

Building a Nonprofit Board of Directors: Legal and Strategic Issues

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Sources of Board Rules

- State corporate statutes – may be a separate nonprofit corporate code
- IRS rules for nonprofit organizations
- Articles of incorporation
- Bylaws
- Board policies

Who Are the Governance Players?

- Board of directors
- Board of directors vs. board of trustees
- Officers – must they be board members?
- Members
- Types of members and their roles

Role of the Board

- Set policy and direction of the nonprofit
- Monitor investments and finances
- Regular meetings
- Maintain minutes of meetings
- Review annual tax return (Form 990) and financial reports
- Familiarity with corporate documents and policies
- Familiarity with grants and programs

Who Appoints the Board

- Self-perpetuating model – board replaces itself
- Appointed by members
- *Ex officio* board members
- Classes of board members

Ancillary Boards

- Advisory board
- Honorary board members
- Board emeritus members
- Generally, no voting powers and don't count for quorum
- May attend meetings on invitation
- May receive board materials

Board Size

- Need to review state corporate statutes
- Generally no limit on board size (need one) – what do the bylaws provide
- Benefits to smaller boards
 - Easier to meet
 - Better informed
 - Efficiency
- Benefits to larger boards
 - More ideas
 - Diversity

Board Size (cont.)

- Fundraising capacity
- Spread the work

Terms and Term Limits

- Generally, state corporate statutes defer to the bylaws
- Some states set limits on length of board terms
- Life directors
- Arguments for term limits
 - New thinking
 - Give board members a graceful way to exit the board
 - Create room for new members
 - Prevent sense of “ownership” of the organization

Terms and Term Limits (cont.)

- Arguments against term limits
 - Hard to find board members
 - Lose good board members
 - Lose potential funding sources

Voting and Quorum

- Normally, one vote per board member
- Majority vote at a meeting where quorum is present
- Quorum – normally a majority of the board; can be lower, subject to state statute (e.g., one-third)
- Can require “supermajority” votes

Voting

- Voting by class
 - Can have different voting rights for different classes of directors
 - Can require approval of all classes of directors (veto)
 - Nonvoting class of directors

Voting (cont.)

- Reserved powers in member
 - Election of directors
 - Amendment of charter and bylaws
 - Extraordinary corporate actions (merger, dissolution, acquisitions)
 - Significant loans
 - Selection of auditor

Qualifications of Board Members

- Age (?)
- U.S. citizen (?)
- Skill sets
- DEI

Board Positions

- Chair, vice chair
- Are these officer positions?

Conflict of Interest

- Conflict of interest policy – process for resolving conflicts
- No economic benefit to director or family
- Corporate opportunity doctrine
- Conflicted director can participate in discussion to provide information, but recuses self from vote

Self-Dealing (Private Foundations)

- Foundation assets cannot be used to provide an **economic** or **commercial** benefit to directors (disqualified persons)– **goodwill** and good **public relations** are permissible
- Can generally secure recognition for the foundation or disqualified persons
- Can secure naming rights for the foundation or disqualified persons
- Can't use foundation to secure additional business for disqualified persons
- Foundation grants may not be used to satisfy pledges or other obligations of directors
- In the case of a company-based foundation, can make grants to charities where related company employees, management, or customers sit on the grantee's board and can take into account requests from customers, but grants cannot be based on securing additional business
- Generally, cannot use foundation to purchase tickets to an event unless only foundation representatives will be attending – can't use tickets for related company employees or customers

Excess Benefit Transactions

- Applies to 501(c)(3) and 501(c)(4) organizations (not private foundations)
- Imposes penalty tax on transactions between nonprofit organizations and disqualified persons where value of the economic benefit provided exceeds the value of consideration received
- Applies to compensation arrangements, purchases, leases
- Disqualified persons include individuals exercising “substantial influence” over the organization – includes directors
- 25% tax on disqualified person; 10% tax on board members who knowingly approved the transaction (unless not willful and due to reasonable cause) up to \$20,000

Subsidiaries of Nonprofit Organizations

- Important to maintain corporate separation between parent and subsidiaries – liability protection
- Best practice is to have only a minority board overlap
- Disregarded entities (LLCs)

Board Compensation

- Permissible to compensate board
- Compensation must be reasonable
- Compensation surveys
- Outside consultants
- Permit board members to designate a portion of the charity's grants
- Tax on excess compensation?

Board Meetings and Minutes

- Generally, no “required” number of board meetings – check state statute
- Typically, 4-6 board meetings per year
- Regular attendance at board meetings
- Minutes
 - Record only important information. No extraneous information
 - Not a transcript
 - Keep record of board vote

D&O Insurance

- Be clear on what policy covers
 - Employment claims
 - Legal fees
 - Sexual assault
 - May need separate fiduciary policy

Lobbying and Political Activity

- Board members can engage in lobbying and political activity in their **personal** capacity
- Need to take care that activity is not attributed to the nonprofit organization
- Board members should avoid mentioning board position in their political or legislative activities

Resignation, Removal, and Vacancies

- Typically, spelled out in bylaws
- State corporate law provisions
- Resignation should specify effective date

Board Policies

- Confidentiality
- Conflict of interest
- Gift policy
- Compensation

Board Committees

- Board committees vs. advisory committees
- Joint committees



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