



## University of Baltimore Law Review

Volume 18  
Issue 2 Winter 1989

Article 8

1989

# Comment: Nonprofit Corporations and Maryland's Director and Officer Liability Statute: A Study of the Mechanics of Maryland's Statutory Corporate Law

Stewart P. Hoover  
*University of Baltimore School of Law*

Follow this and additional works at: <http://scholarworks.law.ubalt.edu/ublr>

 Part of the [Business Organizations Law Commons](#)

### Recommended Citation

Hoover, Stewart P. (1989) "Comment: Nonprofit Corporations and Maryland's Director and Officer Liability Statute: A Study of the Mechanics of Maryland's Statutory Corporate Law," *University of Baltimore Law Review*: Vol. 18: Iss. 2, Article 8.  
Available at: <http://scholarworks.law.ubalt.edu/ublr/vol18/iss2/8>

This Article is brought to you for free and open access by ScholarWorks@University of Baltimore School of Law. It has been accepted for inclusion in University of Baltimore Law Review by an authorized administrator of ScholarWorks@University of Baltimore School of Law. For more information, please contact [snolan@ubalt.edu](mailto:snolan@ubalt.edu).

# COMMENT

## NONPROFIT CORPORATIONS AND MARYLAND'S DIRECTOR AND OFFICER LIABILITY STATUTE: A STUDY OF THE MECHANICS OF MARYLAND'S STATUTORY CORPORATE LAW

### I. INTRODUCTION

Characteristic of nonprofit corporations and organizations ("nonprofits")<sup>1</sup> is the unique legal relationships which exist among members, managers and third parties that deal with this type of corporate entity. Although nonprofits resemble business corporations because they are typically incorporated under state statutes and managed by officers and directors,<sup>2</sup> nonprofit organizations are prohibited from distributing profits to their members.<sup>3</sup> This nondistribution constraint is for the benefit of the association's patrons,<sup>4</sup> and may obligate the managers of nonprofits

- 
1. For the purposes of this article "nonprofit corporation" is synonymous with "not-for-profit corporation" and "nonstock corporation." For a discussion of the lack of any substantive distinction between the terms "nonprofit" and "not-for-profit," see H. OLECK, *NONPROFIT CORPORATIONS, ORGANIZATIONS AND ASSOCIATIONS* 17-20 (4th ed. 1980). Professor Oleck points out that while there are a few nonprofit corporations remaining that have outstanding stock, the large majority of nonprofit corporations issue certificates of membership and are therefore nonstock corporations. *Id.* at 47. The Corporations and Associations article of the Maryland Annotated Code refers to "Nonstock Corporations" rather than "nonprofits." MD. CORPS. & ASS'NS CODE ANN. §§ 5-201 -208 (1985). Because the terms are virtually synonymous, "nonprofit" will be used in this article since it is a more widely recognized term. See Hansmann, *Reforming Nonprofit Corporation Law*, 129 U. PA. L. REV. 497, 501 n.3 (1981) [hereinafter Hansmann, *Reforming Nonprofits*].
  2. See generally Hansmann, *The Role of Nonprofit Enterprise*, 89 YALE L.J. 835 (1980) [hereinafter Hansmann, *Role of Nonprofits*]. A nonprofit may be organized as an unincorporated association, but the law is not well defined in this area and personal liability may be greater than that for managers of incorporated nonprofits. K. HOFFMAN, R. LARKIN & K. LUNDEEN, "NOT FOR PROFIT" ORGANIZATIONS 111-15 (MICPEL 1986) [hereinafter K. HOFFMAN].
  3. See K. HOFFMAN, *supra* note 2, at 111-12; Hansmann, *Reforming Nonprofits, supra* note 1, at 501-02; Hansmann, *Role of Nonprofits, supra* note 2, at 838. Professor Hansmann labels the prohibition on distribution of profits the "nondistribution constraint." Hansmann, *Reforming Nonprofits, supra* note 1, at 501-02. As he explains, nonprofits are permitted to earn a profit after payment of reasonable compensation to the managers of the organization, but the profits must be used for association purposes, not for the pecuniary gain of the members. *Id.*
  - Historically, state statutes also imposed constraints on nonprofit corporations by limiting the purposes for which the association could be operated. Hansmann, *Role of Nonprofits, supra* note 2, at 840. Today, many states, including Maryland, do not regulate the purposes of nonprofits. Because tax exempt status is one of the primary purposes of qualifying as a nonprofit, nonprofit regulation has been left up to the Internal Revenue Service. With the exception of the nondistribution constraint and the possible purpose limitation, incorporated associations are otherwise regulated by general corporation statutes. *Id.*; see also MD. CORPS. & ASS'NS CODE ANN. § 5-201 (1985).
  4. Patrons are the customers, donors and beneficiaries of nonprofits. See Hansmann, *Reforming Nonprofits, supra* note 1, at 606-09.

to act for the patron's benefit.<sup>5</sup> Managers of business corporations, on the other hand, are obligated to protect the shareholders of the corporations and may be only indirectly responsible to business patrons for a breach of their duty to use reasonable care in making business judgments.<sup>6</sup>

Because of the differences between nonprofit corporations and business corporations, courts and commentators have applied and advocated several different theories for judging the standard of care for officers and directors of nonprofits.<sup>7</sup> For example, some nonprofit charitable organizations are almost functionally identical to charitable trusts, and are therefore particularly amenable to the application of trust laws.<sup>8</sup> Conversely, other nonprofits bear little resemblance to charitable trusts and are closer in operation to business corporations.<sup>9</sup>

All nonprofits, however, may be accurately described by the "trust model," of corporate theory<sup>10</sup> which holds that officers and directors are analogous to trustees employed to preserve the fund and manage the assets with the same care that they would use *in managing their own prop-*

