

**BE PREPARED:
Non-Profit Organizations' Legal Risks and Protections¹**

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by

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I. INTRODUCTION

Non-profits³ face exposure to a wide array of [legal risks](#). Some risks are unique to non-profits – they may arise, for example, from an organization’s tax-exempt status or from the inherent nature of association activity. As non-profits increasingly feel pressure to do more with fewer resources, however, many non-profits have turned to business models traditionally maintained by for-profit enterprises to increase efficiency and impact by developing new ways of creating revenue, increasing employee utilization and enhancing marketing techniques. “Capacity building,” as this process has been called, is a growing trend in the operation of non-profits. Not surprisingly, as non-profits become more like their for-profit counterparts, the laws and duties that apply to – and the claims that are asserted against – non-profits likewise evolve. The result is that non-profits face more exposure to legal risks. Moreover, even the successful resolution of a matter may leave a non-profit facing significant legal defense costs.

When faced with such potential liabilities, non-profits and their management⁴ should weigh carefully how best to protect their organizations as well as their own personal assets. Given the limitations of [indemnification](#) and [statutory immunity](#), one of the most effective protections available is [insurance coverage](#). Among the primary types of insurance that a non-profit may wish to consider are [directors and officers liability policies](#) and [employment practices liability policies](#).

This article provides an overview of the potential legal risks that today’s non-profit organizations and their directors and officers may encounter. It also discusses certain statutory and other protections that may be afforded to non-profits which are at risk of legal liability. Finally, the article discusses the availability of insurance coverage to better protect non-profits and those who oversee and operate them.

II. LEGAL RISKS OF NON-PROFITS AND THEIR DIRECTORS AND OFFICERS

Non-profits and their directors and officers are susceptible to numerous types of claims. Such claims may include allegations concerning [employment](#), [civil rights](#), [defamation](#) or other assertions by employees, clients, members or other individuals who seek to hold the organization or its directors and officers liable for an injury suffered as a result of actions taken by the non-profit. Directors and officers may be sued for [breaches of fiduciary duties](#) that they owe to the organization. Non-profits may be subject to [government enforcement actions](#) by state or federal officials to enforce the organization’s compliance with applicable statutes and regulations. In addition, some non-profits may face liability for [antitrust claims](#) or [other claims](#) asserted by creative litigants.

In fact, in some respects directors and officers may be at a greater risk of liability in a non-profit than they would be in a for-profit corporation given that many non-profits have smaller budgets, fewer personnel performing more functions, and less defined policies and procedures (particularly with respect to employment practices). Moreover, for financial reasons non-profits may be unable to retain or consult professionals such as accountants and lawyers on as frequent a basis as for-profit companies. All of these factors and others may increase the likelihood of supervisory lapses or other errors. The potential for liability may be of particular

concern for directors, who very often serve on the boards of non-profits without compensation. The most common types of liability confronting non-profits and their directors and officers are discussed below.

A. Employment Claims

Employment-related disputes comprise the largest source of claims asserted against non-profits and their directors and officers. These claims involve a wide array of workplace issues that may be brought under general legal principles ([common law causes of action](#)) and a broad network of federal, state and local laws designed to protect employees ([statutory causes of action](#)). As a predicate to certain employment litigation, a claimant also may be required first to pursue his or her claims in [administrative proceedings](#).

While [potential defenses](#) to the employment claims exist, the [potential damages](#) are great. Although some claims are dismissed quickly, others may result in protracted and expensive litigation even if the non-profit ultimately prevails. Most claimants are entitled to a jury trial. The relief that may be awarded to a successful claimant ranges from reinstatement of employment to monetary damages, including, in some instances, reimbursement of attorney's fees.

1. Types of Claims

Although most individuals in the workplace are “at-will” employees (without contracts for a definite term) – and thus their employment may be terminated with or without cause – employers must assure that employment is not terminated for legally prohibited reasons. An employee may sue on behalf of himself or herself, but also may bring suit on behalf of a similarly situated class of individuals (often referred to as a “class action”). Depending upon the employment claim asserted, an employee may sue the non-profit itself. Under most federal statutes the organization, rather than an individual, is considered to be the “employer.” In other instances, however, an employee may name directors and officers as defendants, particularly if those individuals were involved in decisions relating to that employee's hiring, evaluations, training and termination. Employment claims may pose a special risk for non-profit directors and officers because employment claims brought under federal statutes are beyond the protection of state [liability-limiting statutes](#) that grant immunity to non-profits' directors and officers in certain circumstances.

a) Statutory Causes of Action

Federal, state and local governments over the last several decades have enacted a variety of legislation to protect employees from discrimination in the workplace. The most commonly cited federal statute is Title VII of the Civil Rights Act of 1964, which prohibits employment discrimination against individuals on the basis of race, color, religion, sex or national origin. Notably, Title VII also prohibits sexual harassment in the workplace. States and local jurisdictions may have analogous statutes or regulations that may expand the protected classes to include, for example, sexual orientation. Some of these statutes, though, may apply only to employers with a specified number of employees.

Title VII Employment Claims

An electrical apprentice filed a Title VII action against several defendants, including a non-profit which provided job training, alleging that she had been subjected to sexual harassment and discriminatory treatment in the non-profit's classroom and during on-the-job training with a private employer. She alleged the harassment had been so severe that she had been forced to quit the apprenticeship program. The court denied the non-profit's motion for summary judgment, finding that the record supported an inference that a sexually hostile work environment existed for which the non-profit could be held liable. The court also concluded that the non-profit's offer to reinstate the plaintiff would not insulate it from potential liability for back pay and front pay. See Herrera v. International Brotherhood of Elec. Workers Union, 228 F. Supp.2d 1233 (D. Colo. 2002). According to the court's docket, the parties subsequently settled.

An employee who formerly worked for a non-profit engaged in the revitalization of local communities brought a sexual harassment claim under Title VII and the Missouri Human Rights Act against the non-profit based upon the advances of a board member. The court affirmed the lower court's judgment in favor of the non-profit on the basis that plaintiff did not prove a sufficiently severe hostile work environment to support a harassment claim. See LeGrand v. Area Resources for Community and Human Servs., 394 F.3d 1098 (8th Cir. 2005).

Other federal statutes prohibit discrimination based on an individual's mental or physical disability (the Americans with Disabilities Act ("ADA")), age (the Age Discrimination in Employment Act ("ADEA")), or sex-based wage differentials where the work involves the same skill, effort and responsibility performed under the same working conditions (the Equal Pay Act). Other frequently litigated employment statutes include the Family and Medical Leave Act ("FMLA"), which entitles employees in certain circumstances to take leave without losing their position, seniority or health insurance benefits and the Fair Labor Standards Act ("FLSA"), which regulates minimum wages, overtime compensation and child labor. Many of these statutes also prohibit retaliation by an employer against an employee who pursues his or her statutory rights and protections or who discloses wrongful or illegal activities. "Whistle-blower" provisions in the Sarbanes-Oxley Act also may be triggered.

Other Federal Statutory Employment Claims

Plaintiff filed a complaint against a non-profit health system alleging that it had violated its written policy for staff reductions and terminated her employment based on her age, disability, and leave status, rather than on the permissible basis of seniority, in violation of the ADA, ADEA, FMLA, and Pennsylvania Human Relations Act (“PHRA”). Although the court granted summary judgment to the defendant on the ADA claim (and the related PHRA claim), it allowed the remaining causes of action to proceed, including a PHRA claim for age discrimination. See Madden v. Wyoming Valley Health Care System, Inc., Civil Action No. 3:04-344 (M.D. Pa. Apr. 26, 2005).

Plaintiffs, who had participated in a job skills training and counseling program operated by a non-profit, brought suit against it alleging that they were employees of the non-profit and therefore asserted that the non-profit organization violated the FLSA and state laws by paying them sub-minimum wages. The court concluded that the non-profit had violated employment law and ordered the non-profit to pay the plaintiffs’ back wages and attorneys’ fees and costs which totaled over \$1.05 million. See Archie v. Grand Central Partnership, 997 F. Supp. 504 (S.D.N.Y. 1998) and Archie v. Grand Central Partnership, 86 F. Supp.2d 262 (S.D.N.Y. 2000).

A candidate for the position of State Coordinator under a contract between a non-profit and the Commonwealth of Pennsylvania asserted a claim under 42 U.S.C. § 1983 for alleged violation of his First Amendment right to freedom of speech by purportedly not hiring him in retaliation for an interview he gave. The court dismissed the claim, finding that the non-profit was not acting under color of state law, a threshold requirement for Section 1983 liability. Similarly, the court dismissed a whistleblower claim under a state law protecting public employees. See Halstead v. Motorcycle Safety Foundation, 71 F. Supp.2d 455 (E.D. Pa. 1999).

Many other state and local statutes and regulations also may govern an employment relationship.

b) Administrative Proceedings

Some statutes – federal, state and local – require that an individual complaining about employment discrimination first seek resolution of the claim through a designated government agency. For example, to advance a claim of race discrimination under Title VII, an employee first must file a complaint or “charge” with the United States Equal Employment Opportunity Commission (“EEOC”). (The employee also may be required to file with an analogous state or local agency.) The EEOC (or other agency) considers the charge and may take a variety of actions – it may investigate and ask the employer to respond and/or to provide documents, suggest alternative dispute resolution, effectuate a resolution, or pursue the action on behalf of the employee. Often, the EEOC concludes its review by issuing the employee a “right to sue letter,” a prerequisite for filing suit in court. At each step of the process, the non-profit may be asked to defend its employment decision.

EEOC Claims⁵

In an ADA case, the EEOC alleged that a non-profit community-based primary care organization failed to hire the charging party for a position as a clinic director because it perceived that she was disabled. Specifically, the non-profit revoked a job offer, which had been conditioned on a physical examination, telling the charging party (who had a history of diabetes and cardiac problems) that she had failed the examination. Under a three-year consent decree, the non-profit must pay the charging party \$116,000 in back pay and compensatory damages and is required to comply with the ADA. See EEOC v. Detroit Community Health Connection, No. 03-73188 (E.D. Mich. May 23, 2005).

The EEOC alleged that the defendant, which operates eight hospitals and other medical facilities, terminated the charging party from her position because of her age, 74, in violation of the ADEA. Under a two-year consent decree, the charging party will receive \$157,500 in monetary relief. See EEOC v. St. Vincent Catholic Medical Center, No. 03-CV-4968 (E.D.N.Y. Jan. 19, 2005).

The EEOC sued the Canyon Lake Property Owners' Association alleging that two female employees were the victims of crude, sexually suggestive comments and unwanted touching. In April 2005, the association agreed to pay \$285,000 and make certain policy changes in order to settle the matter. See EEOC v. Canyon Lake Property Owners' Ass'n, Case No. 5:03-01118-RT (C.D. Cal.).

