at such later date when the contract is renewed or even materially changed or amended. Renewals and material amendments generally are treated under the tax law as new contracts and, consequently, the relationship with the contracting party may, at that subsequent time, have become one that is covered by these excess benefit transaction rules.

IV. WHEN TO FILE FORM 990

The Form 990 must be filed four months and 15 days after the organization’s accounting period ends. For a calendar year organization (where the accounting period ends on December 31st), the due date for Form 990 is May 15th. For an organization with a fiscal year ending September

⁹ Treas. Reg. § 53.4958-4(a)(3).

31, the Form 990 is due February 15th. The due dates may be extended up to six months by filing Form 8868.

This memorandum is not designed to answer the many questions and issues that arise in connection with the preparation and filing of the Form 990, or otherwise to substitute for the expert advice of a qualified tax return preparer. Please contact your tax return preparer, accountant or an attorney if you have questions about the new requirements in the revised Form 990.

Internal Revenue Service Circular 230 Notice: To ensure compliance with requirements imposed by the IRS, we inform you that any U.S. tax advice contained in this memorandum (including any attachments) is not intended or written to be used, and cannot be used, for the purpose of (i) avoiding penalties under the Internal Revenue Code or (ii) promoting, marketing or recommending to another party any transaction or matter addressed herein.

May 2013

SAMPLE BOARD GUIDELINES

The board of a not-for-profit organization may find it useful to set forth governance guidelines it applies in fulfilling its responsibilities, including board functions and processes, and the organization's expectations of directors.

Board guidelines are very specific to the needs and circumstances of the individual not-for-profit organization. This sample provides only one fairly simple example. "One size does not fit all" – governance structures and processes should reflect and be tailored to meet the needs and circumstances of the particular organization.

Please note that various factors unique to a not-for-profit organization (including, among others, organizational structure, activities, life-cycle stage, funding mechanisms, and applicable requirements of local, regional or national law) may affect the provisions that should be addressed. Accordingly, while this sample includes standards and provisions that may be generally appropriate for some not-for-profit organizations, different and additional provisions may be appropriate in particular circumstances.

[NAME OF NOT-FOR-PROFIT ORGANIZATION]

BOARD GUIDELINES

I. THE ROLE OF THE BOARD

The role of the Board of Directors (the “Board”) of _____ (the “Organization”) is to (i) direct the affairs of the Organization and (ii) set expectations about the tone and ethical culture of the Organization. In doing so, directors are expected to apply their business judgment and act with due care, in good faith and in accordance with the best interests and mission of the Organization.

The Board fulfills its role (directly or by delegating certain responsibilities to its committees) by:

1. Setting the mission and values of the Organization – the “tone at the top” – and ensuring that an ethical culture of trust, honesty and integrity is promoted throughout the Organization;
2. Providing advice, counsel and support to the Chief Executive Officer and principal senior executives;
3. Selecting, regularly evaluating, fixing the compensation of, and, where appropriate, replacing the Chief Executive Officer;
4. Establishing measures of organizational performance and utilizing those measures to ensure senior management accountability;
5. Reviewing the Organization’s program for management development and succession planning;
6. Overseeing the conduct of the Organization’s business and strategic plans to evaluate whether the business is being properly managed in accordance with the Organization’s mission;
7. Reviewing and approving the Organization’s fundraising and development plans, budgets and actions;
8. Reviewing and approving the Organization’s annual budget, financial objectives and other major organizational plans and actions;
9. Reviewing and approving significant changes in the Organization’s auditing and accounting principles and practices;
10. Providing oversight and ensuring the integrity of internal and external audit processes, financial reporting and recordkeeping;
11. Reviewing the Organization’s Form 990 prior to filing with the Internal Revenue Service;

12. Providing oversight of risk assessment and protection processes ensuring appropriate management of significant risks;
13. Acting with integrity and adhering to the policies in the Organization's Code of Conduct and Ethics and the Conflict of Interest Policy. Any waiver of the requirements of the Code of Conduct and Ethics for any director must be approved by the Board;
14. Keeping confidential all non-public information that relates to the Organization's business, unless disclosure and/or use of such information is authorized pursuant to Part VI of these Guidelines. Such information includes, but is not limited to, information regarding the finances and operations of the Organization, donor lists, mailing lists and any information relating to fundraising (including fundraising efforts, plans, ideas and proposals), minutes, reports and materials of the Board and its committees, and other documents identified as confidential by the Organization;
15. Ensuring that compliance systems and processes designed to promote legal and ethical compliance are reasonably effective, and monitoring the Organization's compliance with relevant laws;
16. Monitoring the effectiveness of the Organization's governance practices and organizational documents and making changes as needed; and
17. Performing such other functions as the Board believes appropriate or necessary, or as otherwise prescribed by law or regulation.

II. DIRECTOR QUALIFICATION STANDARDS

A. Selection of Board Members

The Board is responsible for selecting the members of the Board. The Board has delegated the selection process to the Nominating and Governance Committee. The Board will review [annually/periodically] the appropriate experience, qualifications, attributes and skills required of directors in the context of the Organization's current circumstances and the Board's needs.

The Board expects that all directors will, at a minimum:

1. Have experience or knowledge with respect to at least one area of the Organization's operations or area of board responsibility, such as strategic planning, financial management, technology, fundraising and development, public relations or human resources; and
2. Be committed to the Organization's mission and programs.

The Nominating and Governance Committee is responsible for reviewing with the Board, on an annual basis, the appropriate skills and characteristics required of directors in the context of the current make up of the Board.

B. Board Independence

Directors should be able to exercise objective judgment – they should be “independent-minded.” The Board should ensure that only “independent” directors are appointed to the Audit Committee, Compensation Committee and Nominating and Governance Committee, as these committees are responsible for making decisions with respect to issues where management may have a potential conflict or blind spot. In determining director independence, the Board should consider all relevant facts and circumstances that could affect a director’s ability to exercise objective judgment, including materiality of relationships (business, familial and social) each director may have with the Organization, management, beneficiaries, donors, clients, suppliers and other important constituents. In addition, a director may only be considered “independent” if:

1. The director was not compensated as an officer or other employee of the Organization or a related organization;
2. The director did not receive total compensation exceeding \$10,000 during the most recent tax year from the Organization (or related organizations) for services provided in the director’s capacity as an advisor, consultant or independent contractor[other than reasonable compensation for service as a director]; and
3. Neither the director, nor any family member of the director, was involved in a loan, grant, excess benefit transaction, or a business transaction involving an interested person that is reportable on Schedule L of Form 990, with the Organization (whether directly or indirectly through affiliation with another organization).

III. DUE CARE

Directors are expected to exercise appropriate diligence in providing managerial oversight and decision-making, and are expected to:

1. Attend and participate actively at all Board and committee meetings, preferably in person;
2. Review meeting materials and agendas in advance;
3. Request other information from management and trustworthy and reliable experts where appropriate before making decisions or taking actions; and
4. Be sensitive to indications of potential problems or concerns and make further inquiry until reasonably satisfied that management is dealing with those concerns appropriately.

IV. OTHER EXPECTATIONS

In addition to fulfilling the duties outlined above, the Board is expected to:

1. Meet at least [three] times per year;
2. Conduct an annual self-evaluation of the Board and each committee;
3. Meet regularly without members of management present;
4. Maintain minutes of Board and committee meetings;
5. Review and approve policies and procedures relating to the work and structure of the Board;
6. Approve major engagements with respect to public policy and other external affairs activities; and
7. Provide for the orientation of new directors and make available continuing director education opportunities as appropriate.

In addition to fulfilling the duties outlined above, directors are expected to:

8. Join and participate actively in the activities of at least one committee of the Board;
9. Pay for a ticket to and attend the Organization's annual benefit;
10. Make every reasonable effort to bring financial support to the Organization annually from external sources;
11. Make personally meaningful financial gifts to the Organization at least annually;
12. Leverage personal relationships with others (including corporations, professional service firms, foundations, individuals and government agencies) to assist the staff of the Organization with implementing fundraising strategies, including adding names of potential sources of support to the Organization's mailing list;
13. Act as an ambassador for the Organization with respect to dealings with the general public, donors, government agencies and clients;
14. Advise the Chair of the Nominating and Governance Committee upon a change in the director's professional responsibilities (such as resignation or change of employment) and prior to accepting an invitation to serve on another board of directors;
15. Act as a mentor to other directors; and

16. Suggest to the Nominating and Governance Committee any potential Board candidates who fulfill the Board's criteria for directors and who could make significant contributions to the Board and the Organization.

V. BOARD COMMITTEES

The Board currently has [six] standing committees: [Audit, Compensation, Nominating and Governance, Development, Finance and Public Relations]; and [two] task-specific committees: [Executive and Strategic Planning]. The Board retains discretion to form new committees, including sub-committees, and can disband committees where appropriate.

VI. CONFIDENTIALITY

Pursuant to their fiduciary duties of loyalty and care, directors have an obligation to keep confidential all non-public information obtained by a director that relates to the Organization's business. Directors must not use or disclose such information to any person or entity during or after service, except with written authorization of the Board or as may be otherwise required by law or regulation.

VII. BOARD INTERACTION WITH THE MEDIA AND OTHERS

In most situations, the Chief Executive Officer speaks on behalf of the Organization with donors, employees, clients, suppliers, the media and others. The Chair of the Board is the spokesperson of the Board. Other directors should not communicate with representatives of the media unless duly authorized by the Chair of the Board or the Chief Executive Officer, so as to prevent any inadvertent disclosure of confidential information.

VIII. TENOR OF BOARDROOM DELIBERATIONS

Achieving an atmosphere in which full and frank discussion can thrive, and consensus can ultimately be reached, is a challenge. It is the responsibility of the Board to act in the best interests of the Organization and disagreements may arise. Within the context of their fiduciary duties, directors should seek to participate and express disagreement in an open and collegial manner, with developing consensus and resolution as the ultimate goal.

May 2013

SAMPLE CONFLICT OF INTEREST POLICY

The board of a not-for-profit organization should adopt a conflict of interest policy to assist the directors, officers and others in the Organization in identifying, evaluating and resolving conflicts of interests.

While there is no federal legal requirement that an organization have a conflict of interest policy, the organization, its directors and officers may be subject to liability, and the organization's exempt status may be at risk, if the organization enters into transactions that result in improper financial benefit to persons affiliated with the organization. Additionally, the IRS requires public charities to disclose on their annual information return whether they have a conflict of interest policy that meets certain requirements. This sample policy was designed to address these matters and also was designed to be used with a code of conduct and ethics that further describes the policies and values of the organization.

Please note that various factors unique to a not-for-profit organization (including, among others, organizational structure, activities, life-cycle stage, funding mechanisms, and applicable requirements of local, regional or national law) may affect the provisions that should be included. Accordingly, while this sample includes standards and provisions that may be generally appropriate for some not-for-profit organizations, different and additional provisions may be appropriate in particular circumstances.

[NAME OF NOT-FOR-PROFIT ORGANIZATION]

CONFLICT OF INTEREST POLICY

This conflict of interest policy ("Conflict Policy") of _____ (the "Organization") has been adopted by the board of directors (the "Board") and is applicable to all current and former (within the last five years) directors, officers, as well as, [employees, volunteers, independent contractors, substantial contributors], and others who have the ability to exercise substantial influence over the Organization ("Covered Persons").

A. General. All directors, officers and staff owe a duty of loyalty to the Organization. The duty of loyalty requires that they exercise their powers in good faith and in the best interests of the organization, rather than in their own interests or the interests of another entity or person.

Conflicts between the interests of the Organization and the personal or financial interests of a Covered Person may arise from time to time. Some conflicts of interest are illegal or may subject the Organization or its directors and officers to liability. Some conflicts of interest may be legal, but also unethical or may create an appearance of impropriety. Some conflicts of interest may be in the best interests of the Organization so long as certain procedures are followed. This Conflict Policy is designed to assist the directors, officers and others in the Organization in identifying conflicts of interest and in handling them appropriately.

Neither the Organization nor any Covered Person shall enter into any transaction or arrangement that involves an actual, potential, or apparent conflict of interest except in compliance with this Conflict Policy.

B. Conflict of Interest. A conflict of interest arises whenever the interests of the Organization come into conflict with a competing financial or personal interest of a Covered Person or an affiliated party (as defined below), or otherwise whenever a Covered Person's personal or financial interest could be reasonably viewed as affecting their objectivity or independence in fulfilling their duties to the Organization.

While it is not possible to anticipate all possible conflict situations, conflicts of interest typically arise whenever a Covered Person, or any affiliated party has (directly or indirectly):

1. a compensation arrangement or other interest in a transaction with the Organization;
2. a compensation arrangement or other interest in or affiliation (subject to *de minimis* exceptions) with any entity or individual that: (a) sells goods or services to, or purchases goods or services from, the Organization; (b) competes with the Organization; or (c) the Organization has, or is negotiating, or contemplating negotiating, any other transaction or arrangement;

3. used his or her position, or confidential information or the assets of the Organization to his or her (or an affiliated party's) personal advantage or for an improper or illegal purpose;
4. solicited or accepted any gift, entertainment, or other favor where such gift might create the appearance of influence on the Covered Person (other than gifts of nominal value, which are clearly tokens of respect and friendship unrelated to any particular transaction);
5. acquired any property or other rights in which the Organization has, or the Covered Person knows or has reason to believe at the time of acquisition that the Organization is likely to have, an interest;
6. an opportunity related to the activities of the Organization that is available to the Organization or to the Covered Person, unless the Board has made an informed decision that the Organization will not pursue that opportunity;
7. been indebted to the Organization, other than for amounts due for ordinary travel and expense advances; or
8. any other circumstances that may, in fact or in appearance, make it difficult for the Covered Person to exercise independence, objective judgment or otherwise perform effectively.

C. *Affiliated Party.* “Affiliated party” means a member of the Covered Person’s family (including spouses (and their siblings), lineal ancestors and descendants, spouses of lineal descendants, siblings (and their spouses and children), and domestic partners), or any entity in which the Covered Person (or any affiliated party) is a director, officer, or has a beneficial interest of more than 5%.

D. *Disclosure of an Actual, Potential or Apparent Conflict of Interest.*

1. Conflict identification and analysis can be difficult and, therefore, Covered Persons and other staff are at all times expected to err on the side of caution and bring to the attention of [a responsible supervisor, the Organization’s legal counsel, the President or Chair of the Board or Audit Committee] all material facts of any matters that may involve conflicts of interest or be perceived by others to raise questions about potential conflicts even if the person does not believe that an actual conflict exists. Disclosures should be made in advance, before any action is taken on the matter.

2. In addition, each Covered Person who currently serves as a director or officer[, or as an employee, volunteer or independent contractor, or who is currently a substantial contributor] or any person who currently has the ability to exercise substantial influence over the Organization shall complete a Questionnaire Concerning Conflicts of Interest (attached) each year of their affiliation with the Organization, disclosing any actual, potential or apparent conflicts, and affirming that they have read, understand, and have and will continue to adhere to

this Conflict Policy. They shall also submit a new Questionnaire disclosing any relevant change in circumstances. The Questionnaires shall be reviewed by the [Audit Committee / the Nominating and Governance Committee].

E. Evaluation of an Actual, Potential or Apparent Conflict of Interest. The [Audit Committee / Nominating and Governance Committee / Board] will evaluate conflict disclosures and make other necessary inquiries to determine the extent and nature of any actual or potential conflict of interest and, if appropriate, investigate alternatives to the proposed transaction or arrangement. [The Committee shall report to the disinterested members of the Board for resolution.] After disclosure of the potentially conflicting interest and all material facts, and after answering any questions, the interested person shall recuse himself or herself from deliberations and voting relating to the matter and shall refrain from attempting to influence other decision-makers relating to the matter. However, as a member of the Board or committee, an interested director may be counted in determining the establishment of the quorum at a meeting relating to the matter.

F. Resolution of an Actual, Potential or Apparent Conflict of Interest. The Organization may enter into a transaction or other arrangement in which there is an actual or potential conflict of interest only if at a duly held meeting of the Board¹ a majority of those directors (if a quorum is present at such time) who have no interest in the transaction or arrangement² approve the transaction or arrangement after determining, in good faith and after reasonable inquiry, that:

1. entering into the transaction or arrangement is in the best interests of the Organization, while considering the Organization's mission and resources, and the possibility of creating an appearance of impropriety that might impair the confidence in, or the reputation of, the Organization (even if there is no actual conflict or wrongdoing);
2. the transaction or arrangement in its entirety, and each of its terms, are fair and reasonable to the Organization;
3. after consideration of available alternatives, the Organization could not have obtained a more advantageous arrangement with reasonable effort under the circumstances;
4. the transaction or arrangement furthers the Organization's mission and charitable³ purposes; and

¹ Conflicts should typically be reviewed by all disinterested directors, but very large boards may find it appropriate to delegate this function to the Audit or other committee.

² Organizations may consider whether to include a provision that also excludes from deliberations any directors who have other potentially conflicting arrangements with the Organization.

³ Exempt organizations other than charitable organizations should use "exempt" instead of "charitable."

5. the transaction or arrangement is not prohibited under state law⁴ and does not result in private inurement, an excess benefit transaction or impermissible private benefit under laws applicable to tax exempt organizations.

G. *Records of Conflict Disclosures and Proceedings.* The minutes of the Board or any committee meeting during which a potential or actual conflict of interest is disclosed or discussed shall reflect the name of the interested Covered Person, the nature of the conflict, and details of the deliberations of the disinterested directors (such as documents reviewed, alternatives considered, comparative costs or bids, market value information and other factors considered in deliberations) and the resolution of the conflict including any ongoing procedures to manage any conflict that was approved. The interested person shall only be informed of the final decision and not of particular directors' positions. In addition, certain related party transactions are required to be disclosed in the notes to the Organization's audited financial statements and its annual federal tax filing on Form 990.

H. *Compliance.* If the Board, the Audit Committee, or the [President] has reasonable cause to believe that a Covered Person has failed to comply with this Conflict Policy, they may make such further investigation as may be warranted in the circumstances and if they determine that a Covered Person has in fact failed to comply with this Conflict Policy, they shall take appropriate action which may include removal from office or termination.

I. *Amendment.* This Conflict Policy may be amended only by the Board.

⁴ For example, New York N-PCL §716 and Cal. Corp. Code §5236 prohibit loans to officers and directors except in specified circumstances.

[NAME OF NOT-FOR-PROFIT ORGANIZATION]
Questionnaire Concerning Conflicts of Interest and
Affirmation re: Organization Policies

Have you or any affiliated party (as defined in the Conflict Policy), had or engaged in, or do you know of any other Covered Person that has or engaged in, any of the following? (other than matters already fully disclosed, evaluated and resolved)

	Yes	No
1. a compensation arrangement or other interest in a transaction with the Organization;		
2. a compensation arrangement or other interest in or affiliation (subject to <i>de minimis</i> exceptions) with any entity or individual that: (a) sells goods or services to, or purchases goods or services from, the Organization; (b) competes with the Organization; or (c) the Organization has, or is negotiating, or contemplating negotiating, any other transaction or arrangement;		
3. used his or her position, or confidential information or the assets of the Organization to his or her (or an affiliated party's) personal advantage or for an improper or illegal purpose;		
4. solicited or accepted any gift, entertainment, or other favor where such gift might create the appearance of influence on the Covered Person (other than gifts of nominal value, which are clearly tokens of respect and friendship unrelated to any particular transaction);		
5. acquired any property or other rights in which the Organization has, or the Covered Person knows or has reason to believe at the time of acquisition that the Organization is likely to have, an interest;		
6. an opportunity related to the activities of the Organization that is available to the Organization or to the Covered Person, unless the Board has made an informed decision that the Organization will not pursue that opportunity;		
7. been indebted to the Organization, other than for amounts due for ordinary travel and expense advances; or		
8. any other circumstances that may, in fact or in appearance, make it difficult for the Covered Person to exercise independence, objective judgment or otherwise perform effectively.		

If yes, to any of the above please describe the relevant facts (attach a separate sheet if necessary):

The answers to the foregoing questions are stated to the best of my knowledge and belief.

I also acknowledge that I have received, read and understood the Conflict of Interest[, Code of Conduct and Ethics, and Whistleblower] Policies⁵ of the Organization and agree that I have and will continue to abide by such policies.

Additionally, I understand that in order to maintain its federal tax exemption the Organization must engage primarily in activities that accomplish one or more of its tax exempt purposes.

Date: _____

Signature:_____

Printed
Name:_____

⁵ List other relevant policies of the Organization.

May 2013

SAMPLE CODE OF CONDUCT AND ETHICS

The board of a not-for-profit organization may find it useful to adopt a policy applicable to the board, management, employees and volunteers requiring fulfillment of responsibilities in a manner that furthers the mission of the organization and complies with law, regulations, ethical standards and policies adopted by the organization.

Each not-for-profit organization will need to decide for itself the level of detail required in its code of conduct and ethics. This sample provides only one fairly simple example. “One size does not fit all” – governance structures and processes should reflect and be tailored to meet the needs and circumstances of the particular organization.

Note that the Federal Sentencing Guidelines provide for the mitigation of certain penalties depending on a number of factors, including the existence and adequacy of the organization’s compliance program, one part of which is the code of ethics. Although the Department of Justice has not issued formal guidelines for not-for-profit compliance programs, among the most critical factors in evaluating the effectiveness of such a program is whether it is designed to prevent and detect wrongdoing by employees and whether management enforces the program.

Please note that various factors unique to a not-for-profit organization (including, among others, organizational structure, activities, life-cycle stage, funding mechanisms, and applicable requirements of local, regional or national law) may affect the provisions that should be addressed. Accordingly, while this sample includes standards and provisions that may be generally appropriate for some not-for-profit organizations, different and additional provisions may be appropriate in particular circumstances.

[NAME OF NOT-FOR-PROFIT ORGANIZATION]*

CODE OF BUSINESS CONDUCT AND ETHICS

[Consider including a letter from the Chair of the Board or Executive Director. This introductory letter should be aspirational in tone and addressed to employees, volunteers, officers and directors explaining the purpose of the Code.]

I. YOUR OBLIGATIONS

This Code of Conduct and Ethics (this “Code”) is designed to promote **honest, ethical and lawful conduct** by all employees, volunteers, officers and directors of [_____] and all of its affiliates (collectively, the “Organization”). This Code is intended to help you understand the Organization’s standards of ethical business practices and to stimulate awareness of ethical and legal issues that you may encounter in carrying out your responsibilities to the Organization. In addition, independent contractors, consultants and agents who represent the Organization are expected to apply the same high standards while working on Organization business.

The actions of every employee, volunteer, officer and director affect the **reputation and integrity** of the Organization. Therefore, it is essential that you take the time to review this Code and develop a working knowledge of its provisions. You are required to complete a certificate attesting to compliance with the Code upon becoming an employee, volunteer, officer or director and, thereafter, on an annual basis.

At all times, **you are expected to:**

- **Avoid conflicts** between personal and professional interests where possible;
- **Comply with the Organization’s Conflict of Interest Policy including disclose any conflict** to [a responsible supervisor, the Organization’s legal counsel, the President or Chair of the Board or Audit Committee] and otherwise **pursue the ethical handling of conflicts** (whether actual or apparent) when conflicts or the appearance of conflicts are unavoidable;
- **Provide accurate and complete information** in the course of fulfilling your obligations and communicate information in a timely manner;
- **Provide full, fair, accurate, timely, and understandable disclosure** in reports required to be filed by the Organization with regulators and in other public communications made by the Organization;

* Provisions included throughout this sample in brackets denote that these provisions should be conformed to the Organization’s particular circumstances.

- **Comply with all applicable laws, regulations and Organization policies;**
- **Seek guidance** where necessary from a responsible supervisor;
- **Promptly report any violations** of this Code to the Organization's legal counsel; and
- Be **accountable personally** for adherence to this Code.

**WHO DO I CONTACT
FOR GUIDANCE OR TO REPORT CONCERNS?**

If you believe a situation may involve or lead to a violation of this Code, you have an affirmative duty to seek guidance and report such concerns.

- **Seek guidance** from a responsible supervisor (for example, your immediate supervisor, a department head or location manager) or other appropriate internal authority (for example, your local Human Resources representative or compliance officer).
- **Disclose concerns or violations** of this Code to the Organization's legal counsel.
- **Report audit and accounting concerns** to the [Helpline or the Audit Committee].

[HELPLINE:]

[INSERT NUMBER(S)]

[Organization's legal counsel]

[INSERT CONTACT DETAILS]

Audit Committee:

[INSERT CONTACT DETAILS]

It is the Organization's policy to encourage the communication of bona fide concerns relating to the lawful and ethical conduct of business, and audit and accounting procedures or related matters. It is also the policy of the Organization to protect those who communicate bona fide concerns from any retaliation for such reporting.

Confidential and anonymous mechanisms for reporting concerns are available and are described in this Code. However, anonymous reporting does not serve to satisfy a duty to disclose your own potential involvement in a conflict of interest or in unethical or illegal conduct.

This Code is part of a broader set of Organization policies and compliance procedures described in greater detail in the Organization's employee manuals and distributed memoranda. This Code is not intended to supersede or materially alter specific Organization policies and procedures already in place and applicable to particular employees as set forth in the Organization's employee manuals and distributed memoranda, and communicated to Organization employees.

No Organization policy can provide definitive answers to all questions. It is difficult to anticipate every decision or action that you may face or consider. **Whenever there is doubt about the right ethical or legal choice to make, or questions regarding any of the standards discussed or policies referenced in this Code, you should fully disclose the circumstances, seek guidance about the right thing to do, and keep asking until guidance is obtained.**

Those who violate the standards in this Code will be subject to disciplinary action. Failure to follow this Code, as well as to comply with federal, state, local and any applicable foreign laws, and the Organization's policies and procedures may result in termination of employment or termination of board service.

II. COMPLIANCE WITH LAWS, RULES AND REGULATIONS

The Organization requires you to comply with all applicable laws, rules and regulations. Violation of laws and regulations may subject you, as well as the Organization, to civil and/or criminal penalties. To assure compliance with applicable laws and regulations, the Organization has established various policies and procedures, including those relating to: [List policies, e.g., Conflict of Interest, Whistleblower, Records Retention]. You have an obligation to comply with these policies and procedures and to promptly alert [a responsible supervisor, the Organization's legal counsel, or other appropriate internal authority] of any deviation from them.

Legal compliance is not always intuitive. To comply with the law, you must learn enough about the national, state and local laws that affect your work at the Organization to spot potential issues and to obtain proper guidance on the right way to proceed. When there is any doubt as to the lawfulness of any proposed activity, you should seek advice from the Organization's legal counsel.

Certain legal obligations and policies that are particularly important are summarized below. Further information on any of these matters may be obtained from the Organization's legal counsel.

III. CONFLICTS OF INTEREST

The Organization expects you to exercise good judgment and the highest ethical standards in your activities on behalf of the Organization as well as in your private activities outside the Organization. Particular care should be taken to ensure that no detriment to the interests of the Organization (or appearance of such detriment) may result from a conflict between those interests and any personal or business interests which you may have. In particular, you have an

obligation to avoid, and where avoidance is not feasible to disclose to your supervisor or as otherwise set forth in this Code, any activity, agreement, business investment or interest or other situation that might in fact or in appearance cause you to place your own interests, or those of another, above your obligation to the Organization. Care should be taken about the appearance of a conflict since such appearance might impair confidence in, or the reputation of, the Organization even if there is no actual conflict and no wrongdoing.

While it is not possible to describe or anticipate all the circumstances that might involve a conflict of interest, a conflict of interest may arise whenever you take action or have interests that may make it difficult to perform your work objectively or effectively or when you or an “affiliated party” receives improper personal benefits as a result of your position or relationship with respect to the Organization. An “affiliated party” is a member of your family or any entity of which you or any affiliated party is a director or officer or in which you or any affiliated party has a beneficial interest of more than 5%. For example, a conflict may arise if you have a financial or personal interest in a contract or transaction to which the Organization is a party. In addition, receipt by you or a member of your immediate family of an improper personal benefit as a result of your position with the Organization may be deemed a conflict of interest.

In all instances where the appearance of a conflict exists, you must disclose the nature of the conflict to [a responsible supervisor, the Organization’s legal counsel, the President or Chair of the Board or Audit Committee]. We will work with you to determine what to do next. Directors, officers and others who have the ability to exercise substantial influence over the Organization are required to comply with the Conflict of Interest Policy.

IV. COMMUNITY, POLITICAL, CHARITABLE AND OTHER OUTSIDE ACTIVITIES

The Organization generally encourages participation in community activities outside the Organization. However, employees should avoid any outside personal interest or activity (whether or not for profit) that will interfere with their duties to the Organization. As a guideline, such activities should not encroach on time or attention employees should be devoting to Organization business, adversely affect the quality of their work, compete with the Organization’s business, imply Organizational sponsorship or support without express approval by the Organization, and/or adversely affect the reputation of the Organization.

No employee shall publicly utilize any affiliation of the Organization in connection with the promotion of partisan politics, religious matters, or positions on any issue not in conformity with the official position of the Organization.

V. PROTECTION AND PROPER USE OF THE ORGANIZATION’S ASSETS

You have a personal responsibility to protect the assets of the Organization from misuse or misappropriation. The assets of the Organization include tangible assets, such as products, equipment and facilities, as well as intangible assets, such as intellectual property, trade secrets, reputation and business information (including any non-public information learned as an employee, volunteer, officer or director of the Organization).

5.1 *Theft/Misuse of Assets*

The Organization's assets may only be used for business purposes and such other purposes as are approved by the Organization. You must not take, make use of, or knowingly misappropriate the assets of the Organization for personal use, for use by another, or for an improper or illegal purpose. You are not permitted to remove, dispose of, or destroy anything of value belonging to the Organization without the Organization's express prior written consent, including both physical items and electronic information.

5.2 *Confidential Information/Privacy*

You must not use or disclose any confidential information to any person or entity outside the Organization, either during or after service with the Organization, except with written authorization of the Organization or as may be otherwise required by law or regulation. You may not use confidential information for your own personal benefit or the benefit of persons or entities outside the Organization.

Confidential information includes all non-public information learned as an employee, volunteer, officer or director of the Organization. It includes, but is not limited to:

- Non-public information that might be (i) of use to suppliers, vendors, joint venture partners or others, (ii) of interest to the press, or (iii) harmful to the Organization or any of its constituents, if disclosed;
- Non-public information relating to the Organization's operations, including financial information, donor lists, mailing lists and any information relating to fundraising (including fundraising efforts, plans, ideas and proposals), minutes, reports and materials of the Board of Directors and its committees, and other documents identified as confidential;
- Non-public information about discussions and deliberations, relating to business issues and decisions, between and among employees, volunteers, officers and directors; and
- Non-public information about fellow employees, directors, officers or volunteers, or any other individuals about whom the Organization may hold information from time to time.

5.3 *Outside Communication*

The Organization is committed to providing full, fair and accurate disclosure in all public communications and in compliance with all applicable law, regulations and rules. Consistent with this commitment, employees may not answer questions from the media, donors, potential donors or any other members of the public unless specifically authorized to do so. If you should receive such an inquiry, you should obtain the name of the person and their contact information if possible and immediately notify [the Public Relations Manager].

As individuals we all have rights to speak out on issues including in a public forum, whether at your town hall or on a social networking media application or website. However, when you speak as an individual it is critical that you do not give the appearance of speaking or acting on the Organization's behalf and that you do not speak about the Organization. You should be especially aware of the broad reach of social networking media applications and websites, and that such media is increasingly being monitored by donors, customers, competitors, regulators and colleagues. Your comments may be attributed to the Organization, even though you did not intend for your comments to be attributed that way.

Whether or not you identify yourself as an employee of the Organization, you may not comment on or provide information relating to the Organization's business (even if such information is not confidential) in an internet chat room, newsgroup, guest book, bulletin board, blog, social or business networking site or similar forum unless you are specifically authorized to do so. You should not comment in such a forum on any subject matter as to which you have knowledge or expertise by virtue of your duties with the Organization. (For additional rules regarding confidential information, See "Confidential Information/Privacy" above.) Finally, you should not post in such a forum your opinions about the Organization unless you are specifically authorized to do so.

5.4 *Network Use, Integrity & Security*

The Organization reserves the right to monitor or review any and all data and information contained on any employee's or officer's computer or other electronic device issued by the Organization. In addition, the Organization reserves the right to monitor or review an employee's or officer's use of the Internet, Organization Intranet and Organization e-mail or any other electronic communications without prior notice.

Access to Organization systems will be revoked and disciplinary action may be taken in the event that such systems are used to commit illegal acts, or to violate the nondiscrimination, harassment, pornography, solicitation or proprietary information terms of this Code, or any other terms of this Code.

In order to maintain systems integrity and protect the Organization's network, no employee or officer should divulge any passwords used to access any Organization computer or database. Any suspected breach of the Organization's network security systems should be reported to a responsible supervisor or appropriate internal authority immediately.

