Litigation Risks Facing Nonprofit Boards

April 13, 2023

Dailey LLP

Agenda

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

Risks of Litigation

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- 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

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- **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.

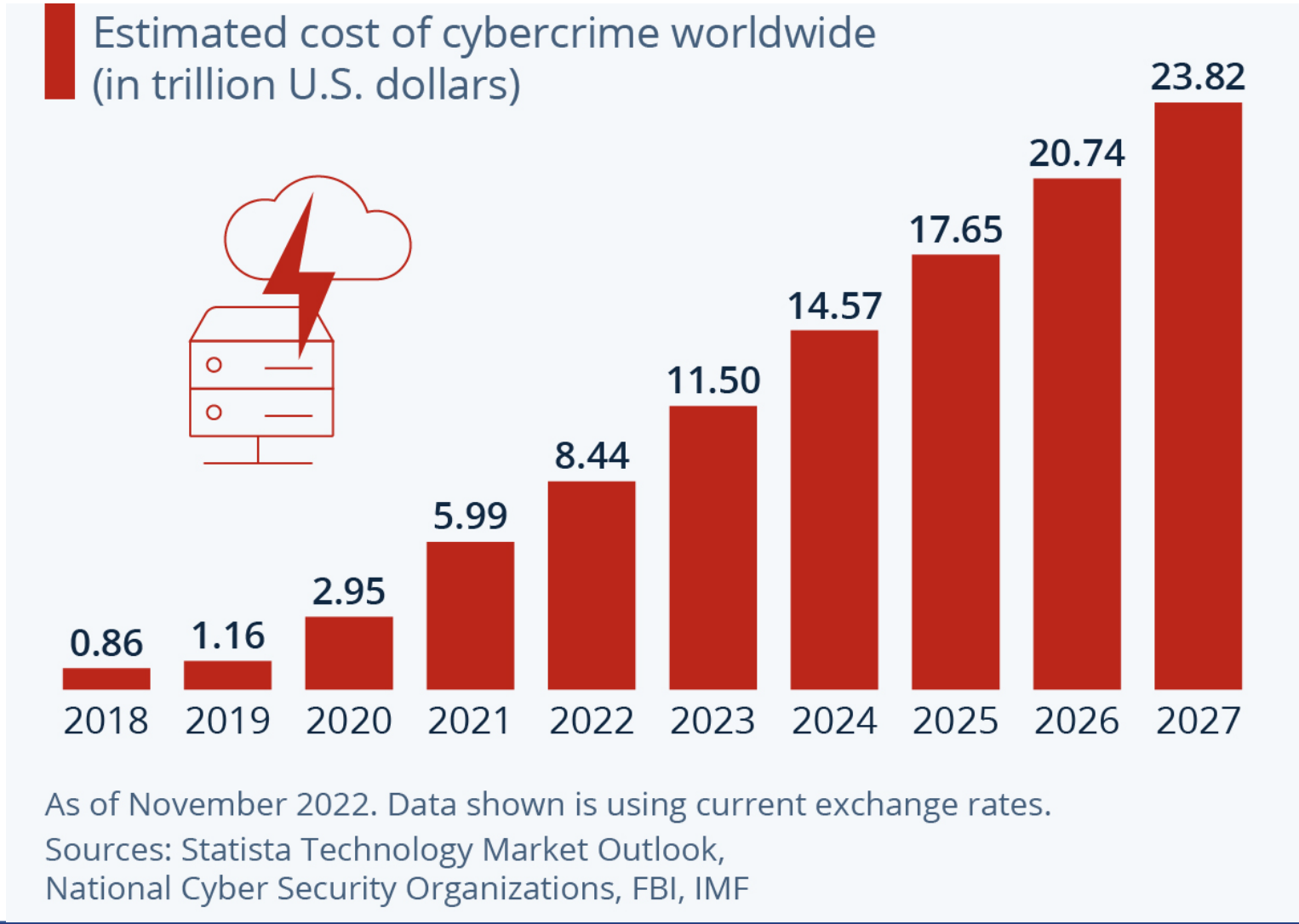
Dispute with Companion Organization

- 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



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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

Questions

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Thank you.

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