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CORPORATE CITIZENSHIP

Limiting the liability of nonprofit directors

Volunteer service on the board of directors of a nonprofit corporation should be encouraged because it can provide both community benefit and personal satisfaction.

But, it also can expose the volunteer to personal liability. For this reason, nonprofit directors should understand their duties as directors, their personal liability for breach of those duties and the protections available to limit that personal liability.

The duties of a nonprofit director are generally derived from the law of the state in which the nonprofit corporation is organized and existing.

For Washington nonprofit corporations, a director has duties to act in good faith, in a manner the director believes to be in the best interests of the corporation, and with the care that an ordinarily prudent person would be expected to use under similar circumstances.

In fulfilling those duties, a director is entitled to rely on the opinions, financial statements and other information prepared or presented by trusted corporate representatives, outside experts (including legal counsel and public accountants), and committees of the board upon which the director does not serve; provided, that the director acts in good faith, after reasonable inquiry, and without knowledge that reliance is unwarranted.

For breach of those duties, a director may be held personally liable to a third party or the corporation itself for resulting injury or loss.

But, there are a number of protections available to limit the liability of nonprofit directors.

1. In its articles of incorporation, a nonprofit corporation may eliminate or limit the personal liability of a director to the corporation or its members for monetary damages for conduct as a director that does

RISK ASSESSMENT



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not involve intentional misconduct, knowing violation of law or any transaction from which the director received a personal benefit to which the director is not legally entitled.

2. By statute, a nonprofit corporation must indemnify a director who is wholly successful in defending claims based on being a director against the reasonable expenses incurred in the proceeding.

3. In addition to the mandatory indemnification provided by statute, a nonprofit corporation may provide discretionary indemnification in its articles of incorporation, by resolution or by a private contract, to the extent not prohibited by law, for the advance of reasonable defense costs, amounts due under a settlement agreement or monetary damages so long as the director acted in good faith, reasonably believed the action was in the best interests of the corporation, and is not adjudged liable to the corporation on any basis or to anyone else for a personal benefit improperly received.

4. There is special statutory immunity under a Washington statute that eliminates individual liability of a nonprofit director to third parties for any discretionary decision (or failure to make one) within his or her official capacity as a director unless the decision or failure to decide constitutes gross negligence.

Although that statute specifically does not limit the liability of a director to the nonprofit corporation or its members, the nonprofit corporation may limit the liability of a director to the corporation and its

members for monetary damages subject to the limitations noted above for intentional misconduct, knowing violation of law and improper personal benefit transactions.

5. There is also a federal statute known as the Volunteer Protection Act of 1997, which limits the liability of uncompensated volunteers, including uncompensated nonprofit directors, for an act or omission of the volunteer on behalf of the corporation, subject to exceptions for willful or criminal misconduct, gross negligence, reckless misconduct, or flagrant indifference to the rights or safety of the individual harmed.

6. There are several insurance products that insure a nonprofit director against personal liability, including director and officer insurance covering liability for official acts or omissions, employment practices liability insurance covering employment discrimination, sexual harassment, wrongful termination and other employment related liabilities, and charitable or volunteer service endorsements to personal liability insurance policies.

Considering the risk of personal liability from serving as a director of a nonprofit corporation and the opportunities for managing that risk, the prudent nonprofit corporation, its existing board of directors and any newly proposed directors should evaluate whether the corporation is doing all that it reasonably should to protect its nonprofit directors from personal liability, and thereby facilitate their recruitment and retention as good corporate citizens.

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