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Not Your Grandmother's Impact Investing

Reference Outline

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TABLE OF CONTENTS

I. INTRODUCTION

The field of impact investing continues to expand and provide an increasingly wide range of opportunities for nonprofit organizations looking to sync their mission and their investments. The Global Impact Investing Network has estimated the size of the global impact investing market to be $502 billion.[1] The impact investing market is not only large in dollar size, but it is also diverse in the types of impact investment options. The range of options continues to grow. Current options include social impact funds, charitable note programs, SAFEs, pay-for-performance transactions, and most recently, the ability to invest in qualified opportunity zones. This paper is intended to provide a base legal reference for charitable organizations in the area of investing. The presentation provided in relation to this paper and the slides for that presentation will provide more detail on various impact investment options.

II. BRIEF OVERVIEW OF FIDUCIARY DUTIES

While the power to act for the organization is typically vested in a Board of Directors acting collectively, each director owes certain fiduciary duties to the organization. Fiduciary law developed as common law with various aspects subsequently codified in state trust and corporate statutes. Directors of corporations owe a strict fiduciary obligation to the corporation as a matter of law. In the charitable context, directors owe fiduciary duties to the corporation they serve and to the public in charity. Charitable fiduciaries stand in the unique position of being the keeper of the organization's assets and the guardian of the organization's mission. This unique role plays itself out in the duties of care, loyalty, and obedience. Decision makers exercise these duties largely in the realm of making strategic decisions, evaluating, reviewing, overseeing, and approving of actions. Because directors must always be concerned with satisfying their fiduciary duties when making decisions on behalf of the foundation, it is useful to review these duties prior to turning to considering what additional mechanisms for mission are available.

A. Duty of Care

Nonprofit managers are subject to the fiduciary duty of care. The duty of care, most simplified, is a duty to stay informed and exercise ordinary care and prudence in management of the organization. With respect to nonprofit directors, the duty of care generally obligates the decision maker to act (1) in good faith, (2) with ordinary care, and (3) in a manner he or she reasonably believes to be in the best interest of the corporation.[2]

1. Good faith

The law rarely seeks to define "good faith" in the context of fiduciaries. Broadly, the term describes "that state of mind denoting honesty of purpose, freedom from intention to defraud, and,

[1] Global Impact Investors Network (visited December 31, 2019) <http://thegiin.org/impact-investing/need-to-know/#what-is-impact-investing>.

[2] *See, e.g.,* Tex. Bus. Orgs. Code § 22.221(a).

generally speaking, means being faithful to one's duty or obligation."[3] In claims for legal malpractice, for example, "good faith" is a defense wherein the attorney can demonstrate that he made a decision that a reasonably prudent attorney could have made in the same or similar circumstances.[4] Thus, at least in the context of legal malpractice (which bears many similarities to breach of fiduciary duty), good faith is measured objectively based on objective facts. "Good faith" can, however, be contrasted with "bad faith." One court has stated that a fiduciary acts in bad faith when the fiduciary acts out of a motive of self-gain.[5] Certainly bad faith would also include intent to affirmatively do harm to the organization. As a result, good faith would include putting the good of the organization first and seeking to affirmatively benefit the organization.

2. Ordinary care

"Ordinary care" requires the director to exercise the degree of care that a person of ordinary prudence would exercise in the same or similar circumstances. It should be noted that where the director has a special expertise (e.g., accounting expertise, legal expertise, etc.), ordinary care means that degree of care that a person with such expertise would exercise in the same or similar circumstances. A director may delegate decisions (including investment decisions) if she exercises reasonable care, skill, and caution in selecting the agent, establishing the agent's scope, and periodically reviewing the agent's actions to confirm conformance with the terms of the delegation. For example, it is common for the directors of a family foundation to delegate administrative matters to employees of a family office. While a director may delegate these types of decisions or activities, she cannot delegate her oversight (i.e. governance) responsibility.

To satisfy her duty to use ordinary care, the director should be reasonably informed with respect to the decisions she is required to make. Specifically, the decision maker must understand the purposes of the organization as set forth in the organization's governing documents and make decisions comporting with those purposes and direction. Furthermore, the decision maker should be familiar with management of the organization, policies of the organization, and any financial data relevant to the decisions she is making. Such familiarity and knowledge requires that the director attend board meetings and actively seek the information necessary to make an informed and independent decision regarding which course of action is in the corporation's best interest. A director should be careful to personally weigh the benefits and detriments of the course of action to the corporation rather than simply voting with the majority.

In discharging the duty of care, it is common for state law to provide that a director may rely in good faith on information, opinions, reports, or statements, including financial statements or other financial data, concerning the corporation or another person that was prepared or presented by officers, employees, a committee of the board of which the director is not a member, or, in the case of religious corporations, (1) a religious authority; or (2) a minister, priest, rabbi, or other person whose position or duties in the corporation the director believes justify reliance and

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[3] *See* BLACK'S LAW DICTIONARY 693 (6th ed. 1990).
[4] *See Cosgrove v. Grimes*, 774 S.W.2d 662, 665 (Tex. 1989).
[5] *See Bohatch v. Butler & Binion*, 905 S.W.2d 597, 602 (Tex. App.—Houston [14th Dist.] 1995) *aff'd* 977 S.W.2d 543 (Tex. 1998).

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