The Attorney Audit of the Community Association Insurance Puzzle

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You are sitting there surrounded by a couple of octogenarian retirees in Bermuda shorts and black shoes and socks, one a former life insurance agent and another a retired Chicago attorney. Also around the table is a mother with her nine month old fusing in her lap, a middle aged couple in matching sweat suits and a nice looking young man in a suit. You pinch yourself and yes it is true, you are sitting in the Bay View Condo Association club house in front of the association's new board of directors. You have been asked as the association's counsel to attend the board meeting to review and discuss the association's insurance program.

Apparently, the condo insurance has been handled by the prior board president's son-in-law who is AllFarm agent, a captive agent of an insurance company. The son-in-law specialized in homeowners insurance, auto insurance and life insurance. The board is not confident that the insurance program is appropriate for all their exposures. The good news for the condo is that it was not impacted by the most recent hurricane, it has had no claims and the cost of the insurance has been quite inexpensive. You immediately recall the comment you heard at a recent errors and omissions seminar where the speaker put up the slide that stated: "ignorance is bliss until there is a claim."

Why does an attorney for the community association need to understand the client's insurance program. Two of the key reasons are (1) clients are budget driven entities that do not in the normal course budget for nor anticipate litigation and (2) a significant element of the board's fiduciary obligation is the purchase of insurance needed to protect the association's greatest assets, the common elements Accordingly, when an association is presented with a loss or claim, or facts or circumstances that could reasonably give rise to a claim, or loss they will look to is its counsel for direction. As a result, it is imperative for the counsel to know what is covered, which policy is applicable, when must a claim be made and how must a claim be made. This knowledge will help maximize coverage and minimize out of pocket expense to the client. Failure of counsel to be knowledgeable of the client's insurance product could negatively and irreparably impact the client and could even lead to professional negligence.

THE COMMUNITY ASSOCIATION:
The Convergence of Individual and Common Interests
Counsel's first obligation is to understand the community association risk. Condominium and homeowner's associations are legal entities similar to other commercial risks. However, these risks also have their own unique elements. The community association is unique, because it is entails a group of individual members, many unsophisticated, with their own "individual separate" legal interests while sharing "common" legal interests with the other members of the association. The common interest can be as simple as a set of paint color guidelines for a group of 20 homes to a complex set of conditions, covenants and restrictions for a 20 story 200 unit high rise with multiple shared amenities.

Notwithstanding the multiple manifestations that the common interest development may take, theses entities have an identifiable common denominator.

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[1]Depending on the jurisdiction, the common interest development may be operative by virtue of an enabling statute other than a corporate status such as a real estate trust or other condominium statute.
[2]In California they have the well known Davis Sterling Act.

These are legal entities that are normally set up as a Not-For-Profit corporation. These legal entities most often have "articles of corporation" (legal formality)[1], "by-laws" (the operating manual) and "covenants, conditions and restrictions" (the association rules). Since these are legal entities, they do not operate on their own so they need a management team which is normally the board of directors. The by-laws dictate who manages and how they manage. The CC&Rs are the rules the board enforces. In theory, when an "individual" chooses to move into a specific community association, they agree to comply with these governing documents.

These governing documents and the management of a community association are not absolute. For example, in Florida, as in most other states[2], there are state laws and regulations that supplement the association's governing documents. What many association boards do not realize is that they may follow the association's governing documents to the letter and intent of the rules, but if they are contrary to the state laws and regulations, the best of intentions are insufficient. The board will be presumed to know the law. In Florida, these rules can be found in: 2000 Florida Statutes, Title XL Real and Personal Property; Chapter 718 Condominiums; 719 Cooperative; 720 HOAs.

Tip: Why should an association's legal counsel be concerned with these issues? Like the association board, the legal counsel will be presumed to know what the association's governing documents and the state laws say, or don't say with respect to insurance requirements.

THE INSURANCE PUZZLE: Where do you Begin?

Existing Program: The place to begin is to understand the scope of the community association that you are counseling. The natural place to start is with the existing insurance products and program in place. However, this is only the "start." Counsel should never assume that what the client has in place is adequate. That is part of putting the puzzle together, but it is not the end of the process. The best tool counsel could have is a community association insurance specialist to assist in a review.

