Duties of Nonprofit Corporate Directors - Emphasizing Oversight Responsibilities

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DUTIES OF NONPROFIT CORPORATE DIRECTORS—EMPHASIZING OVERSIGHT RESPONSIBILITIES

THOMAS LEE HAZEN** & LISA LOVE HAZEN***

The law on nonprofit directors' obligations is sparse. Nevertheless, in recent years nonprofit directors have faced increased scrutiny. This Article explores this increased scrutiny and sheds light on the development of North Carolina nonprofit law as it pertains to directors' duties.1 North Carolina imposes stringent duties on nonprofit directors including the duty of overseeing the nonprofit's operations. However, following the pattern in most states, there are limited avenues for holding directors accountable.

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1. This Article focuses on nonprofits in North Carolina. For a national perspective, see generally Thomas Lee Hazen & Lisa Love Hazen, Punctilios and Nonprofit Corporate Governance—A Comprehensive Look at Nonprofit Directors' Fiduciary Duties, 14 U. PA. J. BUS. L. 347 (2012). Some portions of this Article are adapted from the aforementioned Article.
INTRODUCTION

There is scant literature on nonprofit directors' duties under North Carolina law. Nationally, there has been a rethinking of nonprofit best practices in the wake of corporate governance reforms in the for-profit sector. The IRS in 2008 enhanced its scrutiny of nonprofits with a focus on governance structure. North Carolina law relating to nonprofit directors' duties is relatively new but has some interesting history. This Article explores the obligations of nonprofit directors in North Carolina in light of these developments and the unique history of the North Carolina statute governing nonprofits. Ordinarily, increased responsibilities result in a comparable increase in accountability. Increasing nonprofit directors' liability, however, would likely deter many conscientious candidates from considering board service. The current balance in the North Carolina nonprofit statute makes sense. If nonprofit directors do not follow the heightened oversight guidelines suggested here, there will be increased need for the Attorney General to provide oversight.

There have been many highly publicized scandals involving nonprofit corporations. These generally involve excessive compensation to executives

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2. See infra Part II (discussing the amendments to Form 990).

or other insiders and, in the most extreme cases, outright embezzlement. North Carolina has not been immune from high levels of nonprofit executive compensation. Typically in these extreme situations, the wrongdoing is allowed to occur because the nonprofit’s board members were not adhering to proper oversight practices. These abuses are not limited to large-scale, nationally-known nonprofit governance failures. Happily, there are also some publicized examples of North Carolina nonprofit boards doing what they are supposed to do.


This Article begins with a discussion of nonprofit organizations and an overview of the role of the governing board. Part II analyzes the changes to Form 990 that have significantly increased nonprofit governing board oversight responsibilities. We then turn to a discussion of best practices for nonprofit boards. The discussion of best practices leads into an analysis of the obligations imposed by law generally, and then we consider North Carolina law specifically. This is followed by a discussion of the limited remedies available to redress nonprofit director failure to adequately oversee the nonprofit. Finally, we conclude that there is a gap between the nonprofit directors' obligations and the available remedies to hold them more accountable. This gap in turn puts more pressure on the Attorney General who has oversight obligations with respect to nonprofits.

I. OVERVIEW OF NONPROFIT ORGANIZATIONS

Nonprofit organizations, whether set up as corporations or as trusts, generally have a governing board, and its members are fiduciaries. Identifying directors and trustees as fiduciaries only goes so far. In the oft-quoted words of Justice Felix Frankfurter: "[T]o say that a man is a fiduciary only begins the analysis; it gives direction to further inquiry. To whom is he a fiduciary? What obligations does he owe as a fiduciary? In what respect has he failed to discharge these obligations?" Fiduciary relationships place the fiduciary under a zealous duty of good faith. The scope of a fiduciary's obligations does not lend itself to a bright-line test. Descriptions of fiduciary relationships share a common thread—the existence of heightened obligations. Fiduciary relationships established by law often are mirrored

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8. See infra Part I.
9. See infra Part II.
10. See infra Part III.
11. See infra Part IV.
12. See infra Part V.
13. See infra Part VI.
14. See infra Conclusion.
15. Nonprofit corporate statutes contemplate a board of directors. See, e.g., MODEL NONPROFIT CORP. ACT § 8.01(a) (2008) ("A nonprofit corporation must have a board of directors."); see also infra note 77 and accompanying text. Charitable trusts are generally managed by a trustee or a board of trustees. See GEORGE GLEASON BOGERT, GEORGE TAYLOR BOGERT & AMY MORRIS HESS, BOGERT'S TRUSTS AND TRUSTEES § 330 (2011) (discussing the structure of charitable foundations).
16. See infra Part V.
by relationships established by custom that reflect positive social attributes including "loyalty, civility, self-sacrifice, vocational excellence, and high standards of honesty." The law thus recognizes that a fiduciary relationship entails a strong duty of the utmost loyalty. Loyalty means that the fiduciary must act solely in the beneficiary's best interests to the detriment of what may be the fiduciary's own interests. This Article explores application of these general principles to nonprofit corporations organized under the North Carolina Nonprofit Corporation Act.

History tells us that nonprofit corporation wrongdoing traceable to the governing body generally reflects a lack of both good governance procedures and transparency. At a minimum, nonprofit boards should be committed to effective oversight of the organization's operations while also assuring transparency. This means that the board needs to ensure that management is transparent to the board so that the board can be transparent to the public and others to whom the organization is accountable.

A. Role of Nonprofit Governing Boards

The principal functions of a nonprofit board have been identified as follows:

(1) to select, encourage, advise, evaluate and, if need be, replace the chief executive officer; (2) to review and adopt long-term strategic directions and to approve specific objectives, financial and other, such as reviewing the basic mission of the organization in light of changed circumstances; (3) to ensure to the extent possible that the necessary resources, including human resources, will be available to pursue the strategies and achieve the organization's objectives; (4) to monitor the performance of management; (5) to ensure that the organization operates responsibly as well as effectively; and (6) to nominate suitable candidates for election to the board, and to establish and carry out an effective system of governance at the board level, including evaluation of board performance.

20. See FitzGibbon, supra note 18, at 340.
23. See, e.g., JAMES J. FISHMAN & STEPHEN SCHWARZ, NONPROFIT ORGANIZATIONS CASES AND MATERIALS 124 (4th ed. 2010) (noting the many "examples of poor judgment, ethical lapses and outright fraud ... throughout these materials"). Nothing so tarnishes the nonprofit sector's halo than wrongdoing by charities. More often than not, these actions indicate inadequate corporate governance procedures and a lack of transparency of the organization's activities. Good governance is the implementation of certain principles and policies that should protect the organization's activities.
24. Id. (relying on WILLIAM G. BOWEN, INSIDE THE BOARDROOM: GOVERNANCE BY DIRECTORS AND TRUSTEES 18–20 (1994)). For a ten-factor list of nonprofit board
As discussed later, nonprofit directors' liability is limited. Otherwise, serving as a nonprofit board member would result in significant risks that likely would dissuade many good candidates from being willing to serve on nonprofit boards.

It is generally assumed that nonprofit directors are volunteers and are not compensated for their services.\(^2\) There are some notable exceptions where directors are compensated.\(^3\) In fact, the North Carolina Nonprofit Corporation Act recognizes that directors may be compensated.\(^4\) The authors of this Article firmly believe that in those rare instances where directors are compensated, they should not be relieved in any way from accountability for their misdeeds.\(^5\)


25. See infra Part VI.A.

26. For example, the original indenture for the Duke Endowment stated: “Each trustee shall be paid at the end of each calendar year one equal fifteenth part of three percent of the incomes, revenues and profits received by the trustees upon the trust properties and estate during such year . . . .” ROBERT FRANKLIN DURDEN, LASTING LEGACY TO THE CAROLINAS: THE DUKE ENDOWMENT, 1924-1994, at 337 (1998). The current version of the indenture, as modified by court order, provides that trustees shall be compensated annually pursuant to a court order. See THE DUKE ENDOWMENT, INDENTURE OF TRUST 4 (2009), http://www.dukeendowment.org/images/stories/downloads/tde/Duke-Indenture-MAR-16-2011.pdf. Another example occurred when Blue Cross Blue Shield of North Carolina directors made between $33,000 and $51,200 in 2009. See Pay for Blues Plans' Board Chairs Could Decline in Next Few Years, AISHEALTH, http://aishealth.com/archive/nblul2l0-06 (last visited Aug. 27, 2012); see also, e.g., ELIZABETH T. BORIS ET AL., FOUNDATION EXPENSES AND COMPENSATION: HOW OPERATING CHARACTERISTICS INFLUENCE SPENDING 31 (2006), http://www.urban.org/UploadedPDF/311281_Foundation_Report_final.pdf. The report found that although 23.8% of independent foundations compensated trustees, fewer corporate (7.6%) and community foundations (3.2%) compensated their directors. Id. For those 2,181 foundations that compensated trustees, 2,110 (96.7%) were independent foundations. Id. About 20% of independent foundation trustees received compensation, while only 3.2% of corporate foundation trustees and less than 1% of community foundation trustees were compensated. Id. For those foundations compensating directors, the median compensation was $7,750; the 75th percentile was $20,036. Id. The average (mean) compensation was $15,637; when uncompensated trustees are included, the mean drops to $2,417. Id.

27. N.C. GEN. STAT. § 55A-8-12 (2011) (“Unless the articles of incorporation provide otherwise, a board of directors may fix the compensation of directors.”).

28. Cf. id. § 55A-8-60(a)(1) (stating that the higher threshold for nonprofit director liability does not apply to the extent that directors are compensated).
B. Regulation of Nonprofits

The regulation of nonprofit and charitable governance is an amalgam of trust law, corporate law, and tax law. Nonprofit associations of any size generally incorporate under a nonprofit corporation statute. Distinct nonprofit corporation laws are relatively new when compared to laws governing for-profit corporations. The law of nonprofit corporations is not as fully developed as the law of for-profit enterprises. In order to fill gaps in nonprofit law, courts and policymakers often look to the business corporation law for guidance by analogy.