- 
5. *Id.* Professor Hansmann notes that courts generally have denied patrons standing to sue officers and directors of nonprofits for breaches of fiduciary duty. *Id.* at 606. He argues, however, that courts should grant standing for patrons because those with standing (the Attorney General and the Internal Revenue Service) rarely enforce private charter restraints except for their own benefit or when it is in the public interest. *Id.* at 600-06. A court may permit "patron" standing provided that the patron has a sufficiently concrete interest in the outcome of the case to be considered a real party in interest. Therefore, it is advantageous for officers and directors of nonprofits to exercise their judgment with the patrons' interests in mind.
  6. See *Dodge v. Ford Motor Co.*, 204 Mich. 459, 507, 170 N.W. 668, 684 (1919) ("A business corporation is organized and carried on primarily for the profit of shareholders."); see also Hansmann, *Reforming Nonprofits*, *supra* note 1, at 568. Managers of business corporations may be indirectly responsible for decisions regarding the protection of business patrons when, for example, they make uninformed business decisions to market and sell unreasonably dangerous products. If the decision dilutes a shareholder's interest (e.g., where stock is rendered worthless after the corporation is forced into bankruptcy because of consumer tort judgments), the shareholder may have a cause of action against the officers and directors based on their breach of duty to make only informed business judgments. Cf. Solomon & Collins, *Humanistic Economics: A New Model For the Corporate Social Responsibility Debate*, 12 J. CORP. L. 331, 332-37 (1987) (describing the three corporate social responsibility models).
  7. See Fishman, *Standards of Conduct for Directors of Nonprofit Corporations*, 7 PACE L. REV. 389, 391-93, 399-403 (1987).
  8. See Pasley, *Non-profit Corporations—Accountability of Directors and Officers*, 21 BUS. LAW. 621, 637 (1966); Fishman, *supra* note 7, at 401-03.
  9. Cooperatives, for example, are not organized for profit but result in financial benefit to their members. See Hansmann, *Reforming Nonprofits*, *supra* note 1, at 508, 587-99. Furthermore, many of the modern nonprofit cooperatives are large, complex entities. Such complexity requires the officers and directors of these cooperatives to delegate many of their duties. Trustees of a charitable trust, however, typically are not permitted to delegate their management responsibilities. See Fishman, *supra* note 7, at 402 n.46-47.
  10. See Baysinger & Butler, *Race for the Bottom v. Climb to the Top: The ALI Project and Uniformity in Corporate Law*, 10 J. CORP. L. 431, 439-42 (1985).

erty.<sup>11</sup> In contrast, business corporations may be described by the "contract model" of the corporation,<sup>12</sup> which holds that officers and directors are employed to maximize profits through shrewd business maneuvers, using the same care an "ordinarily prudent person reasonably would be expected to exercise *in a like position* . . . under similar circumstances."<sup>13</sup>

The dilemma of which model theory to apply to nonprofits, and the question of whether to apply the law of trusts, traditional corporation law or law created specifically for nonprofits, has culminated in states adopting several different types of statutes: 1) statutes with separate provisions for business corporations and nonprofits;<sup>14</sup> 2) statutes applying to all corporations generally;<sup>15</sup> and 3) statutes with provisions applying to all corporations generally followed by special provisions for particular types of corporations such as nonprofits, close corporations and foreign corporations.<sup>16</sup> Maryland's law is of the latter type: Titles 1 through 3, the "Maryland General Corporation Law,"<sup>17</sup> are followed by provisions for specific classes of organizations in Titles 4 through 7.<sup>18</sup>

In 1988, the Maryland General Assembly followed the lead of Delaware<sup>19</sup> and adopted a provision in the Maryland General Corporation Law which enables the stockholders of a corporation to determine the limits of liability of its officers and directors to the corporation and its stockholders.<sup>20</sup> Although designed primarily with the interests of business corporations in mind,<sup>21</sup> the structure of Maryland's new statute may be such that the liability limiting provision is applicable to nonprofits as well as to business corporations.<sup>22</sup> Limiting the liability of officers and

---

11. See Fishman, *supra* note 7, at 401-03.

12. See Butler & Ribstein, *Free at Last? The Contractual Theory of the New Maryland Officer-Director Liability Provisions*, 18 U. BALT. L. REV. [ ], [ ] (1989).

13. Fishman, *supra* note 7, at 399.

14. See, e.g., N.Y. BUS. CORP. LAW (McKinney 1986 & Supp. 1989); N.Y. NOT-FOR-PROFIT CORP. LAW (McKinney 1970 & Supp. 1989).

15. See, e.g., DEL. CODE ANN. tit. 8 (1983 & Supp. 1988).

16. See, e.g., MD. CORPS. & ASS'NS CODE ANN. §§ 1-101 to 7-305 (1985 & Supp. 1988).

17. See *id.* § 1-103 (Supp. 1988).

18. *Id.* Title 4 of the Corporations and Associations article is entitled "Close Corporations," Title 5 "Special Types of Corporations," Title 6 "Regulated Finance and Insurance Corporations" and Title 7 "Foreign Corporations."

19. See DEL. CODE ANN. tit. 8, § 102(b)(7) (Supp. 1988).

20. Act of Feb. 18, 1988, ch. 3 & 4, 1988 Md. Laws 740-41, 746-47 (codified at MD. CORPS. & ASS'NS CODE ANN. § 2-405.2 (Supp. 1988)).

21. The liability limiting statute was enacted to dissuade Maryland business corporations from reincorporating in states which previously had enacted similar types of statutes. See Hanks & Scriggins, *Let Stockholders Decide: The Origins of the Maryland Director and Officer Liability Statute of 1988*, 18 U. BALT. L. REV. 235, 242-43 (1989); Sargent, *Two Cheers for the Maryland Director and Officer Liability Statute*, 18 U. BALT. L. REV. 278, 279 (1989).

22. See MD. CORPS. & ASS'NS CODE ANN. §§ 1-102, 5-201 (1985). Although the directors and officers liability statute uses the term "stockholders," and nonprofits have members rather than stockholders, "stockholder" is defined broadly by the Maryland Code to include "a member of a corporation organized without capital stock." MD. CORPS. & ASS'NS CODE ANN. §§ 1-101(t), 2-405.2 (1985 & Supp. 1988). The

directors to the members and the nonprofit corporation by charter amendment, however, does not afford the officers and directors the degree of protection it does in the case of business corporations. Specifically, officers and directors of nonprofits have significant potential liability to third parties for damages resulting from mismanagement of the corporation, apart from any liability to the members and the corporation.<sup>23</sup>

This article analyzes the applicability of the director and officer liability statute to nonprofits by examining the mechanics of Maryland's statutory corporation law. Next, it discusses the arguments regarding whether officers and directors of nonprofits should be afforded such protection. Finally, this article addresses whether allowing officers and directors of nonprofits to implement liability limiting provisions is indicative of a weakness in the structure of Maryland's corporation law.

## II. THE OFFICER AND DIRECTOR LIABILITY LIMITING STATUTE

Recently enacted section 2-405.2 of the Corporations and Associations article provides: "The charter of a corporation may include any provision expanding or limiting the liability of its directors and officers to the corporation or its stockholders for money damages . . ." <sup>24</sup> Section 2-405.2, however, does not apply in three situations: 1) where the officer or director has received an improper benefit or profit; 2) where the officer's or director's action or inaction was the result of "active and deliberate" dishonesty; and 3) where the officer's or director's liability arises out of specified banking transactions.<sup>25</sup> The liability limiting statute, which is based at least partially on the contractual theory of the corporation,<sup>26</sup> allows the stockholders to determine to what extent the officers and directors of their corporation will be held accountable for breach of their fiduciary duty.<sup>27</sup> Presumably, by limiting the liability of officers and directors, stockholders and the corporation will be able to attract managers who will not be deterred from taking potential profit-yielding

---

effect of the liability limiting provision on other statutes that protect officers and directors of nonprofit corporations is discussed *infra* notes 29-79 and accompanying text.

