McGowan Insurance Agent Resource Newsletter

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Here at McGowan Program Administrators, we stay intimately involved in the community association industry. Our insurance professionals spend the time and energy to ensure our products and resources are state of the art. The ins and outs of community association insurance can be tricky at times. We feel it is our responsibility to make sure you and your clients understand exactly what is being covered and why.

Many agents and insured's feel an Insured v. Insured Exclusion on their D&O policy leaves a negative mark. Based on our extensive experience in the community association industry, we believe it is in the best interest of the association to have this protection.

The board acts and should conduct its board business solely and completely as a single body. In the board room, they can debate, challenge, discuss, argue and deliberate. At the end, each member whether they are at their first meeting, or if they have been president for 25 years has one vote. When the vote is made, the majority wins and the entire body in theory is required to support the decision of the board once they exit the meeting whether they like it or not. Although it may shock you, some members will leave the board and immediately breach their duty of care and loyalty and go against the decision, share confidential information about something said in an executive meeting or something else such as enter into a contract which they have the apparent authority to do as a board member. The board will ask the individual to not do or undo something they were not supposed to do, or get out of a contract they entered contrary to a board decision. If the rogue board member refuses, the majority board members on behalf of the entity may have to bring a claim or file an action against that rogue board member. Since the rogue board is a "board member", if you do not have this entity v. insured exclusion, the D&O carrier will probably have to defend the rogue board member in an action by the rest of the board on behalf of the Insured Organization. Does the board want to finance this rogue board members defense with the association's D&O policy?

If there is no Insured v. Insured exclusion as was the case with the Chubb policy up until recently, the carrier could find itself on both sides of the case, especially if the rogue board member cross complains against the rest of the board members. Also, we found that board members would say to us: "why is the carrier funding that board member's defense"?

Attached you will find an article written by Joel W. Meskin, Esq., CIRMS, entitled *Insured V. Insured Exclusion – What Is It All About in the Community Association's Directors and Officers Policy.* This article goes into further detail of why this exclusion is more beneficial than people often first believe.

As usual, we urge to pass this information and article along to others in the community association industry. Do not hesitate to contact us with any questions or concerns that may arise. We are ALWAYS here to help!!

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Insured v. Insured Exclusion

What is it all About in the Community Association's Directors and Officers Policy

by Joel W. Meskin, Esq., CIRMS ◆ Featured in *Community Interests*, May 2009

The directors & officers policy is a critical piece of the community association insurance puzzle. The community association world included condos, homeowner associations, time-shares and other entities. These entities have two items in common.

- Membership is based on real property ownership – a condo unit, a single family home, a timeshare interval or a similar "individual property interest."
- The second element in the equation is that these individual members have a "common interest" with the other members of the association – the common areas, pools, other amenities and the common conditions, covenants and restrictions on the individual and common property.

Due to the nature of these associations and the shared common interest, they require a method to manage the common interests. In the normal course, this management is done by a group of volunteers. This group of volunteers is normally a board of directors elected or appointed pursuant to the association's by-laws to manage the association. The board is authorized pursuant to the association governing documents to do what is necessary to manage the common interests. These board members are required to use their "business judgment" to manage. As shocking as it may be, the boards are often challenged for their decisions. In order to encourage individuals to volunteer for these positions, the association needs to obtain directors and officers insurance to protect them when their decisions are challenged.

As with any insurance policy, the directors and officers policies have certain exclusions. One of the key exclusions found in a directors' and officers' policy is what is referred to as "Insured v. Insured" exclusion. Contrary to most perceptions of insurance consumers, exclusions are not randomly inserted in a policy. Rather, exclusions are inserted so as to eliminate risks that may otherwise make a policy unaffordable to consumers and to avoid risks that were not intended to be included in a policy for public policy type reasons. In the directors and officers policy, a historical issue that led to the inclusion of the "insured v. insured" exclusion was "collusion."

Insured Versus Insured Examples

Claim Scenario	Insured v. Insured	Entity v. Insured
One current board member sues a second current board member to require that the second board member agree not to vote on a bid repair contract being bid by the second board member's brother-in-law.	No coverage.	Coverage.
The association brings an action against a board member who without authorization has sent out a notice of assessment for a project that the board member wants, but the entire board did not authorize.	No coverage.	No coverage (entity versus the insured).
The association brings a breach of contract action against the Management company for breach of the management agreement.	No coverage.	No coverage for the manager as the claim is brought against an insured by the entity.
The management company brings a claim against the association for breach of management agreement.	No coverage.	Coverage (as long as the association has defense of breach of third party contracts).
Association brings a claim against a former board member to recover all the association's books and documents.	No coverage.	No coverage for the former board member since the action is by the entity.
One board member brings a claim by another board member claiming that they were defamed in an e-mail sent out to the entire association.	No coverage.	Coverage (assuming there is coverage for personal injury offenses).
Current board president brings action against the immediately prior board president regarding his decision to assign himself prime parking spots before he exited the board.	No coverage.	Coverage.
Immediate past board president sues the new board president challenging the election.	No coverage.	Coverage.

