

# The Top 10 Legal Risks Facing Nonprofit Boards

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With ultimate authority for guiding and advancing the mission of the organizations they serve, effective boards need to pay close attention to the risks the organization embraces, manages and avoids. The array of risks your nonprofit faces include some with legal implications. This article offers a glimpse of the top legal risks facing nonprofit boards as well as practical tips for addressing risk at the board table.

**Exposures from social media use, misuse and naivete.** From listserves and blogs, to employee Blackberries and work-related Facebook posts, social media and online networking are integral aspects of the nonprofit world today. However, utilizing new technologies carries with it new risks. For example, posting materials from presentations can lead to copyright and trademark infringement; taking advantage of available social media to ensure that present and potential employees fit within an organization's culture may create privacy violations and discrimination claims; and allowing free reign for employees to express their views on a nonprofit's websites or blogs—or on social media while identifying themselves as employees of the organization—can expose the nonprofit to liability for defamation, tortious interference, or otherwise reflect poorly on the organization. While risk will always be present, the solution is not to turn a blind eye to the inevitable. With proactive planning by nonprofit boards—including the development and communication of internal and external policies—risks can be managed and the rewards of social media can be prudently and effectively harnessed.

**Unhappy staff and volunteers.** While it's impossible to keep everyone on a nonprofit's payroll perpetually happy, boards should be aware that dissatisfaction and legal risk may go hand in glove. Some unhappy employees may be victims of workplace bullying—abusive or threatening conduct by bosses and co-workers. According to the Workplace Bullying Institute, 38% of workers report having experienced workplace bullying first hand. Nearly half of the state legislatures have introduced a new law (the Healthy Workplace Bill) that would make it an "unlawful employment practice" to subject an employee to an abusive work environment. Even without this pending legislation in place, employers can be found legally responsible in cases alleging intentional infliction of emotional distress or even assault. What's the board's role? The board should ensure that an easy-to-use internal complaint procedure is in place and that the CEO sets the tone for appropriate workplace behavior. A CEO who could play the boss in *The Devil Wears Prada* is a liability exposure your nonprofit cannot afford.

**IRS Form 990 and federal tax-exempt status.** Those who have undertaken the process of applying to the IRS for recognition of federal tax-exempt status understand how valuable that status is. Not only does tax-exempt status relieve an organization of most federal and state corporate income tax liabilities, as well as the ability to receive tax-deductible charitable contributions (for those exempt under Section 501(c)(3)), but it offers credibility with the public. However, those benefits come with a price tag in the form of the federal tax laws' many restrictions on a tax-exempt organization's income, fundraising, meetings, educational programs, publications, lobbying and political activities, standard setting, certification, and other activities. Failure to comply with these restrictions can jeopardize an organization's tax-exempt status and result in other penalties as well (such as "intermediate sanctions" for "excess benefit transactions"). The IRS' principal tool for monitoring compliance with the federal tax laws is the very comprehensive Form 990 information return, which must be filed annually by most exempt organizations. Thus, to protect their organization's tax-exempt status, board members should have a basic understanding of the restrictions imposed by the tax laws, and implement policies and procedures responsive to these requirements as well as the Form 990's reporting mandates.

**Copyrights and trademarks.** The risk of committing actionable violations of copyright and trademark law lurks behind the doors of every nonprofit. Too few staff members at a typical nonprofit appreciate the potential exposure associated with their enthusiastic "borrowing" of the work of others, often accomplished by mastering keyboard

commands for “copy” and “paste.” The opposite risk also exists—the failure to adequately protect the nonprofit’s written and artistic expressions (copyright-protected material) and names and symbols that identify the nonprofit as the source of goods or services (trademarks). What’s the board’s role? The board should inquire about the steps taken and policies in place to both prevent the violation of others’ copyright-protected material and trademarks, as well as whether the nonprofit has taken appropriate measures to protect its own intellectual property. Registering trademarks can be costly and time-consuming (registering copyrights is fairly easy and inexpensive), but may be worth it to protect a nonprofit’s valuable assets.