23. See *infra* notes 60-66 and accompanying text.

24. MD. CORPS. & ASS'NS CODE ANN. § 2-405.2 (Supp. 1988).

25. *Id.* § 2-405.2(b).

26. See Honabach, *Consent, Exit, and the Contract Model of the Corporation—A Commentary on Maryland's New Director and Officer Liability Limiting and Indemnification Legislation*, 18 U. BALT. L. REV. 310, 331-46 (1989).

27. One commentator has argued that charter or by-law amendments that modify the duties and liabilities of officers and directors are of little benefit in the nonprofit context. See Haller, *Directors' Indemnity in Non-Profit Corporations: Should Charity Begin at Home*, 11 (April) BUS. LAW. 6-9 (1956). Charter provisions rely on the self-interest of shareholders as a check on director action. Members of nonprofits do not necessarily have the same self-interest that checks the directors actions. *Id.* at 9.

risks out of fear of liability from failure.<sup>28</sup> Therefore, the reasoning goes, the stockholders are benefitted as much as the officers and directors by the limit of liability.

### III. MECHANICS OF OTHER STATUTES AFFECTING NONPROFITS

Section 1-102(a) of the Corporations and Associations article reads: "Except as otherwise expressly provided by statute, the provisions of this article apply to every Maryland corporation and to all their corporate acts."<sup>29</sup> The exception to this rule is set forth in section 1-102(d): "To the extent that any provision of the Code which relates to a *specific class* of corporations conflicts with a general provision of this article, the specific provision governs."<sup>30</sup> Taken as a whole, section 1-102 requires that Title 2, which includes the liability limiting provisions of section 2-405.2, apply to all Maryland corporations unless a Code provision relating to a *specific class* of corporations conflicts with a general provision.

Title 5 of the Corporations and Associations article is entitled "Special Types of Corporations," and includes subtitle 2, "Nonstock Corporations."<sup>31</sup> The nonstock corporation subtitle does not repeat all of the provisions applicable to corporations generally but rather incorporates those provisions by reference.<sup>32</sup> Section 5-201 states:

The provisions of Maryland General Corporation Law apply to nonstock corporations unless:

- (1) The context of the provisions clearly requires otherwise; or
- (2) Specific provisions of this subtitle or other subtitles governing *specific classes* of corporations provide otherwise.<sup>33</sup>

This section reaffirms that the general provisions of Maryland Corporations Law embodied in Titles 1 through 3 are applicable to nonprofits. The exceptions delineated in subsections (1) and (2), however, are not a reiteration of the exception contained in section 1-102(d). Subsection (1) of section 5-201, by use of the term "clearly," seems to envision a situation where the provision of a certain section would be difficult to apply to nonprofits or where applying the provision would lead to an absurd result. Subsection (2) addresses the situation where a statute would *specifically* exclude part or parts of the Maryland General Corporation Law and is probably limited by its terms to conflicting provisions that appear in the Corporations and Associations article. Nowhere in subtitle 5 or

---

28. See Hanks & Scriggins, *Let Stockholders Decide: The Origins of the Maryland Director and Officer Liability Statute of 1988*, 18 U. BALT. L. REV. 235, 252 (1989).

29. MD. CORPS. & ASS'NS CODE ANN. § 1-102(a) (1985).

30. *Id.* § 1-102(d) (emphasis added).

31. *Id.* §§ 5-201 - 208.

32. See *Carter v. Glen Burnie Vol. Fire Co.*, 292 Md. 165, 167, 438 A.2d 278, 279 (1981).

33. MD. CORPS. & ASS'NS CODE ANN. § 5-201 (1985) (emphasis added).

elsewhere in the Corporation and Association article is there any indication that the power granted by the liability limiting provisions of section 2-405.2 should not be available to nonprofits.

There are, however, two sections of the Courts and Judicial Proceedings article of the Maryland Code which address the liability of officers and directors of certain types of nonprofits.<sup>34</sup> Section 5-312 is entitled "Personal Liability—Agents of Certain Associations and Organizations," and provides that *agents* of certain specified nonprofits shall not be personally liable for damages in any suit if the nonprofit maintains insurance for the particular act or omission which is the subject matter of the suit; the insurance must meet certain coverage requirements and the coverage is the cap on the amount of damages the plaintiff may recover.<sup>35</sup> Section 5-314 entitled "Same—Volunteer of Charitable Organization," provides that a volunteer of a charitable organization will not be liable in any suit beyond the limits of any personal insurance the volunteer may have for acts or omissions in providing services for the charitable organization.<sup>36</sup>

---

34. MD. CTS. & JUD. PROC. CODE ANN. §§ 5-312, 5-314 (Supp. 1988).

35. Section 5-312 provides in pertinent part:

(b) *Conditions prohibiting the imposition of personal damages.*—Except as provided in subsection (d) of this section, an agent of an association or organization is not personally liable for damages in any suit if:

- (1) The association or organization maintains insurance covering the liability incurred by the association or organization or its agents, or both, as a result of the acts or omissions of its agents in providing services or performing duties on behalf of the association or organization;
- (2) The terms of the insurance policy under which the insurance is maintained provide coverage for the act or omission which is the subject matter of the suit and no meritorious basis exists for the denial of the coverage by the insurance carrier; and
- (3) The insurance has:
  - (i) A limit of coverage of not less than \$200,000 per individual claim, and \$500,000 per total claim that arise from the same occurrence; and
  - (ii) 1. If the insurance has a deductible, a deductible amount not greater than \$10,000 per occurrence; or  
2. If there is coinsurance, a rate of coinsurance of not greater than 20 percent.

(c) *Limitation of recovery.*—In suits to which the provisions of subsection (b) of this section apply, the plaintiff may recover damages from the association or organization only to the extent of the applicable limit of insurance coverage including any amount for which the association or organization is responsible as a result of any deductible or coinsurance provisions of such insurance coverage.

MD. CTS. & JUD. PROC. CODE ANN. § 5-312(b), (c) (Supp. 1988).

36. *Id.* § 5-314(c). Section 5-313 of the Courts and Judicial Proceedings article, which is substantially similar in operation to section 5-314, applies to "community recreation programs." The programs may be incorporated, but section 5-313 gives no protection to *officers* or *directors*, unless they are also either a referee or umpire at a game, or the athletic coach, manager, or program manager. *Id.* § 5-313(a)(2)-(4).

"Agent" in section 5-312 is defined to include officers and directors,<sup>37</sup> and "volunteer" in section 5-314 is defined to include officers and directors performing services without receiving compensation.<sup>38</sup> Consequently, a volunteer officer or director of a charitable organization is protected by both sections 5-312 and 5-314.

