

ORANGE COUNTY BUSINESS JOURNAL

Will Your Charitable Service Go Unpunished?

by Michael Reynolds, Partner, Snell & Wilmer

“No good deed goes unpunished.” While this famous aphorism is often attributed to sources as diverse as Clare Booth Luce and Andrew Mellon, it is being uttered with increasing frequency by charitable board members who find themselves in the crosshairs of law enforcement investigations and litigation. Recent, vigorous prosecutions by the California Attorney General’s office and the IRS demonstrate the willingness of both agencies to pursue **volunteer** directors of charities for fines, penalties, investigative costs and unpaid employment taxes (as well as interest and penalties on those taxes).

You didn’t volunteer to be sued when you signed up to serve on that charitable board. So you should ask some basic questions and learn some basic rules before agreeing to serve as a director of a charity.

Does the charity handle large sums of money?

The more money that passes through a charity’s hands, the more likely the charity’s activities will be on the AG’s radar. This, in turn, results in greater risk to the volunteer director. State and federal rules present an array of accounting and accountability requirements. Directors bear the ultimate responsibility to see that the charity complies with them.

Unfortunately, many of the record-making and corporate governance rules in California are vague. For example, California requires a charity to keep “adequate and correct books and records of account” but doesn’t say what is “adequate” or “correct.” Therefore, a prospective director would be wise to ask who handles the books and records and who prepares and files any annual reports to the state AG’s office and the IRS. Do they appear skillfully presented by competent professionals? Does the board have competent legal counsel to advise the charity how to govern itself? If so, you, as a director, may be protected by a statutory “safe harbor” governing actions undertaken on the advice of these professionals.

California law also requires a charity to keep minutes of the proceedings of its board and committees. Ask to see these, if for no other reason than to better understand how the charitable board operates. Are the minutes clear? Do they seem to be sufficiently detailed, or do they raise more questions than they answer? Does the board seem to be acting reasonably?

What duties will I have?

Although it is an honor to be asked to serve on a charitable board, your service entails responsibilities you may not have thought about. This is true even for volunteer directors who serve in an “honorary” capacity, often because they are large donors.

All directors have two fiduciary duties – a duty of loyalty and a duty of care. The duty of **loyalty** obligates the director to avoid engaging in financial transactions with the charity that aren’t approved in advance by a “disinterested majority” of the board. Does this mean that a majority of disinterested directors must approve the transaction? Or does it mean the majority of the directors of the charity must be disinterested, and the number of disinterested directors voting in favor of the transaction must constitute a majority of the entire

board? The AG has taken the latter position in recent litigation.

There are various other requirements surrounding financial dealings between the charity and its members. Many of these are also vague, such as the requirement that compensation paid to officers be “just and reasonable.” Who defines “just” and “reasonable?” It could quite possibly be a jury of your peers. Worse yet, the AG has sued disinterested directors for failing to stop compensation arrangements which, after the fact, the AG believed not to be just and reasonable. Other requirements are clearer, such as the statutory prohibition on the chief executive or president serving as chief financial officer or treasurer.

The **duty of care** is, in short, the duty to stay awake. It obliges a director to be actively involved in overseeing the charity’s operations. Board members who show up for the occasional meeting but fail to ask questions, inspect minutes and delve into treasurer’s reports are asking for trouble. The AG has sued volunteer directors alleging they breached their duty of care by failing to stop other directors from breaching their duty of loyalty.

What is the charity’s financial condition?

Is the charity living within its financial means? In a time of declining donations and revenues, some charities are in danger of exhausting their financial resources. A director can be held personally responsible for a charity’s tax debts. To avoid these liabilities, a director may need to summon the courage to make unpopular financial choices on the charity’s behalf.

How prominent is the charity?

The higher profile the charity, the more likely it is to be on the radar screen of the AG, the IRS, the media and the public at large. While the public attention can be alluring for some, for others it is a potential distraction from the larger, charitable goals of the organization.

Does the charity carry directors and officers insurance?

The plethora of laws and regulations and the spasmodic enforcement campaigns by AGs makes it important for charities to maintain directors and officers coverage appropriate to the risks that their direc-

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tors undertake. The insurance has two functions: to fund the cost of a legal defense and to provide coverage in the case of loss. The ideal policy will have sufficiently high coverage limits and will provide "defense outside the limits of coverage," meaning that legal expenses will not be deducted from the policy loss limits.

Americans have given of their time, talents and resources on a scale unprecedented in world history. We are a nation of volunteers; volunteers are needed now more than ever, given recent constraints on public revenues. But when accepting the call to serve as a director of a charity, you must realize you can expose yourself to liability, however good your intentions. Be active, stay vigilant and behave independently. Educate yourself as to your duties and don't let your good deeds be punished.