Director and Officer Discipline in Nonprofit Corporations

by Michael E. Malamut

The settlers of the American colonies brought the basic principles of English common law with them when they arrived in the area that eventually became the United States. Voluntary nonprofit corporations, such as municipalities, churches, schools, and hospitals, were common English institutions at the time of settlement and long predate the rise of business corporations. The law applicable to the internal governance of such corporate institutions was not significantly differentiated. In fact, most of the early English cases involving corporate discipline in corporations involved municipal governments, where holding office (including a position on a governing board) was considered a significant honor. There was no significant distinction in the older cases between the rights and duties of directors (governors/trustees) and those of officers, as officers were often volunteers and members of a governing board (early corporations often had several governing boards). Removal of a director or officer for cause, called "amotion," came to be treated as an inherent right of corporations. This is the context from which the early cases involving officer and director discipline derived and granted considerable internal due process rights to subjects of internal corporate discipline.

The second common law treatise on corporations, published in 1702, included treatment of removal from office. Anonymous, *The Law of Corporations, Containing the Laws and Customs of All the Corporations and Inferior Courts of England* c. 26, at 327–31 (1702). This first academic treatment consisted largely of snippets of case rulings, such as these gems:

> If an alderman be a common drunkard, this is good cause to remove him from his place; for a common drunkard is not fit for government.
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> If an alderman comes to the age of 70 years, this is no cause to remove him; for some men at that age have good parts and understanding. . . .
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> [A burgess said] *I care not for Mr. Mayor, nor any of the Burgessess,* and for this cause he was expelled [from the governing body] and [the court ruled that] It is no cause of expulsion; wherefore a write of restitution was awarded.
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> *Law of Corporations* (1702), at 328, 330 (citations omitted).

The third common law treatise on corporations, written just after American independence by a well respected author, sets the stage for subsequent director and officer discipline law. 2 Stewart Kyd, *Law of Corporations* c. 3, § 9, at 50–58 (1794):

> Every corporation aggregate has a power necessarily incident to it, of . . . removing [officers] for reasonable cause, without any express grant conferring on them such a power. . . .
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> This power, like every other *incidental* power, is incident to the corporation at large, and not to any select body [governing board], and as applied to the latter, the proposition is true 'that there can be

> *no* power of amotion, unless given by charter, o claimed by prescription, or in consequence of a bye law made by the body at large.' . . .
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> This power, whether possessed as incident to the corporate at large, or vested in a particular body, must appear to be exercised at a regular meeting held in a corporate character . . . .
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> This power of amotion, when possessed as incident to the corporation at large, cannot b exercised without reasonable cause . . . : but a charter, by express words, empower either the corporation at large, or a select body, to remove an officer at pleasure, or empower them to choose him *during* pleasure, they may in either case remove him without cause. . . .
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> The offences for which . . . a corporate officer [may be] removed, have been distributed into three distinct classes. FIRST, Such as relate merely to his . . . official character, and amount to breaches of the condition tacitly or expressly annexed to his . . . office. SECONDLY, Such as have no immediate relation to him . . . official character, but are in themselves of so *infamous* a nature, as to render the offender unfit to enjoy *any* public franchise; such as perjury, forgery, &c. AND, Thirdly, offences of a mixed nature, being not only against his . . . official duty, but also indictable at common law. . . .
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> Misconduct in *one* corporate office is not a cause to amove the offender from *another* . . . .

Id. at 50, 56–58, 62–63, 80 (emphasis in original). Examples of good cause for removal from office mentioned by Kyd include defacing or corrupting corporate documents, riot during elections, hindering the rights of others to attend meetings, subverting the corporation by taking unauthorized action on behalf of the corporation, habitual drunkenness, inability to pay taxes (cause for removal from office, but not membership), moving out of the relevant jurisdiction on a permanent basis (cause for removal from office, but not membership), gross ignorance of the law (for an officer charged with knowledge of the law). Issues not considered good cause for removal include bankruptcy, old age, non-attendance at meetings, use of opprobrious or indecent language to another corporate officer, mistaken interpretation of the law in a single instance. *Id.* at 63–94.

