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[Chapter] 8
DIRECTORS AND OFFICERS

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B. Meetings and Action of the Board
C. Directors
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[Subchapter] A
BOARD OF DIRECTORS

§ 8.01801, Requirement for and functions of board of directors.
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§ 8.01801. REQUIREMENT FOR AND FUNCTIONS OF BOARD OF DIRECTORS

(a) A nonprofit corporation must have a board of directors.

(b) Except as provided in Section 8.12812 (designated body), all corporate powers must be exercised by or under the authority of the board of directors of the nonprofit corporation, and the activities and affairs of the corporation must be managed by or under the direction, and subject to the oversight, of its board of directors.


CROSS-REFERENCES

Designated body, see § 8.12812.
Director standards of conduct, see § 8.30830.
Indemnification, see §§ 8.50-8.58850 through 858.
Officers, see §§ 8.40 & 8.41840 and 841.

OFFICIAL COMMENT

Section 8.01801(a) requires that every nonprofit corporation have a “board of directors.” That term is defined in Section 1.40 to include a designated body to the extent the powers, functions, or authority of the board have been vested in the designated body. The ability to create one or more designated bodies permits wide flexibility when designing the governance structure of a particular corporation.

The definition of “board of directors” in Section 1.40102 provides that the term refers to “the group of individuals responsible for the management of the activities and affairs of the nonprofit corporation, regardless of the name used to refer to the group.” Thus the board of directors may be referred to as the “board of trustees” or by some other name. Regardless of the name by which it is known, if a group satisfies the definition of “board of directors” it will have that status.

That term “board of directors” is defined in Section 102 to include a designated body to the extent the powers, functions, or authority of the board have been vested in the designated body. The ability to create one or more designated bodies permits wide flexibility when designing the governance structure of a particular corporation.

In Section 8.01801(b) states that “the activities and affairs of the corporation must be managed by or under the direction, and subject to the oversight, of its board of directors.” The phrase “by or under the direction, and subject to the oversight, of” encompasses the varying functions of boards of directors of different nonprofit corporations. In some
corporations, the board of directors may be involved in the day-to-day activities and affairs and it may be reasonable to describe management as being “by” the board of directors. But in many other corporations, the activities and affairs are managed “under the direction, and subject to the oversight, of” the board of directors, since operational management is delegated to officers and other professional managers.

While Section 8.01801(b), in providing for corporate powers to be exercised under the authority of the board of directors, allows the board of directors to delegate to appropriate officers, employees or agents of the nonprofit corporation authority to exercise powers and perform functions not required by law to be exercised or performed by the board of directors itself, responsibility to oversee the exercise of that delegated authority nonetheless remains with the board of directors. The scope of that oversight responsibility will vary depending on the nature of the corporation’s activities.

Although delegation does not relieve the board of directors of its responsibilities of oversight from its responsibility to oversee the activities and affairs of the nonprofit corporation, directors should not be held personally responsible for actions or omissions of officers, employees, or agents of the nonprofit corporation, so long as the directors have relied reasonably and in good faith upon those officers, employees, or agents. See Sections 8.30830 and 8.31831 and their Official Comments. Directors generally have the power to probe into day-to-day management to any depth they choose, but they have the obligation to do so only to the extent that the directors’ oversight responsibilities may require, or, for example, when they become aware of matters that make reliance on management or other persons unwarranted.

§ 8.02802. QUALIFICATIONS OF DIRECTORS

A director of a nonprofit corporation must be an individual [of the age of majority]. The articles of incorporation or bylaws may prescribe other qualifications for directors. A director need not be a resident of this state or a member of the corporation unless the articles or bylaws so prescribe.


CROSS-REFERENCES

Articles of incorporation, see § 2.02202 and Ch Subch. 409A.
Bylaws, see § 2.06206 and Ch Subch. 409B.
Selection of directors, § 804.

OFFICIAL COMMENT
The elimination of mandatory special qualifications for directors is now nearly universal, but the articles of incorporation or bylaws may prescribe special qualifications where a nonprofit corporation considers that appropriate.

Some states permit a minority of directors of a nonprofit corporation to be younger than the age of majority, sometimes limiting the use of such directors to youth clubs or other nonprofit corporations with a similar mission. Restricting service as a director of a corporation to individuals of the age of majority is proposed as an optional provision in Section 802, and an enacting state should review its existing law before deciding whether to include that optional provision.

Although this section requires that directors be individuals, there is no such requirement with respect to delegates or members of a designated body or delegates and the definitions. The definition of “delegate” in Section 1.40 refers simply to the “persons” who comprise those groups, a “person”, and the definition of “This section does not apply to a designated body” in Section 102 refers to “a person or group.” “Person” is defined in Section 102 to include “an individual and an entity.” The qualifications of members of a designated body are dealt with in Section 8.12812(c).

Qualifications may apply to all board members or to a specified percentage or number of directors. An example of a qualification applying to fewer than all directors would be a requirement that at least two directors must have specified nonprofit, business, or professional experience or a particular educational degree or background. Careful consideration should be given to the intended effect of the application of any qualification that applies to fewer than all directors in the context of an election contest in which only some of the nominees satisfy this qualification. In the event that specified qualifications for some or all directors are not satisfied, remedial steps could be addressed in the articles of incorporation or bylaws, or can be left to other mechanisms available to a nonprofit corporation, its members and/or its board, such as the provisions permitting changes in the number of directors and providing for the filling of vacancies on the board. See Sections 803 and 810.

The purpose of Section 802(a) is to permit qualifications that may benefit the corporation by enhancing the board’s ability to perform its role effectively. However, this needs to be balanced against the risk that qualifications could be misused for entrenchment purposes by incumbents or for other improper purposes. An example of a qualification that would not be proper would be a requirement that is impermissibly discriminatory under the Civil Rights Act of 1964.

§ 8.03803. NUMBER OF DIRECTORS

(a) A board of directors must consist of three or more directors, with the number specified in or fixed in accordance with the articles of incorporation or bylaws.
(b) The number of directors may be increased or decreased (but to no fewer than three) from time to time by amendment to, or in the manner provided in, the articles of incorporation or bylaws.


CROSS-REFERENCES

Annual meeting of members, see § 7.01.
Classification of board of directors, see § 8.06.
Deadlocked board of directors as ground for dissolution, see § 14.301120.
Voting Staggered terms for directors, see § 7.27806.
Terms of directors generally, see § 8.05805.
Voting for directors, § 727.

OFFICIAL COMMENT

Section 8.03803 prescribes rules for (i) determining the size of the board of directors and (ii) changing the number of directors once the board’s size has been established.

1. Minimum Number of Directors

Section 8.03803(a) requires a nonprofit corporation to have a minimum of three directors. So long as that limitation is satisfied, the size of the board of directors may be “specified in or fixed in accordance with” the articles of incorporation or bylaws. The size of the board of directors thus may be fixed initially in one or more of the fundamental corporate documents, or the decision as to the size of the initial board of directors may be made thereafter in the manner authorized in those documents.

2. Changes in the Size of the Board of Directors

Section 8.03803(b) provides a nonprofit corporation with the freedom to design the provisions of its articles of incorporation and bylaws relating to the size of its board with a view to achieving the combination of flexibility for the board of directors and protection for members that it deems appropriate. The articles or bylaws could provide for a specified number of directors or a variable range board, thereby requiring member action to set board size within a range from a minimum to a maximum, or an unlimited size not fewer than three, with the number to be fixed by the members or the board. If the members or the board want to change the fixed specified size of the board, to change the limits range established for the size of the variable-range board, or to change from a variable-range board to a fixed board or vice versa, the articles or bylaws could permit amendment by the board of directors, or board size within a range or of unlimited size to a specified board size or vice versa, member or board action would be required.
to make those changes by amending the articles or bylaws could require that any amendment, in whole or in part, be made only by the members. Any change would be made in the manner provided by the articles or bylaws. Typically, the board of directors would be permitted to change the board size within the established variable range. If a corporation wishes to ensure that any change in the number of directors be approved by members, then an appropriate restriction would need to be included in the articles or bylaws.

The board’s power to change the number of directors, like all other board powers, is subject to compliance with applicable standards governing director conduct. In particular, it may be inappropriate to change the size of the board for the primary purpose of maintaining control or defeating particular candidates for the board. See Blasius Indus., Inc. v. Atlas Corp., 564 A.2d 651 (Del. Ch. 1988).

§ 8.04804. SELECTION OF DIRECTORS

(a) The directors of a membership corporation (other than any initial directors named in the articles of incorporation or elected by the incorporators) shall be elected by the members entitled to vote at the time at the first annual meeting of members, and at each annual meeting thereafter, unless the articles or bylaws provide some other time or method of election, or provide that some or all of the directors are appointed by some other person or designated in some other manner.

(b) The directors of a nonmembership corporation (other than any initial directors named in the articles of incorporation or elected by the incorporators) shall be elected, appointed, or designated as provided in the articles or bylaws. If no method of designation or appointment is set forth in the articles or bylaws, the directors (other than any initial directors) shall be elected by the board.

(c) If the articles of incorporation or bylaws authorize dividing the members into classes, the articles or bylaws may also authorize the election of all or a specified number of directors by the holders of one or more authorized classes of members. A class or multiple classes of members entitled to elect one or more directors is a separate voting group for purposes of the election of directors.


CROSS-REFERENCES

Initial directors:

Appointed by incorporators, see § 2.05205
Named in articles, see § 2.02202

“Membership corporation” defined, see § 1.40102.
“Nonmembership corporation” defined, see § 1.40102.
Number of directors, see § 8.03803
OFFICIAL COMMENT

1. Membership Corporations

If a nonprofit corporation has members, the members are entitled to elect all the directors in the absence of a contrary provision in the articles of incorporation or bylaws. The articles or bylaws may set forth a simple one-vote-per-member structure or may provide for election by voting groups of members, chapters or other organizational units or by region or other geographic groupings. See Sections 2.02202 and 2.05205 as to appointment of initial directors. See Sections 7.04704, 7.09709, 7.21721, 7.25725, and 7.27727 as to the ways in which members may vote.

Section 8.04804 should be applied in a manner consistent with the concept that an election procedure must be reasonable. See Dozier v. Automobile Club of Michigan, 69 Mich. App. 114, 244 N.W.2d 376 (1976); Braude v. Havenner, 38 Cal. App. 3d 526, 113 Cal. Rptr. 386 (1974); Valle v. North Jersey Automobile Club, 125 N.J. Super. 302, 310 A.2d 518 (1973). The act does not specify detailed procedures, but leaves the matter to developing case law.

Even if a nonprofit corporation has members, the members need not elect some or all of the directors. Directors may hold office as a result of designation in the articles of incorporation or bylaws or as a result of being appointed by some person or entity.

Designation occurs when the articles of incorporation or bylaws name an individual as a director or designate the holder of some office or position as a director. For example, the President of Harvard, the Bishop of New York, or the head of a union may become a director of a nonprofit corporation pursuant to an article or bylaw provision designating the holder of their position as a director of the corporation. The individual would cease to be a director upon ceasing to hold the designated position.

2. Nonmembership Corporations

Section 8.04804 authorizes self-perpetuating boards of directors. If a nonprofit corporation does not have members, the board elects directors in the absence of a provision in the articles of incorporation or bylaws setting forth some other approach.

3. “Ex Officio” Directors

An individual may serve as a director of a nonprofit corporation “ex officio,” which means that the individual is a director because of some other office or position that the individual holds. Although an ex officio director is sometimes not entitled to vote as a director, the term “ex officio” does not include the concept that the position is non-voting. If an ex officio director is to be non-voting, that must be provided for expressly.
§ 8.05805. TERMS OF DIRECTORS GENERALLY

(a) The articles of incorporation or bylaws may specify the terms of directors. If a term is not specified in the articles or bylaws, the term of a director is one year. Except for directors who are appointed by persons who are not members or who are designated in a manner other than by election or appointment, the term of a director may not exceed six years.

(b) A decrease in the number of directors or term of office does not shorten an incumbent director’s term.

(c) Except as provided in the articles of incorporation or bylaws, the term of a director elected to fill a vacancy expires at the end of the unexpired term that the director is filling.

(d) Despite the expiration of a director’s term, the director continues to serve until the director’s successor is elected, appointed, or designated and until the director’s successor takes office unless otherwise provided in the articles of incorporation or bylaws or there is a decrease in the number of directors.


CROSS-REFERENCES

Annual members meeting, see § 7.01.
Court-ordered members meeting, see § 7.03703.
Number of Directors, § 803.
Removal, see of directors, §§ 8.08808 and 8.09809.
Resignation, see § 8.07.
Size Resignation of board directors, see § 8.03807.
Staggered terms for directors, see § 8.06806.
Vacancies, see Vacancy on board, § 8.10810.

OFFICIAL COMMENT

The usual term of directors is one year, but Section 8.05805(a) permits the articles of incorporation or bylaws to provide for longer terms. In the case of directors elected by the members, the permissible longer term is limited to six years. However, Section 8.05(a) permits directors who are not elected to serve for terms longer than six years maximum term is provided for individuals who are appointed by persons who are not members (such as the board of another nonprofit corporation that is not a member) or a director who is designated by means other than election or appointment (such as the designation of the president of the nonprofit corporation as a member of the board). Directors who serve “ex officio” are
“designated” for purposes of Section 8.05805(a) and thus are not limited to a term of six years. The act does not provide for term limits and thus a director may be elected to more than one term, regardless of the length of a term, unless the articles of incorporation or bylaws limit the number of terms a director may serve.

Section 8.05805(b) provides that a decrease in the number of directors does not shorten the term of an incumbent director or divest any director of his from office. Rather, the incumbent director’s term expires at the meeting of members at which the incumbent’s successor would otherwise be elected on the date that the incumbent director’s term would have expired prior to the decrease in the number of directors and the incumbent director does not continue to serve (“holdover”) after that date.

Section 8.05805(d) provides for “holdover” directors so that directorships do not automatically become vacant at the expiration of their terms but the same persons continue in office until successors qualify for office, unless there is a decrease in the number of directors or unless otherwise provided in the articles of incorporation or bylaws. Thus, this means that the power of the board of directors to act continues uninterrupted even though an annual meeting of the members at which directors are to be elected is not held, or the members, in a membership corporation, or the board, in a nonmembership corporation, are deadlocked and unable to or otherwise do not elect directors at the meeting.

The act recognizes that an individual may become a director of a nonprofit corporation in one of three different ways:

1. The individual may be elected a director, whether by the members, the incumbent board, or a designated body. Election by the board may be to fill a vacancy or in a regular election if the corporation does not have members.

2. The individual may be appointed in the manner provided in the articles of incorporation or bylaws. For example, the bylaws of a religious corporation may provide that the leader of a superior religious order may appoint directors of the corporation.

3. The individual may be become a director because the individual is designated as a director in the articles of incorporation or bylaws. For example, the bylaws of a religious corporation may provide that the individual serving at the time as the leader of a superior religious order is designated as a director of the corporation.

§ 8.06806. STAGGERED TERMS FOR DIRECTORS

The articles of incorporation or bylaws may provide for staggering the terms of directors by dividing the total number of directors into groups of one or more directors. The terms of office and number of directors in each group do not need to be uniform.

OFFICIAL COMMENT

This section validates Section 806 permits the practice of “classifying” the board or “staggering” the terms of directors so that less than all of the directors are elected each year. Unlike the case with business corporations, where each class of directors must be as nearly equal in number as possible, this section permits classes of directors to vary in size from each other. This section also does not limit the number of classes that may be created.

§ 8.07. RESIGNATION OF DIRECTORS

(a) A director may resign at any time by delivering a signed notice of resignation in the form of a record to the chair of the board of directors or to an executive officer, its chair, or the secretary of the corporation.

(b) A resignation is effective when the notice is delivered unless the notice specifies a later effective time or an effective time determined upon a future event.


CROSS-REFERENCES

“Deliver” defined, see § 1.40.102.
Notice, see § 1.40.103.
“Secretary” defined, see § 1.40.102.
Vacancies, see Vacancy on board, § 8.10.810.

OFFICIAL COMMENT

The resignation of a director is effective when the resignation notice is delivered unless the notice specifies a later effective time, in which case the director continues to serve until that
later time. **Since a** director giving the notice **with a delayed effective date** is still a member of the board, he or she, that director may participate in all decisions until the specified time, including the choice of a successor under Section 8.10810.

Vacancies created by a resignation effective at a later time may be filled before that date under Section 8.10.

Under Section 8.10, a vacancy that will occur at a specific later date by reason of a resignation effective at a later date may be filled before the vacancy occurs, but the new director may not take office until the vacancy occurs.

§ 8.08808. REMOVAL OF DIRECTORS BY MEMBERS OR OTHER PERSONS

(a) Removal of directors of a membership corporation is subject to the following provisions:

(1) The members may remove, with or without cause, one or more directors who have been elected by the members, unless the articles of incorporation or bylaws provide that directors may be removed only for cause. The articles or bylaws may specify what constitutes cause for removal. See Section 10.22922(a) (bylaw amendments requiring member approval).

(2) Except as provided in the articles of incorporation or bylaws, if a director is elected by a voting group of members, or by a chapter or other organizational unit, or by a region or other geographic grouping, only the members of that voting group or chapter, unit, region, or grouping may participate in the vote to remove the director.

(3) The notice of a meeting of members at which removal of a director is to be considered must state that the purpose, or one of the purposes, of the meeting is removal of the director.

(4) The board of directors of a membership corporation may not remove a director except as provided in subsection (c) or in the articles of incorporation or bylaws.

(b) The board of directors may remove a director of a nonmembership corporation:

(1) With or without cause, unless the articles of incorporation or bylaws provide that directors may be removed only for cause. The articles or bylaws may specify what constitutes cause for removal.

(2) As provided in subsection (c).

(c) The board of directors of a membership corporation or nonmembership corporation may remove a director who:

(1) has been declared of unsound mind by a final order of court:
(2) has been convicted of a felony;

(3) has been found by a final order of court to have breached a duty as a director under [Subchapter] 8C (directors);

(4) has missed the number of board meetings specified in the articles of incorporation or bylaws, if the articles or bylaws at the beginning of the director’s current term provided that a director may be removed for missing the specified number of board meetings; or

(5) does not satisfy at the time any of the qualifications for directors set forth in the articles of incorporation or bylaws at the beginning of the director’s current term, if the decision that the director fails to satisfy a qualification is made by the vote of a majority of the directors who meet all of the required qualifications.

(d) A director who is designated in the articles of incorporation or bylaws may be removed by an amendment to the articles or bylaws deleting or changing the designation. See Section 10.30930 (approval of amendments by third persons).

(e) Except as provided in the articles of incorporation or bylaws, a director who is appointed by persons other than the members may be removed with or without cause by those persons.

Source Note: Subsection (a) is derived from Model Nonprofit Corporation Act (1987), 3rd Ed. (2008), § 8.08. Compare Cf. Model Business Corporation Act, 3d Ed. (2002) § 8.08. Subsection (c) is patterned after Cal. Corps. Code § 5221(a) and (b). Subsections (d) and (e) are derived from Model Nonprofit Corporation Act (1987) § 8.09. (2016 Revision), § 8.08.

CROSS-REFERENCES

Court-ordered removal Member meetings, see §§ 8.09 through 703.
Director standards of conduct, see § 8.30.
Election of directors generally, see § 7.27.
Meeting notice, see § 7.05.
“Membership corporation” defined, see § 1.40102.
“Nonmembership corporation” defined, see § 1.40102.
Member meetings Notice of meeting, see §§ 7.01 through 7.03.
Quorum for voting group, see §§ 7.24 through 7.26.
Removal of directors by judicial proceeding, § 809.
Standards of conduct for directors, § 830.
Voting for directors, § 727.
“Voting group” defined, see § 1.40102.
Section 8.08 provides a default rule that the members should normally have the power to change at will the directors elected by them. This section reverses the common law position that directors have a statutory entitlement to their office and can be removed only for cause—fraud, criminal conduct, gross abuse of office amounting to a breach of trust, or similar conduct. However, Section 808 permits the power to remove directors of a membership corporation is subject to certain restrictions set forth in Section 8.08:

without cause to be eliminated by a provision in the articles of incorporation or bylaws. A

(1) The power to remove a director without cause may be eliminated by a provision in the articles of incorporation or bylaws.

(2) If the articles of incorporation provide that a voting group of members or other group is entitled to elect a director (see Section 8.04), only that group may participate in the vote whether or not to remove that director. But that director may be removed by court proceeding under Section 8.09809 despite this section.

Although Section 808(b) and (c) have specific requirements with respect to removal of directors elected by particular voting groups, those directors nevertheless may be removed by court proceeding under Section 809. Section 808(d) acknowledges the seriousness of director removal by requiring the meeting notice to state that removal of specific directors will be proposed. Section 808(d) governs removal of directors at a meeting of members, but does not preclude removal by means of member action by written consent under Section 704. In the absence of a greater vote requirement in the articles of incorporation or bylaws removal of a director by less than unanimous written consent would require that a majority of the members of the relevant voting group consent to the removal.

§ 8.09809. REMOVAL OF DIRECTORS BY JUDICIAL PROCEEDING

(a) The [name or describe] court of the county where the principal office of a nonprofit corporation (or, if none in this state, its registered office) is located may remove a director from office in a proceeding commenced by or in the right of the corporation if the court finds that:

(1) the director engaged in fraudulent conduct with respect to the corporation or its members, grossly abused the position of director, or intentionally inflicted harm on the corporation; and

(2) considering the director’s course of conduct and the inadequacy of other available remedies, removal would be in the best interest of the corporation.

(b) A member, individual director, or member of a designated body proceeding on behalf of the nonprofit corporation under subsection (a) shall comply with all of the requirements of [Chapter] 135 (derivative proceedings).
(c) The court, in addition to removing the director, may bar the director from being reelected, redesignated, or reappointed for a period prescribed by the court.

(d) Nothing in this section limits the equitable powers of the court to order other relief.

(e) If a proceeding is commenced under this section to remove a director of a charitable corporation, the plaintiff must give the attorney general notice in record form of the commencement of the proceeding.


CROSS-REFERENCES

Derivative proceedings, see Ch. 135.
Director standards Standards of conduct for directors, see § 8.30830.
“Member” defined, see § 1.40102.
“Principal office”:
defined, see § 1.40102.
designated in annual report, see § 16.21421.
“Proceeding” defined, see § 1.40102.
Registered office:
designated in annual report, see § 16.21421.
required, see §§ 2.02, 5.01, 202 and 15.07220.
Removal by members, see § 8.08 808.

OFFICIAL COMMENT

Section 8.09 809 is designed to operate in the limited circumstance where other remedies are inadequate to address serious misconduct by a director and it is impracticable for members to invoke the usual remedy of removal under Section 8.08. In recognition that director election and removal are principal prerogatives of members, Section 8.09 authorizes judicial removal of a director who is found to have engaged in serious misconduct as described in subsection (a)(1) if the court also finds that, taking into consideration the director’s course of conduct and the inadequacy of other available remedies, removal of the director would be in the best interest of the nonprofit in the case of a membership corporation or the directors in a nonmembership corporation. Misconduct serious enough to justify the extraordinary remedy of judicial removal does not involve any matter falling within an individual director’s lawful exercise of business judgment, no matter how unpopular the director’s views may be with the other members of the board. Policy and personal differences among the members of the board of directors should be left to be resolved by the members in a membership corporation or by the board in a nonmembership corporation.
Section 809 is designed to interfere as little as possible with the usual mechanisms of corporate governance. It is not intended to permit judicial resolution of internal corporate disputes involving issues other than those specified in subsection (a).

Section 8.09809(d) makes it clear that the court is not restricted to the removal remedy in actions under this section but may order any other equitable relief. Where, for example, the complaint concerns an ongoing course of conduct that is harmful to the nonprofit corporation, the court may enjoin the director from continuing that conduct. In another instance, the court may determine that the director’s continuation in office is inimical to the best interest of the corporation.

A proceeding under this section may be brought directly by the board of directors. A proceeding may also be brought by a member or an individual director or member of a designated body suing derivatively. If an action is brought derivatively, all of the provisions of Chapter 135, including dismissal under Section 13.05505, are applicable to the action.

Section 8.09 is designed to interfere as little as possible with the usual mechanisms of corporate governance. Accordingly, except for limited circumstances such as those described above, where members have reelected or declined to remove a director with full knowledge of the director’s misbehavior, the court should decline to entertain an action for removal under Section 8.09. It is not intended to permit judicial resolution of internal corporate disputes involving issues other than those specified in subsection (a).

§ 8.10810. VACANCY ON BOARD

(a) Except as otherwise provided in subsection (b), the articles of incorporation, or the bylaws, if a vacancy occurs on the board of directors, including a vacancy resulting from an increase in the number of directors, the vacancy may be filled by a majority of the directors remaining in office even if they constitute less than a quorum.

(b) Except as provided in the articles of incorporation or bylaws, a vacancy in the position of a director who is:

(1) elected by a voting group of members, by a chapter or other organizational unit of members, or by a region or other geographic grouping of members, may be filled during the first three months after the vacancy occurs only by that voting group or chapter, unit, region, or grouping;

(2) appointed by persons other than the members, may be filled only by those persons; or

(3) designated in the articles of incorporation or bylaws may not be filled by action of the board of directors.

(c) A vacancy that will occur at a specific later time (by reason of a resignation effective at a later time under Section 8.07807(b) (resignation of directors) or otherwise) may be
filled before the vacancy occurs but the new director may not take office until the vacancy occurs.


**CROSS-REFERENCES**

- Number of directors, see § 8.03803.
- Quorum and voting of directors, see § 8.24824.
- Removal of directors, see §§ 8.08 & 8.09808 and 809.
- Resignation of directors, see § 8.07807.
- Terms of directors generally, see § 8.05805.
- Voting by voting group, see §§ 7.24724 and 7.25725.
- “Voting group” defined, see § 1.40102.

**OFFICIAL COMMENT**

Section 8.10810(a) allows a majority of the directors remaining in office to fill vacancies even though they are fewer than a quorum. For example, on a board of six directors where a quorum is four, if there are two vacancies, the vacancies may be filled by action of three of the remaining directors.

Section 8.10810(b)(1) protects the special rights of groups of members to elect directors by restricting the ability of the board of directors to fill a vacancy of a director elected by the group. The group is given the exclusive opportunity to fill the vacancy for an initial period, but the board is then given the power to fill the vacancy if the group does not act. The board of directors never has the power, however, to fill a vacancy in the case of a director designated or appointed in a manner other than election. Only the persons authorized to appoint a director may fill a vacancy in the appointed board seat. A vacancy in a designated board seat will only be filled when an individual satisfies the requirements of the designation.

Under Section 8.10810(c) permits vacancies that will arise on a specific later time to be filled in advance of that time so long as the designee does not actually take office until the vacancy occurs. The director in the office that will become vacant may participate in the selection of the successor. Such a vacancy arising at a later time is most likely to arise because it typically arises when there is a resignation by a director that is effective at a later date; it may also arise in connection with retirements or with prospective amendments to bylaws.

§ 8.11811. COMPENSATION OF DIRECTORS
Unless the articles of incorporation or bylaws provide otherwise, the board of directors may fix the compensation of directors.


CROSS-REFERENCES

Committees of board of directors: Board and advisory committees, see § 8.25825.
Director standards: Standards of conduct for directors, see § 8.30830.

OFFICIAL COMMENT

This section overrules the common law doctrine that prohibited directors from setting their own compensation.

When exercising their power under this section, the directors must comply with their duties as directors under Subchapter 8C.

Reimbursement of expenses incurred as a director in accordance with expense reimbursement policies of the nonprofit corporation, or as approved by the board, does not constitute compensation under this section. See Section 6.41641 with respect to amounts that may be paid as compensation or reimbursement of expenses.

§ 8.12812. DESIGNATED BODY

(a) Some, but less than all, of the powers, authority, or functions of the board of directors of a nonprofit corporation under this Act may be vested by the articles of incorporation or bylaws in a designated body. If such a designated body is created:

(1) The provisions of this [chapter] and other provisions of law on the rights, duties, and liabilities of the board of directors or directors individually also apply to the designated body and to the members of the designated body individually. The provisions of this [chapter] and other provisions of law on meetings, notice, and the manner of acting of the board of directors also apply to the designated body in the absence of an applicable rule in the articles of incorporation, bylaws or internal operating rules of the designated body.

(2) To the extent the powers, authority, or functions of the board of directors have been vested in the designated body, the directors are relieved from their duties and liabilities with respect to those powers, authority, and functions.

(3) A provision of the articles of incorporation regarding indemnification of directors or limiting the liability of directors adopted pursuant to Section 2.02202(b)(8) or (c)
(articles of incorporation) applies to members of the designated body, except as otherwise provided in the articles.

