

**“What the Prudent Director or Officer of Illinois Non-Profit Corporations Should Know”**

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If you were an officer of your class or sorority/fraternity, captain of the debate team, chairperson of the Martin Luther King lecture series or homecoming weekend festivities at your college or high school, you may have graduated from those activities to positions of leadership in community service groups, political or trade associations, or other not-for-profit organizations, and you should be aware of your legal responsibilities as a director or officer of such entity. Much like those who serve as president or chairman of the board of a Fortune 500 company, the law in every state imposes duties on the individual who serves as a director or officer of a not-for-profit organization. So, whether you are president of the local chapter of the Lion's Club or treasurer of a community theater group, you are well advised to know the law governing your position, the activities of the organization and its employees for which you may be responsible, and the provisions which the organization has made (or has not made) to protect you in the event a grievance or lawsuit is brought against you as a director or officer.

Generally, most states impose certain duties on directors and officers. First, the *duty of care or diligence* requires that directors and officers take seriously the responsibilities they have accepted by, for example, keeping active in the organization staying informed of its purposes, goals and activities, as well as attending and participating in meetings. Individuals must act on corporate matters with the same care as a reasonable, prudent person would use in conducting his or her own affairs. Second, the law exacts a *duty of loyalty* from directors and officers, i.e., they must avoid situations in which there would be a conflict of interest between the director and officer and the corporation. For example, any business or other corporate opportunity brought to the attention of a director and officer must be offered to the organization and may not be usurped by the individual. Similarly, directors and officers should not “self deal” with assets of the corporation, by making personal loans to themselves or others from the organization's treasury.

The incidence of suits against directors and officers of not-for-profit organizations, while not as high as those against their for-profit counterparts, has increased in recent years. When asked to serve as a director and officer, an individual is wise to inquire about the purpose and activities of the organization and his or her responsibilities. In addition, a prospective director and officer should read and be familiar with the organization's governing documents, usually referred to as its charter and by-laws. The director or officer should inquire as to whether, and in what circumstances, the organization has agreed to indemnify him or her for attorneys' fees, expenses and liability if a suit is filed, as well as whether the organization carries directors' and officers' liability insurance. One may also wish to inquire as to the law governing the activities of directors and officers and in the organization's state of incorporation and operation. For example, some states provide certain immunities for directors and officers of not-for-profit organizations.

In Illinois, for example, immunities for uncompensated officers and directors have become part of the law through the General Not For Profit Corporation Act of 1986. For officers of Illinois non-profit corporations, there is no liability for damages resulting from the exercise of judgment or discretion in connection with their duties as an officer, as long as there is no willful or wanton conduct. The section defines “willful or wanton conduct” as “a course of action which shows actual or deliberate intention to cause harm or which, if not intentional, shows an utter indifference to or conscious disregard for the safety of others or their property.” In addition, directors of Illinois non-profit corporations are immune from suit, except for willful or wanton conduct, as long as their salary remains at or below \$5,000 per year, exclusive of reimbursement for actual expenses incurred on behalf of the corporation.

Despite these protections, Illinois non-profit directors and officers face some of the same liabilities encountered by directors and officers of for-profit corporations. With regard to the duty of care or diligence, for example, directors of non-profit corporations can be held jointly and severally liable if they are found to have conducted the following activities:

1. Voting for or assenting to any distribution of funds not authorized under Section 109.10 or Article 12 of the Act (allowing for pre-dissolution distribution of corporate funds only to compensate persons or organizations for actual work done for the corporation).
2. Failing to take “reasonable steps”, found in Section 112.75 of the Act, to provide notice to any known creditor and a dissolved corporation proceeds to bar any known claims against it.
3. Continuing to conduct the affairs of the corporation after the Secretary of State has filed articles of dissolution, except as may be necessary to wind up the affairs of the corporation.

Regarding the duty of loyalty, Illinois law provides that business dealings involving a corporation and one of its directors or a group or business affiliated with a director are not per se illegal, as long as the transaction is fair to the corporation. The person asserting the validity of an action has the burden of proving its fairness, unless the transaction is approved through either one of the following methods:

1. The material facts of the transaction are disclosed and a majority of the disinterested directors vote in favor of the transaction.
2. The material facts of the transaction are known or disclosed to members entitled to vote, and these members approve or ratify the transaction without counting the votes of any interested director.

Additionally, there are special loyalty issues codified in the Illinois Charitable Trust Act. The Trust Act which is enforced by the Illinois Attorney General defines “trustee” to include any chief operating officer, executive director, or owner of a corporation soliciting or holding property for a charitable purpose.

The Trust Act lists eight fiduciary duties that apply to these corporation:

1. Avoid “self-dealing” and conflicts of interest;

2. Avoid wasting charitable assets;
3. Avoid incurring penalties, fines and unnecessary taxes;
4. Adhere and conform the charitable organization to its charitable purpose;
5. Make non-program loans, gifts or advances to any person, except as allowed by the General Not For Profit Corporation Act of 1968;
6. Utilize the trust in conformity with its purposes for the best interest of the beneficiaries;
7. Timely file registration and financial reports required by this Act;
8. Comply and to cause the charitable organization to comply with this Act, and, if incorporated, the General Not For Profit Corporation Act of 1986.

The Trust even provides criminal penalties for any trustee who disburses or causes to be used for his or her personal benefit an amount in excess of \$1,000 within a five year period. Such a trustee is guilty of a Class 2 Felony, and is subject to a criminal penalty up to the amount misused and a civil penalty up to \$50,000.

Under Illinois law, a corporation may indemnify a director, officer or employee against all expenses, including any fines imposed, settlements paid or attorney's fees incurred in a lawsuit involving the corporation brought by a third party. In a derivative suit, where the corporation itself is the plaintiff, indemnification is only permitted for reasonable expenses (including attorney's fees), and not for any, fines imposed or settlements made. If a director or officer is successful on the merits or otherwise in defending any legal action, he or she must be indemnified against reasonable expenses, including attorney's fees.

While these comments are not exhaustive by any means, they should guide the director or officer of a not-for-profit corporation in educating himself or herself with respect to the duties, responsibilities, and potential liability connected with those positions. For more specific advice, an individual should contact an attorney with expertise in the area of directors' and officers' liability.

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