AVOIDING LEGAL PITFALLS

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1. Ensure Legal & Ethical Integrity
2. Build a Competent Board
3. Determine Mission & Purpose; Ensure Effective Planning; Monitor & Strengthen Programs & Services
4. Protect Assets & Provide Financial Oversight
5. Ensure Adequate Financial Resources
6. Enhance the Organization’s Public Standing
7. Select, Support & Evaluate the Chief Executive

BoardSource, https://boardsource.org/ Washington DC
1 - Core Legal Concepts for Nonprofit Boards

Business Judgment Rule:
- good faith
- best interests
- reasonable inquiry, skill & diligence
- ordinary prudence

Duty of Care + Duty of Loyalty + Duty of Obedience

non-management, mis-management & conflict of interest

2 - Cases & Scenarios: What’s a Good Board Member to Do?
PA Business Corporation Law (1988)

PA BCL = Legal requirements & regulations surrounding corporations 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.
Business Judgment Rule:
Courts 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."

**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
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 costs $35,000 to resolve (a combination of legal defense costs and 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.
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
1. During COVID, the Board began to hold its monthly meetings on zoom. A Board member who had missed more than half of the Board meetings pre-COVID is now missing most all of the Board meetings. The Board member makes an extremely large annual donation to the annual fund. What should the Board do?

2. A nonprofit is having an issue recruiting enough volunteers to help, because of lingering COVID concerns amongst its cadre of volunteers. Staff is doing all it can to fill in amidst their other work, but cannot fill the gap. A Board member offers themselves and their extended family to provide the services, below the typical market cost, but still for a fee. What should the Board do?

3. 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?

4. When COVID struck, the Senior Staff & Board of a nonprofit with a $20M annual operating budget implemented immediate program cuts and closures. It also laid off personnel whose work would be impossible because of social distancing regulations, and cut administrative staffing. These moves cut the annual operating budget in half.

   The Board also agreed to tap the nonprofit’s $5M in financial reserves to provide basic services during COVID.

   Throughout COVID, nonprofit has partnering strategically and significantly with other nonprofits, to show the community that it is open and able to help.

   Now that COVID has become “normalized/manageable,” the nonprofit continues to provide basic services to a grateful constituent group, raise modest funds, and hold on for dear life. The reserves are almost fully depleted, and the annual operating budget has been pared to a shadow of its former self. What’s the Board to do?
Scenarios & Cases: fundraising & donor accountability

1. Staff uses social media, especially Facebook & GoFundMe, to encourage involvement & donations. More and more donations are coming in online from social media. A Board member wonders whether this raises any legal issues.

2. The nonprofit received a large gift from a donor last year, earmarked for a special new project. The funded project closed down due to COVID-related issues and the donated money remains unspent. The nonprofit would like to spend the remaining money on a new, different initiative. Can they? What should the Board do?

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

4. 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?”

5. 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.

6. 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.
1. When COVID first struck, the nonprofit’s 100+ person staff quickly adapted. Administrative staff worked remotely from home, and direct service staff took full precautions while working face to face with clients. Staff held weekly Zoom coordination calls; monthly committee meetings; and quarterly Board meetings. Currently, some administrative staff have returned to the office; but some would rather continue working remotely.

   The Executive Director is concerned about the growing divide between direct service staff and administrative staff; along with decreasing productivity, synergy and accountability. The Executive Director would like to bring all staff back onsite safely. Administrative staff point out that worldwide, employers have adapted to flexible remote work, and nonprofits need to do so, or lose experienced employees.

   What is the Board’s role here?

2. The Executive Director admits to the Board Chair that they are finding it difficult to monitor and evaluate the quality of staff’s work with constituents, as much of it is private, conversational and does not have immediate impact. What concerns does the Board need to address?