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Update: The Current State of Nonprofit Director Liability

Jaclyn A. Cherry*

I. INTRODUCTION

The nonprofit world is in a state of transition. The glut of organizations establishing themselves as nonprofit charitable entities has forced funders and the communities being served to reassess how these groups benefit society and just what privileges they should be afforded.¹ Board of Director scandals, both nationally and locally, have littered newspapers over the past decade, threatening “to undermine the trust and goodwill necessary for the nonprofit sector to function successfully.”² Yet, there remains a strong belief that the function these organizations perform is valid and extremely important to the business and moral fabric of the nation. In the United States, three traditions and concepts, the Judeo-Christian “tzedaka,” the Greek notion of philanthropy, and the notion of fiduciary responsibility, or “trustworthiness,” are strongly ingrained in the legal treatment afforded charitable organizations.³

A number of external variables are causing nonprofit

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¹ This article evaluates the role of directors serving IRC § 501(c)(3) organizations, although much of the discussion also pertains to the other 501(c) categories.


organizations to defend and redefine their role and purpose. These variables include competition from secular organizations operating as for-profits; mandates from funding agencies to merge, consolidate, or form consortiums to compete for limited resources; changing community expectations; and the ever-increasing demand on board members to be knowledgeable and accountable for their actions are but a few such variables.

This article examines the role and responsibilities of nonprofit directors in the nonprofit arena. It first reviews the current state of the law and standard of accountability among board members while acknowledging the need for more serious oversight by the agencies empowered to monitor these organizations. Although this article emphasizes the need for director accountability, it also examines the protections from liability that are afforded board members and considers whether these safeguards are sufficient to attract able persons.\(^4\) If directors, who are typically busy individuals acting in a volunteer capacity, are discouraged from serving on nonprofit boards because of a fear of growing exposure to liability, the nonprofit world will suffer and the community at large will encounter huge gaps in services once provided by organizations gone extinct because of a lack of commitment to serve on their boards.\(^5\)

II. ROLE AND RESPONSIBILITIES OF NONPROFIT DIRECTORS

The historical role and responsibilities of nonprofit directors has evolved in response to changes in the nature of modern nonprofit organizations. "A nonprofit organization is, in essence, an organization that is barred from distributing its net earnings, if any, to individuals who exercise control over it, such as members, officers, directors, or trustees."\(^6\) Institutions organized for charitable purposes can be traced back as far as the 1601 English Statute of Charitable Uses, although it is almost certain charitable

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6. Henry Hansmann, The Role of Nonprofit Enterprise, 89 Yale L.J. 837, 840 (1980). Note that this is the most widely accepted definition. See, for example, Fishman, The Developments of Nonprofit Corporation Law and an Agenda for Reform, 34 Emory L.J. 617-18 (1985).
organizations existed for centuries before.\(^7\) The Statute of Charitable Uses had two main objectives: the first was to reform the administration of trusts that were established for charitable purposes throughout the England countryside,\(^8\) the second, and that of primary historical significance, enumerated those purposes that were considered charitable and, therefore, within the jurisdiction of the commissions.\(^9\)

The favorable treatment afforded to charitable organizations in England was brought to the New World by the first settlers.\(^10\) In early Colonial American society, influential Protestant churches looked with favor on philanthropic activities, and charities persisted in the New World due largely to the churches.\(^11\) The various denominations "all shared the traditional Protestant emphasis upon the individual's responsibility for the spiritual material welfare of the community, and accordingly supported a variety of charitable institutions."\(^12\) The immediate need that inspired this benevolent behavior was the necessity for hospitals, churches, and schools.\(^13\)

The nonprofit corporation became the most prominent organizational form for charitable activities in the United States.\(^14\) The popularity of this corporate form has been attributed to "the special circumstances of the New World, the vagaries of historical

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7. 43 Eliz. Ch. 4 (1601), officially titled "An Act to Redress Misemployment of Lands, Goods and Stocks of Money Heretofore Given to Charitable Uses."


