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Legal Basics for Nonprofit Management: Corporate Governance

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This presentation will cover:

1. Suggested good governance practices
2. A primer on the legal principles of nonprofit corporate governance

Principles covered will include:

- ▶ The sources of corporate rules
- ▶ The roles of members, board of directors, board committees, and officers
- ▶ The duties of directors
- ▶ How to deal with conflicts of interest
- ▶ Measures that will help reduce liability risks

Knowing the Rules: Primer

- ▶ Applicable Law (mainly California Corporations Code, but also Attorney General regulations, federal and state tax law and other laws).
- ▶ Articles of incorporation
- ▶ Bylaws
- ▶ Board resolutions, policy statements, committee charters

Knowing the Rules: Suggested Practices

1. Provide each director with a Director's Binder (or CD or password-protected website) that contains at least these source documents:
 - ▶ California Attorney General's GUIDE FOR CHARITIES (<http://ag.ca.gov/charities/publications.php>)
 - ▶ Articles of incorporation (with amendments)
 - ▶ Current bylaws
 - ▶ Important board resolutions, policy statements, committee charters
2. Provide training to directors at orientation and periodically thereafter.

Elements of Corporate Structure: Primer

- ▶ Some nonprofits are trusts, associations or LLCs, but most charities are public benefit corporations
- ▶ Hierarchy:
 - ▶ Members (if any)
 - ▶ Board of Directors and its committees
 - ▶ Officers
 - ▶ Employees and other agents

Elements of Corporate Structure: Suggested Practices

1. Be clear regarding whether “members” are *legal members* with voting, information and other rights, or merely supporters who receive “membership benefits.”
2. If there are legal members, observe legal and Bylaw provisions regarding scheduling and notice of annual and other meetings, election of directors, voting and proxies, removal of members, etc.
3. Observe legal and Bylaw provisions regarding scheduling and notice of board meetings.
4. Never refer to directors as “advisory” or “honorary.”

Elements of Corporate Structure: Suggested Practices

5. Do not nominate, elect or appoint the chief executive (executive director / president) to the board.
6. Have regular executive sessions.
7. Use committees for the heavy lifting. Have written committee charters, either in the bylaws or in separate board resolutions.
8. Be clear about whether “committees” have the authority to act for the board, or are merely advisory or auxiliary.

Duties of Directors: Primer

- ▶ Duty of care
- ▶ Duty of loyalty
- ▶ Duty of confidentiality
- ▶ Duty not to pay too much
- ▶ Duty not to intervene in political campaigns or engage in substantial lobbying

Duties of Directors: Primer

- ▶ Duty to observe gift restrictions
- ▶ Duty to maintain financial controls and to report
- ▶ Duty to comply with investment standards
- ▶ Duty not to misspend trust fund taxes

Duties of Directors: Suggested Practices

1. Maintain written records of board and committee proceedings, including for each meeting:
 - Notice given to directors
 - Minutes of meeting
 - Information packet provided to the board/committee.
2. Provide a written packet (agenda, draft minutes, reports, financials) to each director several days in advance of each meeting.
3. The board chair should follow fair and reasonable procedures for governing meetings. (Avoid Robert's Rules of Order, unless required by the bylaws; and then consider changing the bylaws.)
4. Adopt a clear policy regarding matters that should be board (or committee) decisions and matters that should be management decisions.

Duties of Directors: Suggested Practices

5. Have a board calendar providing for regularly scheduled agenda items (e.g., annual election of directors and officers) and periodic review of important issues or policies.
6. Consider: an independent auditor and an audit committee. These may be required by state law (\$2 million of revenues), federal contracts, grant conditions or the like.
7. Use term limits and an active nominating committee to ensure a regular turnover in board membership and a steady flow of new talent.
8. Do not rely on board members for legal, accounting or similar professional advice.

Duties of Directors: Suggested Practices

9. Ensure that the articles and/or bylaws provide for the broadest indemnity possible for directors (and possibly for officers and agents).
10. Procure and maintain insurance:
 - ▶ General liability insurance at least satisfying the requirements of Corp Code § 5239
 - ▶ Director and officer (“D&O”) liability insurance (highly desirable and not usually expensive)
 - ▶ Employment practices liability insurance (desirable where nonprofit has employees, often packaged with D&O policy).
 - ▶ Other insurance appropriate to the activities of the organization (e.g., malpractice, workers comp).

Duties of Directors: Suggested Practices

11. Do not compensate directors. (Note: If directors receive expense reimbursements, be sure the policy and payments are properly documented.)
12. Ensure that the organization uses an outside payroll service to *report and pay* payroll taxes. (If the organization collects sales taxes, ensure compliance through similar measures.)

Conflicts of Interest: Primer

- ▶ A conflict of interest is presented when one owing a duty of loyalty to the organization is in a position to decide, vote on or influence a matter in which the person has a financial or other interest.
- ▶ Conflicts of interest frequently arise at the board of directors level, because the board, by definition, should consist of experienced people with a broad network of contacts in the community.

Conflicts of Interest: Primer

▶ Common examples:

- Services: The organization is considering using the services of a law firm, accounting firm, brokerage firm, real estate broker, bank or other services firm that has a principal or employee on the board of the organization.
- Property: The organization is considering renting or buying real estate from an entity that has ties to a director.
- Goods: The organization may wish to procure office supplies, furniture, or other goods from an entity affiliated with a director.

Conflicts of Interest: Primer

- There is a correct legal procedure for addressing conflicts: Disclose, abstain, and act in good faith.
 - The fact of the director's personal or financial interest should be disclosed or known to the board of directors and noted in the minutes.
 - The board thereafter must authorize, approve, or ratify the contract or transaction in good faith by a vote sufficient for the purpose without counting the vote or votes of such financially interested member or members.
 - The contract or transaction must be just and reasonable as to the organization at the time it is authorized or approved.

Conflicts of Interest: Primer

- ▶ Some transactions are prohibited by law or penalized by the tax code, whether fair or not. Example: Loans to directors and officers are generally prohibited.
- ▶ Consider obtaining the prior approval of the Attorney General, or filing a notice with the A.G. (in order to start the 2-year statute of limitations).
- ▶ Ensure compliance with IRS rules for excess benefit transactions – e.g., independent valuation, written documentation supporting the decision.

Conflicts of Interest: Suggested Practices

1. Maintain a Conflict of Interest Policy.
2. Require board members to annually sign a certification of having read the Policy.
3. Provide board training.
4. Make sure the minutes reflect compliance with the legal standards.
5. Remember the “front page test.”
6. Seek legal counsel when difficult conflicts issues arise.

Legal Basics: Corporate Governance

Additional Resources:

- ▶ California Attorney General's Guide for Charities
(<http://ag.ca.gov/charities/publications.php>)
- ▶ Registrar of Charitable Trusts
(<http://www.ag.ca.gov/charities>)
- ▶ Nonprofit Support Center
(<http://www.supportcenter.org>)
- ▶ BoardSource (website and newsletter)
(<http://www.boardsource.org>)
- ▶ Mike Schley's blog:
(<https://www.slg1-law.com/nonprofits.aspx>)