

## Costs of Charity

# Even Volunteers Could Face D&O Suits

## Employment practices seen as biggest threat

■ By Steven Tuckey

Who would think public-spirited citizens volunteering their time to serve on a nonprofit board would ever face the business end of a directors and officers lawsuit? According to some of the nation's major commercial insurance underwriters writing such D&O coverage for nonprofit organizations, there are apparently plenty of reasons to believe so.

The nonprofit realm encompasses a wide variety of organizations with pockets often as deep as their for-profit counterparts. Hospitals, school boards, homeowners associations are among the many groups falling into this arena with plenty to worry about in terms of disgruntled members, patients, customers or other stakeholders, and in some instances, stake-drivers.

Experts estimate the entire market attracts between \$300 million and \$500 million in annual premium each year.

Peter Taffae, managing director for Los Angeles-based ExecutivePerils, a national wholesaler, can recall the days "when the line was really a gold mine."

That may not be the case anymore, but the line still draws fewer claims than others in the for-profit world, according to Robert Sargent, president of Hartford-based Tenant Risk Services. "Most nonprofits have very low exposure and therefore infrequent claims," Mr. Sargent said.

Medical services have proved to be a magnet for D&O claims, Mr. Taffae said.

"One of the biggest exposures today is assisted living," he said. When a facility promises a prospective client pork chops on Tuesday and fish on Friday that turns into cereal and crackers, the lawyers may get involved, he said.

"It is a breach of contract, but the charges can come down

to misrepresentation and fraud," Mr. Taffae said. "Naturally, the lawyers will follow the money."

D&O claims will often arise when claimants exhaust other lines of coverage. "The allegation is failure to purchase enough insurance," Mr. Taffae said. "When every other policy fails, it is just the best policy to go after. And unless it is specifically excluded, the lawyers usually can get something out of" the D&O policy.

The more claims there are, the more nonprofits resemble their profit counterparts.

"There was a time you would have scratched your head if an underwriter gave you a \$25,000 deductible on a nonprofit," Mr. Taffae said, referring to the fact that the typical deductible used to be considerably lower. "Nowadays, with 25 employees or maybe 100 volunteers, you are definitely looking at such a figure."

Policy limits start at about \$1 million. "But three [million] is the average," Mr. Taffae said. "And we have a couple of nonprofit health care policies that are in excess of 700 grand in premium with \$25 million in limits."

Claims can involve restraint of trade, such as when a doctor who is terminated and is forbidden to practice files suit against the nonprofit facility that terminated the doctor. "We have had some class action suits on accounting fraud and Medicare



double-billing," Mr. Taffae added.

Elda Martocci, vice president, nonprofit D&O products for St. Paul Travelers Bond in Hartford, said that employment practices claims constitute the most frequent claims against nonprofits. "Larger nonprofits, those more national in scope, can also be impacted with antitrust and intellectual property issues, which can be quite severe," she said.

Mr. Sargent said "some experts estimate that up to 90 percent of all claims against nonprofits are employment related." Greater exposure to employment claims may result from more part-time work and more informal approaches to employment arrangements compared to more structured for-profit enterprises, Mr. Sargent said.

But this may be changing as many nonprofits have instituted new risk management steps to mitigate the exposure, he said.

Nonprofit D&O forms can include EPLI coverage along with errors and omissions, but often

they do not. "While one policy form may incorporate the additional EPL and E&O coverages, the forms are often referred to as 'nonprofit D&O,'" he added.

Often nonprofit D&O coverage is also broader than its for-profit counterpart, and can incorporate specific coverage provisions for the specialty nature of the organization.

Potential targets should not take too much comfort for so-called "safe harbor" statutes that some states have to protect nonprofit organizations from lawsuits, he warned. "Most importantly, they do not protect directors from lawsuits, but only, if the situation qualifies, from damages to plaintiffs in a lawsuit," Mr. Sargent said.

Misappropriation of funds, failure to fulfill fiduciary duties, and membership complaints and discrimination are also common D&O claims.

"Because of the charitable nature of organizations, claims for wrongful action in nonprofit organizations can become extremely divisive and personal," Mr. Sargent said.

The taxpayers of the Roslyn,

N.Y., school district provided adequate proof of that when they were torn over a lawsuit filed against school board members who were allegedly asleep at the switch when district officials embezzled what is now believed to be about \$11 million. The board sought the full \$11.2 million from those members who served during the thefts, including Carol Margaritis.

In a Nov. 18, 2005 letter to the Roslyn News, Ms. Margaritis detailed the “stressful and frightening” ordeal she has been through starting out with a \$20,000 bill to merely answer the summons she must now absorb.

“My husband and I have always taught our children that justice prevails, and this has been a difficult lesson in our household lately. What can I say to my children about community service these days when their mother is

being sued for just that?”

Even more important than education, people would consider the sanctity of their home inviolable, even if they joined a development and gave up certain rights for the greater good.

For that reason, said Sarah Pike, underwriter for the Shand Morahan & Company Inc. of Deerfield, Ill., members of homeowners and condominium association boards can often find themselves lawyering up in the face of angry neighbors.

“We have seen lots of claims that said something was not built right,” Ms. Pike said. “That is why we would rather not have the builder and developer on the board.”



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Tenant Risk Services

As for pricing, Ms. Martocci said the nonprofit sector has avoided both sharp spikes as well as declines of the for-profit D&O world in recent years. “Interestingly, pricing moves over the past few years in this niche have not been related to 9/11 or Enron-type scandals, but rather to the increased frequency of EPL claims,” she said.

The line, however, is not immune to underwriters looking to make a quick kill in pursuit of market share.

“There is a phenomenon

where a couple of big players have come in with very restricted coverages, and so they are writing this stuff inexpensively,” Mr. Taffae said.

But that small account could turn into a big headache in terms of an agency E&O suit from a disgruntled insured if the policy did not measure up to expectations, he said.

“No one wants to spend hours and hours on a \$5,000 account because no one makes any money on it,” Mr. Taffae said. “But that could easily cost you 50 [thousand dollars], if it turns into a lawsuit.” ♦

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