Because these sections 5-312 and 5-314 of the Courts and Judicial Proceedings article apply only to specified nonprofits, the question arises whether these sections are provisions affecting *specific classes* of corporations within the meaning of section 1-102(d) or section 5-201 of the Corporations and Associations article which would displace the application of the new liability limiting provisions of section 2-405.2.<sup>39</sup> Unfortunately, the Maryland courts have not had an opportunity to shed light on this issue.<sup>40</sup> Whether sections 5-312 and 5-314 displace section 2-405.2 of the Corporations and Associations article, therefore, requires resolution of two subsidiary issues: 1) whether the classes of organizations protected by sections 5-312 and 5-314 of the Courts and Judicial Proceeding article are subject to the provisions of the Corporations and Associations article, and 2) whether the protection granted in sections 5-312 and 5-314 are "specific provisions" within section 1-102(d) that conflict with the liability limiting provision of section 2-405.2.

#### A. *Associations and organizations protected by sections 5-312 and 5-314*

The liability protection of section 5-312 is available only to athletic clubs, charitable organizations, community associations and homeowners associations.<sup>41</sup> Similarly, section 5-314 applies only to charitable organizations.<sup>42</sup> Each type of organization listed in section 5-512 or section 5-314, however, is only a *subclass* of nonprofit corporations.<sup>43</sup> Charitable organizations, for example, are the largest subclass targeted by sections 5-312 and 5-314, yet they only represent a segment of the nonprofits in Maryland.<sup>44</sup> Therefore, even if sections 5-312 and 5-314 are interpreted

---

This comment does not address section 5-313 because it does not expressly apply to officers and directors.

37. *Id.* § 5-312(a)(7).

38. *Id.* § 5-314(a)(4).

39. Section 1-102(d) of the Corporations and Associations article may be the more important of the two provisions, because the wording of section 5-201(2) appears to exclude only those provisions that conflict with another section in the Corporations and Associations article.

40. *Cf.* Carter v. Glen Burnie Vol. Fire Co., 292 Md. 165, 167, 438 A.2d 278, 279 (1981) (brief discussion of section 5-201 of the Corporations and Associations article).

41. MD. CTS. & JUD. PROC. CODE ANN. § 5-312(a) (Supp. 1988). These corporations must be exempt from taxation under I.R.C. § 501(c) (1986) to qualify for inclusion in section 5-312.

42. MD. CTS. & JUD. PROC. CODE ANN. § 5-314(a) (Supp. 1988).

43. *See* H. OLECK, *supra* note 1, at 19-21.

44. A charitable corporation is necessarily a nonprofit, but a nonprofit need not be organized for charitable purposes. *See* H. OLECK, *supra* note 1, at 19. The Corpora-



as being in conflict with the liability limiting provisions of section 2-405.2, the effect would be to make section 2-405.2 unavailable only to the enumerated nonprofits.

It can be argued, however, that sections 1-102 and 5-201 of the Corporations and Associations article only permit displacement of provisions of Maryland General Corporation Law when statutes affect whole classes of corporations, such as regulated financial corporations, foreign corporations, close corporations and nonprofits, and not when statutes affect only *subclasses* of corporations.<sup>45</sup> There is no support in the statutory scheme of the Corporations and Associations article for distinguishing corporations in smaller classes than the classes recognized in the Code.<sup>46</sup> Section 5-201(2) of the Corporations and Associations Code supports this argument because it provides for the displacement of statutes only when specific provisions of "subtitles governing specific *classes* of corporations provide otherwise."<sup>47</sup> Further, the term "specific class" as used in section 1-102 of the Corporations and Associations article can be construed synonymously with "specific class" as used in section 5-201. It can be concluded, therefore, that a "specific class" of corporations is one that is governed by either a title or a subtitle.<sup>48</sup>

#### B. "Specific provisions" and the conflict with section 2-405.2

In addition to the fact that sections 5-312 and 5-314 of the Courts and Judicial Proceedings article apply only to certain nonprofits,<sup>49</sup> the liability limiting provisions of these sections are different in nature than the liability limiting provisions of section 2-405.2. This difference is illustrated by the class of individuals that are protected from liability as well as the types of actions to which these protections apply. First, sections 5-312 and 5-314 protect a broader spectrum of individuals than does section 2-405.2. The term "agent" in section 5-312 is defined to include all employees of an organization, and in section 5-314 to include all those

---

tions and Associations article does not further classify corporations beyond the class of nonstock corporations. See MD. CORPS. & ASS'NS CODE ANN. §§ 5-201 - 208 (1985).

45. Although nonprofits are one class of corporation, the organizations mentioned in sections 5-312 and 5-314 are subclasses of nonprofits. Title 5 of the Corporations and Associations Code does not distinguish between the various types of nonstock corporations. See MD. CORPS. & ASS'NS CODE ANN. §§ 5-201 - 208 (1985).

46. Cf. Hansmann, *Reforming Nonprofits*, *supra* note 1, at 580-86. Professor Hansmann comments that the development of statutes in some states that address various subclasses of nonprofits "though understandable, is unfortunate." *Id.* at 580.

47. MD. CORPS. & ASS'NS CODE ANN. § 5-201(2) (1985) (emphasis added).

48. This interpretation is also supported by construing section 5-201 as a "specific provision" within the meaning of section 1-102(d). Both sections 1-102 and 5-201 are conflicts provisions. Because section 5-201 is a *more specific* conflicts provision than section 1-102, by the terms of section 1-102 if section 5-201 conflicts with section 1-102, section 5-201 should apply, not section 1-102. Compare MD. CORPS. & ASS'NS CODE ANN. § 1-102(d) (1985) with MD. CORPS. & ASS'NS CODE ANN. § 5-201 (1985).

49. See *supra* notes 41-44.

providing services for the corporation without receiving compensation.<sup>50</sup> The rationale for protecting the employees of certain nonprofits from civil liability is similar to the rationale supporting the other protective provisions in subtitle 3 of title 5 of the Courts and Judicial Proceedings Code. Subtitle 3 is entitled "Limitations and Prohibited Actions" and includes provisions such as immunity from liability for emergency medical care.<sup>51</sup> Like sections 5-312 and 5-314, all the actions excluded or liabilities limited in subtitle 3 appear to be mandates of public policy. Specifically, sections 5-312 and 5-314 appear to codify the belief that no one working for a charitable or benevolent organization, especially those doing so on a volunteer basis, should be personally liable for acts or omissions while performing their work.<sup>52</sup> Therefore, sections 5-312 and 5-314 protect officers and directors only as an incident to protecting all employees.<sup>53</sup>

In contrast, section 2-405.2 of the Corporations and Associations article is part of a subtitle 2, which enumerates all the powers, duties and liabilities of officers and directors. The provisions of section 2-405.2 are aimed specifically at officers and directors of business corporations.<sup>54</sup> Furthermore, one of the rationales upon which section 2-405.2 is based is that corporations are the manifestation of a contractual relationship between stockholders and the officers and directors.<sup>55</sup> Consequently, the stockholders have a self-interest in determining the extent to which officers and directors will be held personally liable for breach of their fiduciary duty to the corporation.<sup>56</sup> Section 2-405.2 is therefore unique to officers and directors.

