



THE LAW OFFICES OF
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Should Nonprofit Directors Worry about Personal Liability?

It is an honor to be asked to serve as a director on the board of a nonprofit organization, but by agreeing to serve are you exposing yourself to personal liability?

Incorporation

In order to determine the amount of personal liability a director of a nonprofit organization might be exposed to, it is first important to understand the entity type of the organization - corporation, limited liability company ("LLC"), etc. Typically, when an organization is incorporated or registered with the Department of State as an LLC, the business owners are protected from personal liability. This is also the case for directors of nonprofit organizations. If the organization has been incorporated, its directors usually are not personally responsible for the debts or liabilities of the organization. Although, pursuant to Florida Statutes, if a director were to act on behalf of an organization knowing there was no incorporation of the organization he or she would be personally responsible for the liabilities of the organization.

Business Judgment Rule

The Business Judgment Rule is a rule of law that provides corporate immunity to directors of corporations, protecting them from liability for the consequences of informed decisions made in good faith. In Florida, the Business Judgment Rule operates as a shield protecting directors from personal liability when exercising their reasonable judgment in the regular course of conducting business. Florida Courts have held the Business Judgment Rule will protect a nonprofit corporation's board of directors' business judgment as long as they can show they are acting reasonably and in good faith – that they are performing their duties of care and loyalty.

Generally speaking, absent actual wrongdoing in the form of fraud, self-dealing, or unjust enrichment, nonprofit directors cannot be held personally liable for corporate acts. But, the protection afforded by the Business Judgment Rule fades when the director's act crosses the line from "negligence" to "gross negligence" (i.e. serious carelessness). The standard of ordinary negligence is the conduct one expects from the "reasonable man." In order to be grossly negligent, a person's action would have fallen well below the ordinary standard of care one expects. So, just because a nonprofit director's actions might not be "right" or correct, or even if decisions are made that turn out to be costly or wrong, this would most likely not lead to personal liability for those wrong decisions. So long as the director acted reasonably under the circumstances, the likelihood is the Business Judgment Rule will protect their decisions.

When there is Liability

However, the Business Judgment Rule does not apply where a director breaches his or her fiduciary duty.

As mentioned, acts of gross negligence can expose the director to liability. If there is clear evidence of intent to break the law, for example, theft, fraud, forgery, burglary, misappropriation of funds, or obstruction of justice, the director could be personally liable for his or her acts related to the nonprofit. Other examples of when a nonprofit director might be held personally liable are if he or she: personally or directly injured someone, personally guaranteed a bank loan or a business debt on which the entity defaults, fails to ensure that the nonprofit files necessary tax returns, or co-mingles nonprofit and personal funds.

It should be pointed out a nonprofits' unpaid taxes can be the biggest risk in terms of a director's personal liability. If a failing nonprofit finds itself unable to pay taxes and ultimately closes its doors, the IRS may look to the board of directors for payment of unpaid taxes of the organization. Conversely, the board of directors for a nonprofit that is not required to pay taxes due to a 501(c)3 tax exempt designation would not have this risk.

D&O Insurance

Even with organizational structure protection for board members, it is still a good idea to have liability insurance for the directors and officers of a nonprofit ("D&O insurance). D&O insurance is relatively inexpensive and can go a long way toward providing protection to those who serve. If your organization already has general liability coverage (which it should), your board members may already be covered, or D&O coverage may be added at a low additional cost.

D&O coverage is of particular importance to nonprofit organizations because nonprofits usually rely on volunteer board members to make important decisions. Even when acting in good faith, these volunteer board members may be subject to personal liability as discussed above. By recognizing this risk and providing solid D&O protection, it may be easier for the nonprofit to attract and retain quality board members. The nonprofit will also have a much better chance of weathering a wrongful act claim. Directors and officers coverage helps protect both the organization and its board members against financially devastating board member lawsuits.

There are a number of safeguards in place to protect someone from personal liability while acting as a board member of a nonprofit organization. However, it is still important to understand the structure of the organization and check into the liability coverage the organization provides it board members. Overall, being on the board of a well-run nonprofit can be a wonderful opportunity and the fear of personal liability should not be a deterrent from serving.

The Law Offices of Hoyt & Bryan assists families in the protection of their loved ones by focusing their practice in the areas of Estate Planning, Probate and Trust Administration, Elder Law including Medicaid and VA Planning and Special Needs Planning, Pet Planning, Business Succession Planning and Real Estate. The founders, Peggy Hoyt and Randy Bryan, are both dual board certified by the Florida Bar in Wills, Trusts and Estates as well as Elder Law. Hoyt & Bryan is the only law firm in Florida with the distinction of two attorneys with these certifications. We offer many complimentary educational workshops each week in our Learning Center at The Law Offices of Hoyt & Bryan and monthly workshops in the Auditorium of One Senior Place in Altamonte Springs. For more information please contact our office at 407-977-8080 or visit our website HoytBryan.com.