All employees and officers should refrain from using or distributing software that may damage or disrupt the Organization's work environment by transmitting a virus or conflicting with Organization systems.

No employee or officer should engage in the unauthorized use, copying, distribution or alteration of computer software whether obtained from outside sources or developed internally. All software, including "shareware," contains terms of use that must be adhered to.

VI. ILLEGAL PAYMENTS

No illegal payments of any kind are to be made to any local, state or Federal Government officials of the United States, or to government officials of any other country, territory or municipality at any time or under any circumstances. Moreover, no funds or other assets of the Organization are to be paid, directly or indirectly, to government officials or persons acting on their behalf or to representatives of other businesses for the purpose of influencing decisions or actions with respect to the Organization's activities. Kickbacks to or from any person are prohibited.

Any question as to whether a gift or payment would be considered improper under the Organization's guidelines or national or foreign laws must be discussed with the Organization's legal counsel.

Under no circumstance is it acceptable for you to offer, give, solicit or receive any form of bribe, kickback, payoff, or inducement.

You may not use agents, consultants, independent contractors or other representatives to do indirectly what you could not do directly under this Code or applicable law, rules and regulations.

VII. MAINTAINING A SAFE, HEALTHY AND AFFIRMATIVE WORKPLACE

The Organization is an equal opportunity employer and bases its recruitment, employment, development and promotion decisions solely on a person's ability and potential in relation to the needs of the job, and complies with local, state and federal employment laws. The Organization makes reasonable job-related accommodations for any qualified employee or officer with a disability when notified by the employee that he/she needs an accommodation.

The Organization is committed to a workplace that is free from sexual, racial, or other unlawful harassment, and from threats or acts of violence or physical intimidation. Abusive, harassing or other offensive conduct is unacceptable, whether verbal, physical or visual. If you believe that you have been harassed or threatened with or subjected to physical violence in or related to the workplace, you should report the incident to an appropriate supervisor or Human Resources [or the Organization's legal counsel], who will arrange for it to be investigated. All efforts will be made to handle the investigation confidentially.

The Organization will not tolerate the possession, use or distribution of offensive materials on the Organization's property, or the use of the Organization's personal computers or other equipment to obtain or view such materials. All employees and officers must promptly contact an appropriate supervisor or Human Resources [or the Organization's legal counsel] about the existence of offensive materials, especially child pornography, on the Organization's systems or premises so that appropriate action may be taken, including notifying the proper authorities if necessary.

The Organization is committed to providing a drug-free work environment. The illegal possession, distribution, or use of any controlled substances on the Organization's premises or at Organization functions is strictly prohibited. Similarly, reporting to work under the influence of any illegal drug or alcohol and the abuse of alcohol or medications in the workplace is not in the Organization's best interest and violates this Code.

All accidents, injuries, or concerns about unsafe equipment, practices, conditions or other potential hazards should be immediately reported to an appropriate supervisor.

VIII. ACCOUNTING PRACTICES, BOOKS AND RECORDS AND RECORD RETENTION

Honest and accurate recording and reporting of information is critical to our ability to make responsible business decisions. You have a strict obligation to provide accurate information in the records of the Organization.

You are expected to support the Organization's efforts in fully and fairly disclosing the financial condition of the Organization in compliance with applicable accounting principles, laws, rules and regulations and making full, fair, accurate timely and understandable disclosure in our reports filed with regulatory agencies and other communications. Our financial statements and the books and records on which they are based must accurately reflect all transactions and conform to all legal and accounting requirements and our system of internal controls.

All employees, volunteers, officers and directors – and, in particular, the executive director[, the chief financial officer, the comptroller and the principal accounting officer] – have a responsibility to ensure that the Organization's accounting records do not contain any false or misleading entries.

We do not tolerate any misclassification of transactions as to accounts, departments or accounting periods and, in particular:

- All accounting records, as well as reports produced from those records, are to be kept and presented in accordance with law and are to comply with generally accepted accounting principles;
- All records are to fairly and accurately reflect the transactions or occurrences to which they relate;
- All records are to fairly and accurately reflect in reasonable detail the Organization's assets, liabilities, revenues and expenses;
- No accounting records are to contain any false or misleading entries;
- All transactions are to be supported by accurate documentation in reasonable detail and recorded in the proper account and in the proper accounting period; and

- The Organization's system of internal accounting controls, including compensation controls, is required to be followed at all times.

Always record data in a timely and accurate manner. This protects the Organization's resources and meets the expectations of the people who rely on the accuracy of the Organization's records to perform their jobs. Falsifying business records is a serious offense, which may result in criminal prosecution, civil action and/or disciplinary action up to and including termination of employment. If you are authorized to make expenditures or enter into transactions on behalf of the Organization, you must ensure that the applicable records comply with the Organization's accounting and purchasing policies and that all transactions are recorded properly.

Consistent with the reporting and recordkeeping commitments discussed above, you should accurately and truthfully complete all records used to determine compensation or expense reimbursement. This includes, among other items, reporting of hours worked (including overtime) and reimbursable expenses (including travel and meals).

Compliance with the Organization's [Records Retention Policy and Procedures] is mandatory. Destroying or altering a document with the intent to impair the document's integrity or availability for use in any potential official proceeding is a crime. *Destruction of records may only take place in compliance with the Organization's [Records Retention Policy and Procedures.]* Documents relevant to any pending, threatened, or anticipated litigation, investigation, or audit shall not be destroyed for any reason. If you believe that Organization records are being improperly altered or destroyed, you should report it to a responsible supervisor, the appropriate internal authority or the Organization's legal counsel.

IX. RAISING QUESTIONS AND CONCERNS

Each employee, volunteer, officer and director is responsible for promptly reporting to the Organization any circumstances that such person believes in good faith may constitute a violation of this Code, or any other Organization policy, or applicable law, regulations or rules. If you are in a situation that you believe may involve or lead to a violation of this Code, you have an affirmative duty to disclose to, and seek guidance from, a responsible supervisor, the Organization's legal counsel or other appropriate internal authority. *See "Who Do I Contact for Guidance or to Report Concerns?" above.*

You are strongly encouraged to report any complaint regarding accounting, internal accounting controls or auditing matters (including confidential and anonymous complaints) to the Organization's [Helpline on [INSERT NUMBER(S)] or by letter to the Audit Committee] – see "Who Do I Contact?" above.

[The Helpline is a special toll-free line available 24 hours a day, 365 days a year. It is intended to operate in addition to other resources available to you to voice complaints or concerns, such as supervisors, managers and Human Resources staff. The Helpline is monitored by a third party for reporting to the Organization's Audit Committee.]

It is the Organization's policy to encourage the communication of bona fide concerns relating to the lawful and ethical conduct of business, and audit and accounting procedures or related matters. It is also the policy of the Organization to protect those who communicate bona fide concerns from any retaliation for such reporting. No retribution against any individual who reports violations of this Code in good faith will be permitted. Confidential and anonymous mechanisms for reporting concerns are available and are described in this Code. However, anonymous reporting does not serve to satisfy a duty to disclose your potential involvement in a conflict of interest or in unethical or illegal conduct. Every effort will be made to investigate confidential and anonymous reports within the confines of the limits on information or disclosure such reports entail. While self-reporting a violation will not excuse the violation itself, the extent and promptness of such reporting will be considered in determining any appropriate sanction, including dismissal. The Organization will investigate any matter which is reported and will take any appropriate corrective action.

X. VIOLATIONS OF THIS CODE

Allegations of Code violations will be reviewed and investigated by the Organization's legal counsel, or, in appropriate circumstances by the Organization's Audit Committee.

Those who violate the standards in this Code will be subject to disciplinary action. Failure to follow this Code, or to comply with federal, state, local and any applicable foreign laws, and the Organization's policies and procedures may result in, among other actions, suspension of work duties, diminution of responsibilities or demotion, and termination of employment or termination of board service.

CERTIFICATE OF COMPLIANCE

I _____ hereby certify that I have read, understand
(Print name)

and am in compliance with the terms of the foregoing “Code of Conduct and Ethics.”

Date: _____

Signature: _____

Title: _____

If you have any questions, please contact the Organization’s legal counsel:

[INSERT CONTACT DETAILS]

May 2013

SAMPLE WHISTLEBLOWER POLICY

The board of a not-for-profit organization should establish a whistleblower policy that encourages individuals to report credible information on illegal practices or violations of policies of the organization, specifies that the organization will protect the individual from retaliation, and identifies the parties to whom such information can be reported.

While there are no federal legal requirements regarding whistleblower policies, exempt organizations are required to disclose on their Form 990 whether a whistleblower policy has been adopted.

Each company must also decide what reporting mechanisms will best balance the organization's valid interests in promoting the internal reporting of concerns about conduct and ethics, achieving efficiency in the use of resources for compliance efforts and preserving attorney-client privilege. This sample provides only one fairly simple example. "One size does not fit all" – governance structures and processes should reflect and be tailored to meet the needs and circumstances of the particular organization.

Please note that various factors unique to a not-for-profit organization (including, among others, organizational structure, activities, life-cycle stage, funding mechanisms, and applicable requirements of local, regional or national law) may affect the provisions that should be addressed. Accordingly, while this sample includes standards and provisions that may be generally appropriate for some not-for-profit organizations, different and additional provisions may be appropriate in particular circumstances.

[NAME OF NOT-FOR-PROFIT ORGANIZATION]

WHISTLEBLOWER POLICY

All directors, officers and employees are expected to act in accordance with all applicable laws and regulations, and with the policies of _____ (the “Organization”) at all times, and to assist in ensuring that the Organization conducts its business and affairs accordingly.

Any director, officer, employee or consultant who has engaged in, or who reasonably suspects any other director, officer, employee, consultant, or grantee of engaging in, any violation of the law, regulations, ethical rules or any policy of the Organization must report such activity as soon as possible. Such activity may include, but is not limited to, financial wrongdoing (including circumvention of internal controls or violation of the accounting policies of the Organization), fraud, harassment, or any other illegal or unethical conduct.

Reports may be made by writing to the Chair of the [Audit Committee or Board] [insert contact information]. Alternatively, employees may make such reports to their supervisor or to the [Chief Executive Officer (CEO)], where appropriate. Any person receiving such a report must refer it to the [CEO] or to the Chair of the [Audit Committee or Board] as soon as possible. Reports may be made anonymously, however the obligation to report a violation of a law, regulation or policy of the Organization is not satisfied by the individual reporting his or her own violation anonymously. All reports will be investigated and handled in a timely and sensitive manner. Confidentiality will be maintained throughout the investigation to the extent reasonable and practicable under the circumstances, and consistent with appropriate investigative and corrective action.

There will be no adverse employment action or other retaliation against any individual who reports a suspected violation or assists in an investigation, except in those instances where the Organization determines that a false report was made with intent to harm the Organization or an individual within the Organization.

Intimidation, coercion, threats or discrimination against any individual who reports suspected wrongdoing is prohibited and will be subject to appropriate disciplinary action, which may include termination.

May 2013

SAMPLE NOT-FOR-PROFIT AUDIT COMMITTEE CHARTER

The board of a not-for-profit organization is responsible for ensuring the integrity of the organization's accounting and financial reporting systems. Depending on the complexity of the organization and its accounting and reporting systems, the board may wish to establish an audit committee comprised of independent directors to assist it in fulfilling this responsibility.

Additionally, while there are no federal legal requirements regarding audit committees, exempt organizations are required to disclose on their Form 990 whether they have an audit committee with responsibility for overseeing the compilation, review or audit of its financial statements, and selection of an independent accountant or auditor that compiled, reviewed or audited the financial statements.

Whether a not-for-profit organization would find it valuable to establish an audit committee will depend on the financial resources and complexity of the financial structures of the particular organization. "One size does not fit all" – governance structures and processes should reflect and be tailored to meet the needs and circumstances of the particular organization. For example, a not-for-profit organization with significant financial resources or complex financial arrangements may benefit significantly by establishing an audit committee comprised of independent directors who are financially literate, responsible for retaining and compensating the organization's independent auditor (if any) and providing oversight of internal controls and related processes designed to assure that reported financial data is reliable. In contrast, a small not-for-profit organization with simple financial structures may decide that it would be more efficient and effective to entrust responsibility for ensuring the integrity of financial reporting to the entire board. (In either case, it is important that some members of the board be financially literate and at least one director should be sophisticated concerning financial reporting and accounting.)

This sample audit committee charter is intended to comport with generally accepted practices for audit committees of not-for-profit organizations. The sample assumes that the not-for-profit organization maintains some internal audit function, and presumes that this function is headed by a member of management (other than the chief executive officer) having as a principal responsibility the internal audit function. These provisions should be modified or omitted as appropriate so as to conform to the not-for-profit organization's particular circumstances.

Please note that various factors unique to a not-for-profit organization (including, among others, organizational structure, activities, life-cycle stage, funding mechanisms, and applicable requirements of local, regional or national law) may affect the provisions that should be addressed. Accordingly, while this sample includes standards and provisions that may be generally appropriate for some not-for-profit organizations, different and additional provisions may be appropriate in particular circumstances.

[NAME OF NOT-FOR-PROFIT-ORGANIZATION]

AUDIT COMMITTEE CHARTER

I. PURPOSE

The Audit Committee (the “Committee”) shall assist the Board of Directors (the “Board”) of _____ (the “Organization”) in fulfilling its responsibility to provide oversight of management regarding: (1) the Organization’s systems of internal controls and risk management; (2) the integrity of the Organization’s financial statements; (3) the Organization’s compliance with legal and regulatory requirements and ethical standards; and (4) the engagement, independence and performance of the Organization’s independent auditors.

II. MEMBERSHIP

The Committee shall consist of three or more members of the Board, each of whom the Board has selected and determined to be “independent” in accordance with the Board Guidelines. The Chair of the Committee shall be designated by the Board and shall preside at meetings of the Committee.

Committee members shall have a basic understanding of finance, accounting, and fundamental financial statements. At least one member of the Committee shall have a sophisticated understanding of financial reporting and accounting as determined by the Board.

III. MEETINGS AND QUORUM

The Committee shall meet on a regularly scheduled basis, at least [four] times per year, whenever requested by a Committee member and additionally as circumstances dictate. The Committee shall meet at least [twice] each year with the head of the internal audit function and with the independent auditor in separate executive sessions to provide the opportunity for full and frank discussion without members of senior management present.

Notice of meetings shall be given to all Committee members, or may be waived[, in the same manner as required for meetings of the Board]. Meetings of the Committee may be held by means of conference telephone or other communications equipment by means of which all persons participating in the meeting can hear and speak to each other. A majority of the members of the Committee shall constitute a quorum. The act of a majority of the Committee members present at a meeting at which a quorum is present shall be the act of the Committee.

IV. AUTHORITY

The Committee’s role is one of oversight. The Organization’s management is responsible for preparing the Organization’s financial statements and the independent auditors are responsible for auditing those financial statements. The Committee recognizes that management, including the internal audit staff and the independent auditors, have more time, knowledge and detailed information about the Organization than do the Committee members. Consequently, in carrying out its oversight responsibilities, the Committee is not providing any expert or special assurance

as to the Organization's financial statements or any professional certification as to the independent auditor's work.

In discharging its role, the Committee is empowered to inquire into any matter it considers appropriate to carry out its responsibilities, with access to all books, records, facilities and personnel of the Organization. In addition to retaining the Organization's independent auditor, the Committee shall have the power to retain outside counsel, other auditors or other advisors to assist it in carrying out its activities. The Organization shall provide adequate resources to support the Committee's activities, including compensation of the Organization's independent auditor and any counsel, other auditors and other advisors retained by the Committee. The Committee shall have the sole authority to retain, compensate, direct, oversee and terminate the Organization's independent auditor and any counsel, other auditors and other advisors hired to assist the Committee, who shall be accountable ultimately to the Committee.

The Committee may request any person including, but not limited to, any officer or employee of the Organization or the independent auditor, to attend Committee meetings or to meet with any members of, or advisors to, the Committee.

V. KEY RESPONSIBILITIES

The Committee shall undertake the following responsibilities, which are set forth as a guide. The Committee is authorized to carry out these activities and other actions reasonably related to the Committee's purposes or assigned by the Board from time to time.

A. *Independent Audit*

1. Recommend the appointment, review and approve the terms of the independent auditor's retention, engagement and scope of the annual audit, pre-approve any audit-related and non-audit services (including the fees and terms thereof) to be provided by the independent auditor, and, in connection with any pre-approval of permissible tax services [and services related to internal control over financial reporting], discuss with the independent auditor the potential effects of such services on the independence of the auditor, and evaluate, compensate and oversee the work of, the independent auditor who shall report directly to the Committee, and, if appropriate, terminate the independent auditor's engagement;
2. Review and confirm the independence of the independent auditor annually by obtaining and reviewing a report from the independent auditor delineating all relationships between the independent auditor and the Organization and discussing with the independent auditor any such disclosed relationships and their impact on the independent auditor's independence, and by obtaining the auditor's assertion of independence in accordance with professional standards;

3. At least every five years, review and approve the terms of the independent auditor's retention, including a review of fees charged by the auditors for the annual audits;
4. At least annually, review a report from the independent auditor describing the auditing firm's internal quality-control procedures and any material issues raised by the most recent quality-control review of the firm, or by any inquiry or investigation by governmental or professional authorities within the preceding five years, with respect to one or more independent audits carried out by the firm and any steps taken to deal with any such issues;
5. Review with the independent auditor any problems the auditor has encountered performing the audit, any management letter provided and the Organization's response to that letter, and matters that the independent auditor is required to communicate to the Committee; and
6. Review and discuss with management, the independent auditor and the internal auditor any significant findings during the year, any restrictions on the scope of activities or access to required information, any changes required in the scope of the audit plan, the audit budget and staffing and, coordination of audit efforts.

B. *Internal Audit*

1. Review the risk assessment that drives the internal audit plan and annually approve the plan;
2. Review the activities and evaluate the performance of the internal audit function;
3. Review significant adverse internal audit findings and management's response; and
4. Review the effectiveness of the internal audit function including staffing.

C. *Internal Control and Risk Oversight*

1. Review and discuss with management and the independent auditor the adequacy of the Organization's internal controls and the Organization's major financial risks or any significant exposures and assess the steps management has taken to minimize such exposures;
2. Review and discuss with management and the independent auditor the Organization's policies with respect to risk assessment and risk management;

3. Oversee compliance with and review the effectiveness of the Organization's internal control systems, including through regular executive sessions, whether internal control recommendations identified by internal and independent auditors have been implemented by management; and
4. Establish and oversee procedures for the receipt, retention and treatment of complaints regarding accounting, internal controls, or auditing matters and the confidential, anonymous submission by employees of concerns regarding questionable accounting or auditing matters.

D. Financial Reporting

1. Review and discuss with management and the independent auditor all critical accounting policies and practices used by the Organization and any significant changes in the Organization's accounting policies;
2. Review with the independent auditor significant accounting and reporting issues, including recent professional and regulatory pronouncements, understand their impact on the financial statements, and ensure that all such issues have been considered in the preparation of the financial statements;
3. Review issues related to judgments made involving valuation of assets and liabilities, and commitments and contingencies;
4. Review with management the annual financial statements, the annual audit report and recommendations of the independent auditor, including any audit problems or difficulties, and management's response;
5. Review with management and the independent auditor any complex and/or unusual transactions or other significant matters or events not in the ordinary course of business; and
6. Annually review with management and the external tax advisor any issues or judgmental areas relating to the Organization's tax compliance.

E. Oversight of Legal and Ethical Compliance

1. Review periodically with the Organization's legal counsel the scope and effectiveness of the Organization's legal and regulatory compliance policies and programs, and ethical standards and policies;
2. Oversee legal and regulatory compliance and compliance with ethical standards and policies, including the Conflict of Interest Policy, and act on reports of non-compliance;

3. Review and discuss with management and the auditors any possible areas of noncompliance with laws or policies and ensure that management follows up with relevant procedures where appropriate;
4. Ensure through inquiry and other appropriate means that management is communicating the importance of the Organization's values, code of conduct and ethics, and internal controls; and
5. Review, discuss with management and the independent auditor, and approve or ratify any transactions or courses of dealing with related persons (*e.g.*, including directors, executive officers, their immediate family members) that are significant in size or involve terms or other aspects that would likely be negotiated with independent parties, involving any safeguards or additional procedures to be applied in such circumstances.

F. Other Responsibilities

1. Maintain minutes of meetings and periodically report Committee findings, recommendations and actions to the Board, including on any issues that arise with respect to the quality or integrity of the Organization's financial statements, the performance and independence of the independent auditors and the performance of the internal audit function, the Organization's compliance with legal or regulatory requirements and its ethical standards and policies, and any other matters the Committee deems appropriate or the Board requests.

May 2013

**SAMPLE NOT-FOR-PROFIT
NOMINATING AND GOVERNANCE COMMITTEE CHARTER**

The board of a not-for-profit organization is typically responsible for nominating candidates for board selection, ensuring that the size, leadership and composition of the board are appropriate and overseeing governance structures and policies, including committee structure and bylaws. The board may wish to establish a nominating and governance committee comprised of independent directors to assist it in fulfilling this responsibility.

Nominating and governance committees may represent best practice for certain not-for-profit organizations. Whether a not-for-profit organization would find it valuable to establish a nominating and governance committee will depend on the size and complexity of the particular organization. “One size does not fit all” – governance structures and processes should reflect and be tailored to meet the needs and circumstances of the particular organization.

This sample nominating and governance committee charter is intended to comport with generally accepted practices for nominating and governance committees of not-for-profit organizations.

Please note that various factors unique to a not-for-profit organization (including, among others, organizational structure, activities, life-cycle stage, funding mechanisms, and applicable requirements of local, regional or national law) may affect the provisions that should be addressed. Accordingly, while this sample includes standards and provisions that may be generally appropriate for some not-for-profit organizations, different and additional provisions may be appropriate in particular circumstances.

[NAME OF NOT-FOR-PROFIT ORGANIZATION]

NOMINATING AND GOVERNANCE COMMITTEE CHARTER

I. PURPOSE

The Nominating and Governance Committee (“Committee”) shall assist the Board of Directors (the “Board”) of _____ (the “Organization”) in: (1) developing and overseeing implementation of policies and procedures regarding Board size, leadership and composition, recommendations of candidates for nomination to the Board, Board guidelines and conflicts of interest; (2) determining qualifications and characteristics needed by directors; (3) identifying, screening and reviewing individuals who are qualified to serve as directors; (4) recommending to the Board candidates for nomination and appointment to the Board, and its committees; (5) assisting in orientation programs for newly appointed directors; (6) evaluating the effectiveness of directors; and (7) reviewing on a regular basis the overall governance of the Organization and recommending improvements when necessary to the Board.

II. MEMBERSHIP

The Committee shall consist of three or more members of the Board, each of whom the Board has selected and determined to be “independent” in accordance with the Board Guidelines. The Chair of the Committee shall be designated by the Board and shall preside at all Committee meetings.

Committee members should be interested in recruiting individuals to serve as directors and enhancing their effectiveness through orientation and training.

III. MEETINGS AND QUORUM

The Committee shall meet on a regularly scheduled basis, at least [two] times per year and additionally as circumstances dictate.

Notice of meetings shall be given to all Committee members, or may be waived[, in the same manner as required for meetings of the Board]. Meetings of the Committee may be held by means of conference telephone or other communications equipment by means of which all persons participating in the meeting can hear and speak to each other. A majority of the members of the Committee shall constitute a quorum. The act of a majority of the Committee members present at a meeting at which a quorum is present shall be the act of the Committee.

IV. AUTHORITY

In discharging its role, the Committee is empowered to inquire into any matter it considers appropriate to carry out its responsibilities, with access to all books, records, facilities and personnel of the Organization. The Committee has the power to retain outside counsel, director search and recruitment consultants or other advisors to assist it in carrying out its activities. The Organization shall provide adequate resources to support the Committee’s activities, including compensation of the Committee’s counsel, consultants and other advisors. The Committee shall have the sole authority to retain, compensate, direct, oversee and terminate counsel, director

search and recruitment consultants, and other advisors hired to assist the Committee, who shall be accountable to the Committee.

V. KEY RESPONSIBILITIES

The Committee shall undertake the following responsibilities, which are set forth as a guide. The Committee is authorized to carry out these activities and other actions reasonably related to the Committee's purposes or assigned by the Board from time to time. To fulfill its purposes, the Committee shall:

1. Oversee the process of selection and nomination of directors, including ensuring that director nominees meet the qualifications required by the [certificate of incorporation, bylaws, and Board Guidelines] and establishing other criteria that are desirable for directors;
2. Identify, screen and review individuals to serve as directors, consistent with applicable qualifications or criteria, and recommend to the Board for approval candidates for nomination, appointment, and re-election;
3. Review annually the relationships between directors, the Organization and members of management, and recommend to the Board whether or not each director qualifies as "independent" under the definition of "independence" in the Board Guidelines;
4. Review annually with the Board the size and composition of the Board as a whole, its committees, and any advisory bodies including whether the Board, its committees and advisory bodies reflect the appropriate balance of independence, sound judgment, business specialization, technical skills, diversity, fundraising and development ability, geographic representation, and other desired qualities;
5. Coordinate and oversee a self-evaluation of the role and performance of the Board, its committees, advisory bodies, and individual directors, advisors and management at least every three years;
6. Oversee the implementation and effectiveness of, periodically review, and recommend modifications as appropriate to, the Organization's committee structure and organizational documents, including the certificate of incorporation, bylaws, Board Guidelines, [Code of Conduct, Conflict of Interest Policy and Whistleblower Policy] and recommend to the Board amendments as the Committee deems appropriate;
7. Coordinate and oversee the orientation and training of new directors, including identification of experienced directors as appropriate mentors of new directors;
8. Consider governance issues that arise and make appropriate recommendations to the Board; and

9. Maintain minutes of meetings and regularly report to the Board on Committee findings, recommendations and actions, and any other matters the Committee deems appropriate or the Board requests.

May 2013

SAMPLE NOT-FOR-PROFIT COMPENSATION COMMITTEE CHARTER

The board of a not-for-profit organization is responsible for determining and reviewing the compensation of the chief executive officer, other senior managers, and “disqualified persons” (as defined in the Internal Revenue Code) and for ensuring that compensation is reasonable. Compensation decisions of tax-exempt organizations are presumed reasonable if based on objective, documented, comparable information. The board may wish to establish a compensation committee comprised of independent directors to assist it in fulfilling this responsibility.

Additionally, while there are no federal legal requirements regarding compensation committees, exempt organizations are required to disclose on their Form 990 whether, among other things, compensation arrangements for certain key employees are reviewed and approved by disinterested directors or a compensation committee.

Compensation committees may represent best practice for certain not-for-profit organizations. Whether a not-for-profit organization would find it valuable to establish a compensation committee will depend on the size of the particular organization and the complexity of its compensation policies. “One size does not fit all” – governance structures and processes should reflect and be tailored to meet the needs and circumstances of the particular organization.

This sample compensation committee charter is intended to comport with generally accepted practices for compensation committees of not-for-profit organizations.

Please note that various factors unique to a not-for-profit organization (including, among others, organizational structure, activities, life-cycle stage, funding mechanisms, and applicable requirements of local, regional or national law) may affect the provisions that should be addressed. Accordingly, while this sample includes standards and provisions that may be generally appropriate for some not-for-profit organizations, different and additional provisions may be appropriate in particular circumstances.

[NAME OF NOT-FOR-PROFIT ORGANIZATION]

COMPENSATION COMMITTEE CHARTER

I. PURPOSE

The Compensation Committee (the “Committee”) shall assist the Board of Directors (the “Board”) of _____ (the “Organization”) in overseeing the Organization’s management compensation policies and practices, including (1) making recommendations to the independent directors with respect to the compensation of the Organization’s Chief Executive Officer (“CEO”); (2) reviewing and approving the compensation of the Organization’s other managers and employees who have substantial influence over the affairs of the Organization (“key executives”); (3) reviewing and approving management incentive compensation policies and programs; and (4) reviewing and approving bonus compensation programs for employees and exercising discretion in the administration of such programs.

II. MEMBERSHIP

The Committee shall consist of three or more members of the Board, each of whom the Board has selected and determined to be “independent” in accordance with the Board Guidelines. The Chair of the Committee shall be designated by the Board and shall preside at meetings of the Committee.

III. MEETINGS AND QUORUM

The Committee shall meet on a regularly scheduled basis, at least [two] times per year and additionally as circumstances dictate. The Committee shall meet at least [annually] with the CEO and any other officers the Board and Committee deem appropriate to discuss and review the performance criteria and compensation levels of key executives.

Notice of meetings shall be given to all Committee members, or may be waived[, in the same manner as required for meetings of the Board]. Meetings of the Committee may be held by means of conference telephone or other communications equipment by means of which all persons participating in the meeting can hear and speak to each other. A majority of the members of the Committee shall constitute a quorum. The act of a majority of the Committee members present at a meeting at which a quorum is present shall be the act of the Committee.

IV. AUTHORITY

In discharging its role, the Committee is empowered to inquire into any matter it considers appropriate to carry out its responsibilities, with access to all books, records, facilities and personnel of the Organization. The Committee shall have the power to retain outside counsel, compensation consultants or other advisors to assist it in carrying out its activities. The Organization shall provide adequate resources to support the Committee’s activities, including compensation of the Organization’s counsel, consultants and other advisors retained by the Committee. The Committee shall have the sole authority to retain, compensate, direct, oversee and terminate counsel, compensation consultants, and other advisors hired to assist the Committee, who shall be accountable ultimately to the Committee.

V. KEY RESPONSIBILITIES

The Committee shall undertake the following responsibilities, which are set forth as a guide. The Committee is authorized to carry out these activities and other actions reasonably related to the Committee's purposes or assigned by the Board from time to time. The Committee shall base its decisions on objective, documented and comparable data where such data is available. To fulfill its purposes, the Committee shall:

1. Establish and review the Organization's overall management compensation philosophy and policy;
2. Review and approve the Organization's goals and objectives relevant to the compensation of the Organization's key executives, including annual performance goals and objectives;
3. Oversee compliance with the compensation policies and procedures and the terms of employment contracts;
4. Review and authorize any employment, compensation, benefit or severance agreement with key executives;
5. Evaluate at least annually the performance of the key executives against the Organization's goals and objectives, including the annual performance objectives and, based on this evaluation, determine and approve (or recommend to the Board for approval in the case of the CEO) the compensation level (including any incentive awards and any material perquisites) for the key executives, reviewing as appropriate, any agreement or understanding relating to their employment, incentive compensation, or other benefits based on this evaluation;
6. Determine and approve the compensation level (including any incentive awards and any material perquisites) for other members of management of the Organization as the Committee or the Board may from time to time determine to be appropriate;
7. Review on a periodic basis the Organization's management compensation programs, including any management incentive compensation plans as well as plans and policies pertaining to perquisites, to determine whether they are appropriate, properly coordinated and achieve their intended purpose(s), and recommend to the Board any appropriate modifications or new plans or programs;
8. Review and recommend to the Board incentive compensation plans of the Organization and any modifications of such plans and review at least annually the awards made pursuant to such plans;
9. Review and recommend to the Board any changes in employee retirement plans or programs, and other employee benefit plans and programs; and

10. Maintain minutes of meetings and regularly report to the Board on Committee findings, recommendations and actions, and any other matters the Committee deems appropriate or the Board requests.

VI. REASONABLE COMPENSATION¹

The Committee should ensure that no more than reasonable compensation is paid to the Organization's employees. "Reasonable compensation" is the value that would ordinarily be paid for like services by similar organizations under similar circumstances. Compensation will be presumed reasonable under the relevant tax rules if the following three conditions are met:

1. The compensation arrangement is approved by disinterested members of the Board or the Committee.
2. The Board or Committee obtained and relied upon appropriate data as to comparability of compensation such as the compensation paid by similarly situated organizations, both taxable and exempt, for functionally comparable positions. This may include reviewing compensation surveys, actual written offers from similar organizations competing for the executive's services, or other objective external data to establish comparable values for executive compensation.
3. The Board or Committee adequately documents the basis for its determination that the compensation is reasonable concurrently with making that determination.

In some cases, the Board or Committee may find it impossible or impracticable to fully implement each step of the rebuttable presumption process described above. In such cases, the Board or Committee should try to implement as many steps as possible, in whole or in part, in order to substantiate the reasonableness of compensation as timely and as well as possible.

¹ Entities that may be subject to New York State Executive Order 38, scheduled to go into effect July 1, 2013 to limit compensation and administrative expenses at New York State funded not-for-profit and for-profit entities, should consider whether additional language addressing such limits on compensation and expenses is appropriate.