Although incorporation is not required to operate as a nonprofit organization, the nonprofit corporation is the form of choice, especially for charitable organizations seeking preferred tax treatment under the Internal Revenue Code. Effective with fiscal year 2008, charitable organizations have enhanced IRS filings that include the board of directors' involvement. These enhanced IRS filing requirements place an increased focus on the role and obligations of nonprofit directors.


31. See, e.g., Kara A. Gilmore, Comment, House Bill 1095: The New Nonprofit Corporation Law for Missouri, 63 UMKC L. REV. 633, 633 (1995) (“Nationally, nonprofit corporations have not received as much attention from lawmakers as for-profit corporations because the former do not impact the economic status of Americans as directly as for-profit corporations.” (footnote omitted)).


33. See, e.g., David S. Walker, A Consideration of an LLC for a 501(c)(3) Nonprofit Organization, 38 WM. MITCHELL L. REV. 627, 633 (2012) (“While the charitable trust form is an option and, for some, the unincorporated nonprofit association may be a viable choice, the 'predominant' form of charitable organization in the United States is the nonprofit corporation.” (citing FISHMAN & SCHWARZ, supra note 23, at 48–53)).


have been criticized for not performing fiduciary and oversight obligations. The Sarbanes-Oxley Act of 2002 raised corporate governance standards for publicly held for-profit companies. Scandals in the nonprofit world caused some observers to call for similar reforms in nonprofit governance. Although responsive (discussing new questions raised for nonprofit directors by the new Form 990); James R. King et al., Form 990 Disclosure Requirements Challenge Hospitals, Provide Opportunities, 21 THE HEALTH LAW. 1, 3–12 (2009) (describing how the new Form 990 will affect governance at hospitals); cf. Rummama Alam, Not What the Doctors Ordered: Nonprofit Hospitals and the New Corporate Governance Requirements, 2011 U. ILL. L. REV. 229, 245–60 (2011) (arguing that the IRS reforms are too burdensome).


37. See generally Vacco v. Diamandopoulos, 715 N.Y.S.2d 269 (N.Y. Sup. Ct. 1998) (upholding Attorney General's complaint seeking to hold directors accountable for excessive compensation and mismanagement of university's assets; denying defendants' claim for advanced indemnification). The court noted: "[T]he Regents found 'that Lois neglected both his duties of due care and undivided loyalty to Adelphi, and that he violated his fiduciary duty by failing to disclose to the board that LOIS/USA was, indeed, being paid for services rendered to Adelphi.' The Regents concluded that Diamandopoulos and Lois should be removed 'for neglect of their fiduciary duties of due care and loyalty.' The Regents also found 'that the full board of trustees neglected its duty of due care to Adelphi by failing to take appropriate action once it learned of Procope's and Lois' potential conflicts.' They recommended removal of the 18 trustees 'for neglect of their duty of due care.' The Regents did not address whether Lois' company received excessive payment for the work which was done." Id. at 272–73; cf. State ex rel. Petro v. Gold, 166 Ohio App. 3d 371, 2006-Ohio-943, 850 N.E.2d 1218, at ¶ 91 (suit by Attorney General finding breach of fiduciary duties by executive director in connection with use of professional solicitation firms).


39. See supra note 3.

legislation for nonprofits at the federal level was not forthcoming, many nonprofits began to look to Sarbanes-Oxley as a recipe for best practices. The impetus for governance reforms has, however, come from the tax laws rather than traditional corporate governance sources.

II. FEDERAL TAX EXEMPTION AND RESULTING IMPACT ON BOARD DUTIES

Section 501 of the Internal Revenue Code grants tax exempt status for qualifying nonprofit organizations. Among other things, the 2008


41. See generally Fremont-Smith, supra note 40, at 642-44 (discussing the relatively insignificant federal efforts to reform nonprofit regulation); Lloyd Hitoshi Mayer & Brendan M. Wilson, Regulating Charities in the Twenty-First Century: An Institutional Choice Analysis, 85 CHI.-KENT L. REV. 479 (2010) (discussing and evaluating various approaches to reforming the law governing management of charities). Although there was no legislation at the federal level to extend Sarbanes-Oxley type requirements to nonprofits, there was some movement in the states. For example, in California, charitable nonprofits having annual revenue of more than $2 million must be audited and make that audit publicly available, and the organization must have an audit committee which must be made available to the public, and that does not have more than a 50% overlap with the finance committee. Nonprofit Integrity Act of 2004, § 7(e), 2004 Cal. Stat. 7158, 7162-63; see also Solicitation of Charitable Funds Act, 2005 Conn. Acts 101 (Reg. Sess.); N.H. REV. STAT. ANN. § 7:28 (LexisNexis 2008). In addition, all nonprofits, regardless of size, must make their audited financial statements available to the public and, consistent with Form 990, must disclose the compensation of President, CEO, Treasurer and CFO approved by the board. CAL. GOV’T CODE § 12586 (West 2011).


43. Corporate governance both in the for-profit and nonprofit sectors evolves from the law of the state of the organization’s incorporation. See, e.g., Faith Stevelman, Regulatory Competition, Choice of Forum, and Delaware’s Stake in Corporate Law, 34 Del. J. Corp. L. 57, 60 (2009).

44. For a more detailed discussion of the IRS requirements, see Hazen & Hazen, supra note 1, at 364-75.
amendments to IRS Form 990 ("Form 990") inquire about the board's role in governing the nonprofit. Since Form 990s are publicly available, these amendments make the nonprofit organization's governance a matter of public record. This increased focus by the IRS is likely to impact the state law obligations of board members. State attorneys general and others concerned with a nonprofit organization's operations now have access to details about the governance structure that may bring into question the board's role when wrongdoing occurs. The IRS instituted additional reforms beyond the enhanced Form 990 disclosures. For example, in June 2011, the IRS posted a list of more than 8,000 North Carolina nonprofits that lost their

45. See I.R.C. § 501(c); see, e.g., Bob Jones Univ. v. United States, 461 U.S. 574, 589 (1983) ("What little floor debate occurred on the charitable exemption provision of the 1894 Act and similar sections of later statutes leaves no doubt that Congress deemed the specified organizations entitled to tax benefits because they served desirable public purposes."); see also BORIS I. BITKER & LAWRENCE LOKKEN, FEDERAL TAXATION OF INCOME, ESTATES AND GIFTS § 100.1 (2012) ("[T]he Internal Revenue Code (the Code) exempts a wider range of groups than the 'nonprofit' label implies. The best-known exempt organizations—charitable institutions, schools, colleges, churches, and the like—serve the interests of society in a broad sense, ordinarily without economic benefit to their organizers or benefactors. But many other exempt organizations (such as chambers of commerce, labor unions, and consumer cooperative societies) are operated primarily for the economic benefit of their members, and they are nonprofit groups only in the limited sense that they do not engage in business with the general public for the benefit of investors.").

46. See infra text accompanying notes 52-61.

47. See IRS Releases Final 2008 Form 990 for Tax-Exempt Organizations, Adjusts Filing Threshold to Provide Transition Relief, INTERNAL REVENUE SERVICE (Dec. 20, 2007), http://www.irs.gov/newsroom/article/0,00.html ("When we released the redesigned draft form this past June, we said we needed a Form 990 that reflects the way this growing sector operates in the 21st century. . . . The public comments we received in response to our draft form helped us develop a final form consistent with our guiding principles of transparency, compliance and burden minimization."). The IRS described the thrust of the enhanced disclosures:

The new form's summary page provides a snapshot of key financial, governance and operating information, including a comparison of the current year's revenues, expenses, assets, and liabilities, with those of the prior year. The reordered core form provides a description of the organization's program service accomplishments immediately after the summary page, to provide context before the user proceeds to sections on tax compliance, governance, compensation, and financial statements. The Checklist of Required Schedules also provides a quick view of whether the filing organization is conducting activities that raise tax compliance concerns, such as lobbying or political campaign activities, transactions with interested persons, and major dispositions of assets, and indicates which schedules the organization is required to file with the form.

nonprofit tax exempt status for failure to file their Form 990.48 The tax code lists twenty-eight categories of qualifying nonprofits. Most nonprofits fall under § 501(c)(3) which includes religious, charitable, scientific, testing for public safety, literary, or educational organizations.49 The most common explanation for the § 501(c)(3) tax exemption is that charities provide a public good. As explained by the Supreme Court:

When the Government grants exemptions or allows deductions all taxpayers are affected; the very fact of the exemption or deduction for the donor means that other taxpayers can be said to be indirect and vicarious “donors.” Charitable exemptions are justified on the basis that the exempt entity confers a public benefit—a benefit which the society or the community may not itself choose or be able to provide, or which supplements and advances the work of public institutions already supported by tax revenues.50

These charitable organizations are also justified under the public good justification given they provide services that otherwise might fall on the government.51


49. I.R.C. § 501(c)(3). As explained by the IRS:

To be tax-exempt under section 501(c)(3) of the Internal Revenue Code, an organization must be organized and operated exclusively for exempt purposes set forth in section 501(c)(3), and none of its earnings may inure to any private shareholder or individual. In addition, it may not be an action organization, i.e., it may not attempt to influence legislation as a substantial part of its activities and it may not participate in any campaign activity for or against political candidates.


51. See, e.g., Why are Nonprofits Tax-Exempt?, BOARDSOURCE, http://www.boardsource.org/Knowledge.asp?ID=3.171 (last visited Aug. 27, 2012) ("Tax-exemption is an acknowledgment of an organization performing an activity that relieves some burden that would otherwise fall to federal, state, or local government. The government, in fact, provides an indirect subsidy to nonprofits and receives a direct benefit in return. Nonprofits also benefit the society as a whole when they provide valuable services. The viability of some of these services would be threatened if they were subject to taxes. Tax-exemption is afforded to churches as a safeguard to preserve separation of church and state by preventing governments from using taxation to favor one religion over another."); see also, e.g., Miranda Perry Fleischer, Equality of
The new requirements for tax years starting in 2008 were aimed in large part at nonprofit corporate governance; in particular, the new disclosures were designed to increase transparency and accountability of nonprofit boards.\textsuperscript{52} Form 990 is an annual tax return to be filed by nonprofits. Form 990 filing was amended to add a category of all "key employees" whose names and compensations must be disclosed.\textsuperscript{53} Most importantly, the 2008 Form 990 amendments require the nonprofit to answer a number of questions. For instance, Form 990 must indicate whether the form itself was shown to the governing board before the form was filed with the IRS.\textsuperscript{54} A nonprofit may say that it provided Form 990 to the board only if it provided a copy of the Form 990 (including the required schedules) to each voting member of the nonprofit's governing body, prior to filing with the IRS.\textsuperscript{55} Form 990 must also describe the process for reviewing Form 990 prior to filing. This includes a full description of the process for review by any of the organization's officers, directors, trustees, or management and whether it was reviewed before or after it was filed with the IRS, which includes disclosure of who conducted the review, when it was conducted, and the extent of the review.

