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Not-For-Profit Officer and Director Liability: A Volunteer's Cautionary Tale

HIGHER EDUCATION, NOT-FOR-PROFIT
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Early this year, the United States Court of Appeals issued an opinion confirming a jury verdict that held former officers and directors of a bankrupt nursing home jointly and severally liable to the home's creditors for breach of fiduciary duty in failing to properly oversee and manage the non-profit entity. In addition to the $2.25 million award, the Court upheld punitive damages of $1 million and $750,000 against the home's Administrator and Chief Financial Officer.

Fiduciary Standards

The Third Circuit Court found, under Pennsylvania State Law, that not-for-profit corporate officers and volunteer board members could be held to the same fiduciary standards as for-profits. The Third Circuit Court recognized that under the "deepening insolvency" theory, board members must prevent actions that cause the financial position of an insolvent organization to further decline. Official Committee of Unsecured Creditors in re: Lemington Home For The Aged v. Baldwin, et al (3rd Circuit January 26, 2015).

The Lemington Home for the Aged had a history of Pennsylvania Department of Health deficiency citations. Operational reviews were undertaken including a review by the Pennsylvania Department of Health. Among other items, the studies recommended replacing the Administrator with a qualified, experienced hire. In spite of the feedback, the Board retained the Administrator and supported her transition to part-time status. Pennsylvania law requires a nursing home administrator position to be full-time.

In addition to operational deficiencies at the Lemington Home and investigations into patient deaths, a general ledger was not kept; Medicare bills were not filed and bills went unpaid. Board and committee positions went unfilled. Bankruptcy protection was sought three months after the Board voted to close the Home.

The jury found that the Administrator failed to uphold her duty of care and duty of loyalty. As a result of evidence of self-dealing and a failure to put the needs of the Home over her self-interest, punitive damages were awarded.

For his failure to maintain books and records, failure to collect Medicare payments and less than forthright communications with the Board, the jury found that the Chief Financial Officer breached his duty of care and imposed punitive damages for the Chief Financial Officer's failure to exercise his duty of loyalty.

The Board breached its fiduciary responsibilities for failure to replace the Administrator and Chief Financial Officer in spite of knowledge regarding their deficiencies, and failure to fill critical Board and Committee positions. Because there was no evidence that the Board personally benefitted from their inaction, the Court found insufficient evidence to support punitive damages against the Board members.

The Lemington Case underscores the importance of a non-profit board member's responsibility to execute his or her fiduciary duties of care and loyalty. This responsibility includes hiring competent management and taking remedial action when concerns are raised. In Pennsylvania, board members have a heightened sense of duty when an organization is financially insolvent. This duty runs not only to the organization but also to creditors of the not-for-profit corporation. Officers and directors must adhere to strong governance practices and remain informed and engaged with respect to their fiduciary responsibilities.

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