



PROFESSIONAL LIABILITY UNDERWRITING SOCIETY

Recent Trends in D&O and the Private and Non-Profit Market

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Recent Trends in D&O and the Private and Non-Profit Market

Directors and Officers Liability provides coverage for settlements, judgments and defense costs arising out of the wrongful acts of directors and officers. It reimburses the private company or non-profit for indemnification of its directors and officers. If indemnification cannot be made, then the policy pays the directors and officers directly.



Recent Trends in D&O and the Private and Non-Profit Market

A recent survey of 451 executives of privately owned companies produced some startling facts:

- 26% of the companies experienced a D&O suit in the last 5 years
- The suits cost companies with D&O insurance an average loss of \$129,625. Those without D&O insurance had an average loss of \$408,469

- Why do companies purchase D&O coverage?
 - Protect the personal assets of company and non-profit directors and officers
 - Protect the company's assets
 - Cost of defending corporate lawsuits may exceed the net worth of most private companies
 - Competitor disputes
 - Disputes over inventorship
 - Shareholder disputes

- Why do companies purchase D&O coverage? (cont.)
 - Misappropriation of trade secrets
 - Breach of investment agreement
 - Misrepresentation/deceptive trade practices
 - Antitrust/government agency lawsuits
 - Inaccurate disclosures
 - Construction fraud
 - Unfair trade practices using the internet

- Policy Overview
 - Side A/B/C
 - Key Exclusions
 - Key Definitions
 - Conditions



Recent Trends in D&O and the Private and Non-Profit Market

- Traditional Claims and Recent Claims Trends
 - Private
 - Non-Profit

- Claim
 - Frequency
 - Severity



Recent Trends in D&O and the Private and Non-Profit Market

- Capacity and Industry Challenges



Recent Trends in D&O and the Private and Non-Profit Market

- Current Market Conditions



PLUS

PROFESSIONAL LIABILITY UNDERWRITING SOCIETY

Defending D&O Claims: Private and Non-Profit

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The Travelers D&O Claims Unit

INTRODUCTION

- Non-compete as “the place where three roads meet”
 - Commercial Litigation
 - Employment Law
 - Intellectual Property
- Overlapping claims, policies and insureds



Defending D&O Claims: Private and Non-Profit

COVERAGE AND CONFLICTS

COVERAGE & CONFLICTS

- Potential Defendants
 - The Company
 - Executive Team
 - New Executive/Employee

COVERAGE & CONFLICTS (cont'd)

- Potential Claims
 - Breach of Contract
 - Breach of Fiduciary Duty
 - Interference/Usurpation
 - Fraud
 - Deceptive Trade Practices
 - Infringement
 - More!

COVERAGE & CONFLICTS (cont'd)

- Who is covered for what
- What counsel will cover which defendant(s) for which claims
- Dealing with non-panel counsel
- Exhausting Conflicts

COVERAGE & CONFLICTS (cont'd)

- Reservations of Rights
 - Notifying litigation counsel of ROR
 - The tyranny of “I can’t get involved in coverage”

COVERAGE & CONFLICTS (cont'd)

- Litigating Non-covered Claims
 - Fraud
 - Infringement
 - Others



Defending D&O Claims: Private and Non-Profit

COVERAGE & CONFLICTS (cont'd)

POLICY LIMITS & DEPLETING POLICIES

Versus

THE COSTS OF LITIGATION & SCOPE OF
ADVERSE VERDICTS

COVERAGE & CONFLICTS (cont'd)

- Who Pays What?
- Coverage Issues &
 - Special Verdict Forms
 - Reasoned Decisions
 - Attorney Fees
 - The “Prevailing Party”



PROFESSIONAL LIABILITY UNDERWRITING SOCIETY

D&O Underwriting: Private and Non-Profit

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AIG





D&O Underwriting: Private and Non-Profit

- Application Components



D&O Underwriting: Private and Non-Profit

- Internal Factors (company specific)



D&O Underwriting: Private and Non-Profit

- External Factors (non-company specific)

- D&O Rating / Pricing
 - Differentiating Risks
 - Characteristics of good risks
 - Characteristics of challenging risks
 - Pricing Factors
 - Claim history
 - Industry
 - Size
 - Governance
 - Financials



PROFESSIONAL LIABILITY UNDERWRITING SOCIETY

Non-Profit Board Risk Management and Assessment

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BASIC ELEMENTS OF NONPROFIT BOARD TRAINING

- Duties
- UPMIFA
- Governance Practices
- Protections from Liability

JOB DESCRIPTION

- Monitor Mission and Strategy
- Oversee Executive Director (hire, compensate, review, supervise, fire)
- Actively participate in Board oversight of organization
- Exercise board duties responsibilities in accordance with applicable standards
- Meet appropriate financial, governance and legal obligations
- Duty is not to micromanage but make sure policies, structures, and competent management are in place and decisions appropriately made

DUTIES OF DIRECTORS AND OFFICERS

- **Minnesota Nonprofit Corporation Act**
 - A director shall discharge the duties of the position of director **in good faith**, in a manner the director reasonably believes to be **in the best interests** of the corporation, and with the **care an ordinarily prudent person** in a like position would exercise under similar circumstances. A person who so performs those duties is not liable by reason of being or having been a director of the corporation.
- Minn. Stat. § 317A.251, subd. 1 (2010). (emphasis added)

DUTIES OF DIRECTORS AND OFFICERS

(cont'd)

Three general "duties" of directors:

- Duty of care
- Duty of obedience
- Duty of loyalty

"Good faith" means honesty in fact in the conduct of an act or transaction. Minn. Stat. § 317A.011, subd. 10 (2010).