When issues of officer and director discipline first arose in the United States, American courts reached back to English common law precedents. The quotations below are taken from cases, presented in chronological order, that develop the concepts inherent on the common law of internal director and officer discipline.

Murdock v. The Trustees of Phillips Academy, 12 Pick. (29 Mass.) 244 (1831) (professor treated as officer; ecclesiastic precedents applicable to an incumbent in a church office applied): "[A]t the annual meeting of the trustees ..., a committee was appointed to inquire generally into the state and condition of the institution, and

into the conduct and measures of the students and of the faculty, so as to present a full view of the state of the [corporation]. This committee proceeded to make the proposed inquiry, in conducting which, they inquired of each of the professors [officers of the corporation], severally, including the plaintiff, and also of others. [T]hey made their report, and thereupon the trustees voted, that the interests of the seminary required, that the connexion of the plaintiff therewith should be dissolved; but no notice was given to the plaintiff of their intention to pass such vote. … A committee was then appointed … to consider what further measures it was advisable for the trustees to take in relation to [the plaintiff]; who reported at the same meeting, recommending the removal of the plaintiff from his office. A copy of this report was communicated to the plaintiff, that he might have opportunity to make any communication in regard to it which he thought proper. The plaintiff desired to be heard by counsel, and to show cause by legal evidence, against his removal. The trustees declined hearing him by counsel, but expressed their willingness to attend to any communication he might see fit to make. They afterwards informed him that they were not unwilling that he should have the aid of counsel in preparing any argument or testimony which he might choose himself to present to the board, and that he might have opportunity to introduce any pertinent testimony in relation to the report of the committee recommending his removal. … [T]hey took the cause into consideration, and being satisfied that there was just and sufficient ground for the removal of the plaintiff from office, … they voted that the report be accepted, and that the plaintiff be removed from his office of professor."

"From the tenure of the plaintiff's office, it is quite clear, that he was not liable to be removed by the trustees, upon mere considerations of expediency or convenience, nor unless he had forfeited his office for some of the causes mentioned in the statutes. 'These things must concur: 1. A monition or citation of the party to appear. 2. A charge given him, to which he is to answer, called a libel. 3. A competent time assigned for the proofs and answers. 4. A liberty for counsel to defend his cause, and to except against the proofs and witnesses. 5. A solemn sentence, after hearing all the proofs and answers. These are the fundamentals of all judicial proceedings in the ecclesiastical courts, in order to a deprivation; and if these things be not observed, the party hath just cause of appeal, and may have a remedy by a superior court.'" (citation omitted) (emphasis in original).

"[T]here rules indicate the course which must in substance be pursued, by every tribunal acting judicially upon the rights of others. If the trustees at the time considered themselves as acting judicially, we think they virtually disregarded these salutary rules."

"[O]n the facts stated in the report of the examining committee they declared their opinion, that the interests of the seminary required that the connexion of Dr. Murdock therewith should be dissolved, without any notice of their intention to pass such a resolution and without any specified charges or accusations made against him, and without hearing the party so seriously to be affected in character and estate by these proceedings. … But we think it is manifest that there was no trial

and no inquiry into the facts upon which the final vote of removal passed, other than the ex parte examination, made by the committee of inquiry. ... If the plaintiff was liable to removal for incapacity or misconduct, declared to be a ground of removal by the statutes, such case of incapacity or misconduct was a fact to be tried by proper and competent evidence, and in the trial of which the plaintiff had a deep interest. But when the examining committee were conducting their investigations, the plaintiff did not understand, nor did the committee understand, that he was on trial, nor indeed were they commissioned or authorized to try him, but to examine into the state and condition of the institution. Their proceedings thus far were manifestly administrative and not judicial."

