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VOLUNTEER PROTECTION ACT OF 1997

by Brad Caftel

Introduction

In recent years, California and many other states have enacted personal liability protection laws for volunteer directors, officers, and others at nonprofit organizations. For the most part, these laws provide limited protection.

Congress has now stepped into this issue by enacting a uniform federal law that also offers limited protection. Volunteer directors and officers of nonprofit organizations in California should not be lulled into a false sense of security by passage of the Volunteer Protection Act of 1997, Public Law 105-19, 42 USC 14501 et seq., which applies to conduct occurring after September 16, 1997.

This article analyzes the new federal law and compares it to the protections provided under California law to directors and officers of nonprofit corporations, tax exempt under Internal Revenue Code Section 501(c)(3).

Understanding the New Federal Law

Definitions

Under the federal law, a volunteer is a director, officer, trustee, or service provider who performs services for a nonprofit organization or governmental entity and does not receive compensation (other than reasonable reimbursement or allowance for expenses) or anything with a value in excess of \$500 per year.

"Nonprofit organization" is defined broadly, and is not limited to organizations tax exempt under Internal Revenue Code Section 501(c)(3). It includes any not-for-profit organization that is organized and conducted for public benefit and operated primarily for charitable, civic, educational, religious, welfare, or health purposes, whether or not tax exempt. Excluded are organizations that practice any action that constitutes a hate crime. A governmental entity includes a state and its political subdivisions.

Available Protection

A volunteer is not liable for harm caused by his or her act or omission on behalf of the organization or entity if:

- (1) at the time of the act or omission, the volunteer was acting within the scope of his or her responsibilities in the organization or entity;
- (2) if appropriate or required, the volunteer was properly licensed, certified, or authorized by the appropriate authorities to undertake the activities or practice in the state;
- (3) the harm was not caused by willful or criminal misconduct, gross negligence, reckless misconduct, or a conscious, flagrant indifference to the rights or safety of the individual harmed; and
- (4) the harm was not caused by the volunteer operating a vehicle for which the state requires the operator or owner to possess an operator's license or maintain insurance.

Limitations on Volunteer Protection

This volunteer protection does not apply when the volunteer's misconduct constitutes a crime of violence, act of international terrorism, or hate crime, or to any misconduct that involves a sexual offense, the violation of a federal or state civil rights law, or intoxication or drug use.

As with many state laws, the federal law provides that a volunteer is not liable for merely negligent acts or omissions, but can be liable for gross negligence. An individual allegedly harmed by a volunteer can still sue the volunteer, claiming gross negligence. Whether or not the volunteer successfully defends the civil lawsuit, the volunteer must pay the cost of his or her defense.

A volunteer found to be liable may have to pay all of the harmed individual's economic losses, whether or not the harm was caused solely by the volunteer, but a volunteer acting within the scope of his or her responsibilities to the organization or entity will be liable for noneconomic losses such as pain and suffering only in proportion to the volunteer's responsibility for the harm.

The federal law does not affect the liability of the organization or entity with respect to harm caused by the volunteer to any person. If the organization or entity is found to be liable for the harm caused by the volunteer, the organization or entity may be able to seek recovery from the volunteer. The federal law does not protect the volunteer from civil lawsuits brought against the volunteer by the organization or entity on whose behalf the volunteer performs services.

Permissible Conditions on Volunteer Protection

The federal law permits a state law to impose one or more of the following conditions on the protection of volunteers:

- (1) The organization or entity must adhere to risk management procedures such as mandatory training of volunteers.
- (2) The organization or entity is made liable for the acts or omissions of its volunteers to the same extent as an employer is liable for the acts or omissions of its employees.
- (3) Volunteers are not protected if a state or local government officer pursuant to state or local law brings a civil lawsuit.
- (4) The organization or entity must provide a financially secure source of recovery for individuals harmed by the volunteer, such as an insurance policy, coverage in a risk pool, equivalent assets, or other arrangements.

Preemption of State Laws

The federal law preempts the laws of any state to the extent such laws are inconsistent with the Act. Not preempted are state laws that provide volunteers with additional protection from liability for services to an organization or entity. Also, a state may enact legislation that elects not to apply the Act to specified civil actions.

