
Directors' & Officers' Liability Insurance (D&O)

Excerpted From Coverage, Claims and Consequences: An Insurance Handbook for Nonprofits, *Second Edition*

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Another liability policy to consider is a nonprofit directors' & officers' liability policy. The D&O policy protects the organization, its directors, officers, employees and volunteers for their "wrongful acts" in governing and managing the organization. The actual people insured depends on which policy the organization purchases. Wrongful acts are allegations of breach of duty, errors and omissions, and other acts that cause harm to the organization or its members. The D&O policy doesn't cover loss for bodily injury or property damage; that's covered under the general liability policy.

If the nonprofit publishes a newsletter, marketing materials etc. you should consider a D&O policy that includes publishers' liability and personal injury. This provides broader coverage for libel, defamation, copyright or trademark infringement than the general liability policy.

If you have employees, you'll also want to make certain that your D&O policy includes employment practices liability (EPLI) coverage or that you purchase a separate EPLI policy. Employment related claims are the most common D&O claims filed against nonprofits.

The main argument for the D&O policy is that even with state and federal volunteer protection laws, a board member can be held personally liable for mismanagement of the organization. As for limits, the base limit should be \$1 million unless the organization is very small. (Note: you should review the volunteer protection laws which apply in your state—the Nonprofit Risk Management Center's Web site features a publication describing the statutory protections for volunteers in various states. (<http://nonprofitrisk.org/library/state-liability.shtml>).

Professional Liability Coverage Under the Nonprofit D&O Policy (page 113)

There is a fairly clear distinction between professional liability and directors' & officers' liability. Professional liability coverage is liability for providing professional services to clients or patients. D&O liability is liability for corporate governance. For nonprofits, confusion about the difference arises principally from the significant expansion of coverage under nonprofit D&O beyond the traditional coverage provided under for-profit

D&O policies. In an attempt to acknowledge this expansion of coverage into essentially a different type of policy, some underwriters began to reclassify nonprofit D&O under new names such as *Association Professional Liability* or *Nonprofit Professional Liability*. This understandably led some nonprofits to mistakenly believe that their D&O policy was a professional liability policy.

The scope of a particular nonprofit D&O policy may be so broad that it sometimes can, in fact, provide incidental professional liability coverage, although this is never its primary intent. Nonprofit D&O coverage is for *wrongful acts* subject to policy exclusions, so the policy will provide professional liability coverage to the extent it is not excluded.

Because D&O policies exclude bodily injury and property damage, incidental professional liability provided under the policy will be limited to pure financial loss arising from the acts of professionals such as attorneys, accountants, real estate managers, investment managers, or financial planners. Claims for emotional distress or mental anguish, which commonly arise from counseling or social work, will usually not be covered because most nonprofit D&O policies exclude emotional distress and mental anguish as part of their bodily injury and property damage exclusion.

A typical D&O bodily injury and property damage exclusion reads as follows:

Any actual or alleged: bodily injury, mental anguish, emotional distress, loss of consortium, sickness, disease or death of any person, or damage to or destruction of any tangible property including loss of use thereof.

Employment practices liability will usually be exempt from the mental anguish and emotional distress portion of this exclusion.

Many nonprofit D&O policies also have specific exclusions for professional liability. These exclusions are either built into the policy itself or added by endorsement. For example:

Exclusion Example #1

The rendering or failure to render medical, psychological or counseling services or referrals

Exclusion Example #2

Claim or claims based upon, arising out of, directly or indirectly resulting from or in consequence of, or in any way involving the performance of any professional services for others for a fee, and caused by any act, error or omission



Exclusion Example #3

Any claim made against any insured based upon, arising out of, directly or indirectly resulting from, in consequence of, or in any way involving any liability arising out of any error or omission, malpractice or mistake of a professional nature committed or alleged to have been committed by or on behalf of the insured in the conduct of any of the activities of the organization

Exclusion Example #4

Claim or claims based upon, arising out of, directly or indirectly resulting from or in consequence of, or in any way involving the rendering or failure to render professional services in connection with the member's business as a provider of professional services, including but not limited to: providing medical, surgical, chiropractic, dental, phlebotomy, acupuncture, psychiatric or nursing treatment, diagnosis or services, including the furnishing of food or beverage in connection therewith; furnishing or dispensing drugs or medical, dental or surgical supplies or appliances; providing veterinary services; offering any advice in connection with any of the above

The first two of the four listed exclusions are narrow enough to potentially leave coverage for incidental professional liabilities. The last two exclusions attempt to exclude professional liability entirely.

