

Protecting Your Nonprofit and the Board

Resource Type: Articles

Topic: Insurance and Risk Financing

New Book on Nonprofit D&O Insurance Suggests Multi-Faceted Strategy

The Nonprofit Risk Management Center offers a comprehensive text on insurance for nonprofits, [Coverage, Claims and Consequences](#), that includes a chapter addressing Directors and Officer's Liability Insurance. The chapter is available for download in pdf format for \$12.00.

Pursue a Multi-Faceted Strategy

As community-serving nonprofits grow and many assume responsibility for social services previously delivered by governments, the need for committed, enthusiastic, and capable volunteer board members has never been greater. While claims against nonprofit boards remain rare — most nonprofits will never be sued in their institutional lifetimes — the fear of liability continues to grow. This fear is fueled, in part, by widespread publicity surrounding celebrated cases. This publicity in turn leads to more claims. Nonprofit and corporate directors share a common concern: that of personal liability for serving on a board. At the end of litigation against nonprofits, nonprofit board members are rarely required to use personal funds to pay for harm committed by the board or organization, but the possibility remains. Some party or the nonprofit itself may charge the director with a breach of duty that he or she owed to that party.

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Every nonprofit must work diligently to recruit and retain suitable board leaders. One strategy is to address the potential for personal liability by taking steps that substantially reduce the likelihood that a board member's personal assets will be exposed to loss. We suggest a three-part protection strategy for nonprofit boards as described below:

1. **Risk Control** — Every nonprofit should begin the process of reducing the potential of a director being held personally responsible by minimizing the risk. This effort begins with examining the board's governance activities, and the common law duties owed by each and every board member. Do board members fully understand their legal duties? Do board operations reflect a commitment to fulfill these duties? What actions are taken when a breach of a fiduciary duty is suspected? Has the board established rules and procedures governing its operations? Are these procedures followed? The process of identifying priority risks and implementing strategies to address them should continue with all major operational areas. Form a volunteer risk management committee to coordinate the process of risk identification and strategy development. Even the smallest nonprofit can and should establish a risk management committee. In smaller nonprofits volunteers will hold most of the seats on the committee, while in a midsize or large nonprofit the committee may consist principally of paid staff. The nonprofit should focus first on high priority risks — those most likely to occur and those with the greatest financial and other adverse impact

on the organization.

2. **Indemnification & Volunteer Protection** — Most nonprofit bylaws include indemnification provisions — language that expresses the intent of the nonprofit to cover the expenses a board member might incur in defending an action and paying settlements or judgments related to his service on the board. There are circumstances, however, when indemnification is not available or becomes a hollow promise. These include:

- When the nonprofit does not have sufficient resources to pay the losses and expenses incurred by a director or officer;
- When state or federal law limits the protection that may be afforded through indemnification due to public policy considerations;
- When the board is unsympathetic to the plight of the director who has been sued and refuses to authorize the indemnification;
- When the organization decides that it is inappropriate to use the nonprofit's financial resources to indemnify a director.

Every state has a volunteer protection law and the federal Volunteer Protection Act (VPA) became the law of the land in September 1997. The Volunteer Protection Act provides that, if a volunteer meets certain criteria, he or she shall not be liable for simple negligence while acting on behalf of a nonprofit or governmental organization. The VPA also provides some limitations on the assessment of noneconomic losses and punitive damages against a volunteer. The Volunteer Protection Act does not, however, protect a volunteer from liability for harm “caused by willful or criminal misconduct, gross negligence, reckless misconduct, or a conscious, flagrant indifference to the rights or safety of the individual harmed by the volunteer action.” The Act does not prohibit lawsuits against volunteers nor does it provide any protection for nonprofits.

The state volunteer liability laws vary significantly. Some states only protect directors and officers while other states extend the protection to all volunteers, however, every volunteer protection statute has exceptions. The most common exclusions are for claims based on a volunteer's willful or wanton misconduct, criminal acts, or self-dealing.

1. **Risk Financing** — Every nonprofit must consider how it will pay for injuries, damages, legal expenses and other costs that stem from the harm it causes. For some organizations, reserve funds are sufficient to pay for anticipated losses. For the majority of the nation's 1.5 million nonprofits, reserves are inadequate. For this reason, a growing number of nonprofits choose to purchase insurance and pay an annual premium in exchange for the promise that funds will be available in the event a covered loss occurs.