Exercise Caution When Placing Directors and Officers Coverage

By Timothy Cline, CIRMS, Timothy Cline Insurance Agency, Inc.

Entering into an agreement to manage a community association nearly always results in the manager incurring vicarious liability for the board's actions or failure to act. Vicarious liability is a legal doctrine that assigns liability for an injury to a person who did not cause the injury but who has a particular legal relationship to the person who did act negligently. The community manager is a professional who is providing advice and counsel to a volunteer, non-compensated board of directors, so it isn't particularly surprising that the plaintiff's attorneys always choose to name both the board of directors and community manager in nearly every lawsuit. The management agreement typically requires the association to indemnify and hold the community manager harmless except in cases of gross negligence or willful misconduct. Community association boards rely on insurance to help fund this obligation, but will insurance always protect the manager?

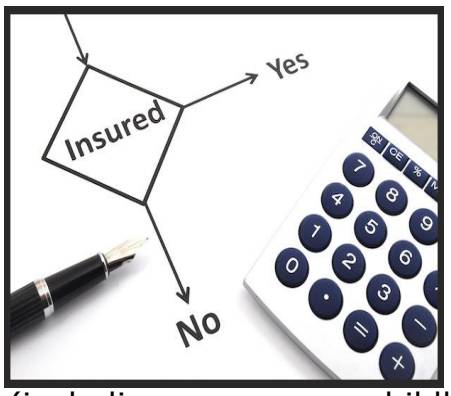
The standard Insurance Services Office's (ISO) general liability policy form automatically recognizes "any person (other than an employee or volunteer) or any organization while acting as the named insured's real estate manager." This portion of the general liability policy is designed to protect the association, the board of directors and the real estate manager for sums they are legally obligated to pay as a result of bodily injury or property damage.

What about allegations of a wrongful act, error or omission that didn't result in bodily injury or property damage? What about allegations of discrimination? Is there the

same sort of automatic extension of coverage for the community manager under the Directors and Officers Liability coverage?

Not all D&O policies extend to the management agent: Directors and Officers Liability coverage that is simply endorsed to, or embedded in, the fire/liability Master Policy are commonly very bare bones forms that provide an extremely narrow definition of "insured" and nearly always omit the community manager. Yes, this approach is affordable (often $250 to $300 per year), but this "penny wise, pound foolish" approach leaves the community association to self-fund the manager's defense and indemnity expenses, costing the association tens of thousands of dollars.

Bare Bones D&O policies lack coverage for Non-Monetary claims:
When D&O coverage is provided by endorsement to the fire/liability Master Policy, it typically excludes coverage for "anything other than money damages." That is fine if a plaintiff is simply seeking money damages but the vast majority of claims we're seeing submitted by community association boards are for non-money damages. Lawsuits over the failure to enforce a provision in the CC&Rs, failure to enforce the architectural guidelines, challenges to elections, and view obstruction disputes are all circumstances where the claimant is not seeking a monetary award. Instead, they simply want something rectified or set-straight. These "non-money" claims can be very expensive for the Association to defend. The best stand-alone D&O policies cover both monetary and non-monetary complaints.



An inexpensive D&O policy likely provides no coverage for Discrimination claims: Both the board and the community manager can inadvertently find themselves in the cross-hairs of a complaint filed with the Department of Fair Employment and Housing (DFEH). Under California law, it is unlawful to discriminate against a person or harass a person because of the person's race, color, religion, sex (including pregnancy, childbirth or medical conditions related to them, as well as gender and perception of gender), sexual orientation, marital status, national origin, ancestry, familial status, source of income, or disability. While the broader, stand-alone D&O policies respond to DFEH complaints, the bare-bones D&O endorsements indicate their coverage does not apply to "violation of any federal or state civil rights law or local ordinance, including but not limited to discrimination on account of race, religion, sex or age." For an example of the application of such an exclusion refer to the 2012 United States District Court case *Forest Meadows Owners Association v. State Farm General.*

Community managers may have the most at stake: Board members in common interest developments have the benefit of several immunity protections. In addition to indemnification and "hold harmless" language contained in most CC&Rs, there is Civil Code §5800 ("Limitation of Officer and Director Liability"), and protections afforded by the Business Judgment Rule (Corporations Code §7231). Despite the tremendous exposure, a surprising number of community managers fail to maintain their own Errors and Omissions (E&O) coverage and must rely solely on successfully enforcing the indemnification and "hold harmless" language in their management contract (and hope the Association has purchased a policy to extend to the management agent).

Managers should take the lead. In this litigious environment, community managers must take a more active role in the D&O placement for the communities they manage to ensure not only that they are protected, but afforded the broadest coverage possible. Sometimes when you pay less, you get less. In the case of some D&O policies you might pay less, and get nothing.

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