(b) Some, but less than all, of the rights or obligations of the members of a nonprofit corporation under this Act may be vested by the articles of incorporation or bylaws in a designated body. If such a designated body is created:

(1) The provisions of this Chapter and other provisions of law on the rights and obligations of members also apply to the designated body and to the members of the designated body individually. The provisions of this Chapter and other provisions of law on meetings, notice, and the manner of acting of members also apply to the designated body in the absence of an applicable provision in the articles of incorporation, bylaws or internal operating rules of the designated body.

(2) To the extent the rights or obligations of the members have been vested in the designated body, the members are relieved from responsibility with respect to those rights and obligations.

(c) The articles of incorporation or bylaws may prescribe qualifications for members of a designated body. Except as otherwise provided by the articles or bylaws, a member of a designated body does not need to be:

(1) an individual,

(2) a director, officer, or member of the nonprofit corporation, or

(3) a resident of this state.

(d) See Section 10.22922(a) (bylaw amendments requiring member approval).


CROSS-REFERENCES

“Designated bodies” were not referred to as such in the prior version of the act, although it did authorize a nonprofit corporation to adopt analogous governance arrangements. More detail has been provided in the current act to give nonprofit corporations greater certainty when...
using the flexibility inherent in the concept of a designated body to organize their affairs. It is not necessary for a designated body to be referred to by that name, and designated bodies are typically referred to by the name they have for other purposes.

If all the powers, authority, and functions of the board of directors are vested in a body, it is not a designated body but has instead the status of the board of directors. Similarly, if all the rights and obligations of the members are vested in a group of persons, the group is not a designated body and its members instead have the status of members.

If all the members of a group of individuals that have some of the powers, authority, or functions of the board of directors are directors and the group is established by action of the board, the group will be a committee of the board rather than a designated body. If at least one member of a group is not a director, however, the group will be a designated body.

Use of a designated body does not reduce accountability because this section makes clear that members of a designated body have the duties and liabilities of directors when discharging functions that would otherwise be within the purview of the board.

See Section 40.301030 with respect to special requirements for approval of amendments of the articles of incorporation or bylaws.

The Official Comments to certain sections of the act indicate some of the important issues on which a designated body can act, but those comments are not intended to be an exhaustive indication of how designated bodies may be used.

[Subchapter] B
MEETINGS AND ACTION OF THE BOARD

§ 8.20820. Meetings.
§ 8.21821. Action without meeting.
§ 8.22822. Call and notice of meeting.
§ 8.23823. Waiver of notice.
§ 8.24824. Quorum and voting.
§ 8.25825. Board and advisory committees.

§ 8.20820. MEETINGS

(a) The board of directors may hold regular or special meetings in or out of this state.
(b) Unless restricted by the articles of incorporation or bylaws provide otherwise or action of the board of directors may permit, any or all directors to participate in a regular or special meeting by, or conduct of the meeting board through the use of, any means of communication by which all directors participating may simultaneously hear each other during the meeting. A director participating in a meeting by this means is considered deemed to be present in person at the meeting.

CROSS-REFERENCES

Action without meeting, see § 8.21.

Notice Call and notice of meeting, see § 8.22.

Quorum and voting, see § 8.24.

Waiver of meeting-notice, see § 8.23.

OFFICIAL COMMENT

This section authorizes Section 820 provide flexibility with respect to holding meetings of directors and authorizes those meetings to be held anywhere. No distinction is made between meetings in-state and out-of-state. It also authorizes the board of directors to permit under Section 820, a meeting in which any or all of the directors to participate in a meeting by the use or through any means of communication by which all directors participating may simultaneously hear each other. This decision is discretionary with the section 820(b) will meet the statutory requirements. Depending on the nature of the matters to be considered, however, a board of directors, and a person participating in this fashion is considered to be present in person at the meeting for purposes of quorum and voting requirements may require an in-person meeting to provide greater opportunity for interchange. If a director is hearing-impaired, participation by that or other directors in a meeting by means of communications technology will still be permissible if reasonable accommodations are made to permit the hearing-impaired director to follow the discussion.

With the development of modern electronic technology, it is possible that the advantages of the traditional meeting, at which all members are present at a single place, may be obtained even though the participants are physically dispersed and no two directors are present at the same place. The advantage of the traditional meeting is the opportunity for interchange that is permitted by a meeting in a single room at which participants are physically present. If this opportunity for interchange is thought to be available by the board of directors, a meeting may be conducted by electronic means although no two directors are physically present at the same place and no specific place for the meeting is designated.

The provisions of this section also apply to meetings of a designated body. See Section 8.12.

§ 8.21. ACTION WITHOUT MEETING
(a) Except to the extent that the articles of incorporation or bylaws require that action by the board of directors be taken at a meeting, action required or permitted by this [actAct] to be taken by the board of directors may be taken without a meeting if each director signs a consent in the form of a record describing the action to be taken and delivers it to the nonprofit corporation.

(b) Action taken under this section is the act of the board of directors when one or more consents signed by all the directors are delivered to the nonprofit corporation. The consent may specify a later time as the time at which the action taken in the consent is to be effective. A director’s consent may be withdrawn by a revocation in the form of a record signed by the director and delivered to the corporation prior to before delivery to the corporation of unrevoked consents signed by all the directors.

(c) A consent signed under this section has the effect of action taken at a meeting of the board of directors and may be described as such in any document.


CROSS-REFERENCES

Call and notice of meeting, § 822.
Notice generally, see § 1.41103.
Notice of meeting, see § 8.22.
"Record" defined, see § 1.40102.
"Sign" defined, see § 1.40102.
Waiver of meeting-notice, see § 8.23823.

OFFICIAL COMMENT

The power of the board of directors to act unanimously without a meeting is based on the pragmatic consideration that in many situations a formal meeting is not needed. The consent may specify the time at which the action taken thereunder is to become effective.

Directors may take action by consent without a meeting only when approval of an action is unanimous. Accordingly, if a director abstains, is recused or withholds consent on an action, the action could not be authorized by consent, and a meeting would need to be held for the action to be approved.

Under Section 8.21 the requirement of unanimous consent precludes the possibility of stifling or ignoring opposing argument. A director opposed to an action that is proposed to be taken by unanimous consent, or uncertain about the desirability of that action, may compel the holding of a directors’ meeting to discuss the matter simply by withholding consent.

A designated body may act without a meeting pursuant to this section. See Section 8.128(a)(1).
§ 8.22822. CALL AND NOTICE OF MEETING

(a) Unless the articles of incorporation or bylaws provide otherwise, regular meetings of the board of directors may be held without notice of the date, time, place, or purpose of the meeting.

(b) Unless the articles of incorporation or bylaws provide for a longer or shorter period, special meetings of the board of directors must be preceded by at least two days’ notice of the date, time, and place of the meeting. The notice need not describe the purpose of the special meeting unless required by the articles of incorporation or bylaws.

(c) Unless the articles of incorporation or bylaws provide otherwise, the chair of the board, the highest ranking officer of the corporation, or 20% of the directors then in office may call and give notice of a meeting of the board of directors.

(d) The articles of incorporation or bylaws may authorize oral notice of meetings of the board of directors.


CROSS-REFERENCES

Action without meeting, see § 8.21821.
Meetings of board of directors, see §§ 8.20 & 8.21.
Notice, see § 1.41103.
Waiver of notice, see § 8.23823.

OFFICIAL COMMENT

Regular meetings of the board of directors may be held without notice and, special meetings always require only two days’ notice unless other requirements are imposed. The notice may be in the form of a record or oral if oral notice is reasonable in the circumstances. See Section 1.41103(a). If the notice of a special meeting is mailed, it must be deposited with the U.S. Mail at least seven days before the meeting because Section 1.41103(e) provides that notice by mail is effective five days after mailing.

No statement of the purpose of any meeting of the board is necessary in the notice unless required by the articles of incorporation or bylaws. These requirements differ from the requirements applicable to meetings of members because of the
fundamental differences in their roles: directors are a collegial body and meetings of directors are held more systematically and regularly than meetings of members.

The provisions of this section also apply to meetings of a designated body. See Section 8.128(a)(1).

§ 8.23823. WAIVER OF NOTICE

(a) A director may waive any notice required by this Act, the articles of incorporation, or the bylaws before or after the date and time stated in the notice. Except as provided by subsection (b), the waiver must be in the form of a record, signed by the director entitled to the notice, and filed with the nonprofit corporation for filing by the corporation with the minutes or corporate records.

(b) A director’s attendance at or participation in a meeting waives any required notice to the director of the meeting, unless the director at the beginning of the meeting (or promptly upon arrival) objects to holding the meeting or transacting business at the meeting and does not thereafter objecting, vote for or assent to action taken at the meeting.


CROSS-REFERENCES

Action without meeting, see § 8.21821.
Call and notice of meeting, § 822.
Meetings of board of directors, see § 8.20820.
Notice generally, see § 1.41103.
Notice of meeting, see § 8.22.
“Record” defined, see § 1.40102.
“Secretary” defined, see § 1.40102.
“Sign” defined, see § 1.40102.

OFFICIAL COMMENT

Section 8.23(a) reverses the common law rule that invalidates waivers of notice by directors after the date and time of the meeting. In modern practice notice is often a technical requirement and waivers should be freely permitted.

Section 8.23(b) recognizes that the function of notice is to inform directors of a meeting. If a director actually appears at the meeting, Section 823(b) generally provides that the director has probably had notice of it and generally should not be able to raise a technical
subsequently raise an objection about lack of notice.

If a director does wish to object, in cases where actual prejudice occurs because of the lack of notice, as may be indicated by the absence of one or more other directors, the director must call attention to the defect lack of notice at the outset of the meeting or promptly upon arrival and not vote for any action taken at the meeting. That director, or a may then attack the validity of any action taken at the meeting on the grounds of lack of notice, as may any other director who did not receive notice and was not present at the meeting. If a director properly objects to the meeting being held, the director is not presumed to have assented to actions taken thereafter, but if the director thereafter votes for or assents to action taken at the meeting an objection as to lack of notice is waived. See Section 8.24(d).

A member of a designated body may waive notice in the manner provided in this section. See Section 8.128(a)(1).

§ 8.24 QUORUM AND VOTING

(a) Except as provided in subsection (b), the articles of incorporation, or the bylaws, a quorum of the board of directors consists of a majority of the directors in office before a meeting begins.

(b) The articles of incorporation or bylaws may authorize a quorum of the board of directors to consist of no fewer than the greater of one-third of the number of directors in office or two directors.

(c) If a quorum is present when a vote is taken, the affirmative vote of a majority of directors voting is the act of the board of directors unless a greater vote is required by the articles of incorporation or bylaws.

(d) A director who is present at a meeting of the board of directors when corporate action is taken is considered to have assented to the action taken unless one of the following applies:

(1) The director objects at the beginning of the meeting (or promptly upon arrival) to holding it or transacting business at the meeting; or

(2) The director dissents or abstains from the action and:

(12) the dissent or abstention by the director from the action taken is entered in the minutes of the meeting; or

(13) the director delivers notice in the form of a record of the director’s dissent or abstention to the presiding officer of the meeting before its adjournment or to the corporation promptly after adjournment of the meeting.
The right of dissent or abstention is not available to a director who votes in favor of the action taken.


CROSS-REFERENCES

Action without meeting, see § 8.21.
Committees of board of directors, see § 8.25.
Director standards of conduct Board and advisory committees, see § 8.30.
Meetings of board of directors, see § 8.20.
Notice, see § 1.41.
Number of directors, see § 8.03.
“Record” defined, see § 1.4.
“Secretary” defined, see § 1.40.
Standards of conduct for directors, § 830.

OFFICIAL COMMENT

Section 8.24(a) allows the articles of incorporation or bylaws to increase the quorum up to and including unanimity or to reduce it to not less than one-third (or at least two directors). Section 8.24(c) generally requires a majority vote of those directors voting for action by the board, but allows the articles or bylaws to increase the vote necessary for the board to take action. The increased vote could be either a supermajority requirement, or a requirement that action by the board requires the affirmative vote of a majority of the directors present.

The phrase “when a vote is taken” in Section 8.24(c) is designed to make clear that the board of directors may act only when a quorum is present. If directors leave during the course of a meeting, the board of directors may not act after the number of directors present is reduced to less than a quorum.

Under Section 8.24(d) directors who If a director, who is present at a meeting, wishes to object or abstain with respect to action taken by the board of directors or a committee of the board of directors, that director must make their his or her position clear in one of the ways described in this subsection. The objection Section 824(d). Section 824(d) serves the important purpose of forcefully bringing the position of the dissenting member director clearly to the attention of the balance of the board of other directors. The requirement of an objection in the form of a record also prevents a director from later seeking to avoid responsibility because of secret unexpressed doubts about the wisdom of the action taken. The right of dissent or abstention is not available to a director who voted in favor of the action taken.
Section 8.24824(d) applies only to directors who are present at the meeting. Directors who are not present are not considered to have assented to any action taken at the meeting in their absence.

This section applies to meetings of a designated body. See Section 8.12812(a)(1).

§ 8.25825. BOARD AND ADVISORY COMMITTEES

(a) Unless this [act] provides otherwise, the board of directors may create one or more board committees of the board that consist of one or more directors to perform functions of the board.

(b) Unless this [act] otherwise provides, the creation of a committee and appointment of directors to it must be approved by the greater of:

(1) a majority of all the directors in office when the action is taken; or

(2) the number of directors required by the articles of incorporation or bylaws to take action under Section 8.24824 (quorum and voting).

(c) Sections 8.20820 (meetings) through 8.24824 apply both to board committees of the board and to their members.

(d) To the extent specified by the board of directors or in the articles of incorporation or bylaws, each board committee may exercise the powers of the board of directors under Section 8.01 except as limited by subsection (e). A board committee may not:

(1) authorize distributions;

(2) in the case of a membership corporation, approve or propose to members action that this [act] requires be approved by members;

(3) fill vacancies on the board of directors or, subject to subsection (g), on any of its committees; or

(4) adopt, amend, or repeal a provision of the articles or bylaws.

(e) The creation of, delegation of authority to, or action by a committee does not alone constitute compliance by a director with the standards of conduct described in Section 8.30830.
The board of directors may appoint one or more directors as alternate members of any board committee to replace any absent or disqualified member during the member’s absence or disqualification. If the articles of incorporation, bylaws, or the action creating a board committee so provides, the member or members present at any board committee meeting and not disqualified from voting may, by unanimous action, appoint another director to act in place of an absent or disqualified member during that member’s absence or disqualification.

A nonprofit corporation may create or authorize the creation of one or more advisory committees whose members need not be directors. An advisory committee:

1. is not a committee of the board; and
2. may not exercise any of the powers of the board.


CROSS-REFERENCES

Amendment of articles, Subch. 9A. 
Amendment of bylaws, Subch. 9B. 
Derivative proceedings, see Ch. 135. 
Director standards of conduct, Designated body, see § 8.30. 
Designated body defined, § 102. 
Distributions prohibited, see § 6.40. 
Duties of board of directors, see § 8.01. 
“Membership corporation” defined, see § 1.40. 
Quorum and voting, see § 8.24. 
Requirements for and functions of board of directors, § 801. 
Standards of conduct for directors, § 830. 
Vacancies, Vacancy on board, see § 8.10. 

OFFICIAL COMMENT

Section 8.25 makes explicit the common law power of a board of directors to act through committees of directors and specifies the powers of the board of directors that are nondelegable, that is, powers that only the full board of directors may exercise.

Section 825(a) through (f) deals only with board committees authorized to perform functions of the board.

Under Section 825(a), except as otherwise provided by this [Act], the articles of incorporation, or bylaws, a board committee may consist of a single director. This accommodates
situations in which only one director may be present or available to make a decision on short
notice, as well as situations in which it is unnecessary or inconvenient to have more than one
member on a board committee or where only one board member is disinterested or independent
with respect to a matter.

Section 8.25 The requirement of section 825(b) provides that, unless this act[Act], the
articles, or bylaws otherwise provides, a board committee of the board of directors may
be created only by the affirmative vote of the greater of a majority of all the board of directors
then in office, or, if greater, by when the action is taken or the number of directors required to
take action by the articles of incorporation or bylaws. This supermajority requirement to take
action under Section 824 (quorum and voting), reflects the importance of the decision to invest
board committees with power to act under Section 8.25. Section 13.05(b) requires that a special
litigation committee, to consider whether the maintenance of a derivative action is in the
corporation’s best interest, be appointed by a majority vote of independent directors present at a
meeting of the board. Section 8.55(b) contains a generally similar requirement with regard to the
appointment of a committee to consider whether indemnification is permissible.

Section 8.25(a) permits a committee to consist of a single director. This accommodates
situations in which only one director may be present or available to make a decision on short
notice, as well as situations in which it is unnecessary or inconvenient to have more than one
member on a committee. Committees also are often employed to decide matters in which other
members of the board have a conflict of interest; in such a case, a court will typically scrutinize
with care the committee’s decision when it is the product of a lone director. See, e.g., Lewis v.
Fuqua, 502 A.2d 962, 967 (Del. Ch. 1985).

Section 8.25 limits the role of board committees in light of competing policies: on the
one hand, it seems clear that appropriate committee action is not only desirable but is also likely
to improve the functioning of larger and more diffuse boards of directors; on the other hand,
wholesale delegation of authority to a board committee, to the point of abdication of director
responsibility as a board of directors, is manifestly inappropriate and undesirable. Overbroad
delegation also increases the potential, where the board of directors is divided, for usurpation of
basic board functions by means of delegation to a committee dominated by one faction.

The statement of nondelegable functions set out in Section 8.25(e) prohibits delegation of
authority with respect to most mergers, sales of substantially all the assets, amendments to
articles of incorporation and voluntary dissolution since these require member action. In
addition, Section 8.25(e) prohibits delegation to a board committee of authority to fill board
vacancies, subject to subsection (g), or to amend the bylaws and not delegated to a committee. On
the other hand, under Section 8.25(e) allows board committees to take many actions of a that
may be material nature, such as the authorization of long-term debt and capital investment, may
properly be made the subject of committee delegation.
Section 8.25825(fe) makes clear that although the board of directors may delegate to a committee the authority to take action, the designation of the committee, the delegation of authority to it, and action by the committee does not alone constitute compliance by a noncommittee board member with the director’s responsibility under Section 8.30830. On the other hand, a noncommittee director also does not automatically incur personal risk should the action of the particular committee fail to meet the standard of conduct set out in Section 8.30830. The noncommittee member’s liability in these cases will depend upon whether the director’s conduct was actionable under Section 8.31. Factors to be considered in this regard will include the care used in the delegation to and supervision over the committee, the extent to which the delegation was required by applicable law, and the amount of knowledge regarding the actions being taken by the committee which is available to the noncommittee director. Care in delegation and supervision may be facilitated, in the usual case, by review of minutes and receipt of other reports concerning committee activities. The enumeration of these factors is intended to emphasize that directors may not abdicate their responsibilities and avoid liability simply by delegating authority to board committees. Rather, a director against whom liability is asserted based upon acts of a committee of which the director is not a member avoids liability under Section 8.31 by an appropriate measure of monitoring—particularly if the director met the standards contained in Section 8.30 with respect to the creation and supervision of the committee.

Section 8.25825(gf) has no application to a member of the committee itself. The standards of conduct applicable to a committee member are set forth in Section 8.30830.

Section 8.25825(hg) is a rule of convenience that permits the board of directors or the other board committee members to replace an absent or disqualified member during the time that the member is absent or disqualified. Unless otherwise provided, replacement of an absent or disqualified member of a committee is not necessary to permit the other committee members to continue to perform their duties.

Section 8.25825(hg) recognizes that the board of directors or management may establish nonboard committees to perform functions that are not required to be exercised by the board of directors. Those committees are sometimes purely advisory, but may also perform functions that would otherwise be performed by officers, employees, or agents. If a nonboard committee exercises any of the powers of the board, it will have the status of a designated body and its members will have fiduciary duties under Section 8.12(b).
INTRODUCTORY COMMENT TO SUBCHAPTER C

The provisions of this act with respect to the duties and liabilities of directors of nonprofit corporations closely follow the provisions of the Model Business Corporation Act on the same subjects. This is consistent with the view that the relationship of directors to a nonprofit corporation is more akin to that of directors of business corporations than to that of trustees to their beneficiaries. Stern v. Lucy Webb Hayes National Training School for Deaconesses and Missionaries, 381 F.Supp. 1003 (D.D.C. 1974). — See “Duties of Charitable Trust Trustees and Charitable Corporation Directors,” REAL PROPERTY, PROBATE AND TRUST JOURNAL 545 (1967).

Depending on the status of a particular state’s law, Sections 8.30830 and 8.31831 will replace, modify, clarify, or set forth the basic standards that govern the conduct of directors of nonprofit corporations. States may have statutory or common law rules that apply a trust rule to director conduct. Those states should consider repealing those rules so that this act will replace those rules even though the corporation, as distinguished from its directors, may hold or be deemed to hold property in trust or subject to restrictions.

§ 8.30830. STANDARDS OF CONDUCT FOR DIRECTORS

(a) Each member of the board of directors, when discharging the duties of a director, shall act:

(1) in good faith, and
(2) in a manner the director reasonably believes to be in the best interests of the nonprofit corporation.

(b) The directors or members of a committee of the board of directors, 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.

(c) In discharging board or committee duties a director must disclose, or cause to be disclosed, to the other board or committee members information not already known by them but known by the director to be material to the discharge of their decision-making or oversight functions, except that disclosure is not required to the extent that the director reasonably believes that doing so would violate a duty imposed by law, a legally enforceable obligation of confidentiality, or a professional ethics rule.

(d) In discharging board or committee duties, a director who does not have knowledge that makes reliance unwarranted may rely on the performance by any of the persons specified in subsection (f)(1), (3), or (4) to whom the board may have delegated, formally or informally by course of conduct, the authority or duty to perform one or more of the board’s functions that are delegable under applicable law.
In discharging board or board committee duties, a director who does not have knowledge that makes reliance unwarranted may rely on information, opinions, reports, or statements, including financial statements and other financial data, prepared or presented by any of the persons specified in subsection (f).

A director may be entitled to rely, in accordance with subsection (d) or (e), on:

(1) one or more officers, employees, or volunteers of the nonprofit corporation whom the director reasonably believes to be reliable and competent in the functions performed or the information, opinions, reports, or statements provided;

(2) legal counsel, public accountants, or other persons retained by the corporation as to matters involving skills or expertise the director reasonably believes are matters:

   (i) within the particular person’s professional or expert competence, or
   (ii) as to which the particular person merits confidence;

(3) a board committee of the board of directors of which the director is not a member, if the director reasonably believes the committee merits confidence; or

(4) in the case of a corporation engaged in religious activity, religious authorities and ministers, rabbis, imams, or other persons whose positions or duties the director reasonably believes justify reliance and confidence and whom the director believes to be reliable and competent in the matters presented.

A director is not a trustee with respect to the nonprofit corporation or with respect to any property held or administered by the corporation, including property that may be subject to restrictions imposed by the donor or transferor of the property.

Subsection (g) is a reenactment of Model Nonprofit Corporation Act (1987) § 8.30 (e).

CROSS-REFERENCES

Committees of board of directors: Board and advisory committees, see § 8.25825.
Conflict of interest, see transactions, Subch. 8F.
Derivative proceedings, see Ch. 135.

Functions of board of directors, see §§ 8.01-8.04.

Indemnification, see §§ 8.50-8.58 and advancement of expenses, Subch. 8E.

Meetings of board of directors, see § 8.20.

Officer standards of conduct, see § 8.42.

Officers, see §§ 8.40 & 8.41.

Removal of directors, see §§ 8.08 & 8.09.

Requirements for and functions of board of directors, § 801.

Standards of conduct for officers, § 842.

Standards of liability for directors, see § 8.31.

Unlawful distributions, see § 8.33.

OFFICIAL COMMENT

Section 8.30 defines the general standards of conduct for directors. Under subsection (a), each board member must always perform a director’s duties in good faith and in a manner reasonably believed to be in the best interests of the nonprofit corporation. Although each director also has a duty to comply with its requirements, the focus of subsection (b) is on the discharge of those duties by the board as a collegial body. Under subsection (b), the members of the board or a board committee are to perform their duties with the care that a person in a like position would reasonably believe appropriate under similar circumstances. This standard of conduct is often characterized as a duty of care. Subsection (c) sets out the responsibility of each director, in discharging board or committee duties, to disclose or cause to be disclosed to the other members of the board or board committee information, of which they are unaware, known by the director to be material to their decision-making or oversight responsibilities, subject to countervailing confidentiality duties and appropriate action with respect thereto.

Section 8.30 sets forth the standards of conduct for directors by focusing that focus on the manner in which directors perform their duties, not the correctness of the decisions made. These standards of conduct are based on former Section 35 of the 1969 Model Business Corporation Act, a number of state statutes, and on judicial formulations of the standards of conduct applicable to directors. Section 8.30 should be read in light of the basic role of directors set forth in Section 8.01(b), which provides that the “activities and affairs of the corporation must be managed by or under the direction, and subject to the oversight, of the board, as supplemented by various provisions of the act assigning specific powers or responsibilities to the board. Relevant thereto, directors often act collegially in performing their functions and discharging their duties. If the observance of the directors’ conduct is called into question, courts will typically evaluate the conduct of the entire board (or committee). Deficient performance of Section 8.30 duties on the part of a particular director may be overcome, absent unusual circumstances, by acceptable conduct (meeting, for example, subsection (b)’s standard of care) on the part of other directors sufficient in number to perform the function or discharge the duty in question. While not thereby remedied, the deficient performance becomes irrelevant in any evaluation of the action taken. (This contrasts with a director’s duties of loyalty, fair dealing, and disclosure which will be evaluated on an individual basis and will also implicate discharge of the director’s duties under subsection (a).) Further relevant thereto, the board may delegate or assign to appropriate officers, employees, or agents.
of the nonprofit corporation the authority or duty to exercise powers that the law does not require
it to retain. Since the directors are entitled to rely thereon absent knowledge making reliance
unwarranted, deficient performance of the directors’ Section 8.30 duties will not result from their
delegates’ actions or omissions so long as the board acted in good faith and complied with the
other standards of conduct set forth in Section 8.30 in delegating responsibility and, where
appropriate, monitoring performance of the duties delegated. The standards of conduct for
directors established by section 830 are analogous to those generally articulated by courts in
evaluating director conduct, often referred to as the duties of care and loyalty.

In the prior version of the act the duty of care element was included in subsection (a),
with the 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-a-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).

Long before statutory formulations of directors’ Section 830 addresses standards of
court, courts would invoke the business judgment rule in evaluating directors’ conduct and
determining whether to impose liability in a particular case. The elements of the business
judgment rule and the circumstances for its application are continuing to be developed by the
courts. Section 8.30 does not try to codify the business judgment rule or to delineate the
differences between that defensive rule and the section’s standards of director conduct. Section
8.30 deals only with standards of conduct—of directors, i.e., the level of performance expected
of every director entering into the service of a nonprofit corporation and directors undertaking the
role and responsibility of the office of director. The section Section 830 does not
deal directly with address the liability of a director—although exposure to liability will
usually may result from a failure to honor satisfy the standards of conduct required to be observed
by subsection (a). See Section 8.31(a)(1) and clauses (i) and (ii)(A) of Section 8.31(a)(2). The
issue of director liability is addressed in Sections 8.31831 and 8.33 of this subchapter832.
Section 8.30 does, however, play an important role in evaluating a director’s conduct and the
effectiveness of board action. It has relevance in assessing, under Section 8.31831, the
reasonableness of a director’s belief. Similarly, it has relevance in assessing a director’s timely
attention to appropriate inquiry when particular facts and circumstances of significant concern
materialize. It also serves as a frame of reference for determining, under Section 8.33832(a),
liability for an unlawful distribution. Finally, Section 8.30830 compliance may have a direct
bearing on influence a court’s analysis where transaetional justification (e.g., a suit to enjoin a
pending merger) is at issue injunctive relief against a transaction is being sought. Directors act
both individually and collectively as a board in performing their functions and discharging their
duties. Section 830 addresses actions in both capacities

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A director complying with the standard of care expressed in subsection (b) is entitled to rely (under subsection (d)) upon board functions performed pursuant to delegated authority by, and to rely (under subsection (e)) upon information, opinions, reports, or statements, including financial statements and other financial data, provided by, the persons or committees specified in the relevant parts of subsection (f). Within this authorization, the right to rely applies to the entire range of matters for which the board of directors is responsible. However, a director so relying must be without knowledge that would cause that reliance to be unwarranted. Section 8.30 expressly prevents a director from “hiding his or her head in the sand” and relying on the delegation of board functions, or on information, opinions, reports, or statements, when the director has actual knowledge that makes (or has a measure of knowledge that would cause a person, in a like position under similar circumstances, to undertake reasonable inquiry that would lead to information making) Under the standards of Section 8.30, the board of directors may delegate or assign to appropriate officers or employees of the corporation the authority or duty to exercise powers that the law does not require the board to retain. Because the directors are entitled to rely on these persons, absent knowledge making reliance unwarranted, the directors will not be in breach of the standards under section 8.30 as a result of their delegatees’ actions or omissions, so long as the board acted in good faith and complied with the other standards of conduct set forth in section 8.30 in delegating responsibility and, where appropriate, monitoring performance of the duties delegated. In addition, Sections 8.30 (d), (e) and (f) permit a director to rely on enumerated third parties for specified purposes, although reliance is prohibited when a director has knowledge that makes reliance unwarranted. The standards in subsection (a) Section 8.30(a)’s standards of good faith and reasonable belief in the best interests of the corporation also apply to a director’s reliance under subsections Sections 8.30 (d), (e), and (f).

