



## INSURANCE FOCUS

### DIRECTORS AND OFFICERS INSURANCE

More and more community associations are finding that insurance for directors and officers is a necessity. Board members and other volunteers can be held personally liable for decisions and actions made on behalf of their associations.

Directors and Officers (D&O) Liability insurance provides important coverage and financial protection for those individuals in community associations who are willing to take on the often thankless positions of volunteer directors and officers. It also can protect employees, committee members, and other volunteers. The need for D&O insurance is great, particularly considering the willingness of people to bring a lawsuit over almost anything.

#### Why insure directors and officers?

As the name implies, D&O Liability insurance is designed especially for those situations in which directors and officers are held personally responsible for decisions and actions made on behalf of their association. This is often the result of allegations of a breach of fiduciary responsibility on the part of the board in the management (or mismanagement) of common funds or policies.

Simply put, board members should not risk their personal assets to serve as volunteer directors or officers.

D&O insurance can provide insurance protection against allegations such as mismanagement of common funds or policies, discrimination, sexual harassment, or wrongful termination of employees. D&O insurance can provide coverage for damages (awards and settlements) and the defense costs resulting from allegations of wrongful acts.

#### What should board members know?

Directors and officers of community associations are usually elected by the association membership, or appointed if a vacancy occurs before the next election. Ideally, board members should be knowledgeable about the statutes and covenants of their association. They should be familiar with procedures related to the following fiscal responsibilities:

- collection of fees,
- personnel matters,
- employment and termination policies, and
- maintenance of buildings and common areas.



They should also have a clear understanding of rules governing parking, use of common rooms and areas, and any recorded documents that exist.

Perhaps most important of all, directors and officers should take the time to review all association insurance coverage with their

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association's insurance representative. This, obviously, is the time to find out whether the association carries D&O insurance and if the scope of the coverage is sufficient.

### What does D&O protect against?

Board members of non-profit organizations may be viewed as having the same liabilities as board members of corporations. These board members are responsible for decisions if they turn out to be ill-advised or improperly carried out.

Although the "business judgment rule," which protects board members acting in good faith and without corrupt motives and who use reasonable care and act within the scope of their duties, is usually upheld by the courts, numerous decisions have eroded this rule. Even if upheld by the courts, legal cost to defend an action can be huge.

Some of the complaints brought against directors and officers of community associations include the following:

- acts in bad faith,
- breach of loyalty,
- conflict of interest,
- defamation of character,
- failure to collect assessments,
- failure to maintain property and common areas,
- failure to obtain competitive bids,
- failure to properly fund reserves,
- improper payments,
- libel,
- misleading representation,
- mismanagement of funds,

- poor judgment in the conduct of association affairs,
- slander,
- waste of association's assets,
- wrongful termination/discrimination, and
- wrongfully filed lien.

The general category of gross negligence is often cited as another complaint. The legal costs of defending against any of these charges can be staggering. Defense costs for such claims can easily be \$100,000 or more. Some states have enacted legislation permitting non-profit organizations to limit the liability of their directors and officers, but such statutes have not necessarily been tested by the court system.

### Are all directors and officers, past and present, included in the coverage?

D&O policies are predominantly written on a claims made basis. The claims made approach provides that claims made during the policy period are covered regardless of when the act giving rise to the claim occurred, assuming the insured party had no knowledge nor could have reasonably foreseen any circumstances that might result in a claim or suit prior to inception of the policy.

Unfortunately, many policies may exclude or limit coverage for previous directors and officers and prior acts. Beware of any D&O policy that is subject to a retroactive date or has an exclusion for prior directors and prior acts.

### What is a participation clause?

Most policies contain a deductible. Many of the policies provide that after the deductible, the association must participate in a specified percentage of the loss payment. With court costs running into thousands of dollars, this clause can have a major impact on association finances. Think twice about any policy that contains a participation clause.

### Are claims alleging discrimination or wrongful termination of employees covered?

Coverage for claims alleging discrimination and employment practices liability are often excluded. Check the policy to make sure discrimination and wrongful termination of employees, including both indemnification and defense costs associated with such a suit or complaint, are included.





### Who is covered?

The D&O policy should provide coverage for the following:

- the association,
- all past, present, and future directors, officers, and board members, whether duly elected or appointed,
- committee members,
- association employees,
- any unit owner acting at the direction of the board of directors in a volunteer capacity, and
- developers on the board of directors.

