

Liability and the Board: What Governing Teams Need to Know



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With more than 1.5 million registered, tax-exempt organizations in the U.S., it's likely that many times that number of Americans currently serve on nonprofit boards. Board service involves a commitment of time, attention, enthusiasm, and in many cases, a personal financial contribution. When you serve on a board you're likely to make new friends and professional connections, and gain an insider's view of the organization's programs and services. With so many positive aspects of board service, what are the downside risks?

Some of the downside risks of volunteer board service include:

- Discomfort from unmanaged conflict between members of the board or between the board and CEO
- Stress from the knowledge that available financial resources are insufficient to support the mission, programs, staffing and obligations of the nonprofit
- Anxiety in the wake of legal claims alleging negligence, defamation, or breach of contract versus abstaining
- The risk of personal liability for your acts or omissions as a board member

The risk of unmanaged conflict should be addressed without delay. Techniques to reduce the likelihood of conflict include conducting an annual, thorough board orientation; resolving to keep the communications channels open between the board and CEO; and choosing how the governing team will deal with conflict before it occurs. For example, one technique is to designate a leader, such as the Board Development Committee Chair, as the point person for addressing occasional bad board behavior. Another technique is to adopt a code of conduct describing the board's aspirations for the way it will work. For example, the code might indicate that board members should never agree how they will vote on an issue prior to a board meeting. Doing so compromises the ability of the board to hear all sides of an issue and collaboratively reach the best possible decision.

The risk of inadequate financing for the nonprofit's mission can be managed by thoughtful deliberations about potential sources of funding, proposed strategies for exploiting those opportunities, and hard decisions about what programs and activities should be continued, bolstered, or shuttered.

This article focuses on the final two risks: legal claims against the board for which the organization is responsible, and the risk of personal liability facing individual board members.

Plaintiffs and Causes of Action in Cases Brought Against the Board

Nonprofit governing teams make countless decisions throughout the fiscal year, from deciding how to allocate financial resources, to determining which programs must be cut to make way for new initiatives. These decisions potentially affect—in positive as well as negative ways—a wide array of stakeholders, from clients and service recipients, to members, neighbors, and vendors, as well as individual and institutional donors. Each of these stakeholders is a potentially aggrieved plaintiff in a lawsuit alleging wrongful decisions by the board. For example:

- Neighbors of a nonprofit bring a lawsuit to halt construction of an addition to the nonprofit's headquarters building, alleging that the addition is too close to the property line.
 - The parents of a child who was denied admission to a private school allege discriminatory admissions practices in violation of the law.
 - Members of an amateur athletic organization sue the board of a nonprofit after the organization issues new rules governing its competitions.
- A wealthy donor sues the board of the surviving nonprofit after the merger of two organizations. The donor's suit alleges that the merger led to the cancellation of the specific project for which the donor contributed funds.

In each of these cases a court will first determine whether the individual or group bringing the lawsuit has standing to sue in the court where the case has been filed. Standing refers to a legal "Whether a nonprofit is liable for harm connected to the decisions of a board depends on a number of considerations. These include: whether a duty was owed by the nonprofit to the plaintiff, whether that duty was breached, and whether members of the board acted in good faith and with ordinary diligence." standard requiring that the plaintiff in litigation has a sufficient connection to the actions that are the focus of the suit, such as alleged violations of law, tort damages or the consequences of a contract breach. In most cases this means that the plaintiff has suffered harm directly attributable to the alleged action or inaction of the nonprofit (the defendant). In many cases brought against nonprofits and nonprofit boards, the plaintiff will be deemed to have standing to sue. The next issue for consideration is whether the nonprofit is responsible for the plaintiff's harm or loss.

When is a Nonprofit Liable for the Decisions of the Board?

Whether a nonprofit is liable for harm connected to the decisions of a board depends on a number of considerations. These include: whether a duty was owed by the nonprofit to the plaintiff, whether that duty was breached, and whether members of the board acted in good faith and with ordinary diligence.

For example, the board owes the institutional and individual donors of the organization a duty to ensure that donated funds are spent in accordance with the wishes of a donor. To adequately discharge that duty the board may approve a gift acceptance policy; delegate to the CEO (and her team) responsibility for tracking pledges and grant-supported expenses; and review and accept the budget of the entity, quarterly financial statements and the annual tax filings of the organization. This level of care and due diligence makes it likely that the organization, and not its individual board members, will be held responsible if a court of law finds that the organization breached its duty to the plaintiff.