May 2013

SAMPLE NOT-FOR-PROFIT EXECUTIVE COMMITTEE CHARTER

The board of a not-for-profit organization directs the affairs of the organization and is accountable for ultimate performance. The responsibilities of the board within this mandate are wide-ranging and require the board to make complex decisions on a consensus basis. The boards of some not-for-profits may find that their size or structure makes it difficult for the board to efficiently make timely decisions. Such boards may benefit significantly by establishing an executive committee comprised of a mix of executive and non-executive directors to make decisions on behalf of the board if required, provided it is appropriate to do so.

This sample executive committee charter is intended to comport with generally accepted practices for executive committees of not-for-profit organizations. However, “one size does not fit all” – governance structures and processes should reflect and be tailored to meet the needs and circumstances of the particular organization.

Please note that various factors unique to a not-for-profit organization (including, among others, organizational structure, activities, life-cycle stage, funding mechanisms, and applicable requirements of local, regional or national law) may affect the provisions that should be addressed. Accordingly, while this sample includes standards and provisions that may be generally appropriate for some not-for-profit organizations, different and additional provisions may be appropriate in particular circumstances.

[NAME OF NOT-FOR-PROFIT ORGANIZATION]

EXECUTIVE COMMITTEE CHARTER

I. PURPOSE

The Executive Committee (“Committee”) shall exercise powers of the Board of Directors (the “Board”) of _____ (the “Organization”) in relation to matters that arise between regularly scheduled Board meetings or when it is not practical or feasible for the Board to meet. The Committee is delegated the authority to act as the full Board when exercising the powers and authority under this charter, subject to the limitations listed below.

II. MEMBERSHIP

The Committee will consist of the chair of each of the standing committees of the Board and any additional directors selected by the Board.

III. MEETINGS AND QUORUM

The Committee shall meet as circumstances dictate.

Notice of meetings shall be given to all Committee members, or may be waived[, in the same manner as required for meetings of the Board]. Meetings of the Committee may be held by means of conference telephone or other communications equipment by means of which all persons participating in the meeting can hear and speak to each other. A majority of the members of the Committee shall constitute a quorum. The act of a majority of the Committee members present at a meeting at which a quorum is present shall be the act of the Committee.

IV. AUTHORITY

In discharging its role, the Committee is empowered to inquire into any matter it considers appropriate to carry out its responsibilities, with access to all books, records, facilities and personnel of the Organization. The Committee shall have the power to retain outside counsel or other advisors to assist it in carrying out its activities. The Organization shall provide adequate resources to support the Committee’s activities, including compensation of the Organization’s counsel and other advisors retained by the Committee. The Committee shall have the sole authority to retain, compensate, direct, oversee and terminate counsel and other advisors hired to assist the Committee, who shall be accountable ultimately to the Committee.

V. KEY RESPONSIBILITIES

The Committee shall undertake the following responsibilities, which are set forth as a guide. The Committee is authorized to carry out these activities and other actions reasonably related to the Committee’s purposes or as assigned by the Board from time to time. To fulfill its purposes, the Committee shall:

1. Act on behalf of the Board on matters that arise between scheduled Board meetings or when it is not practical or feasible for the Board to meet, to the extent

permitted by applicable law and regulations, the certificate of incorporation and the bylaws. However, the Committee shall not have the power or authority to act on behalf of the Board with respect to the following matters:

- a. Adopting, amending or repealing any provision of the certificate of incorporation or bylaws;
 - b. Amending the Organization's mission;
 - c. Filling Board vacancies;
 - d. Changing the membership of, or filling vacancies in, the Executive Committee;
 - e. Appointing or terminating the appointment of the Chief Executive Officer; and
 - f. The amendment or repeal of any resolution of the Board which by its terms shall not be so amendable or repealable;
2. *[Consider whether other functions should be reserved to the Executive Committee]*
 3. Call special meetings of the Board when required; and
 4. Maintain minutes of meetings and regularly report to the Board on Committee findings, recommendations and actions, and any other matters the Committee deems appropriate or the Board requests.

May 2013

[NAME OF NOT-FOR-PROFIT ORGANIZATION]

FINANCE COMMITTEE CHARTER

I. PURPOSE

The Finance Committee (the “Committee”) shall assist the Board of Directors (the “Board”) of the _____ (the “Organization”) in fulfilling its oversight responsibilities relating to fiscal management by: (1) overseeing the management of organization-wide financial assets; (2) reviewing investment policies and strategies; (3) reviewing financial results; (4) ensuring the maintenance of an appropriate capital structure; and (5) reviewing and recommending approval of an annual operating budget.

In addition, in order to assist the Organization in the proper and prudent management of its financial resources, the Committee will ensure that the Organization employs personnel, systems and investment managers, capable of providing timely and accurate financial information to key decision-makers.

II. MEMBERSHIP

The Committee shall consist of three or more members selected by the Board. The Chair of the Committee shall be designated by the Board and shall preside at meetings of the Committee.

Committee members shall have a basic understanding of finance, accounting, investment management and fundamental financial statements. Members that have special skills or expertise have a duty to use those skills or expertise in managing and investing the Organization’s funds.¹

III. MEETINGS AND QUORUM

The Committee shall meet on a regularly scheduled basis, at least [four] times per year, whenever requested by a Committee member and additionally as circumstances dictate.

Notice of meetings shall be given to all Committee members, or may be waived[, in the same manner as required for meetings of the Board]. Meetings of the Committee may be held by means of conference telephone or other communications equipment by means of which all persons participating in the meeting can hear and speak to each other. A majority of the members of the Committee shall constitute a quorum. The act of a majority of the Committee members present at a meeting at which a quorum is present shall be the act of the Committee.

The Committee shall have direct access to, and complete and open communications with, the Board.

¹ UPMIFA §3(6), 12 Del. Code § 4703(i), NYPMIFA §552(e)(6).

IV. AUTHORITY

In discharging its role, the Committee is empowered to inquire into any matter it considers appropriate to carry out its responsibilities, with access to all books, records, facilities and personnel of the Organization. The Committee shall have the power to retain outside counsel or other advisors to assist it in carrying out its activities. The Organization shall provide adequate resources to support the Committee's activities, including compensation of the Organization's counsel and other advisors retained by the Committee. The Committee shall have the sole authority to retain, compensate, direct, oversee and terminate counsel and other advisors hired to assist the Committee, who shall be accountable ultimately to the Committee.

V. KEY RESPONSIBILITIES

The Committee shall undertake the following responsibilities which are set forth as a guide. The Committee is authorized to carry out these activities and other actions reasonably related to the Committee's purposes or assigned by the Board from time to time. To fulfill its purposes, the Committee shall:

1. Understand the Board's investment goals, risk tolerance level and spending plans in order to develop an investment strategy to meet these goals;
2. Oversee the implementation of and compliance with, periodically review, and revise as appropriate the Organization's investment policy including but not limited to:
 - a. hiring and terminating investment managers;
 - b. regularly reviewing investment performance results;
 - c. setting investment objectives;
 - d. establishing performance objectives and benchmarks;
 - e. devising the asset allocation strategy;
 - f. portfolio rebalancing; and
 - g. restricting investments, as necessary.
3. Oversee the prudent management of the Organization's funds in compliance with applicable law, and specifically shall:
 - a. incur only investment fees and costs that are appropriate and reasonable in relation to the assets, the purposes of the Organization and the skills available to the Organization;
 - b. consider the following factors when managing and investing the Organization's funds: general economic conditions; inflation [or

- deflation]; tax consequences; expected total return from income and appreciation; other resources of the Organization; the needs of the Organization to make distributions and to preserve capital; an asset's special relationship or special value, if any, to the charitable purposes of the Organization [; the role that each investment or course of action plays within the overall investment portfolio of the Organization];
- c. make individual investment decisions not in isolation but rather in the context of the entire portfolio and as a part of an overall investment strategy having risk and return objectives reasonably suited to the Organization;
 - d. diversify the Organization's investment portfolio unless the Committee reasonably determines that, because of special circumstances, the Organization is better served without diversification [(in which case the Committee shall review the decision not to diversity as frequently as circumstances require, but at least annually)]²; and
 - e. promptly make and carry out decisions concerning the retention or disposition of investments, or to rebalance a portfolio, in order to bring the portfolio into compliance with the Organization's purposes, investment policy, distribution requirements and legal requirements.
- 4. Review and advise investment managers on a regular basis regarding the form, content and frequency of financial information necessary for it to fulfill its responsibilities;
 - 5. Direct management and investment managers where necessary to undertake longer term financial planning to evaluate future financial needs;
 - 6. Receive and review on a quarterly basis investment performance statements and financial statements (statement of financial position, income statement and operating statement) relating to the then current year-to-date as well as key financial benchmarks the Committee deems relevant from time to time. These investment performance statements and financial statements may be accompanied by a narrative highlighting any financial issues and, where necessary, actions related thereto;
 - 7. Review annually an operating budget proposal by management [or the Grants Committee] for the next fiscal year to be approved by the Board;
 - 8. Approve the financing of capital projects;
 - 9. Review, approve and generally oversee the Organization's participation in any joint ventures or similar arrangements. If the Organization does propose to enter

² Include bracketed text if the organization is incorporated in the State of New York.

into a joint venture, the Committee will approve a joint venture policy, maintain the proper documentation establishing the overriding exempt purpose of the joint venture; and

10. Maintain minutes of meetings and regularly report to the Board on Committee findings, recommendations and actions, and any other matters the Committee deems appropriate or the Board requests.

May 2013

[NAME OF NOT-FOR-PROFIT-ORGANIZATION]
STRATEGIC PLANNING COMMITTEE CHARTER

I. PURPOSE

The Strategic Planning Committee (the “Committee”) shall assist the Board of Directors (the “Board”) of _____ (the “Organization”) to develop and monitor performance against the Organization’s mission and strategic plan.

II. MEMBERSHIP

The Committee shall consist of [the chair of each of the standing committees of the Board], as well as officers and additional directors selected by the Board. The Chair of the Committee shall be designated by the Board and shall preside at meetings of the Committee.

III. MEETINGS AND QUORUM

The Committee shall meet on a regularly scheduled basis, at least [two] times per year and additionally as circumstances dictate.

Notice of meetings shall be given to all Committee members, or may be waived[, in the same manner as required for meetings of the Board]. Meetings of the Committee may be held by means of conference telephone or other communications equipment by means of which all persons participating in the meeting can hear and speak to each other. A majority of the members of the Committee shall constitute a quorum. The act of a majority of the Committee members present at a meeting at which a quorum is present shall be the act of the Committee.

IV. KEY RESPONSIBILITIES

The Committee shall undertake the following responsibilities which are set forth as a guide. The Committee is authorized to carry out these activities and other actions reasonably related to the Committee’s purposes or assigned by the Board from time to time. To fulfill its purposes, the Committee shall:

1. Assess annually the Organization’s success in achieving long-term funding and any program-related goals, as articulated in the Organization’s mission and strategic plan adopted by the Board;
2. Review the mission and recommend to the Board amendments as the Committee deems appropriate;
3. Review the strategic plan and recommend to the Board modifications as the Committee deems appropriate, prior to the budget being developed for the next fiscal year; and

4. Maintain minutes of meetings and regularly report to the Board on Committee findings, recommendations and actions, and any other matters the Committee deems appropriate or the Board requests.

May 2013

[NAME OF NOT-FOR-PROFIT-ORGANIZATION]

DEVELOPMENT COMMITTEE CHARTER

I. PURPOSE

The Development Committee (the “Committee”) shall assist the Board of Directors (the “Board”) of _____ (the “Organization”) to raise financial and other resources for the Organization by: (1) assisting Board members in their own fundraising efforts; (2) recruiting potential donors; and (3) assisting staff in planning fundraising events.

II. MEMBERSHIP

The Committee shall consist of three or more members selected by the Board. The Chair of the Committee shall be designated by the Board and shall preside at meetings of the Committee.

Committee members should preferably have personal or professional relationships with individuals and organizations such as corporations, professional service firms and foundations that may be interested in and able to contribute to the Organization. Committee members should be prepared to leverage these relationships where appropriate for the purpose of furthering the Organization’s fundraising efforts and should encourage Board members to make contact with prospective donors and make personally meaningful contributions of their own.

III. MEETINGS AND QUORUM

The Committee shall meet on a regularly scheduled basis, at least [four] times per year and additionally as circumstances dictate.

Notice of meetings shall be given to all Committee members, or may be waived[, in the same manner as required for meetings of the Board]. Meetings of the Committee may be held by means of conference telephone or other communications equipment by means of which all persons participating in the meeting can hear and speak to each other. A majority of the members of the Committee shall constitute a quorum. The act of a majority of the Committee members present at a meeting at which a quorum is present shall be the act of the Committee.

IV. KEY RESPONSIBILITIES

The Committee shall undertake the following responsibilities which are set forth as a guide. The Committee is authorized to carry out these activities and other actions reasonably related to the Committee’s purposes or assigned by the Board from time to time. To fulfill its purposes, the Committee shall:

1. Assist and encourage Board members to reach out to potential donors and make personally meaningful contributions of their own;

2. Endeavor to recruit new institutional donors;
3. Assist staff in planning and developing fundraising-related events including benefits and other events designed to maintain existing donors and recruit new donors; and
4. Maintain minutes of meetings and regularly report to the Board on Committee findings, recommendations and actions, and any other matters the Committee deems appropriate or the Board requests.

May 2013

[NAME OF NOT-FOR-PROFIT-ORGANIZATION]

PUBLIC RELATIONS COMMITTEE CHARTER

I. PURPOSE

The Public Relations Committee (the “Committee”) shall assist the Board of Directors (the “Board”) of _____ (the “Organization”) to increase the profile of and awareness about the activities of the Organization towards target audiences such as potential donors and volunteers, and in the community generally.

II. MEMBERSHIP

The Committee shall consist of three or more members selected by the Board. The Chair of the Committee shall be designated by the Board and shall preside at meetings of the Committee.

Committee members should be willing and able to cultivate relationships with the public and be willing to leverage off media and corporate contacts where appropriate.

III. MEETINGS AND QUORUM

The Committee shall meet on a regularly scheduled basis, at least [two] times per year and additionally as circumstances dictate.

Notice of meetings shall be given to all Committee members, or may be waived[, in the same manner as required for meetings of the Board]. Meetings of the Committee may be held by means of conference telephone or other communications equipment by means of which all persons participating in the meeting can hear and speak to each other. A majority of the members of the Committee shall constitute a quorum. The act of a majority of the Committee members present at a meeting at which a quorum is present shall be the act of the Committee.

IV. KEY RESPONSIBILITIES

The Committee shall undertake the following responsibilities which are set forth as a guide. The Committee is authorized to carry out these activities and other actions reasonably related to the Committee’s purposes or assigned by the Board from time to time. To fulfill its purposes, the Committee shall:

1. Develop relationships with organizations and individuals external to the Organization, including media outlets, public relations firms and advertising agencies where appropriate, to increase awareness of the Organization, especially in donor and volunteer communities; and
2. Maintain minutes of meetings and regularly report to the Board on Committee findings, recommendations and actions, and any other matters the Committee deems appropriate or the Board requests.

May 2013

NOT-FOR-PROFIT BOARD SELF-EVALUATION

Practice Note: This questionnaire is intended to assist in obtaining viewpoints of trustees and directors regarding the functioning of the Board to assist the Board in its continuous efforts to improve its own effectiveness in governing the not-for-profit entity. The questionnaire can be used in several ways: it can be distributed to trustees/directors for them to fill-out and return (anonymously if need be) to a Board Committee or Committee Chair or other person who then collates and reports back to the Board; it can be used as a guide for interviews of trustees/directors; or it can be used to facilitate a discussion by the Board directly. However it is used, evaluation is most effective if the full Board has an opportunity for candid and open discussion about any concerns raised or suggestions for areas of improvement.

Please rate the statements that follow on a scale of 1 to 3, with 1 indicating agreement or a positive reaction and 3 indicating disagreement or a negative reaction. A score of 2 indicates neutrality, no opinion or no knowledge.

Board Composition

- | | | | | |
|----|---|---|---|---|
| 1. | The Board has an appropriate number of members. | 1 | 2 | 3 |
| 2. | The current Board composition reflects an appropriate mix and range of experiences, skill and expertise sufficient to provide sound and prudent guidance of the entity. | 1 | 2 | 3 |
| 3. | The current Board composition reflects an appropriate mix of diverse racial, ethnic, gender, cultural and other backgrounds. | 1 | 2 | 3 |
| 4. | The Board makes appropriate use of the talent, skills and expertise of its members. | 1 | 2 | 3 |
| 5. | Circle the three most important skills or attributes that directors should possess: | | | |
| | (a) business experience | | | |
| | (b) financial acumen | | | |

- (c) ability to think strategically
- (d) expertise in relation to governance
- (e) fundraising skill and experience
- (f) access to a network of donors
- (g) passion with respect to the organization's mission
- (h) commitment to volunteerism
- (i) experience in the [insert] industry
- (j) understanding of ethical issues
- (k) understanding of political issues and engagement in the political process
- (l) ability to make a financial contribution
- (m) other

Comments and suggestions:

Board Functions and Director Engagement

- | | | | | |
|----|---|----------|----------|----------|
| 1. | Directors come to meetings prepared and ready to engage in discussion. | 1 | 2 | 3 |
| 2. | Directors are attentive in Board meetings and everyone contributes to the discussion. | 1 | 2 | 3 |
| 3. | The Board promotes and considers the entity's not-for-profit mission in its operations and decision-making. | 1 | 2 | 3 |
| 4. | The Board devotes sufficient attention to: | | | |
| | (a) fundraising and funding issues | 1 | 2 | 3 |
| | (b) whether the entity is being properly managed | 1 | 2 | 3 |
| | (c) financial statements and processes | 1 | 2 | 3 |
| | (d) annual operating plans and budget | 1 | 2 | 3 |
| | (e) long-term plans | 1 | 2 | 3 |
| | (f) standards of governance and conduct | 1 | 2 | 3 |

	(g) periodic review of major projects	1	2	3
5.	The Board is well-informed about operations and financial condition.	1	2	3
6.	The Board provides appropriate oversight relating to internal controls and compliance with applicable laws and regulations.	1	2	3
7.	The Board understands and assesses major risk factors relating to performance and reviews measures to address and manage such risks.	1	2	3
8.	The Board is appropriately engaged in evaluating the performance of the Executive Director and determining his or her compensation.	1	2	3
9.	The Board communicates its goals, expectations and concerns to the Executive Director, and the Executive Director is responsive to such communications.	1	2	3
10.	The Board provides clear and well-understood policy direction.	1	2	3
11.	The Board understands and respects that its role is to provide oversight and direction and it does not unduly intrude into the day-to-day operations of the entity.	1	2	3
12.	Directors disclose personal interests in matters under review, and abstain from voting where appropriate, in accordance with the organization's Conflict of Interest Policy.	1	2	3
13.	The Board has adopted appropriate corporate governance guidelines and ethics policies.	1	2	3
14.	Each director participates in the organization's fundraising activities.	1	2	3
15.	The current expectation concerning director financial contributions is appropriate.	1	2	3

Comments and suggestions:

Board Mechanics

- | | | | | |
|----|---|----------|----------|----------|
| 1. | The Board holds an appropriate number of meetings. | 1 | 2 | 3 |
| 2. | Directors receive information in sufficient time to allow them to prepare for meetings. | 1 | 2 | 3 |
| 3. | Information provided to directors is brief but detailed enough to provide the desired information and is analytic as well as informative. | 1 | 2 | 3 |
| 4. | Board meetings are of an appropriate length to cover the business to be conducted and enable directors to meet their responsibilities. | 1 | 2 | 3 |
| 5. | Meetings are conducted in a manner that ensures open communication and timely action. | 1 | 2 | 3 |
| 6. | Board meeting time is appropriately allocated between Board discussion and management presentations. | 1 | 2 | 3 |
| 7. | Directors have sufficient input into shaping the Board's agenda and priorities. | 1 | 2 | 3 |
| 8. | The Board's leadership is effective. | 1 | 2 | 3 |
| 9. | Executive sessions of the Board (without the Executive Director or other employees present) are held periodically. | 1 | 2 | 3 |

Comments and suggestions:

Board Committees

- | | | | | |
|----|---|-----------------|-----------------|-----------------|
| 1. | The current Committee structure, charters and membership facilitate and assist the Board in the execution of its responsibilities and contribute to its efficiency and effectiveness. | <i>1</i> | <i>2</i> | <i>3</i> |
| 2. | The Board reviews the charters of its Committees periodically and with appropriate care. | <i>1</i> | <i>2</i> | <i>3</i> |
| 3. | The Board's current approach to rotation of Committee membership and chairmanship is appropriate. | <i>1</i> | <i>2</i> | <i>3</i> |
| 4. | The Committees communicate their activities, findings and recommendations to the full Board. | <i>1</i> | <i>2</i> | <i>3</i> |

Comments and suggestions:

May 2013

THE VOLUNTEER PROTECTION ACT: FEDERAL PROTECTION FOR BOARD MEMBERS AGAINST LIABILITY, 42 USC 14501 ET. SEQ. (THE “ACT”)

I. PURPOSE OF THE ACT

The purpose of the Act is to provide certain protections from liability abuses related to volunteers serving nonprofit organizations and governmental entities.¹ While the Act limits liability of volunteers it does not limit liability of a nonprofit organization itself.

II. LIMITATION ON LIABILITY FOR VOLUNTEERS

Except as provided in sections 3 and 8(C) below, no “volunteer”² of a nonprofit organization or governmental entity shall be liable for “harm”³ caused by an act or omission of the volunteer on behalf of the organization or entity if:

1. The volunteer was acting within the scope of his/her responsibilities in the nonprofit;⁴
2. If appropriate or required, the volunteer was properly licensed, certified or authorized by the appropriate authorities for the activities or practice in the state where harm occurred;⁵
3. Harm was not caused by willful or criminal misconduct or a conscious flagrant indifference to the rights and safety of the individual harmed by the volunteer;⁶ and
4. Harm was not caused by the volunteer operating a motor vehicle, vessel, aircraft or other vehicle that requires the operator/owner to possess a license and maintain insurance.⁷

III. RESPONSIBILITY OF VOLUNTEERS TO ORGANIZATIONS AND ENTITIES

The Act’s limitation on a volunteer’s liability does not bar any civil action brought by a nonprofit organization or governmental entity against any volunteer of such organization or entity.⁸

IV. NO EFFECT ON LIABILITY OF ORGANIZATION OR ENTITY

The Act’s limitation on a volunteer’s liability is not to be construed to affect the liability of any nonprofit organization or governmental entity with respect to harm caused to any person.⁹

V. LIMITATION ON PUNITIVE DAMAGES BASED ON VOLUNTEERS’ ACTIONS¹⁰

As a general rule, punitive damages may *not* be awarded against a volunteer for harm arising out of the volunteer’s actions acting within the scope of the volunteer’s responsibilities to the nonprofit organization or government entity *unless* the claimant establishes, by clear and

convincing evidence, that the harm was proximately caused by an action of such volunteer that constitutes willful or criminal misconduct or a conscious, flagrant indifference to the rights or safety of the harmed individual.¹¹

VI. EXCEPTIONS TO LIMITATIONS ON LIABILITY

The limitation on a volunteer's liability shall *not* apply to any misconduct that:

1. Is a crime of violence or an act of international terrorism for which the defendant has been convicted in any court;
2. Constitutes a hate crime as such term is defined in the Hate Crime Statistics Act¹² for which the defendant has been convicted in any court;
3. Involves a sexual offense for which the defendant has been convicted in any court;
4. Involves misconduct for which the defendant has been found to have violated a Federal or state civil rights law;¹³ or
5. Results where the defendant was under the influence (as determined by applicable state law) of intoxicating alcohol or drugs at the time of the misconduct.¹⁴

VII. LIABILITY FOR NONECONOMIC LOSS

Each defendant who is a volunteer shall be liable only for the amount of noneconomic loss¹⁵ allocated to that defendant in direct proportion to the percentage of responsibility of that defendant for the harm to the claimant for which the defendant is liable.

The Act specifies that the trier of fact shall determine the percentage of responsibility of that defendant for the claimant's harm.¹⁶

VIII. PREEMPTION AND ELECTION OF STATE NONAPPLICABILITY

- A. *Preemption.*** The Act preempts state law to the extent that such laws are inconsistent with the Act, except that the Act does not preempt any state law that provides additional protection from liability to volunteers while performing their duties for a nonprofit organization or governmental entity.¹⁷
- B. *Election of State Regarding Nonapplicability.*** The Act does not apply to any civil action in a state court against a volunteer in which all parties are citizens of the state if such state enacts legislation providing that the Act shall not apply to such civil action in the state.¹⁸
- C. *Exceptions to Volunteer Liability Protection.*** If the law of a State limits volunteer liability but is subject to one or more of the following conditions, such conditions shall not be inconsistent with the Act:¹⁹

1. Requires a nonprofit organization or government to adhere to risk management procedures, including mandatory training of volunteers;
2. Makes the nonprofit organization or governmental entity liable for the acts or omissions of its volunteers to the same extent as an employer is liable for the acts or omissions of its employees;
3. Makes a limitation of liability inapplicable if a civil action was brought by a State officer or local government pursuant to State law; or
4. Makes such limitation of liability inapplicable only if the nonprofit organization or government entity provides a financially secure source of recovery for individuals harmed by such volunteer (i.e., insurance policy, comparable risk pooling mechanism, equivalent assets or alternative arrangements that satisfy the State).²⁰

ENDNOTES

¹ 42 USC 14501(b). The impetus for the Act was that volunteers and prospective volunteers had become increasingly fearful of being sued. The Act sought to establish a level playing field for volunteer protection. There are no signs that the number of suits filed against volunteers or nonprofits has decreased since the enactment of the Act. This is probably because the Act does not prohibit lawsuits; it simply provides a limited defense for certain volunteers under certain circumstances. Ironically, the Act may be helpful to plaintiffs seeking damages from volunteers, in that it makes it clear how a suit must be styled to require a review of the facts by a judge or jury. *State Liability Laws for Charitable Organizations and Volunteers*, Nonprofit Risk Management Center, p.12 (published September 2001, updated 2005, 2008 and December 2009), available at <http://nonprofitrisk.org/downloads/state-liability.pdf>.

² “Volunteer” means “an individual performing services for a nonprofit organization or a governmental entity who does not receive (A) compensation (other than reasonable reimbursement or allowance for expenses actually incurred) or (B) any other thing of value in lieu of compensation, in excess of \$500 per year, and such term includes a volunteer serving as a director, officer, trustee or direct service volunteer.” 42 USC 14505 Sec. (6). Accordingly, volunteers who do not meet these conditions enjoy no protection under the Act. For example, someone working as a volunteer for an organization that is not a qualified nonprofit under the laws of the state in which it operates might not be protected by the Act. See *Gaudet v. Braca*, 2002 WL 31440878 (Conn. Super.), 33 Conn. L. Rep. 200, (vacating prior decision for summary judgment based on defense of the Act because question of fact existed as to whether club existed as a legal entity or is merely a distinguishing name). A volunteer who receives a stipend of \$50 per month, or \$600 annually, is not protected under the Act.

³ “Harm” includes “physical, nonphysical, economic and noneconomic losses.” 42 USC 14505 Sec. (2). Federal courts have interpreted the Act’s liability protection to generally cover claims made under state laws. *Armendarez v. Glendale Youth Center, Inc.*, 265 F.Supp.2d 1136, 1140 (D. Ariz. 2003). Federal courts are split however, on the Act’s liability protection to generally cover claims made under federal laws. *Armendarez v. Glendale Youth Center, Inc.*, 265 F.Supp.2d 1136, 1140 (D. Ariz. 2003), *American Produce, LLC v. Harvest Sharing, Inc.*, 2013 WL 1164403 (D. Colo. 2013).

⁴ In many cases, the scope of a volunteer’s responsibility is not defined. Accordingly, it may not be easy to determine whether this criteria has been satisfied.

⁵ It may not be readily apparent as to whether a volunteer was authorized to act.

⁶ This language provides guidance to plaintiff’s counsel in terms of wording a complaint so that it will avoid protection of the Act. A plaintiff need only state that a volunteer’s action was willful or in flagrant indifference to the rights and safety of the individual harmed.

⁷ 42 USC 14503(a).

⁸ 42 USC 14503(b).

⁹ 42 USC 14503(c).

¹⁰ The Act clarifies that this section does not create an action for punitive damages and does not preempt or supersede any Federal and State law that would limit the award of punitive damages.

¹¹ 42 USC 14503(e).

¹² 28 USC 534.

¹³ Many suits against volunteers are employment disputes, and the exclusion of suits alleging violation of State and Federal civil rights laws may eliminate certain disputes from coverage by the Act.

¹⁴ 42 USC 14503(f).

¹⁵ “Noneconomic losses” means losses for physical and emotional pain, suffering, inconvenience, physical impairment, mental anguish, disfigurement, loss of enjoyment of life, loss of society and companionship, loss of consortium (other than loss of domestic service), hedonic damages, injury to reputation and all other nonpecuniary losses of any kind or nature: 42 USC 14505 Sec. (3). Case law has found that a claim for negligent infliction of emotional distress is a claim *per se* for negligence and within the protection of the Act. *Foss v. Nadeau*, 2003 WL 22853695 (Conn. Super.), 36 Conn. L. Repr. 23, 27 (2003). These are distinct from punitive damages, which are expressly limited by provisions of Section 14503(e) of the Act (*See* section 5, above). “Economic losses” are defined as pecuniary loss resulting from harm (including the loss of earnings or other benefits related to employment, medical expense loss, replacement services loss, loss due to death, burial costs, and loss of business or employment opportunities) to the extent recovery for such loss is allowed under applicable State law: 42 USC 14505 Sec. (1). Noneconomic losses must be specified in the relevant motion. *Armendarez v. Glendale Youth Center, Inc.*, 265 F.Supp. 1136, 1138 (D. Ariz. 2003).

¹⁶ 42 USC 14504(b)(2).

¹⁷ 42 USC 14502(a).

¹⁸ 42 USC 14502(b).

¹⁹ 42 USC 14503(d).

²⁰ 42 USC 14503(d).

CALIFORNIA

I. CHARITABLE IMMUNITY

Immunity abolished. *Malloy v. Fong*, 37 Cal. 2d 356, 232 P.2d 241 (1951).

II. STATE STATUTES OFFERING PROTECTION

A. *Non-profit Volunteer Director or Volunteer Executive Officer Immunity.* Cal Corp. Code §5239.

A volunteer director or executive officer of a nonprofit corporation is not liable for monetary damages to a third party if (i) the act or omission was done in good faith, (ii) such act or omission was within the scope of the director's or executive officer's duty and (iii) damages caused by the act or omission are covered pursuant to a liability insurance issued to the corporation (either in the form of a general liability policy or a director's and officer's liability policy) or personally to the director or officer or in the event there is no liability insurance policy, the volunteer director or volunteer officer shall not be personally liable for damages if the board of directors of the corporation and the person had made all reasonable efforts in good faith to obtain available liability insurance. This immunity does not apply to reckless, wanton, gross or intentional negligence. The statute expressly provides that it does not eliminate or limit the liability as provided in Section 5233 (self-dealing transactions; interested director) or Section 5237 (liability of director with respect to distributions, loans or guarantees) of the California Corporate Code, or in any action or proceeding brought by the Attorney General. If a nonprofit public benefit corporation has an annual budget of less than \$25,000 and is exempt from federal income taxation under Section 501(c)(3) of the Internal Revenue Code, the condition to "make all reasonable efforts in good faith to obtain a general liability insurance policy" is satisfied if the corporation makes at least one inquiry per year to purchase a general liability insurance policy and the insurance was not available at a cost of less than 5 percent of the previous year's annual budget of the corporation. The statute further specifies that any inquiry made shall obtain premium costs for a general liability policy with an amount of coverage of at least five hundred thousand dollars (\$500,000).

B. *Volunteers Pressed into Service During Emergency.* Cal Gov. Code §8657.

Volunteers enrolled with the office of California Emergency Management Agency, or any disaster council, or unregistered persons pressed into service during an emergency have the same responsibility and immunity as officers and employers of the state. This immunity does not apply to gross or willful misconduct.

C. *Immunity from Liability for Advice Given to Small Claims Litigants.* Cal Gov. Code §818.9.

Volunteers of a public entity are not liable for any advice given to small claims court litigants pursuant to the Small Claims Act. This immunity does not apply to gross or willful misconduct.

D. Architectural Volunteer. Cal Bus and Prof Code §5536.27.

An architect who voluntarily and without compensation provides structural inspection services at the scene of an emergency at the request of a public official is not liable in negligence for injury or damages caused by the architect's good faith. This immunity applies for inspections that occur within 30 days of the emergency. However, this immunity does not apply to gross or willful misconduct.

E. Engineering Volunteer. Cal Bus and Prof Code §6706.

An engineer who voluntarily and without compensation provides structural inspection services at the scene of an emergency at the request of a public official is not liable in negligence for injury or damages caused by the engineer's good faith. This immunity applies for inspections that occur within 30 days of the emergency. However, this immunity does not apply to gross or willful misconduct.

