

Non-Profit (Non-Stock) Corporations

The Corporation Itself

Potential Liabilities- Nonprofit corporations are much like a for-profit corporation when determining potential liabilities. While a nonprofit corporation is able to incur debt in its own name, it is also fully liable for those debts and any other obligations that come to the corporation. In addition, a nonprofit corporation can be sued in the name of the organization for any number of things, including:

- Torts (e.g. negligence, personal injury, etc);
- Breach of contract;
- Statutory violations (e.g. taxes, worker's compensation, environmental – though hopefully not the latter in the case of a river or watershed group!);
- Vicarious liabilities (e.g. liabilities caused by actions of employees in course of their work).

Strategies for Risk Management- In order to limit the instances that might cause problems for your organization, think about whether developing a risk management plan (see sidebar) would be worthwhile. At the very least, you should:

- Honor the terms of all contracts and agreements;
- Pay loans and bills on time;
- Know and follow the statutes and regulations that apply to your organization;
- Be aware of the safety issues that arise from your organization's activities, and take steps to ensure safe practices;
- Impose internal controls for handling of cash (e.g. one person writes checks, another opens and reviews bank statements);
- Report claims to insurance carriers in a quick and timely fashion;
- Ensure employees and volunteers are properly trained for, and, if necessary, licensed for, any activities they undertake.

Insurance- There are many insurance products available from different carriers at different price levels. Before purchasing any particular coverage, you should weigh the cost of the insurance against the likelihood and magnitude of the risk. For instance, a group that has no office or equipment might not need business property coverage.

This is a list of some of the different types of coverage available. This list is not exhaustive, and often different policies can be combined into a single package.

- *General liability:* Typically covers bodily injury, property damage (this may be limited to damage of others' property) and personal injury coverage. The organization should check that all of its activities are covered by the general liability policy, and, if not, consider purchasing additional coverage.
- *Business Property:* Covers the loss of property owned by the business, which is probably not covered by a general liability policy.
- *Directors and officers:* Covers an organization's cost to indemnify its directors, officers and sometimes staff and members. Policies vary greatly, and careful consideration should be made of needs, cost and what the policy will actually cover.

- *Automobile*: Covers liability of the organization regarding the use of motor vehicles. This can insure an organization's vehicles as well as provide insurance for staff or volunteers who rent vehicles. Consult with your insurance agent to see if it would also cover staff or volunteer use of their personal vehicles.
- *Worker's compensation*: Covers injury to workers while on the job. This is required of most employers in Wisconsin.
- *Contractual liability*: Covers liability in the case of an organization's breach of contract. If contracting is infrequent, the organization is probably covered under a general liability policy. Check with an insurance agent.
- *Personal injury*: This coverage is usually contained in a general liability policy and covers things like libel, slander, false arrest, or other harms to a person's reputation or privacy.
- *Event Insurance*: While members, volunteers, directors and officers are afforded all of the protections listed in this guide when holding special events such as river cleanups, the organization may be liable for problems arising out of the event. For that reason, event insurance should be considered. If events are infrequent, they may be covered though the general liability policy of the organization. Consult an insurance professional for more information. See the sidebar on waivers to further protect your organization from lawsuits.
- *Other insurance coverages*: These include special coverage for crimes, host liquor liability, as well as supplemental coverages to complement the policies listed above. Consult an insurance agent for more information about the types of policies available in your area and for your organization's specific types of activities.

Waivers

Waivers are statements signed by participants that purport to waive the participant's right to sue the organization for anything that happens during the event. While having participants sign waivers is crucial, recent court decisions in Wisconsin have called their effectiveness into question. A strong waiver should:

- Include a specific waiver of negligence on the part of the organization;
- Include specific information regarding the risks of that day's events (e.g. a waiver for a paddling event should include specific information about the section of river being paddled, or better yet, include info on the conditions *on the day of the event*);
- Appear on a separate page from any other material;
- Be verbally explained to the signer, allowing the signer to ask questions;
- Consider giving the signer the right to negotiate the terms of the waiver. A recent Wisconsin Supreme Court ruling indicated that the signer should have the ability to bargain for the waiver to be held valid.