The federal law does not permit punitive damage awards against a volunteer acting within the scope of his or her responsibilities to the organization or entity unless it is established by clear and convincing evidence that the harm was directly caused by the volunteer's willful or criminal misconduct, or a conscious, flagrant indifference to the rights or safety of the individual harmed. A federal or state law that further limits punitive damages is not preempted.

Comparison With California Law

In some cases, the federal law slightly expands the protections available in California to volunteer directors and officers of nonprofit corporations, tax exempt under Internal Revenue Code Section 501(c)(3). In other cases, California law provides broader protection. However, the insurance requirements of California law serve to defeat much of the protections available under both federal and California law.

Three separate California Corporations Code sections address the liability of directors and officers of such corporations.

Section 5231

Section 5231 provides that, except for self-dealing or interested director transactions, a director is not liable for failing to discharge the obligations of a director, when performing duties in good faith and in a manner the director believes to be in the best interests of the corporation, and with such care, including reasonable inquiry, as an ordinarily prudent person in a like position would use under similar circumstances. Officers are not specifically protected.

The federal law provides greater protection to volunteer directors than does Section 5231 (and protects volunteer officers), thus preempting Section 5231 if all other requirements of the federal law are met, in the following circumstances:

- (1) The director is negligent and does not meet the standard of care required by Section 5231, but is not grossly negligent, reckless, etc.
- (2) The director is found liable for non-economic losses or punitive damages.

Section 5231 provides greater protection to volunteer directors than does the federal law, and is not preempted, in the following circumstances:

- (1) The director is compensated for services rendered to the corporation, or receives anything with a value in excess of \$500 per year.
- (2) The corporation practices an action that constitutes a hate crime.
- (3) The corporation brings a civil lawsuit against the director, if the director has met the standard of care required by Section 5231.

Section 5047.5

Section 5047.5 provides that a volunteer director or officer is not personally liable to the corporation or third parties for monetary damages from his or her negligent act or omission occurring within the scope of his or her duties as a director or officer, in good faith, in a manner the volunteer believes to be in the corporation's best interests, and in the exercise of his or her policymaking judgment. Exceptions include intentional, wanton, reckless, grossly negligent, fraudulent, oppressive, or malicious acts, and self-dealing and other improper transactions.

Protection under Section 5047.5 is available only if the corporation maintains a general liability insurance policy with at least \$1 million in coverage (\$500,000 for corporations with an annual budget less than \$50,000), and a policy covers the damages caused by the volunteer. A policy, not necessarily the same one, must be in force both at the time of injury and of the claim. The claim against the volunteer must also be makeable against the corporation, so that a policy is applicable to the claim.

The federal law provides greater protection to volunteer directors and officers than does Section 5047.5, thus preempting Section 5047.5 if all other requirements of the federal law are met, in the following circumstances:

- (1) The volunteer receives any thing up to \$500 per year in value, in lieu of compensation.
- (2) The volunteer does not act in good faith, in a manner that the volunteer believes to be in the corporation's best interests, and in the exercise of the volunteer's policymaking judgment, but is not grossly negligent, reckless, etc.
- (3) The corporation unlawfully restricts membership, services, or benefits on the basis of race or other grounds specified in Section 5047.5.
- (4) The volunteer is found liable for non-economic losses or punitive damages.

The general liability insurance requirement of Section 5047.5 is a permissible limitation on the protection of volunteers. Except for the noneconomic losses and punitive damages protections, which apply despite the insurance requirement, the federal law protections are available only if this insurance requirement is met.

However, in most cases, this insurance requirement will not be met, leaving a volunteer director or officer without the protection of either Section 5047.5 or the federal law.

A general liability insurance policy typically does not cover a breach of employment contract claim made by a disgruntled employee, and some policies have a specific exclusion for all employment-related lawsuits. A director's and officer's liability insurance policy might cover these claims, however.

A general liability insurance policy typically does not cover intentional acts, yet such acts are the basis for most lawsuits against volunteers. Due to this exclusion, the policy would not be applicable to the claim and would not cover the damages.

Some claims against a volunteer, such as slander, might not be makeable against the corporation, so a general liability insurance policy would not be applicable to the claim and would not cover the damages.

If the corporation could not pay the policy deductible, or if the policy limits were inadequate to cover the damages, for example, due to attorneys fees or other costs charged against the policy limits, then the policy would not cover the damages.