A number of Form 990 questions are designed to address governance practices in setting executive compensation.\textsuperscript{56} In particular, Form 990 must disclose the number of independent voting members in the governing body.\textsuperscript{57}

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\textsuperscript{53} See T.D. 9423, 2008-2 C.B. 966, 970. "Key employees" are defined as those with "responsibilities or powers similar to those of officers, directors or trustees" and "also persons who manage a discrete segment or activity of the organization that represents a substantial portion of the activities, assets, income, or expenses of the organization." \textit{Id.} The redesigned Form 990 requires reporting only for key employees making more than $150,000. \textit{Id.}


\textsuperscript{56} See, e.g., Allison, supra note 35, at 14-20 (discussing the new 990 requirements); King et al., supra note 35, at 3-5 (same); cf. Alam, supra note 35, at 245-60 (arguing that the IRS reforms are too burdensome).

\textsuperscript{57} A board member is "independent" if three specific conditions are satisfied throughout the organization's tax year: 1. The board member was not a compensated employee of the organization or of a related organization; 2. The board member did not receive total annual compensation or other payments in excess of $10,000 as an independent contractor (other than reimbursement of expenses under an expense
Form 990 must also disclose whether the nonprofit has a written conflict of interest policy. Further, Form 990 must indicate whether the nonprofit’s officers, directors or trustees, and key employees are required to disclose annually interests that could give rise to conflicts. Form 990 must also state whether the nonprofit contemporaneously documents meetings of the board and its committees. In addition, Form 990 must also disclose whether the process for determining CEO and other key officer and key employee compensation included a review and approval by independent persons, comparability data, and contemporaneous substantiation of the deliberation and decision for the organization.

III. BEST PRACTICES

The enhanced Form 990 disclosures increase the organization’s transparency since the extent of board oversight and involvement is now public. This gives board members new incentives to adopt best practices. A number of best practices can be identified as a result of the foregoing Form 990 enhancements. The IRS’s increased concern about nonprofit executive compensation led to the disclosures relating to the board’s involvement in setting compensation and in dealing with conflicts of interest. Although the IRS does not require boards to be involved in setting compensation, the degree of the involvement must be disclosed. Since the absence of board reimbursement procedure) or reasonable compensation for services provided as a member of the board; and 3. Neither the board member, nor any family member of the board member, was involved in an “interested persons” transaction reportable on Schedule L. INSTRUCTIONS, supra note 55, at 56. “Interested Persons” include current and former officers, directors/trustees, key employees and the five highest compensated employees. INTERNAL REVENUE SERV., INSTRUCTIONS FOR SCHEDULE L (FORM 990 OR 990-EZ) 2 (2011), http://www.irs.gov/pub/irs-pdf/i990sl.pdf. Reportable transactions with interested persons now include excess benefit transactions, loans, grants or assistance, and business transactions that exceed specified thresholds. See id.; see also, e.g., Dana Brakman Reiser, Director Independence in the Independent Sector, 76 FORDHAM L. REV. 795, 814–31 (2007) (discussing independent directors in the context of nonprofit organizations); cf. Benjamin Moses Leff, Federal Regulation of Nonprofit Board Independence: Focus on Independent Shareholders as a “Middle Way,” 99 KY. L.J. 731, 765–77 (2011) (arguing that the IRS should require independence on the board only under rare circumstances). But cf. Kathleen M. Boozang, Does an Independent Board Improve Nonprofit Governance?, 75 TENN. L. REV. 83, 136 (2007) (arguing that the “ongoing move toward board and director independence in the nonprofit sector appears to be a movement without a clear goal, supported by little evidence that independence has accomplished improvements in the business sector”).

58. FORM 990, supra note 54, at 6, Question 12(a).
59. Id. at Question 12(b).
60. Id. at Questions 8(a) and (b).
61. Id. at Questions 15(a) and (b). Affirmative responses will allow the nonprofit to qualify for the rebuttable presumption that the compensation is reasonable. Treas. Reg. § 53.4958-6 (2011).
62. Id.
involvement may trigger increased IRS scrutiny, the disclosure requirement certainly encourages board involvement. Consider, for example, the following list of recommended best practices suggesting that nonprofits:

Implement an annual disclosure questionnaire to determine each board member's independence and the family or business relationships between and among directors/trustees, officers and key employees.

Adopt (if not already adopted) or Review (if a policy currently exists) a Conflict of Interest Policy. The policy should:

- Cover trustees/directors, officers, key employees, others with substantial influence.
- Require disclosure of actual/potential conflicts of interest.
- Implement annual disclosure process to determine if conflicts exist.
- Include procedures for determining whether a relationship, financial interest or business affiliation results in a conflict.
- Prescribe a course of action when a conflict is identified.
- Require independent directors to review and approve transactions where a conflict of interest exists.
- Require appropriate documentation of actions.
- Require conflicted person to leave room and recuse him/herself from discussion and decision.

Require contemporaneous documentation of board and committee meetings and establish recommended practices for contents of documentation and for retaining such documentation. For this purpose, contemporaneous means the document must be prepared by the later of (1) the next meeting of the governing body or committee, or (2) 60 days after the date of the meeting and reviewed and approved by the governing body or committee within a reasonable time period thereafter.

Adopt an executive compensation process that includes a determination of the positions whose compensation is to be reviewed; review and approval of the compensation decisions by an independent committee based on appropriate comparability data; and contemporaneous documentation of the decision.63

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63. YAFFE & CO., THE NEW FORM 990 AND EXECUTIVE COMPENSATION: "BEST PRACTICE" RECOMMENDATIONS FOR BOARDS AND COMPENSATION COMMITTEES 4–5 (2009), http://www.yaffeco.com/site/wp-content/uploads/2011/04/Form-990-Exec-Comp-White-Paper.pdf. The following compensation practices were also recommended as stemming from the IRS changes to Form 990:
The North Carolina Bar Association in conjunction with the North Carolina Center for Nonprofits has similar suggestions in its guidebook for nonprofit directors, but those suggestions predate the enhanced Form 990 disclosure requirements. Although the above-mentioned best practices to a large extent can be attributed to the IRS rules, they necessarily bear upon reasonable conduct under the North Carolina Nonprofit Act. The state law regarding director conduct is based on how a reasonable person would act under like circumstances. Evolving best practices necessarily inform what may constitute reasonable conduct, which in turn determines the scope of director accountability.

Adopt an executive compensation philosophy that outlines the process and procedures for reviewing and approving the total compensation paid to senior executives and “key employees”

Appoint a compensation committee comprised of independent members of the board

Adopt a compensation committee charter that sets out, among other things, the purpose, responsibility and authority of the compensation committee, including the following:

- Adherence to the compensation philosophy
- Compliance with the rebuttable presumption of reasonableness
- Use of an independent compensation consultant to provide comparability data

Adopt an expense reimbursement policy that outlines the procedure for the payment, reimbursement or provision of the following expenses, including requiring substantiation prior to reimbursement:

- First class or charter travel
- Travel for companions
- Tax indemnification and gross-up payments
- Discretionary spending accounts
- Housing allowance or residence for personal use
- Payments for business use of personal residence
- Health or social club dues or initiation fees
- Personal services (maid, chauffeur, chef, etc.)

Id. at 6.


The IRS does not require nonprofits to adopt compensation and conflict of interest policies. However, a nonprofit's failure to adopt practices and policies governing executive compensation can result in the organization not qualifying for the benefit of the IRS safe harbor that results in a rebuttable presumption of reasonableness for executive compensation decisions. This rebuttable presumption applies if executive compensation decisions are approved by an “independent” body, are based on appropriate comparability data, and documented contemporaneously with the decision. Furthermore, when the organization's officials have knowledge of excessive compensation or other improper private benefits and nevertheless give their approval, they can be held accountable to the IRS. This could result in exposure for board members who knowingly ignore excessive compensation or other improper benefits.

The IRS disclosures do not expressly mandate better governance practices. However, they clearly are designed to strongly encourage transparency and accountability in setting executive compensation. By its nature, disclosure encourages sounder practice. It seems that the state-law imposed duties of care and good faith require at a minimum that the board consider whether to adopt appropriate governance practices and procedures for setting compensation. Given the cost of losing a tax exemption (even on a temporary basis), the board should think long and hard before making a decision not to follow best practices in this area. It has been suggested, for example, that adopting good governance policies beyond those listed above and suggested by Form 990 requirements is worth considering as a belt and suspenders approach to preserving the organization's tax exempt status.

