

# The I's Have It: Immunity, Indemnification, and Insurance for Nonprofit Directors

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There are many opportunities to serve on the board of a nonprofit corporation, whether a public charity, private foundation, home-owner association, trade association, or church. Before joining a nonprofit board, however, you should consider the liability protections you can expect under the North Carolina Nonprofit Corporation Act, the nonprofit corporation's governing documents and the nonprofit corporation's directors' and officers' liability insurance policy.

## Director Immunity Under the North Carolina Nonprofit Corporation Act

The North Carolina Nonprofit Corporation Act ("Act") allows nonprofit corporations to limit or eliminate directors' personal liability for monetary damages by the inclusion of certain language in the nonprofit organization's articles of incorporation. The immunity applies to monetary damages arising out of any action whether that action is taken directly by the nonprofit organization or in the name of the organization, or the action is a breach of the director's duty. However, there are exceptions to this immunity and no provision in the organization's articles of incorporation will protect a director from:

- Any liability arising from an act or omission that the director, at the time of the act or omission, knew or believed was clearly in conflict with the best interests of the corporation;
- Any liability associated with the loan, guarantee or other form of security made or provided by a nonprofit corporation to or for the benefit of its directors or officers;
- Any transaction from which the director derived an improper personal financial benefit.

The Act also provides that a person serving as a director of a nonprofit corporation is immune individually from civil liability for monetary damages for the director's act or failure to act arising from service as a director, except to the extent the nonprofit corporation has insurance coverage. Again, however, there are exceptions and this statutory immunity does not apply if:

- The director is compensated for his or her services beyond reimbursement for expenses;
- The director is not acting within the scope of his/her official duties;
- The director is not acting in good faith;
- The director commits gross negligence or willful or wanton misconduct that resulted in damage or injury;
- The director derives an improper personal financial benefit from a transaction which involved the

nonprofit corporation;

- The director incurs the liability from the operation of a motor vehicle; or
- The director is involved with an improper loan or guarantee with the nonprofit corporation.

Immunity for a director is personal to the individual and the Act does not immunize the nonprofit corporation against liability for acts or omissions of its directors.

Immunity is a powerful protection for directors of nonprofit corporate boards, but you should understand that this immunity only provides protection at the conclusion of a lawsuit. Neither language in the articles of organization nor immunity provisions in the Act will protect you, as a director, from being sued or for having to pay your costs of defending a lawsuit brought against you.

### **Indemnification for Directors and Officers of Nonprofit Board Members under the Act**

In addition to the immunity provisions, the Act also contains an indemnification provision that supplements the immunity. Indemnification is synonymous with reimbursement. Under the Act, this means that if you are sued individually in your capacity a director of a nonprofit corporation and you are found to be immune from liability, the nonprofit corporation must reimburse you for your legal expenses for defending the lawsuit. Specifically, the Act provides that unless limited by the nonprofit corporation articles of incorporation, the nonprofit corporation shall indemnify directors who are wholly successful on their merits or otherwise, in the defense of any proceeding to which the director is a party because he/she was a director or officer of the nonprofit corporation against reasonable expense actually incurred by director in connection with the litigation.

Thus, indemnification supplements the immunity protection because it can provide you, as a director or a nonprofit corporation, reimbursement of legal fees if the you successfully defend a claim brought against the you in your capacity as a director.

### **Advances to Directors to Cover Legal Costs Under the Act**

Immunity is a valuable protection, and indemnification provides reimbursement of legal costs after a successful outcome, but the burden of carrying the expense of attorney fees to defend a lawsuit can still be substantial. To address this issue, the Act provides that expenses incurred by a director to defend a lawsuit may be paid by the nonprofit corporation in advance of the final disposition of the lawsuit. This means that the nonprofit corporation can advance its indemnification obligations. However, this also means that even though as a director you may not have to "front" your legal costs, if you are not successful in defending the lawsuit, you will be obligated to repay the nonprofit corporation for the legal fees. Typically, this obligation is memorialized in a written agreement between the nonprofit corporation and its directors.

