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CHARITY TAX TOOLS**

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

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A. INTRODUCTION

- People who serve as volunteers on charitable or not-for-profit boards of directors
 - Do so out of a spirit of volunteerism
 - Desire to assist in achieving the goals of the particular organization
 - But also, face potential legal liability for their decisions

- Directors and officers' liability insurance is an important shield to protect:
 - Directors, officers, other volunteers and employees of your organization from personal legal liability
- Directors and officers of charities and not-for-profits face many of the same potential liabilities faced by those involved in for-profit corporations
- Your status as a volunteer board member, does not insulate you from potential legal liability for your decisions
 - The mere fact of being a director or officer exposes you to potential legal liability under numerous statutes

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

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

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

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

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

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

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

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

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

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

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

- 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

- 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

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

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

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

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
 - Retaliatory treatment of employees who have validly attempted to exercise their legal rights (such as the right to refuse unsafe work under the *Occupational Health and Safety Act*)

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

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

- D&O policies will exclude claims for:
 - Bodily injury, sickness, mental anguish 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

- Further, most D&O policies exclude coverage for breach of contract
 - E.g. If the organization is alleged to have breached a contract with one of its suppliers, which results in a lawsuit against both the organization and its directors, the D&O coverage would not typically be triggered. As well, if an organization's labour force is unionized, claims against the directors related to any grievance brought pursuant to the collective agreement would not be covered under the D&O policy

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
- An organization's activities and the laws do not remain static. It is important that your D&O insurance protection keep up with the growth or changes in your organization's activities and the laws which govern them

- An important example of this is the issue of “cyber security” and privacy liability. Recent news stories have reported computer hackers either stealing personal information from private computer systems or otherwise causing security breaches in what were considered to be highly secure systems. These types of attacks could give rise to privacy breach claims by individuals whose privacy rights were compromised, as well as substantial remedial expenses to repair the damaged systems

- Some D&O insurers are now offering what is called “cyber security and privacy liability extension” coverage to organizations and their directors and officers in their D&O policies. Having insurance protection of this type is something that should be seriously considered
- Your broker review your overall coverage annually prior to renewal and discuss ways coverage could be improved

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

- General liability coverage:
 - Intended to protect both the organization and directors/officers from 3rd party claims arising from physical injury, disease, death, damage to 3rd 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

- 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

- In most insurance policies, “abuse” is defined as follows:
 - “Abuse” means molestation, harassment, corporal punishment or any other form of physical or mental abuse committed or alleged to have been committed by any ‘Insured’

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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