Other administrative agencies in addition to the EEOC may have jurisdiction to hear certain types of employment claims. For example, the National Labor Relations Board ("NLRB") may investigate and remedy unfair labor practices by employers and unions.

Other Employment-Related Administrative Proceedings

The NLRB issued a complaint against a non-profit charter school for violation of the National Labor Relations Act. The school allegedly terminated an employee for engaging in activity protected by the Act. An administrative law judge found that the school had discriminatorily discharged the employee and ordered it to offer her reinstatement and awarded her back pay. A three member panel of the NLRB affirmed the award. See Children's Studio School Public Charter School, Case 5-CA-31624, 343 NLRB No. 89 (Nov. 30, 2004).

c) Common Law Causes of Action

A non-profit also may be the target of an employment claim based upon "common law" (non-statutory) causes of action. Such actions include wrongful termination, termination in violation of public policy, breach of contract (*e.g.*, an express employment contract or an implied contract such as an employee handbook), constructive discharge (where an employer allegedly makes working conditions so intolerable that an employee is forced to resign), [defamation](#), invasion of privacy, intentional infliction of emotional distress, torts based on negligence (*e.g.*, negligent hiring, negligent training, negligent supervision, or negligent evaluation), and

intentional/fraudulent misrepresentation (*e.g.*, in providing substantive recommendations for former employees).

Common Law Employment Claims

A football coach alleged that the NCAA had tortiously interfered with his contract to coach the University of Washington's football team through the NCAA's investigation and statements alleging that the plaintiff had placed bets on NCAA basketball tournament games. After a six-week trial, the case was settled in March 2005 for a total of \$4.7 million, of which the NCAA paid \$2.5 million. See Neuheisel v. University of Washington, Case No. 03-2-342688-8SEA (Wash. Super. Ct., King County).

An individual with mental disabilities, cerebral palsy and psychological disorders sued the Association for Retarded Citizens of Alachua County, Inc. alleging it was responsible, under a theory of negligent hiring, for damages arising from its employee's sexual relations with the plaintiff, who was unable to grant consent. The jury returned a \$450,000 verdict against the association in October 2004 and the court awarded the plaintiff over \$172,000 in attorneys' fees and costs. See DiVito v. Association for Retarded Citizens of Alachua County, Inc., No. 00-CA-3831 (Fl. Cir. Ct., Alachua County).

A former employee who was terminated as general manager of a dissolved non-profit corporation that operated a credit union brought claims for breach of contract and tortious interference with contract against the corporation's board of directors. The court affirmed the dismissal of the suit on the basis that the board validly terminated the plaintiff's employment for cause. See Rodriguez v. Tech Credit Union Corp., 824 N.E.2d 442 (Ind. Ct. App. 2005).

In sum, employment claims run the gamut and often are restricted only by the creativity of legal counsel for the claimant. This is true whether the employer is a non-profit or a for-profit enterprise.

2. Potential Defenses

For as many types of wrongful employment claims as exist, a myriad of defenses also may be available. These include "technical" defenses such as a statute of limitations, or a failure to exhaust administrative remedies, that may be fatal to the claim. Other defenses may be more substantive in nature, including that the non-profit's employment decision was not prohibited by law and, moreover, was supported by a bona fide business reason. Each employment claim is likely to be factually unique.

Successfully Defended Claims

A former employee brought civil rights claims for wrongful termination against her former employer, a non-profit that provided childcare and room and board to at-risk children. The court dismissed the suit for lack of jurisdiction. See Dixon v. Vera Lloyd Presbyterian Home & Family Servs., Inc., 116 Fed. Appx. 34 (8th Cir. 2004).

3. Potential Damages

The relief that may be awarded in employment claims varies depending upon the type of action asserted. It may include injunctive relief, which is non-monetary in nature. Such relief may require an employer, for example, to reinstate an employee to his or her job or prohibit certain employment practices or, in the case of a disability, to provide an employee with an accommodation, which enables the employee to enjoy equal employment opportunities. An employee also may recover monetary damages in the form of back pay, front pay (future damages), compensation for non-economic damages such as emotional distress, punitive damages or, in some cases, liquidated damages. Title VII, however, imposes caps on compensatory damages (not including back pay or front pay) depending upon the number of employees in an organization. Of particular note is that some statutes, including Title VII, provide that a successful employee also may recover his or her attorney's fees. Employment cases often are expensive to litigate for both sides, which makes the recovery of attorney's fees a factor in assessing a case against a non-profit (or any organization). Similarly, it is not uncommon for a non-profit's legal defense costs to exceed a settlement amount or a judicial/jury award.

Employment Claims Can Be Costly

A teenage male employee sued his employer, a non-profit organization, and his supervisor for sex discrimination and wrongful discharge. The employee alleged that his supervisor acted aggressively towards him and that the organization failed to investigate the improper conduct. The case went to mediation and settled for \$750,000. See Doe v. Roe, 2000 WL 33395242 (Cal. Ct. Apr. 2000).

A female project coordinator sued her employer, a non-profit economic development association, for wrongful discharge and retaliation in violation of state law. She alleged that her former employer failed to provide her with a written employment contract, as promised, and terminated her employment in retaliation for reporting that the association's president had misused funds. A jury found in favor of the employee, awarding her \$272,000 in compensatory damages and \$600,000 in punitive damages. See Anderson v. Central Bering Sea Fisherman's Assoc., 3AN-98-10450, 2000 WL 33954811 (Alaska Ct. Apr. 2000).

B. Civil Rights Claims

Federal and state civil rights law are not limited to the employment context; they also prohibit discrimination in, among other things, education, housing, public accommodations, public facilities, and certain federally funded programs. Various statutes, including 42 U.S.C. § 1981 and Title VII, prohibit discrimination on the basis of race, sex, disability, religion and national origin.

Non-Employment Discrimination Claims

Female applicants to a local chapter of a nationwide benevolent membership organization brought an action against it as a place of public accommodation, alleging gender discrimination. The New Hampshire Supreme Court rejected the organization's argument that it was not a place of "public accommodation" and upheld the New Hampshire Commission for Human Rights' award of \$10,000 in compensatory damages to each petitioner, plus attorneys' fees and costs, and a \$24,000 fine. See Franklin Lodge of Elks v. Marcoux, 825 A.2d 480 (N.H. 2003).

A non-native Hawaiian student brought an action for race discrimination in violation of Title VII and Section 1981 against a private school, a charitable trust and its trustees, challenging its race-conscious admissions policy of accepting only native Hawaiian students. The court found that the race-based admissions policy was not a valid affirmative action plan and held that the admissions policy was unlawful because the school could not show that the policy was supported by a legitimate nondiscriminatory reason. See Doe v. Kamehameha Schools/Bernice Pauahi Bishop Estate, 416 F.3d 1025 (9th Cir. 2005).

In Martin v. PGA Tour, Inc., 984 F. Supp. 1320 (D. Or. 1998), the plaintiff, who suffered from a degenerative disease that limited his ability to walk, brought an action under the Americans with Disabilities Act against the PGA, a non-profit association of professional golfers, challenging the association's rule which required that players walk the golf course. The case eventually made its way to the United States Supreme Court, which upheld an injunction requiring the PGA to permit plaintiff to use a golf cart on the course. See PGA Tour v. Martin, 532 U.S. 661 (2001).

C. Defamation, Libel and Slander Claims

"Defamation" is commonly defined as an "intentional false communication, either published or publicly spoken, that injures another's reputation or good name."⁶ Libel is written defamation, while slander is oral defamation. Defamation claims are governed by state law and defined either by state statutes or state court decisions.

Defamation claims against non-profits may arise from numerous circumstances. For example, an employee filing a wrongful discharge action may include a defamation claim, alleging that the employer slandered her when providing a reference. Improper handling of confidential or sensitive client information may lead to a defamation claim. Statements on a non-profit's website may be the subject of a defamation claim.

The primary defenses to a defamation claim are truth and privilege. There may be an "absolute privilege" defense when public policy or the administration of justice requires complete immunity, such as statements made by a witness in an EEOC proceeding. A "qualified privilege" prohibits recovery when the communication at issue was made in good faith to someone who had a legitimate interest in hearing it. Thus, for example, employee references may be protected by a qualified privilege – so long as a court does not conclude that the employer abused the privilege or acted with malice.

Some, but not all states, have recognized that defamation claims can be thinly-disguised attacks on exercising First Amendment/free speech rights, and have enacted statutes aimed at discouraging strategic litigation against public participation (“SLAPP”). Anti-SLAPP statutes generally are limited to statements that concern an issue of widespread public interest, and not all states offer this form of statutory protection.

Defamation Claims

A Texas appellate court affirmed a jury’s verdict and ordered a non-profit to pay \$65,000 for indemnification of legal fees and costs incurred by the non-profit’s treasurer who had successfully defended himself against an action filed by a member of the non-profit for several claims including slander, intentional infliction of emotional distress, and gross negligence. See Charles A. George Dental Society, Inc. v. Poindexter, No. 01-02-01230, 2004 WL 170030 (Tex. App. Ct. Jan. 29, 2004).

A seller of women’s apparel filed an action for defamation, interference with prospective business advantage, unfair business practices, and nuisance against a non-profit and one of its employees, alleging that the defendants had falsely claimed that the plaintiff owed hundreds of thousands of dollars in unpaid wages to workers who sewed the clothing designed for sale in the plaintiff’s stores. The trial court denied the defendants’ motion to dismiss the action as a SLAPP suit. Only after an appeal was the suit dismissed. See Fashion 21 v. Coalition for Humane Immigrant Rights, 117 Cal. App.4th 1138 (Cal. App. Ct. 2004).

A chiropractor brought suit against a non-profit insurance industry association for claims arising out of its inclusion of his advertisement in materials for its seminar on insurance fraud. The chiropractor alleged libel and false light invasion of privacy. The court granted summary judgment to the non-profit, holding that its materials did not make any untrue statement or portray the chiropractor falsely. See Zarach v. Atlanta Claims Assoc., 500 S.E. 2d 1 (Ga. Ct. App. 1998).

A spiritual philosophy teacher brought a libel action against a non-profit and its officers based on statements made in a letter from the non-profit stating that “senior teachers” from the plaintiff’s organization had sexually exploited and coerced women as part of the training. The court denied the defendants’ summary judgment motion, finding that although the plaintiff was not named in the letter, he may be able to maintain his libel action if he can show that he is a member of the defamed group and that the group is small enough so that a reader could infer that the statement refers to him. See Sovik v. The Healing Network, 244 A.D.2d 985 (N.Y. App. Div. 1997).

