

# Litigation Risks Facing Nonprofit Boards

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**Dailey**<sub>LLP</sub>

# Agenda

- Risks of Litigation
- Who May File Suit?
- Examples of Disputes
- Final Reminders

# Risks of Litigation

# Risks of Litigation

- 63% of nonprofit organizations in the U.S. report a D&O claim over a 10-year period.
- nonprofit D&O claims are filed twice as often as private companies.
- 85% of claims filed are employment related.
- Every nonprofit organization is at risk of a data breach as they keep and maintain donor financial files, employee records, client data, and volunteer data.

\* Willis Towers Watson D&O Liability Survey

## Risks of Litigation (cont.)

- The risk of personal criminal or civil liability on the part of individual board members is small.
- Board members who act in good faith and diligence and care are unlikely to be held personally responsible for their actions on the nonprofit's behalf.
  - Poor judgment, relying on faulty expert advice, or making a decision based on incomplete information rarely leads to personal liability.

## Risks of Litigation (cont.)

- **Situations that create or increase personal liability exposure:**
  - Actions that intentionally cause injury to persons or property.
  - Participation in the tortious conduct of a nonprofit's employees.
  - Approval of criminal acts or active involvement.
  - Personal involvement in a contract involving the nonprofit that is tainted by fraud.
  - Active participation in a transaction with an entity in which the board member had a substantial personal or financial interest.

# Risks of Litigation (cont.)

- **Personal Liability**

- You may have to pay to defend yourself and any judgment.
- Criminal and/or civil penalties.
- Risk to your license to practice

**VS**

- **Personal Toll**

- Increased time spent on board activities.
- You are deposed.
- If inadequate insurance or funds, may have to pay fees.
- Potential reputational risk due to association.

Who Might File Suit?



# Who Might File Suit?

- **Donors**
  - Donors and contributors may bring a lawsuit against the organization, often citing misappropriation of a restricted donation.
- **Beneficiaries**
  - The recipients of the work a nonprofit does alleging they were harmed by the services or discriminated against.
- **Regulatory Bodies**
  - State attorneys general in most jurisdictions. At the federal level, entities such as the Internal Revenue Service or the Department of Labor can bring legal action.

# Who Might File Suit? (cont.)

- **Members**
  - If operating as a membership organization, members can allege harmful acts with respect to the interests of the members.
- **Third party affiliates**
  - Vendors, fundraisers, or other nonprofit organizations that have a relationship with the organization in question can allege harm.
- **Employees**
  - Staff (current and former) can bring suit for alleged wrongful acts including discrimination, wrongful termination, ADA violations, and sexual harassment.

# Examples of Disputes

# Employment Disputes

- **Discrimination Claims**
  - Claims brought by a job applicant or an employee based on race, color, religion, sex (including pregnancy, gender identity and sexual orientation), national origin, age (40 or older), disability or genetic information.
- **Retaliation and Wrongful Termination Claims**
  - Claims related to termination due to whistleblowing, complaints about workplace safety, or taking protected leave.
- **Sexual Harassment**
  - Could be brought by an employee or volunteers.
- **Defamation**
  - Statements made about former employees or volunteers.

# Breach of Bylaws

- Lawsuits filed by members.
- Usually because Board usurped some power reserved for members.
- Examples include:
  - Election of a new Executive Director violated bylaws.
  - Board dismissal of a Director of the Board, where bylaws provide that only members can elect or remove.

# Dispute Between Members

- Internal member disputes often lead to suits.
  - A club contemplating bylaw changes.
  - Several members opposed. Attempting to gather support, two members sent threatening emails to other members.
  - The Board terminated their memberships as a result.
  - The former members filed suit against the club seeking reinstatement, removal of the discipline from their files, and attorney's fees.
  - Case went to trial and cost approximately \$400,000 in legal fees.

# Misappropriation of Funds

- **Challenges to the use of funds are common.**
  - A nonprofit grant foundation receives private donations in support of the foundation's expressed mission.
  - A claim is made against the foundation alleging the funds were used for purposes not aligned with the foundation's mission.

