

LIABILITY EXPOSURES FOR DIRECTORS  
AND OFFICERS OF NON PROFIT CORPORATIONS

By Attorney Michael H. Wald

One of the great things about Texans is that they are involved in their communities. Thousands of individuals, from all walks of life, serve as uncompensated volunteers in charitable, religious and educational organizations. What may surprise many of these people, particularly those that serve as directors or officers of such organizations, is that they can be held personally liable for actions taken in these capacities.

Under Texas law, a non-profit corporation can be formed for the following purposes: charitable, benevolent, religious, eleemosynary, patriotic, civic, educational, social, and athletic. Also construed to be non-profit corporations are lodges, cooperatives and industrial, commercial or trade associations. There are few restrictions as to what purposes non-profit corporations can be created for, but two important restrictions are that a non-profit corporation cannot provide income to its members, directors or officers, and, secondly, it must be in compliance with the Internal Revenue Code regarding the tax exempt status of non-profit corporations.

The board of directors and officers as a group are individuals who manage the affairs of the corporation. It is these people that can be personally held liable for their actions and therefore risk loss of their personal assets.

The following are some areas where directors and officers could be vulnerable to suit:

- Lending money to a director is strictly regulated, and if other directors sanction the loan they can be held liable to the corporation. Directors may be accused of conflicts of interest if they have an

outside business relationship with the organization.

- Government agencies can bring suit under a variety of laws. The IRS can hold the directors liable if employee withholding taxes are not properly paid. Suits can be brought alleging discrimination in hiring practices or in how services are rendered to the public.
- Directors can be sued for taking actions beyond the scope of the authority granted to them in the corporate by-laws.
- Irregular attendance of the board meetings could be grounds for a suit, especially if the corporation is mismanaged.
- Failure to keep records or books, or, in certain circumstances, failure to make them public, can result in a suit.
- Suits can be brought for assets distributed out of the corporation when the directors knew or should have known about unpaid creditors.

Texas law does permit its non-profit corporations to indemnify its directors and officers for their reasonable legal defense costs and for adverse judgments rendered against them, but there are limitations. An individual cannot be indemnified if he is accused of improperly receiving personal benefit or if he is found liable to the corporation itself. The best way to assure this right of indemnification is to have it stated in the articles of incorporation or by-laws.

Directors and Officers Liability Insurance may also be purchased to protect the personal assets of these individuals. However, because of the present restricted market conditions for this coverage, it may not be practical for many non-profit organizations to purchase it.

Directors and officers of non-profit corporations should visit with their legal counsel to make sure they understand the full extent of their legal responsibilities as well as to verify that the broadest

indemnifications permitted are available to them. It is also recommended that they consult with their insurance adviser or agent with regards to obtaining Directors and Officers Liability insurance.

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