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Legal Alert: Directors & Officers Liability Insurance for Nonprofits

Directors and officers liability insurance (D&O Insurance) can be an important and effective tool for protecting directors and officers against personal liability in the nonprofit context. This legal alert will highlight the basics and benefits of D&O insurance for a nonprofit organization.

Why Do Nonprofits Need D&O Insurance?

As a general matter, directors and officers are not personally liable for actions they take on behalf of the organization. One of the primary exceptions to this rule is when a director breaches his or her fiduciary duty. Just like directors of for-profit corporations, directors (or trustees) and officers of nonprofits have fiduciary duties to the organization. These duties include the duty to act with reasonable care and the duty to act in the best interests of the organization. In a nonprofit context, this also means that directors should act in accordance with the charitable mission of the organization and to strive to protect its assets. A legal claim asserted against the organization based on these fiduciary duties could result in directors and officers having to defend themselves from those allegations; if unsuccessful, those directors and officers could be held personally liable for the costs.

While nonprofits often provide for indemnification of or reimbursement for these kinds of costs, if legal fees and damages could exceed the organization's liquid net assets, it may prevent the organization from indemnifying directors and officers and threaten the organization's ability to serve the community. In these circumstances, the reputation of the directors and officers as well as the nonprofit organization could be at stake (not mention their finances).

Three Types of D&O Insurance

D&O Insurance comes in three forms: A-side coverage, B-side coverage, and C-side coverage. A-Side coverage allows directors and officers to receive direct payment from the insurer for defense costs and liability if they are sued and do not have a right to be indemnified. B-Side coverage covers the organization itself as opposed to the directors and officers, and offers reimbursement to the organization for any indemnification payments made to a director or officer to satisfy a claim. C-Side coverage also provides insurance for the organization, for its own wrongful acts, typically to cover securities claims and to avoid an allocation of benefits between the organization and the directors and officers. You should carefully review all options with your insurance provider.

What's Covered by D&O Insurance (and What's Not)

D&O Insurance can cover a wide range of claims. For example, claims for employment-related issues (*e.g.*, harassment, discrimination, and wrongful termination), failure to properly provide services, failure to ensure the nonprofit organization files all applicable tax returns, and misuse of designated funds and assets of the organization are typically covered by these policies.

But D&O Insurance isn't limitless, and policies often include a number of exceptions. For example, certain actions that would normally be covered by D&O Insurance can be excluded from coverage for a claim it knew about prior to purchasing the insurance. This is most relevant when directors or officers are affiliated with outside entities that dealt with the nonprofit organization defending the claim, perhaps as a result of a business or other relationship. D&O Insurance coverage also isn't a license to misbehave. D&O Insurance policies will nearly always exclude coverage if the director or officer is seeking to gain a personal profit from the coverage (e.g., if a director or officer acted on behalf of both his or her own nonprofit organization and also for another entity in which he or she currently has a financial stake). And almost any D&O Insurance plan will exclude coverage for claims arising out of losses related to criminal or deliberately fraudulent conduct.

What Nonprofits Should Do Now

1. If your organization does not have D&O Insurance, but has a board of directors, consider talking to an insurance broker, bearing in mind the differing policies and considering which would work best for your organization, given its size and available assets.
2. Evaluate your D&O Insurance policy to make sure you understand who is covered under the policy, to what extent, and what exceptions will render certain actions to be excluded from coverage.
3. Make sure that all directors and officers are aware of their duties and responsibilities to the organization. This can be iterated in the bylaws, board resolutions, committee charters, or a conflict of interest policy (or all four). Consider holding a training for the board of directors to ensure they are all aware of their obligations and any applicable restrictions.

This alert is meant to provide general information only, not legal advice. If you have any questions about this alert please contact Ciarra Chavarria (212) 219-1800 ext. 228 or visit our website at www.lawyersalliance.org for further information.

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