# Dispute with Companion Organization

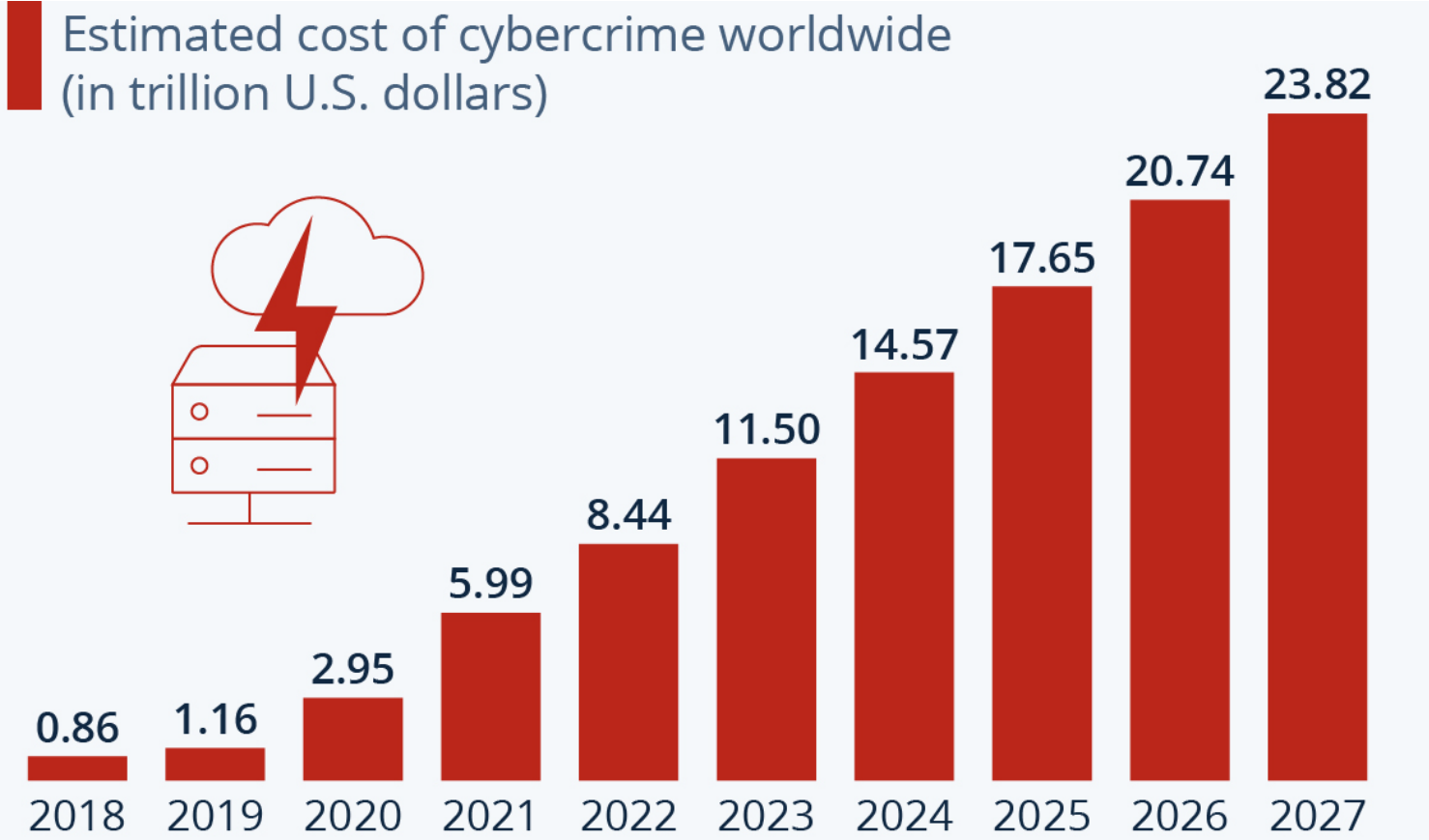
- **Partnerships with other nonprofits can sour.**
  - A nonprofit solicited funds to endow a school in Europe, which was operated by a separate foundation there.
  - The European foundation terminated its contract, initiated a lawsuit alleging gross misconduct, and asked the court to declare the endowment funds be turned over to the foundation.
  - The litigation lasted nearly a decade and cost the insurer approximately \$3,000,000 to defend.



# Identity Theft

- Expect increased challenges to how nonprofits protect information.
- Employees or donors file suit alleging that they suffered damages, including identity theft, financial loss and significant emotional distress resulting from a nonprofit organization's failure to maintain adequate controls over personal, non-public information, failure to adequately screen staff and failure to safeguard information entrusted to the nonprofit.

# Cybercrime



As of November 2022. Data shown is using current exchange rates.

Sources: Statista Technology Market Outlook, National Cyber Security Organizations, FBI, IMF

# Cybercrime (con't)

- Tricking financial institutions into giving access to fraudsters to send unauthorized wire transfers.
- **Phishing emails and websites**
  - Over 90% of all successful cyberattacks start with a phishing attack.
  - Many are credential phishing.
  - Nigerian prince to Microsoft imposters
  - Fake websites and fake social media profiles that offer to provide benefits, such as discounts also used to mine information.

## Cybercrime (con't)

- What IT security in Place?
- What insurance in place? Breach? Crime Loss?
- What training in place?
- What evaluation of financial controls and bank transaction limitations?

# Final Reminders

**Feel free to contact:**

**Jeffery A. Dailey**

[jdailey@DaileyLLP.com](mailto:jdailey@DaileyLLP.com)

215-282-5172

Thank you.

**Dailey**<sub>LLP</sub>