D&O Insurance—excerpted from Chapter 6

Prior to the early 1960s, overseas insurers such as Lloyd's of London were the only writers of directors' and officers' (D&O) policies for for-profit businesses. The first D&O policies were intended to protect board members of publicly traded corporations from shareholder lawsuits. Coverage was for wrongful acts, which were commonly defined as "any act, error, or omission by the Directors or Officers of the Company." Bodily injury and property damage were always excluded (BI & PD Exclusion). In the 1960s, two major U.S. companies, St. Paul and American International Group (AIG) began writing corporate D&O policies.

The number of policies sold grew considerably after 1968 when Delaware (as a leading state for corporate domiciles) passed new laws authorizing corporations to purchase D&O liability coverage.

Today, several dozen U.S.-based insurers sell the vast majority of D&O coverage for businesses and nonprofits.

Besides the number of companies, each insurer offers many different forms, including, in some cases, one or more policies written specifically for nonprofits. Insurance companies then further complicate D&O policies by attaching endorsements that modify coverages.

Is D&O Coverage Required or Necessary?

State laws permit—but do not require—the purchase of directors’ and officers’ liability coverage by a nonprofit organization. There are, however, various volunteer protection statutes at the state level whose terms are affected by whether a nonprofit maintains liability coverage of a prescribed amount. For example, under a number of state volunteer-protection statutes immunity for simple negligence by a volunteer is contingent upon the nonprofit organization’s purchase of liability insurance with a specified limit. This means that a volunteer working for a nonprofit without insurance is vulnerable to claims, even those alleging simple negligence. For example:

District of Columbia

D.C. Code § 29-599.15, Non-profit volunteers—Any person who serves in good faith as a volunteer, including an officer, director, trustee or any person who performs uncompensated services for the organization, is immune from civil liability for acts and omissions within the scope of duty.

This immunity applies only if the nonprofit corporation maintains liability insurance with a limit of coverage not less than \$200,000 per individual claim and \$500,000 per total claim that arise from the same transaction.

In several states the protection afforded volunteers under the state laws disappears if the volunteer is protected by liability insurance:

Idaho

Idaho Code § 6-1605, Non-profit directors and volunteers—Officers, directors and volunteers who serve a nonprofit organization or corporation without compensation are immune from civil liability arising out of conduct that was within the course and scope of their duties and was at the direction of the corporation or organization.

Exceptions: No immunity attaches to the following categories of conduct:

- conduct which was willful, wanton, or involves fraud or knowing violation of the law;
- conduct for which liability insurance was purchased to the extent that it was purchased;
- intentional breach of fiduciary duty owed to the organization, corporation or members;
- acts or omissions not in good faith and involving intentional misconduct, fraud or knowing violation of the law;

- a transaction from which the officer, director or volunteer received an improper, personal benefit;
- damages that result from operation of a motor vehicle; and violations of Idaho Nonprofit Corporation Act.

North Carolina

N. C. Gen. Stat. § I-539.10, Charitable volunteers—A volunteer who in good faith performs reasonable services for a charitable organization is not liable in civil damages for acts or omissions resulting in injury, death or loss arising from the services rendered.

Exceptions: the acts or omissions of the volunteer amount to gross negligence, wanton conduct or intentional wrongdoing, the acts or omissions occurred while the volunteer was operating a motor vehicle. A volunteer is deemed to have waived immunity to the extent that he has liability insurance.

In two states, a volunteer is not liable for civil damages simply if the nonprofit he or she serves maintains general liability insurance: Kansas and Hawaii.

Kansas

K. S. A. § 60-3601, Nonprofit volunteers—If a nonprofit organization has general liability insurance, a volunteer of the organization is not liable for damages in a civil action for acts or omissions.

Hawaii

HRS § 662-D2, Volunteer immunity—A volunteer is immune from civil liability for an act or omission resulting in damage or injury caused by the volunteer's negligent conduct. This applies if the volunteer acted in good faith and within the scope of duty for a nonprofit organization or corporation, a hospital or a government entity; and if organization has a general liability policy during the time of injury and at the time the claim is made of not less than \$200,000 per occurrence and \$500,000 aggregate; or the organization has total assets of less than \$50,000.



General Liability and Directors & Officers Liability — Differences and Similarities

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Differences

General Liability

Covers Bodily Injury and Property
Covers accidents only. Claims usually arise directly from operations rather than governance.

Usually Occurrence Liability
Standardized policy wording.

Directors & Officers Liability

Always excludes Bodily Injury and Property
Covers Wrongful Acts. Claims usually arise from governance or management decisions. Board members, management staff and the organization itself are likely to be defendants.
Usually Claims-Made Liability.
Non-standard policy wording.

Similarities

General Liability

Covers liabilities common to all nonprofits.
Provides broad catch-all coverage. Other liability coverages are more specific and narrower in scope.
Includes all board members, employees and volunteers as Insureds.

