

PBPA Podcast Transcript

Episode 14: Options for Nonprofits to Minimize the Risk of Personal Liability to Board Members

(19:47 minutes)



Sireesha ([00:02](#)):

Some nonprofits may not realize that their board members could be held personally liable for the actions of the organization. How can a nonprofit minimize that risk to itself and its officers and directors? Erin McGinniss will answer that question, and more, as she talks about directors' and officers' insurance in today's episode of the PBPA Podcast.

Sireesha ([00:32](#)):

Hello and welcome to the PBPA podcast. In each episode of the PBPA podcast, we explore legal questions relevant to Georgia nonprofits. I'm your host Sireesha Ghanta, Counsel and Education Director at the Pro Bono Partnership of Atlanta. PBPA strengthens our community by engaging volunteer attorneys to provide nonprofits with free business legal services. We provide numerous free resources via our website, including articles and webcasts specific to Georgia nonprofits and their business legal concerns. We also provide direct legal services to our clients. For more information on client eligibility requirements, to apply to be a client or to access our vast learning center, visit our website at pbpatl.org. Before we jump into this episode's topic, keep in mind that this podcast is general information, not legal counsel, contact your attorney for guidance on your nonprofits' specific situation.

Sireesha ([01:42](#)):

Erin McGinniss is a partner at the law firm of Nelson Mullins. She's also been a dedicated volunteer with PBPA for years, advising numerous nonprofits on issues around corporate governance. Thanks for joining us today, Erin.

Erin ([01:56](#)):

Thank you for having me.

Sireesha ([01:58](#)):

To start off, tell us what is D&O insurance?

Erin ([02:04](#)):

Sure. D&O insurance refers to directors' and officers' liability insurance. The purpose of D&O insurance is to protect the organization's directors and officers against claims for certain wrongful acts committed in their capacity as directors and officers. Claims may arise from a variety of sources and may encompass a range of actions. For example, a donor or beneficiary of the organization may bring a claim based on mismanagement or the organization's resources, including for instance, the use of funds. Employees may raise a variety of grievances, such as discrimination, wrongful termination, and retaliation. Third parties may bring claims based on contractual disputes. And governments may seek to hold directors and officers liable for certain regulatory violations of the organization.

Sireesha ([03:00](#)):

Okay, so it [D&O insurance] minimizes risks to individual directors and officers, not the organization. Um, why should a nonprofit need to carry a D&O policy?

Erin ([03:11](#)):

So there, there are a few reasons. Georgia law allows nonprofit organizations to exculpate their directors and to indemnify and to advance expenses. And you could think of each of these as shields in a way. Exculpation says that a director will not be liable or will only be liable to a limited extent in certain situations. So in that way, exculpation shields a director from liability. Indemnification says that a director will be made whole if they are held liable. So they are shielded from personal loss in that way. However, the indemnification and exculpation provisions of Georgia law are permissive, meaning the nonprofit has to opt into them.

Depending on the legal advice that the nonprofit has received, the organization may not have opted into or may choose not to opt into these provisions. In addition, there are limitations on what's allowed both with respect to exculpation and indemnification. There are also limitations on indemnifying, all expenses, both from a public policy perspective and from a statutory perspective.

So from the organization's standpoint, having D&O insurance may allow them to recruit more qualified officers and directors, and it reduces the liability exposure of the organization. Relatedly, another reason to have insurance is really the same reason we carry insurance on our homes and cars and why some people, uh, obtain an additional umbrella policy, right? It's to shift the risk of loss to the insurer and away from you or in this case, the organization. And here also to protect the organization solvency. D&O insurance can also provide the organization with a better defense against claims that arise. And finally, it's important to remember that even if an organization does opt in to indemnification and exculpation as permitted by Georgia law, these provisions are not necessarily eternal. Um, an organization's governing documents wherein it opted in, those can be changed and very likely can be changed without requiring the consent of everybody who would be impacted by a loosened indemnification or exculpation provision. And Georgia law can be changed too. So even if an organization's governing documents provide for indemnification and exculpation to the fullest extent currently permitted by law, if the law were to become more restrictive, the more restrictive terms of the law would apply. And so D&O insurance can bridge any of these gaps that exist or that may arise in the future.

Sireesha ([06:04](#)):

Okay. That's an interesting point that you make about how it can bridge and it can also be a recruiting tool. Um, it's common for nonprofit organizations to recruit board members who have so much passion for the cause yet who don't necessarily have any experience serving as board directors. Since board of directors have the broad responsibility of overseeing programs and services of the nonprofit, which could make them potentially liable for the operations of the organization, D&O insurance can come and bridge it. But board members can be protected if the organizations articles of incorporation specifically exculpate them, right. If that is the case, why is D&O still needed?

