

How to limit a director's and officer's liability for mismanaging corporate funds.

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Directors and officers of fire protection and EMS corporations can be held personally accountable for mismanaging, wasting or illegally transferring corporate funds. Directors and officers should be careful to protect themselves from personal liability for these actions. In some cases, the directors and officers can be forced to pay the funds back out of their own pockets. Losing such a lawsuit can be easier than one thinks, and many boards of directors are not doing what they must to protect themselves.

This article deals with the most common problem we find among fire and EMS corporations in New York. Directors and officers fail to provide proper notice of meetings, fail to hold meetings in accordance with their bylaws and New York State law, and fail to adequately document the decisions.

Why are directors and officers liable for mismanagement of corporate funds?

Most fire protection corporations and many EMS corporations in New York State are not-for-profit corporations. The law which regulates those corporations is titled the "Not For Profit Corporation Law". The Not For Profit Corporation Law provides that members of the corporation may bring a lawsuit on behalf of the corporation against a director for mismanaging or improperly spending or transferring corporate funds. Thus, if you are a director or officer, your own members may start a lawsuit on behalf of the corporation, against a director for actions which resulted in the transferring or wasting of corporate funds.

There are a number of ways that directors and officers can mismanage, waste or improperly transfer funds. This article provides only a few of the many important suggestions.

How can the directors and officers protect themselves?

First, the bylaws of the corporation should give the directors and officers the power to make decisions regarding the spending of corporate assets. Some corporations give the members the right to approve all of the expenditures. This can be dangerous because members can assert that they did not understand or approve of the expenditure. If members are going to be permitted to approve of the expenditures, or as is more common, the more expensive expenses (e.g.: any item over \$2,000), the members should be presented with a very specific resolution clearly identifying the item to be purchased, the cost, and the method used to pay for it.

Second, the directors and officers must receive proper notice of the meeting at which the expenditure is approved. Notice must be given in accordance with the bylaws and the New York State Not For Profit Law. If the corporation amended its bylaws without consulting the law, there is a danger that the notice given was insufficient. Thus, any vote taken at the meeting may be invalid and improper. The same is true for a member meeting if the members are permitted to approve any expenditure.

Third, there must be a proper quorum at the meeting, and the vote must take place in accordance with the bylaws. Again, quorum and voting requirements are imposed by New York law, and the law must be consulted when drafting the bylaws.

Fourth, after a proper vote is taken, minutes should be maintained documenting the resolution was approved. The minutes should state something like: "Upon motion made, seconded and discussion held, the following resolution was approved: Be it resolved that...". The motion should simply be to approve the resolution. The resolution should be specific and clear. For instance, instead of stating "The corporation resolved to purchase a new engine", the resolution should state: "The directors and officers shall be permitted to expend funds in order to purchase a new type x engine between the amounts of \$x and \$x. The corporation may purchase the engine by entering into a lease, executing a note for a loan at x% interest for x years, or paying for in cash". Learning how to draft resolutions is a critical skill in order to ensure that the directors were fully aware of what they voted upon.

The minutes should then be reviewed and approved at the next board meeting. Of course, a motion to approve the minutes should be made, seconded and carried.

Conclusion

Since the law does permit lawsuits to be brought by members against directors and officers of the corporation for mismanaging or inappropriately transferring corporate funds, the board of directors should be extremely careful to ensure that they follow proper procedures for spending the funds. Directors and officers should receive training each year by a lawyer knowledgeable in managing corporations to ensure that members are not in a position to challenge the decisions made based simply on bad procedures or poor record keeping. The bylaws should also be reviewed to ensure compliance with New York State law. Bradley M. Pinsky, Esq. can assist with each of these tasks.