F. Qualified Immunity for Personnel Engaging in Emergency Rescue Operations.
Cal Health and Safety Code §1799.107.

A public entity or emergency rescue personnel is not liable for injury caused by an act made within the scope of employment to provide emergency services. "Emergency rescue personnel" includes volunteer firefighters. This immunity does not apply to any act made in bad faith or in a grossly negligent manner.

III. CASE LAW

Munoz v. City of Palmdale, 75 Cal. App. 4th 367, 1999. A volunteer placed a coffeepot on a shelf at a senior center. The pot fell and injured a woman. The court granted the senior center immunity from vicarious liability for the volunteer's actions, because she was acting as a volunteer, not as an employee.

CONNECTICUT

I. CHARITABLE IMMUNITY

Charitable immunity has been abolished pursuant to Conn. Gen. Stat. §52-557d.

II. STATE STATUTES OFFERING VOLUNTEER PROTECTION

A. *Non-profit Immunity.* Conn. Gen. Stat. §52-557m.

An uncompensated director, officer or trustee of a non-profit organization qualified as a tax-exempt organization under Section 501(c) of the Internal Revenue Code is immune from civil liability resulting from any act performed in the scope of the individual's official responsibilities if the person was acting in good faith. This immunity does not extend to damage or injury caused by reckless, willful or wanton misconduct.

B. *Municipality Liability for Damages Caused by Volunteer Fireman or Volunteer Ambulance Member.* Conn. Gen. Stat. §7-308.

Requires the municipality to pay, on behalf of a volunteer fireman or volunteer ambulance member, any damages for liability imposed on the volunteer if the damages resulted from their official duties and were not a result of willful or wanton misconduct or in the event of damages to a person caused by an employee to a fellow employee while both employees are engaged in the scope of their employment for such municipality.

C. *Indemnification for School Board Volunteers.* Conn. Gen. Stat. §10-235.

The Board of Education is responsible, to protect a school board volunteer, for legal fees and costs arising out of a claim of negligence of the volunteer so long as the volunteer was acting in the discharge of her duties under the direction of the Board of Education and did not act wantonly, recklessly or maliciously.

D. *Good Samaritan Law.* Conn. Gen. Stat. §52-557b.

Connecticut provides a series of "good samaritan" laws protecting (i) a person licensed to practice medicine or surgery from civil damages resulting from the acts of the volunteer which may constitute ordinary negligence, (ii) a volunteer fireman, policeman, teacher or other school personnel, a member of ski patrol, a lifeguard, a conservation officer, patrolman or policeman for the Department of Environmental Protection, emergency medical service personnel who has completed a certified first aid course and who performs emergency first aid from civil damages resulting from negligent acts, (iii) an employee of a railroad company who has successfully completed a certified CPR course (and the railroad company which has provided such a course) will be immune from civil damages resulting from such employee's ordinary negligence in administering CPR.

An exception to all of the "good samaritan" laws is any act which constitutes gross, willful or wanton negligence.

III. CASE LAW

Federal Volunteer Protection Act has been used as a successful defense to dismiss causes of action on summary judgment, where the organization is clearly a nonprofit organization and the volunteer is ordinarily negligent in the performance of its volunteer duties.

Avenoso v. Mangan, 2006 WL 490340 (Conn. Super.), 40 Conn. L. Rptr. 637 (February 2006) (volunteer soccer coach not liable for causing injuries when he falls on child); and

Singletary v. Poyton, 2005 WL 704370 (Conn. Super.), 38 Conn. L. Repr. (volunteer building scaffold for school play not liable for personal injuries caused to individual when scaffolding fell on her).

DELAWARE

I. STATE STATUTES OFFERING VOLUNTEER PROTECTION

A. *Non-profit Immunity.* Del. Code Ann. Tit. 10, § 8133

An uncompensated director or officer (defined as a “volunteer”) is protected against civil liability arising under Delaware law resulting from a negligent act or omission performed during or in connection with an activity of a nonprofit organization. Protection does not extend to any act or omission constituting willful and wanton or grossly negligent conduct.

B. *Immunity for Certain Medical Volunteers.* Del. Code Ann. Tit. 10, § 8135

A licensed physician, nurse, dentist or dental hygienist engaged in an activity related to medical or dental care, as applicable, for a medical or dental clinic without compensation (defined as a “Volunteer”) shall not be subject to suit directly, derivatively or by way of contribution or indemnification for any civil damages resulting from any negligent act or omission performed during or in connection with an activity of the Volunteer while serving the medical or dental clinic, unless said Volunteer has insurance coverage for such acts or omissions in which case the amount recovered shall not exceed the limits of such applicable insurance coverage. This immunity does not extend to circumstances involving a Volunteer’s operation of a motor vehicle related to the performance of medical or dental care as discussed above. In such a circumstance, liability is limited to the limit of applicable insurance coverage maintained by or on behalf of such Volunteer with regard to the negligent operation of a motor vehicle.

C. *Good Samaritan Law.* Del. Code. Ann. Tit. 16 § 6801-6802

Any person (including members or employees of nonprofit volunteer or governmental ambulance, rescue or emergency units) who voluntarily renders first aid, emergency treatment or rescue assistance to a person who is unconscious, ill, injured or in need of rescue assistance, or any person in obvious physical distress or discomfort is not liable for damages for injuries alleged to have been sustained by such person or for damages for the death of such person alleged to have occurred by reason of an act or omission in the rendering of such first aid, emergency treatment or rescue assistance, unless it is established that such injuries or such death were caused willfully, wantonly or recklessly or by gross negligence on the part of such person. This provision does not apply to first aid or medical treatment rendered on the premises of a hospital or clinic.

Additionally, any nurse, licensed by any state, who in good faith renders emergency care at the scene of any emergency or who undertakes to transport any victim to the nearest medical facility shall not be liable for any civil damages as a result of any act or omission in rendering the emergency care; provided, however, such act or omission is not grossly negligent or intentionally designed to harm the victim.

FLORIDA

I. CHARITABLE IMMUNITY

Florida abolished charitable immunity as it would violate the public policy of the Florida constitution whereby any person injured should not be deprived of a right of action. *Wilson v. Lee Memorial Hosp.*, 65 So. 2d 40 (Fla. 1953).

II. STATE STATUTES OFFERING VOLUNTEER PROTECTION

A. *Florida Volunteer Protection Act.* F.S.A. Sec. 768.1355(1).

A person who volunteers to perform any service for a nonprofit organization, with no compensation, shall not incur any liability for any act or omission which results in personal injury or property damage if (1) such person acted in good faith, within the scope of the duty, and the volunteer acted as an ordinary reasonably prudent person would under the same or similar circumstances and (2) the injury was not caused by wanton or willful misconduct on the part of the person performing the duties.

B. *Elder Care Volunteers.* F.S.A. Sec. 430.204(3)

The department for community care for the elderly may provide appropriate insurance to protect volunteers from personal liability while acting within the scope of their duties.

C. *Volunteer Team Physicians.* F.S.A. Sec. 768.135

Any person licensed to practice medicine who acts as a volunteer team physician, who is in attendance at an athletic game sponsored by a public or private elementary or secondary school and agrees gratuitously and in good faith prior to the event to render emergency care or treatment during or as a result of the event, is not liable for civil damages resulting from the care rendered or any failure to act in providing or arranging further medical treatment. This immunity does not extend where such care was rendered in bad faith, for malicious purpose or with a wanton or willful disregard for safety.

D. *Volunteer Donors.* F.S.A. Sec. 768.136

A good faith donor or gleaner¹ who donates food apparently fit for human consumption to a bona fide charitable or nonprofit organization will not be subject to criminal penalty or civil damages arising from the condition of the food. Also, a charitable or nonprofit organization or a volunteer acting on behalf of such organization that collects, transports or distributes food apparently fit for human consumption will not be subject to criminal penalty or civil damages arising from the condition of the food. This immunity does not extend to injury caused by gross negligence, recklessness, or intentional misconduct on the part of the donor.

¹ "Gleaner" means a person who harvests for free distribution an agricultural crop that has been donated by the owner. F.S.A. Sec. 768.136 (3)(b).

III. CASE LAW

Campbell v. Kessler, 848 So. 2d 369, 2003. The Florida District Court of Appeal reversed a lower court's grant of summary judgment for the defendant pursuant to the Florida Volunteer Protection Act (the "Act"). The plaintiff brought a negligence action against the defendant, who rear-ended the plaintiff's car while he was serving as a volunteer member of a citizen patrol. The defendant had struck the plaintiff's car while the plaintiff was stopped at a traffic light and acknowledged failing to see her. The Court found that each requirement of the Act had to apply before immunity could be granted. The facts of the case were unclear as to whether the defendant acted as a reasonably prudent person. The Court stated that the Florida "legislature's clear intent is not to immunize volunteers from liability, but to shift liability from the volunteer to the non-profit organization only where the volunteer is exercising reasonable care and meets the other statutory criteria."

Halenda v. Habitat for Humanity, 125 F. Supp. 2d 1361, 2000. A family injured in a motor vehicle collision sued the defendants for damages sustained in the accident. The family also sued Habitat for Humanity ("Habitat") alleging that the non-profit was vicariously liable. The District Court found that while the wife was an employee of Habitat, the husband, who was driving when the accident occurred, was not in the process of rendering a volunteer service for Habitat. Accordingly, the Court declined to hold Habitat vicariously liable.

ILLINOIS

I. CHARITABLE IMMUNITY

Immunity abolished. *Gubbe v. Catholic Diocese of Rockford*, 122 Ill. App. 2d 71, 257 N.E. 2d 239 (1970).

II. STATE STATUTES OFFERING VOLUNTEER PROTECTION

A. *Limited Liability of Directors, Officers and Persons who Serve Without Compensation.* 805 ILCS 105/108.70.

No director or officer of tax exempt nonprofit organized under the state nonprofit corporation act shall be liable and no cause of action may be brought for damages resulting from the exercise of judgment or discretion in connection with the duties and responsibilities of such director unless: the director earns in excess of \$25,000 per year from his duties as director (other than reimbursement for actual expenses) or the act or omission involved willful or wanton conduct.

No person who, without compensation other than reimbursement for actual expenses, renders service to or for a corporation organized under the state nonprofit corporation act or a tax exempt nonprofit shall be liable, and no cause of action may be brought, for damages resulting from an act or omission in rendering such services. This immunity does not apply to any act or omission involving willful or wanton misconduct.

B. *“Employee” Includes Volunteers for State Employee Indemnification Act.* 5 ILCS 350/1.

For purposes of the State Employee Indemnification Act, the term “employee” includes people who perform volunteer services for the state and people who volunteer for non-profit organizations as long as the volunteer relationship is in writing.

C. *Court-appointed Special Advocate.* 705 ILCS 405/2-17.1.

A court-appointed special advocate who serves as a volunteer without compensation and acts in good faith within the scope of duty has immunity from civil and criminal liability. The good faith of a court appointed special advocate will be presumed. This immunity does not apply to any willful or wanton misconduct.

D. *Rape-crisis Volunteer.* 735 ILCS 5/8-802.1.

A volunteer rape crisis counselor who participates in good faith in the disclosing of particular records and communications has immunity from civil, criminal or any other liability that may arise from the action.

E. Volunteer Firefighter. 740 ILCS 75/1.

If a volunteer firefighter causes injury to person or property while engaged in the performance of duty, and the injured person does not contribute to the negligence, the fire district or incorporated fire organization whom the firefighter is working for is liable for the injury.

A volunteer firefighter may enter upon land to carry out his duties and is not civilly or criminally liable. A volunteer firefighter is not liable in damages for injury to person or property caused by him during the performance of duties. This immunity does not apply to any injury resulting from willful or wanton misconduct.

F. Good Samaritan Act Provisions. 745 ILCS 49/2.

The provisions of the Good Samaritan act will be liberally construed to encourage people to volunteer their time and talents.

1. *CPR volunteer.* 745 ILCS 49/10. Any certified person who performs CPR up to generally recognized standards without compensation, in good faith, and on a person in need of such is not liable for civil damages for an act or omission. This immunity does not extend to willful and wanton misconduct.
2. *Defibrillator volunteer.* 745 ILCS 49/12. Any person who renders emergency medical care using an automatic external defibrillator in good faith and in accordance with his or her training without compensation is not liable for civil damages to the person helped. This immunity does not extend to willful and wanton misconduct.
3. *Dental Good Samaritan.* 745 ILCS 49/15. Any licensed dentist who renders emergency medical care at the scene of an accident without fee is not liable for civil damages. This immunity does not extend to acts involving willful or wanton misconduct.
4. *Dental Clinic Volunteer.* 745 ILCS 49/20. Any licensed dentist who in good faith renders free dental care at a clinic is not liable for civil damages. This immunity does not apply to acts involving willful or wanton misconduct.

In addition, care provided at the clinic shall not include general anesthesia or an overnight visit.

5. *Court Volunteer.* 745 ILCS 10/2-214. A volunteer is not liable for acts or omissions in performing volunteer services pursuant to a court order that is part of a court volunteer program. This immunity does not extend to any act or omission constituting willful or wanton misconduct.
6. *Volunteer Coach.* 745 ILCS 80/1. A volunteer who provides services as a manager, coach, instructor, umpire or referee or voluntarily assists a

manager, coach, instructor, umpire or referee in a sports program of a non-profit association is not liable for civil damages as a result of rendering services or sponsoring a sports program.

This immunity is not granted if: the conduct of the person falls substantially below typical standards of a similar person rendering similar services, or the person did an act or omitted doing an act the person had a duty to do, knowing the act posed a substantial risk of harm. Establishing that the person acted below the ordinary standard of care is sufficient to impose liability.

III. CASE LAW

In *Momans v. St. John's Northwestern Military Academy, Inc.*, 2000 WL 33976543 (N.D. Ill.), plaintiffs sued certain members of the Board of Trustees of St. John's Northwestern Military Academy, Inc. ("St. John's") alleging that they were persuaded to enroll their children in St. John's based upon misrepresentations made by the defendants. The defendants relied on the Volunteer Protection Act and the state statutory protections of Wisconsin law to support the argument that plaintiffs cannot state a claim against them. The court concluded that a fact-finder could find that the misrepresentations made by the defendants could fall within the willful misconduct exception under both the federal and state law statute.

MASSACHUSETTS

I. CHARITABLE IMMUNITY AND TORT CAP

Massachusetts abolished charitable immunity in 1971 but currently imposes a \$20,000 limit (exclusive of interest and costs) on tort liability arising from any activity carried on to accomplish directly a charitable organization's purposes. This limitation on liability does not extend to activities that are primarily commercial in nature, even if such activities obtain revenue to be used for charitable purposes. Mass. Gen. Laws ch. 231, § 85K.

II. STATE STATUTES OFFERING VOLUNTEER PROTECTION

A. *Directors, Officers, and Trustees of Charitable Corporations.* Mass. Gen. Laws ch. 231, § 85W.

An uncompensated director, officer, or trustee of any nonprofit charitable organization will not be liable for civil damages resulting from any acts or omissions related solely to the performance of such person's duties as a director, officer or trustee. Reimbursement for reasonable expenses is generally not considered compensation. This immunity does not extend to (i) acts or omissions intentionally designed to harm, (ii) grossly negligent acts or omissions that result in harm to a person, (iii) acts or omissions committed in the course of activities that are primarily commercial in nature, even if such activities obtain revenue to be used for charitable purposes, and (iv) any cause of action arising out of such person's operation of an automobile.

B. *Directors, Officers, and Incorporators of Charitable Corporations.* Mass. Gen. Laws ch. 180, § 6C.

A person who serves as a director, officer, or incorporator of a charitable corporation will not be liable for performing such person's duties in good faith, in a manner reasonably believed to be in the best interests of the charitable corporation, and with such care as an ordinarily prudent person in a like position in a charitable corporation would use under similar circumstances. Such persons are entitled to rely on certain records of, and information provided by, the charitable corporation.

C. *Protection Under the Articles of Organization of a Charitable Corporation Organized Under Chapter 180.*

1. *Exculpation and Limitation of Liability of Directors and Officers of a Charitable Corporation Organized Under Chapter 180.* Mass. Gen. Laws ch. 180, § 3. The articles of organization of a charitable corporation organized under Chapter 180 of the Massachusetts General Laws may, but are not required to, contain a provision eliminating or limiting the personal liability of directors and officers to the charitable corporation or its members for monetary damages for breach of fiduciary duty. Such a provision may not eliminate or limit liability (i) for any breach of the director's or officer's duty of loyalty to the charitable corporation or its members, (ii) for acts or omissions not in good faith or that involve intentional misconduct or a knowing violation of law, or (iii) for any

transaction from which the director or officer derived an improper personal benefit.

2. *Indemnification of Directors, Officers, Employees, and Other Agents of a Charitable Corporation Organized Under Chapter 180.* Mass. Gen. Laws ch. 180, § 6. The articles of organization, the bylaws, a vote adopted by the members, or (in the case of persons other than directors) a vote adopted by the directors of a charitable corporation organized under Chapter 180 of the Massachusetts General Laws may, but are not required to, provide for the indemnification of directors, officers, employees, and other agents of a charitable corporation and persons who serve as at its request in a capacity with respect to any employee benefit plan.

D. *Directors, Officers, and Trustees of Educational Institutions.* Mass. Gen. Laws ch. 231, § 85K.

An uncompensated director, officer, or trustee of an educational institution (that is, or at the time of the cause of action was, a charitable organization and qualified under I.R.C. § 501(c)(3)) who acts in good faith and within the scope of such person's official duties and functions will not be liable for any act or omission resulting in damage or injury to another person solely by reason of such person's services as a director, officer, or trustee. This immunity does not extend to damages or injuries caused by (i) willful or wanton misconduct or (ii) such person's operation of a motor vehicle.

E. *Emergency Care of Injured Persons.* Mass. Gen. Laws ch. 112, § 12B.

Any (i) duly registered physician, (ii) duly registered physician assistant, (iii) employing or supervising physician of a registered physician assistant, (iv) duly registered or licensed nurse, or (v) duly registered resident from another state, the District of Columbia, or a province of Canada, who, in good faith, as a volunteer and without fee, renders emergency care or treatment will not be liable in a suit for damages as a result of his acts or omissions, and such person will not be liable to a hospital for its expenses if, under such emergency conditions, such person orders a person hospitalized or causes such person to be admitted to the hospital. This immunity does not extend to conduct in the ordinary course of such person's practice.

F. *Voluntary Emergency Care or Treatment by a Public or Collaborative School Employee.* Mass. Gen. Laws ch. 71, § 55A.

A public or collaborative school teacher, principal, secretary to the principal, nurse, or other employee who, in good faith, renders emergency first aid or transportation to a student who has become injured or incapacitated in a public or collaborative school building or on its grounds will not (i) be liable in a suit for damages, (ii) be liable to a hospital for its expenses if under such emergency conditions such person causes the admission of such injured or incapacitated student, and (iii) not be subject to any disciplinary action by the school committee, as a result of such person's acts or omissions either for such first aid or as a result of providing such emergency transportation to a place of safety.

G. *Trained Individuals Rendering Emergency CPR.* Mass. Gen. Laws ch. 112, § 12V.

Any person and who, in good faith, attempts to render emergency care (including, but not limited to, cardiopulmonary resuscitation or defibrillation) and does so without compensation, will not be liable for acts or omissions resulting from the attempt to render such emergency care. This immunity does not extend to (i) persons whose usual and regular duties include the provision of emergency medical care or (ii) gross negligence or willful or wanton misconduct.

III. CASE LAW

Connors v. Northeast Hosp. Corp., 789 N.E.2d 129 (Mass. 2003) (leading case analyzing charitable purposes and activities that are “primarily commercial in nature”). A hospital was entitled to the benefit of the charitable tort cap under Section 12B of Chapter 112 of the Massachusetts General Laws in a negligence suit arising from a slip-and-fall that occurred because of snow and ice buildup on the hospital’s parking lot, which was available for use by anyone in need of medical attention at the hospital.

In re Boston Regional Medical Center, Inc., 328 F. Supp. 2d 130 (D. Mass. 2004) (activities of uncompensated trustees were not primarily commercial in nature, which entitled them to the benefit of the charitable tort cap).

Proctor v. North Shore Community Arts Foundation, 713 N.E.2d 969 (Mass. App. Ct. 1999) (the maintenance of a picnic area, which was not created with the intent of raising revenue, but which was available to patrons at no cost and at which occurred the sale of refreshments by another entity, did not constitute “primarily commercial in nature”).

Missett v. Cardinal Cushing High School, 680 N.E.2d 563 (Mass. App. Ct. 1997) (school was entitled to the benefit of the charitable tort cap relating to acts occurring at a school dance).

Hopper v. Callahan, 562 N.E.2d 822 (Mass. 1990). A physician who treated an involuntarily committed patient who died after the physician ordered her to be placed in seclusion was not entitled to charitable tort cap, because the physician was acting “in the ordinary course of his practice.” The physician (i) treated the patient because no one else was available, (ii) had authority to order the patient to be placed in seclusion, (iii) was responsible for her care, and (iv) was considered a salaried employee when working his required hours at the hospital.

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NEW JERSEY

I. CHARITABLE IMMUNITY

New Jersey established the doctrine of charitable immunity in 1925 in *D'Amato v. Orange Memorial Hospital*, 101 N.J.L. 61, 127 A 340 (N.J. 1925) (wherein the Court barred a negligence suit against a corporation established to maintain a public charitable hospital). The doctrine was abolished in a 1958 New Jersey Supreme Court ruling, but then re-emerged with the adoption of the New Jersey Charitable Immunity Act ("NJCIA").

II. STATE STATUTES OFFERING VOLUNTEER PROTECTION

A. *NJCIA*. N.J.S.A. Sec. 2A:53A-7.

Nonprofit organizations organized exclusively for religious, charitable, educational or hospital purposes and their trustees, directors, officers, employees, agents, servants or volunteers are not liable to any person who suffers damage from the negligence of any agent or servant of such organization if such person is a beneficiary, to whatever degree, of the nonprofit organization, *provided, however*, that such immunity from liability shall not apply to any person who suffers from the negligence of such nonprofit organization or of its agents or servants where such person is unconcerned in, unrelated to and outside of the benefactions of such nonprofit organization. This immunity does not apply to willful, wanton or grossly negligent acts, including sexual assault and other crimes of a sexual nature, negligent operation of a motor vehicle or an independent contractor of a nonprofit corporation. Also, this immunity does not extend to any health care provider, in the practice of his profession, who is a compensated employee, agent or servant of any nonprofit organization organized exclusively for religious, charitable or educational purposes. The NJCIA is inapplicable in lawsuits alleging negligent hiring, supervision or retention of an "employee, agent or servant" that resulted in a sexual offense being committed against a person under the age of 18. N.J.S.A. Sec. 2A:53A-7.4

B. *Blood Bank Volunteers*. N.J.S.A. Sec. 2A:53A-7.2.

A person serving a blood bank without compensation is not liable for damages resulting from the exercise of judgment in connection with official duties, or for any acts or omissions arising out of services rendered by the volunteer unless the actions evidence a reckless disregard for the duties imposed by the position. This immunity does not extend to any damage caused by negligent operation of a motor vehicle.

C. *Emergency Care Law Enforcement Officers*. N.J.S.A. Sec. 2A:62A-1.1.

A municipal, county or State law enforcement officer is not liable for any civil damages as a result of acts or omissions taken in good faith in rendering emergency care at the scene of an accident or emergency or while transporting the victim to a care facility. This immunity shall not exonerate a law enforcement officer for gross negligence.

D. *Emergency Care Health Care Professionals.* N.J.S.A. Sec. 2A:62A-1.3.

A health care professional who, in good faith, responds to a life-threatening emergency within a hospital or other health care facility and was not under a duty to render such care is not liable for civil damages as a result of an act or omission in the rendering of emergency care. This immunity does not extend to acts or omissions constituting gross negligence, recklessness or willful misconduct.

E. *Emergency Volunteers.* N.J.S.A. Sec. 2A:53A-12.

A member of a volunteer first aid, rescue or emergency squad, or a volunteer member of the National Ski Patrol who provides emergency public first aid and rescue services in good faith is not liable in any civil action as a result of acts or omissions in rendering aid. This immunity does not extend to operation of a motor vehicle or a willful and wanton omission or commission.

F. *Volunteer Fire Company Members.* N.J.S.A. Sec. 2A:53A-13

A member of a volunteer fire company who in good faith provides emergency first aid or rescue services for the control and extinguishment of a fire, or a member of a volunteer first aid or rescue squad is not liable in any civil action as a result of acts or omissions in rendering aid. Exceptions: This immunity does not extend to operation of a motor vehicle, or a willful and wanton omission or commission.

G. *Fraternal Benefit Societies.* N.J.S.A. Sec. 17:44B-8

A director, officer, employee, member or volunteer of a fraternal benefit society serving without compensation is not liable for damages resulting from the exercise of judgment or discretion in connection with the duties or responsibilities of that person for the society. This immunity does not extend to acts or omission resulting from willful or wanton misconduct.

III. CASE LAW

Nazarro v. United States, 304 F. Supp. 2d 605, 2004. The plaintiff, a senior member of the Civil Air Patrol (“CAP”) sued CAP for personal injury damages sustained while participating in a recreational outing arranged by CAP. The Court found that CAP was a charitable organization under the NJCIA and therefore, qualified for charitable immunity.

Velazquez v. Jiminez, 763 A. 2d 753, 2000. The Court found that a physician who responded to an emergency situation while delivering a baby was not entitled to immunity under the Good Samaritan Act N.J.S.A. 2A:62A 1.1-1.3 (the “Act”) since the Act was meant to encourage persons to render aid in circumstances where they did not otherwise have a duty to do so. Here, the physician was under a professional duty of care and therefore not entitled to immunity.

NEW YORK

I. CHARITABLE IMMUNITY

New York abolished charitable immunity because it was contrary to the public policy of the State and because insurance made full compensation possible without any significant diminution of a charitable organization's funds. *Rakaric v. Croation Cultural Club "Cardinal Stepinac Organization"*, 76 A.D.2d 619, 430 N.Y.S. 829 (1980).

II. STATE STATUTES OFFERING VOLUNTEER PROTECTION

A. *Volunteer Fire Fighters.* NY Gen. Mun. Laws Sec. 205-b.

Members of volunteer fire companies are exempt from civil liability for any act done in the performance of their duties as volunteer fire fighters. The exemption does not apply to acts constituting willful negligence or malfeasance.

B. *Volunteers of National Ski Patrol.* NY Unconsol. Laws Ch 211-A, Sec. 1.

A person who is registered with the National Ski Patrol and voluntarily and without compensation renders first aid or emergency treatment at a ski area to a person in need is not liable for damages for injuries alleged to have been sustained by such person from the care rendered. The exemption does not apply to injury or death caused by gross negligence.

C. *University Immunity.* NY Educ. Laws Sec. 6205.

Any member of the board of trustees of the City University of New York and any duly appointed member of the teaching or supervising staff, officer, employee (including a volunteer expressly authorized to participate in a volunteer program at the City University of New York) or student serving on a university or college body of the City University of New York will be indemnified against any claim or suit arising from an act or omission occurring within the scope of his/her duties.

III. CASE LAW

Tobacco v. Babylon Volunteer Fire Dept., 696 N.Y.S. 2d 340, 1999. A woman who was injured when a fire truck struck the car she was in sued the fire department and the voluntary firefighter who was driving the truck for negligence. The court found that volunteer fire fighters are afforded immunity for simple negligence and that Gen. Mun. Law, Sec. 205-b provides in unambiguous terms that volunteer fire districts shall be liable for the negligence of their volunteer firefighters. The court held that the fire department could be held liable for ordinary negligence even though the individual fire fighter was immune from liability for simple negligence.

TEXAS

I. CHARITABLE IMMUNITY

Texas abolished the doctrine of charitable immunity with respect to causes of action arising from events occurring after March 9, 1966 in *Howle v. Camp Amon Carter*, 470 S.W.2d 629 (Tex. 1971).

II. STATE STATUTES OFFERING VOLUNTEER PROTECTION

A. *The Charitable Immunity and Liability Act of 1987.* Tex. Civ. Prac. & Rem. Code Ann. §84.003-§84.007.

A person who volunteers to render services for a non-profit organization, with no compensation, including directors, officers, trustees, direct service volunteers, or volunteer health care providers, shall be immune from liability for any act or omission resulting in death, damage, or injury if the volunteer was acting in the course and scope of the volunteer's duties or functions. Non-profit organizations are defined as: (1) those qualified as tax-exempt under Section 501(c) of the Internal Revenue Code; (2) organized exclusively for any bona fide charitable, religious, prevention of cruelty to children or animals, youth sports and youth recreational, neighborhood crime prevention or patrol purposes, or educational organization, excluding fraternities, sororities, and secret societies; (3) homeowners associations qualified as a tax-exempt under Section 501(c)(4) of the Internal Revenue Code; (4) volunteer centers; and (5) local chambers of commerce. This immunity does not apply: (1) to an act or omission that is intentional, willfully negligent, or done with conscious indifference or reckless disregard for the safety of others; (2) if the organization was formed substantially to limit its liability under the law; (3) to organizations formed to dispose, remove, or store hazardous waste, industrial solid waste, radioactive waste, municipal solid waste, garbage, or sludge; (4) a governmental unit or employee of a governmental unit; (5) statewide trade associations that represent local chambers of commerce; (6) to health care providers unless they have liability insurance that covers \$1,000,000 for personal injury and \$100,000 for property damage or are providing services at a federally funded migrant or community health center, provides services below cost basis or is a non-profit health maintenance organization; and (7) to negligent operation or use of motor driven equipment.

B. *The Texas Good Samaritan Law: Liability for Emergency Care.* Tex. Civ. Prac. & Rem. Code Ann §74.151.

A person is not liable for damages arising from the administration of emergency care, including the use of an automated external defibrillator, if the person acted in good faith at the scene of an emergency or in a health care facility. This immunity does not extend to willful and wanton actions. Furthermore, immunity does not extend to care administered for or in expectation of remuneration, or by a person who was at the scene of the emergency because he or a person he represents as an agent was soliciting business or seeking to perform a service for remuneration. Also, immunity is not available for a person whose negligence was a producing cause of the emergency for which care is being administered.

C. *Volunteer Firefighter or Volunteer Fire Department.* Tex. Civ. Prac. & Rem. Code Ann §78.001.

A volunteer firefighter or a volunteer fire department is not liable for damage to property resulting from the firefighter's or the fire department's reasonable and necessary action in fighting or extinguishing a fire on the property. This immunity does not apply to any injury resulting from willful or wanton misconduct.

D. *Food Donor.* Tex. Civ. Prac. & Rem. Code Ann §76.001.

A person or gleaner is not subject to liability arising from the condition of apparently wholesome food that the person or gleaner donates to a church, or a non-profit organization for distribution to the needy. Wholesome food is defined as food meeting all quality standards of local, county, state and federal agricultural and health laws and rules, even though the food is not readily marketable due to appearance, age, freshness, grade, size, surplus, or other condition. Canned goods that are leaking, swollen, dented on a seam, or no longer airtight are not wholesome food. This immunity does not apply to an injury or death that results from an act or omission of the donor constituting gross negligence, recklessness or intentional misconduct.

E. *Transplants and Transfusions.* Tex. Civ. Prac. & Rem. Code Ann §77.003.

A person who donates, obtains, prepares, transplants, injects, transfuses or transfers a human body part from a living or dead human to another human or a person who assists or participates in that activity is not liable as a result of that activity except for negligence, gross negligence or an intentional tort.

F. *Donation of Medical Devices.* Tex. Civ. Prac. & Rem. Code Ann §89.001.

A person authorized to possess a medical device is not liable for personal injury, property damage, or death resulting from the nature, age, packaging, or condition of a device that the person donates in good faith to an authorized non-profit health care organization for use in providing free or reduced cost health care. A medical device includes braces, artificial appliances, durable medical equipment and other medical supplies. This immunity does not apply to a person who donates a device: (1) knowing that use of the device would be harmful to the health or well-being of another person; (2) with actual conscious indifference to the health or well-being of another person; or (3) in violation of state or federal law.

III. CASE LAW

The limited liability provided by the Texas Good Samaritan Law is an affirmative defense. Therefore, after a lawsuit is filed, a physician has the burden to prove that he or she should be provided immunity under the Texas Good Samaritan Law. In *Ramirez v McIntyre, MD*, 59 S.W.3d 821 (2001), the defendant, Dr. McIntyre an obstetrician, was working on his own patient in a hospital when he answered an emergency call to deliver a baby born to another physician's patient. The baby was injured during delivery and the baby's parents sued Dr. McIntyre. The Texas Third Court of Appeals held that Dr. McIntyre was not entitled to protection under the Texas Good Samaritan Law because he did not conclusively prove, as a matter of law, that he was not entitled to charge a fee for the care he rendered. This decision, in effect, rendered the

Texas Good Samaritan law useless because it placed a nearly impossible burden of proof on the physician. However, in *McIntyre v. Ramirez*, 109 S.W.3d 741 (2003), the Texas Supreme Court reversed the Court of Appeals holding that Dr. McIntyre was not required to prove that he had no legal entitlement to receive remuneration in order to be protected by the Texas Good Samaritan Law.

