In an increasingly litigious world, independent schools are finding a need to be ever vigilant to assure that their institutions are operating in accordance with legal obligations. Towards that end, ISACS commissioned the firm of Athas, Foley, Kowal & Bridge, legal counsel for ISACS and other independent school associations, to revise a legal primer originally written by Nancy L. Thomas for the Connecticut Association of Independent Schools (CAIS), in order to update the information contained therein and to make it applicable to all the Midwest states represented within the ISACS region.

As a service to its member schools, ISACS offers unlimited access to our legal firm (the first 15 minutes of each call being free, and any additional time charged on an hourly basis) for counsel on any and all legal matters.
INTRODUCTION
This document contains an analysis of the authority, duties and liability of trustees of not-for-profit (charitable) corporations created for educational purposes. It is designed to offer guidance to those who volunteer for leadership positions on the boards of not-for-profit educational institutions.

SOURCES OF AUTHORITY, DUTY AND LIABILITY
The conduct of trustees of secular schools is governed by the Not-For-Profit Corporation Act, the individual corporation's Articles of Incorporation and Bylaws, and common law. Insofar as they provide additional authority or restrictions, other corporate records and both written and unwritten policies and procedures may also define the scope of trustee authority, duty and liability. Religious entities in some jurisdictions are governed by certain types of Acts applicable only to religious corporations/organizations.

A. Not-For-Profit Corporation Act
Most statutory classification systems include recognition of the not-for-profit corporation, which ordinarily includes educational, charitable and philanthropic nonprofit organizations. In many states there are separate provisions dealing with Religious Corporations.

Not-For-Profit Corporation Acts govern how nonprofit corporations organize, operate, reorganize and dissolve. They grant each nonprofit corporation the following basic powers: 1.) to sue or be sued; 2.) to use a corporate seal; 3.) to utilize the corporate name; 4.) to purchase, accept and hold property; 5.) to make donations to charities; 6.) to invest funds; 7.) to borrow money; 8.) to make contracts; and 9.) to act reasonably to effect the express purpose stated in the Articles of Incorporation. In short, a not-for-profit corporation possesses all powers reasonably necessary to accomplish its proper purposes.

B. Articles of Incorporation
General corporate powers and trustee authority and duties may be set forth in the educational institution's Charter or Articles of Incorporation. This document, prepared by the organizers of the corporation, generally contains the following information: the name of the corporation, the nature of the activities to be conducted or promoted, a statement of the not-for-profit purpose of the corporation and a statement on whether the corporation is to have members and the manner of election or appointment, the qualifications, and the rights of such members. The Articles of Incorporation may also contain additional information such as a statement prohibiting conflicts of interest for trustees.

Trustees should review and remain cognizant of the Articles of Incorporation and the rights and duties outlined therein. Trustees must be familiar with the purpose clause articulated in the Articles of Incorporation since it defines the scope and range of their proper activities.
C. Bylaws The Bylaws supplement the Articles of Incorporation by identifying the procedures, authority and duties of trustees, members and officers, and the internal practices and procedures of the corporation. Bylaws constitute a binding contract as to how the business of the Board of Trustees will be conducted. The Bylaws should be reviewed by trustees regularly to ensure that they are current and that the trustees are acting in compliance with their requirements.

D. Corporate Records, Policies and Procedures Although they are not sources of authority, the corporate records such as the minutes and the policies and procedures may limit the activities of trustees.

Each corporation is required by statute to keep complete books and records of accounts, plus minutes of the proceedings of its incorporators, members, trustees and committees of the trustees. Minutes should reflect decisions by the trustees in connection with a specific task especially in regard to authorizing any expenditure of funds.

Educational institutions often prepare written policies and procedures to provide further regulatory guidance. Although trustees are responsible for overseeing internal operations rather than performing day-to-day functions, the trustees or the administration, or both, can compile policies and procedures for the institution. These might include rules concerning attendance requirements, student conduct, grading policies, record-keeping, etc. Like the Bylaws, the policies and procedures can be construed as a binding contract on the corporation and, as such, may expand or limit the authority of trustees and may provide additional information regarding trustee duties. The policies should be reviewed periodically by the trustees and legal counsel to assure that they are in conformity with the law.

E. Common Law Trustee authority, duty and liability may be expanded or limited by the common law. Specific questions regarding the role of trustee should be directed to the corporation's legal counsel.