Directors & Officers Liability

Same
Same
Same

Nonprofit D&O Claims Examples

Employment Practices Claims

- Wrongful Termination
- Breach of Employment Contract
- Discriminatory Hiring Practices
- Failure to Promote
- Negligent Evaluation
- Retaliation
- Sexual Harassment
- Wrongful Discipline
- Failure to Grant Tenure
- Invasion of Privacy
- Employment Related Defamation
- Employment Related Infliction of Emotional Distress

Non-employment Claims

- Misallocation of Funds
- Breach of Fiduciary Responsibilities
- Self Dealing / Conflict of Interest
- Anti-trust or Restraint of Trade Violations
- Third Party Discrimination, Defamation, or Invasion of Privacy
- Negligent Financial Advice to Third Parties
- Failure to Maintain Insurance
- Tortious Interference with Contract
- Breach of Contract
- Failure to Accredite or Certify
- Infringement of Trademark, Patent or Copyright



To Buy Coverage or Not

Under a D&O insurance policy, coverage is provided for the defense of actual or alleged wrongful acts by directors, officers and other insureds under the policy. The person filing suit may be an insider, such as an employee or volunteer, or an outsider, such as a service recipient, donor or governmental official.

While directors' and officers' liability insurance may provide defense against allegations of fraudulent, criminal or dishonest acts, these acts are not insurable (nor indemnifiable) as a matter of public policy. However, many policies contain a *nonimputation clause* that states that the fraudulent, criminal or dishonest acts of one insured will not be imputed to an innocent insured. In other words only insureds actually guilty of fraudulent, criminal or dishonest acts will be excluded from coverage.

Every nonprofit must decide for itself whether or not it should purchase D&O insurance. Most nonprofit bylaws contain an indemnification agreement, whereby the nonprofit agrees to pay the legal expenses incurred by board members who must defend themselves in suits based on their work as board members. These board member indemnification agreements are hollow promises unless the nonprofit has financial resources to fund the indemnification. While a small percentage of nonprofits may be able to set aside funds to pay for future litigation costs, the vast majority of organizations will find it easier to afford an annual premium for D&O insurance.

Some wrongful acts are neither insurable nor indemnifiable, however the vast majority of allegations against the board, staff and the organization will be activities potentially covered by a D&O policy.

Sources of Claims Against Nonprofit Boards

One of the myths associated with nonprofit D&O insurance is that claims are unlikely because nonprofits do not have shareholders. While claims against nonprofits may be rare for other reasons, it is not because of a lack of potential plaintiffs. Nonprofits serve large and varied constituencies to which their boards owe specific fiduciary duties similar to duties owed by corporate boards. These constituencies are potential plaintiffs in legal actions brought against nonprofit boards. Potential claimants in a suit against nonprofit directors include:

1. *Insiders*

The current and former staff of a nonprofit may bring actions alleging a host of wrongful acts, including wrongful termination, discrimination, sexual harassment, Americans with Disabilities Act violations and more.



2. Outsiders

Third parties that have a relationship with the nonprofit may allege harm caused by the nonprofit and/or its directors, officers or employees. Outside sources can be vendors, funders, or another nonprofit.

3. The Entity

The nonprofit may bring an action against its directors and officers. Examples include claims by current management against a former trustee. In some states, derivative suits are permitted. In a derivative suit, members of a nonprofit may bring a claim on the nonprofit's behalf against a director and officer. (Note: Claims by the entity against its directors and officers are likely to be excluded under most nonprofit D&O policies.)

4. Directors

A nonprofit director may sue another board member alleging violation of a duty owed to the nonprofit. Under certain circumstances such an action may be compelled (caused by overwhelming pressure). These claims are likely to be excluded under most nonprofit D&O policies.

5. Beneficiaries

The people you are in business to help — your service recipients — may bring claims against directors and officers alleging wrongdoing in the deployment of resources and personnel.

6. Members

Directors and officers of membership associations are vulnerable to claims brought by members alleging harm to the interests of the member.

7. Donor

A nonprofit's corporate, foundation, and individual contributors may sue directors and officers alleging misuse of a restricted gift.

8. State Attorney General

In most states, the state attorney general represents the interests of the general public in assuring the proper management of public benefit corporations. As such, the attorney general may bring a claim against nonprofit directors and officers alleging wrongdoing.

9. Other Government Officials

Other government officials, including representatives of the Internal Revenue Service and the Department of Labor, may bring actions against nonprofit directors alleging violation of state or federal laws, for example, the failure to remit employment-related taxes on salaries paid to employees.

Choosing a D&O Insurance Policy

Insurance companies write D&O policies in a variety of ways. Some carriers offer a traditional D&O policies with additional coverages provided through endorsements to modify coverage for nonprofits. Some policies provide minimal coverages to corporate directors with substantive exclusions, and the nonprofit coverages are restored through various endorsements that modify the provisions in the main policy. Another choice for the nonprofit buyer is designed for nonprofit organizations and provides the essential coverages. These policies may be called Nonprofit Organization Liability Insurance, Not-for Profit Organization Professional Liability Insurance, or something similar.