With rare exceptions, members of a nonprofit board are protected against personal liability due to the following:

- An incorporated entity is responsible for its debts. In the vast majority of circumstances, judgments imposed on a nonprofit by a court of law have to be paid by the organization, not individual directors.
- The bylaws of most nonprofits contain a promise to indemnify board members to the full extent permitted under the relevant state's nonprofit corporation law, for any statement, vote, decision or failure to act because of their role as a director or officer of the organization.
- Nonprofits that purchase general liability ("GL" coverage), professional liability ("PL" coverage), and directors' and officers' liability insurance ("D&O" coverage) have taken an extra step to finance the cost of the promise to indemnify members of the board. Each of these policies responds to different types of claims—all of which could be filed against the nonprofit, its board, or both. General liability coverage responds to claims alleging bodily injury and property damage. Professional liability coverage responds to claims alleging negligence in the delivery of professional services. D&O policies respond to claims

alleging wrongful management decisions. In some cases defense costs are in addition to the limit of liability, while in other policies funds spent on legal defense reduce the limit available for judgments and settlements.

- Board members who act with good faith and exercise due care are shielded from personal liability for the decisions they make while serving on a board.
- Every state in the United States has a volunteer protection statute "...board members who act in good faith and with diligence and care, are unlikely to be held personally responsible for their actions on the nonprofit's behalf." that limits in some respect the personal, legal liability of volunteers. Some state volunteer protection laws only protect directors and officers serving nonprofits, while others protect even narrower categories of volunteers, such as firefighters or other emergency service personnel. The federal Volunteer Protection Act of 1997 is similar in some respects to the state laws, but sometimes offers more robust protection. In states where the VPA offers greater protection than the state law, volunteers in that state enjoy the broader protection of the federal law. One legislative purpose of the VPA was to shift responsibility for harm caused by volunteers away from volunteers and over to the nonprofit organizations they serve.

Personal Liability

The risk of personal criminal or civil liability on the part of individual nonprofit board members is small but difficult to quantify. It is important to note that exercising poor judgment, relying on an expert whose advice is later determined to be faulty, or making a decision based on incomplete information rarely lead to personal liability on the part of individual board members. This means that board members who act in good faith and with diligence and care, are unlikely to be held personally responsible for their actions on the nonprofit's behalf. However, there are a number of specific situations that create or increase the exposure to personal liability, such as:

- Actions and activity that intentionally cause injury, harm or damage to persons or property
- Personal participation in the tortious conduct of a nonprofit's employees (tortious conduct is conduct that subjects the actor to civil liability under the law)
- The knowing approval of criminal acts or active involvement in criminal activities by the organization
- Personal involvement in a contract involving the nonprofit that is tainted by fraud
- Active participation in a transaction approved by the board with an entity in which the board member had a substantial personal or financial interest.

Risk Tips for Board Liability

Follow the tips below to manage the risk of board liability and reduce the exposure of board members to legal claims and judgments:

1. **Provide an annual board orientation to which new and returning board members are invited.** The orientation should address the legal duties of the board, the expectations of all board members, the structure of the organization and its governance function, current board policies and governing documents, and the oversight role of the board with respect to fiscal health, risk, and employment matters.
2. **Provide regular communications to the board to keep the governing body apprised of programmatic developments, major contractual relationships, staffing changes, stakeholder concerns, threatened or ongoing claims and litigation, and fundraising trends and forecasts.** A board kept in the dark is of little use to the management team or the mission of a nonprofit. And when trouble surfaces, an informed board is a valuable partner. A misinformed or neglected board will be unable to provide needed support during a crisis, nor will it be able to boost and sustain the confidence of external stakeholders. And in a worst case scenario an uninformed board could take action that makes the crisis worse, rather than better.
3. **Keep the board apprised about the steps the organization has taken to protect the nonprofit and its governing team, including the promise of indemnification found in the bylaws and details surrounding the nonprofit's directors' and officers' liability insurance ("D&O") and other liability coverages.** Include the Bylaws and D&O policy wording in material provided to the board as part of its annual orientation and make sure that these and other background items are readily available year-round.
4. **Hold each and every board member accountable for their commitments, from the beginning**

of their term of service until the end. Accountable simply means doing what you have agreed to do. To make accountability a reality, consider designating a member of the board, such as the board chair or the chair of the Board Development Committee, to follow up with board members who fall short of their commitments, such as missing more than an acceptable number of meetings, failing to submit reports for the committees they lead, etc. For more information on holding the board accountable, see: “Enforcing Board Member Responsibilities” at [www.https://nonprofitrisk.org/](https://nonprofitrisk.org/).