**AUTHORITY**

The Not-for-Profit Corporation Act provides that the affairs of the corporation shall be managed by its board of trustees. (The Act uses the term "director", but in a not-for-profit corporation, the title of "trustee" is often preferred. The words are used interchangeably in reference to a member of the board of a not-for-profit corporation.) The authority to act is given to the trustees collectively. Independent action by one trustee generally is not binding on the corporation absent the grant of express authority by the collective trustees. The Bylaws or Articles of Incorporation may permit the trustees to create and delegate authority to committees with certain limitations.

The trustees' role as managers of the affairs of the corporation includes the selection of senior administrators, managing assets and investments, capitalization and fund raising, assessing major plans and action, amending Articles of Incorporation and Bylaws (usually with member approval), and considering and recommending fundamental changes.
Trustees generally monitor rather than manage and administer. Trustees do not handle the day-to-day operations, but instead pursue the broad issues that impact upon the corporation.

At all times, trustees are limited to acting consistently with the corporate purpose specified in the Articles of Incorporation.

Trustees in the independent school sector have broad power, including the right to eliminate departments, to approve cost-reduction programs, to determine admission standards, to increase or decrease faculty salaries, to hire and terminate employees, to eliminate degree programs, and to alter retirement policies.

DUTIES
Most Not-for-Profit Corporation Acts provide that a trustee has a fiduciary duty to the corporation. This means that he or she shall perform duties in good faith, in a manner he or she reasonably believes to be in the best interest of the corporation, and with such care as an ordinarily prudent person in a like position would use under similar circumstances in his or her own personal affairs. Trustees have three commonly recognized duties to the corporation: duty of care, loyalty and obedience.

Trustees owe these special duties to the corporation as a whole, rather than to individual constituencies, including students, faculty, staff, parents, alumni, members or any other potentially interested party.

A. Standard of Care: Ordinary Prudence Trustees must exercise the same care in managing the corporation as they would in handling their own business or personal affairs. Trustees must attend meetings regularly and stay well informed enough to make honest, good faith business decisions on behalf of the corporation.

Directors without compensation cannot be held personally liable for an exercise of judgment or discretion or an act or omission in rendering services.

Trustees may delegate some matters to entities or fellow-trustees (including outsiders), but they may not delegate their supervisory role. Thus, it is permissible for board members to retain and rely upon accountants, financial planners, lawyers, consultants, and other experts in performing their duties, but trustees may not delegate the responsibility for overseeing these delegates. Trustees may reasonably rely on the advice of such outsider consultants.

B. Duty of Loyalty The duty of loyalty requires that a trustee acting on behalf of the corporation keep the corporation's interests paramount to all others. Trustees must have an undivided allegiance to the corporate purpose when using either the power of their position, the information they may possess, or the corporation's property.
Trustees may have a personal interest in a transaction with the corporation without invalidating the transaction. However, any possible conflict of interest in this regard should be disclosed to the entire board and recorded in the minutes. When an action involves this interest, the conflict should be reiterated on the record. Trustees must confront potential conflict and should attempt to minimize its effects through the disclosure and non-participation of certain members of the board. Trustees having a conflict should not use personal influence on the matter nor should they vote. Their presence may be counted in determining a quorum for meeting purposes. Minutes should reflect the disclosure, abstention and the count to constitute a quorum.

Where appropriate, a trustee must inform other trustees of any reason why the transactions might not be in the best interest of the corporation.

A trustee's duty of loyalty is violated if the trustee pursues the interest of a third party, including parents, students, faculty, staff and alumni, unless such interest is merely ancillary to the corporation's interest.

Trustees must exercise caution in engaging outside consultants (accountants, lawyers, contractors, bankers, etc.) in order to avoid a conflictual situation from arising. For example, the deposit of an institution's funds in a bank in which a trustee has an interest or the use of a trustee's law firm as the institution's legal advisor may create an obvious conflict. Trustees also should avoid investment of an institution's endowment in securities of a corporation in which a trustee has an interest. Trustees who donate land, art, collections or other property to their institutions should have the gift independently appraised by a disinterested party.

Trustees should adopt a written conflict of interest policy for inclusion in the corporation's Bylaws. The policy should state the duty of loyalty, set forth disclosure rules, and establish the procedure to be followed in the event of a conflict (e.g. interested trustee will not vote, disinterested trustees will evaluate a transaction, etc). Trustees should be required to report conflicts and should be required to update this information regularly. A committee or individual trustee should be responsible for evaluating personal interests and scrutinizing transactions.

