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# **THE OTTAWA REGION CHARITY & NOT-FOR-PROFIT LAW SEMINAR**

**Ottawa – February 13, 2014**

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## **Directors' & Officers' Insurance – Know Your Coverage and Your Options**

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**By Barry W. Kwasniewski, B.B.A., LL.B.**

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	Ottawa – February 13, 2014
<b>Directors' &amp; Officers' Insurance – Know Your Coverage and Your Options</b>	
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<b>A. INTRODUCTION</b>	
<ul style="list-style-type: none"><li>• People who serve as volunteers on charitable or not-for-profit boards of directors<ul style="list-style-type: none"><li>– Do so out of a spirit of volunteerism</li><li>– Desire to assist in achieving the goals of the particular organization</li><li>– But also, face potential legal liability for their decisions</li></ul></li></ul>	
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<ul style="list-style-type: none"><li>• Directors and officers' liability insurance is an important shield to protect:<ul style="list-style-type: none"><li>– Directors, officers, other volunteers and employees of your organization from personal legal liability</li></ul></li><li>• Directors and officers of charities and not-for-profits face many of the same potential liabilities faced by those involved in for-profit corporations</li><li>• Your status as a volunteer board member, does <u>not</u> insulate you from potential legal liability for your decisions<ul style="list-style-type: none"><li>– The mere fact of being a director or officer exposes you to potential legal liability under numerous statutes</li></ul></li></ul>	
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## B. EXAMPLES OF LEGAL CLAIMS A DIRECTOR OR OFFICER MAY FACE

### 1. Breach of By-laws

- Example:
  - A volunteer board of a service club votes unanimously to expel a member of the club after several incidents of disruptive behaviour
  - The expelled member refuses to accept the decision, and commences a legal action against the service club and its directors, alleging that they acted in breach of the club's by-laws and had no grounds to expel him

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### 2. Wrongful Dismissal and Defamation

- Example:
  - A not-for-profit organization terminated the employment of an employee who has been with the organization for years
  - Employee did not accept the termination package offered and sued the organization alleging wrongful dismissal
  - Employee sues the directors alleging that he had been defamed by the directors as a result of critical and disparaging emails that found their way into the hands of individuals outside of the board

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### 3. Discrimination

- Example:
  - Having been passed over for a promotion, an employee of a charity alleges that the supervisor denied her promotion because she refused to accede to his sexual advances
  - Employee resigns and files an application with Ontario Human Rights Tribunal alleging wrongful discrimination on the basis of sex
  - Application includes claims for damages against the directors of the organization, alleging they failed to institute proper procedures to prevent sexual harassment and discrimination in the workplace

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#### 4. Breach of a Funding Contract

- Example:
  - A not-for-profit organization applied for and received government funding for the purpose of providing a program to reduce homelessness
  - Substantial funds were received over 3 years
  - Government audit of the program subsequently finds that a substantial portion of the funds were diverted for other uses
  - Government alleges that the board failed to properly monitor the spending, which was under the sole control of the CEO, and files a lawsuit seeking repayment of funds from the organization, CEO and board members personally

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#### 5. Breach of Trust

- Example:
  - A long time member of a church provides a substantial donation of \$300,000 for the renovation of the church building
  - Few years after renovations are completed, a schism in the church results in the church breaking away from its affiliated church
  - Donor disagrees with decision of the church board and claims she is entitled to a return of her donation on the basis that the directors were in breach of trust authorizing the church to separate
  - Donor files lawsuit against the church corporation and directors on a personal basis demanding return of the funds

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#### 6. Contaminated Land

- Example:
  - A not-for-profit organization purchases land upon which to build a new headquarters
  - Several years later, it's discovered that the land had been contaminated by a previous industrial use, which was not known at the time of purchase
  - Ontario Ministry of the Environment orders that the site be decontaminated and remediated
  - Cost of doing so is estimated to be \$500,000
  - MOE remediation order is made against the charity and directors of the charity