Erin ([06:53](#)):

Yeah, that that's correct. So as I just explained, D&O insurance is, it's still beneficial. Even if an organization has opted in to the statutory exculpation, as provided by Georgia law. So for instance, as I mentioned, Georgia law requires exculpation to be specifically enumerated in the articles. Um, so the Georgia nonprofit corporation code provides that the articles may, which again, this is permissive, include a provision eliminating or limiting a director's liability to the organization or to its members for any action, except for liability for four things. And those four things are one: appropriation of a business

opportunity of the organization; two: intentional misconduct for knowing violations of law; three: conflict of interest transactions in which the director's interest in the transaction is in conflict with the organization's interest in the transaction; and four: transactions in which the director received an improper personal benefit.

Erin ([07:58](#)):

So that's exculpation which must be in the articles. If the organization is opting in and again, exculpation is essentially providing a no liability shield, but it can't be used for the four things I laid out: appropriation of business opportunities, intentional misconduct or violations of law, conflict of interest transactions and improper personal benefit transactions. And then with respect to indemnification, organizations can indemnify directors for liabilities, if the director conducted himself or herself in good faith and met the applicable standard of conduct, which is on a sliding scale, depending on the capacity in which the director took the action at issue. So if the conduct at issue was in the director's official capacity, the director must have reasonably believed that the conduct was in the best interest of the corporation. If the conduct at issue was outside of the director's official capacity, the director must've reasonably reasonably believed that the conduct was at least not opposed to the best interest of the corporation.

Erin ([09:05](#)):

And if the conduct at issue was criminal, the director must've had reasonable cause to believe the conduct was lawful. So long as the applicable standard is satisfied and the director conducted himself or herself in good faith, indemnification is permitted. So just to recap indemnification, the director first has to act in good faith and they have to meet an additional standard of conduct that changes based on the capacity in which the director was acting. And there are two exceptions to indemnification set forth in the Georgia code. The first is that directors may not be indemnified for proceedings by or in the right of the corporation, except for reasonable expenses incurred in connection with that proceeding. Um, so long as the applicable standard of conduct has been met. And the second exception is the directors may not be indemnified in connection with any other proceeding in which the director was found liable on the basis that he or she received an improper personal benefit.

Erin ([10:02](#)):

And finally indemnification for the specific proceeding must be authorized by the board. This means that the board can't just provide a blanket approval for indemnification of directors across the board, or even something like all situations involving X instead, the board has to specifically approve indemnification for the proceeding at issue. And this authorization takes different form depending on composition of the board or the circumstances. For instance, if there are two or more disinterested directors on the board, a majority of disinterested directors or a committee of at least two interested directors must approve the indemnification. If there are fewer than two disinterested directors, a majority vote of a quorum (in which the interested directors may not participate) must approve. And indemnification can also be authorized by special legal counsel selected in accordance with Georgia law or by the members of the organization. And if that were the case, the any interested director members would be excluded, um, from that vote.

Erin ([11:05](#)):

Another permissive provision under Georgia law is advancement of expenses. Um, so a corporation may advance expenses for a director in connection with the proceeding, if the director gives the corporation

two things: first, they must give written affirmation of their good faith belief that they meet the relevant standard of conduct for indemnification, or that the conduct is one for which the articles provide exculpation. And second, they must give a written undertaking to repay funds advanced if it's ultimately determined that the director isn't entitled to indemnification. So again, for the organization to advance expenses to a director, the director has to affirm that they believe they're entitled to indemnification or even exculpation. And must affirm that they'll repay the organization, if it's later determined that indemnification was proper. Further advancement of expenses must be approved by the board. It's similar standards as the indemnification approval that I just laid out. Georgia law also provides the corporations shall indemnify, a director against reasonable expenses incurred in connection with a proceeding in which the director is successful on the merits or otherwise, and the director of the party to the proceeding because they were director of the corporation.

Erin ([12:23](#)):

So that's reimbursement of expenses. Um, so again, we've got, we've got exculpation, we've got indemnification, we've got advancement of expenses and we've got reimbursement of expenses, all of which are permitted to different extents under, under Georgia law.

Sireesha ([12:43](#)):

So a nonprofit can indemnify a director and the nonprofit can advance for reimburse their litigation expenses if it wants to.