Governing Documents and Statutory Requirements: The second step after reviewing the risk and the existing program is to review the association's governing documents to identify the insurance requirements. Once you understand what thedocuments require, do not be lulled into a false sense of security. As many of us know, governing documents were very often created by a developer years if not decades ago. They may be outdated from a legal compliance standpoint and they may not make sense for the specific association, especially if they were cookie cutter documents. Once you make sure you understand the requirements of the governing documents and if those requirements make sense, you must determine if they comply with state requirements. Although the association may feel comfortable with the adage that ignorance is bliss, as a professional this is not a defense.

Experts: At this point, if you do not have experience in the area of community association insurance, this

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[3]The author wants to make it clear that he has no financial interest in any reserve study company.

[4]The common interest development can include many variations including cooperatives, timeshare or interval ownership associations, commercial condominiums, condo hotels, master associations, mixed use developments where membership in the not for profit entity is premised on real property ownership.

[5]The master policy is normally the name given to the policy covering all the common interests of the association.

[6]It should go without saying that notwithstanding the governing documents, counsel should confirm that the governing documents are not contrary to any statutory requirements.

is the time you become an expert, seek a community association insurance professional, a community association legal professional and join the corresponding industry trade groups that will give you the resources you need. It is never too late to master a niche. It is estimated that there are approximately 310,000 community associations in the United States and despite the economy the number is growing.

The Puzzle Pieces: The community association whether a condominium or a single family homeowner association has a general common denominator forming the basis of the insurance puzzle. On the one hand, the association is a general commercial risk. On the other hand, the community association has the overlay of members with individual legal interests separate from the common interests.

THE INSURANCE PUZZLE: Analyzing the Pieces

Step One – The Property Exposure
In a perfect world, the rainbow leading to the pot of gold in analyzing the property exposure for a community association is an existing current Reserve Study.[3] Probably one of the most important tools for a community association is a reserve study. This will identify the association's physical exposures, the condition of the exposures and the life of the elements within the scope of the study. This tool enables the association management team, normally the board of directors and the community manager, to properly maintain the association's physical and real property assets. This in turn will obviate many of the other potential issues that can arise amongst the individual association members.

Tip: If an association does not have a study, or has one that is outdated, the best advice you can provide is to recommend that the association obtain one.

The next step in analyzing the property exposure depends whether it is a Condominium where the individual association members share the dwelling in common or whether it is a single family homeowner's association.[4] This again is where the association's governing document becomes critical. For a condominium, this step includes the determination of the extent that the association's governing documents require the "master policy"[5] to provide coverage.[6] This is generally broken down into four different options.

Bare Walls – the association is only responsible up to the inside of the drywall
Single Entity – the association is responsible for betterments and improvements as set forth in the original built plans
All In – the association is responsible for the unit owners betterments and improvements
Silent – the governing documents have no express requirement
The key to understanding the extent that the master policy must provide coverage leads to advising the association as to what it may recommend that the individual unit owners should carry in their policies, especially with respect to improvements and betterments coverage.

The property puzzle also includes the following items that tend to be issues in many community associations:

Property Value: appraisals.
One issue to keep in mind is that associations hear what they want to hear when it comes to property value as the lower the appraised value the lower the cost of property coverage.
The related issue is that if at the time of loss if the appraised value is not accurate, it could have an impact on the recovery for loss, including the possibility of co-insurance penalties for not maintaining a certain level of insurance to the appraised value.

Replacement Coverage: actual cash value, full replacement cost or guaranteed replacement cost.
Building Ordinance: critical for older buildings.
Loss of Use or extra expense coverage.
Flood, Windstorm, and Earthquake.
Boiler/Machinery: mechanical breakdown
All Risk: broad form, basic form.
Out buildings.

Step Two – General Liability Insurance
The general liability policy is well known to most counsel as one of its key indirect benefits is that it is the life blood of many attorney's and their law firms and it is the basis for providing associations with defense to claims brought against it for potential liability. However, we should not let ourselves be lulled into a false sense of security where a little bit of knowledge could be dangerous. The community association has some clear although not complicated issues. Again, we need to look to the governing documents for any express requirements, and compare them to any statutory requirements.

Definition of Insured: Very often, there are programs that offer general liability coverage that is quite competitive. What must be first do is make sure we have an adequate definition of insured. One caveat is to make sure that the definition of Insured does include the real estate manager as does the ISO form. As many of these associations are in fact managed by a community manager and since most of the associations agree to "indemnify" the managers, this is a critical issue to be confirmed. It is also important to make sure that the definition of "insured" will also extend to "volunteers" who should include directors and officers, committee member and other volunteers providing services to the association pursuant to the authority of the board of directors.