This section also applies to a designated body pursuant to Section 8.12.

1. **Section 8.30(a)**

Section 8.30(a) establishes the basic standards of conduct for all directors. It's command is to be understood as peremptory (its obligations are to be observed by every director) and at the core of the subsection’s mandate is the requirement that, when performing director duties, a director shall act in good faith coupled with conduct reasonably believed to be in the best interests of the nonprofit corporation. This mandate governs all aspects of director duties: the duty of care, the duty to become informed, the duty of inquiry, the duty of informed judgment, the duty of attention, the duty of disclosure, the duty of loyalty, the duty of fair dealing and, finally, the broad concept of fiduciary duty that the courts often use as a frame of reference when evaluating a director’s conduct. These duties do not necessarily compartmentalize and, in fact, tend to overlap. For example, the duties of care, inquiry, becoming informed, attention, disclosure, and informed judgment all relate to the board’s decision-making function, whereas the duties of attention, disclosure, becoming informed, and inquiry relate to the board’s oversight function. and its mandate governs all aspects of directors’ conduct, including the requirements in other provisions of Section 8.30.

Two of the phrases chosen to specify the manner in which a director’s duties are to be discharged used in Section 8.30(a) deserve further comment:
The phrase “reasonably believes” is both subjective and objective in character. Its first level of analysis is geared to what the particular director, acting in good faith, actually believes—not what objective analysis would lead another director (in a like position and acting in similar circumstances) to conclude. The second level of analysis is focused specifically on “reasonably.” Although a director has wide discretion in marshalling the evidence gathering information and reaching conclusions, whether a director’s belief is reasonable (i.e., could (not would) a reasonable person in a like position and acting in similar circumstances, taking into account that director’s knowledge and experience, have arrived at that belief) ultimately involves an overview that is objective in character.

The phrase “best interests of the nonprofit corporation” is key to an explication understanding of a director’s duties. The term “corporation” is a surrogate for the enterprise as well as a frame of reference encompassing the body of members. In determining the corporation’s “best interests,” the director has wide discretion in deciding how to weigh near-term opportunities versus long-term benefits as well as in making judgments where the interests of various groups within the body of members or having other cognizable interests in the enterprise may differ and its purpose, as well as the members in a membership corporation that is not a charitable corporation.

As a generalization, Section 8.30 operates as a “baseline” principle governing director conduct “when discharging the [ongoing] duties of a director” in circumstances uncomplicated by self-interest taint. The act recognizes, however, that directors’ personal interests of directors may not always align with the nonprofit corporation’s best interests and provides procedures by which interest-conflict situations and transactions involving conflicts of interest can be processed. See Subchapter E (indemnification and advancement of expenses) and Subchapter F (conflicting interest transactions) of this Chapter 8 and Chapter 135 (derivative proceedings). Those procedures generally contemplate that the interested director will provide appropriate disclosures and will not be involved in taking action on the interest conflict transaction. And the common law has recognized that other interest conflict situations may arise which do not entail a “transaction” by or with the corporation. See Subchapter G of this Chapter 8 (business opportunities). The interested director is relieved of the duty to act in connection with the matter on behalf of the corporation (specifically, the traditional mandate to act in the corporation’s best interests), given the inherent conflict. However, the interested director is still expected to act in good faith, and that duty is normally discharged by observing the obligation of fair dealing. In the case of interest conflict transactions, where there is a conflicting interest with respect to the corporation under Section 8.60, the interested director’s conduct is governed by Subchapter F of this Chapter 8. In other cases, Section 8.30’s standards of conduct are overlaid by various components of the duty to act fairly, the particular thrusts of which will depend upon the kind of interested director’s conduct at issue and the circumstances of the case. As a general rule, the duty of fair dealing is normally discharged by the interested director through appropriate disclosure to the other directors considering the matter followed by abstention from participation in any decision making relevant thereto. If and to the extent that the interested director’s action respecting the matter goes further, the reasonableness of the director’s belief as to the corporation’s best interests, in respect of the action taken, should be evaluated on the basis of not only the director’s honest and good faith belief but also on considerations bearing on the fairness of the transaction or conduct to the corporation, the matter giving rise to the conflict of interest.
Section 8.30830(b) establishes a general standard of care for directors in the context of their dealing with the board’s decision-making and oversight functions. While some aspects will involve individual conduct (e.g., preparation for meetings), these functions are generally performed by the board through collegial collective action, as recognized by the reference in subsection Section 830(b) to board and committee “members” and “their duties.” In contrast with the Section 830(a)'s individual conduct mandate in Section 8.30(a), Section 8.30830(b) has a two-fold thrust: it provides a standard of conduct for individual action and, more broadly, it states a conduct obligation —“must discharge their duties” — concerning the degree of care to be collegially used collectively by the directors when performing those functions. It provides that directors have a duty to exercise “the care that a person in a like position would reasonably believe appropriate under similar circumstances.”

The traditional formulation for a director’s standard (or duty) of care has been geared to the “ordinarily prudent person.” For example, the act’s prior formulation (in former Section 8.30(a)(2)) referred to “the care an ordinarily prudent person in a like position would exercise under similar circumstances,” and almost all state statutes that include a standard of care reflect parallel language. The phrase “ordinarily prudent person” constitutes a basic frame of reference grounded in the field of tort law and provides a primary benchmark for determining negligence. For this reason, its use in the standard of care for directors, suggesting that negligence is the proper determinant for measuring deficient (and thus actionable) conduct, has caused confusion and misunderstanding. Accordingly, the phrase “ordinarily prudent person” has been removed from the act’s standard of care and in its place “a person in a like position” has been substituted. The standard is not what care a particular director might believe appropriate in the circumstances, but what a person in a like position and acting under similar circumstances would reasonably believe to be appropriate. Thus, the degree of care that directors should employ, under subsection Section 830(b), involves an objective standard.

Some state statutes have used the words “diligence,” “care,” and “skill” to define the duty of care. 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” are not used in Section 8.30’s standard of care.

The process by which a director becomes informed in carrying out the decision-making and oversight functions will vary. The directors’ decision-making function is reflected in various sections of the act, including dismissal of derivative proceedings (Section 505); determination and authorization of indemnification (Section 855); conflicting interest transactions; voidability (Section 860); amendment of articles of incorporation (Sections 902, 903, 905 and 907); amendment of bylaws (Sections 920 and 921); member approval of certain dispositions (Section 1002(b)(1)); and approval of dissolution (Section 1102). The directors’ oversight function is established under Section 8.01. In relying on the performance by management of delegated or assigned Section 8.01 duties (including, for example, matters of law and legal compliance), as authorized by subsection (d), directors may depend upon the
In discharging the Section 8.01 duties associated with the board’s oversight function, the standard of care entails primarily a duty of attention. In contrast with the board’s decision-making function, which generally involves informed action at a point in time, the oversight function is concerned with a continuum and the duty of attention of the directors accordingly involves participatory performance over a period of time.

Several of the phrases chosen to define the standard of conduct in Section 8.30(b) deserve specific mention:

1. The phrase “becoming informed,” in the context of the decision-making function, refers to the process of gaining sufficient familiarity with the background facts and circumstances in order to make an informed judgment. Unless the circumstances would permit a reasonable director to conclude that he or she is already sufficiently informed, the standard 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. The process typically involves review of written materials provided before or at the meeting and attention to, or participation in, the deliberations leading up to a vote. In addition to considering information and data on which a director is expressly entitled to rely under Section 830(e), “becoming informed” can also involve consideration of information and data generated by persons other than legal counsel, public accountants, etc., retained by the corporation, as contemplated by subsection (f)(2) other persons; for example, review of industry studies or research articles prepared by unrelated third parties could be very useful. It can also involve direct communications, outside of the boardroom, with members of management or other directors. There is no one way for “becoming informed,” and both the method and measure—“how to” and “how much”—are matters of reasonable judgment for the director to exercise.

2. The phrase “devoting attention,” in the context of the oversight function, refers to considering such matters as the nonprofit corporation’s information and reporting systems of the nonprofit corporation and not to proactive inquiry searching generally and not to an independent investigation into particular system inadequacies or noncompliance. While directors typically give attention to future plans and trends as well as current activities, they should not be expected to anticipate any particular problems that the corporation may face except in those circumstances where something has occurred to make it obvious to the board that the corporation should be addressing a particular problem. The standard of care associated with the oversight function involves gaining assurances from management and advisers that appropriate systems believed appropriate have been established, coupled with ongoing monitoring of the systems in place, such as those concerned with legal compliance, risk assessment or internal controls—followed up with a proactive response. Such assurances also should cover establishment of ongoing monitoring of systems in place with appropriate follow-up responses when alerted to the need for inquiry issues requiring attention.

3. The reference to “person,” without embellishment, is intended to avoid implying any qualifications, such as specialized expertise or experience requirements, beyond the basic attributes of common sense, practical wisdom, and informed judgment (however, see (6) below).
The phrase “reasonably believe appropriate” refers to the array of possible options that a person possessing the basic director attributes of common sense, practical wisdom, and informed judgment would recognize to be available, in terms of the degree of care that might be appropriate, and from which a choice by such person would be made. The measure of care that such person might determine to be appropriate, in a given instance, would normally involve a selection from the range of options and any choice within the realm of reason would be an appropriate decision under the standard of care called for under subsection Section 830(b). However, a decision that is so removed from the realm of reason, or is so unreasonable, that it falls outside the permissible bounds of sound discretion, and thus is an abuse of discretion, will not satisfy the standard.

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

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 nonprofit 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 that director’s compliance with the standard of care. Even though the combined phrase is intended to take 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 basic director attributes of common sense, practical wisdom, and informed judgment.

3. Section 8.30(c)

A duty requirement to disclose to other directors information that a director knows to be material to the oversight or decision-making or oversight functions of the board of directors or committee has always been embraced of the board is implicit in the standards of conduct set forth in subsections Sections 830(a) and (b). Subsection Section 830(c) makes this explicit this existing duty of disclosure among directors. Thus, for example, when a member of the board director knows information that the director recognizes is material to a decision by the board to approve financial statements of the nonprofit corporation but is not known to the other directors, the director is obligated to see to it that such information is provided to the other members of the board. Such disclosure is accomplished, the action required of the director can occur through direct statements in meetings of the board, or by any other timely means, including, for example, communicating the information to the chairman chair of the board or the chairman chair of a committee, or to the corporation’s general counsel, and requesting that the recipient inform the other board or committee members of the disclosed information.

Subsection Section 830(c) recognizes that a duty of confidentiality to a third party can override a director’s obligation to share with other directors information pertaining to a current
corporate matter, and that a director is not required to make such disclosure to the extent the
director reasonably believes that such a duty of confidentiality prohibits it. In some
circumstances, a duty of confidentiality to a third party may even prohibit disclosure of the
nature or the existence of the duty itself. Ordinarily, however, a director who withholds material
information based on a reasonable belief that a duty of confidentiality to a third party prohibits
disclosure should advise the other directors of the existence and nature of that duty. Under the
standards of conduct set forth in Section 8.30830(a), the director may also be required to take
other action in light of the confidentiality restraint. The precise nature of that action must, of
necessity, depend on the specific circumstances. Depending withholding of material information
may, depending on the nature of the material information and of the matter before the board of
directors or committee of the board, such action may include abstention or absence require that a
director abstain or recuse himself or herself from all or a portion of the other directors’
deliberation or vote on the matter to which the undisclosed information is material, or even
resignation as a director. Finally, a duty of confidentiality may not form the basis for the
limitation on disclosure unless it is entered into and relied upon in good faith.

4. Section 8.30830(d)

The delegation of authority and responsibility under subsection described in Section
830(d) may take the form of a variety of forms, including (a) formal action through a board
resolution, (b) implicit action through the election of corporate officers (e.g., chief financial
officer or controller), or the appointment of corporate managers (e.g., credit manager), or a
(c) informal action through an appropriate course of conduct (e.g., the discharge by the board chair
of a board function such as oversight of actions by the president). A. Under Section 830(d), a
director may properly rely on those to whom authority has been delegated pursuant to
subsection Section 830(d) respecting particular matters calling for specific action or attention in
connection with the directors’ decision-making function as well as matters on the board’s
continuing agenda, such as legal compliance and internal controls, in connection with the
directors’ oversight function. Delegation should be carried out in accordance with the standard of
care set forth in Section 8.30830(b) and is subject to limitations in the articles, bylaws,
resolutions of the board, or other law.

By identifying those persons upon whom a director may rely in connection with the
discharge of duties, Section 8.30830(d) does not limit the ability of directors to delegate their
powers under Section 8.01801(b), except where delegation is expressly prohibited by the act or
otherwise by applicable law (see, e.g., Section 8.25(e)). See Section 8.25825 and its Official
Comment for detailed consideration discussion of delegation to board committees of the board of
the authority of the board under Section 8.01 and the duty to perform one or more of the board’s
functions. And by 801, By employing the concept of delegation, Section 8.30(d) the act does not
limit the ability of directors to establish baseline principles as to management responsibilities.
Specifically, Section 8.01801(b) provides that “all corporate powers must be exercised by or
under the authority of” the board, and a basic board function involves the allocation of
management responsibilities and the related assignment (or delegation) of corporate powers. For
example, a board can properly decide to retain a third party to assume responsibility for the
administration of designated aspects of risk management for the nonprofit corporation (e.g.,
health insurance or disability claims). This would involve the directors in the exercise of
judgment in connection with the decision-making function pursuant to subsection (b) (i.e., the assignment of authority to exercise corporate powers to an agent). See the Official Comment to Section 8.01. It would not entail impermissible delegation to a person specified in subsection (f)(2) pursuant to subsection (d) of a board function for which the directors by law have a duty to perform. They have the corporate power (under Section 8.01(b)) to perform the task but administration of risk management is not a board function coming within the ambit of director duties; together with many similar management responsibilities, they may assign the task in the context of the allocation of corporate powers exercised under the authority of the board. This illustration highlights the distinction between delegation of a board function and assignment of authority to exercise corporate powers.

Although the board of directors may delegate the authority or duty to perform one or more of its functions, reliance on delegation and reliance under subsection Section 8.30(d) may not alone constitute compliance with Section 8.30 and reliance on Sections 8.30(a) and (b) and the action taken by the delegate may not alone constitute compliance by satisfy the directors or a noncommittee board member with member’s Section 8.01 responsibilities. On the other hand, should failure of the board committee or the corporate officer or employee performing the function delegated fail to meet Section 8.30(b)’s standard of care, noncompliance by the board with Section 8.01 will not automatically result in violation by the board of Section 8.01. Factors to be considered, in this regard, determining whether a violation of Section 8.01 has occurred will include the care used in the delegation to and supervision over the delegatee, and the amount of knowledge regarding the particular matter which is reasonably available to the particular director. Care in delegation and supervision includes appraisal of the capabilities and diligence of the delegatee in light of the subject and its relative importance and may be facilitated satisfied, in the usual case, by receipt of reports concerning the delegatee’s activities. The enumeration of these factors is intended to emphasize that directors may not abdicate their responsibilities and avoid accountability simply by delegating authority to others. Rather, a director charged with accountability based upon acts of others who is accountable for the acts of delegates will fulfill the director’s duties if the standards contained in Section 8.30 are met.

5. Section 8.30(e)

Reliance under subsection Section 8.30(e) on a report, statement, opinion, or other information is permitted only if the director has read the information or heard orally presented the report, statement, opinion, report, or statement or other information in question, or was present at a meeting at which it was orally presented, or took other steps to become generally familiar with it. A director must comply with the general standard of care of Section 8.30(b) in making a judgment as to the reliability and competence of the source of information upon which the director proposes to rely or, as appropriate, that it otherwise merits confidence.

6. Section 8.30(f)

Reliance on one or more of the corporation’s officers or employees, pursuant to the intracorporate frame of reference of subsection (f)(1), is conditioned upon a reasonable belief as to the reliability and competence of those who have undertaken the functions performed or who
prepared or communicated the information, opinions, reports, or statements presented. In determining whether a person is “reliable,” the director would typically consider (i) the individual’s background experience and scope of responsibility within the nonprofit corporation in gauging the individual’s familiarity and knowledge respecting the subject matter, and (ii) the individual’s record and reputation for honesty, care, and ability in discharging responsibilities which he or she undertakes. In determining whether a person is “competent,” the director would normally take into account the same considerations and, if expertise should be relevant, the director would consider the individual’s technical skills as well. Recognition in the statute of the right of one director to rely on the expertise and experience of another director, in the context of board or committee deliberations, is unnecessary, for the group’s reliance on shared experience and wisdom of other board members is an implicit underpinning of director collective board conduct. In relying on another member of the board, a director would quite properly take advantage of the colleague’s knowledge and experience in becoming informed about the matter at hand before taking action; however, the director would be expected to exercise independent judgment when it comes time to vote.

Subsection (f)(2), which has an extracorporate frame of reference, permits reliance on outside advisers retained by the nonprofit corporation, including persons specifically engaged to advise the board or a board committee. Possible advisers include not only those in the professional disciplines customarily supervised by state authorities. Advisers on whom a director may rely under Section 830(f)(2) include not only licensed professionals, such as lawyers, and accountants, and engineers, but also those in other fields involving special experience and skills, such as investment bankers, geologists, management consultants, actuaries, and real estate appraisers. The adviser could be an individual or an organization, such as a law firm, accounting firm or investment advisory firm. Reliance on a nonmanagement director who is specifically engaged to undertake a special assignment or a particular consulting role would fall within this outside adviser frame of reference. In addition, a director may also rely on outside advisers where skills or expertise of a technical nature is not a prerequisite, or where the person’s professional or expert competence has not been established, so long as the director reasonably believes the person merits confidence. For example, a board might choose to assign to engage a private investigator the duty of inquiry to inquire into a particular matter (e.g., follow-up on rumors about a senior executive’s “grand lifestyle” alleged misconduct) and properly rely on the private investigator’s report. And it would be appropriate for a director to rely on advice from a lawyer in the corporation’s outside law firm, without due inquiry concerning that particular lawyer’s technical competence, where the director reasonably believes the lawyer giving the advice is appropriately informed (by reason of resources known to be available from that adviser’s legal organization or through other means) and therefore merits confidence.

Subsection Section 803(f)(3) permits reliance on a board committee when it is submitting recommendations for action by the full board of directors as well as when it is performing supervisory or other functions in instances where neither the full board of directors nor the committee takes dispositive action. For example, the compensation committee typically reviews proposals and makes recommendations for action by the full board of directors. In contrast, there may be reliance upon an investigation undertaken by a board committee and reported to the full board, which forms the basis for a decision by the board of directors...
not to take dispositive action. Another example is reliance on a board committee of the board of directors, such as an audit committee with respect to the board’s ongoing role of oversight of the accounting and auditing functions of the corporation. In addition where reliance on information or materials prepared or presented by a board committee is not involved, in connection with board action, a director may properly rely on oversight monitoring or dispositive action by a board committee (of which the director is not a member) empowered to act pursuant to authority delegated under Section 8.25825 or acting with the acquiescence of the board of directors. See the Official Comment to Section 8.25825. A director may similarly rely on committees not created under Section 8.25825 which have nondirector members and on designated bodies. In parallel with subsection Section 830(f)(2)(ii), the concept of “confidence” is substituted for instead of “competence” in order to avoid any inference that technical skills are a prerequisite. In the usual case, the appointment of committee members or the reconstitution of the membership of a standing committee (e.g., the audit committee), following an annual meeting of the members, would alone manifest the noncommittee members’ belief that the committee “merits confidence.” However, depending on the circumstances, the reliance contemplated by subsection Section 830(f)(3) is geared to the point in time when the board takes action or the period of time over which a committee is engaged in an oversight function; consequently, the judgment to be made (i.e., whether a committee “merits confidence”) will arise at varying points in time. After ordinarily, after making an initial judgment that a committee (of which a director is not a member) merits confidence, the director may depend upon the presumption of regularity, absent knowledge or notice to the contrary, continue to rely on that committee so long as the director has no reason to believe that confidence is no longer warranted.

Subsection Section 830(f)(4) provides a special rule for religious corporations that permits directors to rely on superior authorities within a religious organization of which the corporation is a part.

7. Application To Officers

Section 8.30830 generally deals only with directors and, pursuant to Section 8.12812(a), with members of designated bodies. Section 8.42842 and its Official Comment explain the extent to which the provisions of principles set forth in Section 8.30830 apply to officers.

8. Trust Property

Section 8.30830(g) is not found in the Model Business Corporation Act because it is only relevant in the context of nonprofit corporations. It provides that a director is not a trustee with respect to the corporation or any property held by it. Absent Section 8.30830(g), it might be possible to argue that a director meeting his or her duties under Section 8.30830 was liable for a breach of trust by improperly using, disposing of, or otherwise dealing with assets held by the corporation in trust. As a result of Section 8.30830(g), this argument has no validity. A director who satisfies Subchapter 8C, but improperly acts or fails to act in regard to property held in trust, will not be liable. Depending on a particular state’s law, if a corporation holds trust property, the corporation itself may be liable for breach of trust.
§ 8.31831 STANDARDS OF LIABILITY FOR DIRECTORS

(a) A director shall not be liable to the nonprofit corporation or its members for any decision to take or not to take action, or any failure to take any action, as a director, unless the party asserting liability in a proceeding establishes that:

(1) none of the following, if liability is not precluded by a defense interposed as a bar to the proceeding by the director, precludes liability based on:

(i) subsection (d) or any provision in the articles of incorporation authorized by Section 2.022(b)(10) or (c) (articles of incorporation);

(ii) satisfaction of the requirements in the protection afforded by Section 8.60 for validating a (conflicting interest transactions; voidability); or

(iii) satisfaction of the requirements in the protection afforded by Section 8.70 for disclaiming a (business opportunity opportunities); and

(2) the challenged conduct consisted or was the result of:

(i) action not in good faith; or

(ii) a decision:

(A) which the director did not reasonably believe to be in the best interests of the corporation, or

(B) as to which the director was not informed to an extent the director reasonably believed appropriate in the circumstances; or

(iii) a lack of objectivity due to the director’s familial, financial or business relationship with, or a lack of independence due to the director’s domination or control by, another person having a material interest in the challenged conduct:

(A) which relationship or which domination or control could reasonably be expected to have affected the director’s judgment respecting the challenged conduct in a manner adverse to the corporation, and

(B) after a reasonable expectation to such effect has been established, the director shall not have established that the challenged conduct was reasonably believed by the director to be in the best interests of the corporation; or

(iv) a sustained failure of the director to devote attention to ongoing oversight of the activities and affairs of the corporation, or a failure to devote timely attention, by making (or causing to be made) appropriate inquiry, when particular facts and circumstances of
significant concern materialize that would alert a reasonably attentive director to the need
therefor such inquiry; or

(v) receipt of a financial benefit to which the director was not entitled
or any other breach of the director’s duties to deal fairly with the corporation and its members
that is actionable under applicable law.

(b) The party seeking to hold the director liable:

(1) for money damages, also has the burden of establishing that:
(i) harm to the nonprofit corporation or its members has been
suffered, and
(ii) the harm suffered was proximately caused by the director’s
challenged conduct; or

(2) for other money payment under a legal remedy, such as compensation for
the unauthorized use of corporate assets, shall also have whatever persuasion burden may be
called for to establish that the payment sought is appropriate in the circumstances; or

(3) for other money payment under an equitable remedy, such as profit
recovery by or disgorgement to the corporation, shall also have whatever persuasion burden
may be called for to establish that the equitable remedy sought is appropriate in the
circumstances.

(c) Nothing contained in this section:

(1) in any instance where fairness is at issue, such as consideration of the
fairness of a transaction to the nonprofit corporation under Section 8.60860(a)(3), alters the
burden of proving the fact or lack of fairness otherwise applicable,

(2) alters the fact or lack of liability of a director under another section of this
[act], such as the provisions governing the consequences of an unlawful distribution under
Section 8.33832 (directors’ liability for unlawful distributions), a conflicting interest transaction
under Section 8.60860, or taking advantage of a business opportunity under Section 8.70870; or

(3) affects any rights to which the corporation or a director or member may be
entitled under another statute of this state or the United States.

(d) Notwithstanding any other provision of this section, a director of a charitable
corporation shall is not liable to the corporation or its members for money damages for any
action taken, or any failure to take any action, as a director, except liability for:

(1) the amount of a financial benefit received by the director to which the
director is not entitled;
(2) an intentional infliction of harm;
(3) a violation of Section 8.332; or
(4) an intentional violation of criminal law.


CROSS-REFERENCES

Article provision limiting or eliminating director liability, see Section 2.02(c).
Article provision permitting expanded indemnification, see Section 2.02(b)(8).
Derivative proceedings, see Ch. 135.
Director’s conflicting interest transaction, see Subch. 8F.
Directors’ liability for unlawful distributions, § 832.
Duty of board of directors, see § 8.01801.
Expanded indemnification, § 202(b)(8).
Indemnification, see §§ 8.50-8.58 and advancement of expenses, Subch. 8F.
Loans to or guarantees for directors and officers, § 833.
Provision limiting or eliminating director liability, § 202(c).
Judicial removal of directors by judicial proceedings, see § 8.09809.
Standards of conduct for directors, see § 8.30830.
Unlawful distributions, see § 8.33.

OFFICIAL COMMENT

Subsections (a) and (b) of Section 8.30 establish standards of conduct that are central to the role of directors. Section 8.30(b)’s standard of conduct is frequently referred to as a director’s duty of care. The employment of the concept of “care,” if considered in the abstract, suggests a tort-law/negligence-based analysis looking toward a finding of fault and damage recovery where the duty of care has not been properly observed and loss has been suffered. But the act’s desired level of director performance, with its objectively-based standard of conduct (“the care that a person in a like position would reasonably believe appropriate under similar circumstances”), does not carry with it the same type of result-oriented liability analysis. The courts recognize that boards of directors and corporate managers make numerous decisions that involve the balancing of risks and benefits for the enterprise. Although some decisions turn out to have been unwise or the result of a mistake of judgment, it is not
reasonable to reexamine an unsuccessful imposition of liability for an informed decision made in good faith that with the benefit of hindsight. As observed in Joy v. North, 692 F.2d 880, 885 (2d Cir. 1982): “Whereas an automobile driver who makes a mistake in judgment as to speed or distance injuring a pedestrian will likely be called upon to respond in damages, a corporate [director or] officer who makes a mistake in judgment as to economic conditions, consumer tastes or production line efficiency will rarely, if ever, be found liable for damages suffered by the corporation.” turns out to be wrong or unwise. Therefore, as a general rule, a director is not exposed to personal liability for injury or damage caused by an unwise decision—While a director is not personally responsible for unwise decisions or mistakes of judgment—, and conduct conforming with the standards of Section 8.30 will almost always be protected—a director can be held liable for misfeasance or nonfeasance in performing the duties of a director. And while a director whose performance meets the standards of Section 8.30 will almost always be protected—reach that level meet the standards of Section 830 does not automatically itself establish personal liability for damages that the nonprofit corporation may have suffered as a consequence. Nevertheless, a director can be held liable for misfeasance or nonfeasance in performing his or her duties. Section 831 sets forth the standards of liability of directors, as distinct from the standards of conduct set forth in Section 830.

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This section also applies to a designated body pursuant to Section 812.

Courts have developed the broad common law concept of the business judgment rule. Although formulations vary, in basic principle, a board of directors generally enjoys a presumption of sound business judgment and its decisions will not be disturbed by a court substituting its own notions of what is or is not sound business judgment if the board’s decisions can be attributed to any rational business purpose. It is also presumed that, in making a business decision, directors act in good faith, on an informed basis, and in the honest belief that the action taken is in the best interests of the nonprofit corporation. The elements of the business judgment rule and the circumstances for its application continue to be developed and refined by courts. Accordingly, it would not be desirable to freeze the concept in a statute. Thus, section 831 does not codify the business judgment rule as a whole, although certain of its principal elements, relating to personal liability issues, are reflected in section 831(a)(2).