ISSUES AND CONCERNS FOR DIRECTORS OF TROUBLED NOT-FOR-PROFIT ORGANIZATIONS: RECOGNIZING AND FACING THE CHALLENGES

I. FIDUCIARY DUTIES

All directors owe certain fiduciary duties to their organizations, whether the organizations are for-profit or not-for-profit. For example, directors owe a duty of care, which requires them to be informed, attend board meetings, exercise independent judgment and act in good faith. Directors also owe a duty of loyalty, which requires them to act in the best interests of the corporation by avoiding conflicts of interest, observing confidentiality obligations and not abusing corporate opportunities for personal gain. See **Tab 2** for more information on fiduciary duties. In general, the directors of a solvent organization owe their duties to the organization and, in the context of a for-profit corporation, its shareholders, but not to creditors.¹ When an organization is insolvent, however, most courts recognize that fiduciary duties are owed to, or at least can be enforced by, creditors.² When an organization is merely in the “zone of insolvency,” a murky area that occurs when the organization cannot generate and/or “obtain enough cash to pay for its projected obligations and fund its business requirements for working capital and capital expenditures with a reasonable cushion to cover the variability of its business needs over time,”³ the law varies from jurisdiction to jurisdiction as to whether directors’ fiduciary duties expand to creditors.⁴

In the for-profit context, the fact that duties are owed to creditors upon insolvency typically means that directors should maximize the value of the corporation for its creditors and other parties in interest. In the not-for-profit context, however, a director also has a duty of obedience to the organization’s charitable mission.⁵ The challenge for a director of a New York not-for-profit organization that is insolvent or in the “zone of insolvency” is to balance the interests of the organization’s creditors against the interest of preserving and adhering to the organization’s charitable mission. Whereas many for-profit corporations are able to rely on their own operations to sustain them in times of crisis, many not-for-profit corporations rely on donations. Directors of not-for-profits need to be mindful of their organizations’ commitments and expenses when the organization’s solvency depends on future fundraising and donations.

Abandonment of an organization’s charitable mission is a last resort.⁶ Thus, in evaluating a proposed sale of the assets of a not-for-profit corporation, a court will consider whether the sale will enable the organization’s charitable mission to continue. If a not-for-profit animal rescue organization proposes to sell its assets to a greyhound racing business, for example, a court may be unwilling to sanction the sale. Accordingly, directors of a troubled not-for-profit organization should be aware that they must keep the organization’s charitable mission at the forefront of their concerns in making decisions about the organization’s fate.

The consequences of breaching a fiduciary duty owed to a not-for-profit corporation are just as severe as the consequences for breaching a duty owed to a for-profit corporation. These consequences include not just personal liability but also the negative impact the breach will have on employees and on those who rely on the charitable purpose of the organization.

II. DEALING WITH CREDITORS

When a not-for-profit organization runs into trouble, often the first parties it will hear from are its creditors. Generally, creditors do not share concerns about an organization's charitable mission and may threaten various remedies to force a not-for-profit organization to pay its debts. Because not-for-profit organizations typically do not have operations that generate cash, such organizations have limited sources of funds with which to satisfy their creditors. Borrowing money to repay creditors may not be an option for a troubled not-for-profit and, even if it is, the organization ultimately will have to generate the funds to repay its loans. Moreover, many donations and grants are restricted and cannot be used to repay lenders and creditors or finance general operations. As discussed above, courts may impose restrictions on an organization's ability to sell its real estate or even substantially all of its assets to pay its creditors if they see such sales as a threat to the organization's charitable mission. Thus, when a not-for-profit organization encounters financial difficulties, dealing with its creditors may prove to be complicated.

A. *Accessing Charitable Donations to Pay Creditors*

State law determines whether a not-for-profit organization will be able to access private donations to repay its creditors. This is so even if the not-for-profit organization is in bankruptcy.⁷ Under New York law, for example, a not-for-profit organization is bound to observe the restrictions donors place on their contributions.⁸ Notably, these restrictions also apply to interest or appreciation on donated funds if the gift instrument expressly specifies the donor's intent that the organization may not spend any accrued appreciation.⁹

New York law requires the board of a not-for-profit corporation to cause the corporation to keep accurate accounts of directed donations separate and apart from other accounts.¹⁰ New York law also requires the organization's treasurer to make an annual report to the organization's members (or board, as applicable) regarding the use of restricted assets and the income derived from them.¹¹ Misuse of restricted funds (or failure to comply with restrictions) may give rise to personal liability for the directors and officers¹² or to an action for an order requiring return of the funds to the donor.¹³

Organizations may attempt to obtain releases of donor restrictions by (i) obtaining the donor's consent in a record,¹⁴ or (ii) applying to the supreme court (or the surrogate's court if the gift was by will), if "the restriction has become impracticable or wasteful, it impairs the management or investment of the fund, or because of circumstances not anticipated by the donor, a modification of [the] restriction will further the purposes of the fund."¹⁵ In evaluating whether to authorize a release of a donor restriction, a court must determine whether (i) the gift was charitable in nature, (ii) the language of the gift instrument indicates the donor intended a general, rather than specific, charitable intent, and (iii) the purpose for which the gift was created has failed.¹⁶ Even if a restriction is released, however, the released funds must be used for the charitable purposes of the corporation rather than general operating expenses, and the cy pres¹⁷ doctrine still applies.¹⁸

Similarly, under New York law, charitable gifts may not be considered property of a bankruptcy estate for distribution to creditors upon dissolution.¹⁹ One New York court rejected the

argument that payment of a charitable organization's debts is a proper charitable object.²⁰ In so deciding, the court noted that donors who make general gifts to charitable organizations intended to further "the charitable purpose for which the entity was formed as set forth in its charter. In the case of hospital corporations, such purpose is deemed to be the actual and continued provision of acute patient care services rather than the satisfaction of creditors' claims."²¹

A bankruptcy court in Massachusetts, however, issued a contrary decision allowing not-for-profit debtors to use restricted gifts to repay their creditors.²² The court went as far as to hold that the debtor, which was liquidating and had permanently discontinued its charitable operations, could still receive bequests intended for charitable purposes and apply them to satisfy the claims of its creditors. On appeal, however, the United States Court of Appeals for the First Circuit noted that it disagreed with the bankruptcy court's extension of the definition of "charitable purposes" to payment of creditors where the organization had discontinued its charitable operations.²³ The First Circuit's decision turned on the timing of the gift.²⁴ The court found that, because the bequest in question had vested when the hospital was still operating, the hospital could use the proceeds to pay its creditors for debts incurred while the organization was still operating.²⁵ Accordingly, the court affirmed the bankruptcy court's decision allowing the organization to use the bequest to pay its creditors' claims.

The United States District Court for the District of Columbia also affirmed a similar bankruptcy court decision.²⁶ The court's decision was based on the not-for-profit corporation law of the District of Columbia, which provides that in dissolving a not-for-profit corporation, the liabilities of the corporation must first be satisfied before any charitable gifts are returned or distributed to other charitable institutions. According to the court, D.C. law clearly illustrates a legislative determination that "the ultimate charitable goals of [a] grantor are subordinate to the corporation's responsibilities of its creditors."²⁷ The court also noted with approval the bankruptcy court's assessment that a not-for-profit organization's payment of its debts is not at odds with a donor's intent because payment of debts is essential to the operation of a not-for-profit.²⁸ The court further noted that allowing grantors to reclaim charitable grants would increase the cost of borrowing for not-for-profit corporations because lenders would be wary about the sources of their repayment if the corporation's assets were susceptible to recall.²⁹

B. Soliciting Additional Donations

As discussed above, troubled organizations may not be able to tap into restricted funds to pay creditors. Troubled organizations, however, may decide to go public with their troubles in an attempt to bring in new donations to pay creditors. Depending upon the organization and the circumstances, public awareness of the organization's financial troubles may stimulate or impede fundraising. If the organization decides to seek additional donations during a period of financial trouble, donors may be more inclined to restrict donations or seek assurances that their contributions will be used for charitable purposes rather than to pay creditors. Because New York courts will not infer that donors intended their gifts to be used to pay creditors, financially troubled New York organizations who solicit donations may want to consider setting up special unrestricted funds or creating a pledge form that explicitly allows the organization to use the gift in support of operations and/or restructuring.

C. Compelling Donors to Pay Their Pledges

Troubled organizations may also seek to bring in money by enforcing outstanding pledges for charitable contributions. Under New York case law, pledges are generally enforceable.³⁰ A pledge can create a unilateral contract between the pledgor and pledgee. The pledgor can be compelled to complete performance on the pledge if there was consideration for the pledge, such as creation of a named scholarship on the pledgor's behalf, or if the pledgee acted in substantial reliance on the pledge. Such reliance may include using a pledge agreement as collateral to obtain funds necessary to carry out the organization's charitable mission and make good on the promises the organization made to the donor in return for the pledge.

As discussed above, however, if the organization is seeking to compel payment on pledges or bequests for the purpose of paying its creditors, this analysis may change. Moreover, even if an organization may be able to compel payment on pledges, the organization should consider whether doing so would cause public relations problems whose costs would outweigh the benefits of receiving the pledges.

D. Member Contributions

Creditors may also seek payment from members of not-for-profit corporations. Such members will only be liable to the extent of (i) any unpaid portion of lawfully imposed initiation fees, membership dues, or assessments or (ii) any other debts the members owe to the organization.³¹ Notably, however, a creditor may only bring an action to apply such liability to a debt of the corporation if, *inter alia*, the corporation is adjudged bankrupt or the creditor obtains a final judgment against the corporation that is unsatisfied.³²

E. Accessing Government Grants to Pay Creditors

A number of courts have held that federal grants remain the property of the federal government unless and until expended in accordance with the terms of the grant.³³ These courts arrived at their holdings by evaluating the specific restrictions placed by the government on each organization's use of grant funds.³⁴ According to one court, where a grant specifically provides that its proceeds may be used to pay a grantee's creditors, then such grant will be considered property of the grantee's bankruptcy estate.³⁵ But because many federal grants impose such "pervasive restrictions" on the identity of the grantee and the administration of the funds, the grantee cannot be considered to have a property interest in the grant.³⁶ Accordingly, such grants generally are not considered property of the bankruptcy estate.³⁷ Notably, even if an organization is able to treat the proceeds of government grants as property of the estate, the organization may have trouble securing future grants.

F. Selling Assets to Pay Creditors

Troubled not-for-profit organizations may decide to sell off assets in order to repay creditors. Although this seems straightforward, many states require board and/or court approval of significant asset sales. In New York, for example, a not-for-profit organization generally must secure the approval of two-thirds of its board before selling all or substantially all of its assets.³⁸ In addition, most types of New York not-for-profit corporations must seek court approval before selling all or substantially all of their assets.³⁹ If state law requires the corporation to obtain

court approval for such a sale, the court may require the assets to be distributed to organizations involved in substantially similar activities.⁴⁰ Moreover, because the Bankruptcy Code requires sales of property of a not-for-profit debtor's estate to be conducted in accordance with applicable nonbankruptcy law, not-for-profit organizations that file for bankruptcy protection will not be able to avoid state law provisions governing the sales.⁴¹ They may, however, be able to substitute what may be a more expeditious bankruptcy court approval for the requirement of obtaining state court approval.

The Bankruptcy Code also may affect sales of donor lists and other personally identifiable information. Section 363(b)(1) of the Bankruptcy Code has been amended to provide that if the debtor "in connection with offering a product or a service discloses to an individual a policy prohibiting the transfer of personally identifiable information about individuals to persons that are not affiliated with the debtor and if such policy is in effect on the date of the commencement of the case, then the trustee may not sell or lease personally identifiable information to any person unless" the sale is consistent with the privacy policy or a consumer privacy ombudsman is appointed and the court approves the sale.⁴² Even though this provision is not explicitly directed at not-for-profit corporations, not-for-profit organizations should be aware of the potential impact on a not-for-profit debtor's sale of donor lists where the debtor had previously indicated to its donors that their personally identifiable information would be kept private.

If a not-for-profit enters into any real estate transactions, it should be sure it complies with any special approval requirements imposed by the applicable not-for-profit statute. For example, in New York, a not-for-profit corporation generally may not purchase, sell, mortgage, or lease real property unless authorized by two-thirds of its board (or an absolute majority of the board if the corporation has more than 20 board members).⁴³ The statute does not address the consequences of the failure to comply with this provision, although, given the "strong-arm" powers of a debtor in possession or trustee in bankruptcy, lessors and counterparties to real estate transactions may face an attempt to unwind any transaction for which the statutory approval was not obtained. It is also not clear what liability directors and officers could face for failing to comply with this provision.

III. DIRECTOR AND OFFICER LIABILITY

When an organization runs into trouble, any number of parties may seek to impose liability on the organization's directors and officers. These parties include (i) employees (*e.g.*, wrongful termination or Anti-Discrimination Act violations), (ii) outsiders (*e.g.*, vendors, other not-for-profits), (iii) the not-for-profit corporation itself (via derivative claims), (iv) other directors (for violation of fiduciary duties), (v) beneficiaries of the organization's mission, (vi) members, (vii) donors (*e.g.*, misuse of a restricted gift), (viii) state attorneys general, and (ix) other government officials (*e.g.*, IRS, Department of Labor). Directors may be held liable for any number of acts or omissions. Examples of such types of liability are provided below.

A. Employee Wages

Under New York law, directors and officers may be subject to criminal liability for failing to pay employee salaries as they come due.⁴⁴ In addition, directors and officers of an organization can be held personally liable if the organization fails to pay the government withholding taxes

(income tax, social security, and Medicare taxes) deducted from employee wages.⁴⁵ Accordingly, if a not-for-profit organization encounters financial difficulties, the board should ensure that employee-related payments are not diverted to pay creditors.

B. Director Support of Prohibited Actions

Another common basis for imposing liability on not-for-profit directors is director support of actions prohibited by law. Section 719 of the New York not-for-profit corporation law makes directors jointly and severally liable for the benefit of creditors, members, or an organization's ultimate beneficiaries to the extent of any injury caused by the director's voting for or support of prohibited actions. Examples of such prohibited actions include (i) self-dealing, (ii) redemption or payment of interest on capital certificates, subvention certificates, or bonds contrary to not-for-profit corporation law, and (iii) distribution of assets after dissolution of the corporation (a) in violation of New York's requirement that a not-for-profit corporation's assets be distributed to entities engaged in substantially similar activities or (b) without paying or adequately providing for all known liabilities of the corporation (excluding untimely claims). If a director is found to have discharged his or her duties to the organization pursuant to section 717 of the not-for-profit corporation statute, however, the director will not be held liable for supporting the prohibited action.⁴⁶ Section 717 requires directors and officers to discharge their duties "in good faith and with that degree of diligence, care and skill which ordinarily prudent men would exercise under similar circumstances in like positions."⁴⁷ Notably, section 717 allows directors (and officers) to rely on information or reports prepared by officers or employees of the organization, counsel or other professional advisors, or a committee of the board, provided such directors (i) believe such committee or individuals are competent and reliable, and (ii) do not have knowledge that would make such reliance unwarranted.⁴⁸

C. Director Misconduct

Directors also may be subject to liability for neglect or violation of their duties in managing corporate assets or for knowingly supporting or effecting unlawful conveyances of corporate assets.⁴⁹ Specifically, section 720(a) of the New York Not-for-Profit Corporation Law provides:

An action may be brought against one or more directors or officers of a corporation to procure a judgment for the following relief:

1. To compel the defendant to account for his official conduct in the following cases:
 - a. The neglect of, or failure to perform, or other violation of his duties in the management and disposition of corporate assets committed to his charge.
 - b. The acquisition by himself, transfer to others, loss or waste of corporate assets due to any neglect of, or failure to perform, or other violation of his duties.

2. To set aside an unlawful conveyance, assignment or transfer of corporate assets, where the transferee knew of its unlawfulness.
3. To enjoin a proposed unlawful conveyance, assignment or transfer of corporate assets, where there are reasonable grounds for belief that it will be made.⁵⁰

Section 720 applies to, *inter alia*, wrongful transfers of corporate assets by not-for-profit directors or officers to themselves and unauthorized use of corporate funds for personal expenses.⁵¹

Actions for director misconduct may be brought by the state attorney general, the corporation itself, other directors, officers, a state law receiver, a bankruptcy trustee, judgment creditors, members (as a derivative action), or, if the organization's bylaws permit, by a party who contributed at least \$1,000 to the organization.⁵²

D. Excess Benefits and Compensation

Not-for-profit directors who receive or approve excess benefits are subject to liability under both state and federal law. Under New York law, not-for-profit corporations may elect or appoint officers and fix the reasonable compensation of directors and officers.⁵³ Although New York law provides little guidance to not-for-profit boards for setting director compensation,⁵⁴ the not-for-profit corporation statute generally requires a vote of the majority of the entire board to set officer compensation.⁵⁵ In one high profile case, the New York Court of Appeals considered a complaint for excessive compensation against the former chairman of the New York Stock Exchange. One of the counts of the complaint included a claim for violation of section 715(f), which requires approval of the majority of the board to fix an officer's salary if not done in or pursuant to the bylaws.⁵⁶ The Court of Appeals dismissed the claim because it found that it would impose liability on directors without any proof that they were at fault. According to the Court, this was contrary to the general design of the not-for-profit corporation statute, which provides directors with a "business judgment" defense if they can show that they acted in good faith.⁵⁷ The decision suggests that proper authorization procedures may help protect directors against liability, while at the same time, technical violations of the statute will not automatically result in liability where the directors acted in good faith.

In addition to incurring liability for excess compensation under state law, not-for-profit directors may be subject to liability under federal tax law for excess benefits. The IRS may impose "intermediate sanctions" on not-for-profit directors who receive or approve excess benefits. Intermediate sanctions are excise taxes of 25% on the amount of the excess benefit.⁵⁸ Even if an offending director pays the 25% tax, failure to return the excess benefit, with interest, may result in the imposition of an additional excise tax of 200% of the benefit.⁵⁹

In determining whether a benefit is excessive, the IRS will look to the market and to the compensation allowed at similar organizations.⁶⁰ There is a rebuttable presumption that compensation is not excessive if it satisfies the following test: (i) it was approved in advance by an authorized body – such as a compensation committee – of individuals, none of whom had a

conflict of interest with regard to the compensation decision at issue, (ii) the authorizing body relied on comparable data to set compensation (*i.e.*, compensation of similar individuals at comparable organizations), and (iii) the decision was adequately documented.⁶¹ Accordingly, not-for-profit directors should insist that their organizations implement compensation approval systems that will satisfy this test.

E. Limitations on Liability

Except with respect to director misconduct and director support of prohibited actions as described above and except with respect to actions brought by the attorney general or a beneficiary of a charitable trust, directors who do not receive compensation for their services cannot be held liable to any entity other than the corporation itself unless such directors were grossly negligent or intended to cause harm.⁶² For more detail on protections available to not-for-profit volunteers, please refer to **Tab 15**.

Under New York law, except as otherwise provided in the applicable gift instrument, a not-for-profit corporation's board may delegate to its committees, officers or employees, the authority to act in place of the governing board in investment or reinvestment of institutional funds.⁶³ No director (whether for-profit or not) will be held liable for investment and reinvestment of institutional funds by, and for the other acts or omissions of, persons to whom authority is so delegated or with whom contracts are so made.⁶⁴ As such, directors who receive compensation for their services should strongly consider encouraging their boards to reasonably delegate investment authority to investment professionals.

F. Indemnification

New York's not-for-profit corporation law includes detailed indemnification provisions and also provides for contribution from other directors and/or recovery from other parties who knowingly received unauthorized distributions.⁶⁵ There are two types of indemnification under New York not-for-profit corporation law: mandatory and permissive. A not-for-profit corporation may extend indemnification beyond restrictions of mandatory or permissive indemnification by including a provision in the corporation's bylaws or certificate, passing a board resolution, or entering into a separate agreement. However, indemnification of a director is not permissible under any circumstance if the director acted in bad faith, was deliberately and materially dishonest, or procured some illegal gain.⁶⁶

1. ***Mandatory Indemnification.*** Under New York law, not-for-profit corporations are required to indemnify their directors for expenses (including costs and attorney's fees) incurred in successfully defending a civil or criminal proceeding, whether brought by the corporation as a derivative suit or by a third party.⁶⁷ Although a director does not have to secure a victory on the merits of the litigation to be eligible for indemnification, mandatory indemnification is not available to a director who settles.⁶⁸ If a director is only partially successful in his or her defense, the corporation is still required to indemnify the director proportionately.⁶⁹ If a not-for-profit corporation fails to comply with its

mandatory indemnification obligations, a director may apply to the court to order such indemnification.⁷⁰

2. *Permissive Indemnification.* New York law also allows not-for-profit corporations to indemnify their directors even if directors (i) are unsuccessful in defending actions against them or (ii) decide to settle.⁷¹ Permissive indemnification is only allowed, however, if a director acted in good faith and reasonably believed that he or she was acting in the best interests of the corporation.⁷² Additionally, if a director was involved in a criminal proceeding, he or she must have had no reasonable cause to believe that his or her conduct was unlawful.⁷³

Directors may be indemnified for settlement costs and reasonable expenses, including attorney fees and the costs of appeal, in both derivative suits and third-party actions, but directors may not be indemnified for judgments and fines in derivative suits. If a corporation declines to exercise permissive indemnification, but a director has met the conditions allowing permissive indemnification, then the director can petition the court to order the corporation to provide indemnification.⁷⁴

New York law sets forth three alternative procedures for corporations to follow when determining whether to indemnify directors who were unsuccessful in defending against third-party litigation or directors named as defendants in derivative actions.⁷⁵ These alternatives also apply to corporate approval of indemnification of ongoing expenses.⁷⁶ The alternatives are (i) authorization by a quorum of disinterested directors finding that the director in question has satisfied the standards for permissive indemnification (*i.e.*, acted in good faith, reasonably believed he or she was acting in the best interests of the corporation, and, in the case of a criminal proceeding, had no reasonable cause to believe his or her conduct was unlawful),⁷⁷ (ii) authorization by a quorum of disinterested directors who have relied on the opinion of an independent legal advisor that the director in question has satisfied the standards for permissive indemnification,⁷⁸ or (iii) authorization by a quorum of disinterested directors who have based their decision on the approval of the membership of the corporation (if the corporation has members) that the director in question has satisfied the standards for permissive indemnification.⁷⁹

3. *Director and Officer Insurance.* Under New York law, not-for-profit corporations may maintain directors and officers insurance (“D&O Insurance”) to indemnify the corporation or directors and officers as described above.⁸⁰ If a court finds that a director has committed acts of deliberate and active dishonesty or the director has personally gained an illegal profit or advantage, the D&O Insurance may not be used to cover indemnification costs, but it may be used to cover defense costs.⁸¹ D&O Insurance may not be used to indemnify parties for punitive damages.

Modern D&O Insurance policies include three different components.⁸² “Side A” coverage insures past, present, and future directors and officers in their respective capacities as individual insureds (including defense costs) against any insured loss arising from a claim for any actual or alleged wrongful act. “Side B” coverage insures the corporation for amounts it pays out to indemnify its directors and officers. “Side C” coverage insures the corporation against any loss arising from a claim against it for any actual or alleged wrongful act of the corporation. The causes of action covered by a D&O Insurance policy depend on its terms.

Courts generally engage in fact-intensive inquiries to determine whether the proceeds of an organization’s D&O Insurance policy are property of the debtor organization’s estate and thus subject to bankruptcy’s automatic stay, or whether they belong to directors and officers personally.⁸³ Courts have not decided the issue uniformly.⁸⁴ If such proceeds are found to be property of the estate, a director seeking access to them would have to petition the bankruptcy court to lift the automatic stay.

Many modern D&O Insurance policies contain “insured vs. insured” exclusions. Conceived as a protection against collusive lawsuits, insured vs. insured exclusions prevent recovery against a policy where a lawsuit is brought by, or on behalf of, an insured party (for example, the organization) against another insured party (for example, a director). Most insured vs. insured exclusions, however, do not apply when the lawsuit is being brought derivatively, without the aid or assistance of an insured party.

4. *Removal of Directors.* Generally, directors of not-for-profit corporations may be removed for cause by a vote of members or directors, as long as a quorum of a majority of directors is present at the applicable meeting, and provided that (i) if the organization has cumulative voting, the number of votes cast against removing a director would not be enough to elect the director at an election of the entire board and (ii) in organizations in which directors are elected by classes or groups of an organization (e.g., holders of bonds), then a director so elected may only be removed by vote of such class or group.⁸⁵ A director may also be removed for cause upon an action brought by the state attorney general or 10% of the corporation’s members requesting removal for cause.⁸⁶ A court may bar from reelection any director so removed.⁸⁷ A director may be removed without cause by a vote of an organization’s members if the organization’s certificate of incorporation or bylaws so permit.⁸⁸
5. *Resignation of Directors.* Generally, a director has the right to resign from a board and will not incur additional liability by doing so,⁸⁹ but resigning from the board will not absolve the director of liability for prior bad acts.⁹⁰ Moreover, after resigning, the former director will retain certain fiduciary duties, such as confidentiality. Notably, however, some courts have held

that a director cannot resign if doing so would harm the corporation or leave the interests of the corporation in jeopardy.⁹¹

IV. WHAT TO DO IF YOUR ORGANIZATION ENCOUNTERS DIFFICULTIES

One of the most common problems for any organization that runs into trouble is denial.

Not-for-profit organizations are no different, and, in fact, because not-for-profit organizations generally do not have the same onerous public reporting obligations that for-profit corporations do, the realization that an organization may be getting into financial trouble may be even more delayed. Further delay may aggravate the problem. Accordingly, not-for-profit directors who encounter trouble should act quickly to determine what course of action to take. Refer to **Tab 19** for a checklist of items to consider when a not-for-profit organization begins to experience financial difficulties. Among other things, the board of directors should determine whether special financial, restructuring, and/or legal advisors are needed and, if so, retain them.⁹²

Boards should also begin to consider whether the trouble is serious enough to warrant restructuring or going out of business altogether. If an organization decides to restructure, it may be able to effectuate the restructuring out of court. Sometimes, however, the organization will need the protections and powers that a court proceeding affords, whether under state law or under the federal Bankruptcy Code. The not-for-profit organization, with the assistance of its advisors, should review the federal and state law options available to it and determine, in light of all the circumstances, which option best addresses the needs and problems of the organization. Some of the reorganization and liquidation options available to not-for-profit organizations are summarized below. See also **Tab 18**.

A. *Restructuring Options*

1. *Out-of-Court Restructuring.* Organizations may renegotiate their debt obligations out of court. Out-of-court restructurings may be accomplished in conjunction with new financing secured on the basis of the corporation's goodwill and/or the threat of bankruptcy. An out-of-court restructuring may be beneficial because it may help a not-for-profit avoid the stigma of bankruptcy and certain other disadvantages of chapter 11. Out-of-court restructurings also demonstrate creditor confidence and involve fewer parties than bankruptcy cases. On the other hand, negotiating separately with every creditor constituency (as compared with a bankruptcy case in which all creditors are brought into the same forum) may be time consuming. In an out-of-court restructuring, it is often difficult to demonstrate to creditors that you are treating them fairly and that one creditor is not being treated less favorably than others. In addition, the powers available to a debtor in bankruptcy (*e.g.*, automatic stay, the ability to "cram down" on a dissenting class, and inducements available for postpetition financing) are not available in out-of-court restructurings. Without these powers, there is a potential for hold-outs and there is no guarantee that parties will come to a consensus regarding the restructuring.

2. *Chapter 11 Cases.* Chapter 11 of the Bankruptcy Code typically contemplates the continuation and financial and operational rehabilitation of a debtor's business, but an organization may also liquidate under chapter 11. A reorganization under chapter 11 permits an organization to continue its business operations in bankruptcy while a plan of reorganization is negotiated, confirmed, and consummated. The plan of reorganization describes how the debtor's liabilities will be addressed and discharged and lays out the debtor's plan for emerging from chapter 11 (typically as a viable enterprise). Among other things, a not-for-profit debtor will have to show that its plan for addressing liabilities is feasible under section 1129 of the Bankruptcy Code, *i.e.*, not likely to be followed by liquidation. Unlike for-profit enterprises that utilize sales history to project future revenue, courts are hesitant to rely on previous donations as evidence of future fundraising ability when determining a plan's feasibility under section 1129.⁹³ Courts reason that raising funds during or immediately after a bankruptcy case will be more difficult as donors are hesitant to give for the purpose of satisfying creditors.⁹⁴

Although chapter 11 is a relatively costly process and may pose a significant distraction to management, there are many advantages to reorganizing under chapter 11.⁹⁵ Foremost among these advantages is the "fresh start" to which a chapter 11 debtor is entitled. This fresh start results from the discharge of all of the debtor's debts under the Bankruptcy Code.⁹⁶ In addition, the bankruptcy court provides a single forum for resolving all issues concerning the debtor. This gives the debtor a certain amount of leverage and, as such, may enable the debtor to obtain better trade terms than it would in an out-of-court restructuring.

In addition, the Bankruptcy Code provides for an automatic stay of all actions against the property of the debtor's estate. Although the automatic stay is interpreted broadly and is designed to give a debtor a "breathing spell" from its creditors so it can focus on reorganizing, there are some limitations to the automatic stay.⁹⁷ Moreover, even where such limitations are not applicable, creditors may petition the bankruptcy court for relief from the stay. Nonetheless, the automatic stay is a valuable tool for debtors and is not available outside of bankruptcy.

Other tools available in bankruptcy include inducements to prospective financiers to assist debtors in securing financing during the course of their bankruptcy cases,⁹⁸ the power to assume, assign, and reject executory contracts and unexpired nonresidential real property leases,⁹⁹ and the ability to sell assets free and clear of liens (subject to court approval).¹⁰⁰ Chapter 11 debtors may also resort to "cramdown." Cramdown involves confirming a chapter 11 plan over the dissent of a class or classes of creditors provided at least one class of creditors that is impaired by the plan accepts the plan and the court finds the plan does not discriminate unfairly and is fair and equitable.¹⁰¹ Specifically, to meet the criteria for

cramdown, a chapter 11 plan may not violate bankruptcy's "absolute priority rule," which prevents junior interests from receiving distributions before senior interests have been paid in full.¹⁰² In the for-profit context, this means, *inter alia*, that equity (and other junior classes) may not receive a distribution unless senior interests, *i.e.*, creditors, are paid in full. In the not-for-profit context, on the other hand, there is some question as to whether the absolute priority rule would prevent retention of control by members or controlling entities of the not-for-profit organization if creditors are not paid in full.¹⁰³ Courts have found that the absolute priority rule does not extend to members or controlling entities of non-profit organizations who are not receiving distributions.¹⁰⁴

In spite of all of these tools, a chapter 11 case certainly has disadvantages. First, the stigma of bankruptcy may negatively affect operations and impair fundraising (although for some organizations, bankruptcy may have the opposite effect and generate support and donations from the community). Moreover, a bankruptcy filing may give rise to increased scrutiny of the organization. Directors and officers may also be subject to more scrutiny after a bankruptcy filing. In addition, upon request of a party in interest, a bankruptcy court may appoint an examiner to examine the affairs of a debtor.¹⁰⁵ A court may also appoint a trustee to run the debtor's estate in the event of fraud or gross mismanagement, or if the court determines the appointment of a trustee is in the best interests of the debtor's constituents. When a court appoints a trustee, the management of the debtor loses control of the organization. Appointment of a trustee is relatively rare, however, especially in cases without fraud.

Chapter 11 can also be costly. Not only must the debtor retain professionals, but it also pays for the fees and expenses of professionals engaged by the creditors' committee. One issue from the not-for-profit debtor's perspective is whether a board member can also act as counsel for the debtor in its chapter 11 case. In this context, two issues arise: (1) whether the board member's engagement as counsel results in a conflict of interest, and (2) whether the services as counsel overlap with the board member's regular board duties. In one bankruptcy court decision, the court answered both of these questions in the negative and approved the board member's fee application.¹⁰⁶

Prior to 2005, not-for-profit organizations could use the Bankruptcy Code to circumvent certain state law restrictions on transactions related to property of not-for-profit organizations. In 2005, however, Congress amended the Bankruptcy Code to restrict the authority of a not-for-profit debtor to use, sell, or lease property.¹⁰⁷ Now, the use, sale, or lease of such property must be in accordance with applicable nonbankruptcy law, and such use, sale, or lease may not be inconsistent with any relief granted under certain specified provisions of section 362 of the Bankruptcy Code concerning the applicability of the automatic stay.