"[A]fter proceeding thus far, and declaring such opinions upon such grounds, embracing the very merits of the alleged offence, and the facts, on which it was to be sustained, the trustees had disqualified themselves from acting judicially . . . . He was furnished with a copy of the report, with liberty to make any communication in relation thereto, which he saw fit. That is, in effect, he was allowed to impugn or refute the charges therein contained, and to rebut and disprove the facts, upon which they were founded, if he could. But it is very manifest, that the plaintiff was entitled to the benefit of the legal presumption in favor of innocence, until the contrary was proved. The burden of proof therefore was upon those who made the accusation, and that proof was to be made openly, and in presence of the accused, after due notice and an opportunity for a full hearing."

"[T]here was no offer to file specific charges, to fix a time for hearing them, to take upon themselves the burden of proving them by competent testimony, in presence of the accused. They refused the party accused access to the files, papers and documents, which had relation to the charges intended to be relied on, and from which the report of the committee containing the charges and the grounds of them, had been prepared. . . . But the trustees made up their mind from evidence or reasons which they did not and would not communicate to the plaintiff, that it was for the interest of the institution that his connexion with it should be dissolved; and having advanced so far in ex parte proceedings, it is not strange that the plaintiff should have complained of being afterwards suspended from office without specific charges, hearing or trial. The final decree of the trustees was passed without giving the plaintiff an opportunity of examining the records and documents and papers which had been produced against him by 'other persons besides the professors, in an ex parte examination touching the manner in which the plaintiff had performed the duties of his office.'"

"[T]he trustees, by the vote in question, did not intend to act judicially, but merely in the administration of the duties assigned them, as managers and guardians of the institution, and meaning to do that which in their judgment the good of the institution required, without intending to adjudicate upon the rights of the plaintiff. But whatever might be their intention, the Court are all of opinion, that for the reasons already given, the measure cannot be supported as a judicial proceeding, and did not affect the title of the plaintiff to his office, or his actual possession and

enjoyment of the office."

Spillman v. Supreme Council of Home Circle, 157 Mass. 128, 31 N.E. 776 (1892) (discipline of volunteer sofficers and members equated), at 157 Mass. at 130, 31 N.E. at 777: "The supreme council was a body whose will was a law unto itself. It was to have original jurisdiction in all cases of its own officers and members, but no mode of procedure was specified for their trial. It would seem, therefore, that it might adopt such mode of trial as it pleased, subject only to the implied limitation that it must be fair. In the present case there is no reason to doubt that the plaintiff's trial was conducted with such substantial fairness as the nature of the case would admit of. Charges in writing were preferred against him, and he had an opportunity to be heard upon them." (citation omitted).

at 157 Mass. at 131, 31 N.E. at 777: "Taking the charges and specifications together, they appear to have been sufficiently minute and specific to give him notice of the ground of complaint against him."

Brandenburger v. Jefferson Club Ass'n, 88 Mo. App. 148 (1901): Expulsion of a member who is also an officer of the club, by vote of the directors as authorized by its corporate bylaws, is permissible, although the removal of an officer from his position required a two-thirds vote of the whole club.

Canadian Religious Ass'n v. Parmenter, 180 Mass. 415, 62 N.E. 740 (1902) (removal of a "trustee" with powers of a director), at 180 Mass. at 422, 62 N.E. at 743: "[I]n the call for the meeting at which the association proceeded to elect new trustees in place of the respondents there was no notice that the removal of officers or the choice of new officers would be brought up. Whether the respondents were still members or not, their places could not be filled at the meeting, because there was no notice upon that in the warrant."

Green Bay Fish Co. v. Jorgensen, 164 Wis. 548, 163 N.W. 142 (1917): Taking corporate funds constitutes good cause for removal.

Guttman Silk Corp. v. Reilly, 189 A.D. 258, 178 N.Y.S. 457 (1919): Unjustified attacks on the president and refusal to cooperate with him constitute good cause for removal.

Bechtold v. Stillwagen, 119 N.Y. Misc. 177, 195 N.Y.S. 66 (1922): Removal without cause permissible if provided for in bylaws or statute.