9. Id. The purposes set forth by the Statute are as follows: "relief for the aged, impotent and poor people, for maintenance of the sick and maimed soldiers and mariners, schools of learning, free schools and scholars in universities, for repair of bridges, ports, havens, causeways, churches, sea-banks, and highways, for education and preferment of orphans, for or towards relief, stock or maintenance for houses of correction, for marriages of poor maids, for supportation, aid and help of young tradesmen, handicraftsmen, and persons decayed, for relief or redemption of prisoners or captives, and for aid or ease of any poor inhabitants concerning payments of fifteens, setting out of soldiers and other taxes."

Preamble to the Statute of Charitable Uses.

10. Fishman, supra note 8, at 29, citing Howard S. Miller, The Legal Foundations of American Philanthropy 1776-1844 (1961). But see, Robert H. Bremener, American Philanthropy 5-18 (2ed. 1988), who suggests that the first philanthropists in the New world were not the first settlers, rather they were the Indians first encountered by Christopher Columbus, who, according to Columbus' reports were "ingenious and free" with all they had, gave anything away that was asked of them, and bestowed each gift "with as much love as if their hearts went with it."

11. Fishman, supra note 8, at 621-22.

12. Fishman, supra note 8, citing Miller, supra note 12, at 4-8.

13. Id.

14. Fishman, supra note 8, at 619.
scholarship, the rapid growth of the charitable sector and increasing similarities in size, structure, and management between charitable organizations and business corporations."  

From these early beginnings and definitions of charities within the communities they serve in today's sophisticated charitable nonprofit world, the role and responsibilities of board members have evolved. Today's board members face a myriad of issues that simply were not present during the early development of nonprofit law. Although courts have historically looked to trust law as the basis for defining director liability, most recently, the courts have begun to look to nonprofit corporate law.

Nonprofit directors act for the benefit of others and, therefore, have fiduciary duties that are defined by state corporate statutes and federal income tax law. State nonprofit corporate statutes generally define a board of director's duties as the duty of care, duty of loyalty, and duty of obedience. Internal Revenue Code § 501(c) specifically outlines directors' responsibilities in maintaining an organization as an exempt charitable organization.

The duty of care requires directors to discharge their duties "with the care an ordinarily prudent person in a like position would exercise under similar circumstances." In discharging these duties, nonprofit corporate directors may rely on information, opinions, reports, or statements of other board members, employees of the corporation, legal counsel, and committees of the board, as long as directors believe the source to be reliable and competent. A director may not rely blindly on others. However, "a director need not exhaustively research every issue personally to comply with the legal requisites." The obligation of directors to exercise due care

15. Id.
16. Nonprofit directors are also often constrained by state tax law, which includes requirements for tax exemption similar to Internal Revenue Code § 501(c)(3). Most state codes have provisions for exempting nonprofit corporations from income, sales and property tax. See, e.g. 72 P.S. § 5020-204; 10 P.S. § 371-75 (Supp. 1998).
17. Those states that do not have a separate nonprofit code section either follow the for profit law closely or the Revised Model Nonprofit Corporation Act. See Fishman, supra note 14.
18. See IRC § 501(c).
20. See id. § 8.30 (b)(1)-(4).
does not mean that the directors will incur liability for honest mistakes of judgment. The "business judgment" rule provides that decisions by boards about "business" matters are presumed to be correct. The rule provides complete protection from liability for business judgments as long as the judgment is rational and involves no conflicting interest and the director acts in a manner that he or she believes is reasonably informed.\textsuperscript{22}

"The duty of loyalty requires directors to exercise their powers in the interest of the corporation not in their own interest or in the interest of another entity or person."\textsuperscript{23} To satisfy the duty of loyalty, a nonprofit director must act in "good faith" and "in a manner the director reasonably believes to be in the best interests of the corporation."\textsuperscript{24} The duty of loyalty requires a director to be sensitive to potential conflict, to disclose the conflict before the board takes any action, and, upon disclosure, to have a disinterested board review the matter.\textsuperscript{25}