In addition, Congress added section 541(f) to the Bankruptcy Code to provide that any property of a not-for-profit debtor's estate may be transferred to an entity that is not such a corporation, but only under the same conditions that would apply if the debtor was not in bankruptcy. Similarly, section 1129(a)(16) provides that transfers of property under a not-for-profit debtor's chapter 11 plan must be made in accordance with applicable nonbankruptcy law governing transfers of the property of not-for-profit corporations. Because most states have laws prohibiting not-for-profits from transferring their property to organizations that are not engaged in substantially similar activities as the debtor, not-for-profit debtors will no longer be able to use bankruptcy law to circumvent transfer restrictions. To the extent, however, that state law permits such a transfer so long as the not-for-profit organization (typically, on notice to the state attorney general's office) obtains a court order permitting such transfer, approval of the Bankruptcy Court may be a more expeditious means of obtaining such relief.

3. *Involuntary Chapter 11 Cases.* Although the Bankruptcy Code does allow creditors of for-profit corporations to commence involuntary chapter 11 proceedings against them, creditors may not commence involuntary bankruptcy proceedings against not-for-profit corporations.¹⁰⁸ In addition, a court may not convert a voluntary chapter 11 case to a chapter 7 (liquidation) case unless the debtor so requests.¹⁰⁹ A court may, however, dismiss the case altogether if cause exists for conversion.¹¹⁰
4. *Prepackaged and Prenegotiated Chapter 11 Cases.* In a prepackaged chapter 11 case, the debtor negotiates a plan of reorganization with creditors before filing for bankruptcy. As a result, debtors in prepackaged chapter 11 cases typically emerge from bankruptcy more quickly than debtors in traditional chapter 11 cases. "Prepacks" may offer not-for-profits the best of both worlds. Because they are typically shorter than traditional chapter 11 cases, prepacks resemble out-of-court restructurings but allow debtors the use of many of the tools and advantages of chapter 11.

In addition to their relative speed, prepacks may also be preferable to ordinary chapter 11 cases because a prepack debtor will have obtained a favorable vote on its plan of reorganization before entering chapter 11. As such, a true prepackaged chapter 11 case is often less contentious than ordinary chapter 11 cases.

For a typical not-for-profit organization, however, a prepackaged chapter 11 case may be difficult to accomplish. In a bankruptcy case, entities whose claims are being affected (impaired) by a chapter 11 plan are entitled to vote to accept or reject the plan. The nature and extent of trade claims against a potential debtor can change on a daily basis. Thus, it is virtually impossible to conduct a prepetition solicitation of a class

consisting of trade claims, as would be necessary if a prepackaged plan proposed to affect them. As a result, most true prepackaged cases are only used where the debtor wants to use the bankruptcy process to restructure one or more classes of claims (such as bank debt, publicly traded debt, or even tort claims), but might not be able to get the 100% approval that would be required under applicable non-bankruptcy law for such restructuring. The typical prepackaged plan provides for payment in full of trade claims so the debtor does not have to solicit the votes of trade creditors. This makes it difficult, though, for the debtor to use other powers of the Bankruptcy Code, such as the ability to reject contracts and leases, to its full advantage. Thus, where an operational – as opposed to a financial – restructuring is needed, it may not be possible to accomplish such restructuring through the means of a prepackaged plan.

Where a potential debtor does wish to alter rights of general, unsecured creditors and has the basic structure of an agreement for the restructuring that is supported by its major constituencies, it may pursue a “prenegotiated” plan. In this situation, the potential debtor negotiates the terms of the plan with its principal constituents (and, therefore, has a degree of confidence that they ultimately will vote to accept the plan), but the potential debtor has not conducted a formal solicitation of votes on the plan. The debtor commences its chapter 11 case and then follows the same process as in a traditional chapter 11 case. The only real difference is that, having ironed out the terms of its restructuring prior to commencing its chapter 11 case, the debtor is likely to be able to emerge from chapter 11 more quickly than a traditional chapter 11 debtor.

B. Liquidation or Dissolution¹¹¹

1. *Chapter 7 Cases.* Chapter 7 of the Bankruptcy Code contemplates an expeditious, orderly liquidation of all of the debtor’s property. Under chapter 7, the debtor does not continue as an ongoing business enterprise. Instead, a trustee is appointed to take over the management of the debtor and convert the debtor’s assets and properties to cash. The proceeds are then distributed to creditors in accordance with the priorities established in the Bankruptcy Code. Liquidation under chapter 7 has many advantages over dissolution under state law. For example, chapter 7 proceedings are generally relatively quick and inexpensive. In addition, many of the tools available in chapter 11 are available to a chapter 7 trustee, such as the automatic stay and the power to sell assets free and clear of liens. The disadvantages of chapter 7 include appointment of a trustee, who effectively replaces management and the board of directors of the debtor, and additional scrutiny on the organization’s prepetition dealings. In addition, no discharge of prebankruptcy debts is available for a debtor that liquidates, rather than reorganizes.

2. *Non-Judicial State Law Dissolution.* Under New York law, non-judicial dissolution procedures differ depending upon the type of not-for-profit corporation¹¹² and the amount of assets and liabilities the corporation has.¹¹³ If the corporation has no assets other than a reserve fund of no more than \$25,000 to be used to pay (1) the costs of winding up the organization's affairs such as attorneys' and accountants' fees and (2) liabilities that do not exceed \$10,000, then the corporation can use a streamlined procedure for dissolution.¹¹⁴

If, on the other hand, the corporation has assets and/or liabilities in excess of those described in the previous paragraph, the board must engage in a slightly stricter and more time consuming process.¹¹⁵ Pursuant to this process, among other requirements, the organization must seek approval of its Plan of Distribution from the supreme court. The Plan of Distribution is the document that sets forth how the dissolving entity's assets will be distributed, first, to its creditors and then to organizations engaged in substantially similar activities.

Non-judicial dissolution is generally slower and more complex than a liquidation under chapter 7 of the Bankruptcy Code. In addition, the attorney general typically becomes an integral component of the dissolution process. As such, the sale of a dissolving not-for-profit's assets is subject to review by the attorney general and may give rise to personal liability for directors if any of the sales are deemed to be inappropriate, *e.g.*, to organizations not engaged in substantially similar activities.¹¹⁶ Accordingly, non-judicial dissolution under state law may not compare favorably to liquidation under the Bankruptcy Code.

3. *Judicial State Law Dissolution.* New York law also provides for judicial dissolution, which is similar to non-judicial dissolution but involves more court oversight over the process.¹¹⁷ Judicial dissolution may be initiated by the attorney general in the case of fraud or related misconduct. Generally, however, judicial dissolution in the liquidation context is initiated by an organization's board. In such a situation, a majority of the directors may present a petition for judicial dissolution where the assets of a not-for-profit corporation are insufficient to discharge its liabilities or where dissolution will benefit the corporation's members.
4. *Receivership.* Receivership under state law involves court appointment of a receiver to run the not-for-profit corporation in order to pay off its debts.¹¹⁸ In some ways a receivership is very similar to chapter 11, but receivership is typically thought of as a creditor remedy because the debtor loses control of the company. Receiverships may or may not result in the dissolution of the corporation. In New York, receivership law is largely considered obsolete.

5. *Assignment for the Benefit of Creditors.* Another rarely used wind down method under New York law is an assignment for the benefit of creditors. In an assignment for the benefit of creditors, a corporation assigns all of its nonexempt property to an assignee (typically a lawyer) who then liquidates the property (sometimes under court supervision) and distributes the proceeds pro rata to creditors.¹¹⁹

ENDNOTES

¹ See *N. Am. Catholic Educ. Programming Found., Inc. v. Gheewalla, C.A.*, 930 A.2d 92, 99 (Del. 2007).

² Under Delaware law, the fiduciary duties are not owed directly to the creditors of an insolvent corporation, but creditors of the insolvent corporation are able to enforce the directors' duties to the corporation. The Delaware Supreme Court in *Gheewalla* clarified that while creditors of an insolvent Delaware corporation do not have direct claims against directors for breaches of fiduciary duties, creditors have standing to pursue such breaches derivatively on behalf of the corporation. See *id.* at 101-02. This is because creditors of an insolvent corporation "take the place of the shareholders as the residual beneficiaries of any increase in value," and "the corporation's insolvency makes the creditors the principal constituency injured by any fiduciary breaches that diminish the firm's value." *Id.* (internal citations omitted).

In contrast, under New York law, it appears fairly well-settled that the directors of an insolvent corporation owe fiduciary duties to creditors. This premise arises from a 1953 New York Court of Appeals case that is still cited as good law. *N.Y. Credit Men's Adjustment Bureau, Inc. v. Weiss*, 110 N.E.2d 397, 398 (N.Y. 1953) ("If the corporation was insolvent at that time it is clear that defendants, as officers and directors thereof, were to be considered as though trustees of the property for the corporate creditor-beneficiaries"); see also *Clarkson Co. v. Shaheen*, 660 F.2d 506, 512 (2d Cir. 1981), *cert. denied*, 455 U.S. 990 (1982) (citing *Weiss* in holding that directors of an insolvent New York corporation owe fiduciary duties to creditors, and creditors can sue to enforce those duties); *Hughes v. BCI Int'l Holdings*, 452 F. Supp. 2d 290 (S.D.N.Y. 2006) (holding that creditors had standing to assert a breach of fiduciary claim against the director of an insolvent New York corporation, because even though "[a]n officer or director does not owe a fiduciary duty to the creditors of a solvent corporation, the fact of insolvency causes such a duty to arise.") (internal citations omitted); *C3 Media & Marketing Group, LLC v. Firstgate Internet, Inc.*, 419 F. Supp. 2d 419, 431 (S.D.N.Y. 2005) (same; dismissing claim by creditor against director for fraudulent inducement because the director made the statement prior to the company's insolvency and did not therefore, at the time he made the statement, owe the creditor a fiduciary duty); *Economic Dev. Growth Enter. Corp. v. McDermott*, 478 B.R. 123, 128 (N.D.N.Y. 2012) (citing *Hughes* in holding that directors of an insolvent corporation owe a fiduciary duty to preserve the assets of the corporation for the benefit of creditors); *Post-Confirmation Comm. of Unsecured Creditors v. Feld Group, Inc. (In re I Successor Corp.)*, 321 B.R. 640, 659 (Bankr. S.D.N.Y. 2005) ("Once a corporation becomes insolvent, the fiduciary duties of corporate officers and directors also extend to creditors.") (internal citations omitted); *Kittay v. Atl. Bank of N.Y. (In re Global Serv. Group LLC)*, 316 B.R. 451 (Bankr. S.D.N.Y. 2004) (Under New York law, "[o]nce insolvency enures, the fiduciary duties of corporate officers and directors also extend to creditors. As a result, the officers and directors owe duties to multiple constituencies whose interests may diverge. At this point, they have an obligation to the community of interest that sustained the corporation, to exercise judgment in an informed, good faith effort to maximize the corporation's long-term wealth creating capacity") (internal citations omitted); *Securities Investor Protection Corp. v. Stratton Oakmont, Inc.*, 234 B.R. 293, 334 n.27 (Bankr. S.D.N.Y. 1999) ("Under the New York law, a director's fiduciary duty runs to creditors when the corporation becomes insolvent."); cf. *Brenner v. Philips, Appel & Walden, Inc.*, 1997 WL 33471053, at *6 (S.D.N.Y. 1997) ("Under New York law, directors of an insolvent corporation have a duty not to divest the corporation of assets without affording creditors an opportunity to present and enforce their claims."); *In re Mid-State Raceway, Inc.*, 323 B.R. 40, 58 (Bankr. N.D.N.Y. 2005) ("In the bankruptcy context, the directors owe duties not only to the corporation and its shareholders, they also owe a duty of good faith to the creditors.").

The theory under which directors of insolvent New York corporations are found to have fiduciary duties to creditors is sometimes referred to as the "trust fund" doctrine. See, e.g., *Credit Agricole Indoseuz v. Rossiyskiy Kredit Bank*, 729 N.E.2d 683, 688 (N.Y. 2000) (By virtue of the trust fund doctrine, "the officers and directors of an insolvent corporation are said to hold the remaining corporate assets in trust for the benefit of its creditors."); *Heimbinder v. Berkovitz*, 175 Misc. 2d 808, 816 (N.Y. Sup. Ct. 1998) (The fiduciary duty that corporate directors and officers owe to creditors derives "from the principle that the corporate assets constitute a trust fund for the benefit of creditors."); *Roos v. Aloï*, 127 Misc. 2d 864, 868 (N.Y. Sup. Ct. 1985) ("As to the right of creditors, the courts of this state have, under certain circumstances, adopted the 'trust fund' theory. Under this theory, the assets of a corporation, in certain situations, constitute a trust fund for the benefit of creditors."); see also *RSL Commc'ns PLC v. Bildirici*, 649 F. Supp. 2d 184, 202 (S.D.N.Y. 2009) *aff'd*, 412 Fed. Appx. 337 (2d Cir. 2011), *cert. denied*, 132 S.Ct. 97 (2011) ("[T]he duty that directors owe to the creditors of an insolvent corporation under New York law is defined primarily

by the ‘trust fund doctrine.’”). Generally, however, “the application of the trust fund doctrine in New York has been for the purpose of imposing liability on corporate directors or transferees for wrongful dissipation of assets of an insolvent corporation, in actions later brought by court-appointed receivers, trustees in bankruptcy or judgment creditors,” rather than as a general source of fiduciary duties. *Credit Agricole*, 729 N.E.2d at 688. Moreover, a creditor’s remedy’s thereunder are “limited to reaching the asset which would have been available to satisfy his or her judgment if there had been no conveyance.” *Heimbinder*, 175 Misc. 2d at 816. Furthermore, the trust fund doctrine does not automatically create an actual lien or other equitable interest in corporate assets and may not be used by a general creditor to obtain a preliminary injunction in aid of a money judgment not yet obtained. *Credit Agricole*, 729 N.E.2d at 688.

The recognition by New York courts of broad director duties likely stems from the fact that even outside the context of insolvency, New York statutory law permits directors of a for-profit corporation to consider interests beyond those of the shareholders, including creditors. See N.Y. BUS. CORP. LAW § 717(b) (McKinney 2005) (“In taking action, a director shall be entitled to consider, without limitation (1) both the long-term and the short term interests of the corporation and its shareholders and (2) the effects that the corporation’s actions may have in the short-term or in the long-term upon any of the following: . . . (iv) the corporation’s customers and creditors.”). Interestingly, the New York Not-For-Profit Corporation Law does not have a completely analogous provision; it only provides that the board, subject to any specific limitations set forth in the applicable gift instrument, must take into account “(A) general economic conditions; (B) the possible effect of inflation or deflation; (C) the expected tax consequences, if any, of investment decisions or strategies; (D) the role that each investment or course of action plays within the overall investment portfolio of the fund; (E) the expected total return from income and the appreciation of investments; (F) other resources of the institution; (G) the needs of the institution and the fund to make distributions and to preserve capital; and (H) an asset’s special relationship or special value, if any, to the purposes of the institution,” when delegating investment management of institutional funds. See N.Y. NOT-FOR-PROFIT CORP. LAW § 552(e) (McKinney, Westlaw through Sept. 2010 amendments) (providing that these factors should guide directors’ decisions regarding the delegation of investment management of institutional funds pursuant to section 514 (Delegation of investment management)). Section 552 was added as a part of the Prudent Management of Institutional Funds Act (the “NYPMIFA”), passed by the New York State Legislature in September of 2010. S. 4778, 2009-2010 Leg., Reg. Sess. (N.Y. 2010). Although the new provision alters the factors that directors of a not-for-profit corporation may consider when delegating investment management functions, it contains no explicit grant of permission to consider the not-for-profit corporation’s creditors. N.Y. NOT-FOR-PROFIT CORP. LAW § 552 (McKinney, Westlaw through Sept. 2010 amendments). New York statutory law, however, explicitly grants creditors the right to sue directors for certain actions that caused harm to the creditors in both the for-profit and not-for-profit spheres. See N.Y. BUS. CORP. LAW § 719(a) (“Directors of a corporation who vote for or concur in any of the following corporate actions shall be jointly and severally liable to the corporation for the benefit of its creditors or shareholders, to the extent of any injury suffered by such persons, respectively, as a result of such action” in various specified circumstances, including in the declaration of dividends, the purchase of shares, dissolution, and the making of loan to directors); N.Y. NOT-FOR-PROFIT CORP. LAW § 719(a) (McKinney 2005) (“Directors of a corporation who vote for or concur in any of the following corporate actions shall be jointly and severally liable to the corporation for the benefit of its creditors or members or the ultimate beneficiaries of its activities, to the extent of any injury suffered by such persons, respectively, as a result of such action,” in certain specified circumstances, including the unauthorized distribution of the corporation’s cash or property to members, directors or officers, certain redemptions, dissolution, or the making of loans to directors). Finally, New York statutory law explicitly provides judgment creditors, receivers, and bankruptcy trustees the right to sue a director or officer “in the right of the corporation” for such director’s or officer’s wrongful conduct or violation of general duties. See *id.* § 720; N.Y. BUS. CORP. LAW § 720 (McKinney 2010).

³ See *Pereira v. Cogan*, 294 B.R. 449, 521 (S.D.N.Y. 2003) *cert. denied*, 126 S.Ct. 2286 (2006) (applying Delaware law), *rev’d on other grounds*, *Pereira v. Farace*, 413 F.3d 330 (2d Cir. 2005).

⁴ Specifically, some courts have stated that the fiduciary duties of an organization’s directors expand to creditors even if the organization is not yet insolvent, if it is in the zone of insolvency. See, e.g., *In re James River*, 360 B.R. 139, 170 (Bankr. E.D. Va. 2007) (applying Virginia law and stating that “[o]nce a corporation enters the zone of insolvency, the fiduciary duties owed by Directors extend also to the corporation’s creditors”). Under Delaware law, however, directors of a corporation in the zone of insolvency do not owe fiduciary duties to creditors, and it

does not appear that creditors of such a corporation can even assert claims for breaches of fiduciary duty derivatively. Clearing up confusion from lower court opinions that suggested otherwise, the Delaware Supreme Court held definitively that directors of a solvent Delaware corporation operating in the zone of insolvency do not owe fiduciary duties to creditors and creditors may not assert direct claims for breaches of fiduciary duty against those directors. *See Gheewalla*, 930 A.2d at 101. Although the *Gheewalla* court did not say so explicitly, the thrust of its opinion appears to be that creditors of a corporation operating in the zone of insolvency cannot even bring claims derivatively on behalf of the corporation. *Id.* (“When a solvent corporation is navigating in the zone of insolvency, the focus for Delaware directors does not change: directors must continue to discharge their fiduciary duties to the corporation and its shareholders by exercising their business judgment in the best interests of the corporation *for the benefit of its shareholder owners.*”) (emphasis added).

No New York court has considered whether to adopt the Delaware court’s reasoning in *Gheewalla*, and New York caselaw regarding directors’ duties while an organization is operating in the zone of insolvency is scant. In *RSL Communications*, the United States District Court for the Southern District of New York concluded that “there is no support under New York law” for imposing upon directors an unlimited fiduciary duty of care with respect to the organization’s creditors. *RSL Commc’ns PLC*, 649 F. Supp. 2d 184, 207 (S.D.N.Y. 2009). The *RSL Communications* court declined, however, to decide whether New York law would find that the trust fund doctrine applies while an organization is in the zone of insolvency and noted that the duties imposed by the trust fund doctrine are more “narrow” than a general fiduciary duty of care. *Id.* at 203 n.10. At least one New York court indicated that the trust fund doctrine does apply when a corporation is on the brink of insolvency though not yet technically insolvent. *See Weiss*, 110 N.E.2d at 398 (“If the corporation was then technically solvent but insolvency was approaching and was then only a few days away, defendants, as officers and directors, were, in effect, the trustees by statute for the creditors by virtue of section 60 of the General Corporation Law which obligated them to protect the trust res for the creditors and to account for waste in not obtaining full value for the res, if there was any waste by reason of their conduct.”). Section 60 of the General Corporation Law, cited in *Weiss*, is the predecessor statute to N.Y. BUS. CORP. LAW § 720. *Purves v. ICM Artists, Ltd.*, 119 B.R. 407, 411 n.7 (S.D.N.Y. 1990). Prior to the *RSL Communications* decision, several federal district courts stated that New York law may impose upon an organization’s directors fiduciary duties to its creditors while in the zone of insolvency. *See Stratton Oakmont, Inc.*, 234 B.R. at 334 n.27 (stating that no New York case holds that a board’s fiduciary duties do not begin to run to creditors as soon as the corporation approaches insolvency); *Hallinan v. Republic Bank & Trust Co.*, 2007 WL 39302, at *8, n.29 (S.D.N.Y. 2007) (appearing to apply New York law and noting in dicta that “once a corporation enters the zone of insolvency, the directors owe fiduciary duties to the corporations’ [sic] creditors, in addition to its shareholders) (internal citations omitted); *Fed. Nat’l Mortgage Assoc. v. Olympia Mortgage Corp.*, 2006 WL 2802092, at *6 (E.D.N.Y. 2006) (upholding claim against officers and directors for breach of fiduciary duty based on a theory that when a corporation enters the zone of insolvency, the officers and directors owe fiduciary duties to the corporation’s creditors; the defendants, however, did not dispute that proposition but argued for the claim to be dismissed on other grounds); *Kittay v. Flutie N.Y. Corp. (In re Flutie N.Y. Corp.)*, 310 B.R. 31, 57 (Bankr. S.D.N.Y. 2004) (“Michael Flutie, much as a director of a corporation that is in the zone or vicinity of insolvency, owes a fiduciary duty not only to [the corporation] and any shareholders, but also to its creditors.”) (applying New York law but citing cases applying Delaware law); *cf. Clarkson Co.*, 660 F.2d at 512 (rejecting proposition that directors only owe duties to creditors when “liquidation is imminent and foreseeable” or “it is clear that the corporation is no longer a going concern”) (internal citations omitted). It should be noted that the *Flutie* court’s reliance on pre-*Gheewalla* Delaware cases renders that decision of questionable persuasiveness. The issues of whether and to what extent directors of New York organizations owe fiduciary duties to the organization’s creditors while it is operating in the zone of insolvency thus remain open questions. It is clear, at least, that, as is the case under Delaware law, creditors of New York corporations operating in the zone of insolvency have standing to sue the directors derivatively for breaches of fiduciary duties. *See In re I Successor Corp.*, 321 B.R. at 659 (“[C]laims based on the breach of fiduciary duty to creditors when a company is in the zone of insolvency are derivative of claims of breach of fiduciary duty to the company itself.”).

⁵ The rationale for this duty is that donations to nonprofit organizations are made on the assumption and reliance that the charitable purposes of the organization will be fulfilled and the donations will not be used for other purposes. *Trs. of Rutgers Coll. v. Richman*, 125 A.2d 10 (N.J. Ch. 1956).

⁶ See, e.g., *Manhattan Eye, Ear & Throat Hosp. v. Spitzer*, 715 N.Y.S.2d 575, 595 (1999) (“Embarkation upon a course of conduct which turns it away from the charity’s central and well-understood mission should be a carefully chosen option of last resort. Otherwise a board facing difficult financial straits might find a sale of assets, and ‘reprioritization’ of its mission, to be an attractive option, rather than taking all reasonable efforts to preserve the mission which has been the object of its stewardship.”); *In re United Healthcare Sys., Inc.*, No. 97-1159, 1997 WL 176574, at *5 (D.N.J. Mar. 26, 1997) (when analyzing an articulated business reason for a sale of a charitable institution’s assets, the court must consider the fact that a debtor is a charitable institution and that the board of the non-profit organization has a fiduciary obligation to maintain the acute care facility in question); *In re Brethren Care of S. Bend, Inc.*, 98 B.R. 927, 935 (Bankr. N.D. Ind. 1989) (finding that a sale that would provide continued services to the debtor’s patients/residents was a good business reason for the sale of a charitable institution’s assets). But see *Dennis v. Buffalo Fine Arts Acad.*, No. 2007-2220, 2007 WL 840996 (N.Y. Sup. Ct. Mar. 21, 2007) (limiting the holding in *Manhattan Eye, Ear, & Throat Hospital* to sales of all or substantially all of the entity’s assets, and determining that the same considerations do not apply when a charitable entity disposes of only a small portion of its assets in a way that does not depart from its corporate purposes).

⁷ *In re Winsted Mem’l Hosp.*, 249 B.R. 588, 594 (Bankr. D. Conn. 2000) (the debtor’s ability to pay creditors out of private donations “depends on whether, in the absence of the bankruptcy filing, the [debtor] would have been permitted to do so”); see also 11 U.S.C. § 363(d) (2006) (“The trustee may use . . . property [of the estate] only (1) in accordance with applicable nonbankruptcy law that governs the transfer of property by a corporation or trust that is not a moneyed, business, or commercial corporation or trust . . .”).

⁸ *Id.* § 513(b) (McKinney 2005) (With certain exceptions, “the governing board shall apply all assets thus received to the purposes specified in the gift instrument and to the payment of the reasonable and proper expenses of administration of such assets.”).

⁹ *Id.* § 553 (McKinney, Westlaw through Sept. 2010 amendments). NYPMIFA, discussed *supra* in note 2, repealed subsections (c) and (d) of section 513 of the New York Not-for-Profit Corporation Law and replaced them with section 553 (Appropriation for expenditure or accumulation of endowment fund; rules of construction). NYPMIFA continued, however, to honor express donor restrictions regarding the use of interest or appreciation on donated funds. *Id.*

¹⁰ *Id.* § 513(b).

¹¹ *Id.*

¹² *Id.* § 720(a) (McKinney 2005). The New York Legislative Committee on Corporations, Authorities and Commissions is currently considering a bill that would alter the text of this statute, but the proposed changes would not affect the scope of director and officer liability. S.B. 2138, 2009-2010 Leg., Reg. Sess. (N.Y. 2009).

¹³ Generally, donors of restricted gifts who do not retain a property interest in their gifts do not have standing to sue for return of such gifts in the event donees fail to comply with the restrictions. See, e.g., *Steenneck v. Univ. of Bridgeport*, No. CV 93 0133773, 1994 WL 463629, at *7 (Conn. Super. Ct. Aug. 18, 1994). Notably, however, one court granted a donor’s request for return of its charitable gift directed toward building a school when the recipient mismanaged the school project and failed to meet the deadlines and other requirements of the gift instrument. *Dickler v. Cigna Prop. and Cas. Co.*, No. Civ. A. 90-4288, 1998 WL 126938, at *7 (E.D. Pa. Mar. 19, 1998); see also *Smithers v. St. Luke’s-Roosevelt Hosp. Ctr.*, 723 N.Y.S.2d 426, 434 (N.Y. App. Div. 2001) (court-appointed estate administratrix had standing to sue for recovery of allegedly misused restricted assets because she was enforcing her late husband’s rights under his agreement with the hospital through specific performance of that agreement).

¹⁴ N.Y. NOT-FOR-PROFIT CORP. LAW § 555(a) (McKinney, Westlaw through Sept. 2010 amendments).

¹⁵ *Id.* § 555(b). Section 555(b) also requires the not-for-profit institution to “notify the donor, if available, and the attorney general,” and both parties “must be given an opportunity to be heard.” *Id.* This provision requires that the funds be used to further the not-for-profit corporation’s charitable purposes, rather than its operating expenses. *Id.*

§ 555(a) (“A release or modification may not allow a fund to be used for a purpose other than a charitable purpose of the institution.”). In addition, section 555(b) permits a court to modify a restriction on the use or purpose of a fund that is or has become “unlawful, impracticable, impossible to achieve, or wasteful” as long as (i) the modification is “consistent with the purposes expressed in the gift instrument,” (ii) the donor, if available, has been given notice of the application, and (iii) the attorney general has been notified and given an opportunity to be heard. *Id.* § 555(c). Pursuant to the law, a not-for-profit corporation would be able to release or modify a restriction on the management, investment or purpose of a fund without court approval (but upon notice to the donor, if available, and 90-day notification to the attorney general) if (i) the restriction is “unlawful, impracticable, impossible to achieve, or wasteful,” (ii) the fund has a total value of less than \$250,000, (iii) the fund is more than 20 years old, and (iv) the not-for-profit corporation uses the property in a manner consistent with purposes expressed in the gift instrument. *Id.* § 555(d).

¹⁶ *In re Othmer*, 710 N.Y.S.2d 848, 851 (N.Y. Sur. Ct. 2000) (stating that courts may free a charitable organization from restrictions and limitations attached to a donation where the following three conditions are satisfied: “(1) the gift or trust must be charitable in nature; (2) the language of the will or trust instrument, when read in the light of all attendant circumstances, must indicate that the donor demonstrated a general, rather than specific, charitable intent; and (3) it must be determined to the court’s satisfaction that the particular purpose for which the gift or trust was created has failed, or has become impossible or impracticable to achieve.”); *In re Edward John Noble Hosp. of Gouveneur*, 39 Misc. 3d 279 (N.Y. Sup. 2013) (applying the test for release of a donor restriction set forth in *Othmer* and modifying the terms of certain trusts to permit the principal of the trusts to be pledged as collateral, or, in the alternative, paid directly to not-for-profit hospital so that it could meet its financial commitments because the court found that the donors had a general charitable intent and the not-for-profit’s financial condition made it impracticable for it to both abide by the donors’ restrictions and satisfy the donors’ charitable intent).

¹⁷ Under the *cy pres* doctrine, a court will assign a similar charitable purpose to an organization or funds when the original restriction becomes obsolete and the restriction does not specify what to do in such situation. *See, e.g., id.* at 850.

¹⁸ N.Y. NOT-FOR-PROFIT CORP. LAW § 555(f) (“This section shall not limit the application of the doctrine of *cy pres*.”).

¹⁹ *See In re Kraetzer’s Will*, 462 N.Y.S.2d 1009, 1013 (N.Y. Sur. Ct. 1983) (holding that a chapter 11 trustee of a bankrupt hospital could not distribute funds from a general gift to the hospital’s creditors because courts have uniformly held that the intention of a testator in making a general gift to a charitable corporation was the furtherance of the charitable purpose for which the entity was formed as set forth in its charter).

²⁰ *Id.* at 1012 (The termination of a charitable organization’s “benevolent services causes the loss of a charity’s right to receive an absolute disposition or continued income, as the case may be, despite the prior vesting of the bequest or devise. Charitable gifts by will, being for public purposes, are impressed with a public trust imposed by the charter of each particular entity even if no express trust was created by the donor.”).

²¹ *Id.* at 1013.

²² *Boston Reg’l Med. Ctr., Inc. v. Reynolds (In re Boston Reg’l Med. Ctr., Inc.)*, 298 B.R. 1, 28 (Bankr. D. Mass. 2003) (donors to hospitals “do not contemplate that hospital personnel will apply donated monies directly to patients’ wounds. They understand full well that the hospital will use the funds to pay the employees and other creditors through whom it provides medical care to its patients.”).

²³ *Boston Reg’l Med. Ctr., Inc. v. Reynolds (In re Boston Reg’l Med. Ctr., Inc.)*, 410 F.3d 100, 111 (1st Cir. 2005) (“We decide only that, absent a contrary provision in the will or indenture of trust, a charitable organization that has ceased to perform any charitable work and that is incapable of redirecting new funds for charitable purposes is ineligible to receive a charitable bequest or gift.”).

²⁴ *Id.* at 114.

²⁵ *Id.*

²⁶ *Bierbower v. McCarthy*, 334 B.R. 478 (D.D.C. 2005) *appeal dismissed* 2006 WL 3086921 (D.C. Cir. Oct. 17, 2006); *cf.* N.Y. NOT-FOR-PROFIT CORP. LAW § 1002-a (McKinney Supp. 2011).

²⁷ *Bierbower*, 334 B.R. at 481.

²⁸ *Id.* at 481-82.

²⁹ *Id.* at 482 n.4.

³⁰ *See, e.g., In re 375 Park Ave. Assocs.*, 182 B.R. 690, 694-95 (Bankr. S.D.N.Y. 1995) (citing numerous cases for the proposition that “New York courts have uniformly held that a charitable pledge constitutes a unilateral contract, that, when accepted by the charity by incurring liability in reliance thereon, becomes a binding obligation”).

³¹ N.Y. NOT-FOR-PROFIT CORP. LAW § 517(b) (2005) (“A member shall be liable to corporation only to the extent of any unpaid portion of the initiation fees, membership dues or assessments which the corporation may have lawfully imposed upon him, or for any other indebtedness owed by him to the corporation.”).

³² *Id.* (“No action shall be brought by any creditor of the corporation to reach and apply any such liability to any debt of the corporation until after final judgment shall have been rendered against the corporation in favor of the creditor and execution thereon returned unsatisfied, or the corporation shall have been adjudged bankrupt, or a receiver shall have been appointed with power to collect debts, and which receiver, on demand of a creditor to bring suit thereon, has refused to sue for such unpaid amount, or the corporation shall have been dissolved or ceased its activities leaving debts unpaid.”).