DUTY OF CARE

Must discharge duties “with the care an ordinarily prudent person in a like position would exercise under similar circumstances.” Minn. Stat. § 317A.251, subd. 1.

DUTY OF CARE (cont'd)

Per Attorney General's Guide for Board Members (<http://www.ag.state.mn.us/charities/FiduciaryDuties.asp>), this includes:

1. **Active Participation.** Directors must actively participate in management of the organization including attending board meetings, evaluating reports, reading minutes, reviewing performance and compensation of the Executive Director. Spend time necessary.
2. **Committees.** Directors remain responsible for committees, but may have committees act and may rely on their information, opinions or reports.

DUTY OF CARE – AG STANDARDS (cont'd)

3. **Board Actions.** Director present at a meeting is presumed to have agreed to actions taken unless (a) director objects to the meeting because it was not lawfully called and doesn't participate in the meeting; (b) director votes against the action; or (c) director is prohibited from voting on the action (e.g. because of a conflict of interest).
4. **Minutes of Meetings.** Written accurate minutes should be taken at every board meeting.
5. **Books and Records.** Director should have general knowledge of the books and records of the organization as well as its general operation.
6. **Accurate Record Keeping.** Director should generally assure that records and accounts are accurate. (e.g. take steps to require regular audits by an independent certified public accountant and assure proper internal controls).

DUTY OF CARE – AG STANDARDS (cont'd)

7. **Trust Property.** Director has duty to protect, preserve, invest and manage the corporation's property consistent with donor restrictions and legal requirements.
8. **Resources.** Director must assist the organization in obtaining adequate resources to enable it to further its charitable mission.
9. **Charitable Trusts.** Trustee of a charitable trust has a higher standard of care than a director of a nonprofit corporation. Trustee has duty to exercise the care an ordinary person would employ in dealing with that person's own property. Trustee with higher skill level must use skill.
10. **Investigations.** Investigate warnings or reports of officer or employee theft or mismanagement. Director may have to report misconduct to appropriate authorities, such as the police or the Attorney General. Where appropriate, a director should consult an attorney or other professional for assistance.

DUTY OF CARE – AG STANDARDS (cont'd)

Directors may rely on information, including financial data, prepared by:

- officers or employees whom the director reasonably believes to be reliable and competent in such matters presented;
- counsel, accountants, or others as to matters that the director reasonably believes are within the person's professional or expert competence; or
- a board committee ... as to matters within its designated authority, if the director reasonably believes the committee to merit confidence.

Id. § 317A.251, subd. 2(a) (2010). [Does not shield a director who has actual knowledge concerning the matter that makes the reliance unwarranted. *Id.* § 317A.251, subd. 2(b) (2010).]

DUTY OF OBEDIENCE

Director must:

- Adhere to the intended purpose or mission of the nonprofit; and
- Comply with state and federal law.

DUTY OF OBEDIENCE (cont'd)

Per Attorney General's Guide for Board Members

(<http://www.ag.state.mn.us/charities/FiduciaryDuties.asp>), this duty includes:

1. **State and Federal Statutes.** Directors should be generally familiar with state and federal statutes and laws (including IRS laws) relating to nonprofit corporations, charitable solicitations, sales and use taxes, FICA and income tax withholding, unemployment and workers' compensation obligations.
2. **Filing Requirements.** Directors must assure that deadlines are met for tax and financial reporting, for registering with the Attorney General, filing with the Secretary of State's Office, for making social security payments, for income tax withholding, etc.

DUTY OF OBEDIENCE – AG STANDARDS (cont'd)

3. **Governing Documents.** Directors should be generally familiar with the organization's governing documents and follow the provisions (e.g. re: proper notice for meetings, regular meetings, proper appointment of directors and re organization's mission).
4. **Outside Help.** Where appropriate, directors should obtain opinions of legal counsel or accountants.

DUTY OF LOYALTY

Requires a director to discharge the director's duties "in good faith, in a manner the director reasonably believes to be in the best interests of the corporation." Minn. Stat. § 317A.251, subd. 1.

DUTY OF LOYALTY (cont'd)

Duty of Loyalty includes:

- Not using Board position or the organization's assets in any way that would result in pecuniary gain for director or for any member of their family (includes prohibition on director receiving loans from organization).
- Not exploiting position as an 'insider' by appropriating to him/herself a business opportunity properly belonging to the corporation.

