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Lawyers

Can They Take My House?

Responsibilities of a Director of a Not-for-Profit Corporation

by Marshall A. Susler

You have just been chosen to serve on the board of directors of your favorite charity. Now you begin to wonder: Can I be sued? What can I do so I won't be sued? What happens if I am sued? The purpose of this article is to supply some answers to those questions.

Can I be sued as a director of a not-for-profit corporation? The answer obviously is yes, but fortunately suits against directors of not-for-profit corporations are rare, and rarer still is for a director to be found liable.

Suits may be brought against directors for mismanagement of the funds of the corporation, for engaging in transactions with the corporation for the benefit of the director, for failure to obtain available information necessary to make an informal decision, for committing fraud by misrepresenting or concealing an important fact from other directors or from persons dealing with the corporation, or for discrimination or sexual harassment. There are many reasons why a person may sue directors of a corporation.

What can I do so I won't be sued? Since one can never entirely protect himself or herself from being sued, the question probably should be stated: What can I do so I won't be found liable if I am sued? To answer that question, we need to consider what the duties of a director are.

A director owes a fiduciary duty to the corporation and its members. A fiduciary is someone in whom another puts his absolute trust. Hence a director owes a duty to administer the corporate affairs to the best of his or her ability by exercising the best care, skill and judgment he or she can in the interests of the corporation. This proposition is also called the director's duty of loyalty to the corporation. So when a director engages in business with the corporation for his or her own personal benefit, he or she may be in breach of his or her fiduciary duty or the duty of loyalty to the corporation. The director cannot engage in business with the corporation for his or her own personal benefit at the expense of the corporation. To do so is a conflict of interest. So if the not-for-profit corporation does business with you, a director, or your company, you should disclose to the board exactly what that business is and your involvement in it and have the other directors, who are not involved, decide whether to continue doing business with you. Full disclosure of any possible conflict to the other members of the board who have no conflict and their approval of the transaction is a defense to a suit for conflict of interest or breach of loyalty.

In addition to their fiduciary duty, directors must manage the funds of the corporation as they would their own. This is known as the prudent person rule and is often expressed as the duty to exercise the degree of care in the management of the corporation which prudent persons, prompted by self-interest, would exercise in the management of their own affairs. Under this rule, directors have a duty to attend the meetings of the board, to inform themselves of the facts necessary to act intelligently, to ask questions about what is going on in the business of the corporation, and to be sure his or her vote is recorded. A director who votes in favor of a corporate resolution is bound by his or her vote. A director who votes against or abstains from a vote has the obligation to see that a proper record is made of the no vote or abstention. If a director misses a meeting and doesn't vote, he or she should make sure his or her absence is noted on the minutes or other record of the meeting. The position of directors on corporate resolutions may be important if the resolution becomes part of a lawsuit.

If a director has been diligent and careful and has informed himself or herself, he or she will not be liable for honest errors or mistakes of judgment. This is known as the business judgment rule. The rule is often stated that absent allegations of bad faith, fraud, illegality or gross overreaching, courts will not interfere with the exercise of business judgment by corporate directors.

Therefore, if a director keeps up with the corporate business, attends meetings, votes issues and exercises the same degree of care he or she would in managing his or her own affairs, he or she can very likely successfully defend any lawsuit which will be brought.

What happens if I am sued? Many not for profit corporations today provide insurance coverage for their directors. That coverage usually includes providing a legal defense (a lawyer) to the suit as well as payment of any liability up to the limits of the policy. If the corporation does not have insurance, it may nonetheless vote to indemnify the directors in the event of a lawsuit. In the absence of insurance coverage or a resolution for indemnification by the corporation, one may be able to obtain insurance for himself or herself. If a director is not protected by the corporation and has no insurance, he or she will have to hire his or her own attorney to defend the lawsuit. Although one might undertake to defend himself or herself, this is an area of law that is complex and requires a certain amount of expertise and knowledge.

Although the language of the law may seem confusing, all one has to do is what one would do in the exercise of care in his or her own personal affairs, and if you are sued, remember our services are available to you.

If You Would Just As Soon Your Guardian Were An Angel...

by Dan Moore

Our November, 1994 issue of Legal Lines carried an article about the health care power of attorney and the living will. We promised to discuss property powers of attorney in a future issue. This is it.

Just as the health care power of attorney lets us name people to act as our agent making our health care decisions if we are not able to, the property power of attorney lets us empower someone to make our money and other property decisions for us.

Like the health care power of attorney, the property power of attorney used most is a product of our State legislature, passed in 1988. It is also durable. That is, it will still be effective even if we have been declared incompetent. In fact, that is when you would really want your agent to act — not before.

The property power of attorney is very broad in the statutory form, giving your agent the power to perform almost any business transaction you could perform for yourself, were you able. Among other things, the agent could sell and transfer title to your real estate, engage preparation and filing of tax returns and handle all your banking and other investments. Because the powers are very broad, it is important to name an agent whom you could trust. The agent does not have to act, but if he or she does, the agent is duty-bound to act in your best interests. The agent can be called into court to account, by any one who thinks the agent is not properly acting for you. Your property power of attorney can, and should be tailored to your own personal needs. Among other things, you may want your agent to be able to make gifts for you, to transfer property to trusts you or others have created, or to exercise powers of appointment you may have received from others.

The main thing the property power of attorney can do for you is to avoid the expense and complexity of a court guardianship should you become unable to manage your own affairs. The power of attorney normally says who you would want to act as your guardian should you ever need one, but we have yet to see the necessity for guardianship where one has a valid power of attorney with a competent agent or successor agent willing to act.

But don't expect your agent under a property power of attorney to be able to do anything about your property after your death. The property power of attorney is not that durable. That is when your executor (if you leave a will) or your administrator (if you do not) takes over. Remember, a durable power of attorney can be good from the time you make it until your death. Your will only begins to be effective when the power of attorney terminates.

Even at death, court involvement may not be necessary; if you leave an estate of less than $50,000 in your name alone, beside your real estate, or if all of your assets over that amount are in a living trust. More about living trusts and small estate affidavits in another issue.

Powers of attorney, both health care and property, are for the living. They are effective and fairly simple insurance against complex and expensive court-created guardianships when one becomes incapable of making decisions. It is difficult to imagine a competent adult who shouldn't consider having both of them.

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