Directors are required to maintain confidentiality with respect to all matters involving the nonprofit corporation "until there has been a general public disclosure or unless the information is a matter of public record or common knowledge."\textsuperscript{26} Conflicts of interest and corporate opportunity matters also fall within the duty of loyalty. Directors must reveal to their fellow directors any conflicts of interest or potential conflicts of interest and are obligated to refer to the corporation business opportunities appropriate for the organization before they may use them for their personal benefit.\textsuperscript{27}

The Internal Revenue Code provides that a tax-exempt organization must be organized and operated so that "no part of [its] net earnings inures to the benefit of any private shareholder or individual."\textsuperscript{28} This prohibition against inurement means that a private individual should not receive organization funds except as reasonable compensation for goods or services.\textsuperscript{29} In addition, the organization cannot pay excessive compensation, pay for services


\textsuperscript{23} GUIDEBOOK FOR DIRECTORS OF NONPROFIT CORPORATIONS 28 (George W. Overton ed., 1993).

\textsuperscript{24} REV. MODEL NONPROFIT CORP. ACT § 8.30 (a) (1), (3).

\textsuperscript{25} Id. § 8131 (a)-(c).

\textsuperscript{26} Overton, supra note 23, at 32.

\textsuperscript{27} Id.

\textsuperscript{28} IRC § 501 (c)(3).

\textsuperscript{29} Id.
that are not provided, or provide free or below-market-price goods or services to private persons, other than members of the charitable class the organization serves.\textsuperscript{30} Proscribed private inurement involves transactions involving unreasonable compensation, unreasonable rental charges, and unreasonable borrowing arrangements.\textsuperscript{31}

The duty of obedience requires nonprofit boards to follow the organization's founding documents (i.e., corporate articles and bylaws) when taking any action and when spending funds donated to the corporation.\textsuperscript{32} A principal rationale for the duty of obedience is the reliance of donors on an organization's faithfulness to its purpose.\textsuperscript{33} The duty places limits on how an organization may modify its activities without invoking some representative of the public interest to step forward and defend the organization's mission.\textsuperscript{34}

\section*{III. Current State of the Law}

The board of directors of a nonprofit corporation is, as a body, responsible for the oversight of the corporation. Although individual directors have little authority in their personal capacities, they are legally accountable and have certain rights and obligations that flow from their office.\textsuperscript{36} Most corporations organized for the public benefit do not have members; therefore, the board of directors is typically the sole policy making authority and is self-perpetuating.\textsuperscript{35} Nonprofit directors and trustees are selected for reasons such as the following: they represent constituency groups; they have special skills or have access to sources of funding; they bring recognition through their prominence; or they represent the community or sources of support.\textsuperscript{37} Board members are elected to be responsive to those who elected or appointed them and to

\begin{itemize}
\item \textsuperscript{30} Id.
\item \textsuperscript{31} Id.
\item \textsuperscript{33} Daniel L Kurtz, Safeguarding the Mission: The Duties and Liabilities of Officers and Directors of Nonprofit Organizations, (726 AU-ABA 15, 1992, citing Trustees of Rutgers College v. Richman, et al., 125 A.2d 10, 26 (1956).
\item \textsuperscript{34} Id.
\item \textsuperscript{35} Id.
\item \textsuperscript{36} Attorney General v. Hahnemann Hospital, 494 N.E.2d 1011 (1986).
\item \textsuperscript{37} Rev. Model Nonprofit Corp. Act §8.01 (1987).
\end{itemize}
remain loyal and promote the organization itself.  

A basic function of the board is to select the organization's executives and oversee their performance.  