Erin ([12:54](#)):

Yes. And with D&O insurance as well, a nonprofit can provide that coverage to its directors. So if you think of it as a progression, the first line of defense can be the exculpatory provisions in an organization in an organization's articles because they serve as a shield for certain types of liability. The next line of defense is indemnification or making the director whole for their losses. But of course there are limitations on the organization's ability to indemnify directors that we just talked about, including certain standards of conduct that directors must meet. Then the nonprofit can also advance on the front end or reimburse on the backend for litigation expenses. And finally, they can have D&O insurance to provide additional coverage that would go beyond the resources of the organization, potentially.

Sireesha ([13:44](#)):

Well, Erin, many of our small community organizations operate on really tight budgets. So insurance, like this seems like a luxury. What would you say to nonprofit that feels they can't afford D&O insurance or it's considering 'Yeah. We'll just take on that risk.'

Erin ([14:03](#)):

Yeah. Well, well, it's understandable that an organization with a small budget might consider D&O insurance as an extra that it can pass on. There's some good reasons to give it another look as with other types of insurance, the premiums are often quite low compared to the coverage limits. Um, and without insurance and organization would likely find that the costs associated with a single claim far exceed the premiums that would be paid on a D&O policy. So again, as with any insurance, you're shifting the risk, you know, you're preparing for that. What if scenario and the same things apply in the corporate context? It also, as we've mentioned previously, it helps with recruiting strong board members. Um, do you know policy might allow them to recruit more qualified board members? Um, and

if an organization does not have D&O coverage perspective, board members might be scared off by the prospect of losing their assets if the nonprofit is sued.

Erin ([15:09](#)):

Um, so a lot of more seasoned directors will look, will be on the lookout for D&O coverage. It also covers officers. And again, there are a lot of potential sources of lawsuits, as I mentioned, um, there are several claimants that may bring suits against an organization's directors or the organization itself. So as we discuss employee lawsuits for things such as harassment, wrongful termination, and the like, donor lawsuits for misuse of funds third parties bring contract or personal injury disputes and governmental bodies regulatory violations, tax liabilities, and things like that. And also D&O insurance can help cover the types of expenses that may arise in connection with claims. For instance, D&O insurance can, um, cover the cost of mounting a defense to the claim, which can get very expensive. It could cover the amount of an adverse judgment in the event that there is a judgment, um, and it could also cover settlement costs in the event of a settlement. And all of this is dependent upon the terms of the policy, of course.

Sireesha ([16:23](#)):

Erin, can you share with us briefly, how does D&O insurance work and what should nonprofits be aware of when considering a policy?

Erin ([16:32](#)):

Sure. So D&O, insurance works fairly similarly to other types of insurance that you may be familiar with, but just applied to the corporate context. So for instance, an organization seeking coverage will go through underwriting, which will consist of a review of the organization's employment practices, the size of the workforce financial stability of the nonprofit, potentially the industry the organization is in with certain ones like healthcare, education getting a little bit of increased scrutiny from insurance carriers. All of these things will impact the type of coverage, the amount of the premiums and so on. Um, the organization will provide various organizational documents in connection with this application, including governance information and particularly risk management policies (which an insurer is going to be very interested in) prior claims and litigation history and financial information. And then once the policy is in effect, its operations will be governed by the specific terms of policy, of course, but for instance, a policy can provide for reimbursement versus paying on behalf of the organization.

Erin ([17:42](#)):

So with the former, with reimbursement, the organization will be responsible for the upfront costs and will get reimbursed by insurance. While in the latter, the organization would generally not be responsible for upfront costs. The, the insurer will pay on behalf. The policy will also likely cover the insurer's involvement in defense of a claim, whether the insurer will assume control of the claims defense, including choosing legal counsel or whether the organization will retain some control. Um, and then other provisions to look out for include deductibles, exclusions from coverage, and then authority to enter into the, excuse me, to enter into settlements, whether the organization can enter into a settlement or whether the insurer must be brought in to handle those.

Sireesha ([18:31](#)):

And listeners, we encourage you to follow up with your current insurance provider. They could probably provide further information regarding D&O coverage for your organization. Erin, thank you so much for

outlining the options available to nonprofits if their directors are sued, and how D&O insurance can help protect a nonprofit, its mission, and its directors and officers. We appreciate you taking the time to answer our questions today.

Erin ([19:01](#)):

Sure. Thank you for having me.

Sireesha ([19:05](#)):

We hope that you found this episode of the PBPA podcast to be informative and helpful. We add new episodes every month with short conversations about general, yet important legal information for Georgia nonprofits. Remember that this is not legal counsel. Talk to your attorney about your organization's specific concerns. Thanks for tuning into the PBPA Podcast. And to all nonprofits listening out there, thank you for all the good work you continue to do in our community.