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**7. Unpaid Wages**

- Example:
  - A charity is in financial trouble and the directors resolve to cease operations
  - Several employees advise the directors that they have not been paid their wages for a month, despite promises from ED that they would be paid
  - There are not enough funds available to pay the employees, who file complaints with Ministry of Labour for unpaid wages
  - Ministry issues orders to pay wages against the insolvent charity and its directors personally

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**C. HOW TO PROTECT YOURSELF**

- Even if you exercise good governance, as a board member there always remains the risk of claims
  - Sued for what you have alleged done or not done
  - Sued and have no insurance available to defend and indemnify you
- Indemnity rights may be in the corporation's by-laws
  - Will require the corporation to defend and indemnify you for claims/judgments against you for acts done on behalf of the corporation
  - Only as good as the solvency of the organization
    - No funds to pay the indemnity is of no benefit
    - Solution? Directors and officers insurance

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**D. DIRECTORS AND OFFICERS INSURANCE**

**1. Board's Involvement**

- Board should have direct involvement in the process of obtaining D&O insurance
  - Broker should be in direct contact with board
  - Do not delegate task to employee; even at executive level, without contact with board
  - Board should spend time discussing options directly with the broker - insurance is for the directors' own personal benefit
  - Insurance should be reviewed as an annual board meeting agenda item

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**2. Insurers**

- Several insurers offer D&O insurance packages
- No standard legally mandated form of D&O policy
  - Unlike insurance policies that are regulated by statute (e.g. automobile insurance policies)
- Many D&O policies have similar wording and formats
- However, still are a number of important differences between policies, which will affect the extent of your coverage

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**E. FACTORS WHEN CONSIDERING COVERAGE**

- D&O policy coverage typically requires insurer to respond to claims alleging “wrongful act” against a director
  - “Wrongful act”? Defined as:
    - i) Claims arising from the individual’s conduct in the capacity of a director or officer,
      - Covers claims arising from the actual or alleged acts or omissions of the director
    - ii) Or claims arising against him/her as a result of having held a director or officer position
      - Covers claims attracted by a director’s legal status, such as statutory claims for unpaid wages or taxes

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- D&O policies typically cover claims for damages and related legal defence costs
  - Policies vary in the extent to which they cover administrative or regulatory proceedings, and civil matters
  - Statutory fines and penalties typically not covered
    - Some policies cover legal defence costs in proceedings which are taken to exact a fine or penalty against a director
  - Scope of coverage influenced by the types of proceedings in the policy’s definition of “claim”
    - A “claim” triggers rights under the policy and insurer’s duty to provide a defence

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- D&O policy for directors of not-for-profits and charities differs from that of for-profit corporations
  - Financial protection for directors and officers, but also extends the same coverage to protect employees, volunteers, committee members, trustees, and organization itself
  - Contemplates errors and omissions of directors and officers, but list of insured persons also includes those who are associated with the entity
  - When obtaining coverage, ensure every person who needs to be covered is covered

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**F. MATTERS WHEN PURCHASING D&O COVERAGE**

**1. Insurance Limits**

- Amount starts at \$1 or \$2 million
- Depending on size and complexity of organization, limits may need to be substantially increased to avoid a claim that is only partially insured because of inadequate limits
- Recommend minimum of \$2 million in coverage with limits much higher for larger charities & not-for-profits
- Coverage of \$10 million or more is not uncommon
- Coverage for any legal or claim investigation fees should be separate from liability limits
  - Otherwise, substantial amount of coverage could be consumed by legal fees if needs to be litigated

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**2. Broad Definition of "Insured"**

- All person involved in carrying out organization's activities should be covered by D&O coverage
  - Volunteers, members, employers, organization itself
  - Don't risk your own personal financial security
  - Broad definition of who is insured is vital
- Organization should be covered
  - Organization may be named as a party if an individual is alleged to have committed a wrongful act
- Provide indemnity coverage to organization required by its by-laws to indemnify director, officer, other person acting on its behalf