Second, sections 5-312 and 5-314 of the Courts and Judicial Proceedings article provide broader protection than section 2-405.2 of the Corporations and Associations article. Section 5-312 limits the liability of an agent if the conditions of subsection (b) are met.<sup>57</sup> In order to limit officer and director liability, the organization must have an officer and director liability policy that covers the particular act or omission which is the subject matter of the suit.<sup>58</sup> Pursuant to subsection (b), agents

---

50. MD. CTS. & JUD. PROC. CODE ANN. §§ 5-312(a)(7), 5-314(a) (Supp. 1988).

51. *Id.* § 5-309.

52. All of the special exemptive provisions are inapplicable in cases where the individual is guilty of "willful, wanton, or grossly negligent" acts or omissions to act. *See, e.g.*, MD. CTS. & JUD. PROC. CODE ANN. §§ 5-312(d), 5-314(c) (Supp. 1988).

53. *See id.* §§ 5-312(b), 5-314(c) (Supp. 1988).

54. MD. CORPS. & ASS'NS CODE ANN. § 2-405.2 (Supp. 1988).

55. *See supra* note 21 and accompanying text.

56. *See Honabach, supra* note 26, at 324; *see also Haller, supra* note 27, at 9. *But cf. Hansmann, Reforming Nonprofits, supra* note 1, at 608-11 (discussing patron standing to sue nonprofits).

57. MD. CTS. & JUD. PROC. CODE ANN. § 5-312(b) (Supp. 1988).

58. Lloyd's standard policy for directors and officers has two parts: the first part insures the company for any indemnification it provides to a director or officer; the second part provides direct coverage for individual directors. *See, e.g.*, Shapiro v. American Home Assurance Co., 584 F. Supp. 1245, 1247 (D. Mass. 1984); *see also Kurtz & Goodman, Duties and Liabilities of Directors and Officers of Charitable Organiza-*

generally can be protected against damages arising from any suit if there is insurance protecting against the particular act or omission. The only exception to this liability protection is that the agent will be personally liable to the extent the judgment for damages exceeds the limits of any insurance in cases where it is found that the agent acted with malice or gross negligence.<sup>59</sup> In short, when the conditions of subsection (b) of section 5-312 are met, and the agent is not found to have acted with malice or gross negligence, an agent is protected from personal liability from any private plaintiff.

The protection afforded under section 5-312 is significant because the officers and directors of charitable organizations have potential liability for mismanagement to the corporation,<sup>60</sup> members,<sup>61</sup> patrons,<sup>62</sup> beneficiaries,<sup>63</sup> the Internal Revenue Service<sup>64</sup> and the Attorney General.<sup>65</sup> With the exception of the Attorney General, section 5-312 limits the potential recovery by a plaintiff to the limit of the nonprofit's insurance coverage, including any deductible the organization would have to pay.<sup>66</sup>

Section 5-314 differs from section 5-312 because it does not require an officer or director to take affirmative action to claim the protection of the section.<sup>67</sup> Although section 5-314 protects only uncompensated officers and directors, the protection is broad. Subsection (b) of section 5-314 provides:

(b) *Liability of Volunteers.*—A volunteer is not liable in dam-

*tions*, in NON-PROFIT ORGANIZATIONS 230 (J. Small ed. 1984) ("Legally, insurance may provide more protection for directors than indemnification statutes."). Non-profit director and officer insurance is more readily available and lower priced than similar insurance for business corporations. "Insurance may be available for as little as \$600 a year for \$1,000,000 worth of coverage; it commonly runs \$2000 - \$5000 for that amount of coverage." *Id.*; cf. Sargent, *supra* note 21, at 290-95 (discussing difficulty in obtaining director and officer liability insurance).

59. MD. CTS. & JUD. PROC. CODE ANN. § 5-312(d) (Supp. 1988).

60. *See, e.g.,* Berger v. Amana Society, 253 Iowa 378, 111 N.W.2d 753 (1961). *See also supra* note 35 and accompanying text.

61. *See, e.g.,* Beard v. Achenbach Memorial Hosp. Ass'n, 170 F.2d 859 (10th Cir. 1948). Members of nonprofits, however, have been granted statutory standing to bring suit in only a few states. *See, e.g.,* N.Y. NOT-FOR-PROFIT CORP. LAW §§ 623(a), 720(b)(3) (McKinney 1970 & Supp. 1989); CAL. CORP. CODE §§ 5420(b), 7710 (West Supp. 1989).

62. *See* Hansmann, *Reforming Nonprofits*, *supra* note 1, at 606-11.

63. *See* Jones v. Grant, 344 So. 2d 1210 (Ala. 1977). *But cf.* George Pepperdine Found. v. Pepperdine, 126 Cal. App. 2d 154, 271 P.2d 600 (1954) (holding that only the Attorney General could bring an action in the name of the Foundation). The *Pepperdine* case, however, never appeared to reflect law outside of California and was overruled by Holt v. College of Osteopathic Physicians and Surgeons, 61 Cal. 2d 750, 757, 394 P.2d 932, 937, 40 Cal. Rptr. 244, 249 (1964).

64. *See* Hansmann, *Reforming Nonprofits*, *supra* note 1, at 601-06.

65. *Id.* at 600-01. The risk of liability to these parties, however, is in reality rather slim. *See id.*

66. MD. CTS. & JUD. PROC. CODE ANN. § 5-312 (Supp. 1988); *see also supra* note 35.

67. MD. CTS. & JUD. PROC. CODE ANN. § 5-314(b), (c) (Supp. 1988) (liability limited to any personal insurance the volunteer has, which may be nothing).

ages beyond the limits of any personal insurance the volunteer may have in any suit that arises from the actions or omissions of any of the officers, employees, trustees, or other volunteers of the charitable organization for which the volunteer performs services, unless:

- (1) The volunteer knew or should have known of an action or omission of a particular officer, employee, trustee, or other volunteer, and the volunteer authorizes, approves, or otherwise actively participates in that action or omission; or
- (2) After an action or omission of a particular officer, employee, trustee or other volunteer, the volunteer, with full knowledge of that action or omission, ratifies it.<sup>68</sup>

The language of subsection (b) creates some doubt as to whether a volunteer officer or director would be protected from liability for mismanagement by this section. Subsection (b) is only a protection against vicarious liability from the actions or omissions of another volunteer. Subsection (c), however, gives a volunteer protection from liability arising out of his or her own actions or omissions. Section 5-314(c) provides:

- (c) *When volunteer liable.*—A volunteer is not liable in damages beyond the limits of any personal insurance the volunteer may have in any suit that arises from the volunteer's actions or omissions in connection with any services that the volunteer performs for the charitable organization, unless an action or omission of the volunteer constitutes reckless, willful, or wanton misconduct or intentionally tortious conduct.<sup>69</sup>

By virtue of this statute, a *volunteer* officer or director of a charitable organization is not personally liable for any damages beyond the limits of the individual's personal insurance unless the conduct is willful, wanton, reckless or intentional. Literally, section 5-314(c) provides that if the volunteer officer or director has no insurance the "limits of any insurance the volunteer *may* have" would be zero, and the plaintiff would not be able to recover anything from the volunteer.<sup>70</sup> Section 2-405.2, on the other hand, is a focused provision containing specific protection. To invoke the protections of section 2-405.2, the stockholders must agree to what extent they desire to limit the liability of the officers and directors

---

68. *Id.* § 5-314(b).