This exclusion originated in the for-profit directors and officers policies and was carried over into the community association context as the policy was created.

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The typical situation that motivated this exclusion was where a board of directors made a decision that the board itself realized was in hindsight a bad decision and as a result there was some form of loss to the association. As a result, the board itself decided to sue it or one another to trigger the directors and officers insurance policy to pay for this mistake (otherwise defined in the policy as a "wrongful" act). The intent of the policy was to defend or indemnity the board when the board's decision was challenged by others and not to protect the board from its own identified wrongful acts. In the insurance world, this would lead to what is otherwise known as a "moral hazard." Similarly, the policy does not contemplate actions by the entity itself against the directors and officers for imprudent decisions or unexpected consequences of everyday decisions.

In the community association context, these concerns do exist, but generally the decisions being made are not of the same financial consequences as with for profit or public corporations. Challenges to the community associations are not generally of the collusive type, but rather genuine challenges by association members or third parties. There are two general types of "insured b. insured" exclusions found in the community association context. One is what we characterize as pure "insured v. insured" exclusion and the second is a hybrid exclusion often referred to as "entity v. entity" exclusion.

The first example below is an insured v. insured exclusion where, for all intents and purpose, any action between two "insureds" as defined in the policy would not be covered.

The Company shall not be liable to make payment for Loss or Defense Costs (except where otherwise noted) in connection with any Claim made against the Insured arising out of, directly or indirectly resulting from or in consequence of, or in any way involving any Claim by, at the behest of, or on behalf of the Organization and/or any Individual Insured; provided that this Exclusion shall not apply to:

(1) *Any derivative action on behalf of, or in the name or right of the Organization, if such action is brought and maintained totally independent of, and without solicitation, assistance, participation or intervention or any of the Insureds; or*

(2) *A Claim that is brought and maintained by or on behalf of any Individual Insured for contribution or indemnity which is part of, or results directly from a Claim which is otherwise covered by the terms of this Policy*

The second example is more of a hybrid exclusion where it is more limited to actions by the "Organization" or "Entity" against other insureds, but does not limit actions between "Individual Insureds."

The Insurer shall not be liable to make any payment for Loss in connection with a Claim made against any of the Insureds brought or maintained by or on behalf of the Insured Organization, expect a Claim that is brought and maintained totally and independently of, and totally without the solicitation, assistance, participation, or intervention of any officer, director or trustee of the Insured Organization.

The second example of exclusion is truly focused on addressing the historical intent of the "insured v. insured" exclusion by preventing the concerns of collusion and the concern or moral hazards where the insured is attempting to create a warranty against its poor or imprudent business decisions. The coverage is to protect the board not "from itself" but from non-insureds. This is similar to the exclusions on a homeowner policy where the "family members" cannot recover under the homeowner's policy by suing one of its other family members. Specifically, while a son can sue his parents when he injures himself by slipping on the front steps, the parents will not be covered for this loss under their homeowners policy. The logic should be clear here as it clearly avoids collusion (not that any insureds would ever consider insurance fraud).

The issue that has to be addressed is whether these exclusions are good for community associations. At first glance, insured do and should want as broad an insurance policy as possible. On the other hand, insureds, including community associations, want and should want affordable coverage while obtaining broad coverage. The key is a basic cost benefit analysis. Let's say that all insured v. insured exclusions are removed from the policy. The benefit seems at first glance to be a no-brainer – isn't it always good to remove exclusions? Let's look at some of the "costs" in the cost/benefit equation:

- Removing the exclusion will make the policy more susceptible to claims which will impact the coverage in general as additional claims are covered and premiums are increased.
- Does the association want to provide the renegade board member with coverage when the association determines it is necessary to bring an action against him or her to prevent him or her from doing something that the remainder of the board determines is not in the best interest of the association? This would include creating a litigation war chest for that board member of the community manager when the association sues either.

- Does the association want to cover in-fighting between board members? Are these disputes in the best interest of the community association to pay for board members from being able to handle their duties and obligations?

In the community association context, many carriers have gone with the second type of exclusion which precludes the actions that fall within "collusive" nature where the board is suing itself, but not limiting the actions between individual insureds, because these really have not be a chronic issue, but which protect board members when that renegade board member sues another board member who is doing what he or she believes is in the best interest of the community association.

In conclusion, the "Insured v. Insured" exclusion is not a random addition to the policy, but in the community association context, hybrid exclusion has been developed in many policies to protect the ultimate issues and concerns from an actuarial standpoint.

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