Directors and Officers

Potential Liabilities- Directors and Officers of a nonprofit corporation enjoy the limited liability protection of the organization's corporate status. Because of their positions, however, they hold certain common law duties to the organization, and a court may ignore the corporate liability protections if these duties are breached (see "Piercing the Veil" sidebar for more information). Under Wisconsin law, directors are protected from liability for their actions except when:

- *Self-dealing*: The director acts to benefit him or herself and against the best interests of the corporation. Self-dealing can be avoided if the director's interest is disclosed to the organization's Board or members prior to approval of any contract, and the contract is fair and reasonable to the corporation.

- *Participating in a crime*: The director participates in the commission of a crime, unless he or she believes their conduct was lawful or had no reason to believe it was unlawful.
- *Wilfull misconduct*: This action is undefined by statute, but probably involves conduct the officer knows to be wrong, but that is not self-dealing or a violation of a criminal statute.
- Liability protection is also waived if the liability arises from a(n):
 - Government proceeding;
 - A proceeding brought by a person under a statute that provides citizens with the right to bring such actions (a private right of action);
 - The director votes for a distribution of the organization’s assets that is unlawful;
 - Tax liability;
 - Violation of workers compensation laws;
 - Violation of unemployment compensation laws;
 - Violation of antidiscrimination law;
 - Violation of environmental law.

Common Law Duties- A breach of one or more of these duties may cause a director or officer to lose the liability protection of the corporation:

- *Duty of Loyalty*: Avoid situations of conflict between the interests of organization and the interests of the director.
- *Duty of Care*: Exercise a reasonable amount of care in the performance of the director’s duties.
- *Duty of Obedience*: Uphold the purpose of the organization as expressed in its organizational documents (e.g. a mission statement).

The limited liability protections may be upheld even in one of the above referenced situations if the director was acting out of reasonable reliance on information obtained from an officer or employee of the corporation, professionals hired by the organization, or a committee of the Board of Directors of which the director is not a member.

“Piercing the Corporate Veil”

When an organization alone is unlikely to satisfy the damages of a plaintiff’s claim, the plaintiff may attempt to include individual directors, officers, members or volunteers in the lawsuit. Wisconsin law provides a limited shield to these individuals, but this “veil” may be “pierced” in certain situations.

While Wisconsin law is not clear as to when a court would pierce the veil of a nonprofit organization, previous legal decisions in the for-profit world point to the following ways to limit the chances a court will disregard its liability protections:

- The organization should be adequately capitalized (i.e. sufficiently funded to meet its liabilities over the long term);
- The organization should observe certain corporate formalities, such as;
 - Hold meetings and take minutes;
 - Maintain records;
 - Clearly distinguish between organizational and personal property;
 - Refrain from fraudulent or inequitable conduct.

Strategies for Risk Management- *Directors and Officers should:*

- Attend Board and committee meetings;

- Review *and understand* financial statements. A director should seek help if there is something he or she doesn't understand, and the organization should consider training its board so they understand the statements;
- Ensure that any objections or disagreement over an action are recorded in the meeting minutes;
- Disclose in writing any conflict of interest or personal benefit from a Board action. Don't vote on any such matters;
- Ensure good practices by the organization (e.g. signing contracts properly, providing adequate insurance, hiring competent employees, etc);
- Act in consort with the organization's mission at all times when acting on behalf of the corporation.

Indemnification of Officers and Directors

According to Wisconsin law, a nonprofit corporation must indemnify a director or officer, unless the corporation's articles of incorporation limit that indemnification. In addition, indemnification of directors and officers can be expanded by:

- The articles of incorporation or bylaws;
- A written agreement between the director or officer and the corporation;
- A resolution of the board of directors;
- A resolution, adopted after proper notice, by a majority vote of members with voting rights.