5. **Help the board understand its responsibility to disclose actual and potential conflicts of interest through a thoughtful, annual process.** Explain to the board that conflicts of interest may be inevitable and are not necessarily a bad thing. For example, nonprofits that have two board members who have a family or business relationship must disclose these reportable relationships on the IRS Form 990, yet whether a conflict of interest exists depends on the circumstances before the board. The key questions are:
- **Do any board members have potential or actual conflicts of interests?**
 - **If yes, is the conflict of the type that must be reported on the IRS Form 990 or only disclosed in the annual conflict of interest disclosure process?** Family and business relationships must be disclosed on the Form 990, while it is not necessary to disclose to the IRS that a board member serves on the staff of a philanthropic foundation from which the nonprofit receives or intends to solicit funds.
 - **Where conflicts are disclosed, what process will the board use to address the conflict if it becomes necessary to do so?** For example, a board member owns a piece of property that the nonprofit seeks to buy. The conflict should be disclosed to the full board prior to the board’s discussion about the purchase and the board should decide, possibly after hearing the recommendation of the executive committee, whether to excuse the member from the discussion and the vote about the purchase, or only from the vote.

Risk Tips for Personal Liability

It is not unusual for some members of a nonprofit board to express concern about the risk of personal liability arising from their volunteer service on the governing body. And although the risk of personal liability being imposed on volunteers is low, there are steps every board member can take to reduce the risk from low to negligible. To minimize exposure to personal liability, every current and prospective board member should:

1. **Serve for the right purpose:** Never agree to serve on a nonprofit board as a personal favor to a friend. The sense of satisfaction that service offers comes with a price tag. The cost of service includes the willingness to put personal interests aside while voting on issues before the board, as well as an investment of personal time and other resources to support the mission of the nonprofit.
2. **Pause before accepting a leadership role:** Give careful thought prior to volunteering to serve as an officer or Committee Chair, recognizing that these important roles require additional time and focus in support of the organization’s mission.
3. **Come to board and committee meetings fully prepared to share your questions and perspective:** Carefully review background material provided in advance of board meetings and prepare thoughtful questions for which you seek additional information or clarification. Remember that the legal duty of care applicable to every member of the board requires the care and concern of an ordinarily prudent person. Ask: Would I be comfortable making this decision if it required the expenditure or commitment of personal funds? What additional information do I need to feel confident the board is making the best possible decision at this time?
4. **Vote “yes” only when you’re confident it’s the right thing to do:** Never vote “yes” on a matter before the board if you are unclear about the implications of the decision, if you believe that a “yes” vote is not in the best interests of the nonprofit, or if you are convinced that further study or reflection is needed on the issue before the board.
5. **Be courageous:** Always vote “no” (versus abstaining) if you disagree with the proposed action before the board. Take the opportunity to explain why you are voting “no” during the comments or questions period.
6. **Listen to the small voice telling you to speak up:** Never tacitly or openly endorse an action you believe is wrong. Always speak up if you believe the organization, or any of its paid or volunteer leaders, are acting in a way that is illegal, unethical, fraudulent or violates regulatory requirements to which the nonprofit must adhere. Speak up if you believe a conflict of interest should be disclosed and discussed prior to a vote on a matter before the board.

The potential for an organization to be held legally responsible for its acts or omissions is a constant companion

of every nonprofit mission. And as guardians of a nonprofit's mission as well as its assets, the board has a special responsibility to deliberate and act with care. Doing so not only increases the quality of the decisions made by the board, it also reduces the organization's exposure to legal claims. Armed with the resolve to be adequately prepared for committee and board meetings and the courage to speak up, every member of the board can also reduce the less likely, but still present risk of personal liability.

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