**Lobbying and political activity compliance.** While political issues and players often have a huge impact on the mission of a nonprofit, the IRS restricts the ability of many tax-exempt nonprofits to engage in governmental affairs activities. For example, Section 501(c)(3) public charities must avoid all political campaign activities and keep lobbying within permissible limits, whereas a Section 501(c)(6) association may engage in limited political campaign activities and may lobby as its primary activity. Nonprofit board members should understand where the limitations lie—and where they can safely engage in needed advocacy. Furthermore, any such activities must be undertaken with an understanding of federal and state lobbying disclosure requirements, gift and ethics rules, and campaign finance laws.

**Third-party sexual harassment.** Many board members may not be aware that the nonprofits they serve are exposed to claims alleging third-party sexual harassment—illegal harassment committed against employees by vendors or volunteers, or illegal harassment committed by the nonprofit’s employees where third parties such as vendors or volunteers are victims. With ultimate responsibility for oversight of the nonprofit’s employment policies, the board should make certain that language prohibiting harassment is broadly worded to include third-party harassment. The board also should be certain that claims alleging illegal harassment are handled with care and without delay, and that sufficient training is undertaken regularly to help prevent harassment from occurring in the first place.

**Failure to limit contracting authority and other common mistakes in contracting.** Some may say that the best business arrangements—even in the nonprofit world—are negotiated on a handshake. However, failure to memorialize the terms of a new venture or consulting arrangement, for instance, in a written contract can leave a nonprofit holding the bag for significant unforeseen liabilities and create other serious challenges down the road. Contracts always should outline the key aspects of the parties’ understanding, including the obligations of each party, benchmarks by which performance can be measured, clear payment terms, provisions addressing who owns and/or can use any intellectual property resulting from or involved in the arrangement, and a reasonable exit strategy, among other provisions. The day-to-day business of a nonprofit, including contractual matters, typically are handled by staff. However, boards can help manage contracting risks by ensuring that staff members are well educated on common issues to address in contracts, and when to seek legal advice. Finally, the board should limit the authority to sign contracts to only a qualified few, and with the exception of the CEO’s employment agreement, volunteers should not have signature authority.

**Lack of synchronicity in board policy and practice.** The missions of many nonprofits include statements espousing fairness, justice and protecting the planet. It’s all good. But from time to time, a closer look at the governance operations of a nonprofit reveals less-than-best practices. For example, the board of a nonprofit promoting ethical conduct may be reimbursing board members without requiring sufficient documentation of expenses. From time to time, every board should examine its practices in light of the nonprofit’s overarching mission. Ask, what would our stakeholders say if a light was shined on our governance operations? Getting the nonprofit’s policies and practices “in sync” with its mission is a worthwhile exercise for every organization.

**Failure to understand and manage conflicts of interest.** In recent years, awareness of conflicts of interest in the nonprofit sector has been especially high, with watchdog organizations, the IRS (via the Form 990), and even Congress aggressively monitoring nonprofit governance practices for any hint of abuse. Nonprofits that fail to manage conflicts of interest run the risk of losing public confidence, or worse, becoming the object of a media scandal. Such risks provide ample reason to avoid even the appearance of impropriety by implementing a well-drafted conflict of interest policy and a transparent disclosure process and procedure for managing conflicts. Conflict of interest policies should help nonprofit managers and volunteer leaders understand that not all conflicts involve bad actors with poor ethics. Rather, a conflict can arise any time a nonprofit manager or volunteer leader’s personal, financial or other

interests could potentially conflict with the interests of the nonprofit. And recognize that not all conflicts are necessarily bad for the nonprofit; some can even be in the organization's best interests. But the key to effectively dealing with potential conflicts is for the board to undertake a routinized process for identifying, disclosing and managing them.

**Reliance on the goodwill, good nature, and insurance coverage of others.** Partnerships are the name of the game in today's nonprofit world. Few nonprofit missions would be possible to carry out without links between and among nonprofits, and between nonprofits and for-profits. A nonprofit may be unwittingly exposed to legal risk when it relies on the goodwill, promises and even the insurance coverage of its partners. What's the board's role? The board should have confidence that the nonprofit uses written MOUs or contracts to specify the roles and responsibilities of the parties to any partnership, joint venture, or other collaboration. Board members should be comfortable asking whether key relationships have been memorialized in a written document signed by authorized representatives of all parties to the agreement. The process of putting expectations and roles in writing will often uncover areas where dangerous assumptions have been made, and will help to map out what happens if the relationship sours or simply runs out of steam. It's always better to sort out the details before the parties to a collaboration head off together.

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