Note on Directors’ Liability

A director’s financial risk exposure to financial liability (e.g., in a lawsuit for money damages suffered by the nonprofit corporation or its members claimed to have resulted from misfeasance or nonfeasance in connection with the performance of the director’s duties) can be analyzed as follows:

1. Liability limitation. If the nonprofit corporation is a charitable corporation (and its directors are accordingly entitled to the benefits of subsection Section 831(d)), or if the corporation’s articles of incorporation contain a provision eliminating its directors’ liability to the corporation or its members for money damages, adopted pursuant to Section 2.02202(c), there is no liability unless the director’s conduct involves one of the prescribed exceptions in
subsection Section 831(d) or Section 2.02202(c) that preclude the elimination of liability. See Section 2.02202 and its Official Comment.

2. Director’s conflicting interest transaction safe harbor. If the matter at issue involves a director’s conflicting interest transaction (as defined in Section 860) and one of the procedures in Section 8.60860 has been followed to approve the transaction, there is no liability for the interested director arising out of the transaction.

3. Business opportunities safe harbors. Similarly, if the matter involves a director’s pursuit or taking of a business opportunity, there is no liability for that director if (i) an applicable limitation or elimination of any duty to offer that business opportunity has been adopted pursuant to Section 202(b)(10), or (ii) a safe harbor procedure under Section 870 has been properly implemented, even if the articles of incorporation contain no provision under Section 202(b)(10).

34. Business judgment rule. The presumptions, standards of judicial review, and procedural matters related to the business judgment rule may insulate a director from liability for conduct in connection with a corporate decision if none of (i) subsection (d), (ii) a provision of the articles of incorporation adopted pursuant to Section 2.02202(c), or (iii) one of the procedures under Section 8.60870 does not shield the director’s conduct from liability; the business judgment rule standard of judicial review for director conduct—deeply rooted in the case law—presumes that, absent self-dealing or other breach of the duty of loyalty, directors’ decision making satisfies the applicable legal requirements. A plaintiff challenging the director’s conduct in connection with a corporate decision, and asserting liability by reason thereof, encounters certain procedural barriers. In the first instance, many jurisdictions have special pleading requirements that condition the ability to pursue the challenge on the plaintiff’s bringing forward specific factual allegations that put in question the availability of the business judgment presumption. Assuming the suit survives a motion to dismiss for failure to state (in satisfaction of such a condition) an actionable claim, the plaintiff has the burden of overcoming that presumption of regularity.

45. Damages and proximate cause. If the business judgment rule does not shield the directors’ decision-making from liability, as a general rule it must be established that money damages were suffered by the nonprofit corporation or its members and those damages resulted from and were legally caused by the challenged act or omission of the director.

56. Other liability for money payment. Aside from a claim for damages, the director may be liable to reimburse the nonprofit corporation pursuant to a claim under quantum meruit (the reasonable value of services) or quantum valebant (the reasonable value of goods and materials) have monetary liability for other reasons, for example, if corporate resources have been used without proper authorization.

67. Equitable profit recovery or disgorgement. An equitable remedy compelling the disgorgement of the director’s improper financial gain or entitling the nonprofit corporation to profit recovery of financial gains, where directors’ duties have been breached, may require the payment of money by the director to the corporation.
38. Corporate indemnification. If the court determines that the director is monetarily liable, the director may be indemnified by the nonprofit corporation for any payments made and expenses incurred, depending upon the circumstances, if a third-party suit is involved. If the proceeding is by or in the right of the corporation, the director may be reimbursed for reasonable expenses incurred in connection with the proceeding if ordered by a court under Section 8.54(a)(3). See Subchapter 8E.

39. Insurance. To the extent that corporate indemnification is not available, the director may be reimbursed for the money damages for which the director is accountable, together with proceeding-related expenses, if the claim and grounds for liability come within the coverage under directors’ and officers’ liability insurance that has been purchased by the nonprofit corporation pursuant to Section 8.57857.

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Section 8.31 includes steps (1) through (6) in the analysis of a director’s liability exposure set forth in the above Note. In establishing general standards of director liability under the act, the section also serves the important purpose of providing clarification that the general standards of conduct set forth in Section 8.30 are not intended to codify the business judgment rule—a point as to which there has been confusion on the part of some courts.

A board member’s obligation to a nonprofit corporation and its members has two prongs, generally characterized as the duty of care and the duty of loyalty. The duty of care refers to the responsibility of a corporate fiduciary to exercise, in the performance of his tasks, the care that a reasonably prudent person in a similar position would use under similar circumstances. See NYBCL Section 717. In evaluating a manager’s compliance with the duty of care, New York courts adhere to the business judgment rule, which “bars judicial inquiry into actions of corporate directors taken in good faith and in the exercise of honest judgment in the lawful and legitimate furtherance of corporate purposes.” Norlin Corp. v. Rooney, Pace Inc., 744 F.2d 255, 264 (2d Cir. 1984) [quoting Auerbach v. Bennett, 47 N.Y. 2d 619, 629 (1979)].

Sections 8.30 and 8.31 adopt the approach to director conduct and director liability taken in the Norlin decision. See Section 8.30 and its Official Comment with respect to the standards of conduct for directors. For a detailed analysis of how and why standards of conduct and standards of liability diverge in corporate law, see Melvin A. Eisenberg, The Divergence of Standards of Conduct and Standards of Review in Corporate Law, 62 Fordham L. Rev. 437 (1993).

The act does not undertake to prescribe detailed litigation procedures. However, it does deal with requirements applicable to derivative suits (see Chapter 13) and Section 8.31 builds on those requirements. If none of (i) subsection (d), (ii) a liability-eliminating provision included in the corporation’s articles of incorporation, pursuant to Section 2.02(c), or (iii) protection for a director’s conflicting interest transaction afforded by Section 8.60; is interposed by a defendant director as a bar to the challenge of his or her conduct, the plaintiff’s role in satisfying the requirement of subsection (a)(1)—i.e., establishing that the articles of incorporation provision or the conflicting interest approval provision interposed does not apply—would be governed by the court’s procedural rules. Consistent with the general rules of civil procedure, the plaintiff generally has the burden under subsection (b) of proving that the director’s deficient conduct caused harm resulting in monetary damage or calls for monetary reimbursement; in the
alternative, the circumstances may justify or require an equitable remedy.

12. Section 8.31831(a)

a. SECTION 831(a)(1) – affirmative defenses

If subsection (d) or a provision in the nonprofit corporation’s articles of incorporation adopted pursuant to Section 2.02202(c) shields the director from liability for money damages, or (ii) a provision in the articles adopted pursuant to Section 202(b)(10) limits or eliminates any duty to offer the particular business opportunity to the corporation and the procedures set forth in Section 202(b)(10) are followed, or (iii) approval under Section 8.60860 or Section 870(a)(1) shelters the director’s conduct in connection with a conflicting interest transaction, or the pursuit or taking of a business opportunity, and such defense applies to all claims in plaintiff’s complaint; then there is no need to consider further the application of Section 8.31831’s standards of liability. In either case of those events, the court would presumably grant the defendant director’s motion for dismissal or summary judgment (or the equivalent) and the proceeding would be ended. If the defense applies to some but not all of plaintiff’s claims, dismissal or summary judgment would presumably be granted with respect to those claims. Termination of the proceeding or dismissal of claims on the basis of a provision in the articles of incorporation or a safe harbor procedure will not automatically follow, however, if the party challenging the director’s conduct can assert any of the valid bases for contesting the availability of the liability shelter. In the absence thereof, the relevant shelter provision is self-executing and the individual director’s exoneration from liability is automatic. Further, under both Section 860 and 870, the directors approving the conflicting interest transaction or approving a director’s taking of the business opportunity will presumably be protected as well, because compliance with the relevant standards of conduct under Section 830 is important for their action to be effective and because, as noted above, conduct meeting Section 830’s standards will almost always be protected.

If a claim of liability arising out of a challenged act or omission of a director is not resolved and disposed of under subsection 831(a)(1), subsection 831(a)(2) provides the basis for evaluating whether the conduct in question can be challenged. One of the elements in Section 831(a)(2) must be established for a director to have liability under Section 831.

b. SECTION 831(a)(2)(i) – GOOD FAITH

Note on the Business Judgment Rule

Over the years, the courts have developed a broad common law concept geared to business judgment. In basic principle, a board of directors enjoys a presumption of sound business judgment and its decisions will not be disturbed (by a court substituting its own notions of what is or is not sound business judgment) if they can be attributed to any rational business purpose. See Sinclair Oil Corp. v. Levien, 280 A.2d 717, 720 (Del. 1971). Relatedly, it is presumed that, in making a business decision, directors act in good faith, on an informed basis, and in the honest belief that the action taken is in the best interests of the nonprofit corporation. See Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1983). When applied, this principle operates.
both as a procedural rule of evidence and a substantive rule of law, in that if the plaintiff fails to
rebut the presumption that the directors acted in good faith, in the corporation’s best interest, and
on an informed basis, the business judgment standard protects both the directors and the
decisions they make. See Citron v. Fairchild Camera & Instrument Corp., 569 A.2d 53, 64
(Del. 1989).

Some have suggested that, within the business judgment standard’s broad ambit, a
distinction might usefully be drawn between that part which protects directors from personal
liability for the decision they make and the part which protects the decision itself from attack.
While these two objects of the business judgment standard’s protection are different, and judicial
review might result in the decision being enjoined but no personal liability (or vice versa), their
operative elements are identical (i.e., good faith, disinterest, informed judgment, and “best
interests”). As a consequence, the courts have not observed any distinction in terminology and
have generally followed the practice of referring only to the business judgment rule, whether
dealing with personal liability issues or transactional justification matters.

While, in substance, the operative elements of the standard of judicial review commonly
referred to as the business judgment rule have been widely recognized, courts have used a
number of different word formulations to articulate the concept. The formulation adopted in
Section 4.01(c) of The American Law Institute’s Principles of Corporate Governance: Analysis
and Recommendations (1994) provides that a director who makes a business judgment in good
faith (an obvious prerequisite) fulfills the duty of care standard if the director:

(1) is not interested [as defined] in the subject of the business judgment;
(2) is informed with respect to the subject of the business judgment to the extent the
director . . . reasonably believes to be appropriate under the circumstances; and
(3) rationally believes that the business judgment is in the best interests of the
corporation.

Referring to clause (2) above, the decision-making process is to be reviewed on a basis
that is to a large extent individualized in nature (“informed . . . to the extent the director . . .
reasonably believes to be appropriate under the circumstances”)—as contrasted with the
traditional objectively-based duty of care standard (e.g., the “care . . . an ordinarily prudent
person . . . would exercise”). An “ordinarily prudent person” might do more to become better
informed, but if a director believes, in good faith, that the director can make a sufficiently
informed business judgment, the director will be protected so long as that belief is within the
bounds of reason. Referring to clause (3) above, the phrase “rationally believes” is stated in the
Principles to be a term having “both an objective and subjective content. A director . . . must
actually believe that the business judgment is in the best interests of the corporation and that
belief must be rational.” 1 Principles, at 179. Others see that aspect to be primarily geared to the
process employed by a director in making the decision as opposed to the substantive content of
the board decision made. See Aronson v. Lewis, supra, at 812 (“The business judgment rule is . . .
a presumption that in making a business decision the directors of a corporation acted on an
informed basis, in good faith and in the honest belief that the action taken was in the best
interests of the company. . . . Absent an abuse of discretion, that judgment will be respected by
the courts.”). In practical application, an irrational belief would in all likelihood constitute an
abuse of discretion. Compare In re Caremark International Inc. Derivative Litigation
(September 25, 1996) (1996 Del. Ch. LEXIS 125 at p. 27: “whether a judge or jury considering
the matter after the fact . . . believes a decision substantively wrong, or degrees of wrong
extending through “stupid” to “egregious” or “irrational”, provides no ground for director liability, so long as the court determines that the process employed was either rational or employed in a good faith effort to advance corporate interests — the business judgment rule is process oriented and informed by a deep respect for all good faith board decisions.”

Section 8.31 does not codify the business judgment rule as a whole. The section recognizes the common law doctrine and provides guidance as to its application in dealing with director liability claims. Because the elements of the business judgment rule and the circumstances for its application are continuing to be developed by the courts, it would not be desirable to freeze the concept in a statute. For example, in recent years the Delaware Supreme Court has established novel applications of the concept to various transactional justification matters, such as the role of special litigation committees. See Zapata Corporation v. Maldonado, 430 A. 2d 779 (Del. 1981). Under Zapata, a rule that applies where there is no disinterested majority on the board appointing the special litigation committee, there is no presumption of regularity and the corporation must bear the burden of proving the independence of the committee, the reasonableness of its investigation, and the reasonableness of the bases of its determination that dismissal of the derivative litigation is in the best interests of the corporation.

The business judgment concept has been employed in countless legal decisions and is a topic that has received a great deal of scholarly attention. For an exhaustive treatment of the subject, see D. Block, N. Barton & S. Radin, The Business Judgment Rule: Fiduciary Duties of Corporate Directors (4th ed. 1993 & Supp. 1995). While codification of the business judgment rule in Section 8.31 is expressly disclaimed, its principal elements, relating to personal liability issues, are embedded in subsection (a)(2).

a. Good faith

The expectation that a director’s conduct will be in good faith is an overarching element of his or her baseline duties. Relevant thereto, it has been stated that a lack of good faith is presented where a board “lacked an actual intention to advance corporate welfare” and “bad faith” is presented where “a transaction . . . is authorized for some purpose other than a genuine attempt to advance corporate welfare or is known to constitute a violation of applicable positive law.” See Gagliardi v. TriFoods Int’l Inc., 683 A.2d 1049 (Del. Ch. 1996). If a director’s conduct can be successfully challenged pursuant to other clauses of subsection (a)(2), there is a substantial likelihood that the conduct in question will also present an issue of good faith implicating clause 2(i). Conduct involving knowingly illegal conduct that exposes the corporation to harm will constitute action not in good faith, and belief that decisions made (in connection with such conduct) were in the best interests of the corporation will be subject to challenge as well. If subsection (a)(2) included only clause 2 subsection (i), much of the conduct with which the other clauses are concerned could still be considered pursuant to the other clauses, on the basis that such conduct evidenced the actor’s lack of good faith. Accordingly, the canon of construction known as eiusdem generis has substantial relevance in understanding the broad overlap of the good faith element with the various other subsection (a)(2) clauses. Where conduct has not been found deficient on other grounds, decision-making outside the bounds of reasonable judgment — an abuse of discretion perhaps explicable on no other basis — can give rise to an inference of bad faith. That form of conduct, sometimes characterized by the court as “constructive fraud” or “reckless indifference” or “deliberate disregard” in the relatively few case precedents, giving rise to an
inference of bad faith will also raise a serious question regarding whether the director could have reasonably believed that the best interests of the corporation would be served. These issues could arise, for example, in approval of conflicting interest transactions. See the Official Comment to Section 860.

b. Reasonable belief

c. SECTION 831(a)(2)(ii) – REASONABLE BELIEF

A director should reasonably believe that his or her decision will be in the best interests of the nonprofit corporation and a director should become sufficiently informed, with respect to any action taken or not taken, to the extent he or she reasonably believes appropriate in the circumstances. Liability under Section 831(a)(2)(ii) turns on a director’s reasonable belief with respect to the nature of the director’s decision and the degree to which the director has become informed. In each case, the director’s reasonable belief calls for an actual subjective belief and, so long as it is his or her honest and good faith belief, a director has wide discretion. However, there is also an objective element to be met, in that the director’s belief must also be reasonable. The inquiry is similar to that in section 830(a) – could a reasonable person in a like position and acting in similar circumstances have arrived at that belief? In the rare case where a decision respecting the corporation’s best interests is so removed from the realm of reason (e.g., corporate waste), or a belief as to the sufficiency of the director’s preparation to make an informed judgment is so unreasonable as to fall outside the permissible bounds of sound discretion (e.g., a clear case is presented if the director has undertaken no preparation and is completely uninformed), the director’s judgment will not be sustained.

d. Lack of objectivity or independence

d. SECTION 831(a)(2)(iii) – LACK OF OBJECTIVITY OR INDEPENDENCE

If a director has a familial, financial, or business relationship with another person having a material interest in a transaction or other conduct involving the nonprofit corporation, or if the director is dominated or controlled by another person having such a material interest, there is a potential for that conflicted interest or divided loyalty to affect the director’s judgment. If the matter at issue involves a director’s transactional interest, such as a “director’s conflicting interest transaction” in which a “related person is involved (see Section 860), it will be governed by Section 8.60; otherwise, the lack of objectivity due to a relationship’s influence on the director’s judgment will be evaluated, in the context of the pending conduct challenge, of the director’s conduct under Section 8.31. If the matter at issue involves lack of independence, the proof of domination or control and its influence on the director’s judgment will typically entail different (and perhaps more convincing) evidence than what may be involved in a lack of objectivity case. The variables are manifold, and the facts must be sorted out and weighed on a case-by-case basis. If that other person is the director’s spouse or employer, the concern that the director’s judgment might be improperly influenced would be substantially greater than if that person is the spouse of the director’s step-grandchild or the director’s partner in a vacation time-share. When the party challenging the director’s conduct can establish that For example, the closeness or nature of the relationship or the domination or control in question could reasonably be expected to affect the director’s judgment respecting the matter at issue in a manner adverse
to the corporation, the director will then have the opportunity with the person allegedly exerting
influence on the director could be a factor. If the director is required under section
831(a)(2)(iii)(B) to establish that the action taken by him or her the director was reasonably
believed to be in the best interests of the corporation—The reasonableness of the director’s belief
as to the corporation’s best interests, in respect of the action taken, should be evaluated on the
basis of not only the director’s honest and good faith belief but also on considerations bearing on
the fairness to the corporation of the transaction or other conduct involving the corporation that
is at issue, the inquiry will involve the elements of actual subjective belief and objective
reasonableness similar to those found in Sections 831(a)(2)(ii) Section 830(a). To call into
question the director’s objectivity or independence on the basis of a person’s relationship with,
or exertion of dominance over, the director, the person must have a material interest in the
challenged conduct.

d. Improper financial benefit

Subchapter 8F of the act deals with conflicting interest transactions. Its coverage of those
interests is exclusive and its procedures for approval of conflicting interest transactions will
establish a director’s entitlement to any financial benefit gained from the transactional event. A
director’s conflicting interest transaction that is not protected by the fairness standard set forth in
Section 8.60(a)(3), pursuant to which the conflicted director may establish the transaction to
have been fair to the nonprofit corporation, would often involve receipt of a financial benefit to
which the director was not entitled (i.e., the transaction was not “fair” to the corporation).

e. Financial benefit/material interest

A director is expected to observe an obligation of undivided loyalty to the corporation
and, while the law will not concern itself with trifling deviations (de minimis non curat lex),
there is no materiality threshold that applies to a financial benefit to which a director is not
properly entitled. The act observes this principle in several places (e.g., the exception to liability
elimination prescribed in Section 2.02(c)(1) and the indemnification restriction in Section
8.51(d)(2), as well as the liability standard in subsection (a)(2)(v)). In contrast, there is a
materiality threshold for the interest of another in a transaction or conduct where a director’s lack
of objectivity or lack of independence has been asserted under subsection (a)(2)(iii). In the
typical case, analysis of another’s interest would first consider the materiality of the transaction
or conduct at issue—in most cases, any transaction or other action involving the attention of the
board or one of its committees of directors or a board committee will cross the materiality
threshold, but not always—and would then consider the materiality of that person’s interest
therein in the matter. The possibility that a director’s judgment would be adversely affected by
another’s interest in a transaction or conduct that is not material, or that another’s immaterial
interest of another in a transaction or conduct, would adversely affect a director’s judgment is
sufficiently remote that it should not be made subject to judicial review.

f. Sustained inattention

In situations where there may be a lack of objectivity, domination, a conflict of interest or
divided loyalty, or even where there may be grounds for the issue to be raised, the better course
to follow where board or committee action is required is usually for the director to disclose the
facts and circumstances posing the possible issue, and then to withdraw from the meeting (or, in
the alternative, to abstain from the deliberations and voting). The directors free of any possible
taint may then take appropriate action as contemplated by section 830 (or section 860, if
If this course is followed, the director’s conduct respecting the matter in question should be beyond challenge.

e. SECTION 831(a)(2)(iv) – FAILURE TO DEVOTE ATTENTION

The director’s role involves two fundamental components: the decision-making function and the oversight function. In contrast with the decision-making function, which generally involves action taken at a point in time, the oversight function under Section 8.01801(b) involves ongoing monitoring of the nonprofit corporation’s activities and affairs over a period of time. This involves the duty of ongoing attention, when actual knowledge of particular facts and circumstances arouse suspicions which indicate a need to make inquiry. As observed by the Supreme Court of New Jersey in Francis v. United Jersey Bank, 432 A.2d 814, 822 (Sup. Ct. 1981):

Although Directors are under a continuing obligation to keep informed about the activities of the corporation, Directors may not shut their eyes to corporate misconduct and then claim that because they did not see the misconduct, they did not have a duty to look. The sentinel asleep at his post contributes nothing to the enterprise he is charged to protect. Directorial management does not require a detailed inspection of day to day activities, but rather a general monitoring of corporate affairs and policies.

While the facts will be outcome-determinative, deficient conduct involving a sustained failure to exercise oversight – where found actionable – has typically been characterized by the courts in terms of abdication and continued neglect of a director’s duty of attention, not a brief distraction or temporary interruption. However, embedded in the oversight function is the need to inquire when suspicions are aroused. This need to inquire is not a component of ongoing oversight, and does not entail proactive vigilance, but arises under Section 831(a)(2)(iv) when, and only when, particular facts and circumstances of material concern (e.g., evidence of embezzlement at a high level or the discovery of significant inventory shortages) suddenly surface.

f. Other breaches of a director’s duties

The first clause of Section 831(a)(2)(v) should be read in conjunction with Section 860, which deals with directors’ transactional interests. Section 860’s coverage of those interests is exclusive and its procedures provide shelter from legal challenges based on interest conflicts, when properly observed, will establish a director’s entitlement to any financial benefit gained from the transactional event.

Unauthorized use of a nonprofit corporation’s assets also would provide a basis for a proper challenge of a director’s conduct. There can be other forms of improper financial benefit not involving a transaction with the corporation or use of its facilities, such as where a director profits from unauthorized use of proprietary information.
There is no materiality threshold that applies to a financial benefit to which a director is not properly entitled. The act observes this principle in several places, for example, the exception to liability elimination prescribed in section 202(b)(4)(i) and the indemnification restriction in section 851(d)(2), as well as the liability standard in section 831(a)(2)(v).

Subsection The second clause of Section 851(a)(2)(v) is, in part, a catchall provision that implements the intention to make Section 8.31831 a generally inclusive provision but, at the same time, to recognize the existence of other breaches of common law duties that can give rise to liability for directors. A doctrine of corporate governance, well-established in the case law, is that a director owes a duty of loyalty to the nonprofit corporation; relatedly, the courts impose a duty of fair dealing on directors when their conduct affects the interests of the corporation. It has long been recognized that a director must first offer a “corporate opportunity” to the corporation before taking advantage of it. The term “corporate opportunity” can be readily stated in principle but, when determining the doctrine’s application, the facts will often be outcome determinative. It has been defined in Section 5.05(b)(1) of The American Law Institute’s Principles of Corporate Governance: Analysis and Recommendations (1994) to mean, insofar as a director is concerned: As developed in the case law, these actionable breaches may include unauthorized use of corporate property or information (which as noted above, might also be characterized as receipt of an improper financial benefit), unfair competition with the nonprofit corporation or the taking of a corporate opportunity. In the case of corporate opportunity, if the director is alleged to have wrongfully diverted a business opportunity as to which the corporation had a prior right, the act provides two possible safe harbors. First, any duty to offer the business opportunity to the corporation may have been limited or eliminated pursuant to a provision in the articles of incorporation authorized by section 202(b)(10). Second, section 870(a)(1) provides a safe harbor procedure for a director who wishes to pursue or take advantage of a business opportunity, regardless of whether such opportunity would be characterized as a “corporate opportunity” under existing case law. Note that section 870(b) provides that the fact that a director did not employ the safe harbor procedure of section 870(a)(1) does not create an implication that the opportunity should have first been presented to the corporation or alter the burden of proof otherwise applicable to establish a breach of the director’s duty to the corporation.

Any opportunity to engage in a business activity of which a director . . . becomes aware, either:

(A) In connection with the performance of functions as a director . . ., or under circumstances that should reasonably lead the director . . . to believe that the person offering the opportunity expects it to be offered to the corporation; or

(B) Through the use of corporate information or property, if the resulting opportunity is one that the director . . . should reasonably be expected to believe would be of interest to the corporation . . .

The application of the corporate opportunity doctrine, in cases where it is operative, is typically conditioned on the nonprofit corporation’s financial ability to exploit the opportunity, although some courts have held it is up to the corporation to judge that ability and the opportunity should therefore always be offered. Relatedly, a formal offer is not essential, so long as the surrounding circumstances indicate an awareness of, and afford the corporation reasonable access to, the opportunity and there is indicated disinterest, manifested by inaction or due to

Failure to observe this obligation first to refer a corporate opportunity to the corporation results in a breach of a director’s duty. See Subchapter G of Chapter 8 for a procedure under which the taking of a corporate opportunity by a director may be approved.

A related duty obligates the director to refrain from gaining a pecuniary benefit by engaging in competition with the corporation that would cause reasonably foreseeable harm to it; unless authorized by the corporation, that conduct will constitute a breach of the director’s duties.

3. Fairness

Pursuant to Section 8.60(a)(3), an interested director (or the nonprofit corporation, if it chooses) can gain protection for a director’s conflicting interest transaction by establishing that it was fair to the corporation. (The concept of “fair” and “fairness,” in this and various other contexts, can take into account both fair price and fair dealing on the part of the interested director.) Under case law, personal liability as well as transactional justification issues will be subject to a fairness standard of judicial review if the plaintiff makes out a credible claim of breach of the duty of loyalty or if the presumptions of the business judgment standard (e.g., an informed judgment) are overcome, with the burden of proof shifting from the plaintiff to the defendant. In this respect, the issue of fairness is relevant to both subsection (a) and subsection (b). Within the ambit of subsection (a)(2), a director can often respond to the challenge that his or her conduct was deficient by establishing that the transaction or conduct at issue was fair to the corporation. See Kahn v. Lynch Communications Systems, Inc., 669 A.2d 79 (Del. 1995).

Cf. Cede & Co. v. Technicolor Inc., 634 A.2d 345 (Del. 1993) (when the business judgment rule is rebutted — procedurally — the burden shifts to the defendant directors to prove the “entire fairness” of the challenged transaction). It is to be noted, however, that fairness may not be relevant to the matter at issue (see, e.g., clause (iv) of subsection (a)(2)). If the director is successful in establishing fairness, where the issue of fairness is relevant, then it is unlikely that the complainant can establish legal liability or the appropriateness of an equitable remedy under subsection (b).

Subsection (a)(2) deals, throughout, with a director’s action that is taken or not taken. To the extent that the nonprofit corporation or its members have suffered harm and whether a particular director’s conduct involves a breach of his or her duty of care or duty of attention within the context of collegial action by the board or one of its committees, proper performance of the relevant duty through the action taken by the director’s colleagues can overcome the consequences of his or her deficient conduct. For example, where a director’s conduct can be challenged under subsection Section 831(a)(2)(ii)(B) by reason of having been uninformed about the decision — he or she did not read the merger materials distributed prior to the meeting, or arrived late at the board meeting just in time for the vote but, nonetheless, voted for the merger in favor solely because the others were in favor — the favorable action by a quorum of properly informed directors would ordinarily protect the director against liability. When the director’s conduct involves the duty of fair dealing within the context of action taken by the board or one of its committees, the wiser choice will usually be for the director not to participate in the collegial action. That is to say, where a director may have a conflicting interest or a divided loyalty, or even where there may be grounds for the issue to be...
raised, the better course to follow is usually for the director to disclose the conduct-related facts and circumstances posing the possible compromise of his or her independence or objectivity, and then to withdraw from the meeting (or, in the alternative, to abstain from the deliberations and voting). Either because there was no 2. SECTION 8.31(b)

After satisfying the burden of establishing that the conduct of the director is challengeable under subsection (a), the plaintiff, in order to hold the director liable for money damages under clause (b)(1), has the further burden of establishing that: (i) harm (measurable in money damages) has been suffered by the nonprofit corporation or its members, and (ii) the harm or the offending director’s challenged conduct was actions were not the proximate cause of that the harm. Although the concept of “proximate cause” is a term of art that is basic to tort law, and the cases providing content to the phrase represent well-developed authority to which a court will undoubtedly refer. A useful approach for the concept’s application, for purposes of subsection Section 831(b)(1), a useful approach for the concept’s application would be that the challenged conduct must have been a “substantial factor in producing the harm.” See Francis v. United Jersey Bank, supra, 432 A.2d at 829. Similarly, the plaintiff has the burden of establishing money payment is due from the director pursuant to clause (b)(2). If, while challengeable, the conduct at issue caused no harm under clause (b)(1) or does not provide the basis for other legal remedy under clause (b)(2), but may provide the basis for an equitable remedy under clause (b)(3), the plaintiff must satisfy whatever further burden of persuasion may be indicated to establish that imposition of the remedy sought is appropriate in the circumstances. In Brophy v. Cities Service Co., 70 A.2d 5, 8 (Del. Ch. 1949), an employee was required to account for profits derived from the use of the corporation’s confidential plans to reacquire its securities through open-market purchases. Notwithstanding the fact that harm to the corporation had not been established, the Chancellor observed: “[p]ublic policy will not permit an employee occupying a position of trust and confidence toward his employer to abuse that relation to his own profit, regardless of whether his employer suffers a loss.” Once actionable conduct that provides the basis for an equitable remedy under clause (b)(3) has been established, its appropriateness will often be clear and, if so, no further advocacy on the part of the plaintiff will be required.

