



Do all nonprofit organizations need Directors & Officers Liability Insurance?

The following article is a summary of an NonProfit Coordinating Committee of New York (NPCC) workshop on the topic of whether or not an organization should carry Directors & Officers (D&O) insurance. NPCC's past president, Peter Swords, has been involved with the issue of D&O liability insurance, and led the session.

Unlike general liability insurance -- which any organization that has a physical plant would be foolish not to have -- many nonprofits are uncertain whether they need D&O coverage. When a person becomes a board member of a nonprofit organization, s/he assumes a level of responsibility for the organization ("duty of care"), and exposes her/himself to claims for not running and managing it in a proper way. Whether or not your organization needs D&O insurance depends on what the likelihood is that one of your board members will be the target of such a claim.

Generally, claims fall into two categories: bodily injury (physical harm) and non-bodily injury (non-physical harm, like discrimination or termination).

The majority of liability claims are for bodily injury. Your general liability insurance covers board members, subject to policy terms and conditions, for claims arising out of bodily injury and property damage.

Directors & Officers liability insurance only covers non-bodily injury claims.

Non-bodily claims include: (a) employment-related claims and (b) mismanagement of funds.

Fear of non-bodily injury lawsuits would be one reason to have D&O insurance. Although there are very few reported cases, it doesn't mean that claims have not been filed and then either settled out of court or dropped.

Generally, there are two types of lawsuits in which a claim might be brought against a board member: (a) derivative lawsuits or (b) direct or third-party lawsuits.

- Derivative lawsuits are claims against a board member on behalf of the corporation. The typical claim here would be mismanagement of assets. But, under New York State law only a few people have "standing" or the right to bring such claims. They are: (1) board member(s) suing other board member(s), (2) members of an organization suing a board (if at least 5% of the total membership join the lawsuit), and (3) the state Attorney General. Because of these restrictive standing rules, very few derivative claims are ever made. It should be noted that claims of these types are not made for awards to an individual, but rather to make the corporation "whole."
- Direct or third-party lawsuits are brought by an employee or by a person not connected with the corporation who asserts a claim against it or its board on account of some non-bodily injury. Employment practices like termination and discrimination are the largest exposure in these types of claims. If you have a small, friendly staff, and feel unlikely to have employment claims resulting in a lawsuit, you might not think it necessary to carry D&O insurance. However, when employees feel they have been wronged and are angry, they may file a claim even if it is baseless. At that point, you will have to hire lawyers. Your D&O then becomes a legal defense policy.

Indeed, Swords' view is that D&O insurance is essentially legal defense insurance, noting that "99.99% of the cases brought against a board are going to be thrown out, but you're still going to have to pay the legal fees if a claim is filed." In this connection, the "deep pocket" theory is relevant. This theory holds that only people with money are likely to be sued. Lawyers may file a suit based on a bogus claim against "deep pocket" board members with the

hope of securing a settlement for their client. Organizations that have a board made up of "ordinary" people who aren't known to have vast amounts of money may then be comfortable without D&O insurance.

If an organization decides that it needs D&O insurance, it should be aware that D&O policies vary greatly, unlike general liability policies which are somewhat standard. Some policies are exorbitantly expensive and often have serious coverage limitations. When shopping for a policy there are three major items to keep foremost in mind: (a) who is covered and who is not; (b) what types of lawsuits are excluded from coverage; and (c) what is the rating and payment history of the underwriter.

- **Who is covered?** All policies, obviously, include an organization's directors and officers. Officers include the executive director and possibly a few "key" employees. However, many policies don't include staff and volunteers or the entity itself. If a claim is filed against a board member, in many cases it will also be filed against the nonprofit. Furthermore, many nonprofits have volunteers other than board members serving on their committees.
- **What is excluded?** When purchasing D&O insurance be aware of what is not included. Many D&O policies exclude employment related claims (which are the majority of claims brought against a board) and non-pecuniary actions. A non-pecuniary, or non-monetary claim, is one where a plaintiff is not asking for monetary damages, but is ideological in nature, i.e.: a suit against the board for not fulfilling its mission. These types of suits, although rare, are usually lengthy and costly in legal fees.
- **Insurance Underwriter.** Be sure to investigate the insurance underwriter, the financial integrity of that company, and whether they are admitted into New York State (so that in the event that they fail they will be covered by the State fund). Find out what the rating of the company is; never sign on with a company whose rating is less than "A.". A.M. Best & Co. and Standard & Poor are two of the larger companies who provide underwriter ratings. Also, determine whether the company has a good record of claims payments by asking your broker or agent to show you how it is viewed by the rating organizations.