C. Duty of Obedience Trustees are charged with carrying out the purpose of the corporation articulated in the Articles of Incorporation. Trustees may not deviate from the duty to fulfill the particular purpose for which the organization was created. Trustees as well as staff are also implementers of the school policies - both written and oral.

TRUSTEE LIABILITIES, INDEMNIFICATION AND INSURANCE
Trustees may be personally liable for 1.) breach of fiduciary duties, 2.) negligence, 3.) breach of contract, or 4.) intentional misconduct.

Trustees can be sued individually by the school or someone acting on its behalf, such as fellow trustees, members, or governmental officials. Trustees also can be sued by a third person when the school commits a tort or breaches a contract.
A. Statutory Protection for Business Decisions Certain state laws afford trustees some protection from liability for business decisions. Those laws provide that trustees who perform their duties in a good faith manner reasonably believed to be in the best interest of the not-for-profit corporation are presumed to have no individual liability for their actions. Absent gross negligence, a breach of fiduciary duty, or intentional misconduct, trustees are not generally liable for honest mistakes in the performance of their duties. The rule is designed to encourage people to become trustees and to encourage the exercise of good faith actions in business decisions.

B. Breach of Fiduciary Duties A trustee is a fiduciary, meaning a person acting primarily for another's benefit. The chief fiduciary duty of a trustee is to act for the benefit and betterment of the school.

Liability has been imposed upon trustees of a not-for-profit corporation in the following situations: conflict of interest such as self-dealing; wrongful taking of a corporate opportunity; a board member's deviation from the corporate mission; the trustee's exceeding his or her authority or power; mismanagement; or a claim that the corporation was fraudulently designed to shield the board's actually doing business in the personal capacity of the individual members. Even in the absence of pecuniary profit to a trustee, such conduct will be deemed actionable. In determining non-management or mismanagement, courts will consider a trustee's attendance at meetings, management of funds, and efforts to verify facts and keep abreast of corporate activities.

When a transaction is improper because of a trustee's breach of his or her fiduciary duties, the courts may impose injunctive relief, thereby preventing a transaction or contract from taking effect. The courts may rescind the transaction if it has already taken effect, thereby restoring the status quo. In some cases, the courts have ordered the trustees to compensate the corporation for a loss occasioned by their malfeasance.

Most state laws provide some protection for trustees faced with a conflict of interest. Generally, if a contract or transaction is fair to the corporation and is approved by disinterested members of the board, after disclosure of a conflict, then there will be no personal liability on the part of the trustee nor will there by personal liability on the part of the disinterested trustees who approved the conflictual contract or transaction.

C. Negligence Trustees can be liable for negligence if they participated directly in the tortious conduct or failed to satisfy their fiduciary duties. More often, trustees acting on behalf of the corporation can in some instances be afforded immunity from third-party claims that allege negligence. Many states provide for immunity from the liability for damages resulting from the conduct of a trustee or officer of a not-for-profit corporation. Immunity is extended to protect trustees from liability resulting from any act made in "the exercise of such person's policy or decision-making responsibilities" if such person was acting in good faith and within the scope of "such person's official function or duties." A trustee is not immune to claims that conduct was willful or wanton.
Some not-for-profit corporation immunity provisions distinguish between ministerial and policy functions of trustees. A "wronged" individual can recover against an organization when the defendant is an officer or trustee who negligently performed a ministerial function (e.g., maintaining the premises, operating a motor vehicle, and other routine administrative functions). Corporations indemnify these types of claims and should have insurance to cover them.

D. Breach of Contract It is within the power of a Board of Trustees to make contracts. Trustees who contract on behalf of the corporation, with authority and in accordance with their fiduciary duties, are presumed to have no personal liability for debts or obligations owed under that contract.

Trustees who personally guarantee a loan or agreement can be personally liable and may not be entitled to indemnity.

E. Intentional Misconduct Trustees of a corporation are personally liable for their intentional, criminal and fraudulent acts. Trustees may also be personally liable if the corporation engages in criminal activities, even though the trustees do not personally direct or supervise the specific criminal or fraudulent acts of subordinates.

F. Indemnification Not-For-Profit Corporations Acts provide, so long as certain conditions are met, that a trustee is exempt from personal liability, and a corporation must indemnify that trustee for debts, liabilities and obligations of the corporation. Indemnification can include protection/reimbursement against fines, judgments, penalties, amounts paid in settlement, and reasonable expenses incurred by the trustee and by the trustee's legal representative in connection with any legal proceeding against a trustee brought by virtue of the fact that he or she is acting as an agent of the corporation.