3. SECTION 8.31(c)

While Section 8.31 addresses director liability to Section 831(c) expressly disclaims any shift of the burden of proof otherwise applicable where the question of the fairness of a transaction or other challenged conduct is at issue. This is the case whether the question of fairness arises under another section of the Act, such as Section 860, under existing case law, under a judicial requirement in a particular instance or otherwise. Similarly, Section 831 does not affect liability under other sections of the Act. It also does not foreclose any rights of the nonprofit corporation or its members under the act—and related case law dealing with corporate governance concepts coming within the common law’s ambit—it does not limit any liabilities or foreclose any rights expressly provided for under other law. Subsection (c) merely acknowledges that those rights are unaffected by Section 8.31. And other laws. In addition, directors can have liability to persons other than the corporation and its members, such as (i) liability to employee benefit plan participants and beneficiaries (who may or may not be members), if the directors are determined
to be fiduciaries under the Employee Retirement Income Security Act of 1974, 29 U.S.C. Sections 1001-1461 (1988 & Supp. IV 1992), (ii) other applicable laws, to government agencies for regulatory violations, or (iii) to individuals claiming damages for injury governed by tort law concepts (e.g., libel or slander). Section 831 is not intended to change the standards applicable under these other laws or legal principles.

As discussed above in the Official Comment to Section 8.31(a), the concept of “fairness” is often relevant to whether a director will have liability if his or her conduct is challenged. Specifically, a director can successfully defend a financial interest in a transaction with the corporation by establishing that it was fair to the corporation. See Section 8.60 and its Official Comment. More generally, the courts have resorted to a fairness standard of review where the business judgment rule has been inapplicable. See Weinberger v. UOP, Inc., 457 A.2d 701 (Del. 1983). In the usual case, the defendant seeking to justify challenged conduct, on the basis of fairness, has the burden of proving that it was fair to the nonprofit corporation. Subsection (c) expressly disclaims any intention to shift the burden of proof otherwise applicable where the question of the fairness of a transaction or other challenged conduct is at issue.

§ 8.32. LOANS TO OR GUARANTEES FOR DIRECTORS AND OFFICERS

(a) A nonprofit corporation may not lend money to or guarantee the obligation of a director or officer of the corporation.

(b) This section does not apply to:

(1) an advance to pay reimbursable expenses reasonably expected to be incurred by a director or officer;

(2) an advance to pay premiums on life insurance if the advance is secured by the cash value of the policy;

(3) advances pursuant to [Subchapter] 8E;

(4) loans or advances pursuant to employee benefit plans;

(5) a loan secured by the principal residence of an officer; or

(6) a loan to pay relocation expenses of an officer.

(c) The fact that a loan or guarantee is made in violation of this section does not affect the borrower’s liability on the loan.

Source Note: Subsections (a) and (c) are a reenactment of Model Nonprofit Corporation Act (1987) § 8.32. Subsection (b) is new.

OFFICIAL COMMENT

Section 8.32 is an optional section that prohibits all loans to and guarantees for directors and officers. Whether the potential abuse in this area is so great as to warrant prohibiting all loans and guarantees for the benefit of directors and officers is a policy judgment that individual states will need to make. Some members of the drafting committee for the act believe that having the ability to make loans and guarantees may be beneficial to a nonprofit corporation, such as when they are used to facilitate the recruitment of an executive from another area of the country who will have substantial moving expenses. Other members of the drafting committee believe that the potential abuses justify prohibiting all loans and guarantees notwithstanding the possible benefits under certain circumstances.
If this section is not adopted in a particular state, the making of loans and guarantees will still be subject to scrutiny under Sections 8.31 and 8.60.

§ 8.33 DIRECTORS’ LIABILITY FOR UNLAWFUL DISTRIBUTIONS

(a) A director who votes for or assents to a distribution made in violation of this Act is personally liable to the nonprofit corporation for the amount of the distribution that exceeds what could have been distributed without violating this Act if the party asserting liability establishes that, when taking the action, the director did not comply with Section 8.30 (standards of conduct for directors).

(b) A director held liable under subsection (a) for an unlawful distribution is entitled to:

(1) contribution from every other director who could be held liable under subsection (a) for the unlawful distribution; and

(2) recoupment from each person of the pro-rata portion of the amount of the unlawful distribution the person received, whether or not the person knew the distribution was made in violation of this Act.

(c) A proceeding to enforce:

(1) the liability of a director under subsection (a) is barred unless it is commenced within two years after the date on which the distribution was made; or

(2) contribution or recoupment under subsection (b) is barred unless it is commenced within one year after the liability of the claimant has been finally adjudicated under subsection (a).


Subsections (a) and (b) are substantially a reenactment of Model Nonprofit Corporation Act (1987) § 8.33. (2016 Revision), § 8.32.

CROSS-REFERENCES

Article provision limiting liability, see § 2.022 § 2.022(c).
Compensation and other permitted payments, § 641.
Director duties in dissolution, see § 14.091 § 14.09109.
Director standards of conduct, see § 8.30.
Distributions prohibited generally, see § 6.406 § 6.40640.
Indemnification, see §§ 2.022 § 2.022(b)(8), 8.50-8.58, § 850 through 858.
Permissible distributions, Standards of conduct for directors, see § 6.41 § 6.41830.

OFFICIAL COMMENT
Section 832 has limited application to nonprofit corporations because most do not make
distributions.

A director who is compelled to restore the amount of an unlawful distribution to the
nonprofit corporation is entitled to contribution from every other director who could have been
held liable for the unlawful distribution. The director may also recover a pro-rata portion of the
amount of the unlawful distribution from any person who accepted the distribution whose
conduct, in voting for or assenting to a distribution, is challenged under Section 832 will have no
liability unless the complaining party establishes a breach of the relevant standards of Section
830, for example a failure to act with the care required by Section 830(b) or reliance on persons
or information unwarranted under Section 830(d) or Section 830(e). Although no attempt has
been made in the act to work out in detail the relationship between the right of recoupment from
other persons and the right of contribution from directors, it is expected that a court will may
equitably apportion the obligations and benefits arising from the application of the principles set
forth in this section Section 832.

Section 8.33(832(c) limits the time within which a proceeding may be commenced against
a director for an unlawful distribution to two years after the date on which the effect of the
distribution was measured. Section 8.33(c) also limits and the time within which a proceeding for
contribution or recoupment may be made to one year after the date on which the liability of the
claimant has been finally determined and adjudicated. This, The one-year period specified in
clause Section 832(c)(2) may end within or extend beyond the two-year period specified in
clause Section 832(c)(1).

This section also applies to a designated body pursuant to Section 8.12812.

§ 833. LOANS TO OR GUARANTEES FOR DIRECTORS AND OFFICERS
[Optional]

(a) A nonprofit corporation may not lend money to or guarantee the obligation of a
director or officer of the corporation.

(b) This section does not apply to:

(1) an advance to pay reimbursable expenses reasonably expected to be
incurred by a director or officer;

(2) an advance to pay premiums on life insurance if the advance is secured by
the cash value of the policy;

(3) advances pursuant to [Subchapter] 8E (indemnification and advancement
of expenses);

(4) loans or advances pursuant to employee benefit plans;
(5) a loan secured by the principal residence of an officer; or
(6) a loan to pay relocation expenses of an officer.

(c) The fact that a loan or guarantee is made in violation of this section does not affect the borrower’s liability on the loan.

Source Note: Model Nonprofit Corporation Act, 3rd Ed. (2008), § 8.32.

OFFICIAL COMMENT

Section 833 is an optional section that prohibits all loans to and guarantees for directors and officers. Whether the potential abuse in this area is so great as to warrant prohibiting all loans and guarantees for the benefit of directors and officers is a policy judgment that individual states will need to make. Some members of the drafting committee for the act believe that having the ability to makes loans and guarantees may be beneficial to a nonprofit corporation, such as when they are used to facilitate the recruitment of an executive from another area of the country who will have substantial moving expenses. Other members of the drafting committee believe that the potential abuses justify prohibiting all loans and guarantees notwithstanding the possible benefits under certain circumstances.

If this section is not adopted in a particular state, the making of loans and guarantees will still be subject to scrutiny under Sections 831 and 860.

[Subchapter] D
OFFICERS

§ 8.40840. Officers.
§ 8.41841. Duties Functions of officers.
§ 8.42842. Standards of conduct for officers.

§ 8.40840. OFFICERS

(a) The officers of a nonprofit corporation are the individuals who hold the offices described in its articles of incorporation or bylaws, or are appointed or elected in accordance with the articles and bylaws or as authorized by the board of directors.

(a) A nonprofit corporation has the officers provided for in its articles of incorporation or bylaws, and such other officers as the board of directors may provide or may authorize other officers to appoint.

(b) The manner in which officers are appointed or elected must be in accordance with any applicable provisions of the articles of incorporation or bylaws. Except as provided in the
articles or bylaws, the board of directors may elect individuals to fill any office of a nonprofit corporation. An officer may appoint one or more officers if authorized by the articles of incorporation or bylaws or the board of directors.

(b) The articles of incorporation or bylaws or the board of directors must assign to one of the officers responsibility for preparing or supervising the preparation of the minutes of the meetings of the board of directors and the members, if any, and for maintaining and authenticating the records of the corporation required to be kept under Sections 16.01401(a) and 16.01(ecorporate records).

(c) The except as provided in the articles of incorporation or bylaws, the same individual may simultaneously hold more than one office in a nonprofit corporation.


CROSS-REFERENCES

Agents of corporation, see § 3.02302.
Contract rights of officers, see § 8.44844.
“Designated body” defined, see § 1.40102.
Duties Functions of officers, see § 8.41841.
“Officer” defined, § 102.
Officer as employee of corporation, see definition of “employee” in § 1.40102.
Removal Resignation and removal of officers, see § 8.43843.
“Secretary” defined, see § 1.40102.
Standards of conduct for officers, § 842.
Tenure of officers, see § 8.44844.

OFFICIAL COMMENT

Section 8.40840 permits every nonprofit corporation to designate the offices it wants. The designation may be made in the articles of incorporation or bylaws or by the board of directors consistent with the articles and bylaws, officers it will have. No particular officers are required except as provided in Section 840(c).

Section 8.40(a) indicates that, while it is generally the responsibility of the board of directors to elect officers, an officer may appoint one or more officers if authorized by the articles of incorporation or bylaws or the board of directors.

The board of directors, as well as duly authorized officers, employees, or agents, may also appoint other agents for the nonprofit corporation. Nothing in this section is intended to limit the authority of In addition, a board of directors has the intrinsic power to organize its own internal affairs, including designating officers of the board.
The articles of incorporation or bylaws or the board of directors must assign to an officer who has the responsibility for preparation of the minutes and authentication of the corporate records referred to in Sections 16.01(a) and (e); the person performing this function is referred to as the “secretary” of the nonprofit corporation throughout the act. See Section 1.40. Under the act, a corporation may have this and all other corporate functions performed by a single individual.

The person who is designated by the articles of incorporation, bylaws or board to have responsibility for preparing minutes of meetings and maintaining the corporate records has authority to bind the nonprofit corporation by that officer’s authentication under this section. This assignment of authority, traditionally vested in the corporate “secretary,” allows third persons to rely on authenticated records without inquiry as to their truth or accuracy.

The powers of the board of directors under this section may be vested by the articles of incorporation or bylaws in a designated body. See Sections 2.02, 2.02(b)(2) and 8.12812.

§ 8.41 DUTIES OF OFFICERS

Each officer has the authority and the obligation to perform the duties set forth in the articles of incorporation or bylaws or, to the extent consistent with the articles and bylaws, the duties prescribed by the board of directors or by direction of an officer authorized by the board to prescribe the duties of other officers.


CROSS-REFERENCES

“Officer” defined, § 102.
Assistant officers, Officers, see § 8.40840.
Officer as employee of corporation, see definition of “employee” in § 1.40102.
“Secretary” defined, see § 1.40102.
Standards of conduct for directors, § 830.
Standards of conduct for officers, § 842.

OFFICIAL COMMENT

Section 8.41 recognizes that persons designated as officers have the formal authority set forth for that position (1) by its description in the articles of incorporation or bylaws, (2) by specific resolution of the board of directors, or (3) by direction of another officer authorized by the board of directors to prescribe the duties of other officers.

These methods of investing officers with formal authority in Section 841 do not exhaust the sources of an officer’s actual or apparent authority. Many cases state that specific
Specific officers, particularly the chief executive officer, may have implied authority to take certain actions on behalf of the nonprofit corporation merely by virtue of their positions. This authority, which may overlap the express authority granted by the articles of incorporation or bylaws to an officer, generally has been viewed as extending only to transactions in the ordinary course of operations, although some cases have recognized unusually broad implied authority of the chief executive officer or have created a presumption that corporate officers have broad authority, thereby placing on the nonprofit corporation the burden of showing lack of authority. Corporate officers may also be vested with apparent (or ostensible) authority by reason of corporate conduct on which third persons reasonably rely.

In addition to express, implied, or apparent authority, a nonprofit corporation is normally bound by unauthorized acts of officers if the unauthorized acts are ratified by the board of directors. Generally, ratification extends only to acts that could have been authorized as an original matter. Ratification may itself be express or implied and may in some cases serve as the basis of apparent (or ostensible) authority.

The powers of the board of directors under this section may be vested by the articles of incorporation or bylaws in a designated body. See Sections 2.02(b)(2) and 8.12812.

§ 8.42842. STANDARDS OF CONDUCT FOR OFFICERS

(a) An officer with discretionary authority must discharge his or her duties under that authority, when performing in that capacity, has the duty to act:

(1) in good faith;
(2) with the care an ordinarily prudent person in a like position would reasonably exercise under similar circumstances; and
(3) in a manner the officer reasonably believes to be in the best interests of the corporation.

(b) The duty of an officer includes the obligation to inform:

(1) to inform the superior officer to whom, or the board of directors or the board committee thereof to which, the officer reports, of information about the affairs of the nonprofit corporation known to the officer, within the scope of the officer’s functions, and known to the officer to be material to the superior officer, board, or committee; and

(2) to inform his or her superior officer, or another appropriate person within the nonprofit corporation, or the board of directors, or a board committee thereof, of any actual or probable material violation of law involving the corporation or material breach of duty to the corporation by an officer, employee, or agent of the corporation, that the officer believes has occurred or is likely to occur.
In discharging his or her duties, an officer who does not have knowledge that makes reliance unwarranted may be entitled to rely on:

1. the performance of properly delegated responsibilities by one or more employees of the nonprofit corporation whom the officer reasonably believes to be reliable and competent in performing the responsibilities delegated;

2. information, opinions, reports, or statements, including financial statements and other financial data, if prepared or presented by:
   (1) one or more officers or employees of the nonprofit corporation whom the officer reasonably believes to be reliable and competent in the functions performed or the matters presented, or
   (2) legal counsel, public accountants, or other persons retained by the corporation as to matters involving skills or expertise the officer reasonably believes are matters:
      (i) within the particular person’s professional or expert competence, or
      (ii) as to which the particular person merits confidence;

3. in the case of a corporation engaged in religious activity, religious authorities and ministers, priests, rabbis, imams, or other persons whose positions or duties the officer reasonably believes justify reliance and confidence and whom the officer believes to be reliable and competent in the matters presented.

An officer shall not be liable to the nonprofit corporation or its members for any decision to take or not to take action, or any failure to take any action, as an officer, if the duties of the office are performed in compliance with this section. Whether an officer who does not comply with this section shall have liability will depend in such instance on applicable law, including those principles of Section 8.31 (standards of liability for directors) that have relevance.


CROSS-REFERENCES

Appointment of officers, see § 8.40. 
Duties of officers, see § 8.41. 
Indemnification, see and advance of expenses, §§ 8.50-8.58. 
Removal resignations and removal of officers, see § 8.43. 
Standards of conduct for directors, § 830.
Standards of liability for directors, see § 8.31831.

OFFICIAL COMMENT

Subsection Under Section 842(a) provides that, an officer must, when performing in such officer’s official capacity, is required to meet standards of conduct generally similar to those expected of specified for directors under Section 8.30. Consistent with the principles of agency, which generally govern the conduct of corporate employees, an officer is expected to observe the duties of obedience and loyalty and to act with the care that a person in a like position would reasonably exercise under similar circumstances. See RESTATEMENT (SECOND) OF AGENCY § 379(1) (1958) (“Unless otherwise agreed, a paid agent is subject to a duty to the principal to act with standard care and with the skill which is standard in the locality for the kind of work which he is employed to perform and, in addition, to exercise any special skill that he has”). This section modified as appropriate to reflect the different role of officers. Section 842 is not intended to modify, diminish or qualify the duties or standards of conduct that may be imposed upon specific officers by other law or regulation. Section 842 applies to all officers, whether or not they are also employees.

The common law, including the law of agency, has recognized a duty on the part of officers and key employees to disclose to their superiors material information relevant to the affairs of the agency entrusted to them. See RESTATEMENT OF (SECOND) OF AGENCY § 381; A. Gilehrist Sparks, III & Lawrence A. Hamermesh, Common Law Duties of Non-Director Corporate Officers, 48 Bus. Law, 215, 226-29 (1992). This duty is implicit in, and embraced under, the broader standard of subsection (a). Subsection (b) explicitly sets forth this disclosure obligation by confirming that the officer’s duty includes the obligation (i) to keep superior corporate authorities informed of material information within the officer’s sphere of functional responsibilities, and (ii) to inform the relevant superior authority, or other appropriate person within the nonprofit corporation, of violations of law or breaches of duty that the officer believes have occurred or are about to occur (i.e., more likely than not to occur) and are or would be material to the corporation. Subsection explicitly Section 842(b)(1) specifies that business information must be transmitted through the officer’s regular reporting channels. Subsection (b)(2) specifies the reporting responsibility differently with respect to actual or probable material violations of law or material breaches of duty. The use of the term “appropriate” in subsection (b)(2) is intended to accommodate both the normative standard that may have been set up by the corporation and as well as situations where there is no designated person but the officer’s immediate superior is not appropriate (for example, because the officer believes that individual is complicit in the unlawful activity or breach of duty).

Subsection (b)(1) should not be interpreted so broadly as to discourage efficient delegation of functions. It addresses the flow of information to the board of directors and to superior officers necessary to enable them to perform their decision-making and oversight functions. See the Official Comment to Section 8.31831. The officer’s duties under subsection (b) may not be negated by agreement; however, their scope under
subsection **Section 842(b)(1)** may be shaped by prescribing the scope of an officer’s functional responsibilities.

With respect to the duties under subsection **Section 842(b)(2)**, codes of conduct or codes of ethics, such as those adopted by many large corporations, may prescribe the circumstances in which and mechanisms by which officers and employees may discharge their duty to report material information to superior officers or the board of directors, or to other designated persons.

The term “material” modifying violations of law or breaches of duty in subsection **Section 842(b)(2)** denotes a qualitative as well as quantitative standard. It relates not only to the potential direct financial impact on the nonprofit corporation, but also to the nature of the violation or breach. For example, an embezzlement of $10,000, or even less, would be material because of the seriousness of the offense, even though the amount involved might not be material to the financial position or results of operations of the corporation.

The duty under subsection **Section 842(b)(2)** is triggered by an officer’s subjective belief that a material violation of law or breach of duty actually or probably has occurred or is likely to occur. This duty is not triggered by objective knowledge concepts, such as whether the officer should have concluded that such misconduct was occurring. The subjectivity of the trigger under subsection **Section 842(b)(2)**, however, does not excuse officers from their obligations under subsection **Section 842(a)** to act in good faith and with due care in the performance of the functions assigned to them, including oversight duties within their respective areas of responsibility. There may be occasions when the principles applicable under Section **8.30830(c)** limiting the duty of disclosure by directors where a duty of confidentiality is overriding may also apply to officers. See the Official Comment to Section **8.30830(c)**.

An officer’s ability to rely on others in meeting the standards prescribed in Section **8.42842** may be more limited, depending upon the circumstances of the particular case, than the measure and scope of reliance permitted a director under Section **8.30830**, in view of the greater obligation the officer may have to be familiar with the affairs of the nonprofit corporation. The proper delegation of responsibilities by an officer, separate and apart from the exercise of judgment as to the delegatee’s reliability and competence, is concerned with the procedure employed. This will involve, in the usual case, sufficient communication to the delegatee that the delegatee understands the scope of the assignment and, in turn manifests to the officer a willingness and commitment to undertake its performance. The entitlement to rely upon employees assumes that a delegating officer will maintain a sufficient level of communication with the officer’s subordinates to fulfill his or her supervisory responsibilities. The definition of “employee” in Section **1.40102** includes an officer who is otherwise employed by the corporation; accordingly, Section **8.42842** contemplates the delegation of responsibilities to other officers as well as to non-officer employees.

Although under Section **842(d)**, performance meeting that section’s standards of conduct will eliminate an officer’s exposure to any liability to the corporation or its shareholders, failure by an officer to meet that section’s standards will not automatically result in liability. Deficient performance of duties by an officer, depending upon the facts and circumstances, will normally be dealt with through intracorporate disciplinary procedures, such as reprimand, compensation.
adjustment, delayed promotion, demotion or discharge. These procedures may be subject to (and limited by) the terms of an officer’s employment agreement. See Section 844.

In some cases, failure to observe relevant standards of conduct can give rise to an officer’s liability to the nonprofit corporation or its members. A court review of challenged conduct will involve an evaluation of the particular facts and circumstances in light of applicable law. In this connection, subsection Section 842(d) recognizes that relevant principles of Section 8.31, such as duties to deal fairly with the corporation and its members and the challenger’s burden of establishing proximately caused harm, should be taken into account. In addition, the business judgment rule will normally apply to decisions within an officer’s discretionary authority. Liability to others can also arise from an officer’s own acts or omissions (e.g., violations of law or tort claims) and, in some cases, an officer with supervisory responsibilities can have risk exposure in connection with the acts or omissions of others.

The Official Comment to Section 8.30 supplements this Official Comment to the extent that it can be appropriately viewed as generally applicable to officers as well as directors.

§ 8.43. RESIGNATION AND REMOVAL OF OFFICERS

(a) An officer may resign at any time by delivering notice to the nonprofit board of directors, or its chair, or to the appointing officer or secretary. A resignation is effective when the notice is delivered unless the notice specifies a later effective time. If provides for a delayed effectiveness, including effectiveness determined upon a future event. If effectiveness of a resignation is made effective at a later time stated to be delayed and the board of directors or the appointing officer accepts the future effective time delay, the board of directors or the appointing officer may designate a successor to fill the pending vacancy before the effective time if the board or the appointing delayed effectiveness but the new officer provides that the successor may not take office until the effective time vacancy occurs.

(b) Except as provided in the articles of incorporation or bylaws, an officer may be removed at any time with or without cause by:

(i) the board of directors;

(ii) the appointing officer who appointed the officer being removed, unless the article of bylaws of the board of directors provides otherwise; or

(iii) any other officer authorized by the articles, the bylaws or the board.

(c) In this section, “appointing officer” means the officer (including any successor to that officer) who appointed the officer resigning or being removed.

CROSS-REFERENCES

Contract rights of officers, see § 8.44.
“Deliver” defined, see § 1.40.
Effective date of notice, see § 1.41(e).
Notice to the corporation, see § 1.41.
“Secretary” defined, § 102.

OFFICIAL COMMENT

Section 8.43(a) is consistent with current practice and declaratory of current law. It recognizes: that corporate officers may resign; that, with the consent of the board of directors or the appointing officer, they may resign effective at a later time; and that a future vacancy may be filled to become effective as of the effective time of the resignation.

In part because of the unlimited power of removal confirmed by Section 8.43(b), a board of directors nonprofit corporation may enter into an employment agreement with the holder of an office that extends beyond the term of the board of directors, giving the officer rights in the event of removal or failure to be reelected or reappointed to office. This type of contract is binding on the nonprofit corporation even if the articles of incorporation or bylaws provide that officers are elected for a term shorter than the period of the employment contract. If a later board of directors refuses to reelect that person as an officer, the person has such an employment agreement does not override the removal power set forth in Section 8.43(b) and may give the officer the right to sue for damages, but not for specific performance, if employment is terminated before the end of the contract term.

Section 8.43(b) is consistent with current practice and declaratory of current law. It recognizes that the officers of the nonprofit corporation are subject to removal by the board of directors and, in certain instances, by other officers. It provides the corporation with the flexibility to determine when, if ever, an officer will be permitted to remove another officer. To the extent that the corporation wishes to permit an officer, other than the appointing officer, to remove another officer, the articles of incorporation or bylaws or the action by the board resolution should set forth clearly the persons having removal authority.

A person may be removed from office irrespective of contract rights or the presence or absence of “cause” in a legal sense. Section 8.44 provides that removal from office of a holder who has contract rights is without prejudice to whatever rights the former officer may assert in a suit for damages for breach of contract.

The powers of the board of directors under this section may be vested by the articles of incorporation or bylaws in a designated body. See Sections 2.02(b)(2) and 8.12812.

§ 8.44. CONTRACT RIGHTS OF OFFICERS
(a) The election or appointment of an officer does not itself create contract rights.

(b) An officer’s removal does not affect the officer’s contract rights, if any, with the nonprofit corporation. An officer’s resignation does not affect the corporation’s contract rights, if any, with the officer.


CROSS-REFERENCES

Appointment of officers and assistant officers, see § 8.40840.
Resignation or removal of officers, see § 8.43843.

OFFICIAL COMMENT

Section 8.44 makes clear that the appointment of an officer does not itself create contract rights in the officer. The removal of an officer with contract rights is without prejudice to the later enforcement by the officer of contract rights in a suit proceeding seeking for damages for breach of contract. See the Official Comment to Section 8.43843. Similarly, an officer with an employment contract who prematurely resigns may be in breach of the officer’s employment contract. The mere election or appointment of an officer for a term does not create a contractual obligation on the officer’s part to complete the term.

[Subchapter] E

INDEMNIFICATION AND ADVANCE FOR ADVANCEMENT OF EXPENSES

§ 8.50850. Subchapter definitions.
§ 8.51851. Permissible indemnifications.
§ 8.52852. Mandatory indemnification.
§ 8.53 Advancement of expenses.
§ 8.54 Court-ordered indemnification and advancement of expenses.
§ 8.55 Determination and authorization of indemnification.
§ 8.56 Indemnification of officers.
§ 8.57 Insurance.
§ 8.58 Variation of indemnification.
§ 859 Exclusivity of subchapter.

INTRODUCTORY COMMENT

The substance of this subchapter is based almost entirely on an amendment the 2016 revision to the 1969 Model Business Corporation Act adopted in 1980 and substantially revised
in 1994 (the “MBCA”). Thus, the act closely follows the law with respect to indemnification of
directors and officers of business corporations and advancement of their litigation expenses. This
is consistent with the view that the relationship of directors to a nonprofit corporation is more
akin to that of directors of business corporations than to that of trustees to their beneficiaries.
Stern v. Lucy Webb Hayes National Training School for Deaconesses and Missionaries, 381
Corporation Directors,” REAL PROPERTY, PROBATE AND TRUST JOURNAL 545 (1967).

The only differences in the area of indemnification between this act and the MBCA are
that this act (i) changes the rule in Section 8.528, (ii) omits Section 8.598 of the MBCA, and
(iii) treats members of a designated body vested with some of the powers, authority, or functions
of the board of directors, as directors. The change in Section 8.528 is explained in the Official
Comment to that section. Omitted Section 8.598 of the MBCA provides that a business
corporation “may provide indemnification or advancement of expenses to a director or
officer only as permitted by” Sections 8.508 through 8.598. The omission from this act of a
provision analogous to Section 8.598 of the MBCA means that the provisions of this
Subchapter 8E will not be the exclusive basis for providing indemnification and
advance for advancement of expenses to directors and officers of nonprofit corporations. Defining
“director” in Section 8.508(2) to include a member of a designated body is consistent with the
role of designated bodies as provided in Section 8.128.