If the right to indemnification is not limited or expanded, Wisconsin law requires the following:

- The director or officer must be indemnified to the extent that he or she has successfully defended him or herself against a claim arising from his or her status as an officer or director. The director or officer is entitled to all reasonable expenses incurred in the proceeding.
- If defense of a claim is unsuccessful, indemnification may still be required:
 - By a majority vote of a quorum of the board of directors who are not parties to the same or related proceedings;
 - By an attorney selected by a quorum of the board of directors who are not parties to the same or related proceedings;
 - By a panel of three arbitrators;
 - By an affirmative vote of members having voting rights, not including members who are parties to the same or related proceedings;
 - By any other method allowable under Ch. 181 of the Wisconsin statutes.
- Indemnification is not required if the director was unsuccessful in his or her defense if the liability was created from a breach of the director's or officer's duty to the corporation and it was one of the following:
 - A willful failure to deal fairly with the corporation fairly when the director or officer has a conflict of interest;
 - A violation of criminal law;
 - An improper personal profit on the part of the director or officer;
 - Willful misconduct.

Insurance- *Directors and Officers insurance* does not directly cover the directors and officers, but covers organizations for the cost for an Officer or Director to defend him or herself against a liability claim. The organization may be required to cover these costs for the director under the indemnification rules (see sidebar), so this type of insurance is highly recommended. Having this type of insurance in

place may also make it easier to attract directors. Coverages vary greatly, so a consultation with an insurance professional is necessary before purchasing a policy. This can also be a pricey type of insurance, so it may not be reasonable for all organizations, despite its many benefits.

Members

Potential Liabilities- Members are generally not liable for a corporation's debts, liabilities or obligations, though courts can order a member liable in certain situations (see "Piercing the Corporate Veil" sidebar). The size and degree of control of an organization can affect the likelihood of a member being held liable. For instance, one member of a 2000-member statewide river organization is much less likely to be held liable for the group's actions than one member in a 5-member local organization.

Strategies for Risk Management- Members can reduce their liability risk by:

- Ensuring that the corporation is adequately capitalized (i.e. sufficiently funded to meet its liabilities over the long term);
- Ensuring that the corporation observes corporate formalities (e.g. holding annual member meetings, board meetings, annual reporting, etc);
- Refraining from fraudulent or inequitable acts when acting on behalf of the corporation.

Insurance- In some cases, *Directors and Officers* insurance may also cover indemnification of general members as well, but the policy must be carefully reviewed to confirm if this is the case. If so, it is likely more expensive. A member may also be able to obtain additional protection from their homeowner's policy.

Volunteers

Potential Liabilities- Volunteers are generally not liable for their acts for the organization. This liability protection arises out of both the Wisconsin statutes and the Federal Volunteer Protection Act.

Liability protection under Wisconsin law

- Volunteers are protected from liability arising from their acts or omissions as volunteers, except when the volunteer:
 - Commits a crime, unless the volunteer reasonably believed the conduct to be lawful or had no reason to believe it to be unlawful;
 - Commits an act of willful misconduct;
 - Acts as a Director or Officer of the corporation. This simply means the volunteer does not receive protection under this statute (see the section on directors and officers for applicable liability protections for that role);
 - Receives compensation or something of substantial value for acting;
 - Acts negligently in a situation where a license is required (e.g. lawyer).
- Volunteers are *not* provided liability protection in relation to:
 - A civil or criminal proceeding;
 - A proceeding brought by a person for violation of a state or federal law, where that law gives the person a private right of action;
 - Negligent operation of a motor vehicle, train, or other sort of motorized transport.

