

LETTER OPINION
94-L-113

April 15, 1994

Mr. Charles W. Stroup
Director
Department of Economic Development
and Finance
1833 East Bismarck Expressway
Bismarck, ND 58504

Dear Mr. Stroup:

Thank you for your letter concerning the liability exposure of nonprofit development corporation board members. Specifically, you ask whether the board members have liability exposure while serving on the board and, secondly, if so, would the liability be different if the corporation were structured as a city job development authority.

A certified nonprofit development corporation is defined under N.D.C.C. ? 10-24-39 as "a corporation organized under [N.D.C.C. ch. 10-24], certified by the secretary of state under section 10-24-40, and no part of the income of which is distributable to its members, directors, or officers." "[A] majority of funds of the corporation must be used for investment in primary sector business." N.D.C.C. ? 10-24-40. A primary sector business is defined under N.D.C.C. ? 10-24-39(2) as "an individual, corporation, limited liability company, partnership, or association that, through a process employing knowledge and labor, adds value to a product produced for resale."

In the mid-1980s, increased judicial attention was focused on corporate officer and director (D&O) liability issues. See Theodore D. Moskowitz, Note, Turning Back the Tide of Director and Officer Liability, 23 Seton Hall L. Review 897 (1993); Michael W. Mitchell, Comment, North Carolina's Statutory Limitation on Directors' Liability, 24 Wake Forest L.Rev. 117, 118 (1989) ("The corporate community has endured a noticeable increase in the number and

Charles W. Stroup
April 15, 1994
Page 2

severity of claims that have been made against its directors over the last several years.").

Because of the "dark shadow in the form of potential lawsuit[s] and the high cost of liability insurance coverage," House Bill No. 1079 was enacted in 1987. Hearings on H. 1079 before the Senate Committee on State and Federal Government, (March 10, 1987) (Statement of Senator Nalewaja); 1987 N.D. Sess. Laws ch. 401, ? 1. HB 1079 was enacted to provide immunity from civil liability to directors, officers, and trustees of nonprofit organizations who do not receive over \$2,000 per year for reimbursement for expenses or any compensation for services provided. Id. The immunity for directors, officers, or trustees of nonprofit organizations is governed under N.D.C.C. ? 32-03-44, which provides:

Immunity of officers, directors, and trustees of nonprofit organizations. Any person who serves as a director, officer, or trustee of a nonprofit organization that is, or would qualify as a nonprofit organization that is, described in paragraphs 3, 4, 5, 6, 7, 10, and 19 of section 501(c) of the Internal Revenue Code of 1954 as amended [26 U.S.C. 501(c)(3), (4), (5), (6), (7), (10), and (19)], is immune from civil liability for any act or omission resulting in damage or injury if at the time of the act or omission all of the following are met:

1. The officer, director, or trustee was acting in good faith and in the scope of that person's official duties as a director, officer, or trustee of the nonprofit organization.

2. The act or omission did not constitute willful misconduct or gross negligence on the part of the officer, director, or trustee.

3. The officer, director, or trustee did not receive or expect to receive reimbursement for or payment of expenses in excess of two thousand dollars per year for expenses actually incurred as a result of providing services as a director, officer, or trustee of the nonprofit organization and did not receive or expect to receive compensation or anything in lieu of compensation as payment for services provided as a director, officer, or trustee of the nonprofit organization.

Charles W. Stroup
April 15, 1994
Page 3

Thus, a director, officer, or trustee is generally immune from civil liability for any act or omission resulting in damage or injury if such person was acting in good faith within the scope of official duties, and if such person was not guilty of gross negligence or willful misconduct.

However, granting civil immunity does not act to protect the director, officer, or trustee from the expenses involved in defending a civil lawsuit or claim. Accordingly, N.D.C.C. ? 10-24-05 was also amended in 1987 to provide for indemnification of nonprofit corporate directors, officers, and trustees if such persons were not guilty of gross negligence or willful misconduct. Specifically, N.D.C.C. ? 10-24-05(14) provides:

14. When any claim is asserted, whether by action in court or otherwise, against any person by reason of his being or having been a director, or officer of a corporation, the court in the proceeding in which such claim has been asserted, or any court having the requisite jurisdiction of an action instituted by such director or officer on his claim for indemnity, may assess indemnity against the corporation, its receiver, or trustee, for the amount paid by such director or officer in satisfaction of any judgment on or in compromise of any such claim (exclusive in either case of any amount paid to the corporation), and any expenses and costs (including attorneys' fees) actually and necessarily incurred by him in connection therewith to the extent that the court shall deem reasonable and equitable, provided, nevertheless, that indemnity may be assessed under this section only if the court finds that the person indemnified was not guilty of gross negligence or willful misconduct in the performance of his duties as such director or officer. The right and remedy provided by this section shall be exclusive when any action brought on such claim has resulted in judgment against the person claiming indemnity, or when the person claiming indemnity has paid or agreed to pay any sum in settlement of any such claim or action, and in such case indemnity shall be awarded only upon order of court pursuant to the provisions of this section. In all other cases the right and remedy provided by this section shall not be exclusive, but each corporation shall have power to indemnify any director or officer or former director or officer of such corporation against expense and costs (including attorneys' fees) actually and necessarily incurred by him in connection with any claim asserted against him, by action in court or otherwise, by reason of his being or having been such director or officer, except in relation to matters as to which he shall have been guilty of gross negligence

Charles W. Stroup
April 15, 1994
Page 4

or willful misconduct in the performance of his duties as such director or officer.