1. Policy Issues Raised by Indemnification and ADVANCE FOR Advancement of
Expenses

Indemnification (including advancement of expenses) provides financial
protection by the nonprofit corporation for its directors against exposure to expenses and
liabilities that may be incurred by them in connection with legal proceedings based on an alleged
breach of duty in their service to or on behalf of the corporation. Today, when both the volume
and the cost of litigation have increased dramatically, it would be difficult to persuade
responsible persons to serve as directors if they were compelled to bear personally the cost of
vindicating the propriety of their conduct in every instance in which it might be challenged.
While reasonable people may differ as to what constitutes a meritorious case, almost all would
agree that corporate directors should have appropriate protection against personal risk and that
the rule of New York Dock Co. v. McCollom, 173 Misc. 106, 16 N.Y.S.2d 844 (Sup. Ct. 1939),
which denied reimbursement to directors who successfully defended their case on the merits,
should as a matter of policy be overruled by statute.

The concept of indemnification recognizes that there will be situations in which even
though the director does not satisfy all of the elements of the standard of conduct set forth in
Section 8.30(a) or the requirements of some other applicable law, but where the
nonprofit corporation should nevertheless be permitted (or required) to absorb the economic
costs incurred by the director in any ensuing litigation. A carefully constructed
indemnification statute should identify these situations.

Subchapter 8E is an integrated treatment of indemnification and advancement of
expenses and strikes a balance among important public policies. It would be difficult to persuade
responsible persons to serve as directors if they were compelled to bear personally the cost of vindicating the propriety of their conduct in every instance in which it might be challenged. If permitted too broadly, however, indemnification may violate equally basic tenets of public policy. It is inappropriate to permit management to use corporate funds to avoid the consequences of certain conduct. For example, a director who intentionally inflicts harm on the nonprofit corporation should not expect to receive assistance from the corporation for legal or other expenses and should be required to satisfy from his director's personal assets not only any adverse judgment but also expenses incurred in connection with the proceeding. Any other rule would tend to encourage socially undesirable conduct.

A further similar policy issue is raised in connection with indemnification against liabilities or sanctions imposed under state or federal civil or criminal statutes. A shift of the economic cost of these liabilities from the individual director to the nonprofit corporation by way of indemnification may in some instances frustrate the public policy of those statutes. The fundamental issue that must be addressed by an indemnification statute is the establishment of policies consistent with these broad principles: to ensure that indemnification is permitted only where it will further sound corporate policies and to prohibit indemnification where it might protect or encourage wrongful or improper conduct. As phrased by one commentator, the goal of indemnification is to “seek the middle ground between encouraging fiduciaries to violate their trust, and discouraging them from serving at all.” Johnston, “Corporate Indemnification and Liability Insurance for Directors and Officers,” 33 Bus. Law. 1992, 1994 (1978). The increasing number of suits against directors, the increasing cost of defense, and the increasing emphasis on diversifying the membership of boards of directors all militate in favor of workable arrangements to protect directors against liability to the extent consistent with established principles.

Some of the same policy considerations apply to the indemnification of officers and, in many cases, employees and agents. The indemnification of officers, whose duties functions are specified in Section 8.41, is dealt with separately in Section 8.56. However, other considerations apply to employees and agents, who have significantly different roles and responsibilities and as to whom the spectre of structural bias (sympathetic directors approving indemnification for themselves or for colleagues on the board or for officers, who may work closely with board members) is not present. The indemnification of employees and agents, whose duties are prescribed by sources of law other than corporation law (e.g., contract and agency law), is beyond the scope of this subchapter. Section 8.58(ed), however, makes clear that the absence in Subchapter E of provisions concerning employees and agents is not intended to limit a corporation’s power to indemnify or advance expenses to them employees and agents in accordance with applicable law.

2. Relationship of Indemnification to Other Policies Established in the Act

Indemnification is closely related to the standards of conduct for directors and officers established elsewhere in Chapter 8. The structure of the act is based on the assumption that if a director acts consistently with the standards of conduct described in Section 8.3030 or with the standards of a liability-limitation provision in the articles of incorporation (as authorized by Section 2.02202(c)), the director will not have exposure to liability to the nonprofit corporation or to members and any expenses necessary to establish his defense will be borne by the
corporation (under Section 8.52). But the converse, however, is not necessarily true. The basic standards for indemnification set forth in this subchapter, Section 851, for a civil action, in the absence of an indemnification provision in the corporation’s articles (as authorized by Section 2.02(b)(8)), are good faith and reasonable belief that the conduct was in or not opposed to the best interests of the corporation. See Section 8.51851. In some circumstances, a director or officer may be found to have violated a statutory or common law duty and yet be able to establish eligibility for indemnification under these standards of conduct. In addition, this subchapter, Subchapter E, permits a director or officer who is held liable for violating a statutory or common law duty, but who does not meet the relevant standard of conduct, to petition a court to order indemnification under Section 8.54(a)(3) on the ground if the court determines that it would be fair and reasonable to do so.

3. Application of Amendments to Prior Conduct

Each jurisdiction adopting amendments to its indemnification statutes should consider the extent to which the statutes, as amended, should apply to conduct occurring prior to the effective time of the amendments. Absent constitutional or statutory provisions dealing generally with retroactivity of statutory amendments, resolution of this issue may be made to depend upon whether a claim for indemnification was made prior to (and was pending at) the effective time of the amendment. Alternatively, the amended statute can specifically provide that it applies to conduct occurring before or after the effective time.

§ 8.50850. SUBCHAPTER DEFINITIONS

In this Subchapter:

(1) “Corporation” includes any domestic or foreign predecessor entity of a nonprofit corporation in a merger, conversion, or domestication.

(2) “Director” or “officer” means an individual who is or was a director or officer, respectively, of a nonprofit corporation or who, while a director or officer of the corporation, is or was serving at the corporation’s request as a director, officer, manager, partner, trustee, employee, or agent of another domestic or foreign corporation, partnership, joint venture, trust, entity or employee benefit plan, or other entity. A director or officer is considered to be serving an employee benefit plan at the corporation’s request if the individual’s duties to the corporation also impose duties on, or otherwise involve services by, the individual to the plan or to participants in or beneficiaries of the plan. “Director” includes a member of a designated body vested with some of the powers, authority, or functions of the board of directors. “Director” or “officer” includes, unless the context requires otherwise, the estate or personal representative of a director or officer.

(3) “Disinterested director” means a director who, at the time of a vote referred to in Section 8.53853(c) (advancement of expenses) or a vote or selection referred to in Section 8.55855(b) or (c) (determination and authorization of indemnification), is not:
(i) a party to the proceeding, or

(ii) an individual having a familial, financial, professional, or employment relationship with the director whose indemnification or advancement of expenses is the subject of the decision being made, which relationship would, in the circumstances, reasonably be expected to exert an influence on the director’s judgment when voting on the decision being made.

(4) “Expenses” includes counsel fees.

(5) “Liability” means the obligation to pay a judgment, settlement, penalty, fine (including an excise tax assessed with respect to an employee benefit plan), or reasonable expenses incurred with respect to a proceeding.

(6) “Official capacity” means:

(i) when used with respect to a director, the office of director in a nonprofit corporation; and

(ii) when used with respect to an officer, as contemplated in Section 8.56, the office in a corporation held by the officer.

“Official capacity” means the office of director in a nonprofit corporation or the office in a corporation held by an officer. The term does not include service for any other domestic or foreign corporation or any partnership, joint venture, trust, employee benefit plan, or other entity.

(7) “Party” means an individual who was, is, or is threatened to be made, a defendant or respondent in a proceeding.

(8) “Proceeding” includes a threatened, pending, or completed proceeding.


CROSS-REFERENCES

Act definitions, see § 1.40102.
Effect of merger, § 1226.
“Entity” defined, § 102.
“Expenses” defined, § 102.
Officers, see § 8.40(a)840.
“Proceeding” defined, see § 1.40102.
Witness indemnification, see § 8.58(d).

OFFICIAL COMMENT
The definitions set forth in Section 8.50 apply only to Subchapter 8E and have no application elsewhere in the act (except as set forth for the use of “liability” in Section 2.02 (b)(8)).

1. Corporation

A special definition of “corporation” is included in Subchapter E to make it clear that predecessor entities that have been absorbed in mergers are included within the definition. It is probable that the same to negate any argument that a different result would might be reached for many transactions under Section 11.07(a)(1226) (effect of merger), which provides for the assumption of liabilities by operation of law upon a merger. The express responsibility of successor entities for the liabilities of their predecessors under this subchapter is broader than under Section 11.07(a)(1226) and may impose liability on a successor although Section 11.07(a)(1226) does not. The definition of “corporation” in Section 8.50 is thus an essential aspect of the protection provided by this subchapter for persons eligible for indemnification. The definition of “corporation” similarly makes clear that predecessor entities in a conversion or domestication are included within the definition.

2. Director and Officer

A special definition of “director” and “officer” is included in Subchapter E to cover individuals who are made parties to proceedings because they are or were directors or officers or, while serving as directors or officers, also serve or served at the nonprofit corporation’s request in another capacity for another entity. The purpose of the latter part of this definition is to give directors and officers the benefits of the protection of this subchapter while serving at the corporation’s request in a responsible position for employee benefit plans, trade associations, nonprofit or charitable entities, domestic or foreign entities, or other kinds of profit or nonprofit ventures. To avoid misunderstanding, it is good practice from both the corporation’s and director’s or officer’s viewpoint for this type of request to be evidenced by resolution board minutes, memorandum, or other writing. The definition covers an individual who is or was either a director or officer so that further references in the remainder of Subchapter E to an individual who is a director or officer necessarily include former directors or officers.

The second sentence of the definition of “director” or “officer” in Section 8.50 addresses the question of liabilities arising under the Employee Retirement Income Security Act of 1974 (ERISA), 29 U.S.C. §§ 1001-1461. It makes clear that a director or officer who is serving as a fiduciary of an employee benefit plan is automatically viewed for purposes of this subchapter as having been requested by the nonprofit corporation to act in that capacity. Special treatment is believed necessary because of the ERISA’s broad definition of “fiduciary” in Section 3(21) of ERISA, 29 U.S.C. § 1002(21), and the requirement of Section 404 (29 U.S.C. § 1104(a)) that a “fiduciary” must discharge his that individual’s duties “solely in the interest” of the participants and beneficiaries of the employee benefit plan. Decisions by a director or officer who is serving as a fiduciary under the plan on questions regarding, for example (i) eligibility for benefits, (ii) investment decisions, and (iii) interpretation of plan provisions regarding (a) qualifying service, (b) years of service, and (c) retroactivity, are all subject to the protections of this subchapter Subchapter.
8E. See also Sections 8.50(5) and 8.51(b) of this subchapter the “official capacity” in Section 850.

The last sentence of Section 8.50(2) provides that the estate or personal representative of a director or officer is entitled to the rights of indemnification possessed by the director or officer himself. The definition of “director” or “officer” in Section 850, the phrase “unless the context requires otherwise” was added to make clear is intended to clarify that the estate or personal representative does not have the right to participate in directorial decisions by directors authorized in this subchapter.

3. Disinterested Director

This term identifies, for purposes of Subchapter 8E, those members of the board who are eligible to make, in the first instance, the authorizations and determinations required in connection with decisions on advancement of expenses and indemnification. It is used only in Sections 8.53(c) and 8.55(b) and (c) and is not applicable to any other sections of the act.

To be a “disinterested director,” a member of the board must not be a party to the proceeding at the time the board makes the determination or authorization and that director must not be the subject of the request for advance or indemnification with respect to which action is being taken. He must also not have a familial, financial, professional, or employment relationship that could reasonably be expected to influence that director's decision. The fact that a director was nominated for the board by directors who are parties to the proceeding or are interested in the request or that a director is also a director of another corporation of which the director who is a party to the proceeding or is interested in the request is also a director should not, absent unusual circumstances, constitute a disqualifying relationship.

4. EXPENSES Liability

“Expenses” is defined to include counsel fees in order to avoid repeated references to such fees every time “expenses” appears throughout the subchapter. “Expenses” does not include the other items listed in the definition of “liability,” such as judgments or amounts paid in settlement.

5. LIABILITY

“Liability” is defined for convenience in order to avoid repeated references to recoverable items throughout the subchapter. Even though the definition of “liability” includes amounts paid in settlement or to satisfy a judgment, indemnification against certain types of settlements and judgments is not allowed under several provisions of Subchapter 8E. For example, indemnification in suits brought by or in the right of the nonprofit corporation is limited to expenses (see Section 8.54(a)(1)), unless indemnification for a settlement is ordered by a court under Section 8.54(a)(3).

The definition of “liability” permits the indemnification of “reasonable expenses incurred.” The definition of “expenses” in Section 102 limits expenses to those that are reasonable. The result is that any portion of expenses falling outside the perimeter of
reasonableness which is not reasonable should not be advanced or indemnified. In contrast, unlike earlier versions of the act and statutes of many states, Section 8.50(5) provides that amounts paid to settle or satisfy substantive claims are not subject to a reasonableness test. Since payment of these amounts is permissive – mandatory indemnification is available under Section 8.52 only where the defendant is “wholly successful” – a limitation of “reasonableness” for settlements is inappropriate.

“Penalties” and “fines” are expressly included within the definition of “liability” so that, in appropriate cases, these items may also be indemnified. The purpose of this definition is intended to cover every type of monetary obligation that may be imposed upon a director, including civil penalties, restitution, and obligations to give notice. This definition also expressly includes as a “fine” the levy of excise taxes under the Internal Revenue Code pursuant to ERISA.

65. Official Capacity

The definition of term “official capacity” is necessary because the term determines which of the two alternative standards of conduct set forth in Section 8.51 applies: If the action was taken in an “official capacity,” the person must have reasonably believed that the individual was acting in the best interests of the nonprofit corporation. In contrast, while if the action in question was not taken in his “official capacity,” the individual need only have reasonably believed that the conduct was not opposed to the best interests of the corporation. See also the Official Comment to Section 8.515.

76. Party

The definition of “party” includes every “individual who was, is, or is threatened to be made, a defendant or respondent in a proceeding.” Thus, the definition includes present and former parties in addition to individuals currently or formerly threatened with being made a party. An individual who is only called as a witness is not a “party” within this definition and, but as specifically provided in Section 8.585 de, payment or reimbursement of his expenses is not limited by this subchapter.

8. Proceeding

The definition of “proceeding” in this section supplements the definition of the same term in Section 1.40. Both definitions are non-exclusive and are intended to have an identical and very broad scope. The term is redefined in this section because corporate indemnification statutes have traditionally included a definition that emphasizes that its application is not restricted by the time a proceeding is commenced or resolved. The broad definition of “proceeding” ensures that the benefits of this subchapter will be available to directors in new and unexpected, as well as traditional, types of litigation or other adversarial matters, whether civil, criminal, administrative, or investigative. It also includes arbitration and other dispute resolution proceedings, lawsuit appeals and petitions to review administrative actions.

§ 8.516. PERMISSIBLE INDEMNIFICATION
(a) Except as otherwise provided in this section, a nonprofit corporation may indemnify an individual who is a party to a proceeding because he or she is or was a director against liability incurred in the proceeding if:

(1) the individual:
   (i) acted in good faith; and
   (ii) reasonably believed:

(A) in the case of conduct in an official capacity, that the conduct was in the best interests of the corporation; and

(B) in all other cases, that the individual’s conduct was at least not opposed to the best interests of the corporation; and

(iii) in the case of any criminal proceeding, had no reasonable cause to believe his or her conduct was unlawful; or

(2) the individual engaged in conduct for which broader indemnification has been made permissible or obligatory under a provision of the articles of incorporation (as authorized by Section 2.02(b)(8) (articles of incorporation)).

(b) A director’s conduct with respect to an employee benefit plan for a purpose the director reasonably believed to be in the interests of the participants in and the beneficiaries of the plan is conduct that satisfies the requirement of subsection Section 851(a)(1)(ii)(B).

(c) The termination of a proceeding by judgment, order, settlement, or conviction, or upon a plea of nolo contendere or its equivalent, is not, of itself, determinative that the director did not meet the relevant standard of conduct described in this section.

(d) Unless ordered by a court under Section 8.54(a)(3) (court-ordered indemnification and advancement of expenses), a nonprofit corporation may not indemnify a director:

(1) in connection with a proceeding by or in the right of the corporation, except for reasonable expenses incurred in connection with the proceeding if it is determined that the director has met the relevant standard of conduct under subsection Section 851(a); or

(2) in connection with any proceeding with respect to conduct for which the director was adjudged liable on the basis that the director received a financial benefit to which he or she was not entitled, regardless of whether or not involving the director’s official capacity.


CROSS-REFERENCES

Advance for Advancement of expenses, see § 8.53853.
Conflicting interest transactions; voidability, § 860.
“Corporation” defined, see § 8.50(1)850.
Court-ordered indemnification and advancement of expenses, see § 8.54854.
Derivative proceedings, see Ch. 135.
Determination and authorization of indemnification, see § 8.55855.
“Director” defined, see § 8.50(2)850.
Director’s conflicting interest transaction Exclusivity of subchapter, see § 8.60859.
“Expenses” defined, see § 8.50(4)850.
“Liability” defined, see § 8.50(5)850.
Liability-limitation provisions for charitable corporations, see §§ 2.02(e) and 8.31831(d).
Limiting director liability by provision in articles of incorporation, § 202(c).
Limits on indemnification for a predecessor of the corporation, see § 8.58858(c).
Mandatory indemnification, see § 8.52852.
Obligatory indemnification, see §§ 2.02202(b)(8), 8.58(a) and 8.58.
“Officer” defined, § 850.
Officer indemnification, see § 8.56856.
“Official capacity” defined, see § 8.50(6)850.
“Party” defined, see § 8.50(7)850.
“Proceeding” defined, see §§ 1.40102 and 8.50(8)850.
Standards of conduct for directors, see § 8.30830.
Standards of liability for directors, see § 8.31831.

OFFICIAL COMMENT

1. Section 8.51851(a)

Subsection 8.51(a) permits, but does not require, a nonprofit corporation to indemnify directors if the standards of subsection (a)(1) or of a provision of the articles referred to in subsection (a)(2) are met. This authorization is subject to any limitations set forth in the articles of incorporation pursuant to Section 8.58(c). Conduct which does not meet one of these standards is not eligible for permissible The standards for indemnification of directors contained in Section 851(a) define the limits of the conduct for which discretionary indemnification is permitted under the act, although except to the extent that court-ordered indemnification may be available under Section 8.54854(a)(3). Conduct that falls within these limits does not automatically entitle directors to indemnification, although a nonprofit corporation may obligate itself to indemnify directors to the maximum extent permitted by applicable law. See Section 8.58858(a). Absent such an obligatory provision, Section 8.52852 defines much narrower circumstances in which directors are entitled as a matter of right to indemnification.

Some state statutes provide separate, but usually similarly worded, standards for
indemnification in third-party suits and indemnification in suits brought by or in the right of the corporation. Section 8.51 makes clear that the standards of conduct for which indemnification is permitted should not be dependent on the type of proceeding in which the claim arises. To prevent circularity in recovery, however, Section 8.51(d)(1) limits indemnification in connection with suits brought by or in the right of the corporation to expenses incurred and excludes amounts paid to settle such suits or to satisfy judgments. In addition, to discourage wrongdoing, Section 8.51(d)(2) bars indemnification where the director has been adjudged to have received a financial benefit to which the director is not entitled. Nevertheless, a court may order certain relief from these limitations under Section 8.54(a)(3).

The standards of conduct described in subsections (a)(1)(i) and (a)(1)(ii)(A) that must be met in order to permit the nonprofit corporation to indemnify a director in Section 851(a) are not dependent on the type of proceeding in which the claim arises. These standards are closely related, but not identical, to the standards of conduct imposed by Section 8.30 on members of the board of directors when discharging the duties of a director: good faith, reasonable belief that the best interests of the corporation are being served, and appropriate care (i.e., that which a person in a like position would reasonably believe appropriate under similar circumstances). Unless authorized by a charter provision adopted pursuant to subsection (a)(2), it would be difficult to justify indemnifying a director who has not met any of these standards. It would not, however, make sense to require a director to meet all these standards in order to be indemnified because a director who does so would normally have no liability, at least to the corporation or its shareholders, under the terms of Section 8.31.

Section 8.51(a) adopts a middle ground by authorizing discretionary indemnification in the case of a failure to meet the appropriate care standard of Section 8.30(b) because public policy would not be well served by an absolute bar. A director’s potential liability for conduct which does not on each and every occasion satisfy the appropriate care requirement of Section 8.30(b), or which with the benefit of hindsight could be so viewed, would in all likelihood deter qualified individuals from serving as directors and inhibit some who serve from taking risks. Permitting indemnification against such liability tends to counter these undesirable consequences. Accordingly, Section 8.51(a) authorizes indemnification at the nonprofit corporation’s option even though Section 8.30’s appropriate care requirement is not met, but only if the director satisfies the “good faith” and “corporation’s best interests” standards. This reflects a judgment that, balancing public policy considerations, the nonprofit corporation may indemnify a director who does not satisfy the appropriate care test but not one who fails either of the other two standards.

As in the case of Section 8.30, where the concept of good faith is also used, no attempt is made in Section 8.51 to provide a definition for that term. The concept involves a subjective test, which would permit indemnification for an unwise decision or “a mistake of judgment,” in the words of the Official Comment to Section 8.31, even though made unwise or negligently by objective standards. Section 8.51 also requires, as does Section 8.30, a “reasonable” belief that conduct when acting in the director’s official capacity was in the nonprofit corporation’s best interests. It then adds a provision, not found in Section 8.30, relating to criminal proceedings that requires the director to have had no “reasonable cause” to believe that the conduct was unlawful. These both involve objective standards applicable to the director’s belief concerning the effect of the conduct in question. Conduct includes both acts and omissions.
In Section 8.51851(a)(1)(ii)(B) requires, if not acting in the director’s official capacity, that the action be “at least not opposed to” the nonprofit corporation’s best interests. This standard is applicable to the director when serving another entity at the request of the corporation or when sued simply because of the director’s status. The words “at least” qualify “not opposed to” in order to make it clear that this standard is an outer limit for conduct other than in an official capacity. While this subsection is directed at the interests of the indemnifying (i.e., the requesting) Although this provision deals with indemnification by the nonprofit corporation, a director serving another entity by at the request of the corporation remains subject to the provisions of the law governing service to that other entity, including provisions dealing with conflicts of interest. Should indemnification from the requesting corporation be sought by a director for acts done while serving another entity, which acts involved breach of the duty of loyalty owed to that other entity, nothing in Section 8.51851(a)(1)(ii)(B) would preclude the requesting corporation from considering, in assessing its own best interests, whether the fact that its director had engaged in a violation of the duty owed to the other entity was in fact “opposed to” the interests of the indemnifying corporation. Receipt of an improper financial benefit from a subsidiary would normally be opposed to the best interests of the parent.

If the relevant standards are met, Section 8.51851 also permits indemnification in connection with a proceeding involving an alleged failure to satisfy legal standards other than the standards of conduct in Section 8.30830, e.g., violations of antitrust, environmental or securities laws.

In addition to indemnification under Section 8.51851(a), Section 8.51851(a)(2) permits indemnification under the standard of conduct set forth in a charter provision of the articles of incorporation adopted pursuant to Section 2.02202(b)(8). Based on such a charter provision, Section 8.51851(a)(2) permits indemnification in connection with claims by third parties and, through Section 8.56856, applies to officers as well as directors. (This goes beyond the scope of a charter provision of the articles of incorporation adopted pursuant to Section 2.02202(c), which can only limit liability of directors against claims by the corporation or its members.) Section 8.51851(a)(2) is subject to the prohibition of subsection Section 851(d)(1) against indemnification of settlements and judgments in derivative suits, except as ordered by a court under Section 854(a)(3). It is also subject to the prohibition of subsection Section 851(d)(2) against indemnification for receipt of an improper financial benefit; however, this prohibition is already subsumed in the exception contained in Section 2.02202(b)(8)(i).

2. Section 8.51851(b)

As discussed in the Official Comment to the definition of “director” or “officer” in Section 8.50(2), ERISA requires that a “fiduciary” (as defined in ERISA) discharge the fiduciary’s duties “solely in the interest” of the participants in and beneficiaries of an employee benefit plan. The standard in Section 8.51851(b) makes clear that for indemnification of a director who is serving as a trustee or fiduciary for an employee benefit plan under ERISA meets the standard for indemnification under Section 8.51(a) if the director reasonably believes the conduct while serving in that capacity was in the best interests of the participants in and beneficiaries of the plan.
This standard is arguably an exception to the more general standard that conduct not in an official corporate capacity is indemnifiable if it is “at least not opposed to” the best interests of the nonprofit corporation. However, a corporation that causes a director to undertake fiduciary duties in connection with an employee benefit plan should expect the director to act in the best interests of the plan’s beneficiaries or participants. Thus, subsection Section 851(b) establishes and provides a standard for indemnification that is consistent with the statutory policies embodied in ERISA. See Official Comment to Section 8.50(2).

3. Section 8.51(c)

The purpose of Section 8.51(c) is to reject the argument that indemnification is automatically improper whenever a proceeding has been concluded on a basis that does not exonerate the director claiming indemnification. Even though a final judgment or conviction is not automatically determinative of the issue of whether the minimum standard of conduct was met, any judicial determination of substantive liability would be entitled to considerable weight in determining whether the standards of Section 851(a) were met. By the same token, it is clear that the termination of a proceeding by settlement or plea of nolo contendere should not of itself create a presumption either that conduct met or did not meet the relevant standard of subsection Section 851(a), since a settlement or nolo plea of no contest may be agreed to for many reasons unrelated to the merits of the claim. On the other hand, a final determination of non-liability (including one based on a liability-limitation provision adopted under Section 2.02(c) or an acquittal in a criminal case automatically entitles the director to indemnification of expenses under Section 8.52.

Section 8.51(c) applies to the indemnification of expenses in derivative proceedings (as well as to indemnification in third party suits). The most likely application of this subsection in connection with a derivative proceeding will be to a settlement since a judgment or order would normally result in liability to the nonprofit corporation and thereby preclude indemnification under Section 8.51(d)(1), unless ordered by a court under Section 8.54(a)(3). In the rare event that a judgment or order entered against the director did not include a determination of liability to the corporation, the entry of the judgment or order would not be determinative that the director failed to meet the relevant standard of conduct.

4. Section 8.51(d)

This subsection makes clear that indemnification is not permissible under Section 8.51 in two situations: (i) a proceeding brought by or in the right of a nonprofit corporation that results in a settlement or a judgment against the director and (ii) a proceeding that results in a judgment that an improper financial benefit was received as a result of the director’s conduct.

Permitting Section 851(d) does not permit indemnification of settlements and judgments in derivative proceedings which would give rise to a circularity in which the nonprofit corporation receiving payment of damages by the director in the settlement or judgment (less attorneys’ fees) would then immediately return the same amount to the director (including attorneys’ fees) as indemnification. Thus, the corporation would be in a poorer economic position than if there had been no proceeding. This situation is most egregious in the case of a judgment against the director. Even in the case of a settlement, however, prohibiting indemnification is not unfair. Under the revised procedures of Chapter 13, upon motion by the
corporation, the court must dismiss any derivative proceeding which independent directors (or a
court-appointed panel) determine in good faith, after a reasonable inquiry, is not in the best
interests of the corporation. The court may further, in many cases, the director may be protected (i) by a
provision in the articles of incorporation under Section 202(c) limiting liability, (ii) because
liability of directors of a charitable corporation is limited by Section 8.31831(d). Furthermore,
under Section 2.02(c), the directors of a corporation that is not a charitable corporation have the
opportunity to propose to members adoption of a provision similarly limiting the liability of
directors in derivative proceedings. In view of these considerations, it is unlikely that directors
will be unnecessarily exposed to meritless actions. In addition, if directors were to be
indemnified for amounts paid in settlement, the dismissal procedures in Chapter 13 might not be
fully employed since it could be less expensive for the corporation to indemnify the directors
immediately for the amount of the claimed damages rather than bear the expense of the inquiry
required by Chapter 13, or (iii) because a proceeding was dismissed under Section 505.

The result could increase the filing of meritless derivative proceedings in order to
generate small but immediately paid attorneys’ fees. Despite the prohibition on indemnification
of a settlement or a judgment in a derivative proceeding, subsection (d)(1) permits
indemnification of however, does not extend to the related reasonable expenses incurred in the
proceeding so long as the director meets the relevant standard of conduct set forth in Section
8.51851(a). In addition, indemnification of derivative proceeding and advance of expenses and
amounts paid in settlement where the relevant standard was not met may be ordered by a court
under Section 8.54854(a)(3), even if the relevant standard was not met.

