

## HISTORIC HUDSON HOOSIC RIVERS PARTNERSHIP

August 28, 2017 Directors' Liability for HHHRP

At the June Board meeting a question of possibility of Director's being liable for HHHRP actions was raised. The matter was deferred to the August meeting. It should be noted that this is not intended to address all the possible situations under the topic of directors' potential liability. It only looks at whether by being on the board of HHHRP the directors are liable for the actions of HHHRP. It is also intended to start a discussion.

A. Generally, HHHRP directors are not personally liable for the actions of HHHRP merely by being a member of the Board of Directors. This is because HHHRP is a corporate entity (under the Not For Profit Corporation Law) and the protections afforded corporate directors under general principals apply to HHHRP directors. A basic principal is that it is the corporation, as an entity separate and distinct from its shareholders and managers that incurs the liabilities, not the directors (or shareholders/members). This principal applies to not for profit as well as for profit corporations.

Although there is a short answer, for discussion purposes we should divide this into; 1. Contracts and 2. Torts (negligence).

1. As stated, directors are not liable for contracts or debts of a corporation simply by being on a board of directors. There can be exceptions such as if a director (or officer) deliberately agrees to be personally liable for a specific contract. Another possibility is if there is fraud or misrepresentation involved in the contract and the director(s) were personally involved in the fraud or misrepresentation. This could give rise to a direct claim against the individual director(s) involved.

One thing HHHRP could do would be to state in all contracts that they are "subject to availability of funds" and make clear that the source is exclusively from identified grants. Thus, all contractors would be warned in advance of limited funding and could not make claims beyond the identified funds.

2. Applying the general rule to tort liability also means that any liability of the corporation for torts (negligence) does not by itself automatically attach to the directors personally. However, as individuals, directors have a separate duty to personally not act in a negligent manner. Therefore, if a director in addition or separately from being a director is also involved in an activity of the corporation and acts in a personally negligent way, that director could be personally liable for injuries to third parties. Put another way being on the board of directors does not shield directors from personal liability for their own individual negligent behavior.

Although directors are not automatically liable for torts of the corporation, adequate insurance is a topic for discussion below.

B. In discussing directors' liability for corporate actions there are two more concepts to keep in mind. These are; 3. 'piercing the corporate veil' and 4. Business judgment rule. These can work together.

3. You've probably heard of 'piercing the corporate veil'. This is an idea that the protection afforded to shareholders/directors of the corporate entity can be set aside if the corporation is not operated as a corporation should be. For example a small corporation that functions more like a partnership will in fact

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be treated as a partnership and the corporation owners (shareholders) will be personally liable as would the owners of a partnership. Third parties, either contractors or tort claimants will seek to ‘pierce the corporate veil’ if there are insufficient assets or resources to cover breach of contract or tort liability damages.

4. The ‘business judgement rule’ is simply that if in making decisions the directors act in good faith, are reasonably prudent and rely on adequate information in making corporate decisions, courts will not second guess those decisions. This concept has been codified in NFPCL Section 717 Duty of Directors and Officers (attached). Most typically, this rule is to protect directors from suits by shareholders (for profit) or members (non profit), but seems that it can be used as part of a defense in third party lawsuits as well. Note at the end of Section 717 it specifically says: “Persons who so perform their duties shall have no liability by reason of being or having been directors or officers of the corporation.”

C. Risk management, or the evaluation of necessary insurance, is an exercise of business judgment and can help avoid the motive to pierce the corporate veil.

5. Commercial Liability Insurance. As mentioned, a motivation for claimants to try to pierce the corporate veil is that there are insufficient assets to cover damages. In the context of a negligence lawsuit against a corporation for something like a slip and fall on property (‘premises liability’) if the corporation does not have adequate (or any) liability insurance it is possible (and for HHHRP likely) that there will be insufficient resources to pay an award of damages. Thus, the claimant will have a motivation to ‘pierce the corporate veil’ to get at personal assets of directors (and shareholders/members).

As a matter of good corporate management, an organization that owns or manages property should have adequate commercial liability insurance to cover negligence claims. As HHHRP continually evolves from a regional planning council to a project management organization, corporate liability is an important matter. Having adequate commercial liability insurance would be both good exercise of ‘business judgment’ and lessen motivation to pierce the corporate veil. In addition, and pertinent to this discussion, commercial liability insurance covers officers, directors and volunteers of the corporation when performing their duties and acting within scope of their activities.

6. Directors and Officers Liability Insurance (D&O). As part of an overall risk management review, this type of insurance should be examined to see if it provides additional protection that is necessary under the HHHRP circumstances. In very general terms this insurance provides coverage for decisions that are made by directors and officers. The evaluation of D&O should be coordinated with the commercial liability insurance because D&O typically does not cover personal injury or property damage negligence.

D. It should be noted that the Not For Profit Corporation Law does provide additional protection of certain not for profits. NFPCL Section 720-a (attached) provides that directors and officers, who serve without compensation, of a corporation “described in Section 501 ( c ) (3) of the Internal Revenue code” will not be liable to any person based solely on their conduct as a director or officer, unless their conduct with respect to the person claiming harm was grossly negligent. HHHRP does not currently have official status as a 501( c)(3) corporation, therefore, it is not clear whether we can rely on Section 720-a.