### Are managing agents covered?

A managing agent's rider is available to extend D&O insurance to independent management agents. Although most community associations are protected under D&O insurance, the managing agent typically is not. In more and more cases, both the association and the managing agent are named as defendants in lawsuits.

The association may have ultimate responsibility for the managing agent's costs. In fact, many management agreements state that if the managing agent is sued, the association must assume defense and indemnity costs.

As an example, New York City-based Orsid Realty was sued because a

managing agent rearranged a building employee's schedule, requiring him to work Sundays. The employee claimed his religion required him to be in church that day, so he sued the manager and the building on the grounds of "religious discrimination."

The community association and its board members were covered by D&O insurance, but the independent managing agent was not. The association won the case but paid \$4,500 in legal fees incurred to defend the managing agent. A managing agent's rider could have covered the legal fees in this case.

The average defense costs for D&O claims are in excess of \$100,000.

### Does the policy provide coverage for non-monetary damages?

Non-monetary damage claims occur when a suit or other cause of action against the board of directors is brought for other than money damages.

### What are the standard exclusions?

Generally illegal or dishonest acts, willful misconduct, a knowing violation of the criminal law or any act committed with willful and malicious intent to cause harm are common exclusions, although policies differ in this regard.

### What's the bottom line?

Serving as a board or committee member in a community association can be a rewarding experience but can also have far-reaching consequences. Frequently it is difficult to find individuals willing to give their time and energy only to have the added worry of possible legal action. By providing the reassurance that comes from a thoughtfully written D&O policy, a community association will continue to attract qualified volunteer board and committee members.

Check with both legal counsel and your insurance representative to be sure your coverage in this critical area is appropriate. If you have any questions or need further information, please contact Steve Dickerson (703-205-8788 or Steve.Dickerson@usi.biz) or Theresa Melson (703-205-8753 or Theresa.Melson@usi.biz).

(Ask the Expert—continued from page 4)

### So, if I am an insured, and I have a broad D&O policy and I am sued for a wrongful act committed during the policy period, am I covered for the loss?

This depends on the exclusions. Standard D&O exclusions include bodily injury/property damage, pollution, illegal or dishonest acts, willful misconduct, or having knowledge of a past situation or occurrences that may give rise to a claim.

It is said that the D&O policy is considered the most important insurance coverage a community association can purchase. Unfortunately, it is probably the most misunderstood. The majority of the D&O policies available on the market are inadequate. Many of the exposures outlined above would be excluded under most D&O policies. If you find your D&O policy falls short on any one of these items, you should speak to your insurance agent about obtaining a quote for a more comprehensive policy.



“Ask the Expert” is a regular column in *Insurance Focus*, featuring information from an expert about an important insurance issue facing community associations. This month our expert is Kevin Davis of Kevin Davis Insurance Services. He has more than 25 years of experience in the area of D&O insurance for community associations.

**Case #1**

The condominium board terminated the contract with its former property manager, on the basis that the manager was not performing his duties in an appropriate fashion. The property manager claims the board failed to give him timely notice and hence the contract renewed. The insured has declined to pay any additional sums allegedly due under the contract. The manager filed suit alleging breach of contract.

**Case #2**

A former board member filed suit alleging that the current board passed amendments to the bylaws intended to keep him from ever serving on the board again. The board member claims that the amendments, one of which was that no person without a four-year degree can serve as a board member, create two classes of stockholders—those with degrees and those without. The former board member believes he is being singled out because he’s Hispanic and sued for discrimination.

**Case #3**

A unit owner decides to challenge the validity of the covenants, conditions, and restrictions adopted by the insured association dating back to the 1930s. He alleges the association was improperly formed and therefore has no authority to assess or enter liens against association members. The complaint seeks a declaratory judgment that the association was illegally formed and not a valid association.

**What do all of these incidents have in common?**

1. They all resulted in Directors and Officers Liability claims;
2. Each claim resulted in over \$50,000 in defense costs; and
3. Most D&O policies would deny coverage on all three claims.

A Directors & Officers Liability insurance policy protects the insured against a claim for a wrongful act made against it during the policy period. It is designed especially for those situations in which directors and officers are held responsible for decisions and actions made on behalf of their association.

**What about past, present, and future directors and officers? Are they included in the coverage?**

Most D&O policies provide coverage for duly elected or appointed directors or officers, and coverage does not extend to the past board members. Unfortunately, claims against past board members are common.

**Does this mean that claims alleging discrimination or wrongful termination of employees are covered?**

Coverage for claims alleging discrimination and employment practices liability should not be excluded from this coverage.

(continued on page 3)