Indemnification under Section 8.51851 is also prohibited if there has been an
adjudication that a director received an improper financial benefit (i.e., a benefit to which the
director is not entitled), even if, for example, the director acted in a manner not opposed to the
best interests of the nonprofit corporation. For example, improper use of inside information for
financial benefit should not be an action for which the corporation may elect to provide
indemnification, even if the corporation was not thereby harmed. Given the express language of
Section 2.02202(b)(8) establishing the outer limit of an indemnification provision contained in
the articles of incorporation, a director found to have received an improper financial benefit
would not be permitted indemnification under subsection Section 851(a)(2). Although it is
unlikely that a director found to have received an improper financial benefit could meet the
standard in subsection Section 851(a)(1)(ii)(B), this limitation is made explicit in Section
8.51851(d)(2). Section 8.54854(a)(3) permits a director found liable in a proceeding referred to
in subsection Section 851(d)(2) to petition a court for a judicial determination of entitlement to
indemnification for reasonable expenses. The language of Section 8.51851(d)(2) is based
on parallels Section 2.02202(c)(1) and, thus, the same standards should be used in interpreting the
application of both provisions. Although a settlement may create an obligation to pay money, it
should not be construed for purposes of this subchapter Subchapter 8E as an adjudication of
liability.

§ 8.52852. MANDATORY INDEMNIFICATION
A nonprofit corporation must indemnify a director to the extent the director was successful, on the merits or otherwise, in the defense of any proceeding to which the director was a party because the director was a director of the corporation against reasonable expenses incurred by the director in connection with the proceeding.


CROSS-REFERENCES

“Corporation” defined, see § 8.50(1).
Court-ordered indemnification and advancement of expenses, see § 8.54.
“Director” defined, see § 8.50(2).
“Expenses” defined, see § 8.50(4).
Limits on indemnification for a predecessor of the corporation, see § 8.58.
“Party” defined, see § 8.50(7).
Permissible indemnification, see § 8.51.
“Proceeding” defined, see §§ 1.40 and 8.50.

OFFICIAL COMMENT

Section 8.51 determines whether indemnification may be made voluntarily by a nonprofit corporation if it elects to do so. Section 8.52 determines whether a nonprofit corporation must indemnify a director for his expenses; in other words, Section 8.52 creates a statutory right of indemnification in favor of the director who meets the requirements of the section. Enforcement of this right by judicial proceeding is specifically contemplated by Section 8.54(a)(1). Section 8.54(b) gives the director a statutory right to recover expenses incurred by him in enforcing his statutory right to indemnification under Section 8.52.

This section is consistent with the argument accepted in Merritt-Chapman & Scott Corp. v. Wolfson, 321 A.2d 138 (Del. Super. 1974), that a defendant may be entitled to partial mandatory indemnification if, by plea bargaining or otherwise, he was able to obtain the dismissal of some but not all counts of an indictment. In contrast Section 8.52 of the Model Business Corporation Act provides that indemnification is mandatory only if a defendant is “wholly successful,” in other words only if the entire proceeding is disposed of on a basis that does not involve a finding of liability.

The basic standard for mandatory indemnification is that the director has been “wholly successful, on the merits or otherwise,” in the defense of the proceeding. A defendant is “wholly successful” only if the entire proceeding is disposed of on a basis which does not involve a finding of liability. A director who is precluded from mandatory indemnification by this requirement may still be entitled to permissible indemnification under section 851(a) or court-ordered indemnification under section 854(a)(3).
The language in earlier versions of the act and in many other state statutes that the basis of success may be Although the standard “on the merits or otherwise” is retained. While this standard may result in an occasional defendant becoming entitled to indemnification because of procedural defenses not related to the merits, e.g., the statute of limitations or disqualification of the plaintiff, it is unreasonable to require a defendant with a valid procedural defense to undergo a possibly prolonged and expensive trial on the merits in order to establish eligibility for mandatory indemnification.

§ 8.53. ADVANCE FOR ADVANCEMENT OF EXPENSES

(a) A nonprofit corporation may, before final disposition of a proceeding, advance funds to pay for or reimburse the reasonable expenses incurred in connection with the proceeding by an individual who is a party to the proceeding because he or she is or was a director, if the individual delivers to the corporation an undertaking in a record to repay any funds advanced if:

(1) an affirmation in the form of a record of his or her good faith belief that he or she has met the relevant standard of conduct described in Section 8.51 or that the proceeding involves conduct for which liability has been eliminated by Section 8.31(d) or under a provision of the articles of incorporation as authorized by Section 2.02(c); and the director is not entitled to mandatory indemnification under Section 8.52 (mandatory indemnification); and

(2) an undertaking in the form of a record to repay any funds advanced if the individual is not entitled to mandatory indemnification under Section 8.52 and it is ultimately determined under Section 8.54 or 8.55 that the director is not entitled to indemnification.

(b) The undertaking required by subsection (a)(2) must be an unlimited general obligation of the director, but need not be secured and may be accepted without reference to the financial ability of the director to make repayment.

(c) Authorizations under this section must be made:

(1) by the board of directors:

(i) if there are two or more disinterested directors, by a majority vote of all the disinterested directors (a majority of whom will constitute a quorum for that purpose) or by a majority of the members of a committee of two or more disinterested directors appointed by such a vote; or

(ii) if there are fewer than two disinterested directors, by the vote necessary for action by the board in accordance with Section 8.24(c) (quorum and voting), in which authorization directors who do not qualify as disinterested directors may participate; or
by the members.


CROSS-REFERENCES

Committees of the board, see § 8.25825.
“Corporation” defined, see § 8.50(1)850.
Court-ordered indemnification advancement of expenses, see §§ 8.54854.
Determination and authorization of indemnification, see §§ 8.55855.
“Director” defined, see § 8.50(2)850.
“Disinterested director” defined, see § 8.50(3)850.
“Expenses” defined, see § 8.50(4)102.
Limits on advancement of expenses, see § 8.58858(c).
“Party” defined, see § 8.50(7)850.
“Proceeding” defined, see §§ 1.40102 and 8.50(8)850.
Quorum of directors, see § 8.24824(a).
Standard for indemnification, see § 8.54851.

OFFICIAL COMMENT

Section 8.53853 authorizes, but does not require, a nonprofit corporation to pay for advance or reimburse, in advance, a director’s reasonable expenses if two conditions are met. This authorization is subject to delivery of the repayment undertaking required by Section 853(a) and any limitations set forth in the articles of incorporation or bylaws pursuant to Section 8.58858(cd). The repayment undertaking required by section 853 is also required in connection with obligatory advancement pursuant to section 858(a).

Section 8.53853 recognizes an important difference between indemnification and an advance for advancement of expenses: indemnification is retrospective and, therefore, enables the persons determining whether to indemnify to do so on the basis of known facts, including the outcome of the proceeding. Advance indemnification may include reimbursement for expenses that were not advanced. Advancement of expenses is necessarily prospective and, in situations where advancement is not obligatory, the individuals making the decision whether to advance expenses authorize expense advancement generally have fewer known facts on which to base their decision. Indemnification may include reimbursement for non-advanced expenses.

Section 8.53853 reflects a determination that it is sound public policy to permit the nonprofit corporation to advance (by direct payment or by reimbursement) the defense expenses of a director so long as the director believes in good faith that he was acting in accordance with the relevant standard for indemnification set forth in Section 8.51 or that the proceeding involves conduct for which liability has been eliminated by Section 8.31(d) or pursuant to Section 2.02(e).
and agrees to repay any amounts advanced, if it is ultimately determined that the director is not entitled to indemnification. This policy is based upon the view that an individual who serves an entity in a representative capacity should not be required to finance his own defense of actions taken in that capacity. Moreover, adequate legal representation often requires substantial expenses during the course of the proceeding and many individuals are willing to serve as directors only if they have the assurance that the corporation has the power to advance these expenses. In fact, many corporations contractually obligate themselves (enter into contractual obligations (e.g., by a provision in the articles of incorporation or bylaws or otherwise by individual agreements) to advance expenses for directors. See Section 8.58(a).

Section 8.53(a) requires an affirmation in record form by the director of his good faith belief that he has met the relevant standard of conduct necessary for indemnification by the nonprofit corporation and a written undertaking by the director to repay any funds advanced if it is ultimately determined that he has not met the standard of conduct. A single undertaking pursuant to Section 853(a) may cover all funds advanced from time to time in connection with the proceeding. Under Section 8.53(b), the undertaking need not be secured and financial ability to repay is not a prerequisite. The theory underlying this subsection Section 853(b) is that wealthy directors should not be favored over directors whose financial resources are modest. The undertaking must be made by the director and not by a third party. If the director or the nonprofit corporation wishes some third party to be responsible for the director’s obligation in this regard, either of them is free to make those arrangements separately with the third party.

In the absence of an obligatory provision established pursuant to Section 8.58(a), the decision to advance expenses must be made in accordance with Section 8.53(c). Section 8.53 does not address the question of the standard by which the decision to advance expenses is to be made. Accordingly, the standards of Section 8.30 should, in general, govern. The conditions for advance for expenses are different from the conditions for indemnification. Directors normally meet the standards of Section 8.30 in approving an advance for expenses if they limit their consideration to the financial ability of the nonprofit corporation to pay the amounts in question and do not have actual knowledge of facts sufficient to cause them to believe that the subsection (a)(1) affirmation was not made in good faith. The directors are not required by Section 8.30 to make any inquiry into the merits of the proceeding or the good faith of the belief stated in that affirmation. Thus, in the great majority of cases, no special inquiry will be required. The directors acting on a decision to advance expenses may, but are not required to, consider any additional matters they deem appropriate and may condition the advance of expenses upon compliance with any additional requirements they desire to impose.

If advancement is not obligatory, the standards of section 830 should, in general, govern the decision of directors acting on a request for advancement. In making such a decision, the directors may consider any matters that they deem appropriate and may condition the advance of expenses on compliance with any requirements that they believe are appropriate, including, for example, an affirmation of a requesting director’s good faith belief that the director is entitled to indemnification under section 851.
A nonprofit corporation may obligate itself pursuant to Section 8.58(a) to advance expenses under Section 8.53 may be made obligatory upon a nonprofit corporation pursuant to Section 8.58(a) by means of a provision set forth in its articles of incorporation or bylaws, in a resolution by action of its members or board of directors, in a contract or otherwise. However, any such provision must comply with the requirements of subsection (a) of Section 8.53 regarding furnishing of an affirmation and or by an agreement.

Unless provided otherwise, Section 8.58(a) deems a general obligatory provision requiring indemnification to the fullest extent permitted by law to include advancement of expenses to the fullest extent permitted by law, even if not specifically mentioned, subject to providing the required repayment undertaking. No other procedures are required or contemplated, although obligatory provisions arrangements may include notice and other procedures in connection with advancement of expenses and indemnification requests any other requirements that the directors believe are appropriate.

At least one court has held that a general obligatory provision requiring indemnification to the extent permitted by law does not include advance for expenses if not specifically mentioned. See, e.g., Advanced Mining Systems, Inc. v. Fricke, 623 A.2d 82 (Del. Ch. 1992). Section 8.58(a) requires the opposite result, unless provided otherwise.

If advancement is not obligatory, the decision to advance expenses is required to be made only one time with respect to each proceeding rather than each time a request for payment of expenses is received by the nonprofit corporation. The directors are, however, free to reconsider the decision at any time, (e.g., upon a change in the financial ability of the corporation to pay the amounts in question). The decision as to the reasonableness of any expenses may be made by any officer or agent of the corporation duly authorized to do so.

The procedures set forth in subsection Section 853(c) for authorizing an advance for advancement of expenses parallel the procedures set forth in Section 8.55(b) for selecting the person or persons to make the determination that indemnification is permissible. Unless the authorization is made if the advancement of expenses is not authorized by the members under subsection (c)(2), first resort must be made to subsection (c)(1)(i). If it is unavailable, then resort may be made to subsection (c)(1)(ii) Section 853(c)(2), the applicable procedure specified in Section 853(c)(1) must be used.

Under subsection (c)(1)(i), the vote required when the disinterested directors act as a group is an absolute majority of their number. A majority of the disinterested directors constitutes a quorum for board action for this purpose.

The committee of two or more disinterested directors referred to in subsection (c)(1)(i) may include a standing committee of the board of directors to which the power to authorize advances for expenses has been delegated, so long as (1) the committee was appointed by a majority vote of directors who were, at the time of appointment of the committee, not parties to the proceeding in connection with which the advance is being sought, and (2) the advance is authorized by a majority vote of members of the committee who, at the time of the vote, are disinterested directors.

Under subsection Section 853(c)(1)(ii), which is available only if subsection Section 853(c)(1)(i) is not available, the board’s action of the board of directors must be taken in accordance with Sections 8.20 or 8.21, as the case may be, and directors who are not
disinterested directors may participate in the vote. Allowing non-disinterested directors who at the time are not disinterested directors to participate in the authorization decision, if there is no or only one disinterested director, is a principle of prudence that is based on the concept that if there are not at least two disinterested directors, then it is preferable to return the power to make the decision to the full board (even though it includes non-disinterested directors) rather than to leave it without one disinterested director. An interested director should absent himself from any meeting considering a request for advance for expenses by him or the appointment of a committee to consider such a request.

Illustration 1: The board consists of 15 directors, four of whom are interested. Of the eleven disinterested directors, nine are present at the meeting at which the authorization is to be made (or the committee is to be appointed).

Under subsection Section 853(c)(1)(i), a quorum is present and at least six of the nine disinterested directors present at the board meeting must authorize any advancement of expenses because six is an absolute majority of the eleven disinterested directors. Alternatively, six of the nine disinterested directors present at the board meeting may appoint a committee of two to all (eleven) of the disinterested directors to decide whether to authorize the advance. Action by the committee requires the vote of a majority of the members appointed committee.

Illustration 2: The board consists of 15 directors, only one of whom are interested is a disinterested director.

Subsection Section 853(c)(1)(i) is not available because the number of disinterested directors, one, is less than two. Accordingly, the decision must be made by the board under subsection Section 853(c)(1)(ii) (or, as is always permitted, by the members under subsection Section 853(c)(2)).

Authorizations by members rather than by directors are permitted by Section 8.53(c)(2), but memberships under the control of directors who at the time do not qualify as disinterested directors may not be voted on the authorizations of eligibility for indemnification. This does not affect rules governing the authorization as to the presence of a quorum at the meeting.

The fact that there has been an advancement of expenses does not determine whether a director is entitled to indemnification. Repayment of any advance is required only if it is ultimately determined that the director did not meet the relevant standard of conduct in Section 8.51—A proceeding will often terminate without a judicial or other determination of as to whether the director’s conduct met the applicable standard of conduct in Section 8.51.

Nevertheless, the board of directors should make, or cause to be made, an affirmative determination of entitlement to indemnification at the conclusion of the proceeding. This decision should be made in accordance with the procedures set forth in Section 8.55.855.

Judicial enforcement of rights granted by or pursuant to Section 8.53853 is specifically contemplated by Section 8.54.854.
§ 8.54854. COURT-ORDERED INDEMNIFICATION AND ADVANCE FOR ADVANCEMENT OF EXPENSES

(a) A director who is a party to a proceeding because he or she is or was a director may apply for indemnification or an advance for advancement of expenses to the court conducting the proceeding or to another court of competent jurisdiction. After receipt of an application and after giving any notice it considers necessary, the court must:

(1) order indemnification if the court determines that the director is entitled to mandatory indemnification under Section 8.52852 (mandatory indemnification);

(2) order indemnification or advance for advancement of expenses if the court determines that the director is entitled to indemnification or advance for advancement of expenses pursuant to a provision authorized by Section 8.58858(a) (variation of indemnification); or

(3) order indemnification or advance for advancement of expenses if the court determines, in view of all the relevant circumstances, that it is fair and reasonable:

(i) to indemnify the director, or

(ii) to advance expenses to the director, even if, in the director's case of clause (1) or (2), he or she has not met the relevant standard of conduct set forth in Section 8.51851(a) (permissible indemnification), failed to comply with Section 8.53853 (advance of expenses) or was adjudged liable in a proceeding referred to in Section 8.51851(d)(1) or (d)(2), but if the director was adjudged so liable his or her indemnification must be limited to reasonable expenses incurred in connection with the proceeding.

(b) If the court determines that the director is entitled to indemnification under subsection (a)(1) or to indemnification or advance for advancement of expenses under subsection (a)(2), it must also order the nonprofit corporation to pay the director’s reasonable expenses incurred in connection with obtaining court-ordered indemnification or advance for advancement of expenses. If the court determines that the director is entitled to indemnification or advance for advancement of expenses under subsection (a)(3), it may also order the corporation to pay the director’s reasonable expenses to obtain court-ordered indemnification or advance for advancement of expenses.


CROSS-REFERENCES

Advance for Advancement of expenses, see § 8.53853.

“Corporation” defined, see § 8.50(1)850.

“Director” defined, see § 8.50(2)850.
“Expenses” defined, see § 8.50(4).

Limits on indemnification and advance for advancement of expenses, see § 8.58(c).

Mandatory indemnification, see § 8.52.

Obligatory indemnification, see § 8.58(a).

“Party” defined, see § 8.50(7).

Permissible indemnification, see § 8.51.

“Proceeding” defined, see §§ 1.40 and 8.50.

OFFICIAL COMMENT

Section 8.54(a) provides for court-ordered indemnification in three situations:

1. A director is entitled to mandatory indemnification under Section 8.52. If so, the director may enforce that right by judicial proceeding.

2. A director is entitled to indemnification or advance for expenses pursuant to a provision in the articles or bylaws, board or member resolution, or contract. If so, the director may enforce that right by judicial proceeding. To the extent that these rights are contractual, the nonprofit corporation may have contractual defenses. If the corporation has contracted to indemnify a director to the fullest extent permitted by law, a court may, nevertheless, deny an advance for expenses if it determines that the director did not have, at the time he delivered the affirmation required by Section 8.53(a)(1), a good faith belief that he met the relevant standard of conduct.

3. A court in its discretion determines that it is fair and reasonable under all the relevant circumstances to order an advance for expenses or indemnification for the amount of a settlement or judgment (in addition to expenses), whether or not the director met the relevant standard of conduct in Section 8.51 or is otherwise ineligible for indemnification. However, there are two exceptions: an adverse judgment in a derivative proceeding (Section 8.51(d)(1)) and an adverse judgment in a proceeding charging receipt of an improper financial benefit (Section 8.51(d)(2)), although in either case the court may order payment of expenses. Thus, with these exceptions, Section 8.54(a)(3) permits a court to order indemnification for amounts paid in settlement of and expenses incurred in connection with a derivative proceeding or a proceeding charging receipt of an improper financial benefit. Section 8.54(a)(3) applies to (a) a situation in which a provision in the articles of incorporation, bylaws, resolution, or contract obligates the nonprofit corporation to indemnify or to advance expenses but the relevant standard of conduct has not been met, and (b) a situation involving a permissive provision pursuant to which the board declines to exercise its authority to indemnify or to advance expenses.

However, in determining whether indemnification or expense advance would be “fair and reasonable,” under Section 8.54(a)(3), a court should give appropriate deference to an informed decision of the board of directors or committee made in good faith and based upon full information. Ordinarily, a court should not determine that it is “fair and reasonable” to order indemnification or expense advance where the director has not met conditions and procedures to which the director agreed.

A director seeking court-ordered indemnification or expense advance under Section 8.54(a)(3) must show that there are facts peculiar to his situation that make it fair and reasonable to both the nonprofit corporation and to the director to
override an intra-corporate declination or any otherwise applicable statutory prohibition against indemnification, e.g., Section 8.51(a) or (d).

Aside from the two exceptions noted above and other than the fairness and reasonableness requirement, there are no statutory outer limits on the court's power to order indemnification under Section 8.54(a)(3). In an appropriate case, a court may wish to refer to the provisions of Sections 2.02(c) and 8.31(d) establishing the outer limits of director exoneration. It would be an extraordinary situation in which a court would want to provide indemnification going beyond the limits of Sections 2.02(c) and 8.31(d), but if the court, as the independent decision-maker, finds that it is “fair and reasonable,” then the court is permitted to do so. It should be emphasized again, however, that the director seeking indemnification must make a showing of fairness and reasonableness and that exercise of the power granted by Section 8.54(a)(3) is committed to the court's discretion.

Apart from the provisions of Section 854(a)(3), there are no statutory outer limits on the court's power to order indemnification under that subsection. In an appropriate case, a court may wish to refer to the provisions of Section 202(b)(8) establishing the outer limits of a liability-limiting provision in the articles of incorporation. It would be unusual for a court to provide indemnification going beyond the limits of Section 202(b)(8), but the court is permitted to do so.

Among the factors a court may want to consider under Section 854(a)(3) are the gravity of the offense, the financial impact upon the nonprofit corporation, or, in the case of an advancement of expenses, the inability of the director to finance his defense. A court may want to give special attention to certain other issues. First, for example, has the corporation joined in the application to the court for indemnification or an advancement of expenses? This factor may be particularly important where under Section 8.51(d) indemnification is not permitted for an amount paid in settlement of a proceeding brought by or in the right of the corporation. Second, also, in a case where indemnification would have been available under Section 8.51(a)(2) if the corporation had adopted a provision authorized by Section 2.02(b)(8), was the decision to adopt such a provision presented to and rejected by the members; and, if not, would exculpation of the director’s conduct have resulted under Section 8.31(d) or a charter provision adopted under Section 2.02(c)? Third, additionally, in connection with considering indemnification for expenses under Section 8.51(a)(2) in a proceeding in which a director was adjudged liable for receiving a financial benefit to which he was not entitled, was such the financial benefit insubstantial – particularly in relation to the other aspects of the transaction involved – and what was the degree of the director’s involvement in the transaction and the corporate decision to participate?

Under Section 8.54(b), if a director successfully sues to enforce his right to indemnification of expenses under subsection (a)(1) or to indemnification or advancement of expenses under subsection (a)(2), then the court must order the nonprofit corporation to pay the director’s expenses in the enforcement proceeding. However, if a director successfully sues for indemnification or advancement of expenses under subsection (a)(3), then the court may (but is not required to) order the corporation to pay the director’s expenses in the proceeding under subsection (a)(3). The basis for the distinction is that the corporation breached its obligation in the first two cases but not in the third.
Application for indemnification under Section 8.54854 may be made either to the court in which the proceeding was heard or to another court of appropriate jurisdiction. For example, a defendant in a criminal proceeding who has been convicted but believes that indemnification would be proper could apply either to the court which heard the criminal proceeding or bring an action against the nonprofit corporation in another forum.

A decision by the board of directors not to oppose the request for indemnification is governed by the general standards of conduct of Section 8.30830. Even if the nonprofit corporation decided not to oppose the request, the court must satisfy itself that the person seeking indemnification is entitled to or otherwise deserving of receiving it under Section 8.54854.

As provided in Section 8.58858(cd), a nonprofit corporation may limit the rights of a director under Section 8.54854 by a provision in its articles of incorporation. In the absence of such a provision, the court has general power to exercise the authority granted under this section.

§ 8.55855. DETERMINATION AND AUTHORIZATION OF INDEMNIFICATION

(a) A nonprofit corporation may not indemnify a director under Section 8.51851 (permissible indemnification) unless authorized for a specific proceeding after a determination has been made that indemnification of the director is permissible because the director has met the relevant standard of conduct set forth in Section 8.51851.

(b) The determination shall be made:

(1) if there are two or more disinterested directors, by the board of directors by a majority vote of all the disinterested directors (a majority of whom shall constitute a quorum for this purpose), or by a majority of the members of a committee of two or more disinterested directors appointed by such a vote;

(2) by special legal counsel:

(i) selected in the manner prescribed in subdivision (b)(1); or

(ii) if there are fewer than two disinterested directors, selected by the board of directors (in which selection directors who do not qualify as disinterested directors may participate); or

(3) by the members.

(c) Authorization of indemnification shall be made in the same manner as the determination that indemnification is permissible, except that if there are fewer than two disinterested directors or if the determination is made by special legal counsel, authorization of
indemnification **shall** be made by those entitled to select special legal counsel under subsection (b)(2)(ii) to select special legal counsel.


**CROSS-REFERENCES**

Advance for Advancement of expenses, see § 8.53853.

Committees of the board, see § 8.25825.

“Corporation” defined, see § 8.50(1)850.

“Director” defined, see § 8.50(2)850.

“Disinterested director” defined, see § 8.50(3)850.

“Party” defined, see § 8.50(7)850.

“Proceeding” defined, see §§ 1.40102 and 8.50(8)850.

Quorum of directors, see § 8.24(a)824.

Standard for indemnification, see § 8.51851.

**OFFICIAL COMMENT**

Section 8.55 provides the method for determining whether a nonprofit corporation should indemnify a director under Section 8.51. In this section a distinction is made between a “determination” that indemnification is permissible and an “authorization” of indemnification. A “determination” involves a decision by individuals or groups described in Section 8.55(b) whether, under the circumstances, the person seeking indemnification has met the relevant standard of conduct under Section 8.51 and is therefore eligible for indemnification. This decision may be made by the individuals or groups described in Section 8.55(b). In addition, after a favorable “determination” has been made, the nonprofit corporation must decide whether to “authorize” indemnification except to the extent that an obligatory provision under Section 8.58858(a) is applicable. This decision includes a review of the reasonableness of the expenses, the financial ability of the nonprofit corporation to make the payment, and the judgment whether limited financial resources should be devoted to this or some other use by the corporation. While

Although special legal counsel may make the “determination” of eligibility for indemnification, counsel may not “authorize” the indemnification. The existence of an A pre-existing obligation to “authorize” indemnification is subject to the existence of an obligatory provision under Section 8.58858(a) to indemnify if the director is eligible for indemnification dispenses with the second-step decision to authorize indemnification.

Section 8.55855(b) establishes procedures for selecting the person or persons who will make the determination of permissibility of indemnification. As indicated in the Official Comment to Section 8.53(e), the committee of disinterested directors referred to in subsection Section 8.55(b)(1) may include a standing committee of the board to which has been
delegated the power to determine whether to indemnify a director has been delegated, so long as
the appointment and composition of the committee members comply with subsection Section
855(b)(1). In selecting special legal counsel under subsection Section 855(b)(2), directors who
are parties to the proceeding may participate in the decision if there are insufficient disinterested
directors to satisfy subsection Section 855(b)(1). Directors who do are not qualiﬁable to act as
disinterested directors may also participate in the decision to “authorize” indemnification on the
basis of a favorable “determination” if necessary to permit action by the board of directors. The
authorization of indemnification is the decision that results in payment of any amounts to be
indemnified. This limited participation of interested directors in the authorization decision is
justified by the principle of necessity.

Under subsection Section 855(b)(1), the vote required when the disinterested directors act
as a group is an absolute majority of their number. A majority of the disinterested directors
constitutes a quorum for board action for this purpose.

If there are not at least two disinterested directors, then the determination of entitlement
to indemnification must be made by special legal counsel or by the members.

Legal counsel authorized to make the required determination is referred to as The phrase
“special legal counsel.” In earlier versions of is not deﬁned in the act, and in the statutes of many
states, reference is made to “independent” legal counsel. The word “special” is felt to be more
descriptive of the role to be performed; it is intended that the counsel selected should be
independent in accordance with governing legal precepts. “Special it is important that the process
be sufﬁciently ﬂexible to permit selectin of counsel in light of the particular circumstances. In
many instances, however, it may be important that the “special” legal counsel” normally should
counsel having no prior professional relationship with those seeking indemnification, should
be retained for the speciﬁc occasion purpose, and should not be or have been either inside counsel
or regular outside counsel to the nonprofit corporation. Special Among other factors that may be
considered are whether “special” legal counsel usually has any familial, ﬁnancial, or other relationship with any of those seeking indemnification that would, in the circumstances,
reasonably be expected to exert an inﬂuence on counsel in making the determination. It is
important that the process be sufﬁciently ﬂexible to permit selection of counsel in light of the
particular circumstances and so that unnecessary expense may be avoided. Hence the phrase
“special legal counsel” is not deﬁned in the statute.

Determinations by members rather than by directors or special legal counsel are
permitted by Section 8.55(b)(3), but memberships under the control of directors who at the time
do not qualify as disinterested directors may not be voted on the determination of eligibility for
indemnification. This does not affect rules governing the determination as to the presence of a
quorum at the meeting.

Section 8.55855 is subject to Section 8.58858(a), which authorizes and
arrangement obligating the nonprofit corporation to obligate itself in advance to provide
indemnification or to advance expenses. Although such an arrangement may effectively provide
an authorization of indemnification, the determination requirements of Sections 855(a) and (b)
must still be satisfied.
§ 8.56856. INDEMNIFICATION OF OFFICERS

(a) A nonprofit corporation may indemnify and advance expenses under this Subchapter to an officer of the corporation who is a party to a proceeding because he or she is or was an officer of the corporation:

(1) to the same extent as a director; and

(2) if he or she is an officer but not a director, to such further extent as may be provided by the articles of incorporation, the bylaws, a resolution of the board of directors, or a contract approved by the board of directors or members except for:

(i) liability in connection with a proceeding by or in the right of the corporation other than for reasonable expenses incurred in connection with the proceeding, or

(ii) liability arising out of conduct that constitutes:

(A) receipt by the officer of a financial benefit to which he or she is not entitled,

(B) an intentional infliction of harm on the corporation or the members, or

(C) an intentional violation of criminal law.