D. Breaches of Fiduciary Duty

Directors and officers of non-profits owe “fiduciary duties” to the organization, *i.e.*, specific legal duties which may be generally characterized as ensuring that the interests of the organization are paramount. Specifically, directors and officers owe a non-profit three fiduciary duties: (1) the **duty of care**, which requires that the directors and officers act reasonably with

respect to the management of the organization’s affairs; (2) the [duty of loyalty](#), which prohibits directors and officers from using their positions in the organization to further their own personal interests; and (3) the [duty of obedience](#), which requires directors and officers to ensure that the organization is run in accordance with its charter and bylaws, and that the organization complies with applicable laws.

Fiduciary duties generally are governed by state law. Representative provisions defining fiduciary duties may be found in the Revised Model Non-profit Corporation Act (1987) (the “Model Non-Profit Act”),⁷ a draft statute that serves as guideline legislation for states to enact in whole or in part. A number of states have adopted some version of the Model Non-Profit Act, including Alabama, Nebraska, North Carolina, North Dakota, Oregon, Tennessee, Texas, Virginia, and Wisconsin, as well as the District of Columbia. While California and New York have separate not-for-profit statutes that differ significantly from the Model Non-Profit Act, some of their provisions – such as the standard for the duty of care – are nonetheless substantially similar to the Model Non-Profit Act. Delaware’s corporations law governs both non-profit and for-profit corporations.

1. Standing: Who May Sue for Breach of Fiduciary Duties

Because fiduciary duties are owed to the organization, there are restrictions on who may bring suit against directors and officers who allegedly have breached their fiduciary duties. In a for-profit corporation, for example, the company’s shareholders may bring suit against the directors and officers for mismanagement of the corporation. Such an action is referred to as a “derivative action,” and the shareholders, as owners of the company, sue on behalf of the company on the theory that the company’s directors and officers have failed to take actions to rectify abuses or errors by management. While non-profits do not have shareholders, their directors and officers may still be sued to enforce compliance with their fiduciary duties by certain classes of individuals or entities possessing legal eligibility, or “standing,” to bring a lawsuit.

The first group of individuals that may sue directors and officers for possible breaches of their fiduciary duties are fellow directors and officers of the organization.

Internal Corporate Disputes

The directors of a foundation that operated an art museum brought an action against other directors, seeking to prevent the transfer of the foundation’s collection, pursuant to a settlement with the state attorney general approved by the defendant directors. The court affirmed the settlement to which the plaintiff directors had objected. See Buntrock v. Terra, 810 N.E.2d 991 (Ill. Ct. App. 2004).

Second, where the non-profit has members, such as trade associations composed of businesses in the same industry, the members usually have standing to bring an action against the organization’s directors and officers. Because the members are analogous to shareholders in a for-profit corporation, these suits are also often referred to as derivative actions. For example, the Model Non-Profit Act permits an action to be brought in the name of the non-profit

corporation by “any member or members having five percent or more of the voting power or by fifty members, whichever is less.”⁸ Similarly, New York permits an action to be brought by “five percent or more of any class of members.”⁹ Even where a state statute does not explicitly grant standing, state court decisions may. Thus, Florida, Indiana, and Massachusetts also permit members to sue directors and officers of non-profits to which they belong.¹⁰

Derivative Actions by Non-Profits’ Members

Dues paying members of a property owners association organized as a non-profit corporation brought suit for breach of fiduciary duty and fraud against the general manager of the association. While the court dismissed the claim because the plaintiffs had no standing to sue the association’s employee in their individual capacities, it indicated the claim could be brought derivatively by the plaintiffs on behalf of the corporation. See Sayyah v. O’Farrell, No. CA2000-06-017, 2001 WL 433789 (Ohio Ct. App. Apr. 30, 2001).

A former member may be able to bring a derivative action against a non-profit organization if it was a member during the time when the non-profit’s directors or officers allegedly engaged in wrongful conduct. See Convenient Food Mart Franchising Co. v. Region 3 Advertising Corp., No. 99-L-008, 2000 WL 655441 (Ohio Ct. App. May 19, 2000).

A third group of potential adversaries are state attorneys general, who are often authorized by statute to enforce the directors’ and officers’ fiduciary responsibilities to the organization.

Suits by State Attorneys General

The New York Attorney General filed an action alleging that the New York Stock Exchange violated New York’s Not-for-Profit Corporation Law by paying its former chairman and chief executive officer compensation that was not reasonable and commensurate with services performed. The court denied the defendant’s motion to dismiss. See New York v. Grasso, 350 F. Supp. 2d 498 (S.D.N.Y. 2004).

Another group of persons or entities that may possess standing to sue directors and officers includes the ill-defined class of those who are in a “special relationship” with the non-profit. The existence of a special relationship is largely the product of judicial decisions finding such a relationship under very specific facts. Although courts generally disfavor the creation of new classes of individuals with standing to sue non-profits, it is nevertheless uncertain in any given case whether a court will find such a relationship and permit a suit to go forward. Even if the court eventually concludes that the plaintiff lacks standing, the directors and officers may incur significant legal expenses and fees in the meantime.

Special Relationships Permitting Suits Against Non-Profits

Examples of individuals in a “special relationship” with a non-profit entitling them to bring suit include students, faculty and staff at a college who brought a class action against the

college's president and board of directors for misuse of church and federal funds, see Jones v. Grant, 344 So.2d 1210 (Ala. 1977) (overruled, however, by subsequent statute), and hospital patients who brought a class action against the hospital's trustees alleging that the trustees engaged in self-dealing with other businesses that resulted in higher charges to patients and injury to the hospital. See Stern v. Lucy Webb Hayes National Training School for Deaconesses and Missionaries, 367 F. Supp. 536 (D.D.C. 1973).

Finally, as a result of the tax-exempt status of many non-profits, the fiduciary duties of non-profits' directors and officers also may be enforced by the Internal Revenue Service ("IRS").¹¹ The Internal Revenue Code provides that no part of the net earnings of a tax exempt organization is to inure to the benefit of any private shareholder or individual.¹² Courts have interpreted the non-inurement requirement as a restriction on self-dealing by directors of tax-exempt organizations. As a penalty for directors' breach of their fiduciary duties, the IRS may revoke the organization's tax-exempt status, and, in the case of private foundations, may include an excise tax on the self-dealing party.¹³ State tax law may impose similar constraints on directors.¹⁴

2. Duty of Care

The responsibilities of non-profits' boards of directors have been defined as including the following activities:

- Establishing and overseeing the organization's policies;
- Monitoring the conduct of the staff to ensure the organization is being properly managed;
- Reviewing the organization's finances, including approving the annual budget, to ensure resources are expended only to further organizational activities;
- Defining, modifying and communicating the organization's mission;
- Hiring and firing the chief executives and establishing compensation for the executive leadership;
- Securing the resources necessary to enable the organization to fulfill its mission;
- Serving as an advocate for the organization;
- Ensuring compliance with rules or standards established by law, mandated by accreditation agencies, or required by the organization's articles of incorporation and bylaws;
- Recruiting new board members and evaluating the performance of fellow board members; and
- Establishing procedures to ensure that each board member understands and complies with his or her duties as a board member.¹⁵

In order to ensure that the foregoing responsibilities are fulfilled, directors and officers have a fiduciary duty of care to the non-profit.

There has been recent debate over whether non-profits' directors and officers should be held to the standard of care applied to directors and officers of for-profit corporations, or whether the more stringent standard applied to "trustees" is appropriate.¹⁶ The trend in the law, however, has been to apply the corporate standard to non-profits' directors and officers, which requires that a director or officer act with the care that a reasonably prudent person in a similar position would exercise under the same circumstances.¹⁷ Specifically, the Model Non-Profit Act defines the director's duty of care as follows:

A director shall discharge his or her duties as a director, including his or her duties as a member of a committee:

- (1) in good faith;
- (2) with the care an ordinarily prudent person in a like position would exercise under similar circumstances; and
- (3) in a manner the director reasonably believes to be in the best interests of the corporation.¹⁸

Although California and New York have not enacted the Model Non-Profit Act, their provisions governing the standard of care are substantially similar.¹⁹

In order to fulfill the duty of care, directors must regularly attend meetings of the board, as well as meetings of any committees of which they are members. In most states, a director may not vote by proxy at meetings. Directors and officers must exercise their independent judgment, which means the judgment must be an informed one and should not be dominated by the opinion of other directors or officers. Directors and officers, however, are permitted to rely upon information and reports provided by: (1) officers or employees of the non-profit "whom the director reasonably believes to be reliable and competent in the matters presented"; (2) professionals and other persons retained by the organization "as to matters the director reasonably believes are within the person's professional or expert competence"; and (3) a committee of the board "as to matters within its jurisdiction, if the director reasonably believes the committee merits confidence."²⁰ A director, however, is not acting "in good faith" if he or she relies upon information where the director's own personal knowledge renders such reliance unwarranted.²¹ Further, in delegating the responsibilities of the organization's management to others, the directors must implement appropriate policies and procedures that provide for the oversight of personnel. Directors and officers must not willfully avoid learning information that, if known, would reveal problems in the organization. If, however, directors and officers act in good faith, and in a prudent, diligent and informed manner, they will be protected from liability under a legal defense known as the "business judgment rule" for any corporate actions that later events show to have been unwise or mistaken.²²

3. Duty of Loyalty

Under the duty of loyalty, directors and officers owe their non-profit an undivided allegiance to the organization's interests, which means that directors and officers may not use their positions to further their own interests or those of another person or entity unconnected

with the organization. The duty of loyalty also requires that directors and officers always act to further the best interests of the organization as a whole, and not merely for the benefit of a particular constituency. The duty of loyalty is generally regarded as encompassing three related areas: (1) [conflicts of interest](#) between directors and officers and the interests of the organization; (2) [corporate opportunities](#) that become available to the organization; and (3) [confidentiality](#) of non-public information regarding the organization.²³

a) Conflicts of Interest

A conflict of interest arises when a director or officer has a direct or indirect personal interest in a transaction involving the organization.²⁴ For example, a director or officer may be personally involved in the transaction, or have a financial or investment interest that would be furthered as a result of the transaction. A conflict may also exist if the interest of a family member of the director or officer would be furthered by the transaction. The concern is that in such instances, the director or officer may approve of the transaction for reasons other than the benefits that would accrue to the organization.

Conflicts of interest are not, however, *per se* prohibited. Indeed, many individuals are recruited to serve on the boards of non-profits because of their professional or business affiliations and activities. There may be situations in which, as a result of a director's or officer's connection or affiliation with other persons or entities, the non-profit is able to engage in a transaction on terms more favorable than it could have obtained on its own. Liability, therefore, is not imposed on a director or officer for the mere approval of a transaction in which he or she may have a conflict of interest. Instead, the focus is on the process by which the transaction was reviewed and approved by the board.