67. See INSTRUCTIONS, supra note 55, at 33 (“An excess benefit transaction can have serious implications for the disqualified person that entered into the transaction with the organization, any organization managers that knowingly approved of the transaction, and the organization itself.”).
68. For example, in one instance, board members of a nonprofit were personally at risk because of the nonprofit organization's failure to pay payroll taxes. See Sherri Begin Welch, Nonprofit Board Members May Owe; IRS, State Want $1.2M from Cyprian Chair, CRAIN'S DETROIT BUS., May 18, 2009, http://www.crainsdetroit.com/article/20090521/EMAIL01/305219987/nonprofit-board-members-may-owe-irs-state-want-1-2m-from-former-cyprian-chair# (discussing the IRS's placement of a lien on a nonprofit board chair's home).
69. Form 990 requires disclosure whether the board has a role in setting compensation. See FORM 990, supra note 54, at 6, Questions 8(a), 8(b), 12(a), 12(b).
70. See LOUIS D. BRANDEIS, OTHER PEOPLE'S MONEY 92-108 (1914) (“Sunlight is said to be the best of disinfectants; electric light the most efficient policeman.”).
71. See James M. Matthews & Sarah Gohl Isabel, Adopting More Good Policies is Good Policy, 21 TAX’N OF EXEMPTS 21, 21 (July/Aug. 2009). The policies referred to above include:

By virtue of Form 990 and increased IRS scrutiny of nonprofits, federal law has recently imposed heightened duties for nonprofit directors. As discussed later, North Carolina has a long tradition of recognizing directors' fiduciary duties. Increasing directors' liability exposure would likely be counterproductive as it would deter good people from volunteering for nonprofit boards. One answer may be for the State Attorney General to take a more proactive role in monitoring nonprofit operations.

IV. NONPROFIT DIRECTORS' DUTIES UNDER STATE LAW

A. Duties of Care, Loyalty, and Good Faith

Following the pattern with for-profit corporations, the law relating to nonprofit corporation formation and organization is determined by the state of incorporation. The traditional duties of directors have been described as the duties of care, loyalty, and good faith. These traditional duties include a duty of candor.

The duty of care includes obligations of keeping informed, remaining attentive, and acting as a reasonable director would act under like

2. Policies governing chapters, affiliates, and branches (Part VI.A, Lines 9a-9b).
3. Policy for holding conservation easements (Part IV, Line 7 and Schedule D, Part II).
6. Joint venture policy (Part VI.B, Lines 16a-16b; Part IV, Line 37; and Schedule R).
7. Foreign grant and activity policies (Part IV, Lines 14-16 and Schedule F).
8. U.S. grant procedures (Part IV, Lines 21-22; Part IX, Lines 1-2; and Schedule I).

Id. 72. See infra Part V.
73. For example, the Oregon Attorney General has alerted the public to the state's twenty worst charities. Press Release, Or. Dep't of Justice, Oregon's 20 Worst Charities: 2011 (Dec. 14, 2011), available at http://www.doj.state.or.us/releases/2011/re1121411.shtml. For discussion of the role of state attorneys general in nonprofit regulation, see infra Part VI.C.
76. See, e.g., Armenian Assembly of Am., Inc. v. Cafesjian, 772 F. Supp. 2d 20, 113 (D. D.C. 2011) (finding breach of duty of candor but no resulting damages). This ruling echoes the well-established rule with respect to for-profit directors that a breach of a duty does not result in liability absent proof of damages proximately caused by the breach. See Barnes v. Andrews, 298 F. 614, 617 (S.D.N.Y. 1924).
circumstances. The duty of loyalty addresses situations in which a director has a direct or indirect conflict of interest, including self-dealing transactions. Although often described as a third fiduciary duty, the Delaware Supreme Court took the proper view when it explained that the duty of good faith is in essence a component of both the duty of care and the duty of loyalty. This is the correct approach in North Carolina, as well, and the North Carolina Business Court has agreed that good faith is not an

77. See 2 JAMES D. COX & THOMAS LEE HAZEN, TREATISE ON THE LAW OF CORPORATIONS § 10:1, at 126-34 (discussing corporate directors' duty of care); ROBINSON, supra note 30, § 14.04 (discussing the duty of care applicable to North Carolina corporations). With respect to nonprofit directors, the American Law Institute's draft principles of nonprofit law provides:

The duty of care requires each governing-board member—

(a) to become appropriately informed about issues requiring consideration, and to devote appropriate attention to oversight; and

(b) to act with the care that an ordinarily prudent person would reasonably exercise in a like position and under similar circumstances.

AM. LAW INST., PRINCIPLES OF THE LAW OF NONPROFIT ORGANIZATIONS § 315 (2007). The duty of care is subject to the business judgment rule, which protects disinterested directors acting in good faith from having their judgment second-guessed by courts. See, e.g., Armenian Assembly of Am., Inc., 772 F. Supp. 2d at 103-04 (acknowledging the application of the business judgment rule to nonprofit directors but not where the directors have an actual or potential conflict of interest).

78. See 2 COX & HAZEN, supra note 77, §§ 10:11-10:19, at 179-222 (discussing corporate directors' duty of loyalty); ROBINSON, supra note 30, § 14.04 (discussing the duty of loyalty applicable to North Carolina corporations).


80. See Stone v. Ritter, 911 A.2d 362, 370 (Del. 2006) ("[A]lthough good faith may be described colloquially as part of a 'triad' of fiduciary duties that includes the duties of care and loyalty, the obligation to act in good faith does not establish an independent fiduciary duty that stands on the same footing as the duties of care and loyalty. Only the latter two duties, where violated, may directly result in liability, whereas a failure to act in good faith may do so, but indirectly. The second doctrinal consequence is that the fiduciary duty of loyalty is not limited to cases involving a financial or other cognizable fiduciary conflict of interest. It also encompasses cases where the fiduciary fails to act in good faith.” (footnote omitted)).

81. See, e.g., ROBINSON, supra note 30, § 14.02 (“The requirement of good faith is listed separately in the statute and has occasionally been cited as a separate duty apart from the duties of due care and loyalty; but it normally operates more as a component of the other two traditional duties, requiring conscientious effort in discharging the duty of care and constituting the very core of the duty of loyalty.” (footnote omitted)).
independent duty but, rather, is included in the more traditional duties of care and loyalty.82

B. Duty of Obedience

Some courts and commentators also speak in terms of a director's duty of obedience.83 References to a duty of obedience capture the idea that a director is under an obligation to assure that the corporation acts within its proper purpose and mission.84

Corporate law treatises tend to reference a director's duty of obedience.85 The directors' duty of obedience receives some mention today in treatises and the like86 but is not universally listed as it once was in

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82. See State v. Custard, No. 06-CVS-4622, 2010 WL 1035809, at *18 (N.C. Bus. Ct. Mar. 19, 2010) ("[T]here is no duty of good faith separate and apart from the duties of care and loyalty under either Delaware or North Carolina law."). The court went on to explain:

Similar to Delaware law, North Carolina law does not contain a third separate duty of good faith. Rather, the requirement of good faith is found in the statute and is the core concept embodied in the requirement of loyalty. What then is "good faith" as embodied in these fiduciary duties? Good faith requires that officers and directors have a loyal state of mind: that is, a justifiable, honestly held belief that they are acting in the best interests of the corporation, whether they are making operating decisions or monitoring certain aspects of corporate functions.

Id. at *30 (footnote omitted).


84. Id.

85. HENRY W. BALLANTINE, BALLANTINE ON CORPORATIONS § 62 (Revised ed. 1946). The successor edition of the Ballantine edition explains that the duty of obedience is in effect the application of the ultra vires doctrine. See 2 COX & HAZEN, supra note 77, § 10:1, at 126–27. The duty of obedience is referred to in a number of classic corporate law texts. See, e.g., I. MAURICE WORMSER, FRANKENSTEIN INCORPORATED 125–30 (1931) ("Directors owe a three-fold duty to the corporation. First, they must be obedient. Second, they must be diligent. Third, they must be loyal. As to obedience, they of course owe a duty to keep within the powers of the corporation as well as within those of the board of directors .... With regard to diligence, the directors owe a duty to exercise reasonable care and prudence .... In no event is the idea to be tolerated that directors serve merely as brightly gilded ornaments of the corporate institution .... The third duty owing by directors is that of undivided loyalty."); see also, e.g., Gearhart Indus., Inc. v. Smith Int'l, Inc., 741 F.2d 707, 719 (5th Cir. 1984). Recent case law in the United States generally does not refer to the duty of obedience.

86. See 2 COX & HAZEN, supra note 77, § 10:1, at 126–27; Rob Atkinson, Obedience as the Foundation of Fiduciary Duty, 34 J. CORP. L. 43, 45 (2008) (suggesting that the duty of obedience is the "foundation" of the traditional board duties of care and loyalty); cf. Megan Wischmeier Shaner, Restoring the Balance of Power in Corporate Management: Enforcing an Officer's Duty of Obedience, 68 BUS. LAW. 27, 27 (2010) (suggesting increased focus on officers' fiduciary duties and, in particular, the duty of obedience).
The duty of obedience is a reflection of the age-old *ultra vires* doctrine, which prohibits corporate acts beyond the corporation's mission and purpose. This obligation is clearly recognized by North Carolina's corporate law. As discussed below, it has even more significance with respect to nonprofit corporations. Most for-profit corporations take advantage of the so-called “all purpose clause,” which allows the corporation to conduct any lawful business. In contrast, many nonprofit organizations have limited missions, and this breathes more vitality into the *ultra vires* doctrine, which is designed to curtail corporations from acting beyond the scope of their purpose.

87. See Atkinson, *supra* note 86, at 45 (“Commentators, both doctrinal and theoretical, have come to agree that the fiduciary relationship rests on twin pillars, the duty of care and the duty of loyalty. This paper argues that a third duty, obedience, is more basic, the foundation on which the duties of care and loyalty ultimately rest.”).

88. For discussion on *ultra vires* in North Carolina, see Robinson, *supra* note 30, § 3.06.


90. See Robinson, *supra* note 30, § 14.03(2) (“The duty of due care requires the directors of every corporation to see that it is operated according to the terms of its articles of incorporation . . . .” (citing Hauser v. Tate, 85 N.C. 81, 85 (1881))).

91. E.g., N.C. GEN. STAT. § 55-3-01 (2011) (“Every corporation incorporated under this Chapter has the purpose of engaging in any lawful business unless a more limited purpose is set forth in its articles of incorporation.”).

92. See Robinson, *supra* note 30, § 3.06.
The duty of obedience, which is often included in guidebooks for nonprofit directors,\(^93\) has been described as a substantive rather than process-oriented duty.\(^94\) As discussed directly below, the duty of obedience is one application of the *ultra vires* doctrine that is designed to assure that corporate action is consistent with the corporate purpose.

