

Liability Trends for Nonprofit Organizations



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Employees. Former employees. Donors. Grantors. Third parties. Fellow board members. You probably don't like to think of them as liability risks to your nonprofit organization, yet all of them can make your nonprofit the target of a lawsuit. Such lawsuits can easily cost a nonprofit organization hundreds of thousands of dollars, not including legal fees.

Employment Practices Is Leading Risk

Concerns over employment practices liability (EPL) claims constitute the greatest single trend in liability issues facing nonprofit organizations. Ever since Anita Hill squared off against Clarence Thomas, EPL claims have led the parade of liability claims against both for-profit and nonprofit organizations. According to the Equal Employment Opportunity Commission (EEOC), the number of employment practices complaints rose sharply after 1992, peaked in 1994 at 91,189, and has since leveled off at between 75,000 and 80,000 annually (77,444 in 1999). However, the EEOC also reports that, despite leveling off, EPL claims have increased in severity, with settlement amounts reaching \$210.5 million in 1999 — a new high.

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A closer look at the different types of EPL claims is revealing. Allegations of race discrimination and/or harassment comprised 37% of EEOC complaints in 1999. These were followed by complaints alleging sexual harassment (31%), discrimination due to a disability (22%), and age discrimination (18%). Retaliation also figured in 25% of claims. It isn't unusual for claims to include a second allegation of retaliation, for things such as failure to promote, job reassignment, or wrongful discharge. Retaliation claims are especially dangerous because a jury that may not be too impressed by one claim — harassment, for example — may still be appalled at the defendant's proven retaliatory action and award a victory to the plaintiff as a result.

Recent experience strongly suggests that the frequency of EPL claims will continue unabated, with little or no relief ahead in the severity of settlements. Employment issues are among the most difficult to resolve — people become emotionally involved and are likely to see their cases through to trial, often seeking damages of hundreds of thousands of dollars.

Sources of Funds

Increasingly, donors seem to be suing nonprofit organizations over how the nonprofits use their funds. In today's increasingly litigious society, nonprofits have to carefully account for how they spend their funds, especially if private donations make up a significant portion of their revenue. With more and more media reports of nonprofit fraud, and more interest shown by consumer advocacy groups in the percentage of funds spent by nonprofits on administrative activities, donors appear to be increasingly sensitive about how their gifts are allocated.

Additionally, there has been a slight increase in claims made by regulatory and enforcement agencies concerning the use of government grants, for much the same reasons.

Another area of growing risk for nonprofit organizations is in an area referred to as "intermediate sanctions." Following the United Way of America scandal in 1992, Congress expressed concern over improper transactions that benefited nonprofit "insiders." Prior to 1992, the only action the Internal Revenue Service could take against an offending nonprofit was to revoke the nonprofit's tax-exempt status. While Congress was concerned about impropriety, this punishment was deemed too harsh. As a result, Congress empowered the IRS to assess a stiff monetary penalty — an "excess benefit transaction excise tax" — on both those who authorized the transaction and the insider(s) who benefited from it.

The Internet

Your nonprofit's website exposes your organization to claims alleging defamation, copyright and trademark infringement, and invasion of privacy. Simply creating and maintaining a website increases the possibility of data theft or loss by hackers and computer viruses, or lawsuits seeking injunctions to prevent the alleged misuse of a trademark. As with other professional liability risks, you don't have to do anything wrong on your website to be sued for a wide variety of claims.

Although website-related claims are relatively rare thus far, the level of exposure is potentially high. Mark Grossman, a Florida lawyer, wrote in Gigalaw.com (July 2000), "Today, any business that uses the Internet for any reason exposes itself to new risks that could have potentially devastating consequences_ Try some of these on for size: If a court finds you guilty of improperly using someone's trademark on-line, you could face a fine of up to \$100,000 per infringement. If you use someone's patented idea on your website, you could pay damages up to three times the amount of profits that you made from the site."

Insurance Coverage Trends

Nonprofit organizations have become much more sophisticated in acquiring liability insurance coverage. Not long ago, there was a general belief that "one size fits all," but these days nonprofits and their insurance brokers are taking advantage of the increasingly competitive marketplace by requesting more tailored insurance policies.

For example, insureds are seeking higher policy limits — that is, the amount of liability the insurer will cover. While a \$1 million limit was common five years ago, today a growing number of nonprofits are purchasing limits of \$2 million or higher. Brokers for nonprofit organizations are also demanding coverage for punitive damages; defense expenses outside of policy limits; claims by independent contractors, third parties, leased employees, and professional employer organizations; fiduciary duties; ERISA compliance issues; and excess benefits.

The U.S. economy is flourishing, and in many ways these are good times for nonprofit organizations. Nevertheless, nonprofits are facing a rising tide of liability risks, some from previously unsuspected sources.

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