(b) The provisions of subsection Subsection (a)(2) shall apply to an officer who is also a director if the basis on which he or she is made a party to the proceeding is based on an act or omission solely as an officer.

(c) An officer of a nonprofit corporation who is not a director is entitled to mandatory indemnification under Section 8.52852 (mandatory indemnification), and may apply to a court under Section 8.54854 (court-ordered indemnification and advancement of expenses) for indemnification or an advance for expenses, in each case to the same extent to which a director may be entitled to indemnification or advance for expenses under those provisions.


CROSS-REFERENCES

Advance for expenses, see § 8.53.
Agents, indemnification of and advance for Advancement of expenses for, see § 8.58(e).

“Corporation” defined, see § 8.50(1).

“Director” defined, see § 8.50(2).

Employees, indemnification of and advance for expenses for, see § 8.58(e).

“Expenses” defined, see § 8.50(4).

“Liability” defined, see § 8.50(5).

Limits on rights to indemnification and advance for Advancement of expenses, see § 8.58(e).

Indemnification of employees and agents, § 858.

“Officer” defined, see § 8.50(2).

Officer standards of conduct, see § 8.428.

“Party” defined, see § 8.50(7).

“Proceeding” defined, see §§ 1.40, 8.50(8).

Volunteers, indemnification of and advance of expenses for, see § 8.58(ef).

OFFICIAL COMMENT

1. in general

Section 8.56 correlates the general legal principles relating to the indemnification of officers of the nonprofit corporation with the limitations on indemnification in Subchapter 8E. This correlation may be summarized in general terms as follows.

(1) An officer of a corporation who is not a director may be indemnified by the nonprofit corporation on a discretionary basis to the same extent as though the individual were a director; and, in addition, may have additional indemnification rights apart from Subchapter 8E, but subject to the limits set forth in Section 8.56(a)(2), the outer limits of such rights are specified. See Section 8.56(a)(2) and (c).

(2) An officer who is also a director of the corporation is entitled to the indemnification rights of a director; and of an officer who is not a director (see preceding paragraph) if his conduct that is the subject of the proceeding was solely in his capacity as an officer. See Section 8.56(b), also to any of the rights of an officer who is not a director. See the preceding paragraph.

(3) An officer of a corporation who is not a director has the right of mandatory indemnification granted to directors under Section 8.52(2) and the right to apply for court-ordered indemnification under Section 8.54. See Section 8.56(2).

Section 8.56 does not deal with indemnification of employees and agents because the concerns of self-dealing that arise when directors provide for their own indemnification and advancement of expenses (and sometimes for senior executive officers) are not present when directors (or officers) provide for indemnification and expense advance for employees and agents who are not directors or officers. Moreover, the rights of employees and...
agents to indemnification and advance for expenses derive from principles of agency, the doctrine of respondeat superior, collective bargaining or other contractual arrangements rather than from a corporation statute. It would be presumptuous for a corporation statute to seek to limit the indemnification bargain that a nonprofit corporation may wish to make with those it hires or retains. The same standard applicable to directors and officers may not be appropriate for office workers and hazardous waste workers, brokers and custodians, engineers and farm workers. None of their roles or responsibilities are prescribed by the act.

Section 3.02 grants broad powers to nonprofit employees, agents and volunteers. Subchapter 8E is silent with respect to employees, agents and volunteers. Section 858(e) specifically states that Subchapter 8E does not limit the nonprofit corporation’s power to indemnify and advance expenses to employee, agents, and volunteers. Employees, agents, and volunteers may be indemnified using broad grants of powers to corporations under Section 302, including powers to make contracts, appoint, and fix the compensation of employees and agents, and to make payments furthering the activities and affairs of the corporation. Many corporations provide for the exercise of these powers in the same provisions in the articles, bylaws or otherwise in which they provide for expense advancement and indemnification for directors and officers.

Indemnification may also be provided to protect employees or agents from liabilities incurred while serving at a nonprofit corporation’s request as a director, officer, partner, trustee, or agent of another commercial, charitable, or nonprofit venture. Although employees and agents are not covered by Subchapter 8E, the principles and procedures set forth in the subchapter for indemnification and advance for expenses for directors and officers may be helpful to counsel and courts in dealing with indemnification and expense advance for employees and agents.

Careful consideration should be given to extending mandatory maximum indemnification and expense advance to employees and agents. The same considerations that may favor mandatory maximum indemnification for directors and officers – e.g., encouraging qualified individuals to serve – may not be present in the cases of employees and agents. Many nonprofit corporations may prefer to retain the discretion to decide, on a case-by-case basis, whether to indemnify and advance expenses to employees and agents, and volunteers (and perhaps even officers, especially nonexecutive officers) rather than binding themselves in advance to do so.

2. Officers Who Are Not Directors

While although Section 8.56 does not prescribe the standards governing the rights of officers to indemnification, subsection 856(a) does set outer limits beyond which the nonprofit corporation may not indemnify. These outer limits for officers (see subsection 856(a)(2)) are substantially the same as the outer limits on the corporation’s power to indemnify directors: (i) in a proceeding by or in the right of the corporation, indemnification is not allowed other than for reasonable expenses incurred in connection therewith, and (ii) in any proceeding, indemnification is not allowed in those situations in which directors’ liability to the corporation or its members would not be eliminated by Section 8.31(d) or a provision included in the articles pursuant to Section 2.02(c), i.e., where there has been receipt of a financial benefit to which the
director is not entitled, intentional infliction of harm on the corporation or members or intentional violation of criminal law. Since officers are held to substantially the same standards of conduct as directors (see Section 8.42842), there does not appear to be any reasoned basis for granting officers greater indemnification rights as a substantive matter. Procedurally, however, there is an important difference. To permit greater flexibility, officers may be indemnified (within the above-mentioned outer limits) with respect to conduct that does not meet the standards set by Section 8.51851(a)(1) simply by authorization of the board of directors, whereas directors’ indemnification can reach beyond those standards, as contemplated by Section 8.51851(a)(2), only with a member-approved provision included in the articles pursuant to Section 2.02202(b)(8). This procedural difference reflects the reduced risk of self-dealing as to officers.

Section 8.56(c) grants nondirector officers the same rights to mandatory indemnification under Section 8.52 and to apply to a court for indemnification under Section 8.54 as are granted to directors. Since their substantive rights to indemnification are essentially the same as those of directors, it is appropriate to grant officers the same affirmative procedural rights to judicial relief as are provided to directors.

The broad authority in Section 8.56856(a)(2) to grant indemnification may be limited by appropriate provisions in the articles of incorporation. See Section 8.58858(c).

3. Officers Who Are Also Directors

Subsection Section 856(b) provides, in effect, that an officer of the nonprofit corporation who is also a director is subject to the same standards of indemnification as other directors and cannot avail himself take advantage of the provisions of subsection Section 856(a) unless he can establish that the act or omission that is the subject of the proceeding was committed solely in his the capacity as officer. Thus, a vice president for sales development who is also a director and whose actions failed to meet Section 8.51851(a) standards could be indemnified provided that his if the officer’s conduct was within the outer limits of subsection Section 856(a)(2) and involved only his the individual’s officer capacity.

This more flexible approach for situations where the individual is not acting as a director seems appropriate as a matter of fairness. There are many instances where officers, who also serve as directors, assume responsibilities and take actions in their nondirector capacities. It is hard to justify a denial of for which indemnification to an officer who failed to meet a standard applicable only to directors when the officer can establish that he did not act as a director—Nor are there likely to be complications or difficulties because some directors are treated differently than others where the high burden of proof—solely as officer—is met. Obviously, the burden will be especially difficult to meet where the roles of officer and director are closely intertwined may be appropriate.

For a director-officer to be indemnified under Section 8.51851 for conduct in his the individual’s capacity as a director when he the individual has not satisfied the standards of Section 8.51851(a), a provision in the articles of incorporation under Section 2.02202(b)(8) is required. If such a provision is included in the articles, the standards for indemnification are those specified in the articles subject to the limitations in Section 2.02202(b)(8). For a director—
officer to be indemnified for conduct solely in his the capacity as an officer, even though the
director-officer has not satisfied the standards of Section 8.56856(a), only a resolution of bylaw
or action by the board authorizing such indemnification is required, rather than a provision in the
articles. If such a resolution is adopted bylaw or action applies, the standards for indemnification
are those specified in subsection Section 856(a)(2). However, when a director-officer seeks
indemnification or expense advance under subsections Section 856(b) and Section 856(a)(2) on
the basis of having acted solely in his the capacity as an officer, indemnification or expense
advance must be approved through the same procedures as set forth in Sections 8.55855 or
8.53853(c), as the case may be, for approval of indemnification or expense advance for a director
when acting in his the capacity as of a director.

§ 8.57857. INSURANCE

A nonprofit corporation may purchase and maintain insurance on behalf of an individual
who is or was a director or officer of the corporation, or who, while a director or officer of the
corporation, serves or served at the corporation’s request as a director, officer, partner, trustee,
employee, or agent of another domestic or foreign corporation, partnership or a joint venture,
trust, employee benefit plan, or other entity, against liability asserted against or incurred by the
individual in that capacity or arising from the individual’s status as a director or officer,
regardless of whether or not the corporation would have power to indemnify or advance
expenses to the individual against the same liability under this [subchapter Subchapter].

Source Note: Patterned after Model Nonprofit Corporation Act, 3rd Ed. (2008), § 8.57. Cf, Model
Business Corporation Act, 3d Ed. (2002) § 8.57,

CROSS-REFERENCES

“Corporation” defined, see § 8.50(1)850.
“Director” defined, see § 8.50(2)850.
Employees, agents, and volunteers, see § 8.58858(e).
“Expenses” defined, see § 8.50(4)102.
“Liability” defined, see § 8.50(5)850.
“Officer” defined, see § 8.50(2)850.
“Official capacity” defined, see § 8.50(6)850.
Standard for indemnification, see § 8.54851.

OFFICIAL COMMENT

Section 8.57 authorizes In authorizing a nonprofit corporation to purchase and maintain
insurance on behalf of directors and officers against liabilities imposed on them by reason of
actions in their official capacity, or their status as such, or arising from their service to the
corporation or another entity at the corporation’s request. Section 857 sets no limits on the type
of insurance which a corporation may maintain or the type of persons who are covered.

Insurance is not limited to claims against which a corporation is entitled to indemnify under this subchapter. Such insurance, usually referred to as “D&O liability insurance,” provides can provide protection to directors and officers in addition to the rights of indemnification created by or pursuant to this subchapter Subchapter 8E (as well as typically protecting the individual insureds against the corporation’s failure to pay indemnification required or permitted by this subchapter) and provides can also provide a source of reimbursement for corporations which indemnify a corporation that indemnifies its directors and others for conduct covered by the insurance. On the other hand, policies typically do not cover uninsurable matters, such as actions involving dishonesty, self-dealing, bad faith, knowing violations of the securities acts, or other willful misconduct. Johnston, “Corporate Indemnification and Liability Insurance for Directors and Officers,” 33 Bus. Law. 1993, 2024–29 (1978). See also Knepper & Bailey, Liability of Corporate Officers and Directors, Section 21.07 (4th ed. 1988).

Although this section Section 857 does not include employees and agents for the reasons stated in the Official Comment to Section 8.56856, the nonprofit corporation has the power under Section 3.02302 to purchase and maintain insurance on their behalf. This power is confirmed in Section 8.58858(df).

This section is not intended to set the outer limits on the type of insurance that a nonprofit corporation may maintain or the persons to be covered. Rather, it is included to remove “any doubt as to the power to carry insurance and to maintain it on behalf of directors, officers, employees and agents.” Sebring, “Recent Legislative Changes in the Law of Indemnification of Directors, Officers and Others,” 23 Bus. Law. 95, 106 (1967).

§ 8.58858. VARIATION OF INDEMNIFICATION

(a) A nonprofit corporation may, by a provision in its articles of incorporation or bylaws or in a resolution adopted an action taken or a contract approved by its board of directors or members, obligate itself in advance of the act or omission giving rise to a proceeding to provide indemnification as permitted by in accordance with Section 8.51851 (permissible indemnification) or advance funds to pay for or reimburse expenses as permitted by in accordance with Section 8.53. Any such obligatory provision shall be deemed to satisfy the requirements for authorization referred to in Sections 8.53853(c) and 8.55855(c) (determination and authorization of indemnification). Any such provision that obligates the corporation to provide indemnification to the fullest extent permitted by law shall be deemed to obligate the corporation to advance funds to pay for or reimburse expenses in accordance with Section 8.53853 to the fullest extent permitted by law, unless the provision specifically expressly provides otherwise.

(b) A right of indemnification or advancement of expenses created by this [Subchapter] or under Section 858(a) and in effect at the time of an act or omission is not eliminated or impaired with respect to the act or omission by an amendment of the articles of incorporation or bylaws adopted, or action taken by the board of directors or members, after the occurrence of the act or omission, unless, in the case of a right created under Section 858(a), the
provision creating such right and in effect at the time of the act or omission explicitly authorizes
such elimination or impairment after the act or omission has occurred.

(b) Any provision pursuant to subsection 858(a) may does not obligate the
nonprofit corporation to indemnify or advance expenses to a director of a predecessor of the
organization, pertaining to conduct with respect to the predecessor, unless otherwise
specifically expressly provided. Any provision for indemnification or advance for advancement of
expenses in the organic records, articles of incorporation, bylaws, or a resolution an action of the
governors, board of directors, members or interest holders of a predecessor of the corporation in
a fundamental transaction, or in a contract to which the predecessor is a party, existing at the
time the fundamental transaction takes effect; is governed by: Section 1226(a)(4) (effect of
merger).

(1) Section 9.23(a)(2) in the case of a domestication;
(2) Section 9.33(a)(2) in the case of a for-profit conversion;
(3) Section 9.42(a)(2) in the case of a foreign for-profit domestication and
conversion;
(4) Section 9.54(a)(2) in the case of an entity conversion; or
(5) Section 11.07(a)(4) in the case of a merger.

cd Subject to subsection (b), a nonprofit corporation may, by a provision in its
articles of incorporation or bylaws, limit any of the rights to indemnification or advance for advancement of expenses created by or pursuant to this [subchapter Subchapter].

df This [subchapter Subchapter] does not limit a nonprofit corporation’s power to pay
or reimburse expenses incurred by a director or officer in connection with
appearance appearing as a witness in a proceeding at a time when the director he or officer she is
not a party.

ef This [subchapter Subchapter] does not limit a nonprofit corporation’s power to
indemnify, advance expenses to, or provide or maintain insurance on behalf of an employee,
agent, or volunteer.

Source Note: Patterned after Model Business
from Model Nonprofit Corporation Act (1987) §
Corporation Act (2016 Revision), § 8.58.

CROSS-REFERENCES

Advance for Advancement of expenses, see § 8.53853.
“Corporation” defined, see § 8.50(1)850.
“Director” defined, see § 8.50(2)850.
Effect of articles amendment, § 909.
“Expenses” defined, see § 8.50(4)850.
Indemnification generally, see §§ 8.51-8.56851 through 856.
Insurance, power to provide, see § 8.57857.
“Officer” defined, see § 8.50(2).
“Party” defined, see § 8.50(7).
Predecessor, see § 8.50(1).
“Proceeding” defined, see § 8.50(8).

OFFICIAL COMMENT

Section 8.58(a) authorizes a nonprofit corporation to make obligatory the permissive provisions of Subchapter 8E in advance of the conduct giving rise to the request for assistance. Many corporations have adopted such provisions, often with member approval or advancement of expenses. An obligatory provision satisfies the requirements for authorization in subsection Sections 8.53(c) of Sections 8.53 and 8.55(c), but compliance is still required with subsections (a) and (b) of these sections for determination of eligibility for indemnification in Sections 8.53(a), 8.53(b), 8.55(a) and 8.55(b) must still be met.

Section 8.58(a) further provides that a provision requiring indemnification to the fullest extent permitted by law, absent an express statement to the contrary, includes an obligation to advance expenses under Section 8.53. This provision of the statute is intended to avoid a decision such as that of the Delaware Chancery Court in Advanced Mining Systems, Inc. v. Fricke, 623 A.2d 82 (Del. Ch. 1992). If a nonprofit corporation provides for obligatory indemnification and not for obligatory advancement of expenses, the provision should be reviewed to ensure that it properly reflects the intent in light of the third sentence of Section 8.58(a). Also, a corporation should consider whether obligatory expense advance is intended for direct suits by the corporation as well as for derivative suits in the right of the corporation. In the former case, assuming compliance with subsections Sections 8.53(a) and (b) of Section 8.53, the corporation could be required to fund the defense of a defendant director even where the board of directors has already concluded that the director has engaged in significant wrongdoing. See Official Comment to Section 8.53.

Section 8.58(b) provides that an obligatory indemnification provision adopted after a fundamental transaction pursuant to subsection (a) does not, unless specific provision is made to the contrary, bind the corporation with respect to a predecessor in the transaction. An obligatory indemnification provision of a predecessor is treated as a liability (to the extent it is one) in a fundamental transaction.

Although Section 8.58 provides that a nonprofit corporation to limit the right of the corporation to indemnify or advance expenses by a provision in its articles of incorporation as provided in Section 10.9909(a), no such limitation will affect rights in existence when the provision becomes effective pursuant to Section 1.2316.

Section 8.58 makes clear that Subchapter 8E deals only with actual or threatened defendants or respondents in a proceeding, and that expenses incurred by a director in connection with appearance as a witness may be indemnified without regard to the limitations of Subchapter E. Indeed, most of the standards described in Sections 8.51 and 8.54(a) by their own terms can have no meaningful application to a director whose only connection with a proceeding is that he has been called as a witness.
Subchapter 8E does not regulate the power of the nonprofit corporation to indemnify or advance expenses to employees and agents. That subject is governed by the law of agency and related principles and frequently by contractual arrangements between the corporation and the employee or agent. Section 8.58(ef) makes clear that, while indemnification, advance for advancement of expenses, and insurance for employees and agents are beyond the scope of this subchapter, the elaboration in Subchapter E of standards and procedures for indemnification, expense advance, and insurance for directors and officers is not in any way intended to cast doubt on the power of the corporation to indemnify or advance expenses to or purchase and maintain insurance for employees and agents under Section 3.02 or otherwise.

[Subchapter] F

CONFLICTING INTEREST TRANSACTIONS

§ 8.60. Conflicting interest transactions; voidability.

§ 8.60. CONFLICTING INTEREST TRANSACTIONS; VOIDABILITY

(a) A contract or transaction between a nonprofit corporation and one or more of its members, directors, members of a designated body, or officers or between a nonprofit corporation and any other entity in which one or more of its directors, members of a designated body, or officers are directors or officers, hold a similar position, or have a financial interest, is not void or voidable solely for that reason, or solely because the member, director, member of a designated body, or officer is present at or participates in the meeting of the board of directors that authorizes the contract or transaction, or solely because his or their votes are counted for that purpose, if:

(1) the material facts as to the relationship or interest and as to the contract or transaction are disclosed or are known to the board of directors and the board in good faith authorizes the contract or transaction by the affirmative votes of a majority of the disinterested directors even though the disinterested directors are less than a quorum;

(2) the material facts as to the relationship or interest of the member, director, or officer and as to the contract or transaction are disclosed or are known to the members entitled to vote thereon, if any, and the contract or transaction is specifically approved in good faith by vote of those members; or

(3) the contract or transaction is fair as to the corporation as of the time it is authorized, approved, or ratified by the board of directors or the members.

(b) Common or interested directors may be counted in determining the presence of a quorum at a meeting of the board that authorizes a contract or transaction specified in subsection (a).
(c) This section is applicable except as otherwise restricted in the articles of incorporation or bylaws.


CROSS-REFERENCES

“Designated body” defined, see § 1.40102.
“Director” defined, see § 1.40102.
Director’s liability for unlawful distributions, see § 8.33832.
“Entity” defined, see § 1.40102.
“Member” defined, see § 1.40102.
Quorum requirements and voting for board meetings, see § 8.24824.
Standards of conduct for directors, see § 8.30830.
Standards of liability for directors, see § 8.31831.

OFFICIAL COMMENT

This section applies to all contracts and transactions between a nonprofit corporation and one or more of its members, directors, members of a designated body, or officers, or between a corporation and any other entity in which one or more of its members, directors, members of a designated body, or officers hold a similar position or have a financial interest. A contract or transaction subject to this section may be permissible under this act yet be prohibited as an excess benefit transaction or otherwise under standards applicable to charitable corporations under the Internal Revenue Code.

This section like Subchapter 8C regarding the standards of conduct of directors, rejects the trustee standard regarding interested transactions in favor of the corporate standard. The trustee standard prohibits any transaction between a trust and a trustee. That standard was considered overly-restrictive for nonprofit corporations. This section also rejects the concept that a director may not obtain any profit from a transaction involving his or her that director’s corporation. If the requirements of Section 8.60860 are met, a director can make a profit from a transaction involving the corporation subject to other applicable provisions of law.

[Subchapter] G

BUSINESS OPPORTUNITIES


§ 8.70870. BUSINESS OPPORTUNITIES

(a) The taking advantage, directly or indirectly, by If a director or officer pursues or takes advantage of a business opportunity directly or indirectly through or on behalf of another
person, that action may not be the subject of equitable relief, or give rise to an award of damages
or other sanctions against the director, officer, or other person, in a proceeding by or in the right
of the nonprofit corporation on the ground that the opportunity should have first been offered to
the corporation, if:

(1) before becoming the director, officer, or other person becomes legally
obligated or entitled respecting the opportunity, the director or officer brings it to the attention of
the corporation and either action by the members or the directors disclaiming the corporation’s
interest in the opportunity is taken in compliance with the same procedures as are set forth in
Section 8.60860 (conflicting interest transactions; voidability), as if the decision being made
concerned a conflicting interest transaction; or

(2) the duty to offer the corporation the business opportunity has been limited
or eliminated pursuant to a provision of the articles of incorporation adopted in accordance with
Section 202(b)(10) (articles of incorporation).

(b) In any proceeding seeking equitable relief or other remedies, based upon an
alleged improper pursuit or taking advantage of a business opportunity by a director or officer,
directly or indirectly through or on behalf of another person, the fact that the director or officer
did not employ the procedure described in subsection (a)(1) before pursuing or taking advantage
of the opportunity does not support an inference shall not create an implication that the
opportunity should have been first presented to the nonprofit corporation or alter the burden of
proof otherwise applicable to establish that the director or officer breached a duty to the
corporation in the circumstances.

(c) As used in this section, “director” includes a member of a designated body.

Source Note: Patterned after Model Nonprofit
Corporation Act, 3rd Ed. (2008), § 8.70. Cf Model
Revision), § 8.70.

CROSS-REFERENCES

Conflicting interest transactions; voidability, § 860.
Standards of conduct for directors, § 830.
Standards of conduct for officers, § 842.
Standards of liability for directors, § 831.

OFFICIAL COMMENT

Section 8.70870(a) provides a safe harbor for a director or officer weighing possible
involvement with a prospective business opportunity that might constitute a “corporate
opportunity.” The phrase “directly, or indirectly through or on behalf of another person”
recognizes the need to cover transactions pursued or effected either directly by the director or
officer or indirectly through or on behalf of another person.
By action of the board of directors or members of the nonprofit corporation under Section 8.70870(a), the director or officer can receive a disclaimer of the corporation’s interest in the matter before proceeding with such involvement. In the alternative, the corporation may, among other things, (i) decline to disclaim its interest, (ii) delay a decision respecting granting a disclaimer pending receipt from the director or officer of additional information (or for any other reason), or (iii) attach conditions to the disclaimer it grants under Section 8.70870(a). The safe harbor granted to the director pertains only to the specific opportunity and does not have broader application, such as to a line of business or a geographic area.

The safe harbor provided under section 870(a)(1) may be utilized only for a specific business opportunity. A broader advance safe harbor for any, or one or more classes or categories of business opportunities must meet the requirements of section 202(b)(10). Section 870(a)(2) confirms that if the duty of an officer or director to present an opportunity has been limited or eliminated by a provision in the articles of incorporation under section 202(b)(10) a safe harbor exists in connection with the pursuit or taking of the opportunity. The common law doctrine of “corporate opportunity” has long been recognized as a core part of the director’s duty of loyalty, and, under court decisions, extends to officers. See Section 842(a) and its Official Comment. The doctrine stands for the proposition recognizes that the nonprofit corporation has a right prior to that of its directors or officers to act on certain business opportunities that come to the attention of the directors. In such situations, a director or officer who acts on the opportunity for the benefit of the director or officer or another person without having first presented it to the corporation can be held to have “usurped” or “intercepted” a right of the corporation. A defendant director or officer who is found by a court to have violated the duty of loyalty in this regard is, as well as related or other persons involved in the transaction, subject to damages or an array of equitable remedies, including injunction, disgorgement or the imposition of a constructive trust in favor of the corporation. While the doctrine’s concept is easily described, whether it will be found to apply in a given case depends on the facts and circumstances of the particular situation and is thus frequently unpredictable. Ultimately, the doctrine requires the court to balance the corporation’s legitimate expectations that its directors will faithfully promote its best interests against the legitimate right of individual directors to pursue their own economic interests in other contexts and venues.

In response to this difficult balancing task, courts have developed several (sometimes overlapping) principles to cabin the doctrine. Although the principles applied have varied from state to state, courts have sought to determine, for example, whether a disputed opportunity presented a business opportunity that was:

- the same as, or similar to, the nonprofit corporation’s current or planned activities (“line of business” test);
- one that the corporation had already formulated plans or taken steps to acquire for its own use (“expectancy” test);
- developed by the director through the use of the corporation’s property, personnel or proprietary information (“appropriation” test); or
- presented to the director with the explicit or implicit expectation that the director would present it to the corporation for its consideration or, in contrast, one that initially came to the director’s attention in the director’s individual capacity unrelated to the director’s corporate role (“capacity” test).
Finally, in recognition that the nonprofit corporation need not pursue every business opportunity of which it becomes aware, an opportunity coming within the doctrine’s criteria that has been properly presented to and declined by the corporation may then be pursued or taken by the presenting director or officer without breach of the director’s duty of loyalty.

The fact-intensive nature of the corporate opportunity doctrine resists statutory definition. Instead, Subchapter G employs the broader notion of “business opportunity” that encompasses any opportunity, without regard to whether it would come within the judicial definition of a “corporate opportunity” as it may have been developed by courts in a jurisdiction. When properly employed, Subchapter G provides a safe-harbor mechanism enabling a director or officer to pursue an opportunity for his or her own account or for the benefit directly, or indirectly through or on behalf of another person, free of possible challenge claiming conflict with the director’s or officer’s duty of loyalty on the ground that the opportunity should first have been offered to the corporation.

1. Section 870(a)(1).

Section 870(a)(1) describes the safe harbor available to a director or officer who elects to subject a business opportunity, regardless of whether the opportunity would be classified as a “corporate opportunity,” to the disclosure and approval procedures set forth therein. The safe harbor provided is as broad as that provided for a director’s conflicting interest transaction in Section 8.60. If the director or officer makes required disclosure of the facts specified and the nonprofit corporation’s interest in the opportunity is disclaimed by director action or member action, the director or officer has foreclosed any claimed breach of the duty of loyalty and may not be subject to equitable relief, damages or other sanctions if the director or officer thereafter pursues or takes the opportunity for his or her own account or through for the benefit of another person.

The safe harbor concept contemplates that the nonprofit corporation’s decision maker will have full freedom of action in deciding whether the corporation should take over a proffered opportunity or disclaim the corporation’s interest in it. If the director or officer could seek ratification after the legal obligation respecting the opportunity arises, the option of taking over the opportunity would, in most cases, be foreclosed to the corporation. The safe harbor’s benefit is available only when the corporation can entertain the opportunity in a fully objective way.

2. Section 870(b).

The concept of “business opportunity” under Section 870 is not defined but is intended to be broader than what might be regarded as an actionable “corporate opportunity.” This approach reflects the fact-intensive nature of the corporate opportunity doctrine, with the result that a director or officer may be inclined to seek safe harbor protection under Section 870 before pursuing an opportunity that may or may not be a “corporate opportunity.” Likewise, a director or officer may conclude that a business opportunity is not a “corporate opportunity” under applicable law and choose to pursue it without seeking a disclaimer by the nonprofit corporation under Section 870(a)(1). Accordingly, Section 870(b) provides that a decision not to seek the safe harbor offered by Section 870(a)(1) neither creates a negative implication nor alters the
burden of proof in any subsequent proceeding seeking damages or equitable relief based upon an alleged improper taking of a “corporate opportunity.”

3. Section 870(c).

Section 870(c) extends the procedures and protections of this section to members of a designated body.

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