

THE COMMUNITY BUILDER

The Corporate Veil... is it Applicable to You?

In the past, we have talked about the Association's legal counsel and who they actually represent. One of our board members made an excellent suggestion that we take it a step further and talk about the corporation and what benefits or protections are provided to officers and directors of a corporation. The same issues apply to both for-profit corporations and not-for-profit corporations, such as the Association.

As most Associations are either a "not-for-profit" corporation or in some states a "non-profit" corporation, it is important to know that this is a corporation specifically formed for purposes other than making a profit. Even though the name implies that the corporation will not make a profit, it is a mistaken belief that they cannot and do not make money. The main structural component that distinguishes profit from not-for-profit is that the profits are not distributed to the shareholders, but go back into the organization.

As an elected director and officer of your corporation you benefit from this organization as it is considered to be a person or a separate legal entity. A corporation is guided by a set of statutory laws and its own internal laws (articles of incorporation, bylaws, policies and procedures) which directs its behavior. Given that the corporation was appropriately formed, the corporation can provide limited liability protection for those who are working within the confines of the statutory law and the corporation's articles of incorporation and bylaws. Without this protection, you could be personally liable. This is called the "corporate veil".

The corporate veil is initiated when the corporation is formed and its articles of incorporation have a statement that provides liability protection. The corporate veil of liability protection is maintained with the articles of incorporation including an indemnification agreement creating an exemption from incurred liabilities for the directors and officers from their actions. Each state has its own requirement, but generally state laws determine what kind of action a board member must take to void this indemnification. As a general rule, if the Board of Directors and



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officers act in good faith, within the scope of their duties, and avoid wrongful acts, they will be protected by this indemnification clause. The board of directors and officers can guard from personal liability by getting the corporation to pay for their legal defense. This indemnification clause generally authorizes the corporation to purchase insurance called director and officer (D&O) insurance to meet the requirements of the indemnification clause.

The corporate veil can be pierced, putting the corporation's liability protection at risk, under a number of circumstances. Each state has different requirement, but generally the corporate veil can be pierced if the corporate formalities are not followed such as not having an annual meeting, not keeping minutes, not maintaining proper filings with the state, not maintaining its own property, financial books and accounts, etc. First and foremost, you can't hide behind a corporation for your own wrong doing. Corporate officers are not liable for corporate activities in which they did not materially participate.

However, officers and directors of a corporation are always liable for their own wrong doing even when the corporation is also liable. This is the case whether the corporate officer participates in the wrong or merely authorizes or directs that it be done. Example: ordering a resident of a property to disconnect exterior lighting that the resident installed to protect herself from criminal activity following rape in a unit (*Frances T. v Village Green Owners Association*); giving permission for exterior alterations without benefit of board approval; acting selectively on collections issues or covenants violations, etc.

As a director and officer of your corporation, you have a legal and binding duty to your shareholders or owners called fiduciary duty. You have the obligation to use the good business judgment rule when making decisions affecting them. By acting in good faith, with the guidance of experts and professionals to guide you, your corporate veil will not be pierced.

