



# FOOD FOR THOUGHT

*for Nonprofit Board Members*

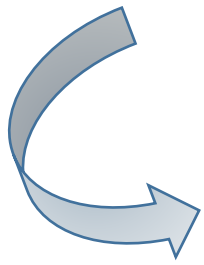
**February 2020 Topic: Board Legal Duties & Avoiding Legal Troubles**

## 1. Board Legal Duties

☐ Duty of Care, Duty of Loyalty, Duty of Obedience

## 2. Scenarios & Cases

☐ Examples: What Would You Do?



# BOARD DUTIES

**1-Ensure Legal & Ethical Integrity**

**2-Build a Competent Board**

**3-Determine Mission & Purpose**

**4-Ensure Effective Planning**

**5-Monitor & Strengthen Programs & Services**

**6-Protect Assets & Provide Financial Oversight**

**7-Ensure Adequate Financial Resources**

**8-Enhance the Organization's Public Standing**

**9-Select, Support & Evaluate the Chief Executive**



*(Board Source, Washington DC)*

# Welcome to Pennsylvania!

## Business Corporation Law



### PA Business Corporation Law (1988)

- PA BCL = Legal requirements & regulations surrounding corps in PA, including:
  - ▣ Registered agent/address in PA
  - ▣ Legal rights: buy & sell property; give & take loans; start another business; sue & be sued
  - ▣ Clear name & purpose
  - ▣ Articles of Incorporation filed with PA Dept of State Business Division
  - ▣ Have a board of directors, officers, qualifications, voting process, annual meeting
    - Note: PA BCLaw requires 3 positions (Pres, Sec, Treas). 1 person may hold all 3.
    - Legal practice/NOT BEST PRACTICE
  - ▣ Have bylaws & operate by them

### Legal Consequences

When an individual board member or a full board fails to comply with statutes, they can be held legally liable for criminal or civil monetary penalties that have the potential to bankrupt the organization.

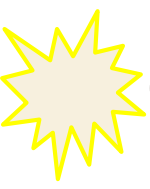
# Standard of Conduct = Business Judgment Rule

## Business Judgment Rule:

Courts will typically apply the Business Judgment Rule when rendering judgments, developed over the years as Courts have deliberated to what extent the corporate fiduciary is liable for honest errors in judgment that lead to loss to the corporation:

“Directors are required to perform their duties in good faith, in a manner in which they reasonably believe to be in the best interests of the corporation, and with such care, including reasonable inquiry, skill & diligence, as a person of ordinary prudence would use under similar circumstances.”





**Good Faith =**

**Duty of Care. Duty of Loyalty. Duty of Obedience.**

## **Duty of Care**

- Responsibility for making **informed judgments** lies with the board member:
  - ▣ Board members need **to secure facts & ask questions** to get **clarity of the issues**
  - ▣ The board should seek **independent professional advice** when decisions are **complex** or in **new** territory
- Per the Office of Inspector General, board members are responsible for two facets of legal compliance with regard to duty of care:
  - ▣ to ensure that **accurate information & reporting systems** exist
  - ▣ to ensure that reporting systems are adequate to **flag board members** in a **timely** manner when the organization is threatened by **legal** concerns



**3Ds:** *con't*

**Duty of Care. Duty of Loyalty. Duty of Obedience.**

## **Duty of Loyalty**

- ❑ Board members must **cast aside any personal & professional interests**, placing the interests of the nonprofit ahead of their own
- ❑ Although Board members technically CAN engage in **financial transactions** with the organization as long as the conflict is disclosed and approved by the other directors, this is perceived by many to be **disloyal self-dealing** and should be refrained from
- ❑ Loyalty means **respecting the confidentiality** of the organization's affairs by **not disclosing them** to outside individuals in a way that leads to **loss of opportunity** for the organization

## **Duty of Obedience**

- ❑ Board members are responsible to **assure compliance with all federal, state, & local laws & regulations**
- ❑ Board members must be **faithful to the organization's vision & mission**

# How Does D&O Help?

## Director's & Officer's Liability Insurance (D&O)

- D&O insurance typically protects individual board members as well as employees, volunteers & the organization itself in the instance of a **civil suit**: slip & falls, accidents, employment-related, someone believes the board intentionally took a significant improper action, etc.
- Almost 95% of claims against D&O policies are employment-related, including harassment, discrimination, and wrongful termination.
  - Per Nonprofits Insurance Alliance Group, annually 1 in 25 nonprofits has a D&O claim against them, nearly all employment-related.
  - The average D&O claim will cost \$35,000 to resolve (a combination of legal defense costs and in a few cases, settlement payments.)
  - 10% of claims will cost more than \$100,000 to resolve.
- If an organization has no employees, its risk of claims against board members is low, but so is the premium for such coverage. *It still makes sense to buy D&O, if for no other reason than to give board members peace of mind.*
- But since each policy is different, sometimes with different features even at the same insurance company, it is important to confirm with your broker that both individuals and the organization are covered, and that coverage for employment practices is included.