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**3. Broad Claim Coverage**

- Some D&O policies only cover claims for “monetary damages” made in civil lawsuits - this is inadequate
- Superior D&O insurance provides coverage for:
  - Demands or claims for monetary damages and non-monetary relief, whether or not lawsuit is actually commenced
  - Criminal, administrative or regulatory proceedings
  - Arbitration proceedings
- If current coverage has limited definition of “claim”, take steps to improve the coverage

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**4. Employment Practices and Liability Coverage**

- Many do not provide coverage for matters relating to legal claims made by employees or former employees
- Depending on size of organization, these types of claims are common and should be covered
- Superior D&O insurance policy provides coverage for claims relating to employment practices:
  - Wrongful dismissal, sexual or workplace harassment and discrimination (including, human rights tribunal proceedings)
  - Employment related libel, slander or invasion of privacy
  - Failure to provide or enforce adequate workplace or employment policies

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**5. Other Potential Exposures**

- Consider coverage for potential exposures to copyright and/or patent infringement
- If you are involved in broadcasting:
  - Require other insurance -“Multi-media liability” insurance to protect organization and those who serve from claims relating to specialized activities
- Tailor D&O policy to your organization
  - Advise your broker or insurance consultant about all the activities your organization carries out for a proper insurance risk assessment
    - Directors need to know what activities and related risks are covered or not covered
    - Not covered: Consider risk of continuing activity

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**6. Policy Exclusions**

- Read and understand what is excluded from your coverage
- Example: most exclude coverage for deliberate, fraudulent, dishonest or criminal acts committed by a director
- There are exclusions for directors gaining any profit, remuneration or advantage they are not legally entitled to receive
  - Important that these exclusions only apply to persons who commit the wrongful conduct, and that innocent co-directors are not affected by these exclusions

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- D&O policies will exclude claims for:
  - Bodily injury or destruction of property
  - Abuse or molestation (including allegations that directors failed to prevent the occurrence of abuse or molestation)
- Will exclude coverage for professional services
  - E.g. You are an accountant providing accounting advice or service to the organization and make an error resulting in financial loss
    - D&O policy would likely not provide coverage
    - Director/accountant would have to rely on own professional liability coverage
  - Directors who are also professionals:
    - Careful in deciding whether to provide professional advice to your own organizations

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**7. Territorial Scope of Coverage**

- Many only cover claims made in Canada or USA
- Activities in other countries?
  - Limited territorial scope of coverage may not be adequate
- May need to expand coverage for claims arising on a worldwide basis, or at least in countries where your organization is active

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**G. OTHER INSURANCE IS REQUIRED**

- D&O policies not intended to cover all risks with operating charity/not-for-profit
- Non-profits or charities require two or more kinds of liability protection to cover entire range of insurable risks faced by directors, officers, trustees, members, employees and volunteers

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- General liability coverage:
  - Intended to protect both the organization and directors/officers from 3<sup>rd</sup> party claims arising from physical injury, disease, death, damage to 3<sup>rd</sup> party's property
  - Civil damages in bodily injury claims can be millions, so commercial & general liability coverage is vital
  - Directors, officers, employees and volunteers should be named as insureds in commercial & general liability insurance,
    - In same manner as D&O to provide full range of protection for risks while acting within scope of their duties on behalf of organization
  - D&O coverage not intended to overlap with general liability policy coverage - you need both forms of coverage for proper protection

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- Abuse and molestation coverage important if organization deals with children
  - Most, if not all, general liability and D&O insurance policies exclude abuse and molestation claims
    - Even exclude claims made against directors alleging they failed to take adequate steps to prevent abuse
  - Abuse and molestation coverage is available
    - High premiums
    - Levels of coverage generally at lower amounts than other forms of liability coverage
    - Insurer requires organization to implement rigorous child protection policy prior to insuring
    - Only provide coverage for claims arising from the date insurance policy is put in place

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**CONCLUSION**

- Evaluate your insurance coverage
  - Do not wait until a claim is made against you or your organization before assessing the adequacy of your insurance coverage

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