The model an organization adopts depends on the size and scope of the nonprofit's activities, its needs, its characteristics, and the board environment. Nonprofit boards translate this mandate in different ways. "Most of the problems that befall groups stem from the fact that boards have over the years, translated their [mandate] with as much variety as husbands and wives interpret their vows to love, honor and obey." 

Board decision-making processes are as varied as these in the organizations that make up the nonprofit sector. In reality, decisions are often made on the basis of incomplete information, under rushed circumstances, or on the basis of gut feelings rather than by following the formalized method of decisions set forth in the law. Some commentators believe that a board's most important decisions regard the content of its agenda; that is, "the decisions as to what it will tend to and how it will allocate the limited resources and time available." Usually the management rather than the board sets the agenda for board consideration; therefore, the board is often more reactive that initiatory. The larger the nonprofit organization, the more complex and diverse its activities will be and the less likely the board will become involved in a particular decision. Regardless of the size of a board, or the scope of its involvement, its responsibilities and liabilities remain the same.

A. The Internal Revenue Code

Board members are required to be faithful to the mandates of Section 501(c)(3) of the Internal Revenue Code, and can be found liable if the requirements of this code section are breached by an

38. Id.
41. Id.
43. Id.
44. Id.
organization under their direction.\textsuperscript{45} To qualify for exempt status under Section 501(c)(3), an organization must be organized as a nonprofit corporation or as a "community chest, fund, or foundation."\textsuperscript{46} An exempt organization must be organized and operated exclusively for religions, charitable, scientific, educational, or other code-designated purposes.\textsuperscript{47} No part of its "net earnings" may inure to the benefit of any private shareholder or individual.\textsuperscript{48} Moreover, "substantial part" of the organization's activities may consist of certain lobbying activities, and the organization may not participate or intervene in any political campaign on behalf of or in opposition to any candidate for public office.\textsuperscript{49} Board members are required to be vigilant so that the organization, in carrying out its mission, continues to meet these requirements.

In addition, Section 503 denies tax exemption to organizations that engage in specified "prohibited transactions."\textsuperscript{50} These transactions include the following: lending money without adequate security; paying excessive compensation; and providing services on a preferential basis to the creator of, or contributor to, the organization.\textsuperscript{51}

If a tax-exempt organization violates the prohibition on private inurement through self-dealing or any other of the requirements set forth above, the penalty is loss of its tax-exempt status.\textsuperscript{52} Some believe this penalizes the organization's patrons and donors more so than the self-dealers.\textsuperscript{53} In some cases, self-dealing may also raise questions as to whether the organization is being operated exclusively for Section 501(c)(3) purposes.\textsuperscript{54}

In an effort to deal more directly with wrongdoers and in response to the extreme penalty of revocation of tax-exempt status, the Internal Revenue Service initiated "intermediate sanctions" as a remedy for situations in which "disqualified persons" engage in an

\begin{footnotesize}
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\item \textsuperscript{45} IRC §501(c)(3); see also Treas. Regs. §§1.501(c)(3)-1(a), (b), (c) (1964).
\item \textsuperscript{46} Id.
\item \textsuperscript{47} Id.
\item \textsuperscript{48} Id.
\item \textsuperscript{49} Id., see also Bruce R. Hopkins, \textsc{The Law of Tax-Exempt Organizations} (6th Ed. 1992).
\item \textsuperscript{50} See IRS §503(b) (1988).
\item \textsuperscript{51} See Id.
\item \textsuperscript{52} See generally 1 Marilyn G. Phelan, \textsc{Nonprofit Enterprises: Law and Taxation} §11A:02 (1985 & Supp. 1992) (analyzing forms of impermissible private inurement).
\item \textsuperscript{53} See Henry B. Hansmann, \textsc{The Role of Nonprofit Enterprise}, 89 \textsc{Yale L.S.} 835, 874 (1980). Hansmann, \textit{supra} note 6, at 874
\item \textsuperscript{54} Id.
\end{itemize}
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"excess benefit transaction" with a Section 501(c)(3) organization. These sanctions impose an initial excise tax of twenty-five percent on the amount of any "excess benefit" provided to an "insider", by a public charity. An additional excise tax of two hundred percent of the excess benefit is imposed when the transgression is not corrected within a certain period of time. Moreover, an additional excise tax of ten percent of the excess benefit may be imposed on any officer, director, trustee, or manager of an organization who agrees to the transaction, knowing it is an excess benefit. The determination of whether compensation is reasonable and whether the decision to give it was adequately considered is determined on the basis of all of the facts and circumstances. "Disqualified persons" are those who have substantial influence over the exempt organization. Such persons include officers and directors of the public charity and persons who have held positions of authority with the charity during the five years preceding the transaction. In an "excess benefit" transaction, the value of the economic benefit conferred exceeds the value of the consideration received. Potential excess benefit transactions include compensation decisions affecting officers, directors, and key employees and transactions involving the sale of property between a public charity and one of its managers or employees.

