



Frequently Asked Questions for Directors & Officers Liability

Why does a non-profit organization require Directors & Officers Liability?

The answer is simple – to protect the personal assets of the directors and maintain the ability to attract qualified people as board members. It becomes much easier to attract qualified people to serve on a Board when they know their personal assets are protected by a Directors and Officers (D&O) Policy.

There is a common misconception that directors of non-profit corporations don't have much of an exposure to liability. Nothing could be further from the truth. In fact, they may have a greater exposure to liability because the firms they serve are smaller and cannot afford to have on-staff lawyers, accountants, IT specialists, etc. in the same manner that larger for-profit corporations are able to. The non-profit entity also does not have the same capital resources to indemnify board members or pay for expensive litigation.

Non-profit organizations generally recruit board members who are passionate about the work of the entity. These individuals may lack experience regarding governance, legal and statutory requirements, their duty of care as a board member and decision-making skills based on sound

business principles rather than emotions. Yet they take on the responsibility of overseeing the business of the entity; setting policies and procedures; overseeing the spending of government and donor funds and hiring/firing/managing staff and volunteers. In the event of mismanagement of the entity, board members are held accountable for their actions or inactions. Ignorance is not a legal defence and resigning isn't always an option to avoid litigation.

Who would sue a non-profit board and why?

- Employees – unlawful dismissal; discrimination in the workplace; unsafe work environment; unpaid wages
- Potential Employees – failure to employ
- Donors and government entities for mismanagement of funds
- Volunteers – unsafe workplace; discrimination
- Stakeholders – suffering a financial loss as a result of the actions or inactions of the board
- Benefactors – misuse of bequeathed fund
- Creditors – in the event of insolvency of the organization

What type of claims are made against board members of non-profit organizations?

Employee

A female employee in a senior management role at a non-profit agency failed to meet the job performance expectations of her male executive director. After several warnings and a negative performance review, the senior manager is terminated with cause. She feels the termination was unfair and hires an employment lawyer. In addition, she files a complaint with the provincial Human Rights Commission claiming discrimination based upon her gender. The Human Rights Commission initiates an inquiry into her allegations of gender discrimination. The organization must hire legal representation and incur significant legal costs.

Government

To conserve cash, an entity has fallen behind in their employee CPP and Income Tax remittances. The directors are personally liable to the respective government agencies for these amounts.

Donor

A wealthy individual donates a \$1,000,000 to a charity with the specific condition that the donation is intended to help expand their facilities. The board decides to redirect some of these funds to general maintenance of the existing facility. The donor finds out about the redirection of funds and is furious. The donor then commences a legal action alleging breach of fiduciary duty and misuse of funds by the directors and requests a return of the funds. The costs for defence are substantial.

Failure to Employ

A prospective employee is advised that they have not been successful in getting the job despite having had two interviews with the organization. While the decision was made based on the individual skills and suitability of the various candidates applying for a single open position, the prospective employee alleges they were discriminated against and threatens to bring suit against the company if they do not hire them. Significant costs are incurred in defending the Company's decision.

Benefit Plan Omission

An organization forgot to add an employee to their benefit plan. The error came to light when the employee was diagnosed with cancer. The cost to settle this claim was hundreds of thousands of dollars.

Bankruptcy

An entity took on significant debt to expand their facility. The board thought they could handle the costs based on their current grants and donations. Unfortunately, a large grant was withdrawn and the entity was forced to declare bankruptcy. The executive director and 10 employees lost their jobs. The directors were responsible for unpaid wages and vacation pay.

What coverage does a D&O policy provide?

In the event of a claim, directors and officers will look to the entity for indemnification of expenses and settlements. There could be circumstances when this indemnification is not available from the entity, typically because it is not permitted by law or the firm is financially unable to indemnify the directors. In these cases, the insurance contract will be called upon to respond directly to protect the personal assets of the directors. This is known as Side A coverage and is the backbone of all D&O policies.

Is there any coverage for the entity?

For situations where the entity has indemnified its directors and officers, it will look to the entity reimbursement section of the D&O policy for coverage. The policy will be called upon to reimburse the entity for amounts paid to indemnify the directors and officers for claims that are covered by the policy.

This section of the policy is often described as corporate balance sheet protection and is subject to a deductible.

This coverage is commonly referred to as Side B coverage and is an optional element under most forms.

How does the insuring agreement read?

The Insurer shall pay on behalf of:

- a. the "Insured Persons", "loss" for which the "Insured Persons" are not indemnified by the "Insured Organization"; and
- b. the "Insured Organization", "loss" which the "Insured Organization" pays to or on behalf of the "Insured Persons" as indemnification; and
- c. the "Insured Organization", "loss"

resulting from "claims" for "wrongful acts" first made during the "policy period" against the "Insureds" and reported.

Does the policy provide any other coverages?

Employment Practices Liability for both the directors and the entity.

Outside Directorship Liability: From time to time an entity may request that its employees sit on the board of other firms. These are typically situations where there is a strategic or relationship value in doing so.

The D&O policy will have an Outside Directorship Liability (ODL) extension which provides coverage to insured persons of the entity who are sued while acting as a director of an outside non-profit entity – **but coverage is limited to those directors serving at the specific request and prior written consent of the entity.**

Employee Benefits Administration.

How does the policy define “claim”?

The definition of claim is typically the entry point to triggering coverage under a policy. It defines what types of actions taken against an insured could allow for the policy to respond.

Every policy will use a variation of this definition but some key elements that should be present include:

- a written demand for monetary or other types of relief
- the commencement of civil, criminal or administrative proceedings
- the commencement of a regulatory or arbitration proceeding
- a derivative demand

What damages are covered under the policy?

Damages are typically one part of what a policy may pay should the claim be deemed to be covered.

These typically include settlements and/or judgments made up of:

- Compensatory damages
- Punitive or exemplary damages
- Pre and post judgment interest incurred

- Damages typically form one part of the Definition of Loss, along with Defense Cost
- Many policies include limitations in their definition of damages or loss. Be sure to review the definition carefully to see what might be excluded. Some forms will also exclude taxes from covered damages. Make sure the policy has a carve-back for statutory liabilities.

Who is an insured under the policy?

The definition of insured is typically made up of two parts:

1. The individual insureds which includes past, present and future directors and officers of the firm, spouses of directors and officers (but only by reason of their status as such) and employees (often when named as a codefendant alongside other directors or officers.)
2. The entity along with subsidiaries as defined in the policy. It is extremely important to ensure all entities intended for coverage are captured by the wording.

What are considered wrongful acts under the policy?

The definition typically includes words like any actual or alleged error, omission, misstatement, misleading statement, neglect, or breach of duties by an insured in the discharge of their legal duties solely in their capacity as a director or officer of the entity.

Summary

Non-profit agencies work hard to provide quality services to the communities they serve. In many cases their resources are scarce and stretched. So, imagine what would happen to those who depend on their services if they had to close their doors because of an unexpected financial loss?

Don't let that happen to your organization. Be prudent and purchase the necessary insurance coverages. When it comes to financial losses, the insurance premium is always cheaper than the loss.

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