To be entitled to indemnification, the trustee must have acted in good faith and in a manner reasonably believed to be in the best interests of the corporation. If the action is criminal in nature, the trustee will be entitled to indemnification if he or she had no reasonable cause to believe his or her conduct was unlawful. When a trustee is successful in defending an action, he or she will be entitled to recover the reasonable costs of defense.

When a controversy arises over a right to indemnification, a trustee may apply, under certain circumstances, to the courts for a ruling declaring whether or not the trustee is entitled to indemnification.

G. Insurance A Board of Trustees, as part of its general powers, has the right to purchase directors' and officers' liability insurance. Directors' and officers' liability policies typically reimburse corporations for indemnification payments to trustees and make direct payments when the trustee is not protected by corporate indemnity. Directors' and officers' liability policies do not protect the general organization.
Directors and officers’ liability insurance can be expensive and subject to a sizable retention deductible. (Legal fees are generally subject to the deductible as well.) In the typical directors' and officers' liability policy, there may be many exclusions, including those for self-dealing, criminal acts and intentional torts (e.g., assault, defamation), fines and punitive damages, administrative matters, investigation, claims involving pollution, discrimination claims and most critically, an exemption from coverage when monetary damages are not being sought. When dealing with an exclusion from coverage, insurance companies will often issue a "letter of reservation" defining the rights of the insured.

Trustees should review insurance policies and their impact with their insurance agents and their legal counsel. The review should include an audit of the titles of those protected since the policies may specify and be inconsistent with the titles of the members of the individual boards. The review should consider whether or not there is a consent clause in the policy (allowing a board to consent to a settlement) and whether or not the policy allows the board to select its own legal counsel to defend it in connection with a claim.

The review should also consider whether the policy is a "claims made" policy, which protects only against claims asserted during the policy period regardless of when the alleged wrong occurred. This type of policy can be improved by an extended reporting period or a "discovery" clause (which allows a claim to be made when it is discovered regardless of the policy periods). Other notice provisions should be reviewed, and board members should be made aware of their obligations to notify an insurance carrier directly of a claim made during a policy period. In most cases, insurance companies require that notice of all claims must be made before the termination of a policy.

H. Liability for Noncompliance with Tax Laws Trustees are required to ensure that their not-for-profit corporation conducts its activities lawfully. The Internal Revenue Code provides severe penalties for the willful failure to pay taxes. Even a good faith belief that payment was not due and owing, will NOT relieve a not-for-profit corporation from liability without reasonable justification.

The Trustees should regularly discuss the entities' tax obligations with its attorney and tax advisor. The Board of Trustees has several clear responsibilities with respect to the taxation of the organization. The first being the receipt of an exemption determination letter from the IRS. Next is the maintenance of not-for-profit status: filing of appropriate tax forms, including the annual filing of tax information returns (Form 990). Qualifying for local property tax exemptions, the review of the organization's activities which might result in state or federal tax on unrelated business income, and debt on financial property must also be reviewed. Also, of concern, are lobbying activities that might result in the loss of tax-exempt status. Finally, employee related tax issues such as tax-sheltered benefits, social security, election and participation issues should be carefully considered by the Trustees.
I. Anti-Trust Issues As a matter of best practice, independent schools can avoid possible claim(s) of violation of the anti-trust laws by not exchanging information PRIOR to tuition increases, salary increases, financial aid awards, etc.

The safest way to share financial information is for I.S.A.C.S. to gather the information and establish a non-personally identifiable database and publish it as a service to association members.

Knowledgeable legal counsel should be contacted if there are to be discussions in this area so as to avoid the potential claim of unfair competition or restraint of trade.

J. ADA & Discrimination The Americans with Disabilities Act and the existing federal and state personnel and nondiscrimination provisions are areas that I.S.A.C.S. schools should be cognizant of by way of potential problems. Fortunately, these areas can all be dealt with proactively by way of adopting appropriate policies, procedures and mission statements.

CONCLUSION

Being on a board for an educational institution is a rewarding, but challenging opportunity. A trustee can impact many young lives by shaping the character and mission of the institution. Those who have the privilege of acting as trustees contribute an invaluable service, which cannot be overestimated.

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