B. Case Law

The courts have been reluctant to uphold Internal Revenue Service decisions to revoke an organization's Section 501(c)(3) tax-exempt status or to impose this penalty themselves. Rather, courts have imposed other remedies or penalties, particularly against nonprofit boards of directors when they have breached

55. IRS § 4958, which became effective for transactions occurring after September 14, 1995.
56. Id.
57. Id.
58. Id.
59. Id.
60. IRC § 4958.
61. Id.
62. Some exceptions include, e.g., Founding Church of Scientology v. United States, 412 F.2d 1197, 1202 (Ct. Cl. 1969), cert. denied, 397 U.S. 1009 (1970) (Court denied tax exemption to a church that made unexplained payments in the form of salaries and rentals, to its founder); John Marshall Law Sch. v. United States, 1981-82 U.S. Tax Cas. (CCH) 9745 (Ct. Cl. 1981) (Court denied tax-exempt status to a law school due to violations of the non-inurement provision); Horace Heidt Found. v. United States, 170 F. Supp. 634, 638 (Ct. Cl. 1959) (Court denied tax exemption where an entertainer personally benefited from a foundation founded by him).
their fiduciary duties of care and loyalty.

In 1997, the New York State Board of Regents removed eighteen of the nineteen trustees of Adelphi University for dereliction of duty in overseeing the university and its president's actions.\(^{63}\) When Peter Diamandopoulous became president of the university in 1985, it had 7,000 students, an endowment of four million dollars, a decaying capital plant, and a declining student body. Although Diamandopoulous increased the endowment to forty-eight million dollars and renovated the campus, the student body declined to 4,300. The university's academic reputation also suffered.\(^{64}\) Diamandopoulous lost the support of all campus constituents except the trustees, most of whom he had appointed.\(^{65}\) In the fall of 1995, a report in the Chronicle of Higher Education revealed that Diamandopoulous was the nation's second highest paid college president and a Committee to Save Adelphi was formed and brought allegations to the New York Board of Regents.\(^{66}\) The committee accused the governing board and president of misappropriation of funds, conflicts of interest, and lavish expenditures by the president.\(^{67}\) The committee alleged the following reasons for the removal of the trustees: excessive compensation paid to the university's president; a failure to review the president's job performance; refusal to abide by the university's bylaws relating to faculty governance; board misconduct; and impermissible conflicts of interest.\(^{68}\) The board was not informed of the president's compensation and expenses (which reached $837,113 in 1995-1996 and included an option to purchase a university-owned luxury apartment in Manhattan, a rent-free home on campus, an $82,000 Mercedes-Benz automobile, and reimbursed expenses such as cognac at $150 a glass).\(^{69}\) After the Regents' decision, the matter was formally referred to New York's attorney general to proceed with a civil action.\(^{70}\)

In another fairly recent public scandal, criminal charges were brought against Aramony, the President of the United Way of

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63. The Committee to Save Adelphi v. Diamandopoulous, Board of Regents of the University of the State of New York (1997).