There is scattered case law throughout the United States referring to a director's duty of obedience for both for-profit\(^95\) and nonprofit corporations.\(^96\) Although the North Carolina statute and case law do not

\(^{93}\) See, e.g., *GUIDEBOOK*, *supra* note 64, at 19, 26, 31 (referring to the duty of obedience).

\(^{94}\) Practitioners have described the duty as substantive. See, e.g., David Robbins, *New Risks for Hospital Boards: Good Faith Decisions with Bad Outcomes*, DUANE MORRIS ATT'YS AT L., http://www.duanemorris.com/articles/static/modern_healthcare _jul06.pdf (last visited Aug. 27, 2012) ("The duty of obedience tests the substantive, as opposed to the procedural, quality of decisions by nonprofit boards.").


expressly reference a duty of obedience, the traditional notions of *ultra vires* capture this concept and necessitate adherence to the corporation’s stated purpose and mission.

Charitable nonprofits often have a limited mission statement that in turn gives rise to the board’s duty of obedience with respect to that mission. Similarly, if there are donor restrictions on the organization’s use of funds, the board needs to assure proper procedures are in place and that there is sufficient transparency to assure obedience to any such donor intent restrictions. The donors’ ability to enforce their intent is spotty at best.

97. See N.C. GEN. STAT. § 55-8-30 (2011) (directors’ standard of care); id. § 55A-8-31 (directors’ conflict of interest provision). Neither section mentions a duty of obedience. A Westlaw search of North Carolina cases did not reveal any cases referring to a director’s duty of obedience. WESTLAW, http://westlaw.com (search terms: director & corporation & “duty of obedience”) (last visited Aug. 27, 2012). The only case retrieved was one relating to an employee’s duty of obedience. See Dobbin v. Richmond & Danville R.R. Co., 81 N.C. 446, 449 (1879) (stating that an agent’s liability will be imputed to the corporation only if he is “an agent clothed in this respect with the authority of the master, to whom the laborers are put in subordination, and to whom they owe the duty of obedience” (emphasis added)).

98. See, e.g., Shorter Coll., 614 S.E.2d at 43. (“It is axiomatic that the board of directors [of a nonprofit] is charged with the duty to ensure that the mission of the charitable corporation is carried out. This duty has been referred to as the duty of obedience. It requires the director of a not-for-profit corporation to be faithful to the purposes and goals of the organization, since unlike business corporations, whose ultimate objective is to make money, nonprofit corporations are defined by their specific objectives . . . .” (quoting Manhattan Eye, 715 N.Y.S.2d at 593) (internal quotation marks omitted)).


This then leaves the primary task of stewardship to the charity's governing board. For example, a hospital in Oklahoma recently was required to return a donor's $500,000 contribution and pay $500,000 in punitive damages for failure to follow the donor's directions. Proper oversight by the board would have monitored management so as to assure obedience to the donor's wishes. If the board had been keeping a watchful eye on management, perhaps the hospital could have avoided losing the donation and prevented the egregious conduct warranting punitive damages.

V. NORTH CAROLINA FORMULATIONS OF NONPROFIT DIRECTORS' DUTIES

A. Parallels Between North Carolina's Business Corporation and Nonprofit Law

North Carolina is recognized as having a strong tradition of upholding directors' fiduciary duties in its business corporation law. North Carolina has adhered to this tradition notwithstanding the ongoing debate as to whether the corporate fiduciary model should shift to a contract paradigm where the corporate constituents can define their rights and obligations by contract. While to some extent other states have moved away from the

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102. See, e.g., Sasso, supra note 24, at 1486 (suggesting "that while not-for-profit corporate law should play an important aspirational role by substantively defining the duty of obedience as a distinct fiduciary duty, it should play a limited role when it comes to enforcing the duty").


104. See, e.g., Fulton v. Talbert, 255 N.C. 183, 184, 120 S.E.2d 410, 411 (1961) (citing Teague v. Teague Furniture Co., 201 N.C. 803, 807, 161 S.E. 530, 532 (1931)) (explaining that the North Carolina Business Corporation Act embraces directors' fiduciary obligations that had been recognized by the courts for a long time); see also, e.g., ROBINSON, supra note 30, § 14.01(b) ("The 1990 Act was not intended to diminish the directors' responsibilities of good faith, due care, and loyalty.").

105. A group of scholars, known as contractarians, believe that the fiduciary paradigm is outmoded. We wholeheartedly disagree with that proposition. See Thomas Lee Hazen, The Corporate Persona, Contract (and Market) Failure, and Moral Values, 69 N.C. L. REV. 273-318 (1991) (discussing the failures and weaknesses of the contractarian paradigm). In addition, following the rule for fiduciary duties generally, nonprofit directors may not
fiduciary paradigm, North Carolina has not strayed from its tradition as a
guardian of directors' obligations.\textsuperscript{106} As is the case with nonprofit law
throughout this country, there is sparse case law in North Carolina. In fact,
prior to the mid-1950s, there was no corporation act dedicated exclusively to
nonprofit organizations. Other than the general corporate law, the only
guidance for nonprofits was the law of trusts.\textsuperscript{107}

North Carolina's Nonprofit Corporation Act consciously parallels the
state's Business Corporation Act.\textsuperscript{108} The drafters of the current North
Carolina Nonprofit Corporation Act were mindful of the relevance of for-
profit corporate law as they made a conscious decision to have a nonprofit
statute that follows the language of the business corporation act except in
instances when the difference between for-profit and nonprofit enterprises
warrants different treatment.

B. History of the North Carolina Nonprofit Corporation Act

In 1957, the North Carolina legislature adopted a business corporation
act and a roughly parallel nonprofit corporation act.\textsuperscript{109} In 1985, the North
Carolina Nonprofit Corporation Act was amended to conform as much as
possible to the Business Corporation Act.\textsuperscript{110} After North Carolina adopted
its new Business Corporation Act that became effective in 1990, the Nonprofit Corporation Act was overhauled to parallel the changes to the Business Corporation Act.\textsuperscript{111}

The general pattern of modeling the Nonprofit Corporation Act on the Business Corporation Act is particularly telling with respect to the development of directors' fiduciary duties. As noted above, it has long been the case that North Carolina has been extremely mindful of directors' fiduciary obligations under the Business Corporation Act.\textsuperscript{112} It follows that a similar approach is embodied in the parallel Nonprofit Corporation Act.

Even before the Nonprofit Act expressed the directors' duties in terms of a fiduciary obligation, the North Carolina statute was clear that the role of the directors was to manage the corporation's affairs.\textsuperscript{113} The current version of the North Carolina Nonprofit Act reflects the more modern view that in many instances the directors' role is to oversee management rather than actually micromanage the corporation's affairs.\textsuperscript{114} As pointed out above in connection with the discussion of the IRS requirements, as part of the

\textsuperscript{111} Act of July 19, 1993, ch. 398, § 1, 1993 N.C. Sess. Laws 1335 (codified at N.C. GEN. STAT. ch. 55A (2011)); see ROBINSON, supra note 30, § 33.01 n.1. Professor Hazen was a member of the General Statutes' drafting committees for both the Business Corporation Act and for the subsequent rewrite of the Nonprofit Corporation Act that became effective in 1993.

\textsuperscript{112} See, e.g., Fulton v. Talbert, 255 N.C. 183, 184, 120 S.E.2d 410, 411 (1961) (noting that the former section 55-35 of the General Statutes of North Carolina's language, including the term "fiduciary," is declaratory of the law prior to the Business Corporation Act); see also Teague v. Teague Furniture Co., 201 N.C. 803, 807, 161 S.E. 530, 532 (1931) ("It is likewise an accepted principle that the directors of a corporate body and others who have the direct control of its affairs and the management of its business occupy in reference to the corporation a fiduciary capacity which imposes the peril of personal liability if they use their knowledge of its financial condition for their own benefit."); Pender v. Speight, 159 N.C. 612, 615, 75 S.E. 851, 852 (1912) ("Directors of a corporation are trustees of the property of the corporation for the benefit of the corporate creditors, as well as shareholders. It is their duty to administer the trust assumed by them not for their own profit, but for the mutual benefit of all parties interested, and, when such directors receive an advantage to themselves not common to all, they are guilty of a plain breach of trust."); Rutheford B. Campbell, Jr., Normative Justifications for Lax (or No) Corporate Fiduciary Duties: A Tale of Problematic Principles, Imagined Facts and Inefficient Outcomes, 99 KY. L.J. 231, 231 (2011) (decrying the movement to lessen or eliminate for-profit directors' and officers' fiduciary duties).

\textsuperscript{113} Non-Profit Corporation Act, ch. 1230, § 1, 1955 N.C. Sess. Laws at 1248 (current version at N.C. GEN. STAT. §§ 55A-8-01, -02 (2011)) (providing that "[t]he affairs of a corporation shall be managed by a board of directors").

\textsuperscript{114} § 55A-8-01(b). The wording of the role of the directors differs slightly from the prior law: "All powers shall be exercised by or under the authority of, and the affairs of the corporation managed under the direction of, its board of directors, except as provided in the articles of incorporation." \textit{Id.} This follows the pattern in most states. See MODEL NONPROFIT CORP. ACT § 8.01(a) (2008) ("A nonprofit corporation must have a board of directors.").
directors' duty of care, the duty of oversight is premised on a duty to keep informed and to assure the organization is operating properly.115 For example, if management is not transparent in informing the board as to operational issues, the board must step in and assure that the organization is being operated properly. Lack of management transparency or other red flags can require the board to get into operational details that some might describe as micromanagement. The duty of care thus may lead the board into micromanagement when there is reason to lack confidence in the organization's managers.