Under the Model Non-Profit Act, and the laws of many states, the existence of a conflict of interest will not be deemed a breach of fiduciary duty if the transaction was approved under certain conditions. First, the director with the conflict should disclose the material facts regarding the conflict to the other board members and refrain from participating in the deliberations and vote on the matter. Second, it must be shown that the disinterested directors approved the transaction in good faith and reasonably believed it was fair to the organization. In some cases, the directors may insulate themselves from liability by obtaining the approval of the state attorney general or a court either before or after consummation of the transaction.²⁵ Some transactions, however, may be prohibited entirely by state non-profit laws. For example, the Model Non-Profit Act bars a non-profit corporation from lending money to or guaranteeing the obligation of a director or officer of the corporation.²⁶

Breaches of the Duty of Loyalty

The New York Attorney General filed an action against the members of the Board of Directors of The New Dance Group Studio, Inc., a not-for-profit corporation, alleging violation by the board and one of its members of their fiduciary duties of loyalty and care by engaging in self-dealing transactions. The board member allegedly lived rent-free in the organization's building and made undocumented loans to the non-profit at excessively high interest rates, causing the organization to mortgage its building in order to make the loan

payments. The board was alleged to have facilitated the member's wrongdoing by giving him blanket authority to act on the non-profit's behalf. The court found that the Attorney General stated a cause of action against the defendants and denied their motion to dismiss. See Spitzer v. Schussel, 792 N.Y.S.2d 798 (N.Y. Sup. Ct. 2005).

In Shepherd of the Valley Church of Hastings v. Hope Lutheran Church of Hastings, 626 N.W.2d 436 (Minn. Ct. App. 2001), a jury found that the vice president of a church set up as a non-profit corporation breached his duty of loyalty by organizing a majority of the congregation into a separate church that ousted the remaining congregation from church property. The vice president held secret meetings among his supporting faction and prepared legal documents to transfer the property, all without informing the church's president of his plans. The court explained that the vice president owed a duty to the whole congregation, and could not favor the interests of the majority over the minority. As a result, the property was returned to the original congregation and money damages were assessed personally against the vice president.

b) Corporate Opportunities

Directors and officers also generally are prohibited from "usurping" corporate opportunities and competing with their non-profit organization. The corporate opportunity doctrine involves any situation where a director or officer is presented with a business opportunity, whether or not she learned of it through her position with the organization, which she reasonably should know may be of interest to the non-profit's present or future activities. In such circumstances, most states require that the director or officer disclose the transaction to the board so that its disinterested members may determine whether the organization should act or decline to act with respect to the opportunity. Only after the board has declined the opportunity on the record should the director or officer take advantage of the opportunity.²⁷

Corporate Opportunities

Two former directors of a condominium association were found to have breached their fiduciary duties by purchasing certain common area property of a condominium and a recreational facilities lease associated with it. The former directors were deemed to have used their board positions to usurp an opportunity of the association. See Florida Discount Properties, Inc. v. Windermere Condominium, Inc., 786 So.2d 1271 (Fla. Dist. Ct. App. 2001).

c) Confidentiality

Directors and officers are under a duty to treat as confidential the organization's internal activities, unless there has been general public disclosure or the information is a matter of public record or public knowledge. There appears to be little or no litigation relating to this duty.

4. Duty of Obedience

The duties of care and loyalty are common to both for-profit and non-profit corporations. The duty of obedience, however, is unique to non-profits. The duty of obedience encompasses two related obligations: (1) [adherence to the non-profit's mission](#), and (2) [compliance with applicable laws](#). Organizations failing to comply with federal, state and local law run the risk of [government enforcement actions](#).

a) Adherence to the Non-Profit's Mission

Non-profits' directors are required to adhere to the purposes, or "mission," for which the organization was established. It is crucial that non-profits follow their enunciated purposes, in part, because the public's trust that the organization will apply funds in conformity with its mission is the motive for donations and grants made to the organization. A non-profit's mission often is found in its articles of incorporation (also referred to as its charter), its by-laws, and/or a "mission statement" that has been adopted by the board of directors. Where the organization is viewed as veering from its core purposes, fellow directors, members of the organization and/or the general public may bring this fact to the attention of the state attorney general, who is empowered in many states to enforce compliance with the mission. In fact, the attorney general or a court may be empowered to unwind any transaction that contravenes the organization's mission or changes the organization's character. If such an improper transaction is found to have occurred, the directors may be liable under state statutes for damages that the organization incurred as a result of the prohibited transaction.

The Duty of Obedience

The directors' duty to fulfill the mission of the non-profit organization is not limited merely to the operations of the organization while it is a financially viable institution. For example, the board of directors of a long-established and world renowned specialty hospital determined that the hospital's financial condition was precarious. The board decided to sell substantially all of the hospital's assets, including its main acute care facility, and use the proceeds to enter upon a new mission. The court held that the board had a duty to consider other options that would have permitted the hospital to continue in operation according to its historical mission. In failing to consider alternative offers from other institutions that would have permitted the hospital to continue its mission, the court ruled that the board had not made a reasoned decision and refused to approve the sale of assets. See In re Manhattan Eye, Ear & Throat Hospital v. Spitzer, 715 N.Y.S.2d 575 (N.Y. Sup. Ct. 1999). Similarly, another court held that a charitable hospital could not abandon its primary mission of operating a hospital in favor of establishing neighborhood clinics. See Queen of Angels Hospital v. Younger, 136 Cal. Rptr. 36 (Cal. Ct. App. 1977).

b) Compliance with Applicable Laws/Government Enforcement Actions

Directors also must ensure that the organization is acting in compliance with the laws and regulations that apply to it. This is especially important because if, for example, the organization fails to comply with the restrictions imposed by the tax laws, it may lose its tax-exempt status and possibly incur other penalties. Additional laws that may apply to non-profits include:

- Income withholding and employment tax requirements;
- Discrimination, equal protection and civil rights laws, including Title VII and the Americans with Disabilities Act;
- State solicitation laws;
- The Employee Retirement Income Security Act of 1974 (“ERISA”);
- The Labor-Management Reporting and Disclosure Act;
- The Health Insurance and Portability and Accountability Act of 1996 (“HIPAA”); and
- Restrictions under tax laws on the political activity of tax-exempt organizations.

Failure to adhere to the organization’s mission may result in civil litigation by private individuals or entities. Statutory violations, however, may lead to government enforcement actions by either state or federal officials to ensure that non-profits comply with applicable statutes and regulations.

Because non-profit corporations are governed by state corporations law, state officials may bring actions for dissolution of the corporation or revocation of its charter if the non-profit engages in fraudulent or illegal conduct.

Federal enforcement actions against non-profits are most likely to be brought under the tax laws, which may impose penalties on non-profits’ directors and officers for noncompliance with various statutory duties. Penalties may be imposed, for example, for failure to timely file tax returns or to withhold income tax and social security taxes from employees’ income. Additionally, the IRS may impose an excise tax on “disqualified persons” who participate in “excess benefit transactions” with tax exempt non-profits. A disqualified person is a person who was in a position to exercise substantial influence over the organization within five years of the transaction, such as officers, directors, high-level employees and major donors to the organization. An excess benefit transaction is a financial transaction in which a disqualified person receives in excess of fair market value from the organization or pays less than fair market value to the organization. In the case of an excess benefit transaction, the IRS can impose a tax of twenty-five percent of the excess benefit amount on the disqualified person, and, if the transaction is not “corrected,” an additional two hundred percent of the excess benefit amount may be imposed. Further, “organization managers” (which include officers, directors, trustees, or other persons holding similar powers) who knowingly approve an excess benefit transaction may be liable for a ten percent excise tax on the excess benefit, up to a maximum of \$10,000, for each transaction. With respect to non-profits that qualify as “private foundations,” similar excise taxes may be imposed against “foundation managers” for self-dealing transactions.²⁸

Tax Law and Fiduciary Duties

Tax law could in the future assume an even more prominent role in ensuring that directors and officers comply with their fiduciary duties. A federal court noted the potential role of tax laws “in assuring the prudent management of charities,” especially if it appears that the charity is being run mostly for the benefit of another firm with which the charity does

business. See United Cancer Council, Inc. v. Commissioner of Internal Revenue, 165 F.3d 1173, 1179 (7th Cir. 1999).

E. Miscellaneous Actions

1. Antitrust Claims

Federal and state antitrust laws are another source of potential liability for various non-profits. Since non-profit trade associations are, by definition, groups of competitors gathered to share common interests and seek solutions to common problems, antitrust laws have special relevance to trade associations and may be implicated in a variety of association activities. But it is well-settled that membership in an association or attendance at association meetings may not be considered evidence of a conspiracy to restrain trade or competition. Because associations often provide benefits that allow members to more effectively compete in the industry, however, membership criteria that create a barrier to membership may give rise to antitrust liability.

Antitrust Liability Arising from Subjective Membership Criteria

In the seminal case of United States v. Realty Multi-List, Inc., 629 F.2d 1351 (5th Cir. 1980), the court found that a real estate membership organization's "favorable credit report and business reputation" membership criteria were facially unreasonable and created unjustified restraints on commerce. In so doing, the court held that "[s]ubjective membership criteria are generally not narrowly tailored to accomplish any legitimate goal of an association."

Sports-related organizations also may find themselves the subject of antitrust claims because of their authority to establish rules, regulations and standards which may have financial consequences on businesses whose activity is tied to that particular sport or sports organization.

Antitrust Claims Against Non-Profit Sports Organizations

A major sportswear manufacturer brought an antitrust suit against the NCAA as a result of the athletic association's enforcement of its bylaw restricting the display of commercial logos on team uniforms. The manufacturer argued that the bylaw, which disqualified some of its apparel from being worn by players in tournaments, restrained trade and represented a group boycott of its goods. The court, however, held that the bylaw was not subject to the antitrust laws because it did not have a commercial purpose or objective. See Adidas America, Inc. v. NCAA, 40 F. Supp.2d 1275, 1283 (D. Kan. 1999).

The manufacturer of a particular golf shoe design brought claims for antitrust violations, slander, and intentional interference with business relations against the USGA, a non-profit association, and some of its officers. The USGA publishes the Rules of Golf which restrict the kinds of equipment that can be used in an event played under the Rules. The USGA determined that the use of the shoe, which assisted golfers in distributing their weight, violated its rules. As a result, many retailers ceased carrying the shoe. The court eventually dismissed all claims against the USGA. See Weight-Rite Golf Corp. v. U.S. Golf Ass'n, 766

F. Supp. 1104 (M.D. Fla. 1991).

Similar to sports organizations, other non-profits that have the authority to establish trade standards that influence an industry, or control membership admittance into the industry, may be subject to antitrust claims by individuals or entities who allege that the non-profit's actions have anticompetitive effects with respect to them. The risk of antitrust claims is greater where the non-profit exercises powers of accreditation or certification over individuals or institutions.