Personal Injury coverage: Another key issue under the general liability coverage is the existence of personal injury coverage. Anyone who lives in the world of community associations know that the issues of defamation, invasion of privacy and wrongful eviction offenses become issues much more than we would hope. This also ties into directors and officers and umbrella coverage as these policies are often without this coverage or are following form or excess of these coverages.

Workers Compensation Coverage: An issue that is becoming important in many states is the inclusion of workers compensation coverage, especially minimal policies for those associations that have no employees. Many WC policies do not cover directors and officers, committee members or volunteers. There are a number of markets that now provide minimal policies in this regard. The roll of counsel is very critical here as many associations just do not understand that if a subcontractor they hire does not provide workers compensation coverage, even if they lie about having it, will lead the association exposed to this coverage.

Automobile Liability Coverage: Most associations do not have auto exposure, but this is clearly a risk that must be evaluated. Even if there are no titled vehicles, there are issues of "hired" and "non-owned" vehicles which could give rise to exposure.

Step Three – Directors & Officers Insurance
The association is a legal entity that is managed by a board of directors. In order to convince the best individuals to sit on these boards it is imperative to provide them the best and broadest coverage. The reality of the D&O coverage is that it is the one coverage that has the greatest divergence in coverage between the various products on the market. This is also a coverage that causes many agents great consternation.

Stand Alone v. Endorsement: Although this is a

generality, it appears that most D&O endorsements in package policies do not provide adequate coverage for today's community associations. Today's D&O policy needs to cover the following:
Defense of Monetary and Non-Monetary Claims
Defense of Failure to Maintain or obtain Insurance
Defense of Third Party Contracts
Full Prior Acts Coverage
Definition of insured includes: Past present and future directors and officers; Committee members; Volunteers; Employees, including leased employees; Independent contractors; Spouses; and, Domestic partners
Discrimination Coverage, including third party discrimination
Personal Injury coverage including: Defamation; Wrongful eviction;
Invasion of right of privacy
Employment Practices Coverage
Property Manager included within Definition of Insured
Consent to Settle Clause, preferably with soft hammer clause

The exclusions of the D&O policy creates a gap in coverage in the event that the association has employees and provides a "defined benefits plan", sometime referred to as the ERISA exclusion. This gap is filled with a somewhat misleadingly titled policy known as a "Fiduciary" policy. As we know, the key duty of the board is a fiduciary policy; however, a Fiduciary policy is really for the purpose of filling the gap of the referenced exclusion.

Step Four – Fidelity and Crime Insurance
The challenge of the fidelity/crime coverage is two-fold. First, many package policies include sub-limits of employee dishonesty coverage. Second, the corresponding premiums are so low that many do not have the patience to spend time on the product. One thing to keep in mind is that this coverage is very often a moving target. This is a first party coverage and what is being insured is "what" the association has. In this regard, an accounting must be done to determine what the association has in all accounts and investments. The association should also be cognizant of windfall deposits such as insurance proceeds and the collection of special assessments that go beyond the normal precede accumulation of associations.

The state of the art association fidelity/crime policies contain the following coverages:

Employee Theft
Forgery Or alteration
Inside the Premises – Theft of Money and Securities
Inside the Premises – Robbery or Safe Burglary of Other Property
Outside The Premises
Computer Fraud
Funds Transfer Fraud

Step Five – Umbrella Liability Insurance
The umbrella liability policy is becoming a much more important part of the community association puzzle as the times we live in become more and more litigious. There are a couple of keys to the umbrella coverage. First, what limits are sufficient? Second, what does the umbrella coverage actually provide? Again, many people do not look close at the coverage because they are convinced that the umbrella policy will never be triggered.

What must also be kept in mind is that limits in and of themselves are not sufficient. Most umbrella policies are "following-form" policies meaning they follow the terms and conditions of the underlying scheduled policies. If those policies do not provide adequate coverage, the umbrella is just proving higher limits of inadequate coverage. In addition, umbrella policies also include their own exclusions that may be in addi-

tion to the underlying policies. Specifically, be cautious that they do not exclude D&O, EPL or coverage for managers.

