
Introduction

Who Should Read This Guidebook?

This *Guidebook* was prepared to aid directors of a nonprofit corporation in performing their duties.¹ It is written for anyone presently serving as such a director, as well as anyone contemplating such service.

There are a wide variety of nonprofit corporations: Art museums, health care providers, social clubs, trade associations, foundations, and homeowners' associations, just to name a few, and this *Guidebook* is written for the directors of all of them. You may ask how this *Guidebook* can address the needs of directors of all nonprofit corporations, given the vast range of nonprofit activities. Despite their variety of purposes, nonprofit corporations have many things in common. For instance, most nonprofit corporations are organized and maintained pursuant to a single state statute, and are managed by a single governing board. Although the size of the resources managed by nonprofit boards varies widely, their fundamental responsibilities are the same.

The rights and duties of directors of nonprofit corporations are in many respects similar to those imposed on directors of for-profit or business corporations. In a large number of states, the statute governing nonprofit corporations has been modeled at least to some degree on the statute governing business corporations. Further, the legal analysis of many corporate governance issues in the nonprofit context often draws on the lessons learned from the law applied to business corporations. A new or prospective director of a nonprofit corporation who is familiar with the working of business corporation boards is therefore likely to feel comfortable that he or she understands the basic requirements of this new role. Still, nonprofit directors need to be aware that, because of the unique nature of nonprofit organizations, in some circumstances both state and federal law may impose additional or

different duties on directors of these organizations—especially directors of tax-exempt corporations and corporations deemed to be public charities or public benefit corporations.

Nonprofits play an important and sometimes irreplaceable role, not only in this country, but throughout the world. The conduct of all nonprofit boards is important not only to their organizations, but also to the constituencies they serve. To help effectively direct these organizations, directors need two things: an informed understanding of their role and effective procedures for making decisions and taking action.

Directors of smaller nonprofit organizations may feel that some of the suggestions in this *Guidebook* only apply to larger entities with bigger staffs and greater resources. Although there are practical limitations imposed on directors of many nonprofits, consistency and regularity in board procedures typically found in established, well-managed corporations (whether for-profit or nonprofit) are not accidental. This *Guidebook* aims to help directors of all nonprofit corporations, big and small, to use their resources to greatest effect.

A Few Definitions

Nonprofit Corporation. A nonprofit corporation is an artificial creation of a government—usually a state. Corporations do not exist simply by mutual agreement of members or directors but come into being only by a specific act of a state or federal government and are kept in existence only by compliance with the regular requirements of that government.

Articles of Incorporation. As part of the creation of the corporation, the articles of incorporation are filed with the government. These articles are sometimes referred to as a charter, certificate of incorporation, or constitution. The *Guidebook* uses the term “articles of incorporation.”

Bylaws. The detailed rules of the corporation’s governance of the corporation, as adopted by the directors, are usually referred to as the bylaws but sometimes are labeled with other names, such as standing rules or constitution. The *Guidebook* uses the term “bylaws.”

Board of Directors. Every nonprofit corporation statute provides for a board of directors; however, in a given corporation, the name of this body varies with the history, tradition—and whim—of the organization involved. It may be called a board of trustees, a board of overseers, a governing committee, or any one of a dozen other names.² This *Guidebook* will use the terms the “board of directors” or “board,” and refers to the board’s members also as “directors.” Throughout this *Guidebook*, the term “director” is used to denote

a member of the governing body of a nonprofit corporation. Any other type of director will be qualified in the text.

Officers. There is similar variety in the titles of officers. The individual who is responsible for overseeing the day-to-day operations of the corporation may be referred to as the president, CEO, executive director, executive officer, or other title. In this *Guidebook*, the term “chief executive” is used to describe the principal executive officer of the corporation, and “chair” to describe the individual who presides over the board of directors.

Members. In the nonprofit world, the term “member” may refer to an individual or entity having the power to elect one or more of the corporation’s directors and having other voting rights that are similar to, or even greater than, those of a stockholder of a business corporation. On the other hand, a nonprofit corporation may use the term “members” for supporters who have no voting rights, with the term member being mostly an acknowledgement of such support, used by a charitable corporation to express appreciation (and sometimes offer special benefits or discounts) to its donors. Although numerous nonprofit corporations have different categories of members, with differing rights and powers, many nonprofit corporations have no members at all. In some organizations, the term “delegate” identifies individuals, such as persons participating in conventions or other representative assemblies, who may have some of the attributes of members but whose rights may be limited to the context of a specific assembly or gathering.³ In this *Guidebook*, the term “member” is used only to refer to a person or entity with rights to vote for directors.

Focus of this Guidebook. This *Guidebook* deals only with nonprofit entities that are organized as corporations. Other nonprofit entities, such as unincorporated associations, charitable trusts, or limited liability companies are outside the scope of this book.⁴

Legal Requirements versus Good Corporate Practice

Throughout this *Guidebook*, we seek to answer two principal questions:

- What does the law require?
- What is good corporate practice, as shaped by the needs of the particular corporation involved and the practical limitations of the director’s service?