64. Id.

65. Id.


67. Id.

68. Id.

69. Id.

70. Id.
America, who resigned after allegations of self-dealing surfaced. Critics charged that he spent corporate funds lavishly and pledged corporate contracts to firms managed by friends and family members. The Board of Directors of the United Way of America was questioned for its dereliction of duties and the organization suffered some public relations setbacks, although no individual board member received any personal punishment.

The board was composed of thirty-seven high-profile chief executives of major corporations and met only twice a year. A fourteen-person executive committee met twice annually. A week or two before each meeting, board members received a one inch-thick booklet containing financial statements, favorable news clippings, upbeat committee reports and an agenda. This was the context of the board’s oversight.

In 1991, the President of the United States Olympic Committee, a federally chartered nonprofit organization, stepped down after reports indicated that he had received at least $127,000 in consulting fees from clients pursuing Olympic contracts. There again, the court did not punish the board of directors for not carrying out its fiduciary duties.

IV. BOARD OF DIRECTOR LIABILITY

A. Who Is Responsible for Oversight

The primary monitor of a nonprofit’s performance and that of its board of directors is the state in which the nonprofit incorporated, but the degree of state scrutiny varies widely across state lines and differs with the type of organization. Hospitals, health care providers, and educational institutions are heavily regulated. “Mutual benefit nonprofits and certain public charities are virtually

71. See Felicity Barringer, United Way Head is Forced Out in a Furor Over His Lavish Style, N.Y. TIMES, Feb. 28, 1998, at A1. In April, 1995, a federal judge found Aramony guilty of stealing more than $600,000 from the United Way and using the funds to support lavish personal expenses and international travel. See Tim Weiner, United Way's Ex-Chief Indicted in Theft, N.Y. TIMES, Sept. 14, 1994 at A12.

72. See Kathleen Teltsch, United Way Awaits Inquiry on its President’s Practices, N.Y. TIMES, Feb. 24, 1992 at A 12.

73. Id.

74. Felicity Barringer, Charity Boards Learn To Be Skeptical, N.Y. TIMES, Apr. 19, 1992 at §1, 10.

75. See Mark Asher & Christine Brennan, Helmick Quits as President of USOC, WASH. POST, Sept. 19, 1991, at B 1; Rachel Shuster & Mike Dodd, Helmick Dealings Raise Questions, USA Today, Sept. 5, 1991, at I C.

self-regulated." The state attorney general is responsible for overseeing nonprofit corporations and may initiate such actions as are appropriate to protect the public interest. Staffing problems and a lack of interest in monitoring nonprofits, however, make attorney general oversight more theoretical than actual. Most state offices of the attorney general lack even one full time lawyer charged with oversight of charitable organizations, and, because directors are essentially volunteers, aggressive attempts to enforce their responsibilities are viewed as inappropriate and likely to discourage others from serving on boards. In recent years, most attorneys general have focused on fundraising and solicitation abuses rather than breach of fiduciary obligations. The attorney general, as the representative of the stockholders and public, promotes accountability of charities and fiduciaries. Other than the attorney’s general, however, only individuals with special interests, such as directors, have standing to initiate legal actions against nonprofits and their boards.

B. What Is Actionable

Board members may be liable in three situations. First, board members may be liable for breach of their fiduciary duties of care, loyalty, and obedience, if as a result of such breach, the organization has been injured. Those fiduciary responsibilities may be enforced by the organization or by someone acting on its behalf, such as other directors, officers, or the state attorney general.

Second, board members may be liable in a third-party lawsuit; that is, if a person dealing with the organization suffers some personal or financial injury. Generally, board members enjoy immunity from liability to third persons arising from acts of agents or employees of the organization. However, individual directors may be liable if they participate in or authorize the action that leads to the harm. Typically, third-party claims arise in the area of tort liability as a result of injury to persons or property arising from wrongful conduct.