# Board Liability Basics:

- ❑ Make sure **taxes are paid** & **laws** are followed:
  - ▣ Assure **withholding taxes** are paid to the IRS
  - ▣ Assure **employment laws** are complied with
  
- ❑ Avoid non-management, mis-management & conflict of interest:
  - ▣ **Non-management** = absent & non-participating board members
  - ▣ **Mis-management** = the process or practice of managing ineptly, incompetently, or dishonestly. Misbehavior, negligence, violation, carelessness, dereliction, misdeed, transgression, malfeasance, impropriety, immorality, wrongdoing.
  - ▣ **Conflict of interest/duality of interest** = a situation in which a fiduciary who, contrary to the obligation & absolute duty to act for the benefit of the nonprofit, exploits the relationship for personal gain



# Scenarios & Cases – page 1

1. A Board member misses 3 of 4 board meetings in a year; but makes a large donation to the annual fund. What should the Board do?
2. A Board member offers to provide services to the nonprofit organization, below the typical market cost, but still for a fee.
3. The Board of an established nonprofit corporation is reviewing its bylaws. There is a question as to whether or not the bylaws should spell out the organization's purpose and mission in great detail. What is required? What are advantages and disadvantages of including a lot of detail?
4. Staff uses social media, especially Facebook & GoFundMe to encourage involvement & donations. The Board wants to know if this raises any legal concerns.
5. A staff member comes to a Board member with complaints about the Executive Director.
6. The Board neglects to conduct appraisals of the Executive Director. The Executive Director neglects to conduct appraisals of staff.
7. You serve on the Board of a large, well-managed 501(c)(3) organization. The Chief Executive Officer has decided to run for Borough Council, a part-time position. Their leadership on Borough Council could provide tremendous benefits to the nonprofit. What concerns does the Board need to address? How much can the Board support the CEO's run for Borough Council?

## Scenarios & Cases – page 2

1. You serve on the Board of a (501)(c)(3) sports nonprofit that runs youth basketball leagues. The nonprofit rents the gym for parties. The bookkeeper says that party rental fees further the basketball program, maintain the gym, & pay staff. A new Board member asks, “Should we do this? Won’t it result in **Unrelated Business Income Tax**?”

2. The Board of a nonprofit with an annual operating budget of \$750,000 has discovered from their new auditor that they have \$25,000 in a restricted account, raised 12 years ago for a building that was never constructed. There are **NO RECORDS of who contributed the money**. Can the Board transfer the money to the general operating fund?

3. The Executive Director is thrilled to report to the Board that an **anonymous donor** is contemplating a \$1,000,000 gift. The donor’s condition is that NO ONE knows who makes the gift. As a 501(c)(3) nonprofit public charity, must the Board know the name of the anonymous donor?

4. -A Board member purchases a **significant auction item** at the nonprofit’s event, on their credit card.  
-The next day the Board member **returns the item** to the nonprofit, telling the Executive Director they want a **refund** on their credit card charge.  
-The Executive Director calls the Board Chair for help.

5. -A donor makes a \$1,000,000 **challenge pledge** to the nonprofit’s first \$10,000,000 capital campaign, to entice other donors to give.  
-This is a **huge, extraordinary gift** for this nonprofit.  
-There is a large **publicity** event to kick off the campaign & **announce** the challenge gift.  
-After 2 years of fundraising, the goal has been met & all other donors’ gifts have been received.  
-The **construction** has begun.  
-The **challenge donor refuses to pay** their pledge.  
-The Board has to decide how to pursue this.

# THANKS TO OUR FOOD FOR THOUGHT DISCUSSION LEADERS & PARTNERS

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# HOPE TO SEE YOU NEXT TIME! PLEASE BRING BOARD FRIENDS



*Do you serve on a nonprofit board?  
Do you want to optimize your board performance?*  
**Join Us for Food For Thought About Nonprofit Boards**

**FREE!** A new community service, brought to you by the  
Chester County Community Foundation & United Way of Southern Chester County

**PRACTICAL • PROVOCATIVE • FUN • FOOD FOR THOUGHT**

Dear Board Members:

Let's face it, navigating nonprofit board service can be tricky. On top of your day job, you've agreed to contribute your best thinking to a nonprofit. Not always easy; but usually rewarding. Join us to explore board service in more depth. RSVP or just pop in at any session that interests you. And please bring board friends.

DATE	TIME	PLACE	FOOD FOR THOUGHT TOPICS	FOOD FOR THOUGHT LEADERS
Tues., 2/11/20	8-9:30 a.m.	The Market at Liberty Place, Kennett Square	Board Legal Duties & Avoiding Liability	Peter Temple Esq.
	5-6:30 p.m.			Don Lynn Esq.
Tues., 4/14/20	8-9:30 a.m.		What Are Organizational Life Cycles? How Do They Impact Boards? How Do We Plan for Leadership Succession of Staff & Board?	Krystine Sipple, CFRE & Lauren Harrell, CPA
	5-6:30 p.m.			Sonia Stamm & Krystine Sipple, CFRE
Tues., 6/9/20	8-9:30 a.m.		Board Self-Assessment & CEO Appraisals Governance Is Not Management, So What Is It?	Connie Carter & Krystine Sipple, CFRE
	5-6:30 p.m.			Karen Simmons & Krystine Sipple, CFRE

**SAVE YOUR PLACE!**

RSVP to [steph@chesccof.org](mailto:steph@chesccof.org) (610) 696-0501

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