



LAURA SOLOMON  
AND ASSOCIATES

**Canonical and Legal Responsibilities of the Vestry**  
***Serviam Institute- November 16, 2021***



**DISCUSS CHANGED ENVIRONMENT**

**REVIEW FIDUCIARY DUTIES**

**EXPLAIN LIABILITY EXPOSURE *AND*  
PROTECTIONS**

**PROVIDE RECOMMENDATIONS**



# ► FIDUCIARY DUTIES IN CONTEXT

FIDUCIARIES FACE INCREASED FOCUS, EXPECTATIONS OF TRANSPARENCY, AND ACCOUNTABILITY

## FOCUS

- 9/11 → congressional oversight

## TRANSPARENCY

- Enron → Sarbane-Oxley Act

## ACCOUNTABILITY

- Pension Protection Act, Tax Cuts and Jobs Act → tax, lobbying, and real estate tax-exemption enforcement



# FIDUCIARY DUTIES

THE BOARD OVERSEES GOVERNANCE AND OPERATIONS IN FURTHERANCE OF THE CHARITABLE MISSION



## POSITIVE FIDUCIARY OBLIGATIONS

- Duty of care
- Duty of loyalty
- Duty of obedience

## NEGATIVE, PROHIBITED CONDUCT

- Conflicts of interest
- Public charities - intermediate sanctions
- Private foundations - self-dealing excise taxes

## ETHICAL/MORAL OBLIGATIONS

- Safety and well-being of staff and clients
- Reputation in the community
- Honoring charitable intentions of donors

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& A

LAURA SOLOMON  
AND ASSOCIATES

[WWW.LAURASOLOMONESQ.COM](http://WWW.LAURASOLOMONESQ.COM)

## ► FIDUCIARY DUTIES (CONT.)

DIRECTORS AND OFFICERS HAVE A DUTY OF CARE AND CAN RELY ON EXPERT ADVICE

### DUTY OF CARE

- Directors must serve in good faith, in a manner reasonably believed to be in the best interests of the corporation and with such care, including reasonable inquiry, skill and diligence, as a person of ordinary prudence would use under similar circumstances

### JUSTIFIABLE RELIANCE

- Directors are entitled to rely in good faith on information, opinions, reports, or statements, including financial statements and other financial data, prepared or presented by officers, employees, lawyers, accountants, Board committees



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[WWW.LAURASOLOMONESQ.COM](http://WWW.LAURASOLOMONESQ.COM)

## ► FIDUCIARY DUTIES (CONT.)

# DIRECTORS AND OFFICERS HAVE DUTIES OF LOYALTY AND OBEDIENCE



### DUTY OF LOYALTY

- Undivided loyalty to the mission and basic well-being of the organization
  - Prohibited from using position to further conflicting interests
  - Prohibited from engaging in self-dealing

### DUTY OF OBEDIENCE

- Take action to ensure that the organization operates to further its mission in compliance with legal requirements
  - Federal tax laws and regulations
  - Legislative/regulatory developments
  - State laws and regulations governing nonprofits and solicitation of charitable contributions

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& A

LAURA SOLOMON  
AND ASSOCIATES

WWW.LAURASOLOMONESQ.COM

## ► FIDUCIARY DUTIES (CONT.)

REGULATORS HAVE INCREASED FOCUS ON FIDUCIARY DUTIES AND INVESTMENT PRACTICES POST-MADOFF



### FEDERAL CONCERNS

- Proposed federal prudent investor rule
- IRS focus on jeopardy investments, “alternatives”

### STATE INVESTIGATIONS

- State Attorneys General investigate directors and officers for breaches of fiduciary duties

### EVOLVING BEST PRACTICES

- Closer monitoring of investments
- Documenting delegation
- Implementation or review of Investment and Conflict of Interest Policies



# ► FIDUCIARY DUTIES - CHARITIES

## DIRECTORS HAVE ADDITIONAL FIDUCIARY DUTIES TO CHARITIES



### **USE ASSETS TO FURTHER MISSION**

- Positive – charitable organization and operations
- Negative – prohibited political, private inurement activity, and limited lobbying private benefit

### **PRESERVE ASSETS TO FURTHER MISSION**

- Granting assets or selling assets for FMV
- IRS required dissolution language
- Preserve assets (confidentiality), recoup diverted assets





