

Indemnity for office holders of incorporated associations

Legal information for Victorian community organisations

This fact sheet covers:

- ▀ indemnity, and
- ▀ directors' and officers' insurance.

The Associations Incorporation Reform Act 2012 (Vic) (AIR Act) includes a provision that requires every incorporated association to indemnify its office holders for liabilities they incur in good faith while performing their duties.

The indemnity is intended to provide comfort to volunteers acting as office holders within incorporated associations as the association must reimburse them when they incur liabilities in good faith.

All associations should consider the potential impact of the indemnity on their organisation. Groups should consider, among other things, their activities and the types of liabilities their office holders could incur, as well as their financial position and ability to meet the costs of reimbursing office holders for their liabilities covered by the indemnity.

Insurance may be one way to manage the risk created by the indemnity for the association, and could also provide further protection for office holders.

What is the indemnity?

An indemnity is an obligation contained in a document or agreement or legislation whereby a person or organisation has to pay for the penalty or legal fees of another person, if something goes wrong.

Under the AIR Act, every association must 'indemnify' its office holders for liabilities that they incur when carrying out their duties as an officer holder (so long as the liability was incurred in good faith – 'good faith' is discussed further below in this fact sheet). This means all associations must pay back office holders (to the extent the group has assets to cover the liability) when they can show they have incurred a liability that is covered by the indemnity.

NOTE

To be **liable** is to be legally responsible for an action, often meaning you have to pay a fine or some other penalty to another person or body.

The indemnity automatically applies to every Victorian incorporated association (your group does not need to write the indemnity into its rules, it will apply irrespective). The indemnity applies in addition to any indemnity that may be already written into your rules or a policy.

Indemnity and office holders

The indemnity applies to "office holders" of an incorporated association. An office holder is:

- a committee member (board member)
- the secretary (including where the secretary is not on the committee)
- any person (including an employee):
 - that makes or participates in the decision making that affects the whole or substantial part of the association's operations
 - that has the capacity to affect the financial standing of the association, or
 - on whose instructions the committee is accustomed to act (excluding people who are asked to provide professional advice).

FURTHER READING ON LEGAL DUTIES

For more information on the legal duties of office holders see Not-for-profit Law's Duties Guide at www.nfplaw.org.au/governance. It specifically includes information on:

- the duty to act in good faith and for a proper purpose
- the duty to act with reasonable care, skill and diligence
- the duty to not misuse information or position, and
- the duty to disclose and manage conflicts of interest.

The Duties Guide also sets out the consequences of breaches of duties.

Does the indemnity mean we need to take out insurance?

No. While it is now compulsory for all associations to indemnify their office holders, there is no requirement in the legislation to take out insurance.

Associations should consider their potential exposure under the indemnity, and, as part of their overall risk management, consider whether or not specific insurance (for instance, D&O insurance) should be taken out to cover the association's potential liability under the indemnity (discussed below).

If your association is required to pay an office holder under the indemnity, and insurance is not available, the payment would come from the association's own assets (including any cash assets and/or by liquidating assets, if necessary).

When would an association need to make a payment to an office holder under the indemnity?

An incorporated association is required to make a payment under the indemnity where an officer holder in good faith has incurred a liability in the course of carrying out their duties.

What kind of liabilities does the indemnity attach to?

The indemnity will be available where the liability is owed by an office holder to a third party and the liability was incurred by the office holder in good faith in performance of their duties. For instance, in certain situations, a negligence claim brought by a third party against an office holder may be covered by the indemnity.

The indemnity is also likely to apply to protect office holders in situations where an office holder incurs a liability (is legally responsible) because they have been involved in a contravention of legislation (for instance, the Australian Consumer Law legislation or equal opportunity legislation) – so long as the office holder can show they acted in good faith.

What does ‘good faith’ mean?

‘Good faith’ has different meanings in different contexts. Conduct that would normally fail to meet the requirement of good faith includes:

- acting maliciously
- acting prejudicially to the interests of the association
- gross negligence, and
- acting fraudulently.

An office holder who acts honestly, with reasonable care and diligence, and in the interests of the association will be acting in good faith.

RELATED RESOURCES

For more information on ‘good faith’ and how it applies in the context of an office holder’s legal duty to act in good faith and for a proper purpose, read Not-for-profit Law’s Duties Guide at www.nfplaw.org.au/insurance.



Liabilities owed to the association

It is unlikely that the indemnity will apply where an office holder is liable to the association, as opposed to a third party. For instance, an office holder who is found to have breached one of the legal duties set out in the AIR Act and is fined, probably will not be able to make a claim against the association under the indemnity. That is, the office holder in that case will not be able to recover the cost of the fine and/or their legal costs from the association.

What is the risk to the association that the indemnity creates?

The indemnity creates a risk for incorporated associations that they will be required to pay or reimburse office holders under the indemnity at significant expense to the association. Where an office holder incurs a large liability that the indemnity applies to, an association may suffer severe financial difficulties or even insolvency if it has a small asset pool and cannot cover the costs of reimbursing the office holder. This risk can be reduced by ensuring an appropriate level of directors' and officers' liability insurance is in place.

There is also a risk that office holders may assume that because the indemnity is now in force, any risk of personal liability will be fully eliminated by the indemnity. This is not the case. If the assets of the organisation are minimal or of little value and cannot cover the full amount of an office holder's liability, the office holder would be liable for the whole or the remainder of the liability. Also, the indemnity will not be available where a liability is incurred by an office holder other than in the course of performing their duties and/or where they have not acted in good faith.