Under N.D.C.C. ? 10-24-05(14), a nonprofit corporation has the authority to indemnify a director or officer against the costs of litigation or defending against a claim except in cases when the officer or director has been determined to be guilty of gross negligence or willful misconduct while performing the officer's or director's corporate duties. The policy issues raised by indemnification have been discussed in the 1986 Revised Model Nonprofit Corporation Act, Exposure Draft (March 1986). Specifically, the necessity of obtaining insurance was explained in the Model Act as follows:

The ability of the corporation to provide insurance which is broader than permissible indemnification further complicates the issues of public policy and public trust. Such insurance, however, is in itself limited by public policy and the available coverage. It is increasingly viewed as an essential complement to statutory indemnification especially where the corporation may have insufficient assets to satisfy indemnification obligations, or be reluctant to satisfy them from funds held for public purposes.

Id. at 8-88.

It rests upon the board members of a nonprofit development corporation to assess for themselves the propriety of purchasing O&D liability insurance. Board members may wish to discuss their particular need for insurance with private counsel and a reliable insurance provider. The board of a nonprofit corporation may also wish to discuss with corporate counsel the appropriateness of the corporation providing such coverage for board members.

The second part to your question asks whether the liability of the board members of a nonprofit development corporation would be different if the corporation were structured as a city job development authority.

A city job development authority is established pursuant to N.D.C.C. ? 40-57.4-01. Under that statute, a city's governing body may by a resolution create a job development authority after a public

hearing but it is subject to a possible city vote. A city job development authority is directed under N.D.C.C. ? 40-57.4-03 to "use its financial and other resources to encourage and assist in the development of employment within the city." Further, N.D.C.C. ? 40-57.4-03 authorizes the job development authority to exercise the following powers:

1. To sue and be sued.
2. To make and execute contracts and other instruments necessary or convenient to the exercise of the powers of the authority.
3. To hire professional personnel skilled in seeking and promoting new or expanded opportunities within the city.
4. To make, amend, and repeal resolutions consistent with the provisions of this chapter as necessary to carry into effect the powers and purposes of the authority.
5. To acquire by gift, trade, or purchase, and to hold, improve, and dispose of real or personal property.
6. To certify a tax levy as provided in section 40-57.4-04 and to expend moneys raised by the tax for the purposes provided in this chapter.
7. To insure or provide for insurance of any real or personal property in which the authority has an insurable interest.
8. To invest any funds held by the authority.
9. To cooperate with political subdivisions in exercising any of the powers granted by this section.
10. To loan, grant, or convey any funds or other real or personal property held by the authority for any purpose necessary or convenient to carry into effect the objective of the authority established by this chapter.
11. To use existing, uncommitted funds held by the authority to guarantee loans or make other financial commitments to enhance economic development.
12. To exercise any other powers necessary to carry out the purposes and provisions of this chapter.

Personal liability of employees of political subdivisions is governed by N.D.C.C. ? 32-12.1-04. An employee is defined under N.D.C.C. ? 32-12.1-02(3) as "any officer, employee, board member, volunteer, or servant of a political subdivision, whether elected or appointed and whether or not compensated, but does not include an independent contractor, or any person performing tasks the details of which the political subdivision has no right to control." N.D.C.C. ? 32-12.1-04(1) provides that "[a]n action for

Charles W. Stroup
April 15, 1994
Page 6

injuries proximately caused by the alleged negligence, wrongful act, or omission of an employee of a political subdivision occurring within the scope of the employee's employment or office shall be brought against the political subdivision." N.D.C.C. ? 32-12.1-04(1) further provides that "[a] political subdivision must defend the employee until the court determines the employee was acting outside the scope of the employee's employment or office." N.D.C.C. ? 32-12.1-04(2) provides that "[a]n employee shall not be personally liable for money damages or injuries when the injuries are proximately caused by the negligence, wrongful act, or omission of the employee acting within the scope of the employee's employment or office." N.D.C.C. ? 32-12.1-04(3) provides that "[n]o employee may be held liable in the employee's personal capacity for acts or omissions of the employee occurring within the scope of the employee's employment unless the acts or omissions constitute reckless or grossly negligent conduct, or willful or wanton misconduct." N.D.C.C. ? 32-12.1-04(4) provides that "[a] political subdivision shall indemnify and save harmless an employee for any claim, whether groundless or not, and final judgment for any act or omission occurring within the scope of employment or office of the employee." Liability insurance policy coverage is authorized under N.D.C.C. ? 32-12.1-05. For your convenience, I have enclosed a copy of N.D.C.C. ch. 32-12.1.

In comparison, there are some minor differences between the potential civil liability of nonprofit corporation board members and city job development board members. For example, the indemnification of nonprofit corporation board members is discretionary with a court or permissive under N.D.C.C. ? 10-24-04(14), but it is mandatory for city job development board members under N.D.C.C. ? 32-12.1-04(4). Additionally, it is only after a court determines that the nonprofit corporation board member is not guilty of gross negligence or willful misconduct that the court may assess indemnity against the corporation. Under N.D.C.C. ? 32-12.1-04(1), a job development authority must defend the board member until the court determines that the board member was acting outside the scope of the member's employment. However, the legal standard of civil liability is much the same, that is, a nonprofit corporation board

Charles W. Stroup
April 15, 1994
Page 7

member or a job development board member will only be personally liable when the board member's actions rise to the level of gross negligence or willful misconduct, or are outside the scope of the board member's official duties.

Sincerely,

Heidi Heitkamp
ATTORNEY GENERAL

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Enclosure