THE INSURANCE PUZZLE: Your Client's Duties & Obligations

As an attorney, the bottom line is that you are hired to protect your client's assets. As much as your client may respect, appreciate and adore you, there are very few that enjoy paying your fees and costs. If a client indicates that she or he does like paying you, or does not mind paying you, you can bet pretty much that it is a direct result that you saved them so much more money or otherwise preserved their assets that after they pay you they are still coming out ahead. Accordingly, the roll of counsel is to do whatever he or she can to pass on the cost of your services elsewhere, which more often than not is to an insurance carrier.

As we know, insurance is a contract and the insured's consideration to obtain a defense and/or indemnity under the terms and conditions of the policy is to pay a premium and to comply with the policy "conditions." Accordingly, as counsel, although you are not a party to that contract, it is critical for you to understand what those conditions are. The community association like any other insured purchased insurance to protect its assets. The assets are either physical assets such as those above covered under a "property" or a "fidelity/crime" policy, or financial assets that could be reduced in the face of potential liability exposure that would be covered under a "directors & officers" policy or a "general liability" policy.

The duties and obligations are "conditions precedent" to the insurer's obligation to either "pay a loss" or to provide "defense and/or indemnification" under the terms of the policy. Most of the conditions are quite straight forward and are set forth in the policy. For example in a property policy, the basic "Duties In The Event Of Loss or Damage" is as follows:

Notify the police if a law may have been broker.
Give us prompt notice of the loss or damage. Include a description of the property involved.
As soon as possible, give us a description of how, when and where the loss or damage occurred.
Take prompt steps to protect the covered Property from further damage …
Provide complete inventories of the damaged and undamaged property.
Permit inspection, including examination of books and records.
Provide a sworn proof of loss within 60 days of the insurer's request.
Submit to an examination under oath.

Under a General Liability policy you will find this condition normally under the Duties In The Event Of Occurrence, Offense, Claim Or Suit."

You must see to it that we are notified as soon as practicable of an "occurrence" or an offense which may result in a claim.

There are additional conditions that can be reviewed, but for the purpose of this article, we will focus on the notice provisions.

The biggest issue for counsel to be aware of is that there is a potential"trap for the unwary." This trap arises in the context of a liability policy where the insured is looking for the insurer to pay for its defense. Under most liability policies that are defense obligation policies, the insurer maintains the right to select counsel to defend the insured, and with some various exceptions, no defense obligation is triggered until "notice" is provided to the insurer.

sel, which is in fact probably the best thing to do. However, although I am sure it does not apply to anyone reading this article, sometimes, counsel does not contemplate the potential coverage that a client may have prior to "starting the clock." As a caveat, there are sometimes timing issues that require immediate action, but as a general rule, both sides of a suit want there to be coverage on the table and although there are exceptions, most plaintiffs or claimants will allow time to get coverage in place.

The consequence of not making timely notice is the issue of "pretender" defense fees and costs. Very often, they will not be covered. We all understand that both insureds and counsel may believe that a matter can be resolved quickly and expeditiously, but some of the most innocuous types of matters turn out to be nightmares for everyone involved.

Another trap for the unwary is the "Claims Made and Reported" policy. In the "occurrence" policy, the trigger of coverage is the date of the occurrence. In the claims made policy, the "wrongful act" that is ultimately the origination of the potential loss or liability is not the trigger of the policy. In very general terms, there are three elements that must be considered in the claims made policy:

The Wrongful Act – often the decision made by a board of directors that is being complained about by a claimant such as a refusal to approve an architectural variance.
The Claim – normally a "demand" by a claimant that the insured do or not do something such as a demand that the board change its decision about an architectural variance decision it made, or a demand that the association not proceed with a capital improvement as it is not authorized to do so.
The Notice – this is the notice given to the "insurer" regarding a "claim" made during the policy period regarding a "wrongful act."

It is all about the timing. Did I mention that it is all about the timing? In the typical D&O policy which is where the community associations will most like find a Claims Made policy, the Wrongful Act must occur during or prior to the policy period. The Claim must be made during the policy period. The Notice of the Claim must be "reported" to the insurer during the policy period or the discovery or extended reporting period if applicable.

CONCLUSION

No article can completely replace an attorney's due diligence in knowing the community association risk and knowing the corresponding insurance program. Hopefully this article provides a starting point for many attorneys to know where to look and why it is critical to properly represent their clients.