Although it is difficult and unlikely that a director will be found

77. Id. at 243.
78. Id.
79. Kurtz, supra note 21, at 93.
80. Fishman, supra note 8.
82. Fishman, supra note 76.
83. Id.
liable in a third-party action, defending such claims can be very expensive. Responding to concern about potential exposure to claims by volunteer nonprofit directors and escalating defense costs, a number of states have passed statutes concerning the liability of nonprofit directors. These tort reform measures are designed to shield uncompensated directors from liability to third persons for injuries to persons or property except in cases of gross negligence.

Third, directors may be liable if they violate the requirements of particular statutes. Directors enjoy no insulation from liability when the corporation is engaged in illegal or fraudulent activities. For example, sanctions may be imposed for the submission of false or inaccurate information filed in connection with regulatory and reporting schemes. The most notable example concerns tax laws under which directors may be held responsible for failure to collect or pay state sales and real estate taxes.

At present, forty-two states impose some form of registration, reporting, or bond requirements on charities that raise funds. Boards can be held liable for failure to follow these filing requirements. Substantial disputes are raging over how far a state can go in regulating this form of interstate commerce and political speech.

C. What Protection from Liability Is Available

Nonprofits can protect their directors from liability in certain situations through indemnification and insurance. State statutory law governs the scope of indemnification; in general, to qualify for indemnification, a director must have acted in good faith and in the best interest of the corporation. Indemnification provisions may also be included in an organization's bylaws.

Even with extensive indemnification provisions, insurance protection is usually necessary to provide broader coverage and protection for board members. Director and officer liability insurance ("D&O insurance") can relieve an organization from the burden of accumulating substantial funds to indemnify its board.

84. Id.
85. Id.
86. Overton, supra note 23 at 32.
87. See e.g., Hospital Utilization Project v. Commonwealth, 487 A.2d 1306 (Pa. 1985).
89. KURTZ, supra note 21.
90. Id.
members and can protect directors if the organization decides not to indemnify even when indemnification is permitted.\textsuperscript{91}

In an effort to offer consistent standards of protection in the area of tort liability, Congress enacted the Volunteer Protection Act in 1997.\textsuperscript{92} The act preempts state immunity laws, unless they provide greater protection, and grants immunity as long as a volunteer was involved in one of four delineated situations set forth in the statute.\textsuperscript{93}

In three recent decisions, the United States Supreme Court has limited the sanctions that state and local governments can impose on board members for failure to file charitable solicitation documents or for otherwise breaching their duties.\textsuperscript{94} Nonetheless, a great deal of uncertainty remains in this area. There is the potential for penalties to be imposed on the charity and perhaps its directors, regardless of any good intent behind the activity.

It is always within a board of director's best interest to put into place risk management procedures.\textsuperscript{95} The procedures usually involve steps to be undertaken by the directors to reduce the chance that the directors will cause injury to the organization or to third parties. Such procedures can involve board oversight, policies, and procedures in potential risk areas, prevention of unlawful conduct, avoidance of self-dealing, and board education.\textsuperscript{96}

V. HOW BOARD MEMBERS ARE HELD ACCOUNTABLE

Although the discharge of fiduciary responsibility rests with each individual board member and, although each board member can be held personally liable in the above-discussed areas, some types of governance structures, the promotion of particular types of behavior, and the fostering of certain habits of deliberation can foster the careful performance of the board's responsibilities.

