

# LIABILITY INSURANCE COVERAGE

## Do Chapters Really Need This Type of Protection?

Serving as a chapter official is an honor and a distinction. However, a fundamental rule in the law of corporations, both profit and nonprofit, is that authority for managing the affairs of the corporation is vested in the board of directors. (For purposes of discussion, chapters are viewed to be identical in concept to associations, although **organizational size and the scope and complexity of sponsored activities may vary considerably.**)

Every nonprofit corporation statute includes a provision that describes the **fiduciary obligations or duties** of a nonprofit director. Most such statutes require directors to act (1) in good faith (the duty of loyalty); (2) with the care an ordinary prudent person in a like position would exercise under similar circumstances (the duty of care); and (3) in a manner the director reasonably believes to be in the best interest of the corporation (the duty of obedience). There are various criteria under each duty that courts generally consider when determining if a board acted responsibly, or should be found liable when a claim materializes. Violations of these "tests" can be the basis for rendering judgments against a board, and possibly its members.

Then, why should a chapter seriously consider liability insurance? Believe it or not, there are a number of claims that a plaintiff may bring against a chapter officer or director, some of them valid and some not. Here are some of the most common grounds for suit. Think of your own chapter and perhaps some recent sensitive experiences, if any. Could any of these apply to your situation? If so, then you may need this protection.

- A chapter expels or disciplines a member, and discussion leading up to such action includes derogatory remarks, which results in a **defamation** lawsuit. A claim for libel (written defamation) or slander (spoken defamation) can arise.
- A chapter board terminates a CEO wrongfully, and a legal claim includes the directors for **wrongful discharge** since the board's members took the action.
- The conduct of a chapter board is sued for **gross dereliction of duty** because chapter funds are not invested in a manner considered to be responsible (i.e. large balances in non-interest bearing accounts for long periods).
- A chapter is liable for **general mismanagement or bad management** due to poor business decisions resulting in consistent/major losses over a period of time.
- A chapter board takes action that someone believes is **contrary to either its articles of incorporation or its bylaws** so a legal claim is instituted.



- A chapter board is accused of violating its fiduciary duty by **not treating members in a fair and above-board manner**. For example, refusal to allow a candidate for the board of directors to promote his candidacy by purchasing an advertisement in their publication was ruled to be self-serving as the board wished to perpetuate themselves in office.
- A chapter board is accused of **insider transactions** where a director gains some advantage by virtue of their insider status, such as engaging the services of director either for an excessively high fee or for services that are not needed.
- A chapter faces a legal claim that it **failed to protect “association” property**, such as its tax-exempt status, copyright ownership of a publication, trademark ownership, or general goodwill and reputation.

Associations, including chapters of AFA, are permitted to purchase insurance to cover liability of their directors and officers. Important coverages include defamation, employment (including wrongful discharge), copyright and other types of infringement, breach of fiduciary duty, and other potential coverages.

Choose such coverage carefully. Look closely to determine if provisions exist that allow the chapter to retain the ability to select its own attorney. Also, review the coverage to see if the payment of costs by the insurance carrier, including attorneys' fees, will be made on an on-going basis, rather than just when the matter is resolved. This is important since litigation can last for extended periods of time and a chapter would otherwise be responsible for paying such costs on a periodic basis which could represent a budgetary problem.

Review your own situation and conditions. The choice is yours to make, and only chapters are in the best position to do so.

Source:

Webster, George D., *The Law of Associations*, Nov., 1997.



## *WHY DOES MY CHAPTER/STATE ORGANIZATION NEED INSURANCE?*

There are a variety of reasons to consider insurance coverage for your chapter/state/affiliate. Listed below are a few questions -- if you answer yes to any of these, you have a need for insurance.

1. Does your Chapter/Affiliate hold meetings in places such as schools, hotels, restaurants, malls, etc., which require evidence/proof of insurance?

\_\_\_\_\_ \_yes \_\_\_\_\_no

2. Does the Chapter/Affiliate own any property such as computers, fax machines or general office furniture?

\_\_\_\_\_ yes \_\_\_\_\_no

3. Does the Chapter/Affiliate have to bond Board Members that routinely handle the Association funds?

\_\_\_\_\_ yes \_\_\_\_\_no

4. Does your Chapter/Affiliate want to protect the assets of its officers/members in the event of a liability claim?

\_\_\_\_\_yes \_\_\_\_\_no

5. Do your officers/members use personal automobiles to perform Chapter/Affiliate functions?

\_\_\_\_\_yes \_\_\_\_\_no



## *CHAPTER OFFICE PACKAGE POLICY*

### *Basic Insurance Coverage*

Most chapters will be primarily interested in securing either General Liability Coverage or Fidelity Bonding to cover their financial activities. The minimum premiums for this type of policy depend on each state's insurance regulations, and policies are usually written for a 3-year term. Policies may include the following coverage:

1. Personal Property (includes furniture, files, materials, etc.)
2. Personal Effects & Property of Others
3. Property Away from Premises
4. Valuable Papers & Record Replacement
5. Business Income Replacement
6. Employee Dishonesty Bond
7. Money & Securities

### *General Liability Coverage*

*(Includes Meeting & event Coverage)*

1. Bodily Injury, Property Damage, etc
2. Personal Injury & Advertising
3. Premises Medical Payment
4. Fire Damage Legal Liability
5. Host Liquor Liability
6. Non-Owned & Hired Auto Liability

NOTE: Other coverages you may need depend on the activities your association engages in and other factors. Possible other coverages include computer policy, umbrella excess liability, building coverage, workers' compensation, convention cancellation, or officers' and directors' liability coverage.

If you decide to obtain insurance, the agency that headquarters uses will be happy to speak with you about coverage.



# INCORPORATION

Recognition as a legal entity which can be sued in its corporate name, in most cases provides a liability shelter against individual financial responsibility for corporate officers and directors. Corporate existence may be perpetual without regard to the life span of the persons who manage the corporation. Administratively, corporate organization provides centralization of control and management: directors determine policy which is implemented by elective or appointed officers. There are advantageous financial, legal, and administrative characteristics of incorporation, however, some successful associations are not incorporated.

The reasons for incorporation in the case of an association are similar to those of other groups. Unincorporated groups for instance, subject their members to the possible risk of personal liability for the activities of the group. The lines of authority and the rights of the members become much cleaner and more certain when incorporated. An unincorporated association is a group of persons acting together for a common purpose without a corporate charter, but pursuant to bylaws which specify the agreement among members and the rules governing the organization.

A professional association must be certain of the legal implications of its organizational form, policies, and activities so that it may properly forecast the effects these factors may have upon its membership. Groups which desire to organize for an isolated purpose, which will require a relatively short period of time to achieve, need not organize as a corporation. If a group does combine for a common purpose, it is generally in the best interests of the participants to incorporate, since future developments may warrant a continuation of group functions. Once incorporated, it is imperative that the organization closely adhere to its by-laws as this practice helps to ensure legal protection for individual members from suits or other actions.

Statutory regulations governing unincorporated associations are generally fragmentary and incomplete; in fact, the majority of statutes concerning unincorporated associations deal with their susceptibility to suit, not with internal organizational affairs. For instance, New Jersey's statute concerning unincorporated associations provides for suits to be brought by or against the association in its recognized name, and for judgments to be obtained against members personally if the organization cannot satisfy a judgment. Adding to the legal uncertainties surrounding unincorporated associations is the question of liability for the acts of its agents.

Professional legal advice should be obtained for all preliminary matters pertaining to incorporation. Typical requirements are:

1. The name of the corporation.
2. The period of duration (usually perpetual).
3. The purpose or purposes for which the corporation is organized.
4. Any provisions, not inconsistent with law, which the incorporators elect to set forth in the articles of incorporation for the regulation of the internal affairs of the corporation, including any provisions for distribution of assets on dissolution or final liquidation:
5. Address of its initial registered office, and the name of its initial registered agent at such address.
6. The number of directors constituting the initial board of directors, and the names and addresses of the persons who are to serve as the initial directors.
7. Name and address of each incorporator.



# Reasons for Incorporating

- Corporate Status as a Legal Entity- In most cases, incorporation provides a liability shelter against individual financial responsibility for corporate officers and directors.
- Corporate existence may be perpetual, as opposed to the life span of an individual. Incorporation gives the organization an entity to continue year after year.
- Incorporation is attractive from both legal and financial aspects.
- Incorporation defines the lines of authority and rights of members more clearly.

## Process and Costs for Incorporating

What is the process for incorporation? An attorney should be retained to provide professional advice and an explanation of the process and requirements.

In addition to the corporate papers and by-laws referenced on the previous page, there are the obvious legal costs associated with seeking incorporation status. These one-time costs are typically about \$1,000. An attorney who practices in this area of the law can provide an actual quote.

Some states may require an annual filing fee once incorporation is obtained. Others do not require such for non-profit organizations.

Once incorporated, with the accompanying by-laws, close adherence to formal procedures contained therein serves as the basis for providing a liability shelter for individuals from possible legal suit. This would include keeping formal minutes of board meetings and the timely filing of corporate tax returns.