³³ *See, e.g., Westmoreland Human Opportunities, Inc. v. Walsh*, 246 F.3d 233, 244 (3d Cir. 2001) (“As we see it, a federal agency’s retention of pervasive restrictions on a grantee’s identity and manner of performance under a HUD-type grant program is inconsistent with the grantee’s assertion of a property interest in the grant relationship.”); *In re Joliet-Will County Cmty. Action Agency*, 847 F.2d 430, 433 (7th Cir. 1988) (“Practical considerations support characterization of these grant moneys as property of the grantors until expended in accordance with the terms of the grants.”); *U.S. Dep’t of Hous. and Urban Dev. v. K. Capolino Constr. Corp.*, No. 01 Civ 390, 2001 WL 487436, *4 (S.D.N.Y. May 7, 2001) (“In determining whether the United States has an interest in particular funds, that have been disbursed to a grantee, courts have considered whether the funds were dispensed according to conditions, whether the United States retains a reversionary interest in the funds, and whether the United States employs accountability procedures to ensure that the grants are being spent as directed.”); *Cmty Assocs. v. Novak*, 173 B.R. 824, 828 (D. Conn. 1994) (adopting the reasoning of *Joliet-Will*).

³⁴ *See Westmoreland*, 246 F.3d at 244.

³⁵ *Id.*

³⁶ *Id.*

³⁷ *Id.* (“[I]f these controls are sufficiently extensive, *i.e.*, if, under the terms of the arrangement between the grantor federal agency and the grantee, the agency retains strict, pervasive, and minute oversight over the identity of the grant recipient and the manner of that recipient’s performance, the existence of such controls can demonstrate that the federal grantor agency’s interest in ensuring the effective administration of that program is weighty enough to exclude the grantee’s interest from § 541’s property definition.”).

³⁸ N.Y. NOT-FOR-PROFIT CORP. LAW § 510(a)(2) (McKinney 2005) (“If there are no members entitled to vote thereon, such sale, lease, exchange or other disposition shall be authorized by the vote of at least two-thirds of the entire-board, provided that if there are twenty-one or more directors, the vote of a majority of the entire board shall be sufficient.”).

³⁹ *Id.* § 510(a)(3) (“If the corporation is . . . classified as a Type B or Type C corporation under section 201, (Purposes) such sale, lease, exchange, or other disposition shall in addition require leave of the supreme court in the judicial district or of the county court of the county in which the corporation has its office or principal place of carrying out the purposes for which it was formed.”).

⁴⁰ *See, e.g., Manhattan Eye, Ear & Throat Hosp. v. Spitzer*, 715 N.Y.S.2d at 597 (denying authorization to sell a not-for-profit hospital’s assets because sale would not promote the hospital’s charitable purpose); *In re Multiple Sclerosis Serv. Org. of N.Y., Inc.*, 505 N.Y.S.2d 841, 867 (1986) (standard for determining suitability of proposed recipient of dissolving not-for-profit’s assets under nonjudicial dissolution plan was whether the organizations were involved in substantially similar activities, not whether the recipient’s activities conformed as nearly as possible to those of the dissolving entity).

⁴¹ 11 U.S.C. § 363(d) (2006) (“The trustee may . . . sell or lease . . . property [of the estate] only (1) in accordance with applicable nonbankruptcy law that governs the transfer of property by a corporation or trust that is not a moneyed, business, or commercial corporation or trust . . .”).

⁴² 11 U.S.C. § 363(b)(1) (2006).

⁴³ N.Y. NOT-FOR-PROFIT CORP. LAW § 509 (McKinney 2005) (“No purchase of real property shall be made by a corporation and no corporation shall sell, mortgage, or lease real property, unless authorized by the vote of two-thirds of the entire board, provided that if there are twenty-one or more directors, the vote of a majority of the entire board shall be sufficient.”).

⁴⁴ *See* N.Y. LAB. LAW § 198-a (McKinney 2009); *Renzler v. D.F. White, Inc.*, 700 N.Y.S.2d 487, 488 (N.Y. App. Div. 1999) (“Labor Law § 198-a provides a criminal penalty . . . against the officers and directors of a corporation.”).

⁴⁵ *See, e.g., Carter v. United States*, 717 F. Supp. 188, 193 (S.D.N.Y. 1989) (holding not-for-profit directors and officers personally liable for failing to pay withholding taxes).

⁴⁶ N.Y. NOT-FOR-PROFIT CORP. LAW § 719(e) (2005) (“A director or officer shall not be liable under this section if, in the circumstances, he discharged his duty to the corporation under section 717 (Duty of directors and officers).”).

⁴⁷ *Id.* § 717(a) (McKinney, Westlaw through Sept. 2010 amendments). Although NYPMIFA, discussed *supra* in note 2, continues to impose a duty of care on directors and officers of not-for-profit corporations, it uses slightly different language than the previous version of the statute. As modified, section 717(a) provides as follows: “Directors and officers shall discharge the duties of their respective positions in good faith and with the care an ordinarily prudent person in a like position would exercise under similar circumstances.” *Id.*

⁴⁸ *Id.* § 717(b) (McKinney 2005) (“In discharging their duties, directors and officers, when acting in good faith, may rely on information, opinions, reports or statements including financial statements and other financial data, in each case prepared or presented by: (1) one or more officers or employees of the corporation, whom the director believes to be reliable and competent in the matters presented, (2) counsel, public accountants or other persons as to matters which the directors or officers believe to be within such person’s professional or expert competence or (3) a committee of the board upon which they do not serve, duly designated in accordance with a provision of the certificate of incorporation or the bylaws, as to matters within its designated authority, which committee the directors or officers believe to merit confidence, so long as in so relying they shall be acting in good faith and with that degree of care specified in paragraph (a) of this section. Persons shall not be considered to be acting in good faith if they have knowledge concerning the matter in question that would cause such reliance to be unwarranted.”).

⁴⁹ *Id.* § 720(a). An amendment to § 720(a) is currently pending before the New York Legislature which would allow not-for-profit corporations to include a provision in their certificates of incorporation limiting or eliminating director liability for certain breaches of fiduciary duty. S.B. 2138, 2009-2010 Leg., Reg. Sess. (N.Y. 2009).

⁵⁰ N.Y. NOT-FOR-PROFIT CORP. LAW § 720(a) (McKinney 2005).

⁵¹ See, e.g., *United States v. King*, No. 98-CR-91A, 2000 WL 362026, *10 (W.D.N.Y. Mar. 24, 2000).

⁵² N.Y. NOT-FOR-PROFIT CORP. LAW § 720(b) (McKinney 2005).

⁵³ *Id.* § 202(a)(12) (McKinney Supp. 2011).

⁵⁴ *Id.* § 715(e) (McKinney 2005) (“Unless otherwise provided in the certificate of incorporation or the bylaws, the board shall have authority to fix the compensation of directors for services in any capacity.”).

⁵⁵ *Id.* § 715(f) (“The fixing of salaries of officers, if not done in or pursuant to the bylaws, shall require the affirmative vote of a majority of the entire board unless a higher proportion is set by the certificate of incorporation or bylaws.”).

⁵⁶ *Spitzer v. Grasso*, 11 N.Y.3d 64 (2008), *aff’g* 836 N.Y.S.2d 40 (N.Y. App. Div. 2007), *rev’g* *Spitzer v. Grasso*, 816 N.Y.S.2d 863 (N.Y. Sup. Ct. 2006).

⁵⁷ *Id.* 70-71 (“The plain language of these provisions reveals a legislative policy decision to provide officers and directors of not-for-profit corporations with the ‘business judgment’ protections afforded their for-profit counterparts. . . . By contrast, the four nonstatutory causes of action are devoid of any fault-based elements and, as such, are fundamentally inconsistent with the [statute].”). The Supreme Court had denied the motion to dismiss with respect to the Attorney General’s statutory and nonstatutory claims. The Appellate Division reversed and dismissed the nonstatutory claims on the basis that they violated the scheme put in place by legislature and thus exceeded the power of the Attorney General. The Court of Appeals affirmed. The remaining statutory claims were subsequently dismissed on the grounds that the stock exchange had ceased to be a not-for-profit corporation.

⁵⁸ I.R.C. § 4958 (Supp. III 2009); Lawrence M. Brauer, et al., *Intermediate Sanctions (IRC 4958) Update*, available at <http://www.irs.ustreas.gov/pub/irs-tege/eotopice03.pdf>. In January of this year, a federal district court found this section of the Internal Revenue Code unconstitutional as not severable. *Florida ex rel. Bondi v. U.S. Dept. of Health and Human Servs.*, No. 3:10-CV-91-RV EMT, 2011 WL 285683, *1 (N.D. Fla. Jan. 31, 2011), *aff’d in part, rev’d in part*, 648 F.3d 1235 (11th Cir. 2011), *cert. granted*, 132 S.Ct. 604 (2011). Three bills have been introduced in the United States House of Representatives aimed at repealing section 4958. H.R. 4242, 112th Cong. (2d Sess. 2012); H.R. 4224, 112th Cong. (2d Sess. 2012); H.R. 4160, 112th Cong. (2d Sess. 2012).

⁵⁹ Treas. Reg §§ 53.4958-1(c)(1), 53.4958-1(c)(2) (2002).

⁶⁰ AM. BAR ASS’N, COMM. ON NONPROFIT CORPS., *GUIDEBOOK FOR DIRECTORS OF NONPROFIT CORPORATIONS* 54, 83 (George W. Overton & Jeannie Carmedelle Frey eds., 2d ed. 2002).

⁶¹ Treas. Reg § 53.4958-6 (2002).

⁶² N.Y. NOT-FOR-PROFIT CORP. LAW § 720-a (McKinney 2005) (With certain exceptions, “no person serving without compensation as a director, officer or trustee of a corporation, association, organization or trust described in section 501(c)(3) of the United States internal revenue code shall be liable to any person other than such corporation, association, organization or trust based solely on his or her conduct in the execution of such office unless the conduct of such director, officer or trustee with respect to the person asserting liability constituted gross negligence or was intended to cause the resulting harm to the person asserting such liability.”). A proposed amendment to §720-a was recently introduced in the New York state legislature which would, among other things, redefine the type of individuals that fall under the protection of §720-a to include all “volunteers” (which would cover most, but not all, unpaid directors, officers, trustees and direct service volunteers). Assem. 1051, 2011 Leg., Reg. Sess. (N.Y. 2011); see also The Volunteer Protection Act of 1997, 42 U.S.C. § 14503(a) (2006) (limiting the scope of director and officer liability).

⁶³ N.Y. NOT-FOR-PROFIT CORP. LAW § 514(a) (McKinney, Westlaw through Sept. 2010 amendments).

⁶⁴ *Id.* § 514(b) (McKinney 2005) (“The governing board shall be relieved of all liability for the investment and reinvestment of institutional funds by, and for the other acts or omissions of, persons to whom authority is so delegated or with whom contracts are so made.”). Section 554 of the New York Not-for-Profit Corporation Law governs delegation of fund management and investment functions to external investment managers. *Id.* § 554 (McKinney, Westlaw through Sept. 2010 amendments). This section permits a not-for-profit corporation to delegate such functions to an external agent only “to the extent that an institution could prudently delegate under the circumstances” and provides that a not-for-profit corporation “shall act in good faith, with the care that an ordinarily prudent person in a like position would exercise under similar circumstances . . . , in: (1) selecting, continuing or terminating an agent . . . ; (2) establishing the scope and terms of the delegation, including the payment of compensation . . . ; and (3) monitoring the agent’s performance and compliance with the scope and terms of the delegation.” *Id.* § 554(a). Only a not-for-profit corporation that complies with these prerequisites is protected from liability for the decisions or actions of the agent. *Id.* § 554(c).

⁶⁵ *Id.* §§ 719, 721-26 (McKinney 2005).

⁶⁶ *Id.* § 721.

⁶⁷ *Id.* § 723(a) (“A person who has been successful, on the merits or otherwise, in the defense of a civil or criminal action or proceeding of the character described in section 722 shall be entitled to indemnification as authorized in such section.”).

⁶⁸ *Id.* §§ 723(a), 722(c); *cf. Waltuch v. Conticommodity Servs., Inc.*, 88 F.3d 87, 96 (2d Cir. 1996) (under Delaware corporate law, success “on the merits or otherwise” in the indemnification context extends to situations in which a defendant entered into a settlement gratis (*i.e.*, without having to pay anything)); *Hermelin v. K-V Pharm.*, 54 A.3d 1093, 1107 (Del. Ch. 2012) (stating that “where the *outcome* of a proceeding signals that the indemnitee has avoided an adverse result, the indemnitee has succeeded ‘on the merits or otherwise,’ and further inquiry into the ‘how’ and ‘why’ of the result is unnecessary.”) (internal citations omitted).

⁶⁹ N.Y. NOT-FOR-PROFIT CORP. LAW §§ 723(a), 722(c) (McKinney 2005).

⁷⁰ *Id.* § 724(a) (“Notwithstanding the failure of a corporation to provide indemnification, and despite any contrary resolution of the board or of the members in the specific case under section 723 (Payment of indemnification other than by court award), indemnification shall be awarded by a court to the extent authorized under section 722 (Authorization for indemnification of directors and officers), and paragraph (a) of section 723.”).

⁷¹ *Id.* § 722(c).

⁷² *Id.*

⁷³ *Id.*

⁷⁴ *Id.* § 724(a).

⁷⁵ *Id.* § 723.

⁷⁶ *Id.* § 723(c).

⁷⁷ *Id.* § 723(b)(1).

⁷⁸ *Id.* § 723(b)(2)(A).

⁷⁹ *Id.* § 723(b)(2)(B).

⁸⁰ *Id.* § 726.

⁸¹ *Id.* § 726(b)(1) (“No insurance under paragraph (a) may provide for any payment, other than cost of defense, to or on behalf of any director or officer: (1) if a judgment or other final adjudication adverse to the insured director or officer establishes that his acts of active and deliberate dishonesty were material to the cause of action so adjudicated, or that he personally gained in fact a financial profit or other advantage to which he was not legally entitled.”).

⁸² Richard M. Cieri & Michael J. Riela, *Protecting Directors and Officers of Corporations That Are Insolvent or in the Zone or Vicinity of Insolvency: Important Considerations, Practical Solutions*, 2 DEPAUL BUS. & COM. L.J. 295 (2004).

⁸³ *See, e.g., Gillman v. Cont’l Airlines (In re Cont’l Airlines)*, 203 F.3d 203, 217 (3d Cir. 2000) (“Other courts of appeals have disagreed as to the circumstances under which the proceeds of a D&O policy can be considered property of the estate, but the analysis has been fact-intensive in any event.”).

⁸⁴ *Compare id.* (“One cannot assume too quickly that the proceeds of this policy are property of the estate when the non-debtor D&Os, not the Continental Debtors, are the direct beneficiaries of the policy. We previously have recognized, albeit in a different context, that the proceeds from an insurance policy should be evaluated separately from the debtor’s interest in the policy itself.”) and *In re Louisiana World Exposition, Inc.*, 832 F.2d 1391, 1401 (5th Cir. 1987); *In re Adelphia Commc’ns Corp.*, 298 B.R. 49 (S.D.N.Y. 2003) (“The problem here, however, is that the Bankruptcy Court assumed that the proceeds from the policies were assets of Adelphia’s estate and automatically subject to the stay under § 362(a)(3). As discussed above, that is not the case.”), with *Minoco Group of Cos. v. First State Underwriters Agency (In re Minoco Group of Cos.)*, 799 F.2d 517, 519 (9th Cir. 1986) (finding that D&O Insurance policy was property of the estate because “the estate [wa]s worth more with the policy than without the policy”); and *First Cent. Fin. Corp. v. Lipson (In re First Cent. Fin. Corp.)*, 238 B.R. 9, 16 (Bankr. E.D.N.Y. 1999) (“While a majority of courts consider a D&O policy estate property [citations omitted], there is an increasing view that a distinction should be drawn when considering treatment of proceeds under such policies.”); *In re W.R. Grace & Co.*, 468 B.R. 81, 128 (D. Del. 2012) (noting that the treatment of proceeds under an insurance policy depends on whether the proceeds are payable to the debtor or some other claimant).

⁸⁵ N.Y. NOT-FOR-PROFIT CORP. LAW § 706(a), (c) (McKinney 2005).

⁸⁶ *Id.* § 706(d) (“An action to procure a judgment removing a director for cause may be brought by the attorney-general or by ten percent of the members whether or not entitled to vote.”).

⁸⁷ *Id.*

⁸⁸ *Id.* § 706(b) (With certain exceptions, “if the certificate of incorporation or the bylaws so provide, any or all of the directors may be removed without cause by vote of the members.”).

⁸⁹ *Frantz Mfg. Co. v. EAC Indus.*, 501 A.2d 401, 408 (Del. 1985) (“Directors are also free to resign.”).

⁹⁰ *7th Sense, Inc. v. Liu*, 631 N.Y.S.2d 835, 836 (N.Y. App. Div. 1995) (lower court “properly determined that the purported resignation of defendant Victor Liu as an officer and director of corporate plaintiff 7th Sense for personal gain did not relieve him of his fiduciary obligations or liability for his acts of misappropriation”); *Dist. 65, UAW v. Harper & Row Publishers*, 576 F. Supp. 1468, 1483-84 (S.D.N.Y. 1983).

⁹¹ *See, e.g., Zeltner v. Henry Zeltner Brewing Co.*, 174 N.Y. 247, 252-53 (1903).

⁹² The business judgment rule will protect directors who rely on their restructuring consultants, even if the restructuring consultants ultimately fail to deliver. *See Gottlieb v. Hicks*, No. CV04-7318-GPS (C.D. Cal. Jan. 13, 2006).

⁹³ *In re Save Our Springs Alliance*, No. 09-50990, 2011 WL 227693, at *2 (5th Cir. Jan. 26, 2011) (“The bankruptcy court’s conclusion that past donations are not evidence of future fundraising ability is thus appropriate.”).

⁹⁴ *Id.*

⁹⁵ For more detail regarding chapter 11, see **Tab 18**.

⁹⁶ While an individual debtor is not entitled to a discharge of all of his or her prepetition debts, corporations are entitled to a full discharge unless they file plans of liquidation.

⁹⁷ See, e.g., *In re Bankr. Appeal of Allegheny Health, Educ. & Research Found.*, 252 B.R. 332 (W.D. Pa. 1999) (automatic stay did not apply to void state court injunction protecting not-for-profit organization's charitable assets from its creditors because the state court litigation was subject to the police powers exception to the automatic stay; movants could seek injunctive relief pursuant to section 105 of the Bankruptcy Code, but existence of a viable exception to the stay would inform court's decision of whether to enjoin a proceeding).

⁹⁸ See 11 U.S.C. § 364 (2006).

⁹⁹ Section 502(b)(6) of the Bankruptcy Code caps the damages claim of a landlord whose lease is rejected to approximately one year of rent. *Id.* § 502(b)(6). This can be very beneficial to debtors with long-term leases.

¹⁰⁰ When assets are sold free and clear of liens, the liens attach to the proceeds of the sale. See *id.* § 363.

¹⁰¹ *Id.* § 1129(b).

¹⁰² *In re Wabash Valley Power Ass'n, Inc.*, 72 F.3d 1305, 1313 (7th Cir. 1995) *cert. denied*, 519 U.S. 965 (1996) (the absolute priority rule "provides that, in order for a bankruptcy plan to be approved in the face of the refusal of an unsecured creditor to accept it (a "cramdown"), the holder of any claim or interest junior to that of the dissenter may not 'receive or retain under the plan on account of such junior claim or interest any property.' ") (internal citation omitted).

¹⁰³ *Id.* at 1318-19.

¹⁰⁴ *Id.* ("The mere fact that the Members of [not-for-profit electric cooperative] are benefited by Wabash's operation and might be disadvantaged by its demise also does not give them an 'interest' cognizable in bankruptcy. Employees, managers and customers, among others, always have an interest, in the broadest sense, in a corporation. The factor which distinguishes these parties from stockholders is not 'control' per se (managers, after all, have at least a limited control) but the ability to make use of that control to generate profits or to increase their own share of profits.").

¹⁰⁵ A bankruptcy court is virtually required to grant an examiner for any reason if the debtor has aggregate debts in excess of \$5 million. See 11 U.S.C. § 1104(c) (2006).

¹⁰⁶ *In re Am. Hous. Found.*, No. 09-20232-RLJ-11, 2010 WL 3211691, at *3 (Bankr. N.D. Tex. Aug. 11, 2010).

¹⁰⁷ 11 U.S.C. § 363(d) (2006).

¹⁰⁸ *Id.* § 303(a).

¹⁰⁹ *Id.* § 1112(c).

¹¹⁰ See, e.g., *In re Sheehan Mem'l Hosp.*, 301 B.R. 777 (Bankr. W.D.N.Y. 2003) (because court could not convert case of not-for-profit debtor that defaulted on its ongoing obligations to chapter 7, it dismissed the case altogether).

¹¹¹ For a comparison of liquidation under state law or chapter 11 or chapter 7 of the Bankruptcy Code, see **Tab 18**.

¹¹² There are four types of not-for-profit corporations under New York law. N.Y. NOT-FOR-PROFIT CORP. LAW § 201(b) (McKinney 2005). Type A corporations are formed for any lawful non-business purpose and may be civic, patriotic, social, etc. *Id.* Type B corporations may be formed for charitable, educational, religious, scientific, literary, cultural, child welfare, or animal protection non-business purposes. *Id.* A type C corporation may be formed for “any lawful business purpose to achieve a lawful public or quasi-public objective.” *Id.* Type D is a catchall covering not-for-profit corporations whose formation is authorized by any other corporate law of New York for any purposes specified by such other law. *Id.* “If a corporation is formed for purposes which are within both type A and type B above, it is a type B corporation. If a corporation has among its purposes any purpose which is within type C, such corporation is a type C corporation. A type D corporation is subject to all provisions of [the not-for-profit corporation law] chapter unless provided to the contrary in, and subject to the contrary provisions of, the other corporate law authorizing formation of the type D corporation.” *Id.* § 201(c).

¹¹³ *Id.* §§ 1001-14 (McKinney 2005 & Supp. 2011).

¹¹⁴ The New York Attorney General has prepared a booklet providing guidance on how to conduct a non-judicial dissolution for a not-for-profit organization that has no assets other than a reserve fund of no more than \$25,000 to be used (1) to pay the costs of winding up the organization’s affairs such as attorneys’ and accountants’ fees and (2) to satisfy liabilities that, in total, do not exceed \$10,000. New York Attorney General’s Charities Bureau, *Procedures and Forms for a Simplified Dissolution* (2006), available at <http://www.charitiesnys.com>. Among other simplifications, for a not-for-profit that meets the criteria, the supreme court’s approval of the Plan of Dissolution is no longer required.

¹¹⁵ See New York Attorney General’s Charities Bureau, *Voluntary Dissolution of Not-For-Profit Corporations with Assets to Distribute* (2006), available at <http://www.charitiesnys.com>.

¹¹⁶ N.Y. NOT-FOR-PROFIT CORP. LAW § 719(a)(4) (McKinney 2005) (directors who vote for distribution of assets after dissolution in violation of quasi cy-pres requirement are jointly and severally liable to the corporation to the extent of any injury suffered therefrom by creditors or members or the corporation itself).

¹¹⁷ *Id.* §§1101-15 (McKinney 2005 & Supp. 2011).

¹¹⁸ See, e.g., *id.* §§ 1201-18.

¹¹⁹ See, e.g., *Compagnia Distribuzione Calzature, S.R.L. v. PSF Shoes Ltd.*, 613 N.Y.S.2d 931 (App. Div. 1994).

May 2013

WARNING SIGNS OF DISTRESS FOR NOT-FOR-PROFIT ORGANIZATIONS

Not-for-profit directors should not “micro-manage” the daily activities of their organizations, but they should “micro-monitor” their organizations, keeping an eye out for warning signs of distress. Listed below are examples of several warning signs of distress for not-for-profit organizations.

I. DECLINING INCOME

Many not-for-profit organizations rely on donations and government/private grants to fund their operations so it is as important, if not more important, to monitor these external income sources as it is to watch operational revenue levels. A decline in any of the following can have a negative impact on the financial viability of the organization:

- A. Contributions
- B. Grants
- C. Dues
- D. Operational Revenue
 - 1. May be evidenced by excessive receivables outstanding for over 90 days
 - 2. May be caused by payment default by major customer

II. INCREASING OR DISPROPORTIONATELY HIGH EXPENSES

An increase in expenses can be a warning sign. Stable or disproportionately high expenses may also be a warning sign if income is decreasing or not increasing proportionately. Remember, the board may not be able to control income, but it can keep a lid on expenses.

III. CREDIT PROBLEMS

Not being able to pay debts as they come due is a bad sign and most likely signals entry into the “zone of insolvency.” (Are you overspending or do you have a cash flow problem? If you don’t know then find out – not knowing can be a bad sign in and of itself.) Credit problems may be evidenced by:

- A. Excessive payables remaining unpaid for over 90 days
- B. Insufficient funds available to make deposits into trust funds such as employee withholding taxes
- C. Inability to fulfill long-term debt obligations

- D. Creditors not willing to advance credit
- E. Losing a major supplier that had performed under special credit terms
- F. Reduction in lines of credit
- G. Excessive re-negotiation of broken loan covenants

IV. ACCOUNTING ISSUES

- A. Unplanned auditor turnover
- B. Weak financial reporting, *e.g.*, financial statements are untimely, lack important detail or are too voluminous to be useful, external auditors fail to identify major financial issues, account analyses are delinquent, or basic financial controls are lacking
- C. Poor record keeping or inadequate financial records
- D. Lack of basic controls, such as perpetual inventory record keeping
- E. Significant discrepancies between actual and projected results of the prior three years

V. OPERATIONAL INEFFICIENCIES

A poorly run organization is bound for financial ruin regardless of how its financials look. Signs of operational inefficiencies include:

- A. Board micro-management
- B. Absentee board members
- C. Laissez-faire board attitudes or a stagnant board roster with long-tenured members selected by the CEO
- D. Excessive dependence on consultants
- E. High administrative overhead costs

VI. OTHER SIGNS

- A. Criminal investigations, extraordinary litigation, or other unusual events not ordinarily encountered in the industry
- B. Loss of key financial officers or key personnel
- C. Although cash management is always a concern, it may be a warning sign if cash management becomes a primary activity at the expense of traditional management functions
- D. Self dealing by directors and/or others, excessive compensation

COMPARISON OF LIQUIDATION OPTIONS

	CHAPTER 11	CHAPTER 7	STATE LAW
Complexity	- Generally more complex and requires significant time, effort, and resources from the debtor. - See <i>Appendix</i>.	- A court appointed trustee handles the liquidation of the estate. Management and the board of directors do not control the case. - Can be relatively quick.	- State law dissolution can be complex and slow. Recent amendments have somewhat streamlined the non-judicial dissolution process for certain organizations that have assets and liabilities below a certain threshold (however, even this process is not without its complexities). - In a state law receivership, there is a complete loss of control. State receivership law is archaic and not commonly used.
Breathing Room	- Automatic stay protects debtors from creditors. - See <i>Appendix</i>.	Automatic stay protects debtors from creditors.	- No automatic stay or analog in state law dissolution proceedings. - If liquidating in a receivership, the appointment of a receiver functions like an automatic stay, but only for actions against property in the receivership. Property in the receivership will be liquidated and distributed pursuant to a court plan.

Contracts & Real Property Leases	• In chapter 11, a not-for-profit organization can deal with all of its contracts immediately rather than as they come due. • Section 502(b) of the Bankruptcy Code caps rejection damages for real property leases and certain other contracts that are rejected. • See <i>Appendix</i>.	• Section 502(b) of the Bankruptcy Code caps rejection damages for real property leases and certain other contracts that are rejected.	• State law dissolution does not offer special protections or powers vis-à-vis contracts and leases. • In a receivership, contracts and leases are maintained until rejected by the receiver.
Dealing with Creditors	• The debtor deals with individual creditors as well as statutory committees. • Because classes of creditors vote on whether to accept a plan of liquidation, approval of all creditors is not required. Furthermore, classes of creditors that do not approve of the plan may be “crammed down” if a single impaired class of creditors votes in favor of the plan. • See <i>Appendix</i>.	• The chapter 7 trustee will deal with creditors.	• Management deals with creditors in a state law dissolution. • If a receivership is established, the receiver deals with creditors who attempt to “prove” their claim in the court that has jurisdiction over the receivership.

Claims	- Allowed claims are paid out pursuant to a plan of liquidation. - See <i>Appendix</i>.	- Allowed claims are paid out pursuant to distributions made under the priorities specified in the Bankruptcy Code. - Unless claims are subordinated under section 510 of the Bankruptcy Code (<i>i.e.</i>, by agreement or because of a creditor's inequitable conduct), priority claims are paid before unsecured claims. Claims for fines, penalties, or punitive damages and postpetition interest are only payable after all other claims are paid.	- If the company is dissolved under state law, any remaining assets will be distributed as part of a plan of distribution that must be approved by the court (or the attorney general, depending on the type of dissolution). Dissolution cannot be used to evade claimants and personal liability may attach for inappropriate distribution of assets. - In a receivership, claims are paid out by the receiver upon liquidation of the assets.
Sources of Funds	- A debtor may use the avoiding powers under the Bankruptcy Code to avoid certain prepetition transfers of property as preferences or voidable transactions. - Under the Bankruptcy Code, assets can be sold free and clear of liens. - The Bankruptcy Code provides incentives to lenders to provide financing during the course of bankruptcy. - See <i>Appendix</i>.	- A chapter 7 trustee may use the avoiding powers under the Bankruptcy Code to avoid certain prepetition transfers of property as preferences or voidable transactions. - Under the Bankruptcy Code, assets can be sold free and clear of liens. - Debtor, absent court approval, will not continue to operate, so financing is typically not an issue.	- Prepetition transfers may be avoided under state fraudulent transfer law, but preferential transfers can only be avoided in bankruptcy. - Assets can be sold free and clear of liens through specific action by the court in a receivership.
Employee Wages	Employee wages are given payment priority under the Bankruptcy Code.	Employee wages are given payment priority under the Bankruptcy Code.	- Employees need to be paid before dissolution. - In a receivership, the court may give employee wages priority.

Judicial and Other Oversight	The bankruptcy court and statutory committees.	The bankruptcy court, although creditors may elect a creditors' committee under section 705 of the Bankruptcy Code. This option is rarely exercised.	- The state court, in a judicial dissolution, and the attorney general in a non-judicial dissolution (ultimately, court approval of a non-judicial plan of distribution is still required, unless the streamlined procedures for certain organizations that have assets and liabilities below a certain threshold are utilized). - The court oversees a receivership (unless the receivership is created by an administrative agency, in which case the agency provides oversight).
Director and Officer Exposure	- Chapter 11 plan may provide for limited releases for directors and officers. - See <i>Appendix</i>.	- No mechanism for releasing directors and officers. - Chapter 7 trustee is entitled to statutory protections.	No additional protection for directors and officers. Personal liability may attach for improper distribution of assets in a state law dissolution.
Possible Loss of Control	- For cause shown (e.g., fraud, dishonesty, incompetence or gross mismanagement), the bankruptcy court may appoint a trustee to displace management. - See <i>Appendix</i>.	The debtor has no control after the chapter 7 trustee is appointed.	- If dissolving pursuant to state law, an organization should be able to retain control of the process, but either the court or the attorney general will play a significant role. - If liquidating through a receivership, the receiver and the court control the process.

APPENDIX

ADVANTAGES & DISADVANTAGES OF CHAPTER 11

	ADVANTAGES	DISADVANTAGES
Breathing Room	Chapter 11 can provide a debtor with breathing room to deal with its creditors' claims. The debtor will no longer have to worry about creditors running to the court to secure judgments against it because the Bankruptcy Code provides for an automatic stay of all actions against a debtor, its property and property in its possession.	The automatic stay is subject to certain limitations.
Contracts & Real Property Leases	- In chapter 11, a not-for-profit organization can deal with all of its contracts immediately rather than as they come due. - A chapter 11 case will afford a debtor with the ability to reject executory contracts and unexpired leases that are no longer advantageous. A rejection is treated as a breach of such contract or lease as of the time of the filing and rejection damages are paid in bankruptcy dollars. - Contracts may also be assumed, or assumed and assigned to a third party. - Section 502(b)(6) of the Bankruptcy Code caps rejection damages for real property leases that are rejected.	- Parties to contracts and leases that must be assumed may insist upon 100% payment of their past due amounts. - Contracts not assignable outside of bankruptcy, such as intellectual property licenses, are also not assignable during bankruptcy. In certain jurisdictions, such contracts also may not be assumable.

