

We're Not Liable – We're Volunteer Board Members

The phone message usually goes something like this:

We currently carry a commercial general liability that provides us with \$5,000,000 public liability, content insurance of \$16,000, exterior glass and sewer back-up. The information provided to previous executives about board insurance is that it is not required because we are governed by the *Societies Act* and are a volunteer board and therefore cannot be held personally liable. Our By-laws do contain a provision stated as long as board members are acting in good faith and are not negligent the organization will look after all their costs. This is right, isn't it?

Board liability insurance, often referred to as Directors and Officers liability insurance (D&O insurance) was developed because the courts found that there are certain responsibilities for which Directors should be held personally liable. ●

This question is a common one, often arising from a misunderstanding of what liability means. Liability is really another way of talking about responsibility. The question in every legal setting is what legal person is responsible for what obligation and why.

Our legal system recognizes two kinds of persons: individuals and associations of individuals granted corporate status. A society is a form of corporation. One of the key attributes of the corporation is the idea of limited liability. This means it — not the members or

shareholders — is the organization that is responsible for its own acts. For example, the Alberta *Societies Act* provides that no member of a society is, in the member's individual capacity, liable for a debt or liability of the society.

Imagine the following happens:

A person trips coming into the place where the Society operates and breaks a leg. The Society is negligent because it did not properly supervise the facilities. A court awards the injured person some amount of money as damages.

The Society is liable to the injured individual, not the members of the society. The Society is responsible to the injured person because the Society did not do what it was supposed to do: make sure its facilities are safe. And that is the reason that the Society has its general insurance package. But what about the individual directors?

Board liability insurance, often referred to as Directors and Officers liability insur-

NOT-FOR-PROFIT law

ance (D&O insurance) was developed because the courts found that there are certain responsibilities for which Directors should be held personally liable. While originally introduced in the United States in the 1930s, D&O coverage did not become mainstream until the later 60s as a number of successful claims were brought against directors of public companies for stock price problems.

D&O coverage, on the other hand, is not intended to be corporate insurance. Nor is it intended to be general corporate insurance for liability caused the corporation by virtue of the acts of its directors and officers. ●

When thinking about D&O insurance or board insurance, it is important to distinguish between the organization and the individual members of the board. The historic focus of D&O insurance is on the financial protection of individual directors, in their personal capacities. This fact distinguishes D&O insurance from other kinds of commercial insurance covering identified areas of company risk.

General liability insurance deals with corporate insurance for bodily injury or property damage claims. Bonding addresses losses corporations might have from the actions of their officers, directors, or employees. D&O coverage, on the other hand, is not intended to be corporate insurance. Nor is it intended to be general corporate insurance for liability caused the corporation by virtue of the acts of its directors and officers. Recently this traditional protection has been supplemented by an expansion of D&O coverage – both in terms of who is protected and against what they are protected. Many underwriters now write coverages that offer protection to the company for its own liability and for specific corporate concerns.

The law of the personal liability of the corporate directors of corporations is not especially developed in Canada, particularly for non-profit and charitable organizations. There have been few cases setting out clear rules so that the directors of volunteer organizations can know when they will be held personally responsible. For example, the recent Supreme Court cases altering the law of vicarious liability in the context of sexual assault against clients in care – *Vancouver Foundation* and the *Vernon Boys and Girls Club* – only resulted in liability against those organizations, not personally against the directors. But it is not difficult to imagine a situation where a Board fails in the proper and prudent exercise of its responsibilities of supervising employees. A court, in that situation, might find individual directors liable for the damages suffered by the individuals in the organization's care.

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But, and this is an important qualification, the circumstance giving rise to a claim against directors is, for the most part, also the situation where the organization and the directors would be held jointly and severally liable. And that is

the reason, noted earlier, that many underwriters now write coverages that offer protection to the company. The company is insured against the errors and omissions of the directors if the company has to pay for their mistakes. In turn, the D&O insurance covers the individual directors against claims by the company.

One other thing to mention is that D&O insurance, for the most part, is what is

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known as *claims based*. D&O insuring agreements generally specify that coverage is limited to claims made during the policy period. In addition, the insurer typically does not have a duty to defend, but is required to cover the costs of the insured's defense. This means that the policy must be in force when the claim is made. For example, if the Society had insurance for the calendar year 2002 and a claim was made next year when a policy was not in force, there would be no coverage. Another way of saying this is that once claims-based insurance is in place and used as a means to satisfy potential liability, a similar policy must be kept current for the protection to be effective.

Because D & O Insurance is for the personal benefit of directors, it raises the question of whether a corporation can pay for this kind of insurance that is a benefit for the directors. Many statutes explicitly prohibit the company from indemnifying its directors for their own negligence or dishonesty. The appropriate response is for each director to pay some portion of the premium. This is the prudent practice, even though the *Societies Act* is unclear as to whether an individual can be indemnified to the extent of the Society paying the entire premium of D&O insurance.

The other issue that is raised here is the question of payment of legal costs. An insurance arrangement normally has two components: the duty to indemnify and the duty to defend. The D&O Insurance is characterized not by a duty to defend but by an indemnity to cover the costs of the insured defence. Another way of saying this is to say that an insurance contract requires that the insurer pay what it has contracted to pay and defend the insured against the claim. Other forms of insurance would provide in the policy that the insured are covered for certain kinds of negligence and that the lawyers employed or hired by the insurance company would defend the claim. In most D&O Insurance policies the insurance company pays the costs of the insured's own lawyer.

The question of the indemnification of costs of the insured director's defence is an important one and may, depending upon the context in which an organization operates and the potential scope of claim against individual directors, justify the payment of the premium to cover the possible cost of legal fees alone, even though likelihood of a successful claim is remote.

So, the people who have said that because they are volunteers and are therefore not personally liable are not completely correct. As members, they would bear no liability but as directors they might. It is the last situation that D&O insurance is designed to cover. What your organization and its Directors need to determine – in

So, the people who have said that because they are volunteers and are therefore not personally liable are not completely correct. As members, they would bear no liability but as directors they might. It is the last situation that D&O insurance is designed to cover. What your organization and its Directors need to determine – in

each case influenced by the scope of coverage of the policy – and bearing in mind the activities of the Society and the possibility of claims, is whether there is additional value to be obtained by paying the D&O premium.

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Should an organization have D&O insurance? Boards need to regularly review the issues involved with this question and answer it for themselves. The first step is to talk with an insurance broker about D&O insurance for non-profit organizations. Ask that person to explain the kinds of risks that are covered by the policy and, more particularly, the kinds of things that are not covered. Also, ask the

broker to explain the relationship of the D&O policy to any general liability policy that the organization carries. In this way the decision can be made whether useful additional coverage is being made available through the D&O policy and whether that coverage is worth payment of the combined premium by the Society and the individual directors. Liability is a concern for everybody in this complex world, volunteer board member or not.

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(Note: An earlier article by Miller, Shelley. *Volunteering for Trouble*. *LawNow* August/September 2001 deals with other issues in being a volunteer member of a Board of Directors, liability and the question of whether a Board needs insurance.)