From 1957 until the 1990s, the North Carolina Business Corporation Act expressly provided that directors owe fiduciary duties.116 From 1957 until 1986, the Nonprofit Corporation Act did not have a provision expressly addressing directors' duties and standards of conduct.117 The Nonprofit Act contained provisions requiring a board of directors,118 setting forth the process for selecting directors,119 the process for filling vacancies,120 and the procedures for directors' meetings.121 The Nonprofit Corporation Act was

115. See supra note 77 and accompanying text.
119. Id. (current version at N.C. GEN. STAT. § 55-8-03 (2011)) (setting forth the rules relating to the number, election, and terms of directors). The current Act outlines the qualification of directors; number of directors; election designation and appointment of directors; terms of directors generally; staggered terms for directors; and resignation of directors. N.C. GEN. STAT. §§ 55A-7-26, 8-03, -04, -05, -06, -08, -09 (2011). The provisions for removal of directors are found at sections 55A-8-08 through -10 of the General Statutes of North Carolina. N.C. GEN. STAT. §§ 55A-8-08 to -10 (2011) (removal of directors elected by members or directors, removal of designated or appointed directors, removal of directors by judicial proceeding).
amended to conform to the Business Corporation Act by adopting a provision, effective in 1986, expressly stating that the directors owed a fiduciary responsibility to the corporation.\textsuperscript{122} In 1990, the Business Corporation Act was amended to eliminate the term “fiduciary” from the statute but without any intent to change the law in North Carolina.\textsuperscript{123} The Nonprofit Act was then amended to parallel the language of the Business Corporation Act, noting that the deletion of the term “fiduciary” was not intended to change the existing law.\textsuperscript{124} Especially in the context of nonprofit corporations,\textsuperscript{125} the deletion of “fiduciary” in the statutory language does not alter the nonprofit director’s fiduciary obligations.\textsuperscript{126}

Because charitable nonprofit corporations are a public good,\textsuperscript{127} directors are held to more trust-like standards than directors of business

\begin{footnotes}
122. Act of June 26, 1986, ch. 801, § 29, 1986 N.C. Sess. Laws 30, 35 (current version at N.C. GEN. STAT. §§ 55A-8-30, -42 (2011)) (“Officers and directors shall be deemed to stand in a fiduciary relation to the corporation and to its members, if any, and shall discharge the duties of their respective positions in good faith, and with that diligence and care which ordinarily prudent men would exercise under similar circumstances in like positions.”).

123. See Act of June 8, 1989, ch. 265, § 1, 1989 N.C. Sess. Laws 566, 615–16 (codified as amended at N.C. GEN. STAT. § 55-8-30 (2011)); § 55-8-30 cmt. (“Although the word ‘fiduciary’ is no longer used in describing the duty owed by a director, there is no intent to change North Carolina law in this area.”); see also Governor's Club, Inc. v. Governor’s Club Ltd. P’ship, 152 N.C. App. 240, 247, 567 S.E.2d 781, 786 (2002) (recognizing the fiduciary duty of directors to their corporation), aff’d per curiam, 357 N.C. 46, 46, 577 S.E.2d 620, 620–21 (2003).

124. See § 55A-8-30.

125. See, e.g., Robert S. Lesher, The Non-Profit Corporation—A Neglected Stepchild Comes of Age, 22 BUS. LAW. 951, 969 (1967) (“The justification [for a higher fiduciary duty] seems to lie in the fact that the assets of the non-profit corporation come in many cases from public solicitations or contributions and therefore are more like a trust res than corporate capital.”). Lesher also raised the argument for a less exacting standard:

Since the director of the non-profit usually serves as a public service, he cannot be expected to devote as much time to the corporate affairs as he would if he had a proprietary interest or opportunity for private gain. The conclusion is that the duty of the director of the non-profit corporation should be less exacting lest the public-spirited citizen refrain from assuming the responsibility as director.

\textit{Id.}

126. See § 55A-8-30.

127. See supra note 50 and accompanying text; cf. Evelyn Brody & John Tyler, \textit{Respecting Foundation and Charity Autonomy: How Public is Private Philanthropy?}, 85 CHI.-KENT L. REV. 571, 573 (2010) (“[W]e conclude by emphasizing the covenant that foundations and other charities—as private, independent, autonomous enterprises—make to pursue and serve purposes that are charitable and worthy of exemption in their grant-making, operational programs, management, and governance. At the same time, foundations and other charities are not inherently public agencies or bodies, and their assets are not and should not be subject to broad-based government or public control. In its focus on premises and assumptions, this article seeks to re-ground the debates and put an end to misuse of the phrase ‘public money.’ ”).
The North Carolina Nonprofit Act follows the Business Corporation Act in many respects. However, the Nonprofit Corporation Act goes further than the Business Corporation Act in defining directors' duties by prohibiting loans made or provided by the corporation to volunteer directors and officers.

C. Comparison of the North Carolina Nonprofit Corporation Act and the Revised Model Nonprofit Corporation Act

It is noteworthy that North Carolina did not adopt more recent changes in the Model Business Corporation and Model Nonprofit Corporation Acts that were designed to clarify a relatively narrow view of director duties. The drafters of the revisions to the Model Nonprofit Corporation Act and the Model Business Corporation Act feared that an overly broad view of directors' fiduciary duties might result from the model acts' language prior to their more recent revisions. Thus, the current versions of the Model Business Corporation Act and the Model Nonprofit Corporation Act adopted

128. See Lesher, supra note 125, at 969.
129. See ROBINSON, supra note 30, § 33.06 ("The standards of conduct (good faith, due care, and loyalty) and the conflict of interest rules are prescribed in virtually the same terms, but there is a tighter prohibition on loans to directors and officers than for a business corporation." (footnotes omitted)). Section 55A-8-30 of the General Statutes of North Carolina sets the basic standard of care for nonprofit directors. § 55A-8-30. The conflict of interest rules for nonprofit directors are set forth in section 55A-8-32, which prohibits loans, guarantees, or other forms of security to or for the benefit of a director unless he or she is a full-time employee of the corporation, in which case the benefits must be granted by the board in accordance with the conflict of interest provisions embodied in section 55A-8-31(a)(1). Id. § 55A-8-31(a)(1), -32.
130. § 55A-8-32 ("No loan, guaranty, or other form of security shall be made or provided by a corporation to or for the benefit of its directors or officers, except that loans, guarantees, or other forms of security may be made to full-time employees of the corporation who are also directors or officers by action of its board of directors . . . "). This prohibition had been included in the former Non-Profit Corporation Act, as well. Non-Profit Corporation Act, ch. 1230, § 1, 1955 N.C. Sess. Laws 1239, 1247 (current version at N.C. GEN. STAT. ch. 55A (2011)). There is no comparable provision in the Business Corporation Act. In fact, that Act expressly permits loans to directors if approved by the shareholders or the directors. N.C. GEN. STAT. § 55-8-32(a)(1)–(2) (2011).
131. MODEL BUS. CORP. ACT § 8.30(b) (2011).
132. Subsection (b) of the 2008 version of section 8.30 of the Model Nonprofit Act provides:

(b) The members of the board of directors or a committee of the board, when becoming informed in connection with their decision-making function or devoting attention to their oversight function, must discharge their duties with the care that a person in a like position would reasonably believe appropriate under similar circumstances.

MODEL NONPROFIT CORP. ACT § 8.30 (2009).
terminology that more narrowly defines the directors' obligations\(^{133}\) than the earlier versions of the model acts. The current North Carolina Business Corporation\(^{134}\) and Nonprofit Corporation\(^ {135}\) Acts are based on the earlier language of the model acts.\(^ {136}\) The drafting committees for both the North

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133. The comments to the 2008 version of the Model Nonprofit Act explain the change as follows:

In the prior version of the act the duty of care element was included in subsection (a), with text reading: "[a] director shall discharge his duties . . . with the care an ordinarily prudent person in a like position would exercise under similar circumstances." The use of the phrase "ordinarily prudent person" in a basic guideline for director conduct, suggesting caution or circumspection vis-à-vis danger or risk, has long been problematic given the fact that risk-taking decisions are central to the directors' role. When coupled with the exercise of "care," the prior text had a familiar resonance long associated with the field of tort law. See the Official Comment to Section 8.31. The further coupling with the verb "shall discharge" added to the inference that former Section 8.30(a)'s standard of conduct involved a negligence standard, with resultant confusion. In order to facilitate its understanding, and analysis, independent of the other general standards of conduct for directors, the duty of care element has been set forth as a separate standard of conduct in subsection (b).


135. Id. § 55A-8-30 ("A director shall discharge his duties as a director, including his duties as a member of a committee: (1) In good faith; (2) With the care an ordinarily prudent person in a like position would exercise under similar circumstances; and (3) In a manner the director reasonably believes to be in the best interests of the corporation."). Others similarly include the prudent person standard in the duties of nonprofit board members. See, e.g., CAL. CORP. CODE § 5231(a) (West Supp. 2012) ("A director shall perform the duties of a director, including duties as a member of any committee of the board upon which the director may serve, in good faith, in a manner that director believes to be in the best interests of the corporation and with such care, including reasonable inquiry, as an ordinarily prudent person in a like position would use under similar circumstances."); MINN. STAT. § 317A.251 (2011) ("A director shall discharge the duties of the position of director in good faith, in a manner the director reasonably believes to be in the best interests of the corporation, and with the care an ordinarily prudent person in a like position would exercise under similar circumstances.").

136. The official comments to the North Carolina Business Corporation Act states:

Section 8.30(a) establishes a general standard of care for all directors. It requires a director to exercise "the care an ordinarily prudent person in a like position would exercise." Some state statutes use the words "diligence," "care," and "skill" to define this duty. E.g., N.C. GEN. STAT. ANN. § 55-35 (1975). There is very little authority as to what "skill" and "diligence," as distinguished from "care," can be required or properly expected of corporate directors in the performance of their duties. "Skill," in the sense of technical competence in a particular field, should not be a qualification for the office of director. The concept of "diligence" is sufficiently subsumed within the concept of "care." Accordingly, the words "diligence" and "skill" were omitted from the standard adopted.

Likewise, section 8.30 does not use the term "fiduciary" in the standard for directors' conduct, because that term could be confused with the unique attributes
Carolina for-profit and nonprofit acts may have signaled a broader duty than exists under the current Model Act that was not adopted in North Carolina. The North Carolina legislature’s inaction by not adopting the language of the revised model acts is strong evidence of a desire not to narrow directors’ obligations as has been the case in some other states and under the most recent iterations of the model acts.