Antitrust Claims Against Accrediting Organizations

The manufacturer of reagent grade water used in laboratories brought antitrust claims against a non-profit accrediting and standards organization, stemming from guidelines promulgated by the organization that required the production of reagent water on site in certain circumstances. As a result, many laboratories acquired equipment that enabled them to produce on site all the reagent water they required for their labs, eliminating the need to purchase water from the manufacturer. The court eventually dismissed the suit. See DM Research, Inc. v. College of American Pathologists, 170 F.3d 53 (1st Cir. 1999).

Hospitals increasingly have become the target of antitrust claims brought by physicians who have been denied staff privileges, or by clinic and physician practice groups in competition with local area hospitals who may be injured by favorable contractual relations between a hospital and healthcare insurance companies.

Rise in Antitrust Claims against Hospitals

A thoracic and vascular surgeon sued a hospital for antitrust violations after it revoked his staff privileges. The hospital revoked the privileges after conducting a statutorily required review of the performance of its surgeons and spotting deficiencies in the plaintiff's services that endangered patients' welfare. The surgeon claimed the physicians, who conducted his peer review, conspired to revoke his privileges because they wanted to eliminate the competition he posed in the thoracic and vascular surgery market. The court affirmed judgment in favor of the hospital. See Johnson v. Nyack Hospital, 964 F.2d 116 (2d Cir. 1992).

2. Other Claims

While the most frequent types of claims brought against non-profits are described above, the reality is that non-profits and their officers and directors may be the targets of claims arising from a wide variety of acts and concerning any area of law. For example, commentators have noted that some non-profits may be exposed to liability under securities laws where they issue notes, bonds or other debt instruments in connection with fundraising activities.²⁹ Another source of potential liability facing non-profits is claims related to internet activities, such as **defamation**, engaging in fundraising activities through websites without registering them under

state solicitation laws, improperly permitting the advertisement of for-profit entities on the non-profit's website, and infringing on the intellectual property of others.³⁰

Non-Profits and Websites

A company that marketed products containing a sugar substitute brought claims of false advertising, deceptive trade practices, unfair competition and product disparagement against the Sugar Association, a non-profit sugar growers association. Plaintiff alleged that, through press statements and websites, The Sugar Association conducted a smear campaign against the sugar substitute used in products sold by plaintiff. The case is pending. See McNeil Nutritionals, LLC v. The Sugar Association, No. C.A. 05-69, 2005 WL 1000242 (D. Del. Apr. 29, 2005).

In summary, the universe of claims that may be asserted against a non-profit and its directors and officers is limited only by the imagination of litigants and their lawyers. At any moment, a non-profit may find itself the subject of an unforeseen – and unpredictable – claim. And, even the successful defense of a claim may nonetheless leave a non-profit facing significant legal defense fees and costs.

The Universe of Potential Claims Against Non-Profits Is Infinite

Recent claims against non-profits and their directors and officers have been asserted involving the following circumstances:

- The parent of a former member of a youth hockey program sponsored by a non-profit corporation sued the corporation and the state amateur hockey association, seeking an order that would compel her son's reinstatement to the program. The complaint was dismissed as time barred. See Belmonte v. Saratoga Youth Hockey, Inc., 795 N.Y.S.2d 378 (N.Y. App. Div. 2005).
- Plaintiffs, who were in the business of selling dogs, commenced an action against the Humane Society, its president, and a volunteer, alleging malicious prosecution, abuse of process, tortious interference with business relations, and civil rights violations, after a Humane Society volunteer demanded that plaintiffs surrender dogs in their possession to the Humane Society because dog purchasers had complained to the Humane Society that the dogs were sick. The court denied the Humane Society's motion to dismiss and permitted the suit to go forward. See Martin v. Columbia Greene Humane Soc., Inc., 793 N.Y.S.2d 586 (N.Y. App. Div. 2005).
- The non-profit dance school established by Martha Graham was sued by Graham's heir, who asserted his alleged rights to certain dance works held by the school. The appellate court affirmed the judgment of the trial court that most of the dances properly belonged to the dance school. See Martha Graham School and Dance Foundation, Inc. v. Martha Graham, 380 F.3d 624 (2d Cir. 2004).

III. GOVERNANCE REFORMS

A. The Sarbanes-Oxley Act and Its Impact on Non-Profits

A new potential source of liability is the Sarbanes-Oxley Act (the “SOX Act”)³¹ and similar state legislation. The SOX Act generally does not apply to non-profits – with two exceptions (whistleblower protection and document preservation), the SOX Act applies only to publicly traded companies – and, to date, there does not appear to have been any litigation involving non-profits and the SOX Act. Nevertheless, the SOX Act should be of concern to non-profits. Several states have enacted, or have proposed enacting, governance reforms modeled on the SOX Act for charities. Inspired in part by the SOX Act’s provisions, the IRS has increased its oversight of tax-exempt entities, revising Form 1023 by which organizations seek new tax-exempt status, developing a new Form 990 tax return for tax-exempt organizations, and proposing to conduct more audits.³² Some non-profits themselves have proposed governance reforms based upon selected provisions of the SOX Act.³³ The SOX Act likely has increased the expectations of regulators, donors, and others with respect to non-profits’ financial reporting and accountability. Future plaintiffs may argue, therefore, that non-profits’ directors and officers breach their fiduciary duties if they fail to act in accordance with the SOX Act’s reforms which they may claim now may represent “best practices.” Thus, non-profits should be aware of the SOX Act and its key provisions.

1. Sarbanes-Oxley Act Provisions Applicable to Non-Profits and For-Profits

Whistleblower Protection: The SOX Act extends protection for whistleblowers who report what they reasonably believe to be illegal activities. Employers – whether for-profit or non-profit corporations – may not “discharge, demote, suspend, threaten, harass, or in any other manner discriminate” against such whistleblowers. The SOX Act grants whistleblowers the right to file a civil suit against their employers for retaliatory actions, and successful whistleblower plaintiffs may obtain compensatory damages and reimbursement of their attorneys’ fees.³⁴

Document Preservation: The SOX Act makes it a federal crime to destroy, alter, or falsify any document, including audit records, to prevent its use in an official proceeding such as a federal investigation or bankruptcy proceeding.³⁵ The document preservation requirements apply to both for-profits and non-profits.

2. Sarbanes-Oxley Act Provisions Currently Applicable Only to For-Profits

Audit Committee: Generally, an audit committee hires, sets compensation for, and oversees the auditor’s activities, and establishes rules and processes for accounting and internal control practices. The SOX Act requires each member of a company’s audit committee to be a member of the board of directors and “independent,” *i.e.*, not part of the management team and not receiving any consulting fee or other compensation from the company, either directly or indirectly, except for compensation for board services. The company must disclose whether or not they have at least one financial expert on the committee and, if not, why.³⁶

Auditors' Responsibilities: The SOX Act prohibits a company's auditor from providing the company with any non-audit services (*e.g.*, bookkeeping, appraisals or valuations, actuarial services, investment banking services, etc.) concurrent with its auditing services, although the board may pre-approve certain services such as tax preparation. The auditor must report to the audit committee about the organization's "critical accounting policies and practices," alternative treatments of financial information within generally accepted accounting principles ("GAAP") that were discussed with the company's management, and other significant written communications with management. The SOX Act requires that the auditing firm's lead partner and reviewing partner rotate off the audit every five years.³⁷

Certification of Financial Statements: Under the SOX Act, the CEO and the CFO must certify, among other things, that the financial statements and disclosures in the company's quarterly and annual reports "fairly present in all material respects the operations and financial condition" of the company; that they have disclosed to the audit committee and the auditors "all significant deficiencies in the design or operation of internal controls which could adversely impact" the company's ability to report financial data, and that they have disclosed any fraud that involves management or other employees who have a significant role in the company's internal controls.³⁸

Conflicts of Interest: The SOX Act generally prohibits a company from providing loans to any of its directors or executives. The SOX Act also prohibits the CEO, CFO, controller, and chief accounting officer from working for the company's auditing firm for one year before the audit.³⁹

Disclosure Requirements: The SOX Act prescribes several disclosure requirements, including disclosure of significant corrections to financial statements, material off-balance sheet transactions, the structure and an assessment of internal controls, transactions involving management and principal stockholders, and whether or not the company has adopted a code of ethics for senior financial officers. The SOX Act also requires companies to disclose "on a rapid and current basis" any material changes in the company's operations or financial situation.⁴⁰

B. State Governance Reforms for Non-Profits

Several states have enacted reforms apparently inspired by the Sarbanes-Oxley Act. California, Connecticut, Kansas, Massachusetts and New Hampshire now mandate that certain charities (the revenue threshold varies by state) file audited financial statements with a state agency or attorney general. The Attorney General of Hawaii now is authorized to require a charitable organization to submit audited financial statements. California charities with gross revenues of \$2 million or greater now must have an audit committee with independent members. Connecticut recently enacted conflict-of-interest standards for charities. Iowa enacted new standards for board conduct for non-profits, related party transactions and loans. Maine also expanded its attorney general's oversight of non-profits and enacted new conflict of interest provisions for non-profits. Many other states have considered – or currently are considering – similar reforms.⁴¹

IV. PROTECTION FOR NON-PROFITS' DIRECTORS AND OFFICERS

As described above, non-profits' directors and officers may face substantial liability for a variety of claims, ranging from [employment claims](#) to derivative actions for [breaches of fiduciary duties](#). Even when the directors and officers ultimately prevail, they may incur significant legal defense costs in the interim. To encourage individuals to serve non-profits, despite the potential liability, several forms of protection have been developed. First, a non-profit itself may provide "[indemnification](#)" to its directors and officers. Second, [liability-limiting statutes](#) may protect the directors and officers of non-profits. The protection afforded by such statutes varies from state to state, but there is more uniform protection for volunteers since the enactment of the [federal Volunteer Protection Act](#). Finally, a non-profit may obtain [insurance](#), particularly [directors and officers liability coverage](#) and [employment practices liability coverage](#), tailored to fill the significant gaps left by other forms of protection.

A. Indemnification

Generally speaking, "indemnification," in the context of corporate governance, means the financial protection that a corporation provides to its directors and officers for expenses incurred by them in lawsuits alleging that they breached a duty in their service to or on behalf of the organization. State law generally governs indemnification, establishing the scope and terms of [permissive \(or "discretionary"\) indemnification](#) (*i.e.*, when the corporation *may* indemnify its directors and officers) and [mandatory indemnification](#) (*i.e.*, when the corporation *must* indemnify its directors and officers). State law also describes when corporations are prohibited from indemnifying their directors and officers. Most states have modeled their indemnification provisions either on the Model Business Corporation Act or the Revised Model Non-Profit Act but state laws may vary considerably. [Non-statutory indemnification](#) also may be available for certain claims. Finally, the [limitations to indemnification](#) may be significant, depending upon the circumstances.