DUTY OF LOYALTY (cont'd)

Conflict of Interest

- An interest (financial or personal) that interferes with exercise of independent judgment in the best interests of the organization.

DUTY OF LOYALTY (cont'd)

Conflict of Interest – Procedures Generally

Organization should:

- Have a written policy on conflicts;
- Require annual disclosures of conflicts;
- Require disclosure regarding conflicts on specific transactions; and
- Require recusal from vote or influence where conflicts may exist.

DUTY OF LOYALTY (cont'd)

Conflict of Interest – Procedures

- Minn. Stat. 317A.255 subd 1(b)(2010) provides that a transaction is not void if:
 - the contract or transaction is proved fair and reasonable as to the corporation when it was authorized, approved, or ratified; or
 - the material facts are fully disclosed and the contract or transaction is approved in good faith by certain percentage of non-interested directors.

Id. § 317A.255, subd. 1(b) (2010).

DUTY OF LOYALTY (cont'd)

“Material financial interest” includes situation where a member of the family of the director, has a material financial interest. *Id.* § 317A.255, subd. 2 (2010). Family member includes spouse, parent, child, spouse of a child, brother, sister, or spouse of a brother or sister. *Id.* § 317A.255, subd 4 (2010).

INSTITUTIONAL FUNDS

Uniform Prudent Management of Institutional Funds Act (UPMIFA), Minn. Stat. §§ 309.73-.77).

- Provides standards and procedures for managing and investing institutional funds, (i.e., funds held exclusively for charitable purposes).

UPMIFA (cont'd)

Requires institutional funds be managed:

- With the care of an ordinarily prudent person in a like position; and
- Considering the charitable purposes of the institution and the purposes of the institutional fund.

UPMIFA (cont'd)

Sets forth factors to consider in making investments, including:

- general economic conditions;
- the possible effect of inflation or deflation;
- the expected tax consequences, if any, of investment decisions or strategies;
- the role that each investment or course of action plays within the overall investment portfolio of the fund;
- the expected total return from income and the appreciation of investments;
- other resources of the institution;
- the needs of the institution and the fund to make distributions and to preserve capital; and
- the asset's special relationship or special value, if any, to the charitable purposes of the institution.

Id. § 309.74(e)(1) (2010).

KEY GOVERNANCE PRACTICES

Directors should protect tax exemption; includes ensuring that:

- Organization is organized exclusively for charitable purposes;
- Organization is operated for charitable purposes and provision of a public, not private benefit;
- Private inurement is not allowed;
- Executive compensation does not violate excess benefit rules; and
- Organization abides by limitations on lobbying and campaigning.

KEY GOVERNANCE PRACTICES (cont'd)

Oversee Finances

- Charities Review Counsel recommends at least 65% of nonprofit's three-year average annual expenses are used to directly support programming (ideal is 70-90%).
- Ensure financial strength to pursue mission (positive balance of unrestricted net assets and balanced reserves).

KEY GOVERNANCE PRACTICES (cont'd)

- Conduct compensation reviews (and comply with excess benefit rules).
- Provide 990 to all Board members for review.
- Ensure separation of functions/identify signing authority.

KEY GOVERNANCE PRACTICES (cont'd)

Provide Transparency to Public

- Provide open and transparent communications to constituents (including reporting of activities and finances).

KEY GOVERNANCE PRACTICES (cont'd)

Ensure Good Board Governance

- Maintain appropriate Board size (IRS recommends at least three to five members).
- Review Board terms and turnover (Charities Review Counsel says that no elected voting member should serve for more than five years without standing for reelection; recommends term limits).
- Board makeup should ensure independence (i.e., sufficient members who are not compensated by the organization) and competence.

KEY GOVERNANCE PRACTICES (cont'd)

- Follow Bylaws, including regarding Board terms/vacancies/selection;
- Ensure Board is engaged and participating in reviews and decision making;
- Ensure regular Board meetings/participation; and
- Keep accurate books and records including accurate Board minutes.

KEY GOVERNANCE POLICIES

- Conflict of Interest
- Whistleblower
- Record Retention
- Policy prohibiting loans to Officers/Directors
- Travel and Entertainment Reimbursement Policy that is cost effective and appropriate

PROTECTIONS FROM LIABILITY

Statute

Generally, an unpaid director of a nonprofit “is not civilly responsible for an act or omission . . . if the act or omission was in good faith, was within the scope of the person’s responsibilities as a director . . . and did not constitute willful or reckless misconduct.”

Minn. Stat. § 317A.257

Exceptions include actions by the attorney general; actions based on federal law; actions based on the person’s contractual obligation or actions based on a breach of a public pension plan fiduciary responsibility or personal physical injury caused by the director.

ABOUT BRIGGS AND OUR CLIENT SERVICE TO NONPROFITS

QUESTIONS?