69. *Id.* § 5-314(c).

70. Section 5-312 supports the argument that if there is no insurance under section 5-314 then there is no liability. Section 5-312 delineates the minimal insurance coverage that is required to invoke the protection of that section; if the legislature had intended that there be a minimal insurance coverage under section 5-314 they would have specified it. Compare *id.* § 5-312(b)(3) with *id.* § 5-314(c). Although this interpretation may result in discouraging volunteers of charitable organizations from obtaining personal liability insurance, it is supported by the plain language of the statute.

and then amend the corporate charter to reflect the agreement.<sup>71</sup> The effect of such a charter provision is that the corporation or stockholders will not be entitled to recovery from the officers or directors for mismanagement of the corporation unless the officer or director's behavior is of a type enumerated in section 2-405.2 for which the liability may not be limited. Section 2-405.2, however, does not protect officers and directors from liability to parties other than the corporation and stockholders.<sup>72</sup>

Nevertheless, a comparison of section 2-405.2 of the Corporations and Associations article with sections 5-312 and 5-314 of the Courts and Judicial Proceedings article reveals a potential for overlapping protection for officers and directors of certain nonprofit organizations. Overlapping protection, however, is not necessarily sufficient to render section 2-405.2 inapplicable to the nonprofits that could take advantage of both types of protection. Sections 1-102 and 5-201 provide that the liability limiting protections of section 2-405.2 will be inapplicable to nonprofits only if there are conflicting nonprofit statutes, rather than overlapping nonprofit statutes.<sup>73</sup> Similarly, there also is a valid argument that section 5-312, by applying to a subclass of nonprofit corporations, is not the type of statute that applies to a "specific class" of corporation within the meaning of section 1-102 or section 5-201.<sup>74</sup> This argument is stronger in the case of section 5-314 because that section only applies to volunteer agents of charitable organizations.<sup>75</sup> Because many officers and directors of charitable organizations receive reasonable compensation, they are not volunteers, and therefore are beyond the protection of section 5-314.<sup>76</sup>

Furthermore, it can be argued that sections 5-312 and 5-314 are more general provisions than section 2-405.2 because they protect individuals other than officers and directors against more potential plaintiffs and suits.<sup>77</sup>

It appears that sections 5-312 and 5-314 were created primarily with the intention of protecting employees or volunteers of certain nonprofits from third party tort liability. Protection against actions by the members of the corporation for mismanagement, however, may be an unintended by-product of the broad language needed to create the protection from tort liability. Section 2-405.2, on the other hand, is very different in nature because it protects specific individuals from actions by plaintiffs in

---

71. MD. CORPS. & ASS'NS CODE ANN. § 2-405.2 (Supp. 1988); *cf.* Honabach, *supra* note 26, at 339 (contending that officers and directors in some corporations actually control the corporate charter).

72. *See supra* notes 60-65 and accompanying text.

73. *See supra* notes 29-33 and accompanying text.

74. *See supra* notes 41-48 and accompanying text.

75. *See supra* note 42 and accompanying text.

76. Officers and directors of charitable organizations can receive reasonable remuneration for their services without causing the organization to lose its tax exempt status. *See* I.R.C. § 501(c)(3) (1986).

77. Sections 5-312 and 5-314 are more specific than section 2-405.2 only in that they apply to certain types of organizations rather than to all corporations generally. *See supra* notes 49-72 and accompanying text.

contractual privity with the corporation for breach of specific duties which are implicit terms of their contract.<sup>78</sup> This leads to the conclusion that sections 5-312 and 5-314 are not specific provisions which would cause the provisions of section 2-405.2 to be inapplicable to nonprofits. The inference to be drawn from sections 1-102 and 5-201 is that for Maryland General Corporation Law to be inapplicable, not only must there be a provision applying to a specific class of corporation, but the provision must also deal with the same narrow subject that is addressed in the Maryland General Corporation Law.<sup>79</sup> Although there is some degree of overlap among sections 5-312 and 5-314 of the Courts and Judicial Proceedings article and section 2-405.2 of the Corporations and Associations article for certain corporations, the different rationales behind the sections, the different individuals that they effect and the different ways in which they effect them all indicate that the nature of sections 5-312 and 5-314 differs from that of section 2-405.2.

#### IV. SHOULD MARYLAND'S NEW OFFICER AND DIRECTOR LIABILITY STATUTE APPLY TO NONPROFITS?

##### A. *Application of Section 2-405.2*

Not everyone would agree that nonprofits should be able to adopt charter provisions to limit the liability of their officers and directors.<sup>80</sup> Opponents of limiting the liability of officers and directors of nonprofits argue that although there has never been a clearly defined standard of duty owed by officers and directors of nonprofits,<sup>81</sup> the uniqueness of nonprofits dictates that their officers and directors should be held to a higher fiduciary duty than officers and directors of business corporations.<sup>82</sup> In addition, there is support for the argument that if the liability of the officers and directors is to be limited in some manner, achieving this by a charter provision is not appropriate because the relationship between a nonprofit corporation and its members cannot be characterized as contractual in the same manner as the relationship between the corporation and the shareholders of some business corporations. The stockholders of a business corporation have a self interest in assuring the corporation is run in the most efficient and profitable manner. This self interest, however, is lacking in the case of nonprofits. Accordingly, a reduction in the risk of liability for officers and directors of nonprofits

---

78. See Sargent, *supra* note 21, at 288-89.

79. See *supra* notes 29-33 and accompanying text.

80. See Haller, *supra* note 27, at 9; Hansmann, *Reforming Nonprofits*, *supra* note 1, at 568-73.

81. See, e.g., *Stern v. Lucy Webb Hayes Nat'l Training School for Deaconesses and Missionaries*, 381 F. Supp. 1003, 1013 (D. D.C. 1974) (court noted that the charitable corporation was "a relatively new legal entity" and discussed the different standards of care for trustees and business directors); see also Fishman, *supra* note 7, at 413.

