DIRECTORS AND OFFICERS OF NON-PROFITS VOW TO CARE, HONOR AND OBEY: Maryland's New Charitable Enforcement and Protection of Charitable Assets Act

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Adherence to fiduciary duties by directors and officers of Maryland corporations formed to carry out charitable purposes has always been important, both for the proper and efficient operation of the nonprofit enterprise, and the protection of such directors and officers against claims that their actions or omissions harmed the enterprise or third parties. However, if nonprofit enterprises in Maryland and their directors and officers were not fully appreciative of or well versed in how to carry out their fiduciary duties, they now have another significant reason to take this issue to heart.

In 2014, a new Act was passed in Maryland entitled "Charitable Enforcement and Protection of Charitable Assets." As part of this Act, new Title 6.5, called "Protection of Charitable Assets," was added to the Maryland Business Regulations Article. Among other things, this Title provides that the Maryland Attorney General has the authority to (among other things) take action to prevent or remedy a "breach of fiduciary or other legal duty in the governance, management, or administration of a charitable asset" (emphasis added).

Considering this new authority, a brief refresher on Maryland nonstock corporations and the fiduciary duties of their directors and officers is in order.

"Nonprofit" organizations that hold "charitable assets" for "charitable purposes" are, commonly, formed for charitable, religious, educational or scientific purposes which serve the interests of the community or benefit the public at large (such as, for example, hospitals, churches, elder care communities, educational institutions and entities created to serve the poor or disadvantaged). Organizations that pursue these purposes are generally formed as corporations under state law. While a number of states have specific statutory provisions permitting the formation of "nonprofit" or "public benefit" corporations, in Maryland that is not the case. The Maryland Corporations and Associations Article (the "Article") does, however, contain a special subtitle allowing for the formation of "nonstock" corporations ("Nonstock"). In Maryland, the Nonstock form is generally used by nonprofit organizations that desire to operate in the corporate form.

Although Nonstocks are formed under different subtitle of the Article, they are nevertheless subject to the same rules that are generally applicable to other Maryland corporations under the Maryland General Corporation Law. Further, as is the case with directors and officers of other Maryland corporations, directors and officers of a Nonstock serve in a fiduciary capacity and are required to exercise their powers and responsibilities in accordance with the duties imposed under common law and by the Maryland General Corporation Law. In general, adherence to these duties requires that a person act in good faith and in a manner reasonably believed to be in the best interests of the Nonstock being served. More specifically, directors and officers of Nonstocks must comply with the fiduciary duties of care, loyalty and obedience.

Regarding the duty of care, the person must perform the duties of the subject position with the care that an ordinarily prudent person in a like position would use under similar circumstances. A person who performs the duties of a director or officer in accordance with this standard has no liability relating thereto. Accordingly, a person serving as a director or officer of a Nonstock should always act honestly and in a manner which she believes furthers the interests of the Nonstock, use common sense and devote sufficient time and attention to the matters at hand to reach informed and reasoned decisions. In this regard, it is important to note that here a director or officer does not possess adequate knowledge or expertise on a matter, reasonable reliance on the opinion or expertise of others, such as other officers and employees of the Nonstock, legal counsel and public accountants, in reaching a decision is permitted.

The duty of loyalty requires an undivided allegiance to Nonstock being served. Issues concerning corporate opportunities, confidentiality of information and conflicts of interest often fall under the duty of loyalty. This fiduciary duty applies to the use or disclosure of any information concerning the Nonstock. Further, loyalty to a Nonstock restricts a director or officer from using her position, or any information she acquires by virtue of her position, to gain a personal financial benefit. A breach of the duty of loyalty often occurs when a director or officer uses a Nonstock's property for personal ends, or appropriates an opportunity which would have benefited the Nonstock for person benefit. Relating to this obligation, it is important to note that under Maryland law, a director or office having a material financial interest in a contract or other transaction with a Nonstock must, at a minimum, either (i) disclose the interest and have the contract or transaction approved by a disinterested persons with the proper authority, or (ii) establish that the contract or transaction is fair and reasonable to the Nonstock.

Concerning the confidentiality aspect of the duty of loyalty, in the normal course of operations, a director or officer of a Nonstock should treat as confidential all matters involving the Nonstock until there has been general public disclosure (typically by an officer or director with the authority to make such disclosure), or the information becomes a matter of public record or common knowledge. On this point, it is worth noting that an individual director typically does not have the inherent power to be a spokesperson for a Nonstock, and thus a director's disclosure to the public of a Nonstock's activities may be a breach of the duty of loyalty unless the disclosure is properly authorized.

Regarding the duty of obedience, directors and officers of a Nonstock are required to adhere to the purpose for which the Nonstock was organized. In the case of a Nonstock operating for nonprofit purposes, adherence to purpose generally means keep the focus on the entity's nonprofit mission and purposes. Further, the duty of obedience also requires that, in accordance with their respective roles and responsibilities, directors and officers of a Nonstock ensure that the Nonstock conducts its activities in a lawful manner.

With this in mind, it is important to note that the Attorney General's powers under the new Act also include conducting investigations in situations where it needs to determine if protective actions regarding "charitable assets" held for "charitable purposes" are advisable, and enforcement powers to prevent or remedy the wasting or loss of the assets, or the breach of fiduciary or other legal duty. Further, if it is determined that a misapplication, diversion or waste of charitable assets has occurred, enforcement actions and remedies may include restraining orders, payment of restitution by responsible parties (e.g., directors or officers whose breach of fiduciary duties caused such wasting or loss), or the transfer of charitable assets to another charitable organization.

Accordingly, boards of directors and officers of Maryland Nonstocks that hold charitable assets for charitable purposes should be aware of the new Protection of Charitable Assets Title, and take appropriate steps to ensure that they understand and are complying with the fiduciary duty obligations they owe to the nonprofit organizations they serve.

For any of your nonprofit-related governance, business transactions, employment/HR, tax planning and litigation needs, please contact one of our attorneys:

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