1. Permissive Indemnification

State law generally permits a non-profit corporation to indemnify its directors and officers where (1) the director or officer is a party in the action because of his or her status as such, (2) the individual "conducted himself or herself in good faith," (3) the individual "reasonably believed" that either "in the case of conduct in his or her official capacity with the corporation, that his or her conduct was in its best interest," or "in all other cases, that his or her conduct was at least not opposed to its best interests." A corporation also generally may indemnify its directors and officers in a criminal proceeding if the individual "had no reasonable cause to believe his or her conduct was unlawful." A director or officer may satisfy the prescribed standard of conduct for discretionary indemnification whether the proceeding is terminated "by judgment, order, settlement, conviction, or upon a plea of *nolo contendere* or its equivalent."⁴² Indemnification generally is prohibited if a court finds the director improperly received a "personal benefit" or if the director is found liable to the corporation in a [derivative action](#).⁴³ A non-profit generally may indemnify "reasonable expenses incurred in connection with the proceeding."⁴⁴ For lawsuits other than derivative actions, "expenses" may include attorneys' fees and costs, judgments, fines, penalties, and settlement amounts. For derivative

actions, state law usually limits indemnification to legal defense costs. Directors and officers typically must pay the judgment or settlement for a derivative action with personal assets, unless they have insurance providing [directors and officers liability coverage](#).⁴⁵

Permissive indemnification generally must be authorized on a case-by-case basis and may be subject to statutory requirements.⁴⁶ Typically, the decision to indemnify must be reflected in the non-profit corporation's charter or by-laws or by formal board action. Discretionary indemnification, however, may be made mandatory by the organization's own articles of incorporation or bylaws.

2. Mandatory Indemnification

Unless otherwise limited by the organization's articles of incorporation, indemnification generally is mandatory under state law if the director or officer was "wholly successful, on the merits or otherwise" in a lawsuit in which she was a party because of her position with the corporation. A director likely would be deemed to be "wholly successful" if there is a verdict or final ruling in the director's favor. Whether a director would be entitled to mandatory indemnification for a settlement likely would depend upon the circumstances and applicable state law. "On the merits or otherwise" means that the director or officer may be entitled to mandatory indemnification if he has a valid defense, whether it is substantive (*e.g.*, he did not breach his fiduciary duties) or procedural (*e.g.*, lack of jurisdiction, standing, or the statute of limitations). Mandatory indemnification is limited to "reasonable expenses actually incurred by the director in connection with the proceeding." Unlike [permissive indemnification](#), however, the director or officer need not establish that she acted in good faith and in a manner she reasonably believed to be in the best interests of the corporation. As noted above, permissive indemnification may be made mandatory by the organization's own articles of incorporation or bylaws. Finally, a court may order indemnification.⁴⁷

3. Non-Statutory Indemnification

Many states' indemnification statutes contain "nonexclusivity provisions" which allow organizations to provide indemnification beyond that described in the statute's [permissive indemnification](#) and [mandatory indemnification](#) provisions, such as for litigation where the directors or officers are not sued in their official capacities.⁴⁸ Even such indemnification, however, may be limited by public policy. In addition to statutory or corporate indemnification, contractual or "third-party" indemnification may be available. For example, as part of a contract of sale, the sellers may agree to indemnify the organization and/or its directors and officers from any claims that arise from that sale. Whether third-party indemnification is available will depend upon the nature of the claim and the nature of the agreement.

4. Limitations to Indemnification

Indemnification may provide some protection to non-profits' directors and officers – but its protection may be limited. First, the value of indemnification may be limited by the organization's resources. As a practical matter, many non-profits may be unable to pay significant sums to defend directors and officers involved in a lawsuit. If the non-profit is

insolvent – or if indemnification would cause insolvency – indemnification likely will be unavailable. Second, unless state law or the organization’s by-laws provide otherwise, indemnification may be limited to *reimbursement* of expenses at the conclusion of the lawsuit, rather than *advancement* of legal expenses as the lawsuit is ongoing.⁴⁹ Third, indemnification may be limited or prohibited by law or public policy. For example, public policy may preclude the indemnification of directors or officers who engaged in intentional or illegal misconduct. Fourth, if the board’s composition changes, the new board may not be sympathetic to the previous directors or officers and decline to make the necessary authorization for permissive indemnification. Finally, the non-profit’s own internal policies may limit indemnification. For example, a non-profit may consider it inappropriate to use donations or other contributions for defending lawsuits against its directors and officers. Consequently, the protection of indemnification is far from absolute.

B. Liability-Limiting Statutes/ Volunteer Protection Statutes

Beginning in the 1980s, a combination of factors – including the rising number of lawsuits and large jury awards – raised concerns that fear of liability might discourage individuals from serving non-profits. All fifty states and the District of Columbia subsequently enacted some form of limited [statutory immunity for non-profits’ directors and officers](#) and/or [volunteer protection statutes](#).⁵⁰ There are significant differences among the states’ liability-limiting laws, although the [federal Volunteer Protection Act](#) sets the floor for volunteer protection. Notably, these statutes generally provide immunity to individuals and *not* to the non-profit itself. [Charitable immunity](#) – full protection for the non-profit itself – has been largely abolished in most states, although some states continue to offer limited immunity. The immunity afforded by liability-limiting statutes, however, applies only to damages: the statutes will not necessarily prevent lawsuits from being filed in the first instance, nor protect a non-profit and its directors and officers from incurring legal defense costs while arguing that the statutes apply.

1. Statutory Immunity for Non-Profits’ Directors and Officers

Many states have statutorily limited the liability of non-profits’ directors and officers under certain circumstances. Such protection may be conditioned, for example, on the officer’s compliance with a specified standard of conduct. Thus, the Model Non-Profit Act provides that if an officer acts in good faith, “with the care an ordinarily prudent person in like position would exercise under similar circumstances,” and “in a manner the officer reasonably believes to be in the best interests of the corporation and its members, if any,” then that “officer is not liable to the corporation, any member, or other person for any action taken or not taken as an officer”⁵¹ A state may dictate, however, that limited liability applies only to non-profits’ directors who serve with no or limited compensation.⁵² Statutory protection may extend only to certain types of cases: for example, only to lawsuits alleging negligence, and not alleging willful, wanton, or intentional misconduct.⁵³ Under the Supremacy Clause of the United States Constitution, state statutes cannot eliminate directors’ and officers’ liability for violations of federal law. This exception to state statutory immunity represents a significant “loophole” given that a frequent source of non-profits’ liability exposure is employment claims under Title VII, the Americans with Disabilities Act, and other federal statutes.

2. State Volunteer Protection Statutes

Most states have enacted some form of statutory protection for individuals acting in their capacity as volunteers, although the scope varies widely since states reached different solutions when attempting to balance the protection of volunteers against assuring compensation for innocent victims of a volunteer's negligence. First, although states commonly define a volunteer as one who does not receive compensation for his or her services, there may be questions about what constitutes "compensation" if it is not clearly defined by statute. In some jurisdictions, volunteers specifically may include directors and officers;⁵⁴ in others, the immunity of directors and officers is governed by separate statutes, as discussed above. Second, the extent of immunity may vary depending on the type of organization or volunteer activity. Some states provide expanded protection for firefighters,⁵⁵ sports program volunteers,⁵⁶ or volunteers in small non-profits with assets less than \$50,000.⁵⁷ Those providing medical services may enjoy enhanced protection under a volunteer protection statute or a good Samaritan law.⁵⁸ Third, although most states include some exclusions to statutory volunteer protection, the precise exclusions vary. Typically, volunteer protection statutes include exceptions for actions (1) based on willful, wanton, or grossly negligent misconduct, (2) involving operation of a motor vehicle, or (3) brought by government official to enforce federal, state or local law.⁵⁹ As discussed above, state statutes cannot provide immunity for federal law violations. Finally, some states either condition immunity on whether the organization has general liability insurance, or provide that volunteers will be subject to liability only to the extent of the available insurance.⁶⁰

3. Federal Volunteer Protection Act

Enacted in 1997, the federal Volunteer Protection Act (the "VPA")⁶¹ was designed to establish certain minimum, uniform protections for volunteers from liability for alleged negligence. The VPA provides that "no volunteer of a non-profit organization . . . shall be liable for harm caused by an act or omission of the volunteer on behalf of the organization or entity" if the volunteer satisfies certain prerequisites. The VPA defines "volunteers" to include directors and officers, so long as they do not receive compensation "other than reasonable reimbursement or allowance for expenses actually incurred" *or* anything in lieu of compensation valued at more than \$500. Organizations covered by the VPA include tax-exempt organizations and any "not-for-profit organization which is conducted for public benefit and operated primarily for charitable, civil, educational, religious, welfare or health purposes" who do not practice hate crimes.

To qualify for immunity under the VPA, the volunteer must satisfy the following prerequisites: (1) the volunteer was acting within the scope of the volunteer's responsibilities in the non-profit organization at the time of the act or omission at issue; (2) "if appropriate or required," the volunteer was properly licensed or certified in the State in which the harm occurred for the activities undertaken as a volunteer; (3) the harm was not caused by "willful or criminal misconduct, gross negligence, reckless misconduct or a conscious, flagrant indifference to the rights or safety" of the person harmed; and (4) the harm was not caused by the volunteer's operation of a vehicle for which the state requires the owner or operator to possess an operator's license or maintain insurance. The VPA also generally prohibits the recovery of punitive

damages against volunteers, and mandates that a volunteer shall be liable for non-economic loss only “in direct proportion to the percentage of responsibility of” the volunteer to the claimant. The VPA does not protect a volunteer from liability arising from violent crimes, terrorism, hate crimes, sexual offenses, civil rights violations under either federal or state law (including employment discrimination claims), or when the volunteer was under the influence of drugs or alcohol. The VPA does not prohibit a governmental entity or the non-profit from bringing an action against a volunteer. Finally, the VPA does not protect the non-profit itself.

The VPA preempts state laws “to the extent that such laws are inconsistent” with the Act, although a State may provide *additional* protection or, alternatively, “opt-out” of the VPA’s coverage. The VPA does not preempt state statutory provisions (1) requiring a non-profit to adhere to risk management procedures, including mandatory volunteer training; (2) making a non-profit liable for the acts or omissions of its volunteers to the same extent that an employer is liable for the acts or omissions of its employees; (3) rendering the immunity inapplicable if the action is brought by an officer of a state or local government pursuant to state or local law, or (4) limiting the applicability of immunity to non-profits that provide a “financially secure source of recovery,” such as insurance.