How can we manage the risks raised by the AIR Act indemnity?

The risks can be managed by educating office holders about the law so that the likelihood they incur a liability is reduced. If office holders incur liabilities while performing their duties, directors' and officers' liability insurance may provide protection against their legal liability, including damages and legal costs, for wrongful acts. These policies may also include a reimbursement component which reimburses an association for amounts that it is required to pay to its office holders under the AIR indemnity (and may also cover costs of any other indemnities an association may have provided to its office holders).

RELATED RESOURCES

Further information about insurance to manage the risk created by the indemnity can be found in Not-for-profit Law's Risk Management and Insurance Guide at www.nfplaw.org.au/insurance.

What is directors' and officers' insurance (D&O insurance)?

An association (or individual committee members) may elect to take out directors' and officers' (D&O) insurance to provide some protection for committee members.

D&O is designed to protect an association's committee members against legal action. Some D&O policies will also reimburse an association where it has indemnified its committee members. D&O policies generally cover nominated committee members against liability for 'wrongful acts' committed in the course of their office. 'Wrongful acts' may include breaches of duty, neglect, misstatement, incompetence or other acts or omissions as set out in the insurance policy.

It is important to understand the limitations of D&O insurance. In general D&O policies will not cover committee members for dishonest or fraudulent actions, insolvent trading or a wilful breach of duty or a contravention of the duty not to misuse position or information.

Unless the the association's constitution or governing rules require the association to maintain D&O insurance on behalf of its directors and officers, an association is not required to take out D&O Insurance. However, for the reasons outlined above, it may be a good idea to have such insurance in place.

Questions to consider when taking out D&O insurance

If your association is considering D&O insurance, it is important to consider the following questions:

- who should be covered by D&O insurance?
- what is the appropriate policy to take out to suit your association's needs?
- is the scope of coverage appropriate for your association's needs?

A D&O insurance policy must be carefully negotiated to ensure that the appropriate level and breadth of coverage is obtained to suit the needs of your association. For example, current office holders and future office holders are usually covered under a typical D&O policy but some policies may also cover people who make or participate in decision making that affects the whole or substantial part of the association's operations.

In addition, it may be necessary to obtain a D&O policy that covers past office holders. Optional cover may be available to extend coverage to retired office holders in respect of past acts. If that is not available, a separate stand alone run-off insurance policy may be available for purchase to cover retired office holders.

The most common type of D&O policy is a "claims made" policy, where all claims or any circumstances that may give rise to a claim must be notified to the insurer during the insurance period. It is important under "claims made" policies that the association did not have knowledge of any fact, situation or circumstance that could have lead to a claim before the start of the insurance period.

There are a number of exclusions which are regularly seen in D&O policies which can include:

- claims arising from breaches of statutory obligations such as environmental or occupational health and safety regulations
- claims alleging dishonesty or fraud (usually only applicable when there is an actual finding of dishonesty against a director), or
- non-disclosure exclusion.

Any exclusion needs to be carefully reviewed and negotiated at the time of entering into the policy to ensure your association is appropriately covered.

What if we already indemnify our officer holders or committee members?

Some associations may already have an indemnity for office holders or committee members in their rules or in a separate policy or document. This can be confusing, as for these organisations, there are

now two sources of indemnity obligations. These organisations need to remember that regardless of the indemnity in their rules, the AIR Act indemnity applies as well.

Some issues to consider are:

- do the indemnities cover the same kinds of liabilities?
- does the AIR Act indemnity apply to more people in your organisation than the indemnity that you already have (because it extends to all office holders, not just committee members)?, and
- should the association's rules or policy be amended to bring them into line with the indemnity in the legislation?

TIP

Organisations that already have an indemnity should compare the indemnity they provide with the AIR Act indemnity. The AIR Act indemnity could be narrower or broader than your existing indemnity. Organisations with a narrower indemnity than the AIR Act indemnity should talk to their insurer about whether their insurance covers the Act indemnity as well as their rules indemnity.



What questions should we be asking our broker or insurer?

If you already have a policy that may apply to cover costs related to the indemnity, you should check with your insurer about the scope of the policy, and confirm that it covers the AIR indemnity. You may need to increase the scope of your insurance coverage.

If you are looking at insurance for the first time, it is important to ask the broker or insurer the scope of the coverage of the policy, and read Not-for-profit Law's Insurance and Risk Management for Community Organisations Guide at www.nfplaw.org.au/insurance.

The types of wrongful acts that may be covered by D&O insurance include negligently giving the wrong advice, requesting someone to perform a dangerous task, dismissing staff without following due process and misleading or deceiving the public in some way. It is important to note that most D&O policies will not cover acts that are outside the scope of the office holder's duties such as criminal or fraudulent acts (although usually only applicable when there is an actual finding of dishonesty against a director).

Resources

Related Not-for-profit Law Resources

The Not-for-profit Law Information Hub (www.nfplaw.org.au) has more resources on the following topics:

- ✔ Insurance and risk – www.nfplaw.org.au/riskinsurance
- ✔ Governance – www.nfplaw.org.au/governance
- ✔ Employees and volunteers – www.nfplaw.org.au/people

Legislation

- ✔ [*Associations Incorporation Reforms Act 2012 \(Vic\)*](#)

This legislation includes an indemnity provision for incorporated associations (see section 87 of the Act).

A Not-for-profit Law Information Hub resource. Access more resources at www.nfplaw.org.au

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