North Carolina’s commitment to preserving board members’ obligations does not, however, translate into heightened liability provisions.

and obligations of a fiduciary imposed by the law of trusts, some of which are not appropriate for directors of a corporation.

Several of the phrases chosen to define the general standard of care in section 8.30(a) deserve specific mention.

(1) The reference to “ordinarily prudent person” embodies long traditions of the common law, in contrast to suggested standards that might call for some undefined degree of expertise, like “ordinarily prudent businessman.” The phrase recognizes the need for innovation, essential to profit orientation, and focuses on the basic director attributes of common sense, practical wisdom, and informed judgment.

(2) The phrase “in a like position” recognizes that the “care” under consideration is that which would be used by the “ordinarily prudent person” if he were a director of the particular corporation.

(3) The combined phrase “in a like position . . . under similar circumstances” is intended to recognize that (a) the nature and extent of responsibilities will vary, depending upon such factors as the size, complexity, urgency, and location of activities carried on by the particular corporation, (b) decisions must be made on the basis of the information known to the directors without the benefit of hindsight, and (c) the special background, qualifications, and management responsibilities of a particular director may be relevant in evaluating his compliance with the standard of care. Even though the quoted phrase takes into account the special background, qualifications and management responsibilities of a particular director, it does not excuse a director lacking business experience or particular expertise from exercising the common sense, practical wisdom, and informed judgment of an “ordinarily prudent person.”

The process by which a director informs himself will vary but the duty of care requires every director to take steps to become informed about the background facts and circumstances before taking action on the matter at hand. In relying upon the performance by management of delegated or assigned duties pursuant to section 8.01 (including, for example, matters of law and legal compliance), the director may depend upon the presumption of regularity, absent knowledge or notice to the contrary. A director may also rely on information, opinions, reports, and statements prepared or presented by others as set forth in section 8.30(b). Furthermore, a director should not be expected to anticipate the problems which the corporation may face except in those circumstances where something has occurred to make it obvious to the director that the corporation should be addressing a particular problem.

§ 55-8-30.
Quite to the contrary, as the following discussion points out, nonprofit directors enjoy considerable immunity under North Carolina law.

VI. LIMITED REMEDIES FOR DIRECTOR MISCONDUCT

A. Qualified Immunity (and Insurance)

The remedies for nonprofit directors' lapses and breaches of duty are quite limited in North Carolina. Nonprofit directors may take advantage of the limited immunity for volunteers. There is a general provision in the General Statutes of North Carolina that provides qualified immunity for charitable volunteers. Volunteers for charitable organizations, including directors who are not compensated, are absolved from liability if they act in good faith and are not guilty of "gross negligence, wanton conduct, or intentional wrongdoing." There is no case law under this specific statute explaining what constitutes "wanton" conduct, but general tort principles focus on intent or a reckless indifference to others' rights. The increased national focus on nonprofit board failures and the increased emphasis on improved best practices are significant. Especially when combined with the IRS initiatives, inattention that many years ago arguably was only careless may today be classified as "wanton."

Federal law imposes a volunteer immunity regime similar to the one created under the North Carolina statutes. The Federal Volunteer

137. N.C. GEN. STAT. § 1-539.10 (2011).
138. Id. § 1-539.10(a)(2).
140. See, e.g., Yancey v. Lea, 354 N.C. 48, 52, 550 S.E.2d 155, 157 (2001) ("In determining or defining gross negligence, this Court has often used the terms 'willful and wanton conduct' and 'gross negligence' interchangeably to describe conduct that falls somewhere between ordinary negligence and intentional conduct. We have defined 'gross negligence' as 'wanton conduct done with conscious or reckless disregard for the rights and safety of others.' " (citations omitted)); see also N.C. GEN. STAT. § 1D-5 (2011) (defining "willful or wanton conduct" in the context of punitive damages as "conscious and intentional disregard of and indifference to the rights and safety of others, which the defendant knows or should know is reasonably likely to result in injury, damage, or other harm"). The volunteer statute expressly includes "gross negligence" as an additional basis of avoiding liability immunity. See id. § 1-539-10(b).
141. See supra Part II.
Protection Act of 1997\(^{142}\) provides a qualified immunity for volunteers of nonprofit and also government organizations unless "the harm was caused by willful or criminal misconduct, gross negligence, reckless misconduct, or a conscious, flagrant indifference to the rights or safety of the individual harmed by the volunteer."\(^{143}\) Subject to stated exceptions,\(^{144}\) the Federal Volunteer Protection Act applies to both federal and state claims\(^{145}\) and preempts state law unless the state law provides greater protection to the volunteer.\(^{146}\)

As is the case with the Federal Act,\(^{147}\) the immunity for charitable volunteers in North Carolina is waived to the extent that the volunteer is

\(^{143}\) 42 U.S.C. § 14503(a)(3). There is an exclusion for listed civil rights and violent actions. Id. § 14503(f).
\(^{144}\) The Act further provides that state law is not preempted in certain additional circumstances:

If the laws of a State limit volunteer liability subject to one or more of the following conditions, such conditions shall not be construed as inconsistent with this section:

1. A State law that requires a nonprofit organization or governmental entity to adhere to risk management procedures, including mandatory training of volunteers.
2. A State law that makes the organization or entity liable for the acts or omissions of its volunteers to the same extent as an employer is liable for the acts or omissions of its employees.
3. A State law that makes a limitation of liability inapplicable if the civil action was brought by an officer of a State or local government pursuant to State or local law.
4. A State law that makes a limitation of liability applicable only if the nonprofit organization or governmental entity provides a financially secure source of recovery for individuals who suffer harm as a result of actions taken by a volunteer on behalf of the organization or entity. A financially secure source of recovery may be an insurance policy within specified limits, comparable coverage from a risk pooling mechanism, equivalent assets, or alternative arrangements that satisfy the State that the organization or entity will be able to pay for losses up to a specified amount. Separate standards for different types of liability exposure may be specified.

Id. § 14503(d).


\(^{146}\) 42 U.S.C. § 14502 ("This chapter preempts the laws of any State to the extent that such laws are inconsistent with this chapter, except that this chapter shall not preempt any State law that provides additional protection from liability relating to volunteers or to any category of volunteers in the performance of services for a nonprofit organization or governmental entity.").

\(^{147}\) See id. § 14503(d)(4).
covered by liability insurance.\textsuperscript{148} While at first glance, it might appear that this means that nonprofit directors should not ask for director and officer ("D&O") liability insurance, that is not a good idea. One of the major benefits of D&O insurance is that the insurance covers not only liability but also the defense of any suit. If suit is brought and the director wins on the basis of the qualified statutory immunity, the prevailing director would still pay out of pocket for his or her legal defense costs. Accordingly, it is prudent for nonprofit directors to assure that the charity carries D&O insurance for its board members.\textsuperscript{149}

The foregoing discussion addressed general qualified immunity for charitable volunteers. In addition to qualified immunity for volunteers generally, North Carolina has a specific qualified immunity provision focused expressly on directors and officers of nonprofit corporations.\textsuperscript{150} Officers and directors of nonprofit corporations are immune from liability (except to the extent covered by insurance) unless the officer or director:

(1) Is compensated for his services beyond reimbursement for expenses;
(2) Was not acting within the scope of his official duties;
(3) Was not acting in good faith;
(4) Committed gross negligence or willful or wanton misconduct that resulted in the damage or injury;
(5) Derived an improper personal financial benefit from the transaction;
(6) Incurred the liability from the operation of a motor vehicle; or
(7) Is a defendant in an action brought under G.S. 55A-8-33 [liability for unlawful loans or distributions].\textsuperscript{151}

\textsuperscript{148} See N.C. GEN. STAT. § 1-539-10(b) (2011) ("To the extent that any charitable organization or volunteer has liability insurance, that charitable organization or volunteer shall be deemed to have waived the qualified immunity herein to the extent of indemnification by insurance for the negligence by any volunteer.").

\textsuperscript{149} While it is true that some personal umbrella policies and homeowners' insurance may cover nonprofit board service as well, the authors recommend a belt and suspenders approach by suggesting that corporation-sponsored D&O insurance should be a candidate's prerequisite to his or her willingness to serve on a nonprofit board regardless of the presence of homeowners' or umbrella insurance that the candidate may otherwise have. In addition to insurance, the Nonprofit Corporation Act provides for both mandatory and permissive indemnification by the corporation for a director's expenses in litigating claims. See id. §§ 55A-8-50 to -58.

\textsuperscript{150} See id. § 55A-8-60.

\textsuperscript{151} Id.
This qualified immunity is designed to encourage nonprofit board membership.\textsuperscript{152} As is the case with the general charitable volunteer immunity, the immunity for nonprofit directors is not absolute. The immunity of nonprofit officers and directors is conditioned on good faith and the absence of willful or wanton misconduct. The statute also provides a notable exclusion from the immunity if the director or officer received an improper personal benefit. As noted above, the current law also denies immunity to officers or directors\textsuperscript{153} who are compensated for their services.

If the immunity statutes do not apply for any of the reasons stated above, directors who do not perform their statutory and fiduciary obligations may be held accountable. The basic remedies for director misconduct would include action by the Attorney General to dissolve the corporation,\textsuperscript{154} and in a membership nonprofit, there is the possibility of a derivative suit.\textsuperscript{155}

\textbf{B. Director Removal}

In an extreme case of director misconduct, the director could be subject to removal for cause.\textsuperscript{156} For example, misuse of the organization’s funds for personal purposes is grounds for removal for cause.\textsuperscript{157} A director’s failure to follow the organization’s procedures may also be grounds for removal for

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\textsuperscript{153} The current statute expressly permits directors to be compensated. N.C. GEN. STAT. § 55A-8-12 (2011). It is the authors’ view that compensated directors who do not serve as full-time employees should be the exception rather than the rule.

\textsuperscript{154} See, e.g., id. § 55A-14-30(a) (dissolution in action by Attorney General).

\textsuperscript{155} Id. § 55A-7-40.

