
Nonprofit Liability: Tools for Loss Mitigation and Risk Management to Avoid Claims and Save Money

Presidents Section Mid-Year Meeting

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Misconceptions about Liability Exposure

- No deep pockets or limited budget
 - Provide a benefit – members, employees are not likely to bring suit
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Current Economic Environment

- Challenges to increasing/maintaining members
 - Limited resources
 - Recession
 - Thinly capitalized
 - Unemployment rate 26-year high of 8.5%
 - 663,000 jobs lost in March
 - 5.1 million jobs during recession
 - Credit crisis
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Current Legal Environment

- Civil litigation and securities arbitrations are up
 - EEOC filings are at record highs
 - Increased scrutiny from regulators
 - Many regulators and courts are favoring employees, members or insureds
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What Does the Future Hold?

- Terminations and layoffs?
 - Mergers and Acquisitions?
 - Rehabilitation or bankruptcy?
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Common Claim Allegations

- Mismanagement of operations or organization assets
 - Self-dealing and conflicts of interest
 - Acts beyond authority granted in by-laws
 - Violation of state and federal laws
 - Breach of fiduciary duties
 - Employment Practices
 - NFCA Member Society claim filings
 - 50% wrongful termination/breach of contract
 - 19% sexual harassment/discrimination
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Claim Scenarios – D&O

Insured entered into numerous joint ventures with various for-profit entities. The IRS audited the joint ventures under the “community benefit standard” and determined that several of the joint ventures with for-profit entities did not meet the standard and the IRS revoked the insured’s tax exempt status. Resulting bondholder claims alleged breach of fiduciary duty by the board for not scrutinizing the issues regarding joint ventures between for-profit entities and not for-profit entities.

Result: case settled for more than \$3M

Claim Scenarios – D&O

An organization, suffering financial difficulties, entered into a strategic business alliance with a third party. Under the agreement, the third party would manage the day-to-day operations and eventually acquire it. The sale was unsuccessful and the organization filed for bankruptcy protection. Creditors sued the D&Os alleging mismanagement in the period prior to insolvency, as well as breach of fiduciary duty in not accepting a competing offer to sell.

Result: case settled in excess of \$3M and incurred over \$2M in defense costs

Claim Scenarios – D&O

Insured filed for bankruptcy. A group of creditors sued each member of the board of directors for breach of fiduciary duty, alleging a series of improper distributions totaling \$2M made by the board members caused the insolvency and violated several state statutes. Plaintiffs alleged breach of fiduciary duties of loyalty and care and violations of state non-profit laws. Plaintiffs sought in excess of \$2M in damages, plus attorneys' fees.

Result: case settled for \$250,000; defense expenses and forensic accounting totaled more than \$300,000

Board of Directors

- Significant responsibilities
 - Operate like a for-profit organization
 - Formal and well-defined procedures
 - Strong financial controls
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Board Member Selection

- Competence, Experience and Education
 - Understands the history of the society
 - Independent
 - Not honorary
 - “Been a member all my life”
 - Time
 - Size
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Board Considerations

- Uniform Selection Process
 - Committees – executive, audit, compensation
 - Monitor day-to-day operations; delegate
 - Include education sessions in Board Meetings
 - CEO succession plan
 - Staff compensation and overhead
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Selection of Competent Experts

- Attorneys, accountants, money managers
 - Independent – avoid conflict, or appearance
 - Avoid close friends or family members
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Documentation

- Accurate, clear and complete minutes
 - Action items should be clearly described, including consideration, discussion and decision
 - Review of minutes by Board and counsel
 - Objective – no inflammatory, subjective or ambiguous language
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Directors and Officers Liability Insurance

- Interest on the rise
 - 67% in 2007 vs. 32% in 2006
- D&O and EPL most common
 - 83% of not-for-profits purchase EPL with D&O

Directors and Officers Liability Insurance

- Directors, Officers and Organization
 - Employment Practices Liability
 - Fiduciary Liability
 - Outside Directorship Liability
 - Fidelity & Crime Insurance
 - Kidnap and Ransom/Extortion
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Limits of Liability

- What is the “right” amount?
 - Are defense costs inside the limit of liability?
 - Does other coverage erode the limit available to the Directors & Officers?
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Retention/Deductible

- Assess how large of a claim the society could absorb
 - Make sure you look at the retention relative to the coverage
 - EPL claims are often frequency based
 - D&O claims are usually severity based
 - Do retentions stack if claim triggers more than one coverage part
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Does the Insurer have an obligation to defend you?

- Indemnity policy
 - Duty to defend policy
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Who is an Insured

- Directors and Officers
 - Trustees
 - Managerial Employees
 - Volunteers, leased employees, temporary employees etc.
 - Create a list of job titles intended to be covered and compare against policy
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In what capacity are they insured?

- Acting in their capacity as a director or officer of the society
 - Outside Directorship Liability
 - Generally limited to not-for profit boards at request or consent of society
 - Not-for profit usually limited to 501(c)3
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What will the policy pay?

- Judgments, settlements, and defense costs
 - Front pay, back pay (EPL)
 - Damages
 - Punitive damages
 - Exemplary damages
 - Multiplied damages
 - Excise Benefit Tax
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What Exclusions Apply?

- Dishonest, fraudulent acts
 - “in fact” or “final adjudication” wording
 - Gain or personal profit
 - In fact wording
 - Failure to maintain insurance
 - Remove
 - ERISA Act
 - Coverage provided under fiduciary policy
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What Exclusions Apply?

- **BI/Personal Injury/Property Damage**

- Covered under CGL
- Libel, slander, emotional distress carve back if EPL purchased

- **Insured versus Insured**

- Not intended to cover recoupment for bad business decisions
- Not intended to cover “infighting”
- Carvebacks including claims for contribution or indemnity, claims by bankruptcy trustees

- **Severability of exclusions**

Additional Considerations

- What happens if the society acquires another society?
 - What happens if your society is acquired?
 - What happens if your society is taken over by a rehabilitator or goes bankrupt?
 - What is the extent of the severability to the application clause?
 - Does the policy contain a priority of payments provision?
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