4. Charitable Immunity

Even if state or federal law provides immunity for individuals serving a non-profit, the non-profit itself still may be held liable for the actions of its directors and officers. The historic immunity charities formerly enjoyed no longer exists in most states, although some limited immunity may still be available in certain states, either by statute or by common law. The scope of charitable immunity varies from state to state. For example, New Jersey non-profits are not liable for negligently causing injury to their beneficiaries, but only where the non-profit is a corporation, society or association organized exclusively for charitable, religious, education or hospital purposes.⁶² Georgia law provides charitable immunity to hospitals in certain circumstances.⁶³ Some states have provided a form of charitable immunity by imposing a cap on monetary damages. In Massachusetts, for example, damages are limited to \$20,000 for torts occurring in the course of activity related directly to the organization’s charitable purpose,⁶⁴ while in Colorado, judgments against non-profits are limited to the extent of existing insurance coverage.⁶⁵ State liability caps, however, may not apply to claims under federal law.⁶⁶

C. Insurance Coverage

A third source of protection for non-profits and their directors and officers is insurance, particularly [directors and officers liability insurance coverage](#) and/or [employment practices liability insurance coverage](#). Although traditionally non-profits have limited insurance coverage to [commercial general liability](#) policies, such coverage may be insufficient to protect against the wide array of risk for their organizations and their directors and officers. Similarly, homeowners’ insurance and professional liability (*e.g.*, attorney malpractice) policies generally are not tailored for non-profits’ directors and officers. Directors and officers’ insurance can specifically fill many of the gaps in the protection afforded by [indemnification](#) and [liability-limiting statutes](#), particularly with respect to coverage for legal defense costs.

1. Commercial General Liability Insurance

Despite the expansion of potential liability, many non-profits and their directors and officers continue to maintain only basic commercial general liability (“CGL”) coverage. CGL coverage applies to claims for bodily injury, personal injury, advertising liability and damage to, or destruction of, tangible property. Such basic coverage, however, often will not respond to [breach of fiduciary duty claims](#), [antitrust claims](#), [government enforcement actions](#) or any other type claim not involving bodily injury, personal injury, advertising liability or property damage. In particular, it is important to note that CGL policies generally do not cover [employment claims](#) for a number of reasons. First, most employment claims allege solely emotional distress and/or mental anguish which many jurisdictions do not consider “bodily injury” under CGL policies unless it is accompanied by physical symptoms or manifestations. Second, CGL policies are intended to cover occurrences or events which are not “expected or intended” by the insured. The acts giving rise to many employment claims are not unexpected or unintended and therefore may not be covered under CGL policies. Finally, many CGL policies contain a specific exclusion for employment-related claims.

2. Directors and Officers Liability Insurance

Given the limitations of other types of protection, directors and officers (“D&O”) liability insurance may be an important component of risk management strategies for many non-profits. Such coverage also may be referred to as “Organization and Management Liability” coverage, thus underscoring that coverage may be available to all participating in the non-profits’ management, and that the organization itself may be covered by the policy. Notably, under several states’ law, insurance may protect directors and officers in situations where the non-profit itself otherwise would be prohibited by applicable law from providing [indemnification](#), such as for settlement of a derivative action. Unlike various [liability-limiting statutes](#), a D&O insurance policy applies to both damages *and* defense costs.

Specific terms vary from insurance policy to insurance policy. The policy “form” often may be modified by “endorsements” negotiated with insurers. The following outlines some typical elements in a D&O liability insurance policy.

A D&O policy usually has separate insuring agreements for: (a) “management liability” coverage which directly pays directors and officers for losses which are not indemnified by the organization, (b) reimbursement to the organization for indemnification of its directors and officers and, in some policies, (c) “entity coverage” that reimburses an organization for loss from its own direct liability. Entity coverage may be particularly beneficial to non-profits since such organizations themselves frequently are the target of lawsuits and usually are not protected by [liability-limiting statutes](#).

Broadly speaking, D&O insurance generally provides coverage for “loss” from “claims” against “insured persons” for “wrongful acts.” Policies usually define “loss” as judgments, settlements, and reasonable and necessary legal defense fees and costs. “Loss” typically does not include fines, penalties, taxes, restitution, or matters which may be deemed uninsurable under applicable law. Policies vary on whether “loss” includes punitive or multiplied damages.

A “claim” generally includes a lawsuit and, depending upon the policy’s definition, may include a regulatory proceeding or a government investigation. “Insured persons” include directors and officers, and may also include employees, trustees, or volunteers. As noted above, some D&O policies may provide coverage for the wrongful acts of the organization itself. A “wrongful act” typically is defined as any actual or alleged breach of duty, neglect, error, misstatement, misleading statement, act or omission by an insured person in his or her capacity as a director or officer (or employee, trustee, etc.) of the insured organization. Such policy definitions are critically important because they define the scope of coverage under the policy.

Most D&O policies currently are “claims-made” policies, *i.e.*, they provide coverage for claims first asserted during the policy period, regardless of when the wrongful act occurred. If the insured provides a detailed notice of circumstances that may give rise to a claim, and a claim subsequently develops, that claim may be deemed “first made” when notice is given even if the claim itself is not actually made until after the policy’s expiration. The policy may have “extended reporting” or “discovery” provisions that allow an insured to pay an additional sum to obtain more time in which to report a claim. Most policies require prompt notice of a claim, and non-compliance with a policy’s notice provisions may eliminate coverage.

D&O policies usually exclude coverage for claims arising out of or based upon: (1) litigation or another proceeding that began before the policy period, (2) intentional conduct, including dishonest, fraudulent or criminal conduct, (3) an insured person’s obtaining a personal profit or advantage to which he was not entitled, (4) pollution, and (5) bodily injury and property damage (which usually are covered by [CGL insurance](#)). If other insurance is available, a D&O policy typically does not provide coverage. Some D&O policies exclude coverage for claims by one insured person against another insured person. Many D&O policies also exclude coverage for [libel or slander](#). D&O policies also may specifically exclude [employment claims](#) (unless [employment practices liability coverage](#) is part of the policy). Similarly, ERISA claims usually are excluded from coverage unless the policy specifically provides fiduciary liability coverage.

If a claim is within a D&O policy’s scope of coverage, and is not otherwise excluded, the organization generally must first pay a deductible (or retention) specified in the policy. If, however, the organization may not indemnify the director or officer, usually the individual need not pay a deductible. The maximum amount of coverage is the “limit of liability.” In most D&O policies, legal defense costs are “within limits,” *i.e.*, payment of defense costs will reduce the remaining available limit of liability. Depending on the policy, the insurer may have a duty to defend the insured (*i.e.*, hire a lawyer to represent the insured) or it may simply pay legal defense costs incurred by the lawyer representing the insured. The policy usually will specify whether the insurer will “advance” legal defense costs or “reimburse” defense costs which have been paid by the insured. The former generally presents less of a strain on a non-profit’s resources. Generally, the insured must have the insurer’s prior written consent to incur legal defense costs or to enter into a settlement. Failure to obtain consent may result in elimination of coverage.

Often, the D&O policy will incorporate the insurance application into the policy. A misstatement in the application may void coverage.

3. Employment Practices Liability Insurance

In the last decade, the right to a jury trial to recover damages in a discrimination case combined with the heightened social attention on workplace conduct, including sexual harassment, have resulted in a significant increase in [employment claims](#). From 2000 through 2004, approximately 80,000 charges of discrimination were filed each year with the United States Equal Employment Opportunity Commission (“EEOC”).⁶⁷ Nearly 90% of all claims against non-profits were employment-related.⁶⁸ To better protect themselves, employers, including non-profits, have turned to employment practices liability (“EPL”) insurance policies. EPL coverage may be provided as part of a standard D&O policy, by endorsement or as a stand-alone policy.

EPL policies typically provide coverage for an insured entity, its directors and officers and its employees. In the non-profit context, coverage also may extend to volunteers. EPL policies generally are claims-made policies (*i.e.*, triggered when the claim is first made versus when the alleged incident occurred), contain specific requirements for reporting of a claim, and provide coverage for indemnity (*e.g.*, a judgment or settlement) and legal defense costs (*i.e.*, attorneys’ fees and costs of litigation). Typically, the legal defense costs are considered to be a part of, or within, the limits of liability under the policy and subject to the policy’s retention or deductible. Most EPL policies specifically address issues of control – which defense counsel will represent the employer, who will control litigation decisions and who will decide whether and when to settle litigation – the insured or the insurer. However, policy provisions vary. EPL policies typically define an “employment claim,” but the scope and breadth of potential coverage will depend on the definition. Most EPL policies currently cover claims for wrongful termination, discrimination and sexual harassment. Beyond these basic, traditional employment claims, EPL policies may cover a wide variety of workplace torts, *e.g.*, wrongful failure to employ or promote, negligent supervision, negligent hiring, wrongful reference, employment-related infliction of emotional distress, wrongful deprivation of a career opportunity, wrongful demotion and negligent job performance evaluation. Again, EPL policy provisions and definitions vary depending upon the policy and its language.

While EPL policies typically provide coverage for emotional distress, they usually do not provide coverage for bodily injury, sickness, disease or death, or property damage. Such claims are more likely to be covered by [CGL policies](#) because they involve actions that are not “expected” or “intended” by the insured. Conversely, however, CGL policies generally will not provide, and often expressly exclude, coverage for employment-related claims, which frequently involve intentional employment actions. EPL policies also often exclude coverage for certain statutory claims related to workers compensation, pensions, ERISA, and HIPAA. And, as with more traditional D&O policies, EPL policies often do not provide coverage for punitive damages, fines, contractual agreements or non-monetary relief.

V. CONCLUSION

Non-profit organizations and their directors and officers face a wide variety of [legal risks](#) including but not limited to lawsuits by employees, government authorities, members of the non-profit and individuals that the non-profit serves. Awareness of potential legal exposures is critical for prudent management. Although directors, officers and volunteers of non-profits may

be entitled, under some circumstances, to statutory and other limitations on their liability and legal expenses, those protections vary greatly and are neither complete nor universal. And the non-profit itself typically does not receive comparable protections from liability or legal expenses. Insurance coverage, including D&O and EPL policies, affords non-profit directors and officers and their organizations broader and more effective protections in a world awash in litigation risks. Once aware of the risks that face them and their organizations, non-profit managers should be prepared and assured that they and their organization are protected adequately.

Endnotes

¹ **Disclaimer.** This article is for informational purposes only. These materials do not constitute legal advice. If you have a legal question, you should contact an attorney and seek legal advice based on your particular situation. The authors expressly disclaim liability for any actions taken or not taken in reliance on this article and disclaim any liability for third-party content that may be accessed through this article.