Neither of these questions has a simple answer. Much of the law concerning a director’s responsibility is derived from practices in business corporations where the accountability of a director may differ from that arising in a nonprofit

context. What constitutes good corporate practice also will vary with the nature and resources of the corporation, its purposes, and the nature of its exposures. The practical expectations of nonprofit directors are shaped in part by the needs and resources of each corporation involved. Nonetheless, there are significant areas of common ground that apply to all nonprofit corporation directors.

The Law's Commands

In writing for directors we must first, as lawyers, alert our readers to the commands and prohibitions imposed by the law. All legal systems necessarily deal with minimum requirements of behavior: “You must do at least X” or “No matter what the circumstances, you must not do Y.” This *Guidebook* indicates legal requirements by the use of imperative verbs such as *must*, *must not*, *shall*, *shall not*, *is required to*, and the like.

Our statements of the law's commands are sometimes a summary of a specific statute or regulation—such as the Internal Revenue Code and the related regulations—and sometimes a reference to the body of judge-made law concerning corporations. The Model Nonprofit Corporation Act, Third Edition (Model Act) is used in this *Guidebook* as the prototype or presumptive guide to issues of statutory corporate law.⁵ Still, directors should be aware that state statutes and legal precedent applicable to specific nonprofit corporations may differ from the Model Act in various respects.

Good Corporate Practice

Equally important is the *Guidebook's* advice—based on experiences of lawyers for nonprofit corporations—outlining what a director should, is expected to, may, or should not do.

The *Guidebook's* statements as to what a director *should* do reflect: (a) policies underlying legal requirements; and (b) general standards of corporate management evolved from the experience of both business and nonprofit corporations.

With respect to good corporate practice, this *Guidebook* describes in part what a director is generally expected to do today and in part what a director may be expected to do in the future. Good corporate practice also describes

the behavior dedicated directors will want to see from their fellow directors, and hence from themselves.

Limitations of Time vs. the Corporation's Needs

The most important practical limitation on a director's service is time. Each individual director should determine how much time he or she can devote to the corporation's affairs. The board of directors as a whole should organize its affairs on a shared assumption as to the time all directors can give. Given that most directors are chosen on the basis of their experiences and activities, director time constraints are an ever-present issue. The board needs to determine how much time directors should spend to appropriately carry out their duties, and make sure that each director is willing and able to do so.

In many of the areas examined in this *Guidebook*, there are no ready-made answers to the conflict of needs versus resources; it will be up to the directors to evaluate how to mediate between these conflicts, and to reassess these decisions periodically in the light of current circumstances. Directors need to be aware of changes in the legal and business climate that affect their corporation, and that may change the determination of what is "enough" time to fulfill their individual duties to the corporation and their fellow board members.

The Organization of This Guidebook

This *Guidebook* is organized as follows:

Chapters 1 through 3 discuss matters of concern to all directors of all corporations: how a board works, the directors' rights and duties, and the functions of committees, advisory bodies, and officers.

Chapter 4, on taxation, surveys tax-exemption issues, an area of concern for most nonprofit corporations and their directors.

Chapter 5 discusses the tax-exemption issues that arise when tax-exempt nonprofit organizations create for-profit subsidiaries or contemplate joint ventures with for-profit entities.

Chapter 6 discusses a host of potential legal issues that may be relevant to a nonprofit organization's Internet activities.

Chapters 7 and 8 discuss legal issues relating to use of a nonprofit corporation's human resources, and suggest standards and procedures for the effective use of volunteers and employees.

Chapter 9 notes some of the general legal issues that arise in fundamental change events, such as mergers, sales, and bankruptcy.

Chapter 10 discusses issues relating to the investment of institutional funds and expenditures from endowment funds.

Chapter 11 covers issues relating to insurance and other liability protection for nonprofit corporation directors.

Chapter 12 offers suggestions on the steps that a nonprofit's directors can take to understand the legal environment in which the organization operates, and on how to select and use legal counsel.

Chapter 13 discusses best practices for orientation of new board members, and ways to revitalize existing board members and the board as a whole.

At the end of each chapter, the reader will find questions that we suggest each individual director review concerning the issues relevant to the subject matter of the chapter. Following the questions in each chapter is a checklist that board members may find helpful to review in light of their organization's specific circumstances.

Endnotes

1. This *Guidebook* is the work of the Committee on Nonprofit Organizations of the Business Law Section of the American Bar Association (ABA).
2. The Model Nonprofit Corporation Act, Third Edition (Model Act) and most state laws specifically reject the trust law standard for the conduct of nonprofit directors. See Model Act § 8.30(e). Thus, the use of the term "trustee" does not connote duties different from or additional to those of a director. In some states and in certain circumstances, however, nonprofit directors may be considered trustees of charitable assets and thereby subject to duties beyond those generally applicable to nonprofit directors. See *Chapter 2, "Duties and Rights of Nonprofit Corporation Directors."*
3. See, e.g., Colorado Revised Nonprofit Corporation Act, COLO. REV. STAT. § 7-121-401(1); Indiana Nonprofit Corporation Act, Ind. Code §§ 23-17-2-8 and 23-17-9-1.
4. For a discussion regarding other types of nonprofit entities, see Lisa A. Runquist, *The ABCs of Nonprofits* (American Bar Association 2005).
5. The Model Act was approved by the Committee on Nonprofit Organizations of the Business Law Section of the ABA in 2008. It was published by the Business Law Section of the ABA in 2009.