When the insurance requirement is met, Section 5047.5 provides greater protection to volunteer directors and officers than does the federal law, and is not preempted, in the following circumstances:

- (1) The corporation brings a civil lawsuit against the volunteer, if the volunteer has met the standard of care required by Section 5047.5, except in the case of a self-dealing transaction and certain other improper transactions.
- (2) The corporation practices an action that constitutes a hate crime.

Section 5239

Section 5239 provides that a volunteer director or executive officer is not personally liable to a third party for monetary damages from his or her negligent act or omission in the performance of his or her duties. The act or omission must have been within the scope of his or her duties as a director or officer, performed in good faith, and must not have been reckless, wanton, intentional, or grossly negligent, or involve a self-dealing or other improper transaction.

An executive officer is a president, vice-president, secretary, treasurer, or an individual serving in a similar capacity, who assists in establishing the policy of the corporation. The volunteer could be liable to the corporation if the standards of Section 5231 or 5047.5 are not met.

Protection under Section 5239 is available only if the damages are covered by a liability insurance policy issued to the corporation, either in the form of a general liability or a director's and officer's liability policy, or personally to the volunteer. If damages are not so covered, the corporation and the volunteer must have made all reasonable efforts in good faith to obtain available liability insurance.

For corporations with an annual budget of less than \$25,000, "all reasonable efforts" means making one inquiry per year to purchase a general liability insurance policy with at least \$500,000 in coverage. The insurance need not be purchased if it would cost 5% or more of the corporation's annual budget in the previous year. A first-year corporation with a budget of \$25,000 or less need not purchase insurance.

Regardless of the corporation's budget, the volunteer must make all reasonable efforts in good faith to obtain liability insurance. A volunteer can often purchase applicable coverage as part of a personal liability insurance umbrella policy issued in connection with the volunteer's home or auto insurance.

The federal law provides greater protection to volunteer directors and officers than does Section 5239, thus preempting Section 5239 if all other requirements of the federal law are met, in the following circumstances:

- (1) The volunteer receives any thing up to \$500 per year in value, in lieu of compensation.
- (2) The volunteer does not act in good faith, but is not grossly negligent, reckless, etc.
- (3) The volunteer is an officer but not an executive officer.

(4) The volunteer is found liable for non-economic losses or punitive damages.

The liability insurance requirement of Section 5239 is a permissible limitation on the protection of volunteers. Except for the non-economic losses and punitive damages protections, which apply despite the insurance requirement, the federal law protections are available only if this insurance requirement is met.

However, in many cases, this insurance requirement will not be met, leaving a volunteer director or officer without the protection of either Section 5239 or the federal law.

The above discussion concerning the coverage limitations of insurance policies is applicable here. Usually, the damages caused by the volunteer will not be covered by a general liability insurance policy. A director's and officer's liability policy might cover the damages.

When the damages are not covered by insurance issued to the corporation, they might have been covered had the individual volunteer purchased a personal liability insurance policy. If the volunteer did not do so, the volunteer might not be able to claim that he or she has made all reasonable efforts in good faith to obtain available liability insurance. Section 5239 has no standard for determining whether the cost of the policy is so high that it is reasonable not to purchase it.

When the insurance requirement is met, Section 5239 provides greater protection to volunteer directors and executive officers than does the federal law, and is not preempted, when the corporation practices an action that constitutes a hate crime.

Conclusion

While the addition of the federal law may deter some lawsuits against volunteer directors and officers of California nonprofit corporations, tax exempt under Internal Revenue Code Section 501(c)(3), it still does not prevent them. Directors and officers must still demonstrate in their defense that they have met the required standard of care. The greatest risk to these volunteers is still the cost of defense.

To address this risk, a corporation can indemnify (self-insure) its directors and officers and pay their defense costs, if it has the necessary funds. The corporation can purchase the broadest possible general liability and director's and officer's liability insurance policies, and should consider purchasing a special employers' legal liability policy. A volunteer can supplement the corporation's policies with a personal liability insurance umbrella policy issued in connection with the volunteer's home or auto insurance.

Most of the limited additional volunteer protections of federal law are lost when the insurance requirements of California law are not satisfied. The insurance requirements serve as a trap for unsuspecting volunteer directors and officers. With the addition of this federal law, California should revise its piecemeal system of volunteer protection laws and enact a comprehensive law that promotes volunteer service while protecting the rights of those harmed by the acts or omissions of volunteers.