Mortimer v. McKeithan Lbr. Corp., 127 S.C. 266, 120 S.E.723 (1923): Mere disagreement or friction between directors or officers s not cause for removal unless disagreement is extreme and interferes with functioning of the corporation.

Kahn v. Colonial Fuel Corp., 198 N.Y.S. 596 (1923): Accused directors and officers must always be given a reasonable opportunity to defend themselves.

Dittemore v Dickey, 249 Mass. 95, 144 N.E. 57 (1924) (trust treated as corporation; religious society with clear intent for hierarchical governance; removal of director), at 249 Mass. at 108–09, 144 N.E. at 62: "The courts do not investigate the question

whether the decision of removal was right or wrong. They ascertain whether there has been compliance with the essential formalities prescribed by the rules of the society or organization, whether the proceedings have been regular, and whether the decision is within the scope of the jurisdiction."

at 249 Mass. at 110, 144 N.E. at 63: "Where the controlling statute or rule, rightly construed, does not require a notice and hearing, then the frequently expressed idea that natural justice demands notice and hearing has no room for operation."

at 249 Mass. at 110–11, 144 N.E. at 63: "The distinction is between an executive or administrative removal where the exercise of the power is absolute, on the one side, and a removal founded on the determination of questions judicial in character where the mandates of natural justice must be obeyed, on the other side. If the removal does not depend upon the decision of judicial or quasi judicial questions, but only upon administrative or executive determination, then there is no occasion to comply with judicial forms. Where there is an express requirement that there can be removal only 'for cause,' there is implied ascertainment of definite facts and a hearing is required."

at 249 Mass. at 111–12, 144 N.E. at 63: "The adequacy of the grounds on which such vote [to remove without notice or hearing] rests is not open to inquiry in a judicial proceeding provided they are actuated by good faith."

State ex rel. Blackwood v. Brast, 92 W. Va. 596, 127 S.E. 507 (1925): If removing authority acted in good faith, pursuant to applicable bylaws, on due notice and after affording the accused an opportunity to be heard, the courts will rarely interfere with the decision of the removing authority.

Boardman Co. v. Petch, 186 Calif. 476, 199 P. 1047 (1921): gross negligence or willful misconduct is sufficient cause for removal.

Piedmont Press Ass'n v. Record Publ. Co., 156 S.C. 43, 152 S.E. 721 (1930): Notice of the charges and a reasonable opportunity to prepare and to speak in one's own defense and cross-examine must always be given.

Malloy v. Carroll, 272 Mass. 524, 172 N.E.2d 790 (1930) (attempted removal of local union officer by international union leadership; voluntary association at issue, but corporate precedents cited without distinction), at 272 Mass. at 536, 172 N.E.2d at 794–95: "the rights of members in organizations such as are now before us must be settled in accordance with the provisions of their constitutions and that every remedy available within such organizations must be exhausted before the aid of a court can be invoked."

272 Mass. at 537–38, 172 N.E.2d at 795: "Even if there had been a right of appeal from the refusal of the executive board to hear the 'protest and appeal' to the convention the master has found that such an appeal would be futile. Such a finding is one of fact, and is within the authority of a master to make on proper evidence, or of an auditor. The evidence is not reported and the finding must stand. 'The law does not require a vain form.' It will not in such a case as here make a mockery of

justice by requiring a party to submit his cause to a tribunal from which he cannot expect the impartiality he may rightfully demand." (citations omitted).

272 Mass. at 539, 172 N.E.2d at 796: "Brennan came to Boston . . . with orders from the international to oust Malloy from office, and . . . the decision so to do had been reached after an ex parte complaint, with no notice to Malloy and no opportunity afforded him to defend. . . . [I]t is plain as matter of law that there is nothing in the evidence that warranted the action of Brennan or of the president and executive board in removing Malloy."

In re Koch, 257 N.Y. 318, 178 N.E. 545 (1931): Corporation has an inherent right to remove an officer; Officer facing removal must be served with specific charges, receive adequate notice, and be afforded a full opportunity for a hearing; removal is subject to judicial review.