# ► ENDOWMENT INVESTMENT AND SPENDING

IN PENNSYLVANIA, ENDOWMENT MANAGEMENT IS GOVERNED BY THE NONPROFIT CORPORATION LAW AND PRUDENT INVESTOR RULE



## PENNSYLVANIA NONPROFIT CORPORATION LAW

- Governs distribution of income from endowment
- Board may elect “total return” investment and distribution policy
- Board sets percentage (*formerly* 2% to 7%) of income distribution each year up to 10%

## PRUDENT INVESTOR RULE

- Governs permitted investments
- Board invests and manages endowment assets as a prudent investor would
- Permitted investments include every kind of property and investment, including mutual funds



## ▶ ACT 71 CHANGES

# ACT 71 CHANGED ENDOWMENT SPENDING, SETTLEMENTS, AND STANDING FOR PENNSYLVANIA NONPROFITS AND DONORS



### INCREASED ENDOWMENT SPENDING

- Spending rule now allows Boards to elect up to **10%** of the income of an endowment or trust for 2020, 2021, and 2022

### NON-JUDICIAL SETTLEMENT AGREEMENTS

- Donors may enter into binding settlement agreements, like trust settlors

### STANDING

- Donors now have standing to enforce charitable gifts, similar to trust enforcement
- Office of Attorney General and charitable beneficiaries also have standing



## DIRECTORS ARE MOST CONCERNED ABOUT LAWSUITS



### LIABILITY

- Duty: nonprofit had duty of care with respect to those harmed
- Breach: nonprofit breached its duty
- Injury: harm actually occurred
- Cause: breach of duty of care was proximate cause of harm

### MOST COMMON LAWSUITS

- Employment disputes
- Automobile accidents
- Intellectual Property



# LIABILITY EXPOSURE – DIRECTORS (CONT.)

## DIRECTORS CAN FACE CRIMINAL AND TAX LIABILITY



### PERSONAL LIABILITY OF DIRECTORS

- Criminal and tax liability
- Piercing of “corporate veil” – equitable remedy for misuse of corporation for personal interests
- Breach of fiduciary obligation that constitutes self-dealing, willful misconduct, or recklessness
- Excess benefit/intermediate sanctions penalties
  - *In Re: Lemington Home for the Aged*

### INTERMEDIATE SANCTIONS

- Excise taxes imposed on “organization managers” who engage in excess benefit transactions
- Compensation arrangements and transactions
- Automatic excess benefit



## PENNSYLVANIA AND FEDERAL LAW LIMITS LIABILITY FOR DIRECTORS AND OFFICERS



### **PROTECTION FOR CHARITIES - *ELIMINATED***

- Charitable immunity abolished
- Lawful operations and good governance
- Insurance

### **PROTECTION FOR DIRECTORS AND OFFICERS**

- State Protection - Nonprofit Corporation Law, Officer, Directors, Trustees' statutory immunity
- Federal Volunteer Protection Act
- Directors and Officers liability insurance
- Indemnification



## ► RECOMMENDATIONS

# SIMPLE ACTIONS YOU CAN TAKE TO PROTECT YOURSELF AND YOUR CHURCH



1. UNDERSTAND FIDUCIARY DUTIES
2. IMPLEMENT POLICIES AND PROCEDURES TO MAXIMIZE LEGAL PROTECTIONS
3. IMPROVE REPORTING, COMMITTEE STRUCTURES
4. TAKE ADVANTAGE OF JUSTIFIABLE RELIANCE
5. DOCUMENT AND MONITOR DELEGATIONS
6. REVIEW INSURANCE COVERAGE
7. DOCUMENT AND COMPLY WITH DONOR INTENT
8. PERIODICALLY REVIEW MISSION AND OPERATIONS
9. FOCUS ON THE MISSION



## **BOARDSOURCE**

<http://boardsource.org/>

## **U.S. SENATE COMMITTEE ON FINANCE**

<http://finance.senate.gov>

## **SOX – GOVERNANCE “BEST PRACTICES”**

Panel on The Nonprofit Sector

<http://www.nonprofitpanel.org>

Independent Sector

<http://independentsector.org/accountability>

## **LAURA SOLOMON ESQ.**

[www.laurasolomonesq.com](http://www.laurasolomonesq.com)





**LAURA N. SOLOMON, ESQ**  
**LAURA SOLOMON & ASSOCIATES**  
**(610) 645-0992**  
**WWW.LAURASOLOMONESQ.COM**  
**[laura@laurasolomonesq.com](mailto:laura@laurasolomonesq.com)**

**Let's connect on LinkedIn**



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LAURA SOLOMON  
AND ASSOCIATES