\textsuperscript{156} Id. § 55A-8-10 (noting a court may remove a director if “(1) [t]he director engaged in fraudulent or dishonest conduct, or gross abuse of authority or discretion, with respect to the corporation, or a final judgment has been entered finding that the director has violated a duty set forth in G.S. 55A-8-30 through G.S. 55A-8-33, and (2) [t]he removal is in the best interest of the corporation.”). The action for judicial removal may be brought by either the corporation or 10\% of the members if it is a membership nonprofit corporation. Id. In addition to judicial removal for cause, directors may be removed with or without cause (unless the articles limit removal to for cause) by the directors or members who elected them. See id. § 55A-8-08; see also id. § 55A-8-10 (removal of designated or appointed directors).

\textsuperscript{157} See, e.g., People v. Winston, No. 007180/10, slip op. at 4 (N.Y. Sup. Ct. Dec. 17, 2010) (finding sufficient cause for removal under section 706 of New York’s Not-for-Profit Corporation statute where two directors had used approximately $13,000 in company debit cards for personal purchases); see also, e.g., Nevins v. Bryan, 885 A.2d 233, 253 (Del. Ch. 2005) (upholding the removal of a nonprofit director who allegedly inappropriately used about $55,000 and noting that removal without cause is allowed by the Delaware statute); Nixon v. Lichtenstein, 959 S.W.2d 854, 861 (Mo. Ct. App. 1997) (finding that the directors’ ignoring of the conflict of interest statutes and setting their salary in excess of the organization’s rules qualified as grounds for removal of directors for cause).
cause. North Carolina follows the Model Nonprofit Corporation Act in providing for removal of directors by the directors or members (if any), as well as judicial removal for cause.

C. Actions by the Attorney General

On occasion, the North Carolina Attorney General has become involved in pursuing nonprofit abuses. Although some state attorneys general have been more aggressive in pursuing nonprofit abuses, following the pattern in most states, the North Carolina Attorney General may not have the resources to focus on nonprofits as an effective monitor of directors' duties. We believe that given the importance of charities and the

158. See Gilbert M. & Martha H. Hitchcock Found. v. Kountze, 720 N.W.2d 31, 33–34 (Neb. 2006) (upholding judicial removal of a nonprofit director for gross abuse of authority where the director refused to participate in board meetings for the preceding four years, changed the corporation's registered office without board approval, and attempted to hold elections for new directors without giving notice to other directors).

159. § 55A-8-08; REVISED MODEL NONPROFIT CORP. ACT § 8.08 (2008).


widespread abuses, the North Carolina Attorney General should devote more resources to pursue nonprofit board omissions, misdeeds, and failures.

D. Derivative Suits

At one time North Carolina did not have a statute recognizing derivative suits with respect to nonprofit corporations. Following the pattern in other states, section 55A-7-40 of the General Statutes of North Carolina expressly permits derivative suits. Derivative suits can be costly to bring. With respect to for-profit corporations, plaintiffs' attorneys are often motivated by the attorneys' fees that could be awarded if the suit is successful or settled. Except with respect to large foundations and nonprofit hospitals and insurers, the economic stakes are quite low. Accordingly, the absence of meaningful economic incentives for bringing a derivative suit is likely to render it an impotent remedy except in the case of large nonprofit organizations.

The lack of adequate resources to police charities has frequently been acknowledged. See, e.g., Nina J. Crimm, Shortcomings in U.S. Federal Tax Regulatory Regime of Private Foundations: Insights for Australia, 35 VAND. J. TRANSNAT'L. L. 749, 783–85 (2002) (discussing the low level of resources available for regulating charities); see also Initiatives, NAT'L ASSOC. OF ATT'YS GEN., http://www.naag.org/initiatives.php (last visited Aug. 27, 2012) (indicating, among other things, the listing includes Amber Alert, DEA National Drug Take Back Day, Federal Trade Commission Money Matters for Consumers, Financial Fraud Enforcement Task Force, and Global Justice Information Sharing Initiative). The Association nevertheless cosponsored a conference on the Intersection of Technology, the Charitable Sector and State Regulators. See NACTRI Co-Sponsors Charities Conference, NAT'L ASSOC. OF ATT'YS GEN., http://www.naag.org/nagtri-co-sponsors-charities-conference.php (last visited Aug. 27, 2012). In Holt, the Attorney General was not the exclusive party to bring suit. Id. The court allowed the plaintiff trustees to bring suit challenging the change in name and mission of the foundation. Id. at 938. The Attorney General had found that the change was not a proper one since the funds were still going toward the public good even though the plaintiff trustees disagreed. Id. at 934.


165. See, e.g., CAL. CORP. CODE § 5710 (2012) (members' derivative suits); REVISED MODEL NONPROFIT CORP. ACT Ch. 13 (2008) (derivative suits generally); id. § 13.02 (stating that derivative suit may be brought by the lesser of five percent or fifty persons with voting rights or any member or director of a designated body).


167. See generally 2 COX & HAZEN, supra note 77, § 13 (discussing derivative litigation with respect to business corporations).
E. Is Best Practices Our Best Hope?

Even without a meaningful remedy for mismanagement, nonprofit directors are held to fiduciary standards of due diligence and oversight. To some extent the law may be largely aspirational168 because, as discussed above, courts and government officials tend to get involved only in the most egregious cases. Many nonprofits that have had problems have had small, homogeneous boards.169 Larger boards may not be feasible for smaller nonprofits, but diversity170 and financial literacy171 are important considerations regardless of size.


169. For a North Carolina example of high compensation with a very small board, see Rose, supra note 4 (describing high compensation paid to board members of what appears to be a family nonprofit). Consider also one instance in which the Missouri Attorney General convinced a nonprofit to follow his recommendations to increase board size so as to wrest control from one individual. See Grant Williams, Changes at Kauffman Foundation Approved by Missouri Attorney General, CHRON. OF PHILANTHROPY, Sept. 16, 2004, http://philanthropy.com/article/changes-at-kauffman-foundation/62237/; Nixon Says Kauffman Has Beefed Up KC Commitment, KAN. CITY BUS. J. (Sept. 1, 2004), http://www.bizjournals.com/kansascity/stories/2004/08/30/daily23.html. A number of nonprofits lost a good deal of money investing in Bernard Madoff funds and most of those nonprofits had small governing boards. See NIKI JAGPAL & JULIA CRAIG, LEARNING FROM MADOFF: LESSONS FOR FOUNDATION BOARDS (rev. ed. June 2009), http://www.ncrp.org/files/learning_from_madoff.pdf; Ian Wilhelm, Madoff Foundation Victims Lacked Adequate Board Size, Says Report, CHRON. OF PHILANTHROPY (June 25, 2009), http://philanthropy.com/article/Madoff-Foundation-Victims/63116/ (“Of the 150 or so nonprofit organizations affected by the Madoff Ponzi scheme, 105 lost 30 percent to all of their assets. Of that group, the median board size was three people, said the report by the National Committee for Responsive Philanthropy, a foundation watchdog group in Washington.”).


As discussed earlier, federal law has recently imposed heightened scrutiny on nonprofits and the role of nonprofit directors. North Carolina has a long tradition of recognizing directors' fiduciary duties. There are sound policy reasons for not increasing liability exposure because it would make nonprofit board service unattractive. Perhaps Form 990 will spur even more oversight and enforcement of nonprofit abuses at the state level. Since Form 990 provides more information than in the past, state attorneys general now have access to the increased transparency of nonprofit board operations. This increased transparency may also help shed light on improper practices. The North Carolina General Assembly has recognized the benefits of increased transparency as evidenced by the recent agreement involving UNC Health Care System and WakeMed under which UNC Health Care System agreed to complete and file Form 990, which will make public the same disclosures that WakeMed is required to file in its Form 990. The agreement was reached through the efforts of legislative leaders and provides an example of the legislature advocating for transparency and public disclosure. Even though the IRS may exempt specific organizations such as UNC Health Care from filing, this is a progressive move by the North Carolina General Assembly to ensure that the public disclosures are equal among two nonprofits. In addition, the North Carolina House and Senate are said to be likely to approve legislation that would give the UNC Board of Governors the ability to select UNC Health Care System directors who have traditionally been appointed by the Health Care System.

172. See supra Part II.
173. See supra Part V.
174. The North Carolina Attorney General provides consumer protection guidance on giving to charities. See Giving to Charity, N.C. DEPT OF JUSTICE, http://www.ncdoj.gov/Consumer/Charities-and-Non-Profits/Giving-to-Charity.aspx (last visited Aug. 27, 2012) (encouraging donors to learn more about charities before making donations). One of the suggestions is for donors to check with Guidestar online where nonprofits' completed Form 990s are readily accessible. Id.
176. See Locke & Frank, supra note 175 (discussing the settlement).
177. See id. ("[T]he GOP-dominated House and Senate are expected to approve a bill introduced Tuesday that would overhaul the UNC Health Care System's governance structure, giving the politically appointed UNC Board of Governors the power to select the membership. The current board is appointed by the health care entity and lawmakers are concerned it is too stacked in UNC's favor and doesn't allow for divergent viewpoints. Apodaca acknowledged the new structure would inject politics into the management of...")
CONCLUSION

Over the past ten years there has been increased concern over nonprofit corporate governance throughout the country. The IRS has enhanced its disclosure requirements with a view toward holding nonprofits more accountable when the governing board's lack of due diligence results in noncompliance with the requirements for federal tax exemption. Following heightened governance standards in the wake of the Sarbanes-Oxley Act, the nonprofit world has significantly revamped its concept of best board practices.

Nonprofit directors' obligations quite properly are under a microscope. This Article has reviewed the history of the North Carolina Nonprofit Corporation Act. North Carolina has a strong tradition of embracing directors' fiduciary obligations. The national developments in recent years necessarily incorporate the heightened awareness of nonprofit board obligations into the directors' obligations of care and due diligence. Director conduct that might have been described as merely careless fifteen years ago could well qualify as "wanton" so as to render the liability immunity statutes inapplicable. In addition, following the pattern in some other states, the North Carolina Attorney General should be given the resources necessary to effectively pursue nonprofit abuse and make this abuse a top priority.

See supra Part II.
179. See supra Part III.
180. See supra Part V.B.
181. See supra notes 139–141 and accompanying text.