Dealing with Creditors	• Chapter 11 provides a single forum for dealing with all of the debtor’s creditors at once. • The protections of chapter 11 change the dynamics of negotiations with creditors. • The debtor will not need unanimous approval of creditors to bind creditors to a plan of reorganization. In a chapter 11 case, a plan of reorganization is accepted by a class of creditors if at least 50% in number and 66-2/3% in amount of the creditors holding allowed claims (who actually vote) vote to accept the plan. • Even if a class does not accept, the debtor will only need one impaired class of creditors voting to accept its plan of reorganization in order to confirm such plan. In other words, the debtor will have the ability to “cramdown” the unsecured creditors, even if they vote against the plan, as long as one of the secured creditor classes supports the plan.	• In order to protect creditors and the debtor’s estate, court approval is required for most actions taken by the debtor during a bankruptcy. The court then becomes a forum for creditors to object to the debtor’s course of action and the court will not approve conduct that will inequitably diminish a creditor’s claim. For example, a debtor will need to obtain court approval to use cash collateral encumbered by a creditor.
Claims	• A chapter 11 filing will bring all claims against the not-for-profit debtor to the forefront, thus enabling the debtor to achieve a true fresh start. Chapter 11 also flushes out contingent claims. • A chapter 11 case provides a mechanism for treating all creditors equally and minimizes the risk of creditor holdouts seeking better treatment.	• May attract and motivate claimants who would have otherwise not pursued claims and claimants with contingent claims.

Sources of Funds	• A debtor may use the avoiding powers under the Bankruptcy Code to recover certain prepetition transfers of property as preferences or fraudulent transfers. • A chapter 11 filing could potentially lead to greater contributions from supporters of the not-for-profit organization. • The Bankruptcy Code offers incentives for financiers to provide financing during a reorganization.	• It is unclear whether restricted funds, including endowments, and restricted donations may be available to satisfy creditors' claims. • Filing for bankruptcy may scare off donors.
Employee/Retiree Benefits Issues	• A chapter 11 case can provide a debtor with a forum for dealing with the termination of retiree benefits. The debtor can seek and obtain the bankruptcy court's blessing prior to taking any action with respect thereto.	
Public Relations	• Ultimately, reorganizing may make the most business sense, despite a negative reaction from the public. A responsible reorganization will leave the reorganized not-for-profit entity more fit to pursue its mission and more deserving of public trust.	• A chapter 11 filing will bring the debtor's troubles into the public eye. This could potentially impair a not-for-profit organization's ability to fundraise. (On the other hand, in some situations, a chapter 11 filing could act as an impetus for donations.)
Director and Officer Exposure	• Some chapter 11 plans of reorganization contain releases for director and officer actions taken during the course of the bankruptcy.	• A chapter 11 case does not afford officers and directors with any greater protection from suit. • A chapter 11 filing may increase director and officer exposure to lawsuits by creditors.
Costs of Chapter 11		• The administrative costs of a chapter 11 case may be high. For example, the debtor is required to pay the creditors' committee's professional fees (lawyers, , accountants and/or financial advisors) and the quarterly US Trustee Fees (fees range from \$250/quarter to \$10,000/quarter based on the debtor's disbursements).

Possible Loss of Control	• The debtor usually runs the chapter 11 case.	• For cause shown (<i>e.g.</i>, fraud, dishonesty, incompetence or gross mismanagement), the bankruptcy court may appoint a trustee to displace management. The appointment of a trustee is atypical in a chapter 11 case.
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May 2013

CHECKLIST FOR DIRECTORS OF TROUBLED NOT-FOR-PROFIT ORGANIZATIONS

- Financial Management
 - Get a handle on the organization's cash position
 - Model quarterly cash flows
 - Analyze and assess the ability of the organization to generate enough cash to survive in the short-term
 - Evaluate whether any business areas that require short-term capital to maximize long-term profit potential
 - Determine when the organization will have liquidity issues
 - Identify any areas of the organization that require immediate funding
 - Analyze liquidity and cash constraints
 - ◆ How much cash is restricted? Is the cash donor-restricted or board-restricted?
 - ◆ How can the organization free up cash (for example, via asset sales or securitization)?
 - Develop calendar of key dates, including dates of major cash outlays, covenant dates, and cure periods
 - Review receivables to determine if current collection methods are sufficient
 - Review payables to determine "critical vendors"
 - Negotiate use of cash collateral with lenders and/or set minimum cash covenants
 - Identify alternative financing sources

- Identify vulnerabilities and determine how to keep them from becoming crises
- Formulate and communicate an action/restructuring plan:
 - How are you going to preserve the profitable operations and abort the unprofitable ones?
 - Can you resolve any operational issues outside of bankruptcy with the consent of the entities involved?
- Set goals and standards by which to judge the organization's financial situation and to evaluate performance (determine what success looks like for the organization and whether the organization is on track to achieve such success)
- Reassess the budget and determine whether to cut back operations
- Reassess loan covenants and determine whether to renegotiate
- Institute internal control procedures for:
 - Handling funds received and expended by the organization
 - Appropriate and timely financial reporting for board members and officers
 - Auditing the organization's financial statements
 - Evaluating staff and programs
 - Maintaining inventory records of real and personal property and their whereabouts
 - Implementing personnel and conflict of interest policies
 - Assuring compliance with requirements regarding restricted funds
- Board Composition (see ***Tabs 1*** and ***10***)
 - Determine whether there are enough board members with adequate finance backgrounds and, if not, add some
 - Add management directors to the board
 - Establish special committees to address problem areas
- Review and Evaluate Advisors, Contracts and Leases, and Expenditures
 - Advisors – is it time for a new accountant and/or audit firm?

- Contracts and leases
 - What contracts and leases are necessary for the organization's continued survival?
 - Are there contracts or leases that could be eliminated?
- Capital expenditures
 - Where are the ongoing capital improvement projects?
 - Which capital expenditures are really needed?
 - Which capital expenditures can be terminated without incurring significant additional liabilities?
- Identify Key Creditor Constituencies and Potential Leverage
- Government Assistance
 - Consider whether assistance can or should be sought from state and/or local governmental authorities
- Employees
 - Determine whether the organization will be able to pay employee salaries in full and on time – failure to pay employee salaries may give rise to director liability
 - Ensure that withholding taxes are paid to the government in full and on time
 - Determine whether the organization will have to give two weeks notice to employees it terminates
 - Communicate openly with employees
 - Watch for employee anger and productivity problems
- Develop a Communications Program
 - Consider how to maintain good relationships with donors while not misleading anyone about the organization's financial condition
 - Determine whether it makes sense to reach out to the Attorney General's office
 - Develop a communications strategy for other key constituents, including employees and donors

**RIGHT FROM THE START
RESPONSIBILITIES OF DIRECTORS OF
NOT-FOR-PROFIT CORPORATIONS**

**Attorney General
of the State of New York
Charities Bureau
120 Broadway
New York, NY 10271**

(212) 416-8401

www.charitiesnys.com

New York State Attorney General Eric T. Schneiderman is pleased to offer this booklet to assist current and future boards of directors of New York not-for-profit corporations (and, by analogy, trustees of New York charitable trusts) to understand and carry out their fiduciary responsibilities to the organizations they serve.

Charitable organizations contribute substantially to our society. They educate our children, care for the sick, preserve our literature, art and music for us and future generations, house the homeless, protect the environment and much more. The fiduciaries of those charitable organizations are responsible for managing and preserving the charitable assets that benefit all of us.

Whatever their mission or size, all organizations should have policies and procedures established so that (1) boards understand their fiduciary responsibilities, (2) assets are managed properly and (3) the charitable purposes of the organization are carried out. A failure to meet these obligations is a breach of fiduciary duty and can result in financial and other liability for the board of directors.

Please read this booklet carefully. It contains general information concerning fiduciary oversight of charitable assets. The Attorney General publishes another booklet, *Internal Controls and Financial Accountability for Not-for-Profit Boards*, which contains more detailed information on managing a charitable organization and overseeing its assets. That booklet and other publications of interest to board members may be found at:

www.charitiesnys.com

This booklet is designed to provide guidance to fiduciaries of charitable assets. It is not a substitute for advice from a qualified lawyer, independent public accountant or other professional.

The following guidelines are designed to assist board members in carrying out their responsibilities.

I. WHO MAY JOIN A BOARD?

Board members come from all backgrounds, bringing many different talents to the organizations they serve. Anyone over eighteen is legally qualified to serve on a board.

II. WHAT SHOULD A PROSPECTIVE BOARD MEMBER KNOW BEFORE JOINING A BOARD?

Anyone considering membership on the board of a not-for-profit corporation should do the following *before* joining:

- Read the organization's certificate of incorporation, application for federal income tax exemption, by-laws and board and committee minutes for at least the last year to learn about its stated purposes, activities and concerns.
- Obtain a current list of board and committee members and find out from the board chair and the organization's chief executive and financial officers what is expected of board members. Try to determine if the organization is managed by its board or its staff and, if the latter, how open is the relationship between board and staff. Talk to current and recent former board members to learn about what the board does and why any former board members recently left the board. In addition, make sure that the board and committee meetings are usually well-attended.
- Review the organization's Internal Revenue Service Form 990 or 990 PF and audited financial statements for at least the last two (2) years as well as its current internal financial reports to see how the organization uses its assets and to evaluate its financial health. Is its auditor's report on its financial statements unqualified? Has the auditor sent the organization a management letter? Has the Internal Revenue Service recently audited the organization? What does its report say? Ensure that it is in compliance with all conditions stated in its federal income tax determination letter.
- Find out if the organization is required to register with the Attorney General's Charities Bureau and, if so, whether it has registered and filed all required reports. Evaluate whether the filings, audit reports and other compliance requirements appear to be completed on a timely basis. Find out whether there are any tax issues or concerns, or notices received from governmental authorities. Find out what other filings might be required. If the organization has paid employees, it must file the appropriate payroll tax forms and pay the appropriate taxes. The organization may also have sales tax and unrelated business income tax responsibilities.

- Obtain an understanding of the internal control structure of the organization and the processes in place to monitor it. Determine whether there is a current accounting policies and procedures manual that is followed. Review the past two (2) years, management letters received from the public accountants and find out what has been done to remedy any problems identified. (For further information on internal controls and accountability, please see the Attorney General's Charities Bureau booklet - *Internal Controls and Financial Accountability for Not-for-Profit Boards*. That booklet and other publications of interest to charitable fiduciaries are available at www.charitiesnys.com.
- Understand the organization's mission, learn about its programs, read its publications, visit its program sites, look at its website and talk to key staff and major donors. Find out about its reputation in the community.
- Review the organizational chart and understand the accountability structure of the organization. Find out the backgrounds of key management and understand the employee evaluation and compensation processes and due diligence procedures for material contracts entered into.
- Make sure there is a conflict of interests and code of ethics policy in place and that it is updated annually.
- Find out what committees the board has established and decide which (if any) to join. Make sure the committees appear to be sufficient (investment, budget, finance, audit, compensation, human resources, nominating, governance, etc.).
- Determine who the organization's auditors are, what their reputation is and what their performance of the audit process has been.
- Find out if materials to be considered by the board or its committees are distributed in advance of meetings and whether they provide sufficient information necessary to be part of the stewardship process. Find out how the meetings are structured; by consent agenda or other means.
- Obtain the current year's budget and cash flow projections. Find out how they compare to actual income and expenses and what processes are in place to monitor these comparisons.
- Find out whether the insurance coverage appears to be appropriate, including Directors and Officers' liability and employee fidelity insurance. The latter is particularly important - it is surprising how often embezzlement is discovered.

- Be sure to be able to devote the time expected of a board member. Understand any responsibilities for fundraising, personal giving commitments and other functions expected of board members. Learn what training (if any) is provided to the board. Joining a board without sufficient time to devote to its business is often at the root of troubles faced by many boards. A decision to decline an invitation to join a board because the invited individual is “over-extended” should be respected.

III. WHAT ARE THE DUTIES OF BOARDS OF DIRECTORS?

While the board is not usually involved in the day-to-day activities of the organization, it is responsible for managing the organization and must make decisions crucial to the life and direction of the organization, such as adding or removing board members, hiring and firing key officers and employees, engaging auditors and other professionals and authorizing significant financial transactions and new program initiatives. In carrying out those responsibilities, members of a board of directors must fulfill fiduciary duties to the organization and the public it serves. Those primary legal duties include the duties of *care*, *loyalty* and *obedience*. If the organization has affiliates or subsidiaries, the legal duty of impartiality, the duty of fairness to all the charitable interests, may also come into play.

A. *Duty of Care*

The *duty of care* requires a director to be familiar with the organization’s finances and activities and to participate regularly in its governance. In carrying out this duty, directors must act in “good faith” using the “degree of diligence, care and skill” which prudent people would use in similar positions and under similar circumstances. In exercising the duty of care, responsible board members should, among other things, do the following:

- Attend all board and committee meetings and actively participate in discussions and decision-making such as setting of policies. Carefully read the material prepared for board and committee meetings prior to the meetings and note any questions they raise. Allow time to meet without senior management present.
- Read the minutes of prior meetings and all reports provided, including financial statements and reports by employees. Make sure her or his votes against a particular proposal are completely and accurately recorded. Do not hesitate to suggest corrections, clarification and additions to the minutes or other formal documents.
- Make sure to get copies of the minutes of any missed committee or board meeting and read them timely, suggesting any changes that may be appropriate.
- Make sure there is a clear process for approval of major obligations such as fundraising, professional fees (including auditors), compensation arrangements and construction contracts.

- Make sure that board minutes reflect any dissenting votes in action taken by the board or that any dissenting vote is expressed in writing by letter to the board. Such records are necessary in order for a board member to disclaim responsibility for any particular decision. Absent board members must do this promptly in writing.
- Read any literature produced as part of the organization's programs.
- Make sure that monthly financial charts of accounts and financial reports prepared for management are available to the board or finance and audit committees, and that they are clear and communicate proper information for stewardship. Make sure there is an ongoing actual to budget comparison with discrepancies explained.
- Participate in risk assessment and strategic planning discussions for the future of the organization.
- Insure that the organization has addressed the sufficiency of its written internal financial controls and written policies that safeguard, promote and protect the organization's assets and that they are updated regularly. Obtain an employees, officers and directors fidelity bond to protect the organization from embezzlement. Have a policy regarding disclosure and identification of fraud (whether or not material). Make sure a policy for records retention and whistleblower protection is in place. Create a background check policy for prospective employees.
- Determine whether or not the organization indemnifies its officers and directors from liability and has directors' and officers' liability insurance. If it does, find out what is covered and what is not. If it does not, find out why.
- Encourage diversity among board members. Diversity will help insure a board committed to serve the organization's mission with a range of appropriate skills and interests.
- Be involved in the selection and periodic review of the performance of the organization's Chief Executive Officer, Chief Financial Officer and other key employees responsible for the day-to-day activities of the organization. The board is responsible for ascertaining whether these individuals have the appropriate education, skills and experience to assume a key position and then evaluating their performance.

B. Duty of Loyalty

The board should have a written "conflicts of interest" policy so that all members are aware of the type of transactions that may prohibit them from joining the board. Some such policies prohibit

board members from engaging in any transaction that may result in even the appearance of a conflict of interest. They should provide for written disclosure of anticipated or actual conflicts.

Directors are charged with the duty to act in the interest of the corporation. This duty of loyalty requires that any conflict of interest, real or possible, always be disclosed in advance of joining a board and when they arise. Board members should avoid transactions in which they or their family members benefit personally. If such transactions are unavoidable, disclose them fully and completely to the board.

In order to exercise this *duty of loyalty* directors must be careful to examine transactions that involve board members or officers. The board must not approve any transaction that is not fair and reasonable, and a conflicted board member may not participate in the board vote. There should be an established code of ethics in place that is updated annually as well.

Transactions involving conflicts should be fully documented in the board's minutes, and conflicts policies and disclosure statements should be discussed with the organization's auditors and attorneys.

C. Duty of Obedience

A board has a *duty of obedience* to insure that the organization complies with applicable laws and regulations and its internal governance documents and policies, including:

- Dedicating the organization's resources to its mission.
- Insuring that the organization carries out its purposes and does not engage in unauthorized activities.
- Complying with all appropriate laws, including registering with the Attorney General's Charities Bureau in New York State, complying with registration and reporting laws and other applicable laws of all states in which it conducts activities and/or solicits contributions, filing required financial reports with the Attorney General, the State Worker's Compensation Board, the State Department of Taxation and Finance and the Internal Revenue Service, paying all taxes such as Social Security, income tax withholding (federal, state and local) and any unrelated business income tax. Board members may be personally liable for failing to pay employees' wages and benefits and withholding taxes on employees' wages.
- Providing copies of its applications for tax-exempt status (IRS Form 1023), federal reports (IRS forms 990, 990 PF, 990 EZ) and its financial reports filed with the Attorney General's Charities Bureau to members of the public who request them.

IV. IDENTIFY, UNDERSTAND AND UPDATE THE ORGANIZATION'S MISSION AND INTERNAL POLICIES

Nonprofit organizations are created to achieve a specific purpose or purposes, such as making grants to operating charities, setting up a soup kitchen, teaching children to read, providing health care, supporting cultural institutions, preserving the environment, assisting senior citizens or one of the many thousands of other charitable activities conducted in our state and our country. Those purposes, or the mission of the organization, are described in the organization's certificate of incorporation and/or by-laws or other constituent document.

If an organization's purposes are not already clearly stated in one of its organizational documents, one of the first activities of the board should be to draft a clear statement of the organization's mission (which should correspond to its stated purpose to the IRS) and to ensure that everyone involved with the organization, directors and officers, employees, volunteers, fundraising professionals, and other professionals, is fully familiar with and understands the mission. Those individuals plan its future, conduct its programs, raise its funds, make it known to the public, present its financial records to regulatory agencies and others and give it professional advice. Unless they fully understand why the organization was formed and what it plans to accomplish, they will not be able to perform their respective tasks appropriately. The mission should be periodically re-assessed and evaluated and amended as needed.

Employees and volunteers should be aware of the organization's internal controls that impact their area of responsibility. At the time of adoption or revisions of internal controls, all directors, officers, employees and volunteers should be made aware of the organization's internal controls, given a copy of the policy and procedures manual, and trained to understand what is expected of them in carrying out their duties and in advising the organization's management and/or the board of directors of violations of the policy. New employees and volunteers should be trained before they assume their responsibilities.

Periodic review of an organization's structure, procedures and programs will assist board members in determining what is working well and what practices the organization might want to change in order to be more efficient, effective or responsible.

V. MONITOR FUNDRAISING CONDUCTED ON BEHALF OF THE ORGANIZATION

Many organizations contract with professionals to raise funds on their behalf. Since the fund raiser represents the organization to the public, the selection of a fund raising professional is extremely important. Establishing and following procedures for selection of a fund raising professional can avoid future problems. Such procedures should include:

- Obtaining bids from several fundraising professionals before entering into a contract. Services and fees differ, and comparing bids will aid in the selection of the best contractor for the organization.

- Checking with the Attorney General's Charities Bureau to see if the fundraising professional being considered are registered and have filed all required contracts and financial reports.
- Asking the Charities Bureau for copies of the fundraising professional's contracts with other charities to determine the services performed for and the fees charged to those charities.
- Asking the fundraising professional for references. A reputable fund raising professionals should be happy to provide a potential client with the names, addresses and telephone numbers of some of its clients.
- Contacting some of the fundraising professional's other clients to see if those nonprofits were satisfied with the services received.
- Finding out whether the organization's fundraising contracts contain the clauses required by Article 7-A of the Executive Law.
- Reviewing all written solicitations and scripts used by the fund raising professional, making sure that solicitation material appropriately describes the organization and its activities, includes the name of the organization as registered with the Attorney General and advises potential contributors that they may obtain the organization's financial report from the organization itself or from the Attorney General.
- Requiring, as mandated by New York law, that the fundraising professional and any of its representatives ("professional solicitors") disclose the name of the specific professional solicitor and the employing fundraising professional and state that the solicitor is being paid to raise funds.

VI. MAKE USE OF AVAILABLE RESOURCES

In carrying out their responsibilities, board members should realize that they need not do it alone. There are many resources available to assist not-for-profit organizations in fulfilling their fiduciary duties. Following are some of those resources:¹

The Attorney General's Web site - <http://www.charitiesnys.com> - posts all forms and instructions for registration and annual filing with the Charities Bureau, links to other web sites that provide resources for not-for-profit boards and publications of interest to not-for-profit organizations.

If the material on the Attorney General's web site does not answer your particular question, you may make an inquiry to the Charities Bureau by phone or email.

¹ In addition to the resources listed in this booklet, many more resources are available on the Internet and in communities around the state. Inclusion of any particular entity should not be construed as an endorsement of that entity or the services it renders.

For questions about not-for-profit organizations, contact:

charities.bureau@ag.ny.gov or (212) 416-8401

For questions about fundraising professionals, contact:

charities.fundraising@ag.ny.gov or (518) 486-9797

Other Helpful Web Sites - links to other helpful web sites are posted on the Attorney General's web site:

www.charitiesnys.com

NOT-FOR-PROFIT GOVERNANCE RESOURCES

I. BOOKS AND TREATISES:

- ABA Coordinating Committee on Nonprofit Governance, *Guide to Nonprofit Corporate Governance in the Wake of Sarbanes-Oxley* (2006)
- ABA Committee on Nonprofit Corporations, *Guidebook for Directors of Nonprofit Corporations* (2005)
- BoardSource, *Accountability: The Buck Stops Here* (2002)
- BoardSource, *Exceptional Board Practices: The Source in Action* (2007)
- BoardSource, *The Source: Twelve Principles of Governance That Power Exceptional Boards* (2005)
- Putnam Barber (ed.), *Accountability: A Challenge for Charities and Fundraisers: New Directions for Philanthropic Fundraising* (Jossey-Bass) (2002)
- Stephen R. Block, *Why Nonprofits Fail: Overcoming Founder's Syndrome, Fundphobia, and Other Obstacles to Success* (2003)
- Victoria B. Bjorklund, et al., *New York Nonprofit Law and Practice: With Tax Analysis*, (2d ed. 2007)
- James J. Fishman & Stephen Schwarz, *Nonprofit Organizations: Cases and Materials and Supplements* (3d ed. 2006; 2007 Supplement)
- Marion R. Fremont-Smith, *Governing Nonprofit Organizations: Federal and State Law and Regulation* (2004)
- Kay Sprinkel Grace, *The Ultimate Board Member's Book: A 1-Hour Guide to Understanding and Fulfilling Your Role and Responsibilities* (2003)
- Bruce R. Hopkins, *The Law of Intermediate Sanctions: A Guide for Nonprofits* (2003)
- Bruce R. Hopkins, *The Law of Tax-Exempt Organizations, and Supplements* (9th ed. 2007; 2008 Supplement)
- Bruce R. Hopkins, *Legal Responsibilities of Nonprofit Boards* (2003)
- Bruce R. Hopkins and Virginia C. Gross, *Nonprofit Organizations Governance: Law, Practices and Trends* (2009)

- Sondra Z. Koff, *Citizen Participation in Non-Profit Governance* (2009)
- Peggy M. Jackson, *Sarbanes-Oxley for Nonprofit Boards: A New Governance Paradigm* (2006)
- Peggy M. Jackson, Toni E. Fogarty, *Sarbanes-Oxley and Nonprofit Management: Skills, Techniques, and Methods* (2006)
- Pamela A. Mann, Practising Law Institute, *Advising Nonprofit Organizations* (2009)
- National Association of Corporate Directors, *2007 NACD Not-For-Profit Governance Survey* (2007)
- Nonprofit Risk Management Center, *State Liability Law for Charitable Organizations and Volunteers* (updated 2005; New Jersey section updated January 2006)
- Howard Leoner Oleck and Martha E. Stewart, *Nonprofit Corporations, Organizations, and Associations*, (6th ed., 1994; 1998/1999 Cumulative Supplement) (1956)
- George W. Overton & Jeannie Carmedelle Frey (eds.), *Guidebook for Directors of Nonprofit Corporations* (2d ed. 2002) (1993)
- Lisa A. Runquist, *The ABCs of Nonprofits* (2006)
- Warren Ruppel, *Not-for Profit Audit Committee Best Practices* (2005)
- Jack B. Siegel, *A Desktop Guide for Nonprofit Directors, Officers, and Advisors: Avoiding Trouble While Doing Good* (2006)
- Norman Silber, *A Corporate Form of Freedom: The Emergence of the Modern Nonprofit Sector* (2001)
- John E. Tropman and Thomas J. Harvey, *Nonprofit Governance: The Why, What and How of Nonprofit Boardship* (2009)

II. STATUTES:

- CSC, *New York Laws Governing Business Entities* (Fall 2007 Edition)
- Michael Hone, *Revised Model Nonprofit Corporation Act: Official Text with Official Comments and Statutory Cross-References* (1988; ABA edition revised through June 2005)
- White, *New York Business Entities* (14th ed. 2005) (1963)

III. ARTICLES, PAMPHLETS AND REPORTS

- Tom Baldwin, Getty Boss Bows Out Amid Row Over Cars, Holidays, and First-Class Flights, *Times (UK)*, February 11, 2006, at 43
- Bill Birchard, *Nonprofits by the Numbers*, *CFO Magazine*, July 1, 2005, at 8
- Honorable Charles A. Bowsher, et al., *A Report to the Board of Regents of the Smithsonian Institution*, (June 2007) available at <http://smithsonianirc.org/>. (The Independent Review Committee was formed in March 2007 by the Regents of the Smithsonian Institution to conduct an independent review of the Secretary of the Smithsonian's compensation and expenses and related governance issues. The forementioned website includes links to the Committee's report and exhibits, which were publicly released on June 20, 2007)
- David Crary, *Red Cross Announces Management Overhaul*, *Wash. Post*, October 31, 2006
- James D. DeWitt, *A Legal Handbook for Nonprofit Corporation Volunteers: Or What to Do Before the Lawyers Come* (2004)
- Angela Dickens & Catherine Oetgen, *How Much is too Much? Participation in Political Activities by Nonprofits*, *The Nonprofit Times*, Vol. 21 Number 20, October 15, 2007.
- Alnoor Ebrahim, *Placing the Normative Logics of Accountability in Thick Perspective*, (Hauser Center for Nonprofit Organizations, Working Paper No. 33.2, 2006)
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- Marion R. Fremont-Smith, *Attorney General Oversight of Charities*, (Hauser Center for Nonprofit Organizations, Working Paper No. 41, 2007)
- Marion R. Fremont-Smith, *The Search for Greater Accountability of Nonprofit Organizations: Recent Legal Developments and Proposals for Change*, (Hauser Center for Nonprofit Organizations, Working Paper No. 33.8, updated March 2007)
- Marion R. Fremont-Smith & Andras Kosaras, *Wrongdoing by Officers and Directors of Charities: A Survey of Press Reports 1995-2002*, (Hauser Center for Nonprofit Organizations, Working Paper No. 20, 2003)

- Peter Frumkin & Elizabeth K. Keating, *The Price of Doing Good: Executive Compensation in Nonprofit Organizations*, (Hauser Center for Nonprofit Organizations, Working Paper No. 8, 2001)
- Iris J. Goodwin, Donor Standing to Enforce Charitable Gifts: Civil Society vs. Donor Empowerment, 58 Vand. L. Rev. 1093 (2005)
- Janet Greenlee, et al., *An Investigation of Fraud in Nonprofit Organizations: Occurrences and Deterrents*, (Hauser Center for Nonprofit Organizations, Working Paper No. 35, 2006)
- James V. Grimaldi, *Smithsonian Head's Expenses "Lavish", Audit Says*, Wash. Post, February 25, 2007
- Elizabeth M. Guggenheimer, *Fiduciary Duties of Directors and Officers of Not-for-Profit Organizations: An Overview for Volunteer Attorneys* (Lawyers Alliance of New York 2000)
- Brennen Jensen, Citing Conflict with the Board, the Head of the NAACP Steps Down, *The Chronicle of Philanthropy*, March 22, 2007
- Harold L. Kaplan, et al., The "Charitable Trust" Doctrine: Lessons and Aftermath of Banner Health, 23-4 Am. Bankr. Inst. J. 28 (2004)
- Elizabeth K. Keating, *Is it Time to Address Selective Disclosure for Nonprofit Organizations?*, (Hauser Center for Nonprofit Organizations, Working Paper No. 33.7, 2006)
- Elizabeth K. Keating, et al., *Assessing Financial Vulnerability in the Nonprofit Sector*, (Hauser Center for Nonprofit Organizations, Working Paper No. 27, 2005)
- Elizabeth K. Keating & Peter Frumkin, *Reengineering Nonprofit Financial Accountability: Toward a More Reliable Foundation for Regulation*, (Hauser Center for Nonprofit Organizations, Working Paper No. 4, 2000)
- Lawyers Alliance for New York, *Serving on the Board of a Not-For-Profit Corporation: A Layperson's Guide* (1993)
- Lawyers Alliance for New York, *The Volunteer Workforce: Legal Issues and Best Practices for Nonprofits* (2007)
- Denise Ping Lee, The Business Judgment Rule: Should It Protect Nonprofit Directors?, 103 Colum. L. Rev. 925 (2003)

- Herman B. Leonard, *Should Mission Statements Be Promises? (And Should they have to be?)*, (Hauser Center for Nonprofit Organizations, Working Paper No. 33.5, 2006)
- Christine W. Letts, *Effective Foundation Boards: The Importance of Roles*, (Hauser Center for Nonprofit Organizations, Working Paper No. 26, 2005)
- Pamela A. Mann, Practising Law Institute, *Principles of Nonprofit Governance* (2009)
- Mark H. Moore & William P. Ryan, *A Framework for Analyzing Nonprofit Governance and Accountability Policies and Strategies*, (Hauser Center for Nonprofit Organizations, Working Paper No. 33.3, 2006)
- Marcus S. Owens, Caplin & Drysdale, Chartered, *Charity Oversight: An Alternative Approach*, (Hauser Center for Nonprofit Organizations, Working Paper No. 33.4, 2006)
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- James G. Wiehl, Roles and Responsibilities of Nonprofit Health Care Board Members in the Post-Enron Era, 25 J. Legal Med. 411 (2004)

IV. WEBSITES:

- Principles for Good Governance and Ethical Practice: A Guide for Charities and Foundations by the Panel on the Nonprofit Sector: <http://www.nonprofitpanel.org/Report/index.html>
- Alliance for Nonprofit Management: <http://www.allianceonline.org>
- CompassPoint Nonprofit Services: <http://www.compasspoint.org>
- BoardSource, Inc: <http://www.boardsource.org>
- Pro Bono Net: <http://www.probono.net/ny/nonprofit/>
- The Chronicle of Philanthropy: <http://www.philanthropy.com>
- The Center for Civil Society Studies: <http://www.ccss.jhu.edu>
- Contributions Magazine: <http://www.contributionsmagazine.com>
- New York Council of Nonprofits: <http://www.ccsnys.org>

- Council on Foundations: <http://www.cof.org>
- The Foundation Center: <http://fdncenter.org>
- GuideStar: <http://www.guidestar.org>
- The Hauser Center for Nonprofit Organizations:
<http://www.hks.harvard.edu/hauser>
- Independent Sector: <http://www.independentsector.org>
- The Internal Revenue Service (exempt organizations):
<http://www.irs.gov/charities/index.html>
- Idealist.Org: <http://www.idealists.org>
- Lawyers Alliance of New York: <http://www.lany.org>
- NASCOnet.org: <http://www.nasconet.org>
- The National Center on Philanthropy and the Law: <http://www1.law.nyu.edu/ncpl>
- New York Foundation: <http://www.nyf.org>
- New York Lawyers for the Public Interest: <http://nylpi.org>
- Nonprofit and Public Management Center: <http://www.nonprofit.umich.edu>
- The Nonprofit Times: <http://www.nptimes.com>
- The Pro Bono Partnership: <http://www.probonopartner.org>
- Support Center for Nonprofit Management: <http://www.supportcenteronline.org>
- Volunteer Consulting Group: <http://www.boardnetusa.org/public/home.asp>

Not-For-Profit Practice Group

May 2013

Mark Hoenig, Co-Chair
Partner, Tax

Joseph T. Verdesca, Co-Chair
Partner, Corporate

Vernon S. Broderick
Partner, Litigation/Regulatory

Matthew D. Bloch
Partner, Corporate

Miriam Buhl
Pro Bono Counsel

Blaire Cahn,
Associate, Business Finance & Restructuring

Debra A. Dandeneau
Partner, Business Finance & Restructuring

Jessica Diab,
Associate, Business Finance & Restructuring

Nick Flynn
Associate, Corporate

Rebecca Grapsas
Associate, Corporate

Holly J. Gregory
Partner, Corporate Governance

Johanna Markson
Pro Bono Administrator

Barbara Nichols
Pro Bono Administrator

Reid Powell
Associate, Corporate

Steven A. Reiss
Partner, Litigation/Regulatory

Aabha Sharma
Associate, Corporate

Jeffrey E. Tabak
Partner, Corporate