

Breach of Fiduciary Duty by Ogling the Doughnuts

10.08.14 | Linda J. Rosenthal, JD



Admit it. You've done it.

You're in the conference room at your nonprofit's board meeting. The corporate secretary presents the minutes of the last minute for approval. But there's silence: You're busy deciding between the pumpkin-glazed doughnuts and the chocolate-topped ones. So is everyone else at the table.

Nonprofit Minutes: One More Worry

Fast forward a year or so. Your organization receives an official audit notice from the Internal Revenue Service. Which documents do you suppose the federal agent will ask to see? The financial records? Yes, of course. The Articles of Incorporation and the Bylaws? Those, too.

Would it surprise you to learn that the IRS wants to see your corporate minutes as well? You bet. In fact, the board-meeting minutes are close to the top of that list of material to turn over.

By the way, the California Attorney General – who has oversight authority for charities in the state – will be interested in them as well.

More Than a Quaint Formality

Meeting minutes are *much more* than routine formalities or handy notes. They are the official, legally mandated, records and history of an organization.

Nonprofits that are incorporated can act *only* by and through the board of directors who, in turn, delegate authority to act to officers, employees, or agents. Documenting board actions and decisions in writing is a critical function because corporate minutes are legally presumed to be correct and are considered formal evidence of the facts they report.

There is no one-size-fits-all formula or format for an organization's meeting minutes. They should be carefully and thoughtfully prepared: neither sketchy outlines or verbatim transcripts. The minutes should be clear, accurate, and sufficient to reflect what actually occurred at the meeting, how decisions were made, who participated, who dissented, and what actions were proposed but not adopted. The best practice is to select and maintain a uniform template with consistent levels of detail across the entire body of corporate minutes.

When adequately prepared and maintained, corporate minutes can serve as contemporaneous proof in regulatory reviews or judicial proceedings that board and committee members fulfilled their fiduciary duties and complied with all laws. For internal purposes, the minutes can reduce later misunderstandings or misrecollections generally, or provide evidence in disputes or lawsuits among board members or factions. They are also valuable sources of institutional history and guidance for future boards.

From time to time, the corporate minutes may be reviewed by outsiders, so they should be drafted "with an awareness of third parties." These include people who were *not* at the meeting in question but are trying – more or less – to understand (after-the-fact) what occurred. While these third parties may be government agents or regulators, they can also be unrelated individuals or entities who sue or are sued by the nonprofit organization.

The Importance of Minutes

A helpful example of how corporate minutes played a key role in the outcome of a lawsuit is a 15-year-old case involving the Walt Disney Co. Although this litigation involved a for-profit business, the general principles apply in the nonprofit context as well.

Members of the Disney board became embroiled in a dispute over approving a key executive's employment contract and compensation package. They were sued for breach of duty for negligently granting that approval. It was a big non-jury case with lots of evidence and arguments back and forth, but in the end the judge zoomed in on the corporate minutes as proof of liability.

For the meeting in question at which the employment and compensation matter was considered, the judge noted that the complete board minutes were 15 pages long. But within those 15 pages, only a page and half covered the issue of the executive's possible employment, and a portion of that page and a half was spent discussing an entirely different matter. The key here was what did *not* happen: "[T]he Board did not ask any questions about the details of [the executive's] salary, ... or a possible termination. The Board also did not consider the consequences of a termination, or of the various payout scenarios that existed." The judge continued – and concluded: "Nevertheless, at the same meeting, the Board decided to [hire the executive]."

There it was: Sherlock Holmes's proverbial dog that did not bark in the night. The custom and practice for Disney board meetings included long and detailed formal minutes with full and complete descriptions of everything that was discussed and considered. Had the board given the matter of this executive's employment and compensation due attention and scrutiny, the corporate secretary would have documented it in black and white right there in those minutes.

Conclusion

In upcoming blog posts, we'll dive further into the scintillating matter of meeting minutes. First up: *Nonprofit Corporate Minutes: What Not To Do* (October 27, 2014).

Grab a few doughnuts.

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