



# Directors & Officers Liability and Insurance Issues for Non- Profit/Charitable Organizations

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- 1) Overview
- 2) Standard of Care for NP directors and officers
- 3) Fiduciary Duty of NP directors and officers
- 4) Types of Claims
- 5) Types of Protection for NP directors and officers
- 6) Types of Insurance Coverage
- 7) Notice Requirements
- 8) Types of Exclusions
- 9) Real World Example in NP context
- 10) Key Takeaways

# 1) Overview

- Claims against directors and officers have increased in the past two decades. Plaintiffs look for any pot of money they can access to recover on litigation.
- Directors and officers of non-profit corporations and charities can similarly be targets.
- How can you recruit people to take on the risk in exchange for little to no financial compensation?
- Three principal ways:
  - Ensure each D&O knows the standard they must meet;
  - Agree to Indemnify the D&O's (if possible); and
  - Buy appropriate D&O insurance coverage.

## 2) Standard of Care for D&O's

- Must assume that you will be held to the same standard as for profit corporate directors and officers.
- Shall
  - Act honestly;
  - In good faith;
  - With a view to the best interests of the corporation;
  - Exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances;
  - Comply with the governing statutes and regulations; and
  - Comply with the Corporation's articles and by-laws.
- Subject to good faith reliance on financial statements/reports, reports from management and professionals (reasonable diligence defence).

### 3) Fiduciary Duty of NP D&O's

- Owe a duty to act in the best interests of the corporation, but not to individual members of the organization (*Cannon v. Funds for Canada Foundation*)
- Fiduciary duty is heightened when dealing with charitable property.
- Charitable corporations owe a fiduciary to the public in general and individuals who donate money for charitable purposes. (*Ontario (Public Guardian and Trustee) v. AIDS Society for Children (Ontario)*).

## 4) Types of Claims

- Acting without authority.
- Negligent mismanagement.
- Voting for monies/property to be paid or distributed contrary to the statute or bylaws.
- Unpaid wages for employees of corporation (6 months)

## 5) Types of Protection

- Indemnity agreements may be practically difficult for non-profit corporations with limited assets and/or charities. Most prefer to transfer the risk to insurer.
- Most NPC will rely on D&O insurance – directors & officers should ask to see the policy (never assume) and ensure they understand it. Corporations should hold session reviewing the policy with each new director or officer.

## 6) Types of D&O Coverage

- Three common types:
  - Side A – insures directors and officers directly for any “loss” caused by their “wrongful acts”, which is not indemnified by the corporation;
  - Side B – reimburses corporations where the corporations indemnify the directors and officers .
  - Side C – insures the corporation itself for its own wrongful acts
- We will focus on Side A coverage, which generally takes priority to the other types and must be paid out first.



## 6) Types of D&O Coverage Con't

- Must comply with governing statute and corporate by-laws.
- One of few transactions where directors are conflicted can vote is for D&O policy coverage (s. 41(5) of *Not-for Profit Corporations Act* (Ontario)).
- Scope of coverage depends on policy wording. Must be attentive to specific language used.
- Who can be covered (permitted beneficiaries)?
  - Director or officer, current or former;
  - Those acting in “similar capacity”; and
  - Acting for the corporation or another entity at the corporation’s request (e.g. subsidiary).
  - Can vary in jurisdictions –e.g. BC extends to heirs of D&O’s.

## 6) Types of D&O Coverage (Con't)

- What can be covered?
  - All REASONABLE costs, charges and expenses;
  - REASONABLE amounts paid to settle an action or pay a judgment;
- Must be incurred as part of any civil, criminal, administrative, investigative or other action or proceeding.
- Director or officer must be involved in that proceeding because of their association with the corporation.

## 6) Types of D&O Coverage Con't

- In Ontario, a charitable corporation is prohibited from buying D&O insurance unless the corporation complies with the *Charities Accounting Act* or obtains an order from the Court.
- Most legislation in Canada prohibits insuring D&O's for loss arising from breach of fiduciary duty. Even where permitted by legislation, policies will likely contain express exclusion for “dishonesty”, “bad faith” and “breach of fiduciary duty” conduct.

## 6) Types of Coverage Con't

- Every policy has a specific limit, which will include monies paid out for defence costs (“eroding policies”).
- Retentions typically do not apply to Side A coverage – individuals are not personally responsible to pay for any amount.
- When is coverage triggered? Three scenarios.
  - When the claim is made against the insured
  - When the alleged wrongful act occurred or
  - The date the claim is reported to insurer

## 6) Types of Coverage Con't

- Duty to Defend versus Defence Costs
- D&O policies typically reimburse reasonable defence costs that pertain to claims covered by the policy.
- Director and officer will have choice of counsel – often from preferred counsel list of insured.
- Most policies also state insurer will advance “reasonable” defence costs when invoiced – avoiding individuals personally funding the defence and waiting for reimbursement.

## 7) Notice Requirements

- Claims-made policies will have notice requirements.
- Insured must notify insurer of any claims within a specified period of time. Failure to notify within that time could void coverage.
- Court will look objectively to all the surrounding circumstances to see if notice was sufficient, but always err on disclosing early and fully.

## 8) Exclusions

- Must pay attention to the endorsements for some common exclusions that could preclude coverage.
  - Insured versus insured – e.g. directors suing each other, corporation suing directors.
  - Prior claims exclusion – claims known at the time of insurance.
  - Other policy exclusion – claims covered by other policies such as E&O policies are excluded
  - Fraud/Criminal Acts exclusion
  - Environmental Liability exclusion
  - Breach of Contract claims

## 9) Real World Example

- *Thunder Masonic Foundation v. Sovereign General Insurance* – 2012 and 2013 the Foundation bought D&O insurance from Sovereign.
- Standard policy – insured loss arising from a claim for a wrongful act.
- Finn Way did construction work on a building owned by the Foundation. The Foundation didn't pay and Finn Way sued the Foundation and each director and officer for \$300K based on breach of contract and unjust enrichment.
- The Foundation's directors and officers brought a court application asking for an order that Sovereign has a duty to defend and indemnify under the policy.



## 9) Real World Example Con't

- A failure to pay is not a “wrongful act” that triggers coverage.
- A D&O policy was never intended to underwrite an insured’s refusal to pay an invoice; it is intended to protect D&O’s from the risk of liability incurred in the execution of their duties as directors and officers.
- A D&O policy is not a policy that protects a business from the commercial disputes it encounters in its operations.
- Application dismissed – without costs.

# 10) Key Takeaways:

- Consult with a lawyer. Don't solely rely on your broker.
- Consider whether indemnity agreements and/or D&O insurance are needed.
- Ensure the protection you choose complies with governing statutes and corporate by-laws.
- Error on the side of over-disclosing facts about the corporation and any prior claims to the insurer.
- READ the policy coverage and ensure you UNDERSTAND it. Ask questions.
- Do NOT accept boilerplate coverage. Negotiate.
- Pay special attention to Exclusions and Notice requirements.
- Ensure D&O's receive and review copies of the policy.
- When in doubt as to whether something is a "Claim" – report it now.

# Questions:

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