

# Avoid Crisis Mode

## Important Tools for a Nonprofit Board of Directors.

BY LEAH COHEN CHATINOVER



If you serve on a nonprofit Board of Directors you know that organizations get into trouble when money runs short. A deficit looms, an accusatory finger is pointed at the executive director, the Board lines up on either side. Suddenly the organization is in crisis.

It may surprise you that nonprofits also get into trouble when too much money is floating around. The Board gets complacent and financial irregularities are often overlooked; or a large donation drops into the organization's lap. The Board argues over how to use the gift. Suddenly the organization is in crisis.

Both of these crises can leave you wondering, "What steps can I take to safeguard myself from personal liability?" These four tools used together offer significant protection:

### D&O INSURANCE

Directors and Officers Liability Insurance is critical. While policies differ, D&O insurance generally covers "wrongful acts" by a director or officer in the discharge of his/her duties. Often, an endorsement covers employment practices. A D&O policy won't prevent a lawsuit, but it should pay defense costs.

### VOLUNTEER PROTECTION STATUTES

Both Connecticut and federal laws protect volunteers from liability to third parties for damage caused by ordinary negligence. Since there are many exceptions, these statutes are only part of the answer.

### INDEMNIFICATION

To simplify a very technical topic: when specified in the by-laws, an organization may (and in some narrow cases, must) compensate you for damages and legal fees if you are sued because you are a director.

### FIDUCIARY DUTY

The best defense is a good offense. Understand your duties as a director and do the right thing. The words "fiduciary duty" sound confusing, but the concept is pretty simple. A fiduciary is someone in a relationship of trust vis-à-vis a more vulnerable person or entity. The fiduciary – you, as a nonprofit director – owe a duty to act in the interest of the organization you serve.

Fiduciary duties are described in statutes and in case law developed over many years (known as "common law"). The Connecticut nonprofit statute requires you to act in good faith, prudently, and in the best interests of the organization.

The common law establishes three fiduciary duties: the duty of care, the duty of loyalty, and the duty of obedience (which has largely been subsumed into the first two.)

### SO WHAT DOES THIS MEAN IN PLAIN ENGLISH?

The **Duty of Care** can be summarized in three simple instructions:

- ✓ Pay Attention!
- ✓ Stay Awake!
- ✓ Ask Questions!

You may make the "wrong" decision – it happens. By monitoring the situation, asking probing questions and engaging in robust discussion you can go a long way toward shielding yourself from liability.

The **Duty of Loyalty** can be summarized in two simple instructions:

- ✓ Don't exploit the organization!
- ✓ Stay away from conflicts of interest!

If, for example, you want the nonprofit you serve to buy insurance from your husband, both you and the rest of the Board must ensure that the price is at or below market rates, and that the contract is approved by the other directors only.

Now that you know what steps to take to avoid liability, you may have some more questions, such as: How do we hire or fire an executive director? What are the technical tax issues surrounding executive compensation? or, How do we resolve board conflicts without painful controversy?

These we will leave to answer in a future newsletter. ■

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