Misconceptions About the D&O Policy

Some board members mistakenly believe that the Nonprofit D&O is their policy, and the CGL is the policy that covers employees. Actually both policies generally cover the same people. The major difference is that nonprofit D&O excludes claims alleging bodily injury and property damage.

Another misconception is that board members are covered for D&O liability under their homeowners and umbrella policies. It is true that a homeowner's volunteer activities are covered under the homeowner's personal policies, but that coverage is often analogous to the coverage provided under the commercial general liability policy, not the nonprofit's D&O policy.

Nonprofit D&O Claims

The scarcity of nonprofit D&O claims ended in the 1980s with the arrival of employment practices litigation, which includes claims for discrimination, sexual and racial harassment, retaliation, and wrongful termination. These claims now account for more than 85 percent of all nonprofit D&O claims. Other claim trends may also be emerging, for example claims from donors alleging misuse of funds, from advocacy groups for the disabled alleging ADA violations, activist district/states attorney general, and from for-profits alleging unfair trade practices.

Claims against nonprofits remain rare, and many nonprofits report never filing a claim under D&O coverage. Generally, the larger the organization (in terms of paid employees), the more likely it is that the nonprofit will someday face an employment-related complaint or suit.



Risk Management Strategies

Since the majority of nonprofit D&O claims allege wrongful employment practices, most risk management tips for this exposure concern employment practices. (For further information consult *Coverage, Claims and Consequences*, Second Edition—pgs 137-145) Tips to minimize the likelihood of a nonemployment D&O claim include:

- Carefully taking and maintaining board minutes that reflect key areas of discussion and inquisition, board votes (including dissenting votes and abstentions) and action items. Board minutes should not be verbatim transcripts of the board discussion.
- Exercising care when soliciting and accepting grant funds. Someone in the organization should carefully review the terms of any grant agreements before the CEO signs them, in order to make certain the nonprofit is capable of meeting all grant requirements. Key deadlines should be entered on an office-wide calendar with someone held accountable for preparing required financial and narrative reports.
- Exercising care when soliciting and accepting donations. In particular, give special care to any donor-imposed restrictions on the use of funds, and any promises made or implied in the nonprofit's fund-raising materials. A growing number of nonprofits are adopting gift acceptance policies as a risk management tool for fund-raising risks.
- Ensuring diverse board composition and board training—the board should be diverse in makeup, independent of management, effectively sized and self evaluating. All board members (and officers), especially new ones, should be well-versed on the nonprofit's mission statement. Code of conduct, conflict of interest, ethics and policy statements should be written, periodically disseminated and acknowledged in writing by board members and officers.

Employment-Related Claims Are the Majority of Nonprofit D&O Claims

Informal surveys of insurance companies that write large numbers of nonprofit policies reveal that a great majority of the claims filed under nonprofit D&O policies allege wrongful employment practices. Some insurers report that 80-90 percent of nonprofit D&O claims are actually employment practices claims. Since the greatest D&O exposure to a nonprofit is an employment-related claim, for many nonprofits, purchasing a D&O policy that includes coverage for employment-related claims makes good economic sense.

EPL coverage is also available as a stand-alone policy. The insurance industry developed EPL insurance for large corporations and followed the for-profit D&O policy model. Therefore, a separate EPL policy may not provide a nonprofit with the depth of coverage that a nonprofit D&O with EPL coverage may include. Many stand-alone EPL policies

do not include the organization, all employees, or volunteers as insureds. The definition of the covered employment actions may be more narrow than a nonprofit D&O with EPL coverage. Finally, a stand-alone EPL policy may be more expensive and include a large retention or possible co-insurance provision where the insured must pay a certain percentage of the loss.

Purchasing employment practices coverage as part of a D&O policy has one disadvantage. A blended policy provides coverage for two very distinct exposures with one policy limit. The inclusion of EPL coverage dilutes the limit of liability (including defense costs) available to protect the directors' and officers' personal assets and to protect the nonprofit and its employees and volunteers. The defense and resolution of an employment-related claim will reduce and, possibly exhaust, the D&O policy limits, thereby leaving limited or no funds for any additional non-EPL claims. The majority of nonprofit D&O policies provide no separate limit for EPL coverage. However, some companies are introducing either a sublimit or separate limit for EPL coverage. Therefore, a nonprofit should carefully evaluate the adequacy of its D&O policy limit when it purchases D&O that includes employment practices liability coverage. At the same time, it is important to keep in mind that most nonprofits will never face a nonemployment related claim, and therefore a D&O policy with employment practices liability coverage may represent an affordable and appropriate option.