Walker v. Maas, 4 N.J. Misc. 230, 132 A. 322 (1926): Corporations have an inherent right to remove for cause.

Walsh v. Int'l Alliance of Theatrical Stage Emp'ees & Moving Picture Machine Operators, 22 N.J. Misc. 161, 37 A.2d 667 (Ch. 1944) (purported removal of union business manager citing cases on discipline of corporate officer), at 22 N.J. Misc. at 669, 37 A.2d 667 at 163–64: The purported charge "fails to comply with the provisions of the Local constitution relative to specification of charges and is inadequate in this it does not specify the nature of the offense or violation charged. The articles and sections of the constitutions of the International and of the Local specified in the complaint are obviously such as [the officer] could not have been guilty of violating, and the specified section of the Local's by-laws refers to at least nine different offenses which might be charged against a member and therefore the complaint failed to acquaint Walsh with any specific charge against him."

Cirrincione v. Polizzi, 14 A.D.2d 281, 220 N.Y.S.2d 741 (1961): Claimed emergency did not validate meeting without notice to remove president.

Brevetti v. Tzougros, 42 Misc. 2d 171, 247 N.Y.S. 2d 295 (1964): Without statutory authorization, a bylaw that permitted removal from office without prior notice was deemed invalid.

Horn v. Kaupp, 147 N.W.2d 607 (S.D. 1967): Unless otherwise provided by statute or the bylaws, directors and officers are to be removed by the body that appointed or elected them.

Grace v. Grace Institute, 19 N.Y.2d 307, 279 N.Y.S.2d 721, 226 N.E.2d 531 (1967): Removal of life member and trustee of charitable corporation was validly sustained by evidence that he had embarked on a course of conduct designed to involve the corporation in endless and costly litigation and that the suits were undertaken for the purpose of harassing the corporation and its members. Trustee was given reasonable opportunity to be heard and to answer charges against him so that procedure by which he was removed was valid, where he was afforded a hearing during which the charges were aired and at which he was represented by attorneys

who were permitted to cross-examine and he was given opportunity to testify and to present evidence.

Board of Managers of Eastbrooke Condominiums v. Padgett, 185 A.D.2d 650, 586 N.Y.S.2d 57 (1992): Attempt to remove condominium Board members was invalid when the notice of the meeting failed to include specific charges of alleged misconduct.

Indiana High School Athletic Assn. v. Reyes, 659 N.E.2d 158 (Ind. App. 1995), *aff'd in relevant part, rev'd in part on other grounds,* 694 N.E.2d 249, 253 (Ind. 1997): "When reviewing an association's actions with respect to factual determinations, 'the scope of review should be the same as that of administrative agencies, *i.e.,* the trial court cannot weigh the evidence and must uphold the organization's finding if it is supported by any substantial evidence.'" "[A]n association's decision on the merits must be upheld unless 'contrary to natural justice, purely arbitrary and one that no honest mind could adopt.'" "[A] trial court is limited to reviewing the record of the proceedings conducted before the [association] . . . The court may not reweigh evidence or judge witness credibility, but simply analyzes the record as a whole . . . to determine whether the [association's] findings were supported by substantial evidence." (citations omitted).

Indiana High School Athletic Assn. v. Reyes, 694 N.E.2d 249 (Ind. 1997): "'A voluntary association may, without direction or interference by the courts, for its government, adopt a constitution, by-laws, rules and regulations which will control as to all questions of discipline, or internal policy and management, and its right to interpret and administer the same is as sacred as the right to make them.' . . . There are some exceptions to this general rule. One . . . is where the decision of the voluntary membership association infringes upon a personal liberty or property right. . . . A second exception has been recognized . . . for situations where the decision of the voluntary membership association constitutes fraud or other illegality. . . . We reject additional exceptions to the rule. Absent fraud, other illegality, or abuse of civil or property rights having their origin elsewhere, Indiana courts will not interfere in the internal affairs of voluntary membership association." (citations omitted).

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