



SECTION: EIGHT

Risk Management

Risk Management

All nonprofit organizations and their directors are exposed to risks such as injured employees or volunteers, theft, property damage, and lawsuits from disgruntled employees. The board should first evaluate the types of risk which the nonprofit is exposed to in the course of its activities. The board then has three options to address the risk: avoidance of the activity, modification of the risk, and transfer of the risk to another entity.

Evaluation of Risks

The board of directors should regularly evaluate the types of risks faced by the nonprofit. The board should consider the probability of occurrence and the extent of losses that could arise from each risk. The types of risk may include:

- ◆ loss or damage of property by fire, water, or accident;
- ◆ fraud or embezzlement;
- ◆ lawsuits by employees and clients;
- ◆ lawsuits arising from an automobile accident;
- ◆ injury to an employee or volunteer;
- ◆ theft or vandalism of property;
- ◆ failure of a contractor to pay its subcontractors or for materials;
- ◆ loss of information from computer breakdown.

Protections Against Risk for Directors

- ◆ **Acting in Accordance with the Duties of Directors.** Directors are protected from liability if they:
 - act in good faith; and
 - do not commit an act that breaches a duty of loyalty to the nonprofit.
- ◆ **Indemnification of Directors.** Directors, even those who work under the protection of a corporate form, can still be sued. Even if they cannot be held liable, they may be responsible for paying for attorney's fees and court costs. Indemnification means that the organization will reimburse a director for any fines, money damages, or attorney's fees that the director incurs as a result of the things the director did in the service of the nonprofit.
 - **Mandatory Indemnification.** A nonprofit is required to indemnify a director for reasonable expenses incurred in a lawsuit filed against the director, after a court order and all appeals are exhausted, as a result of actions made in his capacity as a board

member if:

- the director was wholly successful in the defense of the lawsuit; or
- a court orders indemnification.

- **Permissive indemnification.** A nonprofit may reimburse legal expenses of a director if:
 - in a civil proceeding, if the articles, bylaws, corporate resolution or agreement permit reimbursement, even if the director was not wholly successful in defense of the lawsuit, if it is determined that the director conducted himself in good faith and reasonably believed that his conduct was in the best interest of the nonprofit;
 - in a criminal proceeding, if the articles, bylaws, corporate resolution or agreement permit reimbursement if the director had no reasonable cause to believe that his conduct was unlawful;
 - the articles, bylaws, corporate resolution, or agreement permit reimbursement incurred by a director in connection with his appearance as a witness;
 - a majority of disinterested directors approve advance payment of expenses prior to the final disposition of the lawsuit if the director affirms in writing to the nonprofit that he met the standard of conduct necessary for indemnification.
- **Exception.** Indemnification is prohibited for directors who acted in their own self-interest or engaged in intentional wrongdoing.

Protections Against Risk for Volunteers

- ◆ **Immunity for Personal Injury and Property Damage.** A volunteer serving as an officer, director, trustee, or volunteer is immune from money damages for an act or omission resulting in death, damage, or injury if the person was acting:
 - in the course and scope of her duties or functions; and
 - the organization maintains insurance coverage of at least \$500,000 for each person, \$1,000,000 for each single occurrence of death or bodily injury, and \$100,000 for each single occurrence of injury or destruction of property.
- **Exception.** The volunteer is not immune for damages resulting from "intentional or wantonly negligent acts" or the operation of a motor vehicle.

- ◆ **Immunity for Damages Arising from Rotten Food.** A person, gleaner (a person who harvests the food), grower, or nonprofit organization that provides free food to the needy is not liable for damages arising from food that goes bad if:
 - the condition of food appeared to be wholesome; and
 - the food was donated to a nonprofit organization for distribution to the needy.
- **Exception.** The immunity from liability does not apply to intentional misconduct or grossly negligent acts.

- ◆ **Immunity for Damage, Death or Injury to a Patient.** Volunteer health care providers and physicians who are licensed to practice medicine or retired and eligible to provide health care services may be immune from liability when providing services to nonprofit organizations. A volunteer health care worker is immune from damages for any action that results in death, damage, or injury to a patient if:
 - the volunteer acted in good faith;
 - the volunteer acted within the scope of the volunteer's duties;
 - the act was committed in the scope of providing health care services;
 - the services provided were within the scope of the volunteer's license; and
 - the volunteer has submitted a written notification to the patient stating the limitation of liability and that the volunteer does not expect any payment for services, and has obtained a signed copy of the notification from the patient

Addressing the Risks

- ◆ **Avoidance of Risk**
A nonprofit may address each type of risk in a different manner. Aside from incorporating and other statutory protections, avoidance of the risk is an option. For example, the nonprofit could lease a space rather than own it, or the board could decide not to operate a daycare center for its low-income tenants.
- ◆ **Modification of Risk**
A second and more common option is to modify the risks. One method of modifying risk is to isolate riskier activities by forming a separate organization. **Example:** A nonprofit organization establishes a new entity for the operation of a daycare center or for construction activities.

The board can adopt other risk management strategies, which may include:
 - relying on expert advice regarding investment decisions;
 - utilizing an outside auditor;
 - requiring two signatures on checks written over a specified dollar amount;
 - storing computers in a secure location and backing up data daily;
 - instituting training for all employees on sexual harassment and other employment laws;
 - implementing job safety programs.
- ◆ **Transfer of Risk**
The third option to manage risk is to transfer the risk to another entity. The primary method of transferring risk is to shift risk to an insurer. Other methods include using service contracts, requiring tenants to carry adequate insurance, or hiring independent contractors to perform some necessary functions.