82. See Hansmann, *Reforming Nonprofits*, *supra* note 1, at 568-73.

would remove one of the only effective checks on their actions.<sup>83</sup>

Conversely, other commentators do not object to reducing the liability of officers and directors of nonprofits.<sup>84</sup> These commentators argue that directors and officers of nonprofits are providing a public service, receive less compensation than their counterparts at business corporations and often work on a volunteer basis.<sup>85</sup> If the officers and directors of nonprofits are required to risk liability for monetary damages because of a heightened fiduciary duty, the difficulty of finding qualified prospective officers and directors would be dramatically increased.<sup>86</sup> Section 2-405.2, therefore, offers much deserved protection to the officers and directors of nonprofits.

### B. Application of Section 2-405.1

The debate over the fiduciary duties of officers and directors of nonprofits has arisen from the lack of a settled body of law that defines the responsibilities imposed on officers and directors of nonprofits.<sup>87</sup> It is settled that business officers and directors can be found liable for breach of their fiduciary duties if they are guilty of "gross negligence."<sup>88</sup> A more stringent standard has been imposed upon trustees, who are liable for simple negligence.<sup>89</sup> Both of these standards have at one time or an-

---

83. See Haller, *supra* note 27, at 9; Fishman, *supra* note 7, at 408-09. Professor Fishman explains that "[m]arket constraints are less efficient in the nonprofit area. There are no shareholders who could switch to other investments. Consumer demand may not correlate to quality. Patrons may have neither the capacity, the interest, nor the power under nonprofit corporate law to police the organization and its managers." *Id.*; see also Hansmann, *Reforming Nonprofits*, *supra* note 1, at 568-69.

84. See H. OLECK, *supra* note 1, at 611-13.

85. *Id.* "The compensation of a director (or officer) is irrelevant in assessing the fairness of directors and officers liability so long as the rules for imposing liability are not amended *ex post* to impose personal liability for behavior which before hand was satisfactory. An individual who accepts a corporate position does so knowing both the compensation and the responsibility. . . . Having freely made the decision to serve, he cannot complain that the threat of liability is onerous or unfair." Honabach, *supra* note 26, at 319. If Professor Honabach's position is to be believed, it would follow that those creating the standard of conduct should not be influenced by the compensation normally received at a certain position when creating the standard and should base their formulation strictly on the function of the entity.

86. See, e.g., Attorney General v. Olson, 346 Mass. 190, 198, 191 N.E.2d 132, 137 (1963) (court was influenced in its decision not to remove the trustees of a corporation for a lapse in judgement by the fact that if they were removed "few if any . . . would undertake to act as trustees."); see also Note, *Fiduciary Duty of a Director of a Nonprofit Charitable Corporation Under D.C. Nonprofit Corporation Act is Similar to Duty Imposed Upon a Director of a Business Corporation*, 24 CATH. U. OF AM. L. REV. 657, 660 (1975).

87. See *supra* notes 7-13 and accompanying text.

88. See Smith v. Van Gorkom, 488 A.2d 858 (Del. 1985); see also Stern v. Lucy Webb Hayes Nat'l Training School for Deaconesses & Missionaries, 381 F. Supp. 1003, 1013 (D. D.C. 1974).

89. See Karst, *The Efficiency of the Charitable Dollar: An Unfulfilled State Responsibility*, 73 HARV. L. REV. 433, 435 (1960); RESTATEMENT (SECOND) OF TRUSTS § 379, comment a (1959).

other been applied to nonprofits by the courts.<sup>90</sup> The decision as to which standard to apply, however, has now been settled in many states by statute.<sup>91</sup> Maryland, for example, applies the same "gross negligence" standard to both nonprofits and business corporations.<sup>92</sup> This result, once again, stems from the structure of Maryland's statutory corporate law.<sup>93</sup>

Some commentators, however, have adopted a compromise position in the conflict between the corporate form and the more trust-like function of nonprofits. These commentators have suggested that the standard for officers and directors of nonprofits should be more stringent than for business officers and directors, yet somewhat less stringent than that of a trustee.<sup>94</sup> Because of the various forms and functions within the class of nonprofits, some states have followed this approach and have adopted statutes creating different standards for different types of nonprofits.<sup>95</sup> Along the same lines, the Model Nonprofit Corporation Act, while adopting the business corporation standard, also suggests consideration of the type of nonprofit corporation and its objective in determining whether the officer or director breached the standard.<sup>96</sup>

Even those who espouse a lesser standard for nonprofits, however, do not suggest that the standard should be lower than the business standard. Arguments that the lesser standard should apply are refuted not only by the fact that the nonprofit managers are analogous to trustees but also by the lack of shareholder oversight of the nonprofit's operation. Professor Fishman persuasively articulates the need for constraints on those who run nonprofits:

The corporate standard works well in the for-profit sector. The financial interests of the shareholders, the efficiency of markets, governmental monitoring of corporate activity in public companies, an active plaintiff's bar, and internal mechanisms encourage compliance. Weaknesses in the mechanisms available for policing the managers of nonprofit corporations argue for a stronger, clearer rule of fiduciary conduct for the director of the nonprofit corporation than for the director of the business cor-

---

90. See, e.g., *Stern*, 381 F. Supp. at 1013 (court applied the business standard); *Beard v. Achenbach Memorial Hosp. Ass'n*, 170 F.2d 859 (10th Cir. 1948) (court assumed without discussion that the business standard should apply).

91. See, e.g., MD. CORPS. & ASS'NS CODE ANN. § 2-405.1 (1985).

92. *Id.*

93. The reasoning supporting the application of section 2-405.1 to nonprofits is identical to the reasoning behind section 2-405.2's application to nonprofits. Titles 1 through 3 of the Corporations and Associations article apply to all Maryland corporations. Accordingly, section 2-405.1, which contains the "gross negligence" standard for corporate officers and directors, applies to business corporations and nonprofits alike. See *supra* notes 29-33 and accompanying text.

94. Hansmann, *Reforming Nonprofits*, *supra* note 1, at 569-73.

95. See *id.* at 573-74, 581-99.

96. REVISED MODEL NONPROFIT CORP. ACT § 8.30, official comment 2, at 214-16 (1988).



poration. Because self-enforcement mechanisms may be completely lacking in the nonprofit world, the corporate standard of the director's duty of care should not be applied in all situations.<sup>97</sup>

This argument that section 2-405.1, at least in some situations, is too lenient a standard for managers of nonprofits overlaps into the argument that the existing fiduciary duty should not be subject to further reduction.

### C. *The "rhetoric of contract"*

The drafters of the new directors and officers liability statute suggest that the statute is based on the contract theory of the corporation.<sup>98</sup> They reason that the statute permits a trade-off whereby the shareholders are entitled to reduce the liability of their officers and directors in exchange for managers who are not deterred by the fear of liability from taking the risks necessary to make a business successful.<sup>99</sup> Under this arrangement, the drafters opine, it is actually the shareholders who are benefitted by the new statute.<sup>100</sup> While this may be appropriate and even desirable in the case of business corporations,<sup>101</sup> it may be inappropriate when applied to nonprofit corporations for several reasons.