² Ms. Gere, Mr. Vitrano, and Ms. Schmelz are partners at Ross, Dixon & Bell, LLP. They wish to thank former associate Joseph McCall for his substantial contributions, and associate Rose Stafiej for her assistance, in connection with this paper. Ross, Dixon & Bell is a national firm that has represented associations and non-profit organizations for over 20 years. The firm also enjoys a national reputation for litigation and counseling, particularly with respect to insurance.

³ As used in this article, “non-profits” includes non-profit and not-for-profit organizations, associations, foundations, societies and corporations.

⁴ This article generally speaks in terms of “directors and officers” but the legal risks outlined here, as well as the available protections, may extend to other members of non-profits’ governing body and management.

⁵ Copies of the referenced EEOC cases are available at <http://www.eeoc.gov/litigation/settlements>.

⁶ See Black’s Law Dictionary at 288 (abridged 6th ed. 1991).

⁷ A copy of the Model Act is available at http://www.muridae.com/nporegulation/documents/model_npo_corp_act.html.

⁸ See Model Non-Profit Act § 6.30(a)(i).

⁹ See McKinney’s Consolidated Laws of N.Y. Annotated N-PCL § 632(a).

¹⁰ See, e.g., Fox v. Professional Wrecker Operators of Florida, Inc., 801 So.2d 175 (Fla. Dist. Ct. App. 2001); Brenner v. Powers, 584 N.E.2d 569 (Ind. Ct. App. 1992); Jackson v. Stuhlfire, 547 N.E.2d 1146 (Mass. App. Ct. 1990).

¹¹ See 26 U.S.C. § 170(c)(2)(D).

¹² See 26 U.S.C. § 501(c)(3).

¹³ See 26 U.S.C. § 4941.

¹⁴ See, e.g., Cal. Rev. & Tax Code § 23708(e) (providing that a private foundation shall not be exempt from taxation unless its governing instrument includes provisions that prohibit the foundation from engaging in any act of self-dealing as defined in § 4943 of the Internal Revenue Code).

¹⁵ See, e.g., Peggy Sasso, Searching for Trust in the Not-for-Profit Boardroom: Looking Beyond the Duty of Obedience to Ensure Accountability, 50 UCLA L. Rev. 1485, 1509 (2002-2003).

¹⁶ A “trustee,” who holds title to property for the benefit of another and thus owes fiduciary duties to the beneficiary, may be held under the law of trusts to a higher standard of care than directors and officers generally. The key for the applicable standard of care is the function performed, rather than the title. In this respect, it is important to note that many non-profit board members – such as members of the board of trustees of schools, colleges, and universities – are referred to as trustees but usually are not regarded as trustees under trust law. Conversely, the fact that a board member of a non-profit may not be referred to as a trustee does not foreclose the possibility that in certain circumstances he or she may be held to the standard of a trustee (e.g., a director may be considered a trustee where he or she is responsible for investing and managing an endowment fund). The Model Non-Profit Act provides that “[a] director shall not be deemed to be a trustee with respect to the corporation or with respect to any property held or administered by the corporation, including without limit, property that may be subject to restrictions imposed by the donor or transferor of such property.” See Model Non-Profit Act § 8.30(e).

¹⁷ See, e.g., Peggy Sasso, *supra*, at 1520-22; William E. Knepper & Dan A. Bailey, Liability of Corporate Officers and Directors § 12.01[4] (2004).

- ¹⁸ See Model Non-Profit Act § 8.30(a).
- ¹⁹ See Cal. Corp. Code § 5231(a); McKinney’s Consolidated Laws of N.Y. Annotated N-PCL § 717.
- ²⁰ See Model Non-Profit Act § 8.30(b).
- ²¹ See Model Non-Profit Act § 8.30(c).
- ²² See Model Non-Profit Act § 8.30(c). See generally George W. Overton & Jeannie Carmedelle Frey (eds.), Guidebook for Directors of Nonprofit Corporations 17-29 (2d ed. 2002).
- ²³ See generally George W. Overton & Jeannie Carmedelle Frey (eds.), *supra*, at 29-34.
- ²⁴ See Model Non-Profit Act § 8.31(a).
- ²⁵ See Model Non-Profit Act §§ 8.31(b)(1), (2). Under California law, for example, the prior approval of the transaction by the state attorney general may act as a substitute for the formal procedures of the board. See Cal. Corp. Code. § 5233(d)(1).
- ²⁶ See Model Non-Profit Act § 8.32.
- ²⁷ See generally George W. Overton & Jeannie Carmedelle Frey (eds.), *supra*, at 34-35.
- ²⁸ See 26 U.S.C. § 4958 (for non-profit organizations generally); 26 U.S.C. § 4941 (for private foundations).
- ²⁹ See, e.g., William E. Knepper & Dan A. Bailey, *supra*, at § 12.01[3] (discussing potential for securities fraud claims).
- ³⁰ See, e.g., George W. Overton & Jeannie Carmedelle Frey (eds.), *supra*, at 105-25 (2d ed. 2002) (discussing additional internet-related activities that could result in liability for non-profits).
- ³¹ Pub. L. 107-204, July 30, 2002, 116 Stat. 771. The complete text of the Act is available at <http://www.pcaob.org>.
- ³² PriceWaterhouseCoopers, “Sarbanes-Oxley Health Research Institute: Not-for-Profit Healthcare Update” (May 2005), available at <http://healthcare.pwc.com>.
- ³³ See, e.g., Panel on the Non-profit Sector, “Strengthening Transparency Governance Accountability of Charitable Organizations: A Final Report to Congress and the Non-profit Sector” (June 2005), available at <http://www.non-profitpanel.org/final>; BoardSource and Independent Sector, “The Sarbanes-Oxley Act and Implications for Non-profit Organizations” (2003), available at <http://www.independentsector.org/PDFs/sarbanesoxley.pdf>.
- ³⁴ See SOX Act § 806.
- ³⁵ See SOX Act §§ 802 and 1102.
- ³⁶ See SOX Act §§ 205, 301, and 407.
- ³⁷ See SOX Act §§ 201, 203, and 204.
- ³⁸ See SOX Act § 302.
- ³⁹ See SOX Act §§ 206 and 402.
- ⁴⁰ See SOX Act §§ 401, 403, 404, 406, and 409.
- ⁴¹ See PriceWaterhouseCoopers, *supra*, and National Council of Non-profit Associations, “Non-profit Oversight and Accountability Proposals and Bills Introduced at the State Level 2005,” available at <http://www.ncna.org>.
- ⁴² See Model Non-Profit Act §§ 8.51(a), (c).
- ⁴³ See, e.g., Model Non-Profit Act § 8.51(d)(1).
- ⁴⁴ See, e.g., Model Non-Profit Act § 8.51(e).
- ⁴⁵ See, e.g., John F. Olson et al., Director & Officer Liability: Indemnification and Insurance § 5.19 (2004) (citing cases and statutes regarding what may be indemnified); TLC Beatrice Int’l Holdings, Inc. v. CIGNA Ins. Co., No.

97 Civ. 8589, 1999 WL 33454 (S.D.N.Y. Jan. 27, 1999) (concluding that the settlement of a derivative action was not indemnifiable under New York law).

⁴⁶ See, e.g., Model Non-Profit Act § 8.55.

⁴⁷ See, e.g., Model Non-Profit Act §§ 8.52, 8.54.

⁴⁸ See, e.g., Del. Code, Title 8, § 145(g). Similarly, state law may provide that an organization may purchase insurance for liability asserted against its directors and officers in their capacity as such, whether or not the corporation would have the power to indemnify them against that liability under state law. See, e.g., Model Non-Profit Act § 8.57.

⁴⁹ The Model Non-Profit Act, for example, provides that an organization may advance a director's expenses if: (1) the director provides written confirmation of her good faith belief that she has met the requisite standard of conduct for permissive indemnification; (2) the director provides a written undertaking to repay the advance if it is later determined that the director did not satisfy the requisite standard of conduct; and (3) the facts, as then known to those making the determination to advance expenses, would not preclude indemnification. See, e.g., Model Non-Profit Act § 8.53.

⁵⁰ The Non-profit Risk Management Center has published a survey of these laws, "State Liability Laws for Charitable Organizations and Volunteers," available at <http://www.non-profitrisk.org/pubs/sll.htm> ("State Liability Laws").

⁵¹ See Model Non-Profit Act § 8.42(d).

⁵² See, e.g., Conn. Gen. Stat. §52-557m (immunity applies only to director, officer or trustee of a tax-exempt organization "who is not compensated for such services on a salary or prorated equivalent basis"), 15.805 ILCS §105/108.70(b) (no director of a non-profit organization "shall be liable, and no cause of action may be brought for damages resulting from the exercise of judgment or discretion in connection with the duties or responsibilities of such director, unless (1) such director earns in excess of \$5,000 per year from his duties as director, other than reimbursement for actual expenses . . ."). See generally, State Liability Laws, *supra*.

⁵³ See, e.g., Cal. Corp. Code § 5239.

⁵⁴ See, e.g., Wyo. Stat. § 1-1-125.

⁵⁵ See, e.g., Ala. Code 1975 § 6-5-335.

⁵⁶ See, e.g., Minn. Stat. § 604A.11.

⁵⁷ See, e.g., Hawaii Rev. Stat. § 662D-2.

⁵⁸ See, e.g., Alaska Stat. § 09.65.090.

⁵⁹ See, e.g., 10 Del. Code § 8133; Utah Code Ann. § 78-19-2.

⁶⁰ See, e.g., Kan. Stat. Ann. § 60-360; Ark. Code Ann. § 16-6-105.

⁶¹ 42 U.S.C. §§ 14501-14505.

⁶² See N.J. Stat. Ann. § 2A:53A-7.

⁶³ See Bagley v. Fulton-DeKalb Hosp. Auth., 455 S.E.2d 325 (Ga. App. 1995).

⁶⁴ See Mass. Gen. Laws Ann. Ch. 231 § 85K.

⁶⁵ See Colo. Rev. Stat. Ann. § 7-123-105.

⁶⁶ See, e.g., Pike v. Woods Hole Oceanographic Institution, 233 F. Supp.2d 198 (D. Mass 2002) (finding the Jones Law for maritime employment claims preempts the \$20,000 Massachusetts liability cap for non-profits).

⁶⁷ See EEOC Charge Statistics, available at <http://www.eeoc.gov/stats/charges.html>.

⁶⁸ See Tillinghast-Towers Perrin, 2002 Directors and Officers Liability Survey: Executive Summary of U.S. and Canadian Results, available at http://www.towersperrin.com/tillinghast/publications/reports/Directors_and_Officers_2002/DO_summary2002a.pdf.