The board should become familiar with the types of insurance coverage and policies available that address the nonprofit's risks. The application for insurance is part of the insurance contract. The board should understand the limits of coverage, deductibles, exclusions, the difference between replacement or market value of damaged property, and whether there are any gaps in the coverage.

◆ **Types of Policies**

There are two primary types of liability policies: "claims made" and "occurrence" policies. "Occurrence" policies provide coverage for a claim that occurs within the time period covered by a premium payment. A "claims made" policy provides coverage for claims made during the policy period, even if the event giving rise to the claim occurred outside the period.

◆ **Major Types of Insurance Coverage**

■ **Commercial General Liability Insurance:** Pays for the legal defense and any settlements or judgments as a result of negligent acts committed by the organization, employees, and volunteers that cause members of the public to suffer a bodily injury, property damage, or personal injury such as libel or slander. Wrongful termination is typically not covered. The policy limits should cover the acts of the organization, employees, and volunteers for \$500,000 per person, \$1 million for death or bodily injury, and \$100,000 for each single occurrence for damage to property, or else liability protections under state law do not apply.

■ **Automobile Insurance:**

- **Business Automobile Insurance:** Similar to commercial general liability, this type of insurance is used when coverage is needed by an incorporated entity for ownership, operation, maintenance, and general use of vehicles owned by the nonprofit.
- **Hired and Nonowned Automobile Coverage:** The "hired" automobile endorsement to an auto policy covers bodily injury and property damage resulting from accidents that occur when the nonprofit rents or leases a car. The "nonowned" automobile policy protects the nonprofit for damages caused by volunteers driving their own vehicles on business for the nonprofit. This is very important coverage for nonprofits which utilize volunteers.

■ **Property Insurance:** Covers damages to property owned by a nonprofit after construction has been completed and is based on the type of occupancy. Covered losses include fire, hail or vandalism.

Exclusions: Property insurance may limit or exclude coverage for items such as mold testing or remediation and loss or damage to electronic data and associated systems and equipment.

■ **Workers' Compensation:** Protects the nonprofit and provides benefits to paid workers for job-related injuries and illnesses. Maintaining this insurance limits the amount of

money that is paid to an employee for the injuries. Nonprofits that do not provide workers' compensation insurance have no liability limit if an employee is injured on the job.

- **Fidelity Bond:** Protects the nonprofit if employees embezzle or steal assets of the nonprofit. The bonding company will replace the missing funds and then try to collect from the employee. Depending on the amount of funds handled, a nonprofit should consider conditioning employment in a position of financial responsibility upon the ability to obtain a bond.
- **Director's and Officer's Insurance (D&O):** Covers the costs of defense and damages for wrongful acts and omissions committed by directors, employees, and volunteers. Nonprofits should ask for two different coverages:
 - **Full entity coverage:** Reimburses the nonprofit for amounts paid to indemnify its directors and covers claims against the nonprofit; and
 - **Directors and officers coverage:** Protects the directors and officers for losses for which they are not indemnified.

D & O policies are often "claims made" policies, which means that coverage is provided for claims made within the policy period rather than when the act occurred. If the nonprofit discontinues a policy, a director could be uninsured for acts that occurred during the director's term of office, if the claim is made after the policy is discontinued. Some policies have "retroactive dates" or "extended reporting period" clauses.

Exclusions: D & O policies typically do not provide for the payment of legal expenses until after a final determination of liability. The insurance company has no duty to defend a lawsuit, only to reimburse legal expenses. Lawyer board members who act as counsel to the nonprofit should also examine whether the D & O policy applies to them and whether legal malpractice policies exclude claims that arise if the attorney is acting as a director of a nonprofit. Other exclusions in D & O policies may include: libel or slander actions, fines and penalties, fair employment claims, and punitive damages.

- **Employment Practice Liability (EPL):** Protects nonprofits, directors, and employees. This insurance covers employment discrimination claims, suits of wrongdoing in employment hiring and firing, and other employment practices. Since employment claims are the most common types of insurance claims against nonprofits, it is important to obtain EPL coverage. One of the main values of this coverage is that it covers litigation expenses. Nonprofits should buy a D&O policy that includes EPL.
- **Errors and Omissions:** This type of policy protects the nonprofit, its officers, directors, and employees from acts or omissions arising out the provision of professional services. Professional services could include construction consulting, surveys, or architectural designs.

- **Surety and Performance Bonds:** Protect the nonprofit from acts or omissions of others. For example, surety and performance bonds can be issued to guarantee that a contractor will conduct activities in accordance with all laws and ordinances or will complete a project in a timely and workmanlike manner. A performance bond could also guarantee performance on subcontracts and that all bills incurred by a contractor will be paid at the completion of a project.

- **Specialty Insurance Lines:** Provide coverage for special events such as a fun run or liquor liability. Certain types activities, such as childcare, may not be covered by general liability insurance and, therefore, require a specialty line of coverage.
 - **Owners and Contractors Protective Liability Policy:** Covers the owner or general contractor handling a construction project.
 - **Builder's Risk Insurance:** Covers losses to property while property is being built, e.g., hail, vandalism, etc.

- **Umbrella Policy:** An option for directors to provide additional personal coverage. An umbrella policy may be purchased to provide coverage in excess of the individual director's homeowner's and automobile policies. A commercial umbrella policy might also be useful for the nonprofit.