DUTIES OF DIRECTORS

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As a director, you are subject to three primary obligations – a duty of obedience, a duty of care and a duty of loyalty. The duty of obedience requires that directors be faithful to the purpose of the organization. The duty of care requires directors to participate in decisions of the Board in an informed manner. The duty of loyalty requires that directors exercise their powers in the interest of the organization and not in their own interest or the interest of another entity or person.

Duty of Obedience

The duty of obedience requires that directors be faithful to the purposes and goals of the organization.

This duty of obedience arises from the fact that, unlike for profit corporations that exist solely to make money, nonprofit corporations are defined by their specific objectives; an organization's purpose is its reason for existence. Also, nonprofit corporations have made representations to various governmental agencies (such as the Internal Revenue Service and state departments of revenue) about its purposes and activities in order to obtain tax exemption and other benefits.

Directors have a duty to follow the organization's governing documents to carry out the organization's mission and to ensure that funds are used for lawful purposes. Although board members may exercise their own reasonable judgment concerning how the organization should best meet its mission, they are not permitted to act in a way that is inconsistent with the central goals of the organization.

Duty of Care

Generally, the duty of care requires directors:

- to be reasonably informed,
- to participate in decisions, and
- to do so in good faith and with the care of an ordinarily prudent person in similar situations.

The duty of care is a duty to decide in the best interests of the organization. It is a duty which requires directors to be diligent in getting reliable information before deciding.

To be careful, however, does not mean that directors must avoid making decisions which have risk. Courts will not second-guess a board's decision made prudently and in good faith. This is the so called "Business Judgment Rule[1]." The potential for director liability is minimal when decisions are based on adequate investigation and are made in the best interests of the organization.

It is always possible that a board will make a poor decision, but poor decisions are not necessarily an indication of a breach of the duty of care. So long as the decision is based upon facts and reliable opinions and is made in good faith, the board has obeyed its duty of care. Of course, a director may rely on information and reports from sources that the director reasonably regards as trustworthy such as the organization's officers, staff, legal counsel, accountants, etc.

Board decisions are not held to a standard of perfection. That is, directors need not choose the best possible course of action as revealed by hindsight. They must, however, act in good faith in light of relevant facts and information.

[1] The Business Judgment Rule is a common law doctrine that provides that even when a corporate action has proven to be unwise or unsuccessful, a director will be protected from liability arising therefrom if he/she acted in good faith and in a manner reasonably believed to be in the best interest of the corporation and with independent and informed judgment. In other words, a court will not second guess the reasonable, informed and good faith decisions of the board.

Duty of Loyalty

The duty of loyalty primarily relates to conflicts of interest, corporate opportunities and confidentiality.

Conflicts of Interest

The duty of loyalty is closely related to a director's duty of care. The duty of loyalty requires directors to act in the best interests of the organization, not their own or that of another organization.

Although directors of the organization may have interests in conflict with those of the organization, conflicts of interest are not inherently illegal nor are they to be regarded as a reflection on the integrity of the Board or the director. It is the manner in which conflicts of interest are dealt with that determines the propriety of the transaction.

The concept of "conflict of interest" covers a wide range of situations where an individual's personal interests (or his or her duty to another organization) conflicts with his or her official responsibilities to the organization. This type of "interest" may, for instance, be related to financial gain, professional advancement or promotion, commitments to third parties, or duties to other organizations.

A conflict of interest can occur when, in connection with some issue or matter:

- a person owes a duty of loyalty in such matter to act in the interests of a person or organization; and
- at the same time, the person has a personal interest in the matter or owes a duty of loyalty to act in the matter in the interests of a different person or organization.

A director should be sensitive to any interest he/she may have in a decision to be made by the board and, as far as possible, recognize such interest prior to the discussion of or action on such a matter. When a director has an interest in a transaction being considered by the board, he/she should disclose the conflict before the board takes action on the matter. Upon disclosure by the director, the board should provide for a review and, where appropriate, an approval of the matter by the disinterested directors.

If, however, the interested director has a conflict of interest that has not been disclosed or the transaction is not approved by the disinterested directors, the interested directors will have the burden of proving that the transaction was fair to the corporation (i.e., the director will not have the protection of the Business Judgment Rule). Although this seems like an easy burden to meet, it can be extremely difficult in hindsight, especially if circumstances have changed dramatically between the time of the transaction and the time of the review.

An organization will often enter into transactions with another corporation that share a common director(s). When possible, the common director(s), after having disclosed all pertinent information known to them, should avoid personal participation in approving the transaction and leave the review and approval of the transaction to the disinterested directors.

Corporate Opportunity

A corporate opportunity is a prospect, idea or investment that is related to the activities or programs of the organization that the director knows, or should know, may be of interest to the organization. A director may take advantage of a corporate opportunity independently of the organization only after it has been offered to, and rejected by, the organization. Thus, before a director engages in a transaction which he/she reasonably should know may be of interest to the organization, the director should disclose the transaction to the board in sufficient detail and adequate time to enable the Board to act or decline to act with regard to the transaction.

Confidentiality

A director should deal in confidence with all matters involving the corporation until such time as there has been general public disclosure or unless the information is a matter of public record or common knowledge. This presumption of confidential treatment should apply to all current information about legitimate board or corporate activities.

The following information, while not an exhaustive list, should be considered confidential:

- information received from legal counsel;
- information related to pending or threatened litigation involving the Association that is not publicly available;

- information related to personnel decisions;
- information related to negotiations with a third party; and
- information related to the substance of discussions or comments made by during an executive session.

Whenever a Board member has any doubt about the confidentiality of a particular matter, the member should seek the guidance of the President or the Board before disclosing the information.