Absent language in the nonprofit corporation's articles of incorporation, bylaws or votes to advance legal expenses, as a director, you are still personally responsible for paying the costs of the ongoing litigation while defending the lawsuit. It is only at the conclusion of litigation that the Act requires you to be to be reimbursed, and then only if you meet the criteria for indemnification as established by the Act and the particular articles of incorporation for that entity.

### **Director and Officer Liability Insurance**

In reality, it is often difficult for nonprofit directors to have expenses advanced for defense costs during a lawsuit because, more often than not, all the current board members are also the subject of the lawsuit. When this occurs, there are no disinterested directors to vote on behalf of the nonprofit corporation to advance expenses without falling victim to the Act's provisions dealing with conflicts of interest. To further

complicate this problem, often members of the nonprofit corporation are suing the board, so it is virtually impossible to put the question of advancing director expenses to the membership for purposes of dealing with the conflict of interest concern. Fortunately, the Act specifically authorizes nonprofit corporations to purchase insurance on behalf of an individual who is or was a director, officer, committee member, employee, or agent of the corporation to cover liability asserted against or incurred by the director or officer in the officer or director's capacity or arising from status as a representative of the nonprofit corporation. The nonprofit corporation may seek this insurance coverage regardless of whether or not the corporation would have power and funds necessary to indemnify the director or officer against the same liability. Given these concerns, it is recommended that nonprofit corporations obtain director and officer liability insurance to cover the costs of defense of their nonprofit directors, officers, committee members, and volunteers. However, it is important to be mindful that not all policies are created equal and not all policies cover every type of volunteer or every situation, and directors should carefully consider the options for obtaining this type of insurance.

### **Who and What Should Be Covered by Director and Officer Liability Insurance?**

Typically, the broader the coverage, the better protection the policy will afford the directors and officers. The following are questions that are important to ask when shopping for director and officer liability insurance. Ideally the answer should be "Yes" to all of these questions:

1. Does the policy's definition of insured extend beyond the actual directors and officers (i.e. does it include committee members, volunteers, and employees)?
2. Does the definition of insured protect past, present and future directors?
3. Does the policy cover spouses of directors and officers?
4. Does the policy provide a defense to claims and lawsuits (as opposed to just reimbursing for such costs)?
5. Does the policy cover defamation (i.e. libel and slander)?
6. Does the policy defend claims seeking non-monetary loss? (A non-pecuniary, or non-monetary claim, is one where the plaintiff is not seeing money but has an ideological claim (i.e. a suit against the board for not fulfilling its mission or challenging an unpopular decision of the board))?
7. Does the policy cover wrongful termination or other employer liability claims?
8. Does the policy cover illegal forms of discrimination?
9. Does the policy defend a claim or lawsuit for failure to maintain or obtain insurance?
10. Does the policy provide coverage for decisions directors/officers make in accepting or rejecting contracts?
11. Does the insurer provide the nonprofit corporation with risk management advice?

Additionally, homeowner's associations should also ask:

1. Does the policy provide coverage for your property manager if the Association is professionally managed?
2. Does the policy provide coverage for developer appointed board members if the Association is still under developer control??

### **Summary**

The North Carolina Nonprofit Corporation Act provides a number of protections to volunteer nonprofit corporation directors, but the scope of such protection will often depend greatly on the nonprofit corporation's articles and bylaws. In addition to the protections of the Act, a nonprofit corporation has the ability, and should, obtain director and officer liability insurance coverage. Before accepting a position as a director of a nonprofit corporation, you should question the extent of immunity, indemnification and advance of expenses

you can expect from the nonprofit and also obtain a copy of the nonprofit corporation's director and officer liability insurance policy to determine whether or not there is sufficient coverage. Serving on a nonprofit corporation board can often be a thankless job, but fortunately the Act provides a peace of mind to allow you, as a volunteer nonprofit director, to carry out your duties in the best interests of the nonprofit corporation without fear of liability or legal expense.

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