\textsuperscript{91} Rev. Model Nonprofit Corp. Act § 8.52.
\textsuperscript{93} Id. Delineating the four situations for protection as: (1) acting within the scope of volunteer activity; (2) being properly licensed, if applicable; (3) harm did not occur because of willful misconduct, gross negligence, reckless misconduct or a conscious, outright indifference to the right or safety of the injured party; (4) the harm did not occur while the volunteer was operating a vehicle.
\textsuperscript{95} Ellen M. Burger, Esq., and Mary N. Wilke, Esq., Director Liability in Non-Profit Corporations. What is it? How to avoid it, 34 N.H.B.J. 57, 63-65 (1993).
\textsuperscript{96} Id.
Current director sanctions and punishments can also act as deterrents. The question remains whether these standards are sufficient to guarantee the future of charitable nonprofits and the legal and ethical performance of duties by boards of directors.

State nonprofit corporation statutes do not sufficiently deter directors from violating their fiduciary duties. The new federal “intermediate sanctions” offer an incentive for boards of directors to perform their duties lest they be fired and cause turmoil for the organization or be fined for dereliction of duty. Both state and federal approaches, however, lack sufficient enforcement mechanisms to discourage directors from breaching their fiduciary duties.

The enforcement of duties under state nonprofit corporate law depends mostly on private actions. In the for-profit corporate arena, or the business sector, “entrepreneurial attorneys” enforce fiduciary duties by seeking out profitable causes of action on behalf of the shareholders. Attorney driven litigation is not as effective in the nonprofit sector. One reason is that in the business sector, the public has relatively easy access to information about corporations. In contrast, nonprofit corporations do not issue publicly traded stock and are not subject to securities reporting provisions. This lack of information concerning nonprofit corporations means that a plaintiff must conduct his or her own investigation to bring suit. Moreover, because damages are paid to the corporation and the plaintiff's attorney, plaintiffs may have little incentive to bring a lawsuit. Thus, there are fewer actions against nonprofit directors who breach their fiduciary duties than there are against their for-profit counterparts.

It is also very difficult to deter improper nonprofit director conduct regarding the duties and responsibilities outlined in the

97. IRC § 4958
100. Id.
101. Id.
102. The Securities Act of 1933 specifically exempts charitable corporations satisfying requirements similar to those in IRC § 501(c)(3) from initial public offering registration requirements. These organizations are also exempt from the 1934 Act's registration requirements. See U.S.C. § 781(g)(2)(D) (1988).
Internal Revenue Code. Despite the recent changes to the structure of the Internal Revenue Service, the resources allocated to seeking out violations are limited.\(^{103}\) Many breaches of fiduciary duties go unchallenged or unnoticed. Aside from the ‘intermediate sanctions,’ which permit the Internal Revenue Service to fine directors in limited circumstances, the only other remedy is the denial or revocation of nonprofit status in the event of Section \(\S\) 501 (c)(3) violations.\(^{104}\)

VI. CONCLUSION

Nonprofit charitable organizations perform an important function in society and are, therefore, granted specific benefits. Nonprofit boards of directors can be held accountable in several ways, yet receive protection against liability in certain instances. If we are to hold board members to higher standards of conduct in keeping with the present state of the law then more resources must be made available by the states and federal government to monitor these actions and ensure accountability. In addition, we must be prepared for a decline in volunteerism, which would accompany stricter accountability.

It is to early to determine whether “intermediate sanctions” will be more regularly imposed by the Internal Revenue Service now that a division has been created specifically to handle this area and whether such sanctions will be an effective deterrent. The only way to ensure accountability is for the Internal Revenue Service to consistently follow through with its mandate. States could then follow suit and allot more resources toward this end and more diligently pursue wrongdoing by board members.

Such increased monitoring and imposition of sanctions, although designed to primarily benefit the nonprofits and the public will also benefit boards of directors. Board members could be assured that consistent measures are being followed and implemented and would feel more comfortable in the parameters of their role in serving nonprofits and the communities they benefit.

\(^{103}\) Specifically, the IRS now has a section which deals exclusively with Nonprofit Charitable Organizations.

\(^{104}\) See IRC \(\S\) 4958 which allows for fines to be levied against board members who knew of excessive payments to an executive director and to the executive director himself.