The Federal Volunteer Protection Act (FVPA)

The FVPA defines “volunteer” as anyone working for the nonprofit organization not paid more than \$500 in one year. The FVPA provides limited liability protection to volunteers of both nonprofit corporations and unincorporated associations for acts of ordinary negligence committed in the course of volunteering. For example,

- The Act limits punitive and non-economic damages recoverable from volunteers that are found liable;
- The action of the volunteer must be within the scope of volunteering for the organization, and, if needed, the volunteer must hold a proper license (e.g. for provision of legal services);
- No protection is given for acts committed while driving motor vehicles, boats or trains;
- No protection is given for the following types of acts:
 - Willful or criminal misconduct;
 - Gross negligence;
 - Reckless misconduct;
 - Conscious or flagrant indifference to the rights or safety of those harmed;
 - Acts while under the influence of alcohol or drugs;
 - Acts involving the violation of someone’s civil rights.

Unincorporated Associations

The Association Itself

Potential Liabilities and Risk Management Strategies- To be covered by the liability protections for unincorporated associations of Chapter 184 of the Wisconsin Statutes, a group must have at least three members and be organized for a nonprofit purpose. Chapter 184 allows an unincorporated association to both sue and be sued in the name of the organization. To the degree that an unincorporated association can act in its own name, it sees many of the same potential liabilities and needs to consider some of the same risk management strategies as an incorporated non-profit. In addition, the association should:

- Make sure adequate funding exists for contracts. If the agreement is being entered with the anticipation of paying with future funding, try to get an agreement from the vendor to only seek to recover from the organization, not its members. Unfortunately, many vendors may require a personal guarantee in order to conduct business with the organization.
- Act like a corporation, even if the organization isn’t one – hold meetings, take minutes, sign documents in name of the organization, etc.

Members

For purposes of determining liability and available protections under Ch. 184, a “member” is defined as someone who “may participate in the selection of persons authorized to manage the affairs of the nonprofit association or in the development of policy of the nonprofit association.” (see Chapter 184, Wisconsin Statutes)

Potential Liabilities—Case law in Wisconsin is unclear, but it is likely that the general liability protections of Chapter 184 could be “pierced” in the same manner as in the corporate setting (see the “Piercing the Corporate Veil” sidebar for more information).

- Liability under contracts: Association members enjoy protection from contract liability similar to those protections found in a corporation. In other words, liability for the contract does not exist simply because one is member, though one should ensure that the contract is signed in the name of the organization, not just in the name of the member.
- Liability for torts: Association members also enjoy protection for tort liability (e.g. personal injury, negligence, etc) like members of a nonprofit corporation. Slightly different from a corporation, however, members of an association are not protected for their own tortuous acts, even if they are done in their role as a member.
- Liability for crime: The law is somewhat unclear on this point, but it is unlikely that an unincorporated association could be charged with a crime, so liability for criminal acts would fall to the individuals responsible. Presumably, members not responsible for the crime would not be held liable.

Volunteers

Nonprofit association volunteers are not covered by the liability protections of the Wisconsin Statutes, which cover only volunteers of incorporated nonprofits. Association volunteers are, however, covered by the Federal Volunteer Protection Act. See the sidebar for more information.

Additional Resources

- *Chapter 184, Wisconsin Statutes*, can be found as a pdf file or as a searchable document at www.legis.state.wi.us/rsb/Statutes.html.
- *A Guide for Wisconsin Nonprofit Organizations*, published by the State Bar of Wisconsin, contains information on nonprofit management. Order at www.wisbar.org or call 608/257-3838 or 1-800-728-7788.
- *Managing Risk in Nonprofit Organizations: A Comprehensive Guide*, Melanie L. Herman et. al., John Wiley & Sons, Inc., 2004. This is a relatively new and very comprehensive text on a host of risk management issues.
- *Managing Special Events: Ten Steps to Safety* is a publication produced by The Non-Profit Risk Management Center and the Nonprofits’ Insurance Alliance of California. The book can be ordered at http://nonprofitrisk.org/pubs/spc_evnt.htm.
- The *Non-Profit Risk Management Center* offers articles, books, consultation services and tutorials specifically designed for non-profit organizations. Visit <http://nonprofitrisk.org>.