

# **Duties, Responsibilities and Liabilities Of Non-profit Directors in Texas**

*by Andrew P. Johnson, III*

*(Note: Second in a series on liability of individuals in community service. Next in the series: Potential Liability in the Issuance of Public Securities)*

In recent years, non-profit corporations have rapidly expanded the scope of available services. These corporations are no longer simply the traditional homeowner associations, churches and charities, but now have proliferated into services for the homeless, drug-abuse prevention, elderly care, nursing homes, low income housing, as well as facilitating the extension of services of local governments.

The directors of non-profits do not enjoy governmental immunity, as discussed in the last issue, for the actions and decisions made in the capacity of a director. As a director of a non-profit corporation, you can, however, find protection from personal liability by operating within the parameters set out in the Texas Non-profit Corporation Act ("Act").

And, since no standard of liability is stated for directors of most public non-profit corporations, such as housing finance corporations and health facility development corporations, it could be assumed that the standard of conduct to avoid liability for directors of these corporations is the same as for non-profits under the Act.

## **What are my responsibilities?**

In general, you learned all you need to know to avoid liability in Girl or Boy Scouts. As a director you must be trustworthy (act in good faith), loyal (to the corporation), and obedient (to the corporate documents and the law).

You can demonstrate these qualities by regularly attending meetings and making informed decisions. Directors should request any pertinent information necessary to make an informed judgment regarding board action before the meeting at which the action is scheduled to take place. If a director does not believe that the information before him/her is sufficient, that director should either abstain from voting or ask that the vote be delayed.

Directors also have the responsibility of overseeing delegated activities, be they delegated to an individual or a board committee. A director may rely on information prepared or presented by (a) officers or employees of the corporation, (b) attorneys, accountants or other persons whom the director believes to have professional or expert competence, and/or (c) a committee of the board of which the director is not a member.

But the director may not rely on information if the director has actual knowledge to the contrary. A director should review thoroughly any information or advice on which he or she may rely.

### **Duty of Fairness**

To determine the “fairness” of a transaction involving a conflict of interest, the directors should evaluate whether (a) the terms of the transaction are as favorable to the corporation as those that might be made from an unrelated third-party, (b) a person without interest presented the transaction to the corporation, rather than an interested director, and/or (c) the corporation’s interest in negotiations has been represented by a disinterested person.

When a director has an interest in a transaction to which the corporation is a party, the director must disclose the existence of the interest and describe its nature to the other directors prior to the time the board takes any action on the matter. The director may be counted in determining a quorum, but may not, however, vote on the action.

### **Loyalty**

Directors must pursue the interests of the corporation rather than the interests of a director or of another person or organization. A director must not use his/her position to make a personal profit or gain other advantages.

### **Corporate Opportunity**

Directors may not divert business opportunities from the corporation to themselves. When an opportunity regarding the corporation’s business activities comes to the attention of a director, that director must present the opportunity to the corporation. Only after the board decides not to pursue the opportunity may the director pursue the matter for personal benefit. The director should not take any action that would prejudice the corporation until the board has decided what action to take.

### **Loans**

Loans by the corporation to its directors are prohibited, and directors voting to approve a loan will be jointly and severally liable to the corporation for the amount of the loan.

### **Confidentiality**

The director should treat all information relating to the corporation as confidential until the information is determined to be a matter of public record. A possible exception is the applicability of the Texas Open Records Act to housing finance corporations and other public non-profits. Even then, personnel, real estate, security and attorney-client privilege issues are restricted from public access under state law.

Directors of a non-profit corporation must act within the purposes set forth in the articles of incorporation, bylaws or applications for tax-exempt status as applicable. Failure to fulfill the corporation’s purpose risks loss of tax-exempt status and dissolution by the attorney general.

### **How can I be liable?**

Directors of non-profit corporations may be held liable in three different situations:

- Statutory Liabilities – Directors may be liable by statute or regulation for the corporation's violation of applicable state and federal laws.
- Breach of Duty – Directors may be sued for breaching the duties and responsibilities of a non-profit director.
- Third-party claimants – Claimants who have suffered injury may seek damages from the directors individually. Usually, directors will not be held liable for the obligations of the corporation unless the corporate form has been disregarded or the directors profited in a personal manner from the corporation's activities.

### **What do you have to prove?**

Expect for violations of law which have their own standard of proof, a person who wishes to establish the liability of a director has the burden of proving that the director has not acted in good faith, with ordinary care, in a way the director believes to be in the best interest of the corporation.

As shown in the Open Meetings article (See pg. 1), ignorance of the rules or your stated intent to “do the right thing” may not be a defense. The circumstances may be used against you, as we have seen with events in Washington, D.C.

### **Is there any other protection?**

Yes. First, buy director's and officer's liability insurance. If the policy allows you to select or consent to defense counsel, so much the better, as recent defendants have learned.

In addition, a corporation may indemnify a director if the director: (a) acted in good faith, (b) believed his/her conduct was in the best interest of the corporation, (c) in a criminal proceeding, had no cause to believe conduct was unlawful; (d) is not found liable to the corporation; and (e) is not found liable on the basis that personal benefit was received by the director.

The corporation can make the indemnification provisions mandatory and may purchase insurance to protect against liability. It is always wise to have these provisions in place long before you need them. If the corporation purchases indemnification insurance for its directors, it must disclose to whom the money was paid and in what amount.

### **Conclusion**

Your best protection is a good mix of common sense, insurance and hiring the right professional advisors.

*This is a summary of a paper delivered at the 1998 Texas Association of Local Housing Finance Agencies (TALHFA) Convention in Ft. Worth and the national Association of Local Housing Finance Agencies (ALHFA) Convention in Minneapolis by Andrew P. Johnson, III. A checklist for non-profit directors to avoid liability and full text of this article are available from JR&P. Please contact JR&P at 281/872-1221, use the fax-back page at the end of this newsletter or e-mail us at [apj@publiclaw.com](mailto:apj@publiclaw.com) for more information.*

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