The first indication that section 2-405.2 is inappropriate for nonprofits lies in the fact that the contract model of corporations is not readily compatible with nonprofits. Not all scholars agree that the "rhetoric of contract" should be applied to "matters of corporate governance" even in the case of business corporations.<sup>102</sup> For example, traditional corporation scholars prefer the trust model of the corporation. Professor Honabach summarizes the traditionalists' argument in the following passage:

[T]raditionalists contend that corporate managers, like their trustee counterparts, actually establish and implement all corporate policies. Formal organizational rules placing shareholders at the base of the corporate power pyramid matter little, because management's control of the proxy machinery enables it to maintain control and dictate corporate action. Shareholder action or inaction, traditionalist argue, is not an expression of shareholder will; it merely echoes the interests of those

---

97. Fishman, *supra* note 7, at 413-14 (citations and footnotes omitted).

98. Honabach, *supra* note 26, at 331.

99. Hanks & Scriggins, *supra* note 21, at 247-48.

100. *Id.*

101. See Sargent, *supra* note 21. Presumably, Professor Sargent's two cheers out of a possible three voices an overall approval of the director and officer liability statute. Professor Honabach concludes that the new statute is "justified" when applied to open corporations, but that its application to closed corporations cannot be justified because of the breakdown of the contract theory of the corporation in the case of closed corporations. *Id.* at 344-46.

102. See Honabach, *supra* note 26.

corporate managers who control the medium of shareholder expression. The appearance that shareholders determine corporate policy and practice, traditionalists maintain, is nothing more than a clever illusion.<sup>103</sup>

Because the contract model of the corporation has been rejected by traditionalists and may not be accepted by contract theorists in the case of all business corporations,<sup>104</sup> it is probable that both schools of thought would reject the contract model as a valid description of nonprofits.

A second indication that the application of section 2-405.2 to nonprofits is inappropriate is that many nonprofits are very close in their function to a trust making the trust model a more appropriate description.<sup>105</sup> Furthermore, the members of nonprofits lack the same financial self-interest in the efficient management of the corporation that exists in business corporations.<sup>106</sup> Even though it is argued that managers of business corporations really control the corporation through proxy,<sup>107</sup> there is a very real interest of shareholders of a business corporation in assuring that their directors and officers act prudently.

Finally, the rationale that section 2-405.2 will enure to the benefit of shareholders is unpersuasive in the case of nonprofits where the members stand to receive no financial reward for the success of the corporation. Accordingly, if the contract theory of corporations is the primary justification for the new statute, its application to nonprofits is unjustified.

The question thus arises whether the fact that the new director and officer liability statute is justifiable only in the case of some business corporations<sup>108</sup> and not justifiable at all in the case of nonprofits is indicative of a flaw in Maryland's corporate law structure. Professor Honabach concludes that the drafters of the new legislation should have excluded close corporations from its scope.<sup>109</sup>

If the basis of whether the statute should apply to a particular type of corporation is determined by the applicability of contract principles of the corporation, nonprofits should be excluded along with close corporations. As Professor Honabach points out, however, the pitfalls of this approach are that the legislature, by giving special preference in the statute to one type of corporation, would have to consider all the special types of corporations.<sup>110</sup> To make exclusions for each class of corpora-

---

103. *Id.* at 332 (footnotes omitted).

104. Professor Honabach rejects the contract theory in regard to close corporations and intimates that contract theorists may have the same opinion. *See Honabach, supra* note 26, at 344-46.

105. *See supra* note 8 and accompanying text.

106. *See supra* notes 27, 83 and accompanying text.

107. *See supra* note 71 and accompanying text.

108. *See Honabach, supra* note 26, at 331-46.

109. *Id.* at 346-51. It is ironic that Professor Honabach criticizes the drafters for not excluding close corporations from the scope of section 2-405.2, yet fails to consider that the contract model of a corporation is even less descriptive of nonprofits.

110. The new statute does not apply to banking organizations which are specifically ex-

tion whenever a particular statute is not perfectly suited to all corporations generally would result in long and perhaps complex provisions. Failure to make express exclusions on a class by class basis, however, results in the application of potentially inappropriate statutes to all corporations.<sup>111</sup>

The alternative is to adopt exclusions as part of the particular subtitle or title governing the particular type of organization. In fact, the Corporations and Associations article already envisions this solution.<sup>112</sup> Maryland corporate law mandates that when the Maryland General Corporate Law is amended, due consideration is to be given to the application of such a provision to all types of corporations. This provision is included so that the legislature can exclude a statute that is not in harmony with the title or subtitle governing that particular type of corporation.

It is possible that the legislature and drafters did consider the application of section 2-405.2 to the various classes of corporations and concluded the problems raised were not of significant import to warrant action. If this scenario is accurate, more scrutiny should be given to the effect of new provisions on the various types of corporations so that the structure of the Corporations and Associations article is not defeated by certain types of corporations being affected by inappropriate provisions.<sup>113</sup> Those states that have separate articles governing nonprofits<sup>114</sup> are assured that such scrutiny will be applied, and not surprisingly, none of those states have enacted a director and officer liability statute similar to Maryland's Statute for nonprofits. That is not to suggest that Maryland should have a separate article governing nonprofits but rather that the legislature should not acquiesce in the application of a provision to a particular type of corporation unless it would pass that same provision specifically for that type of corporation.

## V. CONCLUSION

From analysis of the structure of its corporate law, it appears that Maryland's director's and officer's liability statute applies to nonprofit corporations as well as business corporations. Consequently, the officers and directors of charitable corporations have more potential shields against liability than any other corporate managers. Such a result is at odds with with persuasive arguments that officers and directors of nonprofits should be held to a higher standard of responsibility than officers

---

empted from its application. MD. CORPS. & ASS'N CODE ANN. § 2-405.2(b) (Supp. 1988).

111. *See id.* § 1-102 (1985).

112. *See id.* § 5-201.

113. The Corporations and Associations article is designed economically so as not to repeat provisions needlessly. *See Carter v. Glen Burnie Vol. Fire Co.*, 292 Md. 165, 167, 438 A.2d 278, 279 (1981) (Subtitle 5 is designed to incorporate the Maryland General Corporation Law by reference rather than by repeating all the provisions).

114. *See, e.g., N.Y. NOT-FOR-PROFIT CORP. LAW* (McKinney 1970 & Supp. 1989).

and directors of business corporations, and that the fiduciary duties of officers and directors of nonprofits should not be subject to diminishment. If the contract theory of the corporation is the primary justification for adopting this statute, the application of the statute to nonprofits is not justified, and the legislature should amend subtitle 5 of the Corporations and Associations article to exclude its application.

*Stewart P. Hoover*