



## **RISKS OF SERVING**

Understanding the Duties of Nonprofit Directorship

Matthew Kletzli, Management Liability Leader

# ROLE OF THE BOARD & OFFICERS

---

## The Board of Trustees (i.e.-Directors) and Officers

- Are responsible for the strategic direction of the organization
- Are the central decision making body for the organization
- Have ultimate responsibility and accountability for the organization's actions



# ROLE OF THE BOARD & OFFICERS

---

Three fundamental fiduciary duties:

- Duty of Care
- Duty of Loyalty
- Duty of Obedience



A photograph of two men in a modern office setting. They are seated at a desk, looking at a laptop screen. The man on the left is pointing at the screen, and the man on the right is looking at it. The office has large windows in the background, and the scene is lit with a warm, orange glow. The text "Exercising Duties and Related Risks" is overlaid on the image in white, bold font.

## Exercising Duties and Related Risks

# DUTY OF CARE

## Board members should be engaged, informed, and independent

- Hallmarks of a good board:
  - Composed of volunteers who are committed to the mission and demonstrate an understanding of the community served
  - Have appropriate size to effectively further charitable purposes
  - Rotate board members – establish and enforce term limits
  - Meet multiple times a year
- Good trustees ask difficult questions and challenge the status quo



# DUTY OF CARE

---

## Trustees should be engaged, informed, and independent

- Loss Scenario
  - A non-profit organization held a fundraising event.
  - The organization received a temporary operating fund or “float” from another organization which was to be repaid from the proceeds of the events.
  - The funds were used to pay general expenses.
  - The organization subsequently filed for bankruptcy
  - The lawsuit against the organization and directors included negligence for failing to properly supervise the employee and breach of trust.
- Courts have asked how much the board members engage



# DUTY OF LOYALTY

## Act in the best interest of the organization and mission

- Transparency is valuable:
  - Understand and publicly express the mission
  - Structure programs to effectively and efficiently work toward achieving mission
  - State performance expectation and accountability of Board members
    - Meeting attendance
    - Fundraising
    - Committee service
    - Involvement in program activities
- Act in the best interest of the organization/mission



# DUTY OF LOYALTY

---

The mission, activities, finances, and governance should be transparent

- Loss Scenario:
  - Board declares bankruptcy
  - Local newspaper publishes self-dealing
    - Insurance is over priced, agent on the board
    - Price per square foot of lease overpriced, building owner on the board
    - Contract for cleaning services is overpriced, owner on the board
  - Report triggers bankruptcy trustee to investigate board conflicts of interest





# DUTY OF OBEDIENCE

---

- Good practices:
  - Appoint the executive responsible for the day-to-day management and operations of the organization (e.g.-CEO, President, Executive Director, etc.)
  - Establish and periodically review the bylaws and policies to ensure the effective governance and management of the organization
  - Engage in strategic planning
  - Monitor and manage performance



# DUTY OF OBEDIENCE

---

Loss:

- Scenario 1:
  - Home Owners Association begins to utilize the facilities to organize athletic tournaments
  - Home Owners vote to stop the tournaments (facility availability, cost of wear & tear, etc.)
  - Board continues the tournaments, members sue
  
- Scenario 2:
  - Union donates to political campaigns
  - Members bring suit that their dues were misused outside scope of mission



# BREACH OF FIDUCIARY DUTY

And then there are allegations that cross over multiple duties:

- A non-profit organization applied for and received government funding for the purpose of organizing and hosting a concert event.
- The expenses incurred for the event far exceed the revenues received.
- Government conducted an audit and determined the funds had not been used for the purposes described in the funding application.
- The government commenced action seeking damages due to the alleged negligent misrepresentations in the application documents and for the alleged breach of fiduciary duty on the part of the directors of the organization.
- The claim was resolved by way of negotiated settlement.



# BREACH OF FIDUCIARY DUTY

---

- The board of a professional association revoked an individual's membership due to allegations of unethical conduct.
- The member sued the association alleging the board of directors had targeted her and they had not followed the organization's bylaws.
- Although the facts did not appear to support the allegation that the board targeted the member, the bylaws were somewhat ambiguous, making it more difficult to defend the action.
- A settlement was negotiated to avoid any embarrassment or loss of reputation to the association





**THANK YOU**